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

- the staff report for the first review under the three-year arrangement under the Poverty Reduction and Growth Facility and request for a waiver of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **June 25, 2003,** with the officials of Rwanda on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on June 11, 2003**. 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 June 25, 2003 discussion** of the staff report that completed the review.
- a statement by the Executive Director for Uganda.

The document(s) 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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UGANDA

First 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 A. Basu and Michael T. Hadjimichael

June 11, 2003

- 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 (EBS/02/163, 8/29/02). Discussions on the first review of the program were held in Kampala during March 10–26, 2003. The attached letter from the Minister of Finance, Planning, and Economic Development and memorandum of economic and financial policies (MEFP, Appendix I, Attachment I) review the performance under the program through the first half of fiscal year 2002/03 (July–June) and set out the policy agenda for the remainder of 2002/03 and for 2003/04. The second review is proposed to be linked to performance criteria for end-June 2003.
- The Ugandan representatives included the Minister of Finance, Planning, and Economic Development, the Governor of the Bank of Uganda, and other senior government officials. The staff team consisted of Mr. Caramazza (head), Mr. Dunn, Ms. Sayek (all AFR), Mr. Mitchell (PDR), Mr. Palomba (FAD), and Ms. Cheng (Assistant, AFR). The team was assisted by Mr. Mahler, the Fund's Senior Resident Representative in Uganda. The staff also met with members of parliament on the Budget Committee and representatives of the donor and business communities, and various nongovernmental organizations (NGOs). Near the conclusion of the visit, Mr. Caramazza and Mr. Mahler met with President Museveni in Gulu.
- The decision-making body of the ruling National Resistance Movement (NRM) voted in late March to lift the 17-year-long ban on multiparty politics and to support recommendations to revise the constitution to eliminate the two-term limit on the presidency.
- In northern Uganda, fighting between government forces and the Lord's Resistance Army (LRA) rebels continues, as recent attempts to achieve a cease-fire and initiate peace talks have failed to produce tangible results. In a move that should ease tensions in the region, on April 24 the Ugandan People's Defense Forces (UPDF) began withdrawing from the Ituri region of the Democratic Republic of the Congo (DRC), to be replaced by United Nations peacekeepers.

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Executive Summary

- Economic activity thus far in 2002/03 has been weaker than anticipated. For the year as a whole, real GDP growth is expected to be 5.4 percent, more than one percentage point lower than assumed in the program, owing mainly to delays in the construction of the Bujagali hydro electricity project and the impact of adverse weather conditions on agricultural output. Sharp increases in the prices of food crops have boosted headline inflation. The annual rate of underlying inflation, however, is expected to remain subdued.

- Overall fiscal performance in the first half of 2002/03 was in keeping with the program. Tax revenues have performed broadly in line with projections, led by strong outturns in income and VAT collections, while total spending was held below program projections. To accommodate higher-than-budgeted defense spending, nonwage discretionary expenditures not protected under the Poverty Action Fund (PAF) have been sharply curtailed. This has led some donors to cut back this year's disbursements of budget support and hold back on commitments for the coming year.

- The base money program has focused on sterilizing the liquidity injection associated with donor-supported government spending and mopping up commercial banks' excess reserves that had accumulated during the previous year. The Uganda shilling has depreciated steadily during the course of the year, but the Bank of Uganda (BOU) has on occasion had to step up intervention in the foreign exchange market to maintain orderly market conditions. The BOU's stock of international reserves has remained ample, however, at about six months of imports of goods and services. Indicators of the health of the financial system generally point to continued improvement in 2002/03, but some financial institutions are highly exposed to single borrowers.

- In line with the Ugandan Poverty Eradication Action Plan, the program for 2003/04 is aimed at reducing poverty by encouraging strong private sector led growth through macroeconomic stability and sound structural reforms. Building up the integrity of the budget process, improving monitoring and accountability of national and local government operations, and sustaining efforts to strengthen governance are critical to raising the effectiveness of programs and maintaining a good relationship with donors.

- Only a slight fiscal consolidation is planned for 2003/04, reflecting stepped-up defense spending while maintaining expenditures on social and economic programs aimed at reducing poverty. Spending on programs protected under the PAF would grow in line with projected real GDP growth.

- Monetary policy is aimed at lowering inflation to rates that have prevailed over the last several years (below 5 percent). The authorities will continue to enhance operating procedures for monetary and exchange rate policy and improve the liquidity management framework to conduct sterilization operations without giving rise to unnecessary interest or exchange rate volatility.

- External sector policies are aimed at increasing Uganda's international competitiveness and diversifying the export base by raising productivity in the agricultural sector, providing direct support to strategic exports, integrating with regional trade partners, improving infrastructure, and maintaining a flexible exchange rate policy.

I. Introduction

1. **Uganda has a long track record of good performance under Fund-supported programs**. Through sound macroeconomic and financial policies and the implementation of a comprehensive poverty reduction strategy, the economy has achieved sustained high rates of economic growth and low inflation, and, overall, poverty has been reduced dramatically. In some areas of the country, however, the incidence of poverty has remained high, owing mainly to security problems.

2. **Key features of the program supported by the current Poverty Reduction and Growth Facility (PRGF) arrangement include the following:**

- reducing poverty by maintaining strong economic growth and macroeconomic stability;
- making progress toward fiscal and debt sustainability through a gradual fiscal consolidation, diversification of the export base, and enhancement of international competitiveness;
- increasing government revenue, primarily through strengthened tax administration, but also through tax policy measures, and by curbing public administration expenditures to ensure adequate financing of essential programs to support economic growth and poverty reduction;
- improving governance structures at all levels of government, and building an effective budget management and accounting system at the local level to ensure greater effectiveness of donor assistance;
- deepening financial intermediation and building greater confidence in the banking system through the development of long-term instruments and institutions for financial intermediation, passage and implementation of pertinent financial sector legislation, and strict enforcement of banking regulations; and
- implementing structural measures (Box 1) aimed at enhancing the environment for private sector investment and growth.

II. Performance Under the Program and Recent Economic Developments

3. **Performance under the program in fiscal year 2002/03 (July–June) has been mixed.** Nearly all quantitative and structural benchmarks and performance criteria have been observed thus far, albeit with a modest delay in the case of a couple of structural measures (Appendix I, Attachment I, Tables 1 and 2). However, the zero limit on new domestic arrears

Box 1. Uganda: Structural Conditionality

Coverage of structural conditionality in the current program

For the first review under the current PRGF arrangement, the program for 2002/03 includes three structural performance criteria and five structural benchmarks (MEFP, Table 2). New measures were proposed for the program going out to September 2003, consisting of one structural performance criterion and five structural benchmarks. These structural performance criteria and benchmarks support the macroeconomic objectives of the program by underscoring the government's intention to introduce improvements in these areas:

- **Fiscal policy**: Measures in the areas of tax administration, expenditure management, and fiscal decentralization are part of a comprehensive program aimed at fiscal consolidation. The program includes the submission to cabinet of a plan to reduce government expenditure on public administration; production of a business plan for the Uganda Revenue Authority (URA) that spells out its strategy for improving tax collections and associated costs; verification of outstanding domestic budget arrears as at end-June 2002; and, to improve monitoring and reporting at the local government level, production of aggregated local government financial statistics for the 2000/01 fiscal year. New structural measures include announcement of a plan to clear the outstanding stock of nonpension domestic arrears; development of a time-bound plan to clear the stock of pension arrears as part of a comprehensive plan to reform the public service pension scheme; development of the annual business plan for 2003/04 for the URA and a plan for completing the computerization of the URA; establishment of a unit in the office of the Inspector General of Government (IGG) to identify and investigate cases of improper conduct and corruption by URA staff; and production of aggregated local government financial statistics for the 2001/02 fiscal year.
- **Financial sector**: The program includes reforms to strengthen the financial sector and improve its efficiency, including: submission to parliament of a bill to annul the National Social Security Fund (NSSF) Statute to pave the way for regulation of the NSSF by the Bank of Uganda (BOU); and submission to the BOU by all commercial banks of a plan to comply with the higher minimum paid-up capital requirement introduced January 1, 2003; and measures regarding the privatization of the Uganda Development Bank.
- **Safeguards**: Measures to assure the adequacy and integrity of control, accounting, reporting, and auditing systems of the Bank of Uganda.

Status of structural conditionality under the earlier program [1]

Under the 2000/01 program, the prior actions, structural performance criteria, and structural benchmarks covered these same areas, with a strong emphasis on tax administration, domestic arrears, financial sector development, and the external sector (EBS/01/33). All three prior actions were implemented: (i) the authorities appointed a new Commissioner-General of the URA; (ii) two insolvent banks were fully recapitalized by private investors or closed; and (iii) the appropriations to regularize the compensation of depositors of the three closed banks were included in the 2000/01 budget proposal submitted to parliament. Two out of three structural performance criterion were observed on time, while the verification of the stock of domestic central government budget arrears outstanding as at end-June 2000 was not observed owing to capacity constraints. All five structural benchmarks were observed, though with some delays.

Structural measures covered by World Bank lending and conditionality

The World Bank's lending programs are aimed at improvements in the following areas:

- **Fiscal policy**: medium-term expenditure framework, budget execution, budget and poverty monitoring;
- **Financial sector and financial management**: pension reform, insurance industry, legal and institutional framework for the financial sector, measures to reduce fiduciary risk, and strengthening of the public finance accountability cycle in both the central and local governments;
- **Public service management**: measures regarding pay reform and public service reform;
- **Public procurement**: measures to improve the legal and regulatory framework on public procurement;
- **Transparency and corruption**: submission of statements of income, assets, and liabilities of all ministers, presidential advisors, and other senior government officials; measures to ensure sanctioning and exposure of corrupt acts, to improve ability of the private sector to enforce commercial contracts, and to enhance civil society participation.
- **Reforms to increase the ability of the poor to raise their incomes, and increase quality of life:** several measures to address the promotion of enabling environment for rural development and to improve the delivery of basic services.

[1] The last three-year PRGF program ended in March 2001. The measures referred to in this section are detailed in the staff report for the 2001 Article IV Consultation, Second Review Under the Third Annual Arrangement Under the PRGF.

was not observed for end-September and end-December 2002,[1] and the verification of the outstanding stock of domestic arrears, a benchmark for end-March 2003, was completed with some delay; the end-December 2002 performance criterion to submit a plan to cabinet to streamline public administration was not implemented until March 2003; and the performance criterion to submit a bill to parliament by end-March 2003 to repeal the National Social Security Fund (NSSF) statute was not met. In March 2003, the cabinet agreed on several measures to streamline public administration that would begin to generate savings in 2003/04 (Box 2). The production of a business plan for the Uganda Revenue Authority (URA), a benchmark for September 2002, was completed on schedule. The Uganda Development Bank (UDB) was assigned to the privatization unit on time, but the appointment of a privatization advisor was only finalized in March 2003. The authorities have requested waiver for the missed performance criteria, based on corrective actions (discussed below) to address the causes of the slippages in performance.

Box 2. Proposed Measures to Streamline Public Administration

Immediate measures to be implemented in 2003/04

- Reduction in the cost of presidential advisers by keeping the majority on a part-time retainer fee basis only.
- Elimination of the Deputy Resident District Commissioners in districts with less than 500,000 people, and of all Assistant Resident District Commissioners.
- Reduction of the number of Movement Directors by half.
- Reduction in the number of members on District Boards, namely District Service Commission (DSC), District Tender Boards, and District Public Account Committees; provided by a reduction in the allocation of the Poverty Action Fund (PAF) Monitoring and Accountability Grant to these Boards.
- Restrictions on the use of government vehicles.
- No new districts will be created.

Other actions proposed in the near and medium term

Other planned measures include: savings on vehicle costs; harmonization of the salary and establishment structures of commissions and semiautonomous agencies with those of the traditional public service; standardization of discretionary recurrent expenditure across government; rationalization of foreign missions; identification of cuts in expenditure with low positive impact on public service delivery; and the merger of regulatory bodies to form multisectoral agencies, such as a single agency to regulate agriculture and a single agency to regulate utilities.

[1] Data on arrears are based on data from the commitment control system (CCS) for the nonwage recurrent and development budget. These data should be considered as incomplete.

4. **Economic activity thus far in 2002/03 has been weaker than anticipated.** For the year as a whole, real GDP growth is expected to be 5.4 percent, more than 1 percentage point lower than assumed in the program, mainly because of the impact of adverse weather conditions on agricultural output and the delay in the start of construction of the Bujagali hydro-electricity project (Figure 1 and Table 1).[2] Sharp increases in the prices of food crops and fuel, together with a weaker Uganda shilling, have boosted headline inflation, with the 12-month rate reaching 10.9 percent in April. Underlying inflation, which excludes food crops, has also picked up (to 4.3 percent in April) but on a period-average basis is not expected to exceed the program target of 3½ percent for 2002/03 as a whole.

5. In October 2002, the government announced additional defense expenditures, aimed at bringing to an end the long-running insurgency in northern Uganda and improving the poor security situation that has in large measure been responsible for the persistently high poverty rates in the region. Despite these additional expenditures of US$17.5 million (or 0.3 percent of GDP) and higher-than-expected expenditures in public administration and domestic interest costs, **overall fiscal discipline has been maintained in 2002/03**. This has been made possible by sharp cuts in discretionary nonwage expenditures not protected under the Poverty Action Fund (PAF) and a good revenue performance, led by strong outturns in income and value-added tax (VAT) collections that have more than compensated for shortfalls in revenue from domestic excises. The relatively poor performance of PAF expenditures in the first half of 2002/03 was mainly due to the development budget and is not expected to continue in the following months.[3] For the year as a whole, the overall fiscal deficit, excluding grants, is expected to be 11.4 percent of GDP, which would represent a consolidation of 1.3 percentage points from the previous year (Figure 2 and Table 2).[4]

6. Coming as it did, however, after the budget had been approved by parliament and endorsed by donors, **the supplementary spending on defense and the resulting change in**

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[2] The Bujagali project is a US$550 million investment (about 10 percent of GDP) that would increase Uganda's present electricity-generating capacity by at least two-thirds. The construction phase of the project, which would last five years and was expected to begin in July 2002, is now expected to begin in July 2004.

