

Global Financial Crisis Discussion Series

Paper 21: Uganda Phase 2

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February 2010

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¹ This paper was funded by the Swedish Agency for International Development Cooperation (Sida) and is part of a wider research project coordinated by the Overseas Development Institute (ODI) London, but it does not necessarily reflect their views.

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Acronyms

AfDB	African Development Bank
BoU	Bank of Uganda
CMA	Capital Markets Authority
DFID	Department for International Development
FDI	Foreign Direct Investment
fob	Free on Board
GDP	Gross Domestic Product
ICBT	Informal Cross-Border Trade
IDA	International Development Association
IMF	International Monetary Fund
MDG	Millennium Development Goal
MoFPED	Ministry of Finance, Planning and Economic Development
NDP	National Development Plan
NGO	Non-Governmental Organisation
NSSF	National Social Security Fund
NUSAF	Northern Uganda Social Action Fund
ODA	Official Development Assistance
PAYE	Pay As You Earn
PRDP	Peace and Reconciliation Development Programme
UBoS	Uganda Bureau of Statistics
UK	United Kingdom
UIA	Uganda Investment Authority
URA	Uganda Revenue Authority
US	United States
y-o-y	Year-on-Year

Abstract

The global financial crisis affected Uganda's economy through reduced capital inflows, including remittances, portfolio investment, exports and foreign aid, as well as through capital outflows that include repatriation of profits by foreign investors and withdrawal of portfolio investments. Almost all these categories of capital flows decreased and manifested themselves in a depreciation of the local currency. Coupled with increasing food prices, annual inflation rose. As a result, in 2008/09 Uganda recorded a growth rate of 7.1%, against a target of 8.5%. This would ordinarily have an adverse impact on poverty reduction and improvement of people's welfare

Uganda's response to the crisis was not explicit; apart from expenditure reprioritisation to focus more on public infrastructure, the country's fiscal and monetary policies remained largely unchanged. Even when the shilling depreciated, Uganda did not respond by running down its foreign exchange reserves to defend the local currency, nor did the country utilise the stimulus packages provided by the International Monetary Fund (IMF) and the World Bank. In addressing growth constraints, Uganda had already increased public expenditure for infrastructure development, which later was to be prescribed by the international community as the wise thing to do in response to the crisis. The global financial crisis also coincided with increasing regional trade for Uganda, which has had significant positive effects on the country's exports.

There are signs that Uganda's economy is slowly beginning to recover from the adverse effects of the global financial crisis. The Uganda shilling is strengthening, which could be attributed to a rebound in capital inflows and an improved current account balance. The current account balance improved substantially by end-June 2009, recording a positive balance. A similar improvement was observed in direct investment, although portfolio investment remains sluggish. Overall, the balance of payments position has improved. As the economy begins to recover from the adverse effects of the global crisis, growth prospects are brighter, with a likelihood of decreasing poverty.

1. Introduction

There is no doubt that Uganda was insulated from the first-round effects of the financial crisis because of the underdeveloped nature of its financial market integrated with international markets. However, Uganda was vulnerable to the second-round effects, with main channels being through the balance of payments. Specifically, the main transmission channels of the crisis have included trade, private capital flows, private transfers and aid. These in turn have had effects on growth and development prospects for Uganda. There are already indications of an economic slowdown that can be attributed partly to the crisis. On a positive note, there is evidence of some recovery since the second quarter of 2009.

Since the 1990s, Uganda has enjoyed strong and impressive gross domestic product (GDP) growth supported by prudent macroeconomic management. However, although Uganda registered 7.1% growth in GDP in fiscal year 2008/09, this was below the projected growth of 8.9%. Furthermore, analysis at sectoral level reveals differences in performance, notably the poor performance of the coffee sub-sector, resulting in an overall poor performance by the cash crop sector. The drastic deceleration of the construction sub-sector had impacts for the overall performance of the industry sector. The agriculture sector grew, although from a low base. On the other hand, studies have shown that Uganda seems to have emerged from the crisis without serious damage to its financial sector relative to Kenya (Masha, 2009).

In this paper, we highlight the fact that Uganda's initial conditions prior to the crisis may have mitigated the negative effects on the economy. These initial conditions included, among other things, prudent macroeconomic management; increased public sector spending on infrastructure projects; regional trade; a modest debt burden; and sufficient foreign exchange reserves.

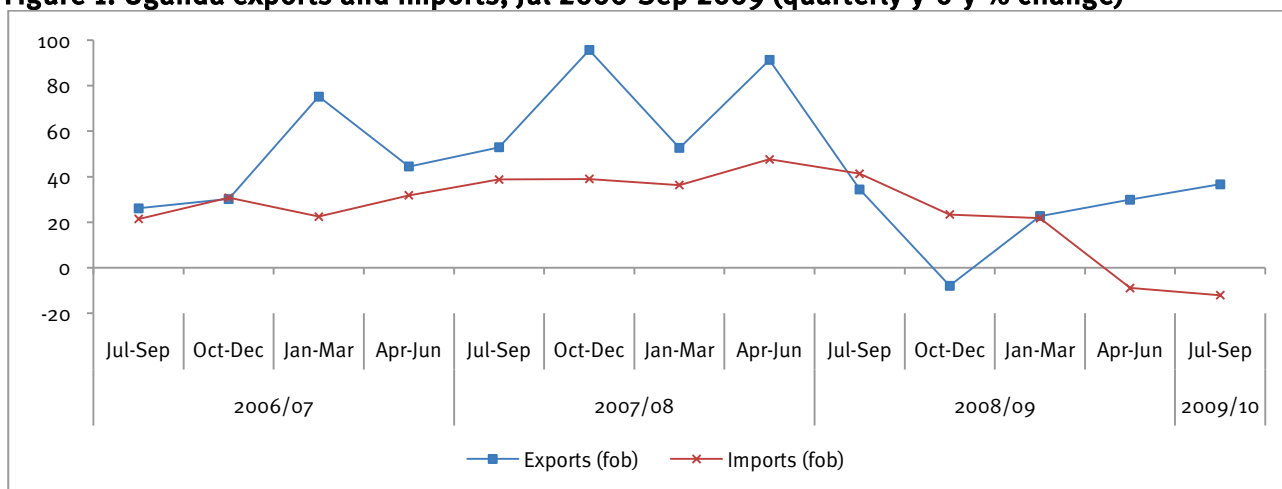
The rest of the paper is organised as follows. The next section discusses the effects of the crisis on Uganda, with a major focus on the main transmission mechanisms. In Section 3, we discuss the growth and development effects of the crisis. A critical review of government responses to the crisis is presented in Section 4. Section 5 concludes.

2. Effects of the global financial crisis on Uganda: Key transmission mechanisms

2.1 Trade

Uganda's goods trade balance started improving in the first quarter of 2009, registering a positive trade balance in the second quarter of 2009 of \$66.28 million, largely because of the strong performance of some components of exports trade. Figure 1 shows that Uganda's year-on-year total export value growth in the fourth quarter of 2008 dropped by 7.9%. However, the value of trade year-on-year for the first, second and third quarters of 2009 increased by about 23%, 30% and 36.7%, respectively.

Figure 1: Uganda exports and imports, Jul 2006-Sep 2009 (quarterly y-o-y % change)



Source: Based on BoU balance of payments data.

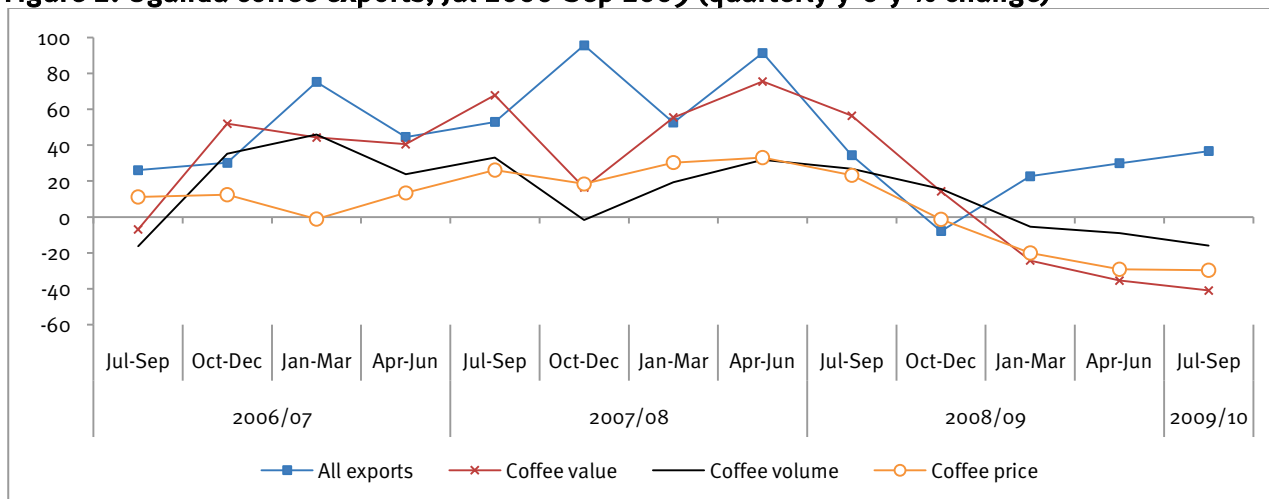
The recession in developed countries contributed significantly to low demand for Uganda's traditional export commodities, especially coffee. The crisis hit countries where coffee consumption is highest – the US and Europe in the case of Uganda. Coffee export earnings continued to drop, with earnings reaching \$336.39 million in 2008/09, down from \$48.63 million in 2007/08 (3.5%). Coffee exports in value terms dropped by 24.3% in the first quarter of 2009 compared with the same period in 2008. The slowdown continued in the second quarter of 2009, with a marked reduction of 35.4% compared with the corresponding period in 2008. Figure 2 reveals dominance of declines in coffee export prices in explaining the poor performance of the coffee export sub-sector relative to declines in the volume of coffee exports. Coffee prices per kg slumped by 20% in the first quarter of 2009 compared with the same period in 2008, and coffee volume slumped by 5.4% during the same period. The corresponding figures for the second quarter were -29.1% for prices and -8.9% for volume. The poor performance of the coffee sector continued in the third quarter of 2009. While the global recession has had significant impacts on Uganda's coffee sub-sector, one should not lose sight of the internal supply constraints impacting on the sub-sector's productivity – including drought and coffee wilt in the Central region.

