Discussion

Uganda: Contradictions of the IMF Programme and Perspective: A Comment

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INTRODUCTION

In his article 'Uganda: Contradictions of the IMF Programme and Perspective', published in *Development and Change* in July 1990, Professor Mamdani sought to criticize the stabilization and structural adjustment programme in Uganda through its immediate economic consequences; through a longer term historical analysis raising more fundamental issues of social transformation; and through a comparative discussion using South East Asian development experience (Mamdani, 1990: 427).

Considerations of space limit the scope of this comment to pointing out that the economic analysis of his article is weak and, in particular, the analysis of the effect of official exchange rate devaluation is incorrect. However, because his analysis of the economics of stabilization underpins the analysis of wider social issues, the faulty economic analysis calls into question the validity of his overall conclusions.

The economic crisis in Uganda is the cumulative result of specific events since the early 1970s — albeit in a wider historical context. But the immediate problem in Uganda is economic: a severe fiscal crisis combined with a persistently fragile balance of payments position. Such disequilibria are unsustainable and must be corrected. With or without the IMF, no country can escape the constraint of making ends meet. It is essential that this process of adjusting to meet changed circumstances takes place in an orderly manner so that the benefits of managed change are realized at least cost to

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the society involved. Otherwise the disequilibria will be removed haphazardly, through disorderly import compression for example.

This comment commences with an outline of the structure of the macroeconomy in Uganda, then considers the state of the fiscal crisis in Uganda and the external payments crisis, closely focusing on the implications and alternatives for policy. In doing so, this comment aims to highlight the weaknesses of Professor Mamdani's economic analysis, and thus to question the validity of its implicit social analysis.

THE STRUCTURE OF THE UGANDAN MACROECONOMY

The main features of the macroeconomy are the low levels of revenue collected by the government of Uganda (about 8 per cent of GDP) and government expenditure (about 12 per cent of GDP, with most of the deficit financed from foreign savings). As a result of the volumes of programme aid, the Government of Uganda is a net seller of foreign exchange. There is shallow monetization of the Ugandan economy, broad money (M2) consisting of only 8 per cent of GDP, which accentuates the impact on the inflation rate of financing budget deficits at the Bank of Uganda.

As a result of the crisis in the balance of payments, there is a grave shortage of official foreign exchange. The official exchange rate remains overvalued, albeit less so now than in the past. Market prices are largely determined by the parallel market exchange rate — locally called the *kibanda* rate — which is the marginal price of foreign exchange.[1] The *kibanda* market imports about US$100m worth of goods each year. This is about 15 per cent of total imports (capital goods plus normal recurrent imports) but over 60 per cent of total private sector imports. As the marginal price for foreign exchange, the *kibanda* rate is determined by the supply and demand for dollars.

THE GOVERNMENT BUDGET

Professor Mamdani correctly points out that fiscal problems in Uganda result from a hugely diminished revenue base, and not from inflated expenditure: 'The problem is not the size of the state budget, but of state revenue, which in turn is a direct result of limited

revenue sources' (Mamdani, 1990: 436). In addition to the decline in revenue as a proportion of GDP, the composition of revenue has changed:

> Following the 'economic war' there was a dramatic collapse in state revenue provided by the taxation of big proprietors. As a result, government revenue was derived almost exclusively from taxing the incomes of peasants and workers. Neither was this a temporary phenomenon: the new stratum of big proprietors (the *mafutamingi*) did not feature as a significant source of government revenue. . . . The trend is for state revenue to be derived directly from the income of working people (peasants, workers and earners of fixed salaried incomes). (Mamdani, 1990: 435)

While Professor Mamdani implies a class conspiracy in such changes, there is an alternative, and in terms of dealing with the problem perhaps more substantial, explanation.

The two main determinants of revenue levels are the size of the formal monetary sector and the institutional capacity to collect revenue. Part of the decline in revenue as a proportion of total GDP (Mamdani, 1990: 436) is explained by the decline in monetary GDP as a proportion of a declining total GDP (*Background to the Budget 1990/91*). In addition, within the monetary sector, there has also been a decline in the share of formal activity relative to informal activity. Therefore the decline in revenue as a proportion of a falling GDP is at least partly explained by changes in the structure of production in Uganda.[2]

In addition, as Professor Mamdani points out, as a result of Amin's economic war 'one of the most efficient state sectors in Africa . . . was overnight turned into a prime example of unwieldy and corrupt state management' (Mamdani, 1990: 433). While Mamdani was referring to the management of the parastatal sector, the same has been true of the management and organization of nearly all public institutions. One major explanation of institutional decay is the effect of inflation on the fixed (and very low) salaries paid to civil servants. Not only does grossly inadequate remuneration strongly influence the degree of individual corruption, it also leads to the institutional collapse of management structures and organizations. Under these circumstances, which prevailed for most of the 1970s and 1980s, the extent to which any one tax is immune to corruption and avoidance will have a highly significant effect on the amount of revenue collected through that particular tax.

