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June 29, 2011

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**Uganda:** Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

June 15, 2011

The following item is a Letter of Intent of the government of Uganda, which describes the policies that Uganda intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Uganda, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

**LETTER OF INTENT**

June 15, 2011

Mr. John Lipsky
Acting Managing Director
International Monetary Fund
Washington, DC 20431

Dear Mr. Lipsky:

On behalf of the Government of Uganda, I would like to provide you with an update on the progress we have made under our program backed by the IMF's Policy Support Instrument (PSI).

As you know, the Executive Board of the IMF was not able to complete the first review under the PSI. However, I am pleased to inform you that we have taken measures since that time to address the concerns of the Executive Board, and we remain fully committed to the policy objectives the PSI aims to support.

Growth has rebounded, notwithstanding some new challenges. The recovery in economic activity has been particularly strong in service and trading sectors. However, inflation has picked up, owing mainly to higher international fuel prices and to a spike in food prices within Uganda that relate to drought conditions and to robust demand for Ugandan food products from our neighbors. I wish to note that—as was the case during the 2008 round of higher food prices—Uganda has refrained from taking any steps to limit food exports to keep domestic prices low. We aim to be the breadbasket of East Africa, and are deeply committed to maintaining a liberal trade regime in the region.

We missed two of the six assessment criteria at end-December 2010 (net international reserves and net domestic assets), and request waivers for the nonobservance of these two targets. These targets were missed because some of the exceptional spending, which we had expected to take place in the second half of the fiscal year, actually had to be effected in December. While regrettable, this shift in the timing of payments had no impact on the full year cost of the exceptional spending. Looking ahead, we request the establishment of quantitative assessment criteria for end-June 2011 and end-December 2011, as set out in the attached Memorandum of Economic and Financial Policies (MEFP) and the Technical Memorandum of Understanding (TMU) that is a part of the MEFP.

The MEFP sets out the Government's objectives and policies for the coming financial year. These are drawn from our National Development Plan (NDP), and emphasize the importance of scaling up infrastructure development to clear the most critical bottlenecks to growth and poverty reduction. The government is taking measures to tighten fiscal and monetary policies in the short run to contain inflationary pressures, and to strengthen the macroeconomic policy framework for the medium-term, to enable the scaling up of infrastructure spending while rebuilding gross international reserves in line with the PSI objectives.

The Government believes the policies set forth in the MEFP are fully sufficient to achieve the objectives of our PSI-supported program, but we as always stand ready to take any further measures that may become appropriate for this purpose. We intend to work with the IMF and other development partners in the implementation of our program, and will consult with Fund staff in advance should revisions to the policies contained in the PSI be contemplated by Government.

Sincerely yours,

*/s/*

Ms. Maria Kiwanuka
Minister of Finance
Ministry of Finance, Planning and Economic Development

cc: Governor Emmanuel Tumusiime-Mutebile, Bank of Uganda

## Attachment I. Memorandum of Economic and Financial Policies
## June 15, 2011

### I. Introduction

1. Peaceful elections were successfully conducted on February 18, 2011, providing President Museveni and the ruling National Resistance Movement with a strong mandate for the coming five years. A key element of the new mandate will be to implement the National Development Plan (NDP), particularly the effort to begin closing the infrastructure gap without losing sight of our immediate poverty reduction objectives.

*Purpose of the MEFP*

2. This memorandum updates Uganda's economic program under the three-year Policy Support Instrument (PSI) for the period 2010-13, approved by the IMF Executive Board on May 12, 2010. The first review of the PSI was not completed. However, the authorities have taken the necessary steps to address the issues which prevented the completion of the first review and request that the Executive Board completes the second review.

3. This memorandum outlines the performance of the economy to date during the 2010/11 fiscal year and the expected outturns for the remainder of the year. It also discusses policies and projections for the 2011/12 fiscal year and the medium term.

*Performance under the PSI*

4. As noted in the Letter of Intent above, four of the six quantitative assessment criteria for December 31, 2010 were met. The exceptions were the net international reserves and the net domestic assets of the central bank, which were missed only because government foreign exchange expenditures were effected in the first half of the fiscal year instead of the second half as had been envisaged when the assessment criteria were drawn up. One of the structural benchmarks for December 2010 was fully met (inventory of government accounts), one was partly met, and one was met with a slight delay. About half of accountants and procurement officers were rotated, and the integrated personnel and payroll system (IPPS) went live at the pilot sites on January 31. The structural benchmark for March 31 to develop a set of leading economic indicators was partly met, as new series were developed and have partly been aggregated into an index to inform the path of monetary policy. The three structural benchmarks for April 1 were broadly met: the Budget Framework Paper (BFP) included a report on utility consumption of spending units and a partial timetable for introduction of the national identification system. Full information on the classified exceptional expenditures is now in the public domain, and the BFP captures the associated spending.

## II. ECONOMIC AND POLICY DEVELOPMENTS

*Outturn in 2010/11*

5. Economic activity picked up in the first half of 2010/11 after a relatively (by recent historical standards) subdued outturn in 2009/10. The recovery was driven by domestic demand, notably more buoyant private sector consumption and investment demand and a more expansionary fiscal stance. Strong private sector credit growth contributed to the rebound in private sector demand. Real GDP is now expected to grow at 6.4 percent in 2010/11 compared to 5.2 percent in 2009/10. The sources of the rebound in growth include a strong recovery in private sector aggregate demand, with private sector credit expanding by about 38 percent since the start the fiscal year; continued growth of exports as demand in export markets improves in the aftermath of the recent global financial crisis; and faster growth in the industry and service sectors.

6. Inflation had been falling for most of 2010 but began to pick up in the final quarter of the year. Annual rates of headline and core inflation stood at 14 percent and 10 percent respectively in April 2011. The rise in inflation is attributable to a number of factors: the renewed buoyancy of consumer demand; high demand for Ugandan food from neighbouring countries; higher international food and fuel prices; poor domestic harvests for food crops; and higher inflation in the countries from which Uganda sources most of its imports.

