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Economic Adjustment and Long-Term Development in Uganda

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CANADA

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ECONOMIC ADJUSTMENT AND LONG-TERM DEVELOPMENT IN UGANDA

The Uganda Economic Study Team

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Foreword

After discussions on April 19 between President Yoweri Museveni and some members of his Government on the one hand and staff of the International Development Research Centre (IDRC) and the Canadian International Development Agency (CIDA) on the other, President Museveni requested IDRC to field an international team of senior economists, including Ugandans, to undertake as a matter of urgency an objective policy-oriented study of the economy of Uganda. The study was considered necessary for the formulation of short-term macroeconomic stabilization policies and for the longer-term development of Uganda. It was expected to produce realistic policy options on major economic issues.

The President of IDRC, Mr. Ivan Head, gave the request his personal and urgent attention. IDRC decided to accede to the request. After consultations with CIDA, with which IDRC has always had close working relations, CIDA agreed to provide the necessary financial support.

The study team constituted as indicated in this report commenced its work on May 20 with collection of data, preparation of position papers on specific aspects of the economy and general reading to provide adequate background for the work. While IDRC is pleased to have been able to assemble this international team, it is particularly happy that the study has involved a significant number of Ugandans. This reflects the mandate and mode of operation of IDRC and its goal of strengthening indigenous research capacity.

The study was formally launched by President Yoweri Museveni on June 17, 1986. After very serious consideration of all aspects of the economy, bearing fully in mind the President's emphasis on a rigorous and scientific evaluation of Uganda's problems and the likely impact of different policy choices, the Team presented its report to the President and Cabinet on 9 July 1986.

In his address at the launching of the study, the President had stated : "I do not expect your ideological commitment to either the free market solution or a planned approach to blind you to the actual realities of this country ... I suggest that in devising solutions to our problems, you should be guided by our own social, political and economic realities rather than experiments based on known theories which might prove totally inapplicable in our context". I believe the Team has taken this plea fully into account in assessing and arriving at the various specific recommendations and options.

I hope the Government will find the results of the study useful in formulating its short and long-term policies. Judging from the Government's interest, support and cooperation, I can say that it has demonstrated abundantly an open-minded and research-based approach to policy formulation. I must emphasize, however, that in supporting this study, neither the Government of Canada through CIDA nor IDRC necessarily agree with the views and recommendations contained in the report.

D. Adzei Bekoe

Regional Director

IDRC, Nairobi

PREFACE

In the latter half of May 1986, the government of Uganda requested the International Development Research Centre (IDRC) Ottawa, Canada to sponsor a joint international/Ugandan team to advise on essentially short run economic policy. The IDRC agreed and was successful in obtaining finance for the project from the Canadian International Development Agency (CIDA).

The terms of reference of the team were:

1. To provide a comprehensive macro-economic framework for the country's rehabilitation and development including policy recommendations toward: -

   - domestic resource mobilisation;
   - the exchange rate and foreign exchange management;
   - inflation;
   - public sector expenditures and revenues;
   - domestic and external debt management.

2. To identify mechanisms and projects for a sound management and development of the economy over the longer term.

The team was assembled at very short notice and commenced work in early June under the joint leadership of Professor John Loxley, Department of Economics, University of Manitoba, Canada and Professor Yoeri Kyesimira, formerly Minister of Planning in the government of Uganda. The President of Uganda, His Excellency Mr. Yoweri Museveni launched the study officially on June 17th 1986.

A very demanding timetable was set with a completion date of the end of the first week of July. This deadline was met as a result of the warm cooperation the team received from everyone it approached for assistance.

The team met the President at State House, Entebbe, for a wide ranging discussion which lasted five hours. It met senior Ministers and government officials, worked closely with the Bank of Uganda and other financial institutions and visited a number of agricultural, industrial and other types of enterprise both within and outside Kampala. Interviews were held with a service club and with representatives of labour, women's groups, training institutions and all major aid agencies and foreign embassies.

Many interested individuals, businessmen and academics were also consulted. As well, the team recruited the services of 16 Ugandans on a formal consultancy basis to prepare background papers, documents and data for use in the study. The team wishes to thank these and all the people consulted for their unqualified help and co-operation in making our task possible.

Most team members also had the opportunity to visit the Luwero Triangle to see, at first hand, the wasteland of what was once a flourishing, productive area. We were appalled by the extent of the devastation and by the suffering of the people of Luwero. At the same time, we were moved by the enthusiasm and optimism of those returning home to that area. We are confident that the government's Emergency Relief and Rehabilitation Programme will be quickly successful. We thank the officials of that district for taking time from this most important work to escort us around Luwero. We also thank the many people there who met with us to share their views on the situation. Finally, we are surprised and saddened that the response of the donor community to the appeal for humanitarian assistance for this and similar devastated areas has, to this point in time, been so disappointingly small.

The team wishes to thank the IDRC and CIDA for their sponsorship of this project: Dr. D. Adzei Bekoe, Regional Director, and Mr. Jeffrey C. Fine, Senior Programme Officer, Economics and Rural Development, International Development Research Centre, for their personal interest in the project; Ms. Esther Mukandoli for administering the project so capably; Dr. Suleiman Kiggundu for his efficient liaison work with government and lead in the general administration of the project; the several government officials who have provided various assistance to the project and Valerie Masinzo, Stephen Kibuka, Daniel Seruwagi, Rogers Kibombo, among others, for their assistance which, in so many ways, was invaluable to the successful completion of the project.

To the many aid agencies who came to our assistance during our copying paper crisis, our thanks for your help. May you extend the principle of an interest free, quickly disbursed, somethings forgivable loan, without conditionality, to other requests for assistance you receive from the government of Uganda.

Yoweri Kyesimira
Co-Team Leader

John Loxley
Co-Team Leader

SUMMARY OF MAJOR FINDINGS AND RECOMMENDATIONS

A. Major Issues in Uganda's Macroeconomic Imbalance

1. The major macroeconomic problems facing Uganda are reduced incomes due to sharp falls in output in recent years and rampant inflation currently estimated at around 100% p.a. The strength of the economy is the resilience of the rural sector.

2. The war and consequent disruption has undermined the basic needs of many Ugandans in the areas of health, education, water supplies. Urban incomes, and especially fixed ones, and wages, have declined sharply. The crisis also puts special pressures on Ugandan women.

3. The Budget is virtually out of control, suffering from lax expenditure control and corruption, a poor revenue base, an overdependence on coffee export duty and low level of productive spending. Salaries of civil servants are too low to encourage productivity or honesty.

4 Real imports have declined significantly since 1981 inhibiting rehabilitation; this is the most serious aspect of the balance of payments. There is an overdependence on coffee which is inevitable in the short run, but which must be corrected for the medium/long run. Low petroleum prices encourage imports and smuggling. Debt servicing commitments and arrears are large and growing. Aid and loan inflows have declined steadily in recent years.

5. The exchange rate for the shilling is overvalued relative to 1983/84 in terms of currencies of major trading partners. This encourages imports and discourages production for official exports. Taxes, subsidies and controls are, in theory, alternatives for addressing this problem.

6. Monetary policy has permissively financed government deficits.

7. Eroded real urban income has led to people adjusting their lifestyles to survive. Lack of incentives causes low productivity and widespread absenteeism and corruption. A distinction must be made between petty corruption for survival and large scale corruption.

8. Financial control and accounting standards in both ministries and parastatals are sadly deficient. Information on which government must take crucial decisions is either not reliable or not available.

9. Major issues of the role of the market versus state intervention must be addressed more systematically. The question of disposal of former Asian properties and parastatals raises important economic, social and political issues for the government.

10. Emergency Relief and Reconstruction is a top priority and must proceed as quickly as possible. More humanitarian aid is needed for this purpose.

B. Assessment of Macroeconomic Programmes 1972-1985

1. The lessons of the 1972/79 period are that army and government discipline is necessary for stability; incentives to farmers and workers are important; extensive controls are difficult to administer; an overvalued exchange rate undermines the balance of payments; import capacity is vital to Uganda; the tax base was very fragile and foreign exchange receipts were used unproductively. Finally, people are incredibly resilient to economic and political misfortune.

2. The lessons of the stabilization experience 1981/85 are that economic programmes cannot work in an insecure, indisciplined and corrupt environment; the IMF programme did not provide for sustaining real import levels for the productive use of foreign exchange; IMF financing was high cost, early repayment money; the shift in income distribution away from the urban sector was too rapid; the budget ballooned to compensate for this and on account of huge defence expenditures; tax administration was insufficiently emphasized; there was no expenditure control and no ability to raise productive expenditure; and local industries were starved of credit and foreign exchange.

C. Assessment of the Government's Interim Economic Measures

1. These measures indicate government willingness to address pressing problems, but they lack coherence and consistency. While attempting to control government expenditures, the configuration of

producer prices and exchange rate chosen will drain the budget of billions of shillings, while imbalances between purchases and sales of foreign exchange at the two different rates will cost the government a further sh.93 billion per annum. There are also concerns that advantage can be taken of the opportunity of buying at the lower exchange rate and selling at the higher one.

D. <u>Proposals for Reform</u>

1. The objectives of reform are to preserve security and stability, rebuild the credibility and integrity of the state, strengthen discipline and morality, revive output growth, ensure reasonable equity and the meeting of basic needs, restore price stability and achieve external balance. If these are achieved in the short term they will facilitate achievement of the government's long term objective of building an independent, integrated and self-sustaining national economy.

2. If no policy adjustments are made this year both the balance of payments and the budget will become totally out of control. The balance of payments deficit will be $111 million or, if government purchases, suppliers credits, and other items are <u>not</u> part of planned cash import allocation of, a staggering $198 million. Meanwhile, the budget deficit will rise to sh.259 billion or over 4 times its 1985/86 level. The year after will be even worse. There is, therefore, a need for immediate policy reform.

3. The main proposals of the team consist of three inter-related packages.

I. <u>The Core Reform Package</u>

a) <u>Fiscal Adjustment</u> :

i. The government should move immediately to halt exchange losses, either by unifying the exchange rate or by switching items from the priority list to the market list or vice versa.

ii. A comprehensive reform of the sales and excise taxes and customs duty should be instituted with immediate effect. This would simplify the rates, remove most exemptions, unify the excise and sales tax and increase revenue on these taxes by planning foreign exchange input into local production. The administration of these taxes would be streamlined and collection monitored and enforced. These measures should raise sh.100 billion in year 1 and more than twice this amount in year 2.

iii. As a medium run measure, income tax should be reformed and collected on businesses through a presumptive approach.

iv. Fees, airport taxes, charges, licenses and stamp duties should be raised to offset inflation. Entry and transit fees should be raised for foreign vehicles.

v. One time revenues might be raised from sale of former Asian properties and currency conversion.

vi. On the expenditure side, a Presidential Commission should be formed to review the structure of the civil service with a view to cutting the number of ministries in half and to reducing staff.

vii. Further expenditure controls on foreign travel, vehicle repair and car hire are needed.

viii. Expenditure estimates for 1986/87 are disturbingly high and utterly unrealistic. Ministries must begin budgeting seriously. Expenditures in all ministries must be pruned, but especially in defence which still does not appear to be under control. Plans for a productive army are supported.

ix. Parastatal subsidies and subventions at over sh.14 billion, must be cut. More flexible ex-factory pricing and disposal of some entities would help.

x. Socially beneficial government spending must be raised; civil service salaries need adjusting; a shorter work day option for some civil servants is proposed. Basic needs expenditures, especially in primary health care, water supply, nutrition, family planning and adult literacy, must be expanded. Low salaries must be raised proportionately more than high ones; an educational scholarship fund for children of poor families should be established.

xi. Government must raise spending on maintenance and rehabilitation of assets and on supplies.

xii. Consideration should be given to establishing a local development fund at a parish level. This would focus on meeting pressing local needs and be financed by local taxes, in cash or kind, central government and foreign funds.

b) Financial Control

i. Detailed proposals are made to improve financial controls in both the government and parastatal sectors.

ii. The main institutional recommendations are a complete revamping of the Auditor General's Department, reinstitution of the Public Accounts Committee, creation of new central purchasing agency, strengthening of UDC's internal audit department, creation of a Professional Accountancy Training Institute, and possibly a State Audit Corporation.

c) Monetary Policy

i. Planning and financing of the budget must be tightly controlled and monitored by the Bank of Uganda.

ii. To ensure that adequate working capital is available to productive enterprises, a system of credit rationing should be introduced.

iii. In the light of (ii) above nominal interest rates should be reduced to just above the anticipated medium term inflation rate of 20-25% p.a.

iv. The idea of a currency reform is endorsed and the possibility of, and likely difficulties in, using this for taxation or redistribution are raised.

v. It is emphasized that a currency reform not accompanied by tight anti-inflation measures would be futile.

d) <u>Supply Expansion Measures</u>

i. Maintenance of security, controls over smuggling and corruption and rapid implementation of the resettlement and rehabilitation schemes will all assist supply expansion.

ii. Efforts must be made to raise immediately available foreign exchange through running down coffee stocks, rescheduling/renegotiating debt service, and raising aid in the form of balance of payments support. With a coherent adjustment programme a minimum of $20-$40 million could be raised; with IMF/IBRD approval of a relatively low conditionality programme this could rise to $160 million, and with a high conditionality programme, to $330 million. If government wishes to deal with the international institutions it should begin immediately to plan a strategy for negotiating.

iii. The use of foreign exchange is crucial. It is suggested that priority be given, in order, to basic needs industries, tax revenue raising industries, transportation and export promotion.

iv. The government should move to a unified exchange rate.

v. Producer pricing is one important factor among many; incentives should be given to specific crops e.g. cotton, and producers should receive a fair proportion of the world price.

vi. Reconstitution of the civil service and the guarantee of an impartial civil service commission are necessary.

vii. Government should rely on a blend of market forces and direct controls choosing its points of intervention carefully. If retail margins continue to be a problem consideration should be given to encouraging properly managed consumer cooperatives.

viii. The principle concerning ownership structure, at this time, should be the promotion of productive capacity. Control should be retained over enterprises producing essential goods, utilities and revenue raisers, subject to government's ability to run them efficiently. Ownership by workers, occupants or cooperatives should be encouraged. Control should be preferred to ownership given management constraints and assets should not be disposed of to known thieves and rogues. Some housing could be transferred to HFCU for disposal against loans thereby increasing its capital and available housing finance.

II. <u>Optional Policy Packages</u>

In accordance with the terms of reference, a series of projections were made of the likely future performance of the economy under different policy assumptions. The different scenarios with the main assumptions and results were as follows :

i. <u>Scenario 2A - Adjusted Status Quo</u>

Assumptions : 100% inflation. Current exchange rates. No policy changes except revenue measures outlined in core package plus concessional inflows and debt rescheduling.

Projected outcome : a large and growing balance of payments deficit. A large and growing budget deficit. No increase in civil service salaries or development expenditure. This is caused largely by an erosion of real coffee prices and therefore of export sales and coffee duty revenue.

ii. Scenario 2B - Adjusted Status Quo B

Assumptions : devaluation of shilling to sh.2500. Inflation 100%. Large initial coffee price increase followed thereafter by increases in line with inflation as exchange rate is also altered with inflation.

Projected outcome : a large initial and thereafter steady increases in coffee sales; a positive balance of payments and a large surplus in the budget.

iii. Scenario 2C - Adjusted Status Quo C

Assumptions : same as in 2B except with large surpluses and foreign exchange availability, inflation rate assumed 25%. Surpluses spent by government and foreign exchange allocated to intermediate inputs.

Projected outcome : as imports rise in response to spending, more intermediate goods come in and industrial activity picks up. Because of import leakages, however, amount of extra foreign exchange available for intermediates declines over time.

iv. Scenario 3 - Concessional Assistance Model

Assumptions : same as 2C except Uganda qualifies for concessional balance of payments support.

Projected outcome : as would be expected, the import constraint is unblocked and a much speedier industrial recovery and diversification is possible. Inflation should be controllable with resource availability rising and money supply constrained by surpluses, even after credit to industries is expanded. Civil service salaries and development spending can rise.

v. <u>Scenario 4 - High Conditionality Model</u>

Assumptions : same as 3 except Uganda qualifies for IMF high conditional assistance.

Projected outcome : even more resources available although on much stricter terms. It is doubtful whether Uganda either needs or can absorb this degree of resource inflow. Standbys are also expensive, repayable early and very demanding.

vi. <u>Scenario 5A - Control Model A</u>

Assumptions : order, extra transport and controls bring inflation down to 50%. Government revalues to sh.1000 per $. Producer prices are scaled down but remain at 50% world price in shillings.

Projected outcome : balance of payments moves into large and growing deficit. Budget deficit large and growing too. No increase in civil service salaries and development spending.

vii. <u>Scenario 5B - Control Model B</u>

Assumptions : inflation falls to -25% p.a. and stays there for three consecutive years. Exchange rate as in 5A.

Projected outcome : simultaneous deficits on both balance of payments and budget accounts. These are smaller in nominal terms than in 5A but because inflation is lower they are higher in real terms.

viii. Scenario 5C - Control Model C

Assumptions : as in 5B but exchange rate revalued to sh.700 per $.

Projected outcome : simultaneous deficits on both balance of payments and budget accounts.

These scenarios are meant only to be indicative of likely outcomes. They are subject to margins of error but are nevertheless suggestive. A majority view and a minority view are presented on the control scenario.

III. Sectoral Issues and Proposals

Summaries of these are to be found in the main body of the report under section 7 while more extensive accounts for most sectors were submitted directly to the government.

4. Since aid flows are common to all scenarios major donors were interviewed. In general they are pleased with the NRM's accomplishments but are awaiting the announcement of a coherent policy package before committing themselves further. They feel that current policies are a step in the right direction but inconsistent and insufficient. Government priorities are not clear.

5. They express concern over delays in finalizing aid packages and over Uganda's absorptive capacity.

6. Centralizing emergency aid in the PM's Office has worked well and emphasizes the importance Uganda attaches to it. In terms of project aid, the PMO should perhaps concentrate on policy and leave day to day details to the Planning Ministry.

7. More emergency aid is needed and should be sought through a publicity campaign. Government should approach donors soon for funds for basic needs areas - health, water, nutrition, basic education and literacy - for trucks and vehicles and for balance of payments support.

9. The above programme focuses on recovery and growth but also makes important provisions for access and expansion of basic needs facilities.

E. <u>Implementation and Phasing</u>

1. Implementation of this programme will tax government's capacity. A small economic secretariat should be established in the President's Office to elaborate a programme and to ensure its implementation.

2. New tax measures, control over spending and foreign exchange account losses must be dealt with immediately.

3. Currency reform should be implemented by December and alongside exchange rate adjustments if desired.

4. The secretariat should allocate scarce implementation resources to high priority areas, should monitor progress and report to the President.

5. Once a programme is in place it should be "sold" to donors.

6. Data collection is necessary for economic planning and control must be strengthened. This will mean addressing the needs of the Statistics Department.

CHAPTER 1

Introduction

1. The post-independence history of Uganda makes sad reading. It is the story of a country with a very high development potential being ruined by a few self-styled nationalists. The majority of Ugandans are much poorer today than they were 20 years ago; the cost of living has skyrocketed; export earnings have not only declined in real terms but more of these earnings have been diverted to purchase armaments and consumer goods at the expense of capital formation. The level of production has accordingly been reduced significantly especially in the industrial sector. This has in turn resulted in massive smuggling of goods which can be produced locally, as well as smuggling export commodities like coffee partly as a way of exporting capital but also for the purpose of financing smuggled imports.

2. The only activity that has stood its ground is food production. It is significant that without substantial food imports, the people of Uganda have not had to face the prospect of starvation. There have been pockets of food scarcity in some areas for reasons such as civil war or drought, but the overall food supply situation has been satisfactory.

3. It is also worth noting that coffee production has not declined as fast as other exports such as cotton and tea; indeed the sharp decline in production of export crops has resulted in coffee becoming the only determinant of export earnings as it contributes over 90% of the value of exports. Unofficial coffee exports also support the activities of a large parallel economy.

4. In the public sector government revenue sources dried up as imports of dutiable goods declined. Given the desire to enlarge the security forces government expenditure soared necessitating huge budget deficits financed mainly by the Central Bank. Against a declining level of domestic production and imports these deficits fueled inflation. With the expulsion of Asians in 1972 the number of parastatal enterprises expanded overnight without proper planning. These have been inefficiently run resulting in a drain on government revenues.

5. Underlying these trends was the state of anarchy and lawlessness which was put in motion in 1966 when Obote and his government decided to abandon the rule of law. In February, 1966 Obote arrested five of his ministers and subjected them to an indefinite period of detention without trial; in May 1966, he ordered Amin to storm the palace of the Kabaka who was also the Head of State of Uganda; and in June he abrogated the Independence Constitution of 1962 replacing it with his own. The army was let loose ostensibly to maintain law and order in the course of which they robbed, tortured and murdered many innocent civilians. The intensity of these atrocities increased with time so that Amin's ruthlessness (1971-79) exceeded that of his predecessor, while during his second rule Obote's atrocities (1980-85) surpassed those of Amin. The insecurity thus created not only alienated the population from the government but also led people to take a very short-term view of life, leading them to engage in speculative ventures with quick returns rather than investing in long-term projects.

6. In addition, the fact that the government of the day could not be bound by the laws and procedures it had itself laid down had a demoralizing effect on the entire population, especially in the public service. Morality and integrity in public affairs became extremely rare commodities, and added to the erosion of living standards of public servants as a result of high rates of inflation, greatly contributed to the present state of corruption, magendo and general inefficiency.

7. The successive regimes lacked the moral authority to enforce discipline since they were the main culprits; furthermore they were not capable of providing direction in matters concerning political, social and economic development. Their main preoccupation seems to have been making sure they survive in the midst of a discontented population and hostile international opinion.

8. The results of the 1980 election were hotly disputed. Some groups which felt strongly that rigging had occurred, thus nullifying the verdict of the people, took to the bush and waged a guerrilla war which, after 5 years, resulted in their victory. Apart from the effects of the war on the economy as some parts of the country were being controlled by freedom fighters while other areas were laid waste by the activities of the

army as in the Luwero Triangle, the governments of the day diverted enormous resources (both local and foreign) to the defence budget to ensure their survival. Only lip-service was paid to long-term planning and the productive sectors of the economy were starved of resources.

9. In our opinion, the overthrow of the Tito Okello government by the National Resistance Army (NRA) in January 1986 and the formation of a broad-based government by the National Resistance Movement (NRM) marks a turning point in the history of this country. Already the new Government has succeeded, against heavy odds, to establish the rule of law and effectively curbs the harassment of civilians by the security forces. As is stated elsewhere in this report, all the diplomats with whom we have had a chance to meet have expressed similar opinions. We cannot over-emphasize the importance of law and order and general security on the development process; the history of Uganda over the last 20 years is clear evidence of this. No plan will succeed against a background of insecurity and lawlessness. In this regard we feel that the NRM Government has laid a basis for national security without which development is difficult to conceive.

10. At the same time the Government faces the enormous task of overcoming the cumulative effects of atrocities and mismanagement of the economy by past regimes. The Government has a duty to instill integrity and morality in public affairs and ultimately eliminate corruption. There is a need to reverse the declining level of earnings in general as part of the effort to improve the morale of the population. A number of policies are needed to get the economy out of the abyss in which the NRM Government found it in January 1986. From our interviews with various Government officials we have formed the opinion that there is a serious effort to get the economy moving again. In this report we make a number of proposals, setting out various options which we hope the Government will find useful in formulating a package of reforms to enable the "Pearl of Africa" to shine again. We also think that the suffering which Ugandans have gone through as well as the seriousness with which the new Government has set about the task of addressing these near-unsurmountable problems deserve the sympathetic attention of the international community.

11. We have also examined the long-term objectives of the government relating to the creation of an independent, self-sustaining and integrated economy. These objectives are commendable; we also believe that the national and human resource base of the country is such that these long-term objectives can be attained. However, given the time constraint within which this study was undertaken, we were not able to examine in detail this aspect of our terms of reference. Moreover, we believe that the government is now faced with serious short-run practical problems to which it must find a solution if the economy is to be put back on its rails. We hope, nevertheless, that whatever short-term reform package is decided upon, the implications of such measures on long-term development will be carefully anaylzed and taken into account.

CHAPTER 2

Major Issues in Uganda's Macroeconomic Imbalance

1. In making recommendations to improve the performance of the economy of Uganda in both the short and longer terms, it is important to specify clearly what are considered to be the major issues to be addressed. Furthermore, it is essential to place these issues in an historical context.

2. The aim of this section is to define the major issues as seen by the team and to interpret recent historical developments giving rise to these issues. Where possible and appropriate attempts are made to draw out the social and political implications of what are often seen as narrowly economic issues.

I. Output and Prices

1. A major problem in analysing the performance of the Ugandan economy in recent years is the steady deterioration in the collection and publication of meaningful statistics. On the basis of somewhat unreliable official statistics, however, the economy grew at 8% and 4% per annum respectively in 1982 and 1983. Since then, real recorded GDP has fallen significantly by 5% p.a. in 1984 and by 5.5% p.a. in 1985. If one excludes government, miscellaneous services and rents and looks, therefore, at productive sectors plus commerce and transportation, the real growth rate has fallen even more dramatically from 12.1% in 1982, to 2.4% in 1983, minus 3.9% in 1984 and minus 8.2% in 1985. Thus, all the gains made in 1982 have since been lost. Since population has grown steadily during this period, material product (on this definition) per head of the population has fallen by 10% since 1981.

2. The reduction in aggregate supply was the result of political insecurity, transport bottlenecks, shortages of crucial imports, industrial mismanagement and the erosion of real incentives to farmers.

3. Supply contraction was accompanied after mid-1984 by a sharp increase in the expansion of monetary demand as the government deficit rose by sh.30 billion or by 134% between 1984 and 1985, all of it financed by money creation. Credit to the private sector also rose sharply by sh. 38 billion or by 70%. It is to be noted however, that most of the expansion of private sector credit went to crop finance and trade while other sectors, such as industry, complained of credit shortages.

4. The result has been inflation bordering on hyper-inflation, with annual rates of 158% in 1985 falling, perhaps (it is too early to tell), to 100% in 1986/87 with the end of the war.

5. Goods shortages have led to a considerable shift of transactions from the formal to the informal economy in which a combination of market imperfections, speculative activity and inflationary expectations have helped fuel the inflationary price spiral. The growth of this market makes it difficult, of course, to ascertain precisely what the level of activity in the economy really is.

II. Income Distribution and Basic Needs

1. The above shifts in output levels and inflation levels have had a profound impact on income distribution in recent years. There has been a sharp reduction in rural/urban cash income differentials from an average of about 1:4 in 1980 to 1:2 in 1985. This was the result of a relatively stagnant urban economy, an extremely buoyant rural sector and a generally inflationary situation. But the urban economy is now also perhaps less distinct from the rural economy than it was in the early 1970's, with many urban dwellers producing at least a part of their own food requirements. This, and the fact that both urban unofficial sources of cash income and rural subsistence sources of income are not directly measurable, means that cash income differentials should be interpreted with caution. Nevertheless, the evidence that overall differentials have narrowed is strong.

2. Within the rural areas there are significant differences in income distribution between different regions of the country, but these are unmeasured. Inequalities exist within different regions too, but again data is deficient. A major potential cause of inequalities is thought to be the 1975 Land Reform Decree which abolished customary, communal tenure and official Mailo and passed all land to the state. Ninety nine year leases can be obtained from the government but only those with access to procedures, money for the various fees and a development plan tend to apply. This decree opens up the possibility of the creation of a small group of wealthy land owners and, as land pressures mount in some areas in the face of high population growth rates, of a large number of landless labourers.

3. Income distribution in the rural areas has also been affected by the war. Several areas of the country and especially the "Luwero Triangle", Madi and West Nile have suffered widespread loss of life and property. Wilful destruction of houses, schools, coffee factories and trading centres have reduced once relatively prosperous families to near destitution. Road networks and health services seem also to have deteriorated in many parts of the rural areas.

4. In spite of the general and relative increase in overall rural incomes in recent years, there has been a terrible deterioration in basic needs and services provided by different levels of government. Primary health care facilities have virtually collapsed, water availability (always a problem) has deteriorated drastically and educational costs, especially at secondary level, have become prohibitive for many families. Food availability has not been a general problem, however, with only some regions suffering shortages. In the rest of Uganda food is plentiful although that is evidence of poorly balanced diets leading to malnourishment in many areas. Overall, the basic needs situation is such that infant mortality rates are reported to be rising while literacy rates have been falling.

5. Changes in the pattern of rural economy have had far reaching implications for rural women. In recent years women have become involved increasingly in raising cash income for the family through the growing and marketing of food crops, brewing, handicrafts etc. This is in addition to their normal cultivating and household chores. So great have become pressures to make additional money that in many areas of the country women are experiencing difficulties in handling the various demands being made upon them.

