BUDGET POLICIES AND INVESTMENTS FOR CHILDREN – A TRAINING COURSE FOR UNICEF STAFF

Module 2B: Uganda Case Example

For every child
Health, Education, Equality, Protection
ADVANCE HUMANITY

Bringing it Together

This last topic may help us to understand why Ministers of Finance often seem to be so insensitive to the needs of the social budget and to the underlying problems of poor families etc.

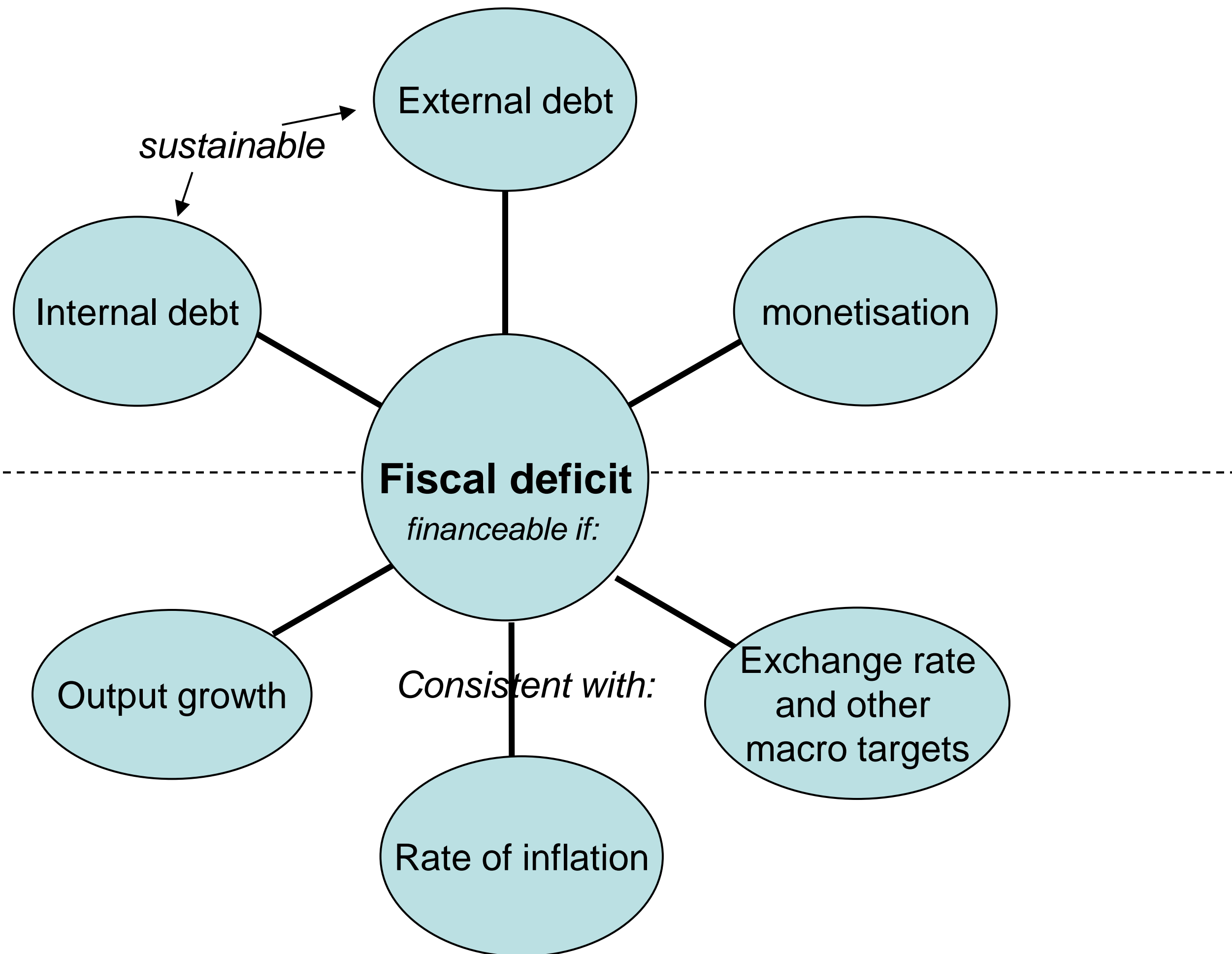
AND

Why the balancing of all the Macroeconomic constraints is a hugely difficult task in almost all low income countries.

We use the example of a relatively well run African country namely Uganda to show that even in such cases, the problems are ever to the fore.

