EPRC
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Towards Sustainable Development

The Uganda Business Climate Index

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Ambrose Ogwang, Maya Denis Makika, Rehema Kahunde, Corti Paul Lakuma, Brian Sserunjogi

COVID-19 containment measures disrupt businesses, but more remain optimistic about future

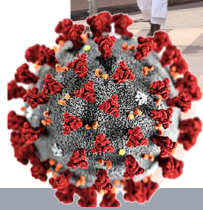


Photo: Businesses struggling to pick despite the reopening of the economy due to high tax measures
Photo: EPRC

Executive summary

Business Climate Index (BCI) improved by three index points to 58 but remained below the full potential. The marginal improvement is attributed to improved demand for goods, access to regional markets and international markets, and improvements in internal business operations. The progress is also linked to the reopening of the economy in July 2021 after the relaxation of some COVID 19 related restrictions. The easing of movement restrictions enabled inter-district travel and weekly agriculture markets. Disaggregated results suggest improved perceptions in the agriculture and manufacturing sector; but a slight decline in the services sector. Businesses are still faced with persisting challenges, including insufficient demand, poor transport infrastructure, corruption and bribery, macroeconomic factors, and electricity availability. The future outlook for the next quarter (October-December 2021) is promising. An expected index of 108 is driven by improvement in conditions for doing business in both the manufacturing and services sectors. This expected performance is due to a general improvement in all indices, especially the anticipation of a relatively large increase in demand.

Data and methods

The data used in computing the Business Climate Index (BCI) is a panel of businesses based on the Uganda Bureau of Statistics Census of Business Establishment 2011, first tracked in 2012. This current quarterly bulletin covered 170 business establishments. The panel element has enabled us to track the business environment in Uganda over time.

The BCI is computed based on the following business evaluation indicators: business activity, turnover, profitability, incoming new business, capacity utilisation, average costs of inputs, price of produced goods, business optimism, number of employees, and average monthly salary. For each of the evaluation indicators, respondents are asked to express their perceptions on a Likert scale as follows: "improved", "did not change", "declined" or "above normal for the quarter", "normal for the quarter", below average for the quarter" or "more favourable", "unchanged", "less favourable". These responses are coded as 0, 1, and 2, respectively. In this case, if a respondent's perception of the business environment is that it deteriorated, such a response would be coded 0, it would be coded one if the business climate did not change, and 2 if the business climate improved.

The index does not consider the magnitude of change in the data but considers the general direction of movement in the key indicators. As such, the index is sensitive to the direction instead of the magnitude of the change in business conditions. During the data collection process, we ask business managers to assess the general economic environment for the current quarter relative to the previous quarter; and their expectations for the next quarter. Based on the business evaluation indicators explained earlier, the business climate index is computed as the weighted arithmetic means of indices of the individual business evaluation indicators. The indices range from 0 – 200. The interpretation of the BCI is such that it scores above 100, point to an improving business climate. Scores below 100, imply that the general business conditions are getting worse. And, a score of 100, points to unchanged business conditions.

Also, the index analyses the evolution of challenges facing businesses during July-Sept 2021 by identifying which business constraints became more of a problem and less of a problem. We also ask business managers to indicate how each identified business constraint has evolved during the quarter. For each of the business constraints, we asked if it was "more of a problem", "unchanged", or "less of a problem". The resultant weighted indices range from -100 to 100, with

positive scores suggesting that a particular constraint is perceived to be more of a problem in the current quarter; negative scores imply that a constraint is less of a problem, and zero scores point to business constraint whose severity has remained unchanged.
Results

Business climate improves, future expectations optimistic

The condition for doing business improved by three index points from the previous 55 for the quarter (April-June 2021) to 58 in the current quarter (July-September 2021) (Figure 1). This shows consistent improvement in conditions of doing business for the fourth consecutive quarter. Even with the slight improvement in condition for doing business, all sub-indices, namely; activity, turnover, profit, new business, capacity utilisation, input costs, product costs, optimism, labour, salary and environment, remain below potential just as in the previous quarter.