   They have responded by cooking more convenience foods or selling for cash previously consumed highly nutritious foods, in both cases leading to a decline in family nutrition. The number of families headed by women is reported to have increased as a result of widowhood, divorce and delayed marriage (J. Wanja Harmsworth "The Economic Status of Rural Women in Uganda" and H. M. K. Tadria "Changes and Continuities in The Position of Women in Uganda" both in "Beyond Crisis : Social Development in Uganda UNICEF 1986). The additional economic pressures on families, and on women in particular are said to have led also to greater stress and conflict within families and to women having less time for communicating at home and for participating in community activities.

6. Rural women complain that they rarely have control over the additional cash they generate. This compounds long standing complaints that women have about the inequality built into the marriage laws, inheritance laws, practices concerning land and other asset ownership and, consequently, related issues such as access to credit and membership of cooperatives.

7. Several of these trends in the changing role and status of women are to be found also in urban and peri-urban areas. Women, especially, have been forced by circumstances to play an active role in the magendo market. In addition, women claim that economic hardship has increased their dependence on men and hence their vulnerability. While accepting that they receive the same pay as men for a given job, professional women claim that it is harder for them to gain access to senior jobs than it is for men.

8. Improving the status of women, as a basic need and right, has never been easy anywhere in the world. The emphasis on democracy and equality of treatment for women in the Ten Point Programme indicates a commitment by the NRM to undertake this difficult task in Uganda. The above issues should help guide the direction of policy.

9. Within urban areas the same deterioration of publicly provided basic needs services has taken place and the cost of access to what remains (both official costs and unofficial charges) have increased. Real wages and salaries have fallen by as much as 60-80% since 1984 with enormous implications for incentives and corruption (see next sub-section).

10. It has been estimated by the team that in 1985 civil service salary levels, on a daily basis, could provide 6.5 times the daily minimum food requirement for officers at U1 scale, 2.6 times for those at U4, 1.4 times for those at U6, 1.1 times for those at U7 and only 0.8 times for those at U8. By 1986 these had been reduced by 50% so that none at level U6 or below could purchase daily requirements out of daily wages. Those at the very bottom of the scale could provide at most 40% of their daily food needs from salary. This <u>excludes</u>, of course, expenditures on housing, clothes, travel, school fees, medicine etc. It is for this reason that the NRM Ten Point Programme makes a commitment to reviewing civil service salaries.

11. These are some of the issues of equity and basic needs which any adjustment programme and long term development programme must address.

III. Budgetary Performance

1. The fiscal position of the Government of Uganda has been steadily deteriorating in a number of ways over the past four years. To begin with, there was a dramatic, 4 fold increase in the BUDGET DEFICIT between 1982 and 1984. Even when inflation is allowed for the deficit rose 2 1/2 times. The deficit also rose steadily as a percentage of GDP and as a percentage of government spending. There is, however, evidence that in 1985/86 the deficit financed by Central Bank borrowing was roughly at its 1984/85 level or at about sh. 53 billion representing a significant drop in real terms and as a percentage of government spending relative to 1984/85.

2. The most important problem in the budget would appear to be the low GROWTH OF RECURRENT REVENUE. Since 1982-83, revenue growth has not kept pace with inflation so that in 1985/86 it was, in real terms, only about a half its 1983/84 level. This problem must be addressed if government is to resume its role in the stimulation and regulation of the economy.

3. The poor revenue performance is intimately linked to problems in the STRUCTURE OF TAX REVENUE. With the severe constraints on import capacity in recent years, and the related collapse of industrial production, revenue from import duties, sales and excise taxes has been greatly constrained. The relative importance of these taxes has, therefore, fallen from over 50% of total revenue in the early 1970's to 32-36% in recent years. Likewise, the collapse of industry, the massive shift of transactions from the formal to the informal, unrecorded sector and the bid to offset erosion of civil servants salaries by exempting them from PAYE, has led to a collapse of direct taxes. Income and Corporate taxes, which used to account for about a quarter of total revenue in the early 1970's do not now exceed 4.5%-6%. Many licensing charges and fees have not been adjusted for inflation and hence realize only a fraction of what they were intended to raise originally.

4. At the same time there is evidence of widespread failure to collect taxes so that actual revenues are well below what they should be even with this diminished base.

5. In consequence, government is relying increasingly, on the coffee export tax as its principal source of revenue. Taxes on coffee, which barely reached 20%, now account for between 55 and 60%. This not only raises questions of equity, it also suggests that budget revenues are not likely to be particularly buoyant or stable in the near future. Diversification of the tax base and the development of buoyant sources of revenue must be the cornerstone of any programme of budgetary adjustment.

6. The Interim Economic Measures should be viewed in this context. By raising coffee prices by 75% without an accompanying exchange rate adjustment, the government stands to lose some Sh.100 b in export tax revenue unless there is an increase in coffee production or a shift of coffee sales from the unofficial market to the official market. To at least neutralize the impact of this measure on the budget, these responses would need to generate extra official coffee sales equal to 75% of the total in 1985.

7. Contrary to widely held views, TOTAL GOVERNMENT SPENDING in Uganda does not appear to be excessive. Indeed, at 9% of GDP in 1983/84 and falling perhaps to 6-7% in 1986/87, this is the lowest recorded expenditure in the whole of sub-Saharan Africa, being less than one half that of the average low income SSA country. The government's ability to influence the social and economic state of the nation through spending is, therefore, very limited.

8. Nominal growth in RECURRENT SPENDING has reached high levels over the past four years, so that total recurrent spending in 1985/86 was 12 times its 1981/82 level. In real terms, however, recurrent expenditure has grown at about 5% p.a., which is not out of line with GDP growth over the period as a whole. There was also a sharp fall in the rate of increase in spending in 1985/86 which reduced the level of real spending in that year to below that of 1982/83.

9. Reliable data on the COMPOSITION OF RECURRENT EXPENDITURE is not readily available. It appears, however, that Defence (25%), Education (15.4%) and Consolidated Fund Expenditures (27.5%) make up two thirds of recurrent spending, leaving little room for health and directly productive services.

It appears that wages and salaries comprise about 28% of recurrent spending, while import content is in the region of 50-55% (direct imports, 6-9%, petroleum 12-15% and foreign debt and interest 31.5%).

10. There are four major concerns regarding this composition. Firstly, the salaries of civil servants are wholly inadequate to their needs, having fallen in real terms since 1981/82 by between 60-80%. Real incomes are now so low that they constitute only a small fraction of what is required for people to get by. As argued more extensively in Section 2 (vii) this means that all civil servants must spend time and energy generating additional income with the result that their civil service job becomes either a sideline activity or a means of generating illegal sources of income. Thus, salaries are too low to generate commitment and productivity and they penalize those who are committed and honest. The second problem is that the number of civil servants has grown substantially in recent years with large numbers of essentially redundant staff, especially at lower levels. Thirdly, there are no less than 35 ministries each complete with its own top leadership and bureaucracy. This absorbs an excessive amount of scarce talent, involves costly duplication, and causes problems of co-ordination. Fourthly, expenditure control in the budget is completely lacking, with accusations and evidence of corruption and the sale of "air" being widespread [see Section 2 (viii)].

11. The problem of recurrent expenditure is therefore not one of an excessive total, quite the contrary, but rather of the manner in which that total is spent.

12. The principal measurable causes of the deficit since 1984 have been the three to six-fold increase in civil servants salaries in July 1984, and the growth in Defence spending. These are estimated to have added sh.31.4 b, and sh.19.5 b respectively to the budget between 1984 and 1985, accounting for almost the whole of the deficit incurred in that year.

13. The DEVELOPMENT BUDGET also raises a number of issues. Development spending in 1982/83, 1983/84 did not keep up with inflation and was approximately 30% less in real terms than it had been in 1981/82. Since that time there has been a pronounced recovery so that real spending in 1985/86 was budgeted to be double that of 1981/82. Even so, the development budget would still be quite small representing no more than 2% of GDP. As it happens, it looks as if budgeted targets will not be reached and that only about two thirds of the budgeted amount (some sh.100 b out of sh.150 b) will be spent by the end of June.

14. The COMPOSITION of development spending has, until recently, been skewed in favour of General Public Service, Security and Education expenditures, which accounted for about two thirds the total in 1982/83. In 1985/86, however, expenditure on economic services was slated to rise to just over a half of total spending.

15. There is evidence that the development budget has been constrained in the recent past by absorptive capacity and by security problems. In the future absorptive capacity may still be a constraint but foreign exchange is likely to be an even more binding one, given the recent trends in foreign capital inflows and in exports referred to in the previous section.

IV. The Balance of Payments

1. The single most important feature of Uganda's balance of payments position since 1981 has been an uninterrupted fall in the real value of imports. By 1985 official flows of real imports were between 28 and 38% lower than their level in 1981 (depending on how one values imports from Kenya). Though there were undoubtedly additional inflows of imports in the unofficial market of smuggled goods, there is no evidence that smuggling has increased since 1981. Also, of course, some of the proceeds of smuggled exports do not increase import capacity at all but simply finance capital flight. The erosion in import capacity is, therefore, real and has helped prevent rehabilitation and recovery of such key sectors as industry and transportation, and has led to an acute shortage of consumer goods. In turn this has discouraged agricultural growth, fuelled inflation and eroded the tax base. Restoration of real import capacity must be a vital element in any economic recovery programme.

2. The composition of imports in recent years has also served to impede economic rehabilitation and recovery. A large proportion of the already constrained import capacity has taken the form of consumer goods (between 43% and 63% of non-oil imports approved by the Bank of Uganda in the past two years). Many of these, such as sugar, salt, cigarettes, alcoholic beverages, soap, textiles and clothing, are items which Uganda could produce in normal circumstances. The necessity to satisfy immediate consumption needs serves, in a situation of declining overall import capacity, to divert resources from rescusitating industrial production of the very same consumer items.

3. Petroleum related imports absorb 20% of total imports but fully 40% of those subject to discretionary allocation by the Bank of Uganda (i.e. excluding aid imports, for instance). The concern here is that these products sell locally at a fraction of their price in neighboring countries, giving rise to smuggling, loss of tax revenue to government and an artificially inflated import demand. The price per litre of petroleum valued at market exchange rates, for instance, is only about US 15 cents compared with US 50 cents in neighboring Kenya.

At the same time there are concerns that the dollar import price of petroleum products is both high and inflexible relative to world prices which, of course, have been falling in recent months.

4. The steady contraction in real import capacity has taken place in spite of a relatively strong recovery in official coffee export volumes since 1980, and in spite of steadily rising international coffee prices in dollars since 1981 (recorded coffee proceeds were in fact over $100 million greater in 1985 than in 1981).

5. The strength and resilience of the coffee sector prevented the decline in real imports from being even more serious than it was. At the same time the overwhelming dependence of merchandise exports on this single crop renders Uganda very vulnerable to international price fluctuations and possible future quota restrictions. World coffee prices have started falling already, adding yet further pressure on the country's fragile import situation.

6. A critical problem facing the government is the revitalization of exports of other traditional crops such as cotton, tea and tobacco.

7. An additional problem on the export side is that of generating earnings from non-traditional exports. The success in exporting maize in 1983/84 demonstrates that significant possibilities do exist in agriculture. Non-agricultural export possibilities also exist, e.g. energy and minerals, but await industrial and infrastructural rehabilitation.

8. A major factor constraining import capacity is the country's large DEBT SERVICING COMMITMENTS. In 1984 these amounted to $130.2 million (including net IMF repurchases and payment of arrears) or to 32% of total export earnings. In 1985 they reached $181 million or fully 48% of exports and will be well above this level, at $249 million or 58% of merchandise exports in 1986/87. Uganda's total external debt, including funds owed to the IMF, now stands at over $1 billion. It is to be emphasized that the reduction in real import capacity would have been even greater in the absence of this borrowing.

9. It is to be noted that debt servicing commitments to the IMF and IBRD cannot be rescheduled. To the IMF alone, these reached $89 million in 1985 and will be $112.0 in 1986/87.

10. Uganda has been unable to meet all its debt obligations in the past so that its arrears of principal and interest stood at $86.3 million in March this year. Since then the rate of payment of principal and interest appears to have slowed considerably so that, while there has been some payment of arrears, the net total has probably increased by a further $40 million to $50 million to end of June. Total arrears, including commercial arrears, now stand at around $130 million.

11. Import capacity has also been adversely affected by a steady fall since 1983 in both unregistered transfers (mainly grants) and official medium and long term capital inflows. These declined from $163.7 million respectively in 1983 to $61 million in 1984 and $85 million in 1985. This decline represents over a quarter of total 1983 import capacity.

12. As a result of the above developments, and in spite of strong positive balances on the current account of the balance of payments, Uganda's gross foreign exchange reserves have fallen by $92.8 million over the past two years, and now stand at the equivalent of only 2 months imports.

V. The Exchange Rate

1. The price of the Uganda shilling is the most important single price in the economy. It influences the volume and structure of output, the level and structure of prices, and the distribution of income. It is therefore not surprising that there should be intense interest and controversy surrounding exchange rate policy.

2. In the 1981-84 stabilization programme the exchange rate was substantially left to be determined by "market forces" at weekly official auctions and on parallel (kibanda) markets. An official rate for selected foreign exchange transactions gradually converged with the market-determined rates until the second half of 1984, following which the gap between them widened again. The auction system has been terminated and, from May 1986, there are two official exchange rates - one for "priority" imports (now virtually all of those for which the Bank of Uganda allocates foreign exchange) and coffee at sh. 1400/dollar, another at sh.5,000/dollar for all the rest.

3. The present dual official exchange rate is intended to achieve low prices for essential imports and assist in the maintenance of government revenues from the coffee sector while offering strong encouragement for non-traditional exports. It represents a compromise between advocates of lower prices, to be achieved with the help of government administrative systems, and those who believe that, with the exception of few key prices, e.g. coffee and petroleum, domestic price structures cannot and should not be governmentally controlled. The underlying disagreements relate to the actual and desirable structure of prices, and the role and current capacities of government.

4. The auction or "free market" system for exchange rate determination had the advantage of keeping official exchange rate changes broadly in line with the changing relative purchasing power of the Uganda shilling during a period of rapid domestic price inflation. It also was intended to have the flexibility to allow profitable enterprises that found themselves unable to function because of the absence of crucial inputs or parts to acquire them quickly and legally if they could afford to pay for them.

On the other hand, because the use of foreign exchange was not specified it encouraged the wealthy to acquire foreign exchange for consumer goods and other purposes not related to Ugandan development. It also left the exchange rate extremely unstable and unpredictable and this too encouraged importation of consumer goods which could be quickly disposed of at scarcity prices. In contrast, producers were never sure that they could recover outlays on raw materials and spares, especially when facing price control at the ex-factory level. It has been said that the exchange rate is much too important a price to be left to the market.

5. In Ugandan circumstances, where effects on private capital flows are likely to be minimal, official devaluation of the currency is exactly equivalent to uniformly increasing duties on all imports and subsidies on all exports. The same considerations of price effects, effects on public revenues, and potential for evasion can and should be applied to exchange rate decisions as would be applied to equivalent tax and subsidy ones. If there is agreement on the desired outcome, the selection of exchange rate policy rather than taxes and subsidies as the operative policy instrument is a relatively technocratic matter.

6. The current dual exchange rate may be seen as the equivalent of a heavy tax (additional to the formal export duty) on coffee together with a hefty subsidy to importers and non-traditional exporters. The value of the "subsidies" substantially exceeds the value of the "tax", so that the implications for government revenues are strongly negative. Current exchange rate arrangements also fail to provide sufficient incentives for the restoration of past levels of tea and cotton exports.

7. An alternative to <u>either</u> exchange rate <u>or</u> tax/subsidy policies is administrative control. Under present policies, the allocation of "free" foreign exchange among different potential importers at a fixed price is done exclusively in this way. Compulsory delivery of coffee to the CMB at a stipulated price is also part of the "control" system. In both cases there is some evasion and some disagreement as to how much. In the case of imports there is the further question,

on which there may be some disagreement, as to the extent to which traders earn "rent" in consequence of their ability to sell their imports, or products made from them, at high "scarcity" (market-determined) prices. If traders can do this one of the principal purposes of current exchange rate policy is not achieved.

Those who doubt the intention, desirability or capacity of the government to control allocations and prices in the social interest tend to favour the use of exchange rates and tax/subsidy policies.

8. If it is agreed that both coffee export tax and import controls are <u>desirable</u>, and that the drain on government revenues of present arrangements is <u>undesirable</u>, can exchange rate policy play a role in the more effective pursuit of governmental objectives?

9. These are the principal issues concerning the exchange rate. The more technical matters will be dealt with in the proposals in section 5.

VI. Monetary Policy

1. The most important feature of monetary policy in Uganda has been the permissive financing since 1984 of government budget deficits. These have been financed by the Bank of Uganda largely through Ways and Means Advances.

2. Net credit to the Government by the Bank of Uganda rose by sh.68 million, from sh.37 billion in early 1984 to sh.105 billion by December 1985 - a rise of 183%.

3. Passive funding of the budget deficit was the main cause of rapid increases in money supply (M2) by sh.145 billion or by 237% during this period. Increased lending to the private sector, by sh. 56.36 or by 157% also contributed as did losses made by the Bank of Uganda on foreign exchange revaluations.

4. Since December 1985 Ways and Means Advances to government have continued to expand rapidly and by April had reached sh.117 billion.

5. This permissive monetary policy, to support a mushrooming budget deficit, has undoubtedly helped fuel inflation since 1984.

6. Other important aspects of monetary policy such as crop finance facilities, credit to agriculture, industry and trade etc., are dealt with under section 7 (VI).

VII. Incentives and Corruption

1. As stressed earlier, the massive erosion of the purchasing power of wages and salaries since 1984 has led to a situation in which wage earners and the salariat survive not from formal earnings from their job, but from other activities.

2. Some have responded by taking more than one job (e.g. teachers, doctors), by petty trading, by cultivating a shamba on the side, by sending other family members out to work or trade, by sharing food and accommodation with a broader group, or, in the case of the highly skilled, by leaving the country. Not all have been successful in mitigating the fall in their incomes. Some have had to make do without items previously thought important (e.g. some foods, clothing, transportation to and from work, education and health services for children, etc.) and in extreme cases have had to resort to begging. In many respects, however, it is probably true to say that Uganda no longer has a pure wage earning or management group since people can no longer survive purely on wages or salaries. The line between urban and rural existence has also become blurred and the gap between average urban and rural incomes, so wide in earlier decades, has narrowed or even been reversed.

3. There are, therefore, few incentives for people to show up at work regularly or once there, to be conscientious and productive. In addition, shortages of foods and transport problems, in themselves, mean that employees must inevitably spend inordinate amounts of time away from the work place. The problem is, however, that all employees are regarded as full time workers and are, supposedly, paid to be there full time.

4. The drastic decline in real incomes has also forced many employees into illegal activities. Theft, conversion, misappropriation of funds, smuggling, black marketeering and exchange control offences are now common.

5. For many ordinary employees engaged in these activities, this is a question of survival. The problem has its origin in grossly deficient real incomes from employment, but it is now so deeply embedded in society that it may take more than a reversal of real income trends to rectify it.

6. Given the speed with which increases in real income were eroded in 1984-86, employees will be skeptical that any subsequent increases can be maintained. It will, therefore, take time to reverse the current negative incentive system even if prices are stabilized.

7. Any action by the government to contain these "corrupt" practices and any steps taken to raise time spent on the job and to promote productivity will be injurious to employees, and probably doomed to failure, unless real incomes can be both <u>raised</u> and <u>maintained</u> over a period of time.

8. The same argument does not apply to large scale corruption in high places. There is considerable concern that the new government has not dealt quickly and effectively with people known to be corrupt and that in some cases, it appears to have rehired or promoted such people.

   There is skepticism that the Commission of Enquiry procedure will work. Concern has been expressed that it is not focussed enough nor does it delve deeply enough into the affairs of those suspected of corruption. The team is not, however, in a position to comment on this, except to state that this method of policing corruption is very much a "top-down" bureaucratic method; it is slow and ex-post and provides no day to day pressure on would-be offenders.

10. There appears to be strong support to government efforts to close the borders to large-scale smuggling traffic. There is, however, considerable empathy towards small scale smugglers seeking, among other things, to obtain scarce consumer items, although in some areas (e.g. the Arabica growing areas near Kenya) it appears that the trade of such small scale smugglers might, <u>in total</u>, be very significant. If so, it is unlikely to be prevented by direct controls and will require addressing the market distortions to which it is a response.

VIII. Financial Control and Discipline in the Public Sector

1. Financial administration and control describe the policies and procedures which, when effectively adhered to, ensure that maximum benefit is derived from resources expended. In this sense of the term, financial administration and control have ceased to exist in the public sector of Uganda. There are simply no effective administrative and procedural checks and balances on the efficient use of financial resources in operation at this time.

a) Ministries.

2. Government expenditure is completely out of control and revenue collection is a mere fraction of its potential. Corruption borders on being endemic and, to 1985, reached all the way to the level of ministers and beyond. The budgeting process has broken down and requests for funds are often totally unconnected to previous years' programming or to any sensible notion of Ministry plans and obligations. Budget guidelines are often simply ignored and requests for funds are usually not accompanied by any detailed justification. Budget requests are seen as a <u>first</u> request to be followed, as a matter of course, with subsequent supplementary subventions. Again, these tend to be accompanied by little or no substantiation.

3. Supporting documentation for purchases of goods or services is limited and such purchases are largely out of control. The procurement system is in disarray with individual Ministries writing their own local purchase orders without having to go through a general purchasing agency. There is, therefore, no independent check that goods are actually bought or that they are bought at reasonable prices. The advantage of bulk buying and quality control is also forfeited.

4. The National Public Accounts have not been prepared for fifteen years. These include :

   Statement of Receipts into and Issues from Consolidated Funds

   Balance Sheet of the Consolidated Fund

   Balance Sheet of the Treasury General Account

Summary of the Appropriation Accounts

Summary of Statements of Revenue

Statement of Public Debt.

5. The Public Accounts Committee has not functioned effectively since 1971 and has not convened since 1981. The Auditor General's Report has been prepared on a current basis but has <u>not</u> been published since 1971. This Department has been terrorized into impotence.

6. Corruption and malfeasance are so widespread that at this point in time little confidence can be placed in the civil service. Staff morale is low and loyalty is questionable. The reasons for corruption are now systemic, however, as discussed in section 2 (VII).

b) Parastatals.

7. Financial administration and control in the parastatal sector depends upon largely untrained or unskilled staff. This sector is also seriously understaffed in this area. Corruption is also evident in many parastatals. In short, financial administration and control is generally extremely weak and meaningful budgeting is almost non-existent.

8. Existing programmes of rehabilitation are proceeding at far too slow a pace and on the basis of an insufficient knowledge of needs, problems and possibilities. The financial statements of most parastatals have either not been prepared or have not been audited since 1983. Part of the problem is that the qualifications, skills and experience of the majority of <u>senior</u> financial staff in the parastatals are inadequate.

9. Control over parastatal operations and performance by the Ministry of Finance has been non-existent since 1971; yet this Ministry has made significant investments in parastatals and has given massive loan guarantees on behalf of parastatals. Subsidies and subventions to this sector now amount to over sh. 14 billion annually, in spite of government having hopelessly inadequate and outdated financial

statements of the performance of those entities requiring such assistance. Government or public control generally over the parastatals is very weak. Managers and Boards of Directors are seemingly not accountable to any one and are not held responsible for their actions or lack of activity.

10. Thus neither civil servants nor parastatal employees are accountable to the public for their actions. Rarely are established legal channels employed to deal with those who abuse their office.

IX. The Role of State Intervention

1. How far and in what ways the State should intervene in the economy is currently being debated with reference to three separate issues. The first and most contentious of these concerns the distribution and pricing of commodities, the second relates to the disposition of former Asian properties and the third to the size and role of the parastatal sector.

I. The Distribution of Commodities

2. The Government has taken the position that certain essential consumer items should be made available at relatively low prices. In the case of sugar it announced a desired price which was much less than the prevailing market price at that time. Government intends to ensure that adequate supplies are ordered from abroad at the priority exchange rate to sustain the indicated official price. An elaborate distribution network is envisaged in which a parastatal company purchases sugar and distributes it to agents selected by village resistance committees. These agents then ensure an equitable distribution at the official price.

3. At this time the Government's view is that this approach to distribution is an essential element of its anti-inflation policy. Greater equity in distribution appears also to be an important consideration. The suggestion is, however, that this is a short term expedient to be abandoned when goods are in abundant supply.

4. The larger merchants, however, see this approach as a threat to their profits if not their existence. In recent days the price of sugar has skyrocketed to in excess of Sh 10,000 a kilo and older stocks in the hands of these merchants appear to have been withdrawn from circulation. Sugar has indeed become a major political issue.

5. It remains to be seen if the distribution system planned by the Government can succeed. Much will depend on how strong the village resistance committees are and how sound is their choice of preferred local agents. There is evidence of some arbitrariness in the selection of agents in some places. Considerable doubts have been expressed that a soundly based and functioning committee structure exists in Kampala and other urban centres.

6. Some argue that the chosen price is needlessly low and that there was general acceptance of sugar prices of around Sh 2,500 per kilo before the announcement. Yet others argue that the current price will discourage local production of sugar since it would not be profitable, and that part of the allocation of foreign exchange for sugar would have been better spent on imports for the sugar factories and estates.

7. Fears are also expressed in some quarters that this is the first step towards the controlled distribution of all "essential commodities". Critics feel that controls are costly, cumbersome and less efficient than the market.

8. For its part, the government clearly sees itself engaged in a war against ruthless speculators and smugglers who take advantage of supply and demand imbalances to gouge the public. Should the new distribution mechanism work, consumers would undoubtedly benefit in the short run. One aspect of the new distribution system which is not likely to appeal to the public is, however, the special treatment in terms of both purchasing procedures and quantity allocation, accorded to senior government officials.

9. On a related issue government also feels that it can deal with market induced illegal flows of goods into neighboring countries. It feels it has the capacity to physically prevent such outflows by policing the borders and by punishing offenders. In this way it believes that prices in Uganda, adjusted for relative exchange rates, can be maintained at levels lower than those in neighboring countries without a drain of commodities taking place. The alternative, of course, would be to allow local prices and/or the exchange rate to rise to destroy the incentive to smuggle, but the government fears this would be inflationary.

II. <u>Disposal of Former Asian Properties</u>

10. Government has decided to dispose of those former Asian properties which have not yet been claimed by their former owners. The view has been expressed in some quarters that these properties are not of great importance and that the issue is really a nuisance, absorbing much precious time which could be better spent on other issues.

11. We believe that these assets are of crucial importance to the economy; that their distribution is a matter of great public concern and that ill-considered redistribution could have serious consequences both for the government and the economy.

12. It is clear that government is correct in believing that current arrangements, with properties being rented from the Custodian Board are not functioning properly. Rents are generally low, collection is often poor and the Custodian Board poorly managed. As a result properties are not maintained. Many buildings and factories have become dilapidated. But these assets account for a considerable proportion of the capital stock of Uganda and much of the urban/industrial and modern agricultural stock.

13. The periodic redistribution which have taken place in the past have had enormous social and political consequences, bestowing economic power on one group at the expense of others. The frequency and arbitrariness of distribution/redistribution has also affected the way in which property has been utilized, giving rise to speculative short term utilization and profit seeking with little interest in investment in maintenance or expansion.

14. Uncertainty of tenure and title have also discouraged the productive use of assets by impeding access to commercial credit.

15. Hasty and unplanned redistribution may again penalize legitimate occupants, or may lead to the concentration of property ownership in the hands of a small group of wealthy Ugandans, many of whom have acquired wealth under dubious circumstances.

16. It is imperative, therefore, that government resolves this issue once and for all and that it takes this opportunity to consciously shape the social and political fabric of this important portion of the economy.

III. Disposition of Parastatal Enterprises

17. The government has also announced its intention of selling off those parastatals which it believes are more suitably owned and operated by the private sector. Criteria for retention or sale have not yet been worked out.

18. There is no question that such a review is needed given the haphazard manner in which parastatals were created and operated in the past. This sector is also a major drain on the budget since it draws over Sh.14 billion annually in subsidies to cover operating deficits.

19. Here again it is clear that these criteria and the manner and terms of the sales will be important is shaping the social and political, as well as the economic future of Uganda.

