



Report of the Private Sector Consultative Meeting on the Impact of the Global Financial Crisis on the Private Sector in Uganda

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A. Background to the financial and economic crises

The effects of what has been termed the worst global financial crisis since the 1930s started to show in the middle of 2007. This crisis started in the United States (US) and was attributed to the collapse of the housing market. Banks were exposed to mortgages issued in the US and when the housing boom reversed and the housing market collapsed, it affected several financial institutions including insurance companies. Around the world, stock markets started to fall, large financial institutions collapsed or were bought out, and governments in the wealthy nations started to come up with rescue packages to bail out their financial systems.

With the collapse of financial institutions world wide, the Ugandan banking sector was fortunate not to be directly affected and continued to run smoothly as banks in Uganda were not exposed to the toxic assets. Generally, Bank of Uganda (BOU) regulations are set tight following the Basel II Capital Accord ensuring a sound financial services sector in the country. However, as the global financial crisis took root, there followed an increased demand for foreign currency from both the corporate and offshore players that led to rapid depreciation of the Uganda shilling in the second half of 2008.

As the global economy suffered the adverse effects of the financial crisis, many markets around the world went into recession leading to the current economic crisis. There followed a significant recession in demand for Uganda's exports and as companies in the US and Europe started closing and others laying off workers, remittances to Uganda and other developing countries begun to fall. As the effects of the credit crisis started to be felt in Uganda, UMA and PSFU started to collate data on how the various sectors were being affected. Future implications of the slowdown were also noted and a workshop was organized for all private sector players to develop positions on the subject. These positions would thereafter guide dialogue with Government to develop practical solutions. This report provides the findings obtained so far¹.

The Ugandan Economy

Since July 2008, the cost of doing business in Uganda has continued to rise steadily as the effects of the global financial crisis continue to be manifest in our economy. This has had negative effects on returns made by businesses forcing them to scale down their operations and others to close down. Some other businesses have relocated to other countries as a move to create focus in their global production units and benefit from better business environments among other reasons, in response to the challenges presented by the crisis. Demonstrably, the private sector in Uganda is experiencing a critical slow down and has become less competitive in the region and globally. The effects of the financial crisis are evident and interventions are required before the successes attained over the last decade, when the country enjoyed high growth rates of over 7% per annum, are wiped away.

As a country, there is need for a unified and well coordinated approach to address the challenges the private sector in Uganda faces, and protect the vulnerable and isolated populations from the shocks of the financial and economic crises through initiatives that maintain their consumer demand while providing meaningful employment. Unilateral approaches to solving global problems pose a threat to the livelihood of so many Ugandans and thus the need for an integrated approach. The root cause of the global financial crisis lies in **excessive deregulation and liberalization**. If we do not work fast enough to address the effects of the economic and financial crises, we risk succumbing to acute inequality and poverty.

So far, there have been positive moves to address the challenges posed by the current financial crisis. Government has responded through budget cuts, well aware of the declining tax revenue and likely reduction in foreign aid to the country. The current rediscount and bank rates at Bank of Uganda are at 9.73 percent

¹ The consultations with the private sector are still on going.

and 10.73 percent (down from 14.88 percent and 15.88 percent) respectively. This move is plausible and is expected to lead to a reduction in interest rates charged by commercial banks with a resultant effect of increased money in circulation. However, more can still be done across all sectors to achieve a balanced and resilient private sector as highlighted in the recommendations made at the wide consultative workshop held on 9th April 2009 by members of the private sector in Uganda.

B. Critical challenges for the private sector posed by the crisis

Exchange rate depreciation

As markets in the major economies begun to collapse, panic gripped investors leading to increased demand for foreign currency from both corporate and offshore players in the last quarter of 2008 leading to withdrawal of their investments from the money markets in Uganda. The Uganda Shilling started to depreciate against the United States dollar (and other major currencies) and has since kept depreciating with an average exchange rate of Shs. 2,150 to 1 US\$ recorded in the first week of April 2009 compared to Shs. 1633 to 1 US\$ in July 2008 (a 32% depreciation of the Shilling). The applicable exchange rate by the Uganda Revenue Authority (URA) in April 2009 is set at Shs 2023.71 to 1US\$ (which implies a 24% increase in real taxes since July 2008). Because of this high applicable exchange rate for import duty, the business community has emphasized that it is faced with very high costs of imported inputs. Importers of merchandise have since been trapped by these increased costs and many goods remain locked up in warehouses around the country. Reports from traders indicate that the traders' relationships with suppliers in China, Japan and other markets have been strained as a result of the abandoned consignments in Mombasa, Inland Container Depots (ICDs) and bonded warehouses following failure to raise the required taxes at the current rate charged by URA. When the orders were made, the exchange rate was approximately Shs 1650 to 1 US\$ and today, they have to meet their tax obligations at a rate of Shs 2023.71 to 1 US\$. In fact, many traders have ceased to request for any more consignments and this will most likely lead to further reduction in revenue collection by URA. A single firm in the steel business in Uganda expects to spend additional Shs 227 million on inputs in 2009 due to the increased cost of inputs and another Shs 551 million in increased interest expense for loans availed in foreign currencies.

