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African Economic Policy Reform Program

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I. INTRODUCTION

In May, 1987 the GOU put into place an IBRD/IMF recommended package of macroeconomic policies. This package, including devaluation, budget deficit ceilings, liberalization of imports, etc, while standard for the IBRD/IMF, meant radical changes in Ugandan economic thinking and policies. Given the bitter and lengthy debate within the Government and National Resistance Movement over the reforms the President had to direct that the package be put in place, thus placing his personal political prestige on the line.

A donor/GOU Consultative Group Meeting in June 1987, greeted the GOU's new policy package with enthusiasm and fully subscribed the $304 million needed to fund the first year of the four year GOU's 4-year REHABILITATION AND DEVELOPMENT PLAN.

The acceptance of IBRD, IMF and other donor assistance will lead to increasing foreign debt and growing dependence on donors in the foreseeable future. The huge cost of rehabilitating a rundown or destroyed physical and institutional infrastructure -- health centers, schools, roads, railroads, and agro-industry -- makes this dependence inevitable in the near term. But given Uganda's agricultural base and human resources, recovery to the days when Uganda was indeed the 'Pearl of Africa', is very possible -- with political will and financial resources.

But the only way Uganda can get off the international dole and import the necessary capital goods and technology is to increase her exports. While full attention has been given to the initial policy reforms and their implementation, the GOU has not yet put together an export strategy with ensueing interrelated policy, program and institutional elements.

This AEPRP is designed to assist policy makers in developing such a strategy, organizing trade programs and "Priming the Pump" by starting activities leading to increases in trade, imports and exports. For reasons that will be explained below we believe that Uganda's initial focus should be upon the Preferential Trade Area (P.T.A.) countries.

Our proposal calls for $15 million of which approximately $11.5 is envisioned to be a line of credit to the Bank of Uganda to finance an eligible list of imports through the P.T.A. In addition we plan to use $3.5 million to undertake marketing and trade studies, design an intra-regional trade strategy and improve institutional capacities to formulate on-going policies to encourage efficient trade, monitor external markets and improve statistical analysis and trade reporting.

II. THE UGANDA ECONOMY: RECENT ECONOMIC HISTORY, REFORM AND CURRENT STATUS

A. Brief Economic History

At independence, Uganda had one of the strongest and most promising economies in Sub-Saharan Africa. Despite the disadvantage of being a land-locked country, the agricultural sector, with its favorable climate and soil conditions, was able to provide ample food to feed the population, plus generate foreign exchange. The industrial sector, although small, supplied the economy with basic inputs and consumer goods, a d contributed foreign exchange through exports of textiles and copper. Uganda's transport system was regarded as one of the best in Sub-Saharan Africa, and through common services with Kenya and Tanzania, Uganda shared access to an effective network of railway, port and airline facilities.

The initial years after independence clearly demonstrated Uganda's economic potential. Real GDP grew by 5.8 percent per annum from 1963 to 1970. The country also maintained a reasonable savings rate, averaging 15 percent of GDP, which permitted the implementation of a respectable investment program without undue pressure on domestic prices or the balance of payments. Although Uganda's export volumes grew only at 3.5 percent per annum, export earnings were more than adequate to cover commercial import requirements. The country maintained a current account surplus in most years, and the government's budgetary position was basically sound.

Starting in 1970, a decade of political turmoil and gross economic mismanagement radically changed the situation. Many of the best trained personnel fled the country, the parastatal sector became bloated with abandoned or confiscated industries, and professional standards within the sector eroded. In addition, the Ugandan economy was shaken by a series of external shocks: sharp rise in petroleum prices after 1973, and the breakup of the East African Community in 1977. As a result real GDP declined by about 20 percent during the 1972-1978 period. An era of extensive economic, social and political destruction culminated in the war with Tanzania of 1979.

B. Economic Status Prior to the 1987 Reforms

At the end of the civil war in January 1986, the economy was in a critical condition. Much of the country had been devastated; the Luwero triangle, once among the richest areas, was a wasteland, with infrastructure destroyed. Countrywide, there was a major transport bottleneck; manufacturing plants were either closed or operating at very low capacity; utilities had severely deteriorated. Official foreign exchange reserves were only $ 24 million, equivalent to about two weeks of "normal" imports. Net foreign reserves were negative to the amount of $ 254 million. The new Government also inherited a considerable external debt burden.

Fiscal and monetary performance further deteriorated in 1986. The budget for FY 86 sought to accelerate the country's recovery effort by doubling budgetary outlays over those of previous years. With a small increase in projected revenues, the budget deficit increased, with most of its financing coming from the banking sector. However, the actual deficit was much larger than projected, due mainly to shortfalls in government revenue. This arose primarily as a result of the overvalued exchange rate which severely penalized producers while at the same time reduced revenues from coffee exports.

In 1986, the balance of payments situation worsened. The shortage of transportation equipment severely hampered exports, particularly coffee, which accounted for 95 percent of total export earnings. As a result, Uganda was unable to reap full benefit from the boom in coffee prices and from the suspension of the ICO country quotas in February 1986. During the year, imports increased by around 30 percent from the very low level of 1985. The Government gave high priority to the importation of raw materials, spare parts, and transportation equipment urgently required to restore productive capacity and facilitate the movement of goods. Meanwhile, imports of key consumer goods such as sugar and salt increased significantly. Despite this increase the huge pent-up demand for imports could not be met, exerting considerable pressure on the parallel foreign exchange market. By early 1987, the parallel rate for the Ugandan shilling exceeded eight times the official exchange rate.

The worsening economic condition throughout 1986 made it clear that a major reversal in economic policies was required. After extensive debate and study there was broad consensus within the government on the need for economic reform.

C. Outline of the 1987 Reform Program

The objectives of the Government's Economic Recovery Program, announced on May 15, 1987, are to: (1) restore price stability and a sustainable balance of payments position; (2) substantially improve capacity utilization in the industrial and agro-industrial sectors; (3) improve producer incentives; (5) restore discipline, accountability and efficiency in the public sector; and (6) improve public sector resource mobilization and allocation. As an important first step towards these goals, the May 15th announcement included:

1) A currency reform under which one new Uganda shilling would be equivalent to 100 old shillings;

2) A 77 percent devaluation, on foreign currency terms, of the Uganda shilling from USh 1,400 old, to 60 new shillings to one US dollar;

3) A 30 percent currency conversion tax applicable to all cash holdings by the public;

4) An increase in the producer prices for coffee, cotton, tobacco, and green leaf tea, ranging between 158 to 400 percent;

5) Subsequent increases in producer prices of the five foodcrops targeted for export, ranging between 130 to 230 percent for beans, maize, sesame, groundnuts and soy beans;

6) An immediate increase in petroleum prices to establish appropriate parity with neighboring countries while providing net revenues to the Treasury;

7) A doubling of the civil service wage bill effective June 1, 1987.

In addition to these actions, the announcement included measures that will be taken in the coming months: establishing an Open General Licensing (OGL) system for foreign exchange allocations and of a credit facility to provide local cover for imports, as well as implementing fiscal and monetary policies consistent with the objective of stabilization.

Reducing the rate of inflation is a key goal of the government's program. To sustain stability and achieve recovery, policies aimed at restraining and controlling demand now have to be supported by measures to stimulate the supply-side. In the short run, the Government expects a supply response from improved producer prices in the agricultural sector, increased capacity utilization in industry, and larger numbers of transport vehicles within the marketing sector. Experience from the 1981-1984 period, when the economy rebounded from prolonged contraction supports this expectation. However, to sustain the expected recovery, the rehabilitation of basic infrastructure, and productive capacity is essential.