[3] Indeed, preliminary data for the first three quarters of the year indicate an overall satisfactory PAF performance at 98.5 percent of program, which is in keeping with previous years.

[4] The program projection implies that the fiscal consolidation in 2002/03 was to have been 2.3 percentage points of GDP (see Table 2). However, adjusting for revised data on donor-supported projects and a change in the treatment of defense expenditures, the programmed consolidation would have been 1.4 percentage points of GDP, suggesting that the outturn was more closely in line with the program. In the program, it was assumed that 10 percent of the projects supported by donors would be accounted for in local government operations and would not affect the central government's accounts. However, a recent study on donor-supported projects implies that all such projects are to be registered in the central government's account; adjusting for this leads to a higher figure for capital spending and the overall balance, excluding grants, of 0.6 percent of GDP in 2002/03. In addition, in the program, defense spending was treated on an accrual basis, thus excluding U Sh 34 billion in expenses incurred in 2000/01 and financed through short-term financing to be paid in 2001/02 that should be added to total defense spending when comparing program and annual cash-based projections.

the composition of government spending, have tended to undermine the integrity of the budget process. This development has induced some donors to scale back the disbursement of general budget support grants by a total of US$35 million. It has also increased uncertainty about future donor assistance, as some major donors have indicated that the level of their budget support for 2003/04 will depend on the budget outturn of the current fiscal year—in particular, on the observance of the revised spending limits on defense and public administration. In addition, the sudden—and, in some areas large—cuts in resource allocations have weakened budget transparency, planning, and monitoring, and have contributed to the accumulation of new arrears by line ministries.

7. **Monetary policy during 2002/03 has focused on sterilizing the large injection of liquidity arising from donor-supported government spending and mopping up the overhang of commercial banks' excess reserves from the previous year.** Following substantial net issues of treasury bills and net sales of foreign exchange by the Bank of Uganda (BOU) to accomplish these tasks, a high degree of stability in the financial and foreign exchange markets has been achieved, as the new operating procedures for the foreign exchange market and liquidity management, employed by the BOU since April 2002, have helped to reduce the daily volatility of interest and exchange rates.[5] Yields on treasury bills, though, rose steeply through late January and subsequently stabilized at about 15 percent (Figure 3), or about 11 percent in real terms, up from near zero a year earlier. As has been the tendency in recent years, commercial bank deposit and lending rates remained more stable than the treasury bill rates during this period. The tighter monetary policy kept the underlying inflation rate subdued despite the sharp increases in the prices of food crops and fuel.

8. **The Uganda shilling depreciated gradually against the U.S. dollar**, in nominal terms, through mid-February 2003, when uncertainty about the government's relationship with donors, together with increased tensions in the region and higher petroleum prices during the run-up to the war in Iraq, led to a brief period of increased volatility and an accelerated depreciation of the shilling (Figure 4). In real effective terms, the depreciation of the shilling was compounded by the weakness of the U.S. dollar against other major currencies, resulting in an 8 percent real depreciation in 2002/03,[6] compared with the 5 percent depreciation envisaged in the program.[7] A series of interventions in the foreign exchange market by the BOU has since helped to narrow bid/offer spreads and moderate the rate of depreciation.

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[5] To facilitate the development of a secondary market for government paper, the BOU in February 2003 introduced two other operational changes in the treasury bill market: it shifted from a weekly to a biweekly schedule of treasury bill auctions in preparation for the adoption of a benchmarking system for new issues of treasury bills, and it introduced the first phase of a primary dealer system.

[6] Based on data up to February 2003.

[7] The depreciation of the Uganda shilling notwithstanding the rise in domestic treasury bill yields, reflects the low degree of integration of domestic capital markets with international capital markets.

9. **The program targets for base money in the first half of 2002/03 were met.** The 12-month rate of expansion of broad money (M2) remained high, however, at about 23 percent during the past year, reflecting the increase in the money multiplier as the monetary authorities mopped up excess reserves in the banking system (Figure 3 and Table 3). Commercial bank credit to the private sector has risen steeply from the depressed levels of the past year. Contributing to this recovery were the return of the Uganda Commercial Bank (UCB) to private sector lending activities, following the completion of its privatization and merger with Stanbic Bank in October 2002, and the increased provision of development finance funds by the BOU to commercial banks for the low-cost financing of export credits.[8]

10. **Bolstered banking supervision has played a key role in the overall strengthening of the banking system in 2002/03.** The BOU has maintained close supervisory relationships with banks through on- and off-site inspections and by reaching regular agreements on banks' operations. On January 1, 2003, higher minimum paid-in capital requirements came into effect. These were met by all banks. Recent parliamentary passage of two legislative proposals should further strengthen the financial sector and encourage financial intermediation. One, the new Financial Institutions Bill (FIB), which was approved in April 2003, should strengthen the banking system by introducing prudential provisions consistent with international standards and ensure prompt bank interventions and other corrective actions deemed necessary by the regulatory and supervisory authorities. Two, the Microfinance Deposit-Taking Bill, which was approved in December 2002, provides for the regulation and supervision of the microfinance industry and should help to ensure that microfinancing is conducted in a manner conducive to the orderly growth of the sector.

11. **Notwithstanding the overall improvement in the health of the financial system, as reflected in a number of financial soundness indicators (Table 4), the exposures of some banks to large borrowers have increased substantially during the past year.** A number of banks have reported loans in excess of the single borrower's limit (25 percent of core capital) and some have very high credit concentrations, with loans to a few borrowers exceeding 100 percent of core capital. The BOU, in March 2003, announced that exemptions from the single borrower's limits, which are allowed under the Financial Institutions Statute 1993 at the discretion of the BOU, would only be approved on an exceptional basis. The new FIB removes the BOU's discretion.

12. **An improvement in the terms of trade, the first in several years, has strengthened Uganda's external position** (Figure 5 and Table 5). Export receipts through the first half of 2002/03 thus kept pace with program projections, even though adverse weather conditions depressed export volume growth for some key crops (coffee, tea, and cotton). Other exports, notably tobacco, flowers, and fish, have shown substantial volume growth, suggesting that Uganda continues to maintain its international competitiveness and is

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[8] The Development Finance Fund operated by the BOU is financed by donors. The main donor is the European Investment Bank, which has disbursed € 40 million over the past 18 months.

diversifying its export base. Private transfers, particularly workers' remittances and transfers to nongovernmental organizations (NGOs), have remained strong in 2002/03, exceeding program expectations. Private capital inflows, however, have fallen well short of expectations, owing mainly to the delays in the Bujagali project. Through the first half of the fiscal year, net international reserves far exceeded the program target, reflecting a generally stronger-than-expected overall balance of payment position. The stock of gross reserves has remained ample, and is expected to end 2002/03 at about six months of imports of goods and services. The net present value (NPV) of debt-to-exports ratio, after incorporating the actual disbursements and the outturn for export earnings, stood at 188.1 percent at end-2001/02 and is expected to peak at 193.5 percent at end-2002/03 compared with 208.7 percent in the recent updated Debt Sustainability Analysis.[9]

III. The Program for 2003–04

13. **The authorities are committed to maintaining macroeconomic stability, and to the effective implementation of programs that directly support economic growth and poverty reduction.** Fiscal policy aims at reconciling the provision of adequate resources for essential poverty reduction programs, and increased domestic security, with financial sustainability. As the government would continue to target annual revenue improvements of about ½ percentage point of GDP through tax measures and stronger tax administration, the overall fiscal deficit, before grants, is targeted to remain constant in 2003/04 and to narrow gradually over the medium term. The domestic deficit, however, is expected to narrow in 2003/04 and in subsequent years. Higher defense spending would reduce the resources available for other government expenditures; however, the impact on poverty reduction would be minimized by maintaining the pro-poor spending protected under the PAF broadly constant in terms of GDP. Moreover, success in achieving greater security in the poverty-stricken north would benefit people for whom insecurity and conflict are key causes of poverty. The structural program would seek to encourage investment and strong private sector growth, and improve the effectiveness of public expenditures through better management systems, while a firm monetary policy would support low inflation. The authorities remain committed to maintaining external competitiveness through a flexible exchange rate policy, which would support export growth. Foreign exchange reserves would be maintained at a prudent level to provide a buffer against external shocks, including delays or reductions in aid disbursements.

14. **The broad policy framework reflects the Poverty Eradication Action Plan (PEAP),** including the emphasis on macroeconomic stability, programs to enhance international competitiveness and private sector growth, and increased spending on social programs, even though higher defense spending would limit the increases in social spending in 2003/04. With insecurity stymieing poverty reduction in the north of the country, a stronger effort to restore peace in the region is warranted. The authorities have begun the

[9] The NPV debt-to-exports ratios have been revised based on updated data on exports of goods and services.

participatory process for the revision of the PEAP, which should be completed by late 2003 or early 2004. The revised PEAP would be based on a new poverty diagnosis that would guide the allocation of resources under future medium-term expenditure frameworks (MTEFs). As suggested in the last joint staff assessment of the Poverty Reduction Strategy Paper (PRSP) progress report, the authorities are expected to either reevaluate the current PEAP target of 7 percent a year real GDP growth over the long term, which is considered necessary to reduce the incidence of poverty below 10 percent of the population by 2017—a more ambitious target than the Millennium Development Goals—or to propose a more vigorous program to step up investment and economic growth. The latter may be needed because budgetary pressures have recently slowed the expansion of some economic and social programs, which could retard the attainment of some PEAP targets in areas such as roads and agriculture.

15. **Given that the quantitative program was largely on track through the first half of 2002/03, the program over the remainder of the fiscal year has been left largely unchanged** (see MEFP, Table 2). The end-June 2003 target for net international reserves, however, would be reduced by US$40 million. Owing to the Uganda shilling's larger-than-expected depreciation thus far this year and the higher-than-expected rise in treasury bill yields, the cost of which has put a burden on fiscal operations, it would be appropriate to alter the composition of sterilization operations by increasing the BOU's foreign exchange sales. Accordingly, the amount of net treasury bill issues for sterilization purposes would be lowered. Although the underlying inflation rate in 2002/03 (at 6.6 percent, end-of-period) is now expected to exceed program projections by 2 percentage points, a monetary tightening and an increase in total sterilization operations do not appear to be warranted, as the jump in inflation is largely the result of temporary factors, such as the surge in fuel prices late in the year. The 12-month growth rate of M2 is expected to fall substantially (to 10.5 percent) by end-June, as programmed.[10] Without revisions, the ceiling on net claims on the government by the banking system is expected to be respected, as the overall fiscal deficit, excluding grants, is projected to remain on track with the program, in nominal terms. Growth in credit to the private sector is projected to plateau over the remainder of the year but would remain high (24.8 percent) for the year as a whole. Gross international reserves would stay at a comfortable level of six months of imports as of end-June 2003.

16. **The revised macroeconomic framework for 2003/04 is based on an expected modest recovery in economic activity, assuming that weather conditions return to normal.** With a pickup in crop production, which accounts for 30 percent of GDP, real GDP growth is projected to increase to 6 percent. Growth is expected to remain broadly based, with construction and manufacturing slightly outpacing overall growth, while a modest pickup in savings and investment would support the higher growth rate. Further investment is expected to yield another year of extraordinary growth (20 percent) in the

[10] In contrast to the extraordinary increase in the last quarter (April–June) of 2001/02, M2 is projected to contract slightly in the final quarter of 2002/03. Preliminary data indicate that most of this contraction occurred in April.

telecommunications sector. Stable food prices and an expected decline in fuel prices would contribute to lower both headline and underlying inflation (under 3 percent for the latter on an end-of-period basis) during 2003/04, supported by a restrained monetary policy. On a period-average basis, underlying inflation would rise to 5.6 percent, mainly reflecting the jump in the prices of fuel and other imports during the second half of 2002/03.

17. **To meet the country's security needs, the authorities intend to raise defense spending to 2.4 percent of GDP in 2003/04, up from the 2.1 percent budgeted in 2002/03.** Compared with the expected outturn for 2002/03, however, the ratio of defense spending to GDP would be up 0.1 percentage points in 2003/04. Concerns by donors about the increase in defense expenditures have generated considerable uncertainty about future budget support disbursements. This is reflected in a reduction in projected general budget support of 2 percentage points of GDP in 2003/04, based on agreements already signed or in the pipeline. Under the circumstances, the authorities have preferred to err on the side of prudence and discounted the budget support expected in 2003/04 at a higher rate than usual.

18. **This increased defense spending, while protecting poverty-related programs, would limit the scope for further fiscal consolidation in the coming year and alter the composition of government spending.** Most sectors would experience little or no growth, but spending protected under the PAF would be increased somewhat to account for 24 percent of the budget (5.8 percent of GDP). Savings from streamlining public administration expenditure, while helpful in this regard, would be limited in 2003/04 to about U Sh 3.7–5.7 billion. Staff underscored, therefore, the importance of realizing increased savings by effectively implementing the medium-term measures proposed in the Presidential Committee on Streamlining Public Administration Expenditures, including harmonizing the salary and establishment structures of commissions and semiautonomous bodies with those of the civil service, developing norms for nonwage recurrent line items, and rationalizing foreign missions.

19. **The need for further expenditure restraint in 2003/04 would be mitigated by allowing greater domestic financing,** reflected in a near-zero buildup of government deposits (and international reserves) in the BOU.[11] Taking into consideration the donor-financed projects, however, spending in the social sectors would increase considerably in 2003/04, particularly in the health sector, which will be receiving grants from the Global Fund for AIDS, Tuberculosis, and Malaria. As a result, the overall fiscal deficit, excluding grants, would be reduced by just 0.1 percentage points of GDP (to 11.3 percent) in 2003/04, compared with the previous year. The program would achieve a greater reduction (0.6 percentage point of GDP) in the domestic deficit and, hence, also in the injection of liquidity through fiscal operations, thus easing some of the burden of sterilization operations.

