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Uganda: Third Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Uganda

In the context of the third review under the three-year arrangement under the Poverty Reduction and Growth Facility and request for waiver of performance criteria with Uganda, the following documents have been released and are included in this package:

- the staff report for the third review under the three-year arrangement under the Poverty Reduction and Growth Facility and request for waiver of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **May 19, 2004,** with the officials of Uganda on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on July 16, 2004**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Press Release summarizing the **views of the Executive Board as expressed during its July 30, 2004 discussion** of the staff report that completed the request and review.

- a statement by the Executive Director for Uganda.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Uganda*
Memorandum of Economic and Financial Policies by the authorities of Uganda*
Technical Memorandum of Understanding*
*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

UGANDA

Third Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria

Prepared by the African Department
(In collaboration with other departments)

Approved by Michael Nowak and Mark Plant

July 16, 2004

- A three-year PRGF arrangement, in the amount of SDR 13.5 million (7.5 percent of quota), was approved by the Board on September 13, 2002. Discussions on the third review of the program were held in Kampala during March 10–23 and May 10–19, 2004. The letter from the Minister of Finance, Planning, and Economic Development (Appendix 1) and the attached memorandum of economic and financial policies review the performance under the PRGF arrangement and sets out the program for 2004/05 (July–June).
- The mission met with the Minister of Finance, Planning, and Economic Development, Mr. Gerald Ssendaula; the Governor of the Bank of Uganda, Mr. Emmanuel Tumusiime-Mutebile; and other senior government officials. The staff team consisted of Mr. Caramazza (head), Mr. Dunn, Mr. Peiris (all AFR), Ms. Gonzalez (FAD), Mr. Mitchell (PDR), and Ms. Silman (Assistant, AFR). The team was assisted by Mr. Allum, the IMF's Senior Resident Representative in Uganda. The staff also met with President Museveni, members of parliament, and representatives of the donor and business communities. An MFD technical assistance mission on monetary policy operations overlapped with the March mission.
- Uganda is undergoing a transition to a multiparty political system in the run-up to the next presidential and parliamentary elections in 2006. An amendment to the constitution that would lift the two-term limit on the presidency is also being considered. This would allow President Museveni to stand for re-election. A national referendum on these constitutional amendments is expected to be held in early-2005.
- The long-running insurgency by the Lord's Resistance Army still threatens the security situation in northern Uganda. The number of internally displaced persons arising from this conflict stands at 1.6 million.

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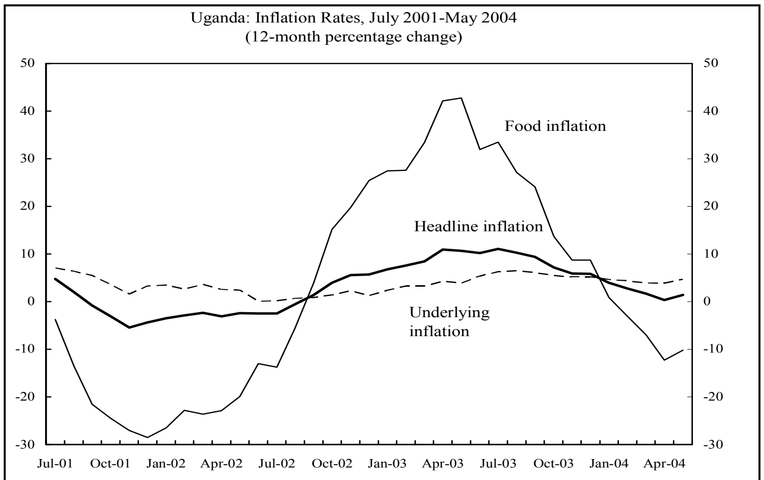
Executive Summary

- Preliminary data indicate that the economy performed well in 2003/04 (July–June). Real GDP growth increased by one percentage point to 5¾ percent, and inflation declined to low single digits. Interest rates, which remained high during the first half of the year, have fallen sharply in recent months, owing in part to an easing of monetary policy. A strong expansion in noncoffee exports contributed to a decline in the external current account deficit, before grants, while donor assistance was stronger than expected and private capital inflows held steady. Official international reserves have grown to about 6½ months of imports and the Ugandan shilling has been broadly stable in real effective terms.
- The fiscal program was broadly on track in 2003/04; however, the composition of government spending deviated somewhat from budget intentions, owing to supplementary expenditures in the second half of the year. While preliminary data indicate that the fiscal deficit excluding grants was little changed from the preceding year, a substantial reduction was achieved in the domestic budget deficit, reflecting the authorities' commitment to curb liquidity injections stemming from fiscal policy.
- Performance under the Poverty Reduction and Growth Facility (PRGF)-supported program was mixed. Despite some slippages, most quantitative performance criteria were observed for December 2003 and there has been progress in the implementation of structural measures. The authorities are requesting waivers for nonobservance of four performance criteria based on corrective actions taken.
- The outlook for the economy in 2004/05 is favorable. Real GDP growth is projected to strengthen and inflation should remain subdued. In line with the nearly completed revision of the Poverty Eradication Action Plan (PEAP), the program for 2004/05 emphasizes progress toward fiscal consolidation and public debt sustainability, while maintaining social spending. Poverty Action Fund (PAF) expenditures will increase slightly as a share of the budget, notwithstanding increased spending on defense and public administration. Tax policy measures will be taken to partly offset the losses in tax revenue Uganda will experience with the advent of the East African Community Customs Union. The monetary program aims at maintaining inflation low. Steadier implementation of the monetary program, based on improved liquidity forecasting, should help to dampen volatility in interest rates. The proposed structural program focuses on tax administration, expenditure management, financial sector development, and debt management. Substantive progress is expected in 2004/05 in the areas of financial sector deepening, including pension reform, privatization, and regional integration.
- The incidence of poverty increased to 38 percent of the population in 2002/03 from 34 percent in 1999/2000. Factors that contributed to this setback include the slowdown in real GDP growth in recent years, deterioration in the terms of trade, especially in agriculture, and high population growth. The policy framework outlined in the draft revised PEAP, and reflected in the 2004/05 budget, seeks to address these factors. In addition, some indicators on consumption and the delivery of public services, point to advances which have mitigated the welfare loss from the increase in poverty rates.

I. Recent Economic Developments and Performance Under the Program

1. **Preliminary data indicate that the economy performed well in fiscal-year 2003/04 (July–June).** Real GDP growth is projected to have increased by one percentage point to 5.7 percent, inflation fell, and the external position generally improved (Table 1 and Figure 1). The construction and communications sectors led a broad economic expansion, while improved weather conditions contributed to a rebound in agriculture. Annual headline inflation declined from 10.2 percent in June 2003 to 1.4 percent in May 2004, as food crop prices fell sharply.[1] Strong growth in noncoffee export volumes and improved terms of trade, helped to narrow the current account deficit, excluding grants, to 11.5 percent of GDP. Greater-than-anticipated donor support and private capital inflows more than covered this deficit, allowing international reserves to build up to about 6½ months of imports. The Ugandan shilling has been generally stable in real effective terms, despite a brief period of volatility in February 2004.



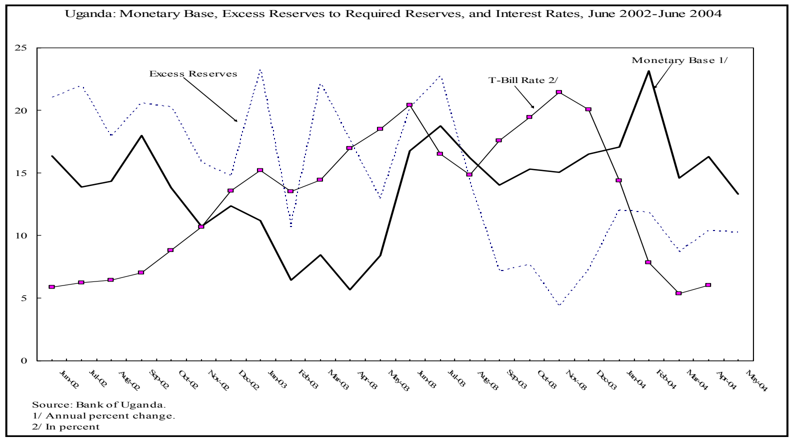
Source: Ugandan authorities.

2. **The fiscal deficit was broadly consistent with the program in 2003/04, but the composition of expenditure deviated somewhat from budget intentions.** The fiscal deficit, excluding grants, narrowed marginally to an estimated 11.2 percent of GDP in 2003/04, while the domestic budget deficit, which excludes grants and externally financed expenditures, declined by an estimated 0.9 percentage points to 4.3 percent of GDP (Table 2 and Figure 2).[2] However, supplementary spending of about 0.9 percent of GDP in the final quarter of the year—mainly to meet security needs, cover shortfalls in salaries, and support State House—resulted in reallocations from the original budget appropriations in nonstatutory spending outside of the Poverty Action Fund (PAF), and contributed to the generation of new domestic arrears. The outturn for revenues fell a little short of the program target, owing mainly to weak value-added tax (VAT) compliance.

[1] Underlying inflation, which excludes food crops (but includes fuel), has been more stable, declining to 4.8 percent in May 2004, from 5.4 percent in June 2003.

[2] Previously, some project support on-lent to other public entities or the private sector were not included in the fiscal accounts. Including these resources and treating the expenditures as external development spending raises the figures for the overall fiscal deficit, excluding grants, and donor support by 0.8 percent of GDP in 2003/04. The fiscal accounts for past years were also revised.

3. **Large variations during the course of the year in government liquidity injections and a shifting emphasis by the Bank of Uganda (BOU) on treasury bill sales to sterilize that liquidity contributed to substantial volatility in interest rates** (Table 3 and Figure 3). In December 2003, the yield on 91-day treasury bills rose to over 20 percent, as stronger-than-projected currency demand exacerbated pressure on interest rates from a tightening in the reserve position of commercial banks. BOU subsequently loosened its monetary stance and shifted its sterilization operations toward increased sales of foreign exchange; this, together with the introduction of long-term government bonds, resulted in a sharp decrease in treasury bill yields. Base money expanded more rapidly than programmed, particularly in the first three quarters of 2003/04, but the rate of expansion has moderated significantly in recent months.[3] In view of the strong demand for currency and the trend decline in the broad monetary aggregates during the past 18 months, inflation is expected to remain subdued.



Uganda: Monetary Base, Excess Reserves to Required Reserves, and Interest Rates, June 2002-June 2004

Source: Bank of Uganda.
1/ Annual percent change.
2/ In percent

4. **The financial sector remains robust.** Indicators of banks' performance and vulnerability point to a sound expansion in balance sheets (Table 4). Supervision by the BOU has been vigilant and, under the Financial Institutions Act 2004, the regulatory framework is undergoing a substantial strengthening, for example, by reducing banks' allowable credit concentrations. In recent months, several micro-finance institutions have applied to the BOU for licenses under the new Micro-Finance Deposit-Taking Institutions Act, an important step for extending financial services to rural areas. The insurance sector has also experienced healthy growth, facilitated by an increase in capital requirements and enhanced supervision through on-site inspections by the Uganda Insurance Commission.

5. **Performance under the Poverty Reduction and Growth Facility (PRGF)-supported program was mixed in 2003/04. Most quantitative performance criteria for December 2003 were observed,** including the ceiling on banking system credit to the public sector and the floor for the net increase in international reserves. But the performance criteria on the increase in base money, on the accumulation of domestic arrears under the Commitment Control System (CCS), and on no new lending by the Uganda Development Bank Limited (UDBL) were not observed. The deviations from the program were minor, however. Base money exceeded the program ceiling by a small margin (i.e., less than

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[3] Preliminary data indicate that the year-on-year growth in base money declined from 23 percent in March 2004 to 13 percent in June 2004.

one-half of one percent of base money at the beginning of the year); the domestic arrears accumulated are a small fraction of total spending under the CCS; and the UDBL extended one small new loan to a viable commercial client, in the amount of U Sh 91 million (about US$50,000). In addition, the indicative ceiling on public administration expenditures was breached, while spending protected under the PAF fell short of its indicative floor, both by relatively small amounts.[4] Preliminary indications are that much of the shortfall in PAF expenditures in the first three quarters of 2003/04 was made up in the fourth quarter.

6. **Progress has been made in the implementation of the program's structural measures; albeit with some delays** (Box 1, Table 5). In particular, the benchmarks on the introduction of long-term government bonds and on verifying and reporting the stock of domestic arrears were observed. However, although most of the arrears accumulated in 2002/03 on spending covered by the CCS have been paid, they will not be fully cleared until September 2004. And the end-March 2004, structural performance criterion on the divestiture option to follow for the UDBL was not observed. As discussed below, the authorities have since decided on a divestiture option and the restructuring of the UDBL that should ensure its sustainability through sound financial management. Based on this decision and the minor nature of the slippages from the program, the Ugandan authorities are requesting waivers for the nonobservance of four performance criteria.

Box 1. Structural Conditionality

Coverage of structural conditionality in the current program

The structural program proposed for the period through end-December 2004 consists of three performance criteria (PC) and eleven benchmarks (see Table 2 of the MEFP). The areas covered by this program can be categorized as (i) *measures to achieve a more sustainable fiscal and external position*, which include strengthening tax administration, curbing public administration expenditures; and improving external debt management; and (ii) *measures in the IMF's domain that will improve medium-term growth prospects*, which include improving the effectiveness of government spending through the elimination of domestic arrears and reform of the budget process to encompass donor-supported projects in the medium-term expenditure framework, strengthening and deepening the financial sector, and enhancing transparency and governance.

Status of structural conditionality from earlier programs

The implementation of the structural conditions for the remainder of the 2003/04 program, set at the completion of the second review under the PRGF arrangement on December 17, 2003, was mixed (see Table 5). One of the two PC was observed and three out of six benchmarks were observed. The PC that was not observed, regarding the divestiture of the Uganda Development Bank Limited, however, was implemented late, while substantial progress was made on the remaining unobserved measures, which have been incorporated in the program for 2004/05.

Structural measures covered by World Bank lending and conditionality

World Bank program lending in 2004/05 is expected to be delivered under the fourth annual Poverty Reduction Support Credit (PRSC). Conditional prior actions include satisfactory execution of the budget, particularly on items protected under the Poverty Action Fund, implementation of the Leadership Code, and reform of local government procurement.

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[4] The slippage on PAF spending was mainly on account of poor cash releases to districts on certain grants, as the districts did not adequately fulfill their reporting requirements to the central government.

II. POLICY DISCUSSIONS

7. **Policy discussions focused on the annual program for 2004/05 and revisions to the medium-term policy and economic outlook, taking into account the emerging recommendations of the revised Poverty Eradication Action Plan (PEAP).** The authorities agreed that, in light of the recent setback to Uganda's efforts to reduce poverty (Box 2), it was important to make some headway in the coming year on the policy agenda to be set out in the revised PEAP.

A. The Medium-Term Framework

8. **The revised PEAP is expected to set out an agenda for raising economic growth rates through increased private investment, the modernization/commercialization of agriculture, and an expansion and diversification of exports.** It will also call for substantial improvements in the effectiveness of government spending over a sustained period, particularly in the delivery of health and education services to the poor and infrastructure investment and maintenance. Over the medium term, real GDP is projected to grow by about 6 percent a year, while inflation would be kept below 5 percent. The strategy hinges on a gradual reduction of the fiscal deficit, excluding grants, to ease crowding out pressures on private investment and exports. The deficit reduction would be achieved by strengthening revenue mobilization in the face of losses from the East Africa Community (EAC) customs union, mainly through improved tax administration, while reducing the growth in total government expenditure, by phasing out project expenditure that is not well aligned with the PEAP priorities and increasing the overall efficiency of public spending. Commitments of donor support, excluding HIPC assistance, are projected to remain steady in U.S. dollars, but would decline relative to GDP. As a result, upward pressures on interest rates and the real value of the Uganda shilling would be expected to ease. The external current account deficit, before grants, would narrow gradually over time, financed by donor support and growing private capital inflows. The authorities would maintain a flexible exchange rate policy, selling regular daily amounts of foreign exchange (from donor inflows) for the purpose of mopping up liquidity and otherwise intervening only if necessary to maintain orderly market conditions. Official international reserves would be maintained at, or above, five months of imports of goods and services (Table 6).[5]

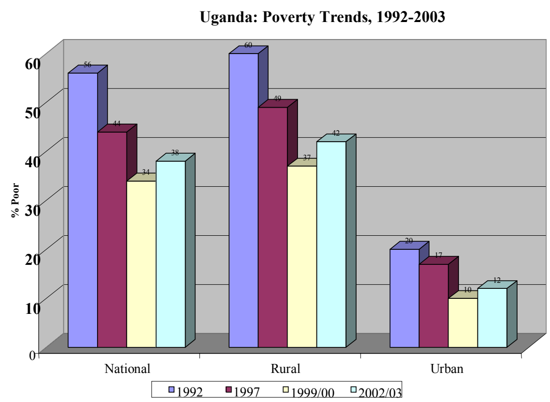
9. **The strategy for raising economic growth will continue to emphasize a policy framework that directly addresses the main impediments to doing business in Uganda.** Addressing these impediments has been the foundation of the government's Medium-Term Competitiveness Strategy (MTCS), which has had success in the past, particularly in improving the delivery of telecommunications and electricity services. Most recently, businesses have cited high costs of domestic financing, poor infrastructure—especially the

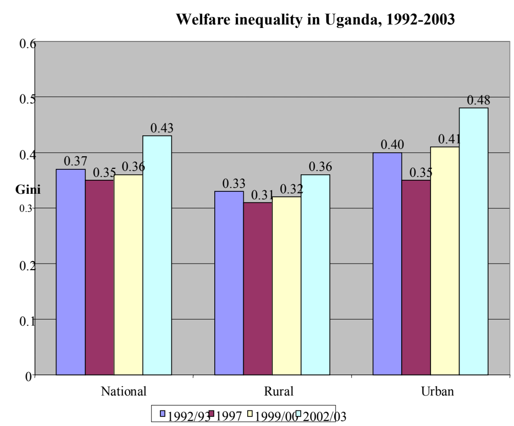
[5] The decline in import coverage partly reflects conservative projections of disbursements of donor support by the authorities for budgeting purposes. Higher-than-projected disbursements would result in a leveling-off of gross international reserves at 5 to 6 months of imports.

Box 2. Poverty Dynamics—Progress and Challenges

Poverty and inequality trends

The 2002/03 household survey shows a moderate increase in income poverty to 38 percent of the population, from 34 percent in 1999/2000—a significant setback from the steady decline in poverty observed during the 1990s. The rise in poverty was broad-based. Mean per capita consumption declined in all four bottom quintiles (80 percent of the population) in both rural and urban areas. The proportionate rise in poverty was greater in urban areas than in rural areas, but with about 90 percent of the poor living in rural areas, poverty remains mostly a rural phenomenon. The rise in poverty was particularly pronounced for households whose head worked in agriculture (from 39 percent to 49 percent), especially crop farming. The largest increase in poverty occurred in the Eastern region, while the highest incidence rates (63 percent) were still found in the conflict-ridden North. Income inequality increased in all regions, but is particularly high in urban areas.[1] Inequality between large and small families also increased.





Factors contributing to the increase in poverty

The slowdown in real GDP growth, deterioration in the terms of trade, especially in agriculture, and high population growth contributed to the setback in income poverty. In rural areas, increases in household size and dependency ratio accounted for most of the decrease in average consumption in the lowest quintiles. Regionally, in the East, lower earnings, arising partly from displacement of people from their homes because of security concerns, were also an important factor. On top of the large deterioration in the external terms of trade, notably the sharp drop in coffee prices, declines in crop prices relative to the prices of other domestically produced goods and services reduced the purchasing power of farmers.

Overall welfare

The impact on the poor of the fall in the monetary value of household consumption has been mitigated by advances in other aspects of welfare. In all income groups, nonincome indicators of welfare improved, including the proportion of households with permanent roofs, radios and bicycles; access to services (e.g., percent of households with safe drinking water, toilets, and utilities); education enrollment rates for both boys and girls; and number of days lost due to sickness.

Policy implications

The biggest challenge is to achieve sustained higher growth in the face of exogenous shocks. In this respect, macroeconomic stability, increased competitiveness, financial deepening, greater investments in physical and human capital, and measures to encourage export diversification, supported by institutional reforms and insurance mechanisms, will be crucial in attaining Uganda's objectives for poverty reduction. Programs aimed at raising agricultural productivity and rural incomes, such as the Plan for the Modernization of Agriculture, could directly impact the main areas of poverty in Uganda. Reproductive and other health interventions (e.g., AIDS prevention) should receive a high priority to lower household size and the dependency ratio. Restoring security in the North would allow large numbers of internally displaced persons to return home and enable greater access to humanitarian services. Further improvements in public service delivery will also be important to enhance nonmonetary dimensions of well-being.

The authorities, with assistance from the World Bank, are undertaking a detailed assessment of the poverty situation. Measures to address the rise in rural poverty include programs to enhance the provision of public goods for agricultural production in the areas of agricultural extension, research and technology, and marketing, as well as the provision of the necessary infrastructure, including roads, electricity, and railways.

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[1] The Gini coefficient rose to 0.43 from 0.36 in 1999/2000.

transportation network—and corruption as leading constraints on business activity. The staff supports the policy agenda that seeks to lower financing costs through lower fiscal deficits and a sound deepening of the financial sector, improve the transportation network through road construction and the privatization of the Uganda Railway, and strong anticorruption measures throughout national and local government.

10. **With the vast majority of the country's poor living in rural areas, the PEAP also emphasizes the need to raise agricultural productivity and rural incomes.** Success will hinge on firm implementation of the Program for the Modernization of Agriculture (PMA), which beyond agricultural advisory services, incorporates policies for the development of financial services, marketing, agricultural research and development, standards, infrastructure, education, land reform, sustainable resource management, and value addition through processing. Furthermore, with agricultural production and service delivery in the North severely disrupted by the rebel insurgency, restoration of security is essential to improve the livelihood of the millions of people affected by the conflict.

B. Macroeconomic Outlook for 2004/05

11. **The outlook for 2004/05 is favorable.** Real GDP growth is expected to strengthen to about 6 percent, reflecting continued strong performances across most sectors of the economy and a rebound in the coffee sector. Underlying inflation is projected to remain subdued at 4 percent. The fiscal deficit, excluding grants, and the domestic deficit are both projected to narrow by 0.3 percentage points to 10.9 percent of GDP and 4 percent of GDP, respectively, easing the burden of sterilization operations.[6] Despite continued export growth, a strong increase in imports and a deterioration in the terms of trade are projected to widen the current account deficit, excluding official transfers, to 13 percent of GDP. Net inflows of donor support are projected to decline by 2 percentage points to 10.1 percent of GDP. Nevertheless, when account is taken of private capital inflows, funding should be sufficient for the overall balance of payments to record a modest surplus. Gross reserves would be maintained at just over six months of imports.

C. Fiscal Policies

12. **Policy discussions focused on the 2004/05 budget and the need to strengthen further expenditure management and the effectiveness of government spending.** The challenge facing the authorities was formulating a budget that achieves a continued gradual reduction in the budget deficit, while maintaining pro-poor expenditure. This was made

[6] In the course of improving the coverage for donor-supported projects, since the last review of the PRGF program, spending for US$42 million (0.6 percent of GDP) in projects that were already contracted, but not recorded in the fiscal accounts, have been included for 2004/05. The fiscal balances of preceding years have also been revised to include previously unrecorded projects. The authorities have, however, consistently included these obligations as part of their total debt stock, and recorded their debt service in the fiscal accounts and debt sustainability exercises.

difficult by, on the one hand, strong pressures for greater spending on defense and public administration and, on the other hand, anticipated losses in tax revenue from the advent of the EAC customs union, currently expected to come into force in January 2005. Development partners indicated that they could not support the draft budget because the proposed allocations for defense and election-related activities squeezed out funding of a number of PEAP priorities. In addition, a number of spending commitments were unfunded in the draft budget, which risked giving rise to supplementaries and arrears that would undermine the credibility of the budget process.

13. **Following extensive consultation with all stakeholders, the authorities agreed to reduce the proposed increase in defense spending in 2004/05, identify additional cost savings in public administration, and adopt new tax policy measures.** These actions, together with a reallocation of some expenditure in the development budget and some additional donor-funded projects, allowed the formulation of a revised budget that strengthened the poverty focus, while achieving some necessary fiscal consolidation.