D. Macroeconomic Policies

Macroeconomic policy in Uganda is dominated by short-term problems of stabilization. The Government's recent initiatives, and the complementary policies to be pursued, are aimed at stabilizing the economy over the next 18 months. The plan restricts the expansion money supply to control the growth in nominal aggregate demand. The plan also restores the revenue base for public spending and in so doing it goes beyond a reduction in public sector borrowing requirements. The recovery in revenues is designed to finance a net repayment of outstanding debts to the banking system. The aim is to release resources for the expansion of non-government sectors without a parallel expansion in total credit.

Revenues will undoubtedly increase as a result of the recent, substantial, devaluation producing two main outcomes. First, it results in an increase in the "implicit" tax on coffee exports, the main source of public revenues. Second, with the price incentives given to producers, the devaluation is expected to lead to an increase in exports, hence in the tax base and import capacity. But it is clear that increased imports are the key to achieve short-run agricultural supply responses.

E. Sector Policies:

The measures announced on May 15, 1987, and the other macroeconomic policies agreed under the PFP and the SAF program, will establish the necessary conditions for the recovery of the economy. The IBRD Economic Policy Credit supports these policies, but its main focus is on supply-side policies designed to affect the performance of the productive sectors and public sector management. The agreed upon PFP calls for action on a wide range of issues. However, all aspects of the Government's program have not been fully developed. Further analysis is required in a number of areas to formulate concrete actions. The IBRD's ongoing and programmed economic and sector work will contribute to the further development of the reform program.

Agricultural Policies. Much needs to be done towards the rehabilitation of the agricultural sector and to realize its full potential. To encourage production and improve efficiency in the short to medium term, pricing, marketing, and credit issues are being addressed under the present program. In the longer term, issues concerning research, training, extension, veterinary services, commodity marketing and input distribution also need to be addressed.

Producer prices of export crops are a crucial issue addressed under the Recovery Program. Meanwhile, the

Government is committed to maintaining, and, if necessary, increasing returns to producers. It has been agreed that producer prices are to be reviewed twice a year; once prior to planting and a second time in the harvesting and marketing season.

In the area of agricultural credit, the Government is aware of the need for improvement in crop financing and has recently introduced a system whereby credit is channelled directly from the commercial banks to cooperative unions with satisfactory accounting and financial expertise. In addition, the government is planning to establish a monitoring and supervision unit in the Ministry of Cooperatives to assure prompt payment to farmers.

Industrial Sector Policies. The macroeconomic policies announced by the government, particularly the establishment of a realistic exchange rate, will substantially improve the policy environment for the industrial sector. Emphasis is being given to the provision of intermediate inputs to rehabilitate the industrial sector.

The government's policy has been to permit domestic prices to be freely determined in the market. However, under the extraordinary conditions that have prevailed in Uganda, including the existence of acute shortages of some basic necessities, the government exercised temporary controls on prices or profit margins for certain items, mainly imports, and, in some cases, assumed their marketing.

The government's commitment to a policy free from price controls was recently evidenced by the fact that despite temporary confusion resulting from the implementation of the currency reform and devaluation, the government decided not to interfere with market determined prices.

Transport Sector. Currently, inadequate transportation is a serious bootleneck hindering rapid economic recovery. There is a shortage of trucks and road equipment to repair truck and feeder roads. A large number of trucks have been ordered by the Government and a significant portion of them have been received.

With donor support, major efforts are currently underway to improve road conditions and maintenance capacity. A Transport Needs Assessment Study has been completed by the IBRD and has been discussed with the government and donors. This study identifies the emergency needs of the transport sector, and provides the basis for a coordinated donor effort to meet these needs.

F. Need to Increase Exports to Sustain Economic Recovery

The donor community has responded in a very positive manner to the government's reform program. It is critical that these resources be put to their best use in terms of increasing the growth and institutional development of the Ugandan economy. But in the longer term it is necessary that the economy generates increased output and savings that can be plowed-back into the economy in the form of investment. Without such an increase in domestic wealth, economic growth cannot be self sustaining.

Increasing trade offers an important vehicle by which economic growth can be stimulated and sustained thereby reducing the dependence on foreign aid. Aid conceived to stimulate and achieve this result will not only return Uganda to its progressive past but also contribute to increasing food production in Africa, and significant improvements in East African welfare. Uganda, then can make a major contribution to Food Security in Africa.

Given the critical nature of exports to achieving a self-sustaining economic recovery and long-term growth, our AEPRP proposal will focus upon removing key constraints to increasing exports, particularly within the P.T.A. countries.

III. RATIONALE FOR A TRADE FOCUS

A. Role of Trade in Economic and Social Development

What determines which items a country trades? Aside from what countries have to offer, relative prices at home and abroad and the relative strength of each country's demand for the other country's product will determine which goods are exported and imported by a given country.

Trade can result in higher national income because of more efficient utilization of domestic resources. This in turn can increase savings, making additional resources available for investment. Since the opening up of the economy to external trade changes relative prices, the tendency toward greater investment is increased if investment goods are also imported or made from imported materials.

In the case of Uganda and other LDCs which do not produce capital equipment, the results can be dramatic. It is not just a matter of re-allocating domestic resources toward specialization of "simple" products and the importation of capital goods. For example, Uganda despite its low income must determine how to increase domestic savings and direct these resources into productive investment. Since this transformation cannot be internally accomplished for a host of reasons, it must be accomplished by exchanging exports for imported capital items. International trade is a vehicle by which this necessary transition can be carried out, and thus becomes a principal instrument of growth. When development is inhibited by inadequate imports of capital items including agricultural inputs, underutilization of land and labor occurs. Trade (and well conceived aid) can break this brake on growth.

International trade does not comprise only flows of finished products intended for the final consumer. Rather, much of it, particularly in the case of Uganda, would consist of agricultural inputs, plant and equipment, semi-processed products, and certain raw materials for local industry. Since Uganda does not possess the technical ability to produce many of its required imports, importation amounts to more than specialization in production. Simply put, increased trade can permit Uganda to reach otherwise unattainable levels of output, technology, efficiency and income. Trade can thus assist the country to overcome critical import and technological gaps within a shorter time frame than under conditions of limited trade.

Increased trade will permit Uganda to achieve a higher growth rate which will tend to feed upon itself as continuously rising production and income make possible increasing levels of savings and investment. In Uganda today the main obstacle to growth is the unavailability of imported resources. Trade offers the principle means, coupled with aid resource flows, to increase the availability of investment goods in order to exploit Uganda's natural resource base and capture its comparative advantages.

In an economy not operating at full capacity (present day Uganda) trade can provide the necessary additional resources to effectively utilize un- or under-employed land and labor. The resulting incremental output that can provide powerful stimuli on the demand side to "get the economy moving" on a rational growth path.

In the case of exports the economic impact is not confined to only the export sector. Rather as export firms (farms that produce the bulk of Uganda's exports) expand and increase production they will require inputs from other sectors and thereby stimulate investments and technological change outside the export sector. As the standard of living of those engaged in export production increases, the goods and services they demand increase in quantity as well as quality and possibly in composition. In turn, this new demand stimulates growth in the industries producing final goods and services as well as those supplying inputs. While, the linkages through which the development process spreads can be debated, there is little doubt that export-led growth is a critical stimulus, if not requirement.

On the import side, external trade makes it possible to gain access to capital equipment and other commodities necessary for investment; without trade such imports may not be obtainable or only a high cost. Agricultural and agro-industrial expansion made possible by such imports tends to spread through the economy generating both growth in production and employment in several sectors.