[11] In the event that budget support during the year exceeds projections, international reserves would be increased commensurately.

20. **Tax policy and tax administration measures would contribute to an estimated increase in government revenue of 0.5 percentage point of GDP, to 12.8 percent, in 2003/04.** To meet the revenue target, the authorities will increase a number of excise taxes and remove some VAT exemptions, while avoiding imposing an excessive burden on the poor. Measures to improve tax administration are not expected to yield large revenue gains in the short term, but these are expected to increase over the medium term by building upon recent efforts to strengthen enforcement and fight corruption at the URA, led by of the judicial commission of inquiry investigation into wrongdoing by URA staff. The URA management intends to implement quickly the commission's recommendations, including dismissal of some staff, and to strengthen the permanent staff-monitoring unit by incorporating its operations under the offices of the Inspector General of Government. Moreover, the URA will by June 2003 prepare its annual business plan for 2003/04, which will emphasize staff recruitment, training, and the computerization of operations. In this respect, the staff emphasized the need to identify monitorable actions in the areas of organization, computerization, auditing, and collection enforcement, so as to be able to monitor progress in tax administration.

21. **To enhance the integrity of the budget process, the government would refrain from nonessential supplementary expenditures and exercise discipline to avoid any new domestic arrears in 2003/04.** The authorities are of the view that the new Public Finance and Accountability Bill will improve expenditure management and help to regulate the use of supplementaries. In the staff's view, however, it will also require the political commitment to reduce additional expenditures mandated by the executive branch, which has been the leading cause of growing supplementaries in recent years.

22. **The government has made progress in dealing with the problem of domestic arrears; however, weaknesses in expenditure management allowed an accumulation of new arrears during the first half of 2002/03.** Some of these new arrears were cleared during the following quarter, in line with the rules of the commitment control system (CCS), but not all, which reflects remaining weaknesses in the application and enforcement of the CCS. That is, despite a good amount of success in reducing the accumulation of new arrears since the introduction of the CCS (from about U Sh 80 billion in 1999/2000 to U Sh 40 billion in 2001/02), the CCS and, more generally, expenditure management as a whole need to be strengthened further. The computerization of the CCS and the pilot integrated financial management system (IFMS) will be introduced in six line ministries in 2003/04, and to the rest of the central government by 2005/06, which should help to achieve greater discipline.[12] The new Public Finance and Accountability Bill approved by parliament in April 2003 will also improve expenditure management and control over supplementary expenditures, which contribute to the creation of new arrears. Efforts are also under way to improve the procurement process on both the national and local levels of government, and, on a voluntary

[12] The authorities are considering requesting a technical advisor to assist with this project, as well as with the strengthening of the accounting and reporting systems of local governments.

basis, the Ministry of Finance, Planning, and Economic Development would provide support to local governments that wish to implement their own (manual) CCS. Moreover, the authorities have made progress in identifying and verifying the outstanding stock of arrears—of which nonpension arrears stood at U Sh 203 billion (1.7 percent of GDP) as of end-June 2002, compared with U Sh 254 billion (2.1 percent of GDP) in June 1998—and will announce by end-June 2003 a time-bound plan for clearing the nonpension arrears. To be effective, the plan must be matched by a strengthened commitment to strictly enforce the expenditure management systems. Much of the domestic arrears arose from the public pension system, and these will be addressed in the context of the reforms to assure its sound financial management. Based on the overall progress in reducing new arrears accumulation and in clearing existing arrears, staff supports the authorities request for a waiver of the missed performance criterion to eliminate the accumulation of new arrears.

23. **The base money program for 2003/04 is aimed at reducing the underlying end-of-period inflation rate to 3.0 percent from 6.6 percent in 2002/03.** With a moderate pickup in the rate of growth of real GDP (to 6.0 percent) and the expected drop in the inflation rate, a slight decline in velocity is projected,[13] so that broad money (M2) would be allowed to grow by 15.0 percent. With the continued mopping up of banks' excess reserves, the growth in base money would be limited to 11.3 percent during the year. Given the targeted buildup of net foreign assets and of programmed net credit to government, the growth in broad money would provide scope for expanding credit to the private sector by 14.0 percent. Continued efforts to implement and enhance operating procedures for monetary and exchange rate policy developed over the past year are expected to reduce volatility in the domestic money and foreign exchange markets. Moreover, the Ministry of Finance and the BOU would continue to improve their coordination in implementing a liquidity management framework to avoid market volatility arising from sterilization operations.

24. **To address the shortage of long-term financial instruments,** the authorities will begin to issue treasury bonds with up to a five-year maturity, which would serve as a benchmark instrument, and they will proceed with initial steps in 2003/04 to reform the NSSF, the country's largest potential source of long-term savings. An intensive capacity-building effort would be needed, however, to develop the role of the Capital Markets Authority (CMA) as the supervisor of large nonbank financial institutions. While this effort is under way, the BOU would exercise regulatory oversight of the NSSF. Moreover, the government will carry out prior consultation with, and the sensitization of, parliament, in order to design an effective bill for the repeal of the NSSF statute, with a view to submitting the bill for parliamentary approval later this year. The privatization of the UDB would provide another potential source of term lending.

25. **The authorities are committed to enhancing Uganda's international competitiveness and to expanding and diversifying the export base.** To this end, programs to

[13] The projected decline in velocity is slightly smaller than the average decline of the last five years.

boost productivity in Uganda's principal exports, notably the Plan for the Modernization of Agriculture (PMA) and the Strategic Exports Program (SEP), are expected to be sufficiently funded. The PMA is a long-term strategy, led by the National Agriculture Advisory Services (NAADS), that has shown strong potential for raising farmers' productivity in demonstration projects. NAADS is scheduled to be fully rolled out to about 1,000 subcounties by 2007/08, with about 200 subcounties targeted in the 2003/04 budget framework. The SEP is designed to complement PMA during its roll-out period by providing more immediate support through direct government interventions, such as the supply of seeds and new plantlets to farmers. Moreover, the authorities are committed to the continued implementation of a flexible exchange rate policy that would support competitiveness. In this regard, the authorities intend to maintain a balanced usage of sterilization instruments, which, combined with the expected easing of overall sterilization needs, would allow for a needed reduction in exchange market interventions. The BOU's net sales of foreign exchange would be limited to US$135 million during 2003/04. Despite an anticipated lower level of donor support, gross international reserves would remain steady in U.S. dollars but would fall in relation to imports to 5.5 months of cover by end-2003/04. Net international reserves would increase in line with scheduled net repayments to the Fund.

26. **Over the past year, the government has granted a number of incentives to a few selected investors in an attempt to attract investment in specific sectors.** The government's aim is to encourage industries to export to the United States and European Union markets under the African Growth and Opportunity Act (AGOA) and the Everything But Arms Initiative. The costs of these incentives—which include low-cost loans and subsidies on the rent of factory premises, the training of labor, and shipment costs—have yet to be fully documented and there has been no cost/benefit analysis of their effectiveness. These incentives have given rise to concerns in the business community about the inherently discriminatory nature of such a selective approach to attracting investment and the potential for corruption. Realizing the potential adverse consequences of ad hoc incentives, the authorities have committed to standardizing incentives under a new investment code and, together with the authorities from the other two member countries of the East African Community (EAC), have requested technical assistance from the IMF and the World Bank on rationalizing and harmonizing investment codes in the EAC.

27. **Uganda's external position and external debt sustainability are expected to improve gradually over the medium term.** The external current account deficit, excluding grants, would widen somewhat to 13.7 percent of GDP in 2003/04, but, excluding imports associated with the Bujagali project, which is expected to enter the construction phase in 2004/05, it would decline gradually thereafter. Foreign aid and private capital inflows would more than cover the current account deficit. Export earnings growth of about 8 percent a year, on average, over the medium term, combined with sound external debt management and fiscal consolidation, would reduce the ratio of the NPV of external debt to exports to 186 percent by 2004/05.[14] Importantly, the ratio of debt service to exports, an

[14] The domestic debt stock is projected to level off at about 9 percent of GDP over the medium term.

indicator of debt-servicing capacity, is projected to remain below 10 percent, well below the indicative Heavily Indebted Poor Countries (HIPC) Initiative target threshold of 15 percent.

28. **Uganda should receive additional HIPC Initiative relief in the near term.** Some progress has been made in securing agreements with the Organization of the Petroleum Exporting Countries (OPEC) Fund, France, and Japan.[15] France has provided debt relief beyond HIPC terms,[16] and Japan is revising its method of providing debt relief so that by end-2003 it will be able to provide full debt forgiveness. Additional HIPC Initiative debt relief should be forthcoming as the governments of Libya, Pakistan, and the Republic of South Korea have pledged to provide debt relief on official debt. However, some non-Paris Club creditors have won judgments totaling US$40 million against the government. As of December 2002, the government settled claims of US$14.5 million to two commercial creditors (from Yugoslavia and Spain) whose judgment cleared the appeals process. Other judgments are still subject to appeal and have not been paid. The authorities will actively pursue agreements for the delivery of debt relief under the HIPC Initiative with all creditors who have expressed their willingness to participate in the Initiative.

29. **The authorities are pursuing a series of structural measures aimed at enhancing the environment for private sector investment and growth by addressing the leading constraints on doing business in Uganda.** Infrastructure will be upgraded by the privatization of the railway, as well as by the improved generation and distribution of electricity. Discussions have begun on a long-term concession for the operation, maintenance, and expansion of the Uganda railway in conjunction with the Kenyan railway. A 20-year concession for the electricity-generating company was concluded in December 2002, and the concession for the distribution company, which would provide for the steady expansion of the electricity grid, is expected to be completed in June 2003. In the area of governance, in addition to taking action to curb corruption at the URA, the authorities are following up with reviews of the judicial system, the government procurement and tendering procedures, and the asset declarations of public officials under the new Leadership Code. However, resources to fulfill this latter commitment are tight.

30. **Poverty and social impact analysis (PSIA) has begun to play a greater role in Uganda's policy decisions.** In the past year, Uganda participated in a pilot project sponsored by the U.K.'s Department for International Development and the World Bank to develop the capacity for ex ante PSIAs in several low-income countries. The study for Uganda focused on the SEP. While the PSIA yielded valuable insights on the role of gender issues in the program to expand coffee production, it showed that, over the foreseeable future, it will continue to be difficult to perform timely PSIAs on a comprehensive set of policies issues.

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[15] Uganda has not been servicing certain of its external obligations pending agreement on the delivery of HIPC Initiative assistance.

[16] France has cancelled the remaining 82 percent on Uganda's post completion point debt, which yields about € 1 million in annual cash flow savings.

The government, in conjunction with other stakeholders, has recently identified urban water tariff restructuring, implementation of the 1998 Land Act (which is still in the early stages of implementation), and tax policy as priority areas for PSIAs in the near term.

IV. Safeguards Assessment

31. The conclusions drawn from the safeguards assessment of the BOU indicate that some vulnerabilities exist in the bank's safeguards framework: (i) there has been a significant delay in the completion of the financial statements for 2002; (ii) the external auditors do not report their findings to the Board of Directors; and (iii) there is no functioning audit committee. The assessment gave risk ratings of medium high in three of the ELRIC[17] areas, with ratings of low and medium low in the other two ELRIC areas. The priority recommendations are (i) publishing the financial statements in a timely manner, and (ii) establishing a functioning audit committee. The latter measure was implemented in April 2003. The BOU financial statements for the year, ended June 30, 2002, were finalized and approved by the BOU Board and submitted to the Auditor General in April 2003; they will be published by end-June 2003. Other measures include (i) amending the 1993 Bank of Uganda Statute, and (ii) strengthening the internal audit function and improving the internal control structure at the BOU. These measures are being monitored by staff under the present PRGF arrangement.

V. Program Monitoring

32. Implementation of the program will be monitored with the help of quantitative and structural performance criteria and benchmarks (see MEFP, Tables 1 and 2). The structural measures focus on tax administration, budget management and planning, fiscal decentralization, financial sector reform and supervision, and safeguards on the use of Fund resources. These measures and targets are complemented by structural measures monitored by the World Bank under the Poverty Reduction Support Credit (PRSC) (Box 3). The next (second) review of the three-year arrangement is expected to be completed in October 2003.

VI. Risks to the Program

33. With the predominance of agriculture and the reliance on basic commodity exports, the performance of the economy is highly vulnerable to weather and commodity price shocks. Furthermore, failure to restore the integrity of the budget process by incurring sizable supplementary expenditures on defense and public administration could result in a shortfall in donor budget support. Over the medium term, the main risks appear to be insufficient private investment for sustaining high economic growth rates, inadequate efforts to maintain a path of gradual fiscal consolidation, 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.

[17] The ELRIC areas are the external audit mechanism; legal structure and independence; financial reporting framework; internal audit mechanism; and the internal controls system.