20. At the same time it is equally important that consideration be given to the manner in which the remaining parastatals are operated. Excessive government intervention in day to day affairs, the prevention of rational pricing and financing policies, the appointment of ill-qualified managers on sinecure, the forced-feeding of UPC party branches in parastatals and the failure to provide for any constructive input by workers into decision making, have all contributed to a parastatal sector lacking in efficiency, integrity and democracy. It does not follow from this, however, that parastatal companies which operated poorly in the past, should necessarily be sold off. With a changed environment their performance might improve. It might also be the case that restoring productive operations, which at this time must be seen as the number one priority, might be achieved in ways other than by selling, e.g. through joint ventures, leases, etc.

X. Emergency Relief and Reconstruction

1. Providing relief and reconstruction in the war-ravaged areas of the "Luwero Triangle", West Nile, Madi, Lira/Apac and elsewhere is, understandably, a matter of the highest priority for the government. Immediate relief is required if resettlement is to proceed and if return to some kind of normality is to be possible, after years of brutalization and destruction.

2. The government Emergency Relief and Rehabilitation Programme was designed to cover requirements over the first three to six months and aimed to raise $161 million from domestic resources and from "friendly countries and the donor community".

3. After five months not much more than $30 million appears to have been raised from foreign donors and the government has decided to use its own scarce resources to import such badly needed items as blankets, hoes, human and animal drugs, scholastic materials, cement and spare parts.

4. It is not clear why donor response has been so minimal, given the humanitarian nature of much of the assistance requested. It is true that not all of the programme could be fitted into a narrow definition of humanitarian needs e.g. spare parts for Radio Uganda, repair and renovation of hotels, facilities and equipment for police and prisons, office supplies, etc. As well, large provisions were made for inputs into local industries for government transportation and for restoration of electricity and the railroads. Such needs are <u>obviously</u> pressing and vital for reconstruction of the economy, but they do not carry the humanitarian appeal of drugs, blankets and agricultural inputs. Even so, aid receipts fall well short of narrowly defined humanitarian needs, perhaps by as much as $70 million and the question is, why?

5. It appears that the campaign for foreign fund raising has not been as well orchestrated or as highly publicised as it ought to have been. After the horrors of the Amin, Obote and the 1985-86 governments, there ought to be much greater international support for a government which has restored peace and security and which is attempting, with minimal resources, to rectify some of the human dislocation and suffering of the past.

6. While it is commendable that the government is proceeding to implement its programme without waiting for such aid, it must be appreciated that this will cause supply constraints in other needy areas of the economy, thereby retarding their recovery and rehabilitation and making it even harder, thereby, to restore economic stability. A much greater effort is therefore needed to raise humanitarian aid from donors. Some donors are, apparently, withholding project and programme aid until Uganda has adopted a clear economic programme. It must be emphasized that there is no justification for withholding humanitarian aid on these grounds.

CHAPTER 3

Assessment of Macroeconomic Programmes 1972-1985

1. Having reviewed briefly the major issues facing the Uganda economy at this time, and before proceeding to analyse possible policies to deal with these issues, it might be useful to survey the recent historical experience of macroeconomic policies. This might help to throw light on the likely efficacy of alternative policy approaches and the pitfalls to be avoided.

2. For ease of analysis we break the period down into two distinct historical policy regimes; that of 1972-1979 and that of 1981-85.

a) 1972-1979

3. The first period saw a gradual erosion of the modern sector of the economy. The expulsion of the Asians led to serious disruptions in trade, industry and provision of professional services. The arbitrariness, unpredictability and brutality of the Amin regime prevented a quick and sustained recovery from this loss and encouraged a very short term, myopic view of economic life and decision taking. Public sector professional standards were compromised by the recruitment of ill-qualified political appointees and by the fear and insecurity experienced by the leadership.

4. Macroeconomic policy during this period was not used actively to try to turn around the economy. A fixed exchange rate was maintained and monetary policy was generally lax (M_2 growing at over 30 p.a.) in a context in which real monetary output fell steadily by 25%. The result was severe inflation which was partially hidden by extensive, but ineffective, official price controls. At the root of the monetary expansion was a huge increase in the budget deficit due to unconstrained government spending and a dislocated tax base.

5. Producer prices were not adjusted to allow for inflation and often delayed cash payments to producers. This, together with officially sanctioned smuggling, led to a reduction in officially marketed coffee from 175,000 tons in 1970 to 80,000 in 1978. How much of this reduction was due to an increase in smuggling and how much to a fall in output is not know.

Other cash export crops were similarly affected as production became less attractive and/or as smuggling increased. Real imports fell significantly because of the stagnation of exports (to 1975) and because of increasing costs due to world inflation. The situation was eased somewhat by the coffee boom of the mid to late 1970's but a large proportion of the proceeds of this was wasted. The country fell deeply into debt and eventually began defaulting on payments. The black market rate for the dollar rose to over sh.70/- compared with an official rate of sh. 7, and 'magendo' flourished.

6. Real wages were eroded, the minimum wage rising by only 54% while inflation rose by more than 11 times. Workers adjusted in the many ways described in section 2 (vii).

7. Among the many narrowly economic lessons to be learned from this period are :

a) that it is much easier to undermine an economy than it is to rebuild it;

b) that incentives to farmers and workers <u>are</u> important,

c) that a collapse of discipline by the army and/or government can seriously disrupt the normal functioning of the economy.

d) that extensive controls are difficult to administer under conditions of widespread deprivation, corruption and where daily necessities are hard to come by.

e) that a fixed exchange rate in the context of rapid monetary expansion erodes the real effective exchange rate (price competitiveness with trading partners adjusted for the exchange rate) and encourages imports at the expense of official exports and also encourages smuggling;

f) that this type of economy is extremely sensitive to the availability or otherwise of imports;

g) that the tax base was very fragile;

h) and that foreign exchange proceeds from foreign borrowing and periodic coffee booms must be used productively to <u>either</u> reduce future import dependence <u>or</u> to strengthen the balance of payments in other ways.

Excessive borrowing and careless use of foreign exchange simply cause problems in subsequent years. A final lesson is that Ugandan workers and peasants are very resilient and react to crisis by strengthening their subsistence base. It is this resilience which has carried Uganda through 15 years of crisis.

b) <u>1981-1985</u>

8. For most of this period Uganda was pursuing a stabilization policy under IMF auspices. This involved a large initial devaluation of the shilling followed by a two window foreign exchange system. Under this system a certain portion of foreign exchange was auctioned while the rest was sold at lower, window 1 prices. Items qualifying for the window 1 price were eventually restricted to coffee and cotton exports and official grants and loans. All other items were sold at a higher, auction rate which fluctuated according to supply and demand. The programme also involved a tight monetary policy and control over the budget deficit.

9. At the same time producer prices for export crops were raised at least 5 fold in 1981 and steadily thereafter at rates in excess of the rate of inflation. Export producers began receiving an increasing share of the world price for their commodities. Since urban wages and salaries were frozen, at least for the public sector, the intention was to redistribute income from the urban to the rural sector.

10. It is difficult to evaluate the significance of real producer price increases on officially marketed crops beginning in 1981 because a number of other factors would have played a role. To begin with there was a tightening of controls over smuggling as the Coffee Board leadership passed to the army, which had its own illicit reasons for wishing to see more coffee flow through official channels. Secondly, there was a considerable improvement in transportation capacity in 1980-81. Thirdly, both Rwanda and Kenya actively discouraged smuggling at this time in order to protect their own quota.

11. Underlying the IMF programme were significant increases in the flow of foreign funds, many of them borrowed from the IMF and elsewhere. Although one might suppose that these were to be used to increase the availability of imported commodities, to assist the recovery and rehabilitation of the transport, agriculture and industrial sectors, in actual fact the IMF did not specify the use to which they should be put.

12. In the first three years of the programme the official rate of inflation first rose significantly but then fell and levelled off in the two subsequent years, the increases being 54.0%, 35% and 35%. Some of the initial inflation is probably fictitious since, apparently, some of the prices in the April 1981 base were recorded at official prices while actual magendo prices paid were much higher.

13. There was a strong recovery in industrial output in 1982/83, and, as seen in section 2 (i), a significant growth in real GDP. Part of this improvement was on account of World Bank assistance to the transport sector for industrial inputs of 1980/81. Officially recorded exports rose by $100 million or by 41% between 1981 and 1982, while real imports rose by 43% in 1980.

14. By 1984, however, the IMF programme had collapsed and 1985/86 was a period of increased political instability and civil war. Recorded GDP fell, and inflation rose to 163% in 1984/85 and to 122% in 1985/86 (April to April). Recorded exports showed little or no growth in 1985 for the first time in 5 years, while import capacity dropped 15%. The budget deficit rose to sh. 53 billion in 1984/85 and, as a result, domestic money supply rose by 91%.

15. It is not easy to unravel the cause of these developments but a tentative explanation would be that the IMF programme had a number of built-in weaknesses. These were :

a) Failure to appreciate that domestic policy cannot work in a political vacuum and under conditions of widespread insecurity, corruption and indiscipline in government.

b) The programme did not provide for the sustaining of real imports, which fell sharply after 1981.

c) The financing of the programme was largely on high cost short grace period money which became payable as early as 1984/85 thereby reducing import capacity in those years.

d) The auction system permitted a large proportion (40-60%) of scarce foreign exchange to be used for the importation of consumer goods, many of which could have been produced locally. It also facilitated capital flight, and was believed to be manipulated with government collusion.

This reduced the availability of spare parts and raw materials and led to a relative stagnation of industrial sector output after an initial strong recovery in 1981/82. This then led to lower than anticipated, or needed, revenues from both direct and indirect taxes.

e) The shift in income distribution to the rural sector away from the urban sector was so large and so abrupt that it constituted a shock to the system which proved uncontainable politically.

f) In order to ameliorate these political pressures the government first abolished PAYE for civil servants in 1982 and, in 1984 raised their salaries by as much as a factor of 6. This came on the heels of a significant increase in the producer price of coffee designed to buy the loyalty of the coffee producing areas in the face of a political and military threat to the government from both the eastern and western areas of the country. In response to this threat, expenditure on defence increased significantly. At the same time the promise of an impending election also led the government to loosen controls over spending. In consequence the budget, therefore, ran out of control and the resulting deficit was financed by domestic borrowing, thereby expanding money supply.

g) The IMF programme seems also to have placed insufficient emphasis on tax administration so that collections fell short of potential revenue.

h) It seems also to have laid less stress on the administration of government spending than it did on control over the <u>total</u> of that expenditure, notwithstanding the fact that Uganda's expenditure as a share of GDP was among the lowest in the world.

i) Tight control over the money supply, coupled with a poor national savings performance, led to several local industries finding it difficult to obtain working capital, and especially local cover for increasingly expensive imports of raw materials, etc.

15. Any proposals for dealing with current problems should attempt to avoid, as far as possible, the pitfalls which befell economic policy in both these periods.

CHAPTER 4

Assessment of the Government's Interim Economic Measures

1. The Economic Measures consisted of the following decisions :

   i) That government expenditure should be cut and more closely controlled.

   ii) That unclaimed former Asian owned properties should be sold off to Ugandans.

   iii) That a committee be established to recommend and arrange sale of some parastatals to the private sector.

   iv) That the National Textiles Board and the Uganda Advisory Board of Trade be abolished and their functions transferred elsewhere.

   v) That a dual exchange rate system be established with a priority rate at sh 1400 to the dollar and a market rate at sh 5000 to the dollar, both rates to be reviewed periodically. Traditional exports, essential imports and external debt payments would convert at the priority rate while non traditional exports, capital inflows and other transactions would take place at the market rate.

   vi) That producer prices for traditional exports be raised significantly e.g. Kiboko Robusta by 75%.

   vii) That interest rates on bank deposits, bank lending, and government borrowing be raised by between 45 and 150%.

   viii) That a currency conversion be carried out at some point in the future.

2. These measures are significant in that, as the first major steps taken in the field of short-run macro policy, they indicate that the government is willing to address immediate and difficult problems facing the economy.

3. They are also explicitly interim measures indicating a readiness on the part of government to take further policy action after having had more time for reflection and evaluation.

4. The measures do not, however, constitute a coherent and comprehensive policy package which could guide the economy into the medium term. Rather, they comprise a mixed bag of issues, some more important than others, some more urgent than others. Above all, some of the measures are quite inconsistent and contradictory with others.

5. In terms of coherence and comprehensiveness, the package overlooked the crucial issues of tax revenue, government spending priorities, consumer pricing policies, the method of determining the exchange rate and agricultural and industrial rehabilitation, to mention a few.

6. In terms of being a mixed bag it deals with the level of the exchange rate and with producer pricing which are vital and it deals with interest rates which are not. Government expenditure controls and decisions on producer prices and exchange rates also required immediate attention, while, clearly, the need to dispose of former Asian property is less pressing.

7. But the major problem with the measures is their inconsistent and contradictory nature. Government is attempting to control and reduce spending in order to reduce the budget deficit. This is essential. At the same time, however, it has introduced a dual exchange rate system under which more is purchased by the Bank of Uganda at the market rate than is sold at the official rate. The result is that the Government budget will have to subsidize the Bank to the tune of an estimated sh 92 billion in the coming year. The essential problem here is that almost all imports are considered priorities at this time. The result is a massive budgetary imbalance which will offset by several times any possible savings on expenditure reduction or control in the short term.

8. Moreover, the decision to increase producer prices without devaluing the Uganda shilling for the export crop transactions involved, will lead to a further drain on the budget. A producer price increase of 75% for Robusta coffee alone will, as argued in Section 2 (iii), reduce budget revenue by over sh.100 billion UNLESS the price increase stimulates significant increases in officially marketed coffee. This is not to argue that the price increase was unwise; on the contrary <u>real</u> producer prices of Robusta, after allowing for inflation, had fallen from sh.484 to sh. 153 between 1984 and 1986.

Obviously, without a price adjustment, government revenue would probably have been lost to enhanced levels of smuggling or reduced levels of coffee output. The point is that large nominal price increases, not accompanied either by measures to raise tax revenues or by a devaluation of the shilling, must, inevitably, put pressure on the government budget through reduced export taxes.

9. Further pressure will be put on the budget by the new interest rate measures both in respect to government debt (which is not a major issue since most payments are to the Bank of Uganda - in effect an internal transfer although one which does show up as increased government spending) and, more importantly with respect to crop finance. With given world prices in shillings, and given producer prices, any increase in interest costs on crop finance and on working capital of processors are more than likely to show up as a fall in export tax revenue, or marketing board transfers of surpluses to government. On last year's crop total, adjusted for new producer prices, additional interest costs and therefore budgetary drain would amount to about sh. 8.75 billion for crop finance and sh.2.3 billion for additional working capital costs for a total of sh. 11 billion. The main beneficiaries of these payments are the commercial banks.

10. The net result of the measures will, therefore, be an unmanageable budget situation unless further revenue raising measures are introduced quickly. The numerical justification for this conclusion is to be found in section 5 (ii).

11. Another point to be emphasized is that, under the dual exchange rate system, foreign businesses or individuals might bring in foreign capital at the market rate and buy up capital assets relatively cheaply. This might be especially relevant to government's plans to dispose of some parastatals and former Asian property. Of course those Ugandans with assets abroad could similarly benefit. This may or may not have been the intention of government but it is a possibility of which government should be aware. Furthermore, foreign investors could potentially bring in their capital at the market rate and buy back foreign exchange for imports at the priority rate, in the process making considerable gains purely on exchange rate transactions. If the goods bought at priority rate are then sold at scarcity prices, these companies would derive additional foreign exchange rents, equivalent to the difference between the priority rate and the ruling market (magendo) rate.

These potential problems arise :

a) because of the dual exchange rate,

b) because the priority list of imports is so comprehensive and,

c) because of scarcity of foreign exchange.

12 There are, in addition to the budgetary problems, concerns about the disposition of former Asian properties and parastatals. These are dealt with in section 2 (ix) and in the recommendations.

13. The question of interest rates is dealt with in section 7 (vi), of producer pricing, the exchange rate, and currency conversions in section 5.

CHAPTER 5

Proposals for Reform

I. Objectives of Reform

Having outlined the major issues to be tackled by economic policy and having assessed recent economic policy stances, we now turn to discuss proposals for reform. The starting point is to define what it is that reform is designed to achieve, given the above definition of the issues and our interpretation of historical performance.

To begin with one must differentiate between short term objectives and long term objectives of policy. In the short term the immediate and paramount objective must be the preservation of security and stability. Without this, the most precious accomplishment of the NRM to date, little meaningful reform is possible. Closely related to this is the need to restore the credibility and integrity of the State, which has been undermined terribly for the last 20 years. This is a complex matter which is discussed at length in the Ten Point Programme. It involves the state being seen as an institution building national unity and eschewing all forms of sectarianism, as well as demonstrating its independence from outside nations. Above all it requires that state power is not used to abuse the people of Uganda and this in turn, implies that the state must be founded on democratic principles and be accountable to the people. A corrollary of this is that discipline and morality must be strengthened, not only in the state sector but among the population at large, for democracy and accountability are a two way process in which people too must be responsible for their actions.

Short term economic policy must focus on restoring output growth in all sectors but crucially, in the industrial and transportation sectors. It must also strive to achieve an equitable distribution of output, at least to the extent that people's basic needs are met.

A key objective in the short term must be to bring about price stability so that the erosion of money incomes and assets by inflation is reduced. Breaking the inflationary expectations, psychology will be essential for general macroeconomic stability. Likewise, sound domestic growth and recovery will be impeded unless external balance is achieved quickly.

If these short term objectives are met, it will be much easier to realize the longer term objective of building an independent, integrated and self-sustaining national economy. Great care must be taken though to ensure that in meeting short term objectives, this fundamental longer term objective is not compromised.

In what follows, an effort has been made to ensure the consistency between proposals and these short and long term objectives. Where it might appear that there is conflict between the short and long term impact of a measure, care will be taken to explain the apparent paradox.

II. The Implications of No Policy Adjustments

1. Given these objectives it remains to be seen how best government policy might be adjusted in order to realize them. To begin with, however, we extend the argument of section 4 to examine precisely what would happen to macroeconomic balance if the government simply stayed with the Interim Economic Measures and took no further policy action at all over the next two years. This scenario will serve two purposes :

   a) It will emphasize the message of section 4 that policy changes are absolutely necessary if overall objectives are to be met, and

   b) It will provide a base case from which to project alternative policy scenarios.

2. The assumptions underlying this No-Policy-Adjustment scenario are that the dual exchange rate and the balance between priority rate - market rate purchases and sales of foreign exchange remain unaltered; producer prices remain at their current nominal levels; the rate of inflation proceeds at 100% in year 1; no additional tax revenue measures are introduced; there are no adjustments to salaries of civil servants; no additional balance of payments support is forthcoming and all foreign debt servicing obligations are payable when originally due.

3. It is assumed that officially marketed coffee exports will rise in the coming year to 160,000 tons on account of the restoration of peace and security and the clampdown on smuggling. World prices of coffee are assumed to fall to $2.5 a kilo on average in the coming year from the current level of $2.6.

4. Most other assumptions are attached to the projections which follow, but some additional critical assumptions are made with respect to imports which may or may not be accurate. These are that cash imports are $188 million including $10 million for new currency purchases (rising to $15 million if currency conversion takes place). All imports on suppliers credits, all government non-aid imports, and all imports out of the expected payments by Kenya as compensation for the EAC breakup are assumed to be included in the $188 million.

If government and the Bank of Uganda are operating under different assumptions, this needs to be rectified immediately, or chaos will result. Steps must be taken forthwith to reduce import plans or else Uganda's balance of payments will be much worse than projected and will be totally out of control by December 1986.

5. On these assumptions it can be seen from Table 1 that the balance of payments would in any case be unmanageable in 1986/87. There would be an uncovered deficit of the order of $71 million. This would rise to $158 million if the items mentioned in the previous paragraph are not covered in cash imports. Clearly either level of deficit is unsustainable and, without any other policy changes, could be met in the short run only by reducing cash imports and/or by running up further arrears.

6. Moreover, Table 2 shows that the budget would be running a deficit of shs.259 billion or over 4 times its projected 1985/86 level. This is on account of increased spending due to inflation, foreign exchange losses and interest rate increases, and to reduced export tax revenues as a result of a combination of increased producer prices and fixed exchange rates.

7. The situation would be even worse in year 2 since, with money supply expanding at about 100% p.a. with little change in real output, it is unlikely that the inflation rate could be contained at 100% p.a.

8. Clearly, there must be adjustments to government policy, and rapid adjustments, if this scenario is not to become reality.

UGANDA MACROECONOMIC SCENARIOS

Number 1: --Status Quo -- 100% Inflation

Table : 5.1

ASSUMPTIONS:	86/87	87/88
Inflation rate per year:	100.0%	100.0%
Price level at beginning of year	100.0	200.0
Average price level for year (86=100)	150.0	300.0
Exchange Rates USh/$		
Preferential	1400.0	1400.0
Market	5000.0	5000.0
Share of exports at pref. rate:	84.0%	84.0%
Share of imports at pref. rate:	90.0%	90.0%
INTERNATIONAL PRICES:		
Index of petroleum prices	100.0	100.0
Level of coffee prices $	2.5	2.4
Index of other imports	100.0	100.0
DOMESTIC PRICES AND QUANTITIES:		
Coffee producer price USh/kg (Kiboko)	850.0	850.0
Coffee producer price (clean)	1574.0	1574.0
Coffee marketing costs	756.0	756.0
Coffee production (BASE)	163.2	166.5
Coffee production (price adjusted)	155.0	133.2

BALANCE OF PAYMENTS SUMMARY: (IN $US)	86/87	87/88
A. Total exports	424.3	368.1
1. Non-coffee visible exports	20.0	22.7
2. Coffee	383.7	319.6
3. Non-factor services	20.6	25.8
B. Total imports	-585.6	-606.9
1. Non-petrol visible imports	-405.0	-424.5
2. Petroleum	-48.0	-52.9
3. Non-factor services	-82.0	-86.2
4. Net factor services	-50.6	-43.3
C. Capital movements		
1. Grants	52.0	57.0
2. Gross loans - to budget	130.2	131.3
3. Loan repayment from budget	-69.3	-69.3
4. Remittances (net)	38.0	39.9
5. IMF repayment	-79.4	-71.0
6. Loans - not to budget	44.4	17.9
7. Loan repayment - not from budget	-66.0	-38.0
D. Basic Deficit Not Financed	-111.3	-171.0

UGANDA MACROECONOMIC SCENARIOS
Number 1: --Status Quo -- 100% Inflation

Table : 5.2

SUMMARY OF GOVERNMENT BUDGET (Shs.Billion)	86/87	87/88
TOTAL REVENUE:	327.0	254.2
1. Tax Revenue	201.6	158.5
a) Income/Profits	17.0	19.1
b) Goods/Services	75.3	112.1
(1) Sales Tax	53.0	73.0
(a) Local	25.0	45.0
(b) Imported	28.0	28.0
(2) Excise	18.8	33.8
(3) Commercial Trans. Levy	3.5	5.3
c) International Trade	108.8	26.8
(1) Import Duties	39.7	33.9
(a) Petroleum	-2.3	-8.1
(b) Other	42.0	42.0
(2) Export Duties	165.3	90.8
(a) Coffee	161.3	86.8
(b) Other	4.0	4.0
(3) Forexchange tax/subsidy	-96.2	-97.9
d) Other Tax	0.5	0.5
2. Other Revenues	52.0	15.0
a) Kenya/EAC settlement	42.0	0.0
b) Other	10.0	15.0
3. Grants	73.4	80.7
TOTAL EXPENDITURES:	662.5	956.4
1. Recurrent Expenditure	470.8	729.6
a) Wages/Salaries	48.5	50.9
b) Interest - External	75.3	75.3
c) Interest - Local	22.0	83.4
d) Other	325.0	520.0
2. Development/Rehabilitation	191.7	226.8
a) Capital Projects	109.5	113.4
b) Rehabilitation/Resettlement	82.2	113.4
FINANCING REQUIREMENT:	335.5	702.2
1. External Net Financing	76.6	78.0
a) Loans + Grants -- Inflow	173.6	175.0
b) Loan Repayment - Amortization	97.0	97.0
2. Net Deficit to be financed	258.9	624.2
a) Foreign inflow for uncovered BOP		
b) Domestic finance required	258.9	624.2

III. The Core Reform Package

1. In order to deal with the inadequacies of current policy and to help realize the objectives in section 5 (I), a number of proposals are made in the sections which follow. To begin with, in this section, a package of core reforms is proposed which, the team feels, should be implemented whatever direction the government decides to take in other policy matters. Secondly, in the next section, a range of policy options is offered. These are differentiated by their assumptions with regard to budgetary measures, administrative measures including direct controls, the exchange rate and reliance on external assistance. In section 7 are to be found specific proposals for some of the main sectors of the economy. Though dealt with separately, these different elements should be seen as three mutually reinforcing, and necessarily overlapping, reform initiatives which combine to constitute a single package, once a policy option from section 5 (IV) has been chosen.

2. The core reform package consists of a number of measures intended to bring the budgetary imbalance under control without, at the same time, constraining productive and socially necessary government spending. These are supported by a monetary policy which reinforces proposals for fiscal policy and greater financial control in restraining inflation, while allowing productive sectors to expand. The fiscal and monetary initiatives are underpinned by a series of proposals designed to bring forth an expansion of supply, to achieve an overall package which can be described as "adjustment and stabilization with growth and equity".

a) Fiscal Adjustment

3. The first proposal is that the government move immediately to prevent further Bank of Uganda losses on the purchase and sale of foreign exchange, resulting from the imbalance between items being bought and sold at the priority versus market rates. This can be accomplished either by unifying the exchange rate at any level (about which, more in section 5 (IV) or by immediately switching some items currently classified as priority items to the list of items to which the market rate applies and vice versa. This measure alone will reduce the government deficit this year by sh.93 billion.

4. A series of measures should be taken immediately to IMPROVE RECURRENT REVENUE COLLECTION.

i) <u>Sales, Excise and Customs Duty Reform</u>

This is an area in which government might raise revenues quickly and relatively easily. What is recommended is a comprehensive reform of these taxes involving :

a) A simplification of sales tax and customs duty rates.

b) The removal of most exemptions from these taxes with the exception of government's own purchases and some aid financed items.

c) The unification of the excise tax into the sales tax.

d) The planned increase in revenue from sales taxation on locally produced goods through priority allocation of foreign exchange to increase production.

e) The restoration of the functioning of the customs duty/sales tax collection system through :

- the immediate training of trustworthy officers drawn from the NRA and elsewhere,

- the immediate introduction of a significant incentive or responsibility allowance for these officials,

- the continuation of the clamp down on large scale smuggling,

- tighter physical control on and recording of the movement of key revenue-raising goods from industrial plants,

- improved record keeping systems and inspection procedures at plant level,

- prompt and proper assessment of tax and duty payable,

- rigid enforcement of payment of customs duties and sales taxes before goods are cleared,

- insistence that the payment of local sales tax for the month be received within 15 days of the end of the month,

- the introduction of procedures to ensure that prompt follow-up takes place when payments are not received,

- the rigid enforcement of penalties assessed for late payment, as provided in the Act,

- if necessary, technical assistance should be obtained from abroad to assist in the immediate revamping of the system. (Tanzania or the Commonwealth Secretariat are possible sources).

These measures are the single most important source of possible improvement in government revenue in the near future, at given exchange rates. They should raise close to sh.100 billion in 1986/87 if implemented by October, and at least double that in the following year.

ii) As a secondary longer term priority, the Income Tax Act should be reviewed with the objective of reducing the high marginal rates of tax while raising steadily the number of individuals and companies subject to tax. While this is being done, a core of staff should be retrained with an emphasis on collecting taxes from businesses. Initially, the approach would be presumptive in nature, requiring an extension and enforcement of the current system of advance payments, but based on estimated incomes. This will require the compulsory registration of businesses, a system of realistic charges, the adjustment of income estimates to allow for inflation and a workable collection system.

This would be implemented at the earliest by 1987/88.

PAYE would continue to be suspended for civil servants but would be reintroduced as and when their wages and salaries have been reviewed. Although the government would be paying with one hand what it receives with the other, reinstitution of PAYE is considered important as a model for the rest of the economy. Those responsible for imposing and spending the proceeds of taxation should be seen not to be exempted from it.

No additional revenue from these initiatives is anticipated for 1986/87 and no projection is attempted for 1987/88, given the difficulty of estimating what a presumptive tax might yield or when profit levels might be restored.

iii) Again of relatively minor importance, would be the revision of the fees, airport tax, charges, licenses and stamp duties to offset, to some degree at least, the inflationary erosion of recent years. Fees would be introduced/raised for the entry and transit of foreign registered motor vehicles. A hotel tax would also be levied.

These should raise a minimum of SHs.5 billion per year by 1987/88.

iv) One time increases in government revenue might be obtained from the sale of former Asian property, the disposal of parastatals and from a currency conversion tax, all of which are discussed later.

