FOR AGENDA

EBS/87/107

CONFIDENTIAL

May 21, 1987

To: Members of the Executive Board

From: The Secretary

Subject: Uganda - Medium-Term Economic and Financial Policy Framework

Attached for consideration of the Executive Directors is a policy framework paper for Uganda which will be brought to the agenda for discussion on a date to be announced.

The Executive Directors of the World Bank will discuss this paper in Committee of the Whole on Thursday, May 21, 1987.

Mr. Artus (ext. 7676) or Mr. Greene (ext. 6518) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

UGANDA

Medium-Term Economic and Financial Policy Framework, 1987/88-1989/90

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

May 20, 1987

I. Background

1. Uganda is a country endowed with substantial human and natural resources, including ample fertile land, but whose economy has been devastated by war, political and economic mismanagement, and the lack of internal peace and security of life and property. Prior to 1972 the Ugandan economy experienced rapid economic growth of over 5 percent. Its export base was diversified, including cotton, coffee, tea, tobacco, and copper. The industrial sector provided the basic essential commodities for the local population, including sugar, hoes, beverages, tobacco, soap, textiles, blankets, leather, cement, matches, and steel products. Many of these products were exported to neighboring countries.

2. The devastation of the Ugandan economy began during 1971-79. In 1972, the declaration of the Economic War and the subsequent intensification of the brutal and murderous reign of terror started off the wave of decline. The expulsion of the Asians and the subsequent distribution of their businesses to persons without any technical or management experience led to a dislocation of the commercial and industrial sectors. This dislocation destroyed the country's tax revenue base, resulting in huge budget deficits financed by bank credit. Despite a rapid inflation, the official exchange rate was kept practically fixed and agricultural producer prices were increased only marginally. Corruption became rampant at all levels of the public sector, and the brutality of the Government and its army resulted in widespread insecurity. The result was a cumulative decline in real GDP of about 20 percent between 1972 and 1978. The war in 1979 to overthrow the regime led to further destruction and decline in the economy. Whole towns were destroyed, and many enterprises were looted.

3. The Government that came to power in 1981, following an interim two-year administration, formulated a medium-term Recovery and Rehabilitation Program covering fiscal years (July-June) 1981/82-1983/84. This program was supported by considerable donor assistance, including three reconstruction credits from the World Bank and three successive one-year stand-by arrangements from the Fund. A dual

exchange rate auction system was introduced in August 1982 and unified in June 1984. Most prices were decontrolled. Those few that remained controlled, notably producer prices for export crops and petroleum prices, were periodically adjusted. Tighter credit policies were implemented, and some upward adjustment of interest rates was undertaken. As cash crop output began to recover, real monetary GDP grew at an average annual rate of 6 percent during the three-year period 1981/82-1983/84. The rate of inflation declined sharply, from an annual rate of about 100 percent in 1980 to 30 percent over the first half of 1984, and the balance of payments improved.

4. The economic recovery remained incomplete, however, owing to persistent structural problems in the industrial sector and with regard to the budget. Even by 1983/84, industrial output was still well below the levels of the early 1970s, with most remaining plants operating at about 20 percent of installed capacity. Little progress was made in solving the problems resulting from an ineffective tax structure and administration, weak expenditure controls, and an underpaid and demoralized civil service. Corruption and indiscipline among political and military leaders increased, and the Government faced a growing and sustained political and military opposition. As a result of activities by the army, large areas of the country, such as the Luwero Triangle and the West Nile, were laid waste, with massive displacement of the people and disruption of economic activity.

5. During 1983/84 and the first half of 1984/85, the fragility of the Recovery Program was exposed, as increased political instability and the intensification of the civil war led to an unraveling of the adjustment effort. In early 1984, financial policies deviated significantly from the adjustment program, and the stand-by arrangement with the Fund became inoperative. Subsequently, budgetary discipline deteriorated, as military expenditure grew rapidly and the limited progress made in controlling other expenditure on goods and services was reversed. After the military coup of July 1985 the economic situation worsened rapidly. As the National Resistance Army (NRA) moved toward Kampala, the authorities lost control of much of the coffee-producing areas. Faced with declining foreign exchange earnings, the authorities restricted the allocation of foreign exchange for general imports and then virtually stopped it. Without access to imports of inputs and spare parts, most of the industrial sector came to a halt.

6. The economic situation inherited by the NRM, following its takeover of Kampala in late January 1986 and the end of the civil war in early April 1986, was extremely difficult. There was a critical transport bottleneck, as large numbers of trucks were destroyed or stolen by the withdrawing former Uganda forces. The communications network, roads, railways, and telephone services were in a terrible state of disrepair. Manufacturing plants were either closed or operating at very low rates of capacity utilization. Utilities such as power and water supply had severely deteriorated. The Luwero Triangle, once among the richest areas, was nothing more than a wasteland, with

most of its inhabitants either dead or displaced, and all infrastructure destroyed. At the end of 1985, official foreign exchange reserves were only US$24 million, equivalent to about three weeks of 1985/86 imports of goods and services, and net foreign reserves were negative to the amount of US$254 million. Taking into account the debt to the Fund, the total debt service scheduled for 1986 was equivalent to one half of the 1984/85 exports of goods and services. Moreover, at end-1985, the stock of external arrears on medium- and long-term debt amounted to an additional US$63 million.

7. During 1986 the broad-based Government established by the NRM took major steps to initiate the vast effort needed to re-establish peace and security and rehabilitate the economy. The Government has introduced disciplined and committed management of public affairs both in the security field and in the general administration of the country. The security situation has improved, and prospects for increased production in the economy are bright. Despite limited foreign aid, the Government's emergency relief and rehabilitation program has helped to revive economic activities in the devastated districts, and by now most of the returnees are already growing their own food, even though the most basic necessities of life, such as lodging and water, remain inadequate. Transportation remains to be improved. Although some trucks have been ordered by the Government and some roads repaired, on the whole, major gaps remain in these areas. The lack of foreign exchange has been a major constraint, as the Government has had to use one half of its limited foreign exchange earnings to import fuels and basic essential commodities and the other half to honor its repayment obligations to the Fund and other international organizations. At the end of 1986, Uganda remained current on these obligations. However, external arrears on medium- and long-term debt to other creditors had risen to US$80 million.

