Uganda and Post-Conflict Recovery: 1987 (A)

Francis Unyofu sat back in his office chair and stared at the dilapidated ceiling. He had not thought life in the government would be quite like this. But fifteen years of political and economic chaos could not be erased in just one year. And there were certainly higher priorities than renovating this government office. At least there was peace now -- well, in most parts of the country -- so Uganda could try to return to some form of normalcy.

At independence in October 1962 there was little indication that Uganda was headed for such privations. Independence came without a struggle: the British set a timetable for their withdrawal and stuck to it. In Uganda it was the Ugandans, not the Europeans, who grew the cotton and coffee that brought a higher living standard, financed the education of their children, and led to increased expectations for the future. There was an impressive number of educated and prosperous middle-class professionals, the prestigious national Makere University, and a gleaming new teaching hospital at Mulago. At independence, Uganda looked optimistically at the future. Now, 25 years later, it is just looking to rebuild.

It is January 1987, one year after Yoweri Museveni led the National Resistance Army (NRA) to power. The past year was spent bringing an inclusive coalition together and debating the country's economic and political future. These were exciting times in the capital, Kampala. But the time for debate is past. The people are getting edgy: there are long queues for consumer goods, unemployment is so high it is not even counted and many factories are not operating. Yes, the time for debate is past. It is now time for a concrete economic proposal, and it is up to Francis Unyofu, the advisor to the new Finance Minister, to draw it up. The Finance Minister, Dr Crispus Kiyonga, was quite clear in his orders to Francis: devise a strategy to increase economic activity while maintaining macroeconomic stability.

This case is the first of three created by Frank Warnock and Patrick Conway of the University of North Carolina at Chapel Hill on the subject of Ugandan economic growth. Thanks to Phillip English and Jorge Araujo for useful comments on its content.

Background

Uganda is blessed with a pleasant climate and excellent growing conditions. Situated at the equator, rain is much more regular than in other African countries; only in the northern lower areas is the climate hot, dry and less suitable for cultivation. The territory is about the size of Ghana (197,000 square kilometers) and is landlocked. Its neighbors are Kenya, Sudan, the former Zaire, Tanzania and Rwanda. The nearest seaport is in Mombasa, Kenya, 1300 kilometers by rail from Kampala. Uganda is overwhelmingly rural: government estimates from 1986 show that of its 15.1 million inhabitants, only 458,000 live in Kampala. Jinja, the next largest city, has 45,000 inhabitants.
There are 28 tribal groups in Uganda (see map for major ethnic groups). The major ethnic division is between the mainly pastoral Nilotic tribes of the north such as the Acholi and the Lango, and the mainly agricultural Bantu tribes of the south, the largest being the Baganda. Historically the southern Bantu tribes were more culturally developed than the northern Nilotes, who were more warlike and aggressive. The British capitalized on this distinction by recruiting its security forces from the northern tribes. This initiated a military domination of the south by the north which lasted from before independence until 1986, when the predominately Bantu-based NRA seized power.

In addition to the traditional tribal divisions there exist powerful religious divisions. Two-thirds of the population is Christian, evenly split between Roman Catholics and Protestants, while 15 percent is Muslim. Membership of the religious communities often cut across tribal divisions. For example, at independence the main political parties were the Kabaka Yekka (KY), which was mainly Protestant and Bagandan, the United People's Congress (UPC), which was Protestant but non-Bagandan, and the Democratic (DP), which was Bagandan and mainly Roman Catholic.

Pre-Independence Economy*

At independence, and throughout the 1960s, Uganda had one of the most vigorous and promising economies in Sub-Saharan Africa (SSA). It relied overwhelmingly on agriculture, which accounted for almost two-thirds of GDP and 90 percent of exports in 1960. The manufacturing sector, although small, was growing and supplied the economy with basic inputs and consumer goods. The transportation system, which included an effective network of roads, railways, port and air transport, was widely regarded as one of the best in SSA. There were both rail and road connections with the seaport of Mombasa, airport connections between the more important Ugandan towns and the other East African territories (Kenya and Tanganyika), a modern international airport at Entebbe, and steamer services on the lakes and the River Nile. There was in

* All tables supporting the data discussed in this text are in Appendix A. Much of the data is presented for years representing the various regimes since 1960: pre-independence (1960), Obote I (1965), Amin (1971 and 1977), Obote II (1981) and Museveni (1986).

addition a large subsistence sector. This non-monetized sector comprised almost one-third of the economic activity, and much of the population remained outside the formal economy.

