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

June 20, 2005

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.

Kampala, Uganda  
June 20, 2005

Mr. Rodrigo de Rato  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431  
U.S.A.

Dear Mr. de Rato:

1. On behalf of the Government of Uganda, I hereby transmit the attached memorandum of economic and financial policies (MEFP) that sets out the objectives and policies that the Government intends to pursue in fiscal year 2005/06 (July–June), as well as the underlying medium-term macroeconomic policy framework. These are in line with the priorities set out in the revised Poverty Eradication Action Plan (PEAP) and the 2005/06 budget proposal, which was submitted to Parliament on June 8, 2005. The attached technical memorandum of understanding (TMU) defines the targets of the program.
2. In light of the progress achieved in the implementation of the program for 2004/05, and given the supporting details provided in the MEFP, the Government of Uganda requests a waiver for nonobservance of the performance criterion for end-December 2004 on the accumulation of domestic arrears under the Commitment Control System. Every effort will be made to pay off these arrears within fiscal year 2004/05. Moreover, the Government will implement a comprehensive set of measures to strengthen the overall monitoring and control of domestic arrears, as outlined in the MEFP.
3. In support of our objectives and policies, the Government of Uganda hereby requests the release of the sixth disbursement under the PRGF in the amount of SDR 2 million (1.1 percent of quota) upon completion of the fifth review.
4. Looking ahead, the policies set out in the attached memorandum, together with continuing implementation of the broader policy agenda as envisaged in the revised PEAP, aim at achieving high sustainable economic growth and reducing poverty. The performance criteria for the sixth review will be based on the test date of end-June 2005 and are set out in the MEFP, together with structural benchmarks. In order to provide sufficient time to evaluate program performance, the Government of Uganda requests an extension of the three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) to December 31, 2005.
5. The Government of Uganda will provide the Fund with such information as the Fund may request in connection with the progress made in implementing the economic and financial policies and achieving the objectives of the program.

6. The Government of Uganda believes that the policies and measures set forth in the MEFP are adequate to achieve the objectives of its economic program for 2005/06 supported by the PRGF arrangement, but it will take further measures to that end if deemed necessary. During the implementation of the arrangement, the Government of Uganda will consult with the Managing Director on the adoption of these measures and in advance of revisions to the policies contained in the MEFP, at the initiative of the Government or whenever the Managing Director requests such a consultation.

7. The Government of Uganda authorizes the publication and distribution of this letter, the attached MEFP and TMU, and all reports prepared by Fund staff regarding the PRGF-supported program.

Sincerely yours,

/ s /

Dr. Ezra Suruma  
Minister of Finance, Planning, and Economic Development

Attachments: Memorandum of Economic and Financial Policies  
Technical Memorandum of Understanding

## **Memorandum of Economic and Financial Policies of the Government of Uganda for 2005/06**

1. The Government of Uganda is committed to achieving sustained economic growth and poverty reduction through the pursuit of prudent macroeconomic policies and structural reforms. The strategy to achieve these goals is set out in the revised Poverty Eradication Action Plan (PEAP). The Government's economic program is supported by the International Monetary Fund (IMF) with a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), which was approved in September 2002. For the fifth review under the PRGF, this memorandum of economic and financial policies (MEFP) reviews the performance under the program since the last review and describes the policies and targets for the fiscal year 2005/06.

### **I. RECENT PERFORMANCE UNDER THE PRGF-SUPPORTED PROGRAM**

2. **Since the early 1990s, Uganda has implemented sound macroeconomic policies and an ambitious program of economic reforms**, which have been supported by substantial donor assistance. These efforts have resulted in robust economic growth and a significant reduction in poverty.

3. **The Ugandan economy has continued to perform well in 2004/05.** Real GDP growth has been sustained at about 6 percent in 2004/05. The construction and communications sectors have maintained their strong growth, while the cyclical rebound in agriculture has, to some extent, mitigated the impact of a prolonged dry spell. However, food crop prices have soared as a result of the drought, sharply raising annual headline inflation from 0.9 percent in June 2004 to 12.6 percent in April 2005. Underlying (core) annual inflation, which excludes food crops, has on average remained below the target of 5 percent, reaching 4.9 percent in April 2005. The external current account deficit, excluding grants, is projected to widen by about 1 percent of GDP to around 13 percent of GDP in 2004/05, as a result of higher oil prices. Greater-than-anticipated donor inflows and private capital flows will more than cover this deficit, allowing the central bank to further build-up its international reserves to a healthy position equivalent to about 6½ months of imports of goods and nonfactor services. The Ugandan shilling appreciated by about 10 percent in real effective terms since December 2003, although it came under some renewed depreciation pressure in April 2005.