In an environment where anyone can falsify accounts, whether

personal or business, where there are no generally acceptable and enforceable accounting standards, and where there is little or no capacity for the assessment of declarations, the proportion of revenue accounted for by the taxation of income, profits, assets and income from assets will inevitably decrease. In such an environment there are immense difficulties both of compiling accurate balance sheets and statements of profit and loss, and of making a sound assessment of statements of accounts.

Similarly, requiring that coffee exports are processed by the Coffee Marketing Board allows for relatively tamper-proof tax collection.[3] It is therefore less than surprising that the proportion of total revenue — a total which is declining in real terms — accounted for by export taxes is likely to increase.

The problems involved in improving revenue performance are neither simple nor can they be swiftly dealt with. The government is keenly aware of the severity of the problem and is dealing with the complex problem of restoring the capacity of the Ministry of Finance to collect tax revenue efficiently. There is external assistance to the Department of Taxation and to the Customs Department, and the post of Director-General of Taxation was recently created and someone from outside government appointed. But the restoration of capacity to an organization short on pay, motivation and training takes time.

Meanwhile, faced with revenue levels of about 8 per cent of GDP the policy options are limited. If government spends more than it receives, the resulting budget deficit has to be financed. In the absence of domestic non-bank financing, budget deficits can only be financed either by printing money, or through foreign savings. Professor Mamdani shows the extent to which the printing of money has been used to finance budget deficits in the past (Mamdani, 1990: 436). The printing of money has been the main source of inflation in Uganda (Morris, 1989a). The effect of money creation on prices is exacerbated by the narrow monetary base in Uganda. Professor Mamdani illustrates the effect of inflation on the fixed nominal wage level in Uganda (Mamdani, 1990: 437) citing 'the sharpest annual decline in ILO registered rates in 1986' (Barrister, 1988: 18). Given the role of low wages in strangling revenue collection capacity and thus helping to cause the fiscal crisis, the continuation of an inflationary environment is severely counter-productive. This effect on wages is merely in addition to the many other well-known costs of inflation.[4]

The only alternative source of non-inflationary finance is foreign savings. In Uganda these are utilized to finance the budget deficit in the form of grants, and highly concessional loans. Increasing the debt burden of an already indebted country is not welcome. Alternative finance is inflationary and the costs of continued inflation — on wages-rates alone — are considerably higher than the costs of highly concessional finance. The only other alternative is an even tighter fiscal position.

The alternative to continuing to fuel inflation by printing money to finance the budget deficit is attempting to match expenditure levels with available resources. Professor Mamdani objects to such prudent budgeting by claiming that it is the poorest who suffer from cuts in government expenditure: through the effect on nominal demand, and through the direct influence of reduced expenditure on social services.

Government expenditure is currently equivalent to, at most, only 12 per cent of GDP. The central government is in Kampala, more than 90 per cent of the population live in the countryside and the poorest are among them. Uganda is perhaps unusual in having a robust non-monetary rural economy hardened through years of turmoil. But Uganda is not very different from nearly all developing countries in that the urban middle classes receive a hugely disproportionate relative share of government spending on social services. That reduced government expenditure is a cost of ensuring prudent budgeting cannot be denied. The cost to the poorest, however, is considerably less than Professor Mamdani makes out, largely because in Uganda direct government subsidies are insignificant. The costs that are incurred are less to do with running a non-inflationary budget and more to do with the distribution of government expenditure. The issue of the distribution of public expenditure is obviously crucial, but is clearly distinct from the issue of the financeable level of expenditure in a non-inflationary budget.

EXTERNAL BALANCE: DEVALUATION

Uganda faces a severe balance of payments crisis. The export base, strong in the early 1970s (particularly in coffee, tea and cotton) has collapsed. Coffee now accounts for more than 95 per cent of official exports. Uganda's balance of payments position was significantly

worsened during 1989 when the price of coffee fell by 50 per cent on world markets.

