DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

EBS/83/5
Correction 1

CONFIDENTIAL

February 28, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Uganda - Staff Report for the 1982 Article IV Consultation and Review of Stand-By Arrangement

The following corrections have been made in EBS/83/5 (1/10/83):

Page 5, title: for "Table . Uganda" read "Table 2. Uganda"

right column, line 3: for "from U SH" read "from U Sh 99.25"

line 4: for "U Sh 99.25" read "U Sh 105.00"

Page 12, para. 2, line 21: for "76 per cent...to 36 per cent"
read "75 per cent...to 35 per cent"

Page 21, 1st full para., line 1: for "June 1981" read "June 1982"

Page 29, penultimate line: for "per week" read "for each four-week period"

Corrected pages are attached.

Att: (4)

Table 2. Uganda: Policy Measures Under the 1982/83 Stand-By Program: Current Status of Implementation

| Program | Current Status of Implementation |
|---|---|
| 1. Exchange rate | |
| a. Establishment of a dual exchange rate system with a modest depreciation in one market (Window 1) which would remain managed and a sharp appreciation in the other (Window II) with weekly auctions | On August 27, 1982 the dual exchange system became operational. The rate at Window I depreciated from U Sh 99.25 per US$ at end-August to U Sh 105.00 per US$ at end-December. The rate at Window II was initially set at U Sh 300 per US$. The rate appreciated progressively to U Sh 240 in December. |
| b. The Bank of Uganda will sell a minimum of US$8 million during each four-week period through the auction market | In the first twelve weeks of the dual exchange system (August 27-November 12) a total of US$13 million was surrendered through the auction market. This amount was below the required minimum. This condition was modified to cumulative sales of US$24 million by end-December 1982. Sales at December 24, 1982 were already in excess of US$25 million. |
| c. *Measures adopted to increase sales* through the auction market | *Administration procedures for obtaining* the necessary documentation have been simplified. Import duties were reduced and both the one per cent fee charged by UABT and five per cent advance import deposits have been suspended. The issuance of import licenses to importers with their own foreign exchange has been suspended. More commodities have been transferred to the auction market and the sectoral limits on commercial bank lending have been relaxed. |
| 2. Supply-side measures | |
| a. Producer price increase for the main export crops ranged from 33 per cent to 100 per cent. Increases in price of petroleum products ranged between 75 per cent and 128 per cent | Both implemented between June 1982 and November 1982. |
| b. Liberalization of both external and domestic trade | Policies being gradually implemented. Removal of zoning restrictions. Measures taken to increase supply of raw materials and spare parts. |
| 3. Public finance | |
| a. Wage policy included zero rating of PAYE and an increase in civil servants' wages of 20 per cent in first half of 1983 | Zero rating of PAYE implemented in July 1982. |
| b. Minimizing cash releases and recourse to extra-budgetary expenditure | Steps have been taken for restraining automatic cash releases for recurrent expenditure and only the highest priority development expenditures were allowed. New measures to limit recourse to extra-budgetary accounts, notably the Treasury main clearance account were implemented. |
| c. Revenue collection administration to be improved | Revenue collection procedures being implemented. Government collected U Sh 2.3 billion of arrears primarily on custom duties, sales tax and excise duty by September 1982. |
| d. Increase in tariffs for some public utilities | Implemented in November 1982. |
| 4. Monetary measures | |
| a. Increase in deposit rates and most categories of lending rates by one percentage point | Implemented in June 1982. |
| b. Increase in lending rates for trade and commerce and unsecured loans | These lending rates were allowed to float up to a maximum of 20 per cent November 1982. |
| c. Rates on Treasury bills to be increased by an average of 1.5 percentage points | Increased by an average of 2.5 percentage points in November 1982. |

Exchange Allocation Committee, were heavily skewed in favor of public administration and certain invisible payments (such as travel), while relatively small amounts were allotted to the productive sector.

As a means of achieving a more efficient allocation of foreign exchange and discouraging parallel market activities, the authorities established, in the context of the 1982/83 financial program, a temporary dual exchange market. Under this arrangement, in one market (the "first window"), foreign exchange proceeds derived from traditional exports (coffee, cotton, tea, and tobacco) and Bank of Uganda loan and interest receipts are sold at a managed exchange rate; the same rate is applied to purchases of foreign exchange for debt service and arrears payments, contributions to international organizations, and specified imports deemed essential to the rehabilitation of the economy (such as petroleum products, equipment, and spare parts). All remaining transactions are conducted in the other market (the "second window"), where foreign exchange is allocated at an exchange rate determined through weekly auctions held by the Bank of Uganda. The excess foreign exchange sold at the second window over the amount surrendered, at that window, is met from the first window and the profits realized from this operation credited to the Treasury.

