FOR AGENDA

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August 24, 1988

To: Members of the Executive Board

From: The Secretary

Subject: Uganda - Policy Framework Paper, 1988/89-1990/91

Attached for consideration by the Executive Directors is the policy framework paper under the structural adjustment facility for Uganda, which will be brought to the agenda for discussion on a date to be announced.

Mr. Keyes (ext. 7888) or Mr. Taha (ext. 8751) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

UGANDA

Policy Framework Paper, 1988/89-1990/91 1/

Prepared by the Ugandan authorities in collaboration
with the staffs of the Fund and the World Bank

August 23, 1988

I. Introduction

1. This is the second policy framework paper (PFP) prepared by the Government of Uganda in collaboration with the staffs of the International Monetary Fund and the World Bank. It updates and extends the policy framework paper for 1987/88-1989/90 issued in May 1987, which contained a description of the historical events and economic developments leading up to the authorities' 1987/88 program. This PFP reviews the progress made during 1987/88 and outlines the Government's objectives and program for the period 1988/89-1990/91.

2. Since early 1986 Uganda has been engaged in a major effort of political stabilization, resettlement of citizens and provision of relief, reconstruction, and economic recovery, following 15 years of continuing political repression and civil war. During 1986 the authorities' efforts necessarily focused on the immediate tasks of restoring peace and providing essential services and relief to those districts devastated by war. In May 1987, the authorities began to implement a comprehensive economic rehabilitation and adjustment program, with the support of the International Monetary Fund, the World Bank, and other donors. A wide range of economic policies was initiated over a broad spectrum aimed at stabilizing the economy and achieving economic recovery.

3. Reflecting these reforms, an improved internal security situation, and greater inflows of donor assistance, industrial and agricultural production showed a respectable increase during the program's first year. Preliminary estimates indicate a 3 percent real GDP growth rate in 1987, as a result of output growth picking up momentum in the second half of the calendar year. Road transportation has improved measurably, and construction activity increased visibly. However, due in part to larger than programmed credit expansion to both the Government and private sector, inflationary pressures were more severe than anticipated, and the balance of payments failed to improve to the extent originally envisaged. Consequently, Uganda fell short of achieving the broad range of economic and financial objectives that had been set out under the

1/ Uganda's fiscal year runs from July 1-June 30.

economic recovery program. The Government recognizes the need for regular review and, where necessary, timely adjustment of the macroeconomic environment with a view to achieving the stabilization and recovery objectives. The present paper outlines the policies and measures the Government intends to implement to achieve these objectives.

II. Program Objectives and Performance

4. The objective of the Government's economic and financial program for 1987/88 that was supported by the Fund's SAF arrangement and the Bank's Economic Recovery Credit (ERC) included significant improvements in the rate of economic growth, price stability, and movement toward external viability. The annual growth rate of real GDP was to rise to 5 percent from the 2 percent achieved during 1982/83-1985/86, so as to allow a 2 percent rise in real GDP per capita. The average monthly rate of inflation was to decrease from the 12 percent experienced in 1986 to about 2.2 percent, reflecting a substantial slowing of monetary expansion and improved supplies of domestic and imported goods. The current account balance was expected to widen from a deficit equivalent to 1.5 percent of GDP in 1986/87 to about 4 percent, reflecting importantly an increased supply of imports financed through much higher levels of concessional external assistance. The overall balance of payments, however, was to strengthen as a result of a recovery in export volumes, the stepping up of production in efficient import-substitution industries, and the restructuring of external debt. Accordingly, by end-June 1988 the bulk of all external arrears was to be cleared, while gross reserves were to rise to US$55 million and net foreign liabilities of the Bank of Uganda were to decline to US$166 million.

5. The Government also undertook to make a census of the civil service, with the eventual aim of reducing government employment; to adopt various reforms to improve tax administration and collection, and strengthen the budgetary formulation and control system; and to initiate significant reforms of the parastatal sector, including the divestiture of expropriated properties through sales or return to the original owners. The Government was also to avoid incurring any new external arrears and to limit external nonconcessional borrowing to US$3 million, with the exception of short-term trade credits and refinancing of external debt in the context of debt rescheduling. In addition, it agreed to monitor and adjust the exchange rate periodically in the light of economic developments and to review and adjust interest rates at end-1987 in the light of inflationary expectations at that time.

6. These macroeconomic policies were supported by important supply-side policies. In the agricultural sector, the Government's program called for the review of producer prices for export crops twice a year, in consultation with the World Bank based on an agreed methodology; allowing cotton producers' cooperatives to sell directly to textile mills; reducing the interest of the Lint Marketing Board in the oil and

soap industry to a minority position; and ensuring the free movement of foodcrops among districts. In the industrial sector, the Government was committed to maintaining a liberal pricing policy except in a few areas where acute shortages existed. An Open General Licensing (OGL) system was to be initiated, covering essential imports for priority sectors, to ensure higher efficiency in foreign exchange allocation. This was to be supported by a Special Credit Facility to facilitate local cover to economically viable firms. Also, revisions were to be made in the Industrial Licensing Act to encourage investment. To improve public resource budgeting and management, actions were to be taken with World Bank support to strengthen the Government's procurement capability, its financial management system, and the Ministry of Finance's monitoring capacity of parastatal finances. Agreement was reached with the Bank on the size and composition of the public investment program for the 1987/88 fiscal year, and a commitment was made for the preparation of a three-year program. Finally, the Government's program called for the completion of a public enterprise restructuring plan; substantial progress in the verification and valuation of expropriated properties; setting up a Public Industrial Enterprise Secretariat; and preparation of a Uganda Development Corporation (UDC) restructuring plan.

7. In mid-May 1987, before the SAF and ERC were finalized, the Government of Uganda embarked on a bold program of policy reform. The Uganda shilling was devalued by 77 percent in foreign currency terms to U Sh 60 per U.S. dollar, in the context of a currency reform in which all outstanding currency and bank deposits were converted into new shillings at a rate of 100 old shillings equal 1 new shilling, along with payment of a 30 percent conversion tax designed to reduce the monetary base. Producer prices for agricultural commodities were substantially increased, with the coffee price rising from the equivalent of U Sh 8.5 per kg to U Sh 24 per kg. In addition, prices of petroleum products were substantially increased.

8. During 1987/88 progress was achieved in attaining some of the specific objectives for that year, and in moving toward the longer-term goals of the three-year economic rehabilitation and recovery program. Real GDP was estimated to have risen by 3 percent in 1987, reflecting recovery of output in the agricultural and manufacturing sectors. Further output increases were anticipated for the first half of 1988, as new inflows of foreign exchange for raw materials helped increase capacity utilization at many leading industrial establishments. This resurgence was supported by a number of factors, including the return of internal security, and improvements in the distribution and transport systems; the initial incentive effects of the May 1987 adjustments in exchange rates and agricultural producer prices; and improved crop financing in the coffee subsector, and efforts by the Coffee Marketing Board to ensure that coffee farmers received timely cash payments for their produce.

9. Notwithstanding the progress made to date, serious difficulties have been encountered in the area of macroeconomic management that have threatened the sustainability of the recovery effort. Continuing high inflation caused a serious overvaluation of the exchange rate. The balance of payments also proved weaker than anticipated, because export performance fell short of expectations, and the external debt service was also underestimated. During the second half of 1987, the principal consumer price index rose by 92 percent, and increases for the early months of 1988 were averaging about twice the planned 2.2 percent monthly rate of increase. Fueling the increase was a doubling of the broad money supply during the second half of 1987, resulting from sales of government securities by the nonbank sector to the Bank of Uganda in June and July, and large increases both in private sector credit and in net credit to government. The large increase in private sector credit reflected a significant expansion of crop finance, resulting from efforts to maximize coffee purchases, and major increases in trade and other commercial credit. During this period interest rates for virtually all loans and deposits remained negative in real terms, while reserve requirements and other instruments for controlling credit expansion remained unchanged.

10. The 1987/88 budget was to aim at reducing outstanding bank credit to government by U Sh 1.9 billion, which was equivalent to about 0.9 percent of originally projected GDP. The original budget was modified in August and again in January 1988 when it became clear that this target could not be reached without expenditure cuts and further revenue measures. During 1987/88, budgetary performance fell considerably short of the programmed objectives. By end-January 1988, when the costs of the currency conversion exercise and payments for external debt service had been charged to Government, net bank credit to Government had increased by U Sh 9 billion, as against an anticipated reduction of some U Sh 1.0 billion. A variety of factors contributed to this development. On the external sector, these included:

(i) Delays in the receipt of anticipated external support for program implementation, which severely constrained the foreign exchange budget for July-December 1987. Although the program was launched in mid-May, external assistance in any measurable size became available only in October and the imports so financed did not arrive in the country until several months later.