The benefits of trade go beyond the exchange of commodities. Flows of capital in various forms occupy an important share of international transactions. Such transfers embody plant, equipment, technology and with direct foreign investment managerial skill. They make possible a fast diffusion of raw materials, inputs and equipment necessary for economic growth. There are likely to be important feedbacks to the supplying country as well; generating increased regional welfare in the case of intra-regional trade. For example, in both the exporting and importing countries trade increases the size of the domestic market. Economies of scale may be realized, which without trade may not be achieved if production were confined to the national market. Also there can be increased competitive pressure on prices, product improvement and technological advancement. Innovation is often held back if competition is lacking. Important impacts on the pool of skilled labor result from expanded markets, innovation and investment in economic infrastructure (external economies). The dynamic effects of a rational, efficient trade strategy can thus be far reaching and a major stimulus to an undercapitalized or lagging economy.

Uganda will export those commodities that are relatively intensive in the factors with which it is relatively endowed. And it will import services of its scarce factors as embodied in the imported goods. The relative factor endowments of Uganda and its trading partners will influence the pattern of trade.

The economic structure of present day Uganda will have a great bearing on the country's ability to trade and what it can export now and in the future, as well as what its essential import requirements are likely to be in the short and intermediate run. Trade compensates for national deficiencies, whether in capital, labor skill, management or technological sophistication. The gains from trade derive from the fact that it enables countries to specialize in goods that require the factors they possess in abundance. It is, in part, a gain from re-allocating resources among different activities. The result is that countries import and export dissimilar goods--the more divergent the factor endowments between two trading partners the more dissimilar will be the commodities exchanged and the greater will be the gains from trade.

B. Financing Consumption, Investment and Debt Service.

Limited foreign exchange earnings constrain the ability of

Government to finance consumption, investment and debt service. In Uganda the current level of foreign exchange earnings do not permit adequate allocations of foreign exchange among these three broad, demanding requirements. Consequently the need to rely upon grants and loans, increase exports and limit imports.

Consumption. The Ugandan economy today produces a limited range of consumer goods aside from fresh fruits and vegetables and meat products. The great bulk of processed food items are imported, a large share from neighboring countries particularly Kenya. Much of these imports has in recent years been financed by the "magendo" trade; however, some essential commodities such as sugar, soap and salt have received foreign exchange allocations from the Bank of Uganda. As the GOU's new monetary and fiscal policies more fully achieve their desired impact, an increasing proportion of foreign exchange that finances the "magendo" trade is likely to be captured by the banking system. To the extent this occurs this will permit and require the BOU to finance their importation. Since donors, with few exceptions, do not finance the import of consumer goods most of these imports must be financed by domestically generated foreign exchange in the near term.

Financing Capital Imports and Economic Infrastructure. The GOU's "Rehabilitation and Development Plan" calls for a total expenditure in foreign exchange of $ 2.4 billion over the full life of the plan. During FY 88 the planned capital development expenditure is $ 220 million. Last year, Uganda's FX earnings were only $340 million dollars. The Consultative

Group Meeting held in Paris June 12th generated $304 million for the next fiscal year, of which $160 is estimated to be "fast disbursing" BOP support. Despite these impressive resource flows the GOU will be hard pressed to fully finance its rehabilitation program and total import requirements.

It is important to note that much of the aid received and to be received over the next several years is in the form of loans and therefore increases Uganda's already heavy debt burden. Thus, to reduce its dependence on foreign aid and loans that must be paid off in the future, there is a critical need to increase exports, to ensure increasingly large flows of domestically generated foreign exchange.

Financing Debt Service. Despite the recent Paris Club debt rescheduling ($70 million over the next 12 months), Uganda's projected debt service payments will be approximately $ 700 million over the next four years. This represents a foreign exchange drain which otherwise could be used to finance domestic investment. Assuming no major break through on third-world debt arrangements, Uganda will have to pay these debts to maintain its credibility with its international creditors.

Thus, the GOU's foreign exchange requirements over the next several years will determine the extent to which economic recovery can take place over the next decade. There are critical trade-offs involved, and it goes without saying that increased exports offer an important vehicle by which the conflicting demands for foreign exchange can be minimized.

IV. JUSTIFICATION FOR INCREASING INTRA-REGIONAL TRADE

A. Uganda's Natural Resource Base

Agriculturally Uganda is endowed with some of the best "real estate" in Africa, the basis for economic growth. The country consists of a total land area of 214,000 sq.km. Fifty percent of the land area is either classified as arable (30%) or pasture land (20%). Natural parks account for an additional 12%, inland waters 20% and urban and waste lands about 18% of total land area.

In the early 1970s about 49,000 sq. km. was cultivated. Current estimates indicate that area under cultivation may be 56,000 sq. km. (5.6 million hectares). Using the 30 percent arable land area (64,200 sq. km.) as a base, there are 8,200 sq. km., or 820 thousand hectares that could still be brought under cultivation before the total arable land base (not including pasture land) is exploited. This does not take into account significant potential to intensify land use via yield increasing technology.

Uganda has a benign climate with plentiful sunshine, good rainfall (except in the North-east and part of the South-west) and low temperature variability. Most of the country has two rainy seasons, and total rainfall ranges from 500 to 2250 mm annually. Because of Uganda's equatorial location, sunshine is plentiful and temperature ranges are small. The weather is determined by the Inter-tropical Convergence Zone which brings two rainy seasons, in April-May, and again in October-November. The cooler winter season falls between the wet seasons, in June-August.

Crops grown depend upon soil types and rainfall. In the south, centre and west, where rainfall is significant (900 to 1,500 mm), perennial crops predominate: coffee and tea are produced as cash crops, with bananas as the main staple food. Cereals (maize, millet, sorghum), pulses, and oil seeds, however, are becoming an important part of the cropping system.

Climatic and soil conditions have played a decisive role in defining Uganda's patterns of agriculture. Sixty percent of the South has a bimodal rainfall of 1400 mm which encourages perennial crops and continuous cropping; unimodal rainfall of 700-1000 mm in the North followed by a protracted dry season favors only seasonal crops and distinct cropping seasons; mean min/max temperatures range from 16 - 31 C, favor a wider choice of crops; and rich alluvial soils around Lake Victoria and similar good soils further North, favor various types of crop production.

Accordingly major agro-ecological zones emerge. About 70% of the cultivated land is planted to seasonal crops, and 30% to permanent crops. In Central Uganda, however, over 70% of the cultivated land is under permanent crops, coffee and banana; 38% of the Central Region is pure coffee and bananas; 60% of the Eastern Region is cotton and millet; 40% of the Northern Region is pure cotton; and 70% of the Western Region is bananas and tea. Overall, pure stands are 100% for teas, wheat and rice; 40% for coffee; 74% for cotton; 50% for cassava; 45% for groundnuts; 16% for maize; 50% for sorghum or millet; and 60% for bananas.

B. Factors Determining Short-Term Comparative Advantage

A combination of climatic conditions, soil types and extensive arable land provide Uganda with the necessary bio-physical environment to produce, and increase the production of, a wide range of annual and perennial crops, not to mention various types of livestock. Uganda's favorable man/arable land ratio and several ecological zones guarantee a diversified agricultural economy, albeit with potential specialization within ecological zones.

Historically Uganda has been able to feed itself even through prolonged periods of civil disturbance or economic mismanagement. But relative to its neighbors, who rely on significant food imports (formal and informal) and given their population growth rates may have to increasingly rely upon food imports, Uganda has the resource base and potential to increasingly produce and export food crops to its neighbors. With time Uganda could also export semi or processed foods to regional and nonregional markets.

