Analysis of Monetary Policy Objectives as Applied to Uganda's Economy: The Dream to Achieve the Middle-Income Status in 2020 is Gone

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Abstract: *This article analyses the effects of monetary policies in terms of monetary objectives, and instruments which are used by most monetary authorities to manage the requirements of the country's economy and how they influence economic activities of the country. The study is centered on four policy objectives which Bank of Uganda has been using namely; full employment, price stability which includes controlling inflation and economic fluctuations, economic growth and maintenance of balance of payment equilibrium. The instruments which are bank rates, open market operations, change in reserve ratios and selective credit controls used by the central bank are dealt with in this study. Though the economic growth figures of Uganda's economy have been in the range of 3.0 % to 6.1 % for many years, this has not demonstrated the general growth of income of Ugandans during the same period. According to the World Bank in 2019, Uganda with its population of over 42 million people has a gross domestic product of US $ 33.6 million and is placed number 3 after Kenya and Tanzania. However, in economic growth, it is number 4, after Rwanda, Tanzania and Kenya respectively. This questions the ability of the country to achieve the middle-income status by 2020 as had been predicted. The weaknesses in implementation of the monetary objectives which caused the government failure to achieve Uganda's goal and finally the important strategies and areas which Uganda should use to generate high rates of economic growth to transfer in the economy and maintain macroeconomic stability are recommended in this aricle.*

Keywords: *Monetary Policy; Middle-Income Status; Economic Growth; Growth Domestic Product; Balance of Payments.*

I. INTRODUCTION

According to the World Bank report of 2018/2019, Uganda, with its geographical size of 241,038 sq km, has a population of 42,137,000. Uganda is land locked to a number of countries in the great lake region; including Kenya, Tanzania, Rwanda, Democratic Republic of Congo and South Sudan. But it is also a land bridge that connects all these countries to each other. In addition, Uganda is a member of several regional economic blocs which include East African Community (EAC) with over 173, 583,000 million people; COMESA free trade area with a market size of over 400 million people and a combined Gross Domestic Product (GDP) of over $ 799 million. The proposed COMESA – EAC – SADC free trade area has a combined GDP of over $ 1 trillion and a combined population of 582 million people. The priority of these countries is development of infrastructure to reduce the costs of production among these states and to introduce policies designed to deliver better access to international markets of their products. These policies can be broken into hard and soft infrastructure where the former refers to factors such as quality roads, airports facilities and freight systems. The latter captures costs associated with lots of administrative works (paper work), legal delays when goods and services move across national borders (taxes). It should be noted that the national income gains come from every country that improves its border administration, transport and communications infrastructure and all related services in order to boost its GDP and Economic Growth. As illustrated in Table 1, Uganda is the 4th in geographical space among the East African States; 3rd in population size and of late it has been 3rd and 4th in the GDP and Economic Growth respectively. The performance has therefore been poor and it may be very difficult for it to move its GDP and Economic Growth rates from where it is now to become number one in East Africa and enabled to be in the middle-income status, unless massive reforms are done in various sectors of Ugandan economy as shown in this paper.

We do not rely entirely on statistics only but on our observations and experience which show that too much foreign borrowing leads to indebtedness of a country and to trade deficit. Lack of manufacturing employment in the country leads to high unemployment rate which exists in Uganda, making Uganda's economy fragile. Because of lack of industrialization policy, the pace of job creation is still markedly slower than other countries in East Africa. The features of Uganda show higher levels of inequality and absolute poverty, higher population growth rate, bigger social fractionalization, larger rural population but also rapid – urban migration which are causing unemployment and lots of associated problems. Very low levels of industrialization because of lack of industrialization policy, low levels of productivity and undeveloped financial markets are among those factors which keep Uganda behind.

