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Like Europe, Uganda needs major economic reforms

Fred Kakongoro Muhumuza Economic Reforms

Yesterday, we saw how Uganda has a structural bias against exports, a public sector deficit, and temporary sources of income. Today we look at corruption & debt, the trouble with quick fixes, and possible policy options

Corruption and debt

The situation has been worsened by leakages arising from corruption, which not only reduces public resources but also offers incentives for the emerging middles class to invest in rent-seeking and secure-savings in the non-tradable sector.

Such a middle class is bound to increase the demand for dollars against a declining supply, which will trigger more external borrowing for consumption leading to a possible debt overhang.

Challenges

Current increases in debt are likely to compromise the commitment to use future oil revenues for infrastructure as debt repayments will override that objective. Besides, even when the infrastructure is built, it is likely to enhance the non-tradable sector with a strong possibility of causing the Dutch disease - near collapse of all other exports apart from oil.

It is also worth noting that, though infrastructure is mandatory for growth, it is a means and not an end. No one needs to be reminded that the Western countries facing economic challenges have the best infrastructure in the world.

Thus, good infrastructure should be complemented with macroeconomic incentives that promote significant investments in the tradable sector.

The trouble with quick fixes

The current macroeconomic challenges require a realignment of fiscal policy in a manner that allows monetary policy to focus on promoting growth through favourable interest rates and rebuilding policy buffers such as foreign reserves.

Otherwise, it will not be possible to pursue the twin objective of maintaining stable macroeconomics and private sector-led growth when increases in interest rates continue to choke productive investments in an economy whose supply is already constrained by structural factors. This can only make a bad situation worse.

While high interest rates may prevent new loans, they negatively affect ongoing projects whose increased costs, amidst restricted demand due to structural inflation and declining real incomes, are likely to trigger defaults and reduced bank profits or capital through loan-loss provisioning. Besides, at high interest rates, the risk profile of borrowers deteriorates leading to the adverse selection problem that can further trigger a wave of bank loan defaults.

To conclude, without addressing the current structure of the public sector deficit, any efforts to increase economic growth will simply promote the non-tradable sector, increase the demand for imports, worsen both the domestic and foreign debts, and consequently, leave the economy more vulnerable to all categories of external and internal shocks. Accordingly, the introduction of oil revenue into such a biased economic structure is likely to worsen the situation by causing a Dutch disease, and possible tension within the social and political structures of the country.

Wishes aside, Uganda will still have small scale farmers for decades to come and it is better to ensure they can access basic inputs.

Possible policy options

A major part of the solution involves adoption of elements of the structural adjustments - the type Uganda had in the early 90s. Several of these policies have since been reversed. To begin with, the following may be considered:

- Lessons of downsizing of government through retrenchment and selling of public corporations are very relevant. While there are only a few public enterprises left, public resources are still likely to be lost through poorly-managed public-private partnerships and unnecessary incentives to private entities.
- In order to meet the funding requirements for core areas fundamental changes will have to be introduced in the overall budget. With constrained budgets where nominal allocations do not fully compensate for inflation, the stock of real resources is effectively declining. Additional resources can easily come from rationalisation of budgets to fund activities along the critical path of service delivery and growth. Services could be aligned to institutional mapping such as referral hospitals and operationalisation of the regional tier rather than individual districts.
- In some liberalised markets that show inefficiencies due to structural rigidities related to oligopoly - collusion by a few actors - or institutionalised exclusion of competition, the networks should be disbanded.
- In other cases, growth of the private sector will need temporary incentives or partnerships with government along critical parts of the value chain. A prior review of the entire chain should be made so that the government addresses a real binding constraint. The bottom line is that government support should largely be for investments in the tradable sector.
- The government should also target reducing the cost of producing tradables in agriculture where constraints range from land tenure, unavailable inputs, and uninsured risks for small scale farmers. Wishes aside, Uganda will still have small scale farmers for decades to come and it is better to ensure they can access basic inputs (mainly quality seeds and farm implements) with ease in terms of price and distance.

The current practice of directly giving small amounts of money to farmers should be compared with supporting input providers to improve quality and also ease the cost of access to inputs.

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