With the pressing need for foreign exchange for investment, debt service and the supply of inputs to the industrial sector, it is clear that the need for increasing export earnings is paramount. Uganda will be unable to make a sustainable economic recovery without increasing its earned import capacity. In order to increase exports, it is clearly absolutely necessary that Uganda's competitiveness in foreign trade be restored: 'The external face of devaluation — especially at the outset of the programme — is necessary to restore real relations in foreign trade' (Mamdani, 1990: 440).

So what of the 'internal face' of devaluation? At this point it is necessary to make a very clear distinction between the two exchange rates which currently operate in Uganda. There is the fixed official exchange rate, which the government can devalue as a policy instrument; and there is the parallel market exchange rate — known as the *kibanda* rate. A dominant structural feature of the Uganda economy is the pervasiveness of the parallel market, as outlined above. Prices in Uganda are largely determined by the parallel market exchange rate. The parallel market exchange rate is determined by the supply and demand for dollars, and depreciates when the government prints shillings, when there is already high inflation (a portfolio balance effect). When the supply of dollars is increased such as through increased export earnings or the Central Bank's 'Special Import Programmes', or when liquidity is reduced, also through the surrender to the Central Bank of shillings to purchase the dollars under 'Special Import Programmes', the parallel market exchange rate appreciates.

Changes in the official exchange rate do not affect the supply and demand for dollars and, therefore, do not affect the parallel market exchange rate. Because market prices, especially of imported goods, are determined by the *kibanda* rate and not the official exchange rate, this lack of a connection between an official devaluation and the supply and demand for foreign exchange on the *kibanda* market means that the cost-push effect of an official devaluation is limited to the effect on transport costs of changes in the official price of fuel. Ministry of Planning estimates show that the elasticity of the level of prices with respect to changes in the fuel price is about one third (Morris, 1989a).

However, as a result of the government being a net seller of foreign exchange, the effect on the government budget of an official

devaluation is positive. At any given level of expenditure, the effect of an official devaluation is an increased local counterpart to programme aid dollars which reduces the financing required for the shilling deficit. A lower shilling financing requirement implies less printing of money and a correspondingly less inflationary fiscal stance. The impact of an official devaluation in such an environment has been detailed for Uganda by Morris (1989b) who points out that:

> Official exchange rate devaluation allows government to reduce government borrowing, and thus inflation, without reducing real government services or the real coffee price paid to farmers. It cannot be overemphasized that devaluation should not be viewed as a substitute for the urgent need to increase real domestic tax revenue as the only long-term solution to macroeconomic imbalance. However, in the short-term it should not be delayed on the pretext of there ultimately being an alternative longer-term solution because the correction of the current macroeconomic imbalances are a necessary pre-condition for the achievement of longer-term solutions.

A similar situation for Ghana has been noted by Chhibber and Shafik (1990: 1), who argue that:

> official devaluation does not cause inflation because prices have already adjusted to the parallel exchange rate.

But Professor Mamdani does not make this distinction between the parallel and official exchange rates. He argues (Mamdani, 1990: 440) that:

> devaluation led to a loss of confidence in the value of the local currency, which in turn led both to an all round increase in prices as traders exchanged liquid money for physical assets for speculative purposes, and to an increase in the black market price of the shilling as these same traders also tried to transfer their savings overseas to protect themselves from the effects of the expected round of devaluation.

If this were true, then the relationship between the official exchange rate and the parallel market exchange rate implied by Professor Mamdani would lead to a more or less constant differential between the two rates, certainly not a narrowing differential. According to Mamdani, official devaluation leads to an increased demand for *kibanda* dollars which leads to a devaluation of the parallel exchange rate. In fact (*Background to the Budget 1990/91*) the

differential between the two exchange rates fluctuates widely. The confidence of traders in the shilling is clearly not a function of changes in the official exchange rate, but a function of inflation and changes in the parallel market exchange rate. The cause of inflation has been the financing of the budget deficit through the printing of money. As the value of the shilling declines, the marginal price of foreign exchange in terms of shillings — the parallel market exchange rate — increases correspondingly. For any given supply of dollars, as long as the government is not printing money then inflation is held in check and the parallel market exchange rate does not change. In Uganda, it is excessive printing of money which causes the shilling to lose value, not official devaluation.