Uganda's short-run comparative advantage in production and intra-regional trade is based upon a solid resource base and production costs involving minor import content. Domestic resource costs (land, labor and home-grown planting materials) dominate the costs of production. Despite the low level of technology employed, the quality of Uganda's agricultural produce is relatively high for horticultural crops, fruit and tree crops and livestock production.

Uganda cannot fully exploit its comparative advantage in food crop production by exports to European and Middle Eastern markets because of high transport costs through Kenya and/or Tanzania to the respective ports. To these costs must be included ocean freight. Thus, CIF prices at ports of entry in foreign markets are excessively high, and would limit exports to a very few high-value crops which, except for coffee and tea, Uganda cannot produce and market in a cost-effective manner at the present time. The short and long-term opportunity that this proposal addresses is Uganda's production and locational advantage, coupled with the fact that its neighbors are not, and are not likely to be in the foreseeable future self-sufficient in food crops. For bulk commodities exported to regional markets Uganda does not face the same cost disadvantages as present day informal trade confirms.

C. Short-Term Constraints

While short-term constraints to intra-regional trade will be more fully described, Uganda cannot exploit its potential environmental and locational advantages in food crop production without addressing critical constraints in terms of the limited availability of agricultural inputs and the cost of domestic marketing. Current transport costs due to deteriorated road conditions, availability of transport services and the costs associated with assembling and export will need to be addressed. Knowledge about regional markets will have to be tackled if incentives to production and trade are to be realized. This calls for not only a better understanding of export possibilities and costs, but also improved trading relationships, facilities and policies. In short, a coherent export strategy involving rehabilitation of economic infrastructure, institutional development, improved trade policies and supporting financial arrangements will need to be considered.

D. Food Imports in Neighboring Countries

Africa experiences periodic severe food and hunger crises. Drought, famine, regional wars, unchecked population growth and declining food production have resulted in massive increases in food imports across the continent. The crisis has been so severe that even former food exporters such as Zimbabwe, Kenya and Tanzania are forced to import large quantities of food. Almost 40 percent of the countries in Sub-Sahara Africa are no longer able to produce enough food to feed their own people. In East Africa it appears unlikely that Kenya, Tanzania, Sudan, Somalia and Ethiopia will regain the ability to feed their populations through domestic production before the end of the century. Consequently the recent "Presidential Initiative to End Hunger in Africa."

Uganda on the other hand has the real potential to become a major African food exporter. Its farmers are very productive by African standards and with support could increase their land and labor productivity significantly. The country faces minimal regional competition and the P.T.A. gives it an additional trading opportunity which has not been tapped in any significant manner.

While there are serious obstacles to achieving this potential we believe that appropriate technical assistance coupled with appropriate resource flows will help Uganda take advantage of the competitive opportunities that exist through the P.T.A.

Uganda is surrounded by 6 countries which imported approximately $420 million of agricultural products from producers within and outside of the region in 1983. All of Uganda's neighbors are facing rapidly rising import food bills, mushrooming population growth and declining agricultural productivity. Yet Uganda remains, despite the civil disturbances over the years, one of the few African states that is largely self-sufficient in basic food crops. The promotion of food exports is considered a major goal of Uganda's development strategy, yet a comprehensive export strategy awaits formulation.

E. Exploiting Location and Transportation Advantages

Despite being a land locked country, Uganda has clear locational advantages in terms of intra-regional markets. As already noted, Uganda's neighbors face increasing food import bills. Historically, Uganda has always had a trade in food crops in these markets. However, much of this trade has been informal and escaped the formal economy, thus not generating foreign exchange or public tax revenue.

There are important constraints to formally expanding intra-regional trade. They are not insurmountable, but an explicit trade strategy and revised economic policies are needed to encourage and facilitate such trade. In addition, the internal transportation network will require continued rehabilitation to provide access to markets (domestic and regional) and to reduce transport costs. Greater incentives and imported inputs will stimulate agricultural production, particularly in those crops for which new and expanded export markets can be identified and developed. As explained in Section X, the proposed AEPRP will be designed to reduce these constraints and facilitate increasing intra-regional trade.

F. Political Implications of Increasing Intra-Regional Trade

Increasing regional welfare has strong appeal and political implications. However, the goal cannot be achieved unless individual nation states embark upon economic strategies and policies that can increase their individual productive capacities. Uganda cannot contribute to regional welfare until it is able to rehabilitate its own economy and return to its former production level and growth rate. To achieve this goal, however, Uganda must increase trade; exchange food exports for imports that will permit increases in agricultural productivity, rehabilitate its economic infrastructure, and import selected consumer goods that it cannot produce domestically.

From this process, economic growth, integration and dependence can be achieved at national levels within the region. This in turn will improve regional welfare. The political implications of the process are far more favorable than an East Africa consisting of a wide disparity in economic strength among its member states.

V. PREFERENTIAL TRADE AREA.

The Treaty for the Establishment of the Preferential Trade Area (P.T.A.) for Eastern and Southern African States, signed in 1982, aims to promote cooperation and development in all fields of economic activity in the sub-region. P.T.A. member states have undertaken to accord each other the most-favored-nation treatment in trade. The P.T.A. Treaty calls for a reduction and gradual elimination of custom duties and non-tariff barriers for trade among themselves.

The two principal provisions which the P.T.A. is concentrating on putting into effect are:

1) reduction of tariff and non-tariff barriers, and

2) the P.T.A. Multilateral Clearing Facility.

The P.T.A. protocol on reduction and elimination of trade barriers enjoins the member states to reduce and progressively eliminate customs duties and other non-tariff barriers to trade among themselves. Member States were to reduce tariffs as of July 1, 1984. Many of the States have reduced their tariffs according to the Common List established by the protocol. The table below details the initial reductions:

TABLE

Groups	Description	Initial Percentage Reduction
I.	Food items (excluding luxury food items):	30 percent
II.	Raw materials:	
	(a) Agricultural	50 percent
	(b) Non-Agricultural	60 percent
III.	Intermediate goods:	65 percent

IV.	**Manufactured Consumer Goods** (excluding luxury items):	
	(a) Durable consumer goods	40 percent
	(b) Non-durable consumer goods:	35 percent
	(c) **Highly competing consumer** goods	30 percent
V.	**Capital goods (including transport equipment):**	**70 percent**
VI.	**Luxury goods:**	**10 percent**

The highest percentage reductions in custom tariffs apply to raw materials, intermediate and capital goods, as well as consumer goods having particular importance to economic and development needs of member states.

The Treaty provides that tariff and non-tariff barriers shall be completely eliminated within a period of 10 years. In order to accomplish this, member states are to negotiate a common list and duty reductions every two years. The Treaty does not change any existing tariff concessions currently in force between certain member states and allows any other P.T.A. member state to join such concessions on a reciprocal basis.

For goods to qualify as originating from a member state and therefore enjoy preferential treatment, the commodities must pass the P.T.A. "rules of origin." The P.T.A. rules of origin requirements are:

1) Goods must be consigned directly from a Member State to a consignee in another Member State.

2) The goods must have been produced in the Member State by enterprises which are subject to management by a majority of nationals and to at least 51 percent equity share holding by the nationals of Member States, their government, institutions, agencies and corporations.