Table 1: Geographical Space (sq. km), Population, Gross Domestic Product ($ million) and Economic Growth Rate of East African States

S/N	Countries	Geographical Space (sq. km)	Population	GDP ($ million)	Economic Growth Rate
1	Tanzania	947,300	49,605,000	61.032	5.4
2	Kenya	580,367	46,756,000	99.246	6.3
3	Uganda	241,038	42,319,000	33.569	6.0
4	Rwanda	26,338	11,887,000	10.211	8.6
5	South Sudan	644,329	13,137,000	3.980	5.0
6	Burundi	27,830	9,879,000	3.573	1.6
	Total	2,443,497	173,583,000		

Source: World Bank (2019)

In Table 1, the population of all the six (6) countries in the East African Community is about 13.15 % of African population (1.33 billion) and 16.72 % of World population (7.71 billion). The four (4) fastest growing economies in the World in 2019 were from Africa; namely Ivory Coast, Ethiopia, Ghana and Rwanda. Uganda is not doing very well both in GDP and Economic Growth contrary to what politicians claim.

In light of this introduction and background information, the paper found out why Uganda is lagging behind some East African States. Is it caused by Uganda's economic policy or monetary policy? The analysis of monetary policy as applied to Uganda's economy shows some answers to these questions. This paper dealt with each in relation to Uganda's economy and showed how monetary policy has not been effective to enable Uganda's income increase to achieve middle-income status by 2020.

Definition of Monetary Policy

The discussion on monetary policy these days is centered on its objectives and instruments. Tinbergen (1964) was the first economist to lay down certain instruments to achieve policy objectives. Economists have extended the discussion to include the targets instruments and indicators of economic policy.

Monetary policy is the macroeconomic policy laid down by the central bank. It involves the management of money supply and interest rate and is the demand side at economic policy level used by the government of a country to achieve macroeconomic objectives like inflation, consumption, growth and liquidity. It is also an economic strategy chosen by a government in deciding expansion or contraction in the country's money – supply. Applied usually through the central bank, a monetary policy employs three major tools:

- Buying or selling national debt
- Changing credit restrictions
- Changing the interest rates by changing reserve requirements

Monetary policy plays the dominant role in control of the aggregated demand and, by extension, of inflation in an economy. Monetary policy is concerned with the changes in the supply of money and credit. It refers to the policy measures undertaken by the government or the central bank to influence the availability, cost and use of money and credit with the help of monetary techniques to achieve specific objectives. Monetary policy aims at influencing the economic activity in the economy mainly through two major variables:

- Money or credit supply
- The rate of interest

The techniques of monetary policy are the same as techniques of credit control at the disposal of the central bank. Various techniques of monetary policy include bank rate, open market operations (OMO), variables of cash reserve requirements and selective credit controls.

Kent (1956) defined monetary policy as "the management of the expansion and contraction of the volume of money in circulation for the explicit purpose of attaining a set of specific objectives such as full employment". According to Shapiro *et al.* (1994), "Monetary policy is the exercise of the central bank's control over the money supply as an instrument for achieving the objectives of economic policy".

In the words of Rowan (1980), "The monetary policy is defined as discretionary action undertaken by the monetary authorities designed to influence:

- The supply of money
- Cost of money or rate of interest
- The availability of money

Monetary policy is not an end in itself, but a means to an end. It involves the management of money and credit for the furtherance of the general economic policy of the government to achieve the predetermined objectives. There have been varying objectives of monetary policy in different countries in different times and in different economic conditions. Different objectives clash with each other and there is a problem of selecting a right objective for the monetary policy of a country. The proper objective of the monetary policy is to be selected by the monetary authority (the Central Bank), keeping in view the specific conditions and requirements of the country's economy.

Monetary Policy Objectives

The principle targets, indicators and instruments as applied to monetary policy make part of the following main objectives:

1. Full employment.
2. Price stability which also includes controlling economic fluctuations, though some authors write the later separately.
3. Economic growth rate.
4. Maintaining balance of payments equilibrium.

Full Employment

Full employment has been ranked among the foremost objectives of macroeconomic goals. It is an important goal not only because unemployment leads to wastage of potential output, but also because of the loss of social standing and self-respect. Moreover, it breeds poverty and insecurity. It is very important for countries like Uganda.

According to Keynes (1937), full employment means the absence of voluntary unemployment. In other words, full employment is a situation in which everybody who is able to work gets work. Full employment so defined is consistent with friction and voluntary unemployment.

