I. Introduction and Context

1. This revised PID is an update to the initial PID disclosed on August 4, 2010 (report No.: AB5385). The operation still proposes to support the improvement of selected municipal LGs in the management and delivery of urban services. However, this proposed operation being part of the Program-for-Results (PforR) pipeline, Bank support is now proposed to be structured following the PforR financing instrument.

A. Country Context

2. **Uganda adopted a liberalization policy, strong macro-economic management and promoted pro-market reforms in the late eighties.** Since 1986, the country has experienced high economic growth, poverty decreased from 57 percent (1992/93) to 24.5 percent (2009/10), and an average annual Gross Domestic Product (GDP) growth of 8.1 percent over the six years 2003/04–2009/10. It has reduced donor assistance from 52 percent of the annual budget in the early 1990s, to the current level of 32 percent. Donor support is expected to decline further with the recent discovery of oil which may come into commercial production in the next three to five years. Nonetheless, in the short to medium term, Uganda will continue to require external financing to maintain its fiscal policy for growth. Domestic revenue mobilization remains low at 13 percent of GDP in FY10/11 and is not expected to increase beyond 15 percent in the medium term. Further external financing will thus be required to sustain its fiscal position.

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2. About 21.5% in FY2011/12 if arrears and non-VAT taxes are excluded.
3. **Uganda has also modernized its governance and service delivery institutions, one aspect of which has been an ongoing process of decentralization and institutional reform.** Government’s decentralization policy - which was first announced in 1992, and subsequently embedded in the Constitution (1995), the 1997 LG Act (CAP 243), and a range of additional policy initiatives, such as the Fiscal Decentralization Strategy of 2002 – has incrementally devolved substantial powers, functions and resources to Local Governments (LGs). Today, LGs are run as fully fledged elected governments with legislative and executive powers, they have extensive service delivery responsibilities, receive and raise significant fiscal resources, hire and fire staff, and prepare and execute five year development plans and annual budgets.

4. **Uganda faces a serious demographic challenge.** It has a large population base of 32 million with 51 percent of the population under the age of 18 years, with high population growth rate (3.2 per cent per year) making it one of the fastest growing countries in Africa. This has serious implications in terms of demand for jobs, land, housing, water, health, education, jobs, and LGs services as well as expected impacts on the environment.

5. **Importance and challenges in the urban sector** - the urban sector has become increasingly central to the growth and structural transformation of the Ugandan economy. While the total urbanization level in Uganda is only 12%, the urbanization rate is over 5% per annum. Urban centers account for 72% of manufacturing output and over 55% of GDP. In the recent years, three challenges have emerged in the urban sector - (i) urban areas remain chronically underserved and poorly managed, infrastructure backlogs are severe, and more than 60% of urban dwellers are accommodated in informal settlements; (ii) within this broad trend, Uganda’s municipal LGs have begun to grow increasingly rapidly and have developed distinctive needs in two key areas: (a) to strengthen the institutional systems of local governance and administration in order to properly plan and manage the increasingly complex human settlements which have emerged in these areas, and (b) development funding modalities to cater for increasing level of infrastructure demand, and its “lumpy” nature - most typical urban investments have unit costs in the range of UGX100 million - 1 billion, compared to an average of about UGX10 million in rural areas and (iii) while the overall level of fiscal flows to local governments has remained fairly robust, urban LGs have not done well, attracting only about 6% of total LGs grants while accounting for almost 15% of the population with no specific or dedicated urban investment window.

**B. Sectoral and Institutional Context of the Program**

6. From 1997 to 2007 development partners, with a total budget of US$235.5 million, piloted the LGs Development Program (LGDP). The objectives of the pilots were to provide technical and financial resources to enable the definition, testing and application of a range of participatory planning, allocation and investment management procedures, which would a) empower LGs and communities to identify, deliver and sustain locally determined investment priorities for public goods and services; b) improve the LGs’ compliance with legal provisions and accountability procedures and, through sanctions and incentives, encourage better performance; and c) provide practically tested lessons from experience and contribute to national policy and procedures for decentralization. From 2008 to date GoU has taken over the LGDP as a Government program and disbursed a total of about UGX320 billion (about US $ 160 million) to LGs over the four year period. The three main areas of thrusts of the program have been: (i) the discretionary local development grant (LDG) and its associated LG capacity building grant (CBG); (ii) ‘deepening’ decentralization such that communities get more involved in the

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3 Municipalities are urban Local Governments.
4 With the exception of the Chief Administrative Officer/Town Clerks and their deputies which have been recentralized and now being appointed by the National Public Service Commission, not the LG Service Commission.
5 Uganda Bureau of Statistics (UBoS) 2002 - Housing and population census,
6 Figures as % of public expenditure.
operations of their Local governments and (iii) institutional strengthening of LGs and organizations that play a role in supporting, monitoring and supervising LGs.

