THE TDP PROJECT

UGANDA: TRADE LIBERALISATION AND ITS IMPACT ON POVERTY

COUNTRY BACKGROUND PAPER

FINAL REPORT

By

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ABSTRACT

The Economic Environment and Institutional Framework

Uganda has implemented significant economic reform, including liberalization of the trade regime since 1987. This has attracted foreign direct investment, mainly in manufacturing, and contributed to continued economic growth. Uganda's real GDP has grown at around 6% per annum on average and is expected to continue growing at about 7% per year in the medium term. Uganda is a member of the East African Community (EAC) and Common Market for Eastern and Southern Africa (COMESA) where she enjoys reciprocal preferential trade arrangements.

Currently Agriculture accounts for about 70% of employment and 38% of real GDP. As a result of diversification efforts the share of industrial sector (including manufacturing, mining and quarrying, public utilities and construction) in real GDP has increased, from about 17% in 1986 to around 20% in 2004. The share of services in real GDP has increased to 42% in 2004 from around 20% since 1986.

Uganda views foreign trade as an important stimulus for economic growth and its trade policies aim to contribute to poverty reduction, promotion of employment and diversification and promotion of exports particularly of non traditional products. These policy objects have been pursued through continuing liberalization, deregulation, privatization and participation in regional agreements, particularly the Common market for Eastern and Southern Africa (COMESA) and the East African Cooperation (EAC).

Insufficient infrastructure coupled with Uganda's land locked status has impaired the growth of its exports and its economic progress. High production costs are evident across all economic sectors. Non tariff barriers in Uganda's main export markets, drought, crop diseases and security problems in the region (due to war and civil conflicts) have also negatively affected Uganda's Economy.

Decline in world prices of most of Uganda's traditional exports (coffee, cotton, tea and tobacco) have contributed to a fall in export earnings despite an upward trend in the share of non-traditional exports resulting from diversification efforts. Overall, agriculture still accounts for the bulk of Uganda's exports contributing over 70% of the value of the total merchandise exports.

Trade Reforms

Tariffs have become Uganda's main policy instruments. Uganda has been applying the customs valuation methods based on the transaction value since July 2000. The tariff structure has been simplified through the reduction of the number of bands from 5 in 1995 to 3 (0, 10%, 25%) which are consistent with the East African Customs Union common external tariff (CET). In addition to tariffs, imports maybe subject to an import license commission of 2%, a 4% withholding tax as well as internal taxes such as the excise duty of 12%.

The only export duty is a 1% cess collected by the Uganda Coffee Development Authority (UCDA) on coffee exports. The two main incentive schemes are the fixed duty draw back scheme (DDBS) and a manufacturing under bond scheme (MUBS) which are currently available to export oriented companies. There are also incentives under which import duties on certain raw materials may be refunded. Private exporters are allowed to export all items except those on a negative list and those for which authorization must be obtained from regulatory bodies.

In September, 2000 Uganda revised its regulations on public procurement for purposes of greater transparency and decentralization; open tendering procedures are generally preferred.

Sectoral Trade Policies

Trade policies in the Agricultural sector have been characterized by diversification of agricultural exports towards non traditional crops and liberalization of the marketing of inputs and products. Export taxes have been eliminated except on coffee. Trade barriers have been substantially reduced and prices are market

determined. The Government's 2000 plan for the modernization of agriculture (PMA) formulated within the PEAP framework, aims to re-orient the activities of subsistence farmers to the market. The maximum tariff rate of 25% applies to imports of certain vegetables, fruit and nuts and specified animal and fishery products.

Low capacity utilization in most industries hampers the competitiveness of Uganda's manufactured products already negatively affected by the land locked position of the country and high price of utilities. Incentive schemes are in place to attract investments into the sector. Imported manufactured goods are subject to the tariff bands of 0%, 10% and 25% on raw materials, intermediate and consumer goods respectively.

Services constitute a promising sector for Uganda. The government is divesting its ownership in financial services where there are currently no financially based ownership restrictions except for deferring minimum capital requirements between Ugandans and foreigners. Most of the sub-sectors have undergone autonomous liberalization and privatisation except the rail transport services still under the monopoly of the state owned Uganda Railways Corporation. Uganda has made specific commitments in tourism and travel related services. And in telecommunication services under the General Agreement on Trade in Services (GATS)

Impact of Trade Liberalization

Uganda has implemented both external and domestic trade liberalization since 1987. External trade liberalization included a whole range of measures that included lowering and binding of tariffs, simplification of trade procedures and abolition of licensing as well as administrative controls. Domestic trade liberalization included elimination of state controls and monopoly commodity marketing boards and state companies, liberalization of the foreign exchange market as well as an attempt to open rural areas to markets through improvement of infrastructure.

In assessing the impact of Trade Liberalization on Poverty, Winters et al. (2000) framework was used. The Framework outlines five areas for examining the relationship between trade liberalization and poverty. These are: Economic growth and stability; Households and Markets; Markets and Prices; Wages and Employment; and lastly Government Revenue and Expenditure. The paper asks questions and explores answers in each of the areas. While the broad sectors of agriculture, manufacturing and services were reviewed during the assessment, care was taken to focus on specific sub sectors of Coffee, Cotton, Tea and Dairy products since these involve large numbers of households and existed before liberalization.

Consistent with theory, trade liberalization has affected different sectors differently, some positively and some negatively, and to different degrees. There are intervening factors regarding the impact of liberalization. These are particularly the unpredictable climatic conditions and vagaries of weather as well as security. Overall, the impact appears mixed. The key notable effect of liberalization in Uganda has been the collapse of the cooperative movement and system. In turn, this has negatively affected productivity and contributed to worsening rural poverty. The key conclusions are that firstly, while tremendous gains have been achieved in the areas of economic growth and stability as well as government revenue, it is also quite clear that liberalization of the economy has achieved marginally in terms of the international competitiveness of domestic production especially in agriculture. Secondly, although domestic markets appear to be working, the poor households seem to have benefited little in terms of income growth and better prices. Thirdly, rapid liberalization has greatly increased the overall exposure of the economy to global markets. Consequently, the vulnerability of the poor households, particularly farming households has greatly increased. Fourthly, it appears primary that any future additional liberalization measures should consider the existing domestic capacity of a sector to effectively engage international market forces.