7. The balance of payments has weakened in 2010/11, mainly because of a widening of the trade deficit by almost 2 percentage points of GDP. Imports are growing strongly because of higher international fuel prices, as well as the rebound in domestic demand and large one-off government imports, whereas export growth, projected at about 7 percent in dollar values, is more modest. The current account of the BOP has been boosted by the receipt of about a billion dollars in capital gains tax revenues from the oil industry, but these resources are being transparently recorded and held in a petroleum fund in the BoU. Thus, the overall BOP is projected to incur a deficit of approximately $600 million in 2010/11, reducing gross international reserves to the equivalent of 3.4 months of imports of goods and services, compared to 4.7 months in the previous fiscal year.

8. The shilling has weakened as a result of the BoP deterioration, as well as rapid broad money growth. In addition, investor caution surrounding the elections, combined with nervousness surrounding events in North Africa, caused some volatility in the market that the BoU only partly attenuated through intervention on the inter-bank foreign exchange market. Cumulatively, the nominal effective exchange rate depreciated by 11 percent in the first 10 months of 2010/11.

*Monetary policy*

9. The BOU began gradually tightening monetary policy in the third quarter of 2010/11 in response to the re-emergence of inflationary pressures in the economy. Growth in the

monetary and credit aggregates had been relatively subdued during most of 2009/10 but began to pick up significantly in mid-2010. Banks faced strong demand for credit from the private sector, especially from firms seeking to fund capital investments. The tightening of monetary stance by the central bank led to an increase in both interbank interest rates and yields on all tenors of government securities. Growth in the money and credit aggregates began to decelerate in the third quarter of 2010/11.

*The financial sector*

10. The financial soundness of the banking system strengthened in the first half of 2010/11. The banking system's annualised return on assets, which had dipped in 2009, climbed back to almost 3 percent in the second quarter of 2010/11, while non performing loans as a share of total loans fell to around 2 percent, from 4 percent in 2009. The ratio of total capital to risk-weighted assets fell slightly to 20 percent, because of very strong growth in risk-weighted assets, rather than a fall in capital. Higher minimum capital regulations came into force in March 2011. All new banks are required to have a minimum of Shs 25 billion in paid up capital, while the existing banks had to have Shs 10 billion in paid up capital by March 2011, and need to have Shs 25 billion by March 2013. All of the existing banks were able to comply with the new minimum capital requirement in March 2011. Legislation to enable banks to undertake bancassurance and offer Islamic financial products, and to introduce a capital charge for market risk, is before cabinet. Legislation to strengthen anti-money laundering is before Parliament, and Parliament has now passed the Uganda Retirement Benefits Regulatory Authority bill.

*Fiscal performance during FY 2010/11*

11. Revenue collections during the first ten months of FY2010/11 were slightly above target, mainly due to the effects of exchange rate depreciation. The VAT on local goods and services performed poorly, however, particularly on mobile telephone airtime, electricity, and cement. There are also structural problems in the application of VAT which Government will address as a matter of priority. Tax to GDP is projected at 12.4% by June 2011. The improvement in the tax to GDP ratio is on account of domestic income and trade taxes, due to the recovery in import volumes particularly in dutiable items, and the exchange rate depreciation.

12. The expenditure to GDP ratio is projected at almost 24% of GDP, a significant increase compared to last fiscal year. The fiscal deficit excluding foreign grants and oil revenues is projected at 10.6% of GDP compared to 7.4% in 2009/10, and is 4.5% of GDP above the target for FY2010/11. The sharp increase in Government spending was due to: increased security-related exceptional spending; wages and salaries for the lower-paid cadre of civil servants; unanticipated pension obligations; and higher thermal power costs due rising fuel prices; and unexpected elections costs.

13. The main thrust of the supplementary budgets passed during FY2010/11 was to reallocate expenditure within the spending envelope of the originally-approved budget. This has inevitably involved the reallocation of resources across and within spending ministries, but government has sought to protect PAF expenditures at approximately 95% of the indicative budgets. In addition, the exceptional classified spending was financed by a drawdown at the Bank of Uganda, and has been authorized by a supplementary budget passed by Parliament. Government plans to make good its position with the Central Bank over the medium term. Government is reviewing and intends to propose amendments to the Public Finance and Accountability Act (PFAA) to enhance the predictability of the budget by creating a contingency fund to finance emergencies and supplementary budgets, with clear criteria for its use. The revised act would also restrict virements (reallocations) between and within spending ministries and working toward best international practice in the treatment of classified expenditures.

14. Government continues to face challenges in respect of the control of expenditure arrears. In part these claims arise because of under-budgeting for fixed costs like utilities, rent, subscriptions for international organizations and term contracts under the development budget. Outside these fixed costs, a major cause of concern is court awards, whose incidence and magnitude are unpredictable. To address this problem, Government commits to provide adequate resources to cover fixed costs such as utilities, rent and pensions, and to extend the "straight-through payment" (STP) system to electricity and water, beginning with the 2011/12 Budget. In practice, this means that the Treasury will effect payment directly for spending unit obligations on water and electricity, deducting the amount paid from the releases made available to spending units.

## Outlook and Medium Term Policies

### *Macroeconomic Objectives*

15. Government's primary macroeconomic objective is to promote rapid, broad based and sustainable economic growth, consistent with the quest to transform the country to a middle income status in the medium term. Consistent with this objective, economic growth is projected to average at least 7% per annum over the medium term. The specific medium term macroeconomic objectives in support of this transformation are to:

- Maintain annual consumer price inflation to no more than 5 percent.
- Promote increased private sector investment as the engine of growth, through *crowding in* the private sector in credit markets.
- Rebuild foreign exchange reserves equivalent to a minimum level of 5 months of imports, to provide a cushion to the economy against any shocks from the external environment.

- Maintain a flexible real exchange rate, which is required to ensure the competitiveness needed to support export sector growth and diversification.
- Ensure that the medium term fiscal strategy gives priority to investments which improve productive capacity in the economy and employment creation.
- And finally introduce a system of petroleum revenue management which is transparent, integrated in the budget process, and which emphasizes growth-enhancing infrastructure investments through the budget.