(ii) Revenue from coffee sales was significantly lower than expected due to the reintroduction of International Coffee Organization (ICO) quotas at relatively low levels for Uganda and the failure of world market prices to react positively to the new quotas.

(iii) Tensions between Uganda and Kenya in December 1987 led to a temporary border closure between the two countries. This delayed shipments which forced the authorities to look for alternative export routes. The resulting accumulation of export stocks led to a worsening in the crop finance credit situation, the accumulation of imports, especially raw materials, at the ports of entry meant a delay in industrial output and therefore a substantial rise in prices.

(iv) Debt service to multilateral institutions and the repayment of suppliers' credit proved to be larger than originally projected.

11. The internal factors included:

(i) Insurgency in the North and East which forced the Government to shift resources to defense and security.

(ii) Hosting of the Preferential Trade Area (PTA) summit in December 1987. This put very heavy pressure on the Government's budget beyond the level of anticipated expenditure.

12. To ease the problems encountered in meeting the pressing external obligations, the Bank of Uganda engaged in sizable forward sales of coffee and increased its external arrears. This shortfall was subsequently made up, and disbursements of official loans and grants over the entire year exceeded earlier projections, covering the shortfall in debt relief relative to the initial program forecast. Nonetheless, the program's budgetary targets continued to be exceeded during the second half of the year due to a failure to fully adjust expenditures to shortfalls in revenue. External payments arrears increased by about US$35 million compared with the targeted settlement of virtually all of the June 1987 stock. Gross reserves were projected to rise to US$35 million by June 1988, rather than US$55 million, and net official reserves thus improved by less than the targeted amount. Reflecting the shortage in foreign exchange and the large increase in consumer prices, the official exchange rate came under intense pressure, and the rate in the parallel (illegal) market depreciated sharply.

13. In November 1987, the Government introduced an OGL system that initially covered seven priority industries, with the intention of broadening the system gradually. By early 1988, a number of manufacturing firms in these subsectors, selected on the basis of some predetermined criteria, were receiving foreign exchange under the OGL system. The Government has reviewed the producer prices for cash crops on the basis of agreed methodology and announced a set of new prices in January-February 1988. Considerable success has been achieved in restoring essential services to devastated districts, and work is underway on a number of rehabilitation projects, including road surfacing. Progress has been made toward the verification and valuation of expropriated industries, and the Government has decided on the list of parastatals to be privatized or liquidated. Measures have been taken to ensure the free movement of foodcrops between districts and to allow cooperatives to sell lint directly to textile mills. A new public investment program has been prepared for the period 1988/89-1990/91.

14. In summary, after a year of implementation, despite the progress made in many areas, the emerging macroeconomic imbalances have threatened the success of the recovery program. The problems that have been encountered are partly attributable to external factors that were beyond the Government's control, but implementation difficulties within the Government have also contributed to the outcome. Also, with hindsight, the speed at which stabilization and recovery could be achieved was overestimated. Some of the problems have proven to be more intractable than originally anticipated. It is clearer now that the achievement of stabilization and recovery objectives will take longer and need stronger effort. It will require more timely and coordinated support from the donor community. The present program, which addresses the issues to be tackled in key policy areas, is drawn on the basis of the experience gained from the first year of program implementation. On the basis of this exercise, exchange rate, monetary and fiscal policies will be coordinated more closely and implementation and monitoring mechanisms strengthened.

III. The Medium-Term Macroeconomic Framework

15. As in the first PFP, the Government's principal economic objectives over the period 1988/89-1990/91 are to achieve a rapid overall economic recovery, attain a viable balance of payments position, set the basis for sustained economic development through diversification of exports, increase capacity utilization, and promote efficient import-substitution activities. To this end, the Government aims to: (i) restore the economic and social infrastructure; (ii) sustain annual GDP growth at 5 percent, thereby allowing income per capita to rise by 2 percent per year; (iii) reduce the annual inflation rate to about 30 percent by the end of the program period; (iv) improve the efficiency of the public sector; (v) restrain the fiscal deficit to 3 percent of GDP by the end of the period; and (vi) accumulate a sufficient level of reserves.

16. However, achieving these objectives will be an arduous process, particularly given the need to pursue rehabilitation and investment activities in the context of economic stabilization and a severe shortage of foreign exchange. Progress will depend crucially on timely availability of local and foreign resources, and the timely implementation of policy measures by the Government.

17. The Government's GDP growth target of 4-5 percent reflects an agricultural growth rate slightly above 5 percent, an industrial growth rate of over 10 percent, and rates of growth slightly below 5 percent for other sectors. To sustain the pace of economic recovery, investment will need to rise further relative to GDP by the end of the period, driven largely by a strong recovery in infrastructure and private investment. The current account balance (excluding official transfers) would drop slightly from 8.8 percent of GDP in 1988/89 to about 6.6 percent by 1990/91. On the whole, the balance of payments would be

strengthened by a continued recovery in the volume of traditional exports (especially tea and cotton), expansion in the export base, and the restructuring of foreign debt.

IV. The Policy Framework

18. To achieve the economic objectives of the program, the Government's strategy in the short run is to restore quickly economic stability by reducing financial imbalances and inflationary pressures, and to implement supply-side measures designed to increase output. This will necessitate the implementation of fiscal, monetary, and external policies in close coordination with sector-specific policies. Price stability will be restored through increases in supply and limits on credit and monetary expansion. Consistent with this objective, the Government will adopt a budgetary policy that ensures an improvement in the overall fiscal position and its net indebtedness to the banking system. In addition to improvements in infrastructure, the marketing system, and the timely availability of agricultural inputs, producer incentives will be improved through appropriate exchange rate and pricing policies, which can contribute both to increased growth and to a widening of the export base. Capacity utilization in industrial and agro-processing units will be raised by increasing the level and improving the procedures for the allocation of foreign exchange to purchase essential inputs. In the medium to long run, institutional improvements, particularly in public sector management, coupled with appropriate macroeconomic and sector policies, will lay the foundation for long-term sustained growth.

a. Macroeconomic policies

External policies

19. As the rapid inflation of recent months has eroded the competitiveness of the Uganda shilling that was achieved by the initial May 1987 devaluation, the exchange rate was depreciated by 60 percent on July 1, 1988, to bring it to more realistic levels, as well as to create incentives for the production of exports. The same considerations will guide exchange rate policy during the program period. The Government will keep the exchange rate under review in light of program objectives and economic developments, including the effect on production in agriculture and industry, balancing of the budget, inflation, and social welfare. In light of such review, the Government will take appropriate action at least on a quarterly basis.

20. The Government intends to further improve the functioning of the OGL system, so that foreign exchange allocations can be made expeditiously for all eligible transactions. To accomplish this, administrative procedures for the processing of applications under the OGL system would be streamlined to the maximum extent feasible. The continuing scarcity of foreign exchange largely dictates the volume of imports

processed under the OGL, and it therefore covers only certain priority industries and certain types of imported goods. However, as the foreign exchange scarcity eases, the coverage of the OGL will be expanded to include additional sectors and goods. This expansion will begin early in 1988/89. Subsequently, the OGL system will be reviewed on at least a semi-annual basis, with the aim of extending its coverage gradually to include more industrial and agricultural inputs, basic necessities, and incentive goods by the end of June 1991.

21. The implementation of the program will require a larger and more regular inflow of external assistance. This would help ease the burden of adjustment. The Government will liaise very closely with the donor community to ensure that there will be a timely disbursement of available resources. In view of the very heavy claims on Uganda's own foreign exchange earnings for external debt service, essential imports, and oil payments, special efforts will be required to expand the range of imports that could be financed through external assistance. While continuing to place highest priority on the rehabilitation of the economy and social infrastructure, the Government will also seek where possible to direct external assistance toward the essential recurrent imports. To derive the maximum possible benefit from Uganda's still-recovering export capacity, efficiency of the export marketing system will be increased, and barter arrangements will be appraised with particular reference to the implications of coffee barter sales to markets which are subject to ICO quotas.