The introduction of the dual market was accompanied by a substantial liberalization of Uganda's exchange control regulations. Quantitative limits on invisible transactions, such as travel, and expatriate remittances and emigrant transfers were raised substantially, while outward unrequited and capital transfers were permitted up to specified amounts. In addition, all restrictions on profit, dividend, and debt service remittances were lifted.

Under the stand-by arrangement, the Bank of Uganda was required to sell at the second window US$8 million during each four-week period. These sales constituted a performance criterion. The authorities requested a waiver and modification of this performance criterion when it became clear that, because of implementation difficulties, the sales target could not be attained. The waiver was approved by the Executive Board on November 24 and the performance criterion was modified to require that a cumulative minimum of US$24 million be sold before end-December 1982 (EBS/82/196 and Supplement I). To promote sales at the second window and reduce both the premium and the volume of transactions on the parallel market, a series of remedial measures were introduced during October and November: the 1 per cent fee charged for the issuance of import licenses and the 5 per cent advance deposit were suspended; import duties were reduced selectively and the practice of granting licenses to importers with their own foreign exchange was terminated; and certain items, notably motor vehicle spare parts and tires, were transferred from the first window. In addition, the ceiling on lending rates to trade and commerce was increased, which should assist importers bidding at the second window.

goods and spare parts through the second window. The Government is also taking measures to increase competition in the transportation industry. As part of the effort to increase competition, textile mills have been authorized to purchase their lint requirement directly from the processors instead of obtaining it from the Lint Marketing Board. Similarly, large tea estates will be allowed to market tea directly instead of having to sell them to the Uganda Tea Authority.

In order to maintain the momentum of recovery, the Government adopted a modest two year Recovery Program beginning in 1982/83, focussing on improving agricultural and industrial production and transportation facilities. There will be concerted effort on a relatively few projects which promise rapid earnings of foreign exchange through increased exports or savings of foreign exchange by import substitution. Investment under the Program is expected to total US$737 million of which 30 per cent will be allocated to agriculture, 29 per cent to industry and tourism and 21 per cent to transportation; the remaining 20 per cent will be allocated to telecommunications and social services.

In the agricultural sector, the Government proposes to expand extension services, increase the supplies of seeds and agricultural implements, improve production techniques, and introduce new crops. In addition, coffee processing plants, cotton ginneries, and tobacco curing barns are being rehabilitated with a view to increasing their productive capacity. These measures, in conjunction with adequate producer pricing policies, are expected to increase agricultural output significantly in the medium-term. The Government is also taking steps to increase commercial milk and meat production by improving breeding stocks, expanding artificial insemination services and rehabilitating existing ranches.

In the industrial sector, the focus will be on the promotion of selected agro-based industries for processing exports and import-substituting industries. Policies to increase industrial output will include encouraging greater private sector participation, strengthening credit and procurement arrangements, mobilizing additional capital resources, and improving training services. The Uganda Development Bank is being strengthened to channel external resources to individual industries (see section 5 below), while the return of the former owners of a number of nationalized companies is expected to provide better management as well as additional capital.

In view of Uganda's land-locked position, the improvement of transportation facilities plays a big role in the strategy for economic recovery. Consequently, the Government is intensifying its efforts to alleviate all bottlenecks in marketing and exports of agricultural produce. It is acquiring additional wagons, rehabilitating the railway facilities and improving port services at Jinja and Port Bell.

### 3. Public finance

The policy and institutional changes since June 1981 have represented a sharp break with the past, but their full impact is difficult to assess. This reflects the nature, magnitude and frequency of policy changes. On the expenditure side, the successive depreciations and the opening of Window 2 have had an enormous impact on the shilling costs of import and service transactions, including payments of debts which have been accumulating over the years, and have involved substantial foreign exchange losses on arrears. In addition, the shift from controlled prices to market prices increased government expenditure substantially. On the revenue side, the freeing of prices, which increased the tax base enormously, the replacement of specific tax rates with ad valorem rates, the merging of various taxes, and efforts to collect tax arrears have contributed to a considerable increase in receipts.