*Economic Outlook*

16. The economy is expected to remain buoyant in 2011/12, with real GDP growth edging up to 6.6 percent on the back of stronger domestic investment. Inflation will remain above target, mainly because of the persistence of the effects of higher fuel and food prices, but it will decline over the course of the fiscal year as monetary policy proceeds in a tightening phase. The balance of payments is expected to improve, with the overall deficit being reduced to almost zero in 2011/12 as a result of stronger capital and financial account inflows. Both foreign direct investment and donor-financed government project financing are projected to increase in 2011/12.

*Monetary policy*

17. The priority for monetary policy in the first half of 2011/12 will be to curb the rise in core inflation. Given the impetus from the rise in global fuel and commodity prices, as well as inflation from Uganda's major trade partners, it is likely that headline inflation will rise to around 15 percent by the end of 2010/11 before falling back during the course of 2011/12. In 2011/12, both broad and base money growth will slow to about 24 percent, and the BoU stands ready to tighten policies further if needed to rein in core inflation. The BoU intends to keep core inflation contained to below 5 percent over the medium term, and increasingly rely on the short term interest rate as an operational target for monetary policy in the process of preparing to move toward a form of inflation targeting (see below).

*Fiscal strategy for 2011/12 and the medium term*

18. The budget for FY 2011/12 will be consistent with the understandings reached in the context of the PSI. Government recognizes the importance of revenue enhancement for ensuring fiscal sustainability. Petroleum revenue, when it comes, will not be a panacea, so there is a need to begin catching up with neighboring countries in terms of revenue performance. The measures we intend to adopt will eliminate many exemptions or incentives in the tax system which have outlived their usefulness. In FY2011/12 government intends to take a number of important measures to help secure the revenue yield of that year and lay the groundwork for more robust revenue performance over the medium term. These measures, which will be outlined in the Minister's Budget Speech and—where appropriate—in the

Finance Act 2011/12, include:

- Eliminate VAT exemption on supply of motor vehicles or trailers of a carrying capacity of 3.5 tons or more designed for the transport of goods (Finance Act);

- Streamline agricultural processing exemption and 10-year export holiday under the corporate income tax, particularly by requiring that URA recertify on an annual basis the eligibility of each taxpayer for the exemption (Finance Act);

- Terminate government incentives for construction materials for hotels;

- Scrap investment trader regime under the VAT (Finance Act);

- URA to issue (by June 30, 2011) and begin to enforce (from July 2011) proposed transfer pricing guidelines; and

- Government to begin to gazette and publish on the internet the names of beneficiaries (whether individual or corporation) of all tax expenditures.

19. Some tax policy reforms will take time to prepare, and in a few cases additional technical assistance may be required. We therefore intend, in the context of the 2012/13 budget, to eliminate a number of additional exemptions, particularly of intermediate sales under the VAT. Beginning in 2012/13, URA will also begin to pay VAT refunds directly, rather than through budgetary appropriation, in order to speed refunds and improve the efficiency of this tax.

20. Government expenditure policy in 2011/12 will emphasize a prudent expansion in public investment in line with the NDP. Beyond these flagship investment projects, expenditures will be restrained in view of our limited resources, including in light of declining donor assistance. Large scale classified expenditures will abate. Nevertheless, we recognize that the major risk to the fiscal outlook for 2011/12 is the possibility of expenditure arrears. If, in the event, expenditure arrears are found to have accumulated in FY2010/11, government will seed to clear them in FY 2011/12 through reallocations from lower priority spending.

21. In the medium term, the fiscal strategy will focus on implementing a few identified priority infrastructure projects in the NDP to unlock the most critical binding constraints to economic growth. In addition to the on-going infrastructure projects already in the MTEF, the new projects which will commence in FY2011/12 include Karuma hydropower project, the oil refinery, and the Kampala-Entebbe express highway. These projects are to be financed mainly by savings accumulated in previous years (Energy Fund), oil revenues, some nonconcessional borrowing for the highway, and government's own current domestic revenues. Other projects to be implemented in the medium term include the rehabilitation of Tororo-Pakwach railway, construction of Kampala-Jinja dual carriage way, and Kampala

metropolitan roads to decongest the traffic in and around Kampala. In light of the large backlog of critical infrastructure projects, we seek an increase in the ceiling on nonconcessional borrowing (NCB) under the program (see below). The Government will work closely with Fund staff to ensure that financing mechanisms, particularly nonconcessional, do not pose any threat to macroeconomic or debt sustainability.

## III. STRUCTURAL ISSUES AND REFORMS

*Revenue administration modernization*

22. Government plans to continue with revenue administration reforms in addition to the tax policy changes noted above. To improve tax administration and reduce cost of compliance, the use of e-tax services is being rolled out across the country to facilitate taxpayers' registration, filing and payments. In addition, Government will introduce Electronic Tax Registers (ETRs) and e-tax receipting and auditing system to reduce taxpayer compliance costs. The implementation of the E-tax will continue in a phased manner, starting with large and medium taxpayers. Government will support VAT taxpayers to install Electronic Cash Registers at their premises to record and relay sales information to the URA automatically. Introduction of e-tax will allow URA to pay VAT refunds directly, rather than through budgetary appropriation, beginning in 2012/13. Introduction of the national identification system will proceed in stages, with an initial 4 million citizens covered by June 30, 2012.

*Public Finance Management*

23. During FY 2011/12, the Government will propose to Parliament revisions to the Public Finance and Accountability Act (PFAA) of 2003 with the aim of strengthening public finance management. Key objectives in this regard include measures to limit strictly the use of supplementary budgets to serious national emergencies, and to restrict virement (reallocation) abilities both across and within spending ministries. In the new PFAA, Government will ensure that any significant reallocation of spending authorities will require ex-ante approval from parliament. In the context of introducing amendments to the PFAA, Government intends to move to a treasury single account system for administering government finances, recognizing this practice will improve cash management and reduce the cost of government borrowing. Further, to ensure realism and credibility of the budget, and strict adherence to annual work plans of spending units, the authorities plan to consider in the PFAA amendments advancing the budget timetable to enable Parliamentary budgetary approval before the start of each new fiscal year.