22. The resolution of Uganda's external payments arrears continues to be a difficult problem, necessitating special consideration from external creditors and donors. The Government intends to make progress as rapidly as possible in eliminating the outstanding external payments arrears and will seek to reschedule as much of the remaining arrears as possible during 1988/89. It intends to settle the remainder during 1989/90, if feasible. Recognizing the difficulty of exchange rate management with a low level of foreign exchange reserves, the Government intends by the end of the 1988/89-1990/91 program period to accumulate reserves equivalent to nearly two months' imports. During 1988/89, the Government will endeavor to increase reserves by US$20 million to US$55 million (4 weeks of imports). To establish a more manageable time profile of debt service obligations, the Government will consider seeking a rescheduling of obligations falling due to bilateral creditors during 1988/89. Furthermore, it will restrain the growth of debt service obligations over the medium term. To this end, the Government will place strict limits on the contracting or guaranteeing of new non-concessional borrowing, with the exception of loans with a maturity of less than one year and debt contracted in the context of rescheduling.

Fiscal policies

23. The Government recognizes that a reduction in the fiscal deficit is of key importance if the current financial imbalances are to be minimized and inflationary pressures reduced. The goal of reducing

domestic credit to Government during the first year of the program was not attained, in part for reasons beyond the Government's control. In the coming years, the Government is committed to reduce substantially its reliance on the domestic banking system.

24. Structural fiscal adjustment in Uganda can only be achieved with comprehensive measures that will require time to take effect. As a consequence, the Government, while working to widen the tax base and improve tax administration, will continue to rely heavily on a relatively narrow base of commodities for the bulk of its revenue. The export tax on coffee, in particular, will remain a principal source of revenue over the foreseeable future, and adjustments in the exchange rate and in producer prices will take this into account. The taxation of beer, cigarettes, and soft drinks also remains an important component of revenue. To supplement these revenue sources and the existing import levies, during 1987/88 customs duties and sales taxes were re-imposed on sugar, which will also provide some protection for the revitalized domestic sugar industry. However, a comprehensive review of customs tariffs and the domestic tax system is needed to assess the scope for broadening the tax base and rationalizing the existing tax structure. The Government will appoint a team of tax experts to conduct this review, which will be completed in time for its recommendations to be incorporated in the budget for 1989/90.

25. The Government recognizes that the present scale of government expenditure is too great for Uganda's current revenue capacity. Consequently, important reductions in the scope of government activity must be made to bring expenditure in line with available revenues. In the context of the 1988/89 budget, the Government has taken action to improve budget formulation, strengthen tax administration and revenue effort, reduce current expenditure, and tighten expenditure control and monitoring. Budget formulation has been improved through an earlier start to the budget process, stricter reviews of expenditure requests, and better accounting of externally financed development expenditure. In addition, the Government has computerized its budgetary information to improve the monitoring of revenue and expenditure. Tax administration has been strengthened through the preparation of a data base on major taxpayers, improved transport facilities for tax collection units, and training programs for tax officers. In the area of new tax measures, deposits required against corporate income taxes were increased by 400 percent, while the scope of the commercial transactions levy was broadened, fees for licenses and road permits were raised, commission on imports increased and petroleum revenues boosted. Specific measures taken to reduce expenditures in the context of the 1988/89 budget include a 30 percent reduction in casual workers, disengaging the Ministries of Agriculture and Animal Industry from the operation and distribution of a range of agricultural and veterinary items, establishing a Central Supplies Directorate to curb excessive decentralization of government purchases, curbing both internal and external travel by government employees, and restricting purchase of new vehicles, office furniture, equipment, and cutting back on the

construction of new houses by Government, the renovation of office buildings, and on purchases of certain materials and supplies.

Measures to strengthen expenditure control and monitoring include limiting expenditures to the ceilings mandated by revenue yields; computerizing data on expenditure releases and the Finance Ministry's payroll operators; and strengthening the Economic Analysis Unit (EAU) in order to prepare monthly reports on the budget and other economic indicators for the use of the new ministerial-level Economic Monitoring Committee.

26. The success of structural fiscal measures will depend on the implementation capacities of the Government, which in turn will depend on the strength of its administrative system. Measures to improve tax administration, strengthen the budgeting and expenditure control system, and provide adequate and timely fiscal reporting are therefore crucial in this context. The Government will continue to build upon the improvements already made in the budgeting process, in order to execute more fully the role of the Ministry of Finance in ensuring that the budget represents the minimum amount of expenditure necessary to achieve the Government's policy goals. Increased use of computerized data systems will enable the Government to monitor budgetary developments more closely during the fiscal year and discern at an earlier stage potential problem areas. Given the Government's macroeconomic goals, the overall level of expenditure will have to be based on accurate revenue forecasting and monitoring. The Ministry of Finance will report monthly on trends in revenue and update the fiscal year forecasts in an objective fashion. This, in turn, will allow spending to be adjusted in line with the overall deficit targets if revenues fall short of the budgeted amounts. The timeliness and quality of the existing database will be improved and fiscal data will be coordinated with the monetary statistics to provide a basis for consistency checks.

27. The effectiveness of tax administration would improve considerably if information on taxpayers were to be exchanged among tax departments. The Government is, therefore, instituting an automated system of information exchange among the income tax, customs and excise, and inland revenue departments, to be completed by the end of 1989. Information on all imports made by taxpayers will be exchanged among departments, and a common taxpayer identification number will be introduced.

28. The establishment and maintenance of fiscal discipline require action in a number of areas simultaneously. These include budgetary reform, establishment of a well-functioning procurement system, civil service reform, and, to an extent, public enterprise reform. These issues need to be addressed in a broad framework and in the context of programs covering several years. Steps have already been taken or will be taken during the 1988/89 fiscal year to initiate action in these areas. The longer-term issues mentioned are discussed under the heading of Public Sector Institutional Issues.

Monetary and credit policies

29. The Government is committed to pursuing monetary and credit policies that will augment net foreign assets and reduce domestic inflation while achieving real gains in per capita income. This requires an active effort to monitor and regulate the increase in total domestic credit so as to bring the rate of monetary expansion in line with the targeted increases in nominal gross domestic product. Besides the policies undertaken to restrain credit to government and the specific measures to improve monetary monitoring, the Bank of Uganda will complete a review of the existing instruments of monetary and credit control and will examine alternative credit control measures by end-December 1988. For 1988/89, it is envisaged that monetary expansion will fall to less than 70 percent, as against an estimated 234 percent in 1987/88, and thereafter will fall progressively to some 30 percent by 1990/91. Despite the provision for an increase in foreign exchange reserves in 1988/89, a strong increase in private sector credit is programmed, facilitated by an improvement in the Government's credit position.

30. Domestic resources for investment must come from the mobilization of private savings, as well as the government budget. This requires an extensive and efficient banking infrastructure as well as interest rates which encourage savings, and attract funds into the banking system. Plans are underway to expand the commercial banking network, but, as a first step, the Government has increased with effect from July 1, 1988, the structure of interest rates by 10 percentage points, and will subsequently keep these rates under review with the objective of encouraging savings and improving efficiency in credit allocation.

31. In view of the large variance in loan-to-deposit ratios among the various banks and the large increase in private sector credit, the Government is undertaking a study of the commercial banking system to assess the adequacy of existing provisions for bank supervision and regulation. This study is scheduled to be completed early in 1989, with the aim of establishing new supervisory and regulatory procedures by end-June 1989. Other aspects of the commercial banking system that need to be addressed are the adequacy of the capital base, and the accounting and managerial procedures.

32. In addition to the problems in crop financing already discussed, the provision of crop finance to producers of export crops remains problematic. The Government will intensify and broaden its program for strengthening the financing accountability and management of cooperative unions, a large number of which remain noncreditworthy. Also, as a background for establishing a comprehensive institutional and policy framework for agricultural credit operations, the Government will prepare an Agricultural Credit Strategy Paper in 1988/89. At the same time, the Government will review the onlending activities of the Coffee

Marketing Board (CMB), to ensure that these are consistent both with overall credit targets and with a rationalization of credit to the agricultural sector.

Program monitoring

33. The experience gained in implementing the economic reform program in 1987/88 indicates that the prevention and timely correction of slippages requires reinforcement of the Government's capacity for economic policy formulation and management. To this end, a monitoring committee composed of the Ministries of Finance and Planning and the Bank of Uganda will be instituted immediately to review developments on a monthly basis and recommend any necessary corrective actions. The EAU in the Ministry of Finance which is being strengthened will act as the Secretariat of the monitoring committee.