Likewise, the value of fish exports faced a steep downturn – the regional fish trade registered a significant decline relative to similar trade with the rest of the world (Figure 3). Fish exports within the region on a year-on-year basis in the second quarter of 2009 had declined by 37%. The corresponding figure for the fish trade with the rest of the world was 34.6%. This finding is contrary to our findings in Phase I (see Ssewanyana et al., 2009), where regional fish exports were faring well compared with those of the rest of the world. Fish exports to the rest of the world stood at \$28.36 million in the third quarter of 2009, marking a drop from \$31.21 million in the same period in 2008. The corresponding third quarter figures for fish exports within the region were \$14.06 and \$15.29 million in 2009 as a

result of overfishing. The fish sector is slowly recovering, mainly because of measures put in place by the government, which include fish restocking programmes and the control of illegal fishing.

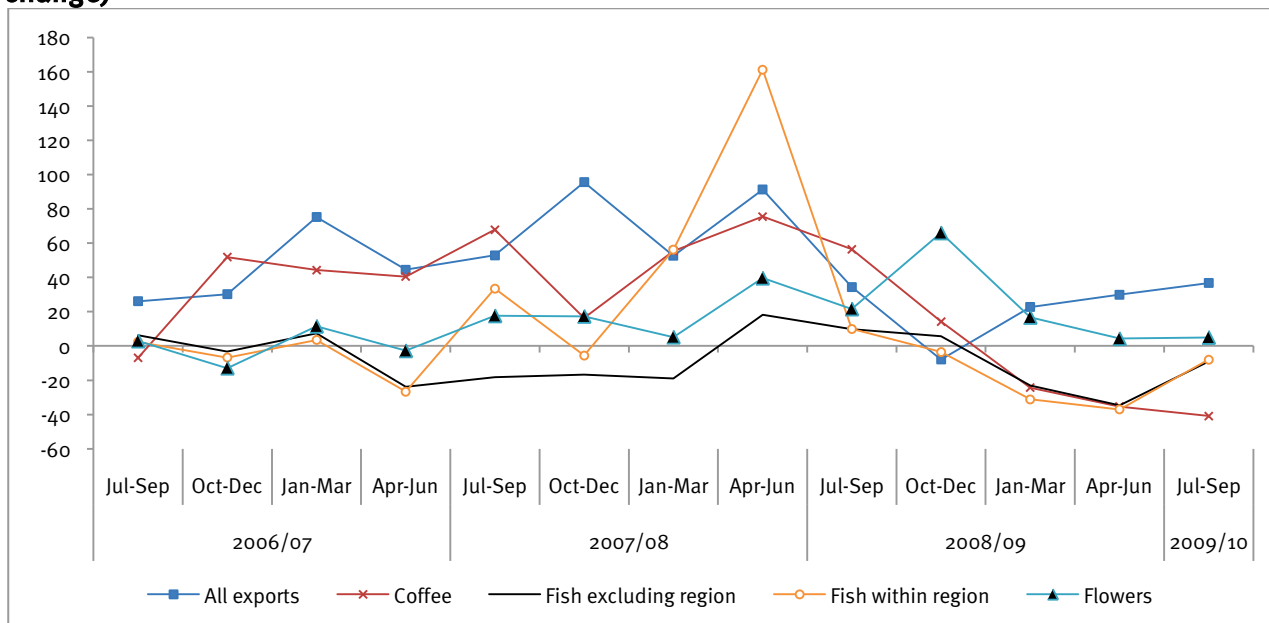
Turning to flowers, the export value increased by 24.5% year-on-year in 2008/09 relative to 2007/08. As shown in Figure 3, flower export earnings increased by 5% in the third quarter of 2009 compared with the corresponding period in 2008.

Figure 2: Uganda coffee exports, Jul 2006-Sep 2009 (quarterly y-o-y % change)



Source: Based on BoU balance of payments data.

Figure 3: Coffee, fish and flower exports in value terms, Jul 2006-Sep 2009 (quarterly y-o-y % change)

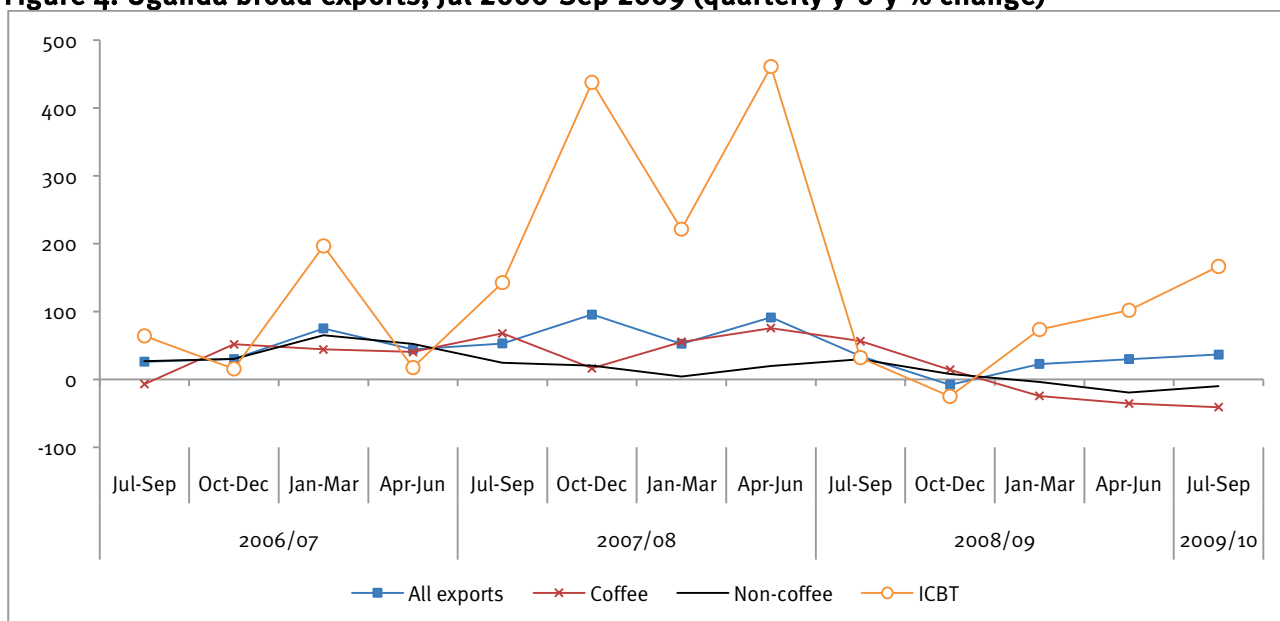


Source: Based on BoU balance of payments data.

The unfolding global financial crisis posed challenges as well as opportunities for Uganda. With regard to the latter, Uganda has reaped significant benefits from informal cross-border trade (ICBT), especially in non-traditional exports such as maize, beans and manufactured goods, including cement and steel products among others, with industrial products contributing more than 65% (high value items relative to food exports) and maize and beans less than 10%. The value of ICBT increased from \$1068.4 million in 2007/08 to \$1549.29 million in 2008/09 (a 45% rise). The percent change in the value of trade in the region increased faster than the overall percentage change in total exports (Figure 4). Put differently, regional trade largely drives the observed positive trade balance and in particular growth in the export sector (Figure 4). The value of ICBT has been higher than the value of formal exports since the first