Uganda's two biggest cash crops, cotton and coffee, made up 76 percent of its exports. Some of the world's best quality tea was grown on a few large Asian-owned estates. Valuable minerals, notably copper, had been discovered, and water power resources were substantial. Export earnings not only financed the country's import requirements but also resulted in a current account surplus.

Prior to independence, the major destinations of Ugandan exports were India (20 percent of total exports, mostly cotton), Britain (16 percent, mainly cotton and coffee), the United States (15 percent, all coffee) and Kenya (12 percent, sugar and a variety of products). Ugandan imports were primarily manufactures from the UK (19 percent of total imports) and Japan (9 percent). Imports from Kenya were also significant, representing 24 percent of total imports.

At independence Uganda was a member of the East African Currency Board along with Kenya and Tanganyika. The currency board was the sole issuer of notes and coins, and the East African shilling was at par with the United Kingdom shilling. Inflationary financing of fiscal deficits was not an option and pre-independence fiscal deficits were correspondingly small, amounting to 0.1 percent of GDP in 1960.

Uganda’s relative affluence had been translated into strong governmental social welfare services. The country’s health sector had developed into one of Africa’s most extensive, and had pioneered health and nutrition programs for low-income citizens. Primary and secondary education was characterized by a pupil-teacher ratio 25 percent below the African average in 1960.

While prospects were bright at independence, some seeds of economic mismanagement were already planted. The colonial government strictly regulated the buying and selling of the major cash crops through marketing boards. At first the marketing boards were set up as a way to unify sales to Allied wartime supply agencies and provide some insurance to growers against fluctuating prices. However, later, as coffee and cotton prices rose on the world markets, the marketing boards did not raise the prices they paid to the farmers. As substantial surplus funds accumulated, considerable transfers were made to the central government for direct budget support. Steep export taxes were also imposed, particularly on cotton. And thus the producers of cash crops began to finance government expenditures.

Political and economic history: Independence through 1985

When Uganda became independent on October 9, 1962, Dr Milton Obote, a Protestant northerner of the Lango tribe, was the first Prime Minister. Obote packed his government and army with ethnic and religious compatriots. Dissent from the southern Bantu tribes was brutally repressed, and in March 1968 Obote suspended the constitution and assumed all powers of government.

The economy did relatively well in the 1960s, as real GDP growth averaged 4.8 percent per year from 1965 to 1970. Cash crop production was quite strong, with 1965 coffee and cotton production at 218,000 tons and 243,000 tons, respectively. Copper production was at a historical high in the late 1960s at over 16,000 tons per year. The manufacturing sector was small but growing, reaching 6 percent of GDP by 1965 and 7.3 percent by 1971.

In 1966 the Bank of Uganda became the Central Bank. It promptly withdrew from the East African Currency Board and issued a new currency, the Ugandan shilling, which remained at par with the UK shilling until 1973. The bank also took over exchange control and the function of controlling commercial banks through credit control. In this way the government could decide who would get foreign exchange and who had access to bank credit. Central government borrowing to finance fiscal deficits began increasingly to crowd out private borrowing, and the annual rate of growth of domestic credit quickly increased from nearly zero in the early 1960s to over 20 percent by 1967.

In 1971 General Idi Amin, a member of a northern Nilotic tribe called the Kakwa, staged a successful coup and went on to brutalize the country with a surge of tribal massacres and political killings. Amin carried out murderous acts in particular on Obote's Lango tribe and their neighbors the Acholi, and maintained a constant persecution of Christians. After rediscovering his Islamic heritage in an effort to secure aid from Libya and Saudi Arabia, Amin promptly reduced Uganda's Muslim population by expelling almost all of Uganda's 70,000 Asians of Indian and Pakistani decent. The Asians, who had been very active in agribusiness, manufacturing and commerce, were forced to leave behind their businesses and belongings. But they could have faced a worse fate: in the eight years under Amin's rule, an estimated 300,000 people were killed.

The once vibrant economy collapsed during Amin's reign. Real GDP growth averaged 0.2% per year in the first half of the 1970s. The second half was worse as real GDP fell an average of 3.5% per year from 1976 to 1980, while per capita incomes fell to among the lowest levels in the world.