34. In addition to the work of the EAU, the Government has established a donor coordination unit in the Ministry of Planning. This unit will provide the Minister of Planning with the latest available information on the receipt and use of foreign assistance in Uganda. It will coordinate with the EAU and the budget monitoring units in the Ministry of Finance in tracking development expenditure. It will also serve as a clearinghouse for donors regarding existing development projects and assist in coordinating information on the public investment programs.

b. Sector policies

Agricultural sector

35. Economic recovery is heavily dependent on the reactivation of the agricultural sector which contributes about 75 percent of GDP and nearly all export revenue. For nearly two decades this sector's production has suffered from civil war, economic disorganization, and the breakdown of infrastructure. Consequently, programs and policies for economic recovery and growth have to be sensitive to their impact on the agricultural supply response and its sustainability. The Government's sectoral objectives focus on achieving self-sufficiency in food, and increasing and diversifying the production and processing of export commodities. The Government also emphasizes the creation of sufficient employment opportunities in agriculture and the welfare of the rural population. The most immediate constraints on the achievement of these objectives have been the lack of foreign exchange to support importation of agricultural inputs as well as spares and equipment for agroprocessing, the lack of transport to move produce to market and crops to processing facilities, marketing inefficiencies, and the high rate of inflation which eroded producer incentives. The first year program implementation reversed previous years' negative growth rates in agricultural sector output with a concentration of growth in marketed production of coffee and foodcrops.

36. In the short to medium term prospects for growth are mainly concentrated in the traditional export subsector, import substitution of sugar, and to some extent in selected nontraditional foodcrop exports. In turn, maintaining producer incentives at adequate levels and securing access by producers and processors to foreign exchange, improvements in road infrastructure, transport, and power supply are the main elements to sustain and broaden the supply response in the traditional export subsector. Net foreign exchange earnings from coffee sales may be increased by processors and the Coffee Marketing Board (CMB) upgrading product quality and improving marketing procedures. The strategy is to establish adequate systems for quality control; rationalize the distribution of hulling capacity to reduce processing costs; introduce methods for CMB coffee sales which capture higher prices, including the sale of arabica coffee through tendering and the limited use of advance sales; increase the transparency and efficiency of CMB's marketing operations; and restore financial viability and managerial efficiency to cooperative unions.

37. Substantial progress can be made in the near to medium term toward restoring tea production to historical levels. The strategy emphasizes adequate incentives for outgrowers to rehabilitate abandoned tea gardens and use yield-improving inputs, strengthening support services to outgrowers, and assignment of titles to expropriated and abandoned tea estates. As with coffee, upgrading of product quality will increase export earnings and support industrial growth. In cotton, the strategy to reverse the declining production trend focuses on maintaining producer incentives, reducing marketing and processing costs, and the provision of inputs. Measures to financially rehabilitate cooperative unions, re-establish their creditworthiness, and pay farmers on time are given high priority. Sugar production is now ready to expand, as the major sugar-producing complexes resume operations following rehabilitation. To support such expansion the Government will ensure that the foreign exchange required to sustain operations is made available.

38. Agricultural sector growth in the longer term is dependent on the expansion of foodcrop production for domestic consumption and the diversification of exports. Given international prices and production costs, the opportunities for profitable exports in selected vegetables, oilseeds, and pulses are limited. The Government will strengthen agricultural support services, including research, extension, seed supply and credit; and increase the availability of agricultural inputs with a view to increasing yields, reducing unit costs, and expanding areas under cultivation. The strategy also promotes efficient domestic and export marketing through participation by the private sector including cooperatives.

39. To support the above strategies, the Government intends to implement a series of policy actions addressing producer pricing, marketing reform, access to foreign exchange (including through an expanded OGL), availability of credit, and rehabilitation of infrastructure. In the area of producer pricing, the Government is committed

to maintaining adequate incentives to producers and will continue to make regular adjustments. Pricing decisions will be based on the methodology that was adopted in 1987, and incorporates the relevant parameters for market efficiency. Consideration will be given to the effect of producer prices on credit levels and the budget. There will be no export tax on tea, cotton, and tobacco. The Government will consult with the World Bank prior to finalizing its pricing decisions, which will take place twice a year. While the Government is committed to pursuing the above pricing policy, it intends to target price interventions to selected inputs, such as veterinary drugs, in order to offset the possible short-term adverse impact of the exchange rate adjustment on production. The Government intends to remove such temporary interventions once price incentives become more effective through improvements in marketing and supporting infrastructure.

40. In the area of marketing reform the Government has started to implement policies and institutional reforms during the past year aiming at increasing efficiency in processing and marketing. These efforts will be intensified and broadened to give maximum support to an enhanced supply response. In the coffee subsector, a program will be implemented to: rationalize national hullery capacity and control expansion in areas where overcapacity exists; streamline procedures for sale of arabica coffee through tendering, and develop marketing strategies for capturing higher export prices based on quality premia and market price differentials; formalize participation by cooperative unions and the private processors in CMB's operations; rationalize operations and improve management and financial control of cooperative unions; and review the Bank of Uganda's system for monitoring export sales and foreign exchange receipts with a view to strengthening it if necessary. Plans to implement the above agenda will be finalized by December 1988 and the implementation will take place in 1989.

41. The Government will take steps to formalize its policy of liberalized export marketing of tea to enhance export revenues and competition. Steps will also be taken to gradually liberalize domestic marketing of sugar and phase out its involvement in sugar distribution as the supply situation improves. In the cotton processing and marketing, actions will focus on preparing and implementing a program for efficient capacity utilization in ginning with concomitant financial restructuring of cooperative unions. In the domestic and export marketing of foodcrops, policy actions will reinforce measures already initiated to remove restrictions on participation by the private sector and cooperatives. It also intends to review and decide on the role, scale, and appropriate structure of the Produce Marketing Board. Similarly, the Government will take steps to promote collection and processing of milk by farmers' cooperatives. The role of the Dairy Corporation within such a strategy will be defined. A timetable will be developed with the Government before end-1988 for implementation of these actions.

2. Industrial sector

42. The Government's industrial sector strategy over the short run is to increase capacity utilization in efficient subsectors, mainly by raising the availability of imported inputs. Despite some improvement in the previous year, a large segment of the manufacturing sector still operates below 20 percent of capacity. With an increased supply of well-targeted inputs and minor rehabilitation, capacity could be expanded rapidly in selected industries. Increased industrial output will play a key role in price stabilization by supplying consumer goods to satisfy unmet demand.

43. The Government will continue its policy of permitting domestic prices to be freely determined in the market. At present, price controls apply to a small number of products. Pricing decisions on these products are subject to approval of the Ministries of Finance, Industry, and Commerce. As part of this program, the Government intends to gradually remove price controls during the program period, as the supply constraints ease. Currently both the system of industrial licensing and the foreign investment legislation are under review, with a view to simplify and shortening approval procedures, in order to encourage both domestic and foreign investors. The Government will finalize the ongoing work in these areas by the end of 1988/89.

44. As discussed in the first PFP, the Government is concerned about the possibility that some economically viable firms may not have access to short-term credit for the local cover for imports and working capital. Under the World Bank's Economic Recovery Credit it was recognized that a number of firms that possess plant, machinery, and competent management may not meet the normal lending criteria of commercial banks because of short-term cash-flow constraints. To meet such specific demands, a Special Credit Facility (SCF) was proposed, to allow the sharing of the risk of default between the banks and a fund established for this purpose. In view of continuing concerns about this issue, the Government, in consultation with the World Bank and the Fund, initiated the preparation of the SCF in June 1988, with a view to finalizing the arrangements before end-1988.

45. Over the medium to long term, industrial recovery and growth will play an important role in strengthening the balance of payments through efficient import substitution and export diversification. To develop Uganda's industrial potential, the program aims to reduce critical constraints facing the sector, which, in addition to foreign exchange scarcity, include: deteriorated transport and energy infrastructure; lack of management and technical skills, and in some instances unsuitable technology; and limited availability of credit in strategic areas.

46. The Government will initiate measures to reduce the skill gap by developing programs to train personnel in key areas during the program period. In addition, where appropriate, the Government will encourage

the use of management and technology contracts for public and private sector firms as a way of improving efficiency and rebuilding local skill capabilities.