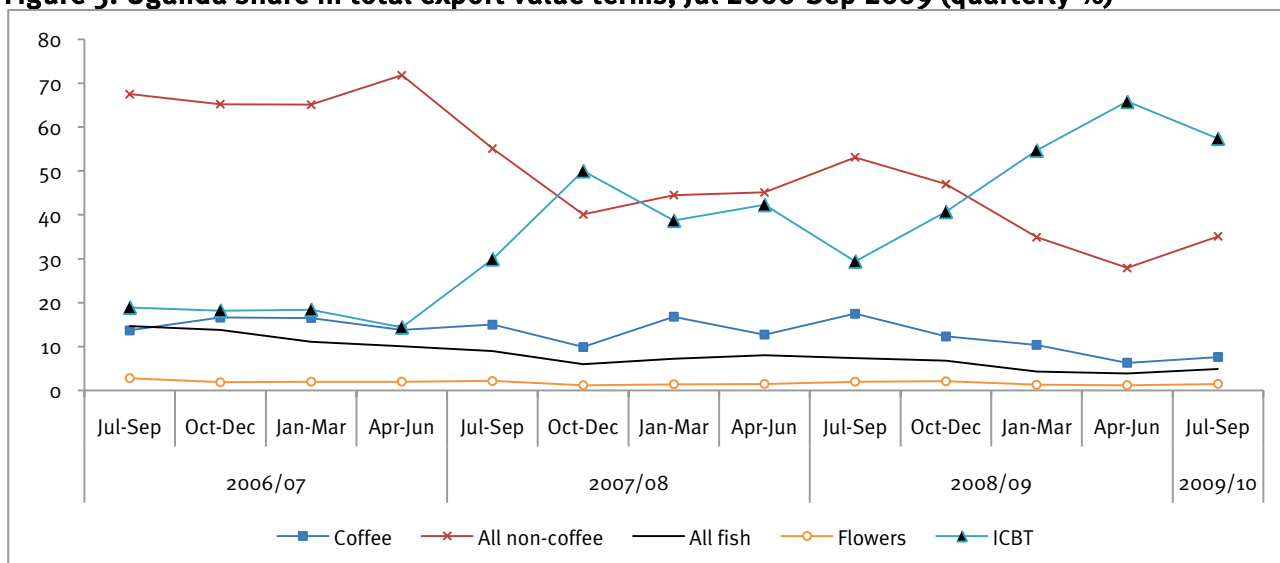
quarter of 2009, demonstrating a crucial contribution to the current account of the balance of payments. The year-on-year total value for the third quarter of 2009 with regard to ICBT had increased by 166.5%. More importantly, the growth in ICBT demonstrates the benefits of regional trade, infrastructural constraints notwithstanding.

Figure 4: Uganda broad exports, Jul 2006-Sep 2009 (quarterly y-o-y % change)



Source: Based on BoU balance of payments data.

Figure 5: Uganda share in total export value terms, Jul 2006-Sep 2009 (quarterly %)



Source: Based on BoU balance of payments data.

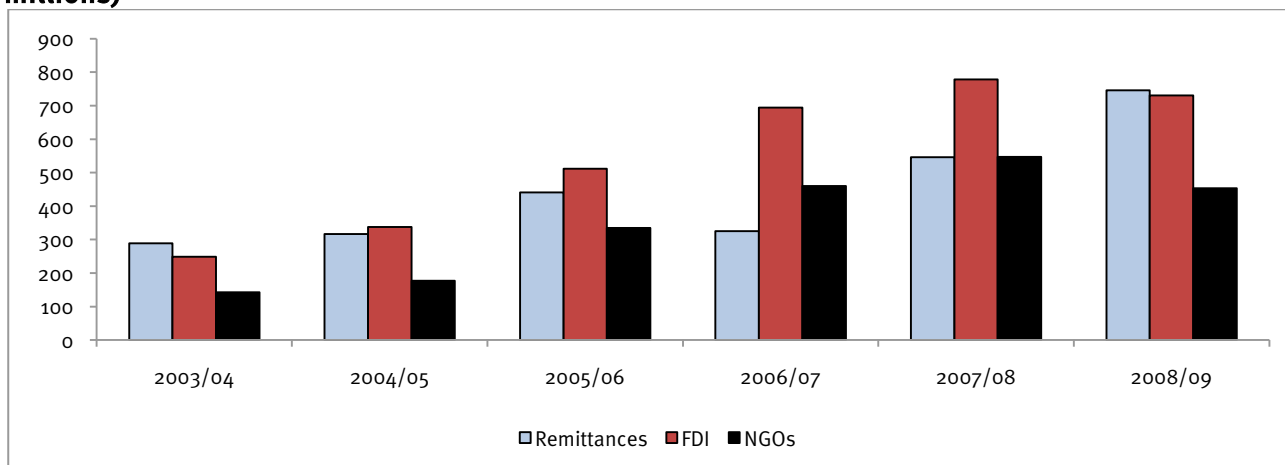
It is also evident in Figure 1 that year-on-year quarterly changes in total import values continued to decline, turning negative in the second quarter of 2009 (8.9%). Similarly, performance of imports continued to decline (by 12.3%) in the third quarter of 2009 compared with the corresponding period in the earlier year. While Uganda is said to have a significant amount of commercial oil deposits, the country still imports all of its oil products. In other words, any effects of the global financial crisis on oil prices will automatically impact on the level of imports and in turn on the economy. In import value terms, the share of oil imports in total imports reduced to 13% in 2008/09 from 15.5% in 2007/08. Considering non-oil imports, some observations emerge. Private sector imports year-on-year in the second quarter of 2009 declined by 12.3% compared with the same period in 2008. This is explained largely by the depreciation of the Ugandan shilling against the US dollar (see Figure 12). On the other

hand, government imports increased by 50% over the same period. These developments in the import sector may not be good for Uganda, given that the country's economy is still highly dependent on imports for intermediate as well as consumption goods. Moreover, the manufacturing sector is still small relative to the size of the economy.

2.2 Private capital flows

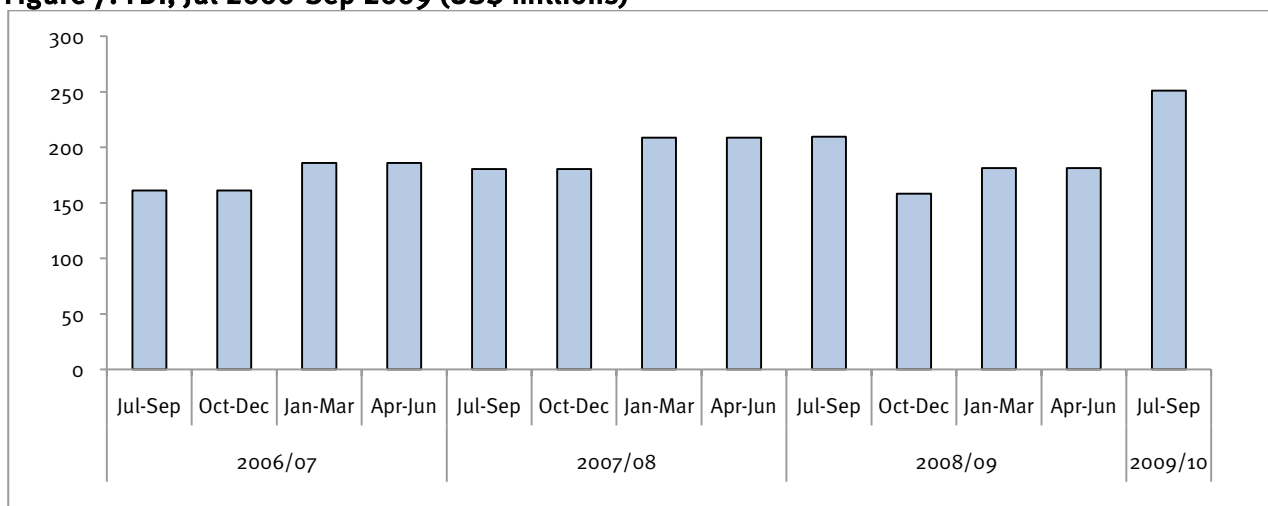
As pointed out in the Phase I paper, foreign direct investment (FDI) in Uganda has been directed mainly towards natural resources, including oil and electricity generation. Other areas of FDI attraction include telecommunications. Uganda's FDI declined from \$778.43 million in 2007/08 to \$730.45 in 2008/09 (Figure 6), or by 6.2%. Uganda recorded a reversal in portfolio capital inflows, from a net inflow of \$66.30 million in 2007/08 to a net outflow of \$108.95 million in 2008/09. On a quarterly basis, some observations emerge. The observed decline, especially in the fourth quarter of 2008, is explained largely by the adverse effects of the global crisis, with foreign firms becoming more focused on activities in their domestic economies (interview with Uganda Investment Authority (UIA), January 2010). By extension, Uganda witnessed closure of some firms, e.g. GTV, and some ongoing projects as a result of the crisis. Some companies, licensed in 2007/08, could not take off in 2008/09. For example, the oil sector attracted little investment compared with previous years. Even oil companies whose exploration contracts were coming to an end had to close business. For example, Tullow and Heritage had to reduce their level of investment in 2008/09 because of the crisis. Some companies had to discount their investment and others invested only a proportion of their total investment plan. For example, Hilton had to stall construction for some time during 2008/09 (interview with Bank of Uganda (BoU), January 2010). However, Figure 7 shows recovery in FDI during the third quarter of 2009. There are possible explanations for this. Some investors are starting to gain confidence as a result of: the government's policy responses so far; slow signs of recovery in countries most hit by the crisis; and a boost in investment in the oil sector (interview with the BoU, January 2010).

Figure 6: FDI, remittances and non-governmental organisations, 2003/04-2008/09 (US\$ millions)



Source: Based on BoU balance of payments data.