The budget outcome for 1981/82 represents a substantial turnaround in fiscal performance; the overall deficit fell from 75 per cent of total expenditure in 1980/81 to 35 per cent in 1981/82. Despite weaknesses in tax administration and expenditure control, the various policies adopted under the 1981/82 financial program led to an increase in revenue of about 800 per cent, while the increase in expenditure, after allowing for some accumulation in domestic arrears, was about 230 per cent (Table 4). Revenue from all trade-related (internal and external) taxes increased sharply. Receipts from coffee duty rose from U Sh 0.1 billion to U Sh 6.7 billion. This reflected a variety of factors, including a new tax formula which effectively raised the duty to 100 per cent of coffee receipts after excluding specified payments; the increase in grants passing through the budget was attributable mainly to the depreciation of the shilling. The major factors contributing to the budgeted increase in expenditure were the depreciation of the shilling and the freeing of prices. The Government's decision to increase wage and salary rates by only 25 per cent was a significant factor in restraining expenditure. However, efforts to improve expenditure control were hindered by the lack of administrative capacity. Consequently, the overall budget deficit turned out to be about 50 per cent higher than in 1980/81. However, as a proportion of total expenditure, it declined from 75 per cent in 1980/81 to 35 per cent in 1981/82. Bank financing of the deficit was higher than in the previous year but the rate of increase during 1981/82 fell from 44 per cent in the first half of the year to 14 per cent in the second half.

The Government's strategy in 1982/83 is to strengthen budgetary discipline so as to contain the growth in expenditure while continuing to improve tax administration. The original budget estimate envisaged an increase in revenue of about 80 per cent, reflecting the continuing impact of the measures taken in 1981/82 and those taken in connection with the 1982/83 financial program, particularly the profits from the operation of the dual exchange market. It was estimated that the overall budget deficit would be about the same in absolute terms as in 1981/82 (U Sh 15 billion), of payments and GDP objectives. In addition to the quantitative ceilings, the monetary authorities raised lending rates for agriculture and for export and manufacturing by 1 percentage point to 15 per cent in June 1982. Rates for commerce and for unsecured loans which were 16 per cent and 17 per cent, respectively, were allowed to float up to a maximum of 20 per cent in November 1982. At the same time, in order to increase sales of Treasury bills to the non-bank public and raise the proportion of non-bank financing of the budget deficit, the rates on Treasury bills were raised by an average of 2.5 percentage points, to a maximum of 12 per cent.

Interest rates on deposits have not been increased since June 1982. In explaining their reluctance to raise deposit rates further, the Ugandan authorities argued that interest rate adjustments since June 1981 had brought the level of interest rates broadly in line with the rate of inflation (11 per cent) during the period July 1981 to end-June 1982. They added that, until certain institutional difficulties were resolved, increases in interest rates would not have a significant impact on savings mobilization. Although some commercial banks with branches in the rural areas had succeeded in mobilizing additional time and savings deposits, other banks were hesitant to expand their activities in those areas because of increased costs of administration, allowance for bad debts, and losses from fraudulent practices. The banks contended that the increase in costs would more than offset their profits from the use of the additional resources. In the circumstances, the authorities did not propose to raise interest rates further at this time, but would continue to encourage the banks to expand their mobile banking facilities. In the event of an excessive tightening of commercial bank liquidity, the Bank of Uganda will rediscount crop finance paper from the commercial banks.

The data for the third quarter of 1982 indicate that monetary and credit restraint measures have been successful. Domestic credit expanded by 9 per cent, compared with an increase of 30 per cent in the corresponding period in 1981. Nearly the entire increase went to the private sector, most of which was for crop-financing, trade and commerce, and manufacturing. Net foreign assets continued to decline, though not as sharply as in 1981, and broad money grew by only 6 per cent compared with an increase of 40 per cent in the corresponding period in 1981.

The monetary authorities said that considerable progress had been made in the updating and presentation of the Government accounts. This would enable them to monitor more closely credit to Government and avoid the repetition of the sudden drastic measures to curtail expenditure which had occurred in the second and third quarters of 1982. With respect to credit to the private sector, they anticipated a sharp increase in the second half of 1982 to finance the larger 1982/83 cotton crop and additional imports purchased through Window 2 and through the Second IDA Reconstruction Credit. They expected some progress in the removal of institutional obstacles to commercial bank lending. For example, the undertaking by the Coffee Marketing Board (CMB) to guarantee commercial banks' loans to the cooperatives should facilitate the flow of crop finance for the marketing of export crops. In the past, lending to industry has been impeded by the uncertainty regarding the ownership of companies, the need to revalue their assets to reflect the depreciation of the shilling, and the consequent lack of adequate collateral. The revaluation of companies assets to take account of the exchange rate float was proceeding slowly, while the Expropriated Properties Act should help to resolve the problem of ownership. These steps are expected to facilitate lending to the industrial sector. The measures recently taken to expand the operations at the second window together with the raising of the lending rates should result in an expansion in commercial bank credit for trade and commerce.