Cash crop production suffered during the Amin regime. By 1977, cotton production had fallen to 14,000 tons, just six percent of the 1965 level. Whereas India was once the single largest destination for Ugandan products, the expulsion of Asians and reduction of cotton production effectively reduced exports to India to nil. Asians managed many of the tea estates, so tea production all but ceased as well. Coffee production also fell, but not nearly as much, as Ugandan smallholders were still able to produce even with political unrest. Copper production was just 15 percent of its 1971 level in 1977, and by 1979 copper production ceased. The manufacturing sector began to contract.

Uganda registered a substantial budget deficit for almost every year in the 1970s as military expenditures grew substantially. Deficits equivalent to over 50 percent of current revenues were not unusual: in 1974 the deficit reached 134 percent. Only in the mid-1970s, when the price of coffee skyrocketed, were the deficits relatively small. Even then the government was crowding out private investment: by the mid-1970s claims on the central government (government borrowing) were consistently near 70 percent of domestic credit. Private savings and investment were reduced to about six percent of GDP, well below the 1960s ratio of 15 percent.

Amin was forced to flee the country in 1979, and Milton Obote returned to power in 1980 in an election that was widely regarded as rigged. Obote's new army conducted savage acts of reprisal against tribes that had been loyal to Amin. For the Baganda, persecuted in Obote's first reign, it was more of the same. By 1981 guerrilla groups were forming in the bush. The largest was Yoweri Museveni's National Resistance Movement, which drew its support from the southern Bantu tribes. After five years of civil war, Obote was overthrown for a second time in July of 1985 by a group led by General Tito Okello (an Acholi). In January 1986, Museveni seized power. Okello's army retreated to the north, looting along the way.

The First Year of Museveni's Regime: 1986

Yoweri Museveni came to power in January 1986 in a devastated Uganda. The country had suffered dictatorship, tribal and regionally based violence, army lawlessness and brutal human rights abuses for most of its 23 years as an independent nation. Life expectancy was measured to be under 50 years, and was one of the worst in the world. Real government spending on health programs was only 27 percent of its level in the 1970s, and real government spending on education fell to only 9 percent of those levels.

Uganda was in economic shambles. Its roads, railways, hospitals, and schools were destroyed. Real per capita GDP was, at US$230, 60 percent of its level in 1971. Its average annual rate of growth from 1965 to 1985 was -2.6 percent, the lowest in the world for that period. The only sector that grew substantially in this period was the government. The non-monetary sector (primarily agriculture) remained resilient throughout the turmoil and in 1986 made up 40 percent of overall production. Indeed, most Ugandans relied on this subsistence sector for the basic means of survival.

Coffee, which is grown mainly by smallholders in Uganda, had fared much better during the 15 years of unrest than the largely estate-grown cotton and tea. In 1986 coffee production was at 160,000 tons or 73 percent of its 1965 level, while cotton production plummeted to only seven percent of its 1965 level. The sugar industry, which had once produced enough to satisfy domestic demand and to export to nearby countries, collapsed in the early 1980s. Copper production had virtually ceased in 1977 with the closing of the Kilembe copper mine.

The industrial sector had suffered greatly from the country's unrest and economic problems. After years of neglect and destruction, Uganda's factories were operating far below capacity: only 10 of 83 establishments surveyed by the Ministry of Planning and Economic Development in 1985 were operating at more than 30 percent of capacity, while 29 recorded no output at all. Estimates of capital-labor ratios in the mid-1980s indicate that Uganda's average capital-labor ratio was only 10 percent of that in Tanzania, and 7 percent of that in Kenya.

The lack of foreign exchange to buy spare parts and lack of functioning infrastructure were serious obstacles to industrial growth. One need only look at the dilapidated road system in and around Jinja, the nation's former industrial hub, to understand the formidable task facing manufacturers: even if they secured the foreign exchange needed to buy imported inputs, transporting their goods was nearly impossible.

The banking sector had contracted during 15 years of negative economic growth. In 1970 Uganda had 290 commercial bank branches. By 1987 there were only 84, of which 54 were branches operated by government-owned banks. And why would a Ugandan want to deposit money at a bank? With inflation over 200 percent and Central Bank-controlled interest rates around 20 percent, it was a losing proposition. Not surprisingly, Uganda's gross domestic saving and investment each represented less than 10 percent of GDP, and domestic consumption was consistently more than 100 percent of GDP.