These improvements could be attributed to the uplifting of the second lockdown at the end of July 2021. This saw the reinstatement of public transport, permitting of weekly markets for agriculture products, and inter-district travel with strict observance of COVID-19 Standard Operating Procedures (SOPs). In addition, the good performance was shored by improvements in demand for products, regional and international market activities, and internal business operations.

Nonetheless, the current index (58 percent) remains below full potential because several challenges constrain the business environment. The main challenges reported by firms include government regulations (13.4 percent), reduced demand for goods and services (9.4 percent), electricity availability (8.8 percent), tax policy, and macroeconomic factors (at least 8 percent each).

The business climate index by sector

Compared to the previous quarter, the condition for doing business improved in both the agriculture sector and manufacturing sector, but marginally declined in the services sector. The respective index for the agriculture and manufacturing sector improved to 88 and 74 points, compared to 62 and 29 points in the previous quarter respectively. However, the services sector BCI declined by 2 index points to 55 (Figure 2). The condition for doing business in the manufacturing sector surpassed that of the service sector for the first time since the fourth quarter of 2020.

The improvement in BCI for the agriculture sector is attributed to rising prices for commodities such as food and non-alcoholic beverages. There was a 3 percent increment in the price for 'furnishings, household equipment and routine Households' in the manufacturing sector. The services sector experienced a 4.8 percent decline in transport services and a 0.4 percent decline in demand for recreation, culture and sports services.[2]

Challenges in doing business

Unlike the previous quarter (April-June, 2021), the top five most important constraints in doing business for the current quarter comprised of insufficient demand and transport infrastructure. This was in addition to the persistent business challenges (corruption and bribery, macroeconomic factors, electricity unavailability, and government regulation) that have not changed since the last quarter. This suggests that major policy and regulatory constraints facing Ugandan businesses are persistent. The insufficient demand in the current quarter could have emanated out of the low purchasing power in the economy as a result of severe job losses caused by the second wave of the COVID-19 pandemic and its effects in 2021. Concerning

Figure 1 The business Climate Assessment

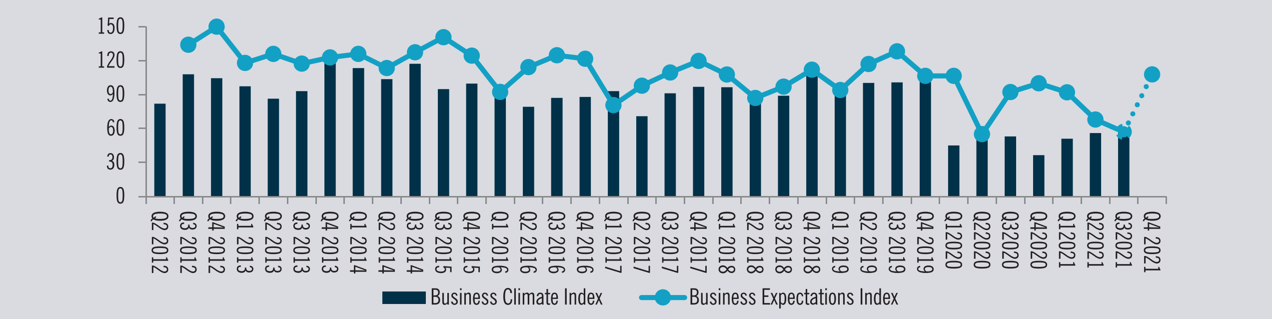
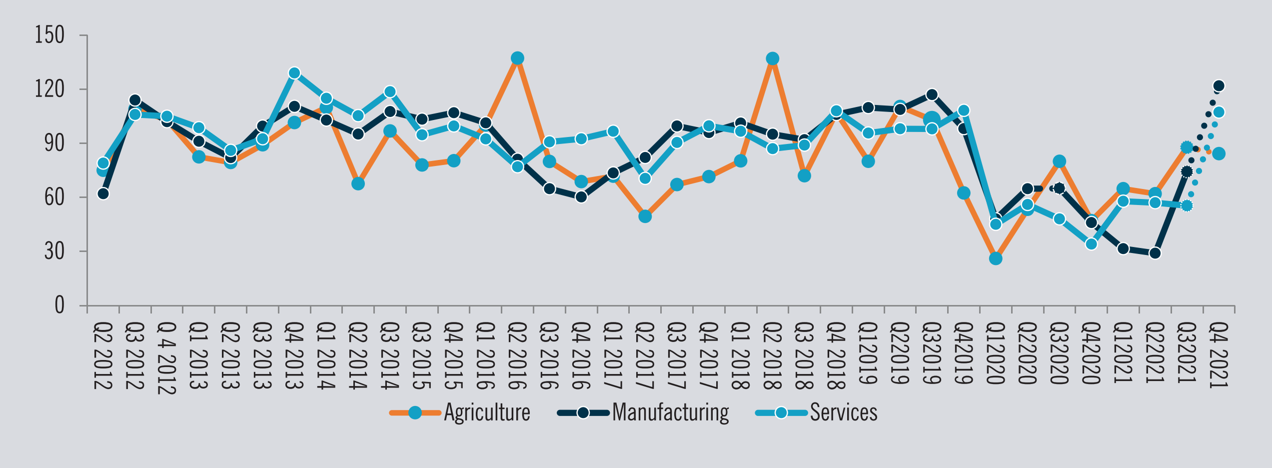