14. **In the 2004/05 budget presented to parliament in June, total spending as a share of GDP is unchanged from the previous year at 23.8 percent; the fiscal adjustment thus relies on a stronger revenue mobilization effort.** Government revenue is projected to rise by 0.3 percentage points to 12.9 percent of GDP, based on buoyant income taxes and international trade taxes and tax policy measures. The latter, which cover increases in the withholding tax on imports and local transactions, excise duties on tobacco and spirits, and traffic fees, are expected to generate 0.2 percent of GDP in additional revenues.[7] The 2004/05 budget also anticipates some modest gains from improved tax administration and stepped up efforts to strengthen nontax revenue collection. Partly offsetting these gains, however, will be the losses in tax revenue from the establishment of the EAC customs union, which in the first full year of operation could amount to ½ percent of GDP (Box 3).[8]

15. **Continued progress in tax administration is essential for Uganda to meet its goal of gradually reducing the fiscal deficit over the next several years, especially in view of the anticipated losses in customs revenue**. To this end the authorities will step up efforts to improve the operations of the Uganda Revenue Authority (URA). While the report by the Judicial Commission of Inquiry on corruption in the URA was completed in February 2004, it was signed by only one (the chair) of the three commissioners and has since been mired in legal proceedings. The authorities, nonetheless, plan to pursue strong actions to restore the integrity of the institution and reduce corruption, including through the introduction of revamped recruiting and training processes, development of a quality code of conduct for the institution, and follow-up examinations of the asset declarations by URA officials and

[7] The withholding tax on imports will be removed as the EAC customs union comes into force in January 2005, thus the yield from this measure only accrues to the first half of the fiscal year.

[8] In 2004/05, the losses are expected to amount to about ¼ percent of GDP, since the start of the customs union has been postponed from July 2004 to January 2005.

potential corruption cases. The authorities have begun restructuring the URA, including the appointment of a new board of directors. In this regard, they indicated that they will request technical assistance from the IMF to assess the institutional and operational changes needed to enhance the URA's capacity to mobilize domestic revenue.

Box 3. The East Africa Community (EAC) Customs Union

On March 2, 2004, the heads of state of Kenya, Uganda, and Tanzania signed the protocol establishing the EAC customs union. The protocol eliminates internal tariffs and charges on imports, and nontariff barriers among EAC countries. Because of differences in industrial development between the member states, Uganda and Tanzania will be allowed to apply internal tariffs on selected products imported from Kenya. These will be gradually reduced to zero over the next five years.[1]

The EAC has adopted a three-band common external tariff (CET), with a 0 percent rate for raw materials and meritorious and capital goods; 10 percent for intermediate goods, and 25 percent for consumer goods; the maximum CET rate will be reviewed after five years.[2] This tariff structure contrasts with Uganda's current tariff band of 0, 7, and 15 percent. Special treatment remains to be defined for a limited number of tariff lines, which will be charged on top of the CET rate.[3] In addition, the EAC Council may approve measures to compensate for any adverse effects resulting from the implementation of the CET.

While the CET will raise Uganda's average tariff, the increase in effective protection rate will be mitigated by several factors.[4] First, Uganda will eliminate the 2-percent commission on all imports and remove excise duties (10-15 percent) charged on nearly 450 products on top of the 15 percent tariff. Second, non-tariff barriers—such as standards and import procedures—will be harmonized or repealed to facilitate trade. Third, imports will be valued at the first point of entry into the EAC, and hence tariffs will no longer apply to transport and insurance costs from Kenya and Tanzania to Uganda.

The customs union will give rise to trade diversion. Preliminary estimates of the impact of the CET on goods in the 25 percent tariff band indicate that in the initial phase of the customs union—with transitional tariffs on Kenyan products—imports from non-EAC countries will decline by up to 1.3percent.[5] Regional imports will increase by 0.15 percent, as the temporary tariffs on Kenya products will constrain their demand. Trade diversion, and welfare losses, will be larger once temporary tariffs are removed; imports from Kenya are estimated to increase by 6 percent, while imports from non-EAC countries will decline by 3.3 percent. To avoid the welfare losses, Uganda should continue to pursue a further reduction in the CET schedule.

The coming into force of the EAC customs union will entail short-term revenue losses for Uganda (of up to ½ percent of GDP), because of the following:

- ***The removal of the commission and withholding tax on imports***, with immediate effect.
- ***The valuation of imports at the EAC point of entry,*** which will reduce Uganda's import tax base by the freight and insurance associated with transport within the EAC.
- ***The restructuring of tariffs vis-à-vis the removal of discriminatory import excises.*** This is expected initially to generate a small net revenue gain, as the average tariff will increase while a fraction of the discriminatory excises (in particular, those applied to Kenyan imports) will be removed only gradually. Over time, however, revenue losses will increase as the transitory duties on Kenya products are phased out, and imports are increasingly sourced from EAC countries, which face no tariffs.

[1] About 426 products imported by Uganda from Kenya will enjoy interim tariff protection at an initial rate of 10 percent, which will be reduced by 2 percentage points per year. Tanzania has requested transitory provisions for nearly 900 products, at different rates, during the same period.
[2] No specific commitment has been made on its reduction.
[3] Special protection will be given to goods such as maize, milk, sugar, rice, and worn clothing.
[4] Uganda's average tariff will rise from 7 percent to 12 percent, while average tariffs will decline for Kenya and Tanzania.
[5] See, "Regional Trade Integration in East Africa—Trade and Revenue Impacts of the Planned Customs Union," World Bank, February 2004.

16. **Greater effectiveness of government spending will be critical in the years ahead to achieving the PEAP objectives and support fiscal consolidation. In particular, public expenditure management and budget prioritization will need to be strengthened** (Box 4). The following measures will be helpful in this regard:

- Beginning with the 2004/05 budget, sector ceilings include donor projects. This will give line ministries greater control over the use of resources, enabling them to align functions with a well-developed sector strategy. The relevant regulations of the Public Finance and Accountability Act (PFAA) will be amended to ensure that donor projects are properly integrated in the budget and that adequate reporting agreements are in place.
- Budgeting and monitoring of defense spending will be strengthened. Beginning with the 2003/04 budget year, classified defense expenditure will be audited. In addition, a sector working group will be established to monitor implementation of the Defense Review and ensure that standard public expenditure management principles are applied in the defense sector, including the preparation of a comprehensive Budget Framework Paper. A Corporate Plan to guide the implementation of the Defense Review recommendations is under preparation.
- To strengthen budget execution, the Integrated Financial Management System (IFMS) will be rolled out to all line ministries and six additional districts in 2004/05.[9] This should improve efficiency, reporting, and accountability of public spending.
- Implementation of the Fiscal Decentralization Strategy (FDS) is proceeding. In 2004/05, 6 pilot districts will be added to the initial 15 districts in the program. The IMF is providing technical assistance to align local government regulations with the PFAA and to assist with the development of a CCS at the subnational level.
- A comprehensive plan to clear nonwage, nonpension arrears according to age profile has been developed and assigned to a well-defined team at the Treasury for execution. Cabinet has also approved a strategy for clearing public service pension arrears in the context of the planned conversion of the present pension system to a contributory scheme. In the 2004/05 budget, 0.4 percent of GDP has been allocated for repayment of arrears.[10] Implementation of the IFMS will facilitate monitoring of the overall flow of arrears, as it will provide an extension of the current CCS to all types of spending. In the transition period, new arrears under the CCS in any quarter of the fiscal year will be cleared within the next quarter from the budget resources provided in that quarter. Furthermore, the authorities will strengthen the application of penalties to those accounting officers who do not comply with the CCS.

[9] During 2003/04, the IFMS was rolled out to 6 line ministries and 4 districts.

[10] The overall stock of nonwage, non pension arrears as of June 2003, was recently verified at about 1.3 percent of GDP. Pension arrears amount to about 2.1 percent of GDP. As noted above, a separate plan for the payment of pension arrears is being developed, with assistance from the World Bank, that would expedite their clearance over the medium term.

Box 4. HIPC Tracking Assessment and Action Plan (AAP)

IMF/World Bank staffs carried out a first comprehensive assessment of Uganda's public expenditure management (PEM) systems in 2001. The objective was to appraise how well such systems tracked poverty-reducing spending in the context of the enhanced HIPC Initiative. Sound PEM systems should contribute to reducing reporting requirements by donors as conditions in providing aid, as they help ensure that funds are used for their intended purpose. In addition, they enhance efficiency in the use of public resources.

A joint IMF-Bank mission visited Kampala in February 2004 to conduct a second assessment. Staff appraised progress made in strengthening the PEM systems since the first exercise and developed, in conjunction with the authorities, an action plan to address weaknesses in PEM and the tracking of pro-poor spending. The assessment was based on 16 benchmarks covering: budget formulation (7 benchmarks) budget execution (4 benchmarks); reporting procedures (4 benchmarks); and procurement mechanisms (1 benchmark). The latter indicator has been added since the last exercise to broaden its scope.

Uganda's PEM systems are strong compared with other HIPCs assessed. In 2001, Uganda met 9 of the 15 benchmarks—5 in budget formulation, 1 in budget execution, and 3 in budget reporting. Of the 24 other countries assessed, Uganda met the highest number of benchmarks. In the latest assessment Uganda met 9 of the 16 benchmarks—4 in budget formulation, 3 in budget execution, and 2 in budget reporting.

Improvements were recorded in four areas considered deficient in 2001: (i) internal control has been fully established at all levels of government; (ii) a significant number of tracking surveys on poverty-reducing expenditure have been carried out; (iii) the books are closed in a timely manner at year end; and (iv) the audit reports are presented to the legislature within an acceptable period of time.

Some significant challenges remain however. First, there is no systematic and timely reporting and ex post accounting of donor aid. Second, there is a lack of reliable data on expenditure arrears. Third, the absence of a functional classification in the chart of accounts makes it difficult to track poverty-reducing spending in a comprehensive and accurate manner. Finally, fiscal reports on budget execution are prepared with a long lag.

The apparent deterioration in Uganda's ranking on budget reporting indicators relative to the 2001 assessment is attributable to two factors. First, IMF/World Bank staffs have defined assessment standards for this exercise somewhat more precisely than previously. Second, some 40 percent of overall government spending and roughly 70 percent of poverty-reducing outlays in Uganda are now devolved to the local governments. The 2004 exercise focused more strongly on PEM systems at subnational levels, where capacity is weaker. Despite growing expenditure devolution, Uganda has been able to maintain the number of fulfilled benchmarks.

D. Monetary Program and Financial Sector Policies

17. **The base money program for 2004/05 aims to maintain low inflation, while allowing for sufficient availability of credit to the private sector** (Table 3). Staff concurred with the authorities that the sterilization of large volumes of liquidity arising from government fiscal operations would continue to pose a challenge to the conduct of monetary policy, but noted that a steadier and more balanced execution of the program of treasury bill and foreign exchange sales would reduce interest rate volatility. In this context, the BOU undertook to review its profile of foreign exchange sales in the event of more buoyant capital

inflows and adopt a number of recommendations of the technical assistance mission designed to strengthen monetary policy operating procedures and the liquidity management framework. This included, in particular, measures to reduce instrument volatility and improve liquidity forecasting.[11] Greater use of multiyear government paper would also ease pressure on short-term interest rates and reduce rollover risks.

18. **The BOU will continue to follow a flexible exchange rate policy aimed at maintaining reserves at a healthy level.** The BOU will maintain orderly conditions in the foreign exchange market but will not target a specific value of the exchange rate. There is no indication that the exchange rate is significantly misaligned (Box 5 and Figure 4).

19. **The authorities have placed great emphasis in recent years on strengthening and deepening the financial sector in recognition of the importance of the sector's performance to the economic development of the country.** Most recently, the reform agenda has focused on the sector's legal and regulatory framework. The authorities are in the process of enforcing the implementation regulations for the Micro-Finance Deposit-Taking Institutions Act 2003 and finalizing the implementing regulations for the new Financial Institutions Act 2004. This should support mobilization of savings and the sound expansion of both types of institutions in a mutually beneficial environment. In this regard, the BOU may have to further strengthen its supervisory capacity of nonbank financial institutions, especially in light of the expectation that the BOU will serve as the interim supervisor of the National Social Security Fund (NSSF). A third piece of legislation, the anti-money laundering bill, should further strengthen the sector. Progress has been slower than planned, however. The bill, which was to have been submitted to cabinet by end-June 2004, is still undergoing careful review.

20. **To enhance credit delivery, especially to small- and medium-sized enterprises, the UDBL will be merged with the Development Finance Department of the BOU and management will be contracted to a private institution. In addition, the government will sell a minority equity stake.** This should avoid the directed lending and governance problems that had led to Uganda Development Bank's insolvency in the past, and bring it under the BOU's supervisory framework. The removal of the Development Finance Department from the BOU will further avoid a potential conflict of interest at the BOU. Pending divestiture neither the government nor the BOU will provide or guarantee further resources for on-lending by the UDBL. On this basis, the authorities have requested a waiver for the nonobservance of the end-March 2004 performance criterion regarding the UDBL.

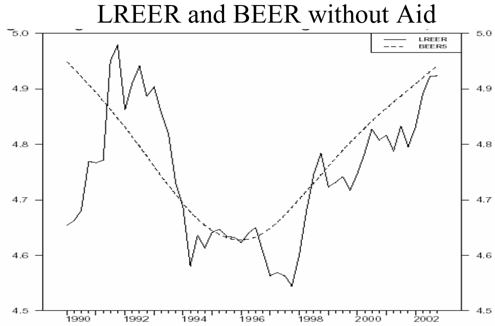
[11] The MFD technical assistance mission in March 2004, advised the BOU on several issues relating to monetary policy operating procedures and on ways of improving the functioning of the government securities market.

Box 5. Uganda: Aid and Real Exchange Rate Dynamics [1]

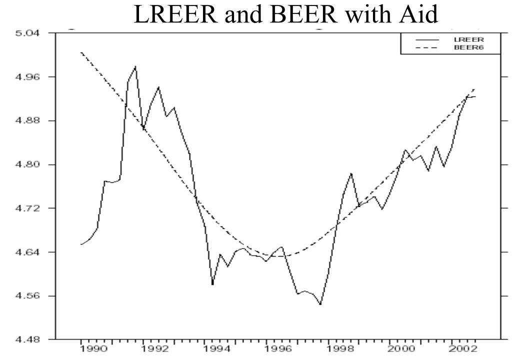
Understanding the evolution of the real equilibrium exchange rate, and hence the possible extent to which the actual value of the currency deviates from its equilibrium value, is of importance to all economies. It is of particular interest to an economy like Uganda's that has received substantial aid inflows (about 10 percent of GDP per year) and has been subject to large terms-of-trade shocks. And furthermore, whose poverty-reduction strategy in part rests on fostering export-led growth. This Box reports on work that examined this issue by first estimating the equilibrium or behavioral real effective exchange rate (BEER) using cointegration-based methods and then producing a measure of misalignment in which the fundamentals are calibrated at some notional equilibrium.

The results point to a stable long run relationship between the real effective exchange rate (REER) and its economic fundamentals. The estimation period is from 1990 to 2002, a liberalized phase of the economy, which produces a single cointegrating relationship between the equilibrium REER and its fundamentals, avoiding any major structural breaks in the data. As expected, productivity differentials in the tradable and non-tradable sectors, trade balance, and terms of trade significantly appreciates' the equilibrium REER (baseline model). The REER adjusts to close the gap of disequilibrium by approximately 12 percent per quarter, suggesting nearly half of the adjustment to a shock to the real exchange rate will be offset after one year. The inclusion of aid flows (both budget and project support) does not substantially alter the results with the coefficient on the aid term implying that a one percent increase in aid as a proportion of GDP appreciates the real exchange rate by only 0.2 percent. Moreover, the system produces a faster real exchange rate adjustment, with about 20 percent of the deviation being closed within one quarter.

LREER and BEER without Aid



LREER and BEER with Aid



There are two distinct periods of real exchange rate misalignment—the period in the early 1990s where the effective rate was undervalued, and the period in the second half of the 1990s and into early 2001 where the currency is clearly overvalued. The figures above plot the inverted (increase is a depreciation) log of the REER (LREER) and the BEER with and without 'Aid' flows smoothed using a Hodrick-Prescott (HP) filter to highlight the degree of real exchange rate misalignment.[2] Both figures depict a similar trajectory with the real exchange rate misalignment narrowing to near equilibrium in 2002. The results support the finding of Atingi-Ego and Sebudde (2001) that show a recent narrowing of the real exchange rate overvaluation.

1/ The box relies heavily on an unpublished paper by Ronald MacDonald (2004), "Modeling the Equilibrium Real Effective Exchange Rate of the Uganda shilling."
2/ Since the HP filter may be biased, especially at the tail end of sample, a time series technique of decomposing the permanent and temporary components of the 'fundamentals' was also used to obtain their sustainable values, which produced similar results.

21. **Pension reform and the insurance sector have the potential for mobilizing domestic resources for long-term financing.** The authorities have now broadly developed a strategy for pension reform. It envisages moving to a fully funded public service pension scheme, making the mandatory scheme for private sector employees more efficient, allowing independent third party retirement savings schemes operated by financial institutions, and regulating and supervising public and private pension schemes as outlined in the Social Security Stakeholder Transition Group (STG) report. The staff emphasized the importance of carefully evaluating the fiscal implications of the reform proposals and paving the way for the BOU to serve as an interim supervisory authority for the NSSF.[12] In the insurance sector, the initial public offering of the National Insurance Corporation (NIC) should encourage competition and product innovation. This, along with the recent issuance of regulations for the licensing of collective investment schemes (unit trusts), should facilitate greater portfolio diversification and capital market development.

E. External Sector Policies and Debt Sustainability

22. **Expanding and diversifying exports is an integral component of Uganda's strategy to boost economic growth and achieve a sustainable external position.** The EAC customs union will create a unified market of 90 million consumers, which should benefit Ugandan food crops exports in particular, and facilitate the development of much needed regional infrastructure. The core programs in this area remain the MTCS and the PMA, complemented by the Strategic Exports Program (SEP). In addition to strengthening implementation of these programs, in particular the PMA through the expansion of micro-finance services and rural roads, the authorities plan to introduce export-processing zones (EPZs). Designated areas would be provided with the necessary infrastructure to support major new investments. The staff emphasized that to ensure the integrity of these operations and to avoid unfair competition in the domestic market, it will be necessary to ring fence these areas with strict implementation of customs duties and other taxes on sales to Ugandan residents. The staff further urged the authorities to avoid investment incentives, such as tax holidays, that could erode the tax base. To avoid harmful tax competition for investment, the Ugandan authorities will propose to the other partner states of the EAC to adopt a common code of conduct for investment incentive and company income taxation. As a first step toward greater transparency in this area, the authorities will publish annually a list of firm-specific benefits granted.

23. **To lower the external debt burden, the authorities will exercise more prudent debt management, including seeking more grant financing in place of loans and limiting new borrowing.** The ratio of net present value (NPV) of debt to exports has risen substantially in recent years (Table 7). Assuming full delivery of HIPC relief, the ratio increased to 258 percent at end 2002/03, compared with 209 percent projected at the time of

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[12] The World Bank is assisting in applying an actuarial model to test the affordability of the various pension benefits packages and parametric changes under consideration.

the last update of Uganda's debt sustainability, which was based on end-June 2001 data. The deterioration entirely reflects valuation changes resulting from the low interest rate environment and the depreciation of the U.S. dollar, since export performance has been better and borrowing flows lower than projected.[13, 14] The NPV of debt to exports is projected to decline in future years, but at 235 percent in 2007/08 (compared with 171 percent in the earlier debt sustainability analysis) would remain significantly above the HIPC Initiative threshold. Other indicators, though, paint a more favorable picture: the NPV of debt to GDP and the debt service-to-exports ratio both remain stable at 31 percent and 9 percent, respectively, well within the HIPC guidelines. However, external debt sustainability would worsen significantly if the debt contracted since the completion point in May 2000 were to be disbursed at a higher rate than the roughly 50 percent experienced to date (Appendix V). To address these concerns, the government will place annual ceilings on new external borrowing. Furthermore, to strengthen the institutional framework for debt management, the regulations of the Public Finance and Accountability Act 2003 will be amended to include clear monitoring and operational procedures.[15]

24. **Uganda has made further progress in obtaining debt relief.** But it should continue to engage creditors, particularly Libya and India, that have yet to provide debt relief under the HIPC Initiative (Table 8). The recent cancellation by the Government of Japan of its remaining claims (US$57 million) on Uganda and the US$3.6 million in debt relief provided by the East African Development Bank should provide some encouragement to the authorities. Reaching final agreements with the remaining creditors would provide debt relief (traditional and HIPC) of about US$293 million in 2003 net present value terms.

III. PRIVATIZATION

25. **Further progress has been achieved in the privatization program.[16]** Most notably: (i) the concession of the Uganda Electricity Distribution Company Ltd. to an ESKOM/CDC partnership was finalized in May 2004—it included a commitment to substantial new investment in the distribution network over the next five years; and (ii) the negotiations to prepare the Uganda Railway Corporation and the Kenya Railway Corporation for a joint

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[13] The assessment is based on preliminary results of an updated debt sustainability analysis being undertaken by the authorities for inclusion in the revised PEAP. For the assessment in 2002.

[14] Exports were 6.5 percent higher and borrowing flows 4.2 percent lower than projected in the earlier debt sustainability analysis. Approximately 85 percent of Uganda's debt is denominated in SDRs, which has appreciated by 12.1 percent against the dollar since June 2001. The U.S. dollar discount rate declined by 27.1 percent over the same period.

[15] This should, among other things, make explicit the responsibilities of the Ministry of Finance and other agencies in the borrowing operations at all stages of the loan cycle and the organizational arrangements and procedures for debt management.

[16] To date, 117 enterprises have been divested, leaving 31 to be privatized.

concession are progressing smoothly, with a possible target date for the transaction of August 2005.

IV. Governance

26. **The 2003 National Integrity Survey showed some perceived improvements in the area of governance. Nonetheless, it continued to highlight corruption as a significant problem.** In recent months, the military has begun to prosecute high-level officers for inflating payrolls with "ghost" soldiers, while the Ministry of Education has acted against schools with "ghost" teachers and pupils. However, implementation of the Leadership Code was recently weakened by a court ruling that the Code violates the constitution when it requires the President to dismiss officials identified by the Inspector General of Government (IGG) as not complying with mandatory asset declarations. The impact of this judicial decision was compounded by the President's decision to reappoint an official found to have actively avoided mandatory asset declaration. The authorities are developing plans to reestablish the disciplines of the Leadership Code, either through redrafting the Code or constitutional amendment. The mission emphasized that a concerted effort to follow up on the findings of the Judicial Commission of Inquiry on the URA and firm implementation of the Leadership Code will be essential to strengthening confidence in public institutions.

V. Program Monitoring

27. The fourth review will assess performance with respect to quantitative performance criteria and benchmarks for June and September 2004, respectively, and the structural performance criteria and benchmarks through September 2004 (Appendix I, Tables 1 and 2). The attached technical memorandum of understanding (Appendix I, Attachment II) details the design of the program, adjustment mechanisms, and terminology.

VI. Risks to the Program

28. Over the near and medium term, the main risks would be insufficient private investment to sustain high economic growth rates, inadequate domestic revenue mobilization efforts to maintain a path of gradual fiscal consolidation, failure to contain emerging spending pressures that undermine the quality of the budget appropriations, and failure to enhance the effectiveness of government spending, particularly for donor-supported social programs delivered at the local level. Insufficient progress in improving governance could impede the creation of an enabling environment for private sector-led growth. While the program is taking steps to mitigate these risks, poor implementation could be costly.

VII. Staff Appraisal

29. **The authorities have continued to demonstrate a strong commitment to sound macroeconomic policies, which have contributed to robust real GDP growth and kept inflation low.** Notwithstanding strong pressures for additional spending, the budget deficit has been kept under control and in some respects the fiscal situation has improved: the domestic balance (and hence the sterilization requirements) has narrowed and revenue

mobilization has increased. The overall balance of payments position has also improved and gross foreign exchange reserves are at a comfortable level. In the financial area, the regulatory framework for financial institutions has been strengthened and the financial system remains sound. Going forward, however, Uganda faces a number of challenges, most notably, reversing the recent setback to poverty reduction. There is also a pressing need to strengthen budget execution and the quality of government spending, and achieve a more sustainable external debt position.