In addition to the above, the goods must satisfy any one of the following:

1) They have been wholly produced in a member state;

2) They have been produced in a member state and the value of materials imported from outside the P.T.A. and used at any stage of production does not exceed 60 percent of the total cost of materials used in the production of goods; or

3) They are produced in a member state essentially from materials imported from outside the P.T.A. and the value added accounts for at least 45 percent of ex-factory cost of the goods, or

4) They have, through a process of production, been substantially transformed out of materials imported from non-P.T.A. countries.

The P.T.A. rules of origin exclude a large number of items produced by multinational firms in Kenya and Zimbabwe. Kenya has argued that multinational firm practices, know-how and capital should be utilized within the P.T.A. The Kenyan argument continues on the broader plane of strategies for development. This is critical because the strategy Kenya has chosen would preclude access to the P.T.A. market for some Kenyan products.

It is also important to note management and equity requirements. The Management rule states that the majority of the Board of Directors and executive staff must be nationals of a Member State before products from their enterprises are considered as originating in a Member State. The equity requirement is that at least 51 percent of the equity shareholding of the producing enterprise must belong to the nationals of a member state, etc. These two rules clearly affect the multinational companies which are prevalent in the Kenyan economy.

The P.T.A. Multilateral Clearing Facility is a scheme under which P.T.A. member countries use their national currencies for settling day-to-day transactions and only settle in convertible currencies at the end of agreed intervals of trade periods (every 75 days). The objective of the facility is to strengthen regional economic cooperation and the integration of development efforts by member countries. The facility came into effect in 1984.

The intent of the facility is to promote trading among P.T.A. Member States. Under the scheme, member countries are able to use national currencies in the settlement of payments during a transaction period of 75 days, with only net balances at the end of their period requiring settlement in convertible currencies. The creation of this additional liquidity is intended to benefit member countries, particularly in light of the acute foreign exchange shortages their economies are facing.

The framework of the payment arrangements are as follows:

1) Unit of Account: The unit of account for the facility is the P.T.A. Unit of Account (UAPTA), which is equal to the Special Drawing Rights (SDR) of the IMF. Intra-regional settlements are expressed and recorded in terms of UAPTA.

2) Exchange Rate: Currency arrangements vary but the currencies of most member countries are pegged either to a single currency, or to the SDR or based on a trade weighted basket system. Each monetary authority quotes a daily spot rate of exchange against SDR/UAPTA. Each monetary authority undertakes to buy

or sell its currency at that quoted rate to other monetary authorities against credit through the Clearing House.

3) Settlements: Settlements are to be made six times a year. The Bank for International Settlements, Basle (BIS) is used to process actual settlements and to this end it is necessary for all members to maintain an account with BIS in US dollars, Marks, Yen, Francs, or Sterling.

4) Default: Any country that cannot pay their settlement amount in hard currency is charged interest at a point above the SDR daily rate, until the payment is made.

5) Net Credit: The limit of each participant's net credit or debit position at any point is equal to 25% or 20% respectively of the average value of a country's total trade within the P.T.A. during the previous three years.

The clearing facility and the accompanying procedures are designed to minimize the usage of convertible currencies in settlement of trade and other intra-regional payments. Such a system should help Uganda to exploit the agricultural comparative advantage it has with its neighbors. We intend to look carefully at the P.T.A. Rules of Origin and Common List in order to focus on areas which can best increase Uganda's export earnings.

VI. INCREASING UGANDA'S PARTICIPATION IN THE P.T.A.

A. Rationale and Short-Term Advantages

Ninety five percent of Uganda's formal export earnings (those that earn foreign exchange), are derived from coffee exports. Given the country's balance of payments deficit, the need to increase the importation of agricultural inputs and capital items to rehabilitate economic infrastructure and formerly productive enterprises, plus the need to reduce dependency on foreign aid, Uganda must increase the production of exportables. The greatest potential for this lies in diversified agricultural exports, particularly those that the GOU has classified as "nontraditional exports."

In the short-run, limited effective demand (domestic) will permit much of the increases in production to be exported. That is to say, border prices for Uganda's exports are likely to be greater than prevailing domestic market prices. An export strategy will therefore expand the market faced by domestic producers and ensure higher producer prices that could not occur without trade.

Because of high domestic transport cost, Uganda's competitiveness in overseas export markets will be limited, to a few select, high value commodity exports such as coffee, tea, hides and skins and possibly pineapple. The real potential to expand exports, aside from these commodities, is in non-processed commodity exports to neighboring countries particularly food-short economies to the south, north, east and west. These markets will permit a 'vent-for-surplus' export strategy in the near term. Uganda's comparative advantage will be in the production of land/labor intensive food crops in exchange for relatively capital intensive agricultural and industrial inputs and materials--items which Uganda cannot, and should not, export in the foreseeable future.

B. Requirements to Increase P.T.A. Trade

In the shortrun, Uganda's principal constraints to increasing intra-regional trade will be (1) farmers' ability to increase production of target commodities with existing resources and production techniques; (2) farmers access to markets and incentive prices; (3) internal marketing capacities and costs; (4) knowledge of demand schedules in regional markets (commodities and intensity of effective demand); (5) competing prices with black-market border trade; (6) the foreign exchange cash flow of the Bank of Uganda, and competing demand for FX; and (7) the ability of the Central Bank to periodically settle the P.T.A. Clearing House Account in hard currency.

In the longer term, to fully capture and exploit the potential advantage of trade through the P.T.A., Uganda will have to develop the capacity to evaluate trade prospects within the P.T.A. and among other trading partners. This will require better market information, improved trading relationships, more efficient domestic marketing including investments in domestic marketing systems, increased productivity within agriculture, the dissemination of products of research embodied in output increasing technology (adapted to the managerial capacity of smallholders), importation of crucial output increasing agricultural inputs and improved price, marketing and export policies.

The AEPRP and the Mission project portfolio will be designed and/or adjusted to address these constraints to increasing intra-regional trade. Policy dialogue with GOU decision makers based upon analytical studies and investigations will be brought to bear on these issues. Shortrun technical assistance will be engaged to undertake comprehensive in-depth marketing and trade studies including an assessment of domestic marketing systems, regional demand, market development, P.T.A. regulations and procedures and Uganda's comparative advantage and export competitiveness in P.T.A. trade versus exports to markets outside the P.T.A.

C. Dealing With the P.T.A. Clearing Account

The development of a rational export strategy will take a concerted effort by GOU policy makers, require interaction with private sector importers and exporters and technical assistance, both Ugandan and foreign. It will be undertaken in phases, designed to identify and deal with the major problems first, followed by more in-depth and longer term trade (and marketing) issues. The analysis will deal with export and import issues. This process will result in the generation of data and analyses upon which GOU policy makers can formulate a comprehensive import-export trade strategy that will guide and influence economic activity geared to generate significant investment, employment and growth within the Uganda economy.

But in the short-run, Uganda's major constraint in effectively utilizing the P.T.A. to increase exports, imports and investment in domestic production and economic rehabilitation will be a foreign exchange constraint imposed by periodic debit balances in the P.T.A. Clearing House Account. An AEPRP funded line of credit, upon which the Bank of Uganda can draw under specific criteria and guidelines, will go a long way to minimize the constraint on increasing Uganda's participation in the P.T.A. As a consequence Uganda will acquire access to much needed imports to foster domestic investment and economic rehabilitation.

D. Regional Benefits

The Mission's proposed African Economic Reform Program will generate significant benefits not only for Uganda but several African (Eastern) countries. The proposal is in line with the philosophical objectives of the "President's Initiative for Ending Hunger in Africa," and USG foreign policy objectives in the region.