The Minister's Dilemma in Summary

THREE types of financing:



Some of the targets impacting fiscal space

An Integrated PRSP Framework

The Figure that follows shows a fully framework taken from the World Bank's PRSP Source Book.

Please be aware of this

We will review a few main features of this in the remaining slides.

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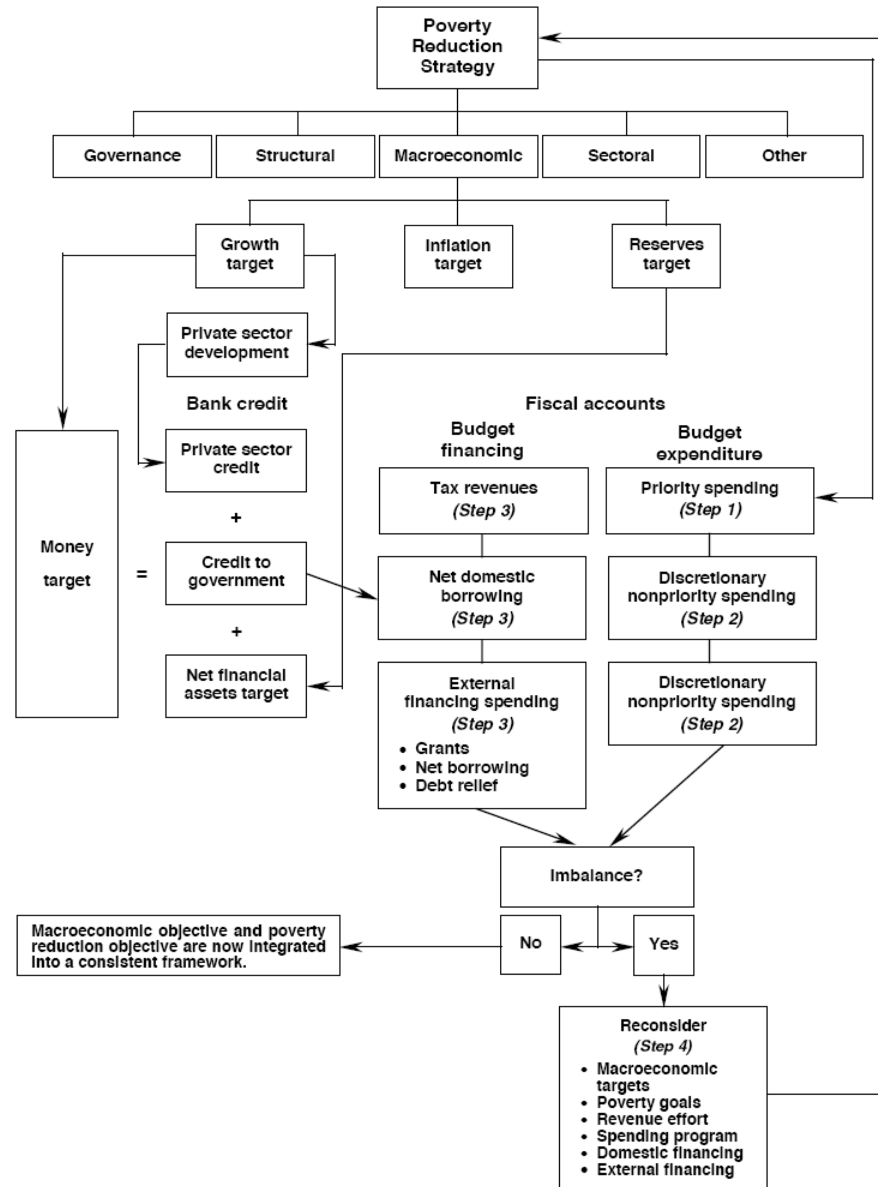
Table 12.1 in the Source Book