Box 3. Structural Measures in World Bank- and IMF-Supported Programs for 2002/03 [1]	
World Bank	**IMF**
Fiscal issues	**Fiscal issues**
• To ensure allocations and actual spending are consistent with the priorities of the PEAP Government of Uganda (GoU) agrees with donors on MTEF for 2002/03–2004/05 and executes the 2002/03 budget consistent with the agreement. • To enhance the timeliness and predictability of resource flows to sectors and districts the Ministry of Finance, Planning and Development (MoFPED), together with relevant line ministries, conducts reviews on resource flows problems and takes remedial action. • MoF, in consultation with the Ministry of Public Services (MoPS), agrees on an approach to integrate the wage bill and staffing plans in expenditure programs. • To minimize deviations of annual outturns from approved budget the MoFPED publishes semi-annual budget performance reports, and makes quarterly reports available on request. • Several sectors incorporate output and outcome measures and targets in the 2003/04–2005/06 budget framework papers to ensure input-oriented plans and programs. • The MoFPED and Office of Prime Minister (OPM) prepare a Cabinet Information Paper to strengthen coordination in public sector management; OPM, MoPS, Ministry of Local Government (MoLG) and line ministries agree on an approach to consolidate GOU inspections, and together with Uganda Bureau of Statistics (UBOS) they agree on common results management concepts and definitions to streamline monitoring and evaluation arrangements and increase their effectiveness.	• A time bound plan for implementing actions to streamline public administration expenditure will be developed and announced. • Uganda Revenue Authority (URA) will produce a business plan that will spell out its strategy for improving tax collection and associated costs. • The URA will be provided additional resources for funding of the emergency equipment project. • Domestic budget arrears outstanding as at end-June 2002 will be verified.
Local government	**Local government**
• To strengthen local ownership and reduce burdensome reporting requirements, MoFPED, MoLG, and Local Government Finance Commission (LGFC) prepare operational manuals and guidelines to implement the fiscal decentralization strategy.	• To improve monitoring and reporting, aggregated local government financial statistics for 2000/01 fiscal year will be produced.
Financial sector and financial management	**Financial sector**
• To improve the quality of investments and access, and resolve the insolvency of the pension system, GoU appoints a pension reform task force to develop policy recommendations and roadmap for pension reform.	• Table to the Parliament a bill to annul the National Social Security Fund (NSSF) Statute to pave the way for regulation of sector by the Bank of Uganda (BOU).
• MoFPED signs and gazettes new insurance regulations to remedy the undercapitalization and underdevelopment of the insurance industry.	• All banks will develop a Capital Compliance Plan detailing proposals for complying with January 2003 capital requirement for minimum paid-up capital.
• To update the legal and institutional framework (i) the Public Finance and Accountability Bill will be enacted; (ii) MoFPED will revise treasury instructions and financial regulations; (iii) MoFPED establishes a sector working group to steer public expenditure management reforms. Furthermore, to improve the recording and reporting of financial transactions MoFPED will (i) approve the design of integrated financial management system (IFMS) and start implementation; (ii) will finalize the new Chart of Accounts.	• Undertake comprehensive on site inspection of two weak banks and take appropriate supervisory action if necessary.

Box 3. Structural Measures in World Bank- and IMF-Supported Programs for 2002/03 [1]	
World Bank	**IMF**
• To reduce the fiduciary risk, and strengthen the public financial accountability cycle in both central and local governments (i) the Directorate of Accounts (DA) will establish a process to ensure timely follow-up of material variances reported in semiannual and quarterly interim financial statements; (ii) MoFPED will issue the Treasury Memorandum for 1997/98 and demonstrate that appropriate action has been taken; (iii) DA develops and implements capacity building programs for local and central governments. Furthermore, to strengthen the audit structures and practices the GoU, the Office of Auditor General (OAG) and the DA will undertake several actions as detailed in the PRSC3 Policy Matrix.	
Public service management	**Privatization**
• MoPS and MoFPED agree on target salary adjustments in line with the pay reform strategy, and associated wage bill will be reflected in MTEF. • MoPS commits to a strategy for modernizing personnel and payroll management; and MoPS reconciles the teachers' payroll with that of Uganda Computer Services (UCS). • MoPS launches the new phase of the public service reform program; and completed a position paper on cost effectiveness and efficiency of staff utilization in social sectors.	• Placement of Uganda Development Bank (UDB) for sale.
Public procurement • Legal and regulatory framework on public procurement will be improved by: (i) creation of procurement units in relevant institutions; (ii) carrying out independent audits of procurements; (iii) establishing an Appeals mechanism to handle complaints; and the framework will be modernized through the enactment of the Procurement Bill provisions that ensures competition in selection of third party procurement agents.	
Transparency and corruption	**Transparency and corruption**
• All Ministers, Presidential Advisors, Permanent Secretaries, Directors, and Uganda Revenue Authority (URA) officials submit to Inspector General of Government (IGG) statements of income, assets, and liabilities. In these lines, select reports of commissions of inquiry will be published within six months of work completion together with a GoU white paper on proposed action. • To ensure sanctioning and exposure of corrupt acts, (i) Directorate of Ethics and Integrity (DEI) will consult with stakeholders on whistleblower protection legislation; (iii) DEI will present to Cabinet the principles of the Prevention of Corruption Bill. • The ability of the private sector to enforce commercial contracts will be improved by satisfactory implementation of undertakings agreed in the Justice, Law and Order (JLO) sector review in June 2002 and confirmed by November 2002 review. • A draft Nongovernmental Organizations (NGO) bill will be agreed on to enhance civil society participation.	• Conclude the Commission of Enquiry on corruption in URA. • Verification of assets, liabilities, and income declared by URA staff, including their spouses and children as required by the new Leadership Code Bill.
Reforms to increase the ability of the poor to raise their incomes, and increase quality of life: The PRSC3 includes several sector-specific measures to address the promotion of enabling environment for rural development and to improve the delivery of basic services, which are detailed in the PRSC3 Policy Matrix.	

[1] As stated in Uganda Third Poverty Reduction Support Credit Policy Matrix and the PRGF Arrangement.

VII. Staff Appraisal

34. The authorities have continued to demonstrate a strong commitment to macroeconomic stability and the pursuit of a comprehensive poverty reduction strategy, both of which have been instrumental to Uganda's achieving sustained high rates of economic growth and poverty reduction. The maintenance of stable macroeconomic conditions reflects the continued implementation of a prudent monetary policy and a strengthened fiscal consolidation effort. In the current fiscal year, a significant consolidation will be achieved, notwithstanding sizable supplementary spending on defense and public administration and higher domestic interest costs. This achievement has helped to curb upward pressures on the real exchange rate and real interest rates. Nonetheless, sterilization of the large liquidity injections arising from government spending, in a manner that minimizes the fiscal cost to the government and the adverse impact on private sector activity, particularly in the export sector, remains a challenge. Improved tax revenue performance has eased the task, but government revenues are still low relative to the size of the economy, and aid dependence remains high.

35. The fiscal deficit programmed for 2003/04 reflects the achievement of a difficult balance between the need to expand social and economic programs aimed at poverty reduction and the need to strengthening fiscal sustainability. The planned rise in defense spending, without a commensurate increase in government revenues, has necessarily constrained the scope for increasing social expenditures. Although the program envisages an increase in government revenue of 0.5 percentage point of GDP in 2003/04, it will be important, from a medium-term perspective, to consider measures that would raise government revenues further to minimize the crowding out of key but unprotected economic and social programs. The forthcoming revision to the PEAP will provide a good opportunity for such an assessment. The timely repayment of outstanding government loans will be needed to assure sufficient resources for the 2003/04 budget.

36. Enhancing the effectiveness of government spending is a critical factor for increasing productivity, and good budget and expenditure management systems are essential to this effort. In this regard, the proposed streamlining of public administration expenditures is a welcome step. It will be important, however, to realize fully the envisaged cost savings in 2003/04 and operationalize expeditiously the proposed medium-term measures. It will also be essential to gradually clear the stock of domestic arrears and eliminate the accumulation of new arrears, paying particular attention to the problem of pension arrears. In this respect, the authorities need to strengthen their efforts to improve the functioning of the CCS. It will be necessary to ensure the timely payment of obligations incurred by line ministries by holding accounting officers accountable for expenditure overruns and strictly enforcing regulations. Furthermore, efforts should be made to verify the stock of arrears every six months and improve the number and quality of CCS submissions. The staff welcomes the government's commitment in the 2003/04 budget to clear nonpension arrears. It will be important, however, to vigorously pursue efforts to reduce the accumulation of new domestic arrears, ensure strict verification of past claims, and strive to fully clear arrears in the next three to four years. Pension arrears should be dealt with in the context of a comprehensive reform of

the public service pension scheme. A sound public employee pension scheme would go a long way toward avoiding new claims from arising. The staff encourages the authorities, therefore, to press ahead with the reform of the pension system.

37. With one-third of total public expenditures going to local authorities, it is critical to improve the accounting, auditing, and reporting systems at the local government level. While the implementation of the IFMS at the local level will certainly bring significant medium-term improvements, it will be essential to guard against delays in implementing these systems and ensuring their effective implementation.

38. Strengthening the integrity of the budget process by reducing the discrepancy between budget intentions and outcomes is critical for both increasing the predictability of donor support and enhancing the effectiveness of government programs. The recent passage of the new Public Finance and Accounting Bill, which will strengthen parliamentary oversight and the transparency of the budget, is a welcome development in this respect. Strict implementation of a budget that has been developed through the public expenditure review process and approved by parliament would not only ensure transparency and a more efficient use of government resources, but would also go far toward allowing donors to provide greater, more reliable assistance in the form of general budget support. It will be crucial also to fully implement systems for the monitoring, reporting, and accountability of government operations, both at the national and local level.

39. The authorities have long demonstrated their strong commitment to maintain a monetary policy that supports low inflation, and it is expected that the coming year will be no exception. The targets for base money and broad money growth in 2003/04 remain appropriately restrictive, taking into account the continued mopping up of banks' excess reserves and some decline in velocity as a result of lower inflation and a modest pickup in real GDP growth. Continued efforts to employ the operating procedures for monetary and exchange rate policy developed over the past year and improvements in the liquidity management framework would help to reduce volatility in the domestic money and foreign exchange markets.

40. Continued vigilant regulatory supervision will be necessary to maintain a healthy financial sector. The task will be eased by the recent passage of the new FIB, which more closely aligns banking regulations with international standards, and the Microfinance Deposit-Taking Bill, which provides for the regulation and supervision of the microfinance industry. The staff urges the authorities to enact the implementing regulations expeditiously. To sustain public confidence in the banking system, it will be essential to ensure that no bank is exposed to excessively risky positions. The reform of the pension system, including the NSSF, and a broadening of the nonbank financial sector could mobilize substantial domestic resources for investment. The staff further urges the authorities to proceed quickly in divesting of the UDB.

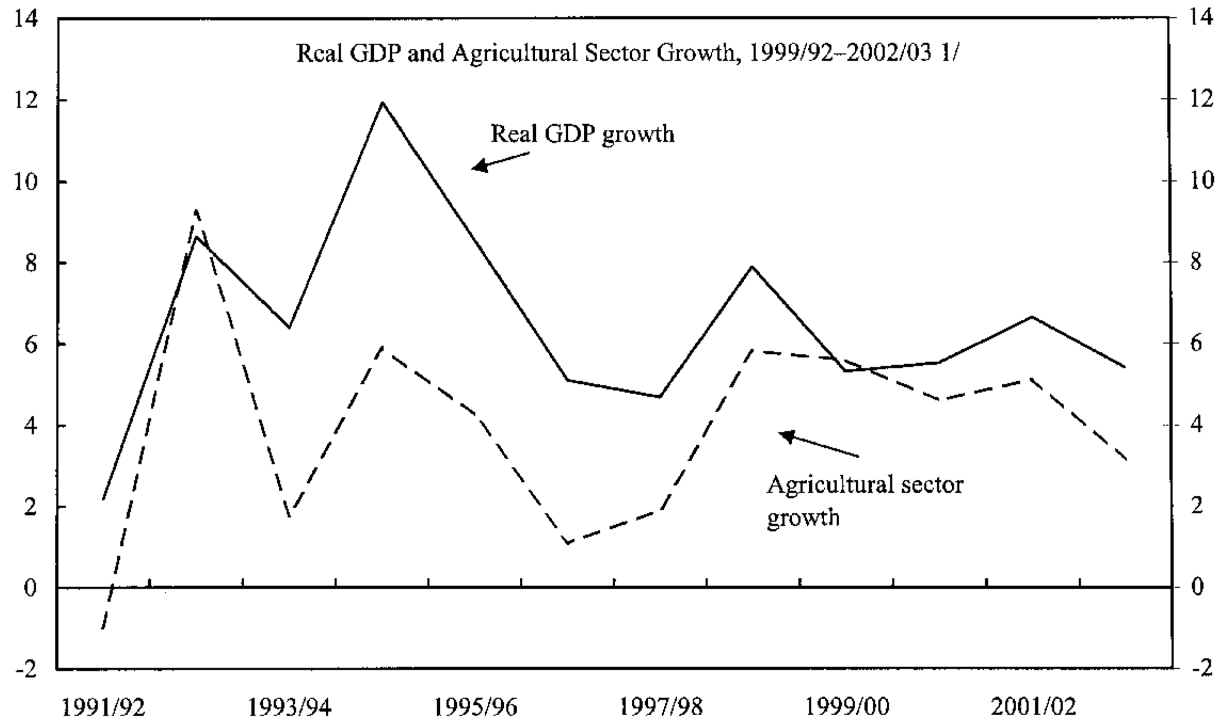
41. To achieve a more sustainable external position and lessen the economy's vulnerability to external shocks, the authorities have appropriately focused on gradual fiscal