8. Throughout 1986, inflation was very high. Owing to lack of transportation, food crops could not easily reach the urban centers. For the same reason, the country could not take full advantage of the high coffee export price. Output also remained constrained by the lack of infrastructure and imported inputs and spare parts, while monetization of the budgetary deficit led to a doubling of the broad money supply (M2). During the first half of 1986, the Government operated on a vote on account. The budget for 1986/87, announced at the end of August 1986, provided for a deficit of U Sh 424 billion (5.9 percent of GDP) on a commitment basis and including grants, with most of its financing expected to come from the banking sector. By December 1986, the 12-month (December to December) inflation rate reached 296 percent. After a brief return to a dual exchange market between June and August 1986, the exchange rate was unified in late August at U Sh 1,400 per U.S. dollar, the level prevailing at the end of 1985. It should be noted that in practice, even during the brief period of return to a dual exchange rate, virtually all the purchases, since they were of essential nature, were at the rate of U Sh 1,400 per U.S. dollar.

9. When the new Government took power in early 1986, work was started to prepare a rehabilitation and development program. This program is now being finalized, in consultation with the World Bank and the Fund.

II. Medium-Term Objectives

10. The program of economic rehabilitation and development for 1987/88-1989/90 aims at achieving a rapid overall economic recovery and setting the base for sustained economic development through diversification of exports, promotion of efficient import-substitution activities, and better utilization of domestic resources. To this end:

(i) Through appropriate exchange rate and pricing policies, the Government will further improve incentives to producers. As the supply situation recovers and the availability of foreign exchange increases, the limited price controls currently in effect will be relaxed and the authorities will gradually implement an OGL system for imports.

(ii) The Government will restore price stability by limiting the budgetary deficit and its domestic financing to a level that is consistent with the moderate expansion of domestic credit to the economy and an improvement in net foreign reserves.

(iii) The Government will restore a sustainable balance of payments position, including a strong reserve position, by maintaining an appropriate exchange rate and foreign exchange management policy and by encouraging exports of traditional and nontraditional goods, as well as efficient import substitution. The external arrears at the end of 1986/87, the bunching of debt service in 1987/88-1989/90, the need to rebuild reserves, and the huge pent-up demand for importation of equipment and spare parts for rehabilitating the industrial sector will give rise to the need for exceptional balance of payments assistance during this period. However, the sustainability of the balance of payments position would be restored as early as 1990/91.

(iv) The Government will continue to work toward the restoration of discipline, accountability, and efficiency in the public sector. It has already made considerable progress by strengthening discipline in the main customs stations and marketing boards by replacing corrupt managers. However, the entire civil service and staff of the parastatals will have to be purged of unproductive elements, while administrative structures and procedures are streamlined.

(v) The Government has formulated a public investment program which is consistent with the requirements of economic recovery and sustainable growth and aims at restoring the economic and social infrastructure, thereby creating conditions for greater production and provision of social services.

(vi) The Government will complete the rehabilitation of the devastated districts. This is an overriding priority not only on humanitarian grounds but also on economic grounds, as areas such as the Luwero Triangle have extremely fertile agricultural lands that can rapidly become productive again and contribute to the overall rehabilitation of Uganda.

11. More specifically, the proposed program for the three years 1987/88-1989/90 is aimed at raising the annual rate of growth of real GDP from an estimated average of 2 percent in 1982/83-1985/86 to about 5 percent in 1987/88-1989/90, entailing an annual increase in real per capita GDP of about 2 percent. The average monthly rate of inflation in terms of consumer prices would decline from the 12 percent experienced in 1986 to less than 1 percent in 1989/90. The current account balance would shift from a small deficit of 1.5 percent of GDP in 1986/87 to a deficit of about 4 percent of GDP in 1987/88 and 1988/89 and 3 percent of GDP in 1989/90, as imports flow more freely into the country, largely on account of increased disbursements of concessional loans from the very low levels observed in recent years. On the whole, the balance of payments would be strengthened through the recovery in the volume of traditional exports, the gradual diversification of the export base, rehabilitation of efficient import-substituting industries, and the restructuring of foreign debt. By end-1989/90, Uganda would have reduced its scheduled debt service to 16 percent of exports of goods and services, accumulated gross foreign exchange reserves equivalent to about 8 weeks of imports, and improved its net foreign reserves by US$185 million to minus US$37.0 million. During 1990/91, as Fund repurchases declined sharply, Uganda would be able to speed up the improvement of its gross reserve position. By end-1990/91, gross foreign exchange reserves could be equivalent to close to 3 months of imports.

III. Medium-Term Economic Policies

12. To achieve the program's objectives, the Government will follow a two-pronged policy strategy of structural reform and financial stabilization. The Government believes that economic recovery will first and foremost depend on the removal of structural bottlenecks, including poor infrastructure, inadequate power and water supplies, lack of transport equipment and agricultural inputs and implements, as well as industrial raw materials and spare parts. Therefore, a program of structural reform designed to restore the productive capacity of the country, thereby increasing the domestic production of agricultural and industrial goods, while, at the same time, improving the provision of social services, must be put in place immediately. The Government also believes that it is urgent to bring about a stable and predictable financial environment through the restoration of public confidence in the national currency. By May 1987, the Government intends to implement a currency reform, set an appropriate exchange rate, adjust domestic prices accordingly, and adopt a budgetary policy that ensures a

significant improvement in the overall fiscal position and a steady reduction in the Government's net indebtedness to the banking system.

a. External policies

13. The Government recognizes the necessity of setting an exchange rate for the new currency that is consistent with the national objectives of restoring production in all sectors to previously achieved levels, setting the base for further economic development, and achieving over the medium term a sustainable balance of payments and a strong foreign reserve position. Therefore, the new exchange rate will be such as to restore adequate price incentives for the production of tradable goods, taking into account the exchange rate effect on the prices of imported inputs and exports. Subsequently, the exchange rate will be reviewed and adjusted periodically in light of developments in the economy, including the rate of inflation, the budget, and the balance of payments position.