30. **Although overall fiscal deficit targets have been met, persistent resort to supplementary appropriations has led to government spending outcomes that deviate from budget intentions, thus weakening the effectiveness of the budget as a development tool.** Weaknesses in public expenditure management have resulted in the accumulation of domestic arrears and, ultimately, a less effective use of government resources. The staff urges the authorities to adhere strictly to the proposed budget for 2004/05 by avoiding supplementary expenditures, especially on public administration and defense. Over the medium term, the government's fiscal consolidation strategy appropriately rests both on increasing revenue mobilization, to be achieved primarily through improved tax administration, as well as on constraining the growth of total expenditure, to be supported by the improved efficiency and targeting of public outlays. Follow through on the authorities' planned efforts to improve the operations of the URA will be essential to attain this goal.

31. **Some progress has been made in constraining the growth of public administration expenditure to free up additional resources for social spending. But more needs to be done.** The staff encourages the authorities to press ahead with the implementation of the various cost-saving and efficiency-enhancing measures that have already been identified, some of which require political support and legislative changes.

32. **Further advances in public expenditure management are necessary to improve the quality of government spending, which is critical for stepping up progress in the fight against poverty.** Moreover, greater transparency in the budget process would go far toward relieving donor concerns and facilitating the delivery of budget support, which in turn would help eliminate a potential source of economic vulnerability. In this respect, the staff welcomes the authorities' decision to establish a sector working group on defense to ensure that standard public expenditure management principles are applied in the defense sector and monitor implementation of the Defense Review.

33. **The staff welcomes the inclusion of donor-supported projects in the 2004/05 budget and the medium-term expenditure framework.** This should enhance transparency, facilitate planning, and give the line ministries greater control over the implementation of sector strategies. The staff is concerned, however, about the delays in establishing the requisite reporting and accountability systems. It encourages the authorities to move ahead quickly in establishing these systems and the institutional framework that will make the full integration of donor projects in the budget an effective tool for strengthening public spending policies.

34. **Domestic arrears continue to accumulate, in spite of the CCS, as the mechanisms to monitor and control them require strengthening.** The staff is encouraged by the steps being taken to clear outstanding arrears and avoid the emergence of new arrears. Wider use of prepayment arrangements for utilities—a main source of arrears—would be helpful, while implementation of the IFMS should curb the emergence of arrears from all types of expenditure. But this will only be the case if, in accordance with the PFFA, accounting officers are held responsible for the overcommitments they incur.

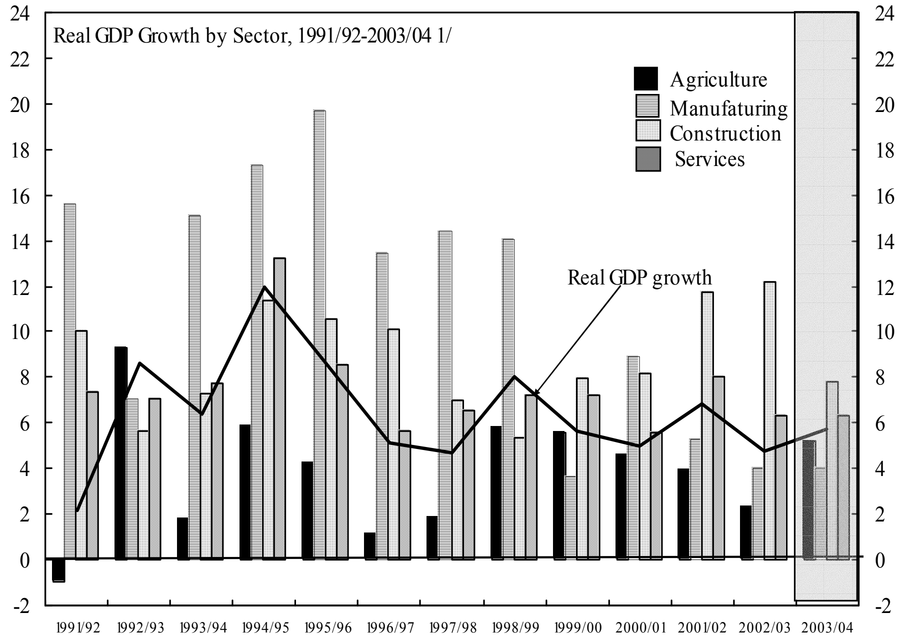
35. **The authorities are to be commended for the successful introduction of long-term government bonds.** These have eased the pressure on short-term interest rates and provided an additional financial instrument for mobilizing savings. During the past year, though, monetary policy excessively shifted between tighter and looser stances as it sought to sterilize the large volume of liquidity injected by government spending, while at the same time trying to dampen upward pressure on the exchange rate. A steadier execution of the programmed sales of treasury bills and foreign exchange and better liquidity forecasting should make interest rates less volatile.

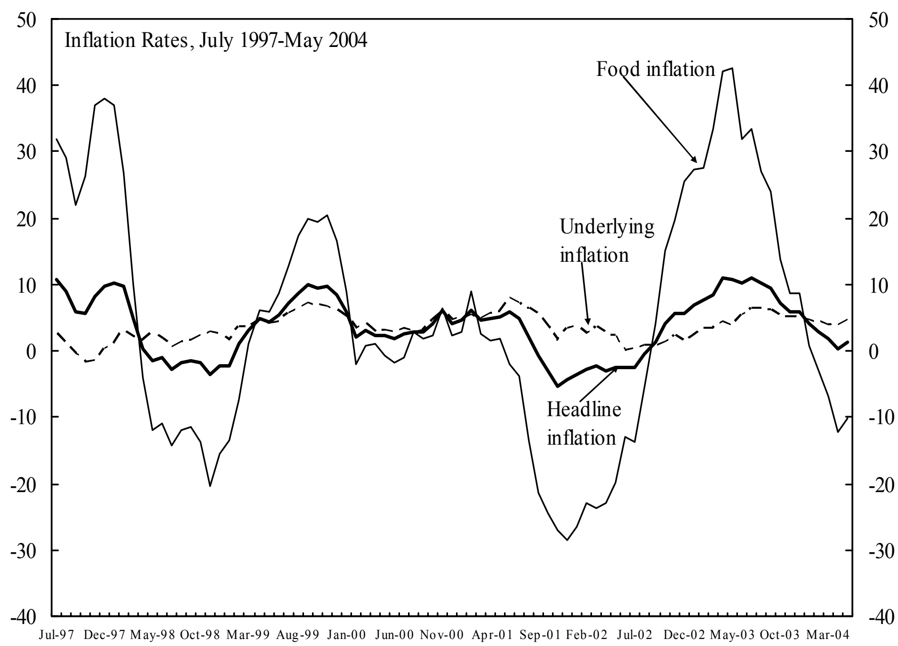
36. **Vigilant supervision has maintained a sound banking system.** The recently enacted Financial Institutions Act represents an important modernization of the regulatory framework, while the licensing of micro-finance institutions under the Micro-Finance Deposit-Taking Institutions Act is expected to increase access to formal financial services for a large number of rural and urban households that have difficulty accessing services from commercial banks. The development of a sound system of micro-finance institutions could play a pivotal role in rural development. In addition, the divestiture of the UDBL will enhance credit delivery to small- and medium-sized enterprises.

37. **The staff shares the authorities' concern about the increase in external debt and agrees with their decision to place an annual cap on new borrowing and to seek to replace loans with grants as central elements of a prudent debt management strategy aimed at achieving external debt sustainability.** Given the risks to export growth inherent in an economy heavily reliant on primary agricultural commodities, it is also essential to strengthen implementation of programs to expand and diversify exports and improve international competitiveness.

38. In view of Uganda's overall satisfactory performance in implementing the program and the actions taken to address slippages, as well as the government's policy intentions for 2004/05, the staff recommends that the request for waivers for the four missed performance criteria be granted and the third review of the PRGF arrangement be completed.

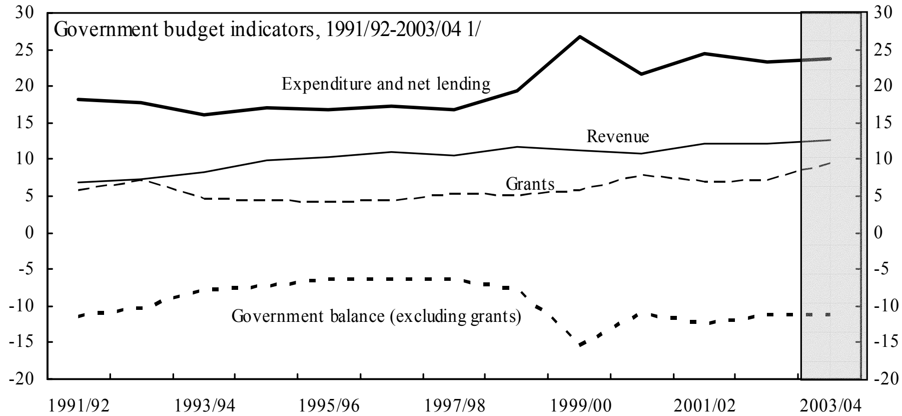
Figure 1. Uganda: Real Sector Indicators 1/
(Annual percentage changes)

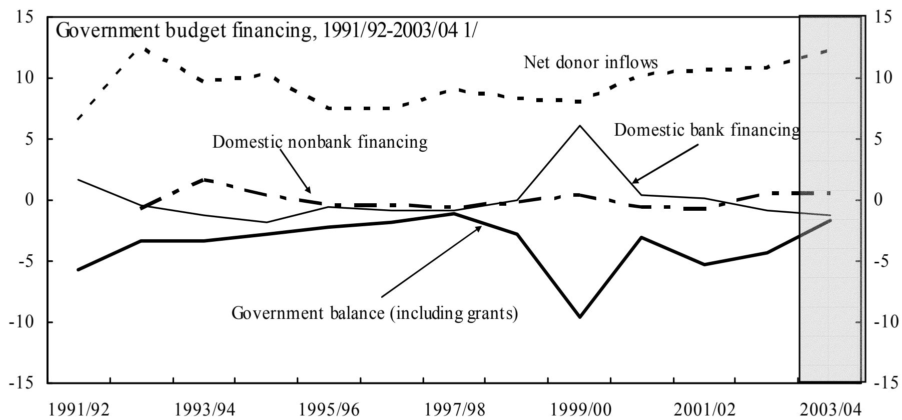


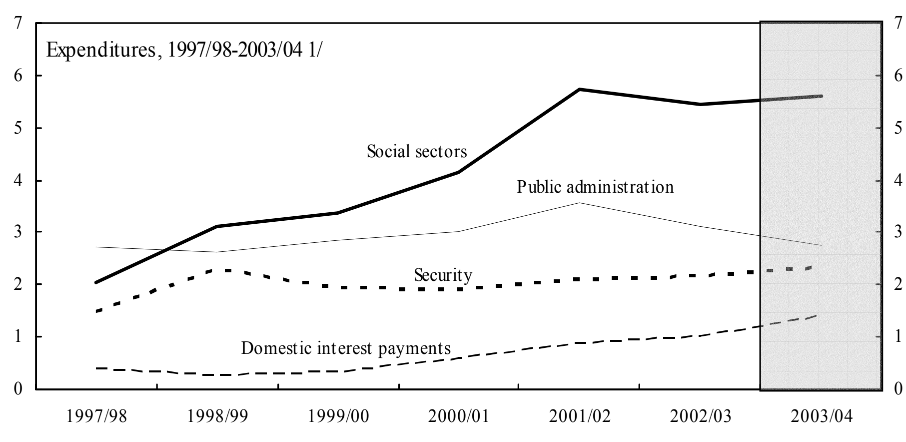


Sources: Ugandan authorities; and IMF Staff estimates.
1/ Fiscal year begins on July 1.

Figure 2. Uganda: Fiscal Indicators 1/
(As a share of GDP at market price, in percent)

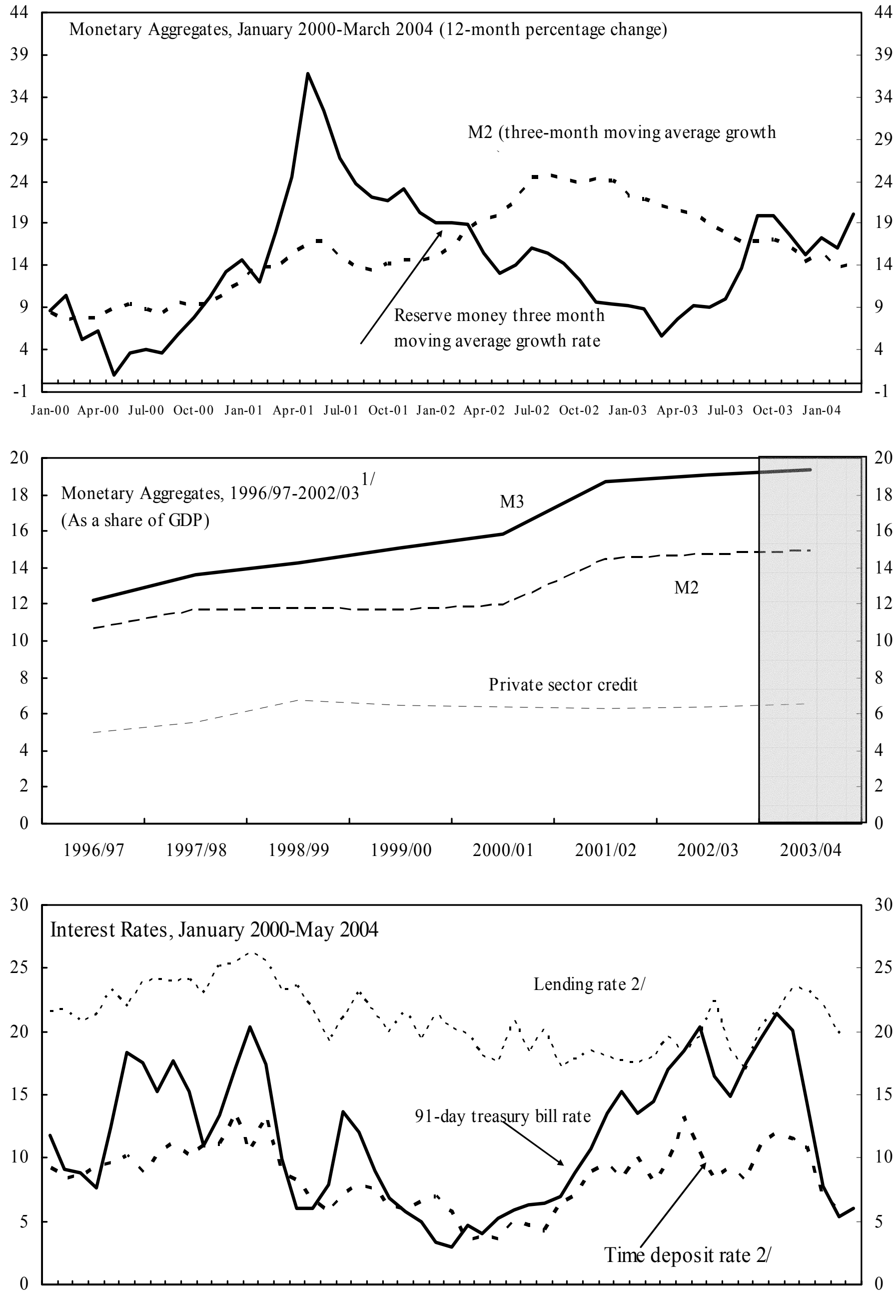






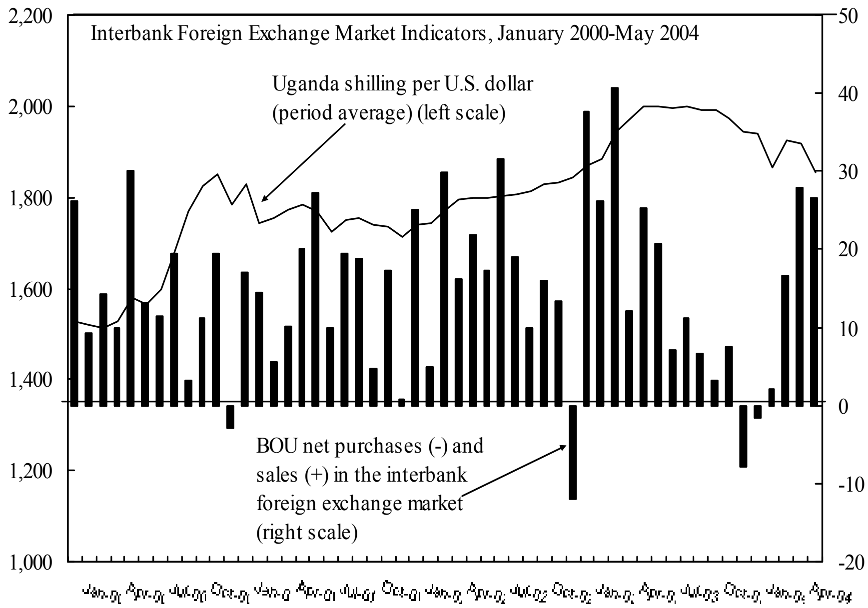
Sources: Ugandan authorities; and IMF staff estimates.
1/ Fiscal year begins in July.

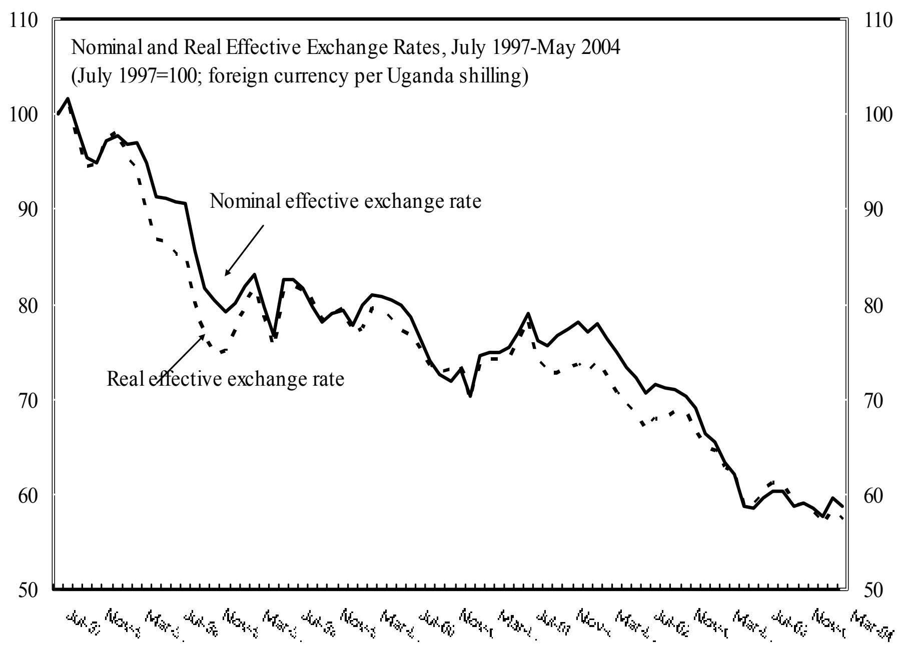
Figure 3. Uganda: Monetary Aggregates and Interest Rates
(In percent, end-period)



Source: Uganda authorities; and IMF staff estimates.
1/ Fiscal year begins on July 1.
2/ Weighted averages for Uganda shilling denominated assets and liabilities.

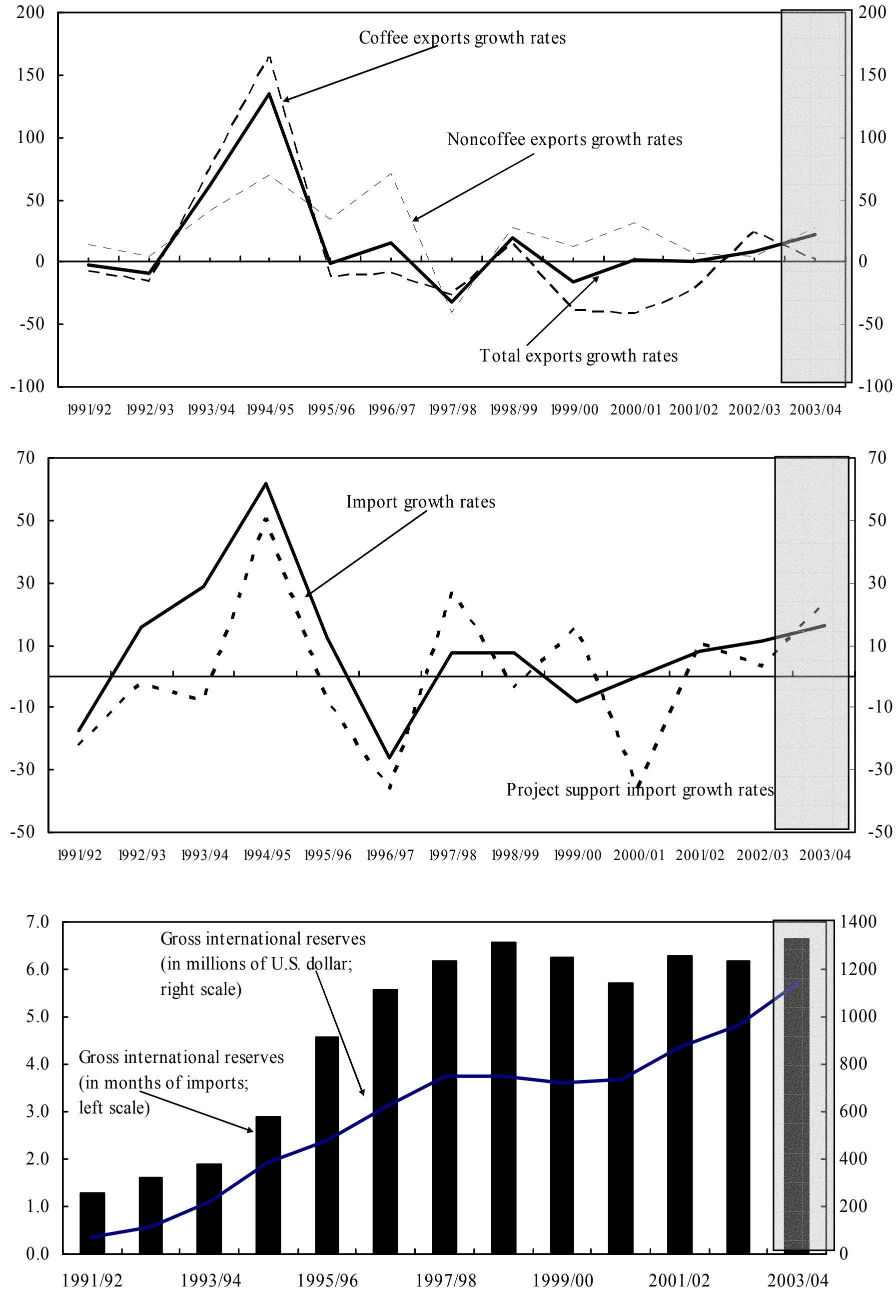
Figure 4. Uganda: Interbank Foreign Exchange Market Indicators, Real and Nominal Effective exchange rate





Sources: Ugandan authorities; IMF staff estimates; and INS, Information Notice System.

Figure 5. Uganda: External sector indicators, 1991/92-2003/04 1/
(Annual growth rates in percent, unless otherwise indicated)



Sources: Ugandan authorities; and IMF staff estimates.
1/ Fiscal year begins in July.

