



UGANDA

Permanent Mission of Uganda
to the United Nations
New York

Tel: (212) 949-0110
Fax: (212) 687-4517

Statement By

H.E. Yoweri Kaguta Museveni
President of the Republic of Uganda

On

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IS THERE A NEED FOR INVESTMENT IN AFRICA?

Africa's need for investment has been clear to the world for a very long time. The irrefutable evidence of this need is the low per capita incomes of most African countries and the absence as well as underdevelopment of basic infrastructure and social services. Let me illustrate this need for investment in Africa by citing a few critical areas that urgently require investment.

THE NEED FOR INVESTMENT IN COMMUNICATIONS

The importance of transportation of both people and products within African countries, within regions and to and from the outside world is self-evident. Yet as I speak, the African road network, the railways and the water ways pose severe challenges to the African populations and to would-be investors.

I am, however, glad to say that there has been significant progress in telecommunications in recent years. Liberalization of telephone networks and introduction of mobile telephones has significantly increased internal communications as well as external communications with Africa. Investors in this field have reaped and are continuing to reap substantial profits thus demonstrating the potential and actual profitability of African investment.

The success of private investments into telecommunications confirms our repeated position that the internal rate of return in Africa, even when adjusted to risks.

Besides telecommunications, there are substantial opportunities in roads and railways in Africa. For example, we are currently working hard to open railways in East Africa to private operation and investment. We are hopeful that this change from public to private operation, with strong public support, will significantly improve the efficiency of haulage of cargo from Mombasa and Dar es Salaam to hinterland countries like Uganda.

But railways alone are not enough to move Africa's growing trade. There are enormous opportunities for road builders across the continent. Perhaps what is needed most now is flexibility on the part of African governments to allow various methods of road construction financing and operation. For example, we need to learn from other parts of the world that the private sector can build and operate

roads efficiently and effectively. African Governments need not assume the sole responsibility for road and railway financing.

THE NEED FOR INVESTMENT IN ENERGY

Financing for hydro electric generation is critical and urgent. We now have to move towards maximum flexibility and pragmatism in our quest for investment in this area. The shortage of power for both lighting and industry compels us to welcome investment from public and private sources and from both domestic and international sources. For example, in Uganda we have expressed our willingness to accept electricity generation based on:

- a) purely private investment in hydroelectric generation;
- b) purely public investment; and
- c) private-public partnerships.

We are prepared to go further to explore other alternative approaches to stimulate investment in electricity generation.

THE NEED FOR FINANCING INDUSTRIALIZATION

While Africa's historical economic role as a supplier of raw materials to the world may have contributed to her economic growth in the past, it is now clear that that role has left Africa in deep poverty and underdevelopment. There is now a need for financing industry in Africa to add value to her raw materials. The industrial processing of Africa's agricultural products such as coffee, cotton, palm oil etc, offers investors opportunities to supply both domestic and regional markets as well as international markets. Regional integration has increased in Africa and this makes financing of industry more profitable as markets increase in size and Customs Unions offer tariff advantages.

THE NEED FOR INVESTMENT IN AGRICULTURE AND WATER IN AFRICA

Africa's agriculture remains labor-intensive with relatively low productivity. There is a compelling need for transformation from small hand tools to more powerful agricultural tools and from low output methods to more technologically productive methods of agriculture. There is, therefore, abundant room for financing and producing better inputs for Africa's agriculture.

Similarly, there is need for financing irrigation schemes to support Africa's agriculture so that it ceases to depend on the vagaries of weather. The recent events in Niger are a case in point. Africa must invest in more sustainable agriculture to feed itself better and protect her population from the scourge of hunger. While the financing of irrigation works will be heavy, it is nevertheless a critical necessity to stop hunger in Africa.

THE NEED TO FINANCE SOCIAL SECTORS: INVESTMENT IN EDUCATION AND HEALTH

The imperative for better human resource capacity and for a healthier population is as compelling in Africa as everywhere else in the world. In line with the United Nations Millennium Development Goals, Africa in general and Uganda in particular, has made significant investment in education and health. Indeed, as a result of these efforts, we have already seen improvements in the human development index. However, much remains to be done to achieve full literacy and to reduce infant and maternal mortality from the current high levels.

SOURCES OF INVESTMENT FOR THE PRIVATE SECTOR

THE ROLE OF DOMESTIC SAVINGS

In every economy, perhaps the primary source of investment and the most reliable and sustainable one, is the savings of the population. Recent economic history has shown that countries which have high rates of saving are able to plow those savings into investments in education and other areas and to attain high rates of economic growth. It is unlikely that Africa can be an exception to this rule. Nor is it acceptable to say that Africa is too poor to save.