14. At the moment, Uganda has a war-devastated economy, and the shortage of foreign exchange is so severe that the Government cannot rely solely on the price mechanism to allocate foreign exchange because it has to ensure that the import of basic necessities such as medical supplies is not pre-empted by the import of less necessary goods by Ugandans with relatively high incomes. However, over the next three years, as the shortage of foreign exchange is alleviated and the domestic supply situation improves, the Government will gradually replace the current administrative system of foreign exchange allocation with an open general licensing (OGL) system under which importers will obtain import licenses and foreign exchange immediately upon request. Initially, in the first half of 1987/88, the coverage of the OGL system will be limited to certain priority industries and to a number of priority items such as agricultural inputs and essential consumer goods. Subsequently, the coverage of the OGL system will be reviewed on a quarterly basis, with the aim of opening up the system to all producer goods, basic necessities, and incentive goods by end-1988. With the objective of encouraging economic efficiency and ultimately extending the OGL system to all imports, the Government will continue to review the tax and tariff schedule periodically.

15. The recent acute shortages in foreign exchange resources have resulted in an accumulation of external payments arrears, calling into question Uganda's external creditworthiness. To rectify this situation, the Government intends to enter expeditiously into negotiations with external creditors on a timetable for eliminating all outstanding arrears. Moreover, in order to limit debt service obligations to sustainable levels over the medium term, the Government will: (i) work with creditors to reschedule debt service obligations due in 1987/88; and (ii) refrain from contracting or guaranteeing a significant amount of new nonconcessional borrowing, except for import financing with a maturity of less than one year and for debt contracted in the context of rescheduling.

b. Pricing and marketing policies

16. With the exception of petroleum products, public utility tariffs, and producer prices for important export crops, the Government's general policy has been to permit domestic prices to be freely determined in the market. However, under the abnormal conditions that prevailed in Uganda in 1986, including the existence of acute shortages of some basic necessities, the Government temporarily imposed controls on prices or profit margins on a number of items and, for salt, sugar, and soap, took over their marketing. The Government intends to gradually relax the remaining few restrictions on pricing and marketing as the supply situation improves.

17. Petroleum products are essential commodities in that they affect people's lives in several ways, viz. transport, industrial inputs, etc. Prices will therefore be set at levels which cover the following components: (i) the landed costs for all products; (ii) all domestic costs for distribution; and (iii) a level and structure of taxation consistent with budgetary requirements and social and economic considerations. These prices will be adjusted periodically to reflect changes in world market prices and the exchange rate.

18. As agreed under the ongoing IDA Telecommunications Project, the Government will continue to adjust international and domestic telephone tariffs in line with domestic and foreign exchange costs. The Uganda Post and Telecommunications has already implemented very sharp increases in tariffs for its various services. Similarly, as agreed under the ongoing IDA Second Power Project, measures will be taken to increase the efficiency and strengthen the financial position of the Uganda Electricity Board (UEB). As a first step, the principal parastatals, including UEB, will strengthen their campaign to collect their outstanding accounts receivable. The ongoing negotations with Kenya to raise the tariff on bulk electric supply from Uganda should yield substantial additional revenues for UEB. The financial position of UEB will, however, continue to be reviewed in consultation with the World Bank, and the tariffs adjusted as required. In this respect, the UEB increased its rates by 300 percent in September 1986.

19. The Government is committed to improving the living standards of the producers in the agricultural sector. In line with this objective, the Government increased the producer prices of key agricultural crops by nearly 100 percent in May 1986 and implemented another substantial increase for five selected food crops (beans, maize, groundnuts, simsim, and soya beans) in January 1987. The Government recognizes the importance of maintaining adequate producer incentives and will regularly adjust minimum producer prices for the major export crops. These producer prices will be chosen on the basis of recommendations of the Agricultural Secretariat, which will have consulted with the World Bank. Producer prices for cotton, tea, and tobacco will reflect world market prices, after allowance for processing and marketing costs. The Government does not intend to levy export taxes on these commodities,

but will seek to tax incomes of cotton, tea, and tobacco farmers in the same manner as other incomes. However, for coffee the Government will retain about 50 percent of export receipts in 1987/88 for revenue purposes. In the following two years, as the supply of domestic goods increases and the collection of taxes on incomes and domestic transactions is enhanced, the Government will gradually reduce its share of coffee export receipts to no more than 40 percent by 1989/90, with the aim of making further reductions in the future as noncoffee revenues contribute a larger share of total receipts.

20. The main problems in coffee marketing have been the widespread corruption in the Coffee Marketing Board (CMB) and in the cooperatives, their lack of accountability, and their failure to pay farmers promptly. To remedy this situation, the Government has recently replaced all top management in the Coffee Marketing Board and required the cooperatives to update and publish their accounts. The Government is committed to improving the efficiency of the CMB and has commissioned studies to identify specific measures to achieve this objective. The recommendations of those studies, including a tendering system for arabica coffee, are presently being reviewed by the Government, and measures will be implemented during fiscal year 1987/88.

21. The top executive of the Lint Marketing Board (LMB) has recently been changed, and a new Board of Directors established. The new Board includes representatives of the cooperative unions and the major cotton-growing areas. Some officials were dismissed for corruption or lack of appropriate qualifications, and, for the first time in many years, the accounts have been brought up to date. There is now better expenditure control, and the Board has taken keener interest in the ginning of cotton and its production. The Board is currently spearheading the emergency cotton rehabilitation program. The Government will reduce the LMB's ownership in the oil and soap industry to a minority position, and ensure managerial autonomy for the enterprise. To further improve the efficiency of the LMB, the Government will allow cooperatives to sell directly to textile mills. The Government will also explore various options to improve the efficiency of exporting cotton.