Table 1. Uganda: Selected Economic and Financial Indicators, 2001/02–2006/2007 1/

	2001/02	2002/03	2003/04 Prog.	2003/04 Est.	2004/05 Prog.	2005/06 Proj.	2006/07 Proj.
	(Annual percentage change, unless otherwise indicated)						
National income and prices							
GDP at constant prices	6.8	4.7	5.9	5.7	5.9	5.5	5.8
GDP deflator	-3.9	10.1	5.7	5.4	3.2	3.6	3.6
GDP at market prices							
(in billions of Uganda shillings)	10,284	11,859	13,066	13,221	14,453	15,804	17,318
Consumer prices							
Headline (end of period)	-2.5	10.2	1.9	0.4	3.5	3.5	3.5
Underlying (end of period)	0.1	5.4	3.0	3.0	4.0	4.0	4.0
Headline (average)	-2.0	5.7	5.9	5.1	3.5	3.5	3.5
Underlying (average)	3.5	2.4	5.6	4.9	4.0	4.0	4.0
External sector							
Exports (volume)	15.6	-5.7	4.2	7.7	10.4	5.9	5.8
Imports (volume)	12.8	3.0	4.5	6.2	9.6	7.4	8.1
Terms of trade (deterioration -)	-16.1	5.5	2.1	3.0	-2.6	1.5	0.8
Average exchange rate							
(Uganda shillings per U.S. dollar)	1,755	1,883	...	...	...	...	...
Effective exchange rate (average) 2/							
Nominal (depreciation -)	3.2	-10.6	...	…	…	…	…
Real (depreciation -)	-0.8	-9.3	...	…	…	…	…
	(Annual changes in percent of beginning-of-period stock of money and quasi money, unless otherwise indicated)						
Money and credit							
Net foreign assets	21.6	28.5	13.2	16.3	9.4	4.7	7.6
Net domestic assets	0.0	-5.2	-0.1	-0.9	5.3	10.2	7.4
Domestic credit	2.8	4.9	3.3	-1.4	8.7	11.0	8.6
Central government	1.4	-4.8	-2.1	-7.2	2.9	4.3	1.6
Private sector	1.7	9.7	5.5	5.9	5.8	6.7	7.0
Money and quasi money (M3)	21.6	23.3	13.1	15.4	14.8	14.8	15.1
M2	24.9	17.3	12.5	15.1	15.1	15.1	15.1
Velocity (GDP/M2) 3/	7.7	7.3	7.0	7.0	6.7	6.3	6.0
Interest rate (in percent) 2/ 4/	6.7	9.6	...	...	...	...	...
National income accounts	(In percent of GDP at market prices)						
Gross domestic investment	19.7	20.7	23.2	21.7	22.9	23.0	23.6
Public	5.3	4.7	5.2	5.2	5.2	4.6	4.6
Private	14.4	16.0	18.1	16.5	17.7	18.4	18.9
Gross domestic savings (excluding grants)	5.9	6.9	9.6	10.1	9.9	10.4	10.2
Public	-6.9	-6.6	-5.5	-6.0	-5.7	-5.1	-4.4
Private	12.8	13.5	15.2	16.1	15.6	15.5	14.7
Gross national savings (including grants)	12.8	14.1	19.3	20.4	17.1	16.9	16.4
External sector							
Current account balance							
(including official grants)	-6.9	-6.5	-3.9	-1.3	-5.8	-6.2	-7.2
(excluding official grants)	-13.9	-13.8	-13.6	-11.7	-13.1	-12.6	-13.3
External debt (including IMF)	65.3	62.1	66.5	59.5	58.7	58.8	58.9
Government budget							
Revenue 5/	12.2	12.1	12.9	12.6	12.9	12.7	12.8
Grants	7.0	7.0	9.7	9.5	6.7	6.1	5.8
Total expenditure and net lending	24.4	23.4	23.6	23.8	23.8	22.4	21.8
Government balance (excluding grants)	-12.2	-11.3	-10.7	-11.2	-10.9	-9.7	-9.1
Government balance (including grants)	-5.3	-4.3	-1.0	-1.7	-4.2	-3.6	-3.3
Domestic balance	-6.4	-5.2	-4.6	-4.3	-4.0	-3.7	-2.9
Net foreign financing	4.6	4.3	1.3	2.5	3.4	2.6	2.8
Domestic bank financing	0.2	-0.8	-0.4	-1.3	0.6	0.8	0.3
Domestic nonbank financing	-0.7	0.6	0.2	0.5	0.3	0.1	0.1
Net donor inflows	10.7	10.8	10.4	12.3	10.1	8.8	8.8
	(In percent of exports of goods and nonfactor services; unless otherwise indicated)						
Debt indicators							
Net present value of external debt 6/	183.6	258.1	223.3	246.4	237.2	230.4	233.5
External debt service ratio 7/							
Including IMF obligations	8.1	7.8	10.0	10.0	10.2	10.9	10.9
Excluding IMF obligations	2.4	2.2	3.8	4.3	4.7	6.2	7.1
Stock of domestic debt (in percent of GDP)	8.8	9.0	8.1	8.8	8.4	8.4	8.3
Interest on domestic debt (in percent of GDP)	0.9	1.0	1.4	1.4	1.5	1.5	1.5
	(In millions of U.S. dollars, unless otherwise indicated)						
Overall balance of payments	150	111	72	220	20	-12	17
External payments arrears (end of period)	304	0	0	0	0	0.0	0.0
Gross foreign exchange reserves	873	964	995	1,145	1,120	1,057	1,017
(in months of imports of goods and services)	6.3	6.2	6.3	6.6	6.2	5.4	4.9

Sources: Ugandan authorities; and IMF staff estimates and projections.
1/ Fiscal year begins in July.
2/ The 2002/03 figure is provisional.
3/ Nominal GDP divided by average of current-year and previous-year end-period money stocks.
4/ Weighted annual average rate on 91-day treasury bills.
5/ The revenue projections are based on a revenue target as a share of GDP, and accordingly include unidentified revenue measures.
6/ Ratio of three-year average of exports and based on CIRRs at June 2003.
7/ The debt-service ratios reflects actual debt service paid, that is, after debt relief including that attributable to the HIPC Initiative, deferment of payments to non-Paris Club creditors with whom bilateral agreements have not yet been reached, and the settlement of arrears.

Table 2. Uganda: Fiscal Operations of the Central Government, 2002/03–2006/07 1/

	2002/03	2003/04 Prog.	2003/04 Est.	2004/05 Prog.	2005/06 Proj.	2006/07 Proj.
	(In billions of Uganda shillings)					
Total revenue and grants	2,264.5	2,948.0	2,918.4	2,841.8	2,965.6	3,212.0
Revenue 2/	1,433.7	1,683.1	1,660.8	1,866.6	2,002.0	2,211.8
Tax 6/	1,337.9	1,560.1	1,546.1	1,742.4	1,895.3	2,094.0
International trade taxes	133.8	153.3	136.5	162.9	187.4	189.8
Income taxes	349.8	407.4	449.7	531.8	560.3	622.6
Excises	388.7	445.1	448.0	474.1	492.2	531.7
Value-added tax	465.6	554.3	512.0	573.6	622.8	702.7
Unidentified measures	0.0	0.0	0.0	0.0	32.5	47.2
Nontax 3/ 6/	95.8	123.0	114.8	124.2	106.7	117.8
Grants	830.8	1,264.9	1,257.6	975.2	963.6	1,000.2
Budget support	469.7	786.0	798.7	496.0	515.7	536.1
Of which : HIPC assistance	129.2	126.5	119.1	142.9	122.1	120.7
Project grants 4/	361.1	478.9	479.1	479.1	447.9	464.1
Expenditures and net lending	2,774.7	3,083.1	3,147.5	3,446.0	3,537.0	3,780.0
Current expenditures	1,565.3	1,743.4	1,757.8	1,935.6	2,036.0	2,129.9
Wages and salaries	611.0	682.8	675.1	765.8	778.5	803.2
Of which: defense	125.0	134.0	128.9	133.6	134.7	137.1
Poverty Action Fund	235.3	265.7	264.6	323.9	330.5	348.0
Interest payments	172.5	242.1	248.2	261.7	309.3	331.7
Domestic	117.9	184.7	185.9	193.5	239.1	255.3
External interest	54.6	57.4	62.3	68.2	70.2	76.4
Transfers to the Uganda Revenue Authority	62.8	57.7	59.1	57.7	58.5	58.7
Other current	719.0	760.9	775.4	850.5	889.8	936.4
Of which: defense	120.7	162.4	167.3	197.4	214.6	225.9
Poverty Action Fund	155.2	166.3	180.8	184.8	204.9	213.7
Additional spending 4/	0.0	0.0	0.0	0.0	0.0	0.0
Development expenditures	1,167.6	1,271.2	1,345.4	1,437.1	1,389.5	1,528.3
Donor-supported projects	672.0	747.4	850.1	936.0	886.7	990.8
Domestic	495.6	523.8	495.3	501.1	502.8	537.6
Of which: defense	9.9	11.5	11.5	16.1	10.4	10.7
Poverty Action Fund	255.6	308.9	295.6	312.9	323.0	346.4
Net lending and investment	-12.6	-9.3	-44.5	-45.5	-45.8	-46.7
Other	54.4	95.0	88.9	118.8	157.2	168.4
Of which: domestic arrears repayment	54.4	45.0	45.0	55.4	85.0	100.0
Overall balance						
Including grants	-510.2	-135.1	-229.2	-604.2	-571.4	-567.9
Excluding grants	-1,341.0	-1,400.0	-1,486.7	-1,579.3	-1,535.0	-1,568.2
Domestic balance 5/	-614.4	-595.2	-574.4	-575.1	-578.1	-501.0
Primary balance						
Including grants	-337.7	106.9	19.0	-342.5	-262.1	-236.2
Excluding grants	-1,168.5	-1,157.9	-1,238.5	-1,317.7	-1,225.8	-1,236.4
Domestic balance 5/	-496.5	-410.5	-388.5	-381.6	-339.0	-245.7
Financing	495.0	135.0	227.1	604.0	571.4	567.9
External financing (net)	513.5	164.7	327.7	486.8	417.4	489.4
Disbursement	617.6	299.6	459.4	649.7	606.1	708.5
Budget support	360.2	31.2	68.2	192.8	161.2	170.2
Project loans	257.4	268.5	391.2	456.9	444.8	538.3
Amortization (-)	-143.0	-147.2	-147.6	-167.9	-167.0	-176.3
Exceptional financing	39.0	12.2	15.9	5.0	-21.7	-42.8
Of which: HIPC rescheduling	7.0	7.9	7.2	6.7	5.1	5.1
Domestic financing (net)	-18.5	-29.7	-100.6	117.2	154.0	78.6
Bank financing	-91.6	-49.7	-170.6	80.2	134.0	58.6
Bank of Uganda (BOU)	-207.4	-58.6	-280.0	12.6	66.0	-23.8
Commercial banks	115.8	8.9	109.4	67.6	68.0	82.4
Nonbank financing	73.1	20.0	70.0	37.0	20.0	20.0
Of which: treasury bills	98.7	20.0	70.0	37.0	20.0	20.0
Errors and omissions/financing gap	15.2	0.0	0.2	0.0	0.0	0.0

Table 2 (concluded). Uganda: Fiscal Operations of the Central Government, 2002/03–2006/07 1/

	2002/03 Est.	2003/04 Prog.	2003/04 Est.	2004/05 Prog.	2005/06 Proj.	2006/07 Proj.
			(In percent of GDP)			
Total revenue and grants	19.1	22.6	22.1	19.7	18.8	18.6
Revenue 2/	12.1	12.9	12.6	12.9	12.7	12.8
Tax 6/	11.3	11.9	11.7	12.1	12.0	12.1
International trade taxes	1.1	1.2	1.0	1.1	1.2	1.1
Income taxes	3.0	3.1	3.4	3.7	3.5	3.6
Excises	3.3	3.4	3.4	3.3	3.1	3.1
Value-added tax	3.9	4.2	3.9	4.0	3.9	4.1
Unidentified measures	0.0	0.0	0.0	0.0	0.2	0.3
Nontax 3/ 6/	0.8	0.9	0.9	0.9	0.7	0.7
Grants	7.0	9.7	9.5	6.7	6.1	5.8
Budget support	4.0	6.0	6.0	3.4	3.3	3.1
Of which : HIPC assistance	1.1	1.0	0.9	1.0	0.8	0.7
Project grants 4/	3.0	3.7	3.6	3.3	2.8	2.7
Expenditures and net lending	23.4	23.6	23.8	23.8	22.4	21.8
Current expenditures	13.2	13.3	13.3	13.4	12.9	12.3
Wages and salaries	5.2	5.2	5.1	5.3	4.9	4.6
Of which: defense	1.1	1.0	1.0	0.9	0.9	0.8
Poverty Action Fund	2.0	2.0	2.0	2.2	2.1	2.0
Interest payments	1.5	1.9	1.9	1.8	2.0	1.9
Domestic	1.0	1.4	1.4	1.3	1.5	1.5
External interest	0.5	0.4	0.5	0.5	0.4	0.4
Transfers to the Uganda Revenue Authority	0.5	0.4	0.4	0.4	0.4	0.3
Other current	6.1	5.8	5.9	5.9	5.6	5.4
Of which: defense	1.0	1.2	1.3	1.4	1.4	1.3
Poverty Action Fund	1.3	1.3	1.4	1.3	1.3	1.2
Development expenditures	9.8	9.7	10.2	9.9	8.8	8.8
Donor-supported projects	5.7	5.7	6.4	6.5	5.6	5.7
Domestic	4.2	4.0	3.7	3.5	3.2	3.1
Of which: defense	0.1	0.1	0.1	0.1	0.1	0.1
Poverty Action Fund	2.2	2.4	2.2	2.2	2.0	2.0
Additional spending 4/	0.0	0.0	0.0	0.0	0.0	0.0
Net lending and investment	-0.1	-0.1	-0.3	-0.3	-0.3	-0.3
Other	0.5	0.7	0.7	0.8	1.0	1.0
Of which: domestic arrears repayment	0.5	0.3	0.3	0.4	0.5	0.6
Overall balance						
Including grants	-4.3	-1.0	-1.7	-4.2	-3.6	-3.3
Excluding grants	-11.3	-10.7	-11.2	-10.9	-9.7	-9.1
Domestic balance 5/	-5.2	-4.6	-4.3	-4.0	-3.7	-2.9
Primary balance						
Including grants	-2.8	0.8	0.1	-2.4	-1.7	-1.4
Excluding grants	-9.9	-8.9	-9.4	-9.1	-7.8	-7.1
Domestic balance 5/	-4.2	-3.1	-2.9	-2.6	-2.1	-1.4
Financing	4.2	1.0	1.7	4.2	3.6	3.3
External financing (net)	4.3	1.3	2.5	3.4	2.6	2.8
Disbursement	5.2	2.3	3.5	4.5	3.8	4.1
Budget support	3.0	0.2	0.5	1.3	1.0	1.0
Project loans	2.2	2.1	3.0	3.2	2.8	3.1
Amortization (-)	-1.2	-1.1	-1.1	-1.2	-1.1	-1.0
Exceptional financing	0.3	0.1	0.1	0.0	-0.1	-0.2
Of which: HIPC rescheduling	0.1	0.1	0.1	0.0	0.0	0.0
Domestic financing (net)	-0.2	-0.2	-0.8	0.8	1.0	0.5
Bank financing	-0.8	-0.4	-1.3	0.6	0.8	0.3
Bank of Uganda (BOU)	-1.7	-0.4	-2.1	0.1	0.4	-0.1
Commercial banks	1.0	0.1	0.8	0.5	0.4	0.5
Nonbank financing	0.6	0.2	0.5	0.3	0.1	0.1
Of which: treasury bills	0.8	0.2	0.5	0.3	0.1	0.1
Errors and omissions/financing gap	0.1	0.0	0.0	0.0	0.0	0.0
Memorandum items (in percent of GDP):						
Total defense expenditures	2.2	2.4	2.3	2.4	2.3	2.2
Total public administration expenditure	3.1	2.8	2.8	2.9	2.9	2.6
Poverty Action Fund	5.4	5.7	5.6	5.7	5.4	5.2
Total HIPC assistance	1.4	1.4	1.3	1.3	1.1	1.0
Previously unrecorded project expenditure	0.1		0.9	0.6	0.6	0.1
Total stock of domestic arrears 7/ 8/	...	...	3.5	2.9	2.1	1.3

Sources: Ugandan authorities; and IMF staff estimates and projections.

1/ Fiscal year begins in July.

2/ The revenue projections are based on a revenue target as a share of GDP, and accordingly include unidentified revenue measures.

3/ From 2001/02 onward nontax revenue includes nontax revenue collected by ministries.

4/ Additional expenditures refer to the expected yield of new tax policy measures.

5/ Revenues less expenditures, excluding external interest due and externally financed development expenditures.

6/ Includes cost from EAC accession.

7/ Includes arrears on pensions, wages, court awards, utilities, non-wage recurrent expenditure, and development expenditure outlays.

8/ Projections reflect the schedule included in the plan to clear arrears submitted by the authorities on June 30, 2004.

Table 3. Uganda: Monetary Survey, 2002/03–2006/07 1/
(In billions of Uganda shillings; end of period, unless otherwise indicated)

	2002/03	2003/04 Prog.	2003/04 Est.	2004/05 Prog.	2005/06 Proj.	2006/07 Proj.
			Banking system			
Net foreign assets (NFA)	2,101	2,415	2,488	2,747	2,893	3,168
Net domestic assets	272	269	251	397	716	985
Domestic credit	1,246	1,325	1,214	1,451	1,796	2,108
Claims on public sector (net) 2/	398	347	226	305	439	497
Claims on private sector	849	979	988	1,146	1,357	1,610
Valuation	-334	-376	-243	-366	-450	-613
Other items (net)	-640	-680	-720	-688	-629	-509
Broad money (M3)	2,373	2,684	2,739	3,144	3,609	4,153
M2	1,749	1,967	2,013	2,317	2,667	3,069
			Monetary authorities			
Net foreign assets	1,501	1,703	1,861	2,021	2,056	2,206
Foreign assets	1,990	2,105	2,259	2,348	2,306	2,383
Of which : foreign reserves	1,931	2,044	2,202	2,288	2,243	2,315
Foreign liabilities	490	402	398	327	250	177
Of which : liabilities to IMF	485	397	393	322	245	171
Net domestic assets	-870	-910	-1,049	-1,102	-1,026	-1,049
Domestic credit	-156	-148	-370	-358	-292	-316
Claims on public sector (net) 2/	-191	-249	-471	-458	-392	-416
Claims on commercial banks (net)	35	102	100	100	100	100
Valuation	-339	-377	-254	-369	-447	-597
Other items (net)	-375	-386	-425	-375	-337	-337
Base money	631	793	812	920	1,031	1,157
			Commercial banks			
Net foreign assets	601	712	627	725	836	962
Net domestic assets	1,311	1,477	1,604	1,851	2,147	2,500
Domestic credit	1,571	1,771	1,888	2,161	2,493	2,889
Claims on public sector (net) 2/	588	596	696	763	831	913
Claims on private sector	849	979	988	1,146	1,357	1,610
Of which : foreign exchange loans	190	215	218	248	283	325
Claims on BOU (net)	134	196	204	252	305	365
Total reserves	134	258	263	305	349	401
Required reserves	199	223	227	259	298	343
Excess reserves	-88	8	9	14	14	14
Reservable cash-in-vault	24	27	28	32	37	43
Valuation	5	0	11	3	-3	-16
Other items (net)	-265	-294	-295	-313	-343	-373
Deposit liabilities to nonbank residents	1,912	2,189	2,231	2,577	2,984	3,462
Shilling deposits	1,288	1,473	1,505	1,750	2,041	2,378
Foreign currency deposits	624	717	726	827	942	1,084
Memorandum items:						
Base money (12-month change in percent) 3/	0	11	13	13	12	12
Money and quasi money (12-month change in percent)	23	13	15	15	15	15
Broad money (12-month change in percent)	17	12	15	15	15	15
M3-to-GDP ratio (percent)	20	21	21	22	24	25
M2-to-GDP ratio (percent)	15	15	15	16	18	19
Credit to private sector-to-GDP ratio (percent)	7	7	7	8	9	10
Currency outside banks-to-M3 ratio (percent)	19	18	19	18	17	17
Foreign currency deposits-to-M3 ratio (percent)	26	27	27	26	26	26
Credit to the private sector (12-month change in percent)	28	15	16	16	18	19
Base money multiplier (M2/base money)	3	2	2	3	3	3
NFA of BOU (millions of U.S. dollars)	749	829	968	990	969	969
Gross reserves of BOU (millions of U.S. dollars)	964	995	1,145	1,120	1,057	1,017
NFA of commercial banks (millions of U.S. dollars)	300	346	326	355	394	423
Foreign currency deposit (millions of U.S. dollars)	312	349	377	405	444	476
Foreign currency loans (millions of U.S. dollars)	95	105	113	121	133	143

Sources: Ugandan authorities; and IMF staff estimates and projections.
1/ Fiscal year begins in July.
2/ The public sector includes the central government, the public enterprises and the local government.
3/ The daily average of June of each financial year is used to calculate the annual percentage change from 2003/04 onward.

Table 4. Uganda: Selected Banking Sector Information, June 2001-March 2004

	2001			2002				2003				2004
	June	Sep.	Dec.	Mar.	June	Sep.	Dec.	Mar.	June	Sep.	Dec.	Mar.
	(In billions of Uganda shillings)											
Adjusted assets	1,937	1,924	1,979	2,110	2,318	2,255	2,406	2,542	2,723	2,845	2,896	3,011
Liquid assets	1,255	1,245	1,292	1,380	1,564	1,517	1,564	1,604	1,789	1,849	1,849	1,947
Tier I	179	182	180	208	200	203	211	238	237	239	219	257
Tier II	23	24	22	24	25	32	29	36	33	34	38	33
Total capital	202	206	203	232	226	235	240	274	270	273	259	291
Risk-weighted assets	879	868	879	906	953	967	1,088	1,209	1,317	1,492	1,515	1,519
Nonperforming assets	43	37	34	27	19	19	20	24	59	60	61	58
Loans and advances	528	527	521	533	536	566	661	723	741	774	847	887
Foreign exchange advances	117	136	140	155	154	153	191	218	189	203	212	226
Foreign exchange deposits	476	453	406	441	515	489	495	574	708	689	746	789
Deposits	1,450	1,447	1,475	1,588	1,764	1,763	1,816	1,910	2,109	2,157	2,210	2,321
	(In percent)											
Return on average assets	5.8	5.4	4.5	4.1	3.2	3.1	3.0	3.7	3.5	4.0	4.5	4.7
Core capital/ risk-weighted assets	20.3	20.9	20.5	22.9	21.0	21.0	19.4	19.7	18.0	16.0	14.4	16.9
Total capital/ risk-weighted assets	23.0	23.7	23.1	25.5	23.7	24.3	22.1	22.7	20.5	18.3	17.1	19.1
Nonperforming assets/total advances	8.2	6.9	6.5	5.1	3.6	3.3	3.0	3.4	8.0	7.8	7.2	6.6
Advances greater than 10 percent of total capital/total advances	63.7	68.2	65.8	60.8	61.0	49.2	59.6	56.3	50.2	47.4	47.1	50.4
Loan loss provision/nonperforming assets	68.2	68.5	70.0	76.8	87.5	81.3	81.5	70.8	46.8	69.8	76.5	84.9
Liquid assets/total deposits	86.5	86.0	87.6	86.9	88.7	86.0	86.1	84.0	84.8	85.8	83.7	83.9
Advances/ deposits	36.4	36.4	35.3	33.5	30.4	32.1	36.4	37.8	35.1	35.9	35.3	38.2
Foreign exchange exposure/core capital 1/	20.2	22.5	4.5	5.9	18.1	4.1	4.3	4.0	6.1	2.3	23.0	22.6
Foreign exchange advances/foreign exchange deposits	24.6	30.1	34.5	35.3	29.8	31.3	38.6	37.9	26.7	29.5	28.4	28.7

Source: Ugandan authorities.

1/ Starting in November 2002, the foreign exchange exposure is calculated using the short-hand method.

Table 5. Uganda: Status of Implementation of Existing Structural Performance Criteria and Benchmarks Under the Program for 2003/04

Performance Criteria/ Benchmark	Policy Measure	Date of Implementation	Implementation Status	Comments
		Fiscal		
Performance criterion	Adoption by cabinet of a time-bound plan to clear the stock of pension arrears.	June 30, 2004	Observed	In April 2004, cabinet approved the broad principles of a pension reform, which included the clearance of pension arrears. The specific plan on clearing pension arrears would be finalized during negotiations on donor financing of the reform.
Benchmark	Ensure that Internal Auditor Office of MFPED will issue a report with a verified figure for the stock of nonwage/ nonpension arrears to June 2003, including revised figures of arrears to date.	December 31, 2003	Observed	Report was issued.
Benchmark	Pay off arrears accumulated under the CCS in 2002/03	March 31, 2004	Not observed	About 75 percent of the overcommitments incurred in 2002/03 were paid by end-March 2004. The remaining balance (about U Sh 3 billion) will be paid by end-September 2004.
Benchmark	Include in the documents for the 2004/05 budget, and an update of plan for clearing the stock of nonpension arrears.	June 30, 2004	Observed	Plan allocates U Sh 23 billion for clearance of nonwage, nonpension arrears in 2004/05, and 25 percent of annual resources for arrears payments specified in the MTEF to the clearing of nonpension arrears thereafter.