#### **A. Fiscal Policy**

4. **Fiscal performance has been somewhat better than budgeted in the first three quarters of 2004/05.** The overall budget deficit, excluding grants, is projected at 9.7 percent of GDP for 2004/05, compared with 10 percent of GDP targeted under the program. Revenue collections have been buoyed by improved performance of the income tax and indirect tax collections in the first three quarters of the year. However, unforeseen expenditures mainly to meet larger-than-programmed wage increases in education and health sectors, as well as higher operational needs by the public administration, were approved in a supplementary

budget. Public expenditure remained broadly in line with the budgetary ceilings, since these needs were contained within the budgeted level of expenditures through cuts in nonpriority outlays, and by lower-than programmed spending execution in the first half of the year. The reallocations altered the composition of the budget, resulting in public administration outlays exceeding their indicative program ceilings to March. Core poverty-reducing outlays under the Poverty Action Fund (PAF) were below their indicative program floor for the year to March, owing mainly to delayed releases of PAF resources to the districts, which are now being expedited, and are expected to reach their indicative floor for the entire fiscal year 2004/05. During the first three quarters of the fiscal year domestic arrears have continued to accumulate for nonwage and nonpension expenditures, in spite of the Commitment Control System (CCS) (Table 1).

### **B. Monetary Policy**

5. **Performance under the monetary program has been good** and the targets for base money growth were met to March 2004/05. However, a build-up in inflationary expectations and an increase in issuance of Government securities, associated with reduced reliance on foreign exchange sales for sterilization purposes, may have led to a modest rise in interest rates. Treasury bill rate volatility has, however, declined due to better liquidity management and steadier execution of the base money program. Broad money growth has slowed down, and so has credit to the private sector, particularly from the large commercial banks. The banking sector remains healthy with a very low level of nonperforming loans, while the implementation of the regulations under the Financial Institutions Act, 2004 should bring down credit exposure concentration.

6. **The performance under the structural program was mixed (Table 2).** The structural performance criterion for end-December 2004 was observed, and two of the four structural benchmarks were met. The structural benchmarks were not observed for reasons indicated below, but action is being taken to correct for the slippages.

## **II. THE POLICY AGENDA FOR 2005/06**

7. **The primary objective of the Government of Uganda in 2005/06 and the medium term is to achieve sustainable economic growth and poverty reduction.** To this end, an important element of the strategy is a gradual reduction in the fiscal deficit. As envisaged in the revised PEAP, this will free up resources for the private sector, reduce donor dependency, contribute to debt sustainability, and help achieve a competitive exchange rate. An enhanced revenue effort in the 2005/06 budget will be key in this respect, while an increase in the efficiency of the public expenditures will help maintain the good progress made in achieving the Millennium Development Goals (MDGs).

8. **Real GDP growth is expected to increase to a range of 6-7 percent in 2005/06.** This assumes the end of drought conditions and is based on increased power generation. Underlying inflation is projected to remain low at around 4 percent, while a decline in food prices should bring down headline inflation to about 4.5 percent in 2005/06. The 2005/06 budget targets an overall fiscal deficit, excluding grants, of 9.2 percent of GDP. The external

current account deficit, excluding transfers, is projected to be largely unchanged in 2005/06 due to a recovery in the terms of trade. International reserves are expected to remain at a comfortable level of nearly 6½ months of imports. For other than sterilization purposes, the BOU will only intervene in the foreign exchange market to limit undue exchange rate volatility.

### A. Fiscal Policy

9. The emphasis in the fiscal area will be given to the following priorities:  
(i) strengthening the monitoring and control of domestic arrears and reducing their stock;  
(ii) implementing revenue measures of the 2005/06 budget and continuing reforms at the Uganda Revenue Authority (URA); and (iii) reinvigorating the public sector reform program to sharpen incentives and realize expenditure savings to accommodate necessary spending on poverty reduction programs.

10. **The fiscal consolidation in 2005/06 is primarily driven by an ambitious tax policy package.** This package amounts to 0.6 percent of GDP and was announced in the 2005/06 budget. Expenditures will reflect increased donor-supported development spending, one-off outlays in connection with the March 2006 Presidential elections, and outlays to mitigate the electricity shortage. Government will limit supplementary expenditures by the security and public administration sectors. The Government will seek to avoid unbudgeted ad hoc wage increases to specific groups of public servants through the fiscal year 2005/06.

#### Public expenditure management

11. **While considerable progress has been achieved in strengthening budget planning and control systems, new arrears have continued to accumulate** and problems in producing reliable and systematically verified data on the outstanding stock of arrears persist. While these weaknesses are partly due to capacity constraints, they also reflect lapses in financial discipline.