7. The major achievements of the LGDP have been the use of formulae driven resource allocation which ensures equity and provides the necessary transparency. In addition, the use of annual minimum conditions and performances assessments have assisted in the a) verification of LGs’ compliance to the provisions of the law governing their operations thereby ensuring improved service delivery and resource management, b) identification of LGs functional capacity gaps, which if addressed would lead to increased outputs and ultimately improved service delivery and poverty reduction, c) rewarding of good performance and sanctioning poor performance as a strategy for institutional strengthening and promoting efficient service delivery. As a result, LGs have been compelled to use the grant in accordance with the national priority program areas (PPA) such as education, health, water and roads. The fact that GoU has now taken over the LGDP as its program is testimony of the commitment of the GoU towards the democratic principle and decentralization policy, which are core to the roles of LGs for planning and provision of services according to local priorities.

8. **Major challenges of the LGDP** - Apart from the size of the amounts available for planning (US$ 1 and US$ 2 per capita for rural and urban LGs respectively), the major concern related to the LGDP, is that the limited funds at each level are divided over too many sectors and activities. In monetary terms, the average size of a single LGDP sub-project (all levels of LGs combined) is below USD 5,000. The result of this is that many of the projects are neither sufficiently strategic nor comprehensive or focused to make visible and/or tangible contributions to service delivery. At US$2 per capita for urban LGs, the LGDP grant is not adequate to address the “lumpy” investment needs of the urban sector which have unit costs in the range of UGX100 million - 1 billion. A two-pronged approach is therefore proposed, whereby on the one hand, there is separate budget line for LGDP-urban window and on the other hand a separate LGDP for rural LGs.

9. **In addition to the challenge of inadequate urban financing highlighted above, there is weak institutional, policy, and legal framework for urban development.** The Ministry of Lands, Housing and Urban Development (MoLHUD) is a new ministry with inadequate capacity to coordinate urban development and management. Although urban development planning and management is a decentralized function, many local governments lack physical planners for preparing physical development plans and guiding developers. Both the Ministry and municipalities lack the capacity to enforce compliance to plans, standards and regulations. Additionally, the implementation of the new Physical Planning Act, 2010 has just started.

10. **Government’s strategy to address the challenges** - In the context of the challenges faced by urban LGs, GoU requested Bank support in introducing a new, urban focused window to the LGDP program to address the needs of selected municipalities so as to strengthen their system of urban governance and improve service delivery. The Government’s desire to create this new urban window into the current program stems from its recognition of the importance of urban areas towards the country’s growth agenda, their distinct institutional requirements and infrastructure investment needs and the existing program’s challenge in providing these. The proposed operation therefore responds to these broader government objectives. The significance of the Bank support to GoU is that total Program expenditure of UGX375 billion as a percentage of total decentralized direct transfers (unconditional grant, LGDP and equalization grants) from central government to LGs will be 20.6 percent of the UGX1,821.21 billion over the Program period.
C. Rationale for Bank support through the PforR financing instrument

11. There are four reasons why PforR instrument has been chosen as appropriate for the proposed Uganda support to municipal infrastructure development (USMID) Program. First it will be part of the GoU LGDP system. The Program will be added to the national LGDP as a municipal window. Like the national LGDP, the municipal LGs window will have two elements – a local development grant (LDG) element to address local infrastructure investment needs of the participating municipal LGs and a capacity building grant (CBG) element to address the capacity building needs of the participating municipalities linked to the annual Program performance assessment results. Second, The Program will focus on institutional strengthening by providing incentives for municipal LGs for sustainability. Like the government program, it will use the existing government system to strengthen capacity at both the MoLHUD and municipal LGs for urban development and management consistent with the Government decentralization policy. Third, the Program has been designed with an in-built incentive structure to allow for rewards and sanctions. The PforR DLI modality does not only fit this incentive structure, but also strengthens it. Forth, the PforR instrument will make safeguards (environmental and social), fiduciary (financial management and procurement systems) and the overall performances integral part of management of the municipalities.