To achieve full employment, Keynes (1937) advocated increase in effective demand to bring about reduction in real wages. Thus, the problem of full employment is one of maintaining adequate effective demand. Keynes (1937) gave an alternative definition of full employment as "a situation in which aggregate employment is inelastic in response to an increase in the effective demand for its output. It means that the test of full employment is when any further increase in effective demand is not accompanied by any increase in output. Since the supply of output becomes inelastic at the full employment level, any further increase in effective demand will lead to inflation in the economy. Thus, the Keynes (1937) concept of full employment involves three conditions:

- Reduction in the real wage rate
- Increase in effective demand
- Inelastic supply of output at the level of full employment. Is this applicable to Uganda where unemployment is caused by supply and not by demand?

According to Jens *et al.* (2011), attempting to define full employment raises many people's blood pressure. Right so, because there is hardly any economist who does not define it in his own way. Beveridge (2104) in his book – "full employment in a free society" defined it as a situation where there were more vacant jobs than unemployment so that the normal lag between losing one job and finding another employment is not always full. There is always a certain amount of frictional unemployment in the economy even when there is full employment. He estimated frictional unemployment of 3 % in a full employment situation. But his pleading for more vacant jobs than the employed cannot be accepted as the full employment level.

According to the American Economics Association, full employment is a situation where all qualified persons who want jobs at current wage rate full time jobs. It does not mean unemployment is zero. Here again, like Beveridge (2104), the association considered full employment to be consistent with some amount of unemployment.

Furthermore, individual economist may, however, continue to differ over the definition of full employment, but the majority has veered round the view expressed by the United Nations experts on national and international measures for full employment that full employment may be considered as a situation in which employment cannot be increased by an increase in effective demand and unemployment does not exceed the minimum allowances that must be made for the effect of frictional and seasonal factors. The definition is in keeping with the Keynes (1937) and Beveridge (2104) views of full employment. It is now agreed that full employment stands for 96 to 97 % employment, with 3 to 4 % unemployment existing in the economy due to friction factors. Full employment can be achieved in an economy by following an expansionary monetary policy and seasonal factors. Whereas in Uganda, unemployment ranges between 60 – 70 % of the workforce available. When will it be full employment?

Price Stability

Price stability is one of the goals of macroeconomic policy and it is to stabilize the price level. Both economists and laymen favour this policy because fluctuations in prices bring uncertainty and instability to the economy. Rising and falling prices are both bad because they bring unnecessary loss to some and undue advantage to others. Again, they are associated with business cycles. So, a policy of price stability keeps the value of money stable, eliminates cyclical fluctuations, brings economic stability, helps in reducing inequalities of income and wealth, secures social justice and promotes economic welfare. This is one of the policies recommended for Ugandan economy but it has not been implemented because of opting to the floot regime of exchange rate and other conflicting economic and social reasons.

However, there are certain difficulties in pursuing a policy of stable price level. The first problem relates to the type of price level to be stabilized. Should the relative or general price level be stabilized, the wholesale or retail, of consumer goods or producer goods? There is no specific criterion with regard to the choice of a price level. Economists suggest, the compromise solution would be to try to stabilize a price level which would include consumers' goods. But a policy of stable prices will reduce profits and retard further investment. Under the circumstance, a policy of stable prices is not only inequitable but also conflicts with economic progress and democracy, not only in Uganda but in the entire World.

Second, innovations may reduce the cost of production but a policy of stable prices may bring larger profits to producers at the cost of consumers and wage earners. However, in an open economy like Uganda which imports raw materials and other intermediate products at high prices, the cost of production of domestic goods will rise. A policy of stable prices will reduce profits and retard further investment. Under the circumstance, a policy of stable prices is not only inequitable but also conflicts with economic progress in Uganda.

Despite these drawbacks, the majority of economists favour a policy of stable prices. But the problem is one of defining price stability. Price stability does not mean that prices remain unchanged indefinitely. Comparative prices will change as fluctuating tastes alter the composition of demand; as new products are developed and as cost reducing technologies are introduced. Differential price changes are essential for allocating resources inflexibility of prices, differential price changes can only be attained by gradual increases in the aggregate price level over the long-run. Further, prices may have to be changed if costs of imported goods increase or if taxation policy leads to the rise in the domestic cost of production. It should be noted that price stability can be maintained by following a counter-cyclical monetary policy, that is easy monetary policy during a recession and dear monetary policy during boom could be looked at by Ugandan monetary policy authorities.

