



IFAD
INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT
Executive Board — Sixty-Sixth Session
Rome, 28-29 April 1999

REPUBLIC OF UGANDA

PRESIDENT'S MEMORANDUM

USE OF SAVINGS

FOR THE

COTTON SUB-SECTOR DEVELOPMENT PROJECT (LOAN 360-UG)



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A. Background

1. The Cotton Sub-sector Development Project (CSDP) was approved by the Executive Board at its Fifty-First Session in April 1994. Of the USD 31.4 million project cost, IFAD assistance totals USD 12.5 million, with the International Development Association (IDA) providing USD 14.0 million, the Cotton Development Organization (CDO) USD 3.0 million and the Government of Uganda USD 1.9 million.

2. The project was conceived as a vehicle for implementing the Government's strategy to revive the cotton industry. The targeting of cotton — a crop cultivated predominantly by smallholders — is in line with IFAD's strategy to support the diversification of Uganda's export base. CSDP was designed to build on the achievements of the closed (1993-96) Smallholders Cotton Rehabilitation Project (SCRIP, IFAD Loan No. 316-UG) whose activities focused on breeding, selection, testing and release of improved cotton varieties; variety purification and multiplication of released cultivars to ensure adequacy of good-quality planting seed; promotion of animal traction as a means of expanding the land area under cotton cultivation; and integrated pest management aimed at lowering the cost of pest and disease control. CSDP has national coverage, including but not limited to the 21 major cotton-growing districts of Apac, Arua, Gulu, Hoima, Iganga, Kamuli, Kasese, Kibaale, Kitgum, Kitodo, Kumi, Lira, Luwero, Masindi, Moroto, Mbale, Mukono, Nebbi, Pallisa, Soroti and Tororo.

3. CSDP has three components:

- (a) restructuring of the cotton industry, including the regulatory framework, policy coordination and monitoring, transformation of cooperative union-owned ginneries into creditworthy operations, and ginnery management and training.
- (b) strengthening cotton support services, especially those related to research (building on the achievements of SCRIP), and extension in Arua, Kamuli and Kasese (districts not covered under the closed IDA-assisted Agricultural Extension Project, 1993-98); and
- (c) seed multiplication and distribution; provision of credit lines for short-term production inputs and medium-term restocking of livestock through the acquisition of oxen, heifers and bulls ("credit fund"); and strengthening of credit delivery mechanisms.

4. While IDA finances components (a) and (b) of the project, IFAD supports component (c) with a loan of SDR 8.95 million (equivalent to USD 12.5 million at the time of loan finalization). Of the IFAD loan, a credit fund of SDR 6.24 million was established and operated as a revolving fund. The Loan Agreement between IFAD and the Government was signed on 26 July 1994 and became effective on 18 November 1994. The loan closing date is 31 December 1999. The cooperating institution for the project is IDA.