12. To address these slippages, the following measures, which are based on the recommendations of a recent technical assistance mission, will be implemented:

- The Government will ensure that accounting officers strictly abide by the rules of the CCS, particularly avoiding the accumulation of new arrears.
- The treasury will issue a special circular to line ministries to record all commitments either in manual CCS or IFMIS, as appropriate. The circular will clarify that bills not recorded will not be accepted for verification by the Internal Audit Office after a grace period of 3 months, following the issuance of the CCS or IFMIS monthly reports on overcommitments and unpaid bills.
- The CCS will be expanded to cover all types of nonwage and non-statutory outlays starting July 2005.

- The verification of arrears under the CCS for end-June 2005 will be completed by end-September 2005, and a report issued to cabinet on the execution of the strategy to clear the overall stock of arrears.

13. **After some delays in need for wider consultation, the Government is now ready to move ahead decisively on the public sector reform program**, by submitting to cabinet the pay policy paper; this policy should lead to savings in the wage bill. The Ministry of Public Service in collaboration with MFPED will submit to cabinet a policy paper on how to control the size of public administration and ensure cost efficiency by end-September 2005.

### **Revenue mobilization**

14. **The Government has made very good progress in implementing the IMF technical assistance recommendations on URA modernization and reform.** A reorganization of the URA has been approved that is in line with the program, a Commissioner General (CG) has been appointed, and an entirely new management team is in place. Positions are being rationalized with all appointments being transparently refilled, an exercise due to be complete by July 2005. An important milestone has been the relaunching of a unified Large Taxpayer Unit (LTU) across VAT and income tax. All these reforms have already provided a boost to revenues in 2004/05. The remaining challenge is to maximize the impact of the new organizational structure and changes, in line with IMF technical assistance, by:

- Tabling a bill to Parliament to amend the URA Act by end-June 2005.
- Strengthening the Information Technology (IT) strategy by tendering an IT system to the Domestic Tax Department (DTD) and computerizing customs.

15. **The Government remains committed to maintaining a level playing field in the industrial sphere** by avoiding the granting of preferential tax treatment or lending/guarantees to specific investors or firms. In addition, the Government will take into consideration comments from the IMF and World Bank, and other stakeholders in considering the introduction of Export Processing Zones (EPZs). Any such proposal will be in line with international best practice and exclude elements that would seriously erode the tax base. To avoid harmful tax competition for investment, Uganda will work with other EAC partner states and the IMF to establish a Code of Conduct to harmonize investment incentives. The 2005/06 budget envisages the creation of an Industrial and Innovation Fund, which will support industrial research and development. Moreover, the Government will continue to submit to Parliament, in line with the Budget Act, a comprehensive list of companies that have benefited from tax expenditures, Government subsidies, loan guarantees, and other incentives during 2004/05 with the 2005/06 budget.

## **B. Decentralization**

16. **The effective implementation of the fiscal decentralization strategy (FDS) is essential to improve the delivery of poverty-reduction services.** Technical assistance from the IMF is being provided to strengthen the public expenditure management systems at the subnational level, including the pilot implementation of the CCS for local governments by end-September 2005, with roll out to be completed by end-June 2006. The development of adequate fiscal reporting and poverty-reducing expenditure tracking under the FDS is also part of the assistance provided. Local governments will be reminded of their obligations to maintain timely and accurate records, in line with their regulations. The local graduated tax, which proved regressive in practice, will be replaced by a broadening of the property tax and additional transfers from central government.

## **C. Monetary and Financial Sector Policies**

17. **The Government remains committed to maintaining annual underlying (nonfood) inflation below the 5 percent target** through the reserve money targeting framework. The monetary policy stance is expected to remain largely unchanged, as the recent rise in inflation was primarily driven by a temporary surge in food prices and, to a lesser extent, higher fuel prices. In this regard, the BOU will use sales of foreign exchange for sterilization as warranted by market conditions. The liquidity and balance sheet effects of the phased transfer of project accounts to the central bank have proceeded smoothly. It has also resulted in reduced exchange rate pressures stemming from the opening of all new project accounts at the central bank.

18. **The Government intends to implement all the key recommendations of the Financial Sector Assessment Program (FSAP) update and IMF TA recommendations to foster a more efficient and deeper financial system.** In this respect, a first step has already been undertaken by the drafting of regulations for the establishment of a credit reference bureau, which is an important element for improving access and outreach of the financial system. However, there have been delays in executing the sale of a minority share and management control of UDBL, because time was needed to build consensus among all stakeholders on the way forward. A policy paper has been submitted to cabinet that recommends the sale of a minority share and management responsibilities of UDBL to the private sector. The operations of the Department for Development Finance (DFD) of the BOU will be merged with those of UDBL. The offer for sale of a minority share and management responsibilities of UDBL to a reputed private investor will be approved by end-September 2005.