The principal thrust of revenue reform is, however, the rationalisation of the indirect tax system on imports and local products and the restoration of the domestic output base on which indirect taxes are levied.

5. These revenue measures should be accompanied by adjustments to improve the effectiveness of government spending.

i) Consideration should be given to reducing the number of Ministries by about a half. In the process, some senior staff could be released to take up responsibilities elsewhere in the public sector, given the acute shortage of managerial level personnel. Some economies of staffing should be achievable at other levels. This move should await, however, the findings of a Presidential Commission into the structure of the civil service. This would advise on how best to achieve a reorganization, on the objectives and responsibilities of different ministries and on required staffing levels.

ii) A significant reduction in civil service staffing with little loss in productivity could be achieved by trimming back by half the number of above-establishment and group employees and by reducing other categories by between 5 and 10%. This would lead to a loss of some 27,000 jobs or a third of civil service positions but would save no more than sh.3.0 billion annually. Any such plan to contain government spending should be studied carefully given the disruption which would ensue to a large number of generally low income earners. It should not proceed without a thorough review of personnel functions and needs. This issue would be an appropriate topic for study by the Presidential Commission.

iii) The steps taken in the Interim Economic Measures to curtail overseas travel and other expenditures are undoubtedly in the right direction. Yet daily overseas allowances are still about 50% higher than they need be and controls over such costly items as vehicle repairs and car hire seem lax. There seems to be a strong case for restoring the Ministry of Works' central and regional workshops. In all ministries a significant portion of expenditures on both local cost and imported products are thought to be 'air' and this must be controlled. Proposals for this are to be found in section 5 (III)b.

iv) Many Ministries have been grossly irresponsible in submitting their estimates for the current year. Total requests add up to sh.1.8 trillion, over 5 times last year's total and obviously ludicrous given the tax base. This demonstrates, vividly, the seriousness of the control problem in government.

v) To take a specific example, defence expenditures have been a large drain on the budget in recent years. With the coming to power of the NRA the expectation has been that such spending would not only be reduced but also controlled. It is with some disappointment, therefore, that the team learned that the initial estimate proposed by the Ministry for 1986/87 was almost 4 1/2 times its 1985/86 revised estimate. Were this request to be granted, it would account for a third of the estimated overall recurrent spending for 1986/87. Even if it is trimmed, it does give the ominous impression that Defence is likely to remain a heavy drain of the budget in the immediate future.

iv) The team has also received information that the Ministry of Defence is honouring, without verification, huge payments on account of deliveries to past regimes. We have also learned that the Ministry of Defence is making ad hoc and unstructured payments not in accordance with the budget, despite the fact that a regular system to pay the army has not yet been started. It is extremely important for the NRA to start off on a correct footing least it sinks into the quagmire of the past indisciplined armies. It is also important that payments within the army are structured, regular, fair and that they are seen to be so.

It is to be hoped that as the security situation improves defence expenditures will decline. The proposal for the army to gradually become a productive army, growing some of its own food and perhaps undertaking civil engineering works on contract, is strongly supported.

vii) The parastatal sector is also a drain on the recurrent budget through subsidies and subventions. The total for 1985/86 is estimated to be in excess of sh.14 billion. Proposals to dispose of some parastatals may help, as would proposals elsewhere in this report to permit parastatals to price their products in such a way that they are able to build up internal capital funds. If the recommendations on financial control in the next section were implemented this also would provide some relief to the budget.

6. But with the lowest share of government spending to GDP in Africa, and with such pressing economic and social problems facing the country, fiscal adjustment in Uganda cannot simply mean expenditure cuts. There is a need to RAISE SOCIALLY BENEFICIAL GOVERNMENT SPENDING, but only in line with increased revenue capacity or savings from expenditure cuts elsewhere, and subject to the constraint of reducing the overall budget deficit and increasing the cost effectiveness of government expenditure.

i) To begin with, the salaries of public service officials <u>must</u> be raised. This should not be implemented until there has been a review of the size of civil service needed. Given the rate of inflation, this can only mean that the Presidential Commission should be appointed as quickly as possible and instructed to complete its work within the next few months.

The size of the increase would need to depend on how much leeway there is in the budget, but for it to have an impact on discipline and productivity it would need to be substantial. Salaries would then need to be adjusted periodically to ameliorate the effects of inflation and to gradually achieve real increases.

ii) One immediate step that might be taken on salaries, which should cost little if anything, is to regularize what is already current practice for many people; that is, to reduce the working day for many middle and lower level employees by a half while retaining current salary levels.

This formally doubles their real salary without corresponding adjustment to the wage bill. This could be done in such a way as to allow employees to work in morning or afternoon shifts to ensure continuity in function. Such a measure might avoid some lay-offs while permitting reasonable real salary increases by the remaining officers without too much drain on scarce budgetary resources. It would need to be accompanied by the strict enforcement of attendance and disciplinary rules to be effective. After the salary review staff might be given the option of working part-time or full time. After that time anyone being paid for full time work would be expected to attend full time and would be subject to dismissal if they failed to attend.

iii) There is a pressing need to expand real expenditures on basic needs in both the recurrent and the development budget. Particular emphasis whould be placed on primary health care, water supply, nutrition, family planning and adult literacy, all of which are discussed in section 7. Government can often obtain some foreign assistance for such initiatives but should in any case accord these areas high priority out of its own resources. The salaries of low income workers should be raised proportionally higher than those of others in any salary adjustment. Consideration should be given to the creation of educational scholarship funds to ensure that children of the poorest families are not denied the opportunity of education at any level. The scholarship funds could be financed out of central government revenues, from local government taxes, from a special parish level tax for the purpose, by loading school fees - or by a combination of these.

iv) The recurrent budget will need to be expanded to make proper provision for maintenance and rehabilitation of government assets many of which are in dire need of repair. Expenditure on supplies and equipment would also need to be restored in real terms and measures taken to guard against pilfering.

v) The most recent growth in development expenditure must be continued within prudent expenditure limits. Reconstruction and rehabilitation needs are presseing in all sectors of the economy. As the absorptive capacity of the government improves, the rate of development spending will, and should, rise. General priorities for such spending are dealt with in section 7 by sector.

Consideration should also be given to the creation of a Local Development Fund which would be devoted entirely to supporting appropriate development initiatives at the local level. This might stimulate local creativity and help promote a less centralized, large-project-oriented approach to development expenditures.

Such a fund, emphasizing appropriate technology and the use of local resources, should be attractive to international donors. It should operate at the Parish level and should be funded mainly out of local taxation in the form of money, commodities or labour, depending on the circumstances of individual families. The focus of these funds would be basic education, primary health care, water and local roads. Complementary inputs would be provided by the central government out of the Development Budget but only to <u>support</u>, not <u>direct</u>, local intiatives. If this idea received national political endorsement this year it could be operational next. The scheme would replace the graduated personal tax but care would have to be taken that some local taxes did reach district level.

It is important, therefore, that a positive attitude be taken towards expenditure adjustment. Balancing the budget should not justify reducing government expenditure as a matter of principle. There <u>is</u> scope for such reductions but, having made them, the goal of the government should be one of raising productive expenditures in line with an expanding revenue base.

b) Financial Control

In order to restore order and discipline to the public sector, it is vital to restore financial control. The proposals for doing so in GOVERNMENT MINISTRIES are :

i) The budgetary process needs to be reconstituted with Ministries being required to submit sensible, well-documented and carefully justified requests for funding. These requests would cover the whole year and supplementary votes would be allowed only in exceptional circumstances. Requests for supplementaries would result in an automatic investigation by the Auditor General's Department reporting directly to the President.

ii) The Public Accounts Committee must be resurrected or a new equivalent established. This must be charged with meeting regularly and where possible, in public. The Committee would report to the NRC.

iii) The Auditor General's Department should be immediately revamped. It should be reorganized and its staff should be retrained. The government must be seen to restore the independence and integrity of this Department whose mandate should be expanded to include management audits.

Reorganization of the AGD may necessitate the use of foreign technical assistance for organization, training and procedures development, on the argument that in such sensitive positions outsiders may have fewer vested interests. Restaffing, possibly by returning exiles, may also be needed.

An annual external audit of this department should be undertaken by an independent auditing firm.

The Auditor General should report directly to the Public Accounts Committee or its equivalent.

iv) The team strongly endorses the idea of introducing an Inspectorate of Government in the President's office. This would be more pro-active than the Auditor General's Department and would have the power to initiate investigations into a wide range of issues. This would complement the Auditor General's functions rather than detracting from them, and would give the President a fulcrum around which to provide the necessary speed, direction and corrective measures in government.

v) A major review of all ministry accounting systems and procedures should be undertaken. This will result in the revision or updating of the Financial Regulations and Treasury Accounting instructions. If thought necessary, technical assistance should be forthcoming for this.

vi) The Central Tender Board is ineffectual and should be abolished in favour of a separate department for the centralized procurement and storage of government supplies to be established under the Ministry of Finance. Once again, technical assistance would be available, if required. Local Purchase Orders should be restricted to relatively low, fixed limits and tightly supervised.

With immediate effect all Ministry purchase orders should require the approval of the Permanent Secretary, Under Secretary or their designate.

vii) All non-aid Government imports should be subject to inspection by the SGS, currently under contract to the Bank of Uganda.

The recommendations for improving financial control in PARASTATALS are :

viii) A detailed review should be undertaken of each parastatal to update existing accounting records, to evaluate staff in the financial area, to audit management and to evaluate the projects for rehabilitation. The relevant external auditor, with any necessary consulting or technical assistance, could be appointed for this task.

ix) The Uganda Development Corporation should seek technical assistance for the development and implementation of an internal audit department to be headed by a very senior officer, an investment or project appraisal department, and a monitoring department.

x) The Ministry of Finance should require parastatals to:

- submit audited financial statements within six months of the year end,

- submit annually a comprehensive list of loans guaranteed by the Ministry, on a cumulative basis,

- submit three year rolling plans and budgets which relate output performance to resources utilized,

- obtain formal approval for annual investment plans.

xi) The recapitalization of existing parastatals should be based on explicitly defined requirements of fixed and working capital, and be subject to the underlying economic viability of the parastatal and to its having in place competent general and financial management.

xii) A comprehensive personnel plan should be prepared to identify training requirements at all senior levels of the parastatals.

xiii) A Professional Accountancy Training Institute should be developed jointly between government, the UDC and independent professional accountancy firms. Once again, given the paucity of skills in this area within the country, technical assistance might be needed.

xiv) Given the paucity of the numbers of qualified auditors and accountants, consideration should be given to creating <u>either</u> an Audit Corporation <u>or</u> a separate department of the Auditor General's Department to review the books of parastatals.

c) <u>Monetary Policy</u>

1. This programme would have two distinct monetary policy components. The first relates to DOMESTIC CREDIT POLICY. The objective here would be partly to restrain central bank financing of government deficits. This is no easy task and depends almost entirely on the accuracy of budget estimates and the tightness of government expenditure control. The Bank of Uganda could, however, play a more active role in budget preparation by analysing and advising on the consistency of budget estimates and proposals, both internally and with respect to balance of payments and money supply projections. For this, the Bank would have to strengthen its Research Department.

2. It is essential that this tight money policy not be applied indiscriminately to productive sectors of the economy. There is evidence that industrial output has been constrained in the past by lack of working capital. Care must be taken to ensure that this does not happen in future or else recovery efforts will be frustrated.

3. To this end it is proposed that a system of credit rationing be introduced to be monitored by the Bank of Uganda. This can be introduced initially as a series of indicative targets to be adjusted if necessary. As experience is gained with the system these targets could become firmer.

4. If credit rationing is to be introduced there is no real need for high nominal rates of interest. This is not a crucial point, but there does appear to be some money illusion on the borrowing side surrounding high nominal rates even when real rates are grossly negative. Certainly, high nominal rates appear to have discouraged long term borrowing and possibly, therefore, investment.

   Furthermore, there is no evidence of any close relationship between different negative rates of interest and levels of real saving. There is <u>some</u> inflationary impact where these rates can be passed on e.g. trade, and some hardship and incovenience where they cannot e.g. farmers. At the same time no particularly serious problems appear to arise from the fact that rents will be earned by borrowers if rates are lower than a positive real rate. The government might wish, therefore, to reduce rates somewhat and base them on a target medium term inflation rate of 20-25% plus a real rate on top of this.

Lending rates would therefore fall by between 7 and 10 percentage points from current levels.

5. The second major element of policy is CURRENCY REFORM. In its pure form of currency conversion, what this does is to exchange units of new currency for much larger units of the old. In effect one is reducing the number of zeros involved in all financial transactions. All incomes and prices, including the exchange rate are reduced by the conversion factor. At this level nothing real is achieved except that book keeping and payment by cash is made easier, the cost of printing notes is reduced, and possibly, if the conversion rate is appropriate, old coinage might be brought back into circulation.

6. But the main objective of the conversion would be to reinforce other economic measures designed to control inflation. It would help alter the prevailing psychology that money is worthless and inflation inevitable. To be successful in this, the accompanying anti-inflation measures must also be successful, or else money would once again lose value rapidly.

7. Currency conversion can be used also to achieve distributional goals. By offering a lower ratio of new notes for old as the amount of currency offered for conversion rises, one may in effect be imposing a one-time tax on the rich. This might be one way of wiping out some of the profits of illicit activities. In the extreme, one could even void all old currency or large denominations of old notes and elect to distribute the equivalent value of new notes in some equitable fashion. In this way one could achieve a redistribution of cash wealth. This would not, however affect other forms of wealth holdings directly, discriminating against those who had not moved into real property or bank deposits.

8. The problem with the conversion tax is administrative. Unless one can achieve a rapid conversion, the holders of large cash balances will have time to divide them up and farm them out to friends and relatives for conversion at the more favourable rates for low cash amounts.

9. The problems with using conversion for redistribution ends are likewise mainly administrative, although the political ramifications are likely to be more significant than those of a conversion tax. Voiding all or a portion of the note issue may paralyse not only 'magendo' but also legitimate trade by wiping out working capital.

Trade would also be adversely affected if it took time to issue the new notes to those previously in possession of no cash or of smaller real quantities. Secondly, it will undoubtely lead to some arbitrariness as all kinds of people and institutions have all kinds of reasons for being in possession of large notes or large quantities of notes on any given day. The more one tries to make exceptions, the less efficacious will be the attempt to redistribute cash wealth. The bigger the size of the redistribution the greater also would be the likely political outcry.

10. Achieving a quick conversion will be difficult in rural areas since there are few bank branches outside of Kampala, Jinja and the other urban centres. Most cash appears to be <u>issued</u> in the large urban centres and especially in Kampala itself, but we have no idea of where currency is circulating. One would not wish to penalise poor rural dwellers in the process of attempting a quick conversion aimed at a more equitable cash distribution.

11. The choice of conversion factor would determine the cost of the new note issue and the possibility of bringing old coinage back into use: A round number should be chosen and 1:100 or 1:1000 seem most reasonable. The face value of new notes must be high enough to offset their costs of printing.

12. The occasion of the conversion could also be used to hide real changes in such items as civil service salaries or the exchange rate.

13. There are many possible economic ramifications of a currency reform which should be noted. If the conversion factor is too large prices will need to be rounded up and this will be inflationary. News of the conversion might stimulate a movement out of currency into bank deposits or real goods, and especially so if a decision to use the occasion for redistributive or tax goals were leaked to the public. These shifts might reverse themselves after the conversion and might, therefore, have short run implications for bank liquidity and commodity prices.

    If a reform succeds in reducing inflation this might have important budgetary and distributional implications. For instance if producer prices were fixed for the year in anticipation of a given rate of inflation, the real income of farmers would rise if inflation fell, and coffee tax collections by government would be less than anticipated.

These and similar economic impacts should be taken into account in planning the reform.

14. Since the government has already decided that there will be a curency conversion, what remains is now the question of how and to what ends. It would be presumptuous of this team to recommend on the <u>details</u> of a currency reform on the basis of our limited relevant experience and time available. The government should seek advice on such details of implementation and the conversion should be proceeded with quickly as there is some anxiety among the public about the exercise.

d) Supply Expansion Measures

1. The success or otherwise of this programme will rest ultimately on the extent to which, and the speed with which, domestic output can be expanded. Fiscal control and discipline and sound monetary policy will be difficult to maintain if real growth in the economy cannot be achieved. Furthermore, distributive justice will also be less easily obtainable in a zero or negative growth situation.

2. MAINTENANCE of SECURITY will be crucial to output expansion. With peace and order, both production and distribution should be stimulated, and this in turn should help repress inflationary pressures. For this reason, an adequate budgetary provision for defence and security is crucial. The problem facing the government is where to draw the line between adequacy and profligacy.

3. CONTROLS OVER SMUGGLING AND CORRUPTION will also be key factors in stimulating domestic supply. If production leakages into illegal exports can be prevented, this will be of enormous assistance in balancing both the budget and external account. The aim should not, however, be to harrass small scale illicit traders, even though their business may be significant in total. In their case efforts should be stepped up to collect import duty on items purchased by the sale of exports. To encourage medium/ large exporters of non-traditional exports to use official channels, export licensing posts should be set up at the borders. Again, duty should then be collected on imports. Control efforts should rather be focussed on the large scale smuggler of coffee, oil and perhaps sugar and kerosene.

   Likewise, anti-corruption efforts which could assist in freeing up significant budgetary and foreign exchange resources, should be focussed on large scale offenders. Trade unions or other representative organs of workers could play a vigilance role against corruption in factories and offices while local resistance councils might be called upon to play a part in residential areas. This is, however, a complex area involving difficult issues of the interface between democracy and legally constituted, generally hierarchal, structures of authority. Care must also be taken to avoid unsubstantiated accusations.

4. Rapid execution of the government's **RESETTLEMENT AND REHABILITATION** plan could produce a significant expansion in output in the short term. This is especially true of the Luwero Triangle which could produce as much as 7,000 extra tons of coffee next year rising to over 20,000 in three years. As well, this area could produce a surplus of staple foodstuffs which might help stabilize the cost of living in Kampala if sufficient transport facilities are forthcoming. For this reason, this plan should be given high priority and extra efforts should be taken to acquire additional humanitarian and related aid from sympathetic donors. An overseas media blitz should be launched by government as soon as possible. This should be handled by the diplomatic missions, assisted where needed by skilled public relations consultants.

5. Given the distorted structure of the Ugandan economy, an unfortunate historical reality which the Ten Point Programme aims to rectify in the medium/long term, it is a fact of life that output expansion at this time will depend heavily on the availability of foreign exchange for imported vehicles, raw materials and spare parts. This raises the question then of **HOW TO RAISE IMMEDIATELY AVAILABLE FOREIGN EXCHANGE RESOURCES.**

   There are three main possibilities :

   i) To obtain an expansion of export earnings over the short term by selling off all remaining coffee stocks as rapidly as possible, while the world price remains high. Unfortunately, the Coffee Board was not able to present the team with estimates of inventories at all levels of the distribution chain. Unofficial estimates place these at 500,000 bags which, if accurate, indicates some possibility of a rapid export surge. Short run efforts to expand exports of non-traditional goods such as wheat and beans should also be supported.

   ii) The government should also place an unofficial moratorium on all but IMF/IDA loan servicing obligations. If possible, it should then negotiate rescheduling/deferment of payments with individual creditors. Even without a formal Paris Club arrangement, it should be possible to defer or negotiate annual payments of up to $50 million if creditors can be persuaded that a coherent and plausible adjustment programme is in place.

It should be emphasized, however, that arrears on official and commercial debts already total in excess of $300 million and that these cannot rise indefinitely without serious implications for capital inflows and the cost of imports.

iii) The third possible source of readily usable foreign exchange is balance of payments support. This is available from three main sources, viz. the World Bank offers Emergency Credits, both under the Special African Facility and IDA. These are soft loans with a ten year grace period followed by a 50 year repayment at minimal annual charges. They require that an acceptable adjustment programme be in place and one which is acceptable to the IMF even if Uganda has no programme with the IMF. This type of arrangement could yield $60 million or more in year one and $70 million or more in years two and three.

The IMF has a complementary relatively low conditionality facility which also carries relatively soft loan terms. This is the new Structural Adjustment Facility which again requires an acceptable adjustment programme. Unlike the Standby Facility under which Uganda borrowed in the early 1980's, the new facility does not require specific performance targets which are reviewed quarterly. Instead, it is more concerned with programmatic direction. Neither would interest rates be high nor repayment be due in the short term. Interest is only 1/2% p.a. and there is no repayment for five years after the end of the three year programme, after which repayment takes place over the next five years.

Uganda is eligible to draw $22.7 million in year 1, and $15.3 million in each of the next two years.

If Uganda wished to enter into a Standby Arrangement with the Fund, it could draw an additional $35-40 million per annum over each of three years and roll over its $70 million or so annual repayments to the IMF of debt incurred in the 1980-84 period. In addition, such an agreement would probably also induce the IBRD to offer an extra $40 million p.a. in Structural Adjustment loans.

The third possible source of balance of payments support is bilateral assistance from both traditional and non-traditional donors. With a coherent economic programme in place, and based on experience elsewhere, Uganda could expect to receive between $10 and $30 million from these donors even if the programme is not acceptable to the IBRD/IMF.

This will require however, an active diplomatic offensive to persuade donors that Uganda is aidworthy and has a sound recovery programme. Donors are likely to be much more cautious in offering assistance after their experiences of the period 1981 - 85. As it is, the scenarios which follow <u>already</u> assume an annual inflow of loans and grants for projects of in excess of $180 million, this figure being based on reasonably firm commitments - most made before the government came to power. If the programme qualifies for <u>concessional</u> IBRD/IMF balance of payments assistance, bilateral donors will be more generous and put in perhaps $50-100 million per annum. If Uganda opted for high conditionality funds and its programme was acceptable, then it might obtain bilateral funds totalling $75-100 million.

It must be emphasised at this point that the precise definition of what will constitute an acceptable programme to qualify for concessional assistance from the Bank and the Fund is not known. This can only be determined in negotiations. There are some doubts that the IMF sees its structural Adjustment Facility as being low conditional, as opposed to concessional, but we have been assured that it <u>will</u> be much easier for Uganda to obtain this facility than to obtain a Standby. Only experience will tell, but whatever the case, a coherent and carefully structured and justified programme will be essential. It is our view that the proposals of this report would constitute a sound package on which to initiate negotiations, although much would depend on the choice of scenario from the next section. There are several possible points of contention on which Uganda should begin preparing its position. The first is the Fund/IBRD view that the exchange rate be set at or close to the black market rate. Uganda's argument on this must be that this is a relatively narrow market which can to some extent be controlled (e.g. by the control of large scale coffee smuggling) and the price in which is not reflective of the real social value of foreign exchange. The Fund/Bank may wish to see much higher petroleum prices, greater liberalisation of markets much less state involvement in the economy, higher real prices to coffee producers and evidence that problems of honesty and capacity in the civil service are being addressed. They might be less sensitive to issues of income distribution than the government.

It must also be stressed that the Fund and the Bank have their differences in specialisation, outlook and approach and each institution needs to be dealt with separately.

With these reservations and words of caution in mind,a summary of the likely sources of balance of payments support under different policy assumptions is to be found in Table 5(a). This lists the summary of possible balance of payments assistance.

Table 5(a).

Balance of Payments Support

Scenario 3	Year 1	Year 2	Year 3
IBRD	60	70	70
IMF SAF	23	15	15
Bilateral	50	75	100
Humanitarian (all scenarios)	30	-	-
	163	160	185
Scenario 5			
IBRD	60	70	70
IBRD SAL	40	40	40
IMF SAL	23	15	15
IMF Standby	35-40	35-40	35-40
IMF Rollover	70	70	70
Bilateral	75	70	70
Humanitarian	30	-	-
	333-338	330-335	330-335

6. The lesson of history, however, is that an inflow of foreign exchange is by itself insufficient to guarantee sustained economic recovery. The USE OF FOREIGN EXCHANGE is crucial. For this reason the team argues that Uganda should not adopt a policy of liberalizing imports as was practised under the auction system, but should instead control the allocation of foreign exchange to favour, as far as possible, raw materials, spare parts and capital goods allowing only a tightly controlled quantity of consumer goods, most of which would be considered essentials.

In allocating scarce foreign exchange the government would develop four categories of imports :

a) inputs into basic needs industries
b) inputs into tax revenue raising industries
c) inputs into transportation, and
d) inputs into export industries.

The proportions between these would need to be calculated carefully so that government objectives of meeting basic needs, at reasonable prices, of balancing the budget and of balancing the external account are met.

7. Crucial to the generation and usage of foreign exchange and as we have seen, to the state of the budget, is the EXCHANGE RATE.

For reasons given above, it is recommended that if Uganda does nothing more on this matter in the near future, it should at least adjust the list of items appearing on the priority /market list to ensure the eradication of foreign exchange losses. The team feels, however, that government should move towards a unified rate and, if necessary, use subsidies and taxes to achieve the intention of the dual exchange rate system, e.g. perhaps giving extra price incentives to cotton farmers while taxing luxury imports more heavily than others.

Once unified, the Uganda shilling should be tied to the SDR so that its value moves roughly in line with that of its major trading partners, ignoring price differentials.

The team could not agree, however, on the level at which the rate should be set, some arguing for an initial devaluation and some flexibility thereafter, others arguing for a revaluation. The rationale and merits of these quite conflicting views are outlined and assessed in section 5(iv).

8. The debate over exchange rate policy has relevance for the level at which government sets PRODUCER PRICES. Policy on producer prices would depend, therefore, partly on policy towards the exchange rate. What the team did agree on was that farmers are to some extent responsive to real producer prices (prices of producer goods relative to the prices of goods consumed by farmers). Other factors such as transportation, degree of control over smuggling, security, etc. are, of course, also important and a real price increase in the absence of these other factors would probably be futile.

It was also agreed that farmers should receive a 'fair' portion of the shilling value of the world price of exports, and that the output of some crops, e.g. cotton and some minor, non-traditional crops might respond markedly to preferential pricing policies provided, again, that non-price constraints such as failure to make cash payments, availability of beginning capacity etc. are not binding.

9. As argued in section 5 ii(c) the availability of credit may be crucial to generating a supply response. Detailed Recommendations on this issue are reserved for section 7.

10. The reconstruction of a functioning, committed and honest CIVIL SERVICE cadre is also considered important as an aspect of supply stimulation. The implementation of new policies, programmes and projects as well as the administration of controls and regulations, <u>is</u> important and <u>does</u> influence the real economy. Inefficiency and corruption causes delays, distortions and rigidities which interfere with normal productions and trade. The government must move immediately to restore the independence of the Public Service Commission as the first step in restoring standards in the civil service.

11. The committee feels that supply stimulation is best achieved through reliance on a BLEND OF MARKET FORCES AND DIRECT CONTROLS. Where markets work reasonably well, i.e. where trade is not monopolised and margins are not unreasonable and goods are available at reasonable prices, they should be left to function without government interference. Government has very limited resources and should focus these on priority areas. We believe these to be the control of large scale smuggling, exchange rate management, foreign exchange allocation, producer pricing of major export crops, public utility rates, and tax revenue collection.

Other forms of intervention, such as the recent sugar compaign, are considered important politically and as a cautionary warning to speculators, but are difficult to sustain over time if supply and demand imbalances are chronic. One alternative to consider might be the encouragement of democratically based consumer cooperatives with links to central supply agencies. These would need encouragement, assistance and time to develop, and the educational and managerial prerequisites, so often lacking in the past, must be in place.

12. This brings us to the question of OWNERSHIP of enterprises. In planning to dispose of both parastatals and former Asian properties, the government should be guided by a number of considerations. The first is the need to bring these assets back into productive use and onto a regular maintenance basis as quickly as possible. The second is the need to retain parastatals which have a crucial role in helping the government meet its long term economic objectives. The third is the need to retain (perhaps even acquire) enterprises which, on our proposals, may become essential to budgetary balance in future (e.g. beer, cigarettes, textiles, etc). Fourth, utilities should be retained. Fifth, joint ventures might be useful in bringing forth scarce inputs needed for the rehabilitation of some enterprises. Sixth, some enterprises and buildings might be sold or leased to groups of workers or occupants. The option of cooperative ownership should be given serious consideration and financial assistance from the Cooperative Bank. It might provide some alternative to cementing in and widening existing wealth inequalities. Seventh , the decision to retain enterprises should be based on a realistic assessment of the capabilities and priorities of the public sector. Where government can achieve its objectives through <u>control</u> as opposed to <u>ownership</u> then, given its limited resources and the past weaknesses of many publicly owned entities, it should opt for the former. Eighth, government should dispose of its direct production units in agriculture, livestock and other natural resource areas which have ceased to have any justification or relevance to ordinary farmers and which are generally inefficient and costly. Ninth, disposal of assets to those well known to have acquired wealth through brutality or other illegal means is not likely to command public support. Tenth, disposition of some buildings might be facilitated by transferring ownership to one of the housing finance stitutions so that properties could be sold on credit. Revenues from loan repayments might then be channelled back into housing.