Secure, low-cost regional sources of food commodities are in the economic interest of the member states of the P.T.A. Fostering economic productivity within a weak economy in the region is also in the political and economic interest of the region. Expanding the size of domestic markets within the P.T.A. family of nations can be an important stimulus to economic growth on both a country-by-country basis and for the region as a whole.

However, regional welfare can only be enhanced to the extent that individual economies are strong or embarking on strategies, policies and programs that can enhance their own productivity, specialization and dependence upon economies within a regional grouping. Expanded, rational trade is the principal vehicle to encourage the exploitation of relative comparative advantages, and specialization to achieve sustainable economic growth and integration.

E. Potential Trade Diversion Problem

To what extent will increasing intra-regional trade through the P.T.A. result in less foreign exchange earnings? That is, divert exports to non foreign exchange earning markets. What are the opportunity costs of such an export strategy?

To address this issue one must consider several factors. Among them are the following:

- What are the economy's production possibilities in the short to longer term?
- Where are the markets for exports and what are the prices these markets are willing to offer for the projected quantity and quality Uganda can export?
- What are the transfer costs involved in exporting to these markets?
- Given production costs, marketing costs, border prices and freight charges, can Uganda achieve the desired level of export competitiveness?

These issues must be analyzed in terms of traditional international markets (outside the P.T.A.) and for trade to P.T.A. markets. In the final analysis it must be determined if trade through the P.T.A. expands overall trade or whether it simply diverts trade that would otherwise earn hard currency in international markets. This is a legitimate issue given Uganda's foreign exchange requirements to finance consumption, investment and debt service, in both the short and long term.

The trade diversion issue must not be analyzed in terms of exports in isolation of imports. Exports through the P.T.A. will generate hard currency during periods when exports exceed imports (not likely in the short-run), or generate credits to finance imports from P.T.A. exporters. The latter reduces theclaim on the BOU's scarce foreign exchange.

Another factor that needs to be considered when evaluating a potential trade diversion problem is the terms of trade. That is, the prices Uganda can receive from exports to the P.T.A. (versus those in other markets) and the price of imports from P.T.A. suppliers (versus those under other import arrangements). If export prices through the P.T.A. are equal to other export alternatives, and import prices from P.T.A. suppliers are not higher than alternative sources, then trade through the P.T.A. is neutral. If P.T.A. imports are cheaper and/or financed with local currency, then P.T.A. trade can result in potentially significant savings of foreign exchange.

Until we can obtain quantitative data on unit prices for exports and imports through and outside the P.T.A. we cannot be certain that trade diversion is a real issue. However, the evidence at this point suggests that P.T.A. trade will not result in trade diversion but rather trade creation, and less of a claim on Uganda's scarce foreign exchange.

VII. ROLE OF AEPRP IN FOSTERING INTRA-REGIONAL TRADE

A. Development of an Export Strategy

By African standards Uganda faces a unique opportunity. With a notable natural resource base for the production of a wide range of agricultural commodities and surrounded by countries that are unable to produce enough food to feed themselves, Uganda has potentially large, nearby export markets. Kenya, Tanzania, Rwanda, Zaire, Sudan and Ethiopia all require foreign exchange to import food that Uganda can produce. A great deal of food crosses Uganda's borders in the form of counter trade or is sold for neighboring currency. However, most of this exchange is informal trade and represents a loss of government revenue and foreign exchange earnings.

In order to capture this trade and expand formal export markets Uganda must develop a comprehensive export strategy and complimentary trade policies. A trade strategy must address several important components including:

1) On a country-by-country basis, what commodities are presently involved in formal and informal border trade? What are the estimated quantities? At what prices (explicit or implied) are these commodities exported? Is present demand satisfied? What is the potential demand over the next 10 years?. The answers to these questions will permit an estimate of the size of neighboring markets and estimated export revenue that can be realized. It will also have important bearing on the potential for increasing domestic production of selected export crops as well as where increased production ought to be centered to capture potential export and locational advantages (minimizing marketing costs).

2) What type of export market information is required to facilitate intra-regional trade? What type of information do farmers, traders and exporters need to become more involved in formal trade?

3) What are the constraints and thus the priority investments in economic infrastructure that are necessary to increase commodity exports to intra-regional markets (e.g. roads, transport, market town development, etc.)?

4) To what extent does the GOU need to revise, reduce, minimize and/or eliminate rules and regulations that restrict formal agricultural exports and the import of agricultural inputs, spare parts and other items

necessary to support the production and processing of agricultural products?

5) Which markets ought to be targetted for intra-regionaltrade in terms of non-traditional commodity exports? To what extent should Uganda concentrate on the production and export of these commodities? Targets must be based upon demand estimates, Uganda's comparative advantages in production and marketing and estimated net foreign earnings.

6) What steps are required and can be taken in the shortrun to improve the promotion, and quality of marketed produce to satisfy prevailing grades and standards in intra-regional markets and increase the effective demand for selected Ugandan exports?

7) How should one devise plans for the coordination of government ministries and organizations involved in the development of export trade policy and administration?

8) How to identify GOU and donor initiatives that will assist in (1) the growth of Ugandan agriculture, (2) the improved structure, conduct and performance of domestic agricultural markets and (3) creation of incentives to facilitate private investment in the production, marketing and export of those commodities that offer the greatest intra-regional export potential.

9) How to rationalize the relationship between the country's overall trade regime and intra-regional trade.

B. Rationalizing Uganda's Trade Regime

Exports. In the 1960s and early 1970s Uganda received export revenues from coffee, tea, cotton, vegetable oil, milk, hides and skins, and a significant amount of fruits and vegetables. Today, coffee accounts for 90 percent of Uganda's export earnings. Coffee prices are at historically low levels. Thus, there is a critical need to diversify exports in order to increase export earnings, be subject to less volatile international prices and to finance the rehabilitation and growth of the economy.

Coffee will likely remain the dominant export earner for many years, however, it is critical that other agricultural exports become increasingly important in the shortrun if export earnings are to increase appreciably and Uganda's ability to finance needed imports is to improve.

Uganda's short to intermediate term ability to increase exports to overseas international markets is seriously limited. With the exception of coffee and tea Uganda cannot at the present time produce adequate quantities of other commodities in the quality demanded by European markets. In addition, transport costs restrict Uganda's ability to compete in such distant markets.

However, intra-regional markets are much closer and can reduce Uganda's strong transport cost disadvantage. Competing suppliers to these markets on the other hand face higher transport costs and longer delivery schedules, if not quality disadvantages, at least for bulk, perishable commodities.

Thus, Uganda has a greater opportunity to expand exports via intra-regional markets than via European or Middle Eastern markets. While these latter markets may be developed in the future, they are not likely to be as important as say, the Kenya market, in the foreseeable future.

Rationalizing export trade will depend upon relative demand in external markets, marketing institutions and infrastructure, standards of processing and packaging, production cost advantages and the relative net foreign exchange earnings (how many dollars in imported inputs does it take to generate $10 in gross trade earnings?) Uganda can earn in respective markets. In the shortrun, at least, intra-regional markets are likely to offer the greatest increase in foreign exchange earnings for Uganda's exports with least expenditure on processing, packaging and transport.

Imports. In terms of formal trade there is significant scope to procure selected imports from intra-regional markets. Present-day informal trade confirms this since a wide range of commodities financed by street dollars are imported from Kenya, and to a lesser extent, other neighboring countries.

It is important to evaluate the cost advantages of various sources of Uganda's required imports. Given Uganda's current and projected balance of payment deficit, a rationalized (in terms of classification, quantities and total values) import policy is critical. In the process of designing such a comprehensive import policy the relative advantage of imports from the P.T.A. must be assessed and compared to imports from outside the East African region.