Figure 7: FDI, Jul 2006-Sep 2009 (US\$ millions)

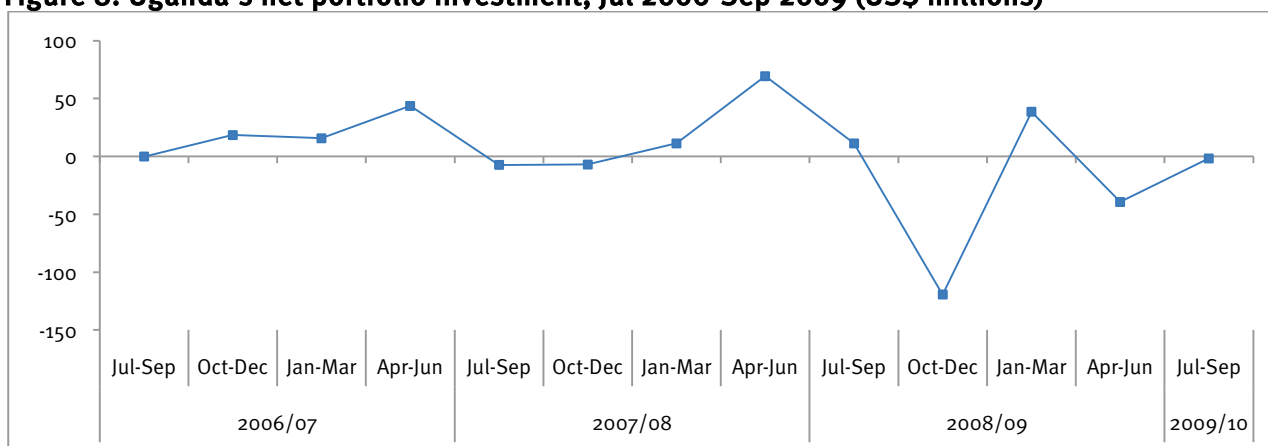


Source: Based on BoU balance of payments data.

Uganda's net portfolio investment is quite small. During the fourth quarter of 2008, it dropped by \$119.4, increasing to \$38.59 in the first quarter of 2009 (Figure 8). The drastic drop in October-December of 2008 partly contributed to the strong depreciation of the Ugandan shilling against the US dollar. The equity market faced instability during the crisis. Some shareholders sold their shares, treasury bills and bonds. Discussions with the Capital Markets Authority (CMA) revealed that over a long time there has been capital flight, with some shareholders leaving the market. It is important to note that the proportion of foreign shareholders is very small, hence the decline cannot be attributed completely to them: the decline in the share price has been the driver. Local shareholders own 70% of total shareholdings. The National Social Security Fund (NSSF) was the biggest shareholder on the market, providing security, stability and market liquidity, which most other investors on the market do not have. There was so much supply that it exceeded demand, and because big buyers like NSSF were absent (the NSSF as a result of the Temangalo saga) the market went into a decline, which created a big risk for many buyers and sellers, who became desperate (interview with CMA, January 2010).

According to CMA officials, there are significant signs of recovery in the equity market. Comparing the first two weeks of January 2010 with the same period in 2009, market turnover was US\$1.4 billion. This is a clear sign of strong recovery and a return of confidence in the market for investments. Annual turnover was US\$19 billion in 2009 compared with US\$84 billion in 2008. Performance in 2009 could be attributed to two factors: 1) uncertainty/hysteria in the market, with shares overpriced and stock owners funding their actual value of the shares on the market; and 2) prices coming down because of low investor confidence. For example, New Vision's shares came down to around US\$400 million but are now recovering.

Figure 8: Uganda's net portfolio investment, Jul 2006-Sep 2009 (US\$ millions)

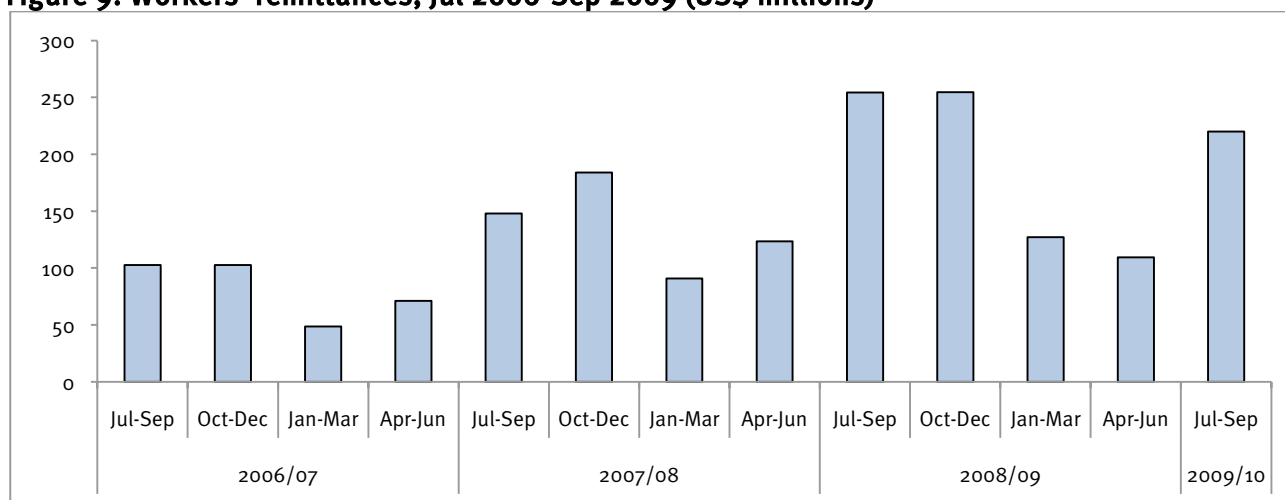


Source: Based on BoU balance of payments data.

2.3 Remittances

Remittances to Uganda are mainly from the US, the UK, Iraq and the United Arab Emirates (Dubai). Remittances increased from \$546.36 million in 2007/08 to \$745.85 million in 2008/09, representing an increase of 36.5% (Figure 6). Remittances were almost at a par with FDI in 2008/09. Figure 9 shows no effect of the crisis on remittances during October-December 2008. Ugandans working abroad continued to remit money home, 1) since such monies are a small share of their total earnings; 2) in anticipation of a bigger disaster as a result of the crisis; or 3) because of the nature of their sector of employment. Most Ugandans working abroad are employed in sectors that have not been able to lay off employees during the crisis because of their nature: social services, for example health and security, have been resilient to the global crisis (interviews with BoU and Ministry of Finance, Planning and Economic Development (MoFPED) officials, 2010). Remittances to Uganda during the second quarter of 2009 were down by 11.4% compared with same period in 2008 (Figure 9). Figure 9 further reveals that workers' remittances in the third quarter of 2009 were slightly lower than those of the corresponding period in 2008. The reduction in remittances partly explains the slowdown in investment in the construction sector (MoFPED, 2009) and therefore its poor performance during 2008/09, discussed in Section 3.2.

Figure 9: Workers' remittances, Jul 2006-Sep 2009 (US\$ millions)

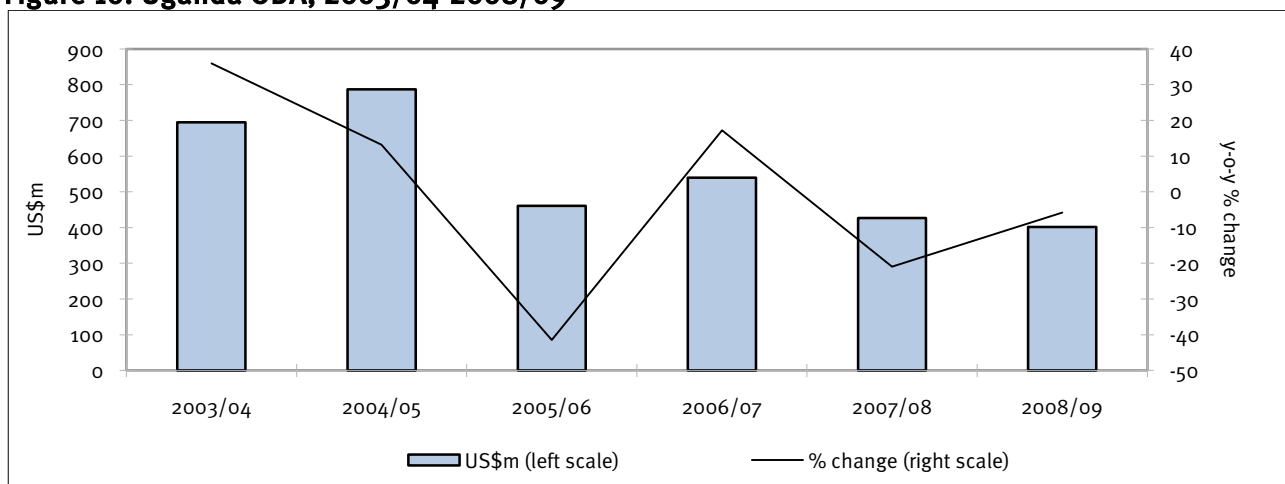


Source: Based on BoU balance of payments data.

