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ISSUES PAPER FOR ECPR

Country:	Uganda
Program:	Economic Policy Reform PAIP
Proposed LOP Funding:	$15 million
Proposed FY 88 Obligation:	$15 million
Authorization Venue:	AID/W

BACKGROUND

The PAIP describes the economic policy reform measures adopted by the Government of Uganda (GOU) in May 1987. It proposes a $15 million AEPRP grant to Uganda to encourage the reform process.

In the Mission's judgment, increasing exports is vital to sustained economic recovery. The objective of the AEPRP grant is to help Uganda increase exports. This will occur by importing the necessary goods and technology required to produce agricultural commodities for which Uganda has a comparative advantage. The AEPRP will also assist Ugandan policy makers in developing an export strategy and fostering viable trade programs.

It is proposed that $11.5 million be provided as a cash transfer to the Bank of Uganda. These funds will finance an eligible list of imports through the Preferential Trade Area (P.T.A.). The $11.5 million will be disbursed in tranches averaging roughly $2.25 million every 75 days to settle what Uganda owes in foreign exchange through the P.T.A. Clearing House Account. Another $3.5 million will be used for marketing and trade studies to help strengthen Uganda's trade performance. Local currency generations will support the production, marketing and export of agricultural commodities. AEPRP conditionality will be prepared at the PAAD stage. Most of the possible items listed for conditionality are linked to expansion of Uganda's export trade sector.

ISSUES

An issues meeting was held on October 21, 1987, chaired by AFR/PD/EAP Chief Tom Lofgren. The meeting was attended by representatives from AFR/PD, AFR/DP, AFR/TR, AFR/EA, AFR/PRE, GC/AFR, PPC/EA, and State/EB. The consensus among those present was that an AEPRP for Uganda is worthy of support. A program directed at encouraging policy adjustments to stimulate exports would be an appropriate use of AEPRP funds.

However, several issues relating to program design were raised. These issues were discussed during follow-on meetings with the USAID/Uganda Assistant Director on October 26 and 27, 1987. Based on these discussions, the Committee recommends that the Mission proceed with development of a PAAD pending resolution of the following issues.

1. Issue: What policy or policies are to be reformed?

There is no clear description about the nature of policy constraints to increased regional trade, and what policy changes will be sought through the AEPRP.

Recommendation: The PAAD must address the major problems associated with expanding intra-regional trade and how the suggested assistance will deal with them. Conditionality should be geared to those economic reforms deemed most crucial in the areas of domestic trade and export policy.

2. Issue: Does it make sense to link the AEPRP to the P.T.A.?

Many question whether the P.T.A. is a viable operational mechanism for increasing Uganda's intra-regional trade. The PAIP does not demonstrate that the P.T.A. is an effective trade regime. Since official exchange rates are employed, it is unlikely that the P.T.A. will be useful for Ugandan exporters so long as the Ugandan shilling is overvalued. Finally, the PAIP does not show how promoting intra-regional trade is more advantageous than promoting trade in general.

Recommendation: The mission should reconsider the efficacy of linking the AEPRP to the P.T.A. The PAAD should contain a more thorough justification for linking the AEPRP to intra-regional trade and why it is necessary to rely upon any single trade regime.

3. Issue: Is the use of $3.5 million for marketing and trade studies appropriate?

The PAIP does not provide specify why $3.5 million for studies is needed. Are these activities essential to successful attainment of the AEPRP's goal? What specifically are the funds to be used for?

Recommendation: The PAAD should contain a more thorough justification for the studies, a description of the major activities to be undertaken, and a budget which substantiates the need for any particular dollar amount requested.

Other concerns raised during the review meetings are summarized below.

1. Relationship to Uganda Concepts Paper

Page 45 of the PAIP states that "The Mission intends to make trade a central focus of our development assistance strategy." How does this fit in with program set forth in the Uganda Concepts paper? Does trade have to be a "central focus" of our development strategy for a successful AEPRP to be developed in Uganda? The PAAD should describe the relationship between the AEPRP's trade focus and the goals and objectives set forth in the Uganda Concepts Paper.

2. Disbursement Schedule

How likely is it that the GOU will need $2.5 million after each 75 day period to clear its accounts? Is this the disbursement schedule the mission is proposing? The PAAD should provide a more refined schedule for disbursements.

3. Evaluations

In the description of the $3.5 million for studies, the PAIP makes no mention of evaluations or assessments. A monitoring and evaluation plan should be designed, incorporated in, and funded through the AEPRP.

4. Local Currency Generations

An illustrative list of potential uses for local currency generations is provided on pp. 47 and 48 of the PAIP. The PAAD should provide a thorough description of how much local currency the AEPRP is likely to generate, how the funds are to be used (presumably to further encourage exports), along with a prospective budget.

5. Legal Questions

Can dollar disbursements be structured to clear Uganda's PTA account without triggering statutory requirements related to commodity procurement?

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UGANDA AEPRP PAIP SUPPLEMENT

UGANDA: Restrictions to Increasing Formal Intraregional Trade

A. Policy Oriented

(1) Monopoly of the Produce Marketing Board in the export of nontraditional exports.