The Ugandan shilling had not fared well. Fixed at 7 shillings to the dollar for most of its existence, it was repeatedly devalued during Obote's second regime. At first, in mid-1981, Obote let the shilling float: it immediately fell to four percent of its previous value before settling at a rate of 78 per dollar. A shortage of foreign exchange gave rise to the *kibanda* (informal and illegal) market. By the end of 1985 the official rate was 1400 shillings to the dollar, while the *kibanda* rate was almost three times higher at 4000, indicating that even at 1400 the official rate was vastly overvalued. Once at par with the Kenyan shilling, the Ugandan shilling had become virtually worthless: on the streets of Kampala one Kenyan shilling could fetch 500 Ugandan shillings.

Museveni faced a difficult transformation from guerrilla leader to the leader of a nation. He could have gone the route of previous Ugandan coups and massacred his defeated opponents, looting along the way, but instead moved to discipline his forces. Drake Ssekeba, the editor of The Star, an independent Ugandan newspaper, noted this: "Every time there is a coup in Uganda there is looting. When Museveni and his men came, there was no looting. That was one of the earliest signs that Museveni was different from those who came before him."

At his installation Museveni voiced his concern for human rights: "The people of Uganda should only die from natural causes, which are not under our control." To be sure, he continued to fight insurgent groups, mostly in the north, but offered total amnesty to those who surrendered their weapons.

In forming a government, Museveni chose a broad, national-front regime: anyone who wanted to join his party was to be accepted, even if they were enemies the day before. The coalition government was inclusive and comprised leaders from many of the movements that formed in opposition to Milton Obote.

Peace finally came to most of Uganda. The slaughter of political dissidents, and of families and children, stopped after his National Resistance Army took power. Yet by late 1986 there was a growing concern that the Museveni government was failing to provide the direction or policies needed to rebuild the country's devastated economy and improve the plight of the average Ugandan. The skills needed to conduct a successful guerrilla war are not necessarily the same as those needed to steer the country toward recovery.

The current political and economic situation: January 1987

The first year of the Museveni regime was marked by a tentativeness in governance that led, according to some, to serious misjudgements in economic policy. A senior Western financial expert noted that "agriculture is heavily, heavily discriminated against in favor of the urban consumers, traders and importers." Several economic decisions have benefitted urban consumers and have had a disastrous effect on Uganda's fiscal condition.

The new economic strategy announced in August 1986 by the finance minister, Mr Ponsiano Mulema, a professor of economics, was a disaster. Its centerpiece was a huge revaluation of the Ugandan shilling. Since May there had been two legal exchange rates: official transactions were carried out at a rate of 1400 shillings to the US dollar, all other transactions at a legal market rate of about 5000 shillings to the US dollar. There were also transactions at the informal *kibanda* market. Mr Mulema abolished the legal market rate, so all legal transactions would be at the 1400 shilling rate. Every exporter has since vowed to keep his money abroad; every would-be importer rushed to get licenses to import at the new, artificially favorable rate. The *kibanda* rate immediately shot up to 8000 shillings per US dollar. In October 1986 Mulema was replaced by Dr Crispus Kiyonga, who has a medical background.

Kiyonga has a difficult task. The government’s finances are shaky at best. In an attempt to enable Ugandan citizens to purchase imported consumer goods, the government fixes their prices below world prices. This, of course, puts considerable pressure on the government's finances: for example, in July 1986 the government imported $4.8 million of sugar to sell at subsidized prices. Similarly, government subsidies enable Ugandans to buy petrol for about 10 U.S. cents per liter, the lowest price in any country that does not produce oil.

The subsidies of imported consumer goods put pressure on the government in another way: they require foreign exchange. At independence, exports of cotton, coffee, tea, grain, copper and a few manufactures earned a substantial amount of foreign exchange. Uganda now exports only coffee. The $400 million per year in export earnings at present barely covers the $200 million debt service payments and imports of oil, sugar and spare parts for the army.

With the non-monetary sector representing almost 40 percent of economic activity, the collection of income taxes is a formidable problem, which forces the government to turn again to the coffee producers. Export taxes on coffee provide over 50 percent of the government's revenue. Moreover, the government controls the marketing of coffee through the Uganda Coffee Marketing Board (CMB). The international price of Ugandan coffee has increased almost 50 percent since its 1980 lows, but it has been the government, not coffee growers, that has benefitted. The CMB periodically increases the prices it pays growers, but in practice the currency depreciation wipes out any increased purchasing power: increases in official CMB prices consistently bring the price paid to producers back up to 10 percent of the world price (computed at the *kibanda* exchange rate).

