Any hope for a recovery budget?

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With Uganda's economic growth slowed down to zero, Maria Kiwanuka needs some magic to save the day

A mixture of high expectations and anxiety will greet Finance Minister Maria Kiwanuka when she steps up on June 14 to read next year's budget. There is likely to be plenty of bad news. With a growth rate of 3.2%, Uganda's economy barely kept pace with the population for the first time in over 15 years. In Kiwanuka's first year as Minister of Finance, Uganda real growth is down to zero.

This is a far cry from the prediction by one of her predecessors, Dr. Ezra Suruma, in his 2007/08 budget speech. That year the economy posted 6% growth. Suruma said with the end of Joseph Kony's war in Northern Uganda and the discovery of oil in the Lake Albert region, it would grow even faster. The opposite has happened.

Government blames the slowdown on various factors, including rising prices, unfavourable balance of payments, exchange rate depreciation and high interest rates.

Bank of Uganda had some good news in its latest monthly statement: Inflation declined for the seventh consecutive month to 18.6% in May from 20% in April. After touching a 30.4% high in October last year, the highest in 19 years, the downward trend has monetarists convinced that while the economy may not be on sound footing yet, it is headed in the right direction.

Still, sources say projections by the Ministry of Finance are more pessimistic in the immediate term, with economic growth for the calendar year 2012 expected to be barely 3%. This would imply negative real growth since the population will continue to grow at over 3% per year.

Analysts are pondering the implications to the wellbeing of Ugandans. When the Finance Ministry presented the budget framework paper (BFP) to Parliament in March, government already knew the economy would slow down, but projected a smoother slide from the earlier projected 7% to 5%. The economy had grown by 6.7% in 2010/11. But ominous signs followed. The economy grew by just 0.4% in the first quarter of 2011/12 (July to October 2011), a sharp dip from 3.2% the previous quarter.

The effects on Ugandans are made most apparent by the Poverty Status Report 2012 recently released by the Ministry of Finance under the theme *Reducing vulnerability, equalising opportunities and transforming livelihoods.* The report shows that about 10 million Ugandans live below the poverty line. Of the 23 million that were above it in 2010, 13 million were considered to be "insecure non-poor". This means any shocks in the economy can easily push them back into absolute poverty.

Slowdown in growth, which is usually accompanied by lower demand for goods and services, job losses, reduced government revenue, reduced production and a further, self-perpetuating reduction in growth, is such a shock, according to Dr. Isaac Nkote, a senior economics lecturer at Makerere University Business School.

Kiwanuka will be expected to provide a way out of the crisis and Geoffrey Ekanya, her counterpart in the Shadow Cabinet, says turning around the economy “is not rocket science”.

“The problem with this government is that it does not listen,” says Ekanya.

Ekanya says the opposition’s pre-budget position has not changed from the campaign manifesto FDC President Kizza Besigye tabled for last year’s election, proposing reduction of taxes and interest rates to encourage production, increasing salaries for civil servants, and investing in production.

Ekanya adds that increase funding for the sectors in which most Ugandans earn a livelihood, like agriculture, or which affect most people, like health, will enhance productivity and improve livelihoods.

He agrees that massive investments in infrastructure like energy, which government has prioritised, is vital, but argues for reduced funding to “non-productive” areas like public administration and defence.

Experts don’t expect government to panic and abandon the policy prescriptions of the International Monetary Fund (IMF) which goes: “Where inflation rates jumped sharply during 2011, priority is to keep monetary and fiscal policy tight until there is clear progress towards inflation objectives.”

The policy debate

But some critics say this policy may be problematic. At a workshop organised by the Economic Policy Research Centre (EPRC) and International Monetary Fund (IMF) at Makerere University on June 1, EPRC’s Lawrence Bategeka punched holes in the IMF’s pet policy of liquidity tightening, which the government is pursuing.

Bategeka said that last year, when the Central Bank Rate (CBR) was raised to its highest of 23% to discourage commercial bank lending and reduce money supply, inflation seemed to defy the measure and kept rising. As the central bank has reduced the CBR, inflation figures have also been reducing.

The policy, Bategeka argued, had created two Ugandas: “Austerity has hurt Uganda’s rural economy for the past decades [and benefitted the] Kampala economy.”

Former Finance Minister Mayanja Nkangi backed the strict monetary policy. Government’s only mistake, Nkangi said, was to use it alone. “If I were the minister,” Nkangi said, “I would let him [pointing at Bank of Uganda Governor Tumusiime Mutebile) continue, but I would also employ the fiscal policy [i.e. public spending and taxation].”

However, Dr. John Mutenyo, a senior economics lecturer at Makerere University, argued that pushing up interest rates to reduce inflation was wrong because in a country where very few households (15%) borrow for consumption, it targeted the producers.

“The measure ended up hurting the 85% who borrow to produce,” added Mutenyo.

Mutenyo said it would have been wiser for Bank of Uganda to use treasury bills and bonds which attract foreign currency and ease inflation.