D. Relationship to the CAS.

12. The proposed operation will specifically contribute to the achievement of CAS strategic objective 2 – Enhanced public infrastructure, and outcome 2.4 - improved management and delivery of urban services. IDA resources under the CAS (FY011-15) are estimated at about SDR1.3 billion (US$1.97 billion equivalent).

13. The proposed operation will also contribute to the National Development Plan (NDP)\(^8\) 2010/11 – 2014/15 which has broadened the country’s development strategy from poverty reduction to structural transformation and has identified urban as one of the complementary sectors for growth. It will also assist in strengthening the capacity of the newly created MoLHUD with a Directorate of Physical Planning and Urban Development and the implementation of the newly passed Physical Planning Act, 2010.

II. Program Development Objective(s)

14. Program Development Objective (PDO) - The Program development objective (PDO) is to enhance the institutional capacity of selected municipal\(^9\) LGs to improve urban service delivery.

15. The PDO level results indicators will be:

   (i) the percentage/number of municipal LGs with improved fiduciary, safeguards and urban planning process,
   
   (ii) percentage of total planned infrastructure completed by participating municipal LGs

16. The intermediate results indicators:

   (a) Roads, street lights and drainage rehabilitated (Kms/Nos),
   
   (b) Garbage collected and disposed (%/tons),
   
   (c) Bus parks, markets, parking lots etc established (Nos),

\(^8\) The NDP is the GoU medium term development strategy for the period 2010/11 to 2014/15. It is a 5-year Plan consistent with the planning framework adopted by Cabinet for the realisation of the 30-Year National Vision.

\(^9\) The fourteen municipal councils (MCs) are Arua, Gulu, Lira, Soroti, Moroto, Mbale, Jinja, Entebbe, Masaka, Mbarara, Kabale, Fort Portal and Hoima, and Tororo
III. Program Description

17. The USMID Program responds to the municipal LGs’ challenges in the context of the GoU’s broader LGDP by addressing the need for the institutional and financial strengthening of selected municipal LGs and financing limited infrastructure investments needs by introducing an enhanced urban window to the government LGDP. It will be implemented over five years period (2013 – 2018).

18. Although there are currently 22 municipal LGs, USMID will initially begin with 14 municipalities namely: Arua, Gulu, Lira (Northern Uganda); Soroti, Moroto, Mbale, Jinja (Eastern Uganda); Entebbe, Masaka (Central); Mbarara, Kabale, Fort Portal and Hoima (Western Uganda). These are because 13 of the 14 municipalities have been in existence since 1994 and relatively mature in terms of capacity to handle the increased investments under the Program. Hoima, which became a Municipality in July 2011, was included as the fourteenth municipal LG because of its potential of becoming an oil city due to the recent discovery of oil deposit in the Western region. In addition, the 14 municipal LGs represent regional balance and are growing faster than Kampala City. The remaining 8 municipalities were Town councils and upgraded in July 1, 2011.

19. The Program will support and complement the Government program – the LGDP which is a performance base grant. The USMID will fully utilize and enhance key elements of the LGDP system. In particular, similarly to the government program, municipal allocations will be based on three weighted parameters namely (i) administrative land area of the municipality (15%); (ii) projected municipal population as provided by UBoS (45%); and (iii) municipal poverty head count (40%). The USMID funds will be used to leverage institutional strengthening both at the municipalities and the MoLHUD for urban development and management; and improvement of municipal urban infrastructure. The program will be coordinated by the MoLHUD which is responsible for urban development.

