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Strengthening Africa in World Trade

THE NEW US $1 BILLION IMF LOAN TO UGANDA

Issue Paper

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Background

On 28th June 2021, the IMF published a press release[1] which stated that the IMF Executive Board had approved a US $1 Billion loan to Uganda under the Extended Credit Facility (ECF) arrangement. Approval of the ECF arrangement enables immediate disbursement of about US$258 million, usable for budget support with other disbursements to be made over the next 36 months in semi – annual tranches. New disbursements will be based on Government's progress in implementing economic reforms agreed on under the new IMF program. The reforms include inter alia; commitments to increase domestic resource mobilization through new tax policy measures and improved tax administration; improved spending efficiency; limiting domestic arrears accumulation; strengthening governance; and enhancing the monetary and financial sector framework among others. The central objective of the reform program is to boost recovery from the COVID-19 pandemic, while generating strong and inclusive private sector-led growth.

The new economic program with the IMF comes with a number of benefits that will go a long way in supporting Uganda's post-COVID recovery; -

The funding support will be critical in beefing up Uganda's healthcare spending including the roll-out of more vaccines to the population and the provision of social welfare support to the most vulnerable at a time when the Government is struggling to raise sufficient revenues domestically. Uganda is currently battling with the 2nd wave of the Coronavirus pandemic that has claimed the lives and livelihoods of many citizens. With only 990,902 doses of the COVID vaccine administered so far in a country with a population of over 45 million people, the pandemic has place serious pressure on the country's healthcare system and exposed the need for greater funding towards the sector.

We have observed that the new IMF loan carries zero interest on repayment which when compared to other non – traditional loan sources like the domestic markets remains highly concessional and will thus act as a cheaper source of finance for the Government to fund her efforts towards post-COVID-19 recovery. Without such additional resources, the Government would have to cut essential spending or resort to expensive domestic and non-concessional external borrowing which would worsen the country's debt sustainability.

Within the new IMF program, there are a number of fiscal policy measures have been agreed upon. These measures are geared towards protecting the vulnerable and supporting recovery. These measures include inter alia; improvement of the spending composition by reducing the share of the expenditure towards security in favor of higher social spending; reduction of expenditures on non-priority items like travels abroad for Government officials; and the limiting of domestic arrears accumulation which will greatly benefit the local private sector.

The Government has also agreed on a number of monetary policy reforms which have the potential of safeguarding the stability of the financial sector. In addition, Government has also committed to strengthen fiscal and spending transparency including the publishing of the first annual tax expenditure statement for FY 2019/20; the adoption of a tax expenditure framework; the establishment of legal and regulatory mechanisms for timely access to accurate basic beneficial ownership information for legal entities; and the adoption of a framework for tracking COVID – 19 spending regardless of source of financing, including parastatals and other State – owned enterprises (e.g. UDB) among others. These will all remain critical in improving the country's tax policy and spending transparency and will also aid efforts to address accountability concerns on the use of the COVID funds.

With regard to improving revenue collection, the Government has committed to adopt an implementation plan of the Domestic Revenue Mobilization Strategy with specific timelines and costing of the tax policy and administration measures needed to achieve at least an increase in revenues by 0.5 percent of GDP per year starting from FY 2021/22. New tax administration measures have included; - arrears management; science – facilitated audits; data and information sharing; leveraging technology through

1 https://www.imf.org/en/News/Articles/2021/06/28/pr21197-uganda-imf-executive-board-approves-ecf-arrangement-for-uganda

enhanced eTax among others. We welcome these new measures as they will help improve tax compliance and thus revenue collection.

The loan comes with a 10-year repayment period which is way too short as compared to other IMF loans offered that usually carry a maturity of over 30 years. The Government is therefore expected to start repaying the above loan after 5 and a half years (referred to as the grace period) and is expected to have completed the entire loan repayment within 10 years. The short repayment period will most likely force Government to forego funding to critical sectors like health and social welfare support for the poor at the time when repayment becomes due.

Although the IMF has made tremendous efforts towards ensuring transparency over the usage of COVID-19 loans, this has not curtailed the misappropriation of these funds as noted in the latest independent audit report by the Auditor General. Therefore, this points to the inadequacy of the transparency and accountability measures agreed on in the loan agreement.

The Government's commitment to increase revenue collection by at least 0.5 per cent per year through new tax policy and administration measures comes with an increased tax burden on the poor and most vulnerable given the fact that some of the taxes are regressive in nature. For example, the increase of the excise duty on petrol and diesel that will likely see fuel and transportation costs rise. The introduction of the excise duty rate on internet data will drive costs of internet upwards in a country where internet access is still at its lowest and will further affect the growth of fragile e-commerce startups within the country.

While the IMF has taken a major step towards addressing the country's liquidity challenges by providing Government with a huge loan sum to beef up her finances, this has largely contributed towards Government's reluctancy to take advantage of the debt relief under the Debt Service Suspension Initiative that has been offered by the G20 to Low Income Countries (LICs). Under this initiative, Uganda would save up to US $198 million which is way above the amount required to vaccinate the planned 40 percent of the population estimated at a cost of USD $122 million.

We also note that despite recent monetary policy measures to reduce the Central Bank Rate from 9 to 7 percent, the commercial lending rates have kept in the high 20's further pointing to the weak monetary policy transmission.

Recommendations:

Government

In order for the Government to ably meet her loan repayment deadlines as agreed upon with the IMF, it should ensure that the new loan funds are used prudently to resuscitate the economy. The funds should be used to provide affordable and sustainable credit to Micro and Small enterprises that will enable them address their cashflow challenges. This should be accompanied by Government's commitment to invest these resources in real productive sectors of the economy like agriculture and agro-processing. Such strategic investments will help beef up the country's tax revenues at the time when repayment becomes due. Furthermore, the funds should be used to strengthen the health system to withstand the current pandemic and any other further pandemics that may occur.

Government must ensure that it implements the policy reforms agreed upon and should ensure that key stakeholders i.e., policy makers, private sector and CSOs participate in these processes.

Government should regulate lending activity by commercial banks instead of relying solely on the market mechanism. Monetary policy should therefore entail more Government regulation to enforce appropriate lending rates.

IMF

The IMF should move beyond promoting transparency to enforce further measures on accountability. It must ensure that what has been agreed on with Government is implemented.

The IMF should also revise her economic program with the Government to remove the regressive taxes. Emphasis should rather be made for commitments to cut down on the unnecessary tax exemptions to large multinationals that have eroded the Government's fiscal space over the years.

The IMF should encourage Uganda Government to participate in the DSSI.

Civil Society

Civil Society should actively participate in and monitor the implementation of the measures agreed upon in this program.

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