What is now needed is to bring the masses of the population who have hitherto been left outside the financial system into it. There is increasing evidence that

when the poor in rural areas have access to financial institutions, they do save. The increased accessibility of financial services to the African people is one way to decrease dependency on the outside world for financing. This process should be accelerated.

THE NEED FOR MEDIUM AND LONG-TERM FINANCING

Africa has experienced persistent difficulty in accessing long term financing at an affordable cost. Indeed the lack of such financing has made Africa dependent on the Multilateral Institutions such as the World Bank and the African Development Bank. Yet, disproportionate dependency on outside sources for medium and long term capital financing is neither desirable nor practicable. It is unpredictable, unquantifiable and, generally speaking, uncertain.

Meanwhile, pressure from would-be investors for affordable long term funds persists. This underscores the need for African development banks to compliment the domestic savings drive. Despite the difficulties, which such efforts have faced in the past, we cannot sit idly by and fail to respond to the demand for development financing. Our quest for external finance must be buffeted by strong domestic efforts to raise internal financing.

COMMERCIAL BANK FINANCING

Improvements in banks supervision and stabilization of currencies in Africa in recent years have made the environment for investment much more attractive. Commercial banks have become more confident and more profitable. However, interest rates have remained high relative to the rates in advanced countries. This has contributed to the problem of African business continuing to be more expensive and less competitive.

There remains much work ahead to make commercial banks in Africa more competitive in relation to banks in other continents. It may be that more domestic competition is needed in this sector, or perhaps further reductions in intermediation costs could help. What is clear to all and sundry is that high interest rates are a problem for many African economies and that this is a significant obstacle to financing investment in Africa.

AFRICAN CAPITAL MARKETS

Stock Exchanges

The participation of the African populations in shareholding in African enterprises is still in its infancy. Stock exchanges have already been started in a number of African countries. However, with the possible exception of South Africa, they are still a relatively minor source of capital for African enterprise. As the populations in Africa become more literate and as confidence in the macroeconomic policies of Africa grows, there will be increased confidence in and a growing role for African stock exchanges.

Bond Markets

With regard to the bond market, it is heartening to note that domestic borrowing using various instruments is growing in Africa. Besides short-term treasury bills used mainly for monetary stabilization, there is a growing volume of medium and long-term bonds issued by both governments and the private sector. The popularity of these instruments signifies a growing confidence in African economies. Participation in these instruments by both African and non-African buyers will increasingly provide resources for African development. Of course while welcoming foreign participation in these instruments; we recognize that care should be taken to prevent extreme capital movements that could destabilize the continent's economies.

FOREIGN DIRECT INVESTMENT

It is important to recognize that African countries have worked extremely hard in the past two decades to attract Foreign Direct Investment (FDI). The strong efforts in macroeconomic stabilization, the experimentation with various tax incentives, one-stop investment centres etc, have all been intended to attract foreign

investment. There has been a degree of success although the pervasive view is that much more FDI is needed to boost the rate of investment even higher.

Africa must certainly do more to attract foreign direct investment. For example, the steps so far taken in implementing regional integration such as the start of the Customs Union in East Africa and the strengthening of Common Market for East and Southern Africa (COMESA) etc. should, as already mentioned above, help to attract FDI in those parts of Africa.

Of course we do recognize that much remains to be done by African countries to reduce the cost of doing business, to reduce perceptions as well as actual occurrences of corruption and to increase confidence in good governance in Africa. All these areas are being tackled and will continue to be tackled.

What would-be investors perhaps need to particularly note is that there are many African governments, which are committed to cooperating with them to ensure their success. Where such commitment exists, as in my own country Uganda, investors should come on board with us as we make a determined joint effort to overcome the obstacles to investment.

FINANCING THE PUBLIC SECTOR

a) Improving the Tax Effort

For the foreseeable future, governments will continue to be the main source of financing for public infrastructure, social sectors and public administration. In order to raise the standard of these public goods, it will be necessary to increase the share of tax revenue relative to GDP. Currently, the ratio of tax revenue to GDP is estimated at 18% in Africa. This remains low compared to other continents. Perhaps an important part of the solution lies in improving information management of our economies so that more and more of our populations become part of the formal economy where economic activity is recorded and accounted for.

b) The Role of Foreign Aid

Africa's development will continue to be an international process. Foreign trade and aid have been and will continue to be crucial to Africa's development. Our deepest desire and stand is that aid should help us to trade more and lessen our need for aid.

In the meantime, aid financing needs to be concentrated in infrastructure investment, trade development and the critical social sectors such as education, HIV/AIDS anti-retrovirals and anti-malaria medicaments. Investments in infrastructure, trade development and education will help us to become self-sustaining economies. Aid in order to trade as well as aid for life saving measures should be our twin slogans.