22. The issues concerning tea are under review and will be handled during the program period in the context of the proposed IDA-financed Tea Rehabilitation Project.

23. The Government will continue its policy on internal marketing of the five specified food crops (beans, soya beans, maize, simsim, and groundnuts). All persons interested in this trade will be licensed, and the licensees will be free to sell to the Produce Marketing Board or any other interested party within the country. For the time being, the Produce Marketing Board will continue to be the sole exporter. As economic conditions improve, private exporters will be allowed to export alongside the Produce Marketing Board.

c. Public resource budgeting and management policies

24. A substantial reduction in the fiscal deficit and an improvement in public sector management form a critical component of the Government's adjustment program. In particular, there is an urgent need to terminate recourse to domestic monetary financing in order to end the runaway monetary expansion and price inflation of recent years, while improving the efficiency of resource use in the public sector. Consistent with the inflation objectives and the credit demands of the private sector, over the next three years the Government plans to reduce substantially its net indebtedness to the domestic banking system. To this end, the Government is committed to restrain the overall fiscal deficit on a commitment basis to 4.5 percent of GDP in 1987/88 and to reduce it subsequently to 3.3 percent of GDP by 1989/90. Initially, this will be achieved mainly because of the favorable effect of the change in the exchange rate on the revenue from the duty on coffee exports. However, the Government is fully aware that this can only be a short-run palliative. During the next three years, it will adopt measures necessary to (i) increase the revenue yields from customs duties, and especially from taxes on incomes and domestic consumption; (ii) restructure and stabilize central government expenditure to enhance its contribution to economic development; and (iii) put in place a strict monitoring system that would ensure that the various administrative units stay within their budgetary allocations. As a result of planned measures, the ratio of tax revenue to GDP, which, at 3.5 percent of GDP in fiscal 1986/87, is currently one of the lowest in the world, would increase to 8.0 percent of GDP by fiscal year 1989/90.

25. Over the next three years, a significant part of the increased tax revenue would come from improved tax administration, through an upgrading in the staff of the three revenue departments, a revamping of their operational procedures, and an increase in the means at their disposal. In particular, by mid-1987 a special commission chaired by the Minister of Finance will review the staffing of all positions of responsibility in the Income Tax, Customs and Excise, and Inland Revenue departments, with a view to ensuring that positions are held by competent and dedicated officers. By mid-1987 the Government will also introduce a system of merit incentives to motivate officers directly involved in tax assessment and collection activities. Beginning in fiscal year 1987/88, the Government will also strengthen the three revenue departments, with a view to identifying potential taxpayers and promoting the rigorous enforcement of pertinent rules and regulations. To help in this task, the authorities will approach prospective donors for appropriate technical assistance.

26. Although the main emphasis will be on improving the implementation of the existing tax laws, some tax policy matters will need to be addressed through revised legislation. The goal of these changes will be to provide adequate incentives to private producers and to promote an efficient allocation of resources. The Government will ensure that the tariff structure promote the development of efficient import-

substitution activities and a diversified export base. The average tariff level will be determined by overall budget considerations. Some exemptions from customs duties that do not concern aid-financed items will be removed in the first half of 1987. This would be part of a comprehensive review of the entire tax system, undertaken with a view to broadening the tax base. In order to enhance tax compliance in general, and as part of the reform of the civil service discussed below, the Government will abolish the existing exemption from income tax for the emoluments of civil servants.

27. The Government will also be prepared to reduce expenditure as needed in the event of shortfalls in revenue or in foreign aid. In addition, in order to limit the scope for unauthorized overspending by ministries and departments, beginning with the 1987/88 budget the Government will strengthen all its monitoring and accounting procedures. Moreover, expenditures in excess of monthly budgeted allocations will be adjusted against subsequent allocations. If allocations are exceeded over three successive months, there will automatically be an investigation by a strengthened Auditor General's Department. The Government will explore possible sources of technical assistance to ensure the implementation of these measures. Furthermore, the Finance Ministry will improve its monitoring and develop more comprehensive records of foreign assistance and related expenditure.

28. These measures to improve control over expenditure should go far in solving a serious problem of recent years--insufficient funding for the Government's operations and maintenance activities. While the share budgeted for such expenditures has generally been adequate, actual allocations have been significantly less than what has been budgeted, causing major problems in project implementation. A tighter linkage between budgeted and actual expenditures would greatly improve the implementation of development projects, and the ability of ministries to carry out such functions as agricultural support services and the provision of basic services in health, education, and water supply. Regarding other expenditures, the improved security situation will permit a reduction of defense expenditure in real terms beginning in 1987/88. Already, the soldiers of the National Resistance Army are involved in the production of food for their consumption. Likewise, subsidies and subventions to parastatals will be scrutinized with a view to reducing these outlays.

29. The Government recognizes the need to overhaul and streamline the civil service in order to increase its efficiency. As a first step, the Government is undertaking a census of the civil service to identify the total number of employees, including regular civil servants, contract employees, and group (i.e., temporary) employees. The Government is also applying strictly civil service regulations concerning the retirement age, attendance, and discipline, to prune the civil service of unproductive elements. By end-1987, the Government will reduce significantly the number of group employees. During the program period, the Government intends to: (i) limit the wage bill to the amount that

is consistent with the target for the overall budget deficit and the need to increase maintenance and development expenditure; and (ii) within this overall constraint, it will substantially increase real wage rates.