(2) Divergence between the official and parallel foreign exchange rates.

(3) Too many government institutions involved in the issuance of export and import licences, resulting in exorbitant transactions costs.

(4) Lack of a comprehensive export strategy to guide and facilitate export trade.

(5) Heavy reliance on formal, public sector barter trade to increase exports in the shortrun.

B. Other

(1) Inadequate foreign exchange supplies to finance private sector imports.

(2) Incomplete knowledge of demand schedules in regional markets.

(3) Lack of knowledge among private businessmen (importers and exporters) on how the P.T.A. works.

(4) Lack of grades and standards to crack into the more discriminating markets.

(5) Projected shortrun production surpluses of nontraditional exports.

C. Proposed A.I.D. Response

Policy reform agenda:

Goal: Liberalize domestic marketing and export trade to increase the role of the private sector.

Specific reforms --

(1) Eliminate the export monopoly of the Produce Marketing Board

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(2) Reduce the number of entities involved in the issuance of export licenses.

(3) Increase access of private sector importers to foreign exchange.

(4) Achieve continued movement on the exchange rate, and

(5) Up-date and adjust producer floor prices.

<u>Outline of the 1987 Reform Program</u>

The policy agenda of the Government's Rehabilitation and Development Plan (Economic Recovery Program) entails measures designed to restore stability in the economy, and policies to revitalize the economic recovery process and set the stage for sustained growth. The main components of this program were developed in collaboration with the IBRD and IMF in the context of a "Policy Framework Paper."

The objectives of the Economic Recovery Program, formally 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; (4) restore desicipline, accountability and efficiency in the public sector; and (5) improve public sector resource moblilization 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 the dollar, to 60 (new) shillings to one US dollar;

(3) A 30 percent currency conversion tax applicable to all cash holdings by the public; demand, savings and time deposits of households and business; all treasury bills and Government

stocks held by the public; and commercial bank cash balances with the Central Bank;

(4) An increase of 182 percent in the producer prices for robusta coffee, 158 percent for arabica coffee, 375 percent for seed cotton, 280 percent for flue cured tobacco, 257 percent for fire cured tobacco, and 257 percent for green leaf tea;

(5) Subsequent increases in producer prices of the five foodcrops targeted for export, ranging between 130 to 230 percent for beans, maize, sesame, goundnuts 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 take in the coming months: the setting up of an Open General Licensing (OGL) system for foreign exchange allocations and of a credit facility for local cover to finance imports, as well as implementing fiscal and monetary policies consistent with the objective of stabilization.

The policies announced by the Government have been designed to accomplish a rapid return to economic stability. The Government believes that the rate of inflation must come down quickly to enable markets and prices to play their allocative role. 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 of the economy. In the short run, the Government expects a significant supply response from improved producer prices in the agricultural sector, and increased capacity utilization in marketing sector. Experience from the 1981-1984 period, when the economy rebounded from prolonged contraction, supports this expectation. To sustain the expected recovery, the rehabilitation of basic infrastructure, as well as the rehabilitation of productive capacity is essential.

Macroeconomic Policies

Macroeconomic policy in Uganda is dominated by short-term problems of stabilization. Stabilization is a necessary first step towards the creation of a policy environment conducive to rapid growth with an equitable distribution of benefits. The Government's recent initiatives, and the complementary policies to be pursued, are aimed at stabilizing the economy over the next 18 months. The following are principal objectives and/or provisions in the GOU's new economic policy program:

- restrict the expansion in money supply to control the growth in nominal aggregate demand;
- release credit resources (from reduced credit to the government) for the expansion of the private sector;
- price incentives to agricultural producers to expand exports, and to help finance critically needed imported agricultural inputs;
- restoration of financial descipline with price stability;
- reducing the fiscal deficit without recourse to monetary expansion, with an overal FY budget deficit limited to 4.5 percent of GDP;
- increased coffee export duty, plus and expected improvement in general tax collection and administration;
- reduction in recurrent expenditure from 7.3 percent of GDP in FY 87; to be achieved from a projected recovery in real GDP growth;
- reducing defense expenditure in real terms in the FY 87 budget;
- recurrent revenues are expected to grow more rapidly than recurrent expenditures, reversing the trend of net negative savings by the public sector (approaching 4 percent of GDP in FY 87);
- reducing inflation while increasing output is a fundamental goal of short-run economic policy;

inflation is expected to decline from an annual rate of 250 percent in FY 86 to about 90 percent in FY 87 and to less than 30 percent in FY 88;

- as a priority, establishing and maintaining a realistic exchange rate; the exchange rate system is to be achored on appropriate monetary policies and strict fiscal discipline;

- the GOU is introducing a limited open general licensing system, under which import licenses and foreign exchange will be provided freely upon request; currently exchange is administratively allocated.

- gradually liberalize the marketing and export arrangements for agricultural commodities; when economic conditions improve the GOU intends to allow private exporters to export;

- emphasis is being given to the provision of imported inputs to rehabilitate both agricultural and industrial enterprises;

- continue to pursue a policy whereby domestic prices are market determined; and

- with donor support, major efforts are currently underway to improve road conditions and maintenance capacity.

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