19. **Pension reform is proceeding satisfactorily.** The Government recognizes the challenge of improving governance of the NSSF and will ensure the inclusion of professional board members by end-September 2005. The liberalization of the pension system and reform of the public service pension system from a defined benefit to a defined contributory system in 2006/07 will be accompanied by an appropriate regulatory framework, while minimizing any fiscal costs and making them explicit in the budget. In order to promote the housing

finance sector, the Government will examine its participation in the Housing Finance Corporation of Uganda. To further build confidence in the financial sector, the Government will seek parliamentary approval of the Anti-Money Laundering Bill, which has already been approved by cabinet.

20. **An important element of the Government's broad anti-corruption strategy is to strengthen confidence in public institutions** by the implementation of reforms at the URA and increasing the power and independence of the Inspectorate General of Government (IGG).

21. **The privatization program is almost complete.** The Government is on track in finalizing a joint concession contract for the Uganda Railway Corporation and the Kenya Railway Corporation by end-September 2005. A majority share in the National Insurance Corporation (NIC) was sold in June 2005 to a reputed insurer, while the privatization of the public water and sewerage enterprise is in progress. In addition, in order to address the shortage in power generation, the Government is in negotiation with a short-listed private investor to start a hydropower project at the Bujagali Falls. A thermal power plant will also be commissioned by end-June 2005.

22. **The EAC customs union became effective on February 1, 2005.** The Government will also pursue broader regional integration in terms of regional roads, railway, and communications/energy infrastructure; this effort will benefit Ugandan exports, particularly food crops.

23. **The Government is committed to achieving external debt sustainability** over the long term, while attempting to achieve the MDGs. The most recent Debt Sustainability Assessment (DSA) indicates that Uganda's debt is above sustainable levels, so the Government is committed to implementing an export-led growth strategy and a gradual fiscal consolidation as critical elements to restoring sustainability. The Government will exercise caution in the use of concessional borrowing, and strive to fund a larger portion of Uganda's development needs in the form of grants. Consistent with the amended regulations to the Public Finance Accountability Act (PFAA), the Government will establish clear monitoring and operational procedures for the contracting of external debt and debt management by end-June 2005.

### III. MEDIUM-TERM MACROECONOMIC POLICY ISSUES

24. **Uganda is committed to implement prudent macroeconomic policies and a second generation of reforms** that will strengthen its economic performance over the medium term. The fiscal policy framework for the medium term (2005/06-2007/08) aims to reduce the fiscal deficit, excluding grants, by an average of 1 percent point of GDP per annum and increase domestic revenue by 0.5 percent of GDP per annum. This strategy will help strengthen exchange rate competitiveness and lower interest rates, and thereby provide a boost to export and private investment performance. The success of this strategy will depend on stronger annual increases in government revenues, notably through an improvement in tax

administration, coupled with a better allocation and efficiency of expenditures. Poverty-reducing expenditures in the PEAP will continue to be ring-fenced in order to contribute to the achievement of the MDGs.

25. The policies to strengthen the investment climate, increase productivity, enhance Uganda's international competitiveness, and achieve a more sustainable and less vulnerable external position, will be supported by the Government's Medium-Term Competitiveness Strategy (MTCS), Plan for the Modernization of Agriculture (PMA) and its Strategic Exports Program (SEP). Progress in the implementation of these programs has been uneven, particularly as there is a need to strengthen agricultural policies, mainly by refocusing the sectoral strategy towards improving productivity, market access and standards, and infrastructure (mainly rural roads and power). In this regard, the stocktaking exercise of the PMA and National Agriculture Advisory Service (NAADS) will be useful as a means of identifying the implementation effectiveness and measures needed to increase efficiency and effectiveness of support provided to farmers. There is also a need to put greater emphasis on efforts to improving infrastructure, a key constraint to doing business in Uganda.