47. The Government regards the private sector as an important contributor to industrial growth. The Government plans to adopt policies which can further encourage a dynamic private sector, while at the same time pursuing a divestiture program, including the resolution of the ownership of previously expropriated properties. The Government intends to develop a comprehensive industrial strategy and accompanying policies designed to increase confidence. It is recognized that the small size and limited savings of the private sector may constrain its participation in the proposed divestiture program. The Government, therefore, will review the need for credit to support divestiture objectives, and seek support from the donor community for credit to facilitate private sector buyouts or equity participation in designated public sector enterprises.

48. The manufacturing sector has the potential to expand capacity utilization for export as well as for domestic markets, especially for manufactured food products and textiles. The Government intends, during the program period, to design a medium- to long-term strategy to promote and diversify exports.

Transportation

49. Uganda faces major challenges in the transportation sector. The success of the recovery program will depend to a great extent on how rapidly and efficiently these challenges are met and the existing bottlenecks removed. As a landlocked country, Uganda has to secure adequate international transport services for its exports and imports. The Government will continue its efforts to develop a system of reliable, least-cost services by redirecting long-haul bulky transport to the railways and developing alternative routes, with due consideration for the related costs. On domestic transportation, efforts will focus on the collection and forwarding of major cash crops, the movement of staple foods from farm to market, and the reverse flow of essential agricultural inputs, fuel, and consumer goods.

50. To improve the transportation system, the Government will continue and intensify its efforts in road reconstruction, restoration of the capability to manage highway and rural road maintenance programs, and will study the feasibility of a road construction and maintenance authority. Steps will be taken to create a healthy and self-financing railway system, and the Government will continue international consultations to facilitate border traffic. The Government will encourage the private sector to increase the stock of trucks and other vehicles. Better maintenance of vehicles and equipment in all sectors will be encouraged by providing imports of spares regularly, so as to reduce foreign exchange requirements for new vehicle imports.

51. To establish a sustainable system of road maintenance and to ease its financial burden on the budget, the Government will continue to encourage the local authorities to utilize labor and other local resources for maintenance and construction of rural roads. In order to enable municipalities to effectively perform tasks related to transport services, the Government will specify the revenue local authorities will be allowed to collect under conditions of improved financial management. These actions will be completed before mid-1989.

Energy sector

52. The Government's objective is to minimize costs and maximize economic efficiency in petroleum consumption, for which Uganda relies entirely on imports. The Government continues to examine the least cost, most practical supply options, and will maintain a petroleum pricing strategy that, without ruling out cross subsidization, reflects landed and distribution costs plus a duty element to mobilize government revenue. In the longer term, the prospects for finding and developing indigenous petroleum resources need to be explored. To this end, the Government will evaluate and decide on applications for oil exploration rights.

53. Uganda is favored with a strong natural resource base, including potentially renewable biomass energy sources and hydropower. In developing its power subsector investment program, the Government will explore alternatives to meet demand at least cost consistent with environmental and other constraints. To improve forest resource management the Government will introduce higher royalty rates for extraction of forest products, beginning in 1989. The Government has embarked on a study to design improvements in electricity consumer billing and collection, as well as tariff changes. A program based on this study will be developed and implemented by end-1988. Planning studies have already been initiated to review policy and physical interventions that will lead to greater efficiency in woody biomass fuel use and reduced natural resource degradation.

Public sector investment program

54. The Government expects to continue with the practice of preparing three-year rolling public investment programs. The most recent program covers the 1988/89-1990/91 period. This program will be reviewed and updated by the Government to cover 1989/90-1991/92 in coordination with the World Bank, by early 1989. To facilitate the restoration of the productive capacity and the provision of basic social services, the public sector investment program will continue to give priority to the rehabilitation and reconstruction needs of the economic and social infrastructure.

55. The Government will improve the coordination between the public investment program and the Development Budget. The Government recognizes that all development projects should be included in the

public investment program, whether they are domestically or externally financed. While working toward this objective, the Government intends to hold the incidence of local capital outlays in the Development Budget not contained in the public investment program to a minimum. Also, the link between the public investment program and the budget, including both recurrent and development expenditure, will be better coordinated to ensure that the objectives, strategies, and multiyear perspectives developed in the plan are accurately translated into an annual program of action in the form of budget allocations. The next review of the public investment program will ensure that these concerns are incorporated into the design.

Public sector institutional issues

56. The public sector in Uganda has been weakened by years of political instability and economic decline. This has had a particularly serious impact on the core economic agencies with primary responsibility for the design and implementation of economic reform programs. The restoration of the Government's administrative and management capacity will entail a sustained long-term effort. The Government's objectives are to: restore discipline, accountability, and efficiency; improve public sector resource mobilization and allocation; improve the information systems; and restore effective expenditure planning and control. Efforts that have already been made toward achieving these objectives need to be strengthened.

57. Support for the Ministry of Planning and Economic Development has been provided under a UNDP project. An Agricultural Secretariat has been set up in the Bank of Uganda to address agricultural policy issues, and a statistical rehabilitation program has been started with World Bank support. In addition, the Government plans to improve the capacity of the Ministry of Finance for policy formulation and implementation. A major component of the program will restore the computerized government accounting system and develop a financial information system to control expenditures, monitor external debt, and meet information needs of the revenue-generating departments. The program, which will be supported by the World Bank, also aims at rationalizing the Government's procurement functions by curbing the excessive decentralization of procurement in order to lower costs and increase efficiency.

Bugetary reform

58. The system of expenditure planning as a whole, and the budget process in particular, needs to be reviewed and substantially strengthened from an institutional perspective. There are a number of weaknesses in the budget process including expenditure patterns not fully consistent with declared priorities, inadequate control of the personnel budget, and the lack of coordination among elements of the budget. It is essential that the key ministries and other relevant agencies work in close coordination in preparing and implementing the budget. Procedures will be developed to ensure such coordination among

the central agencies of the Government. Attention will be paid to capacity building in the Budget Division of the Ministry of Finance through comprehensive and focused training programs, and installing data processing mechanisms. Parallel to these efforts in budget formulation, expenditure monitoring capabilities will be strengthened and expanded. Also, the procedures for initiating and finalizing the budgetary process at the center will be spelled out and restructured. Furthermore, the Government decided to establish for parastatal enterprises an audit corporation for monitoring their financial activities.

59. A budgetary reform program will be developed during 1988/89 for implementation over a three-year period. Under the program, the units in the spending ministries responsible for the preparation of the budget proposals will be strengthened, and procedures for the preparation of prioritized expenditure plans based on clearly stated objectives established. Links between capital and recurrent costs will be clearly articulated. Support for the Government's budgetary reform exercise will be provided under the proposed World Bank Technical Assistance project.

Civil service reform

60. One of the most difficult challenges facing the Government is the urgent need to rehabilitate the civil service in Uganda. In recent years, employment has grown rapidly, particularly in the area of group employees; basic salaries have declined rapidly in real terms; complementary inputs are unavailable; and work discipline has suffered. These difficulties are exacerbated by the scarcity of skilled personnel in key government offices, coupled with organizational shortcomings. All these factors affect the efficiency and output of the civil service, particularly at a time when the Government is trying to implement a recovery program and a number of major projects.

61. The Government will continue its efforts to improve the performance and efficiency of the civil service in the context of a reform program. Elements of this reform program include efforts to: gradually streamline the civil service to an affordable and sustainable size; raise remuneration of civil servants to levels that would provide sufficient material incentive and attract required skills; provide workers with the necessary complementary inputs; and re-establish financial and personnel management systems and related controls.

62. The Government has already made a start in determining the functional and staffing requirements of a number of key ministries under a Bank-sponsored technical assistance project. The review will subsequently be extended to the entire civil service, and will lead to the identification of staffing and training programs. The Government undertook a comprehensive civil service census in July 1987, to determine the exact size and composition of the civil service. The census results will be used to address both short- and longer-term reform issues.

63. Until the studies are completed, the Government intends to follow a restrained recruitment policy, concentrating on areas where shortages exist. The Government also intends to reduce the number of temporary staff and group employees. To this end, the Government will prepare by end-1988: (i) a proposal for streamlining and controlling the recruitment of group employees; and (ii) a plan of action for reducing the number of existing group employees over a three-year period. The plan of action will include specific numerical targets for each year of the reduction exercise.

64. The compensation package of civil servants contains a number of benefits and allowances that are not readily quantifiable, which makes it difficult to identify accurately the true cost of the civil service and to establish an effective salary and remuneration system. The Government plans to address this issue by determining the present real value, and incidence, of salaries, allowances and fringe benefits. An action program to address this problem will, where feasible, involve a merging of some benefits into salaries. Support for this exercise will be provided under the proposed World Bank Technical Assistance project.