30. The Government will also undertake a comprehensive review of the functional and staffing structures of the civil service, with possible assistance of the World Bank. The review will initially concentrate on the Office of the President, and the ministries of Public Service and Cabinet Affairs, Planning and Economic Development, Finance, Local Government, and Works and Education, which together comprise about 60 percent of the civil service staff. Subsequently, it will be extended to cover all other ministries. The initial review will be completed by end-December 1987, and reviews for the remaining ministries by April 1988. These reviews will make recommendations concerning the structure of the civil service, with the objective of improving its efficiency. The Government will then decide by June 1988 on a program to implement a reform of the civil service during the next two fiscal years.

31. Development expenditure will show a relatively large increase during the program period, reflecting Uganda's rehabilitation needs, its absorptive capacity, and the envisaged level of external financing. The Government, in consultation with the World Bank, is finalizing a medium-term public sector investment program (1987/88-1990/91) that will form the basis for development expenditures in the budget. The program gives priority to restoring the country's productive capacity and infrastructure, and only those projects deemed essential for economic recovery have been included. Accordingly, emphasis is placed on provision for needs of industrial and agricultural rehabilitation, on road rehabilitation and maintenance, power generation and transmission, and the provision of social infrastructure, particularly health services. To enhance the overall effectiveness of its development program, the Government will continue its current efforts to improve the monitoring of domestic and foreign-financed investment projects.

32. In the area of industrial policy, the Government's immediate objective is to facilitate the rehabilitation of existing industries, especially those producing basic consumer goods and construction materials. This should promote a return to much greater capacity utilization in these industries. The vast majority of the industrial establishments are in the hands of the private sector, and the Government will continue to encourage the private sector's role in industrial development. As a result of expropriations during past regimes, the Government presently owns a large number of industrial enterprises--most of which are in need of major rehabilitation. The Government has already returned 25 enterprises to former owners and wound up 7 of its own companies. The Government is preparing a plan for further divestiture and will consult with the World Bank on a timetable for its implementation. This will allow the Government to concentrate on rehabilitating those firms remaining in the public domain. In this

context, the UDC will be restructured to enhance its role as a catalyst for investment through a program of divestiture. Finally, the properties left behind by departed expatriates in the early 1970s that have not yet been claimed by their former owners will be put up for sale before end-1987.

33. To improve the financial control of all the parastatals, beginning in fiscal year 1987/88 the Government will require that parastatals submit to the Ministry of Finance audited financial statements within six months of the year-end. In addition, each year the Government will prepare a comprehensive list of loans guaranteed by the Ministry of Finance (on a cumulative basis), as well as three-year rolling plans and budgets relating output performance to resources utilized. The Ministry of Finance will withhold budgetary allocations from any parastatal not meeting these requirements. In addition, studies will be initiated with the assistance of the World Bank focusing on the longer-term restructuring needs of the enterprises.

d. Monetary and credit policies

34. Following the currency reform, the Government will pursue monetary and credit policies designed to strengthen the balance of payments and to reduce domestic inflation over the 1987/88-1989/90 period without undue restraint on credit to productive activities. This will require measures to mobilize domestic savings so as to permit a reasonable expansion in credit to the private and parastatal sectors. The Government will increase the spread and efficiency of the banking services and maintain interest rates that reflect the expected rates of inflation over the various loan and deposit maturities. In particular, this will require that nominal interest rates for deposits and short-term lending remain at their current levels through end-1987, at which time they will be reviewed in the light of inflationary trends. In order to encourage productive investment, interest rates on medium- and long-term loans will reflect the expected decline in inflation over these time periods if they carry fixed rates. Also, to encourage productive investment, flexible credit guidelines will be introduced. In addition, the Government will seek to develop a secondary financial market for government paper by setting competitive interest rates on treasury bills. This will help to reduce the reliance of government finance on the central bank.

35. The pressing agricultural credit problem in Uganda concerns the provision of crop finance to producers and processors of the export crops, notably coffee and cotton. The Government has introduced a system whereby credit is provided directly from the banks to those cooperative unions that have the accounting expertise and financial system necessary to obtain and use bank finance. Once fully operational, the direct provision of bank credit to producers' cooperatives should alleviate the major problem in the current system. There is a program in place with donor assistance to continue developing this capability in those cooperative unions that are as yet to be included in

this scheme. This, combined with supervision from the Government, should accelerate the program. The Government will review the performance of this system by December 1987, and, if necessary, take further measures to accelerate its implementation.

36. In the industrial sector, the Government is particularly concerned about the difficulty firms are encountering in obtaining local currency to purchase the foreign exchange needed to import essential inputs. Many firms have been closed or have operated at low rates of capacity utilization for a prolonged period and, lacking significant working capital, appear uncreditworthy despite their sound prospects over the medium term. To address this problem, the Government will encourage industries to revalue their assets to reflect current market prices, though this may be rendered unnecessary by the currency reform. Moreover, beginning in fiscal year 1987/88, the Government will mobilize external support to establish a revolving fund to be on-lent to the commercial banks, so that they can provide short-term local currency loans to firms seeking to import, through the OGL system, spare parts, small machinery, and intermediate inputs essential for restarting their operations. The risk on those loans will be shared between the Government and the banks.

IV. Social Impact of the Program

37. On balance, the effect of the adjustment and economic rehabilitation program on welfare levels in Uganda is expected to be positive. Undoubtedly, the implementation of the stabilization measures will require further restraints on consumption for all segments of the economy. However, as the stabilization measures take effect, the extremely high rates of inflation would be reduced, significantly slowing the erosion of purchasing power. More importantly, with the enlarged inflow of foreign exchange and improved confidence in the economy, as well as with domestic supply responding to the policies and measures taken under the program, per capita consumption is expected to grow, beginning in 1988.

38. The rural sector is expected to benefit from the implementation of the Government's program more quickly than the urban sector, since the program calls for real increases in smallholder prices, particularly for export products. It may take longer for the urban sector to fully benefit from the program's implementation. Also, urban employment will be adversely affected by the extent of reduction in public sector employment. However, hardships faced by the urban population will continue to be alleviated to a certain extent by urban dwellers supplementing their incomes with produce from their villages. Moreover, under the program, the Government intends to increase civil servants' wages and to improve the provision of basic services, particularly in primary health, education, and water. These measures will help improve the urban standard of living over the medium term.