Economic Growth

One of the most important goals of macroeconomic objectives in recent years has been the rapid economic growth of an economy. Economic growth is defined as the process whereby the real per capita income of a country increases over a long period of time. Economic growth is measured by the increase in the amount of goods and services in each successive time-period. Thus, growth occurs when an economy's productive capacity increases which, in turn, is used to produce more goods and services. However, economic development implies raising the standard of living of the people, and reducing inequalities of income distribution. We all agree that economic growth is a desired goal for a country but economic development is the back bone of its success. Uganda has some successes in the first but lots of failures in the second, leading it not to go to middle-income status because of not producing more goods and services in the country to raise the standard of its people. But there is non-agreement over the magic number viz, the annual growth rate which an economy should attain though it does not mean the country's development.

Generally, economists believe in the possibility of continual growth. This belief is based on the presumption that innovations tend to increase productive technologies of both capital and labour over time. But there is very likelihood that an economy might not grow despite technological innovations. Production might not increase further due to the lack of demand which may retard the growth of the quality of labour in keeping with the new technologies.

However, policy makers do not take into consideration the costs of growth. Growth is not limitless because resources are scarce in every economy. All factors have opportunity cost. To produce more of one particular product will mean reduction in that of the other (opportunity cost). New technologies lead to the replacement of old machines which become useless. Workers are also displaced because they cannot be fitted in the new technological set up immediately. They get retrained or found themselves out of the jobs. Moreover, rapid growth leads to urbanization and industrialization with their adverse effects on the pattern of living and environment. People have to live in squalor and slums. The environment, becomes polluted. Social tensions develop. But growth is worth all its name. Since the price in terms of change in, deterioration of, or even destruction of the environment is not yet fully known. What does seem clear, however, is that growth is not going to be halted because of environmental problems and that mankind must learn to cope with the problem or face the consequences. Uganda monetary authorities should be able to use the policy to generate economic growth but also development.

The main problem is to what extent monetary policy can lead to the growth of the economy and development? It is difficult on this issue. The monetary authority may influence growth by controlling the real interest rate through its effect on the level of investment. By following an easy credit policy and lowering interest rates, the level of investment can be raised which promotes economic growth but Uganda has not used this instrument. Monetary policy may also contribute towards growth by helping to maintain stability of income and prices. By moderating economic fluctuations and avoiding deep depressions, monetary policy helps in achieving the growth objective. However, rapid and variable rates of inflation discourage investment and adversely affect growth, monetary policy helps in controlling hyper-inflation. Similarly, by a judicious monetary policy which encourages investment, growth can be promoted. For example, tight monetary policy affects small firms more than large firms, and higher interest rates have a greater impact on small investments than on large industrial investments. So, monetary policy should be such that encourages investment and at the same time controls hyper-inflation so as to promote growth and control economic fluctuations, this is what Uganda is still lacking. The small and large firms suffer the same interest rates.

Balance of Payments

Another important goal of macroeconomic objectives, that is to maintain equilibrium in the balance of payments. The achievement of this goal has been necessitated by the phenomenal growth in the World trade as against the growth of international liquidity. It is also recognized that deficit in the balance of payment will stop the attainment of other goals. This is because a deficit in the balance of payments leads to a sizeable outflow of capital. But it is not clear what constitutes a satisfactory balance of payments position. Clearly, a country with a net debt must be at a surplus to repay the debt over a reasonably short period of time. Once any debt has been repaid and an adequate reserve attained, a zero-balance maintained over time would meet the policy objective. But how is this satisfactory balance be achieved on the trading account or on the capital account? The capital account must be looked upon as fulfilling merely a short-term emergency role in terms of crisis.

Again, another problem relates to the question: what is the balance of payments target of a country, like Uganda? It is where imports equal exports or when exports exceed imports. But, in practice, a country whose current reserves of foreign exchange are inadequate will have a mild export surplus as its balance of payments target. And when its reserve becomes satisfactory, it will aim at the equality of imports and exports. But Uganda imports more than it exports and has therefore, a deficit on trade balance. This is because an export surplus would mean that the country is accumulating foreign exchange and it is producing more than it is consuming. But this cannot last long because some other country must be having import surplus and in order to avoid it, it would impose trade restrictions on the export surplus country. United States of America is doing this under the disguise of politics in the Middle East and with China.