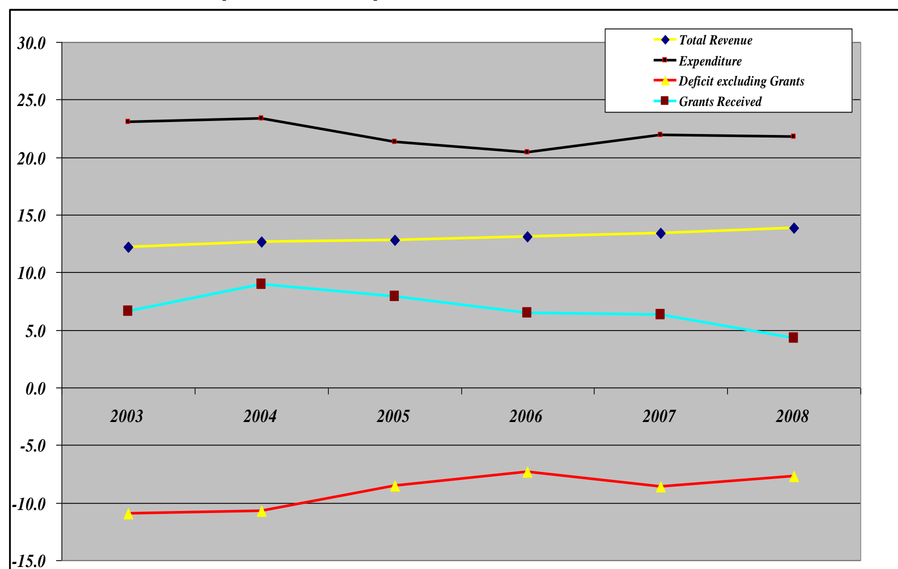
The Parameters defined by IMF Agreements (in the present Uganda programme)

The Minister – Ms Syda Bbumba - also needs to formally observe the following NUMERICAL *criteria and indicative targets* under Uganda's present *Policy Support Instrument* Programme (PSI) with the IMF – as agreed in the 6th Review in December 2009 (see pg 23 of Review)

- Ceiling on base money liabilities of the Central Bank (BOU)
- Ceiling on outstanding bank credit to the GOU
- Ceiling on the stock of external payments arrears of the GOU and BOU
- Ceiling on new non-concessional longer-term external borrowing by the GOU and central bank
- Minimum target increase in international reserves of the BOU (NFA)
- Target to reduce domestic budgetary arrears under the Commitment Control System (CCS)
- Minimum expenditure under the Poverty Action Fund (Incl. the universal primary education component)

An Example: Uganda - 2003 to 2007

Uganda Budget Summary 2003-2008 (% of GDP)



Selected Expenditures (% of GDP)

	2003	2004	2005	2006	2007	2008
Interest	1.4%	1.4%	1.4%	1.3%	1.3%	1.2%
Public Health	2.2%	1.9%	1.9%	1.8%	1.6%	na
Education	4.4%	5.0%	na	na	na	3.8%
Social Protection	0.2%	0.2%	0.2%	na	na	na
Total Health, Education, Social Protection	6.8%	7.1%	7.1%	na	na	na
Military	2.4%	2.3%	2.4%	2.2%	2.3%	na

Issues for the Minister

1. Budget Fragility

- Total Budget Revenues (excluding grants) are only 12-13% of GDP - only slightly more than TOTAL Social Expenditures plus Military Expenditures – i.e. these essential outlays largely exhaust the available revenues
- These revenues have also fluctuated in this period by up to 1.7 % of GDP from year to year – a fluctuation equivalent to the WHOLE of the Health budget
- Grants are now equal to some 6-9% of GDP but these too can fluctuate (i) from year-to-year and (ii) from budget numbers to actual outcomes, by up to 3%: equivalent again to more than the Health Budget

2. Inflation Financing

- Uganda's recent reasonable record on macroeconomic stability– inflation consistently below 10% to 2007 but then rising to 16% in the crisis depends even more now on a low maintained inflation target (now 8% in the PSI program)
- But since the monetisation ratio in Uganda is only around 20%, the Minister is restricted to little more than 1.5% of GDP of financing from the inflation tax (8% X .20 = 1.5%)
- She could relax her inflation target but would then expect to face (i) a run away from the domestic currency and (ii) significantly higher interest rates on government debt – see next slide

Issues for the Minister

3. External Debt

- Uganda's **External** Debt is now much more sustainable after HIPC relief (including recent Multi-lateral Debt write offs of more than 30% of GDP from 2006/2007). External Debt O/S is now <20% of GDP at about $1.5 billion
- Targeted Growth of GDP around 8% allows for some $120 million a year consistently with a stable debt ratio. A slightly rising debt ratio could allow this number to go higher
- But only IF the interest terms on this borrowing are kept below or close to the expected rate of GDP growth. If growth falls short of this target, then far lower new net borrowing is possible
- Similarly a major collapse of the growth rate or a large devaluation (see next slide) would reduce the Minister's head-room for new borrowing.