B. Implementation Progress and Achievements

5. Project performance has been generally satisfactory:
- (a) At the last project supervision in February 1999, 46 of the 49 ginneries (94%) had been transferred to creditworthy operators through outright sales, joint ventures, leases and/or restructuring by cooperative unions. The subsector has attracted significant private sector investment, both local and foreign, which has financed the rehabilitation of existing ginneries and the construction of new ginneries throughout the cotton-growing area. At present, the industry has an excess ginning capacity estimated at over 400 000 bales; current capacity utilization is about 150 000 bales.
 - (b) An effective regulatory framework is in place for the cotton industry, primarily through the development and operationalization of a legal framework and the establishment of a regulatory institution (i.e. CDO).
 - (c) Taking advantage of purified 'SATU-95', 'BPA-95' and other improved cotton cultivars developed under SCRP and the systematic build-up of quantities of certified planting seed, CSDP activities have prompted a substantial increase in lint production, from about 10 000 bales per annum prior to project intervention to over 150 000 bales today — primarily through improved seed purity and quality, increased use of production inputs and improved husbandry practices. With the increasing output of good-quality cotton, Uganda has been able to re-enter the world cotton market.
 - (d) Positive progress also has been made in capacity-building for selected microfinance intermediaries, which are likely to have a crucial role in the foreseeable future for the delivery of financial services in rural areas, especially for short-term investments and trade.
 - (e) Of the SDR 6.24 million credit fund under the IFAD loan, about SDR 4.39 million has been disbursed in short-term loans primarily to individual ginners, the Ginners and Cotton Exporters Associations and the CDO for the procurement and distribution of production inputs, notably planting seeds and agrochemicals. The balance of SDR 1.85 million is expected to remain uncommitted and unspent by the loan closing date because of lower-than-anticipated demand for medium-term credit for livestock restocking and investment in farm enterprises in cotton-growing areas.
6. Overall, CSDP has had an increasingly positive effect on smallholder producers, especially in the northern and north-eastern areas of the country where investment in the cotton industry remains the only major viable option in the national effort to alleviate poverty. The performance of project activities over the remaining period of implementation and beyond will be determined largely by how deep and sustaining subsector reforms prove to be, the extent of further improvement in cotton husbandry, particularly in terms of pest/disease control, and the effectiveness of the institutions responsible for technology dissemination, provision of rural financial services and coordination of smallholder participation in the cotton industry. The forthcoming disbandment of the Directorate of Agricultural Extension of the Ministry of Agriculture, Animal Industry and Fisheries (July 1998) and the assignment of national responsibility for coordination of technology dissemination to the National Agricultural Research Organisation (NARO), in addition to technology generation, make it crucial to support the national research and extension system in its challenging task. Similarly, with the recent completion of the IDA-assisted Agricultural Research and Extension Projects (1993-99), there is urgent need to continue support for research and extension activities, pending the finalization of follow-on interventions.



C. Loan Savings and Proposal for Use

7. IDA-led supervision missions of CSDP in July 1998 and February 1999, in collaboration with the Government, estimated that the SDR 4.39 million already disbursed/committed under the revolving credit fund will be adequate and available for subsequent delivery of credit in support of cotton production. In effect, at loan closing there will remain an unused balance of SDR 1.85 million (approximately USD 2.5 million) saved from the credit fund, and SDR 2.2 million (about USD 3.1 million) under the entire IFAD loan account. Both missions recommended the reallocation of these savings to finance priority areas where activities need to be continued, intensified and expanded for the remaining period of the loan. It is on the basis of this anticipated saving of SDR 2.2 million that the Government made a formal request to utilize this amount to support other ongoing project activities — a request fully supported by IFAD and by IDA as the cooperating institution.

8. The proposed reallocation of SDR 2.2 million saved from the CSDP loan account involves:

- (a) SDR 580 000 to support the continuation of on-farm testing of improved cotton cultivars, integrated pest management, animal traction and other cotton research activities under the coordination of NARO. The aim is to enable the national research system to further refine and test improved technological packages, using the facilities of zonal agricultural research and outreach centres;
- (b) SDR 270 000 in bridging funds for ongoing district-level extension and outreach coordinated by NARO in recognition of the crucial importance of technology transfer and dissemination (in view of completion of the IDA-assisted Agricultural Extension Project);
- (c) SDR 510 000 for intensification of cotton-specific outreach and technology dissemination coordinated by NARO and linked to research activities at the zonal agricultural research and outreach centres;
- (d) SDR 430 000 for continued monitoring, surveys and data analyses of cotton production and related cotton industry activities under the coordination of CDO;
- (e) SDR 190 000 for overall CSDP coordination, impact assessment, and follow-up on ginnery restructuring by the Agricultural Policy Secretariat; and
- (f) SDR 220 000 to remain unallocated for contingency purposes.

D. Recommendation

9. The need for Executive Board consideration of the requested use of the savings is based on the expanded scope of activities to be financed under the project relative to the original approval. Considering that the SDR 4.39 million already committed as revolving credit funds will be adequate to support the continued provision of short-term production credit in aid of smallholder cotton farmers, I recommend that the anticipated savings of SDR 2.2 million which will remain undisbursed at loan closing be reallocated in support of other priority project activities, particularly to intensify efforts to implement cotton research, technology dissemination and adoption, and monitor and coordinate supervision. Except for those necessary changes to reflect the proposed use of savings, the terms and conditions specified in the Loan Agreement dated 26 July 1994 will remain the same.