Consider the last financial year. Between June 1989 and June 1990, the government ran a prudent budget and did not print money (*Background to the Budget 1990/91*). In June 1989 the official exchange rate was USh200: US$1. In June 1990 the official exchange rate was USh400: US$1. In the meantime the parallel market exchange rate was at USh600: US$1 in June 1989, fluctuated through the year in relation to the supply of dollars through the 'SIP' programmes, but in July 1990 was at USh640: US$1. Inflation for the year to end-June 1990 was 25.6 per cent. Devaluation of the official exchange rate was not inflationary. An official devaluation did not, of itself, cause a devaluation of the *kibanda* rate, as Professor Mamdani's analysis would have asserted. Instead there was a narrowing of the differential. The parallel market rate went from three times the official rate to just under one and half times the official rate.

The experience of the last financial year repeats what has happened in the last ten years. Every devaluation has led to a decline in the parallel market premium, provided that fiscal and monetary policy was consistent with exchange rate policy. The facts speak for themselves. In 1980 the ratio of the special rate to the parallel market rate was 1:30. Following a 90 per cent devaluation in 1981 and the floating of the shilling, this ratio was reduced to 1:2 by 1983. The collapse of the Obote II stabilization programme led to an increase in the ratio to 1:3 by the end of 1985. Following the revaluation episode in late 1986 the ratio increased to 1:11 by February 1987 which was the highest level since 1980. After the currency reform and devaluation in May 1987 the ratio fell again to 1:1.8 in July 1987 before rising again to 1:8 by June 1988 because of increasing overvaluation during the 1987/8 financial year. More

flexible exchange rate policy since that time has once again sharply reduced the premium, thereby squeezing the scarcity rents earned by *mafutamingi* and others with access to official foreign exchange.

SOCIAL IMPLICATIONS

The social implications of my analysis of the economics of stabilization in Uganda differ from those of Professor Mamdani, largely because of the fact that the 'internal face' of devaluing the official exchange rate has a different effect to that ascribed to it in Professor Mamdani's analysis. I have shown that in Uganda an official devaluation is not inflationary. The effect of an official devaluation is a transfer from the net users of official foreign exchange to the net earners of official foreign exchange. Professor Mamdani defines *mafutamingi* as those with 'ill-gotten' gains (Mamdani, 1990: 441) and therefore, in Uganda, those with regular access to official foreign exchange include *mafutamingi*. Through devaluation, the implicit subsidy to individuals with privileged access to official foreign exchange is reduced, as is the implicit tax on those who supply official foreign exchange, especially coffee producers. This is the mechanism whereby competitiveness in foreign trade, already agreed to be necessary, is restored. Professor Mamdani asserts, however, that:

> The overall internal effect of devaluation has been double: first, to transfer savings from working people to the propertied strata: secondly, to redistribute incomes within these classes, shaping the very nature of class formation (1990: 440–1).

But working people in Uganda are predominantly rural small-scale producers in agriculture. In reducing the subsidies paid to those with access to official foreign exchange, devaluation represents a transfer from the urban sector to the rural agricultural sector. And with the restoration of competitiveness in foreign trade, the producers for export — the net earners of foreign exchange — benefit. Uganda's comparative advantage is in agricultural produce: the benefits therefore flow to the rural economy. I have argued, backed by evidence, that in Uganda, official devaluation is not inflationary. Therefore — subject to the necessary control of inflation through prudent budgeting argued to be necessary above — nominal increases in the

prices paid to coffee producers, even if by less than the devaluation, will represent an increase in real terms.

CONCLUSION

The economic analysis of Professor Mamdani's article has been argued to be flawed, in particular his analysis of the effect of devaluation of the official exchange rate. To the extent that this economic analysis underpins his analysis of the social implications of programmes for the financial stabilization and structural adjustment of Uganda's economy, the ability of the rest of his paper to inform the on-going debate on the development of Uganda has to be called into question. However, this does not detract from the usefulness of debate. Rather it sharpens the focus: a discussion of economic policy must centre on the essentially economic nature of the problems in question and, to be useful, consider the feasible policy alternatives as part of the discussion.

NOTES

1. The black market for foreign exchange was legalized in July 1990, but this does not affect the conclusions offered here.
2. The low levels of revenue collected by taxes on income, profits and luxury imports are despite an extremely egalitarian tax structure and high nominal rates of taxation. If such nominal rates were to be collected — and this was presumably the original rationale for putting them into legislation in the first place — then the effect on the economy would be substantial.
3. This is despite the Coffee Marketing Board being as afflicted by institutional decay as the rest of the public sector.
4. The minimum wages referred to in Professor Mamdani's article are fixed nominal minima in unchanged legislation; and therefore do not necessarily refer to wage-rates actually paid in Uganda.

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