V. Rehabilitation, Growth, and External Financing Aspects

39. This adjustment and development program is expected to result not only in a GDP growth rate of at least 5 percent per year, but also in a gradual improvement in the overall balance of payments that would lead to a sustainable position by 1990/91. The net foreign reserve position would also improve markedly, with the virtual elimination of the large foreign liabilities by the end of the program and a buildup of gross foreign reserves. However, given the huge task of rehabilitation faced by the authorities, its success can be ensured only through a substantial amount of foreign assistance, including sizable exceptional balance of payments assistance, especially in 1987/88, when quick disbursement will be of primordial importance in order to alleviate the acute shortage of transport equipment, agricultural inputs and implements, and industrial raw materials and spare parts. The Government has categorized external assistance requirements into immediate relief and rehabilitation assistance, quick-disbursing concessional loans of grants for industrial rehabilitation, and project financing. The Government estimates the need for immediate relief and rehabilitation in 1987/88 at US$55 million. With respect to industrial rehabilitation, after a comprehensive survey, the Government estimates that, in relation to the level in 1986/87, additional imports of raw materials, spare parts, and capital goods needed to allow firms to double current production capacity amounts to US$82 million in 1987/88, US$108 million in 1988/89, and US$169 million in 1989/90. The longer term development program has priority projects totaling about US$275 million a year. These estimates would lead to total imports of US$560 million in 1987/88, a 39 percent increase above the average of the preceding four years, and total imports of US$620 million and US$654 million in 1988/89 and 1989/90, respectively.

40. Exports are expected to rise by about 10 percent per annum (in terms of U.S. dollars) during 1987/88-1989/90. The volume of coffee exports should rise by 5 percent per annum, while the price Uganda receives for coffee may drop by 4 percent in 1987/88 and then increase by 4 percent per annum during 1988/89-1989/90. The program should also promote a rapid expansion of noncoffee exports, especially tea, tobacco, and food crops, albeit from a very low base. Given the expansion of imports needed to permit economic recovery during the next three years, Uganda's trade deficit is expected to widen from US$140 million in 1986/87 to a deficit of US$177 million in 1988/89, before narrowing again to US$159 million in 1989/90. With a deficit on services of about US$84 million a year more than offset by the combined net inflow of private transfers and official grants (about US$119 million), the current account deficit including official transfers is also expected to widen, from US$110 million in 1986/87 to US$144 million in 1988/89, before narrowing to US$110 million in 1989/90.

41. Net capital inflows are projected to increase from US$30 million in 1986/87 to US$196 million in 1989/90. Amortization due on medium- and long-term debts is estimated at US$61 million a year during the program

period, while medium- and long-term loan disbursements could rise from US$124 million in 1986/87 to about US$209 million a year during the program period. Nearly half of this amount would come from the large stock of undisbursed commitments (estimated at about US$400 million) existing at end-1986, as the adoption of the program leads to a return to normal disbursement patterns. IDA disbursements on already committed resources would average US$43 million a year. New commitments are assumed to be about US$174 million a year, including US$100 million a year from IDA. This level appears to be a realistic estimate of what could be mobilized through the Consultative Group meeting envisaged for June 1987. Payments by Kenya under the arrangement for the settlement of assets of the East African Community would be about US$29 million a year.

42. In 1987/88 the projected total financing requirement would be US$466 million, including repurchases from the Fund of US$72 million, the virtual elimination of external arrears (US$103 million), and an increase in gross reserves (US$30 million). A major part of this requirement could be met by anticipated loan disbursements from existing commitments (US$133 million). In addition, loan disbursements from expected new commitments, including the second disbursement under the Fund's structural adjustment facility (US$25 million), and payments by Kenya would total US$125 million. Grants are expected to finance another US$47 million. This would leave a financing gap of US$161 million, which the Government would seek to fill by rescheduling a large part of its external arrears and debt service due in 1987/88 through the Paris Club and through comparable agreements with its other creditors, and from additional inflows of exceptional balance of payments assistance. In 1988/89, the financing requirement would decrease to US$352 million, after allowing for repurchases of US$60 million and a further buildup in gross reserves of US$10 million. With disbursements of loans and grants from existing and expected new commitments assumed to total US$308 million, a financing gap of US$44 million would remain, which again could be filled by debt rescheduling. The financing requirements in 1989/90 would be covered by disbursements from existing and expected new commitments.

Table 1. Uganda: Selected Economic and Financial Indicators, 1982/83-1987/88

	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88
	Actual				Proj.	Prog.
	(Annual percent changes, unless otherwise specified)					
National income and prices						
GDP at constant prices	7	5	-4	-1	4	5
Consumer prices (annual average)	27	29	100	129	248	91
Consumer prices (year-end over year-end)	26	16	158	153	270	30
External sector (on the basis of U.S. dollars)						
Exports, f.o.b.	20	7	1	-1	-5	13
Imports, c.i.f.	7	-15	-6	-3	29	12
Non-oil imports, c.i.f.	14	--	13	1	35	17
Export volume	15	-12	-3	-17	5	17
Import volume	-12	3	7	-12	21	8
Terms of trade (deterioration -)	-17	22	--	7	-13	-10
Nominal effective exchange rate (depreciation -) 1/	-18	-36	-40	-45	-1	...
Real effective exchange rate (depreciation -) 1/	-10	-34	-15	-6	154	...
Government budget 2/						
Revenue and grants	91	83	74	97	81	264
Revenue	116	77	74	76	100	236
Total expenditure	35	59	108	97	132	185
Money and credit 3/						
Domestic credit	65	33	145	67	140	9
Government (net)	33	-5	73	31	78	-17 4/
Private sector	32	39	72	36	62	26
Money and quasi-money (M2)	47	61	139	148	148	40
Velocity (GDP relative to M2)	12	11	9	10	13	16
Interest rate (annual rate, one-year savings deposit)	13	17	22	35	35	35
	(In percent of GDP) 5/					
Central government budget deficit (-) 6/	-4.0	-2.8	-5.3	-4.5	-4.8	-4.5
Domestic bank financing	2.0	-0.4	4.2	1.9	3.4	-0.9 4/
Foreign financing (net)	0.8	0.5	0.7	1.4	0.7	1.2
Current account deficit 7/ (-) or surplus	-2.3	0.1	-0.4	1.1	-1.5	-3.8
	(In percent of exports of goods and services)					
Current account deficit 7/ (-) or surplus	...	0.5	-2.5	7.7	-29.1	-30.6
External debt 8/						
Including use of Fund credit	...	259.9	250.3	257.1	277.5	304.8
Excluding use of Fund credit	...	171.3	179.7	191.9	220.5	265.0
Debt service ratio	28.6	40.6	46.2	51.2	53.3	42.3
Interest payments	10.6	12.4	13.3	11.3	10.4	8.8
	(In millions of U.S. dollars)					
Overall balance of payments	-117	61	50	72	-80	23
External payments arrears (at end of period)	183	120	55	74	123	20
Gross reserves (end of period)	15	95	63	64	25	55