24. It is hoped that the revised PFAA will also clarify and limit the ability of government to carry forward expenditure appropriation from one fiscal year to the next. In the meantime, to limit the potential for abuse and diversion of funds, government will take the following measures regarding unspent balances at the end of FY 2011/12: (i) publishing the balances on all government accounts both in the BoU and in commercial banks as at June 30 and

September 30, (ii) Minister responsible for finance to present these accounts to parliament by July 31 and October 30, respectively; (iii) parliamentary approval, as well as supporting work and procurement plans, will be required in order to spend any balances held over from the previous year; and (iv) all unspent balances which have not been re-appropriated by parliament by end-September must be returned immediately to the government Consolidated Fund.

25. Government acknowledges that internal controls to prevent the accumulation of expenditure arrears need to be strengthened. In the context of amendments to the PFAA, Government will take steps to strengthen the Commitment Control system (CCS), including by introducing strong sanctions on accounting officers who are found to have incurred expenditure obligations outside the CCS. The ministry of finance will also begin to report to cabinet on a quarterly basis information on the unpaid claims on spending units. In the meantime, to minimize accumulation of arrears, beginning with FY2011/12 government will extend the "straight-through payment" (STP) system now employed for pensions to utility payments (electricity and water payments) of spending units.

*Oil Revenue Management*

26. Government aims to provide for the prudent management and accountability of petroleum resources in the context of amendments to the PFAA. Our objective is to ensure that the necessary mechanisms for transparency and accountability are in place before large scale oil revenues begin to accrue. We intend to establish a Petroleum Fund into which all oil and gas revenues will be deposited, and we will ensure that all spending is done through the budget. The BoU is to act as the investment manager for these resources on behalf of government, and they will pursue an investment strategy that is—at least in the short run—consistent with their handling of Uganda's foreign exchange reserves. Until the revised PFAA is passed, we are handling the payments of significant capital gains tax revenues consistent with these objectives. We have placed these funds on a special account in the BoU, on which we will report publicly on at least a quarterly basis. Flows out of this account will only be made to the budget and for the near term will be used for financing the Karuma hydropower project.

27. Looking to the medium term, the manner in which oil revenue will be managed must not compromise the growth and export potential of non-oil sectors in order to enhance employment creation in the country. This will entail building capacity in managing oil resources and also research capacity.

*Debt sustainability in the context of improved asset and liability management*

28. Government plans to update our debt strategy to ensure continued debt sustainability in the context of accelerated public infrastructure investment. We envisage an increase in the nonconcessional borrowing ceiling under the program (from $500 million to $800 million), still earmarked for infrastructure, with the state-owned Housing Finance Bank excluded from

the ceiling. With technical support from the IMF and other partners, we intend to review options for external and domestic financing, including the use of public-private partnership (PPP) arrangements. At this time we have no concrete plans to move to international capital markets or to place large-scale domestic debt issuance dedicated to infrastructure.

29. Government recognizes that the most pressing constraint to stepped up infrastructure investment is our own system of project assessment, planning, and implementation. We intend to put in place an evaluation and appraisal criteria to ensure that all projects funded are economically and financially viable and consistent with the overall macroeconomic framework to ensure continued stability.

30. As we establish the legal framework for administering petroleum wealth through the amended PFAA, we will need to review our preparedness for asset management. The petroleum fund will be administered by the BoU, but the investment guidelines and risk tolerance will be set by the government. In this regard, we also look forward to technical support from the IMF, insofar as asset and liability management must be viewed as a package.

*Enhancing the framework for monetary policy*

31. The authorities are considering reforms to the BoU's operating framework for monetary policy, which would entail replacing the current monetary targeting framework with an inflation targeting lite (ITL) framework, the primary policy objective of which will continue to be maintaining core inflation (which excludes the prices of fuel and food crops) at an annual level of 5 percent on average over the medium term.

32. In this regard, it will be important to clarify the financial relations between the Bank of Uganda and the government, including reviewing central bank capital arrangements and limiting direct central bank financing of the government borrowing requirement. Our intention is also to strictly delineate and ringfence the stock of government securities useable for liquidity management purposes as distinct from that intended for fiscal financing purposes. The BoU will begin regular inclusion in its Quarterly Report of data on the net and gross positions of government in the BoU.

33. The central bank will upgrade its communication strategy to provide the public with clarity about the stance and objectives of monetary policy. The authorities have requested the Fund to provide technical assistance and advice on the introduction of inflation targeting, in particular to draw lessons from the experience of other African and developing country central banks, including in the context of IMF program monitoring.

34. Further, the BoU is working with the Uganda Bureau of Statistics to develop high frequency indicators of activity and demand in the formal sector of the economy. The following data have so far been collected and compiled: index of agricultural production (2-month lag); quarterly GDP; index of manufacturing production based on the 50 large

companies; index of construction; and sales data on selected consumer products, building materials, and petroleum (all with a 3-month lag). Efforts are being made to extend the coverage of the index of agricultural production, and collect data on urban employment and the transport & communication sector. We intend to produce and begin disseminating a synthetic index of economic activity to help guide the conduct of monetary policy by September 30, 2011.

## IV. Program Monitoring

35. Progress in the implementation of the policies under this program will be monitored through assessment criteria (ACs), indicative targets (IT), and structural benchmarks (SBs), detailed in the attached Tables 1 and 2 and through semiannual reviews. Assessment criteria are added for end-June 2011 and proposed for end-December 2011, to be monitored respectively at the third and fourth reviews. The third review is expected to be completed by end-December 2011, and the fourth review by end-June 2012. The attached Technical Memorandum of Understanding—which is an integral part of this Memorandum—contains definitions and adjustors. During the program period, we will refrain from imposing or intensifying exchange restrictions as well as restrictions on imports for balance of payments reasons, or from introducing multiple currency practices.