Table 1. Uganda: Quantitative Performance Criteria and Benchmarks for 2004/05 and 2005/06 1/ 2/  
(Cumulative change from end-June 2004 and end-June 2005 for the 2004/05 and 2005/06 program respectively, unless otherwise stated)

	Sep. 30 2004 3/ Prog.	Sep. 30 2004 3/ Adj Prog.	Sep. 30 2004 3/ Est.	Dec. 31 2004 4/ Prog.	Dec. 31 2004 4/ Adj Prog.	Dec. 31 2004 4/ Actual.	Mar. 31 2005 3/ Prog.	Mar. 31 2005 3/ Adj Prog.	Mar. 31 2005 3/ Actual.	June. 30 2005 4/ Prog.	Sep. 30 2005 8/ Prog.	Dec. 31 2005 8/ Prog.	Mar. 31 2006 8/ Prog.	June. 30 2006 8/ Prog.
(In billions of Uganda shillings; end of period, unless otherwise stated)														
Ceiling on the increase in base money liabilities of the Bank of Uganda 5/	41.5	51.5	29.3	107.7	117.7	96.2	105.0	120.0	98.5	108.0	33.0	103.0	110.0	120.0
Ceiling on the increase in net claims on the central government by the banking system	164.5	128.5	37.7	132.7	52.9	-57.0	32.2	232.6	11.7	-34.3	150.0	46.0	153.0	-140.0
Ceiling on the issuance of promissory notes by the government 6/	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Accumulation of new domestic budgetary arrears under the Commitment Control System (CCS) 6/ 7/	0	0	5.0	0	0	2.6	0	0	..	0	0	0	0	0
New lending by Uganda Development Bank Ltd., including on-lending on behalf of the government or the Bank of Uganda, pending divestiture 6/	0	0	0.2	0	0	0	0	0	0	0	0	0	0	0
(In millions of U.S. dollars; end of period)														
Ceiling on the stock of external payments arrears incurred by the government or the Bank of Uganda 6/	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Ceiling on new nonconcessional external borrowing with maturities greater than one year contracted or guaranteed by the government or the Bank of Uganda 6/	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Minimum increase in net international reserves of the Bank of Uganda	-55.0	-15.8	30.4	-5.0	36.8	185.1	41.5	-90.1	194.4	81.2	-35.0	53.0	55.0	150.0
Indicative targets (In billions of Uganda shillings; end of period)														
Minimum expenditures under the Poverty Action Fund (including the Universal Primary Education component of development expenditure)	128.3	128.3	123.0	358.7	358.7	338.6	603.6	603.6	544.5	780.5	198.2	415.4	631.2	857.1
Ceiling on public administration expenditure	60.5	60.5	54.9	126.0	126.0	122.2	191.4	191.4	192.4	256.9	54.3	113.6	172.9	232.1

1/ Fiscal year begins on July 1.

2/ The performance criteria and benchmark targets under the program, and their adjusters, are defined in the technical memorandum of understanding (TMU).

3/ Benchmarks, unless measure is a continuous performance criterion.

4/ Performance criteria.

5/ Cumulative changes from the average of June 2004 and June 2005 for the 2004/05 and 2005/06 program respectively, as defined in the TMU.

6/ Continuous performance criterion.

7/ This item is an indicative target to September 2004 and March 2005, and a performance criteria to December 2004 and June 2005, as defined in the TMU.

8/ Indicative targets.

Table 2. Uganda: Structural Performance Criteria and Benchmarks for 2004/05 and 2005/06

Policy Measure	Date of Implementation	Implementation Status
<b>Structural Performance Criteria</b>		
Amend the regulations of the Public Finance and Accountability Act to (i) ensure proper ex-ante and ex-post integration of donor projects into the budget; and (ii) clarify the responsibilities of all departments and agencies involved in contracting external debt, as well as in the operations of broader debt management.	December 31, 2004	Observed
Submit to parliament amendments to the URA Act in line with the IMF technical assistance report	June 30, 2005	To be determined
<b>Structural Benchmarks</b>		
Pay-off arrears accumulated under the Commitment Control System (CCS) in 2002/03 and 2003/04.	June 30, 2005	To be determined
Approval by Cabinet of the Pay Policy Paper.	December 31, 2004	Not Observed
The Government will approve the sale of a minority share and management responsibilities of UDBL to a reputed private investor short-listed by the Privatization Management Unit (PMU).	March 31, 2005	Not Observed
Verify the overall stock of arrears for all ministries for which IFMIS was rolled out by end-June 2004, in a manner that will allow subsequent updating of the stock per ministry with information from IFMIS.	December 31, 2004	Observed
The Government will place the NSSF under the supervision of the BOU.	December 31, 2004	Observed.
The verification of arrears under the CCS for end-June 2005 will be completed, and a report issued to cabinet on the execution of the strategy to clear the overall stock of arrears.	September 30, 2005	
The offer for sale of a minority share and management responsibilities of UDBL will be approved by Government.	September 30, 2005	

## **Uganda: Technical Memorandum of Understanding**

### **A. Introduction**

1. This memorandum defines the indicative targets described in the memorandum of economic and financial policies (MEFP) for the 2005/06 financial program that would be supported by the IMF Poverty Reduction and Growth Facility (PRGF), and sets forth the reporting requirements under the arrangement.