Figure 2 Business Climate Index by sector



the transport infrastructure, the Parliament of Uganda introduced an Shs100 tax increase per litre of petrol and diesel in this quarter (during the 42 days of the second lockdown).[1] Additionally, the maximum number of passengers permitted to use public transport, especially taxis, to observe the SOPs affected the transport activities. Furthermore, corruption and bribery have continued to be burdensome on businesses operating during the curfew hours.

The severity of the challenges businesses face increased in the current quarter (Figure 4). Unlike in the last quarter (April-June 2021), the severity of the challenges posed by increased government regulation and insufficient demand was perceived to have been elevated during the current quarter. Additionally, tax policy was also reported to be more of a problem in the current quarter as in the previous, due to a decline in the capacity of businesses to meet their tax obligations driven by subdued demand and sales turnover. Unlike during the last quarter, increased corruption, unfavourable macroeconomic factors, substandard products, and adverse weather were severe concerns within the business community, with high severity during the current quarter.

Future business outlook: October-December 2021

The conditions for doing business for the next quarter (October-December 2021) are expected to be above full potential, with the index projected at 108 (Figure 1). This expected improvement is a result of firms reporting an expected improvement in demand (69 percent), a more stable macroeconomic environment (14 percent), expected improvement in internal business operations (6 percent), and regional dynamics (6 percent). The expected improvement in demand reported by the majority of businesses could be due to the Christmas festivities within the quarter.

The projection for the next quarter (October- December 2021) shows expected improvement in both the manufacturing and services sector, but an expected decline for the agriculture sector (Figure 2). The manufacturing and services sectors are expected to operate above full potential, with an index at 122 and 107 respectively, while the agriculture sector is expected to decline to 84 percent.

Question of the quarter

In this quarter, we sought to understand the effect of the 12 percent direct tax levy on the net price of internet data on the performance of businesses. The internet tax replaced the Over-The-Top (OTT) tax and took effect on July 1, 2021. In particular, we asked: a) "Has your business been affected by the 12% tax on internet data that started on 1st July 2021 as a replacement of OTT?" b) "If yes, how has your business been affected?"