Table 1. Uganda: Quantitative Assessment Criteria and Indicative Targets for December 2010 - June 2012 [1]

(Cumulative change from the beginning of the fiscal year, unless otherwise stated) [2]

| | December 31 2010 | | | | 2011 | 2011 3/ | 2011 | 2012 3/ | 2012 3/ |
|---|---|---|---|---|---|---|---|---|---|
| | 31-Dec Prog. | 31-Dec Adjus. Target | 31-Dec Actual | | June 30 | Sep. 30 | Dec. 31 | March 31 | June 30 |
| | Billions of Uganda Shillings | | | | | | | | |
| **Assessment criteria** | | | | | | | | | |
| Ceiling on the increase in net domestic assets of the Bank of Uganda 4/ | 362 | 52.9 | 344.6 | Not observed | 2,093 | 409 | 877 | 1,167 | 1,150 |
| Ceiling on the increase in net claims on the central government by the banking system 4/ | 771 | 229 | 218 | Observed | 1,545 | 274 | 633 | 987 | 829 |
| | (Millions of U.S. dollars unless otherwise specified) | | | | | | | | |
| Ceiling on the stock of external payments arrears incurred by the public sector 5/ | 0 | 0 | 0 | Observed | 0 | 0 | 0 | 0 | 0 |
| Ceiling on the contracting or guaranteeing of new nonconcessional external debt with maturities greater than one year by the public sector 5/ 6/ | 500 | 500 | 110 | Observed | 500 | 800 | 800 | 800 | 800 |
| Ceiling on new external debt with maturity up to one year contracted or guaranteed by the public sector 5/ 7/ | 0 | 0 | 0 | Observed | 0 | 0 | 0 | 0 | 0 |
| Minimum increase in net international reserves of the Bank of Uganda (US$mn) | -48 | 87.6 | -34 | Not observed | -622 | -66 | -121 | -147 | -51 |
| Share of oil revenue placed into Petroleum Fund | | | | | 100 | 100 | 100 | 100 | 100 |
| **Indicative target** | (Billions of Uganda shillings) | | | | | | | | |
| Ceiling on the increase in base money liabilities of the Bank of Uganda 4/ | 302 | 302 | 450 | Not observed | 685 | 187 | 399 | 557 | 743 |
| Stock of domestic budgetary arrears under the Commitment Control System (CCS) 8/ | … | … | | | 176 | | | | 50 |
| Minimum expenditures under the Poverty Action Fund (including the Universal Primary Education component of development expenditure) | 689 | 689 | 648.3 | Not observed | 1285 | … | 650 | … | 1400 |
| **Memorandum item** | | | | | | | | | |
| **Oil revenue inflows to the petroleum fund (in millions of U.S. dollars)** | | | | | 909 | | | | 27 |

[1] The assessment criteria and indicative targets under the program, and their adjusters, are defined in the technical memorandum of understanding (TMU).

[2] Fiscal year begins on July 1.

[3] Indicative targets.

[4] Cumulative changes are from June 2010 (averages for NDA and BM) for December 2010 and June 2011 targets and from June 2011 for FY 2011/12 targets, as defined in the TMU; all targets excluding oil revenue inflows to the petroleum fund

[5] Continuous assessment criterion.

[6] To be used exclusively for infrastructure investment projects. Cumulative change from May, 2010.

[7] Excluding normal import-related credits.

[8] Monitored annually.

**Table 2. Structural Benchmarks**

| **Policy Measure** | **Macroeconomic Rationale** | **Deadline** |
|---|---|---|
| Government to begin to gazette and publish on the internet the names of beneficiaries (whether individual or corporation) of all tax expenditures. | Enforce discipline in issuance of tax exemptions. | September 30, 2011, and quarterly thereafter |
| URA to issue and begin to enforce proposed transfer pricing guidelines. (¶18) | To reduce tax planning and prepare for large scale petroleum revenues. | Issued by June 30, 2011, for enforcement beginning in July 2011. |
| Government to maintain transparency over the treatment of unspent budgetary funds at the end of the fiscal year by (i) publishing the balances as at June 30 and September 30 on all government accounts in the BoU and commercial banks, and (ii) in order to spend any balances held over from the previous year beyond end-June, parliamentary approval as well as supporting work and procurement plans will be required. (¶24) | To enhance budgetary discipline and promote fiscal transparency. | July 31, 2011, and October 30, 2011, respectively. |
| Begin submitting to Cabinet regular quarterly reports on unpaid bills of spending units based on data in the Commitment Control System (CCS) for the previous quarter of the fiscal year. (¶25) | To facilitate control and elimination of expenditure arrears | June 30, 2011, for the report covering Q3 of FY2010/11, and quarterly thereafter. |
| Extend the "straight-through payment" system (STP) now employed for pensions to the utility sector (electricity, water) (¶25) | Help control accumulation of arrears | July 1, 2011. |
| As part of introduction of national identification system, 4 million additional citizens will have received IDs. (¶22) | To support efforts to strengthen revenue collection and combat money laundering and the financing of terrorism. | June 30, 2012. |
| Produce and disseminate within government a monthly index of economic activity relying on the various high-frequency indicators available. (¶32) | To facilitate the conduct of monetary policy. | September 30, 2011, and quarterly thereafter. |
| BoU to include in Quarterly Report data on the net and gross positions of government in the BoU. (¶31) | Enhance central bank independence and prepare Bank of Uganda to move toward inflation targeting. | September 30, 2011, and monthly thereafter. |

## Attachment II. Uganda: Technical Memorandum of Understanding

### I. Introduction

1. This memorandum defines the quarterly assessment criteria and indicative targets described in the memorandum of economic and financial policies (MEFP) for the period of July 1, 2011-May 2013 financial program supported by the IMF Policy Support Instrument (PSI), and sets forth the reporting requirements under the instrument.