Table 5. Uganda: Status of Implementation of Existing Structural Performance Criteria and Benchmarks Under the Program for 2003/04

Performance Criteria/ Benchmark	Policy Measure	Date of Implementation	Implementation Status	Comments
Benchmark	Complete initial stage of the modernization of the URA: • Award contract to implement integrated tax administration system for domestic taxes; • Rollout automated system for customs data (ASYCUDA++) to at least three stations other than the Kampala Long room; • Identify 75 percent of late filers within 45 days of the statutory filing period; and • Prepare registry of pay-as-you-earn (PAYE) per employee and tax bracket.	June 30, 2004	Not observed	Selection of an integrated tax administration system for domestic taxes was postponed until after a restructuring of the URA has been completed. ASYCUDA++ was implemented in the URA's new Customs Business Center, which processes about 60 percent of all customs transactions. Goal of identifying late filers has not been met on a consistent basis. A preliminary registry of PAYE taxpayers has been prepared, but work is ongoing.
		Financial Sector		
Performance criterion	Government will decide on the divestiture option to follow on the UDBL based on the recommendations of the transaction advisor.	March 31, 2004	Not observed	Implemented in June 2004. Government decided to sell about a 30 percent share of the UDBL to a private investor that would also have management responsibility.
Benchmark	Submit to cabinet an anti-money laundering bill.	June 30, 2004	Not observed	Draft legislation has been circulated to commercial banks for comment. Bill is expected to be submitted to cabinet by end-December 2004.
Benchmark	Conduct initial offering of a multiyear treasury bond.	June 30, 2004	Observed	Initial offering of 2-year treasury bonds conducted in January 2004. Since then, several offerings were conducted for 2-, 3-, 5-, and 10-year bonds.

Table 6. Uganda: Balance of Payments, 2002/03–2006/07 1/

(In millions of U.S. dollars)

	2002/03	2003/04 Prog.	2003/04 Est.	2004/05 Prog.	2005/06 Proj.	2006/07 Proj.
Current account	-412	-255	-90	-422	-462	-560
Trade balance	-639	-724	-708	-845	-893	-977
Exports, f.o.b.	512	567	628	652	691	735
Coffee	106	118	108	121	138	157
Noncoffee	406	449	521	531	553	578
Imports, f.o.b	-1150	-1,292	-1336	-1497	-1584	-1712
Government related	-140	-92	-173	-183	-174	-183
Private sector	-1010	-1,199	-1163	-1313	-1409	-1529
Services (net)	-246	-225	-232	-254	-266	-291
Inflows	266	306	299	320	334	348
Outflows	-512	-531	-532	-574	-599	-639
Income (net)	-149	-136	-161	-180	-137	-138
Inflows	20	29	35	31	72	82
Outflows	-169	-165	-197	-211	-209	-219
Of which: interest on public debt	-31	-29	-34	-36	-35	-35
HIPC savings due to cancellation 2/	6	6	5	5	5	4
Transfers	621	830	1011	857	833	846
Private transfers	163	207	308	331	350	370
Of which: nongovernmental organizations	134	125	180	192	201	211
Official transfers	458	623	703	525	483	476
Of which : project support	192	237	239	243	212	209
import support	181	326	352	178	187	187
HIPC assistance 2/	69	62	61	72	58	54
Capital and financial account	434	326	310	441	449	577
Capital account	0	0	0	0	0	0
Financial account	434	326	310	441	449	577
Foreign direct investment (FDI)	192	160	196	198	192	199
Portfolio investment	1	0	14	12	12	12
Other investment	241	166	100	231	245	366
Medium- and long-term	252	138	161	235	203	249
Public sector (net)	252	75	161	236	208	239
Disbursements	328	148	237	320	288	319
Project support	137	133	201	225	211	242
Import support	191	15	36	95	77	77
Amortization due	-76	-73	-76	-84	-79	-79
HIPC savings due to cancellation 2/	15	16	15	16	15	14
Private sector (net)	0	62	0	-2	-5	10
Short-term	-11	28	-61	-3	42	117
Errors and omissions	89	0	0	0	0	0
Overall balance	111	72	220	20	-12	17
Financing	-111	-72	-220	-20	12	-17
Central bank reserves (- = increase)	-133	-78	-228	-23	20	0
Of which: gross reserve change	-91	-31	-181	25	63	40
Of which: IMF (net)	-41	-47	-47	-48	-43	-40
Exceptional financing 2/	21	6	8	3	-8	-17
Of which: HIPC rescheduling 2/	3	3	3	3	2	2
Memorandum items:						
Gross international reserves 3/	6.2	6.3	6.6	6.2	5.4	4.9
Current account balance (in percent of GDP)						
Including official transfers	-6.5	-3.9	-1.3	-5.8	-6.2	-7.2
Excluding official transfers	-13.8	-13.6	-11.7	-13.1	-12.6	-13.3
Debt service (in percent of exports)						
Before debt relief (including IMF)	22.1	20.4	19.9	20.2	17.8	16.0
After debt relief (including IMF)	7.8	10.0	10.0	10.2	10.9	10.9
Coffee price (U.S. cents per kg.)	58.7	65.1	64.3	65.7	68.6	70.9
Coffee export volume (in millions of 60-kg. bags)	2.9	3.0	2.4	2.6	2.7	2.9
Exports of goods and services	778	873	928	972	1025	1083
(three-year moving average)	721	787	801	893	975	1027
Net donor support	683	673	834	729	660	682
Of which: import support	372	341	387	273	263	263
project support	329	369	440	469	424	451
total debt relief including HIPC assistance	94	94	94	94	94	94
Net donor support (in percent of GDP)	10.8	10.4	12.3	10.1	8.8	8.8
Debt service due before HIPC	151	178	162	174	162	155
Foreign direct investment—Gross inflows (in percent of GDP)	3.8	3.9	3.8	3.8	3.9	3.9

Sources: Ugandan authorities; and IMF staff estimates and projections.

1/ Fiscal year begins on July 1.

2/ Except for 2002/03 program figures, where debt relief including full HIPC assistance is included in exceptional financing, the components of debt relief are treated as separate items. HIPC grants are included in import support transfers, debt rescheduling is included in exceptional financing, and debt cancellation is included in amortization.

3/ In months of imports of goods and services of the following year.

Table 7. Uganda: Debt and Debt Service Indicators, 2000/01-2006/07 /1

(In millions of U.S. dollars)

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Net present value (NPV) of total debt 2/, 3/, 6/	1,147	1,255	1,862	1,973	2,117	2,246	2,398
Existing debt	1,147	1,255	1,862	1,857	1,843	1,825	1,810
Multilateral	1,037	1,155	1,720	1,722	1,717	1,707	1,699
Paris Club bilateral	43	45	57	52	48	43	38
Non-Paris Club bilateral	38	31	64	65	65	65	65
Commercial	30	24	21	18	14	10	7
New debt	…	…	…	116	274	421	588
Total debt service	…	65	78	84	94	101	98
Existing debt	…	65	78	83	92	96	92
Multilateral	…	45	65	69	77	82	79
Paris Club bilateral	…	5	5	5	6	7	8
Paris Club bilateral		5	6	7	7	7	6
Non-Paris Club bilateral	…	8	2	2	3	3	3
Commercial	…	7	5	5	5	4	4
New debt	…	…	…	1	2	4	6
NPV of debt-to-exports ratio 2/, 3/, 4/	167.4	183.6	258.1	246.4	237.2	230.4	233.5
NPV of debt-to revenue ratio 2/, 3/	186.9	175.6	244.5	230.9	226.5	236.5	241.1
NPV of debt-to GDP ratio 2/, 3/	20.2	21.4	29.6	29.0	29.3	30.0	30.8
NPV of new debt-to-exports ratio 2/, 3/, 4/	…	…	…	14.4	30.7	43.2	57.3
Debt service-to-exports ratio	…	9.5	10.8	10.5	10.5	10.3	9.6
Debt service-to revenue ratio	…	9.1	10.3	9.9	10.0	10.6	9.9
Memorandum items:							
Gross domestic product	5,681	5,860	6,299	6,792	7,237	7,498	7,785
Exports of goods and services 5/							
Current year	690	697	778	928	972	1,025	1,083
Three-year average	696	683	721	801	893	975	1,027
Revenue	614	714	761	854	935	950	994
New borrowing annual flow	...	318	328	237	322	282	282

Sources: Ugandan authorities; and Bank/Fund staff estimates and projections.

1/ Assumes full delivery of HIPC relief
2/ NPV ratios for 2000/01and 2001/02 are based on CIRRs (discount rate) and exchange rates at June 2001.
3/ NPV ratios from 2002/03 are based on CIRRs (discount rate) and exchange rates at June 2003
4/ In relation to the average of three consecutive years of exports of goods and services ending in the current year.
5/ Exports of goods and services as defined in IMF *Balance of Payments Manual,* 5th edition, 1993.
6/ The comparable NPV of debt estimated for 2002/03 in the August 2002 DSA using end 2000/01 data was US$1,410 million. This assumed annual disbursements of US$351 million and US$322 million, respectively. Actual disbursements during the period were US$318 million and US$328 million, respectively. Exports of goods and services are also US$45.1 million higher than that projected at the time of the August 2002 DSA.

Table 8: Status of HIPC Agreements by Creditor 1/

	Enhanced HIPC Relief US$ millions	Agreement to Provide HIPC Relief?	Modalities/Comments
Total	655.8		
Total relief agreed upon	630.6		There are agreements to provide 96 percent of the total HIPC Initiative relief committed
Relief not agreed	25.3		2 percent of relief identified under the HIPC Initiative is still subject to negotiations.
Multilateral	545.7		
IDA	356.6	yes	Debt-service reduction on eligible stock outstanding as at 30/6/1999 except on PPFs and IDA administered EEC loan
IMF	90.9	yes	Debt-service reduction on principal of stock outstanding as at 30/6/1999
AfDB/F	59.3	yes	Debt-service reduction commenced January 2002 details at discretion of creditor
IFAD	10.1	yes	Debt-service reduction on eligible stock. IFAD to advise details of application periodically
EU/EIB	14.1	yes	One loan cancelled and another partially canceled
NDF	3.7	yes	Reconciliation complete. Not servicing outside eligible period and awaiting final agreement.
OPEC Fund	5.1	yes	Agreement signed August 2003 for both HIPC I and II but is yet to be approved by parliament
BADEA	4.1	yes	Delivering through rescheduling of all loans outstanding at completion point
EADB	0.7	yes	Agreement signed June 14, 2004 for both HIPC I and II, but is yet to be approved by parliament
IDB	0.5	yes	Delivering through rescheduling of all loans outstanding at completion point
PTA Bank	0.5	no	No decision taken on participation
Shelter Afrique	0.1	no	In June 2003, government paid in full to avoid court action that had been initiated.
Paris Club creditors	73.1		
Austria	6.8	yes	Agreement signed for 18 percent cancellation on post-cutoff debt
Finland	1.1	yes	Cancelled the debt
France	6.7	yes	100 percent cancellation on pre-cut-off date debt. Initially cancelled 18 percent of post-cod debt. Recently signed new agreement for the balance of 82 percent.
Germany	0.4	yes	100 percent cancellation on pre-cutoff debt
Israel	1.9	yes	100 percent cancellation on pre-cutoff debt
Italy	20.3	yes	100 percent cancellation on pre-cutoff and post-cutoff debt
Japan	16.5	yes	Agreed to cancel payments as they fall due
Norway	0.1	yes	Agreement signed for 18 percent cancellation on pre-cutoff debt
Spain	13.5	yes	Agreement signed for 18 percent cancellation on pre-cutoff debt
Sweden	1.7	yes	Agreement signed for 18 percent cancellation on pre-cutoff debt
U.K.	4.0	yes	Agreement signed for 100 percent cancellation for pre-cutoff debt
U.S.A.	0.1	yes	Agreement signed for 100 percent cancellation for pre-cutoff debt
Non-Paris Club creditors	29.0		
UAE	0.3	no	No response
Burundi	0.1	no	Bank/IMF have agreed to facilitate
China	2.8	yes	Written off part of the loan. Negotiating terms for remaining balance 5 loans, 3 remain to be considered after other countries have received relief
India	3.7	no	Cancelled government to government claims of US$4.9 million. Government seeking to obtain relief on US$50.6 million in export guarantees
Iraq	0.0	no	Judgment reached. Court awarded US$6.4 million interest to accrue at 2.5 percent until paid. The government of Uganda plans to appeal (Government has requested the holders of the Powers of Attorney to get them renewed by the current Iraq authorities)
Kuwait	6.6	yes	Agreement signed for delivery of old HIPC and enhanced HIPC
Libya	8.2	no	Libya has indicated (to the IMF but government of Uganda's letter to Libya has not been responded to) a willingness to participate. Discussions are ongoing
Nigeria	0.9	no	No agreement in place, no communication
North Korea	0.3	no	Repaid in full before enhanced HIPC Initiative
Pakistan	0.3	no	No response
Rwanda	0.6	yes	Loan has been cancelled
Saudi Arabia	1.5	yes	Agreement signed for provision of enhanced HIPC relief.
South Korea	0.6	yes	Agreement signed October 2003 for delivery of old HIPC and enhanced HIPC
Tanzania	3.2	partial	Bought back 15 percent, balance needs verification
Commercial creditors	8.0		
Italy (Industrial Developme	0.1	no	Repaid in full before enhanced HIPC Initiative
Panama	0.0	no	Repaid in full before enhanced HIPC Initiative
Spain (Banco Arabe)	0.5	no	Judgment reached. Court awarded US$2.7 million. Government of Uganda has fully paid
U.K.	5.0	no	Judgment reached. Court awarded US$9.4 million. The government of Uganda has negotiated a lower settlement figure of US$7.9 million, which was paid in 2003/04.
Yugoslavia (14 Oktobar	2.4	no	Judgment reached. Total court award of US$10.3 million. The government of Uganda has fully repaid.
and Sours Fab Famos)	6.06		(the outstanding was 14 Oktobar US$5.7 and Fap Famos US$0.335)

Sources: Ugandan authorities; and IMF staff estimates.

1/ Figures are based on end-June 1999 data, using end-June 1999 exchange rates and the six-month average Commercial Interest Reference Rate (CIRR) at end-June 1999.

Table 9. Uganda: Schedule of Disbursements Under the PRGF Arrangement

Date	Amounts in millions of SDRs	In percent of quota 1/	Conditions
September 2002	1.5	0.83	Board approval of PRGF arrangement.
June 2003	2.0	1.11	Observance of end-December 2002 performance criteria and completion of first review.
December 2003	2.0	1.11	Observance of end-June 2003 performance criteria and completion of second review.
June 2004	2.0	1.11	Observance of end-December 2003 performance criteria and completion of third review.
December 2004	2.0	1.11	Observance of end-June 2004 performance criteria and completion of fourth review.
June 2005	2.0	1.11	Observance of end-December 2004 performance criteria and completion of fifth review.
September 2005	2.0	1.11	Observance of end-June 2005 performance criteria and completion of sixth review.
Total	13.5	7.5	

1/ Uganda's quote is SDR 180.5 million.

Table 10. Uganda: Millennium Development Goals

	1990	1995	2001	2002
Eradicate extreme poverty and hunger	2015 target = halve 1990 $1 a day poverty and malnutrition rates			
Percentage share of income or consumption held by poorest 20 percent	...	...	5.9	...
Prevalence of child malnutrition (in percent of children under 5)	23.0	25.5	22.8	...
Population below minimum level of dietary energy consumption (in percei	23.0	25.0	19.0	...
Achieve universal primary education	2015 target = net enrollment to 100			
Net primary enrollment ratio (in percent of relevant age group)	...	87.3	...	...
Youth literacy rate (in percent of ages 15-24)	70.1	74.7	79.4	80.2
Promote gender equality	2005 target = education ratio to 100			
Ratio of girls to boys in primary and secondary education (in percent)	76.8	81.0	...	...
Ratio of young literate females to males (in percent of ages 15-24)	75.8	80.4	85.0	85.7
Share of women employed in the nonagricultural sector (in percent)	43.2	...	...	...
Proportion of seats held by women in national parliament (in percent)	...	17.0	...	...
Reduce child mortality	2015 target = reduce 1990 under 5 mortality by two-thirds			
Under 5 mortality rate (per 1,000)	160.0	156.0	145.0	141.0
Infant mortality rate (per 1,000 live births)	93.0	92.0	85.0	83.0
Immunization, measles (in percent of children under 12 months)	52.0	57.0	61.0	77.0
Improve maternal health	2015 target = reduce 1990 maternal mortality by three-fourths			
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	880.0	...
Births attended by skilled health staff (in percent of total)	38.3	37.8	39.0	...
Combat HIV/AIDS, malaria, and other diseases	2015 target = halt, and begin to reverse, AIDS, etc.			
Prevalence of HIV, female (in percent of ages 15-24)	...	...	4.6	...
Contraceptive prevalence rate (in percent of women ages 15-49)	4.9	14.8	22.8	...
Number of children orphaned by HIV/AIDS (in thousands)	...	...	880.0	...
Incidence of tuberculosis (per 100,000 people)	...	...	324.0	377.4
Tuberculosis cases detected under DOTS (in percent)	...	61.0	52.0	46.6
Ensure environmental sustainability	2015 target = various (see notes)			
Forest area (in percent of total land area)	25.9	...	21.3	...
Nationally protected areas (in percent of total land area)	...	9.7	9.7	24.9
CO2 emissions (metric tons per capita)	0.0	0.0	0.1	...
Access to an improved water source (in percent of population)	45.0	...	52.0	...
Access to improved sanitation (in percent of population)	...	...	79.0	...
Develop the Global Partnership for Development	2015 target = various (see notes)			
Fixed line and mobile telephones (per 1,000 people)	1.7	2.1	13.9	18.1
Personal computers (per 1,000 people)	...	0.5	2.9	3.3
General indicators				
Population (in millions)	17.4	20.3	23.9	24.6
Adult literacy rate (in percent of people ages 15 and over)	56.1	61.8	68.0	68.9
Total fertility rate (births per woman)	7.0	6.7	6.2	6.0
Life expectancy at birth (years)	46.8	43.8	42.5	43.1

Source: World Development Indicators database, April 2004.

Kampala, Uganda
July 13, 2004

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

Dear Mr. de Rato:

39. 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 2004/05 (July–June), as well as the underlying medium-term macroeconomic policy framework. These are in line with the priorities set out in the Poverty Eradication Action Plan (PEAP) and its forthcoming revision, and the 2004/05 budget proposal, which was submitted to Parliament on June 10, 2004. The attached technical memorandum of understanding (TMU) defines the terms and conditions of the program.

40. In light of the progress achieved in the implementation of the program for 2003/04, and given the supporting details provided in the MEFP, the Government of Uganda requests a waiver for the missed observance of the performance criterion for end-December 2003 on the increase in base money; the continuous performance criteria on the accumulation of domestic arrears under the Commitment Control System and new lending by the Uganda Development Bank Ltd. (UDBL); and the structural performance criterion for end-March 2004 on the divestiture of the UDBL. With respect to this last criterion, as announced in the budget speech, the Government has decided to merge UDBL with the Development Finance Department of the Bank of Uganda and management of the institution will be contracted to a private firm. In addition, the Government will divest of a minority share.

41. The Government of Uganda also requests a fourth disbursement under its PRGF arrangement with the IMF in the amount of SDR 2 million (1.1 percent of quota), following completion of the third review by the IMF's Executive Board.

42. Looking ahead, the policies set out in the attached memorandum, together with continuing implementation of the broader policy agenda in the PEAP, aim at furthering economic growth and stability and reducing poverty. The performance criteria and benchmarks for the fourth review will be based on June and September 2004 targets, and performance criteria and benchmarks for the fifth review will be based on December 2004 and March 2005 targets as set out in Tables 1 and 2 of the MEFP.

43. The Government of Uganda will continue to provide the IMF with such information as the IMF requires to assess Uganda's progress in implementing the policies described in the accompanying memorandum. Furthermore, the Government will continue to consult the IMF on its economic and financial policies, in accord with the IMF's policies and practices on such consultations.

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

Sincerely yours,

/ s /

Gerald M. Ssendaula
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 2004/05

1. The Government of Uganda is committed to achieving sustained economic growth and poverty reduction through the pursuit of prudent macroeconomic policies and reforms aimed at removing supply-side constraints on growth and spurring structural transformation of the economy. The strategy to achieve these goals is set out in the Poverty Eradication Action Plan (PEAP), which is undergoing its second revision. 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. This memorandum of economic and financial policies (MEFP) reviews the recent performance under the program and describes the policies and targets for fiscal year 2004/05 (July–June), including actions that the Government has taken to address program slippages.

VIII. Recent Performance Under the PRGF-Supported Program

2. Overall, the Ugandan economy continues to perform well. Real GDP growth at market prices is estimated to have increased to about 6 percent in 2003/04 and inflation has been reduced to the low, single-digit rates that have prevailed for much of the past decade. Export earnings increased sharply in 2003/04, led by strong growth in noncoffee export volumes, contributing to a decrease in the external current account deficit excluding grants to 11½ percent of GDP. Net inflows of private capital and donor support were sufficient to cover this deficit, leading to a further buildup of gross international reserves to about 6½ months of imports as of end-June 2004. In real effective terms, the Uganda shilling was fairly stable in 2003/04. However, a brief period of volatility in the foreign exchange market in the quarter up to March 2004 required intervention by the Bank of Uganda (BOU).

3. Revenue collections were broadly on target, led by a strong performance in income tax collection that offset shortfalls in domestic VAT. Preliminary data indicates that total spending remained within the original budget limit for the year as a whole, but the composition of expenditure deviated from budget intentions. This was due mainly to supplementary appropriations in the final quarter, of which U Sh 88 billion were resource supplementaries, mainly to meet security needs, provide support to the Presidency, and cover salary shortfalls. Nonetheless, through March 2004, the fiscal deficit before grants was within program projections.

4. The monetary base expanded somewhat more rapidly than programmed during 2003/04. While the BOU tried to adhere to program targets, only marginally missing the December 2003 ceiling, stronger-than-expected growth in demand for currency resulted in excessive tightness in banks' reserve positions and exerted upward pressure on interest rates. In recent months these pressures have subsided, as the BOU reorientated its instrument mix into longer-term treasury bonds, introduced at the beginning of January 2004, and higher sales of foreign exchange through sterilization, thereby reducing pressure on short-term interest rates. Growth rates of broad money and commercial bank credit to the private sector

have moderated in recent months, but still remain quite strong. Performance indicators suggest that banks' portfolios are generally sound.

5. In terms of the PRGF arrangement, all quantitative performance criteria for end-December 2003 were observed with the exception of the ceiling on base money and the accumulation of new domestic arrears on expenditures covered by the Commitment Control System (CCS). The end-December performance criterion for the accumulation of net international reserves was observed by a wide margin, as was the end-December performance criterion on net credit to the Government by the banking system. The continuous performance criterion that the Uganda Development Bank Limited (UDBL) not engage in any new lending until its divestiture is completed, however, was not observed, owing to a small loan (U Sh 91 million) contracted in March 2004. In addition, the indicative quarterly ceiling on cumulative public administration spending was breached for each of the quarterly test dates through March 2004, while cumulative expenditure under the Poverty Action Fund (PAF) fell short of each of its indicative quarterly floors.

6. On the structural program, progress has been made despite some delays:

- An initial offering of two-year treasury bonds was conducted in January, followed by offerings of longer-term bonds in subsequent months. (Benchmark for June 30, 2004.)

- On December 31, 2003, the Internal Auditor's Office of the Ministry of Finance, Planning and Economic Development (MFPED) issued its report on the stock of nonwage/nonpension arrears outstanding as of June 30, 2003. (Benchmark for December 31, 2003.)

- Nearly 75 percent of the domestic arrears accumulated on spending covered by the CCS during 2002/03, which totaled U Sh 11.8 billion, had been paid by June 2004. The remaining balance of these arrears will be paid by end-September 2004. (Full payment was a benchmark for March 31, 2004.)