Mutebile kept silent through most of the criticism. To continued prodding from Dr. Sarah Ssewannyana, the executive director of EPRC, to say something in response, Mutebile said, “The governor is not here today”.

Gerald Sendawula, another former Minister of Finance, said in a separate interview that debate about which policy option to pursue is always hot because “we (economists) went to different schools”. Sendawula projects that if government hadn’t tightened monetary policy, inflation would now be about 45%. Even now that it is under 20%, he says it is important to maintain the squeeze.

The government looks set to do just that. “Fiscal policy will be tight in 2012/13 due to the need to restore macroeconomic stability and rebuild international reserves to be able to cushion the economy from unexpected shocks,” says the BFP.

But Nkote disagrees with this approach. To him, “20% is moderate inflation in a poor economy,” and “will give people momentum to produce.” To him, austerity is one of those “Washington Consensus theories [that] sometimes don’t work in our case.”

In defence of IMF

Thomas Richardson, the IMF resident representative in Uganda, agreed that low inflation alone is not sufficient for economic growth, but argued that it is still critical.

“We don’t know of any cases of substantive economic growth that don’t have low inflation,” Richardson said.

And he got support from South Korea. Jong-Dae Park, Charge’ D’affaires at the South Korea Embassy in Kampala, said IMF’s austerity policies had put South Korea’s economy back on the road at the turn of the century. But Park also noted that Uganda’s situation was different, as South Korea had by then already undergone social transformation. Park said Uganda needs to invest in enhancing production and capacity building.

Park’s argument suggests investment in agriculture, with which rural transformation in Uganda is inextricably tied. The agricultural sector budget has consistently remained below 10% and for 2012/13, according to the BFP, is projected to reduce from 447.2 in 2011/12 to 351.5, a move that has already attracted criticism. The opposition would allocate at least 10% of the total to agriculture, for instance.

But Nkote would do the opposite: “I would slash the allocation to all those sectors [including agriculture] by half,” he says. Nkote said there was no evidence that budget allocations to agriculture benefited the people, as in fact, most of the money ends up in workshops and “research projects that never benefit the farmers”.

The Poverty Status Report 2012 argues that households stand a better chance of raising their incomes if they move away from agriculture. Between 2005/6 and 2009/10, the proportion of rural households relying primarily on agriculture declined from 64 to 54%.

“Growth has been most pronounced in terms of non-agricultural wage employment,” says the report.

To Nkote, there is no evidence that a bigger budget for the agricultural sector would make farmers better off.

Nkote says funding for infrastructure and energy needs to increase even more. Next financial year government plans to invest in the Kampala-Entebbe Express Highway and other roads, and the construction of Karuma Hydropower dam. Education will again get the biggest chuck of financing to support Universal Primary Education and Universal Secondary Education, while health is set for a cut.

Hope and gloom

But budgeting is based on estimates of revenue and expenditure that are sometimes disproved by reality. IMF and government are aware that certain risk factors will determine whether the money is available. A dip in aid is already expected, especially because 60% of Uganda’s budget support donors come from the euro zone, which is grappling with an economic slowdown of its own.

Whether bigger European economies will bail out crisis-ridden Greece, for example, and how that will affect the rest of the world, is one factor on which Uganda's recovery is partly contingent. External grants are already projected to decline from 2.7% of GDP to 1.8%, possibly more, in 2012/13.

The IMF says an attack on Iran by the US and Israel could further slow down global (and Uganda's) recovery as it would lead to a new spike in oil prices.

The prospect of war between the two Sudans, and in eastern DR Congo, is also a risk Uganda must take account of. The defence budget for the next financial year is expected to be raised on account of these threats.

Optimists argue, however, that the prospect of oil production by 2016 should ensure inflow of foreign direct investment. But Dr. Fred Muhumuza, an economist at EPRC and a senior presidential advisor on the economy, argues that this may no longer be a sure deal as some investors who target Uganda's oil sector don't necessarily have to be based in Uganda.

It is unlikely that Kiwanuka will divert much from government's usual script, but she faces a delicate balancing act. She must present a budget that raises among Ugandans a sense of hope and optimism for recovery without ignoring the above realities.

Increasing taxes is politically dangerous and economists argue it would hurt production, so perhaps she should avoid it. But she will inevitably raise salaries for civil servants by probably a higher margin than usual, at least to avoid strikes. And whereas at best very few will have benefitted from the Youth Fund she proposed last year by the time she presents this year's budget, she is expected to still provide more funding and suggest measures to make it more effective.

But while at it, she will at least need to tell Ugandans that some longstanding problems, one of which is budget absorption, are being solved. Ugandans don't want to hear that while they starve, the government departments are sitting on money they can't spend.

A Ministry of Finance study on absorptive capacity in August 2011 found that particularly at the local government level, money goes unspent because availability of and access to budgetary provisions is unpredictable, releases are delayed, planning is poor, procurements are delayed and the process is corrupt.