Prioritise spending on social sectors - IMF

With an uncertain and volatile outlook, authorities must reduce vulnerability to future shocks. This requires rebuilding buffers and insuring economies against large tail risks. In an interview with Prosper Magazine’s Martin Luther Oketch, the International Monetary Fund resident representative, Ms Izabela Karpowicz provides solutions for Uganda.

Uganda has a low level of tax revenues - below 13 percent of GDP. Reliance on domestic revenue mobilisation is a priority for the government to maintain the positive effects of tax revenue growth. This is why the IMF targets 2.4 percent of GDP increase in tax revenue. Tax expenditure rationalisation is expected to increase the tax revenue ratio to GDP and compensate for the declining grants. Because of this, the government’s efforts in the direction of data collection and transparency in this area are commendable. More recently, the adoption of a tax expenditure rationalisation framework and a plan to reduce tax expenditures under the IMF supported a major accomplishment and precondition for moving decisively in the direction of eliminating wasteful exemptions. Cost-benefit analysis is part of that process.

Empirical studies and international experience suggest that tax incentives do not appear to have sizable effects on investment in the long term. Other factors are more important for attracting investment such as a simple, transparent, predictable tax system, macroeconomic stability, low corruption, good infrastructure, a skilled labour force and others.

What is the IMF’s latest outlook for the SSA region?

The International Monetary Fund Regional Economic Outlook for Sub-Saharan Africa for October 2022 shows that for many policymakers in Sub-Saharan Africa, including Uganda, the road ahead is daunting. With growing social needs, rising inflation, and elevated risks, the recent crisis has pushed many of them even closer to the edge. Plastic fees and shrinking policy space have left little room for error and decisions must often strike a difficult balance across competing demands, which the International Monetary Fund describes as fighting fires.

What shocks are the SSA economies undergoing currently?

Sub-Saharan Africa’s outlook is affected by unfavourable global dynamics: the slowdown in advanced economies and emerging markets, volatile commodity prices, and tighter financial conditions. These developments are weighing on the post-Covid-19 recovery, putting pressures on growth, debt, and adding complexity to the policy decision. Inflation has picked up sharply, driven by rising food prices, which has affected the poor disproportionately. In some countries, food security is an issue, and in others because of climate change. Fiscal buffers are eroded by the weak external demand and the fallout from the pandemic lockdowns, which have stalled progress with revenue mobilisation. Monetary policy space is also limited as it must address rising inflation and respond to demands for stronger credibility and risk undermining growth recovery further.

What must the SSA countries do to overcome the current economic shocks?

The pressing policy priorities for the region are: rebuilding buffers, insuring economies against risks, strengthening policy frameworks and improving governance, and third, implementing growth-supporting reforms to address macroeconomic imbalances. Successful fiscal consolidation will require boosting revenue mobilisation, prioritising spending where possible and reducing public spending efficiency. Credible medium-term fiscal frameworks can raise trust in fiscal sustainability. Excessive exposure to shifts in risk sentiment, and lowering borrowing costs. On inflation, central banks can move gradually, given that the recovery is still fragile and domestic demand pressures have not been an important driver of inflation so far. A coordinated policy approach - that considers the fiscal stance and investment trade developments is the most prudent way forward.