### II. Ceiling on the Cumulative Increase in Net Domestic Assets (NDA) of the Bank of Uganda (BOU)

2. The net foreign assets of the BOU are defined as the monthly average (based on daily data) of foreign assets minus foreign liabilities, and include all foreign claims and liabilities of the central bank excluding oil revenues in the petroleum fund. The monthly average values of all foreign assets and liabilities will be converted into U.S. dollars at each test date using the average cross exchange rates referred to in the table below for the various currencies and then converted into Uganda shillings using the program average U.S. dollar-Uganda shilling exchange rate for October 2010.

| Program Exchange Rates (US$ per currency unit, unless indicated otherwise) | |
|---|---|
| USD | 1.0000 |
| British Pound | 1.5851 |
| Euro | 1.3888 |
| Kenya Shilling | 0.0124 |
| Tanzania Shilling | 0.0007 |
| Japanese Yen | 0.0122 |
| SDR | 1.5691 |
| Uganda Shilling | **2,264.8** |

3. Net domestic assets (NDA) of the Bank of Uganda (BOU) are defined as the monthly average (based on daily data) of base money (defined below) less net foreign assets of the BOU (as defined in para. 2). Based on this definition, the NDA limits will be ceilings on the cumulative change from the monthly average based on daily data for June 2010 to the same monthly average for June 2011, and cumulative changes from the monthly average based on daily data for June 2011 to the same monthly averages for September 2011, December 2011, March and June 2012.

| | In billions of Uganda Shillings | | | | |
|---|---|---|---|---|---|
| | June 30, 2011 1/ | September 30, 2011 2/ | December 31, 2011 2/ | March 2012 2/ | June 30, 2012 2/ |
| Cumulative change in base money | 685 | 187 | 399 | 557 | 743 |
| Cumulative change in NFA | -1408 | -222 | -478 | -610 | -408 |
| Cumulative change in NDA | 2093 | 409 | 877 | 1167 | 1150 |

1/ Cumulative from July 1, 2010; and 2/ Cumlative from July 1, 2011

## III. Base Money

4. Base money is defined as the sum of currency issued by Bank of Uganda (BOU) and the commercial banks' deposits in the BOU. The commercial bank deposits include the statutory required reserves and excess reserves held at the BOU and are net of the deposits of closed banks at the BOU and Development Finance Funds (DFF) contributed by commercial banks held at the BOU. The base money limits will be cumulative change from the monthly average based on daily data for June 2010 to the same monthly average for June 2011, and cumulative changes from the monthly average for June 2011 to the same monthly average for September and December 2011, and March and June 2012.

## IV. Ceiling on the Cumulative Increase in Net Claims on the Central Government by the Banking System[1]

5. Net claims on the central government (NCG) by the banking system is defined as the difference between the outstanding amount of bank credits to the central government and the central government's deposits with the banking system, excluding oil revenues in the petroleum fund and deposits in administered accounts and project accounts with the banking system, including the central bank. Credits comprise bank loans and advances to the government and holdings of government securities and promissory notes. Central government's deposits with the banking system include the full amount of resources freed by the IMF MDRI. NCG will be calculated based on data from balance sheets of the monetary authority and commercial banks as per the monetary survey. The quarterly limits on the change in NCG by the banking system will be cumulative beginning end-June in the previous fiscal year.

## V. Floor on Net International Reserves of the Bank of Uganda

6. Net international reserves (NIR) of the BOU are defined for program monitoring purpose as reserve assets of the BOU net of short-term external liabilities of the BOU. Reserve assets are defined as external assets readily available to, and controlled by, the BOU and exclude pledged or otherwise encumbered external assets, including, but not limited to,

[1] The central government comprises the treasury and line ministries.

assets used as collateral or guarantees for third-party liabilities. Short-term external liabilities are defined as liabilities to nonresidents, of original maturities less than one year, contracted by the BOU and include outstanding IMF purchases and loans.

7. For program-monitoring purposes, reserve assets and short-term liabilities at the end of each test period will be calculated in U.S. dollars by converting the stock from their original currency denomination at program exchange rates (as specified in para 2).

## VI. Ceiling on the Stock of Domestic Budgetary Arrears of the Central Government

8. The stock of domestic payment arrears under the Commitment Controls System (CCS) will be monitored on an annual basis. Domestic payments arrears under the CCS are defined as the sum of all bills that have been received by a central government spending unit or line ministry delivered prior to the beginning of the current fiscal year, and for which payment has not been made by end of fiscal year, under the recurrent expenditure budget (excluding court awards, subscription to international organization and pensions) or the development expenditure budget. For the purpose of program monitoring, the CCS reports, which will include arrears accumulated at IFMS and non-IFMS sites, prepared by the Accountant General, will be used to monitor arrears. Arrears can be cleared in cash or through debt swaps. According to the report prepared by Office of the Auditor General, the stock of arrears was estimated at USh 176.5 billion as of June 2010.[2]

## VII. Expenditures under the Poverty Action Fund (PAF).

9. The compliance with the indicative target on minimum expenditures under the PAF will be verified on the basis of releases (PAF resources made available to spending agencies).

## VIII. Adjusters

10. The NDA and NIR targets are based on program assumptions regarding budget support, assistance provided under the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI), and external debt-service payments.

11. The NCG target, in addition to being based on the aforementioned assumptions, is also based on assumptions regarding domestic nonbank financing of central government fiscal operations. In addition, the NDA target depends on the legal reserve requirements on deposits in commercial banks. Finally, the NDA and NIR targets are based on program

[2] The Auditor General's report (http://www.oag.go.ug/annual_reports.php?dId=1) for FY 2009/10 indicates that some agencies could not disclose their outstanding operating commitments in their financial statements at year's end..

assumptions regarding automatic access by commercial banks to the BOU's rediscount and discount window facilities.

12. The Uganda shilling equivalent of projected budget support (grants and loans) plus HIPC Initiative assistance in the form of grants on a cumulative basis from July 1 of the fiscal year is presented under Schedule A. The ceilings on the cumulative increase in NDA and NCG will be adjusted downward (upward), and the floor on the cumulative increase in NIR of the BOU will be adjusted upward (downward) by the amount by which budget support, grants and loans, plus HIPC Initiative and MDRI assistance, exceeds (falls short of) the projected amounts.