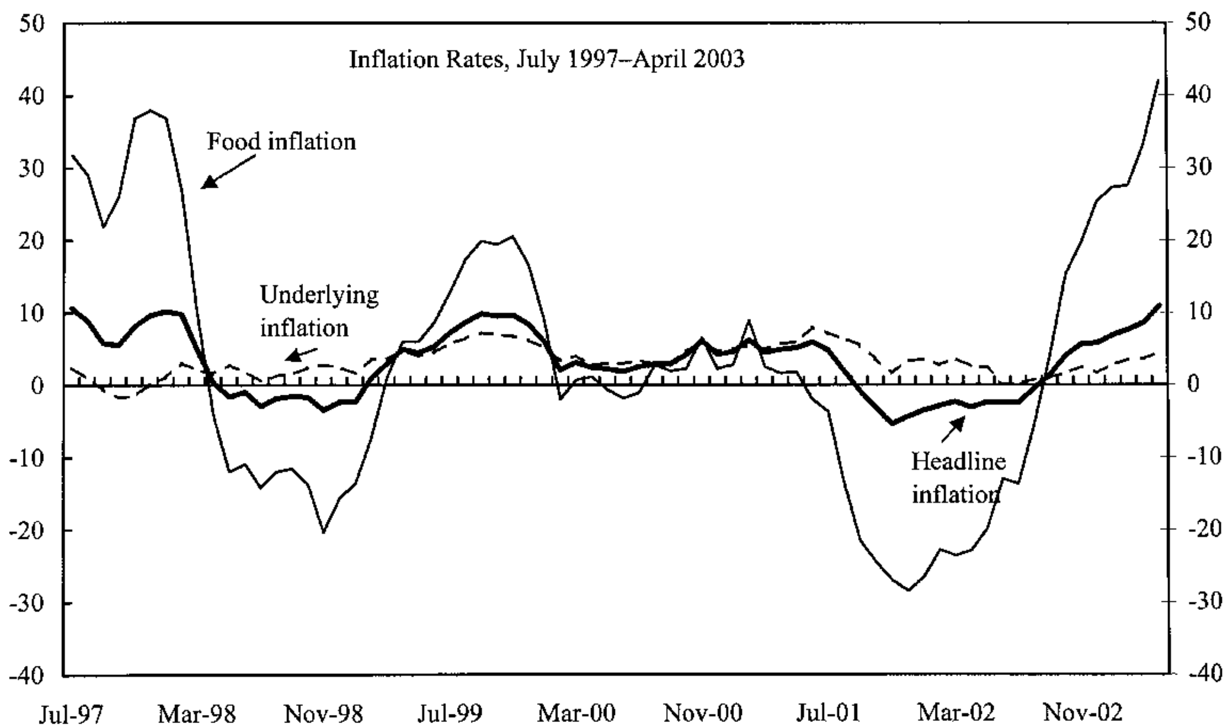
consolidation and measures to expand and diversify the export base. The PMA and the SEP are two central elements of this strategy. While it is important to ensure adequate funding of these initiatives, discretionary investment incentives should be avoided. Such incentives encourage rent-seeking activities and create opportunities for corruption. The government intends to phase out all ad hoc incentives and to move to the harmonized system of incentives of the EAC. The staff welcomes this approach, but strongly encourages the authorities to stimulate investment by intensifying efforts to overcome the broader impediments to doing business in Uganda by, inter alia, improving the rail system, implementing more transparent tendering procedures, and improving the judicial system so that private sector contracts can be fairly enforced.

42. In this respect, the staff welcomes the focus of the authorities' structural program on encouraging private sector growth through a buildup of transportation networks and other infrastructure, a sound expansion of financial intermediation, and strong efforts to fight corruption. With the conclusion of the investigation by the judicial commission of inquiry into corruption at the URA, it will be important for the authorities to follow up with bold actions to restore a culture of honesty, efficiency, and professionalism among URA staff, which would not only remove an impediment to growth, but would also help to raise government revenues.

43. In view of Uganda's broadly satisfactory program performance and the government's policy intentions for 2003–04, as well as the actions to address the program slippages, including the proposed measures to streamline public administration expenditures and the efforts to clear the domestic arrears, the staff recommends that the requests for waiver for the missed performance criteria be granted and the first review under the PRGF arrangement be completed.

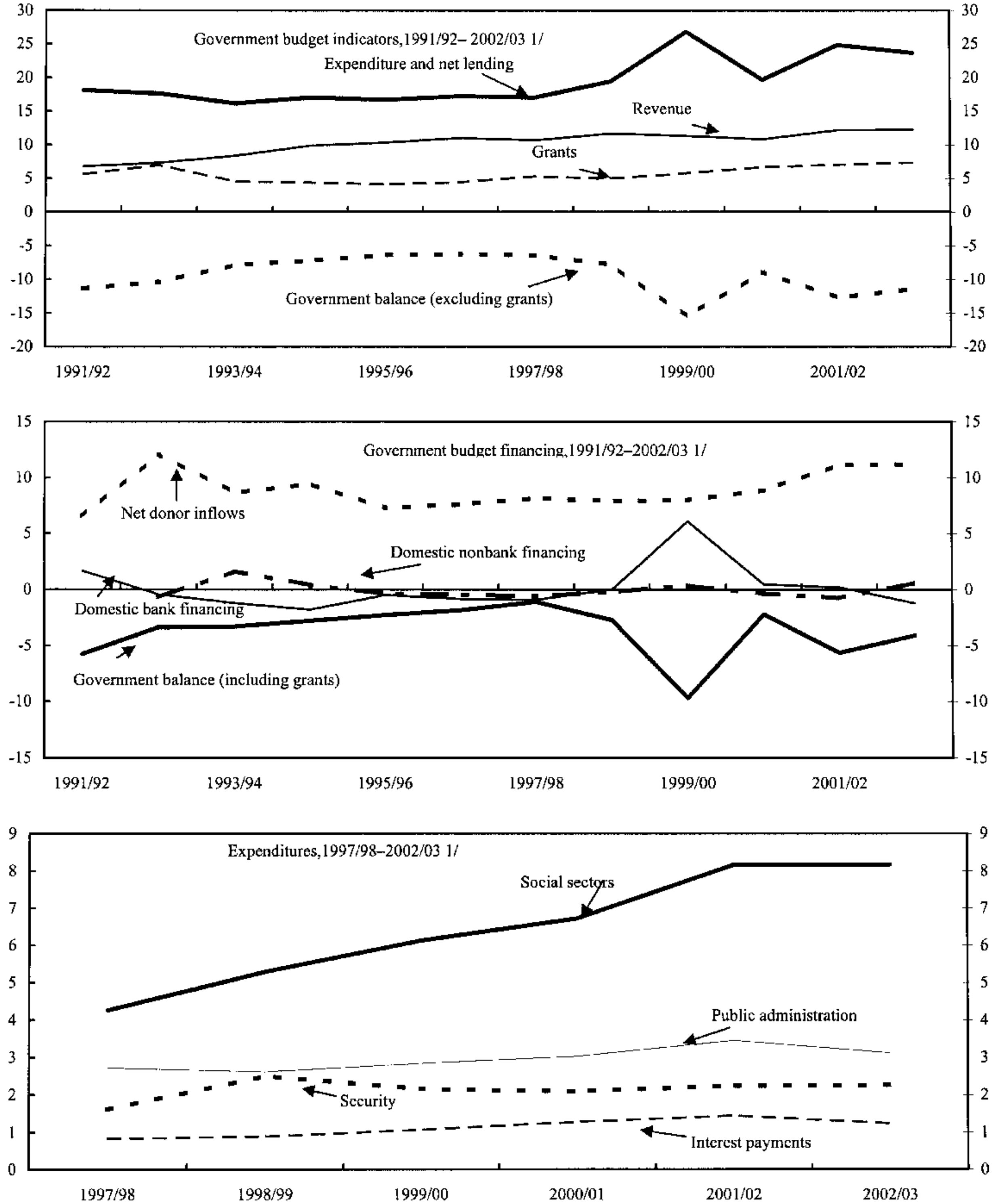
Figure 1. Uganda: Real Sector Indicators 1/
(Annual percentage changes)





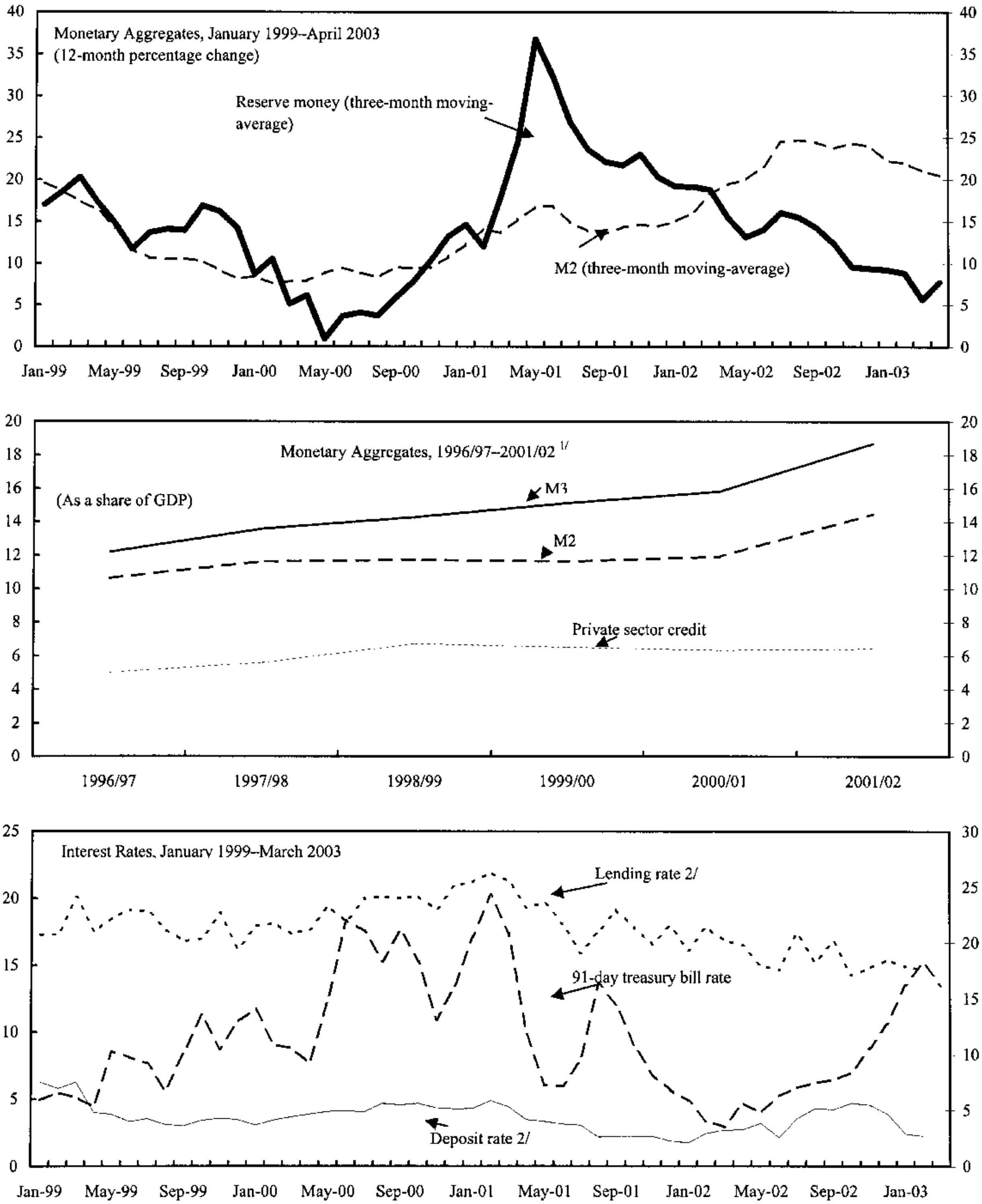
Sources: Ugandan authorities; and IMF staff estimates.
1/ Fiscal year begins on July 1.

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



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

Figure 3. Uganda: Monetary Aggregates and Interest Rates
(In percent)