2.4 Aid

While official development assistance (ODA) to developing countries is expected to be adversely affected by any reversals in economic fortunes, there is little evidence to suggest that this has been the case in Uganda. Figure 10 shows a declining trend in ODA to Uganda since 2006/07, and in particular reveals that ODA declined from \$426.60 million in 2007/08 to \$401.96 million in 2008/09 (5.8%). Of the past six years, it is clear that ODA reached its lowest level in 2008/09. Whether this can be attributed to the global financial crisis is hard to say. What is clear is that development partners made earlier commitments to the government and there is for the most part no indication that they will cut down on these because of the global financial crisis. However, Uganda has registered an aid reduction from Irish Aid. According to the Irish Embassy in Uganda, Ireland was hit so hard by the crisis that donor assistance has had to be reduced. Although the Irish three-year rolling programme of aid to Uganda came to an end in 2009, a five-year programme for the years 2010-2014 to the tune of €175 million is to be completed. This aid will target vulnerable groups in Karamoja (specifically Moroto and Nakapiripiriti districts) and the Northern region (interview with Irish Embassy Development Specialist, January 2010). But for the main part, calls to and commitments by Western countries to increase aid to developing countries have continued.

Figure 10: Uganda ODA, 2003/04-2008/09



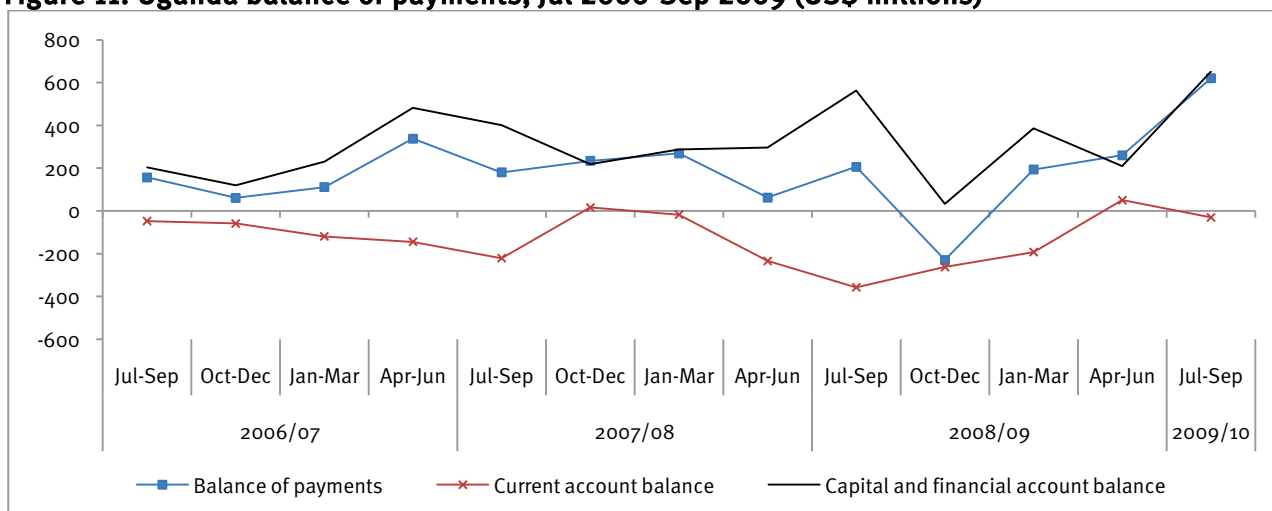
Source: Based on BoU balance of payments data.

Figure 6 above also presents the trend in inflows to NGOs over time. It is evident that inflows to NGOs declined from \$547.23 million in 2007/08 to \$453.64 million in 2008/09, representing a year-on-year reduction of 17.1%.

2.5 Summary: Balance of payments effects

Figure 11 summarises the status of Uganda’s balance of payments. During the October-December 2008 period, Uganda’s balance of payments slipped to a deficit of \$229.5 million, from \$234.0 million in the same period in 2007 – explained largely by poor performance of the export sector. During the first quarter of 2009, Uganda’s balance of payments registered a surplus of \$193.3 million and improved further to \$260.4 million in the second quarter. Notably, the year-on-year third quarter period balance of payments increased from \$629.3 million in 2009 compared with \$205.9 million. Balance of payments performance was driven largely by the capital and financial account balance. The fourth quarter of 2008 registered the worst performance of the capital and financial account balance, of \$33.3 million. On a year-on-year quarterly basis, the capital and financial account balance dropped by 29.2% in the second quarter of 2009 and increased by 15.5% in the third quarter.

Figure 11: Uganda balance of payments, Jul 2006-Sep 2009 (US\$ millions)



Source: Based on BoU balance of payments data.

3. Growth and development effects

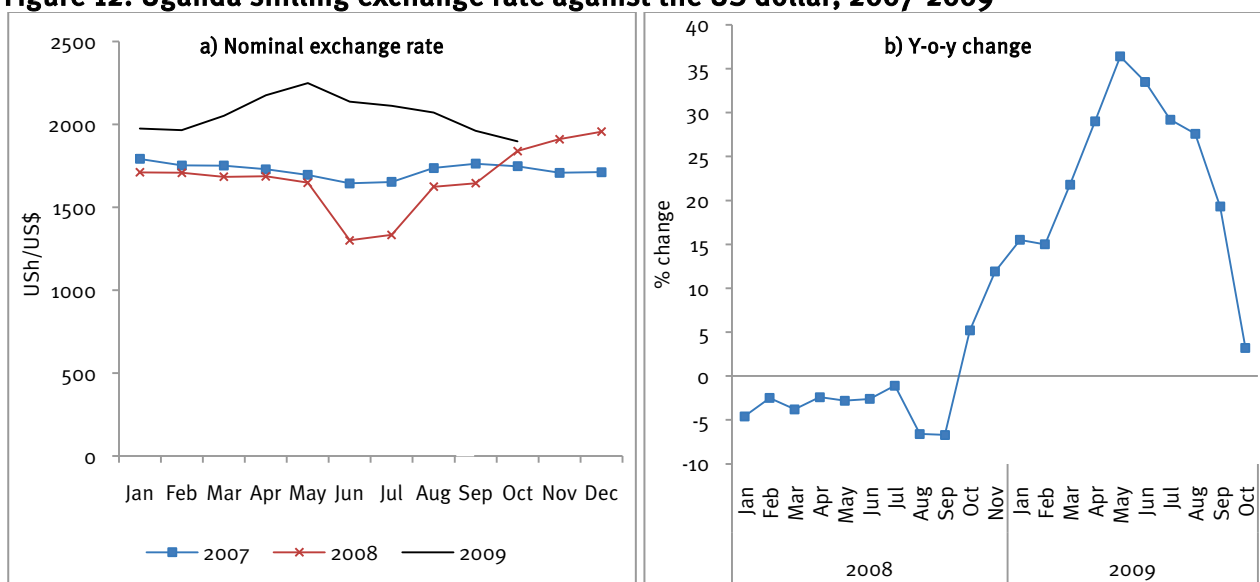
3.1 National-level growth, investment and employment

At the peak of the global financial crisis in the second half 2008, within Uganda there was much talk of how the country was unlikely not to be affected. However, later the crisis became a reality. The Ugandan economy registered a slowdown in 2008/09. In real terms, the economy grew at 7.1%, short of the projected growth rate of 8.9% and below that of 2007/08 of 8.7% in real terms. In spite of this slowdown in real economic growth, Uganda’s growth rate remained above the average for all sub-Saharan African countries. The slowdown in Uganda’s GDP was more pronounced in those sectors that are the drivers of growth in the economy (Section 3.2).

Uganda has also experienced adverse effects on some important macro prices – in particular the exchange rate, interest rates and inflation. The shilling weakened by 17.4% in the first quarter of 2009 compared with the same period in 2008, and it continued to weaken in the second quarter of 2009, by 24.5%, reaching its lowest level in May 2009 (Figure 12a). Figure 12b reveals that the shilling weakened most in May 2009 compared with May 2008 (by 36.4%). However, there has been a rebound in the strength of the shilling, which has almost reached its October 2008 level. The strengthening of the shilling during the past few months is partly a result of the slow recovery in private capital inflows (see Section 2.2).

While Uganda was able to maintain inflation in single digits in the pre-crisis period, annual inflation increased to double digits just before the crisis to date. It increased to 15.5% in May 2008 and stood at 10.9% in December 2009.

Figure 12: Uganda shilling exchange rate against the US dollar, 2007-2009



Source: Based on BoU data.

Broadly speaking, Uganda’s economy has experienced impressive growth, but this has not been matched by the creation of jobs and unemployment continues to pose a major challenge to policymakers. Nor has the resilient growth during the crisis shielded workers against its impact (Sender and von Uexkull, 2009). Sender and von Uexkull (2009) further note that the crisis has had a strong impact on workers, especially through real wages being driven by high food inflation and stagnation of nominal wages. In preparing the five-year National Development Plan (NDP), job creation is one of the major development challenges addressed. However, there is clear recognition within government circles that failure to create jobs could easily lead to social unrest, exacerbated by the current global

financial crisis. However, we hasten to stress that there is no concrete empirical evidence of the impact of the global financial crisis on employment beyond the findings in Ssewanyana et al. (2009) and the rapid impact assessment on vulnerable groups by Sender and von Uexkull. While pay-as-you-earn (PAYE) has increased (see Section 3.2), a lack of data means that it is difficult to attribute this either to more job creation during the period or to strengthened tax administration of PAYE collection by the Uganda Revenue Authority (URA)

3.2 Sectoral-level effects

At sectoral level (Table 1 and Figure 12), the agriculture sector grew by 3.4% in 2008/09 in real terms, compared with 1.3% in 2007/08. Yet the sector's contribution to GDP has been declining over time, standing at 15.2% in 2008/09. The growth in the forestry sub-sector enabled the agriculture sector to register this positive growth despite a sharp fall in the cash crop sub-sector, from 9% in 2007/08 to 5.6% in 2008/09. The food crop sub-sector registered a marginal increase in real growth, from 2.4% to 2.9% in 2007/08 and 2008/09, respectively; the fishery sub-sector seems to have fallen less over the same period. In spite of the declining share of agriculture in GDP, the sector remains the main source of livelihood for a majority of Ugandans, especially the rural poor. It indirectly contributed to the growth of the manufacturing sub-sector during the crisis, through food processing. Increasing regional food prices, with Uganda a net exporter, partly cushioned the sector from the adverse effects of the crisis.