**Schedule A: Budget Support Plus Total HIPC Initiative Assistance**

(Cumulative billions of Uganda's shillings, beginning July 1 of the fiscal year)

| Quarter | 6/30/2011 1/ | 9/30/2011 2/ | 12/31/2011 2/ | 3/31/2012 2/ | 6/30/2012 2/ |
|---|---|---|---|---|---|
| Budget support, including HIPC Initiative grants | 742.0 | 255.7 | 426.4 | 499.9 | 620.3 |

1/ Cumulative from July 1, 2010; and 2/ Cumulative from July 1, 2011

13. The ceiling on the increases in NDA and NCG will be adjusted downward (upward) and the floor on the increase in NIR will be adjusted upward (downward) by the amount by which debt service due[3] plus payments of external debt arrears less deferred payments (exceptional financing) falls short of (exceeds) the projections presented in Schedule B. Deferred payments are defined to be (i) all debt service rescheduled under the HIPC Initiative; and (ii) payments falling due to all non-HIPC Initiative creditors that are not currently being serviced by the authorities (that is, gross new arrears being incurred).

[3] Debt service due is defined as pre-HIPC Initiative debt service due, but from 2003/04 onwards, this excludes debt service subject to HIPC Initiative debt rescheduling.

| Schedule B: Debt Service | | | | | |
|---|---|---|---|---|---|
| (Cumulative billions of Uganda's shillings, beginning July 1 of the fiscal year) | | | | | |
| Quarter | 6/30/2011 1/ | 9/30/2011 2/ | 12/31/2011 2/ | 3/31/2012 2/ | 6/30/2012 2/ |
| Debt Service due before HIPC excluding exceptional financing | 243.0 | 49.9 | 144.8 | 210.9 | 263.2 |
| 1/ Cumulative from July 1, 2010; and 2/ Cumulative from July 1, 2011 | | | | | |

14. The ceiling on the increase in NCG will be adjusted downward (upward) by any excess (shortfall) in nonbank financing[4] less payment of domestic arrears on pensions, to international organizations, and court awards, relative to the programmed cumulative amounts presented in Schedule C. For the purpose of this adjuster, payment of such arrears cannot exceed the programmed amount by more than Ush 45.0 billion.

| Schedule C: Nonbank Financing Minus Repayment of Domestic Arrears | | | | | |
|---|---|---|---|---|---|
| (Cumulative billions of Uganda's shillings, beginning July 1 of the fiscal year) | | | | | |
| Quarter | 6/30/2011 1/ | 9/30/2011 2/ | 12/31/2011 2/ | 3/31/2012 2/ | 6/30/2012 2/ |
| (A) Nonbank Financing | 392.00 | 23.85 | 54.4 | 72.0 | 100.0 |
| (B) Repayment of domestic arrears on pensions, to international organizations, and for court awards | 184.00 | 21.45 | 71.5 | 71.5 | 71.5 |
| (C) Total = (A) - (B) | 208.00 | 2.40 | -17.14 | 0.49 | 28.50 |
| 1/ Cumulative from July 1, 2010; and 2/ Cumulative from July 1, 2011 | | | | | |

15. The ceiling on NDA of the BOU for every test date will be adjusted upward by the daily average amount of commercial bank automatic access to the BOU discount window and rediscounting of government securities by commercial banks.

16. The ceiling on NDA of the BOU for every test date will be adjusted downward/upward to reflect decreases/increases in the legal reserve requirements on deposits in commercial banks. The adjuster will be calculated as the percent change in the reserve

[4] Comprising the check float and the change in government securities and government promissory notes held by the nonbank sector. The change in government securities held by the nonbank sector will be calculated from the data provided by the Central Depository System (CDS).

requirement multiplied by the actual amount of required reserves (Uganda shillings and foreign-currency denominated) at the end of the previous calendar month.

## IX. Ceiling on the Contracting or Guaranteeing of New Nonconcessional External Debt by the Public Sector, and Ceiling on the Stock of External Payments Arrears Incurred by the Public Sector[5]

17. The assessment criterion on short-term debt refers to contracting or guaranteeing external debt with original maturity of one year or less by the public sector. Excluded from this assessment criterion are normal import-related credits and non-resident holdings of government securities and government promissory notes. The definition of "debt" is set out in paragraph 18.

18. The program includes a ceiling on new nonconcessional borrowing with maturities greater than one year contracted or guaranteed by the public sector.[6] Nonconcessional borrowing is defined as loans with a grant element of less than 35 percent, calculated using average commercial interest rates references (CIRRs) published by the Organization for Economic Cooperation and Development (OECD). In assessing the level of concessionality, the 10-year average CIRRs should be used to discount loans with maturities of at least 15 years, while the 6-month average CIRRs should be used for loans with shorter maturities. To both the 10-year and 6-month averages, the following margins for differing payment periods should be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–25 years; and 1.25 percent for 30 years or more. The ceiling on nonconcessional external borrowing or guarantees is to be observed on a continuous basis. The coverage of borrowing includes financial leases and other instruments giving rise to external liabilities, not only current as defined below, but also contingent, on nonconcessional terms. External debt for the purpose of this assessment criterion means borrowing giving rise to liabilities to non-residents. Excluded from the limits are changes in indebtedness resulting from non-resident holdings of government securities and government promissory notes, refinancing credits and rescheduling operations, and credits extended by the IMF. For the purposes of the program, arrangements to pay over time obligations arising from judicial awards to external creditors that have not participated in the HIPC Initiative do not constitute nonconcessional external borrowing. Excluded from these limits are also nonconcessional borrowing within the limits specified in Table 1 of the MEFP. The ceiling also excludes nonconcessional borrowing by one state-owned bank, Housing Finance Bank,

[5] Public sector comprises the general government (which includes the central government, local governments, and monetary authorities), and entities that are public corporations which are subject to 'control by the government', defined as the ability to determine general corporate policy or by at least 50 percent government ownership.