1 https://www.monitor.co.ug/uganda/news/national/govt-under-pressure-to-revise-taxes-over-covid-19-3504794

Figure 3 Figure 3: Business Constraints (%)

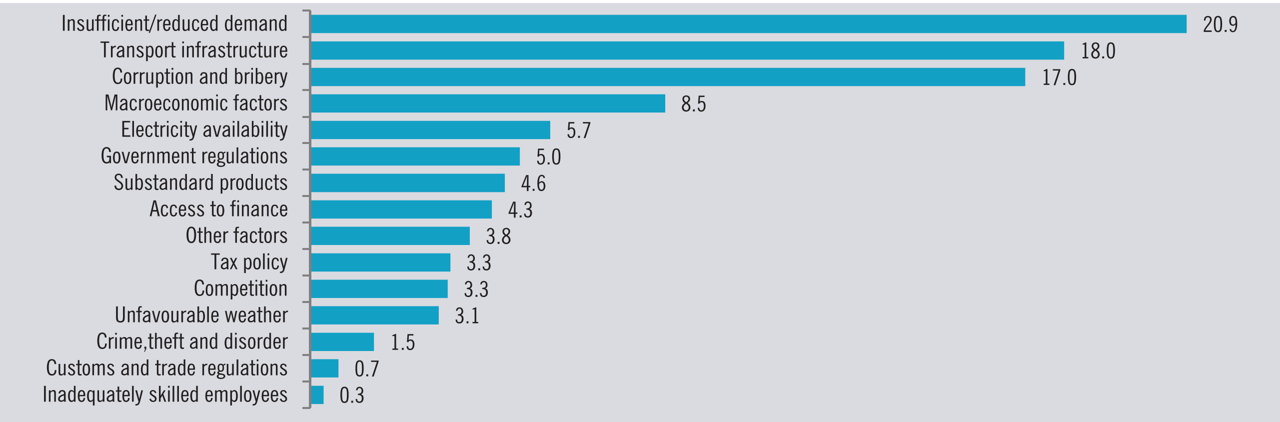


Figure 4 The evolution of business constraints (% of businesses)

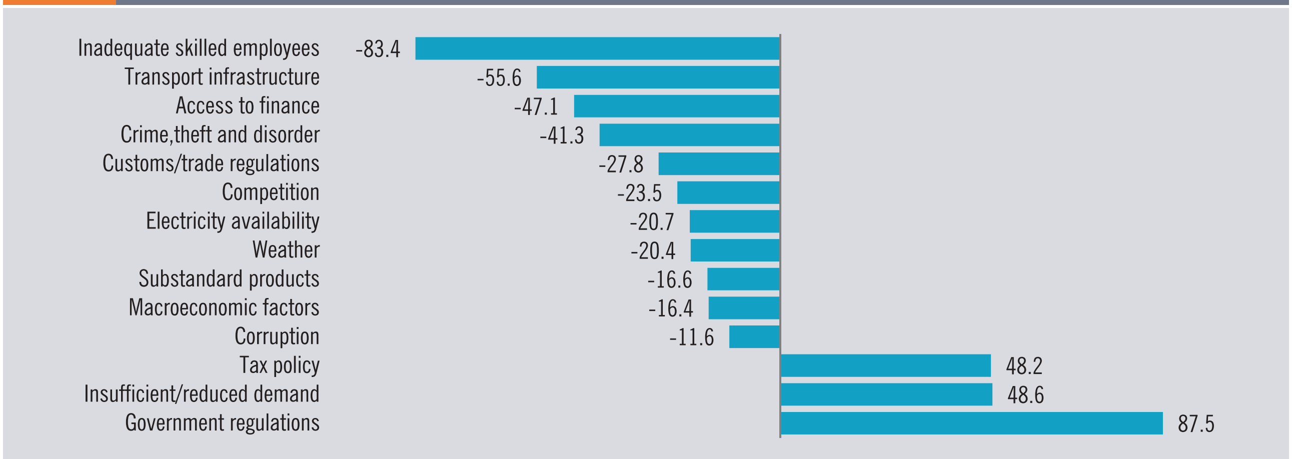
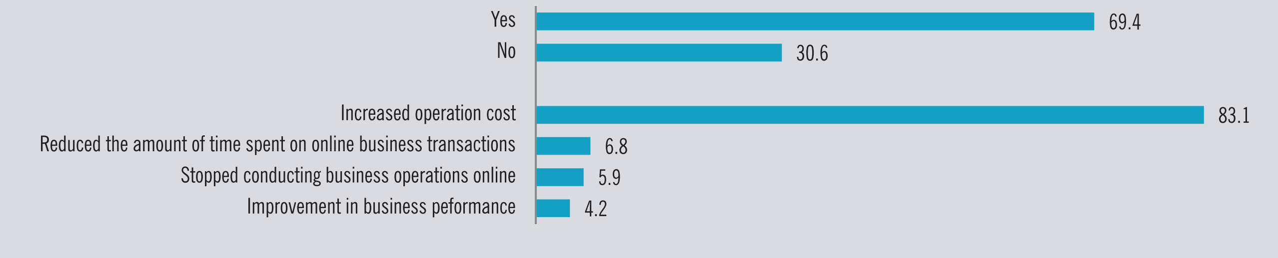