### **B. Base Money**

2. **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 for 2005/06 will be cumulative changes from the daily average of June 2005 to the daily average of September 2005, December 2005, March 2006 and June 2006, and will be monitored by the monetary authority and provided to the IMF by the BOU.

### **C. Net Claims on the Central Government by the Banking System**

3. **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 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. NCG will be calculated based on data from balance sheets of the monetary authority and commercial banks as per the monetary survey. The limits on the change in net claims on the central government by the banking system will be cumulative beginning end-June 2005 for the 2005/06 program.

### **D. Net International Reserves of the Bank of Uganda**

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

5. For program-monitoring purposes, reserve assets and short-term liabilities (excluding liabilities to the IMF) at the end of each test period will be calculated by converting reserve assets measured in Uganda shillings as reported by the BOU using the end-month Uganda shilling per U.S. dollar exchange rate. The U.S. dollar value of outstanding purchases and

loans from the IMF will be calculated by converting the outstanding SDR amount reported by the Finance Department of the IMF using the U.S. dollar per SDR exchange rate at the end of each quarter.

**E. Expenditures Under the Poverty Action Fund**

6. The expenditures under the Poverty Action Fund (PAF) include both wage and nonwage current expenditures under the PAF, and domestic development expenditures under the PAF. The minimum cumulative expenditures under the PAF are defined in Schedule A below. PAF expenditures will be measured based on checks printed for the central government spending units and line ministries, and cash releases to local governments.

<b>Schedule A: Minimum PAF Expenditure</b> (In cumulative billions of Uganda shillings, beginning July 1, 2005)				
Quarter	Sep. 30 2005	Dec. 31 2005	Mar. 31 2006	June 30 2006
Expenditure	198.2	415.4	631.2	857.1

**F. New Domestic Budgetary Arrears of the Central Government**

7. The nonaccumulation of new domestic payment arrears under the Commitment Controls System (CCS) are indicative targets for September 2005, December 2005, March 2006 and June 2006. New domestic payments arrears in each quarter are defined as the sum of all bills that have been received by a central government spending unit or line ministry from a supplier of goods and services delivered in that quarter, and for which payment has not been made within 30 days under the recurrent expenditure budget (including rents and utilities) or the development expenditure budget. For the purpose of program monitoring, the monthly CCS reports prepared by the Treasury Inspectorate will be used to monitor arrears accumulated to September 2005, December 2005, and March 2006. These reports will include arrears accumulated at IFMIS and non-IFMIS sites. For June 2006, the verified reports on arrears for nonwage recurrent and development expenditure prepared by the Internal Audit Office at the Ministry of Finance, Planning and Economic Development shall be used to determine the new arrears. The report will cover both IFMIS and non-IFMIS sites, and will be available within three months following the close of the fiscal year. Arrears can be cleared in cash or through debt swaps.

**G. Ceiling on Public Administration Expenditures**

8. The quarterly expenditure limits for the public administration sector are defined in Schedule B. For the purpose of program monitoring, the public administration sector includes all expenditure (excluding that financed by donor projects) of the following votes: Office of the Prime Minister (003) (excluding development), Foreign Affairs (006), Missions Abroad (201-223), National Planning Authority (108), State House (002), Public Service (005), Public Service Commission (027), Local Government (011) (excluding development), Mass

Mobilization (135), Office of the President (001) (excluding ISO/ESO and E&I), Specified Officers' Salaries (100), Parliamentary Commission (104), Local Government Finance Commission (147), Uganda Human Rights Commission (106), and Electoral Commission (102). Any supplementary allocation of votes in the public administration sector that would exceed program ceilings will be accommodated by cuts in votes belonging to other categories within this same sector. Public administration expenditures will be measured by the cash releases to the line ministries and other government units listed above.

<b>Schedule B: Ceiling on Public Administration Expenditures</b> (In cumulative billions of Uganda shillings, beginning July 1, 2005)				
Quarter	Sep. 30 2005	Dec. 31 2005	Mar. 31 2006	June 30 2006
Expenditure	54.3	113.6	172.9	232.1

### H. Promissory Notes

9. A promissory note is a written promise by the government to pay a debt, where government is defined as the central government,<sup>1</sup> local governments, and autonomous government agencies. It is an unconditional promise to pay on demand or at a fixed or determined future time a particular sum of money to, or to the order of, a specified person or to the bearer. The government will not use promissory notes or any form of a promise to pay for goods and services at a future date, and all domestic arrears payments will be settled in cash or by the transfer of immediately available funds.