IV. Optional Policy Packages

1. To underpin and reinforce the above core reforms the government will need to take important decisions about retail pricing, producer pricing, the exchange rate, the extent of external assistance and additional budgetary, monetary and administrative measures. There is no single policy package option advanced here but rather a series of different options each warranting careful evaluation.

2. Some of the possible options are closely related while others are mutually exclusive. We know, for instance, that significant inflows of concessional aid will be forthcoming from western donors only if Uganda adjusts its exchange rate upwards (devalues). By the same token, experience elsewhere shows that a decision not to devalue or even to go in the opposite direction, and revalue, will not be compatible with large amounts of balance of payments assistance. Such flows are hard to obtain from non-traditional sources. Government must consider this when deciding on which course of action to take.

3. Exchange rate changes and accompanying adjustments to producer 'prices' the rate of inflation and speed of industrial recovery are, indeed, at the heart of the differences between the scenarios which follow.

4. The scenarios have a number of assumptions in common. Each assumes that the existing losses on foreign currency purchases and sales are dealt with. In scenario 2a (note that scenario 1 was dealt with earlier and involves no change in current policies) this is achieved by adopting the measure recommended in the core reform package of shifting items around from priority list to market list and vice versa, while retaining the dual exchange rate system at current rates. In all the other scenarios it is accomplished by unifying the exchange rate.

   All scenarios assume an additional inflow of $30 million in Humanitarian Aid in year 1 because this should not be dependent on the policy package adopted. All assume that there is, initially, no adjustment in civil service salaries but an allowance is made for salary creep and a slight increase in numbers. Finally, all assume that foreign exchange is allocated as a matter of priority to intermediate goods, capital goods and spare parts.

5. The likely outcome of each scenario was estimated using a projection model which also has built into it some basic assumptions about the economy. Each scenario starts from the same base situation which is essentially that presented earlier in Tables 5.1 and 5.2 showing what would happen if government took no further policy action. This base is, however, adjusted initially to zero inflation.

Under each scenario coffee sales are assumed to have the same real response of 0.1 to a given change in real producer prices. This is at the lower end of the generally accepted range for response.

There was, however, some disagreement in the group on the coefficient of official sales response. The majority felt that official sales were responsive to changes in the producer price. A minority felt that smuggling could be controlled effectively, whatever the price, and that farmers have little option but to sell thier coffee. These latter were supportive of the control scenario for this reason.

6. The following scenarios were examined.

i) Scenario 2A - Adjusted Status Quo Model (A).
This assumes 100% inflation; the existing dual exchange rate system modified to end losses on foreign exchange transactions; tax revenue raising measures as in section 5(a)4; Rescheduling of $50 million debt; additional humanitarian aid of $30 million in year 1.

ii. Scenario 2B - Adjusted Status Quo Model (B).
This assumes 100% inflation, a unified exchange rate of sh.2500 to $1 adjusted for inflation thereafter; producer prices indexed to inflation and therefore the exchange rate; other assumptions as in 2A.

iii. Scenario 2C - Adjusted Status Quo Model (C)
This assumes 25% inflation, the expenditure of government surpluses and the expansion of imports - other assumptions as in 2B.

iv. Scenario 3 - Low Conditionality Agreement
This makes all the same assumptions as Scenario 2B and the additional assumption of an inflow of foreign capital on concessional terms of between $160 and $185 million per year.

v. <u>Scenario 4 - High Conditionality Terms</u>
This assumes that Uganda is able and willing to meet the terms of an IMF Stand-by Arrangement. It makes all the same assumptions as scenario 4 except capital inflows are greater and performance requirements are stiffer.

vi. <u>Scenario 5A - Control Model A</u>
This assumes a 50% inflation rate; a <u>revaluation</u> to sh.1000 per $1 with producer prices adjusted down to 50% of world price in shillings. Tax policies as in 2A but with a 75% tax on petroleum products.

vii. <u>Scenario 5B - Control Model B</u>
This assumes an inflation rate of - 25% p.a., a revaluation of the shilling to sh.1000 per $1; other assumptions as in 3A.

viii. <u>Scenario 5C - Control Model C</u>
Assumptions are made as in 5B except revaluation is to sh.700 per $1.

As a word of caution the projection results which follow should be interpreted as being merely indicaive of what might happen in practice. Assumptions are critical and may be varied within reason. The model is also a relatively simple one which cannot capture the complexities of such important variables as weather or absorptive capacity. Nevertheless the projections are the best we have and they are indicative of the likely outcome of each scenario.

7. The results projected are as follows :

<u>Scenario 2 A Adjusted Status Quo</u>

This policy scenario alters the status quo by improving the revenue base through :

a) eradication of losses on foreign exchange and

b) implementing the tax reform proposals in section 5(a)4.

It also improves the budget by <u>not</u> paying $50 m of loan servicing obligations and by attracting modest additional grants.

The result, shown in Table 5.3 and 5.4, is that the budget deficit and the balance of payments deficits go down relative to the figures in Tables 5.1 and 5.2 on Scenario 1. Yet, clearly, the budget deficit is still hopelessly out of control and growing rapidly while the balance of payments simply cannot be balanced.

At the same time, marketing costs are assumed constant, which is not a realistic assumption.

The problem here is that inflation erodes real coffee prices and this undermines production, exports <u>and</u> budget revenue.

This scenario is clearly not sustainable on the assumptions made.

UGANDA MACROECONOMIC SCENARIOS
Number 2: Variant A -- Adjusted Status Quo. 100%
100% Inflation Assumed

Table : 5.3

	86/87	87/88	88/89
ASSUMPTIONS:			
Inflation rate per year:	100.0%	100.0%	100.0%
Price level at beginning of year	100.0	200.0	400.0
Average price level for year (86=100)	150.0	300.0	600.0
Exchange Rates USh/$			
Preferential	1400.0	1400.0	1400.0
Market	5000.0	5000.0	5000.0
Share of exports at pref. rate:	80.0%	80.0%	80.0%
Share of imports at pref. rate:	80.0%	80.0%	80.0%
INTERNATIONAL PRICES:			
Index of petroleum prices	100.0	100.0	100.0
Level of coffee prices $	2.5	2.4	2.4
Index of other imports	100.0	100.0	100.0
DOMESTIC PRICES AND QUANTITIES:			
Coffee producer price USh/kg (Kiboko)	850.0	850.0	850.0
Coffee producer price (clean)	1574.0	1574.0	1574.0
Coffee marketing costs	756.0	756.0	756.0
Coffee production (BASE)	163.2	166.5	169.8
Coffee production (price adjusted)	155.0	133.2	84.9
Industrial production	100.0	100.0	100.0
Intermediate inputs	100.0	100.0	100.0

BALANCE OF PAYMENTS SUMMARY: (IN $US/MILLION)	86/87	87/88	88/89
A. Total exports	424.3	368.1	256.7
1. Non-coffee visible exports	20.0	22.7	24.6
2. Coffee	383.7	319.6	203.8
3. Non-factor services	20.6	25.8	28.3
B. Total imports	-585.6	-606.9	-634.5
1. Non-petrol visible imports	-405.0	-424.5	-447.9
2. Petroleum	-48.0	-52.9	-58.4
3. Non-factor services	-82.0	-86.2	-90.4
4. Net factor services	-50.6	-43.3	-37.8
C. Capital movements			
1. Grants	57.2	62.7	69.0
2. Gross loans - to budget	130.2	131.3	137.6
3. Loan repayment from budget	-44.3	-44.3	-44.3
4. Remittances (net)	38.0	39.9	41.9
5. IMF repayment	-79.4	-71.0	-60.0
6. Loans - not to budget	44.4	17.9	20.4
7. Loan repayment-not from budget	-41.0	-13.0	-14.9
8. Special Purpose Grants	40.0	20.0	30.0
D. Basic Deficit Not Financed	-16.1	-95.3	-198.1

NOTE: (-) = OUTFLOW

UGANDA MACROECONOMIC SCENARIOS
Number 2: Variant A -- Adjusted Status Quo.
100% Inflation Assumed

Table : 5.4

SUMMARY OF GOVERNMENT BUDGET (US Shs.Billion)	86/87	87/88	88/89
TOTAL REVENUE:	454.6	510.6	562.3
1. Tax Revenue	308.5	392.8	418.7
a) Income/Profits	17.0	22.5	30.6
b) Goods/Services	75.3	123.3	218.8
(1) Sales Tax	53.0	79.8	129.8
(a) Local	25.0	49.0	99.0
(b) Imported	28.0	30.8	30.8
(2) Excise	18.8	36.8	74.3
(3) Commercial Trans. Levy	3.5	6.7	14.7
c) International Trade	215.7	156.5	78.8
(1) Import Duties	50.4	64.7	66.6
(a) Petroleum	8.4	18.5	20.4
(b) Other	42.0	46.2	46.2
(2) Export Duties	165.3	91.8	12.2
(a) Coffee	161.3	86.8	7.2
(b) Other	4.0	5.0	5.0
(3) Forexchange tax/subsidy	0.0	0.0	0.0
d) Other Tax	0.5	90.5	90.5
2. Other Revenues	52.0	16.0	33.0
a) Kenya/EAC settlement	42.0	0.0	0.0
b) Other	10.0	16.0	33.0
3. Grants	94.1	101.8	110.6
TOTAL EXPENDITURES:	697.6	1032.3	1540.0
1. Recurrent Expenditure	483.1	765.1	1389.4
a) Wages/Salaries	48.5	50.9	53.5
b) Interest - External	75.3	75.3	75.3
c) Interest - Local	22.0	52.7	149.2
d) Other	337.3	586.2	1111.4
2. Development/Rehabilitation	214.5	267.2	150.6
a) Capital Projects	122.6	140.6	77.0
b) Rehabilitation/Resettlement	91.9	126.6	73.6
FINANCING REQUIREMENT:	243.0	521.7	977.7
1. External Net Financing	120.3	135.8	158.6
a) Loans + Grants -- Inflow	182.3	197.8	220.6
b) Loan Repayment - Amortization	62.0	62.0	62.0
2. Net Deficit to be financed	122.7	385.9	819.1
a) Foreign inflow for uncovered BOP			
b) Domestic finance required	122.7	385.9	819.1

Scenario 2 B - Adjusted Status Quo with Devaluation

On this scenario the capital account and the import bill are the same as in scenario 2 A, but here the shilling is devalued in order to pay coffee producers a higher price. The initial devaluation takes the shilling to sh.2500 per $1. This, in real effective terms, is where it would have to be to be back at its 1983/84 level when the balance of payments was in reasonable equilibrium. As inflation continues at a constant rate (at least on first assumptions), the shilling rate is moved steadily upwards. Coffee producer prices are raised by 80% in real terms initially, and thereafter are increased in line with inflation so that the purchasing power of coffee farmers is maintained at the new level. As a result, as can be seen from Tables 5.5 and 5.6, export sales of coffee rise from 163,000 tons (assumed in scenario 2 A) to 203,500 tons. On this account alone the balance of payments shows a considerable improvement, as do coffee duty proceeds in the budget even after allowing for 100% inflation in marketing costs.

This apparently large response in coffee output comes from two distinct reactions. First, the large increase in real producer prices of 80% gives rise to a short-run increase in output conservatively estimated in all the scenarios to be as low as 0.1. In addition, it is reasonable to expect that as producer prices approach the upper end of the range of the magendo buying prices estimated by the CMB at 1200-1500 U.sh./kg, a strong diversion of coffee sales into the official market will occur. Estimates of potential total coffee production in Uganda range from 200 to 230 thousand tons, putting this estimate of marketed production well within the bounds of possibility.

UGANDA MACROECONOMIC SCENARIOS
Number 2: Variant B -- Adjusted Status Quo.
100% Inflation Assumed. Exchange Rate Unifed at 2500
Producer Prices and Ex. Rate Adjusted

Table : 5.5

	86/87	87/88	88/89
ASSUMPTIONS:			
Inflation rate per year:	100.0%	100.0%	100.0%
Price level at beginning of year	100.0	200.0	400.0
Average price level for year (86=100)	150.0	300.0	600.0
Exchange Rates USh/$			
Preferential	3750.0	7500.0	15000.0
Market	3750.0	7500.0	15000.0
INTERNATIONAL PRICES:			
Index of petroleum prices	100.0	100.0	100.0
Level of coffee prices $	2.5	2.4	2.4
Index of other imports	100.0	100.0	100.0
DOMESTIC PRICES AND QUANTITIES:			
Coffee producer price USh/kg (Kiboko)	2276.8	4553.6	9107.1
Coffee producer price (clean)	4553.7	9107.4	18214.8
Coffee marketing costs	1134.0	1512.0	3780.0
Coffee production (BASE)	203.5	207.6	211.7
Coffee production (price adjusted)	203.5	207.6	211.7
Industrial production	100.0	100.0	100.0
Intermediate inputs	100.0	100.0	100.0

BALANCE OF PAYMENTS SUMMARY: (IN $US/MILLION)	86/87	87/88	88/89
A. Total exports	544.2	546.6	561.0
1. Non-coffee visible exports	20.0	22.7	24.6
2. Coffee	503.6	498.1	508.1
3. Non-factor services	20.6	25.8	28.3
B. Total imports	-585.6	-606.9	-634.5
1. Non-petrol visible imports	-405.0	-424.5	-447.9
2. Petroleum	-48.0	-52.9	-58.4
3. Non-factor services	-82.0	-86.2	-90.4
4. Net factor services	-50.6	-43.3	-37.8
C. Capital movements			
1. Grants	57.2	62.7	69.0
2. Gross loans - to budget	130.2	131.3	137.6
3. Loan repayment from budget	-44.3	-44.3	-44.3
4. Remittances (net)	38.0	39.9	41.9
5. IMF repayment	-79.4	-71.0	-60.0
6. Loans - not to budget	44.4	17.9	20.4
7. Loan repayment-not from budget	-41.0	-13.0	-14.9
8. Special Purpose Grants	40.0	20.0	30.0
D. Basic Deficit Not Financed	-103.8	-83.2	-106.2

UGANDA MACROECONOMIC SCENARIOS
Number 2: Variant B -- Adjusted Status Quo. 100% Inflation Assumed
Exchange Rate Unifed at 2500. Producer Prices and Ex. Rate Adjusted

Table : 5.6

SUMMARY OF GOVERNMENT BUDGET (US Shs.Billion)	86/87	87/88	88/89
TOTAL REVENUE:	1024.7	1792.9	3507.1
1. Tax Revenue	810.6	1471.6	2810.8
a) Income/Profits	17.0	22.5	30.6
b) Goods/Services	82.3	161.1	326.6
(1) Sales Tax	60.0	117.6	237.6
(a) Local	25.0	49.0	99.0
(b) Imported	35.0	68.6	138.6
(2) Excise	18.8	36.8	74.3
(3) Commercial Trans. Levy	3.5	6.7	14.7
c) International Trade	710.8	1197.5	2363.1
(1) Import Duties	50.4	121.4	228.3
(a) Petroleum	8.4	18.5	20.4
(b) Other	42.0	102.9	207.9
(2) Export Duties	660.4	1076.1	2134.8
(a) Coffee	654.4	1061.1	2104.8
(b) Other	6.0	15.0	30.0
(3) Forexchange tax/subsidy	0.0	0.0	0.0
d) Other Tax	0.5	90.5	90.5
2. Other Revenues s	73.0	16.0	33.0
a) Kenya/EAC settlement	63.0	0.0	0.0
b) Other	10.0	16.0	33.0
3. Grants	141.1	305.3	663.3
TOTAL EXPENDITURES:	874.2	1664.5	2711.5
1. Recurrent Expenditure	588.2	1040.7	2002.9
a) Wages/Salaries	48.5	50.9	53.5
b) Interest - External	113.0	225.9	451.8
c) Interest - Local	22.0	-115.4	-407.7
d) Other	404.7	879.3	1905.3
2. Development/Rehabilitation	286.0	623.8	708.6
a) Capital Projects	183.9	454.9	594.2
b) Rehabilitation/Resettlement	102.1	168.9	114.4
FINANCING REQUIREMENT:	-150.5	-128.4	-795.6
1. External Net Financing	322.2	727.1	1698.8
a) Loans + Grants -- Inflow	488.3	1059.4	2363.3
b) Loan Repayment - Amortization	166.1	332.3	664.5
2. Net Deficit to be financed	472.7	855.5	2494.4
a) Foreign inflow for uncovered BOP			
b) Domestic finance required	0.0	0.0	0.0

<u>Scenario 2 C - Adjusted Status Quo with Additional Import Capacity</u>

This assumes that inflation falls to 25% p.a. partly because of initial surpluses and partly because of later demand leakages through imports as well as expansion of supply from increased import capacity.

It seems unreasonable that government would actually run budget surpluses. Therefore, the additional fiscal resources are allocated to a special category that could be spent on wages and salaries and other recurrent expenditure. Pending detailed recommendations for government reform, it is inappropriate to allocate in detail. It is assumed that the average import content of this expenditure will be 0.25 which is shown as additional import capacity used for government in the Balance of Payments Summary.

It also seems unnecessary for Uganda to run a BoP surplus after debt service. Therefore the remaining foreign exchange resources after base projected imports and government additional imports have been satisfied, have been allocated for increasing import of intermediate goods.

The increased availability of intermediate goods is shown in the index near the top of Table 5.7. It will be noted that there is an explosive rise in intermediates and industrial indices in year 1 which cannot be sustained. The reason is that there is no significant import-capacity buoyancy to correspond to the growing import demands arising from fiscal performance.

The combined fiscal restraint and expanded supply of goods and services are fully consistent with the rate of inflation being at or below 25% in the first two years. The question of how quickly inflation can subside given existing dynamics and expectations is not addressed directly by this model. However, over time, the industrial production possibilities decline.

This scenario sheds considerable light on the successes and failures of earlier stabilization measures. In the first two years of simulation, resource constraints are relieved giving potential for increased industrial production, coffee exports recover, and fiscal capacity expands. But the additional imports of intermediate goods in the third year points to the problem of balance between increased domestic resource mobilization and import capacity. In such circumstances, an apparently successful stabilization and initial recovery programme will peak and then subside unless additional import capacity can be generated.

There are opportunities for raising import capacity by raising non-coffee exports, particularly through expansion of exports of cotton, vegetable oils, and tea; and longer- term possibilities for phosphates, tourism, and horticulture. In industrial sectors, there are opportunities for exporting textiles, garments, leather and leather products, as well as for import substitution. But substantial gains in these areas are not likely to be achieved within three years within the given import constraints of this scenario. Therefore, if the stabilization programme is to succeed as a step towards economic restructuring and development, additional supplies of intermediate inputs and capital goods are required and as early as possible. While restoration of price stability, reconstitution of basic governmental capacity, and maintainance of order and security are necessary for long-term resuscitation of the economy, it is certainly not sufficient. The difficult actions to use resources efficiently and build productive capacity require much more analysis at sectoral levels and attention to management and organizational questions, some of which are dealt with in section 7. However, this scenario suggests some of the macro parameters within which reconstruction activities must take place.

These increases do not include any medium-term responses through replanting and other investments. However, it is far from clear that quota allocations would not present a problem at significantly higher production levels. A result of inflation-indexing of the producer price, these one-time increases are sustained but no further supply responses are induced.

On these assumptions, the scenario is sustainable and, given the huge budget surpluses it is likely to result in a significant fall in inflation.

UGANDA MACROECONOMIC SCENARIOS
Number 2: Variant C -- Adjusted Status Quo.
25% Inflation Assumed. Prod. Price and Ex. Rate Indexed
Budget and BOP surpluses allocated

Table : 5.7

	86/87	87/88	88/89
ASSUMPTIONS:			
Inflation rate per year:	25.0%	25.0%	25.0%
Price level at beginning of year	100.0	125.0	156.3
Average price level for year (86=100)	112.5	140.6	175.8
Exchange Rates USh/$			
Preferential	2812.5	3515.6	4394.5
Market	2812.5	3515.6	4394.5
Share of exports at pref. rate:	80.0%	80.0%	80.0%
Share of imports at pref. rate:	80.0%	80.0%	80.0%
INTERNATIONAL PRICES:			
Index of petroleum prices	100.0	100.0	100.0
Level of coffee prices $	2.5	2.4	2.4
Index of other imports	100.0	100.0	100.0
DOMESTIC PRICES AND QUANTITIES:			
Coffee producer price USh/kg (Kiboko)	1707.6	2134.5	2668.1
Coffee producer price (clean)	3415.3	4269.1	5336.4
Coffee marketing costs	851.0	1063.0	1329.0
Coffee production (BASE)	203.5	207.6	211.7
Coffee production (price adjusted)	203.5	207.6	211.7
Industrial production	255.6	164.2	152.4
Intermediate inputs	255.6	164.2	152.4

BALANCE OF PAYMENTS SUMMARY: (IN $US/MILLION)	86/87	87/88	88/89
A. Total exports	544.2	546.6	561.0
1. Non-coffee visible exports	20.0	22.7	24.6
2. Coffee	503.6	498.1	508.1
3. Non-factor services	20.6	25.8	28.3
B. Total imports	-585.6	-606.9	-634.5
1. Non-petrol visible imports	-405.0	-424.5	-447.9
2. Petroleum	-48.0	-52.9	-58.4
3. Non-factor services	-82.0	-86.2	-90.4
4. Net factor services	-50.6	-43.3	-37.8
C. Capital movements			
1. Grants	57.2	62.7	69.0
2. Gross loans - to budget	130.2	131.3	137.6
3. Loan repayment from budget	44.3	44.3	44.3
4. Remittances (net)	38.0	39.9	41.9
5. IMF repayment	79.4	71.0	60.0
6. Loans - not to budget	44.4	17.9	20.4
7. Loan repayment-not from budget	41.0	13.0	14.9
8. Special Purpose Grants	40.0	20.0	30.0
D. Additional Import Capacity	104.3	83.2	106.2
1. For additional government	67.8	61.2	86.8
2. Additional intermediates	36.5	22.0	19.4

UGANDA MACROECONOMIC SCENARIOS
Number 2: Variant C -- Adjusted Status Quo. 25% Inflation Assumed
Prod. Price and Ex. Rate indexed. Budget and BOP surpluses alloc.

Table : 5.8

SUMMARY OF GOVERNMENT BUDGET (US Shs.Billion)	86/87	87/88	88/89
TOTAL REVENUE:	837.3	1023.2	1242.1
1. Tax Revenue	674.2	867.8	1032.3
a) Income/Profits	17.0	20.9	22.5
b) Goods/Services	70.5	92.6	116.5
(1) Sales Tax	51.1	66.5	83.5
(a) Local	21.3	27.7	34.8
(b) Imported	29.8	38.8	48.7
(2) Excise	15.9	20.8	26.1
(3) Commercial Trans. Levy	3.5	5.3	6.9
c) International Trade	586.2	663.8	802.8
(1) Import Duties	53.0	76.7	93.5
(a) Petroleum	8.4	18.5	20.4
(b) Other	44.6	58.2	73.1
(2) Export Duties	533.2	587.1	709.3
(a) Coffee	528.7	580.1	700.5
(b) Other	4.5	7.0	8.8
(3) Forexchange tax/subsidy	0.0	0.0	0.0
d) Other Tax	0.5	90.5	90.5
2. Other Revenues	57.3	12.3	15.5
a) Kenya/EAC settlement	47.3	0.0	0.0
b) Other	10.0	12.3	15.5
3. Grants	105.8	143.1	194.3
TOTAL EXPENDITURES:	683.4	905.8	985.3
1. Recurrent Expenditure	458.7	591.0	766.1
a) Wages/Salaries	48.5	50.9	53.5
b) Interest - External	84.7	105.9	132.4
c) Interest - Local	22.0	22.0	22.0
d) Other	303.5	412.2	558.2
2. Development/Rehabilitation	224.7	314.8	219.2
a) Capital Projects	137.9	213.2	174.1
b) Rehabilitation/Resettlement	86.8	101.6	45.1
FINANCING REQUIREMENT:	-153.9	-117.4	-256.8
1. External Net Financing	241.6	340.8	497.7
a) Loans + Grants -- Inflow	366.2	496.5	692.4
b) Loan Repayment - Amortization	124.6	155.7	194.7
2. Net Deficit to be financed	395.5	458.2	754.5
a) Foreign inflow for uncovered BOP			
b) Domestic finance required	0.0	0.0	0.0

Scenario 3 - Concessional Assistance Model

This is an extension of scenario 2 C. The difference is that it is assumed that on the basis of an overall adjustment programme similar to this one, and using the assumptions of scenario 2 C, Uganda is able to qualify for concessional assistance from the IMF, the IBRD and bilateral donors. The results are shown in Tables 5.9 and 5.10.

Should it wish to go this route, there would be a significant inflow of foreign capital especially in years 2 and 3, which would relieve the incremental import capacity bottleneck identified in scenarios 2 and, as we shall see, 5. The level of intermediate imports which results should enable Uganda to lay the ground work for more substantial import substitution and export promotion. It would also permit a substantial improvement in domestic transportation capacity which should help reduce domestic inflation. In addition, arrears could also be reduced.

While this scenario entails a short term increase in aid dependence, it should be noted that all the inflows are on concessional terms and on policy conditions which Uganda should be able to meet if it implements a programme similar to the one being proposed in this report. Secondly, if the aid is used wisely it should help strengthen, rather than weaken, the economy in terms of ultimate self reliance.

There is, of course, no guarantee that an agreement with the IBRD/IMF would be achievable on the basis of a programme such as the one here recommended. Nevertheless, the team is confident that it it so wishes, Uganda should be able to negotiate successfully from a strong position, on the basis of proposals similar to these.

One area of possible concern may be the inflation rate assumption. Given the scope for reducing the rents currently being earned by those buying foreign exchange at a subsidized price and selling final goods at the equivalent of market rates, there is every reason to believe that inflation will come down well below 100%. With the huge increase in external resources for agriculture, industry and transport, a large supply response should be possible. Even if civil servants' salaries were raised significantly, the budget should still be under control and not running a deficit. Credit could be expanded to industry and other productive areas to finance output increases and any increase in working capital needs due to higher import prices, without an inflationary increase in money supply. The combination of these results should bring inflation down sharply.

UGANDA MACROECONOMIC SCENARIOS
Number 3: Variant A -- Low Conditionality Agreement
Prod. Price and Ex. Rate Indexed
Budget and BOP surpluses allocated

Table : 5.9

	86/87	87/88	88/89
ASSUMPTIONS:			
Inflation rate per year:	25.0%	25.0%	25.0%
Price level at beginning of year	100.0	125.0	156.3
Average price level for year (86=100)	112.5	140.6	175.8
Exchange Rates USh/$			
Preferential	2812.5	3515.6	4394.5
Market	2812.5	3515.6	4394.5
Share of exports at pref. rate:	80.0%	80.0%	80.0%
Share of imports at pref. rate:	80.0%	80.0%	80.0%
INTERNATIONAL PRICES:			
Index of petroleum prices	100.0	100.0	100.0
Level of coffee prices $	2.5	2.4	2.4
Index of other imports	100.0	100.0	100.0
DOMESTIC PRICES AND QUANTITIES:			
Coffee producer price USh/kg (Kiboko)	1707.6	2134.5	2668.1
Coffee producer price (clean)	3415.3	4269.1	5336.3
Coffee marketing costs	756.0	756.0	756.0
Coffee production (BASE)	203.5	207.6	211.7
Coffee production (price adjusted)	203.5	207.6	211.7
Industrial production	156.3	372.3	457.4
Intermediate inputs	156.3	372.3	457.4

BALANCE OF PAYMENTS SUMMARY: (IN $US/MILLION)	86/87	87/88	88/89
A. Total exports	544.2	546.6	561.0
1. Non-coffee visible exports	20.0	22.7	24.6
2. Coffee	503.6	498.1	508.1
3. Non-factor services	20.6	25.8	28.3
B. Total imports	585.6	606.9	634.5
1. Non-petrol visible imports	405.0	424.5	447.9
2. Petroleum	48.0	52.9	58.4
3. Non-factor services	82.0	86.2	90.4
4. Net factor services	50.6	43.3	37.8
C. Capital movements			
1. Grants	52.0	57.0	62.7
2. Gross loans - to budget	124.0	125.3	131.0
3. Loan repayment from budget	-44.3	-44.3	-44.3
4. Remittances (net)	38.0	39.9	41.9
5. IMF repayment	-79.4	-71.0	-60.0
6. Loans - not to budget	69.4	42.9	45.4
7. Loan repayment-not from budget	-41.0	-13.0	-14.9
8. Special Purpose Grants	40.0	20.0	30.0
D. Additional Import Capacity	103.7	173.2	246.2
1. For additional government	67.1	57.6	94.0
2. Additional intermediates	36.6	115.6	152.2

NOTE: (-) = OUTFLOW

UGANDA MACROECONOMIC SCENARIOS
Number 3: Variant A -- Low Conditionality Agreement
Prod. Price and Ex. Rate indexed. Budget and BOP surpluses alloc.