[6] Contracting and guaranteeing is defined as approval by a resolution of Parliament as required in Section 20(3) and 25(3) of the Public Finance and Accountability Act, 2003

which poses limited fiscal risk and is in a position to borrow without a government guarantee.

19. The definition of debt, for the purposes of the limit, is set out in point 9 of the Guidelines on Performance Criteria with Respect to External Debt (Executive Board's Decision No. 6230-(79/140), as amended by Decision No 14416-(09/91, effective December 1, 2009). It not only applies to the debt as defined in Point 9 of the Executive Board decision, but also to commitments contracted or guaranteed for which value has not been received. The definition of debt set forth in No. 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements reads as follows:

> (a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lesser retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property. (b) Under the definition of debt set out in point 9(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

20. The ceiling on the accumulation of new external payments arrears is zero. This limit, which is to be observed on a continuous basis, applies to the change in the stock of

overdue payments on debt contracted or guaranteed by the public sector from their level at end-June 2006. External debt payment arrears consist of external debt service obligations (reported by the Statistics Department of the BOU, the Macro Department of the Ministry of Finance) that have not been paid at the time they are due as specified in the contractual agreements but shall exclude arrears on obligations subject to rescheduling.

## X. MONITORING AND REPORTING REQUIREMENTS

21. The authorities will inform the IMF staff in writing at least ten business days (excluding legal holidays in Uganda or in the United States) prior to making any changes in economic and financial policies that could affect the outcome of the financial program. Such policies include but are not limited to customs and tax laws (including tax rates, exemptions, allowances, and thresholds), wage policy, and financial support to public and private enterprises. The authorities will similarly inform the IMF staff of any nonconcessional external debt contracted or guaranteed by the government, the BOU, or any statutory bodies, and any accumulation of new external payments arrears on the debt contracted or guaranteed by these entities. The authorities will furnish an official communication to the IMF describing program performance of quantitative and structural assessment criteria and benchmarks within 8 weeks of a test date. The authorities will on a regular basis submit information to IMF staff with the frequency and submission time lag as indicated in Table 1. The information should be mailed electronically to AFRUGA@IMF.ORG .

**Attachment II. Table 1. Summary of Reporting Requirements**

| Reporting institution | Report/Table | Frequency | Submission lag |
|---|---|---|---|
| I. Bank of Uganda | Issuance of government securities. | Weekly | 5 working days |
| | Interest rates on government securities. | Weekly | 5 working days |
| | Operations in the foreign exchange market and daily average exchange rates. | Weekly | 5 working days |
| | Consumer price index. | Monthly | 2 weeks |
| | Balance sheet of the BOU, consolidated accounts of the commercial banks, and monetary survey. The Internal Audit Department (IAD) of the BOU will, on quarterly basis, review the reconciliations of monetary survey data with the financial records and the audited financial statements. Any revisions to monetary survey data will be documented and reconciled with the previous presentation to ensure accurate reporting. | Monthly | 4 weeks |
| | Composition of foreign assets and liabilities of the BOU by currency of denomination. | Monthly | 4 weeks |
| | Statement of (i) cash balances held in project accounts at commercial banks; (ii) total value (measured at issue price) of outstanding government securities from the Central Depository System (CDS); and (iii) the stock of government securities (measured at issue price) held by commercial banks from the CDS. | Monthly | 6 weeks |
| | Summary of (i) monthly commodity and direction of trade statistics; (ii) disbursements, principal and interest, flows of debt rescheduling and debt cancellation, arrears, and committed undisbursed balances—by creditor category; and (iii) composition of nominal HIPC Initiative assistance, disaggregated into grants, flow rescheduling, and stock-of-debt reduction by creditor. | Monthly | 6 weeks |
| | Summary of stock of external debt, external arrears, and committed undisbursed loan balances by creditor. | Quarterly | 6 weeks |
| | Standard off-site bank supervision indicators for deposit money banks. | Quarterly | 4 weeks |
| | Summary table of preliminary program performance comparing actual outcome with adjusted program targets for (i) base money; (ii) net claims on central government by the banking system; (iii) stock of external arrears; (iv) new nonconcessional external borrowing; and (v) net international reserves | Quarterly | 5 weeks |
| | Daily average amount of commercial bank automatic access to the BOU discount window and rediscounting of government securities by commercial banks. | Quarterly | 4 weeks |

| Attachment II. Table 1. Summary of Reporting Requirements (concluded) | | | |
|---|---|---|---|
| **Reporting institution** | **Report/Table** | **Frequency** | **Submission lag** |
| II. Ministry of Finance | Summary of central government accounts. Revenues shall be recorded on a cash basis. Expenditures shall be recorded when checks are issued, except for domestic and external debt-service payments, cash transfers to districts, and externally funded development expenditures. Expenditures on domestic interest will be recorded on an accrual basis and external debt service will be recorded on a commitment basis (i.e., when payment is due). Cash transfers to districts will be recorded as expenditures of the central government when the transfer is effected by the BOU. Expenditures on externally funded development programs will be recorded as the sum of estimated disbursements of project loans and grants by donors, less the change in the stock of government project accounts held at the BOU and domestic commercial banks. | Monthly | 6 weeks |
| | Summary of outstanding stock of verified domestic arrears comprising the stock of CCS/IFMS arrears incurred after end-June 2004. | annually | 6 weeks |
| | Summary of contingent liabilities of the central government. For the purpose of the program, contingent liabilities include all borrowings by statutory bodies, government guarantees, claims against the government in court cases that are pending, or court awards that the government has appealed. | Quarterly | 6 weeks |
| | Detailed central government account of disbursed budget support grants and loans, HIPC support, and external debt service due and paid. | Monthly | 4 weeks |
| | Detailed central government account of disbursed donor project support grants and loans. | Monthly | 6 weeks |
| | Statement on new loans contracted during the period according to loan agreements. | Quarterly | 6 weeks |
| | Updated national accounts statistics (real and nominal) according to UBOS and medium-term projections. | Quarterly | 4 weeks |