Table 1: Sectoral and growth rates in constant prices, 2004/05-2008/09 (%)

	2004/05	2005/06	2006/07	2007/08	2008/09
Sectoral contribution to GDP					
Agriculture, forestry and fishing	20.2	18.3	16.9	15.8	15.2
Industry	24.0	24.8	25.1	25.1	24.7
Services	49.0	49.6	49.5	49.9	50.2
Growth rates at market prices					
GDP	6.3	10.8	8.4	8.7	7.1
Agriculture, forestry and fishing	2.0	0.5	0.1	1.3	3.4
Industry	11.6	14.7	9.6	8.8	5.1
Services	6.2	12.2	8.0	9.7	7.6

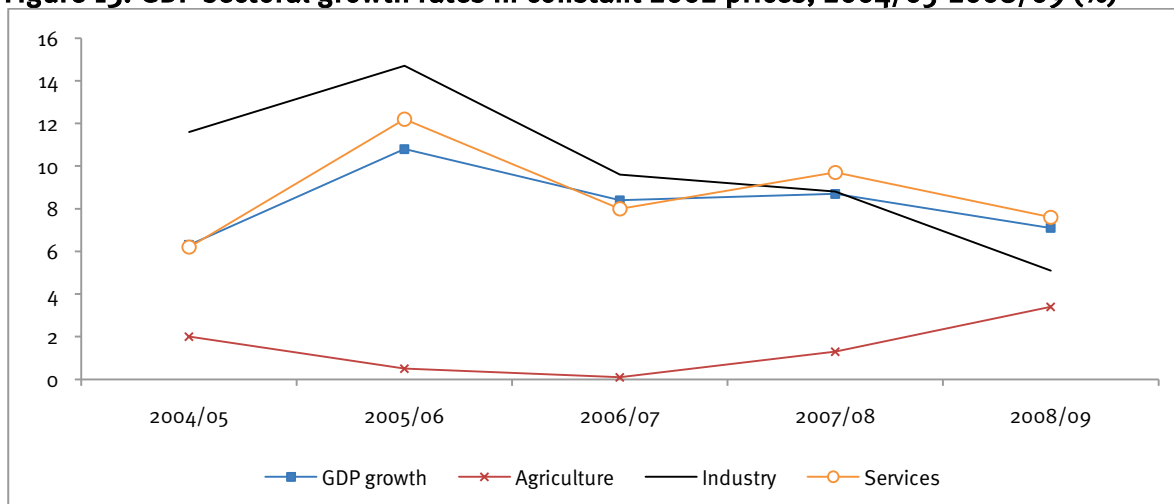
Source: UBoS data.

Growth in both industry and services sectors slowed down, with industry growing slower than services. Within the industry sector, the manufacturing sub-sector grew by 7.3% in 2007/08 as compared with 9% in 2008/09, which negates our earlier speculation that this sub-sector would be significantly affected by the depreciation of the Ugandan shilling against the US dollar, especially for those firms with a high import content of raw materials (Ssewanyana et al., 2009). Strong growth in food processing cushioned manufacturing activities from the impact of the crisis (MoFPED, 2009). While the share of employment in the construction sub-sector is small, the sector's contribution to overall GDP is almost at the same level as that of the agriculture sector (of about 15%). Growth of the construction sub-sector fell significantly, from 10.5% to 3.7% in 2007/08 and 2008/09, respectively, affecting the overall performance of the industry sector. As earlier argued, this is partly attributed to the poor performance of remittances (ibid). However, a slowdown in growth of the construction sub-sector since 2005/06 should also be noted. Overall, the observed slowdown in industry was driven mainly by the poor performance of construction, which is not surprising given its relatively high share in the sector.

Since 2004/05, the services sector has been contributing over 50% of overall GDP, driven mainly – in order of importance – by wholesale and retail trade, transport and communications and real estate activities. The sector, which is the main growth driver, registered a decline in growth from 9.7% to 7.6% in 2007/08 and 2008/09, respectively. The poor performance was driven largely by the poor performance of the wholesale and retail trade sub-sector – owing to low domestic demand and depreciation of the shilling. The growth in hotels and restaurants is partly a result of government incentives to the sector – where 100% of VAT is reimbursed to developers. This incentive structure

started way back before the Commonwealth Heads of Government Meeting held in Kampala, Uganda. We also note a significant sharp decline in the public administration and defence sub-sector, largely explained by the government's ability to restore and sustain peace in Northern Uganda.

Figure 13: GDP sectoral growth rates in constant 2002 prices, 2004/05-2008/09 (%)

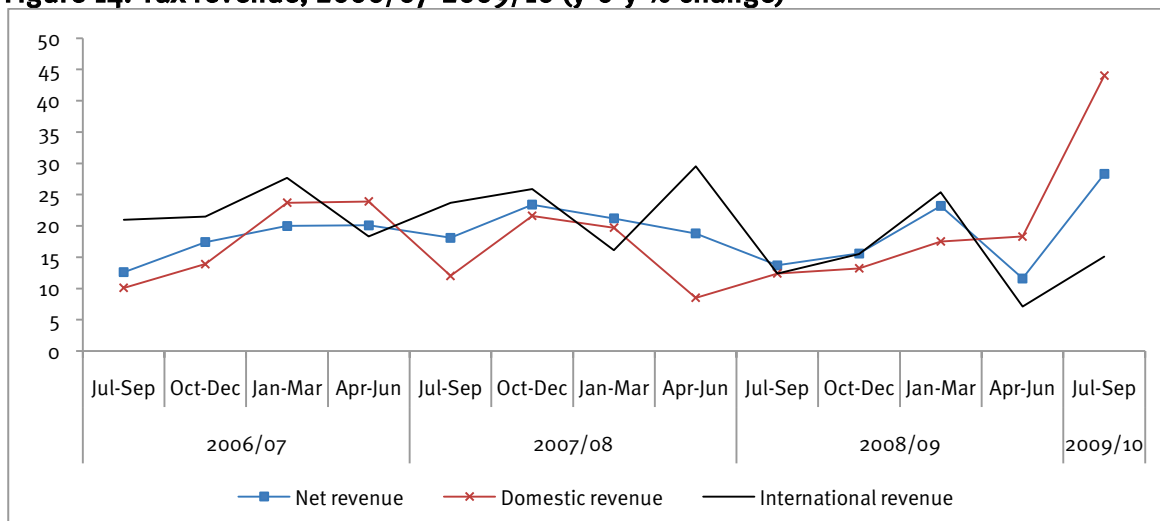


Source: UBoS data.

3.3 Fiscal effects

The global financial crisis affected the performance of government tax revenue and tax refunds in 2008/09. The government registered a shortfall of about US\$151 billion against its revenue projection during the financial year (MoFPED, 2009). The shortfall is largely attributed to the poor performance of domestic indirect taxes and international trade revenue, in particular import duty and petroleum duty. Revenue from domestic sources performed poorly compared with revenue from international trade in 2008/09 relative to 2007/08. Low domestic demand, especially for beers, cement and airtime, contributed to poor revenue performance. Corporate tax revenue also declined because of the impact of the crisis on Uganda's large corporate players, including those in telecommunications and petroleum, among others. However, Figure 14 shows that, towards the end of the second quarter of 2009, the trend seems to have reversed, with domestic revenues increasing on a year-on-year basis by 44% in nominal terms. PAYE increased by 45.9%, with 36.3% for indirect taxes during the same period. The crisis also impacted adversely on the performance of revenue collection from international trade, which contributes nearly half of the government's revenue.

Figure 14: Tax revenue, 2006/07-2009/10 (y-o-y % change)



Source: Based on URA data.

3.4 Poverty and distributional effects

There is no concrete empirical evidence on the impact of the crisis on poverty and inequality. The discussion that follows is very speculative. However, no major budget cuts are evident in the social sectors (see MoFPED, 2009) and tax has remained unchanged. It should also be noted that before the crisis there were efforts by government to address horizontal inequalities beyond the current poverty reduction interventions, with the aim of reducing conflict and increasing social cohesion. Such programmes include the Peace and Reconciliation Development Programme (PRDP) and the Northern Uganda Social Action Fund (NUSAF) II, whose implementation has already started.

According to Ssewanyana (2008), household incomes need to grow by 4%; other similar studies (McGee, 2000; Okidi et al., 2003) estimate growth of at least 7% at national level if Uganda is to achieve Millennium Development Goal (MDG) 1. Going by these estimates, and our earlier discussion, one would not expect a significant increase in poverty. Furthermore, income poverty reduction in Uganda is closely linked to the performance of the agriculture sector, especially the coffee sub-sector (Okidi and Ssewanyana, 2007), and the return of peace in Northern Uganda, the poorest region in the country. In their impact evaluation of NUSAF on the people of Northern Uganda, Ssewanyana and Younger (2009) reported that strong growth in agriculture as a result of a return to peace in the region greatly contributed towards a significant reduction in income poverty. It is using this evidence that one would conjecture a reduction in poverty. On the other hand, we should not underestimate the impact of higher food prices on those households that are net buyers of food, despite gains accruing to net food sellers and poor performance of the coffee sub-sector.