### I. Adjusters

10. The NIR target is based on assumptions regarding import support, assistance provided under the Heavily Indebted Poor Countries (HIPC) Initiative, and external debt-service payments. The NCG target, in addition to being based on the two aforementioned assumptions, is also based on assumptions regarding domestic nonbank financing of central government fiscal operations.

11. The Uganda shilling equivalent of import support (grants and loans) plus HIPC Initiative assistance in the form of grants on a cumulative basis from July 1, 2005 onward is presented under Schedule C. The ceiling on the cumulative increase in 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 import support, grants and loans, plus HIPC Initiative assistance, exceeds (falls short of) the projected amounts.

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<sup>1</sup> Central government consists of the state house, cabinet ministers, all ministries, parliament, the judiciary, and committees.

<b>Schedule C: Import Support Plus Total HIPC Initiative Assistance</b> (In cumulative billions of Uganda shillings, beginning July 1, 2005)				
Quarter	Sep. 30 2005	Dec. 31 2005	Mar. 31 2006	June 30 2006
Import support including HIPC Initiative grants	56.4	355.1	442.9	841.6

12. The ceiling on the increases in 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<sup>2</sup> plus payments of external debt arrears less deferred payments (exceptional financing) falls short of (exceeds) the projections presented in Schedule D. 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).

<b>Schedule D: Debt Service Due, before HIPC Initiative Assistance</b> (In cumulative billions of Uganda shillings, beginning July 1, 2005)				
Quarter	Sep. 30 2005	Dec. 31 2005	Mar. 31 2006	June 30 2006
Debt service due before HIPC excluding exceptional financing	58.0	100.8	161.3	231.5

13. The ceiling on the increase in NCG will be adjusted downward (upward) by any excess (shortfall) in nonbank financing<sup>3</sup> less payment of domestic arrears accumulated prior to introduction of the CCS and wage and pension arrears (up to a maximum amount of U Sh 85.0 billion) relative to the programmed cumulative amounts presented in Schedule E.

<sup>2</sup> Debt service due is defined as pre-HIPC Initiative debt service due, but from 2003/04 onward, this excludes HIPC Initiative debt cancellation.

<sup>3</sup> Comprising the check float and the change in government securities and government promissory notes held by the nonbank public sector. The change in government securities held by the nonbank public will be calculated from the data provided by the Central Depository System (CDS).

<b>Schedule E: Nonbank Financing Minus Repayment of Domestic Arrears</b> (In cumulative billions of Uganda shillings, beginning July 1, 2005)				
Quarter	Sep. 30 2005	Dec. 31 2005	Mar. 31 2006	June 30 2006
(A) Nonbank financing	-64.4	-53.0	-48.0	30.0
(B) Domestic arrears repayment	4.3	81.5	81.5	85.0
(C) Total = (A) - (B)	-68.6	-134.5	-129.5	-55.0

14. The base money ceiling will be adjusted upward up to a maximum of U Sh 15 billion in September 2005, December 2005, March 2006 and June 2006 if the average amount of currency issued by the BOU exceeds those projected in Schedule F.

<b>Schedule F: Currency Issued by the BOU</b> (In cumulative billions of Uganda shillings, beginning July 1, 2005)				
Quarter	Sep. 30 2005	Dec. 31 2005	Mar. 31 2006	June 30 2006
Currency issued by BOU	21.2	74.7	65.1	82.1

#### **J. Nonconcessional External Borrowing Contracted or Guaranteed by the Central Government, Statutory Bodies, or the Bank of Uganda, and Arrears**

15. The program includes a ceiling on new nonconcessional borrowing with maturities greater than one year contracted or guaranteed by the government, statutory bodies, or the BOU<sup>4</sup>. 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 is set at zero and is to be observed on a

<sup>4</sup> Contraction is defined as approval by a resolution of Parliament as required in Section 20 (3) of the Public Finance and Accountability Act, 2003

continuous basis. The coverage of borrowing includes financial leases and other instruments giving rise to external liabilities, contingent or otherwise, on nonconcessional terms. Excluded from the limits are changes in indebtedness resulting from 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 complied with the HIPC Initiative do not constitute nonconcessional external borrowing.

16. 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. 12274-(00/85), August 24, 2000). 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 lessor 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.

17. 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 government, the BOU, and statutory bodies<sup>5</sup> from their level at end-June 2005. It comprises those external arrears reported by the Trade and External Debt Department of the BOU, the Macro Department of the Ministry of Finance that cannot be rescheduled because they were disbursed after the Paris Club cutoff date.

### **K. Monitoring and Reporting Requirements**

18. 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.