Table : 5.10

SUMMARY OF GOVERNMENT BUDGET (US Shs.Billion)	86/87	87/88	88/89
TOTAL REVENUE:	837.7	1023.9	1242.1
1. Tax Revenue	674.6	868.5	1032.3
a) Income/Profits	17.0	20.9	22.5
b) Goods/Services	70.5	92.6	116.5
(1) Sales Tax	51.1	66.5	83.5
(a) Local	21.3	27.7	34.8
(b) Imported	29.8	38.8	48.7
(2) Excise	15.9	20.8	26.1
(3) Commercial Trans. Levy	3.5	5.3	6.9
c) International Trade	586.6	664.5	802.8
(1) Import Duties	53.0	76.7	93.5
(a) Petroleum	8.4	18.5	20.4
(b) Other	44.6	58.2	73.1
(2) Export Duties	533.6	587.8	709.3
(a) Coffee	529.1	580.8	700.5
(b) Other	4.5	7.0	8.8
(3) Forexchange tax/subsidy	0.0	0.0	0.0
d) Other Tax	0.5	90.5	90.5
2. Other Revenues	57.3	12.3	15.5
a) Kenya/EAC settlement	47.3	0.0	0.0
b) Other	10.0	12.3	15.5
3. Grants	105.8	143.1	194.3
TOTAL EXPENDITURES:	683.4	905.8	985.3
1. Recurrent Expenditure	458.7	591.0	766.1
a) Wages/Salaries	48.5	50.9	53.5
b) Interest - External	84.7	105.9	132.4
c) Interest - Local	22.0	22.0	22.0
d) Other	303.5	412.2	558.2
2. Development/Rehabilitation	224.7	314.8	219.2
a) Capital Projects	137.9	213.2	174.1
b) Rehabilitation/Resettlement	86.8	101.6	45.1
FINANCING REQUIREMENT:	-154.3	-118.1	-256.8
1. External Net Financing	241.6	428.7	651.5
a) Loans + Grants -- Inflow	366.2	584.4	846.2
b) Loan Repayment - Amortization	124.6	155.7	194.7
2. Net Surplus	395.9	546.8	908.3
a) Possible additional expenditure			
b) Domestic finance required	0.0	0.0	0.0

Scenario 4 - High Conditionality Model

This scenario would involve negotiating a standby agreement with the IMF. If followed successfully, it would generate even more external resources than scenario 3. The team did not pursue this scenario further on the grounds that the resource flow under the previous scenario would be more than adequate to Uganda's needs while an additional $160 million might be difficult to absorb. Furthermore, while this approach would strengthen the budget and balance of payments position even further, it would also be accompanied by tight performance criteria and domestic policy adjustment to a degree which Uganda might find difficult to meet or uncomfortable to live with. IMF standby money is also expensive and repayable in a relatively short period of time.

If the government wishes to pursue a scenario such as this it would not be difficult to adjust the balance of payments and budget projections of the previous scenario to accommodate it.

The results of this scenario can be seen in Tables 5.11 and 5.12. The result is a mounting balance of payments deficit as well as a large and steadily rising budget deficit. Budget deficit would be even larger (by sh. 28 billion, sh. 96 billion and sh. 186 billion) if marketing margins rose with inflation.

The reason for this is that the revaluation, even with reduced inflation and a coffee producer price which is raised as a percentage of world price, so reduces real producer prices that even on the modest supply responses assumed, official coffee exports plummet. Debt rescheduling would also probably not be acceptable to donors on this scenario, and bilateral balance of payments assistance would probably not be forthcoming. There are also doubts that the loan and grant inflows of $176 million could be sustained.

The revenue from coffee export duty falls partly because of the lower shilling value of the dollar and, again, on account of falling official exports. There is no room in the budget for expenditure increases and certainly no scope for making salary adjustments of the magnitude required.

UGANDA MACROECONOMIC SCENARIOS
Number 5: Variant A -- Control Scenario -- 50% Inflation
Exchange Rate Unified at 1000
Producer Prices adjusted Down

Table : 5.11

	86/87	87/88	88/89
ASSUMPTIONS:			
Inflation rate per year:	50.0%	50.0%	50.0%
Price level at beginning of year	100.0	150.0	225.0
Average price level for year (86=100)	125.0	187.5	225.0
Exchange Rates USh/$			
Preferential	1000.0	1000.0	1000.0
Market	1000.0	1000.0	1000.0
INTERNATIONAL PRICES:			
Index of petroleum prices	100.0	100.0	100.0
Level of coffee prices $	2.5	2.4	2.4
Index of other imports	100.0	100.0	100.0
DOMESTIC PRICES AND QUANTITIES:			
Coffee producer price USh/kg (Kiboko)	500.0	500.0	500.0
Coffee producer price (clean)	925.9	925.9	925.9
Coffee marketing costs	756.0	756.0	756.0
Coffee production (BASE)	160.0	167.0	174.0
Coffee production (price adjusted)	149.4	145.5	135.3
Industrial production	100.0	100.0	100.0
Intermediate inputs	100.0	100.0	100.0

BALANCE OF PAYMENTS SUMMARY: (IN $US/MILLION)	86/87	87/88	88/89
A. Total exports	410.4	397.7	377.6
1. Non-coffee visible exports	20.0	22.7	24.6
2. Coffee	369.8	349.2	324.7
3. Non-factor services	20.6	25.8	28.3
B. Total imports	-585.6	-606.9	-634.5
1. Non-petrol visible imports	-405.0	-424.5	-447.9
2. Petroleum	-48.0	-52.9	-58.4
3. Non-factor services	-82.0	-86.2	-90.4
4. Net factor services	-50.6	-43.3	-37.8
C. Capital movements			
1. Grants	52.0	57.0	62.7
2. Gross loans - to budget	124.0	125.0	131.0
3. Loan repayment from budget	-69.3	-69.3	-69.3
4. Remittances (net)	38.0	39.9	41.9
5. IMF repayment	-79.4	-71.0	-60.0
6. Loans - not to budget	69.4	42.9	45.4
7. Loan repayment-not from budget	-66.0	-38.0	-39.9
8. Special Purpose Grants	30.0	0.0	0.0
D. Basic Deficit Not Financed	-76.4	-122.7	145.1

UGANDA MACROECONOMIC SCENARIOS
Number 5: Variant A -- Control Scenario -- 50% Inflation
Exchange Rate Unified at 1000. Producer Prices Adjusted Down.

Table : 5.12

SUMMARY OF GOVERNMENT BUDGET (US Shs.Billion)	86/87	87/88	88/89
TOTAL REVENUE:	402.1	457.9	489.6
1. Tax Revenue	294.9	371.7	390.0
a) Income/Profits	17.0	21.5	24.9
b) Goods/Services	66.9	78.8	121.5
(1) Sales Tax	46.5	56.5	73.6
(a) Local	22.5	34.1	51.6
(b) Imported	24.0	22.4	22.0
(2) Excise	16.9	16.5	38.7
(3) Commercial Trans. Levy	3.5	5.8	9.2
c) International Trade	210.5	180.9	153.1
(1) Import Duties	72.0	73.3	76.8
(a) Petroleum	36.0	39.7	43.8
(b) Other	36.0	33.6	33.0
(2) Export Duties	138.5	107.6	76.3
(a) Coffee	135.6	104.0	72.7
(b) Other	2.9	3.6	3.6
(3) Forexchange tax/subsidy	0.0	0.0	0.0
d) Other Tax	0.5	90.5	90.5
2. Other Revenues	40.0	13.5	20.6
a) Kenya/EAC settlement	30.0	0.0	0.0
b) Other	10.0	13.5	20.6
3. Grants	67.2	72.7	79.0
TOTAL EXPENDITURES:	519.1	775.5	856.0
1. Recurrent Expenditure	317.0	527.1	775.8
a) Wages/Salaries	48.5	50.9	53.5
b) Interest - External	53.8	53.8	53.8
c) Interest - Local	22.0	43.0	108.5
d) Other	192.7	379.4	560.0
2. Development/Rehabilitation	202.1	248.4	{80.2
a) Capital Projects	120.4	164.0	35.0
b) Rehabilitation/Resettlement	81.7	84.4	45.2
FINANCING REQUIREMENT:	117.0	317.6	366.4
1. External Net Financing	54.7	55.7	61.7
a) Loans + Grants -- Inflow	124.0	125.0	131.0
b) Loan Repayment - Amortization	69.3	69.3	69.3
2. Net Surplus	-62.3	-261.9	-304.7
a) Possible additional expenditure			
b) Domestic finance required	62.3	261.9	304.7

Scenario 5 A - A Control Model

In this scenario an attempt is made to see what would happen to the economy if the government tried to bring prices down by exercising tight control over both importer/producer and retail margins and by revaluing the shilling which would make imported goods less expensive in shillings. The rationale is that an importer/producer who obtains foreign exchange at a highly subsidised rate should and would cooperate with the government in the anti-inflation effort.

The assumption of price reduction in the control model is based on low import costs of final and intermediate inputs in terms of local costs. In addition distribution/retailing is confined to agents whose profit margins are controlled by government guidelines. Free distribution that exploits the prevailing acute shortages is ruled out for most products.

As in other scenarios, this scenario further assumes that government will distribute the foreign exchange it has in favour of industrial production and intermediate inputs thus facilitating the process of industrial rehabilitation. It is also assumed that at a low exchange rate industrial enterprises will overcome the major constraint of lack of local finance to finance imports.

The initial assumption is that with the return to order and stability and with the partial restoration of transport and industrial capacity through the controlled allocation of foreign exchange, the rate of inflation should fall to 50% p.a. With the revaluation of the shilling to a unified re of sh.1000 per $1, producer prices are scaled down but are maintained at 50% of the world price in shillings. A supply official sales response of 0.1 is assumed.

Scenario B

This variant is a most extreme variant of 5 A. It examines what would happen if, through lower cost of imports and government price guidelines, initial inflation fell immediately to -25% p.a. and continued at this rate for three years. The exchange rate is revalued to 1000/- per $1 and producer prices are fixed at one half the world price in shillings.

The results can be seen in table 5.13 and 5.14. This scenario runs simultaneous deficits in both the budget and in the balance of payments. Though the budget deficits are smaller it should be noted that in real terms they are larger than in 5 A, because inflation is now negative.

UGANDA MACROECONOMIC SCENARIOS
Number 5: Variant B -- Control Scenario -- 25% Inflation
Exchange Rate Unified at 1000
Producer Prices adjusted Down

Table : 5.13

	86/87	86/87	87/88	88/89
ASSUMPTIONS:				
Inflation rate per year:		-25.0%	-25.0%	-25.0%
Price level at beginning of year	100.0	100.0	75.0	56.3
Average price level for year (86=100)	100.0	87.5	65.6	49.2
Exchange Rates USh/$				
Preferential	1000.0	1000.0	1000.0	1000.0
Market	1000.0	1000.0	1000.0	1000.0
Share of exports at pref. rate:	0.0%	0.0%	0.0%	0.0%
Share of imports at pref. rate:	0.0%	0.0%	0.0%	0.0%
INTERNATIONAL PRICES:				
Index of petroleum prices	100.0	100.0	100.0	100.0
Level of coffee prices $	2.5	2.5	2.4	2.4
Index of other imports	100.0	100.0	100.0	100.0
DOMESTIC PRICES AND QUANTITIES:				
Coffee producer price USh/kg (Kiboko)	500.0	500.0	500.0	500.0
Coffee producer price (clean)	925.9	925.9	925.9	925.9
Coffee marketing costs	756.0	756.0	756.0	756.0
Coffee production (BASE)	160.0	160.0	167.0	174.0
Coffee production (price adjusted)	160.0	149.4	145.5	135.3
Industrial production	100.0	100.0	100.0	100.0
Intermediate inputs	100.0	100.0	100.0	100.0

BALANCE OF PAYMENTS SUMMARY: (IN $US/MILLION)	86/87	87/88	88/89
A. Total exports	449.6	461.8	481.1
1. Non-coffee visible exports	20.0	22.7	24.6
2. Coffee	409.0	413.3	428.2
3. Non-factor services	20.6	25.8	28.3
B. Total imports	585.6	606.9	634.5
1. Non-petrol visible imports	405.0	424.5	447.9
2. Petroleum	48.0	52.9	58.4
3. Non-factor services	82.0	86.2	90.4
4. Net factor services	50.6	43.3	37.8
C. Capital movements			
1. Grants	52.0	57.0	62.7
2. Gross loans - to budget	124.0	125.0	131.0
3. Loan repayment from budget	69.3	69.3	69.3
4. Remittances (net)	38.0	39.9	41.9
5. IMF repayment	79.4	71.0	60.0
6. Loans - not to budget	69.4	42.9	45.4
7. Loan repayment-not from budget	66.0	38.0	39.9
D. Basic Deficit Not Financed	-67.3	-58.6	-41.5

UGANDA MACROECONOMIC SCENARIOS
Number 5: Variant B -- Control Scenario -- 25% Inflation
Exchange Rate Unified at 1000. Producer Prices Adjusted Down.

Table : 5.14

SUMMARY OF GOVERNMENT BUDGET (US Shs.Billion)	86/87	87/88	88/89
TOTAL REVENUE:	399.0	475.4	522.0
1. Tax Revenue	291.8	390.4	427.1
a) Income/Profits	17.0	21.0	23.1
b) Goods/Services	64.4	67.2	87.9
(1) Sales Tax	45.1	49.2	54.6
(a) Local	21.1	26.8	32.6
(b) Imported	24.0	22.4	22.0
(2) Excise	15.8	12.6	26.0
(3) Commercial Trans. Levy	3.5	5.4	7.2
c) International Trade	209.9	211.8	225.6
(1) Import Duties	72.0	73.3	76.8
(a) Petroleum	36.0	39.7	43.8
(b) Other	36.0	33.6	33.0
(2) Export Duties	137.9	138.5	148.8
(a) Coffee	135.0	134.9	145.2
(b) Other	2.9	3.6	3.6
(3) Forexchange tax/subsidy	0.0	0.0	0.0
d) Other Tax	0.5	90.5	90.5
2. Other Revenues	40.0	12.3	16.0
a) Kenya/EAC settlement	30.0	0.0	0.0
b) Other	10.0	12.3	16.0
3. Grants	67.2	72.7	79.0
TOTAL EXPENDITURES:	504.5	694.8	675.2
1. Recurrent Expenditure	305.0	453.6	600.7
a) Wages/Salaries	48.5	50.9	53.5
b) Interest - External	53.8	53.8	53.8
c) Interest - Local	22.0	34.7	75.6
d) Other	180.7	314.2	417.8
2. Development/Rehabilitation	199.5	241.1	74.5
a) Capital Projects	120.4	164.0	35.0
b) Rehabilitation/Resettlement	79.1	77.1	39.5
FINANCING REQUIREMENT:	105.5	219.4	153.2
1. External Net Financing	54.7	55.7	61.7
a) Loans + Grants -- Inflow	124.0	125.0	131.0
b) Loan Repayment - Amortization	69.3	69.3	69.3
2. Net Deficit to be Financed	50.8	163.7	91.5
a) Foreign inflow for uncovered BOP			
b) Domestic finance required	50.8	163.7	91.5

Scenario 5 C

This is the same as 5 B except that the exchange rate is revalued to Shs.700 per $1.

Once more, as can be seen in tables 5.15 and 5.16 simultaneous budget and balance of payments deficits are experienced.

UGANDA MACROECONOMIC SCENARIOS
Number 5: Variant C -- Control Scenario -- 25% Inflation
Exchange Rate Unified at 700
Producer Prices adjusted Down

Table : 5.15

	86/87	86/87	87/88	88/89
ASSUMPTIONS:				
Inflation rate per year:		-25.0%	-25.0%	-25.0%
Price level at beginning of year	100.0	100.0	75.0	56.3
Average price level for year (86=100)	100.0	87.5	65.6	49.2
Exchange Rates USh/$				
Preferential	700.0	700.0	700.0	700.0
Market	700.0	700.0	700.0	700.0
Share of exports at pref. rate:	0.0%	0.0%	0.0%	0.0%
Share of imports at pref. rate:	0.0%	0.0%	0.0%	0.0%
INTERNATIONAL PRICES:				
Index of petroleum prices	100.0	100.0	100.0	100.0
Level of coffee prices $	2.5	2.5	2.4	2.4
Index of other imports	100.0	100.0	100.0	100.0
DOMESTIC PRICES AND QUANTITIES:				
Coffee producer price USh/kg (Kiboko)	350.0	350.0	350.0	350.0
Coffee producer price (clean)	648.1	648.1	648.1	648.1
Coffee marketing costs	756.0	756.0	756.0	756.0
Coffee production (BASE)	160.0	163.2	166.5	169.8
Coffee production (price adjusted)	160.0	165.2	172.2	178.4
Industrial production	100.0	100.0	100.0	100.0
Intermediate inputs	100.0	100.0	100.0	100.0

BALANCE OF PAYMENTS SUMMARY: (IN $US/MILLION)	86/87	87/88	88/89
A. Total exports	449.6	461.8	481.1
1. Non-coffee visible exports	20.0	22.7	24.6
2. Coffee	409.0	413.3	428.2
3. Non-factor services	20.6	25.8	28.3
B. Total imports	585.6	606.9	634.5
1. Non-petrol visible imports	405.0	424.5	447.9
2. Petroleum	48.0	52.9	58.4
3. Non-factor services	82.0	86.2	90.4
4. Net factor services	50.6	43.3	37.8
C. Capital movements			
1. Grants	52.0	57.0	62.7
2. Gross loans - to budget	124.0	125.0	131.0
3. Loan repayment from budget	69.3	69.3	69.3
4. Remittances (net)	38.0	39.9	41.9
5. IMF repayment	79.4	71.0	60.0
6. Loans - not to budget	69.4	42.9	45.4
7. Loan repayment-not from budget	66.0	38.0	39.9
D. Basic Deficit Not Financed	-67.3	-58.6	-41.5

UGANDA MACROECONOMIC SCENARIOS
Number 5: Variant C -- Control Scenario -- 25% Inflation
Exchange Rate Unified at 700. Producer Prices Adjusted Down.

Table : 5.16

SUMMARY OF GOVERNMENT BUDGET (US Shs.Billion)	86/87	87/88	88/89
TOTAL REVENUE:	322.2	399.2	443.1
1. Tax Revenue	215.0	314.3	348.2
a) Income/Profits	17.0	21.0	23.1
b) Goods/Services	64.4	67.2	87.9
(1) Sales Tax	45.1	49.2	54.6
(a) Local	21.1	26.8	32.6
(b) Imported	24.0	22.4	22.0
(2) Excise	15.8	12.6	26.0
(3) Commercial Trans. Levy	3.5	5.4	7.2
c) International Trade	133.1	135.6	146.8
(1) Import Duties	72.0	73.3	76.8
(a) Petroleum	36.0	39.7	43.8
(b) Other	36.0	33.6	33.0
(2) Export Duties	61.1	62.3	70.0
(a) Coffee	58.2	58.7	66.4
(b) Other	2.9	3.6	3.6
(3) Forexchange tax/subsidy	0.0	0.0	0.0
d) Other Tax	0.5	90.5	90.5
2. Other Revenues	40.0	12.3	16.0
a) Kenya/EAC settlement	30.0	0.0	0.0
b) Other	10.0	12.3	16.0
3. Grants	67.2	72.7	79.0
TOTAL EXPENDITURES:	504.5	718.1	727.5
1. Recurrent Expenditure	305.0	476.9	653.1
a) Wages/Salaries	48.5	50.9	53.5
b) Interest - External	53.8	53.8	53.8
c) Interest - Local	22.0	58.0	128.0
d) Other	180.7	314.2	417.8
2. Development/Rehabilitation	199.5	241.1	74.5
a) Capital Projects	120.4	164.0	35.0
b) Rehabilitation/Resettlement	79.1	77.1	39.5
FINANCING REQUIREMENT:	182.3	318.8	284.4
1. External Net Financing	38.3	39.0	43.2
a) Loans + Grants -- Inflow	86.8	87.5	91.7
b) Loan Repayment - Amortization	48.5	48.5	48.5
2. Net Deficit to be Financed	144.0	279.8	241.2
a) Foreign inflow for uncovered BOP			
b) Domestic finance required	144.0	279.8	241.2

<u>The Majority View on the Control Model</u>

There are margins of error in any form of projection modelling. On the basis of common assumptions with other scenarios, however, the control model failed miserably as a strategy for balancing <u>either</u> the balance of payments <u>or</u> the budget - the two key problems which need to be addressed.

In all variants except 5 A, the most implausible assumption was made that the cost of living fell to -25% per annum and stayed there for 3 years. In no other country in the world over the past 35 years has inflation fallen to this extent for even one year!

Even then, the balance of payments remains in deficit each year and import levels remain, therefore, well below even their current, inadequate, levels.

The budget also is grossly out of balance each year and there is no adjustment in civil servants salaries except through the negative inflation assumptions. Neither can the development budget expand. It is also felt that the problem of lack of local cover is dealt with in the core reform package by proposals concerning expanding credit to industry and relaxing price control <u>at the factory level</u>. Foreign exchange is also tightly allocated in scenarios 2 and 3.

The majority of the team felt that these results speak for themselves. The control option is a dangerous one for Uganda which could bring immeasurable harm. In its best professional judgement, the majority advises against implementing any variant of it.

<u>The Minority View on the Control Model</u>

On the other hand, the minority felt in presenting this model that as professional economists the team had a duty to spell out the implications of all the options available to it without necessarily lending credence to any of them. These members feel that the government should be given a chance to consider the implications of all options available to it to meet the pressing problems arising out of the present internal and external imbalances. It is up to government to balance the objectives of balancing the budget and the balance of payments position with those of controlling inflation and rehabilitating industry and bringing about growth in the rest of the economy.

In this respect is is important to note that in the circumstances in which Uganda finds itself there are three major options open to it in dealing with the exchange rate. These are:

1. Leave the exchange rate as it is;

2. Devalue the Uganda shilling;

3. Revalue the Uganda shilling.

Since the team had at its disposal the data and means to evaluate the implications of each of these options the minority of the team members felt that it would be unfair to the government not to give the implications of the whole range of options.

The minority is not thereby necessarily seeking to advocate one option against the other. Indeed we feel that not to analyse the implications of all scenarios narrows the choice before the government and involves a value judgement which only the government should make. We are convinced that the government is capable, on the basis of information available in this report, and its own conception of its development priorities to make a rational choice between the various scenarios.

All the control model says is that if government wants to reduce the rate of inflation (i.e. to 50%, 0% or -25%) and also revalue the currency it will have a heavy burden of closing the balance of payments gap and the budget deficit. If the government then finds it cannot close these gaps through its external contacts or via internal adjustments, it can then reject the model, but it would be unprofessional to deny them the opportunity to do so.

* *

These, then are some of the policy scenarios available to the government with a rough estimate of the likely consequences for the balance of payments and the budget. In terms of allowing the government breathing space in which to assume control over the economy and to begin to lay foundations for its longer term strategies of self reliance, it appears that some variant of scenarios 2 or 3 involving exchange rate depreciation would be most desirable. Other alternatives place too much pressure on both the budget and the balance of payments to allow the government the flexibility it needs to restore the economy to a proper functioning level.

V. Aid

Each of the alternative scenarios discussed in section 5 (iv) assumes some level of aid flow, the essential differences being the level, source and type of aid assumed. Government policy on aid is clear and straightforward. Aid is welcome if it assists in relief, the reconstruction of the economy and the achievement of longer term goals of national and political independence and the building of an independent, integrated and self-sustaining national economy. It is not if it doesn't. The President has also expressed to donors the government's disappointment over the meagre inflow of aid since February 1986 in spite of the tremendous achievements of the NRM in bringing peace, order and security to the country. The team wishes to echo that disappointment and to emphasize again the need for a more aggressive diplomatic offensive to secure assistance for recovery and rehabilitation and, especially, for humanitarian aid.

At the same time it is important for the government to have a clear idea of what donors themselves are thinking. It must also ensure that machinery is in place to formulate aid policy and to administer aid. These are the subject matter of this section.

a) Attitudes of Foreign Governments and Aid Agencies towards Uganda

1. The attitude of the principal donors/foreign creditors in Uganda towards the new government can best be described as "cautiously optimistic." They welcome the obvious return of relative peace, order and security and generally feel that the NRM offers the promise of long sought after stability. This optimism is reflected in the commitment of over $30 million to the Emergency Relief and Rehabilitation Programme. The cautiousness is reflected in the fact that with less than two months remaining in this Programme, aid offers fall well short of the $161 million needed. The team fails to see why flows of humanitarian assistance should be so slow in coming given the accomplishments of the government in restoring law and order.

2. The principal obstacle standing in the way of enhanced aid flows at this time is the perception of donors that the government lacks a clear economic programme.

Donors uniformly expressed the hope that the work of the study team would rectify this problem, but until it _is_ rectified, they are essentially taking a wait-and-see attitude. There is, however, no reason why this should prevent larger inflows of humanitarian aid since this should be justified in its own terms without reference to broader economic policy.

3. The criteria for assessing what constitutes an acceptable programme to donors/creditors are likely to be set, at least among donors from Western countries, by the IBRD and IMF.

   The attitudes of the IBRD and IMF, which incidentally often differ in important respects, will help shape that of bilateral donors since any economic programme submitted to them would be discussed in a Consultative Group meeting of donors chaired by the World Bank. This would be followed by a Paris Club gathering, the forum for negotiating bilateral debt service relief.

4. The general view of donors/creditors is that the recent interim Economic Measures are "a step in the right direction". They feel, however, that the priority exchange rate is too low and that too many items are classified as priorities. They welcome the increase in producer prices but feel that, at given exchange rates, they will cause budgetary problems. They also welcome the equality of rates between inputs and outputs. They note, however, that the measures do nothing to improve government revenue or significantly improve financial discipline.

5. Donors feel that at this time the government is too highly centralized so that if Ministers are not available, as they frequently are not, then aid transactions are delayed. They complain of delays in general which sometimes prejudice significant rehabilitation programmes. While efforts must be made to improve the working of the system, the team appreciates that rebuilding a public service which, for the last 15 years has been weakened and demoralised will not be easy and will take time. Donors might be encouraged to recognise this, to assist reconstruction and to understand that their exacting standards might not be reachable for some time. It is recognized, also, that bureaucratic procedures on the part of donors themselves sometimes result in delays in finalizing projects.

6. There is a feeling among donors that the government does not have clearly defined priorities; that each project is presented as being as vital and as urgent as the next. They hope that the results of this study will also ease this problem.

7. Concern is also expressed frequently about the absorptive capacity of the government machinery. It is not clear how capable the structure is of handling a sudden, large, influx of assistance. There is, however, agreement that absorptive capacity has improved since the new government took over. Moreover the system probably has a greater capacity to absorb some types of aid e.g. balance of payments support, and less capacity to absorb other types e.g. project aid, at this time.

8. A complaint was received that the Government's policy on food aid was in need of clarification with respect to the importation of wheat for conversion in local markets into staples consumed in food deficit areas. The team feels, however, that the Prime Minister's letter of May 7, 1986 to the IBRD Resident Representative is quite unambiguous on this point. It states, contrary to announcements from other parts of the government, that "Government appreciates food aid in items that are not produced in Uganda and those where we are not self-sufficient yet, such as powdered milk, butter oil, wheat, sugar, salt". As the chairperson of the local donor's group, the Resident Representative must surely have briefed donors on this important issue.

9. There is an effort being made to co-ordinate donors to influence state policy to channel scarce inputs through the private sector rather than through parastatals. The team is not convinced however, that alternative efficient distribution channels exist or that this type of leverage is desirable.

10. Finally, there are still residual concerns about security, about the non-return of vehicles confiscated or stolen in the past, about a possible (but unsubstantiated) impending shortage of petroleum and about corruption in the Ugandan Administration. On the whole, though, there is a recognition that the government is new and that it has made significant progress, especially in the area of security, over the past months.

V.b) Aid Modalities

1. For government to handle aid relationships effectively, it needs to develop its own detailed ground rules and to establish the machinery to interact with bilateral and multi lateral donors. The clearer and more explicit is the government's position on the role of aid in its development strategy, the more readily can it ascertain the scope for pragmatism and accommodation in its dealing with donors. The better the government coordinates its own actions and policies between aid-receiving ministries and agencies, the more effectively will it be able to draw on the international aid community.