Coffee grows in Uganda even if it is neglected, but farmers pick the beans only if they are paid to. Some farmers sidestep the CMB by smuggling their coffee into Kenya or Rwanda, for sale at the average world price of about $1.80 a pound. Bananas, which grow freely on the smallholder coffee estates, give coffee growers another choice: they can pick bananas, a stalk of which fetches, in Ugandan shillings, at least seven times as much as a pound of coffee.

Smuggling has become a way of life in Uganda, and not only for coffee farmers. Price controls on consumer goods, along with the controlled official exchange rate, offer smugglers profitable opportunities. A small-time Ugandan smuggler can buy 20 liters of petrol for $2, strap it to his bicycle and cross the border to Kenya or Rwanda and sell it for $20. Back in Uganda, he can sell the foreign exchange at the *kibanda* rate of 16,000 shillings to the dollar, reaping a net one-day profit of 288,000 shillings. By comparison, a government minister's *monthly* salary is about 90,000 shillings. The minimum monthly wage is 10,000 shillings, not enough to buy a stem of bananas or two pounds of sugar.

The manufacturing sector is hampered by its own foreign exchange problem: imported parts and machinery are required to rehabilitate existing factories, but the foreign exchange to purchase those is unavailable. There is also a great need for skilled workers

-- specifically, engineers and repair people -- and people with management experience. Moreover, a substantial portion of the manufacturing sector is based on processing agricultural products; the problems plaguing the agriculture sector hamper industrial production as well.

Overseas companies seem interested in investing in Uganda but are still quite cautious. The memories of the expulsion of the Asian business community hold some companies back. The government is trying to attract foreign investment by publicly welcoming it, but in practice overseas companies are finding ambivalent attitudes among individual government officials, who give different impressions based on their own viewpoints.

Uganda's relationships with its neighbors are not as smooth as in the past. Political and economic strains caused the demise of the East African Community (EAC) in 1977. Uganda's relationship with Kenya deteriorated further in 1986 as each country alleged the other had been providing support for opposition groups. In the west and north, the movement of ethnic groups across the boundaries with Rwanda, Zaire and Sudan has been a source of friction. Relations with Tanzania have remained good, although its economy is in poor shape as well.

Ugandans believe in Museveni, but their patience is wearing thin. "Rehabilitation by the government is very slow," says the Reverend Wilson Sentongo, waiting for rations of food and other supplies. "We do not know what their plan is. They are telling us to tolerate things. Museveni has sympathy for us, we know, but the problem is supplies are not here and we need help."

Members of the government and many other Ugandans are deeply divided over the course the economy should take. Exchange rate policy and government price controls are the two main issues; the August 1986 budget already cut back fiscal spending. The World Bank and other donors are pushing strenuously for exchange market reform, but Museveni is determined not to let them dictate Ugandan policy. At the same time, Museveni is a pragmatist who wants to do what is best for Uganda.

Policy decision

A presidential economic council has been set up to coordinate all aspects of national economic planning and investment. The council is advisory to the president and includes Dr Kiyonga, the ministers of marketing and commerce and the governor of the Bank of Uganda. Museveni has stressed that he wants economic activity to reattain pre-independence levels. As an economic advisor to Dr Kiyonga, Francis Unyofu must draw up a strategy to increase economic activity without compromising macroeconomic stability.

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Sources

Francis Unyofu is a creation of the authors, but the other details of the Ugandan history are factual. Rather than interrupt the narrative throughout we credit in this section those sources from whom substantial information has been drawn. More detailed citations are available, when needed, from the authors.

Background - drawn from Library of Congress (1992).
Pre-Independence Economy - drawn from IBRD (1962).
Political and economic history: Independence through 1985 - drawn mainly from EIU quarterly Country Reports and annual Country Profiles.
The First Year of Museveni's Regime: 1986 - drawn from EIU Country Profile, Library of Congress (1992) and various articles that appeared in the New York Times, the Economist and the Financial Times, with precise citations available from the author.
The current political and economic situation: January 1987 - drawn from EIU Country Profile and various articles that appeared in the New York Times, the Economist and the Financial Times.

Appendix A.