4. Domestic/Internal Debt

- Uganda's domestic public debt amounts to over 10% of GDP – and so is relatively modest.
- But with T Bill rates as high as 15% in recent years, the budget cost is still circa 1-2% to1.4% of GDP
- New Domestic Borrowing is the first recourse for the Minister should there be a failure in some other aspect of his budget. So for example, a one year collapse of grant funding (6-9% of GDP) could almost double these ratios and absorb up to half of all Health sector funding in ADDITIONAL interest costs

Issues for the Minister

5. The Real Exchange Rate

- Uganda has a large external trade deficit (circa 8% of GDP) mitigated by grants and other transfers that reduce the adjusted-CAB to some and 4% of GDP.
- The real Exchange Rate appreciated strongly through 2007 but has deprecated thereafter.
- Appreciation eased the pressure on (i) prices and (ii) the real burden of debt, but it also puts cumulative pressure on Uganda's export sectors. The subsequent depreciation has reversed these pressures but contributed to worsening inflation.
- A further real devaluation would increase the (now low) external debt burden. e.g. a 10% depreciation of the shilling would add some $150million to the local currency value of debt eliminate a large part of the sustainable new borrowing noted on an earlier slide.

6. Arrears

- The Minister also has to deal with some Sh. 500 billion of unpaid arrears of domestic wages, pensions and other domestic budget commitments.
- These arrears represent the unbudgeted financing of past years.
- Paying them off *in full* would eat up more than 20% of a year's budget expenditures and some 40% of a year's domestic budget revenues. This would be equivalent to ALL social expenditures for one year.
- The Minister instead has committed to paying off some of this by instalments - but it is still a large dent in her available funds for NEW activities.

Optional ADD-ON. Does Foreign Aid (More Grants) Help?

Any significant scaling up of aid (as anticipated both before and even more so after the global crisis) implies significant inflows of foreign exchange to the country

- If this is used FULLY to purchase imports, there is no problem—the foreign exchange comes in and goes out directly for imports
- But if it is used to purchase non-tradable goods and services (e.g. pay teachers' or nurses' salaries or buy buildings or electricity or transport services), the aid will increase demand for goods and services which *cannot* be supplied from imports
- If the country is able to expand local production and the extra demand is matched by increases in supply—with no effect on non-tradable good prices, there is no problem and no obvious impact on local inflation

…..if aid cannot be used to remove supply bottlenecks

THEN we would see pressures on non-tradable goods and services prices

- the price of non-tradable goods (teachers, buildings etc) will also rise *relative to* the price of tradable goods: this is an appreciation of the real exchange rate and could divert resources away from exports

Another way to see it: significant increase in aid leads to an increase in R and thus the money supply or "M" (Remember: $\Delta M = \Delta R + \Delta DC$)

BUT

• this change is reversed automatically when aid is used *fully* to buy imports

• otherwise government can choose to sterilise aid inflows (effect on M) by selling Government securities to the local public. But this can raise interest rates on public debt (significantly if the market is small) and probably crowd out private credit (and so negatively affect growth)

• an alternative is NOT to spend the aid – but then why have it?

Summary

Uganda has many things going for it now:

- A reasonably inflation record – compromised a bit by the crisis.
- A generous HIPC/MRDI settlement already largely implemented
- A prospect for sustained GDP growth at 5-8%

But even so all the constraints involved in the "Minister's Dilemma" are still significant:

- The scope for inflation financing has been substantially reduced by the inflation target
- The head room for new external borrowing created by HIPC relief is constrained by the growth rate – especially if much lower than forecast growth emerges - and by the possible need to further devalue the exchange rate (*and also by the explicit IMF conditionality on new borrowing*)
- New domestic borrowing is seriously constrained by accumulated arrears from the past and by interest rate concerns (*and also by the specific IMF conditionality*)
- External grant and other financing is large but unstable in amount from year to year (and also involves the problems of real exchange rate appreciation and/or interest rate hikes if the Minister chooses to sterilise the aid inflows)

Last Words

It is extraordinarily easy for low-income countries to defend social expenditures in the short term by adopting a variety of rash macroeconomic policies:

- high rates of inflation
- excessive external borrowing at relative high interest cost
- excessive voluntary internal borrowing at high interest rates
- substantial *involuntary* internal borrowing based on raids on banks, pension funds, civil servants pay etc
- various other controls designed to direct more resources to the budget

BUT all these short term devices fail the economy and especially poor people eventually (and often quite quickly), via

- the draconian monetary and fiscal polices that become necessary to eliminate high inflation and excessive debts.
- the tight budgets this year needed to pay back the non-payments of previous years
- the output losses caused by controls that impede efficient productive activity

EVENTUALLY the macroeconomic constraints and realities MUST hold – even low-income countries protect their poor best by recognising this on an ongoing basis.