20. The Program focus on the institutional strengthening at the municipal LGs level will be at technical, fiduciary (financial and procurement), and environmental and social sustainability. Disbursements to participating municipalities and the MoLHUD will be based on their annual performance results, as measured by an independent (third party) annual assessment. The municipal capacity assessment will focus on two major results area (i) institutional improvement and (ii) delivery of urban infrastructure. While infrastructure delivery assessment will focus on the value for money (VFM) in terms of the 3Es – efficiency, effectiveness and economy of the municipal use of the program fund for infrastructure investments; the municipal institutional strengthening assessment will focus on the following key areas:

- Improved linkage between Municipal Physical Development Plan, Five year Development Plan and Budgeting;
- Increased municipal own source revenue (OSR);
- improved procurement performance;
- improved municipal Accounting and core financial management
- Improved Execution/Implementation of budget for improved urban service delivery;
- Improved accountability and transparency (monitoring and communication);
- Enhanced environmental and social sustainability (Environmental, social and resettlement due diligence).

21. Given the fact that the existing government LGDP performance assessment tool will be enhanced in many areas, it is envisaged that the capacities of the participating municipal LGs will increase incrementally over the Program period. However, to promote rapid municipal capacity improvement in the above areas, the Program will promote inter-municipal competition by having incentives and sanction mechanisms which are built at two levels. First, municipal LGs will be required to meet the minimum access condition - only those participating municipalities which have a function capacity and linked their Physical Development Plan to their five year
Development plan and the annual budget; and have the core staff in place will be eligible to assess funds under the Program. Second, there will be a challenge fund (with in-built sanctions and incentives) to be accessed by the municipal LGs on a competitive bases as a weighted average of their performance scores based on their institutional improvement in the core areas highlighted above.

22. The Program will also include a set of activities necessary to support capacity building both at the municipalities and the MoLHUD. The capacity building activities will build on the current demand and supply approach under the government program where central government departments provide supply driven capacity building support to LGs to respond to cross cutting issues. On the demand side, LGs prepare their capacity building activities which are included in their three year capacity building plan formulated on the same timing cycle as their investment plans.

23. Consistent with the decentralization policy and the mandates of municipal LGs, the infrastructure investments which will be financed under the Program will remain at the municipal level and are not expected to entail significant and irreversible adverse impact on the environment or people. Contract values will typically remain relatively low in line with the nature of municipal infrastructure activities in municipal LGs in East Africa.

IV. Initial Environmental and Social Screening

24. **Moderate Environmental and Social Effects** - While the types of activities to be financed by USMID are intended in part to remedy negative impacts of urbanization, and their overall effect will be positive, they have a potential for adverse impacts on the natural, built and human environments. These are largely associated with the construction phase and include mainly the normal impacts of civil works – dust, noise, erosion, surface water sedimentation, traffic interruptions and accidents, impeded pedestrian access, pollution from construction wastes as well as waste from worker campsites, interference with local businesses, disruption of water service, and transmission of HIV/AIDS and other communicable diseases. Because of the nature and relatively moderate scale of the works, the impacts are expected to be minor, temporary, and confined to the area immediately surrounding the construction. The short-term construction impacts for the most part can be prevented or mitigated with standard operating procedures and good construction management practices. The potential impacts during operation are fewer and generally moderate and manageable by means of good design and adherence to proper operating procedures. Similarly, the scope of activities under USMID poses no major displacement threats as such, although tracts of land will be sought for purposes of construction, extension and or rehabilitation of the required infrastructure. Therefore individuals and communities in the respective locations in the municipalities may lose land (however small), and other assets or properties that is on this land. The losses may include structures (permanent, semi permanent and temporary), crops and other vegetation, and shared facilities like water points, community roads, roadside markets, etc. Because of the significant geographic dispersion of the participating municipalities and the scale of proposed investments, cumulative effects of the Program as a whole are unlikely.

25. **Environmental and Social Systems Assessment (ESSA)** - USMID will utilize the existing legal, regulatory and institutional system for environmental assessment and management in Uganda, drawing on experience with implementation of environmental and social safeguards instruments during the previous IDA local government and urban infrastructure projects. The Ugandan regulatory and institutional system is well established and relatively comprehensive, reflecting international practice. It is sufficient to ensure that potential significant impacts will be identified and managed. However, the system is constrained by human resource gaps at various levels, and its implementation is at times inadequate as personnel lack resources, e.g. to make site inspection visits, or to adequately carry out consultations. USMID will support specific actions for strengthening the performance of Ugandan environmental management system that the Program will utilize. The Bank team will complete the Environmental and Social System Assessment (ESSA) of the Program, through consultative process; appropriate risk mitigations plans developed and have the draft ESSA report disclosed before project appraisal.
V. Tentative financing

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