2. While coordination of emergency relief through the Prime Minister's Office appears to have worked quite well, it is questionable whether involving the PMO in the day to day details of ordinary development aid is a good use of the scarce resources of his office. While reflecting the importance government attaches to aid, this could be achieved by making the PMO responsible for aid <u>policy</u>.

3. It might be a more efficient arrangement if aid were coordinated on a day to day basis through the Planning Ministry which, after all, is responsible for the development plans to be funded by aid.

4. The Aid Coordination Committee should continue to meet with the Prime Minister as Chairman; he should, however, work as closely as possible with the Minister of Planning who is responsible for development projects.

5. The government should begin immediately with a publicity campaign to raise more emergency aid.

6. It should also begin approaching donors as soon as possible for funds for such key basic needs areas as health, water, nutrition, basic educational rehabilitation and literacy, for a truck and vehicle programme and balance of payment support.

7. It should also begin sounding out donors for technical assistance in some of the areas identified, e.g. accountancy and auditing, if it decides it wishes to draw partly on expatriate assistance for these tasks.

VI. Incomes Policy and Basic Needs

1. Evidently, the main emphasis in this report is on economic growth recovery and stability. This is the overwhelming requirement in Uganda at this time.

2. Yet issues of distribution and equity are addressed and in ways which, it is felt, will encourage rather than impede growth.

3. The overall dimensions of the incomes policy falling out of these proposals will depend curcially on which of the optional scenarios is chosen. Indeed, so will the rate of growth of the economy. Scenario 3 makes an explicit real income transfer to coffee farmers and also provides budgetary funds for raising public sector wages and salaries. Scenario 5 initially takes real income away from farmers and cannot adjust civil service salaries, although the hope is that if prices can be brought down, real incomes of both groups could adjust upwards over time.

4. Whatever line of policy is adopted by government, care should be taken to ensure that agricultural producers do share in agricultural output gains and that the gap between urban/rural differentials does not return to its pre 1970 level.

5. The core package of proposals also contains some important distributional recommendations. The first and perhaps most important of these is that major government and self-help programmes be launched in the areas of public health, nutrition and water supply. Educational expenditures should also be geared to adult literacy and greater accessibility to primary education.

6. The tax measures proposals also have a built-in progressive element in that the tax burden will fall most heavily on those purchasing luxury or non-essential consumer goods and imported consumer goods. These will tend to be the not-so-poor although it is difficult to say this with any precision. The direct income tax proposals which would become effective in subsequent years would initially hit the business class harder than others, although some of this burden may be passed on through margin adjustments.

7. Proposals are also made that children should not be denied access to education purely on the grounds of income. A scholarship fund should be established, the size of which would depend on resource availability at

central and local government levels, to finance poor students. Likewise, if user fees are to be introduced at Makerere, provision would again have to be made, through loans or grants, to permit access to poor students.

8. Government subsidisation of education for NRA youth and displaced youth is encouraged.

9. This overall proposal aims, therefore, to adjust income incentives for some groups and provide safeguards for others. Obviously, the greater the underlying real growth of the economy, the easier will it be to adhere to this broad incomes policy.

10. Women's issues need also to be addressed directly. More attention should be paid to their access to all levels of education, and to their promotional prospects in the civil service, business etc. Primary health, nutrition and water projects should help relieve some of the double burden they carry while at the same time improving their well-being. Women are also expected to play a key role in the primary health care plan.

11. There is, however, a need for the government to go beyond this. A more representative National Women's Organization is needed which can then prepare a draft policy on women's rights and problems for careful scrutiny at the nation's highest political level. This would inevitably address some of the legal and customary impediments standing in the say of women's equality.

12. Other distributional and basic needs issues that need attention are the land situation and the employment situation. Land ownership arrangements have become unclear since the 1975 decree with practice often deviating from the letter of the law. This decree, and its potential impact on land concentration and landlessness should be the object of careful study by government, with suitable remedial measures being taken if required.

13. Employment policy is not specifically addressed in our programme. It will, however, entail some layoffs and reposting of some civil servants. At the same time industrial output, and, therefore, employment should also pick up. Depending on which policy scenario is chosen, overall employment effects will be either marginally positive or marginally negative in the earlier years.

14. On the whole, therefore, the resulting impact of the programme should not be to adversely affect income distribution while significant gains can be expected in the provision of basic needs.

15. Public participation in all aspects of public decision taking is widely considered to be a basic need. As the situation permits, such participation should be broadened as widely as possible.

CHAPTER 6

IMPLEMENTATION AND PHASING

1. These proposals represent an ambitious and complex program which might tax the government's implementation capacity.

2. It is essential that responsibility for drawing up a government policy position and implementing it be clearly located in a centre of the government which carries credibility and weight. It is proposed therefore that a small economic unit be formed in the President's Office, charged with this task.

3. This would liaise with relevant Ministries to work out the details of a policy package and to assign responsibility for implementation.

4. Phasing is crucial. The budget and the balance of payments are seriously out of alignment. New tax measures and foreign exchange account losses must be dealt with IMMEDIATELY. Government must also clamp down on spending and seek balance of payments support IMMEDIATELY, before the economic situation becomes even more difficult.

5. Currency reform should be implemented carefully but quickly, by December this year. If exchange rate adjustments are required, these could be made initially by narrowing the gap between the two existing rates and by timing larger movements to coincide with currency reform. The earlier and the larger are foreign balance of payments assistance flows, the easier will adjustment be.

6. Once it has designed a programme, the new Economic Secretariat should order its proposals by priority, and channel scarce government resources into areas of greatest concern. Each government ministry and department should assist in determining priorities and should then be assigned a timetable for completion of its tasks. The Secretariat would be responsible for monitoring progress and reporting back to the President on significant departures from the programme or timetable.

7. Once an adjustment programme has been approved by government, whatever its composition, it should then be "sold" to foreign governments. Requests for external assistance must be clear and realistically achievable. Close liaison between the Secretariat and the aid administration unit will be necessary.

8. The government statistical services will need to be strengthened to provide timely, accurate and meaningful statistics. The Statistics Department, Bank of Uganda and Ministry of Finance should cooperate to decide who will produce data of immediate relevance to short term economic management. This data will include balance of payments data - past and projected, composition of <u>actual</u> imports, external debt servicing obligations and arrears, behavior of real effective exchange rates. It will also include government taxation and revenue positions, with brief "flash reports" being available monthly within two weeks of the end of the month. Money supply data <u>must</u> be available weekly if monitoring is to be effective.

9. For the medium term, data collection must be strengthened to provide more accurate data on agricultural trends, industrial activity, wages and employment, cost of living outside of Kampala and, if possible, on the nature and size of the informal sector. A household budget survey would also be useful.

10. For this to happen, the pressing staff, material and financial needs of the Statistics Department must be addressed. If necessary, external (UNDP) assistance can be obtained for this.

CHAPTER 7

MAJOR SECTORAL ISSUES AND RECOMMENDATIONS

I. Agriculture and Rural Development

1. In the next three years the PRIMARY OBJECTIVES in this sector should be :

    a) To increase total output, and

    b) To increase sales through official as opposed to unofficial channels. Raising and controlling the surplus in this sector will be crucial for realizing foreign exchange and tax revenue.

2. Medium and longer term goals will be more complex involving greater integration of this sector into the rest of the economy, improving real incomes and providing for basic needs. In the short run, however, transitional policy reform and expenditures should be phased in, as resources permit, to begin meeting these objectives.

3. Given the relative strength of the food sector, the key to economic recovery in the economy as a whole must, initially, be the restoration of marketed and exportable agricultural surplus. Without this, industrial and transport recovery plans will be aborted. Care must be taken however, to ensure that food security is maintained throughout the country.

4. There are a series of major problems which have depressed the output and officially marketed sales of Uganda's main cash crops in recent years :

    - poor incentives, i.e. low producer prices relative to those of goods purchased by the producer;

    - smuggling;

    - inadequate transportation equipment and poor roads;

    - crop finance and payments difficulties;

    - problems with the availability, quality and timeliness of inputs;

    - creeping marketing margins;

    - unreliable power supplies.

Each of these needs addressing if the situation is to improve.

5. <u>Coffee</u>

i) This crop dominates exports. Informed observers estimate that 40-60,000 tons are smuggled annually, representing a major loss of critically needed foreign exchange. Remedial actions include :

- tightening security checks on the borders, dismissing corrupt officials, moral and political exhortation, and removal of non-price constraints mentioned above;

- the maintenance of and possible improvement in the producers' terms of trade. Producer prices must not be eroded by inflation. Also, since more can be done to raise yield through weeding, pruning, insect control etc., a <u>higher</u> real price can induce a supply response even in as short a time as 4-6 months. The temptation to sell in the unofficial market is also greater the higher the differential between prices in the two markets, reflecting the gap between official and unofficial exchange rates.

ii) The level of the coffee quota may also become a problem in the near future as the quota to list A countries (currently 2.3 million bags) has been reduced. Government should make every argument to have its quota restored to pre-Amin levels as official purchases and stocks increase.

iii) A system of open auction sales, similar to that which is serving Kenya well, should be introduced.

6. <u>Cotton</u>

i) It is technically and economically feasible to raise cotton output significantly, from the current 60,000 to as high as 350,000 bales by 1990. This will require :

- raising the producer price either to the market exchange rate level or to some intermediate level;

- clearing the backlog of unpurchased and unginned cotton;

- removing the purchasing monopoly of cooperative unions which fail to clear old seed cotton by the beginning of the 1987/88 season, and;

- exploring the advantages of vertical linkages from the lint-consuming domestic textile industry to the growers (cf. the patronage previously provided by the Lancashire Textile Industry); the offer of BCGC to advise in this area should be seriously considered.

7. <u>Tea</u>

i) This commodity can be rapidly increased (estimated feasible increase is from around 3000 to 175000 tons by 1990) as the crop is in the ground, in the form of overgrown bushes which can be brought back into production within the year.

ii) This will require a significant real increase in producer prices, as for cotton.

iii) In addition to relieving the general constraints, structural re-organization of the key authorities - UTA and UTGC - is overdue. This should give growers more control over their industry and, while removing the marketing monopoly held by UTA, enhance its capacity to service the industry's needs.

8. <u>Sugar, Tobacco and Oilseeds</u>

i) These activities are discussed in the industrial sector report, although several production aspects of sugar and oil seeds are left to the official agricultural agencies.

ii) In the case of sugar, very serious foreign exchange consuming delays in restoring output have occurred at the Kinyala and Kakira plantations. The former should be placed under an experienced managing agent, as recommended by the Bank of Uganda. In the case of the latter plans now seem to be in hand for reconstruction of the factory. Government might wish to have a say in the proportion of land farmed by the estate and in that farmed by small farmer outgrowers.

iii) Oilseeds production has suffered from non-availability of new seeds varieties, low prices and lack of activity by the LMB in reactivating its ten acquired oil and soap works. These problems should be resolved rapidly.

9. <u>Reorganization on a Vertically-integrated Basis</u>

It is clear that smallholder production difficulties can be overcome most rapidly where there is a strong vertical linkage from the agro-industrial end-user to the producer. This system is now working effectively for tobacco growers and has promise for tea as general economic constraints are removed. It is proposed that studies be initiated immediately to examine scope for vertical integration in the following areas :

- Cotton : A Uganda textile firm consortium to take over financial and technical responsibilities for production and primary processing.

- Oilseeds : A Ugandan oil, soap and animal feeds parastatal ((but not the LMB in view of its past inactivity) to take over financial and technical responsibilities for oil seed production and primary processing (i.e. groundnuts, soya, castor, sesame, but not cotton seed). The proposed investment project AG-24 should be redesigned accordingly.

- Cocoa : An international manufacturing firm to be approached on a managing agent basis to revitalize Uganda's embryonic cocoa industry. Project AG-25 should be redesigned as necessary.

- Hides and Skins : The case for UTLI taking a major role in the improvement of hides and skins marketing including initial preparation, should be examined, with the implications for projects AG-12 and AG-52 assessed accordingly.

10. Complementary changes will be required, if these reforms are accepted, in the role and function of the agricultural and livestock extension service. These should, in general, concentrate on applied farming systems research and on the perishable food crops (see the recommendation on research below).

11. <u>Strengthening Agricultural Planning and Decision-making Capability</u>.

A technical assistance project to assist the planning units/ divisions in the Ministries of Agriculture, Animal Industry and Marketing Cooperatives has been only partially funded to date (PA-01; $2.88 m out of $4.32 m is not yet secured). Work is commencing in farm management economics, but further assistance is urgently required to strengthen :

- project identification and preparation capacity;

- monitoring and ongoing evaluation procedures, and;

- management information systems, integrated across the three main ministries initially, but eventually incorporating the boards and parastatals, as well as major private sector bodies, responsible for the performance of the multi-faceted agricultural sector.

It is recommended that approaches to potential donors to secure this assistance should be initiated immediately.

12. At the level of agricultural policy, a large number of key issues have accumulated which require informed decisions. Agricultural Policy Committee, which is serviced by the Agricultural Secretariat of the Bank of Uganda, should be revived with immediate effect to construct an agenda and timetable for commissioned studies, performance indicators, policy analyses and decisions.

13. In conditions of rapid inflation, the key administered commodity prices should be index-linked if they are not to have reverse consequences from those intended. As the crop price must be set alongside changes in consumer prices in the rural areas, a set of monthly rural consumer price indices should be constructed and maintained as soon as possible (a new TA project may be needed for this). The crop price changes should be incorporated in quarterly price and economic policy reviews at least until inflation rates have fallen to the region of 25 per cent and below. This frequency interval will allow the analysis of monthly indicators of key crop sales and macroeconomic variables to adjust the price signals fairly accurately.

14. <u>Urgent Issues and Recommended Actions</u>

A number of urgent policy issues face the Government of Uganda in the field of agriculture, each of which requires speedy remedial action. These are discussed in detail in a separate submission to government but can be listed here as follows :

i) Food supply policy.

ii) The need to diversify agricultural exports.

iii) Problems of input delivery, finance and public agencies.

iv) Transport constraints on marketed surplus.

v) Environmental Conservation, Forestry and Agro-forestry.

vi) Land policy.

vii) Research strategy.

viii) Area based planning, integrated rural development and decentralized planning.

ix) Prisoner rehabilitation farms.

II. Industry

1. The principal aim in this sector should be the revival of industrial production, using existing assets, to generate incomes, employment, foreign exchange savings and containment of inflation. The immediate constraints are shortages of imported raw material inputs, equipment and spare parts. These shortages stem, in turn, from lack of availability of foreign exchange and, for many companies, local cover. Inability to generate or borrow working capital stems mainly from poor management and inappropriate pricing policies. The results are low levels of capacity utilization and poor financial performance. Improving performance is constrained by insufficient raw materials and spares. The process is circular, and the major constraints at every stage thus need to be tackled frontally.

2. For this reason, the following urgent measures are recommended :

   a) The amount, visibility and accessibility of small-scale industry loans should be increased, and a facility established to import essential tools and raw materials for this sub-sector, which provides 50% of value added, and an estimated 80% of employment in industry.

   b) To resolve the most serious shortages of imported inputs and spares in medium/large scale industry, foreign exchange allocations of $60 million are recommended for UDC and private companies for 1986/87. Suggested company allocations and priorities have been submitted separately to government, based on interviews and industry reports. If necessary, it is suggested that allocations be reduced along the lines of priorities based on three main criteria; basic necessity of goods, generation of government revenues, and potential for net foreign exchange savings.

   c) To resolve most serious local-cover shortages, an estimated 1986/87 budgetary provision of up to U.sh.20 billion is recommended for UDC and other companies in the form of equity, loan guarantees and write-off of existing debt; amounts and mechanisms should be detailed on an urgent basis by the Ministry of Industry and UDC, through review of each company, and company consultation where necessary.

d) Most administrative price regulation at the factory level should be discontinued, and companies directed or encouraged to adopt pricing policies which generate more financing requirements internally. In most cases, this will reduce trading margins to distributors without substantial consumer price increases. The main alternative is to provide much higher budgetary provisions for working capital. Where domestic or import competition is minimal, and will not soon be re-established, more gradual producer price increases could be adopted or, where enforceable, interim retail price controls.

e) The process of management rationalization in UDC and joint ventures should be completed as soon as possible, including dismissal of corrupt and incompetent managers. It is also suggested that trade unions, NRM Workers' Committees or equivalent organizations be established, where they do not exist, to advise on discipline, productivity, management and planning in the workplace.

f) For purposes of spearheading the immediate industrial recovery programme, it is recommended that a small secretariat be established under the auspices of the Office of the President.

g) To avoid problems in the implementation of these measures, it will also be essential to brief senior managers on industrial revival measures and implications for company operations and financial management.

h) In order to encourage industrial development, it is necessary to review effective tariff/protection levels for producer goods industries and implement remedial measures where necessary.

i) It is also necessary to correct/prevent instances of undercutting of domestically produced goods by non-payment of import duties (including smuggling, where possible) and by aid-subsidized goods.

j) Attention should also be given to rapidly resolving remaining industrial ownership cases, by means of a new verifications committee if necessary. Where production revival is urgent and ownership resolution may still be lengthy, consideration should be given to government providing existing management with working capital loan guarantees.

k) Government should hold consultations with banks and financial institutions to brief them on policies and measures, and ensure co-operation in financing industrial working capital borrowing requirements; and

l) Priority should be given to correcting infrastructure (power, water) bottlenecks where presently serious, and as they arise in future.

m) As rapid follow-up measures, it will also be important to proceed with the privatization study and implementation process on an active and visible basis, launch management and skilled manpower training exercises, complete and announce the new foreign investment legislation and incentives package designed to attract foreign capital and expertise to complement national efforts, adjust industrial wages upward as recovery proceeds, and improve the presently dismal occupational health and safety conditions in industrial factories and processing plants.

n) These initiatives can achieve substantial recovery in medium and large scale industry - to an estimated 50% of capacity in 12 months. Significant expansion should also be realized in small scale industry, although this sub-sector is already operating close to full capacity. Because the industrial sector does not account for a large proportion of total value-added or goods supply, however, dramatic immediate effects on prices and net foreign exchange savings should not be expected. To a considerable extent, the immediate recovery programme should be seen as the first step toward full rehabilitation and expansion of the industrial base.

o) Although foreign exchange and budgetary borrowing constraints will dictate careful planning and programming of government resources, this further rehabilitation and expansion can be achieved by proceeding with industrial projects in the Investment Plan on the basis of external project funding and thorough project appraisal.

Preliminary analysis of sequencing priorities stresses sugar, hoes, salt, tobacco, beverages, soap, textiles, blankets, steel products, cement, leather and matches. It would be advisable to obtain, through technical assistance, a highly experienced project appraisal and public finance economist to assist in ensuring that all scheduled industrial projects are thoroughly and correctly appraised - including basic feasibility, net foreign exchange impact and net government revenue impact - <u>prior</u> to major further commitments.

p) Some non-traditional exports are likely to expand or re-emerge in the immediate recovery programme, notably fabricated metal products, ceramics and plastic ware, and waragi. Others can be identified and developed in the medium term; possibilities are indicated in textiles and yarn, phosphate and fertilizer, instant coffee, salt, asbestos sheets, fishmeal and fishoil, canned meat, finished leather products, and processed/dried vegetables.

q) Further medium-term priorities include elaboration and realization of recently initiated technology development initiatives, and efforts to stimulate small scale industry expansion on a direct contact and non-bureaucratic basis.

III. Mining

1. During the 1960's, the mining sector accounted for about 2% of GDP and 9% of export earnings. Presently, its contribution is negligible. Main known and exploited mineral resources are copper, tin, tungsten, beryl, apatite, brisnuth, columbite-tantalite and gold. (Limestone/cement, salt and phosphate are examined under the industry sector). There are also iron ore occurrences in Kabale, but their tonnage, quality and minability have not yet been determined. Little information is available on quarrying operations and their importance in supply of building materials. Significant potential has been identified, however, for expanded use of clay and Kaolin in the manufacture of bricks, tiles, paints and possibly ceramics.

2. Historically, the major mining operations were Kilembe Mines Ltd. (copper) and Byrdal, Mutolere and Kirwa Mines (tungsten). All four had closed by 1982. Other minerals are mined by small mines scattered all over the country, with a heavy concentration in Ankole and Kigezi District in south - western Uganda. The main governmental support has been through the Geological Surveys and Mines Department (GSMD) which has conducted geological surveys and mineral exploration, and provided technical support services to small mines. Collecting and marketing, after the close of the British Metal Corporation in 1972, was conducted from 1973 to 1976 by Itamu Mines, a subsidiary of UDC. Since 1976 a large proportion of mining production is reported to have been smuggled out of the country.

3. The collapse of the mining sector in the 1970's was due to many factors, notably :

   - lack of adequate funds, foreign and local, to replace very old machinery and equipment and to buy essential spares, chemicals, tools (e.g. pick axes) and explosives;

   - lack of financial facilities/institutions interested in lending to risky small mining ventures;

   - lack of an organised marketing system since 1976 (and to some extent since 1972);

   - looting and war damage in which small mines lost machinery, equipment and houses, and the GSMD lost most of its equipment in its offices, laboratories and in the field;

- high labour and transport costs, the latter due to the breakdown of the East African Railway System;

- absence of managerial and technical staff due to many qualified Ugandans leaving the country; and

- depletion of the known rich, and easily accessible ore reserves.

In addition, general inflation of the 1970's increased costs of imported machinery, equipment and materials while, at the same time, there were significant new mineral developments in many parts of the world.

4. While the mining sector can regain a significant contribution to the economy, it is in very bad shape and its rehabilitation will be slow. It is not accorded immediate priority in the Investment Plan; little expenditure is scheduled before 1987-88, and much of the required funding has not yet been secured. Attaching low immediate priority to this sub-sector, in the immediate recovery programme, is considered appropriate. Consideration might nevertheless be given to small foreign exchange allocations for spares/tools/chemicals/explosives for existing small mines; government's provision of explosives, from 1982-84, resulted in a noticeable increase in tin, tungsten and other mineral production.

5. Over the medium term, the government's main priority is the small mining sector. Plans address some of the main reasons for collapse in the 1970's. In terms of financing, study is planned of establishing a desk in the Uganda Development Bank to process proposals, and of instituting a loan guarantee scheme for most promising proposals. Continued geophysical survey and exploration is scheduled, and rehabilitation of topographical survey and mapping activities. Project ME-02 also envisages equipping GSMD to evaluate small-mine feasibility studies, and training of department staff and mine operations, but it is almost totally underfunded to date. Although concern has been expressed about lack of an organized marketing system, however, no concrete initiative to correct this deficiency has been identified. Only in the case of gold is there a proposal to reduce smuggling by establishing localized Bank of Uganda agencies to purchase gold with cash. Re-establishment of a broad collection and marketing system would appear to be an important priority.

6. Prospects for the eventual restoration of the Kilembe mine are good. The mine has been closed since 1979, and maintenance is presently costing the country U.sh.50 million per month. An agreement has recently been signed with a European metal producer to :

   a) study the exploitation of sulphur from the pyrites stockpile for use in domestic phosphate production (also in question);

   b) study potential for exporting cobalt carbonate; and;

   c) carry out a drilling programme to determine copper reserves.

   While $24.8 million is planned for mine rehabilitation and a new smelter, no funds have been secured. Interest in equity investment has, however, been expressed. Although the Board of Kilembe Mines Ltd. has recently urged the government to provide $20 million for Phase I mine and smelter rehabilitation, it is probable that foreign exchange constraints will dictate foreign private investment, or a government foreign joint venture as the only means of reactivating copper production. A prior requirement would be clarification of the legal status of the mine, which is not presently defined.

7. Studies are currently underway of the possible erection of a new phosphate fertiliser plant at Tororo. At this stage, however, the economic feasibility of the plant which would largely export fertilizer is not established. In the interim, it is proposed that consideration be given to rehabilitating the old fertiliser factory. The question of expansion could then be considered later as the country's economic position improves.

8. In summary, with the exception of the rehabilitation of Kilembe, the feasibility of which needs further study, no <u>immediate</u> priorities have been identified for recovery of this sector. Small foreign allocations may be warranted for purchase of spares/tools/chemicals/explosives by small mines and, if so, specific cases and allocation mechanisms should be identified without delay. Medium term plans are in the pipeline, and can be allowed and catalysed by

government within budgetary and other economic constraints. As mining recovery proceeds, attention will be needed to wages and to ensuring that occupational health and safety standards are well defined and enforced.

9. Over the longer term, it will be important to fully utilize Uganda's mineral resources, and integrate the mining industry into the economy, and particularly into mineral- based industries. Many of the almost indefinite possibilities are illustrated in Figure I. In order to achieve this kind of integration, several elements of Mineral Policy Development are considered important, including :

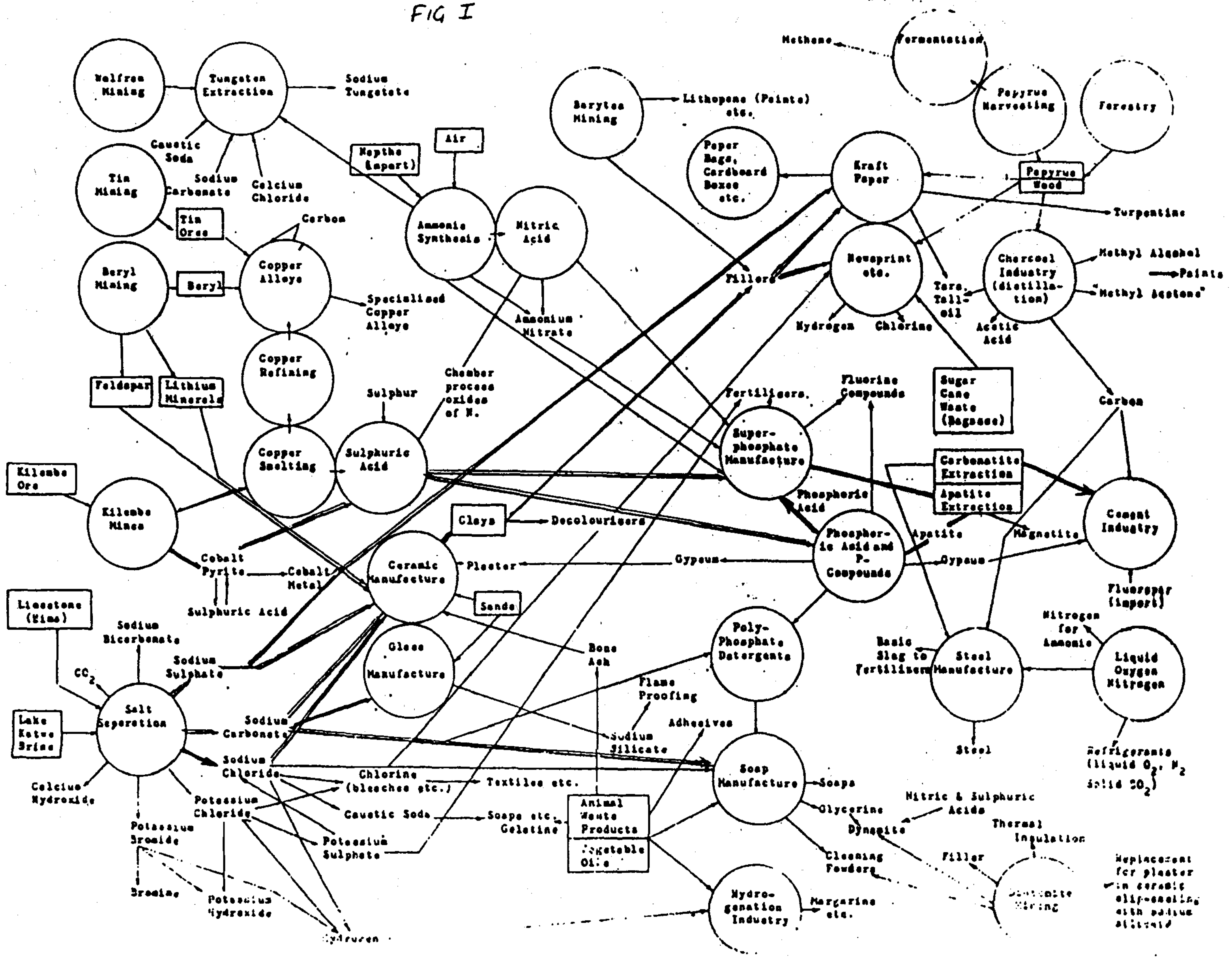
- development of GSMD capacity and activities, particularly in the area of mineral deposit delineation through diamond drilling;

- coordination of mineral and industrial development initiatives, particularly with respect to clay and kaolin (ceramics, bricks and tiles), sulphur from pyrite tailings (sulphuric acid for super-phosphate fertilizers), soda ash from salt extraction (caustic soda used in soap production) and copper refining (cables and wires); and

- development of a clear national minerals policy which will provide the framework for attracting foreign investment, preserving sovereignty over national resources, developing national expertise and capability and enhancing socio-economic benefits from mineral exploitation.