Double-digit inflation

Headline inflation has remained in the double digits at 14.0%² in March 2009 from 12.3% in July 2008. The Kampala average pump prices for a litre of petrol and diesel went down to Shs. 2,320 and Shs. 1,630 respectively in March 2009 (with the significant reduction in the diesel price) but remain volatile and not in synchrony with movements in the global oil prices³. Food and commodity prices have remained high since supply has not significantly increased over the last three months. Agro-processors reported that, in as much as they opted to source raw materials locally due to the depreciating shilling, they suffer high prices and supply shortages in most cases. At the grassroots, the hand hoe has increased from Shs 5,000 to Shs 7,000 and a bag of fertilizer (urea) has moved from Shs 55,000 to Shs 145,000 in a few months for example⁴. In summary, imported inflation has been on the rise and contributed to the persistently high inflation rate within the country.

High Interest rates

Commercial banks raised their lending rates by between 1 and 3 percentage points during the first quarter of 2009 pushing the interest rates charged by commercial banks to between 23.5 and 28% per annum⁵. However,

² As reported by the Uganda Bureau of Statistics

³ From local survey of Kampala pump stations

⁴ Comprehensive list of prices of inputs may be obtained from Uganda National Farmers' Federation

⁵ Refer to press releases and notices by commercial banks released between January and February 2009

some banks have started re-adjusting their base lending rates downwards⁶ following BOU's reduction in the Bank Rate from 19.27 percent to 15.88 percent. Despite this reduction in Bank Rate by BOU, many commercial banks have not responded and thus kept their lending rates up as they study the trends in the market. The instruments deployed by the Central Bank should be sustainable so as to enable commercial banks to be responsive. Internal borrowing by the Government at this point, for example, could lift the interest rates even higher. Against this backdrop, the business community noted with concern that it remains a paradox how businesses are expected to survive with such persistently high interest rates on their borrowings.

Declining Exports (merchandise and tourism)

It has been noted that Uganda's export earnings have continued to fall due to receding demand for commodities in the United States (US), European Union (EU) and Uganda's other major export destinations. Uganda's total (merchandise) export earnings dropped from US\$ 244.39 million in January 2008 to US\$ 193.29 million⁷ in January 2009 registering a 21% decline. The price of coffee for instance has fallen from US\$ 2,600 per metric ton to US\$ 1,600 (i.e. a 40% decline). In addition, the **Southern Sudan (and the Democratic Republic of Congo)** merchandise demand started to fall as the global oil price (and prices of other minerals) took the upward trend reaching \$49 per barrel of oil today from \$38 in February 2009.

In addition to the declining fall in merchandise trade, the Tourism and Hotels sector reported that there was an estimated decline of between 30 and 40 percent⁸. Despite Uganda's ranking among the top 10 countries in the world in biodiversity, our tourism sector has not had any significant boost. Unfortunately, Uganda's image on the international scene has not been built to depict the pearl it truly is. It is no surprise that even with all the potential to emerge as an outstanding tourist destination, little is known of our country's beauty.

Transport sector bottlenecks

The reduction in diesel prices over the last three months has lowered transport costs by 21%. However, the depreciation of the shillings in the same proportion has effectively kept the transport costs up (in real terms) since payments by cross-border transporters is done in US dollars. In addition, transporters have continued to experience reducing volumes of imports because traders are not able to clear goods out of warehouses for onward carriage to their stores. Against this background, the business climate for transporters remains challenging as they compete for the reducing cargo volumes.

Declining remittances from the Diaspora

Remittances by Ugandans living overseas are estimated to have dropped by between 20 and 30 percent over the last one year.⁹

Due to increased costs of doing business resulting from the effects of the financial crisis as highlighted above (i.e.; the double digit inflation rates¹⁰; depreciating Shilling; declining demand for Uganda's exports; reduced remittances; high lending rates coupled with relatively high energy costs; high and ever increasing taxes and levies among others) many businesses are finding it difficult to survive. This situation is worsened by the continuously reducing purchasing power of consumers.

C. Recommendations

⁶ This is happening in the second quarter of 2009. A few banks e.g. DFCU Bank, moved fast in April 2009 to lower the base lending rate and borrowers are hopeful that other commercial banks will do the same.

⁷ Refer to BOU Economic and Financial Indicators for December 2008.

⁸ An accurate figure is yet to be established

⁹ BOU is conducting a survey to establish a more accurate figure regarding the reduced remittances.