The Ugandan Government is also taking steps to increase the flow of financial resources into priority projects in accordance with the objectives of the Recovery Program. To that end, the share capital of the Uganda Development Bank has been increased and its role is being expanded to channel loans from the IBRD, EEC, ADB, the European Investment Bank, and other bilateral donors into the industrial and agricultural sectors. Although most of the external loans are allocated directly to specific projects,which are mainly determined by donors' preferences, the Government is trying to give priority to industries which use local raw materials as inputs. Such industries include the tannery at Jinja, the Hima cement factory, and edible oil factories.

## 6. Balance of payments

During the period between the international coffee price boom in 1977 and the implementation of the 1981/82 financial program, Uganda experienced a sharp deterioration in its balance of payments position. By 1980, the volume of exports had contracted to one-half of the level recorded in 1972, while the share of coffee in total exports nearly doubled over this period to 99 per cent. The chronic shortage of foreign exchange, which was further exacerbated by rising oil payments and a growing debt service burden, led to a sharp contraction in the volume of imports and to the accumulation of substantial arrears.

The action taken with regard to the exchange rate and producer and petroleum prices, in conjunction with other policy initiatives adopted in the context of the 1981/82 financial program, contributed significantly to easing Uganda's balance of payments pressures. Despite a decline in export prices of over 10 per cent, the value of exports rose by 38 per cent during the 12-month period ended June 1982 (Table 7). The financial program also facilitated the mobilization of additional external assistance. In particular, Uganda benefitted from an additional US$30 million balance high level since a substantial volume of committed funds has not yet been disbursed. These considerations suggest an average annual rate of import growth between 1981/82 and 1984/85 in the region of 14 per cent in nominal terms, or about 7 per cent in real terms (broadly in line with the anticipated growth in real income). The current account deficit should narrow considerably over the medium-term as domestically-generated resources from exports and invisible transactions gradually replace concessional loans as the major source of import financing (Chart 1). Assuming no further rescheduling of debt service payments, apart from that obtained within the framework of the Paris Club, the capital account surplus is projected to decline moderately, despite renewed inflows of private capital associated with the Expropriated Properties Act and other policies aimed at increasing foreign investment in Uganda. As a result of these developments, Uganda's overall balance of payments is expected to move into a small surplus position by 1984/85.

Foreign exchange restrictions exist on travel and all remittances except profit, dividend and interest payments. In addition, arrears remain outstanding on current transactions. These restrictions required Fund approval under Article VIII. Since the last consultation in 1979, Uganda has not introduced any new restrictions on payments or transfers for current international transactions. Existing restrictions were relaxed in August 1982 at the time of the introduction of the dual exchange market. The authorities have agreed to a schedule for the elimination of all outstanding arrears. The establishment of the dual exchange market involved a multiple currency practice, for which temporary approval was granted by the Executive Board in August 1982. Uganda maintains no bilateral payments agreements.

## IV. Performance Under Stand-By Arrangement

Uganda's performance under the 1981/82 program was analyzed in detail in EBS/82/125. With the exception of the budget, all the principal objectives of the program were realised and all the performance criteria were observed (Table 10).

On the basis of information for the first three months of the program period, the current program (1982/83) appears to be on track. The deficits in the government budget and in the external current account are now projected to be somewhat smaller than the original program estimates. All performance criteria applicable on September 30, 1982, other than the minimum amount of foreign exchange to be sold by the Bank of Uganda at the second window, were observed. Subsequently, the Executive Board approved a waiver of the performance criterion and modification of the sales requirement from a minimum of US$8 million for each four week period to a cumulative minimum of US$ 24 million to be sold before end-December 1982. 1/ Actual net domestic credit

1/ EBS/82/196 (10/22/82) and Supplement 1 (11/15/82).