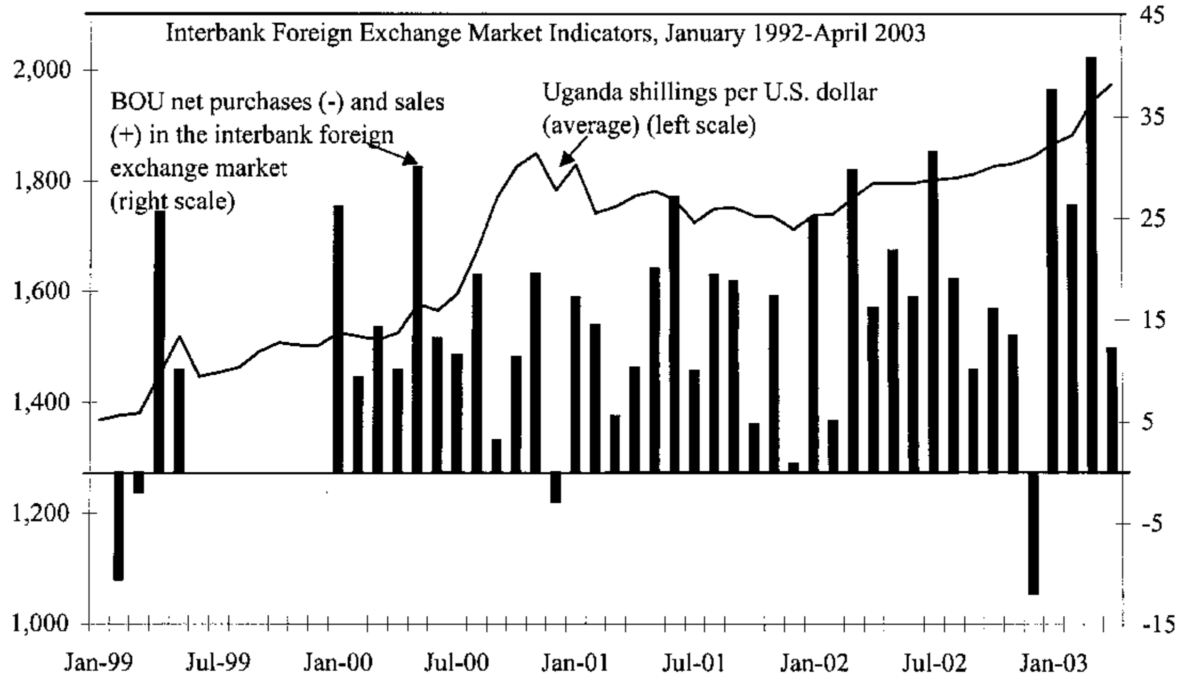


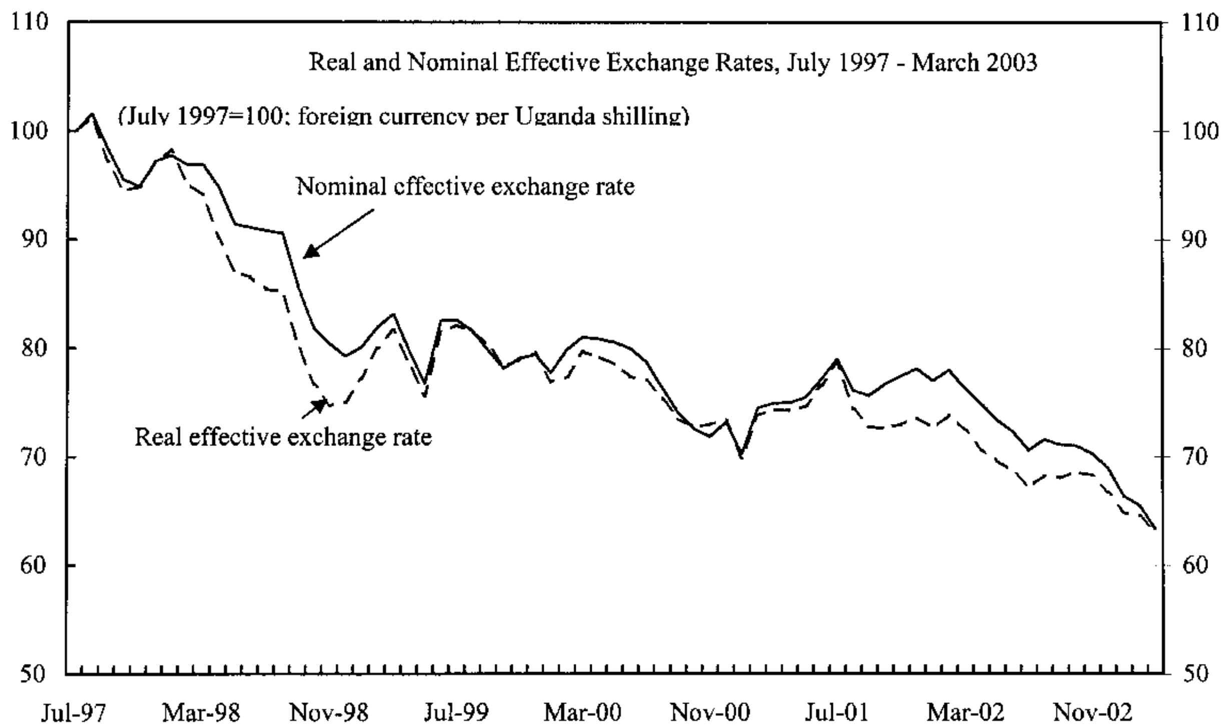
Sources: Ugandan authorities; and IMF staff estimates.

1/ Fiscal year begins on July 1.

2/ Weighted averages for Uganda shilling-denominated assets and liabilities.

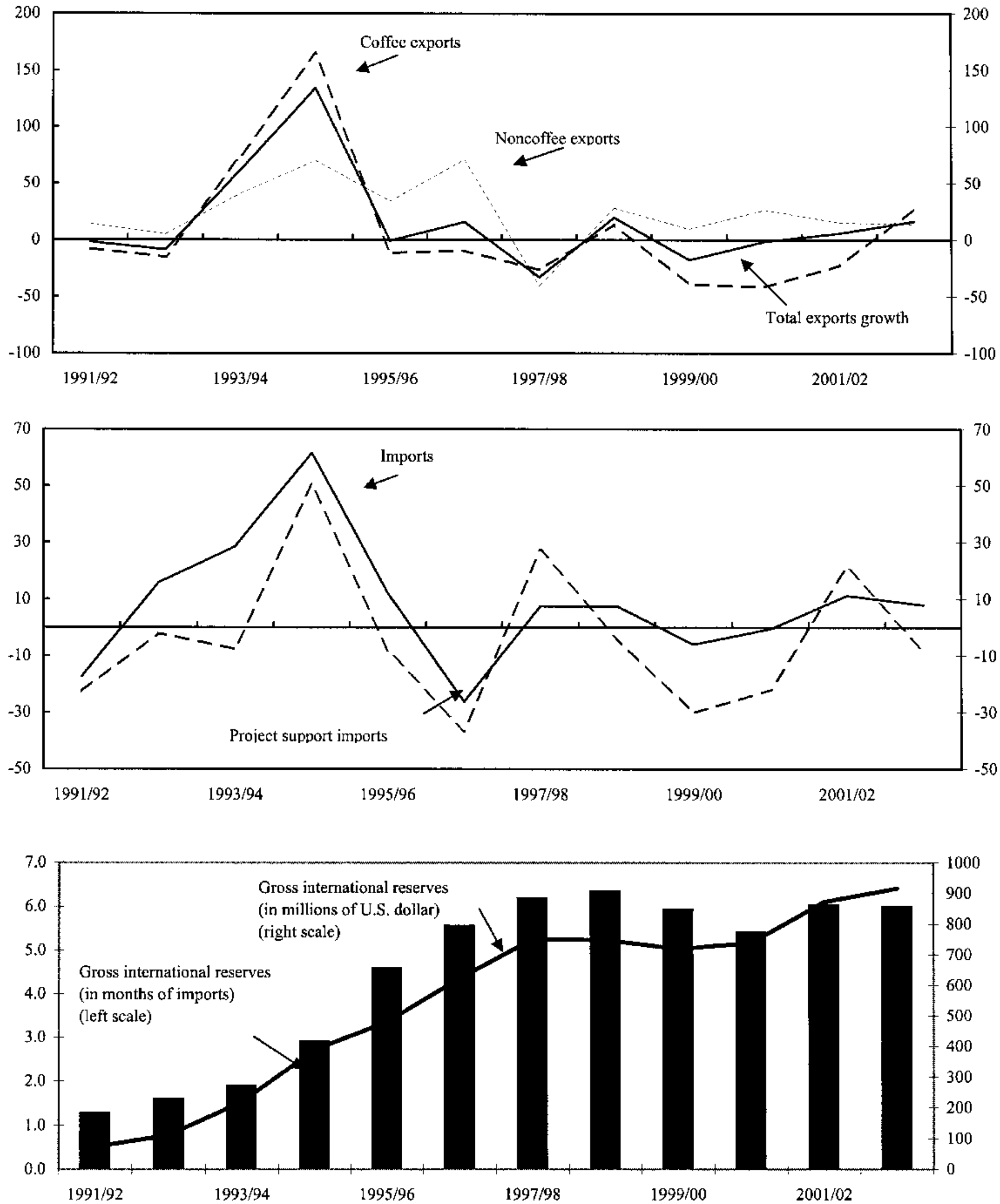
Figure 4. Uganda: Interbank Foreign Exchange Market Indicators, and Real and Nominal Effective Exchange Rate





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

Figure 5. Uganda: External Sector indicators, 1991/92–2002/03 1/
(Annual growth rates in percent, unless otherwise indicated)



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

Table 1. Uganda: Selected Economic and Financial Indicators, 2000/01–2004/2005 1/

	2000/01	2001/02	2002/03 Prog.	2002/03 Proj.	2003/04 Proj.	2004/05 Proj.
	(Annual percentage change, unless otherwise indicated)					
National income and prices						
GDP at constant prices	5.5	6.6	6.5	5.4	6.0	6.4
GDP deflator	6.5	-3.5	2.5	6.5	5.5	3.2
GDP at market prices						
(in billions of Uganda shillings)	10,005	10,293	11,585	11,555	12,921	14,183
Consumer prices						
Headline (end of period)	6.4	-2.5	6.1	10.0	2.7	3.5
Underlying (end of period)	8.5	0.1	4.5	6.6	3.0	3.5
Headline (average)	4.5	-2.0	1.0	5.9	5.9	3.3
Underlying (average)	5.0	3.5	3.5	2.9	5.6	3.4
External sector						
Exports (volume)	10.6	14.1	7.8	3.7	5.9	7.1
Imports (volume)	-0.1	16.0	10.1	3.5	3.9	3.5
Terms of trade (deterioration -)	-10.6	-3.2	8.3	7.6	0.9	-1.2
Average exchange rate						
(Uganda shillings per U.S. dollar)	1,763	1,755	1,843	1,883	...	...
Effective exchange rate (average) 2/						
Nominal (depreciation -)	-6.9	3.2	-4.8	-10.6	...	...
Real (depreciation -)	-6.5	-0.8	-5.3	-9.3	...	...
Government budget						
Total revenue and grants	14.7	13.2	10.2	14.3	18.0	13.3
Revenue	7.2	15.9	14.1	13.1	16.5	12.9
Expenditure and net lending	-17.5	29.9	1.9	6.7	13.8	7.9
	(Annual changes in percent of beginning-of-period stock of money and quasi money, unless otherwise indicated)					
Money and credit						
Net foreign assets	22.6	21.6	15.4	20.2	13.6	19.7
Net domestic assets	-5.1	0.0	-3.9	-8.7	2.0	-5.3
Domestic credit	7.0	2.8	2.6	1.2	9.0	-0.8
Central government	3.4	1.4	-0.9	-7.4	3.7	-6.4
Private sector	4.0	1.7	3.6	8.5	5.4	5.7
Money and quasi money (M3)	17.5	21.6	11.4	11.5	15.6	14.4
M2	15.2	24.9	11.0	10.5	15.0	13.6
Velocity (GDP/M2) 3/	9.0	7.7	7.6	7.4	7.3	7.0
Interest rate (in percent) 2/ 4/	14.3	6.7	...	9.7	...	...
	(In percent of GDP at market prices)					
National income accounts						
Gross domestic investment	20.0	21.2	22.1	21.5	22.2	23.9
Public	6.3	5.8	6.6	5.6	6.1	6.0
Private	13.7	15.4	15.5	15.9	16.1	17.9
Gross domestic savings (excluding grants)	5.5	7.8	6.2	8.2	8.6	8.7
Public	-2.6	-6.9	-3.4	-5.8	-5.1	-4.5
Private	8.1	14.7	9.6	14.0	13.7	13.2
Gross national savings (including grants)	12.4	14.9	12.3	15.8	16.4	16.8
External sector						
Current account balance						
(including official grants)	-7.6	-6.4	-9.8	-5.7	-5.8	-7.0
(excluding official grants)	-14.5	-13.4	-15.9	-13.3	-13.7	-15.2
External debt (including Fund)	58.7	63.7	66.1	67.9	65.6	63.4
Government budget						
Revenue 5/	10.8	12.2	12.3	12.3	12.8	13.2
Grants	6.7	7.1	7.1	7.3	7.9	8.2
Total expenditure and net lending	19.7	24.9	22.8	23.6	24.1	23.6
Government balance (excluding grants)	-8.9	-12.7	-10.4	-11.4	-11.3	-10.5
Government balance (including grants)	-2.2	-5.6	-3.3	-4.1	-3.4	-2.3
Domestic balance	-4.2	-6.4	-4.9	-5.2	-4.6	-4.2
Net foreign financing	2.8	5.0	3.4	4.7	2.6	3.4
Domestic bank financing	0.5	0.2	-0.2	-1.2	0.6	-1.1
Domestic nonbank financing	-0.4	-0.7	0.1	0.6	0.2	0.1
Net donor inflows	8.9	11.2	10.4	11.2	9.8	11.0
	(In percent of exports of goods and nonfactor services; unless otherwise indicated)					
Debt indicators						
Net present value of external debt 6/	167.4	188.1	208.7	193.5	188.4	186.0
External debt service ratio 7/						
Including Fund obligations	9.9	8.7	9.1	9.0	9.2	9.4
Excluding Fund obligations	2.5	1.4	4.4	2.6	2.9	3.8
Stock of domestic debt (in percent of GDP)	5.8	8.8	7.8	8.9	8.7	8.9
Interest on domestic debt (in percent of GDP)	0.6	0.9	0.6	1.0	1.2	1.0
	(In millions of U.S. dollars, unless otherwise indicated)					
Overall balance of payments	7	150	-2	61	34	163
External payments arrears (end of period)	0	0	0	0	0	0
Gross foreign exchange reserves	739	873	946	916	916	1,039
(in months of imports of goods and nonfactor services)	5.4	6.0	6.1	6.0	5.5	6.0

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

1/ Fiscal year begins on July 1.
2/ The 2002/03 figure is for the period July-March 2003.
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 2001.
7/ The debt-service ratio incorporates the effects of rescheduling and assistance provided under the original and enhanced HIPC Initiatives and estimated HIPC assistance from non-Paris Club bilateral creditors with whom bilateral agreements have not yet been reached.