Public enterprise reform

65. The rehabilitation of a large number of public enterprises will be instrumental in sustaining economic recovery, since the physical and managerial environment of parastatals remains deficient after long-term neglect. The Government has already begun a program of divestiture and rehabilitation for industrial parastatals. The Government recognizes, however, that a comprehensive approach is required to improve the efficiency and performance of the entire public enterprise sector. Accordingly, in addition to the program already underway in the industrial enterprises, the Government will identify the most important parastatals for diagnostic study. The studies, when completed, will provide a framework for action in the areas of performance improvement planning, investments in physical rehabilitation, skill training and other human resource development, short- to medium-term management contracts, and embracing where appropriate restructuring and divestiture.

66. It is not only the efficiency or viability of individual enterprises that is of concern to the Government, but the absence of well-defined administrative procedures and the capacity to monitor and evaluate the performance of the public enterprise sector. Therefore, the Government will develop a comprehensive reform program for the public enterprise sector, identifying appropriate institutional arrangements and procedures for effectively fulfilling its ownership function. In parallel, the Government is taking measures to improve its administrative capacity for the financial monitoring of parastatals, through strengthening the Statutory Corporation Division in the Ministry of Finance.

67. The Government is continuing its program of public industrial enterprise divestiture and rehabilitation through the establishment of the Public Industrial Enterprise Secretariat (PIES) to administer this program, and the strengthening of the capacity of the Uganda Development Corporation to rehabilitate the enterprises to be retained in its portfolio. The Government is reviewing the long-term role of UDC and the institutional arrangements for industrial enterprise administration in the Ministry of Industry as part of its intended review of required arrangements for administration of the entire public enterprise sector. The World Bank will provide support to the Government in its effort to restructure the public enterprise sector through the proposed Public Enterprise Sector project.

VI. Social Impact of the Program

68. On balance, the stabilization and economic rehabilitation program is expected to improve the overall economic well-being in Uganda. As stabilization measures begin to take effect, there would be a decrease in inflation, which would reduce the erosion of purchasing power for low-income groups and those on fixed incomes. Adjustments in exchange and interest rates, combined with greater price stability, would reduce speculative activities that generally tend to benefit disproportionally those in middle- and high-income groups. An improved economic climate, the enlarged inflow of foreign exchange, and policies designed to stimulate a supply response in the economy would permit a rise in per capita consumption of about 2 percent annually during the program period.

69. The Government's policy of maintaining the real level of agricultural producer prices for domestic and export markets will substantially benefit the rural sector, especially smallholders. The urban sector, however, may take longer to benefit fully from the program's implementation. Under the program the Government is making a concerted effort to improve the provision of basic social services, particularly in primary health, education, water, and low-income housing. These measures will help to improve urban standards of living over the medium term.

70. The Government is considering ways to assist disadvantaged groups that may be adversely affected by the stabilization measures or that may benefit only slowly from economic reconstruction. With World Bank assistance, the Government is considering a two-pronged approach that would include: (i) support under the UNDP-financed and World Bank-executed Social Dimensions of Adjustment Project, designed to assist the Government in strengthening the data base necessary to define target groups more precisely; and (ii) developing a set of interventions in areas such as health, education, and low-cost housing, to assist groups adversely affected during the adjustment period. The criteria for project selection would include interventions that have a strong poverty focus and high economic and social returns, can be easily and speedily implemented, and that avoid creating unsustainable recurrent cost

commitments. Interventions that meet these criteria would then be packaged into an action program during 1988/89 to be submitted to interested donors.

VII. External Financing Requirements

71. External assistance will continue to play an important part in the Government's program of economic recovery and rehabilitation. In the first year of the program, official grant disbursements rose substantially, as many donors increased the size of their assistance and, in keeping with Uganda's limited debt-servicing capacity, shifted more from loans to grants. Project-related loan disbursements nevertheless roughly maintained the level of the previous year, and these were supplemented by quick-disbursing credits from IDA and some bilateral donors, which were used mainly to finance imports of industrial raw materials and spare parts, and agricultural inputs and implements. Support was also provided by a comprehensive rescheduling of Uganda's external arrears and 1987/88 obligations under the auspices of the Paris Club, as well as the use of Fund credit.

72. Nevertheless, as noted earlier, delays in the disbursement of external financial assistance became a major problem, as most quick-disbursing assistance did not materialize until the second half of the fiscal year. In fact, some will not be available until the next fiscal year.

73. The Government aims to achieve a viable balance of payments position by 1991/92 in the context of growth-oriented adjustment. However, Uganda will continue to require exceptional external financial support during the three-year period covered by this program. In this context, two scenarios entailing differing levels of external assistance for the period 1989/90-1991/92 have been considered. In the first scenario, which was used in formulating the economic program, it was assumed that donors would increase the levels of grant and loan disbursements significantly in 1988/89, in line with their expressed intentions or in their planning documents. However, in 1989/90-1990/91, and after taking into account expected disbursements as well as possible loans from the IMF Structural Adjustment Facility, a financing gap remains that will need to be covered by further debt rescheduling and additional aid disbursements.

74. In the short to medium term, Uganda's limited export capacity and heavy debt service burden will continue to pose a problem. Export diversification is expected to yield significant benefits only toward the end of the three-year program period. Therefore, in 1988/89 coffee is still expected to account for 94 percent of export revenue, and the current outlook for world market prices and ICO quotas does not suggest that coffee receipts will recover fully from the 1987/88 downturn. Meanwhile, the rate of nominal import growth considered necessary to sustain the economic recovery effort is estimated at 10.7 percent in

1988/89 and 6.5 percent in the following two years. With respect to debt service, while interest obligations should decline somewhat in 1988/89, amortization obligations on medium- and long-term public debt will remain high, and total debt service (excluding arrears) is expected to be about 50 percent of receipts from exports of goods and nonfactor services. In addition, external payments arrears on the order of US$150 million also remain to be eliminated. The Government believes that improved foreign exchange management calls for an increase in international reserves over time, and intends to accumulate US$20 million of additional reserves in 1988/89.

75. Taking all these factors into account, Uganda's external financing requirement for 1988/89 is projected at about US$675 million, including the outstanding level of non-Fund external payments arrears. Some US$480 million of this would be met through projected disbursements of grants and credits, including the proposed ERC II from IDA. Of the remaining external financing requirement of about US$195 million, a second-year disbursement under the IMF Structural Adjustment Facility would provide about US$40 million. It is estimated that about US$35 million of debt relief could be obtained from bilateral creditors. Thus, about US$120 million of external arrears will likely remain outstanding at the end of 1988/89. A critical assumption in this outlook has been a further significant increase in quick-disbursing official grants and loans, as described below. The Government will seek to confirm these increases, and to avoid a recurrence of the delays and shortfalls experienced during the previous year. It will also seek additional assistance that might enable it to obtain a further reserve accumulation and reduction in external arrears. The latter result would require that such assistance be in the form of cash grants or of quick-disbursing aid that could be used flexibly to meet a wide variety of import requirements. It should be emphasized that the Bank of Uganda's cash-flow situation is extremely tight, with the maximum displacement of cash imports by donor assistance already taken into account for 1988/89. Thus, any unexpected shortfalls in inflows or demands on foreign exchange will, of necessity, result in a failure to meet targets for external arrears, reserves and short-term borrowing.

76. Of the disbursements expected in 1988/89, about US$185 million would be official grants. Nearly US$70 million of this would be grants for import support, currently anticipated from Canada, Denmark, the European Communities, Germany, Japan, Norway, Spain, Sweden, the United Kingdom, and the United States, which corresponds to a rise of about US$35 million from the previous fiscal year. Other (mainly project-related) grants are also assumed to rise by about US$45 million, to US$115 million, with major donors expected to include Austria, Denmark, the European Communities, Germany, Italy, Japan, the United Kingdom, the United States, and the United Nations (UNICEF, UNDP, and World Food Program). New loan and credit disbursements in 1988/89 are projected to total about US$300 million (including amounts received as compensation for East African Community assets). IDA and the African Development Bank account for US$220 million of this total, of which

about US$100 million would be provided as program lending.