Figure 5 Effect of the 12% internet tax on business performance.



Results (Figure 5) indicate that 69.4 percent of the businesses were affected by the introduction of the 12 percent increment in tax. The tax is a disincentive to online business operations, which are pertinent in the new normal that necessitates social distancing as one of the measures to curb the spread of the pandemic. The majority of businesses reported that the tax led to an increase in their operation costs (83.1%). Close to 6.8 percent of the businesses reported reduced time spent on online business transactions, and 5.9 percent reported having stopped conducting businesses online.

Surprisingly, 4.2 percent of the businesses reported improved performance. Given that most businesses are finding it more costly to operate, the government could consider revising the tax rate downwards to make it less costly for businesses since there is already 18 percent Value Added Tax.

Conclusion

The BCI for the current quarter improved to 58 index points, despite all indices remaining below full potential. This continued quarterly improvement indicates that the BCI has improved for the fourth consecutive quarter. Sector breakdown shows improvement in the agriculture and manufacturing sectors index, whereas that of the services sector declined.

The below full potential index for the current quarter is due to the persistence of some challenges to doing business such as insufficient demand, poor transport infrastructure, corruption and bribery, macroeconomic factors, and electricity availability.

The projection for the next quarter (October -December 2021) indicates expected improvement from the current 50 to 108. This is due to the expected increase in demand for goods and services during the festive season and a more stable macroeconomic environment. Even though this sector breakdown indicates expected improvement in BCI for the manufacturing and services sector, to 122 and 107 respectively. A slight decline of 4 index points is expected in the agriculture sector.

Considering the effect of a 12% tax on internet bundles on the operation of businesses, most of the businesses are faced with high costs of operations, with others forced to reduce the amount of time spent on online business transactions—worst of all, some abandoned online business operations.

The Economic Policy Research Centre (EPRC) has been producing the Business Climate Index (BCI) for Uganda since June 2012. The BCI reflects the perceptions of Ugandan business managers on the current and near-future (expected three months ahead) business conditions. The BCI is a perceptions indicator of economic activity and the general business environment in which businesses operate. The purpose of BCI is to forecast turning points in economic activity and thus provide critical information for policy makers both in Government and the Private Sector.

About EPRC
The Economic Policy Research Centre (EPRC) is an autonomous not-for-profit organization established in 1993 with a mission to foster sustainable growth and development in Uganda through advancement of research – based knowledge and policy analysis.

Address
Economic Policy Research Centre
Plot 51, Pool Road, Makerere University Campus
P.O. Box 7841, Kampala, Uganda
Tel: +256-414-541023/4
Fax: +256-414-541022
Email: eprc@eprcug.org

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