Table 2. Uganda: Fiscal Operations of the Central Government, 2001/02–2004/2005 1/

	2001/02	2002/03 Prog. 2/	2002/03 Proj.	2003/04 Proj.	2004/05 Proj.
	(In billions of Uganda shillings)				
Total revenue and grants	1,981	2,256	2,264	2,670	3,025
Revenue 3/	1,254	1,429	1,419	1,652	1,865
Tax	1,156	1,320	1,323	1,542	1,747
Nontax 4/	98	109	96	110	119
Grants	727	827	845	1,018	1,160
Budget support	364	485	451	496	618
Of which: HIPC assistance	105	158	129	155	163
Project grants 5/	363	341	395	522	542
Expenditures and net lending	2,560	2,640	2,732	3,109	3,354
Current expenditures	1,420	1,504	1,585	1,714	1,830
Wages and salaries	549	628	613	664	683
Of which: Defense	118	128	128	132	137
Poverty Action Fund	213	236	234	253	259
Interest payments	141	147	169	212	221
Domestic	92	75	117	149	153
External Interest	49	72	52	63	69
Of which: HIPC cancellation	11	...	9	10	10
Transfers to the Uganda Revenue Authority	45	63	63	58	58
Other Current	685	667	739	780	948
Of which: Defense	92	65	133	168	168
Poverty Action Fund	147	168	160	187	196
Development expenditures	1,025	1,059	1,106	1,328	1,406
Donor-supported projects 5/	594	569	658	799	830
Domestic	431	490	448	529	539
Of which: Defense	6	11	9	11	10
Poverty Action Fund	230	277	264	310	334
Net lending and investment	5	-24	-14	-29	-19
Additional fiscal measures 6/	0	0	0	0	91
Domestic arrears repayment	110	50	55	45	41
Overall balance					
Including grants	-579	-384	-469	-438	-329
Excluding grants	-1,306	-1,210	-1,314	-1,456	-1,489
Domestic balance 7/	-663	-569	-604	-594	-591
Financing	455	384	469	438	329
External financing (net)	510	391	541	339	481
Disbursement	591	558	660	477	646
Budget support	349	331	397	200	358
Project loans	242	228	263	277	288
Other short-term borrowing	0	-34	0	0	0
Amortization (-)	-123	-176	-159	-164	-174
Of which: HIPC cancellation	-20	...	-21	-26	-26
Exceptional financing	41	43	40	26	9
Of which: HIPC-rescheduling	5	...	6	5	4
Domestic financing (net)	-55	-7	-72	100	-152
Bank financing 8/	21	-17	-142	80	-160
Bank of Uganda (BOU)	-190	-137	-187	-9	-275
Commercial banks	212	120	45	89	115
Nonbank financing	-76	10	70	20	8
Errors and omissions/financing gap	124	0	0	0	0
	(In percent of GDP at market prices, unless otherwise indicated)				
Total revenue and grants	19.2	19.5	19.6	20.7	21.3
Revenue	12.2	12.3	12.3	12.8	13.2
Grants	7.1	7.1	7.3	7.9	8.2
Expenditures and net lending	24.9	22.8	23.6	24.1	23.6
Current expenditure	13.8	13.0	13.7	13.3	12.9
Wages and salaries	5.3	5.4	5.3	5.1	4.8
Interest payments	1.4	1.3	1.5	1.6	1.6
Development expenditures	10.0	9.1	9.6	10.3	9.9
Donor-supported projects	5.8	4.9	5.7	6.2	5.8
Domestic	4.2	4.2	3.9	4.1	3.8
Overall balance					
Including grants	-5.6	-3.3	-4.1	-3.4	-2.3
Excluding grants	-12.7	-10.4	-11.4	-11.3	-10.5
Domestic balance 7/	-6.4	-4.9	-5.2	-4.6	-4.2
Primary balance, including grants	-4.3	-2.0	-2.6	-1.7	-0.8
Financing	4.4	3.3	4.1	3.4	2.3
External financing (net)	5.0	3.4	4.7	2.6	3.4
Domestic bank financing (net)	0.2	-0.2	-1.2	0.6	-1.1
Domestic nonbank financing (net)	-0.7	0.1	0.6	0.2	0.1
Memorandum items:					
Total defense expenditures (in billions of Uganda shillings)	217	204	270	315	334
(in percent of GDP)	2.1	1.8	2.3	2.4	2.2
Poverty Action Fund (in percent of GDP)	5.7	5.9	5.7	5.8	5.7
Total HIPC assistance (billions of Uganda shillings)	141	158	165	196	202
Total HIPC assistance (in percent of GDP)	1.4	1.4	1.4	1.5	1.4

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

1/ Fiscal year begins on July 1.

2/ Defense spending under the program is on an accrual basis which excludes U Sh 34 billion repayments of short-term financing for defense that should be added to total defense spending when comparing program and annual projections. Compared with the program, grants under HIPC have been reclassified according to PDR/FAD guidelines.

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

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

5/ Starting with 2001/02, data on project loans and grants have been revised to reflect the results of a detailed study recently undertaken by the authorities.

6/ These additional expenditures refer to the expected but not yet formally committed budget support and to new tax policy measures.

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

8/ Excludes face value of recapitalization bonds issued to the Bank of Uganda and to the Uganda Commercial Bank. However, full provision is made for the interest costs and amortization associated with these bond issues.

Table 3. Uganda: Monetary Survey, 2001/02–2004/05 1/
(In billions of Uganda shillings; end of period)

	2001/02	2002/03 Prog.	2002/03 Proj.	2003/04 Proj.	2004/05 Proj.
			Banking system		
Net foreign assets (NFA)	1,553	1,835	1,942	2,235	2,723
Net domestic assets	373	240	204	247	116
Domestic credit	1,151	1,208	1,174	1,368	1,348
Claims on public sector (net) 2/	490	476	348	426	265
Claims on private sector	662	732	826	942	1,083
Valuation	-163	-210	-308	-419	-491
Other items (net)	-615	-758	-661	-701	-741
Broad money (M3)	1,925	2,075	2,147	2,482	2,840
Excluding foreign exchange deposits (M2)	1,491	1,614	1,646	1,894	2,151
			Monetary authorities		
Net foreign assets	1,091	1,399	1,372	1,562	1,991
Foreign assets	1,581	1,815	1,860	1,986	2,330
Of which: foreign reserves	1,569	1,787	1,850	1,975	2,319
Foreign liabilities	491	416	488	424	340
Of which: liabilities to IMF	486	412	483	419	334
Net domestic assets	-461	-724	-691	-803	-1,150
Domestic credit	57	-89	-67	-77	-352
Claims on public sector (net) 2/	17	-127	-171	-180	-455
Claims on commercial banks (net)	41	38	103	103	103
Valuation	-161	-191	-281	-374	-436
Other items (net)	-357	-443	-342	-352	-362
Base money	630	680	682	759	841
Currency outside banks plus cash in vaults	448	474	488	539	592
Commercial bank deposits with Bank of Uganda (BOU)	182	206	194	220	249
			Commercial banks		
Net foreign assets	462	436	570	672	733
Net domestic assets	1,056	1,209	1,128	1,316	1,567
Domestic credit	1,317	1,542	1,474	1,710	2,002
Claims on public sector (net) 2/	473	603	518	606	720
Claims on private sector	662	732	826	942	1,083
Of which: foreign exchange loans	155	187	178	218	255
Claims on BOU (net)	182	207	129	162	198
Total reserves	198	221	213	242	275
Required reserves	168	181	186	212	242
Excess reserves	10	25	8	8	8
Reservable cash-in-vault	20	15	19	23	26
Other 3/	128	61	123	126	130
Valuation	-2	-19	-27	-45	-55
Other items (net)	-259	-314	-319	-349	-379
Deposit liabilities to nonbank residents	1,518	1,644	1,698	1,988	2,300
Shilling deposits	1,083	1,183	1,198	1,400	1,611
Foreign currency deposits	435	461	500	588	689
Memorandum items:					
M3 (12-month change in percent)	21.6	11.4	11.5	15.6	14.4
M2 (12-month change in percent)	24.9	11.0	10.5	15.0	13.6
M3-to-GDP ratio (percent)	18.7	17.9	19.2	20.2	21.0
M2-to-GDP ratio (percent)	14.5	13.9	14.8	15.4	15.9
Credit to private sector-to-GDP ratio (percent)	6.4	6.3	7.4	7.7	8.0
Currency outside banks-to-M3 ratio (percent)	21.1	20.8	20.9	19.9	19.0
Foreign currency deposits-to-M3 ratio (percent)	22.6	22.2	23.3	23.7	24.3
Credit to the private sector (12-month change in percent)	4.2	10.0	24.8	14.0	15.0
Base money multiplier (M2/base money)	2.37	2.39	2.42	2.49	2.56
NFA of BOU (millions of U.S. dollars)	607	741	679	725	892
Gross reserves of BOU (millions of U.S. dollars)	873	940	916	916	1,039
NFA of commercial banks (millions of U.S. dollars)	257	231	282	312	328
Foreign currency deposit (millions of U.S. dollars)	242	244	248	273	308
Foreign currency loans (millions of U.S. dollars)	86	99	88	101	114

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

1/ Fiscal year begins on July 1.

2/ The public sector includes the central government, the public enterprises and the local government.

3/ Other includes nonreserve vault cash, holdings of BOU bills and promissory notes, and borrowing at the BOU by the Commercial Banks.

Table 4. Uganda: Selected Banking Sector Information, December 2000–December 2002

	2000	2001				2002			
	Dec.	Mar.	June	Sep.	Dec.	Mar.	June	Sep.	Dec.
	(In billions of Uganda shillings)								
Adjusted assets	1,778	1,797	1,937	1,924	1,979	2,110	2,318	2,255	2,406
Liquid assets	1,106	1,123	1,255	1,245	1,292	1,380	1,564	1,517	1,564
Tier I	148	157	179	182	180	208	200	203	211
Tier II	27	25	23	24	22	24	25	32	29
Total capital	175	183	202	206	203	232	226	235	240
Risk weighted assets (RWA)	851	860	879	868	879	906	953	967	1,088
Nonperforming assets (NPA)	52	49	43	37	34	27	19	19	20
Loans and advances	525	516	528	527	521	533	536	566	661
Foreign exchange advances	114	122	117	136	140	155	154	153	191
Foreign exchange deposits	433	468	476	453	406	441	515	489	495
Deposits	1,315	1,371	1,450	1,447	1,475	1,588	1,764	1,763	1,816
	(In percent)								
Return on average assets	4.8	7.0	5.8	5.4	4.5	4.1	3.2	3.1	3.0
Core capital/ RWA	17.4	18.3	20.3	20.9	20.5	22.9	21.0	21.0	19.4
Total capital/ RWA	20.5	21.3	23.0	23.7	23.1	25.5	23.7	24.3	22.1
NPAs/Total advances	9.8	9.5	8.2	6.9	6.5	5.1	3.6	3.3	3.0
Loan loss provision/ NPA	61.7	58.1	68.2	68.5	70.0	76.8	87.5	81.3	81.5
Liquid assets/ Total deposits	84.2	81.9	86.5	86.0	87.6	86.9	88.7	86.0	86.1
Advances/ Deposits	39.9	37.6	36.4	36.4	35.3	33.5	30.4	32.1	36.4
Foreign exchange exposure/ Core capital 1/	13.5	7.3	20.2	22.5	4.5	5.9	18.1	4.1	4.3
Foreign exchange advances/ Foreign exchange deposits	26.3	26.1	24.6	30.1	34.5	35.3	29.8	31.3	38.6

Source: Ugandan authorities.

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

Table 5. Uganda: Balance of Payments, 2001/02–2004/05 1/
(In millions of U.S. dollars, unless otherwise indicated)

	2001/02	2002/03 Prog.	2002/03 Proj.	2003/04 Proj	2004/05 Proj.
Current account	-374	-617	-351	-355	-455
Trade balance	-611	-668	-620	-648	-752
Exports, f.o.b.	472	541	549	604	640
Coffee	85	107	109	129	138
Noncoffee	387	434	440	475	502
Imports, c.i.f.	-1,083	-1,209	-1,170	-1,252	-1,392
Project related	-109	-100	-100	-95	-95
Other imports	-974	-1,108	-1,070	-1,157	-1,297
Services (net)	-329	-350	-307	-326	-339
Inflows	224	207	257	257	271
Outflows	-553	-557	-564	-583	-611
Income (net)	-124	-141	-139	-150	-190
Inflows	30	34	20	32	57
Outflows	-153	-175	-159	-182	-247
Of which: Interest on public debt	-29	-41	-28	-30	-32
Of which: HIPC cancellation 2/	7	...	6	5	5
Transfers	690	542	715	768	826
Private transfers	276	159	251	286	298
Of which: Nongovernmental organizations	173	87	187	200	204
Official transfers	414	383	465	482	529
Project support	207	206	226	247	247
Import support	148	177	171	162	208
HIPC assistance 2/	60	...	68	73	74
Capital and financial account	426	615	412	389	619
Capital account	0	0	0	0	0
Financial account	426	615	412	389	619
Foreign Direct Investment (FDI)	146	225	154	163	204
Portfolio investment	0	0	0	0	0
Other investment	280	390	258	226	415
Medium and long-term	317	342	300	201	393
Public sector (net)	267	226	250	148	215
Disbursements	337	317	334	226	294
Project support	138	137	124	131	131
Import support	199	179	211	95	163
Amortization due	-70	-91	-84	-78	-79
Of which: HIPC cancellation 2/	11	...	12	11	13
Private sector (net)	50	117	50	53	178
Short-term	-37	47	-42	26	22
Errors and omissions	97	0	0	0	0
Overall balance	150	-2	61	34	163
Financing	-150	2	-61	-34	-163
Central bank reserves (- = increase)	-173	-107	-82	-47	-167
Of which: Gross reserve change	-134	-67	-43	0	-123
Of which: IMF (net)	-39	-41	-39	-47	-45
Exceptional financing 2/	24	109	21	12	4
Of which: HIPC rescheduling 2/	2	...	3	3	2
Memorandum items:					
Gross international reserves 3/	6.0	6.1	6.0	5.5	6.0
Current account balance (in percent of GDP)					
Including official transfers	-6.4	-9.8	-5.7	-5.8	-7.0
Excluding official transfers	-13.4	-15.9	-13.3	-13.7	-15.2
Debt service (in percent of exports)					
Before rescheduling (including IMF)	24.3	23.7	22.0	24.7	22.5
After rescheduling (including IMF)	8.7	9.1	9.0	9.2	9.4
Coffee price (U.S. cents per kg.)	44.5	54.1	56.3	60.9	61.7
Coffee export volume (in millions of 60-kg. bags)	3.2	3.3	3.2	3.5	3.7
Exports of goods and nonfactor services	696	748	807	861	911
(three-year moving average)	672	675	722	788	860
Net donor support	655	654	690	602	714
Of which: Import support	347	357	382	256	371
Of which: Project support	345	343	349	378	378
Of which: Total HIPC assistance	80	86	88	93	92
Net donor support (in percent of GDP)	11.2	10.4	11.2	9.8	11.0
Debt service due before HIPC	169	177	177	213	205
Foreign Direct Investment (in percent of GDP)	3.9	3.6	4.0	4.2	4.7

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

1/ Fiscal year begins on July 1.
2/ Except for 2002/03 program figures, where full HIPC assistance is included in exceptional financing, the components of HIPC assistance are treated as separate items. HIPC grants are included in import support transfers, HIPC rescheduling is included in exceptional financing, and HIPC cancellation is included in amortization.
3/ In months of imports of goods and services of the following year.