Table 10. Uganda: Indicator of Performance Under the Program,

September 1981 - June 1983

| | 1981/82 | | 1982/83 | |
|---|---|---|---|---|
| | Program | Actual | Program | Current Estimate |
| | (Annual percentage changes) | | | |
| Real GDP | 9-10 | 10 | 10 | 10 |
| GDP deflator | 40 | 73 | 25 | 25 |
| | (In per cent of GDP) | | | |
| Government budget | | | | |
| Overall deficit | 2.6 | 3.2 | 2.3 | 2.0 |
| Domestic bank financing | 1.5 | 2.6 | 0.4 | 1.0 |
| | (In millions of U.S. dollars) | | | |
| Balance of payments | | | | |
| Current account deficit | 232.0 | 140.0 | 214.0 | 201.0 |
| Overall deficit | 142.0 | 100.0 | 35.0 | 34.0 |
| Debt service ratio (In per cent of inputs of goods and services) | 47.0 | 45.5 | 22.3 | 27.2 |

| | 1981/82 | | | | | | | | 1982/83 | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Sept. | | Dec. | | Mar. | | June | | Sept. | | Dec. | | Mar. | | June | |
| | Prog. | Act. | Prog. | Act. | Prog. | Act. | Prog. 1/ | Act. | Prog. | Act. | Prog | Act. | Prog | Act. | Prog. 1/ | Act. |
| | (In billions of U Sh) | | | | | | | | | | | | | | | |
| Ceiling on net domestic credit | 34.8 | 34.4 | | 40.8 | 46.9 | 43.5 | 51.6 | 48.2 | 57.9 | 52.5 | 62.6 | ... | 64.2 | ... | 65.5 | ... |
| Ceiling on net credit to Government 2/ | 27.2 | 25.9 | | 29.3 | 31.0 | 29.9 | 33.7 | 33.3 | 36.0 | 33.6 | 36.0 | ... | 38.0 | ... | 38.5 | ... |
| | (In millions of SDRs) | | | | | | | | | | | | | | | |
| Net external borrowing 3/ | | | | | | | | | | | | | | | | |
| 1-12 years maturities | 70.0 | ... | 70.0 | ... | 70.0 | -- | 80.0 | -- | 120.0 | -- | 120.0 | ... | 120.0 | ... | 150.0 | ... |
| 1-5 years maturities 4/ | 30.0 | ... | 30.0 | ... | 30.0 | -- | 30.0 | -- | 50.0 | -- | 50.0 | ... | 50.0 | ... | 60.0 | ... |
| Net reduction in arrears 5/ | 11.0 | 21.2 | ... | 21.1 | 1.0 | 4.3 | 3.0 | -20.2 | ... | ... | ... | ... | ... | ... | ... | ... |
| | (In millions of U.S. dollars) | | | | | | | | | | | | | | | |
| Net reduction in arrears 3/ | ... | ... | ... | ... | ... | ... | ... | ... | 5.5 7/ | 22.8 8/ | 11.0 7/ | ... | 12.0 9/ | ... | 15.0 9/ | ... |
| Sales at second window 3/ | ... | ... | ... | ... | ... | ... | ... | ... | 10.0 | 3.7 | 24.0 | ... | 53.0 | ... | 88.0 | ... |

Source: Data provided by the Ugandan authorities.

1/ Indicative ceilings.

2/ The ceiling for March 31, 1983 will be reduced (raised) by the excess (shortfall) of the cumulative gross deposits lodged by the private sector under the IDA credit arrangement in the project account of the Treasury over (under) U Sh 4.4 billion during the three quarters ending March 31, 1983, and will be reduced (raised) by 70 per cent of the excess (shortfall) of cumulative profits from the operation of the second window since July 1, 1982 above (below) the projected U Sh 5.2 billion. Similarly, the indicative ceiling for June 30, 1983 will be reduced (raised) by the excess (shortfall) of cumulative gross deposits lodged by the private sector over (under) U Sh 5.7 billion during the year ending June 30, 1983, and will be reduced (raised) by 70 per cent of the excess (shortfall) of the cumulative profits from the operation of the second window since July 1, 1982 above (below) the projected U Sh 8.5 billion.

3/ Cumulative.

4/ Of which no more than SDR 20 million of maturities within the range of one to five years will carry an interest rate equal to or in excess of LIBOR.

5/ Quarterly reduction through cash payments and rescheduling.

6/ Cumulative net reductions in arrears from July 1, 1982.

7/ Of which half through cash payments.

8/ Of which US$ 11.2 million through cash payments.

9/ Through cash payments only.