- Government developed a time-bound plan for paying down nonwage, nonpension domestic arrears, according to age profile and other well-defined rules. In 2004/05, the budget is allocating U Sh 55 billion a year to paying down these arrears and other arrears, including pensions, wages, statutory court awards and utilities. In addition, the Government has designated a committee in the MFPED (Internal Audit, Treasury) to be responsible for executing the plans to clear all outstanding arrears and ensuring that no new arrears are accumulated. (Benchmark for June 30, 2004.)

- Cabinet approved the principles of a broad reform of the public pension scheme in April 2004. The Government is currently seeking financial support for this reform. It is expected that a time-bound plan to clear pension arrears, which is part of the broader pension reform, will be ready for adoption by Cabinet by end-September 2004. (Performance criterion for June 30, 2004.)

- In May 2004, the Uganda Revenue Authority (URA) rolled out the automated system for customs data (ASYCUDA++) at the new Customs Business Center; it merges two major customs points (the Railway General Station and the Kampala Longroom) that account for at least 60 percent of all customs transactions. This strategy replaced the previous plan of rolling out ASYCUDA++ to at least three stations other than the Kampala Longroom. (Benchmark for June 30, 2004.)

- The URA is preparing a register of the pay-as-you-earn tax by employee and tax bracket. Its target of identifying 75 percent for the late filers within 45 days, however, has not been consistently achieved. (Benchmarks for June 30, 2004.)

- A draft anti-money laundering bill has been circulated to all stakeholders for their comments in advance of submission to Cabinet. (Benchmark for June 30, 2004.) The BOU has received comments on the draft from commercial banks and other stakeholders and is currently reviewing the draft bill before submitting it to the Minister of Finance, Planning and Economic Development.

- The Government has decided on the divestiture option to follow for the UDBL. The UDBL will be merged with the Development Finance Department of the Bank of Uganda and management of the institution will be contracted to a private firm. In addition, the Government will divest of up to 30 percent of its shares. No new lending will be undertaken by the UDBL during the run-up to divestiture. (Performance criterion for March 31, 2004.)

7. Based on the circumstances and the corrective actions noted below, the authorities are requesting waivers for the nonobservance of the three missed quantitative performance criteria for December 2003 and, because of its late implementation, the nonobservance of the structural performance criterion for March 2004, regarding the divestiture of the UDBL.

- *The nonobservance of the base money ceiling*. The breach in December was relatively minor (U Sh 3.1 billion or less than ½ percent of the stock of base money at the beginning of the year), and warranted, given unexpected developments in the demand for money, observed mainly through higher currency issues. The BOU, together with the MFPED, will implement the recommendations of the IMF technical assistance mission of March 2004 to strengthen its liquidity management and forecasting capacity.

- *The accumulation of new arrears under the CCS*. The overcommitments (U Sh 2.1 billion) incurred during the first half of 2003/04 will be paid by end-December 2004, while any overcommitments incurred during the second half of the year will be cleared by end-June 2005. In line with the rules of the CCS, the payment of these obligations will use resources within each sector's expenditure ceiling. In the future, the Government will strive to have all overcommitments incurred in one quarter cleared during the following quarter in line with the rules of the CCS. The implementation of the integrated financial management system (IFMS) to all line ministries (and 10 local governments) in 2004/05 will facilitate the monitoring of performance under the CCS. Moreover, new pre-payment arrangements for utilities, as called for in the budget speech, should help eliminate an important source of arrears.

- *New lending by the UDBL.* The new loan contracted by the UDBL reflected poor communication between Government and UDBL management regarding the implementation of the PRGF-supported program. The Government has since informed UDBL management that all new lending should cease until the divestiture has been completed.

- *Government decision on the divestiture of the UDBL.* Having decided on the divestiture plan, Government will solicit bids from private investors for a minority share and management responsibilities of the UDBL by end-September 2004.

IX. The Policy Agenda for 2004/05

8. In keeping with the revised PEAP, the policy agenda for 2004/05 aims at a further narrowing of the fiscal deficit before grants—which will require significant tax policy and tax administration measures to raise government revenues, and reductions in nonpriority spending—and public expenditure management measures to increase the effectiveness of government spending, especially on programs to reduce poverty. It includes financial sector measures to encourage the mobilization of resources for investment, and implementation of policies aimed at increasing Uganda's international competitiveness. These policies also aim to improve governance and raise the incomes of the poor.

9. It is envisaged that real GDP growth would be about 6 percent in 2004/05, while inflation would be held below 5 percent. To achieve the inflation objective, the BOU intends to limit the rate of growth of base money to 13.2 percent during the year. The overall fiscal deficit, excluding grants, will be reduced to 10.9 percent of GDP (from 11.2 percent of GDP in 2003/04), as government revenues grow from 12.6 percent of GDP in 2003/04 to 12.9 percent of GDP in 2004/05, while total spending remains roughly constant relative to GDP. Sterilization operations needed to mop up the injection of liquidity would thus be reduced, which is expected to further ease pressures on domestic interest rates and the exchange rate. The external current account deficit, excluding grants, is projected to widen to 13 percent of GDP in 2004/05, as the growth in export volume moderates from the strong performance in 2003/04, while the growth in imports is projected to remain strong. The current account deficit would be fully financed through net inflows of private capital and net donor inflows. Gross international reserves are expected to end the year at 6.2 months of imports.

10. Increasing government revenue is critical to the goal of reducing the fiscal deficit. In this regard, the Government will step up efforts to improve the operations of the URA. In the initial stage of the improvement process, the URA aims to build a database of tax payers and

tax offenders; continue the cleanup of the taxpayer registries for VAT, corporate, withholding and personal income tax, and ensure their consistency with the tax identification number (TIN) and step up the number of comprehensive audits of large taxpayers.

11. To support the second phase of URA improvements, the Government is committed to restructuring the URA and implementing strong and definitive actions to underpin its integrity and professionalism. In this connection, the Government has appointed a new board of directors for the URA and will request assistance from the IMF to assess the structural and operational changes needed to strengthen the URA. The Government plans to follow up on these recommendations as part of the structural conditionality in subsequent program reviews. To fight corruption, the URA will pursue an investigation of the asset declarations of all URA officials at management level and develop a revised, integrated Code of Conduct for the institution. The Inspector General of Government (IGG) will be requested to follow up on the investigation of potential wrongdoing at the URA. Finally, steps will be taken to recruit additional staff and enhance the capacity of the workforce. When appropriate, disciplinary actions will be taken, including dismissal of staff.

12. While strengthening tax administration is essential for fairness and increased tax collections over the medium term, it will not suffice to meet the revenue needs in the year ahead, especially in light of the revenue loss that is expected from the launch of the East African Community (EAC) customs union, which could reach up to U Sh 75 billion (½ percent of GDP in the first 12 months). The 2004/05 budget proposal includes tax measures aimed at mobilizing additional revenue of about U Sh 30 billion (0.2 percent of GDP). The Government is committed to avoiding policies that might undermine revenue collection, including granting preferential tax treatment to specific investors or firms. To achieve greater transparency in the Government's policy of encouraging industrial development, beginning in 2004/05, the MFPED will submit to Parliament on an annual basis, a comprehensive list of companies that have benefited from tax expenditures, government subsidies, loan guarantees, and other incentives. The list would identify the nature of the benefits received.

13. Uganda's participatory budget process has helped align the 2004/05 budget with the priorities identified in the PEAP. In particular, the Government has given a priority to funding key poverty-reduction sectors, including education and health. In addition, it has provided funds for the scheduled implementation of the Plan for the Modernization of the Agriculture (PMA), the maintenance of basic infrastructure (such as roads), as well as to cover some major initiatives to strengthen governance and fight corruption. In the defense sector, an increase in spending will be dedicated to defense modernization, guided by the 2003 Defense Review; this will support efforts to restore peace in the North.

14. Looking ahead, in order to generate savings to fund the revised PEAP's priorities, including those related to security, the Government remains committed to streamlining public administration. To achieve this objective, a number of far-reaching measures will be adopted to generate annual savings from the public administration sector of at least U Sh 15 billion within the next three years.

15. In recent years, substantial progress has been made in implementing a transparent budget process, which is essential for achieving a high degree of effectiveness in government programs. Nevertheless, budget execution is still subject to some highly distortionary practices. In particular, the existence and accumulation of domestic arrears and the addition of unfunded supplementary spending over the course of the year typically result in budget outturns that deviate substantially from budget intentions, especially for expenditures not protected under the PAF. In light of these weaknesses, the Government is committed to strengthening both budget formulation and execution through the following steps:

- To improve the budgeting of public sector wages, a policy paper will be sent to Cabinet by end-September 2004 for harmonizing sector specific pay reforms within the overall pay reform strategy.

- The regulations of the Public Finance and Accountability Act (PFAA) will be amended by end-December 2004, including provisions to ensure proper ex-ante and ex-post integration of donor projects into the budget, and that proper reporting agreements are in place.

16. Clearing outstanding arrears and eliminating new arrears remains a challenge. Beginning in 2004/05, the following steps will be taken to strengthen the strategy for dealing with the existing stock of arrears and avoid the emergence of new arrears:

- A government team will be assigned full responsibility for the execution of the plan to clear the current stock of nonwage, nonpension arrears according to age profile (including the outstanding stock of nearly U Sh 40 billion post-CCS overcommitments accumulated between the implementation of the CCS and June 2002), as well as for the strict enforcement of the CCS. Moreover, the CCS will be expanded to cover all types of expenditure and will be computerized within all central government ministries by June 2005, in conjunction with the implementation of the integrated financial management system (IFMS).

- To further strengthen the control of arrears, the Treasury will work more closely with the Ministry of Public Service and the Privatization Monitoring Unit (PMU) to improve compilation and verification of the stock of all arrears at any given date, including those for wages, pensions, utilities, unpaid court awards, nonwage recurrent and development expenditures. The verified arrears will be classified by type and, to the extent possible, by age profile, in a manner that will allow the updating of the stock as information on the flow of new arrears and/or their clearing emerges from the IFMS.

- Prepayment arrangements for telephone services will be extended to all line ministries by end-December 2004; similar arrangements will be explored for other utilities.

17. With one-third of PAF spending executed by local governments, there is a need to upgrade the capacity for accounting and reporting by local governments and the monitoring of their activities. In 2003/04, the Government implemented the fiscal decentralization strategy (FDS) to achieve such an upgrade, with 15 pilot local governments. Fiscal decentralization will be expanded in 2004/05 to the remaining local governments and 13 municipalities. These local governments will be subject to the new budgeting and planning manuals under the FDS to ensure better reporting and greater accountability. In addition, 4 of the pilot local governments started implementing the IFMS in January 2004. Technical assistance from the IMF is being provided to facilitate some of these initiatives and strengthen the public expenditure management systems at the subnational level, including the implementation of the CCS for local governments and the development of adequate fiscal reporting and poverty-reducing expenditure tracking under the FDS. Other policies geared toward improving public expenditure management include the ongoing implementation of the new chart of accounts, which establishes uniform budget classifications across all local governments (for both pilot and non-pilot governments in the strategy). Finally, the FDS envisages the completion of sector policy reviews, with the aim of aligning sector policies with the decentralization strategy of the Government.

18. On monetary policy, to maintain low inflation and a stable environment for financial intermediation and the foreign exchange market, the BOU will continue to target base money. Broad money (M2), excluding foreign currency deposits, is projected to expand by 15.1 percent in 2004/05, while bank credit to the private sector is expected to increase by at least 16.0 percent. The BOU will implement a number of recommendations of the recent IMF technical assistance mission aimed at strengthening the liquidity management framework.

19. Mobilizing domestic financial resources for investment is an important element to enabling stronger economic growth. The Government has recently prepared a proposal for a reform of the pension system, which could generate substantial long-term savings for private sector capital formation. A proposal for reforming the public pension system will ensure that all government obligations under the reform are incorporated into the budget. As such, excessive guarantees of minimum benefits will be avoided by switching to a defined contributions system and debts arising from the transition to a capitalized pension system would be explicit. As part of the pension reform, a restructuring of the National Social Security Fund (NSSF) will be needed. For this purpose, it is necessary to establish a qualified and independent regulator for the NSSF as soon as possible. By December 2004, the Government will submit a bill to Parliament for the repeal of the NSSF Statute, which would establish the BOU as the interim supervisor.

20. Other measures to facilitate term lending to productive sectors and, more broadly, financial services to rural areas and small towns will be implemented in 2004/05. As stated above, the UDBL will be restructured in a manner that ensures its sustainability through sound financial management. In addition, the MFPED has embarked on an outreach plan for micro-finance institutions (MFIs), with the goal of increasing the capacity of staff and management of MFIs and encouraging their expansion into areas that presently lack access to financial services. In order to promote the development of the MFI sector, the Government

will limit its involvement in the sector to capacity building and regulation. Under the new Microfinance Deposit Taking Institutions Act, about five MFIs are currently in dialogue with BOU in preparation for licenses to act as deposit-taking institutions. These MFIs would be subject to BOU regulatory supervision and would offer the potential for substantial savings by, and intermediation for, small-scale clients. In order to further foster financial sector development, the Government will undertake a diagnostic review of the Housing Finance Corporation of Uganda, with the intention of increasing private equity participation in the institution. The Government also intends to divest the National Insurance Corporation. The Financial Institutions Act will help to maintain the soundness of the financial system.

21. To increase productivity, enhance Uganda's international competitiveness, and achieve a more sustainable and less vulnerable external position, the Government will continue to base its policies on the Medium-Term Competitiveness Strategy (MTCS), the Plan for the Modernization of Agriculture (PMA), and the Strategic Exports Program (SEP), which emphasize creating an enabling environment for private business and commercial agriculture.

22. On March 2, 2004, the heads of state of Kenya, Tanzania, and Uganda signed the protocol for the customs union as a transitional stage to a more integrated EAC. The tariff rates agreed for the common external tariff (CET) are higher than Uganda's current tariff structure. However, all discriminatory excise taxes and other charges imposed on imports that currently exist will be removed when the CET comes into effect, thus mitigating the negative impact on competitiveness. Business opportunities are expected to grow under the customs union with its market of 90 million people, which would encourage new investment. Through the auspices of the EAC, Uganda hopes to tap the region's vast potential in mineral, water, energy, forestry and wildlife resources, and, as a first step in this direction, will seek major improvements to regional infrastructure, particularly in the areas of transportation and communications.

23. As discussed in the draft revised PEAP, the Government plans to introduce Export Processing Zones (EPZs) and Export Processing Villages (EPVs) in 2004/05. To ensure the integrity of these operations and to avoid unfair competition in the domestic market, it will be necessary to securely enclose these areas with strict implementation of customs duties and other taxes on sales to Ugandan residents. Moreover, any incentives will avoid elements that could seriously erode the tax base. The Government will also propose to the EAC Secretariat that the other member states adopt a common code of conduct for investment incentives and company income taxation to avoid harmful tax competition.

24. Notwithstanding the progress made in the past year in obtaining debt relief under the HIPC Initiative, Uganda still faces an unsustainable external debt situation. The Government is taking steps to improve this situation not only by encouraging exports, but also by exercising better debt management. The strategy of borrowing on IDA-equivalent terms or better has generally been adhered to; in addition, beginning in 2004/05, the Government will set caps on new borrowing consistent with its fiscal deficit reduction strategy and debt sustainability. Further, by end-December 2004, the Government will issue instructions that

clarify the responsibilities of all departments and agencies involved in contracting external debt, as well as in the operations of broader debt management. Consistent with PFAA regulations and Treasury Office of Accounts (TOA) instructions, the Government will clarify monitoring and operational procedures for the contraction of external debt and debt management by end-June 2005.

X. Medium-Term Macroeconomic Policy Issues

25. The 2003 household survey revealed that the incidence of poverty has increased somewhat in recent years and income inequality has risen markedly further. While the rise in poverty was fairly widespread throughout the country and across income levels, except for the top quintile, it appears that migration away from regions of insecurity and reduced earnings in agriculture were important factors behind this setback. In addition, the slowdown in economic growth in recent years limited the opportunities for raising incomes.

26. These developments have informed the second revision to the PEAP, which will provide an updated framework for government policies to reduce poverty. In particular, greater emphasis will be accorded to raising rural incomes by increasing agricultural productivity, improving the allocation of public resources, accelerating the process of structural transformation, and establishing security for all regions of the country. As a priority, over the medium term, the Government will allocate additional resources for the modernization of the Ugandan People's Defense Forces (UPDF). This increased spending will need to be (partially) funded through efficiency savings, including in the defense sector, and cuts in nonpriority areas, in order to ensure both the maintenance of fiscal sustainability and the protection of critical social expenditure. To address the need to increase agricultural productivity and rural incomes, the Government is committed to stepping-up the implementation of the PMA.

27. Economic policies will focus on spurring export-led private sector growth, while enhancing fiscal and external sustainability. Central to this strategy is the gradual reduction in the fiscal deficit over the medium and long term. Sterilization of large fiscal injections of liquidity can lead to high interest rates and an excessively strong national currency that crowds out private investment and the export sector. It will be necessary to keep these pressures under control. The success of this strategy will depend on strong annual increases in government revenues coupled with spending restraint. At the same time, there is a need to increase the effectiveness of government spending to ensure that public service delivery continues to improve.

Table 1. Uganda: Quantitative Performance Criteria and Benchmarks for 2003/04 and 2004/05 1/ 2/
(Cumulative change from end-June 2003 and end-June 2004, unless otherwise stated)

	September 30			December 31			March 31			June 30	Sep. 30	Dec. 31	Mar. 31	June. 30
	2003 3/ Prog.	2003 3/ Adj. prog.	2003 3/ Actual.	2003 4/ Prog.	2003 4/ Adj. prog.	2003 4/ Actual.	2004 3/ Prog.	2004 3/ Adj. prog.	2004 4/ Actual.	2004 4/ Prog.	2004 3/ Revised program	2004 4/	2005 5/	2005 5/
	(In billions of Uganda shillings; end of period, unless otherwise stated)													
Ceiling on the increase in base money liabilities of the Bank of Uganda 6/	9.7	9.7	99.1	72.7	72.7	75.9	64.9	64.9	105.3	76.0	41.5	107.7	105.0	108.0
Ceiling on the increase in net claims on the central government by the banking system	127.6	166.1	144.5	145.0	98.2	-69.9	217.3	191.2	-52.9	-49.7	164.5	132.7	168.5	85.0
Ceiling on the issuance of promissory notes by the government 7/	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) 7/ 8/ 9/	...	...	...	0	0	2.1	0	0	10.6	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 7/ 8/	...	...	...	0	0	0	0	0	0.1	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 7/	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 7/	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	-36.3	-42.4	14.2	-93.4	-71.7	117.4	-146.6	-130.5	106.6	79.7	-55.0	-5.0	-35.0	15.1
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 expenditures)	151.8	151.8	135.1	327.3	327.3	319.4	502.1	502.1	483.5	712.8	128.3	358.7	603.6	780.5
Ceiling on public administration expenditure	56.5	56.5	60.1	123.0	123.0	127.9	184.5	184.5	188.8	246.0	60.5	126.0	191.4	256.9

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/ Indicative target.
6/ Cumulative changes from the average of June 2003 for the 2003/04 program and the average of June 2004 for the 2004/05 program as defined in the TMU.
7/ Continuous performance criterion.
8/ This item applies as a performance criterion with effect from the completion of the second review.
9/ This item will cease to be a continuous performance criterion with effect from the completion of the third review, and instead be an indicative target to September 2004 and March 2005, and a performance criteria to December 2004 as defined in the TMU.

Table 2. Uganda: Structural Performance Criteria and Benchmarks for 2003/04 and 2004/05	
Policy measure	**To Be Implemented by:**
Structural performance criteria	
Adoption by cabinet of a time-bound plan to clear the stock of pension arrears.	June 30, 2004
Start second phase of improvement of the URA: • Prepare a revised comprehensive Code of Conduct for all URA staff • Complete verification of the asset declarations of all URA management staff.	September 30, 2004
Amend the regulations of the Public Finance and Accountability Act (PFAA) to (i) ensure proper ex-ante and ex-post integration of donor projects into the budget, and (ii) to 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
Structural benchmarks	
Include in the documents for the 2004/05 budget an update of plan for clearing the stock of nonpension arrears.	June 30, 2004
Cabinet to approve measures to streamline the public administration generating total savings of at least U Sh 15 billion within the next three years.	June 30, 2004
Complete initial stage of the Improvement of the Uganda Revenue Authority (URA): • Roll out automated system for customs data (ASYCUDA++) to at least three stations other than the Kampala long room. • Identify 75 percent of late filers within 45 days of the statutory filing period. • Prepare registry of pay-as-you-earn (PAYE) per employee and tax bracket. • Step-up the number of comprehensive audits on large taxpayers by 30 percent.	 June 30, 2004 June 30, 2004 June 30, 2004 September 30, 2004
Payoff arrears accumulated under the Commitment Control System (CCS) in 2002/03.	September 30, 2004
Solicit bids from private investors for a minority share and management responsibilities of the UDBL.	September 30, 2004
MFPED will submit to Parliament on an annual basis a list of companies receiving subsidies and other benefits from the Government, and the costs of such benefits.	September 30, 2004
Issue the implementing regulations for the new Financial Institutions Act.	September 30, 2004
Payoff arrears accumulated under the Commitment Control System (CCS) in the first half of 2003/04.	December 31, 2004
Verify the overall stock of arrears for all ministries for which IFMS was rolled out by end-June 2004, in a manner that will allow subsequent updating of the stock per ministry with information from the IFMS.	December 31, 2004
Submit to cabinet an anti-money laundering bill.	December 31, 2004
Submit a bill to parliament to repeal the National Social Security Fund (NSSF) statute to pave the way for the regulation of the NSSF by the BOU.	December 31, 2004

Uganda: Technical Memorandum of Understanding

(July 13, 2004)

A. Introduction

28. This memorandum defines the quantitative benchmarks and performance criteria described in the memorandum of economic and financial policies (MEFP) for the 2004/05 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

29. **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. Under this definition, the daily average of June 2004 base money was estimated at U Sh 809 billion. The base money limits for the 2004/05 program will be cumulative changes from the daily average of June 2004 to the daily average of September 2004, December 2004, March 2005, and June 2005, 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

30. **Net claims on the central government** (NCG) by the banking system base 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 project accounts. 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 2004 for the 2004/05 program.

D. Net International Reserves of the Bank of Uganda

31. **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.

32. 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

33. 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 cashed by central government units and line ministries, and releases to local governments.

Schedule A: Minimum PAF Expenditure
(In cumulative billions of Uganda shillings, beginning July 1, 2004)

Quarter	Sep. 30, 2004	Dec. 31, 2004	Mar. 31, 2005	June 20, 2005
PAF expenditure	128.3	358.7	603.6	780.5

F. New Domestic Budgetary Arrears of the Central Government

34. The nonaccumulation of new domestic payment arrears under the Commitment Controls System (CCS) is an indicative target to September 2004 and March 2005 and a performance criterion to December 2004 and June 2005. New domestic payments arrears are defined as the sum of (i) any bill that has been received by a spending ministry from a supplier of goods and services delivered (and verified), and for which payment has not been made within 30 days under the recurrent expenditure budget or the development expenditure budget. For the purpose of program monitoring, the monthly reports for both recurrent and development expenditure under the CCS will serve as audits of arrears to September 2004, December 2004, and to March 2005, while the annual report by the Internal Auditor Office's of the Ministry of Finance, Planning and Economic Development (MFPED) at end-June 2005 shall be used to determine the new arrears created during the entire 2004/05 fiscal year. The result of these audits should be available no later than seven weeks following the close of the covered period.

G. Ceiling on Public Administration Expenditures

35. 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), URA (008), 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.

Schedule B: Ceiling on Public Administration Expenditures
(In cumulative billions of Uganda shillings, beginning July 1, 2004)

Quarter	Sep. 30, 2004	Dec. 31, 2004	Mar. 31, 2005	June 30, 2005
Expenditure	60.5	126.0	191.4	256.9

H. Promissory Notes

36. A promissory note is a written promise by the government to pay a debt, where government is defined as the central government,[17] 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

37. 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.

38. 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, 2004 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.

[17] Central government consists of the state house, cabinet ministers, all ministries, parliament, the judiciary, and committees.