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

1/ Change in yearly average, except for 1986/87, for which data indicate change during July 1986-February 1987.
2/ Fiscal year (July-June).
3/ In percent of money stock at the beginning of the period.
4/ Including accumulation of deposits in the blocked account at the Bank of Uganda.
5/ The following ratios should be treated with caution, owing to the tentative nature of the GDP estimates.
6/ On a commitment basis, including foreign grants.
7/ Includes grants.
8/ Excludes arrears.

Table 2: Uganda: Balance of Payments, 1985/86-1990/91

(In millions of U.S. dollars)

	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
	Actuals	Projections				
Trade balance	-7.9	-140.0	-153.2	-176.6	-159.0	-135.0
Exports, f.o.b.	380.5	361.4	406.8	443.2	494.8	540.0
Imports, c.i.f.	-388.3	-501.4	-560.1	-619.8	-653.8	-675.0
Aid	(104.8)	(136.1)	(179.8)	(183.8)	(207.5)	(209.0)
Non-aid	(283.6)	(365.3)	(380.2)	(436.1)	(446.3)	(466.0)
Services (net)	-93.5	-88.0	-83.6	-84.4	-84.5	-83.0
Unrequited transfers	131.6	118.0	107.2	116.9	133.2	152.0
Current account	30.2	-110.0	-129.7	-144.1	-110.2	-66.0
Capital account	42.2	30.0	152.9	174.1	195.6	168.0
Official medium- and long-term (net)	40.8	67.2	127.7	135.3	165.0	157.8
IDA Program lending	--	--	35.2	38.8	30.7	10.2
Private and official short-term (net) 1/	1.4	-37.2	-10.0	--	--	--
SDR allocation	--	--	--	--	--	--
Overall balance	72.4	-80.0	23.2	30.0	85.4	102.0
Financing	-72.4	80.0	-23.2	-30.0	-85.4	-102.0
Monetary authorities	-84.8	-18.0	-76.7	-53.4	-75.3	-102.0
Gross reserve change	-0.9	39.0	-30.0	-10.0	-30.0	-85.0
IMF (net) 2/	-80.3	-76.6	-71.6	-60.2	-45.3	-17.0
SAF	--	24.9	24.9	16.8	--	--
Other (net)	-3.6	32.0	--	--	--	--
Commercial banks (net)	--	--	-5.0	-10.0	--	--
External arrears	12.4	62.0	-102.7	-10.1	-10.1	--
Financing gap	--	--	161.2	43.5	--	--
Memorandum items:						
Foreign exchange reserves (end period)	63.7	25.0	55.0	65.0	95.0	180.0
Reserves/imports (months coverage)	2.0	0.6	1.2	1.3	1.7	3.2
Current account/GDP	1.1	-1.5	-3.8	-4.4	-3.1	-1.7

Sources: Bank of Uganda; and Fund staff estimates.

1/ Mainly consists of borrowing against future coffee shipments.
2/ Excludes anticipated purchases under the Structural Adjustment Facility and in 1986/87 under the compensatory financing facility.

Table 3. Uganda: Timetable of Policy Actions Under the Structural Adjustment Facility, 1987/88-1989/90

Policy areas and related objectives	Actions	Timing
1. Exchange rate policy		
- Adopt an exchange rate policy consistent with the growth objective and conducive to the achievement of a structural improvement in the balance of payments.	- Adjust exchange rate to a realistic level.	May 1987
	- Review and adjust exchange rate in light of economic developments and the inflationary, budget, and external sector targets.	Periodically during the program.
2. Liberalization of exchange and trade system		
- Reduce distortions arising from the administrative allocation of foreign exchange; improve the supply of inputs to priority sectors.	- Establish an open general licensing (OGL) system for imports of key industries.	End-September 1987
	- Gradually expand OGL system to cover by end-1988 all domestic producers and traders; and all producer goods and basic necessities.	Quarterly beginning 1988:I
3. Petroleum prices		
- Adjust petroleum prices to restore fiscal revenue and reflect all costs.	- Substantially increase retail petroleum prices to cover the landed costs for all products, all domestic distribution costs, and a level and structure of taxation consistent with budgetary requirements and social and economic considerations.	July 1987
	- Subsequently adjust prices to reflect changes in world market prices and the exchange rate.	Periodically during the program.
4. Public investment program		
- Give greater emphasis to projects designed to restore the country's productive capacity and infrastructure.	- Introduce appropriate public investment program for 1987/88 to 1990/91 in consultation with the World Bank.	July 1987
5. Agricultural producer prices		
- Restore adequate incentives for production of key agricultural export crops (coffee, tea, cotton, and tobacco).	- Adjust minimum producer prices on the basis of recommendations of the Agricultural Secretariat, which will have consulted with the World Bank.	Periodically during the program, beginning with the 1987/88 agricultural season.