19. The information, such as the issuance of treasury bills, the intervention in the foreign exchange market, daily average exchange rates, and the interest rate on government securities, will be transmitted to the IMF's resident representative weekly, within five working days of the end of each week.

20. The BOU will reconcile the monetary survey data with the financial statements on an annual basis and with the financial records on a quarterly basis. The Internal Audit Department (IAD) of the BOU will review the reconciliations of monetary survey data with the financial records and the audited financial statements. Any revisions to monetary survey data, in line with the recommendations of the IMF safeguards mission, will be documented and reconciled with the previous presentation to ensure accurate reporting.

21. The government will provide the IMF staff with a summary of the fiscal accounts, both on a monthly and quarterly basis, with a seven-week lag from the end of the reporting month and quarter. Revenues will be recorded on a cash basis as reported by the Uganda Revenue Authority and the MFPED. 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 commercial

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<sup>5</sup> This definition is consistent with the coverage of public sector borrowing defined by the Fund (includes the debt of the general government, monetary authorities, and entities that are public corporations which are subject to the control by government units, defined as the ability to determine general corporate policy or by at least 50 percent government ownership).

banks in Uganda. Information on required and approved supplementary allocations in each month should be provided to the IMF within 15 days of the end of each month.

22. The government will provide the IMF staff with a summary of expenditure cash limits on a quarterly basis with a one-week lag from the date they are provided to ministries, and no later than two weeks after the beginning of the quarter.

23. The government will provide the IMF staff with a summary of the contingent liabilities of the central government on a quarterly basis with a seven-week lag from the end of the reporting quarter. For the purpose of the program, contingent liabilities include all borrowings by statutory bodies, loans borrowed by public enterprises or the private sector and guaranteed by the government, claims against the government in court cases that are pending, or court awards that the government has appealed.

24. Final accounts of the local government authorities for fiscal-year 2003/04 will be consolidated by end-September 2005 by the Ministry of Finance, Macro Department. The summary Status of Submission of District Monthly Accounts Returns will be provided to the IMF Resident Representative within 45 days of the end of each month. A report explaining any noncompliance with the monthly reporting requirement by districts will be provided at the same time as the summary status report to the IMF. Any noncompliance by 45 days following the end of a month will result in a reminder letter being sent from the Treasury Inspectorate Department to the District Chairperson. Any noncompliance for an additional month will result in a memorandum being sent from the Commissioner of the Treasury Inspectorate Department to the Budget Director indicating that the monitoring and accountability grants to the noncompliance districts should be discontinued until compliance is restored. A memorandum indicating this action will be sent to each noncompliant district.

25. As supplementary information, the government will provide the IMF staff on a monthly basis, with a seven-week lag from the end of the reporting month, a statement of the following: (i) outstanding stock of checks issued by the Uganda Computer Services of the MFPED, disaggregated into checks issued for commitments arising during July 1, 2005 through June 30, 2006, and checks issued to settle intraministerial payment obligations; and (ii) the value of budget support (grants and loans) received by the government, and the value of projections of donor project support received so far. The government will provide the IMF forecasts of the value of budget support and project support (grants and loans) expected to be received for the rest of the current year and the medium term, by donor and sector, by the end of each reporting quarter.

26. As supplementary information, the BOU will provide the IMF staff on a monthly basis, with a seven-week lag from the end of the reporting month, a statement of the following: (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.

27. The government will provide the IMF staff on a quarterly basis, with a seven-week lag from the end of the reporting quarter the following: (i) a statement on new loans contracted during the period as per the loan agreement, with additional information on disbursement provided within six months; and (ii) a statement on creditor participation in the HIPC Initiative, the status of creditor litigation cases, and cash payments relating to the settlement of awards.

28. The BOU will provide the IMF staff on a quarterly basis, with a seven-week lag from the end of the reporting quarter, (i) monthly commodity and direction of trade statistics; (ii) the stock of debt, disbursements, principal and interest, flows of debt rescheduling and debt cancellation, arrears, and committed undisbursed balances—by creditor category; and (iii) the monthly composition of nominal HIPC Initiative assistance, disaggregated into grants, flow rescheduling, and stock-of-debt reduction by creditor.

29. The consumer price index will be transmitted monthly to the IMF with no more than a two-week lag from the end of the reporting month. The balance sheet of the BOU, the consolidated accounts of the commercial banks, and the monetary survey will be transmitted to the IMF on a monthly basis with a lag of no more than seven weeks from the end of the reporting month.

30. Standard off-site bank supervision indicators for deposit money banks will be transmitted to the IMF quarterly and on-site reports transmitted as needed, based on the findings of the off-site reports.