C. Targetted Balance of Payments Support

Uganda's participation in the P.T.A. will be determined by its level of formal exports through the P.T.A., the willingness of trading partners to accept Uganda shillings to finance transactions and the consequent overall debit balance in the P.T.A. Clearing House Account which the BOU must settle in hard currency every 75 days. In the recent past Uganda's participation has been limited by its meagre level of formal exports to P.T.A. countries and its inability to settle its

Clearing House Account in a timely manner. The Clearing House debit balance has been large given the imbalance between imports and exports and because trading partners have been unwilling to accept the greatly overvalued Uganda Shilling to denominate transactions. Consequently many of Uganda's P.T.A. trading partners have only been willing to trade in hard currency. With the advent of the economic reform program and specifically the recent devaluation of the Uganda shilling (coupled with other monetary and fiscal measures), trading partners may become more willing to accept the Ugandan currency. The Bank of Uganda's ability to settle Clearing House debits in a timely manner, which the proposed AEPRP would facilitate, is expected to help to improve Uganda's strength as a P.T.A. trading partner.

We envisage a significant amount of foreign exchange provided by an AEPRP would be used to finance a negotiated list of imports. These would be primarily selected agricultural inputs, building materials for farm structures and market town development, inputs and equipment for agriculture and agro-industry, farm and marketing vehicles and the like. Imports would be sourced from P.T.A. countries and largely from Kenya and Tanzania in the shortrun. The list of eligible import items would be based upon cost, locational and appropriate technology advantages. Imports would be based upon competitive bidding from alternative regional suppliers and cost comparisons with suppliers outside the P.T.A. to insure that import prices are internationally competitive (least cost).

USAID and the GOU would mutually determine the eligible list of commodity imports that could be financed with an AEPRP line of credit to the Bank of Uganda. The amount of dollars the Central Bank can utilize every 75 days (to assist the BOU with the P.T.A. Clearing House Account) would be predetermined every two and a half months based upon import requirements, the foreign exchange cash flow of the BOU, and the extent to which P.T.A. trade was financed by local currency transactions during the period under review.

Greater participation in intra-regional trade will require increasing exports through (and outside) the P.T.A., greater knowledge of demand and potential increases in demand for Ugandan exports within P.T.A. markets, and a better knowledge of the availability and cost advantages of imports from P.T.A. countries. In any event there will be a requirement for balancing the Clearing House Account every 75 days and this will require fairly large sums of foreign exchange in the immediate future since the P.T.A. balance of payments position will work to Uganda's disadvantage in the shortrun. The shortrun advantage will be greater access to regionally supplied investment items required for the rehabilitation and growth of the agricultural sector.

D. Linkages Among Domestic Resource Mobilization, Investment and Trade

After 16 years of civil strife and economic mismanagement, Uganda is no longer the progressive economy of the past. The country's economic infrastructure and thousands of previously productive enterprises in both the agricultural and agro-industrial sectors are in need of massive rehabilitation.

Ugandans today do not earn sufficient incomes to create the savings required to rehabilitate the economy. Thus, the critical funds must come from savers abroad in the form of grants-in-aid or loans provided by the IBRD and IMF, or other multilateral and bilateral donors.

However, given Uganda's historical experience, previous and current investment in human capital, and its outstanding natural resource base, domestic resource mobilization can occur if the policy environment and access to resources is assured. And if increasing trade becomes a reality in the shortrun.

The domestic market, as measured by effective demand today, is relatively small by Uganda's own historical standard. It can be argued that external trade, specifically exports, can become an important "demand shifter" to create the necessary incentives and supply responses required to increase the productivity of the Ugandan (largely agricultural) economy. Known markets at incentive prices can be an important stimulus to increase production of selected commodities. Increased trade can also provide an important incentive to invest in agriculture and marketing systems, both commodity and input. Improvements along the production, marketing and export chain can encourage increases in both production and efficiency. Resulting increases in income will create increases in consumption, savings and investment, important indicators and requirements for economic growth.

E. Institutional Development in Support of Increased Trade

Given the need to develop a comprehensive export strategy--which will include production and export targets, and revisions in domestic marketing and export policy--we envision the establishment of institutional capacities to undertake economic analysis to define and formulate policy recommendations that support a meaningful export strategy. Such institutional capacity must also address the need for and improvement in market information systems, P.T.A. trade policy, export/import procedures and regulations, domestic marketing issues, regulations and procedures, requirements for market town development, establishment of grades and standards, and facilitating marketing functions, such as terminal market storage.

A part of the proposed AEPRP funding would be used to establish or up-grade such institutional capabilities, including financing technical assistance, training, and problem-solving domestic marketing and trade studies.

F. Fostering the Development of Private Sector Production, Marketing and Trade

An overall goal of the proposed program grant will be to facilitate the growth and development of the private sector in Uganda. There is little public sector involvement in the direct production of agricultural commodities. This is not the case for domestic marketing as the Produce Marketing Board is involved in both domestic marketing and export trade. While the private sector is actively involved in the domestic marketing of agricultural commodities, it must compete in some cases with parastatals and is not presently permitted to participate in formal export trade, although this is expected to change.

During the preparation of the PAAD the Mission will investigate current restrictions to private sector domestic marketing and external trade, and will also evaluate the present role of parastatals in the marketing and trade of agricultural commodities and imported inputs. The aim will be to identify areas of public sector disengagement and means to liberalize trading practices.

For example, we will determine how the private sector can have greater access to foreign exchange for the importation of agricultural inputs and increasingly acquire licenses for the export and import of commodities within the P.T.A.

Because of the important linkages among agricultural production, marketing and trade, we envision the AEPRP will foster significant growth and development of the private sector in these areas. The funds available will be directed to achieving this program goal.

G. Linking Aid and Trade to Achieve a Common Strategy.

The common denominator between 'aid' and 'trade' is foreign exchange--both generate foreign exchange in the shortrun. Well conceived aid to further trade will create capacities to generate domestic wealth, particularly in a small, domestic market economy such as present-day Uganda. If goals and objectives of donor aid programs can be broadened or extended to achieve a trade creating output, an important linkage is achieved which increases the scope for establishing a long term, self-sustaining productive economic structure.

Our proposed AEPRP is conceived to strengthen the linkage between aid and trade. We are of the view that Uganda's present level of external trade is grossly inadequate. Uganda must become more export oriented if it is to get off the dole of the donor community and generate its own wealth within the intermediate term.

H. Modifying the USAID Country Development Strategy

The GOU's Rehabilitation and Development Plan resulted in an impressive, comprehensive economic reform program. At the time, it reached the absorptive capacity of the GOU to implement much required reforms. However, to achieve the goals of the reform program, basically to rehabilitate a war-torn economy by correcting major macroeconomic distortions and providing new incentives to stimulate growth to finance the rehabilitation of the economy, the reform process must, out of necessity, be a continuing process. One of the major gaps in the reform program is the lack of a comprehensive export strategy, and up-dated trade and marketing policies. This would represent going beyond the "necessary" and beginning to include the "sufficient" conditions for economic growth and development.

The Mission intends to make trade a central focus of our development assistance strategy. This can be accomplished in several ways. One important input will be foreign exchange to facilitate intra-regional trade. Second, sharpening the focus of existing project resources, and third, including external trade in our policy dialogue with the GOU. Fourth, we can sensitize other donors to the importance of a trade focus in their program/project assistance planning.