77. In order to achieve a nominal growth rate of imports of 6.5 percent per annum after 1988/89, implying that in real terms imports grow at the same rate as GDP and in order to make cash settlement of the remaining external payments arrears and accumulating gross international reserves equivalent to nearly seven weeks' imports by June 1991, Uganda would face an external financing requirement of about US$1.1 billion in 1989/90-1990/91. Some US$780 million of this could reasonably be expected to be met through normal disbursements of loans and grants, on the assumption that nonproject assistance from sources other than the World Bank would decline sharply from the levels expected to be reached in 1988/89. However, this would leave a financing gap of US$320 million over the two-year period, of which only about US$60 million could be met through a third-year disbursement under the IMF Structural Adjustment Facility and additional debt relief from bilateral creditors on conventional terms. Thus, roughly US$260 million would remain to be sought. The Government would hope to obtain the bulk of this amount through additional official grants, hopefully with a substantial nonproject component. To the extent additional resources could be obtained in 1988/89 in a form that was suitable to achieving an earlier reserve accumulation and elimination of external arrears, the financing gap for 1989/90 and beyond could be correspondingly smaller.

78. The Government has been encouraged by the results of discussions between the World Bank staff and various donors under the auspices of the Bank's Special Program of Assistance for debt-distressed low-income countries in sub-Saharan Africa. It hopes that resources can be provided through this initiative to meet the remaining financing gaps for 1989/90-1990/91, and for later years, on terms and in forms that are consistent with Uganda's requirements for import financing and meeting its external obligations.

Table 1. Uganda: Selected Economic and Financial Indicators, 1984/85–1987/88

	1984/85 Actual	1985/86 Actual	1986/87 Prel.	1987/88 Prog.	1987/88 Proj.	1988/89 Prog.	1989/90 Prog.	1990/1991 Prog.
				(Annual percent changes, unless otherwise specified)				
National income and prices								
GDP at constant prices	-3	-1	1	5	5	5	5	5
Consumer prices (annual average)	100	129	256	91	188	123	57	36
Consumer prices (year-end over year-end)	158	153	237	30	239	60	45	30
External sector (on the basis of U.S. dollars)								
Exports, f.o.b.	1	-1	1	13	-21	13	13	14
Imports, c.i.f.	6	-3	30	12	22	11	6	6
Non-oil imports, c.i.f.	14	1	26	17	21	14	8	8
Export volume (coffee) 1/	-18	20	-12	17	15	-5	7	3
Import volume (nonoil)	19	-12	18	8	14	7	3	3
Terms of trade (deterioration -)	11	2	-11	-10	-24	7	—	2
Nominal effective exchange rate (depreciation -)	-40	-46	-43	...	—	-72	...	...
Real effective exchange rate (depreciation -)	-15	-6	-79	...	282	-60	...	...
Government budget 2/								
Revenue and grants	74	97	192	264	368	172	113	43
Revenue	74	76	206	236 3/	350 3/	143 3/	147	58
Total expenditure	108	97	142	185	281	118	65	37
Money and credit 4/								
Domestic credit	145	67	107	9	199	26	—	-16
Government	73	31	68	-17	85	-7	...	...
Private sector	72	36	39	26	114	33	...	...
Money and quasi-money (M2)	139	148	95	40	336	68	50	33
Velocity (GDP relative to M2)	10	9	16	16	17	14	14	14
Interest rate (annual rate, one-year savings deposit)	22	35	35	35	28	...	...	...
				(In percent of GDP) 5/				
Central government budget deficit (-) 6/7/	-5.2	-4.5	-3.7	-4.5	-3.7	-1.3	0.4	1.3
Domestic bank financing	4.0	1.9	2.4	-0.9	2.2	0.1	-0.3	-0.2
Foreign financing (net)	0.7	1.4	1.1	5.9 8/	2.8	3.6	2.2	1.5
Current account deficit (-) or surplus								
Including official transfers	-0.5	1.1	-1.0	-3.8	-4.0	-4.5	-4.7	-4.4
Excluding official transfers	-3.0	—	-1.6	-5.2	-6.0	-9.0	-8.0	-6.9
				(In percent of exports of goods and nonfactor services)				
Current account deficit or surplus (-)								
Including official transfers	-4	8	-20	-31	-63	-51	-51	-46
Excluding official transfers	-19	—	-30	-42	-96	-102	-87	-72
External debt, including arrears								
Including use of Fund credit	293	308	326	305	480	457	425	376
Excluding use of Fund credit	222	243	263	265	413	405	385	349
Debt service ratio 9/								
Including the Fund	47	52	54	42 9/	54	48	36	27
Excluding the Fund	24	22	27	9 9/	22	25	20	18
				(In millions of U.S. dollars)				
Overall balance of payments surplus or deficit (-)	55	24	-71	23	-93	36	-35 10/	74 10/
External payments arrears (at end of period)	55	74	113	20	150	120	60	—
Gross reserves (end of period)	63	64	31	55	35	55	75	95

Sources: Data provided by the Ugandan authorities; and staff estimates.

1/ Based on shipments.
2/ Fiscal year (July–June). For 1988/89, based on budget estimates.
3/ Excluding currency reform levy.
4/ In percent of money stock at the beginning of the period.
5/ The following ratios should be treated with caution owing to the tentative nature of the GDP estimates.
6/ On a commitment basis.
7/ Includes grants.
8/ Including programmed figure for debt relief.
9/ After rescheduling; for 1988/89–1990/91, assumes rescheduling with bilateral creditors on same terms as 1987/88.
10/ Assuming that financing gaps are met through supplementary loans.

Table 2. Uganda: External Financing Requirements

(In millions of US dollars)

	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92
		Estimated			Projected		
Current account balance							
(before official transfers)	—	-122	-312	-375	-362	-346	-359
Amortization	-76	-90	-77	-72	-64	-59	-50
Coffee advance sales	10	-32	30	—	-33	—	—
Change in arrears	20	39	37	-30	-60	-60	--
Change in gross reserves	-1	33	-4	-20	-20	-20	-20
IMF repurchases	-84	-81	-78	-64	-48	-35	-33
Other reserve items (net)	-7	2	-9	5	—	—	—
Total financing requirement	-139	-251	-415	-555	-586	-520	-462
Disbursements: existing commitments	148	251	342	289	173	111	67
Project/commercial loans	88	125	132	136	95	67	51
of which: IDA projects	(—)	(63)	(65)	(66)	(47)	(34)	(26)
IDA program loans	—	—	49	39	...	...	...
Kenya compensation	29	28	19	20	...	...	...
IMF purchases/SAF loans	—	57	34	...	...	...	...
Official grants	31	40	108	94	78	44	16
Disbursements: new commitments	...	...	—	192	249	247	305
Project/commercial loans	...	...	—	40	62	84	115
of which: IDA projects	...	...	(—)	(23)	(34)	(47)	(77)
IDA program loans	...	...	...	25	115	60	36
Other program loans	...	...	...	36	—	16	34
Official grants	...	...	...	91	72	87	121
Total lending/grants	148	251	342	481	422	358	373
Short-term + private capital	-9	—	-31	—	—	—	—
Total external financing	139	251	310	481	422	358	373
Gap	—	—	105	74	164	162	89
IMF SAF loans	...	...	...	39	18	—	--
Rescheduling	—	—	105	33	23	20	—
Debt cancellation	—	—	—	—	—	—	--
Residual gap	—	—	—	1	123	142	89

Source: World Bank and IMF staff estimates; data provided by the Ugandan authorities.