Schedule C: Import Support Plus Total HIPC Initiative Assistance (In cumulative billions of Uganda shillings , beginning July 1, 2004)				
Quarter	Sep. 30, 2004	Dec. 31, 2004	Mar. 31, 2005	June 30, 2005
Import support including HIPC Initiative grants	53.7	308.5	567.6	688.7

39. 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[18] 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).

Schedule D: Debt Service Due, before HIPC Initiative Assistance (In cumulative billions of Uganda shillings, beginning July 1, 2004)				
Quarter	Sep. 30, 2004	Dec. 31, 2004	Mar. 31, 2005	June 30, 2005
Debt service due before HIPC excluding exceptional financing	59.0	103.1	170.4	231.1

40. The ceiling on the increase in NCG will be adjusted downward (upward) by any excess (shortfall) in nonbank financing[19] less payment of domestic arrears accumulated prior to introduction of the CCS (up to a maximum amount of U Sh 55 billion) relative to the programmed cumulative amounts presented in Schedule E.

Schedule E: Nonbank Financing Minus Repayment of Domestic Arrears (In cumulative billions of Uganda shillings, beginning July 1, 2004)				
Quarter	Sep. 30, 2004	Dec. 31, 2004	Mar. 31, 2005	June 30, 2005
(A) Nonbank financing	.-83.1	-93.5	-34.8	37.0
(B) Domestic arrears repayment	5.0	16.3	50.0	55.0
(C) Total = (A) - (B)	-88.1	-109.8	-84.8	-18.0

[18] Debt service due is defined as pre-HIPC Initiative debt service due, but as of 2003/04 this excludes HIPC Initiative cancellation.
[19] Comprising the check float and the change in government securities and government promissory notes held by the nonbank public. The change in government securities held by the nonbank public will be calculated from the data provided by the Central Depository System (CDS).

41. The base money ceiling will be adjusted upward up to a maximum of U Sh 10 billion in September 2004, December 2004, March 2005, and June 2005 if the amount of currency issued by the BOU exceeds those projected in Schedule F.

Schedule F: Currency Issued by the BOU
(In cumulative billions of Uganda shillings, beginning July 1, 2004)

Quarter	Sep. 30, 2004	Dec. 31, 2004	Mar. 31, 2005	June 30, 2005
Currency issued by BOU	-8.8	66.0	69.5	71.0

42. The Development Finance Department of the BOU provides export credit guarantee schemes (ECGS) to commercial banks. As of May 2004, the outstanding ECGS amounted to U Sh 3.05 billion, which have a maximum guarantee period of six months. These contingent liabilities fall due on the BOU balance sheet, and therefore do not affect the program targets for the NIR and the NCG.

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

43. 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.[20] 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 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.

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

44. 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 IMF 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."

45. 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[21] from their level at end-June 2004. 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

46. 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.

47. 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.

48. 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.

49. 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 commercial banks in Uganda. Information on required

[21] 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).

and approved supplementary allocations in each month should be provided to the IMF within 15 days of the end of each month.

50. 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.

51. 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.

52. Final accounts of the local government authorities for fiscal-year 2002/03 will be consolidated by end-September 2004 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.

53. The quarterly summaries prepared under the CCS and the overcommitments not backed by cash accumulated in the previous quarter that was cleared in the current quarter will be provided to the IMF staff within 40 days after the end of each quarter.

54. 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, 2004 through June 30, 2005, 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.

55. 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.

56. 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.

57. 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.

58. 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.

59. 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.

Uganda: Relations with the Fund
(As of April 30, 2004)

I. Membership Status: Joined 09/27/1963; Article VIII

II. General Resources Account:	SDR Million	% Quota
Quota	180.50	100.0
IMF Holdings of Currency	180.51	100.0

III. SDR Department:	SDR Million	% Allocation
Net cumulative allocation	29.40	100.0
Holdings	5.02	17.06

IV. Outstanding Purchases and Loans:	SDR Million	% Quota
Enhanced Structural Adjustment Facility (ESAF)/Poverty Reduction and Growth Facility (PRGF) arrangements	151.45	83.91

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	09/13/2002	09/12/2005	13.50	5.50
ESAF/PRGF	11/10/1997	03/31/2001	100.43	100.43
ESAF	09/06/1994	11/09/1997	120.51	120.51
ESAF	04/17/1989	06/30/1994	219.12	219.12

VI. Projected Obligations to the IMF:
Under the Repurchase Expectations Assumptions (without HIPC assistance)

	Overdue	Forthcoming				
	04/30/2004	2004	2005	2006	2007	2008
Principal	0.00	30.13	35.60	30.57	22.43	14.36
Charges/interest	0.00	1.02	0.93	0.76	0.62	0.53
Total	0.00	31.15	36.53	31.34	23.05	14.89

VII. Implementation of HIPC Initiative:

	Original framework	Enhanced framework	Total
Commitment of HIPC assistance			
Decision point date	4/23/1997	2/7/2000	
Assistance committed (1999 NPV terms) [22]			
Total assistance (US$ million)	347.00	656.00	
Of which: IMF assistance (SDR million)	51.51	68.10	
Completion point date	April 1998	May 2000	
Delivery of IMF assistance (SDR million)			
Assistance disbursed to the member	51.51	68.10	119.61
Interim assistance	…	8.20	8.20
Completion point	51.51	59.90	111.41
Additional disbursement of interest income [23]		2.06	2.06

VIII. Safeguards Assessments

Under the IMF's safeguards assessment policy, the Bank of Uganda (BOU) is subject to a full safeguards assessment with respect to the PRGF arrangement, which was approved on September 13, 2002 and is scheduled to expire on September 12, 2005. The assessment was completed on April 13, 2003 and concluded that, although the BOU had several strengths, some vulnerabilities existed. In line with the program, the authorities have been implementing specific measures proposed by the safeguards assessment to address these vulnerabilities. The audited financial statements for the years ended June 30, 2002 and June 30, 2003 have both been completed and laid before the legislature by May 9, 2003 and September 30, 2003 respectively. Both were published on the BOU website (the end-2003 financial statement was posted on the BOU website in November 2003). The BOU has provided the IMF copies of the follow-up plan to address the Auditors' recommendations, the annual audit work plans for 2003/04 and 2004/05, and the risk based auditing framework. The BOU is also in the process of putting into operation a banking application and a new accounting manual, and considering alternative types of risk management frameworks.

[22] Net present value (NPV) terms at the completion point under the original framework, and NPV terms at the decision point under the enhanced framework.

[23] Under the enhanced Initiative for Heavily Indebted Poor Countries (HIPC Initiative), an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

IX. Exchange Rate Arrangement

On November 1, 1993, the BOU stopped the auction of foreign exchange and created an interbank market for foreign exchange, through which the official exchange rate is determined. As of May 31, 2003, the official exchange rate was U Sh 1,833.1 per U.S. dollar. The exchange system is free of restrictions on the making of payments and transfers for current international transactions.

X. Article IV Consultation

The Executive Board concluded the last Article IV consultation on February 12, 2003. The next Article IV consultation with Uganda will be held on the 24-month cycle, subject to the provisions of the decision on consultation cycles approved on July 15, 2002.

In February and April 2001, joint World Bank/IMF missions visited Kampala as part of the Financial Sector Assessment Program (FSAP). A final report was provided to the authorities in November 2001, an MFD mission discussed the report with the authorities during the Article IV consultation discussion in November 2002, and the Financial System Stability Assessment was prepared for Board discussion in February 2003.

XI. Technical Assistance

Uganda has received extensive technical assistance from the IMF in recent years.[24]

An FAD mission visited Kampala in April 1998 to advise the authorities on public service pension reform issues, and another mission visited Kampala in September 1998 to assist the authorities in improving customs administration procedures. A resident advisor in the area of local government budgeting began a six-month assignment in August 1998, which was subsequently extended to October 1999. An FAD resident advisor on budgeting and commitment control commenced a six-month assignment in November 1998, which was extended until June 2002. In October 2000, an FAD mission visited Kampala to provide technical assistance in tax policy and administration. The mission's main objective was to examine options for improving revenue performance. A joint World Bank/IMF TA mission visited Kampala in October 2003 to harmonize tax and nontax investment incentives among the member countries of the East African Community (EAC). Two FAD resident advisors (coordinated through AFRITAC-East) are currently in the field assisting the implementation of a CCS at the local government level and the Fiscal Decentralization Strategy.

An STA multisector statistics mission visited Kampala in December 1998 to conduct a comprehensive assessment of Uganda's macroeconomic statistics, including data compilation and dissemination, and to provide recommendations for improvements. Follow-up STA

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[24] For a description of technical assistance provided prior to 1998, see the staff report for Uganda's request for a three-year arrangement under the PRGF.

missions in national accounts and money and banking statistics visited Kampala in March–April 2000 to examine the status of implementation of the previous recommendations. An STA mission on government financial statistics (GFS) visited Uganda in December 2001 to assist authorities in improving fiscal reporting by establishing regular reporting systems that are aligned with the *GFS Manual 2001*, as well as ensuring consistency within monetary sector data for the government. A follow-up mission on GFS visited Uganda in May 2003. A mission visited Uganda during February–March 2002 to review balance of payment statistics and the progress in implementing the recommendations of the multisector mission of 1998 and of the national accounts mission of 2000 with respect to the measurement of goods imports. A follow-up mission on balance of payments statistics visited Uganda in August 2003. Uganda participates in the General Data Dissemination Standard (GDDS).

Since the 2001 FSAP, MFD's TA to Uganda has focused on liquidity management, exchange rate intervention, central bank accounting and auditing, and banking supervision. The authorities have effectively used TA advice on these topics, and they have made good use of an MFD resident advisor, who took up her initial appointment in mid-July 2001. The advisor has been fully integrated into the supervision function and has been involved in all aspects of the work, including participating in on-site examinations. Her contract has since been extended through July 2004. MFD has fielded two TA missions (July 2001 and January 2002) to assist the authorities with liquidity management and address the problems of interest rate volatility and exchange rate interventions. The BOU has started implementing the recommendations made in the report, and now clearly separates sterilization operations and liquidity management; however, they are still having problems with interest rate and exchange rate volatility and have requested follow-up TA in this area. In March and September–October 2002, MFD provided TA to improve central bank accounting and the Bank of Uganda's accounting manual. A TA evaluation visit was conducted in June 2003, and an MFD mission following up on monetary and exchange rate operations, public debt, and liquidity management was conducted in March 2004.

XII. Future Technical Assistance Priorities

The priorities for IMF technical assistance in the next few years will be in the areas of tax administration, the preparation and monitoring of district budgets, the control and monitoring of central government expenditure commitments, monetary and exchange rate management, bank supervision, national accounts statistics, reporting standards for government finance statistics, monetary and balance of payments statistical reporting, central bank accounting, and audit and debt management.

XIII. Resident Representative

The IMF has maintained a resident representative in Uganda since July 1982.

Uganda: Relations with the World Bank Group

(As of May 04, 2004)

XI. Partnership in Uganda's Development Strategy

1. The development strategy of the government of Uganda is based on the Poverty Eradication Action Plan (PEAP), a medium-term development framework that guides government policy and provides a framework for detailed sector and district plans. Because the PEAP's objectives are fully consistent with those of the poverty reduction strategy paper (PRSP) process, a summary of the revised PEAP was used as a basis for Uganda's PRSP, which was presented to the Boards of the World Bank and IMF in May 2000. Uganda's PEAP/PRSP is based on four pillars: (i) creating an environment for economic growth and structural transformation; (ii) ensuring good governance and security; (iii) directly increasing the ability of the poor to raise incomes; and (iv) directly increasing the quality of life of the poor.

2. The World Bank and IMF support the government's efforts to implement the strategy in a complementary fashion. The IMF provides its support through a second three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), and continues concentrating on macroeconomic and financial sector issues, focusing specifically on short- and medium-term macroeconomic stability, which falls under the first PEAP/PRSP pillar (creating an environment for economic growth and structural transformation). The structural program of the IMF addresses the areas of tax administration, budget management, monitoring of local government finances, financial sector regulations and supervision, and improvement of the national accounts and statistics.

3. The World Bank is supporting the implementation of PEAP/PRSP, specifically focusing on structural and sectoral reforms to alleviate poverty. The assistance is delivered in the form of budget and project support, with a heavy focus also on analytic work. The government is currently in the process of revising its PEAP/PRSP. The new PEAP/PRSP will focus on economic management, enhancing production and competitiveness, strengthening security, governance, and human development.

XII. World Bank Group Strategy

4. The World Bank Group's current Country Assistance Strategy (CAS) for Uganda was approved by the Board on November 16, 2000.[1] The objective of the CAS is to support Uganda's economic transformation and poverty reduction strategy. The emphasis on maintaining macroeconomic stability continues, but the focus is increasingly shifting to sector-level and cross-cutting public sector management issues.

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[1] The next CAS is scheduled to be presented to the Board in fiscal-year 2004/05 (July–June).

5. Consistent with this strategy, the World Bank has been increasingly shifting to programmatic lending through a series of annual Poverty Reduction Support Credits (PRSC) that support the implementation of Uganda's PEAP/PRSP. The first annual single-tranche PRSC (PRSC1) for Uganda was approved by the Board in May 2001. A subsequent arrangement, PRSC2, was approved in July 2002, and PRSC3 was approved by the Board in September 2003. PRSCs support a medium-term reform program, with each annual arrangement linked to specific reform actions. The reform program supported by PRSCs aims to improve public service delivery and agricultural production, since basic services critical to development are still inadequate in Uganda and about 70 percent of the population derives its livelihood from agriculture. Services provided, in particular by the public sector, are of poor quality owing to various governance problems and capacity constraints. Also, the enabling environment for private sector and civil society involvement is weak, thus further constraining service delivery and growth.

6. The World Bank Group's assistance program is fully consistent with and supports the four pillars of the PEAP/PRSP through a combination of lending and analytical activities as follows:

7. **PEAP/PRSP Pillar 1—Creating an Environment for Economic Growth and Structural Transformation.** To promote economic growth and development of the private sector, the World Bank Group supports the development of Uganda's infrastructure, specifically, roads, power, and reform of key utilities. Infrastructure, and in particular power availability, has been identified as one of the key constraints on private sector investments. Projects such as the Fourth Power and Bujagali Hydropower aim to increase Uganda's capacity for power generation and support the reform of the power sector. The World Bank also provides support to the government's ten-year Road Development Program through a series of road sector projects. The Privatization and Utility Sector Reform Project, in turn, supports the reform of key utilities and divestiture of the remaining public enterprises. On a regional basis, the World Bank continues to provide advisory support to the Nile Basin Initiative, in which nine riparian countries of the Nile Basin are cooperating to utilize the resources of the river in environmentally sustainable ways.

8. Through the PRSCs, the World Bank supports the government's efforts to strengthen public expenditure and budgetary management, enhance the results orientation of sector expenditure programs, rationalize and strengthen monitoring and evaluation systems, and proceed with gradual fiscal decentralization by streamlining the intergovernmental fiscal transfer system. To strengthen financial sector performance in terms of soundness, efficiency, and access, PRSCs also support development of the legal and regulatory framework for micro-finance, pension reform, and the strengthening of the insurance sector.

9. **PEAP/PRSP Pillar 2—Ensuring Good Governance and Security.** Good governance is essential for effective public service delivery. The World Bank plays a key role in supporting the government's efforts to improve governance, including in the areas of combating corruption and implementing broad-based public sector reform. The World Bank supports through the PRSCs a variety of cross-cutting public sector management reforms to

increase accountability and transparency, and reduce corruption. These include reforms in public procurement, financial management, public sector pay, payroll and personal management, and anticorruption legislation. Ongoing work on financial accountability through the Second Economic and Financial Management Project (EFMP II) and Local Government Development Project (LGDP) complements these efforts.

10. **PEAP/PRSP Pillar 3—Directly Increasing the Ability of the Poor to Raise Their Incomes.** Agriculture dominates Uganda's economy and the majority of the poor live in rural areas. The World Bank supports several activities that aim to enhance environmentally sustainable rural development and reduce regional disparities. Support is provided to agricultural extension through a demand-driven National Agricultural Services Project. The Second Agricultural Research and Training Project provides support for agricultural research. Furthermore, the series of PRSCs supports the government so that it can identify ways to promote agricultural diversification and modernization, mainstreaming of environmental concerns in government programs, land tenure reforms, and expansion of nonfarm activities in rural areas. The Second Environmental Management and Capacity-Building Project continues support for the government's efforts to strengthen environmental management capacity at national and local levels, the Second Protected Areas Management and Sustainable Use Project supports long-term conservation of biodiversity through, among other things, establishment of the Uganda Wildlife Authority, and the second phase of the regional Lake Victoria Project is designed to sustain the effort to protect Lake Victoria's ecosystem. To reduce regional disparities, the Second Northern Uganda Social Action Fund targets the relatively poor districts of northern and eastern Uganda, which have not benefited proportionately from economic reform and liberalization.

11. **PEAP/PRSP Pillar 4—Directly Increasing the Quality of Life of the Poor.** The delivery of primary education, health care, and potable water has a direct impact on the quality of life of the poor, and the delivery is at the core of the government's poverty reduction strategy. The World Bank supports the government's efforts to improve access to, and quality of, education, health care, and water and sanitation services, primarily through the series of PRSCs. The HIV/AIDs Control Project supports Uganda's effort to fight the HIV/AIDS epidemic by supporting local initiatives that are providing prevention, treatment, and care.

XIII. World Bank Portfolio

12. The World Bank Group is Uganda's largest creditor. As of April 30, 2004 a total of 101 credits, 9 loans, and 3 grants, amounting to US$4.2 billion (including US$4.2 billion from IDA and US$43 million from the IBRD), had been approved for Uganda, and total disbursements amounted to about US$3.3 billion (see table below).

XIV. UGANDA: FINANCIAL RELATIONS WITH THE WORLD BANK GROUP

Statement of Loans and Credits, as of March 31, 2004
(In millions of U.S. dollars)

	IBRD	IDA	IDA Grant	Total
Original principal	43	3,929	300	4,272
Cancellations	277	148	0	149
Disbursement to date	43	3,143	91	3,277
Repayments	35	346	0	381
Undisbursed	0	798	219	1,016
Exchange adjustment	0	0	0	0
Borrower's obligation	0	3,060	0	3,060

13. In fiscal-year (FY) 2004, in addition to the Uganda Third Poverty Reduction Support Operation (PRSC3), a Supplemental Credit to the Second Economic and Financial Management Project and the Sustainable Management of Mineral Resources Project have so far been approved by the Board. The third phase of the Road Development Program is also expected to go to the Board in FY 2004. Four new projects were approved in FY 2003 (Northern Uganda Social Action Fund, Protected Areas Management and Sustainable Use Project, Second Poverty Reduction Support Credit, and Second Local Government Development Project), totaling about US$420 million, and a US$4.5 million supplemental credit for the Lake Victoria Environment Management Project was approved in FY 2003. Five projects were closed in FY 2002, six projects were closed in FY 2003, and one project closed so far in FY 2004.

XV. WORLD BANK-IMF COLLABORATION IN SPECIFIC AREAS

14. The IMF and World Bank staffs maintain a close collaborative relationship in supporting the government's structural reforms. As part of its overall assistance, the Bank supports policy reforms in the following areas in collaboration with the IMF:

15. **Poverty reduction strategy paper.** The World Bank and IMF are assisting the government in the revision and implementation of its poverty reduction strategy. The staffs of the two institutions prepare joint assessments of the PRSP or the PRSP progress report on an annual basis.

16. **Debt sustainability.** The staffs of the World Bank and IMF continue collaborating on issues related to the Initiative for Heavily Indebted Poor Countries (HIPC Initiative), and prepared jointly an updated debt sustainability analysis for Uganda in calendar-year 2002.

17. **Public expenditure management.** Strengthening public expenditure management is the critical first step in improving the efficiency of public service delivery. The World Bank, IMF, and other donors are working closely to provide the government the support needed for

institutional and policy reforms. The IMF is leading the dialogue on fiscal policy, while the World Bank is focusing on strategic expenditure allocation and efficiency of public expenditures through its work on the public expenditure review and PRSC. The staffs of the two institutions prepare, on an annual basis a report that tracks HIPC Initiative poverty-reducing spending, analyzes the quality of public expenditure management in Uganda, and identifies areas needing strengthening.

18. **Financial sector reform.** A joint World Bank-IMF Financial Sector Assessment was conducted in 2001. The assessment indicates that performance of the financial sector has improved in the past few years, but access to financial services remains a problem, especially in rural areas, and the range of financial products is limited. The insurance sector has been liberalized and new companies and brokers have entered the market, but supervision of the sector is still weak. The pension sector needs urgently to be reformed, as civil service pension obligations are taking an increasing portion of budget resources. Both the Bank and IMF are supporting the government's efforts to reform the financial sector. The Bank supports these efforts through PRSC measures to strengthen the insurance sector, reform the pension system, and develop the legal and regulatory framework for micro-finance. The work is closely coordinated with a program supported by the IMF's PRGF arrangement, which addresses selected aspects of pension reform.

19. **Trade reforms.** The World Bank and IMF are working closely to assist Uganda in establishing a pro-growth trade framework. Both institutions are involved in the dialogue on trade reforms in the context of the East African Community at the regional level.

20. Questions may be referred to Dino Merotto, Country Economist, Tel. (202) 458-1987.

Uganda: Core Statistical Indicators

(As of June 30, 2004)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates 1/	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt
Date of latest observation	6/30/04	5/31/04	5/31/04	6/30/04	5/31/04	5/31/04	May. 2004	May. 2004	June. 2003	May. 2004	2002/03	5/31/04
Date received	6/30/04	6/14/04	6/30/04	6/30/04	6/30/04	6/14/04	June. 2004	June. 2004	Aug. 2003	June. 2004	Aug. 2003	June. 2004
Frequency of data 2/	D	M	M	D	M	M	M	M	A	M	A	M
Frequency of reporting 2/	D	M	M	D	M	W	M	M	Q	M	A	O
Source of data 3/	A	A	A	A	A	A	A	A	A	A	A	A
Mode of reporting 4/	C	C	C	C	C	C	C	C	C	C	C	C
Confidentiality	C	C	C	C	C	C	C	C	C	C	C	C
Frequency of publication 2/	D	M	M	M	M	W	M	Q	Q	M	A	...

1/ Treasury bill rates.
2/ Codes for frequency of data, frequency of reporting, and frequency of publication are the following: D=daily; W=weekly; M=monthly; Q=quarterly; A=annual; or O=other.
3/ Codes for source of data are the following: A=direct reporting by central bank, Ministry of Finance, or other official agency.
4/ Codes for mode of reporting are the following: C=for unrestricted use; and D=embargoed for a specified period and thereafter for unrestricted use.

Uganda: Social Output and Outcome Indicators, 2000–05

	2000	2001	2002 Target	2002 Outturn	2003	2004	2005
					PEAP target		
Health							
Outpatient department utilization (OPD) per capita	0.40	0.43	0.43	0.60	0.45	0.47	0.50
Percentage of approved positions filled by a trained health worker	40	47	40	42	43	46	50
DPT3 immunization rates among children less than 1 year old (percent)	41	47	46		50	54	
Deliveries in health units (percent)	25	23	25	19	38	31	35
HIV prevalence (percent)	7	6	6	6.5	6	5	5
Education							
Pupil-teacher ratio	63:1	54:1	54:1	54:1	50:1	45:1	49:1
Pupil-textbook ratio 1/	6:1	4:1	4:1	...	…	3:1	3:1
Pupil-classroom ratio	118:1	98:1	104:1	94:1	92:1	82:1	92:1
P7 net enrollment rate 2/			16	...	20	20	20
Rural water							
Safe water coverage (percent)	52	53	...		...	60	60
New water systems	3,000	2,900	2,900		3,700	3,700	3,700
New public, school, and institutional sanitation systems	450	1,205	1,205		900	900	900
Urban water							
Safe water coverage (percent)	60	62	…		…	65	65
New water connections	3,100	6,300	6,300		7,000	7,000	7,000
Of which: poor households	900	1,800	1,800		2,100	2,100	2,100
New sewerage connections	75	75	70		100	100	100

Source: "Uganda Poverty Reduction Strategy Paper—Progress Report 2002." The 2005 PEAP target and the 2002 output figures are updated from "Uganda Poverty Status Report 2003."