Table 3 (continued). Uganda: Timetable of Policy Actions Under the Structural Adjustment Facility, 1987/88-1989/90

Policy areas and related objectives	Actions	Timing
6. Reforms of agricultural marketing system		
- cotton: improve efficiency of marketing and ginning.	- Reduce Lint Marketing Board's ownership in the oil and soap industry to a minority position and allow cooperatives to sell directly to the textile mills.	Fiscal year 1987/88
- food crops: expand and diversify domestic production and exports.	- Allow all persons interested in marketing food crops to obtain licenses, and allow all licensees to sell food crops to Produce Marketing Board or to any other domestic purchasers.	July 1987
	- Allow private traders to export food crops alongside the Produce Marketing Board.	During the program period.
- coffee: strengthen managerial and financial capabilities of the Coffee Marketing Board (CMB).	- In addition to measures taken to improve the management of CMB, implement recommendations of ongoing studies to improve efficiency, including establishing a tendering system for arabica coffee	During fiscal year 1987/88.
7. Industrial sector policy		
- tariffs: streamline and rationalize the system of industrial incentives.	- Review the level and structure of tariffs, duties, and taxes.	1987
	- Ensure that tariff structure promotes efficient import substitution and a diversified export base.	During the program period.
- price control: gradual elimination of controls.	- Relax remaining restrictions on prices and profit margins of items other than petroleum products, public utility tariffs, and producer prices for important export crops.	During the program period.
- Strengthen ability of firms to import goods approved under the OGL system	- Mobilize external support to establish a revolving fund to be on-lent to commercial banks to provide short-term local currency loans to firms seeking to import through the OGL system spare parts, small machinery, and intermediate inputs essential for restoring operations.	During fiscal year 1987/88.
8. Industrial parastatals		
- Encourage divestiture and promote efficiency in those enterprises remaining in public domain.	- Prepare a plan for divestiture of remaining government-owned industrial enterprises and consult with the World Bank on timing for its implementation.	During the program period.
	- Restructure Uganda Development Corporation through a divestiture program to enhance its role as a catalyst for development.	During the program period.
	- Put up for sale the remaining properties left by departing expatriates and not yet claimed.	By end-1987.
	- Conduct initial studies with World Bank assistance focusing on the parastatals' long-term restructuring needs.	During the program period.
- Improve management and strengthen financial status of parastatals.	- Encourage parastatals to revalue their assets to reflect current market prices.	Fiscal year 1987/88

Table 3 (continued). Uganda: Timetable of Policy Actions Under the Structural Adjustment Facility, 1987/88-1989/90

Policy areas and related objectives	Actions	Timing
9. Budgetary policies		
- Reduce overall fiscal deficit and government indebtedness to the banking sector.	- Improve revenue effort and restrain expenditure. Includes initial revenue gains from effect of devaluation on coffee receipts and petroleum excise duties. Higher revenues from increase in real economic activity.	Beginning with 1987/88 budget and throughout the program period.
- Broaden revenue base and improve tax administration.	- Eliminate a number of exemptions from import duties, begin review of the domestic tax system, institute measures to improve administrative machinery for tax collection, and provide merit incentives to revenue-collecting officers.	July 1, 1987
	- Gradually reduce effective duty rate on coffee exports.	Fiscal years 1988/89 and 1989/90
	- Eliminate tax exemption on civil service remuneration.	July 1, 1987
- Strengthen expenditure policy formulation and control.	- Reintroduce formal system for expenditure policy formulation, monitoring, and control.	Beginning fiscal year 1987/88
	- Provide sufficient funding for government operations and maintenance activities.	Fiscal year 1987/88
	- Improve monitoring and develop comprehensive records of foreign assistance and related expenditure.	Beginning fiscal year 1987/88
- Improve efficiency and integrity of civil service.	- Conduct a census of government employees	May-June 1987
	- Review size of government establishment and reduce regular, group, and contract employees in two stages.	End-June 1987 and end-June 1988 (second stage), with study to be completed in April 1988.
	- Implement reform of civil service.	Fiscal years 1988/89 and 1989/90
	- Increase real wages for remaining staff within budgetary guidelines.	Beginning fiscal year 1987/88
- Limit other current expenditure to levels consistent with overall deficit target.	- Reduce defense expenditure in real terms.	Fiscal years 1987/88-1989/90
	- Scrutinize subsidy payments and subventions to parastatals for possible reductions.	Budget for 1987/88
10. Monetary and credit policy		
- Significantly tighten overall credit policy with some expansion of credit to private and parastatal sectors (including allowance for the local currency lending described above in item 7 to firms participating in the OGL system) and adequate provision for crop finance.	- Establish overall budget targets consistent with reducing outstanding net credit to Government.	Beginning fiscal year 1987/88 and throughout the program period.
	- Establish overall credit targets in agreement with the Fund.	Same as above.
- Revive demand for treasury bills by the nonbank sector.	- Create secondary market by setting competitive interest rates on treasury bills.	July 1, 1987

Table 3 (concluded). Uganda: Timetable of Policy Actions Under the Structural Adjustment Facility, 1987/88-1989/90

Policy areas and related objectives	Actions	Timing
11. Interest rate policy		
- Establish positive real interest rates.	- Review and adjust all interest rates semiannually to reflect domestic inflation targets.	Beginning end-1987
- Mobilize domestic savings.		
12. External debt management		
- Reduce debt service obligations to sustainable levels.	- Clear all outstanding arrears, through rescheduling and cash payments.	1987
	- Avoid contracting or guaranteeing of new nonconcessional borrowing, except for debt contracted in the context of rescheduling or import financing with maturity less than one year. During fiscal year 1987/88, new nonconcessional borrowing will be limited to US$3 million.	Throughout the program period.