Table 3. Uganda: Summary and Timetable of Policy Actions
Under the Structural Adjustment Facility, 1988/89-1990/91

Issues/Objectives and Policies	Actions	Timing
A. Macroeconomic Policies		
a. External policies		
Adopt exchange rate policy that maintains international price competitiveness, provides incentives for production and exports, and contributes to budgetary objectives	Adjust exchange rate prior to beginning of program to restore price competitiveness/ export incentives. Subsequently, review and adjust as necessary in light of program objectives and economic developments, to avoid any appreciation in the real effective exchange rate.	At least quarterly throughout program period.
Improve functioning and expand coverage of the OGL system	1. Review implementation of OGL in order to streamline administrative procedures	Throughout the program period
	2. Expand coverage of goods and sectors over time to include agricultural and all industrial inputs, basic necessities, and incentive goods	Review semiannually; to attain coverage as indicated by end-June 1991
Barter policy	Review all barter arrangements, particularly coffee	End-1988
Reduce debt service obligations to sustainable levels	1. Clear all outstanding arrears, through rescheduling and cash payments	End-June 1990
	2. Limit the contracting or guaranteeing new nonconcessional borrowing, except for import financing with maturity of less than one year, and debt contracted as part of rescheduling	Throughout the program period
b. Fiscal policies		
Reduce the fiscal deficit and government indebtedness to the banking system	Improve revenue effort and restrain expenditure. Continue adjusting retail prices of petroleum and other goods subject to taxation to allow current revenue levels to be maintained.	1988/89 and throughout the program period
Broaden revenue base and rationalize tax structure	Carry out comprehensive review of tax and tariff system to assess scope for broadening tax base and rationalizing tax structure	To be completed in time for 1989/90 budget
Strengthen expenditure control and budget administration	1. Include all development projects in the development budget. Minimize incidence of local capital outlays not contained in the public investment program. Centralize procurement through establishment of Central Purchasing Unit.	July 1988
	2. Restore computerized government accounting system and develop a financial information system to control expenditure	End-1989

Table 3. Uganda: Summary and Timetable of Policy Actions
Under the Structural Adjustment Facility, 1988/89-1990/91 (continued)

Issues/Objectives and Policies	Actions	Timing
c. Monetary and credit policies		
Strengthen credit control mechanisms	1. Bank of Uganda to review credit control measures and explore alternative instruments	By end-1988
	2. Active monitoring of monetary and credit developments and policy actions to achieve programmed credit targets	June 1988
Interest rate policy	Raise interest rates across-the-board by 10 percentage points	June 1988
	Review interest rates periodically in the light of inflationary developments	Throughout the program period
Improve supervision and regulation of commercial banks	Review the adequacy of existing provisions for bank supervision and regulation	Early 1989 with the aim of establishing new procedures by end-June 1989
Improve provision of agricultural credit	1. Initiate a program to strengthen financial accountability and management of cooperative unions	1988/89
	2. Prepare an Agricultural Credit Strategy Paper	1988/89
	3. Review onlending activities of Coffee Marketing Board to ensure consistency with credit targets and agricultural credit strategy	1988/89
d. Program monitoring		
Reinforce government capacity for economic policy formulation and management	1. Establish a Monitoring Committee, with representation from the Ministries of Finance and Planning and the Bank of Uganda, to review economic developments monthly and to recommend timely corrective actions.	July 1988
	2. Economic Analysis Unit in the Ministry of Finance will be strengthened and will serve as Secretariat to Monitoring Committee, preparing monthly reports on economic developments	July 1988
Improve donor co-ordination	Strengthen coordination unit in the Ministry of Planning to provide information on foreign assistance, help track development expenditure, and serve as information clearing house for donors	July 1988

Table 3. Uganda: Summary and Timetable of Policy Actions
Under the Structural Adjustment Facility, 1988/89-1990/91 (continued)

Issues/Objectives and Policies	Actions	Timing
B. Sector Policies		
a. Agriculture		
Maintain adequate producer incentives for export crops	Regularly adjust producer prices in consultation with the World Bank in accordance with agreed methodology	Twice yearly beginning with 1988/89 season
Increase marketing and processing efficiency in the coffee sector	Prepare and implement a plan to: (i) rationalize and control expansion of hullery capacity; (ii) enable export marketing to capture price differentials between markets and qualities of Ugandan coffee; (iii) formalize participation by cooperative unions and private processors in the operations of CMB; (iv) financialy rehabilitate cooperative unions, rationalize operations, and improve managment; and (v) review, and, if necessary, strengthen Bank of Uganda's system for monitoring export sales of coffee and foreign exchange receipts.	Finalize plan before December 1988 and begin implementation during 1988
Liberalize export marketing of tea to reduce costs and maximize export value	Take appropriate steps to formalize elimination of the Uganda Tea Authority's export monopoly	During 1988/89
Liberalize sugar marketing as the supply situation improves	Gradually eliminate the role of Food and Beverages, Limited in domestic sugar distribution	During 1988/89
Increase efficiency in processing and marketing of cotton	Prepare and implement a ginnery rationalization program including financial restructuring of cooperative unions	Finalize plan before end-1988
Liberalize export marketing in food crops	Remove restrictions on private and cooperative unions in domestic and export marketing; review and decide on appropriate role and organization of PMB	During 1988/89
Develop an efficient milk marketing system	Prepare and implement a plan to provide collection and processing of milk by farmers cooperatives; define the role of the Dairy Corporation.	Finalize plan before end-1988
b. Industry		
Expand access to foreign exchange for viable firms through the OGL system	Expand OGL after review of subsectors and firms to be included, based on economic viability, contribution to value added, and capacity	During 1988/89
Reduce the number of items subject to price controls as the supply constraints ease	Review the existing positive list of price-controlled items and gradually reduce their number	During 1988/89
Strengthen management capabilities	Develop with World Bank assistance a program for strengthening the management capacity of private and public sector enterprises	June 1989

Table 3. Uganda: Summary and Timetable of Policy Actions
Under the Structural Adjustment Facility, 1988/89-1990/91 (continued)

	Issues/Objectives and Policies	Actions	Timing
	Improve approval procedures for domestic and foreign investment.	Finalize the changes in the system of industrial licensing and prepare foreign investment legislation.	During 1988/89
	Improve ability of viable firms to import goods under the OGL system	In consultation with the World Bank and IMF, take steps to launch the Special Credit Facility	During 1988/89
	Improve efficiency in the provision of industrial credit	With World Bank assistance, strengthen the administrative capacity and management systems of UDB, UCB, and other financial intermediaries	Throughout the program period
	Encourage manufacturing exports	Prepare an export policy framework and action plan	During the program
c.	Transportation		
	Continue to develop a system of reliable, least-cost services	1. Intensify efforts in road construction and maintenance as well as for creation of a healthy and self-financing railway system	During 1988/889
		2. Study the feasibility of a road construction and maintenance authority	During 1988/89
		3. Continue international consultations to facilitate border traffic	Throughout the program period
	Improve the system of rural road maintenance	1. Encourage the role of local administration in rural road maintenance.	Throughout the program period
		2. Specify the revenues local authorities will be allowed to collect.	Mid-1989
d.	Energy		
	Maintain a petroleum pricing policy to reflect landed and distribution costs plus a duty element without ruling out cross subsidization	Continue to adjust petroleum prices to reflect world market prices and the exchange rate	Throughout the program period
	Increase revenues from forest products	Introduce higher royalty rates for extraction of forest products	Beginning in 1988/89
	Increase electricity tariffs and improve billing and collection	Based on the ongoing study, develop and implement a program of tariff changes and measures to strengthen billing and collection	End-1988
e.	Public sector investment program		
	Prepare and implement a program consistent with resource availabilities and program objectives	1. Continue with the practice of preparing rolling public investment programs with improved coverage	Throughout the program period
		2. Adopt appropriate public investment program for 1989/90-1991/92 in consultation with the World Bank	Early 1989

Table 3. Uganda: Summary and Timetable of Policy Actions
Under the Structural Adjustment Facility, 1988/89-1990/91 (continued)

Issues/Objectives and Policies	Actions	Timing
C. Public Sector Institutional Issues		
a. Budgetary reform		
Improve and strengthen the budget process	Develop with World Bank support a budgetary reform program for implementation over a three-year period	During 1988/89
b. Civil service reform		
Improve the efficiency of the civil service and gradually streamline it to an affordable and sustainable size	1. Extend the ongoing review of functional and staffing requirements to all ministries	Throughout the program period
	2. Follow a restrained recruitment policy, concentrating on areas where critical shortages exist	July 1988
Reduce the number of temporary staff and group employees	1. Prepare a proposal for streamlining and controlling the recruitment of group employees	End-1988
	2. Prepare a plan of action for reducing the number of existing group employees over a three-year period, including a 30 percent reduction during 1988/89	End-1988
Rationalize the wage bill	Determine the present real value, and incidence of salaries, allowances, and fringe benefits. Develop an action program to adhere the issue of establishing an effective salary and remuneration system	June 1988
c. Public enterprise reform		
Encourage divestiture and promote efficiency in retained parastatals	1. Continue the program of divestiture and rehabilitation including the establishment of the Public Industrial Enterprise Secretariat to administer the programs, and strengthen UDC's capacity to rehabilitate retained parastatals	Throughout the program period
	2. Carry out diagnostic studies for key parastatals, identifying restructuring, investment, skill, and management needs	Throughout the program period.