Our project portfolio can be geared to facilitate export trade. For example, the commodities that are imported under three projects --Food Production and Support and its follow-on project, Rural Economic Recovery, and the Rehabilitation of Economic Enterprises--can be redirected to have a greater export generating orientation. Agricultural research activities under the Agricultural Manpower and Development Project can also be re-prioritized to include a focus on food crops that could become important nontraditional exports. Our involvement with agricultural credit (RPE, RER and support to the Uganda Commercial Bank's new Rural Credit Scheme) can also be adjusted to increasingly direct resources toward production loans that can have an important export objective.

I. <u>Uses of Foreign Exchange</u>

Our preliminary estimate is that $15.0 million would provide adequate funds to facilitate intra-regional trade and provide the necessary funds to design a comprehensive export-import trade strategy. It is estimated that $11.5 million would be used as a line of credit available to the Bank of Uganda for purposes of settling, on average every 75 days, $ 2.25 million of the country's trade through the P.T.A. Clearing House Account. The utilization of this line of FX credit would be restricted. The remaining $3.5 million would be used to develop institutional capacities to design a trade strategy, undertake appropriate trade and marketing studies and formulate policies to facilitate rational trade with P.T.A. trading partners.

The dollars granted to the GOU under an AEPRP would generate local currency at the prevailing official FX rate.

J. Conditionality

Appropriate conditionality will be formulated through policy dialogue and negotiated with the Ministers of Regional Cooperation, Finance, and Economic Planning. Conditionality could include one or more of the following:

- A list of eligible imports with associated end-uses.
- The design and implementation of an export/import strategy.
- Formulation and implementation of economic reforms in the areas of domestic trade and export policy.
- Design of incentives to increase private sector participation in intra-regional trade and investment in production, marketing and trade systems.
- Development of institutional capacities to facilitate intra-regional trade.
- Mutual programing of the local currency generated under the program.
- Allocating a percentage of the revenues (local currency and/or foreign exchange) earned from increased intra-regional trade, through the national development budget.

K. Uses of Local Currency Generations

Local currency generations will be used to support the production, marketing and export of agricultural commodities. Illustrative uses could include financing agricultural research on food crops with intra-regional export prospects, small farmer credit to expand production of export crops, rehabilitation of rural farm to market access roads in selected production centers, market town development, farm and/or terminal market storage facilities, marketing and trade studies, production of market news, production and market statistics, etc.

VIII. NEXT STEPS IN THE DESIGN OF THE PROPOSED AEPRP: PAAD

A. Conceptual Framework

The Mission has engaged Prof. E. O. Ochieng, the Chairman of the Department of Economics, Makerere University to undertake an analytical study of Uganda's trade regime, including imports and exports through the P.T.A. Dr. Ochieng is well underway and has already assembled very detailed statistics on Uganda's trade since 1960. The Scope of Work for this study is included as Appendix A. Ochieng's comprehensive study is expected to be completed by October 30.

In the meantime, we have designed a computerized export competitiveness model and we are presently assembling appropriate cost of production and marketing data, both disaggregated on the basis of tradeables and domestic resource costs, on a crop-by-crop basis. We are also collecting for selected crops, border prices offered by overseas international markets and selected P.T.A. markets. Preliminary computer analysis will be undertaken during October-November.

The planned analysis will quantify Uganda's export competitiveness for "traditional exports" destined for overseas international markets, plus "non-traditional exports" to selected P.T.A. markets for crops Uganda currently produces and appears to have strong prospects for increased intra-regional trade. The export competitiveness model will be extended to quantify net foreign exchange earnings for selected crops in selected overseas and intra-regional markets. We will also attempt to get a handle on informal border trade and determine institutional arrangements and policy reforms which could increasingly capture existing informal border trade, and thus expand trade through the Preferential Trade Area (PTA), to improve Uganda's balance of payments position.

In addition, we will address the potential "trade diversion problem" with the aim to back-up our view and that of local experts and policy makers that increased trade through the P.T.A. offers Uganda an effective mechanism for expanding the domestic market, trade creation and significant net foreign exchange earnings at low opportunity costs. We will also attempt to measure the relative cost advantages of imports through the P.T.A., versus sources outside the East Africa region.

From the Professor's study we will be able to describe and include in the PAAD a comprehensive chapter(s) on both export and import trade from a historical perspective up through and including 1986. Included in the data will be information on (1) commodities, quantities and values, (2) patterns of trade, and (3) the relative importance of intra-regional trade. In addition, data will be presented on Uganda's balance of payments record, including the critical factors influencing the balance of payments and the prospects for improvement, in part as a result of the proposed AEPRP.

We anticipate that the Ochieng study and the export competitiveness analysis, continued interaction with GOU policy makers and additional information we will acquire from private and public sector importers and exporters will flesh-out our analysis to date and provide a more comprehensive and coherent argument for A.I.D. support to encourage Uganda to become more actively and effectively involved in intra-regional trade.

B. <u>Personnel</u>

The design of the PAAD will be the overall responsibility of the Missions Program Economist with considerable assistance provided by our Agricultural Economist. In addition, we will utilize the current study being conducted by Dr. Ochieng, plus we will continue to interact with him and seek this professional advice.

During the design of the PAAD we will work closely with the Minister of Regional Cooperation and Development and his staff, plus other senior government officials and private sector representatives as appropriate.

We have requested the assistance of a REDSO Economist and plan to also request a 2 week TDY of the Africa Bureau's Senior Economist. If Dr. Jerry Wolgin is unable to visit Uganda during the preparation of the PAAD we will seek his advice on an equally suitable alternate.

C. <u>Time Frame</u>

Our initial proposal is expected to be available for

AID/W study and review during the first or second week of October. It is our hope that a formal review of the PAID will be held during the last week of October 1987. We would expect AID/W reaction and guidance for the preparation of a PAAD would soon follow.

Assuming this time table is realistic, the Mission would immediately start to prepare the PAAD with the view to submitting it to AID/W NLT February 15, 1988.

D. AID/W Guidance

The Mission hopes to receive a critical review of our proposal from AID/W. From such a review, important issues and guidance can be obtained and addressed during the preparation of the planned PAAD.

The Mission is fully cognizant of the fact that our proposal is unconventional and could generate several concerns and critical issues which will guide the Mission in its thinking, analysis and preparation of the PAAD. We will welcome such a critical review and be guided by it during our ultimate AEPRP design and documentation.

Appendix A: Intra-Regional Trade Study

STATEMENT OF WORK: Prof. E.O. Ochieng

Undertake A study To:

(1) Describe the structure of the economy of Uganda with relevance to external trade.

(2) Identify and describe Uganda's potential to increase the production of tradeables in agricultural primary products and agro-industrial goods.

(3) Describe Uganda's export and import structure: past, present and prospective.

(4) Describe P.T.A. countries' export and import structure: past, present and prospective.

(5) Describe the directions of trade among the P.T.A. countries.

(6) Identify, describe and evaluate Uganda's record with the P.T.A. clearing account.

(7) In the light of 2, 3, 4 and 5, evaluate Uganda's trade potential with P.T.A. countries.

(8) Identify, describe and evaluate the constraints to increasing Uganda's intra-regional trade including lessons to be learned from border trade (smuggling).

(9) Suggest proposals to deal with the constraints to, and promote Uganda's intra-regional trade.

(10) Identify the extent to which increased trade, through the P.T.A. creates a potential trade diversion problem--loss of foreign exchange earnings.

The researcher/analyst involved in this study is engaged for sixty persons days over a three-month period. The final product is expected to be a report of professional standard with appropriate statistical appendices.