On the other hand, investments in health, especially in HIV/AIDS drugs and equipment will help us to extend humanitarian care to the victims of these diseases. We are indeed very grateful to all the nations and institutions that have extended humanitarian financing and I wish to reiterate our full and undivided commitment to the proper use of this aid to ensure that it reaches the victims of HIV/AIDS for whom it is intended.

I wish also to reassure both our multilateral as well as bilateral development partners of our recognition of their role in the economic growth of Africa especially in the last 10 years. Africa's growth has increased and is set to increase as greater efforts are made by our development partners to increase foreign investment, reduce the debt burden and open markets to African goods. In this connection, the reduction of debt by the G-8 is a most welcome measure which should increase development financing to the poorest countries of Africa.

Having seen the need for investment and financing in Africa, let me now point out the merits and demerits of the different mechanisms of financing.

PREFERRED FORM OF DEVELOPMENT FINANCE

Introduction

- I) Development finance or aid is comprised of grants and loans. Grants are transfers that do not need to be repaid while loans have to be paid back.
- 2) Development finance should be used to enhance growth through value-addition and industrialisation, investment in agriculture, innovation and enhancing competitiveness through investments in various facets of developing economies such as human capital development through Universal Primary Education (UPE) and improved health services through Primary Health Care (PHC). Development finance should also support investment in improving transport, telecommunications and infrastructure in order to reduce the costs of doing business and attract both domestic and foreign investment.
- 3) Development finance is needed for both private and public sector investment. In the private sector, development finance can be used to fund investments such as tourism, value-addition industries and agro-processing etc.
- 4) Development funding is also needed for industrial and agricultural research.

Development finance to the public sector: budget support

- 5) In order to provide the right mix, development assistance to public sector is preferably through the national budget in the form of budget support. This mode enables Government to prioritise its expenditures in accordance with its optimal sectoral composition that meet the challenges of poverty eradication. Budget Support is faster, more flexible and more closely aligned to national development priorities.

- 6) The disbursement of budget support is conditional upon Government meeting undertakings agreed upon with donors in the yearly budget and is therefore accompanied by a number of broad conditionalities. These should be limited to the implementation of an agreed program with clear monitorable indicators. The acceptance of budget supports should not be a licence for unilateral conditionality.
- 7) The advantage of Budget Support is that it gives Government the flexibility to fund its budget in accordance with its own priorities, and to channel its expenditures through its established institutions. In the absence of Budget Support, domestic revenues are insufficient to finance recurrent spending, let alone development spending. This flexibility enhances coordinated planning and Government budget ownership, and minimises institutional costs. In order to make Budget Support predictable, Donors should commit to long term financing based on an agreed program and identified priorities.
- 8) In the case of Uganda, however, since both Government and donors who provide Budget Support are committed to the spending priorities set out in the Poverty Eradication Action Plan (PEAP), this risk is normally minimal if Government continues to execute the Budget in accordance with PEAP priorities

Development finance to public sector: project support

- 9) Project Support is, by definition, strictly earmarked for the execution of the specific project outlined in the project agreement. **No further** conditionalities are therefore considered necessary.
- 10) This modality is normally used for large projects such as power, railways and major roads where the procurement is complex and specific expertise is required for appraisal, design, and implementation. Some donors however, prefer direct support either through NGOs or directly to the private sector. This requires a big outlay of experts in the country and much of the support is spent on this. If this type of support is adopted, then it must be in support

of an agreed programme and Government should at least participate in the selection process of the beneficiaries and be kept informed.

- 11) Project Support is disbursed to a specific bank account set up specifically for the purposes of running the project, either in a commercial bank, or in the Central Bank. Project expenditures are governed by project spending plans. Projects are required to submit audited books of accounts on an annual basis.
- 12) Project Support requires the establishment of dedicated Project Implementation Units (PIUs). **Reliance on PIUs for project implementation** entails some drawbacks. The PIUs have overhead costs (staff, office space, vehicles etc) that absorb part of the project funds on unnecessary recurrent expenditure. Moreover, the PIUs often duplicate the functions of Line Ministries and drain qualified staff from the Civil Service. In addition, they undermine coordinated planning, as PIUs tend to operate as stand alone entities controlled by the donor and divorced from the Line Ministry responsible for the sector in which they operate. As a result, projects are not necessarily undertaken in areas which are consistent with Government's budget priorities. However, due to the relative lack of Government involvement in project execution, and the higher degree of participation of the relevant donor, Project Support is less vulnerable to the risk of funding withdrawal, as donors feel sufficiently in control of their projects to run them as they wish, irrespective of how Government executes the budget financed from the Consolidated Fund.
- 13) Besides, too much loose forex from outside causes both exchange rates to appreciate thereby undermining exports and interest rates to continue being high even when the inflation rate has been long under-control. This is caused by the issuance of treasury bills to try and suck back liquidity caused by this excessive artificial influx.