4. Policy responses: A critical review

Policy response could be approached using a four-sector model that links the real sector, the external sector, the monetary sector and the fiscal sector together. The overarching objectives of monetary policy in Uganda are stability of prices (low inflation) and a competitive exchange rate. The fiscal authorities have a mandate to ensure that budget allocations and expenditures are supportive of the monetary policy objective of price stability and the entire economic growth process, by making appropriate budget allocations and providing good incentives for private sector investment.

4.1 Macroeconomic policies to manage the impact of the crisis

4.1.1 Broad reactions by the monetary and fiscal authorities

When global financial crisis or global credit crunch effects began to be felt in Western economies, with some of them recording negative GDP growth in 2007/08, the initial thinking of Uganda's monetary and fiscal authorities was that the Ugandan economy was unlikely to be affected. This thinking was driven mainly by the fact that Uganda's financial system is weakly linked to the global financial system, through which the global financial crisis first manifested itself. However, during 2008/09, Uganda's monetary authorities realised that the country might not avoid second-round adverse effects of the crisis, which were beginning to manifest themselves through decreased capital inflows into the economy. Nonetheless, Uganda's monetary authorities remained focused on macroeconomic stability, particularly the control of inflation.

Inflation considerations (explained further below) largely shaped Uganda's response to the global financial crisis. For fear of worsening the inflation situation, Uganda's monetary and fiscal authorities were initially not willing to put in place what has come to be called a 'stimulus package'.

In addition, while public providers of social services pointed to inadequate funding as a major limiting factor in service delivery, fiscal authorities wanted inefficiencies in the use of public resources to be closed first. Measures that the government put in place to improve efficiency in the use of public resources, such as accountability for results by spending agencies before MoFPED could release more money, led to decreased demand and stockpiling towards the end of 2009.

4.1.2 Monetary policies

During the period of the crisis, Uganda remained focused on maintaining price stability (low inflation) and a competitive exchange rate. The central bank worked closely with the fiscal authorities to ensure the realisation of these objectives. Just before the crisis, Uganda's annual inflation remained in single digits. However, as shown in Section 3.1, inflation has since remained in double digits. The Ugandan monetary authorities chose not to adopt expansionary policies as prescribed by the international community, including the International Monetary Fund (IMF), because of the inflationary pressures from both the food prices and imported inflation. Partly because of the conservative monetary policies Uganda chose to pursue, and also because of decreasing food prices attributed to seasonal factors, Uganda is beginning to witness a decline in inflation, albeit small; the composite annual rate of inflation declined 10.9% in December 2009 (Tumusiime-Mutebile, 2009a; 2009b).

The country did not change its policy on determination of exchange rates, which have been market determined since the liberalisation of the foreign exchange market in 1993; the central bank intervenes in the foreign exchange market only to smooth perceived short-term exchange rate fluctuations. Although the Ugandan shilling depreciated under the onslaught of the crisis towards the end of 2008, the currency then began to stabilise, with some recorded appreciation of the shilling, as discussed in Section 3.1. Uganda did not panic and draw down its foreign exchange reserves to stabilise the shilling when the crisis was at its peak. Accordingly, Uganda's foreign exchange reserves continued to be healthy, at about 5 months of its imports. Uganda's strong reserve position points to the likelihood of

the country maintaining macroeconomic stability in the medium term. The Ugandan authorities also did not make recourse to the stimulus package placed at their disposal by the IMF and the World Bank.

The argument by Uganda's monetary authorities remained that a stable macroeconomic environment is necessary to encourage private sector investment, employment and job creation, all of which translate into higher economic growth. Accordingly, during the period of the crisis to date, Uganda has remained conservative in its conduct of monetary policy (interview with the UK Department for International Development (DFID), 2009). Despite a call from the international community to ease its monetary policy stance in response to the crisis, Uganda has continued to tighten its monetary policy to tame inflation and stabilise the local currency. The merits and demerits of this policy stance remain debatable. Some commentators argue that inflation hurts the poor most and works against economic growth through its adverse effects on investment planning. Others argue that increased spending would be supportive of economic growth and social investments.

To look at inflation as 'always and everywhere a monetary phenomena', as the Uganda monetary authorities chose to do, falls short of appreciating the extent to which increased supply of goods and services would have a mitigating effect on inflation. To tighten monetary conditions in an economy that is already in a recession could drive the economy further down into recession via increased unemployment and reduced investment.

Operating below full employment with excess capacity, Uganda's economy has space for expansionary monetary policy at hardly any risk of inflation. Indicators of excess capacity in the economy include low capacity utilisation in industrial manufacturing plants estimated at less than 50%, and unemployment and underemployment, which are a public outcry in the country. It should be noted that the inflation Uganda witnessed during the period of the crisis was not because of too much money in the economy but largely because of higher food prices arising from low production as a result of drought. There is a need for deliberate measures to increase both public and private sector investment to create jobs, increase incomes and reduce poverty, which current monetary policies are relegating to the fiscal authorities, which have limited financial resources and whose effective capacity is also controlled by the monetary authorities.

4.1.3 Fiscal policies

In Uganda, the mandate to stimulate economic growth resides largely with the fiscal authorities. The fiscal authorities are expected to achieve the objective through budgetary measures (fiscal policy). During the period of the crisis, the country maintained its target on the fiscal deficit – to reduce the deficit to below 5% of GDP and external borrowing from concessionary sources.

Broadly, like monetary policy, fiscal policy in Uganda remained largely conservative during the period, with no expressed policy to increase the size of the fiscal deficit. On the contrary, the fiscal authorities continued with their desire to decrease the fiscal deficit, as stated above. Yet, to address the adverse effects of the crisis, the country needed to increase public sector spending. This was repugnant to Uganda's monetary and fiscal authorities, which thought that such action would have long-lasting adverse effects on the economy through destabilisation of the macroeconomic environment. While we appreciate Uganda's increased public sector investment in infrastructure development, alluded to in Section 4.3, the infrastructure deficit that the country must meet to realise its development aspirations remains enormous, calling for an increase in the size of the fiscal deficit. The issue should not be the size of the fiscal deficit but rather the way it is financed and how the money is spent. The relevant question to address should be, could the benefits of a relatively larger deficit be more than the costs in the medium to long term? If the answer is yes, then the Ugandan authorities should go for a larger deficit than the current target of less than 5% of GDP. It is important to recognise that, in the short run, the binding constraints to the country's economic growth and development need to be removed to foster economic growth and transformation. Uganda is unlikely to register higher inflation just because of a wider fiscal deficit, mainly for the following two reasons:

- High demand for imported inputs for the development of public infrastructure; some of the inputs could be sourced from abroad with little impact on monetary expansion in the domestic economy. Construction of hydropower dams and the railway network provide good examples of inputs that the country could spend on without increased risk of sustained moderate inflation.
- The Ugandan economy is operating at below full employment, calling for a stimulus package to increase resource allocation and utilisation, employment and capacity utilisation.

4.2 Social policies to respond to the impact of the crisis

Because of the global financial crisis, the expectation was that funding to social sectors could suffer as revenues declined. Contrary to this expectation, tax revenue performance continued to do well, remaining broadly within targets. Spending on social sectors was accordingly not reduced on account of poor revenue performance, as had been anticipated.

Before the crisis, the government already had plans to address horizontal inequality through the PRDP and NUSAF II programmes. These two programmes specifically targeted Northern Uganda, which lags behind other regions in terms of development and poverty reduction. Most importantly, implementation of these programmes has gone ahead as planned; any delays in implementation cannot be attributed to shortfalls in revenue. Implementation has been facilitated with relative peace in this part of the country since 2008.

4.3 Economy-wide and sectoral structural policies for getting the country out of the crisis

In its annual budgets, Uganda always announces economy-wide and structural policies that are geared towards increasing the rate of economic growth and enhancing the process of structural transformation. Accordingly, it is not appropriate to interpret the policies that the government announced in its recent budget of June 2009 as a response to the crisis (see MoFPED, 2009). It is noteworthy, however, that Uganda had already identified binding constraints to growth even prior to the onset of the crisis, and that the country was moving ahead to address some of them.

During the 2009/10 national budget speech, Uganda adopted further revenue and expenditure measures geared towards reducing the cost of doing business and encouraging private sector investment in priority sectors. One notable expenditure measure geared towards reducing the cost of doing business was a significant increase in the budget for public sector infrastructure, mainly power generation and construction of roads. Other notable measures, to do with increasing private sector investment, included:

- Encouraging investment in agriculture for production by instituting an agriculture credit scheme. The government put in the budget US\$60 billion for lending to commercial farmers. The government spent the money in November/December 2009.
- Tax refunds to registered businesses that invest in construction of hotels.
- Tax refunds for registered businesses that import education materials.
- Exemption from corporation tax for investors in education services.