The Mineral Policy would, among other things, broaden the range of optional prospecting licenses available to potential investors, and make provision for infrastructure development by government in return for participation in mine ownership and/or benefits.

FIG I



Wolfram Mining
Tungsten Extraction
Sodium Tungstate
Caustic Soda
Sodium Carbonate
Calcium Chloride
Tin Mining
Tin Ores
Carbon
Copper Alloys
Beryl Mining
Beryl
Specialised Copper Alloys
Copper Refining
Feldspar
Lithium Minerals
Copper Smelting
Sulphur
Sulphuric Acid
Naptha (Import)
Air
Ammonia Synthesis
Nitric Acid
Ammonium Nitrate
Chamber process oxides of N.
Kilembe Ore
Kilembe Mines
Cobalt Pyrite
Cobalt Metal
Sulphuric Acid
Clays
Decolourisers
Ceramic Manufacture
Plaster
Sands
Glass Manufacture
Limestone (Kiwa)
Sodium Bicarbonate
Sodium Sulphate
CO_2
Salt Separation
Lake Katwe Brine
Sodium Carbonate
Sodium Chloride
Calcium Hydroxide
Potassium Chloride
Potassium Bromide
Bromine
Potassium Hydroxide
Hydrogen
Chlorine (bleaches etc.)
Textiles etc.
Caustic Soda
Soaps etc. Gelatine
Potassium Sulphate
Bone Ash
Animal Waste Products
Vegetable Oils
Flame Proofing
Sodium Silicate
Adhesives
Barytes Mining
Lithopone (Paints) etc.
Paper Bags, Cardboard Boxes etc.
Kraft Paper
Newsprint etc.
Fillers
Hydrogen
Chlorine
Fermentation
Methane
Papyrus Harvesting
Forestry
Papyrus Wood
Turpentine
Charcoal Industry (distillation)
Methyl Alcohol
Paints
Methyl Acetone
Tars, Tall-oil
Acetic Acid
Sugar Cane Waste (Bagasse)
Carbon
Fertilizers.
Fluorine Compounds
Super-phosphate Manufacture
Phosphoric Acid
Carbonatite Extraction
Apatite Extraction
Apatite
Magnetite
Cement Industry
Gypsum
Phosphoric Acid and P-Compounds
Gypsum
Fluorspar (import)
Poly-Phosphate Detergents
Basic Slag to Fertilisers
Steel Manufacture
Nitrogen for Ammonia
Liquid Oxygen Nitrogen
Steel
Refrigerants (liquid O_2, N_2 solid CO_2)
Soap Manufacture
Soaps
Glycerine
Nitric & Sulphuric Acids
Dynamite
Thermal Insulation
Filler
Cleaning Powders
Hydro-genation Industry
Margarine etc.
Replacement for plaster in ceramic slip-casting with sodium silicate

IV. **Energy**

1. Uganda's present energy consumption is appropriately 3.5% petroleum, 0.5% electricity, 92% fuelwood and 4% charcoal. Sectoral consumption is about 80% households, 12% commerce, 5% industry and 3% transport. Trend declines in the shares of petroleum and electricity, mainly due to collapse in industry and transport, should be reversed as these sectors recover.

2. Major issues in petroleum are cost of supply, pricing, conservation and exploration. Cost and pricing are related. Achieving the lowest possible supply cost is extremely important, particularly with large recent declines in world crude and product prices. Success requires domestic expertise as a base for bargaining with oil companies and Kenya. This expertise is currently lacking, and there is reason to believe that Uganda is being over-charged for petroleum products. A pressing need is to obtain an experienced petroleum economist in the Bank of Uganda on a technical assistance basis. It is understood that this is being arranged for an interim 3-4 month period through the World Bank. The period must be used to obtain a replacement and also desirably, a petroleum supply/ distribution specialist, both for a two-year period.

3. Organizationally, the Ministry of Energy is still too new and weak to contribute to petroleum issues. France is primarily interested in petroleum taxes. This leaves the Bank of Uganda as the main renter of expertise for the for the foreseeable future. With the help of the short-term expert, the Bank should proceed to re-negotiate the pricing formula with oil companies. A review of the Bank's proposals confirm that they are basically sound. Bargaining leverage can be increased by pressing the oil companies to import products directly from the Gulf and transport through Kenya. This is likely to be the cheapest means of supply over the next decade, given excess repricing capacity in the Gulf, and a Mombasa refinery change which is 5-6 times competitive international levels. Oil companies will resist, as their regional operations are integrated, but this approach provides a cost minimum which is very useful in bargaining.

4. Two other services of leverage should be pressed. The first is the alternative supply route through Tanzania, which is reported to be technically and economically viable. Actual and threatened expansion of the route should be pressed on a judgemental basis. Second, while the three dominant suppliers - Shell, Agip, and Total - are in principle Government controlled, this opportunity has never been used to thoroughly monitor supply operations and, in particular, to ensure that products purchased are virtually delivered. It is strongly recommended that the Boards of these companies be staffed with the best government personnel available, and that roles for government managers in daily operations be strengthened on an urgent basis.

5. Domestic product pricing is a difficult issue. While real product prices (deflated by M.I. Kampala price index) have risen some 8-fold since 1981. US dollar prices are still well below those in Kenya; at preferred and market exchange rates respectively they are ($/litre) : gasoline (.46, .13), diesel (.41, .12) and paraffin (.36, .10). Products are imported at the preferred rate, and net duty and tax is currently about U.sh.10 billion per year, or 8.7% of rental sales, according to a recent Bank of Uganda estimate. Given foreign exchange shortages, the incentive to smuggle products out is enormous, and limited evidence suggests that this smuggling continues at a substantial scale. In the near future, the delivered U.sh. cost of products will :

   a) increase if the preferred/official exchange rate devalues and;

   b) decline as the recent (100% plus) falls in world prices come through to Uganda.

   The net effect is not clear, and will depend in fact on success on minimum-supply-cost strategy, but appears likely to be a net increase in the U.sh. delivered cost (see attached Table).

6. The main domestic pricing considerations are thus inflationary impact, tax revenues, reduction in smuggling, and uncertain but probably increasing delivered cost. Once exchange rate policy is decided, these considerations will need to be given empirical content through detailed calculations, and then weighed judgementally. Some very rough scenario calculations (attached table) suggest that an increase

in prices of 50 to 100% (i.e. gasoline prices move from 650 U.sh./litre to 100-1300 U.sh./litre) might bring Ugandan prices much closer to Kenyan prices and improve government revenue collection from low or negative percentages of retail sales to reasonable levels depending on exchange rates and success in squeezing supply costs. In spite of possible inflationary consequences (and world oil price declines), there will be considerable merit in raising (real) domestic oil prices significantly (50% plus) in order to generate revenue and to reduce the incentive to smuggle.

7. Individual product pricing - involving subsidization of some products by others - should be studied on equity grounds, but is not considered pressing relative to the weighted average level of petroleum product prices. Petroleum (and electricity) conservation opportunities should also be studied, as they typically offer the best-cost means of enhancing supply. They do, however, require significant investments in many cases, and it is suggested that conservation be allowed to develop in response to prices for the time being. A petroleum exploration programme, together with domestic institution building, is being mounted with assistance from IDA (project ME-12). Prospects are thought reasonable and potential benefits very large; the programme should proceed with minimization of local investment funding estimated at $1 million, or 15% of total project cost.

8. Electricity is a presently large and potentially larger source of strength in the Ugandan economy. The most pressing needs are to upgrade the utilization of capacity at Owens Falls from 60% to 100%, upgrade the capacity of existing turbines and generators from 150% to 180 MW, and complete the backlog of maintenance and remedial work in the transmission/distribution system which is presently the source of overloads causing power shortages and blackouts. U.E.B. is a well-run organization, and the rehabilitation/ upgrading programme is well in hand (Project ME-06, note that cost and funding estimates need updating) with funding from IDA, ODA, CDC. UEB is to finance mostly local costs of $17 million, of total project cost of $70 million.

9. From 1961-79, there was no change in electricity rates - UEB has increased prices (1980 - 50%, 1981 - 50%, 1982 - 100%, 1984 - 300% and 1986 - 100% - imminent) to remain financially viable. Further increases will be needed, and should be allowed to the extent necessary to maintain viability and generate those funds required from UEB for present rehabilitation/ upgrading and future expansion. Further capacity will be needed by 1982, and planning is underway (Project ME-13). Electricity is still cheaper than woodfuels and charcoal, and future rate increased should not contribute significantly to inflation.

10. Consultants have been appointed to study UEB organization, rates, billing and collection problems and training needs; implementation measures will follow. The collection problem, reported by some to be large, in fact involves only about 5% of revenue and is not serious.

11. UEB exports (now) the equivalent of 30 MW of power to Kenya; recent negotiations have improved Uganda's benefits, although the power is still cheap to Kenya. Kenya needs additional power, at least to 1991, and Tanzania has requested 15 MW of which 9 can be supplied. Study is progressing toward a formal agreement (Project ME-10). Future export possibilities are much larger, if real regional consultation and co-operation can be realized. It is recommended that Kenya and Tanzania be asked to participate in setting up an East African Electricity Board, or similar organization, as soon as possible. Without such co-ordination, political pressures will continue through the 19905 to dictate higher cost domestic system, expansion options, particularly in Kenya.

12. The planned Rural Power Distribution project (Project ME-03), at a cost of $16.85 million, is still 3/4 unfunded. Work is underway on 7 of the 14 schemes under EEC funding, and materials are in Uganda. While important for social reasons and ultimate foreign exchange savings - through closing down 12 diesel generators - it is recommended that remaining schemes be delayed or phased until highly concessional donor funding is secured.

13. Although fuelwood stocks are plentiful in most areas, there are areas of stock depletion and localized shortages. Generalized stock depletion can become a reality rather quickly and its consequences in terms of (rural) energy costs/availability and degradation of water and soil resources, can be immense. Further, the major solutions - agroforestry and conservation through improved stoves - take at least a decade to implement and require well-trained extension services. Given that 96% of energy comes from woodfuels, it is strongly recommended that the currently minimal efforts in resource surveys (Project AG-11) be increased and expanded under the joint responsibility of Agriculture, Forestry and Energy. Advice should be obtained from qualified organizations; the best may be the Beijer Institute (Stockholm) which has a major presence in SADCC countries and Kenya.

14. In summary : petroleum supply/cost and pricing issues need immediate attention and technical assistance; electricity issues are under control; and woodfuel issues merit much greater prominence and programming. Finally, the future of the Ministry should be decided. It should be either eliminated, or preferably, resources permitting, strengthened. If the latter is decided, the possibility of getting an advisory team, as in Kenya, warrants serious consideration. Also, allocation and coordination of responsibilities among the several ministries and departments involved in energy issues will subsequently need to be sorted out.

V. <u>Transportation and Communications</u>

1. Shrinkage of transportation capacity, particularly for goods transport, has become an initial constraint to economic revival. Increasing the number of serviceable road transport vehicles is considered the main priority in this sector. A very rough estimate of requirements suggests the need for :

- 1500 lorries, 2-ton and above, over the next three years;

- the equivalent of about 500 lorries in spare parts, both to revive existing stock and keep existing new stock on the road; and

- additional plugs, tires and tubes, belts, etc. sufficient for the entire vehicle stock.

Accurate estimates of foreign exchange requirements need to be made quickly. A preliminary estimate is $25 million per year; of the 3-year total of $75 million, $60 million is for 2000 lorries (1500 plus 500 equivalent in spares), at $30,000 each, and $15 million is for additional plugs, tires, tubes, etc. Imports need to come in rapidly. The EEC/EDF have proven past ability to move fast on spares, and consideration appears warranted to seeking their rapid response.

2. The question of who gets allocations is important. A survey of government (CMP, PMB) and cooperative (through UCTU) needs is urgently needed; perhaps 1/3 -1/2 of total allocations should go to this sub-sector. It is suggested that the remaining 1/2 - 2/3 of allocations go to small private transporters.

Credit facilities will also be needed here; possibilities of hire-purchase or alternative mechanisms need urgent study and implementation.

3. Bus needs should not be overlooked as they provide considerable passenger and goods transport to Kampala and market centres. Bus transport also provides an alternative, and cost yardstick, to private transporters for many small rural producers. For these reasons, allocations should be made, foreign exchange permitting, for about 80 buses per year for 3 years at a roughly estimated cost of $4 million per year ($40,000 per bus), together with spares, tires, plugs, etc. at about $1 million per year. Priority

should be given to UTC and PTC routes in rural areas and between major towns, and not to inter-city service, particularly in Kampala and Jinja. Essential maintenance requirements for PTC and UDC should be identified and met.

4. The need for importation of bicycles has been suggested. Total needs have been estimated at 40,000 sturdy units per year at an estimated cost of about $4 million. This figure appears high, and the issue of bicycle imports remains for consideration.

5. Priority road patching needs should be quickly surveyed and identified. "Patching" will in some cases be major. On limited present evidence, priorities would include the major arteries immediately outside Kampala, and main transit routes from Kenya. IDA and EEC funds are likely to be available for this and for Kampala city road repairs. Upgrading of maintenance capacity for rural feeder roads is also considered important. For trunk and feeder roads, acceleration of Projects TR-15 (Upgrading of Road Maintenance) and TR-16 (Rural Feeder Road Maintenance Units) is appropriate. Both utilize concessional IDA funding.

   In a similar vein the restoration of crucial ferry links to islands or across major rivers is also high priority (project TR-33). The re-equipping of regional and other maintenance units under the Ministries of Works and Local Government should be given first priority, with other projects ranked on the basis of their economic consequences. The opportunity should be taken of extending route length by replacing higher cost specifications with lower unit acceptable ones e.g. bitumen replaced by murram.

6. The other immediate priority appears to be that of railways. It is understood, but to be confirmed that URC rolling stock is adequate for present needs. Main requirements are maintenance equipment and spares, and repairs to usable sections of the permanent way. It is recommended that major investments to reopen totally dilapidated sections be deferred. Foreign exchange for essential maintenance needs may be in the order of $2-3 million per year.

7. Major expenditures and foreign exchange allocations for water and air transport are considered of low immediate priority. A separate note on Uganda Airlines Corporation argues for pursuing a joint venture with an established international carrier who

could provide maintenance and technical assistance as well as some financing. While the sentiment for preserving the national airline is understandably large, every effort should be made to avoid aircraft purchase at this time. It really comes down to choices such as "purchase aircraft or revive industrial production."

8. Time has not permitted a serious look at the communications sector. On the surface, communications facilities appear adequate, relative to other pressing needs. A total of $47.2 million was spent, to June 1985, on Rehabilitation of Posts and Telecommunications services (Project TR-18); completion of this project at an estimated 1986-87 cost of $1.77 million (IDA Telecoms funded) appears warranted.

9. Taking a medium term look at the 33 projects in the Investment Plan, for the Transport and Communications sector, the following rough priorities are suggested :

- TR-02 Renewal and Improvement of Rail Permanent Stay;
- TR-19 Completion of Diesel Locomotive Repair Workshop;
- TR-15 Upgrading of Road Maintenance;
- TR-16 Rural Feeder Road Maintenance Units;
- TR-33 Rehabilitation of Ferries.

and a sequencing of road reconstruction projects (TR-09 to TR-14, TR-24 to TR-26' TR-31 to TR-32 and TR-34) according to yet-to-be-established priorities.

10. In summary, it is suggested that foreign exchange be allocated for yearly importation of 1500 lorries (plus 500 equivalent spares and plugs/tires/etc.), 80 buses (plus spares and equipment), railways spares and maintenance equipment and, perhaps, bicycles. Roughly estimated annual foreign exchange requirement is $35 million. Important aspects of distribution of allocations are noted above.

VI. <u>Banking and Financial Institutions</u>

1. With an average of 179,000 people per bank office, Uganda has one of the lowest banking densities in the world. Commercial banks should be urged to expand their branch and agency network into the rural areas.

2. Efforts should also be made to revitalise the Post Office Savings Bank which has the potential of reaching more Ugandans more cheaply than other banks.

3. Commercial Banks are highly liquid at this time yet they are reluctant to lend to the government. Efforts should be made to encourage them to invest a portion of their portfolio in long term government bonds. With peace, security and high nominal interest rates, this should be possible and this will also help control liquidity.

4. Most commercial bank lending appears to be for crop finance and consumer imports. Little credit goes to industry and banks claim this is because enterprises are under capitalised and over indebted. In some cases ownership is still unclear. Under capitalisation is a bookkeeping problem arising out of inflation while assets remain on company books at cost price. It should not be a deterrent to lending. If it is, then pending revaluation of assets <u>and</u> the sorting out of ownership issues, government should consider giving credit guarantees to key industries requiring credit.

5. Crop finance accounts for 87% of all loans to agriculture. While this used to be self liquidating it no longer is so. Farmers often must wait long periods of time for payment which, with high rates of inflation, reduces their real returns below levels indicated by official prices. The main reason for this seems to be that current crop finance practices do not take into account working capital needs of processors and especially those whose overhead costs do not, for one reason or another, decline in line with throughput. A portion of crop finance is then diverted for this purpose. Also, sometimes processors use crop finance to bankroll other types of business activities.

6. Accusations are made of union officials diverting crop finance funds to speculative activities, but the practice does not appear to be widespread.

7. Ideally unions should obtain crop finance directly from banks and there has been some movement in this direction recently. This is hampered, however, by managerial and financial weaknesses of the unions. Government assistance is required to strengthen these aspects of union organisation, but otherwise, there should be less interference in the affairs of cooperatives and greater accountability of officials to the members. It may be necessary, for instance, for outstanding cooperative debts to be written off to prevent the crop finance log jam. Alternatively, consideration should be given to finance being advanced directly to producers by companies processing the crop, e.g. in cotton by the textile mills.

8. Commercial banks must begin making credit available to the agricultural sector for purposes other than crop finance. The lead institution in this respect should be the Cooperative Bank which has virtually ceased to service those for whom it was originally established. This bank should also link up more with and encourage, grass roots credit and savings societies. Those farmers not covered by cooperatives might be serviced by the proposed Agricultural Finance Agency. Alternatively, credit from vertically integrated buyers might again be a possibility for such crops as cotton and tobacco.

9. Non-bank financial intermediaries barely lend to the productive sectors either. Most hold their assets in short term government securities. Revitalisation of the building society sector might be achieved by transferring ownership of some former Asian properties to them for sale to the public on credit. Resources so mobilised could be used to build low-cost housing.

10. More hire purchase facilities should be revitalised to ensure that, if the proposals elsewhere in this report on vehicle purchase are implemented, credit will be available for small scale transporters.

11. Other proposals in this area concerning monetary policy generally and interest rates and currency reform specifically, are dealt with elsewhere in this report.

VII. Health, Water and Nutrition

1. Data on health and nutrition are unreliable and incomplete. It seems, however, that about ten diseases have been the main cause of sickness and death in Uganda. Most of these are preventable. In the last twenty years of disorder the health care system has suffered and as a result, epidemics of measles, TB, sleeping sickness, schistosomiasis and oncocerciasis have erupted. Recently a new scourge, AIDS, has been added.

2. The main problems facing this sector have been :

i) Demoralisation, insecurity and preoccupation with daily survival has undermined people's concern with longer term well-being.

ii) There is a lack of trained competent and efficient personnel in the health sector. Morale of workers has deteriorated due to poor real wages, arbitrary and nepotistic actions of leaders and a crumbling infrastructure. Many fled the country, others have left government to work in the private sector.

iii) With political instability, planning ceased and budgetary discipline collapsed.

iv) The sector has suffered from acute lack of funds for supplies. Hospitals are in a poor state of repair and lack drugs and supplies. The information function of the public health section of Ministry of Health has been impotent in recent years for this reason so that public health has suffered badly.

v) There has been poor communication, cooperation and coordination between Ministries and the work of the institutions responsible to the Ministry of Health has suffered as a result e.g. lack of running water for sterilisation, electricity for refrigeration, poor roads, communications etc. By itself the Ministry cannot solve these problems.

vi) Poor water and latrine facilities are responsible for 23% of recorded deaths and for 43.7% of all hospital admissions. In recent years both urban and rural water and sanitation have deteriorated badly.

vii) Poor nutrition, in a country which does not, overall, lack food is a critical problem due to general poverty, educational factors and military disturbances, and is a significant factor in death and disease.

viii) Facilities for and assistance to the physically and mentally disabled are minimal and grossly inadequate.

ix) Occupational health and diseases, in all sectors of the economy, are now virtually unmonitored and unregulated as the Occupational Health and Hygiene Department of the Ministry of Labour lacks personnel, transport and equipment.

3. The main proposal in this sector is the introduction of a Primary Health Care Plan. This would focus on disease prevention, nutrition, clean water supplies, sanitation and occupational health. This should be the main focus of national health policy.

4. The system would rest on re-orienting medical training towards these areas, producing primary health specialists (DPH's) who would then educate master's level public health trainers. In turn these would work at district level training parish health workers.

5. Parish health workers would be elected by villagers, from among women as well as men, and would be responsible to elected parish health committees. Their responsibilities in the areas of primary health would be those of mobilisation, coordination, education, diagnosis and treatment. Public health education would be brought more into schools.

6. The second, and related, proposal is that of greatly improving water supplies and sanitation throughout the country. The emphasis here will be on rural water supplies through a borehole drilling and spring capping campaign to be funded, essentially, by foreign donors.

7. Other elements will be mass immunisation, and the rehabilitation of hospital facilities.

8. There was general, but not unanimous agreement that user fees should be introduced for certain hospital services. There was unanimous agreement, however, that no one should be denied access to health facilities because of an inability to pay.

9. Assistance in the form of foreign exchange and commercial credit should be given to local pharmaceutical firms to assist them to increase production/assembly of pills, capsules, ointments, cough syrups and medical products. Local chemical industries should also be revived.

10. The Ministry of Health laboratory should be rehabilitated and begin researching tests made earlier by others on local herbs, roots etc. used in healing with a view to facilitating the commercial extraction locally of active ingredients.

11. The government should adopt a policy of assisting the greater integration of people with mental or physical disabilities into normal community life, and should adopt a bill of rights for the disabled. It should also work with and assist the organisations of the disabled to acquire necessary aids and equipment from similar organisations abroad.

12. The government should provide the Occupational Health and Hygiene Department with sufficient resources to enable it to launch an effective occupational health campaign assisted by elected health and safety committees in places of work. Assistance from overseas trade unions should be available if needed.

VIII. Education

1. The educational institutions in Uganda are not well synchronized with the needs of the economy. In reality, it is not possible to find white collar jobs and paid employment opportunities for all secondary school leavers and university graduates, yet the goal of the whole educational system is tied to the needs of this small employment sector.

2. The education system must recognize that most school leavers will remain on the land in the near future. It will be necessary, therefore, to assess the curricula in both primary and secondary schools, in the light of the Namutamba project experience, to increase their practical content so as to better prepare the majority of graduates for productive employment or self-employment rather than for the next level of formal schooling. This change would need to be initiated first of all at the teacher training level.

3. Basic education must receive priority and it must be available to all. In this connection, special efforts must be made to raise female enrolments in all levels. The percentage decline of children in general receiving primary education must also be reversed.

4. Particular attention must be devoted to literacy. It is estimated that the literacy rate in Uganda is only 52% which is very low. In this connection, it is worth noting that there has been no adult literacy campaign in Uganda, nor is there any systematic and concerted concern for the education of out-of-school youth and adults.

5. Special attention must be given to the educational needs of the NRA youth and of those youth displaced in recent warfare. Waiving school fees is a step in the right direction but it must be recognized that they are only a small proportion of total costs of schooling which pupils pay these days.

6. Points 4 and 5 emphasize the need for life-long education possibilities, through distance education, more flexible entry and exit, expansion of in-service training, etc. An emphasis on training/retraining might be especially important given the erosion of skills in recent years.

7. Government wage structures should better reflect performance and skills rather than paper qualifications. It is recognized that this would necessitate a rethinking of current procedures and practice. As and when salaries are reviewed, this should be taken into account

8. In general, given the huge potential financial costs of education, it will be necessary to increase the efficiency and quality of those resources that are already in place. Some suggestions are to have morning <u>and</u> afternoon shifts at school to use buildings etc. more fully; reducing the number of courses and length of formal education; creating book banks and a local capacity to print school books; and school equipment.

9. It will also be necessary to continue to rely heavily on local resources for the construction and maintenance of school facilities. Uganda parents have shown the importance they attach to education by their financing the expansion of secondary schools in recent years. The local development tax proposed elsewhere is premised on this commitment to self-help.

10. Given the cost of schooling, it is important that children of poor families have opportunities at all levels. At secondary level, in particular, a scholarship fund must be established so that the poor are not excluded from entering and remaining purely on the grounds of lack of money.

11. Consideration should also be given to charging students at university for some portion of their costs e.g. food and accommodation. Again, provision should be made, by way of loan or grant, for those students who cannot afford to pay.

IX. Housing

1. There is a huge backlog of housing needs both in urban centres and in rural areas. This is estimated at 75,000 units in the former and 176,000 units in the latter. With current demographic trends, total new housing needs will be 575,000 between now and 1990.

2. The level of investment required to fulfil this year's needs has been estimated at the equivalent of $400 million at an exchange rate of sh.5000 to $1.

3. Housing shortages are the result of population growth, destruction and lack of building during the recent wars, the lack of construction skills, the high cost and low availability of building materials, the lack of research into local materials and the acute shortage and expense of imported materials. Housing has also not been a priority of government.

4. Local contractors face a number of difficulties in establishing and expanding their operations including knowledge of costing and tendering, managerial skills, and the lack of access to bridge financing which commercial banks seem unwilling to extend.

5. Government rents have lagged well behind those of the private sector, thereby giving government officers an important subsidy (offsetting to some degree the fall in their real incomes). The result of this is that government has not been able to build up a capital pool for housing.

6. The housing market has been skewed with the incentives being such that output is focused on high income housing. Low income earners have been hurt most by the shortage. The investment climate has also discouraged house building.

7. Low rents and poor management have meant that the custodian board has not been able to maintain its housing stock in good repair, leave alone expand that stock.

8. Housing finance through the H.F.C.U. has dried up. This may in part be due to lack of borrowers given the high cost of housing and recent pressure on real incomes. It may also be due to low ceilings on credit for house purchases. In any event, HFCU's capital base is very narrow.

9. The single most important step that can be taken to expand the housing stock is to revive the construction materials industries and to encourage small scale rural production of building materials.

10. The sale of former Asian properties should be used directly or indirectly by first transferring some of them to HFCU, to build up a housing expansion fund and augment HFCU's meagre capital resources. Credit ceilings for housing should also be raised.

11. Government should encourage the training of lower level cadres in building skills and trades.

12. Self-help Housing Cooperatives should be encouraged in rural areas.

13. Research into appropriate building materials and technologies should be stepped up in order to reduce import dependence (which is very high in modern housing) and to diversify local production. Building codes and standards may need to be reviewed to facilitate this.

14. In urban areas government should begin land banking and site and service schemes, for which some external assistance may be forthcoming if needed.

15. Once the salaries of civil servants have been adjusted, but not before, rents for pool housing should be raised to commercial levels. The government should also give consideration to gradually withdrawing from the obligation of providing housing to civil servants, encouraging individual home ownership as an alternative.

16. Given the acute resource constraints facing the government at this time, the most effective contribution it can make in this sector is to provide an environment conducive to relieving the bottlenecks identified. Strategic intervention in key areas of materials, skills, finance and site and service, will be more useful and more feasible than attempting to provide housing stock directly.

CONCLUSION

There are no simple solutions to the problems facing Uganda and the team does not wish to give the impression that there are. Whatever path the government chooses to follow will be a difficult one since, by its very nature, adjustment is painful. There will, for instance, be resistance to controls over spending, to campaigns against corruption, to attempts to replace imports. There will be enormous difficulties encountered in trying to re-establish discipline and the work ethic in the public service. There will be pressures from Ugandans and outsiders alike for one policy move to be chosen or abandoned in favour of another. There will never be enough resources, domestic or foreign, to do what needs to be done.

We feel, however, that the government has sufficient support, goodwill and commitment to prepare an adjustment programme which will help lead Uganda back to prosperity. We feel, also, that it has the strength to carry out such a programme in the face of inevitable difficulties. We trust that it has the openness to recognize wrong policy choices if it makes them, and the flexibility to chart a new course quickly if this becomes necessary.

It is our hope that this report will assist the government in making difficult policy choices designed to bring the economy back into stability in the short term, ones which must be made if its laudable long term objectives are to be met.

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