1/ Textbooks are to be replaced during this period, so these ratios can be misleading. The current ratio is based on the stock of old textbooks at the schools, whereas the target set for the future concerns the stock of new textbooks in the schools. The outturn for 2002 is zero because of the introduction of the new curriculum in 2000/01. But a wide range of non-textbooks has been distributed to all P1 and P2 classes. A total of 3.5 million books have been distributed to P3 and P4 classes. The cycle to purchase and distribute books to P5-P7 classes has been launched.

2/ In percent. Estimates of net enrollment rates will be provided following the results of the 2002 population census.

Uganda's Debt Sustainability

Uganda faces a difficult external debt sustainability situation, however, over the foreseeable future its debt-service obligations, after HIPC assistance, are manageable (Tables 1 and 2). As shown under the baseline scenario, over the next 10 years, the ratio of the net present value (NPV) of external debt to exports of goods and services (at about 230–260 percent) would remain well above the HIPC Initiative threshold of 150 percent before declining steadily toward a more sustainable level. Moreover, stress tests illustrate that this debt burden would worsen substantially in the event of adverse shocks, particularly to exports.[26] But even in the worst case scenario, the ratio of external debt service to exports does not exceed the indicative HIPC target range of 15–20 percent.

Uganda's heavy debt burden is expected to persist for several years to come, owing partly to projections of substantial loan disbursements to support efforts to reduce poverty. The government has drawn down about half of the US$1,385 million in debt contracted since reaching the HIPC completion point in May 2000, and it is projected to contract an additional US$573 million in 2004/05. While the baseline projection of annual disbursements implied by this contracted debt is about in line with the projected disbursements made at the time of Uganda's completion point, changes in the parameters used in the NPV calculation have raised the impact of new borrowing on debt sustainability, resulting in a rising NPV of external debt-to-exports ratio over a period of time. A higher borrowing scenario (A2), simulating full disbursement over the next four years of existing commitments and projected new debt contracts, shows a deterioration in the ratios of the NPV of external debt to exports and to GDP to 275 percent and 36 percent through 2013/14, respectively. The debt service-to-exports ratio under this scenario continues to remain manageable through 2023/24, reflecting the assumption of highly concessional (IDA comparable) terms for new borrowing. Assuming that US$150 million a year of these higher disbursements are provided in grants (A3), results in a less significant deterioration in the stock of debt indicators, although they are still higher than those in the baseline scenario.

Bounds tests suggest that Uganda's external debt sustainability is quite sensitive to macroeconomic shocks. Scenarios simulating two-year shocks with persistent effects to the export sector (B2), such as terms of trade shock, and a higher inflationary environment (B3), reflecting greater macroeconomic instability, were considered. In both scenarios, these shocks have long-lasting effects, so that by 2013/14 the ratios of the NPV of external debt to exports and to GDP, respectively, increase by up to 127 percentage points and 9 percentage points, compared with the baseline scenario. The export-shock scenario also shows that Uganda's debt servicing capacity could be severely impaired, as the debt service-to-exports ratio initially peaks at 15 percent in the near term, before rising substantially over the long

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[26] The stress tests are based on the analytical framework developed in a recent staff paper. Export figures reflect three-year moving averages.

term. A combination of weaker shocks (B5) would similarly set off debt dynamics that would delay Uganda's prospects of reaching sustainable debt thresholds.

In conclusion, while high NPV of external debt-to-export ratios provide a warning of potentially serious debt sustainability problems on the horizon, Uganda's manageable level of debt service suggests that a gradual correction—by way of a gradual fiscal consolidation that does not jeopardize pro-poor government spending—would be appropriate. The results underscore that, achieving debt sustainability over the long term will largely depend on implementation of a prudent debt management strategy, including greater use of grants, strict limits on the amount of new debt, which should be on highly concessional terms, and guidelines to improve the efficiency and allocation of new borrowing. Given the risks to export growth inherent in an economy that relies heavily on primary agricultural products, it is imperative that the government implement measures to enhance competitiveness and diversify the export base.

Table 1. Uganda: External Debt Sustainability Framework, Baseline Scenario, 2000-2023 1/

(In percent of GDP, unless otherwise indicated)

	2002/03	Historical Average 6/	Standard Deviation 6/	Est. 2003/04	Projections 2004/05	2005/06	2006/07	2007/08	2008/09	2003-08 Average	2013/04	2023/24	2009-23 Average
External debt (nominal) 1/	**62.1**			**59.5**	**58.7**	**58.8**	**58.9**	**58.2**	**55.5**		**52.9**	**41.0**	
Of which: public and publicly guaranteed (PPG)	62.1			59.5	58.7	58.8	58.9	58.2	55.5		52.9	41.0	
Change in external debt	62.1			-2.6	-0.9	0.2	0.1	-0.7	-2.7		-0.6	-3.2	
Identified net debt-creating flows	...			-4.3	0.2	0.7	1.6	1.9	2.8		2.6	9.9	
Noninterest current account deficit	**6.1**	**4.6**	**2.2**	**1.0**	**5.6**	**5.9**	**6.9**	**7.0**	**9.0**		**7.7**	**14.5**	9.7
Deficit in balance of goods and services	14.9			15.7	16.3	16.1	17.0	16.9	17.0		21.0	31.2	
Exports	11.5			11.8	12.3	13.0	13.2	13.3	12.6		13.2	14.7	
Imports	26.4			27.5	28.6	29.1	30.2	30.2	29.6		34.3	45.9	
Net current transfers (negative = inflow)	-9.9	-8.9	2.6	-14.9	-11.8	-11.1	-10.9	-10.6	-9.8		-8.2	-5.7	-7.4
Other current account flows (negative = net inflow)	1.0			0.2	1.1	0.9	0.8	0.6	1.7		-5.2	-11.0	
Net foreign direct investment (negative = inflow)	**-2.3**	**-1.1**	**1.0**	**-2.3**	**-2.3**	**-2.3**	**-2.3**	**-2.3**	**-2.4**		**-2.4**	**-2.4**	-2.4
Endogenous debt dynamics 2/	**...**			**-3.0**	**-3.1**	**-2.8**	**-3.0**	**-2.8**	**-3.9**		**-2.7**	**-2.3**	
Contribution from nominal interest rate	...			0.3	0.3	0.3	0.3	0.3	0.3		0.3	0.3	
Contribution from real GDP growth	0.0			-3.3	-3.3	-3.1	-3.3	-3.1	-4.2		-3.1	-2.5	
Contribution from price and exchange rate changes	0.0			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**...**			**1.7**	**-1.0**	**-0.5**	**-1.5**	**-2.6**	**-5.4**		**-3.2**	**-13.1**	
Of which: exceptional financing	...			-0.1	0.0	0.1	0.2	0.0	0.0		0.0	0.0	
NPV of external debt 4/	29.6			29.0	29.3	30.0	30.8	31.0	30.2		31.2	25.1	
In percent of exports	258.1			246.4	237.2	230.4	233.5	233.7	240.8		235.7	170.4	
NPV of PPG external debt	**29.6**			**29.0**	**29.3**	**30.0**	**30.8**	**31.0**	**30.2**		**31.2**	**25.1**	
In percent of exports	258.1			246.4	237.2	230.4	233.5	233.7	240.8		235.7	170.4	
Debt service-to-exports ratio (in percent)	10.8			10.5	10.5	10.3	9.6	9.2	9.0		8.8	11.1	
PPG debt service-to-exports ratio (in percent)	10.8			10.5	10.5	10.3	9.6	9.2	9.0		8.8	11.1	
Total gross financing need (billions of U.S. dollars)	313.4			-3.0	327.6	366.5	453.6	480.5	694.1		735.8	2,504.7	
Noninterest current account deficit that stabilizes debt ratio	-56.0			3.6	6.4	5.7	6.8	7.7	11.7		8.3	17.7	
Key macroeconomic assumptions													
Real GDP growth (in percent)	4.7	6.7	2.3	5.7	5.9	5.5	5.8	5.5	7.8	6.1	6.0	6.0	6.0
GDP deflator in U.S. dollar terms (change in percent)	2.6	1.0	12.9	2.0	0.6	-1.8	-1.9	-0.2	0.9	-0.1	-1.1	-1.1	-1.1
Effective interest rate (percent) 5/	...			0.5	0.5	0.5	0.5	0.5	0.6	0.5	0.7	0.7	0.7
Growth of exports of goods and services (U.S. dollar terms, in percent)	5.6	14.9	22.5	11.0	11.5	9.2	5.3	5.8	3.1	7.6	6.0	6.0	6.0
Growth of imports of goods and services (U.S. dollar terms, in percent)	7.0	11.0	22.3	12.3	10.9	5.4	7.7	5.1	6.8	8.0	8.0	8.0	8.0
Grant element of new public sector borrowing (in percent)	...	...	...	52.4	52.5	52.5	52.5	52.5	52.5	52.5	53.1	53.1	53.0
Memorandum item:													
Nominal GDP (billions of U.S. dollars)	6,298.5			6,792.2	7,237.1	7,498.1	7,785.4	8,194.9	8,918.2		11,320.0	18,238.0	

Source: IMF staff simulations.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio; with r = nominal interest rate; g = real GDP growth rate; and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that NPV of private sector debt is equivalent to its face value.
5/ Current-year interest payments derived by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2. Uganda: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2003-23
(In percent)

		Est.	Projections						
	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2013/14	2023/24
NPV of debt-to-GDP ratio									
Baseline	30	29	29	30	31	31	30	**31**	25
A. Alternative scenarios									
A2. New public sector loans on less favorable terms in 2004-23 2/	30	29	30	32	34	35	35	**36**	31
A3. Higher public sector grants in 2004-23 2/	30	29	29	30	31	31	30	32	29
B. Bound tests									
B1. Real GDP growth at historical average minus one standard deviation in 2004-05	30	29	30	31	32	32	31	**32**	26
B2. Export value growth at historical average minus one standard deviation in 2004-05 3/	30	29	30	33	34	34	33	**34**	26
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2004-05	30	29	33	38	39	39	38	**40**	32
B4. Net non-debt-creating flows at historical average minus one standard deviation in 2004-05 4/	30	29	32	36	36	36	35	**36**	28
B5. Combination of B1-B4 using one-half standard deviation shocks	30	29	34	39	40	40	39	**40**	31
B6. One-time 30 percent nominal depreciation relative to the baseline in 2004 5/	30	29	42	43	44	44	43	**44**	36
NPV of debt-to-exports ratio									
Baseline	258	246	237	230	234	234	241	**236**	170
A. Alternative scenarios									
A2. Higher public sector borrowing in 2004-23 2/	258	246	246	246	255	264	276	**275**	207
A3. Higher public sector grants in 2004-23 2/	258	246	238	231	233	236	241	**246**	194
B. Bound tests									
B1. Real GDP growth at historical average minus one standard deviation in 2004-05	258	246	237	230	234	234	241	**236**	170
B2. Export value growth at historical average minus one standard deviation in 2004-05 3/	258	246	296	360	364	364	374	**363**	256
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2004-05	258	246	237	230	234	234	241	**236**	170
B4. Net non-debt-creating flows at historical average minus one standard deviation in 2004-05 4/	258	246	261	273	276	275	283	**272**	187
B5. Combination of B1-B4 using one-half standard deviation shocks	258	246	279	309	312	311	319	**308**	212
Debt service ratio									
Baseline	11	11	11	10	10	9	9	**9**	11
A. Alternative Scenarios									
A2. New public sector loans on less favorable terms in 2004-23 2/	11	11	11	10	10	9	9	**9**	12
A3. Higher public sector grants in 2004-23 2/	11	11	11	10	9	9	9	**9**	11
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2004-05	11	11	11	10	10	9	9	**9**	11
B2. Export value growth at historical average minus one standard deviation in 2004-05 3/	11	11	13	15	14	14	13	**13**	17
B3. US dollar GDP deflator at historical average minus one standard deviation in 2004-05	11	11	11	10	10	9	9	**9**	11
B4. Net non-debt-creating flows at historical average minus one standard deviation in 2004-05 4/	11	11	11	11	10	10	10	**10**	12
B5. Combination of B1-B4 using one-half standard deviation shocks	11	11	11	12	12	11	11	**11**	14
Memorandum item:									
Grant element assumed on residual financing (i.e., financing required above baseline) 6/		52	52	52	52	52	52	**52**	52

Source: IMF staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), noninterest current account in percent of GDP, and non-debt-creating flows.
2/ Assumes new borrowing to finance Millennium Development Goals (MDG) is higher than in the baseline, while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and foreign direct investment.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (more financing) in which the terms on all new financing are as specified in footnote 2.

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Third Review Under Uganda's PRGF Arrangement and Reviews Noncomplying Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the third review of Uganda's economic performance under a three-year Poverty Reduction and Growth Facility (PRGF) arrangement and approved the disbursement of an amount equivalent to SDR 2.0 million (about US$2.9 million), which would bring total disbursements under its PRGF arrangement to SDR 7.5 million (about US$10.9 million).

In completing the third review, the Executive Board granted Uganda's request for waivers of non-observance for three end-December 2003 quantitative performance criteria, and the end-March 2004 structural performance criterion regarding the decision on the divestiture of the Uganda Development Bank Ltd.

The Executive Board also reviewed matters relating to a noncomplying disbursement in an amount equivalent to SDR 2.0 million (about US$2.9 million) made on December 29, 2003, following completion of the second review under Uganda’s PRGF arrangement. The Executive Board waived the non-observance of the end-June 2003 performance criterion on the contracting or guaranteeing of nonconcessional public sector external debt with a maturity of more than one year which gave rise to the noncomplying disbursement, in view of the minor deviation from the performance criterion and the subsequent corrective action taken by the authorities.

Uganda’s three-year arrangement was approved on September 13, 2002 (See Press Release No. 02/41) for an amount equivalent to SDR 13.5 million (about US$19.6 million).

Following the Executive Board's discussion on the third review, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chairman, made the following statement:

“Uganda’s continued strong commitment to sound policies has contributed to macroeconomic stability and to robust economic activity. Improved revenue performance contributed to a modest fiscal adjustment in 2003/04, despite strong pressures for additional spending. Further measures are needed to ensure a sustainable reduction in the deficit. Looking ahead, the authorities are committed to reversing a recent rise in the incidence of poverty, especially in rural areas, and are reviewing their policies for boosting economic growth and reducing poverty in the context of the forthcoming revision of the Poverty Eradication Action Plan.

“Sustained economic growth and poverty reduction will require continued pursuit of sound fiscal and monetary policies and structural reforms. To this end, the authorities aim to reduce further the fiscal deficit in 2004/05, thus strengthening fiscal and debt sustainability and alleviating pressure on real interest rates and the real exchange rate. Fiscal measures requiring timely implementation will include measures to raise revenue, improve tax administration, and contain spending on public administration and defense. The authorities remain committed to deepening reforms in public expenditure management and increasing social spending, as critical elements for fighting poverty. Improving governance remains a key objective, including tackling corruption in the Uganda Revenue Authority and strengthening confidence in public institutions more broadly.

“Supported by new instruments for liquidity management, monetary policy will aim at keeping inflation low and reducing interest rate volatility. A flexible exchange rate policy will help preserve Uganda’s international competitiveness. The authorities are making progress in strengthening the framework for bank supervision and regulation of the financial system. The planned liberalization of the pension system and a broadening of the nonbank financial sector should be accompanied by an appropriate extension of this framework. Important legislative initiatives and the planned restructuring and divestiture of the Uganda Development Bank Ltd. will enhance credit to small-and medium-size enterprises.

“The authorities aim to strengthen debt management by placing an annual cap on new concessional borrowing, in addition to the embargo on nonconcessional borrowing, and relying more on grant financing. Structural reforms to modernize agriculture and improve infrastructure will promote export growth and economic diversification,” Mr. Kato said.

On the noncomplying disbursement, Mr. Rodrigo de Rato, Managing Director and Chairman said:

“The Executive Board regretted the authorities’ failure to provide accurate information relating to the end-June 2003 performance criterion on the contracting or guaranteeing of nonconcessional public sector external debt with a maturity of more than one year.

“The Board noted the minor nature of the slippage, and the corrective actions being taken by the authorities following the discovery of the violation of the performance criterion.

“In view of the prompt corrective actions taken by the authorities, and the steps they propose to take in the future to verify and ensure that new loans are appropriately concessional, the Executive Board decided to grant a waiver of nonobservance of the performance criterion that gave rise to the noncomplying disbursement,” Mr. de Rato said.

The PRGF is the IMF's concessional facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent, and are repayable over 10 years with a 5½-year grace period on principal payments.

Statement by Ismaila Usman, Executive Director for Uganda
July 30, 2004

Introduction

Uganda has demonstrated strong commitment to adjustment and reform and has maintained an impressive record of good economic performance. Consequently, the country has continued to enjoy strong support, not only from the Bretton Woods Institutions, but from the broader international community.

The authorities wish to thank the Fund staff for the well balanced reports and for the very close cooperation, understanding and advice given to them while preparing the reports. They request for waiver for the missed performance criteria and completion of the third review of the PRGF arrangement.

Macroeconomic Developments during 2003/04

During 2003/04, real GDP growth is estimated to have increased by 1 percentage point to 5.7 percent. The annual headline inflation rate declined from 10.2 percent in June 2003 to only 1.4 percent in May 2004, as food crop prices fell sharply. Similarly, strong growth in non-coffee exports helped to narrow down the current account deficit before grants to 11.5 percent of GDP during 2003. During 2003/04, donor inflows remained strong following sustained implementation of appropriate macroeconomic policies. Private capital flows also continued to increase. These developments led to a build up in official reserves, to an equivalent of 6.5 months of imports. With the Ugandan shilling remaining stable for most of the period, the Bank of Uganda's (BOU) interventions in the market remained targeted only towards smoothing short term volatility of the exchange rate.

Fiscal and Monetary Program

The Ugandan authorities continued to maintain prudent fiscal policy during 2003/04, implementing revenue enhancing and expenditure rationalization measures, which resulted in attaining a fiscal deficit level that was consistent with the program target. Revenue collections were strong. Overall expenditure remained within budgetary limits, although the need to strengthen security in the Northern part of the country and also to cover shortfalls in salaries, has led to deviations in the composition of the expenditures.

Monetary developments were generally in line with program targets despite higher than programmed donor inflows. Stronger than programmed demand for currency led to some pressure on banks' reserves positions and interest rates, but a quick reorientation of BOU instruments mix was able to contain the pressure. Thus, although growth rates of monetary aggregates were higher than programmed, inflationary pressures were absent, given the higher demand for money. The financial sector remained robust. Indicators of banks' performance and vulnerability point to a sound expansion in commercial banking. The BOU continued to maintain vigilance in banking supervision, while its base money program focused on sterilizing liquidity arising from donor inflows.

Performance Under the 2003/04 PRGF Program

Performance under the PRGF was generally in line with program targets, as most quantitative performance criteria for end December 2003, including the ceiling on credit from the banking system to the public sector and floor for the net increase in international reserves were observed. However, performance criteria on the increase for base money, the accumulation of domestic arrears under the Commitment Control System (CCS) and curtailment of lending by the Uganda Development Bank were missed, but with very small margins. The authorities have already taken measures, to ensure that this does not occur again. The BOU has also embarked on a program to improve liquidity forecasting with assistance from the Fund, while government has taken measures to improve public expenditure management. In line with the rules of the CCS, all over-commitments incurred in one quarter will be cleared during the following quarter. As for the lending by the UDBL, government has already instructed UDBL management to stop all new lending until divestiture has been completed.

Economic and Financial Policies for 2004/05

Despite the impressive record of economic performance, the Ugandan economy remains fragile and faces many challenges:

Growth remains low and poverty is widespread

Growth remains insufficient to tackle the problem of poverty and this underlines the urgent need for higher sustainable GDP growth rate, particularly to raise rural incomes. It is projected that real GDP growth during 2004/05 will be about 6 percent, while overall inflation rate will remain below 5 percent. To achieve the projected growth, government has developed a plan to modernize and strengthen agriculture under the Plan for the Modernization of Agriculture (PMA), and diversify exports under the Strategic Exports Program (SEP). These measures, coupled with policies directed towards creating an enabling environment for private sector development are expected to generate higher GDP growth, consistent with the objective of poverty reduction in Uganda.

Liquidity management by the BOU will ensure that base money growth does not exceed an annual rate of 13.2 percent, in order to attain the inflation objective. Interest rate volatility will be minimized to facilitate flow of credit to the productive sector. The impact of these measures will be complemented by a tight fiscal stance intended to reduce the deficit before grants from 11.2 percent to 10.9 percent of GDP.

Need to strengthen revenues and expenditure management

The authorities are aware that increasing government domestic revenue is critical to reducing donor dependence in the medium term. They remain strongly committed to achieving this objective. Revenue is projected to rise by 0.3 percentage points to reach 12.9 percent of

GDP. To achieve this, the Uganda Revenue Authority (URA) will be restructured to underpin its integrity and professionalism in revenue collection, with assistance from the Fund.

On the expenditure side, public expenditure management and budget prioritization will be strengthened through increased effectiveness of government spending in line with Poverty Eradication Action Plan (PEAP) objectives. Implementation of the Integrated Financial Management System (IFMS) will be strengthened to facilitate more efficient budget execution, while sector spending ceilings will include donor projects so as to give line ministries greater control over resource use. The CCS will be extended under Fund assistance to districts level, in line with the Fiscal Decentralization Strategy (FDS).

Large domestic arrears

Uganda still faces an accumulation of domestic arrears. Clearing all domestic arrears and avoiding new ones will be the main focus of the government in the period ahead. The government is determined to improve budgetary execution, which is currently subjected to distortionary practices. The existence and accumulation of domestic arrears and the addition of unfunded supplementary spending will be curtailed. As explained in the Memorandum, a policy paper will be sent to Cabinet by end-September 2004 for harmonizing sector specific pay reforms within the overall pay reform strategy. The regulations of the Public Finance and Accountability Act (PFAA) will be amended by end-December 2004, including provisions to ensure proper ex-ante and ex-post integration of donor projects into the budget and that proper reporting agreements are in place. A government team will be assigned the responsibility of clearing the current stock of arrears. The prepayment system for telephone bills already adopted will be extended to other services, so as to ensure that no more arrears are accumulated.

Unsustainable debt

Uganda's external debt situation is still difficult, although over the foreseeable future, its debt service obligations after HIPC are manageable. Stress tests have shown that Uganda's debt is very sensitive to macroeconomic shocks and hence, the burden would worsen substantially in the event of adverse shocks, especially on exports. The government has taken measures to improve the situation, by encouraging exports diversification, better debt management and clear debt contracting procedures to all departments and agencies involved in external debt contraction.

Access to financial services

Although the performance of the financial sector in Uganda has improved over the past few years, access to financial services is still poor. The recent decision by Ugandan authorities on the divestiture option and the restructuring of the Uganda Development Bank Ltd. (UDBL) is expected to enhance its financial management and sustainability, while promoting the availability of credit for long term development. In addition, the recently passed Micro-finance Deposit - Taking Institutions Act is expected to play a key role towards increasing the flow of credit and other financial services to rural areas.

Need to broaden trade reforms

The World Bank and IMF are working closely with the government on a pro-growth trade framework, including regional trade in the context of the East African Community, aimed at ensuring that while Uganda continues to participate in regional trade arrangements, the recent regional trade agreement under the EAC does not result into further revenue loss by the government.

Improving Governance

As pointed out in the staff report, the 2003 National Integrity Survey showed that governance in Uganda has improved. However, governance problems take time to be completely rooted out. Ugandan authorities continue to implement measures aimed at improving governance. The effectiveness of the Inspector General of Government (IGG) will be enhanced and the Leadership Code and/or other relevant Laws will be amended to increase effectiveness of the Code in improving governance.

Conclusion

Ugandan government continues to be committed towards attaining and sustaining macroeconomic stability, for higher growth and poverty reduction. The security problem in Northern Uganda however, continues to drain valuable resources that could have been used for productive purposes. While the Ugandan authorities are trying their best to resolve the conflict, there is need for more international support, especially in terms of the much needed financial resources to assist displaced families in this region.

Despite the difficulties and given the good progress achieved in implementing the program for 2003/04 and measures to strengthen domestic policies, we request for a waiver on the non-observance of the performance criteria and completion of the third review of the PRGF arrangement. My Ugandan authorities will continue to cooperate with the Fund in all aspects that are relevant towards the attainment of program objectives and will also continue to consult on all important polices issues.