Development finance to public sector: grants versus loans

- 14) In addition to budget support being preferable to project support, grants, as opposed to external loans, are the preferred delivery channel of aid. Despite

receiving debt relief under the HIPC and Enhanced HIPC initiatives, Uganda's external debt position has again become unsustainable, due largely to an increase in new external borrowings. This has prompted Government to place an annual cap on all new borrowings, consistent with Uganda's external debt ratio returning to the sustainable threshold in the near future. However, for major donors such as the World Bank and ADB, loans are the preferred delivery channel. Therefore, all external borrowing should be limited to raising resources to support investment in productive sectors of the economy, such as transport & power infrastructure. Thus, Government should not borrow to finance recurrent consumption expenditures that do not directly improve the productive capacity of the economy.

Development Finance to Private Sector

- 15) The private sector is the engine of growth of our economies and therefore need to be supported with resources if we are to meet our development challenges. Development finance to the private sector can be channeled through development banks or regional development institutions for investment in long term projects, e.g. IFC, EADB, PTA Bank. They can also be channeled through commercial banks for investment in short/medium term projects.
- 16) Development finance to the private sector has been characterized by shortages of foreign exchange resources, short repayment periods, high interest rates and over dependence on debt and little equity financing. Therefore to ensure efficient and sustainable growth of private sectors of our economies these constraints need to be addressed through a variety of measures including:
 - I. Increasing Resource Availability: While liberalization of economies has led to increase in foreign exchange inflows, many private sector enterprises still have limited access to foreign exchange resources for importation of machinery, capital equipment and raw materials. We need to raise additional foreign exchange resources from bilateral and multilateral sources to meet the needs of private sector entities, many

of which do not have the capacity to raise resources off shore on their own.

- II. **Lowering Interest Rates:** Interest rates charged to private sector enterprises for both foreign and local currency borrowings remain high. In a number of our countries, foreign currency interest rates need to be lowered to single digit levels and those on local currency financing to less than 15% per annum. Multilateral Development Institutions, which are the predominant source of our foreign exchange lines of credit, can contribute to lowering on-lending rates to private sector entities at home by providing lines of credit at more affordable rates.
- III. **Repayment Periods:** Commercial banks raise the bulk of their resources from short-term deposits and are constrained in lending long term to private sector enterprise. Private sector investments that require longer term funding, particularly the housing finance market, will not develop at the desired pace until there is access to 10 – 15 year money.... Local or regional financial institutions, such as EADB or PTA Bank in the case of East Africa, can only provide long term financing if they have access to long term funding themselves. Increased support to such institutions will help address this constraint.
- IV. **Equity Funds:** The majority of our private sector enterprises rely primarily on debt financing and this inhibits their performance because of the debt burden and their inability to grow and expand their operations. Support by multilateral development finance institutions such as IFC in setting up new equity funds, particularly for the Small and Medium Enterprises (SMEs) sector, would help improve gearing and performance of SMEs.
- V. **Improving Assets to Micro-Finance:** Increasing incomes of the majority of our people in rural communities has been hampered by poor access to institutional credit on affordable terms. We must promote the development of micro-credit institutions to improve availability of financial services to rural communities. Support of

multilateral NGOs and other stakeholders, by providing financing and technical assistance would facilitate the development of Micro-Finance institutions. Micro-finance agencies have been overcharging borrowers. We have, recently, decided to add on SACOs (Savings and Credit Organizations) in order to unite the borrower, and the Lender and the Sender.

CONCLUSION

In Conclusion, we need to state the following points: -

- There has always been need for financing in Africa for both Public and Private Investment.
- Secondly, it is profitable to finance private investments in Africa.
- Thirdly, too much loose aid causes the exchange rate to appreciate, thereby undermining exports and causing interest rates to remain artificially high.
- Budget support is the current form of public sector development support.
- Channeling through development banks is good for private sector support.
- FDI is welcome because it helps to convert potential into wealth, thereby expanding the GDP.
- Equity financing through stock markets or in other forms is a good way of creating affordable funding.
- SACOs (Savings and Credit Organizations) are the best form of micro-finance; privately owned micro-finance agencies can also be useful if there is competition that forces the interest rates down.
- The slogan is AVA — Availability, Visibility and Affordability of financing.