With regard to increased public sector investment, during 2009/10 the main focus is on power generation and road construction which, if addressed, would bring down the cost of doing business and increase the country's competitiveness. Moreover, Uganda increased expenditure on infrastructure development just before the crisis manifested itself, which means that this should not be interpreted as a response to the crisis. Nonetheless, some officials of MoFPED point to increased expenditure on infrastructure development as having inbuilt benefits for the economy, akin to those that would accrue to the economy as a result of a fiscal stimulus package. Accordingly, these officials say that Uganda was already ahead in terms of responding to the adverse effects of the crisis – government expenditure

priorities made prior to the crisis were similar to those that would have been prescribed in response to the crisis. In their opinion, partly because of expanded public spending on infrastructure, the crisis did not have a far-reaching adverse impact on the economy, as may have happened without it. Furthermore, recovery from the adverse effects seems to have been faster because of this measure.

4.4 Multilateral and bilateral donor responses in Uganda

4.4.1 Uganda's response to prescriptions by the international community

The prescription by the international community to address the adverse effects of the crisis was the adoption of expansionary monetary and fiscal policies, dubbed as 'fiscal stimulus packages'. Indeed, the rich countries of the North adopted expansionary monetary policies. Uganda did not, having examined their likely impact on the economy from the following perspectives:

- Increased money supply in the economy would have an adverse impact on inflation, which had already increased to 14.5% per annum compared with the single-digit record the country had witnessed for about two decades.
- External sources of funding for increased public sector spending were perceived to be problematic from the perspective of absorptive capacity. External financing of an increased fiscal deficit has historically led to higher interest rates, which partly explain low investment, job creation and economic growth.
- Domestic financing would crowd out private sector investment, which again would work against long-term growth prospects for the economy.

4.4.2 Multilateral donor response

At the global level, the IMF responded to the crisis by increasing its lending from \$1.2 billion in 2008 to an expected \$4 billion by 2010 (te Velde and Massa, 2009). While the IMF made money available to Uganda to borrow to address revenue shortfalls that were manifesting themselves as a result of the global financial crisis, Uganda chose not to access the funds, because of the fears alluded to above. Yet, for a small economy like Uganda, the only financing option for a fiscal stimulus package in response to the crisis was external financing. By choosing not to access financing from the IMF for inflation considerations at a time when the country needed something like a stimulus package, Uganda's medium- and long-term growth performance is likely to fall below potential. (But, given the recovery now, this will no longer be the case: medium- and long-term growth could be restored without further borrowing from the Fund).

Turning to the response by the World Bank globally, the institution trebled its lending from \$13 billion to \$35 billion, spending an estimated \$100 billion by 2012. The International Development Association (IDA) specifically was expected to frontload some \$2 billion (te Velde and Massa, 2009). However, at the national level, Uganda's borrowing from the World Bank remained largely the same.

As for the African Development Bank (AfDB), in March 2009 the institution agreed to respond to the crisis through three different instruments, namely, 1) the Emergency Liquidity Facility, tentatively set at \$1.5 billion; 2) the Trade Finance Initiative of \$1 billion; and 3) faster transfer of resources and greater policy support and advice (te Velde and Massa, 2009). However, at national level, Uganda is yet to register any observed change or increase in resources from the AfDB because of the global financial crisis.

4.4.3 Bilateral donor response

Globally, bilateral donors are reacting, but in different ways – some by cutting aid (e.g. Italy, Ireland), others by reprogramming within and across countries (e.g. the UK's increased focus on social protection) and others by reprogramming towards multilateral channels (te Velde and Massa, 2009). At the country level, Uganda is yet to record a significant reaction from bilateral donors because of the global financial crisis. Some bilateral donors have indicated that they may cut aid to Uganda over governance concerns, but by December 2009 there was no record of donors having done this.

5. Conclusions

This concluding section looks at the impact of the global financial crisis to date in very brief terms. Section 5.1 looks at what happened previously and what has started to happen in recent months. Section 5.2 is forward looking in terms of how the country is positioned to gain from future recovery and grow sustainably.

5.1 The impact of the crisis: An update

Initial expectations by Ugandan monetary and fiscal authorities that the country would not suffer adverse effects of the global financial crisis were short-lived, as the country began witnessing reduced capital inflows, a situation which would inevitably affect the Uganda economy. An early sign of reduced capital inflows was the depreciation of the local currency. Coupled with increasing food prices, inflation shot up. Ultimately, GDP growth, in real terms, in 2008/09 was lower than targeted (7.1% instead of 8.5%) and lower than that of 2007/08. Nonetheless, Uganda's economic performance compared with other sub-Saharan African countries was very good. And, when compared with many economies in the West, which were contracting, Uganda was doing well.

In recent months, mainly from September 2009, the Ugandan economy has been beginning to rebound from the adverse effects of the crisis. The first sign is the appreciation of the local currency which, when coupled with decreasing food prices associated with seasonal factors, is beginning to see inflation decreasing. However, this observation based on the appreciation of the shilling should be taken with caution, because there may be other explanations for it, particularly decreased spending by the public sector.

As already alluded to, the adverse effect of reduced capital inflows has been a reduction in the economic growth rate, which was simulated to have adverse effects on poverty. As the economy begins to rebound, our expectation is that the growth of the Ugandan economy will once again recover to targeted levels and poverty will begin to rescind to the position before the onslaught of the global crisis.

5.2 Looking ahead: How well is the country positioned to gain from a future recovery and grow sustainably?

Uganda had already positioned itself to begin to address the most binding constraint to economic growth, which was initially identified to be mainly poor and inadequate infrastructure, especially in power generation, transport infrastructure and social infrastructure in health and education. The country is in the process of completing its five-year NDP, which identifies further constraints to economic growth that need addressing.

The objective of addressing development constraints is to bring down the cost of doing business in Uganda, thereby enhancing the country's competitiveness through productivity gains. Indeed, Uganda revised its external debt strategy to align it with its development priorities. While Uganda did not put in place a deliberate set of recovery policies, the country's expenditure plans were already in line with the would-be priorities in terms of productivity enhancement.

The country's response to the capital outflows and its conduct of monetary and fiscal policies that largely remained conservative seem to be likely to pay off well in terms of macroeconomic stability, as the foreign reserves of the country remain healthy. However, the future direction for sustained growth

will depend on the extent to which the country will marshal its natural and human resources for economic growth, which would call for increased public sector spending or a fiscal stimulus.

Regarding natural resources, Uganda has recently discovered oil, whose production, expected to come on stream by 2012, will determine the future direction of the economy. Uganda will need to manage oil revenues well to avoid the resource curse and maintain its diversified export base, which partly cushioned the country from the adverse effects of the global financial crisis. Turning to human resources, the country is challenged, with a high population growth of 3.2% annually. This high rate of population growth, if not planned for, could become a daunting challenge in terms of improving people's welfare. However, in the event that Uganda enhances the investment rate (both public and private) to levels that would create jobs for its entire population, the population could then become a source of growth for the Ugandan economy, which would enable the country to take off from being a low-income country to being a middle-income country.

As Uganda celebrates the limited adverse effects of the global financial crisis, the country should remember that this situation is so partly because of the country's narrow financial sector, which is weakly linked to international financial markets. To support robust growth, the country needs a well-developed financial sector. It is therefore important that Uganda makes deliberate efforts to develop the sector, which in any case has a vital role to play in the country's development process.

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Annex 1: GDP by economic activity at constant 2002 prices, 2004/05-2008/09 (%)

	2004/05	2005/06	2006/07	2007/08	2008/09
Total GDP at market prices	6.3	10.8	8.4	8.7	7.1
Agriculture, forestry and fishing	2.0	0.5	0.1	1.3	3.4
Cash crops	-5.5	-10.6	5.4	9.0	5.6
Food crops	-0.2	-0.1	-0.9	2.4	2.9
Livestock	3.0	1.6	3.0	3.0	3.0
Forestry	6.5	4.1	2.0	2.8	6.3
Fishing	13.5	5.6	-3.0	-11.8	-0.1
Industry	11.6	14.7	9.6	8.8	5.1
Mining and quarrying	27.2	6.1	19.4	3.0	4.7
Manufacturing	9.5	7.3	5.6	7.3	9.0
Formal	11.8	7.8	4.9	9.2	10.4
Informal	3.6	6.0	7.7	2.1	4.8
Electricity supply	2.1	-6.5	-4.0	5.4	1.5
Water supply	3.9	2.4	3.5	3.8	5.7
Construction	14.9	23.2	13.2	10.5	3.7
Services	6.2	12.2	8.0	9.7	7.6
Wholesale and retail trade; repairs	7.2	12.3	10.4	14.7	9.4
Hotels and restaurants	6.5	8.7	11.3	10.7	11.9
Transport and communications	9.8	17.1	17.7	21.3	19.6
Road, rail and water transport	6.7	12.8	9.5	20.8	12.4
Air transport and support services	19.4	6.9	13.8	17.8	-3.6
Posts and telecommunication	11.8	26.2	29.1	22.6	32.2
Financial services	13.0	31.7	-11.9	17.1	12.5
Real estate activities	5.5	5.6	5.6	5.6	5.7
Other business services	9.2	12.5	8.0	10.8	12.3
Public administration and defence	-5.4	15.8	-6.3	12.1	-20.9
Education	4.4	9.4	10.6	-6.5	1.4
Health	5.6	12.9	2.7	-4.8	5.1
Other personal and community services	15.0	14.1	13.4	12.8	12.3

Source: UBoS data.



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