¹⁰ Some of this is imported

1. Exchange Rate Stability (import duty relief as stimulant)

As Bank of Uganda deploys strategies to bring down the high and volatile shilling to US dollar exchange rate, the applicable **exchange rate for import duty should urgently be lowered** from the current 2,023.71 to about Shs 1610 to 1 \$, as in July 2008 (or as budgeted for the Financial Year 2009/10). This will increase tax revenue generated through import duty.

2. Pay off domestic debt

Government should pay-off its domestic debt to release money back into the economy raising the purchasing power of the people and thus stimulating production. This move is expected to lead to increased revenue collection from the business community.

3. Increase VAT threshold to Shs 100 Million and reduce VAT to 16%

The VAT threshold should be increased from Shs 50 million to 100 million to support the vulnerable micro and small enterprises. Overall, VAT should be reduced to 16% (same rate as Kenya) to make our business community more competitive regionally and globally.

4. Tax Relief

Tax relief targeted at the low-income workers, the poor and companies in distressed sectors should be advanced. Our proposal is to lift the **PAYE threshold** from the current Shs 130,000. A new threshold of **Shs 250,000** would significantly stimulate domestic demand while providing relief to the employers.

5. Boost the Agricultural Sector

a. Increase food production

As Uganda's export earnings from exports to Europe and the United States fall, the regional demand for our food crops is on the rise. In spite of the recorded decline in demand for merchandise by Ugandan traders in Southern Sudan and Eastern DRC, the regional food markets remain profitable. A **massive campaign to increase food production**, if undertaken, would reduce the high food prices and lead to increased regional trade with our neighboring states.

b. Strategic grain reserves to ensure price stabilization and support seed multiplication

As the massive campaign to increase food production goes on, strategic reserves should be built around the country to ensure price stability and better food security practices. The **seed multiplication** initiatives need to be stepped-up to ensure increased supply of seed. Of the 30,000 metric tons required on the market, existing seed production companies can only raise 10,000 metric tons.

6. Stimulating Exports

a. Restore the Export Guarantee scheme

Restore the Guarantee Scheme and have it managed by Bank of Uganda.

b. Waive Civil Aviation Authority (CAA) charges on export cargo

To increase the competitiveness of our exporting firms, it is vital to waive CAA levies particularly the following:

- (a) **Fuel levy** (currently 5 cents per litre of Jet A1 Fuel). It is proposed that Government meets 4 cents of this charge for all Cargo Carrying airlines.
- (b) **Handling Charges** (CAA currently receives 10% of this charge). It is proposed that the 10% charge be waived for export cargo.
- (c) **Landing fees**. It is proposed that landing fees be waived for Cargo Planes. Landing fees are charged based on the weight of the Air Craft.

(d) **Security Surcharge** (Currently 14 cents per kg). It is proposed that this surcharge is borne fully by the Government for Cargo.

7. Investment in strategic infrastructure

Special focus should be placed on development of the railway, water and road network leading to our export markets and high volume import routes such as the Dar es Salaam-Mwanza-Port Bell alternative route. Proper allocation of the 1.1 trillion shillings to developing a strategic transport network is critical during the 2009/10 Financial Year as should be treated as a stimulus package and deploying labour intensive strategies to create employment.

8. Develop cheap ways to get remittances from the diaspora into Uganda

The Central Bank and other key stake holders may advise on options to provide cheaper alternatives for receiving money from the diaspora as a special package to encourage people overseas to make remittances.

9. Prudent Government Expenditure

Government should ensure that the previous year budget allocation to roads and works is efficiently utilized. Development of guidelines to promote the Private-Public Partnership is critical in this sector. Expansion of the Public Administration system should be halted and budget lines reviewed to ensure expenditure is directed to the critical operations during the 2009/10 Financial Year.

10. Market Uganda as a tourist destination

As a medium-to-short term strategy, Government should embark on marketing Uganda as a tourist destination. This should boost other sectors of the economy while encouraging FDI. The 2009/10 National Budget should have a special allocation to support these efforts and widely build the image of Uganda on the world scene.

11. Establish an Institutional Framework

Due to the crosscutting nature of the effects of the global crisis, integrated approaches need to be adopted to curtail the short-term and long-term effects on our economy. It should be emphasized that the address mechanism for the crisis should be within a strengthened Public-Private-Partnership. Timely review of the impact of set policies is needed while assessing the magnitude and character of any new effects.

Private Sector Coping Mechanisms

To address the challenges caused by the effects of the credit crisis, individual companies/organizations need to devise mechanisms to prevent any further damage. Some of the general guidelines may include:

1. Cost reduction techniques across the sectors

Firms in Uganda need to cut down their operational costs and look for new markets for their products and services.

2. Improved Financial Management Skills by the business community

Many business managers in Uganda do not make use of derivatives that can mitigate the risk of economic loss arising from changes in the value of the underlying (i.e. the value of something else on which value is based). Knowledge of forwards, futures, options and swaps could have reduced the damage caused by the depreciating shilling across the sectors had the business community made use of related products offered by commercial banks.