However, the attainment of a balance of payment equilibrium becomes an imperative goal of macroeconomic policy in a country. How can monetary policy achieve it? A balance of payments deficit is defined as equal to the excess of money holding for foreign goods and securities. Under a system of fixed exchange rate, the central bank will have to sell foreign exchanges reserves and buy the domestic currency for eliminating excess supply of domestic currency. That is how equilibrium will be restored in the balance of payments. Uganda uses a floating exchange system where its shillings are left free to fight against other currencies. This is good for a country which is a net exporter!

If the money is below the existing demand for money at the given exchange rate, there will be a surplus in the balance of payments. Consequently, people acquire the domestic currency by selling goods and services to foreigners. They will also acquire additional money balances by restricting their expenditure relatively to their income. The central bank, on its part, will sell excess foreign exchange reserves and buy the domestic currency for eliminating excess supply of domestic currency. This is how the equilibrium will be restored in the balance of payments. Ugandan monetary authorities have been applying this method but with no success because of weak supply side.

If the money supply is below the existing demand for money at the given exchange rate, there will be a surplus in the balance of payments. Consequently, people acquire the domestic currency by selling goods and securities to foreigners. They will also seek to acquire additional money balances by restricting their expenditure relatively to their income. They central bank, on its part, will buy excess foreign currency in exchange for domestic currency in order to eliminate the shortage of domestic currency.

Most developing economies are not highly monetized and the public is ignorant about monetary tools used such as open market operations (OMO), bank rates, selective credit controls, legal and discount windows lending, marginal requirements etc. They only know government directs intervention or control, which directly affects them. Developing countries, like Uganda, are highly externally influenced by Donors and International Finance Institutions. They have under developed financial markets and a lot of them borrow outside the banking system. Governments use fiscal policy to influence monetary policy carried out banks and sometime using corrupt methods in policy applications.

The monetary policy should be the guidelines given independently by central banks to stabilize the economy and increase the economic growth without government interferences.

More objectives of the monetary policy should also include the following goals:

(i) To stabilize the foreign exchange and balance of payments.

(ii) To stabilize the exchange rates and ensure full employment of factors of production.

(iii) To ensure more even distribution of income amongst people which is lacking in Uganda.

(iv) To increase the rate of economic growth and development and hence, finally increases the level of aggregate demand in the economy.

However, by raising bank rates, the monetary policy in Uganda has had the following negative effects on economy:

(a) Raising the bank rates in the economy will affect the volume of investment negatively.

(b) By raising the interest rates, the central banks contract the money supply because the higher interest rates discourage borrowing.
(c) Demand for labour will fall, resulting in unemployment due to the decline in investment.
(d) Production is reduced due to the fall of investments.
(e) Volume of money in circulation may be reduced and hence, lowering the purchasing power of the people.
(f) The demand for most of the goods will fall, resulting in a fall of prices of the consumer goods leading to low incomes of the people.

Monetary policy is therefore a very important mechanism in an economy and may lead to the following, once properly followed:

(i) Checking on depression.
(ii) Increasing the production.
(iii) Increasing the demand for more commodities.
(iv) Increasing the stock of assets.
(v) Encouraging more investments.
(vi) Encouraging the production for market.
(vii) Increasing the employment.
(viii) Increasing the standard of living because of increased income, which is lacking in Uganda.

II. CONCLUSIONS

High interest rates or high bank charges are becoming disincentives to the development of the savings and banking culture in Uganda and in many developing economies. Low-income earners end up by having substantial portion of their income savings eaten up by the bank charges. New entrants easily retreat from banking system in view of high bank charges, hence undermining the development and the banking culture. This should be avoided by the Bank of Uganda.

Apart from achieving low and stable inflation, monetary policy in a country should provide an incentive to savings, investments and enhancement of productivity gains, investments and planning horizons of economic agents which are conducive to economic growth. Monetary policy should reduce costs of uncertainty, reduce transaction costs and cost of doing business and in general reduce the erosion of savings and of income of the people to stabilize business and investor expectation in an economy. The question now is; does Uganda's monetary policy help the national economy to achieve all these? The time scale of Uganda's planning and monetary policy does not. For instance, the time scale for Uganda as example of macroeconomic policy to bring it to middle-income countries has failed. The World Bank defines middle-income countries in terms of Gross National Income (GNI) per capita, with a lower bound of US $ 1,036 for lower middle-income countries. Uganda's GNI per capita was US $ 510 in 2011, US $ 700 in 2016 and US $ 770 in 2019.

To attain the minimum threshold of $ 1,036 for middle-income status, Uganda must double its GNI per capita in real terms. With a constant real GDP growth of 7 % and population growth below of 3.7 % per year, it will take another 20 years for Uganda to double its real income per capita, not in 2020 as the government had dreamt. To achieve the middle income status, a long term strategy approach must be adopted, focusing on the policies that can generate sustainable high rates of growth for the next 20 years, while maintaining macroeconomic stability over the long term, accommodating demands for public expenditure within the available budget resource envelope to enable public debt to remain sustainable and affordable. This is not enough. It must be combined with structural reforms to strengthen the supply side of the economy, particularly growth in productivity.

III. RECOMMENDATIONS

There are several crucial areas to supply side of the economy of Uganda to achieve middle-income status and transform the structure of its economy in 2040.

The Modernization of Agriculture

This is a prerequisite for industrialization for four (4) reasons:

1. To introduce modern irrigation to fight against climate change and land shortage.
2. To generate agricultural surplus to be used as raw materials in agro-processing industries.
3. To free up labour from agriculture for employment in modern industries employment and to service sector.
4. To create rural market for the products of agro industries and for domestic consumption and export.

Accelerating the Demographic Transition

This plays a major role in economic development. No country can achieve middle-income status without demographic reforms which Uganda has not done up till now. Demographic transition entails:

A fall in the total fertility rate, which reduces the population growth rate and pulls down the age-dependency rate which Uganda suffers from.

Uganda has a total fertility rate of 6.1 children per woman and has one of the highest age-dependency rates in the World, at over 100 dependents per people of working age. Many of the first growing economies of developing Asia have age-dependency rates of around 50, because they began their demographic transition reforms several decades ago. Lower age-dependency rates are closely correlated with higher saving rates and greater real spending per person on human capital development which is crucial for structural transformation. Because it allows an economy to invest in physical and human capital. No or little or sufficient efforts have been devoted to population policies in Uganda to reduce the fertility rates. In countries even with diverse cultures such as China, Iran, Malaysia, Sri-Lanka, fertility rates have been reduced because of government actively promoting smaller families and make available all contraceptives to all the population and investing in reproductive health and women's education.

Private Investment in Labour Intensive Modern Industries

A shift in the labour force out of low productivity, informal, traditional activities into modern, formal sector industries with higher productivity requires policies, effective and big boost to private sector. For example, fiscal concessions, such as tax holidays must be improved, to reduce the cost and risks of doing business in the country. Reduce regulatory burden on business, reduce customs procedures, reduce the burden caused by demands for corruption payments, improve the infrastructures in transport, water and power sectors etc. Besides, Uganda's domestic market is very small and the big firms located in Uganda should serve the entire East Africa market. And non-tariff barriers to intra-regional trade in the East African Community should be removed. The East African Customs Unions, common market, have not properly been implemented. This slows down the trade across boarders within the region. The monetary policy cannot effectively operate unless such problems are removed from economy and more incentives given to both domestic and international private investors in the country.

Export-Led Manufacturing Policy

This would create Uganda economic growth if properly planned and implemented. It would cater for Uganda's strive to achieve 7 % annual economic growth planned by the government.

Prioritized Areas of Economy

Uganda should prioritize areas where it has competitive and comparative advantages, especially in agro-processing industries, by specializing in producing products where Ugandans are good at and close to their capacities. Therefore, Ugandans should produce what they consume and consume what they produce!

Domestic Savings

Domestic savings should come up plus infrastructure development which will continue to be vital in lowering the cost of production and to make the domestic products regionally, continentally competitive.

Harnessing Foreign Investors for Internal Job Creation and Industrialization

Harnessing foreign investors for internal job creation and industrialization in Uganda would be most important in market expansion outside the country and increase revenue for government.

Population Policy

Demographic reform is necessary to reduce population growth and dependency rates. The government should invest in reproductive health and more in women education.

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