Table 6. Uganda: Debt and Debt-Service Indicators, 2000/01–2004/05 [1/, 2/]

	2000/01	2001/02	2002/03 Proj.	2003/04 Proj.	2004/05 Proj.
	(In millions of U.S. dollars)				
NPV of total debt [3/]	1,147	1,264	1,397	1,485	1,599
Existing debt	1,147	1,146	1,145	1,132	1,116
Multilateral	1,037	1,049	1,055	1,047	1,037
Paris Club bilateral	43	41	38	36	33
Non-Paris Club bilateral	38	31	32	32	33
Commercial	30	24	20	17	13
New debt	...	119	252	352	483
Total debt service	...	65	67	80	85
Existing debt	...	63	62	74	77
Multilateral	...	42	51	63	66
Non-Paris Club bilateral	...	8	1	1	2
Commercial	...	7	5	5	5
New debt	...	2	5	6	8
NPV of debt-to-exports ratio [3/, 4/]	167.4	188.1	193.5	188.4	186.0
NPV of debt-to-revenue ratio [3/]	186.9	177.0	186.5	189.8	187.0
NPV of debt-to-GDP ratio [3/]	20.2	21.6	22.8	24.3	24.7
NPV of new debt-to-exports ratio [3/, 4/]	...	17.7	34.9	44.7	56.2
Debt service-to-exports ratio	...	9.4	8.3	9.3	9.4
Debt service-to revenue ratio	...	9.1	8.9	10.3	10.0
	(In millions of U.S. dollars)				
Memorandum items:					
Gross domestic product	5,675	5,865	6,132	6,118	6,471
Exports of goods and services [5/]					
Current year	664	696	807	861	911
Three-year average	685	672	722	788	860
Revenue	614	714	749	782	855
New borrowing annual flow	271	298	319	226	294

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

1/ Fiscal year begins on July 1.

2/ Assumes full delivery of assistance under HIPC Initiative.

3/ NPV ratios are based on CIRRs (discount and exchange rates) at June 2001.

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.

Kampala, Uganda
June 9, 2003

Mr. Horst Köhler
Managing Director

International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Köhler:

1. We recently held discussions with Fund staff on the first review of the economic program supported by a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), which was approved by the Executive Board on September 13, 2002.

2. The attached memorandum of economic and financial policies (MEFP) reviews the implementation of the program for fiscal year 2002/03 (July–June) and describes the objectives and policies that the government intends to pursue for the remainder of the year and in 2003/04. The government is committed to reducing the incidence of poverty in Uganda through the continued implementation of sound economic and financial policies necessary for sustained economic growth and macroeconomic stability. The 2003/04 budget to be submitted to parliament on June 13, 2003 is crafted to maintain the overall fiscal deficit, excluding grants, essentially unchanged, reflecting the need to balance increased defense spending to meet the country's security needs and the expansion of social and economic programs designed to meet the Poverty Eradication Action Plan objectives. The domestic budget balance, however, would decline by over one-half of one percent of GDP. The deficit would be largely covered by expected net inflows of donor support. The focus of the structural program is on building up tax revenues, strengthening budget management, enhancing accountability of both central and local government, improving financial sector regulations, and fighting corruption.

3. In light of the progress achieved in the implementation of the program for 2002/03, and the supporting details provided in the MEFP, the Government of Uganda requests a waiver for the missed observance of the performance criteria for the accumulation of new domestic arrears; submission of a plan to Cabinet to streamline Public Administration; and submission to Parliament of a bill to repeal the National Social Security Fund Statute. The government also requests a disbursement of SDR 2.0 million upon completion of the first review.

4. The Government of Uganda will continue to provide the Fund with such information as the Fund requires to assess Uganda's progress in implementing the policies described in this letter and the accompanying MEFP. In addition, the Government will continue to consult with the Fund on its economic and financial policies, in accord with the Fund's policies and practices on such consultations.

5. The Government of Uganda authorizes the publication and distribution of this letter and MEFP and all reports prepared by Fund 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 2003–04

1. The government's economic and financial policies are guided by the Poverty Eradication Action Plan (PEAP), which aims to reduce poverty by sustaining high rates of economic growth while preserving macroeconomic stability, and implementing social and economic programs targeted to increase the incomes of the poor and improve the quality of their livelihood. Uganda's program to reduce poverty is supported by the International Monetary Fund through a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF). This memorandum of economic and financial policies (MEFP) reviews recent economic performance and the progress in implementing the program and sets out the government's policies and targets for the remainder of the 2002/03 fiscal year (July–June) and for 2003/04.

I. Recent Economic Performance under the PRGF-Supported Program

2. All quantitative benchmarks and performance criteria for end-September and end-December 2002 were met, with the exception of the zero limit on new domestic arrears (Table 1). Based on the partial coverage of the Commitment Control System (CCS), U Sh 3 billion of new arrears on nonwage expenditures were accrued during the first half of 2002/03. This slippage was in part due to the late announcement of spending cuts, mainly to finance unbudgeted defense expenditures. Under the new Public Finance and Accountability Bill, approved by parliament in April 2003, there will be greater constraints on any such supplementary expenditures, which should help to eliminate arrears in the future. Moreover, the planned computerization of the CCS over the next two years would facilitate monitoring of spending by the line ministries and ensure stricter compliance with budget limits. Based on this corrective measure, we are requesting a waiver for missing this performance criterion. In addition, while the ceilings for net credit to the government by the banking system were observed, this outturn is based on data for check float, the quality of which needs to be improved. Therefore, to improve our check-tracking system and methods of measuring check float, we are requesting technical assistance from the Fund.

3. With regard to the structural program, while there have been a few slippages, most measures were met through December 2002: the Uganda Revenue Authority (URA) prepared a business plan for improving tax collections; aggregated local government financial statistics for fiscal year 2000/01 were produced; all commercial banks developed a capital compliance plan well in advance of the increase in the minimum paid-in capital requirement; and the privatization of the Ugandan Development Bank (UDB) was assigned to the Privatization Unit, although there were some delays in contracting a privatization advisor (Table 2). However, the end-December 2002 performance criterion to submit a plan to cabinet to streamline Public Administration was not met until March 2003. Also, the performance criterion to submit a bill to parliament by end-March 2003 to repeal the

National Social Security Fund (NSSF) Statute was not met, owing to the need to build greater political support for the measure beforehand. Based on the discussion below of corrective measures, we are requesting a waiver for these missed performance criteria.

4. Economic activity has been weaker than anticipated thus far in 2002/03. For the year as a whole, real GDP is expected to grow by 5.4 percent, more than one percentage point lower than program projections, owing mainly to delays in the construction of the Bujagali hydro electricity project and the impact of adverse weather conditions on the agricultural sector. Compared to program projections, food crops and some cash crops (coffee, cotton, and tea) have experienced particularly low growth. A sharp increase (over 25 percent) in the prices of food crops, together with the weaker Uganda shilling and high world oil prices, boosted the 12-month headline inflation rate to 8.6 percent in March 2003, and is expected to reach 10 percent by June, for the first time in many years. The rise in underlying inflation, which excludes food crop prices and is thus less volatile, would be considerably lower. On an annual average basis, underlying inflation is expected to rise to 2.9 percent, which would be below the average over the past five years of 3½ percent and would be in line with program projections.

5. Overall fiscal performance has been in keeping with the program, although the composition of spending has deviated from budget intentions. Government revenues have performed broadly in line with projections, led by strong outturns in income and value-added tax (VAT) collections, despite a shortfall in nontax revenue. Through the first half of 2002/03 total expenditure were 3 percent lower than projected in the program, despite higher-than-budgeted defense spending (undertaken to quell the long-running insurgency by the Lord's Resistance Army (LRA) in northern Uganda), an unexpected increase in interest payments on treasury bills, and supplementary spending on public administration. While the government will respect the budget limit on total spending by cutting sharply nonwage discretionary expenditures not protected under the Poverty Action Fund (PAF), the change in the composition of government outlays will result in a budget different from that which parliament had approved and donors had agreed to support. This has led some bilateral donors to cut back or suspend disbursements of budget support (by a total of US$35 million.) For 2002/03 as a whole, the overall fiscal deficit (excluding grants) is expected to decline by 1.3 percentage points to 11.4 percent of GDP, compared with the previous year.

6. The base money program has focused on sterilizing the liquidity injection associated with donor-supported government spending and mopping up commercial banks' excess reserves that had accumulated during the previous year. Mainly for sterilization purposes, net issues of treasury bills totaled 1.4 percent of annual GDP during the first nine months of 2002/03, while the Bank of Uganda's (BOU) net sales of foreign exchange amounted to another 3 percent of GDP (US$181.9 million). As a result, treasury bill yields have risen substantially during this period, while the Uganda shilling depreciated against the U.S. dollar by 8 percent. Initially, the shilling depreciated gradually, but in late February 2003, a confluence of factors, including uncertainty about world petroleum prices, regional tensions, and concerns about the sustainability of donor aid flows, adversely affected market sentiment, resulting in a sharp depreciation of the shilling and increased volatility. As these

concerns dissipated, the downward pressure on the shilling abated. Despite the tightening of liquidity, broad money growth (M2) has remained high (at 22.6 percent during the 12-months ending in February 2003), partly reflecting an increase in the money multiplier. After having stagnated in 2001/02, commercial bank credit to the private sector has recovered in recent months, rising sharply by 32.1 percent during the 12 months ending February 2003.

7. Overall, the health of the financial system has continued to improve in 2002/03. The conclusion of the privatization and merger of Uganda Commercial Bank (UCB) with Stanbic Bank has contributed significantly to the stability of the banking system and has spurred the expansion of much needed financial intermediation. The stability of the banking system was further enhanced by the closure and subsequent takeover by a healthy institution of one small bank, and the recapitalization of another small bank. New capital requirements came into effect on January 1, 2003, raising the minimum paid-up capital to U Sh 4 billion. However, the exposure of some financial institutions to single borrowers has increased substantially.

8. Net international reserves exceeded the end-December 2002 program target by about US$50 million, reflecting lower net sales of foreign exchange by the BOU, and the BOU's migration to International Accounting Standards (IAS) 39. For the year as a whole, the external current account deficit should be narrower than expected, on account of stronger private transfers, particularly in support of NGOs, and a smaller trade deficit. Export earnings are slightly above program projections, as substantially higher-than-expected export prices have compensated for much lower growth in export volume (3.7 percent compared with 18.4 percent in the program), owing largely to the poor weather conditions. Crops that experienced good production, such as tobacco, found ready export markets available, suggesting that Ugandan exports were maintaining their competitiveness. Imports are expected to be lower than program expectations, mainly reflecting the delay to the Bujagali project, although this decline has been tempered by an increase in other imports.

II. Policies for the Remainder of 2002/03 and 2003/04

9. Based on the outturn thus far in 2002/03, we propose only modest changes to the quantitative program for the remainder of the fiscal year—namely, a shift in the burden of sterilization and liquidity management toward greater net sales of foreign exchange (see Table 1). The ceiling on BOU net sales of foreign exchange would be raised to US$227 million for 2002/03, with a corresponding decrease in net sales of treasury bills. Targets for the fiscal deficit and the base money program would remain essentially unchanged. The composition of government spending, however, would be different than was budgeted so as to accommodate the additional defense spending and overruns in public administration expenditures, as well as higher domestic interest payments. Reflecting an agreement reached with some donors, spending on defense and public administration would not exceed their budget allocations by more than the equivalent of US$17.5 million and U Sh 15 billion, respectively. Strict adherence to these objectives over the remainder of this fiscal year would help to enhance mutual confidence between the government and its development partners.

10. The broad outlines of the program for 2003/04 are consistent with the PEAP. The macroeconomic framework is based upon a recovery in real GDP growth to about 6 percent, assuming a return to normal weather conditions for crops. The monetary program will aim to lower underlying inflation to 3 percent during the year, in line with experience over the past several years, while headline inflation would drop to 2.7 percent, as food crop prices respond to a rebound in supply. Despite a projected increase in defense spending, the Government seeks to achieve a slight reduction of the fiscal deficit relative to GDP so as to continue on the path toward improved macroeconomic sustainability and a smaller burden of sterilization operations over the medium term. The monetary authorities will pursue a flexible exchange rate policy, while limiting the share of sterilization operations through BOU foreign exchange sales, so as to allow for continued improvements in Uganda's international competitiveness. The BOU's gross international reserves are projected to be maintained at or above 5½ months of imports of goods and services during the year. To encourage longer-term growth and strengthen international competitiveness, the structural program would continue to address the main impediments to doing business in Uganda, with measures aimed at fighting corruption, building up and restoring transportation infrastructure, expanding financial intermediation, and improving the effectiveness of government economic and social programs. Moreover, as insecurity is a main cause of persistent poverty, the government is committed to providing a safe environment in which all Ugandans can live and work.

11. The greatest challenge in the year ahead will be to maintain a sound fiscal program in light of higher defense spending and a possible reduction in donor support. While providing for a modest increase in poverty-related spending protected under the PAF, a number of areas of nondefense discretionary expenditures will have to be trimmed. To minimize the burden of this tight budget situation, it will be essential that government achieve a solid revenue performance, identify and cut nonessential expenditures, and achieve maximum effectiveness of spending programs. It will also be necessary to avoid unwarranted supplementary expenditures, avoid the accumulation of new arrears, and guard against contingent liabilities arising over the course of the year.

12. The overall fiscal deficit (excluding grants) is programmed to be 11.3 percent of GDP, declining by 0.1 percentage points from the previous year. Government revenues are programmed to increase by 0.5 percentage points, mostly reflecting tax policy measures and some gains from tax administration. Total spending, relative to GDP, is projected to increase by 0.4 percentage points. Assuming that only half of the projections for non-HIPC Initiative non-PAF general budget support is disbursed, net donor support, including HIPC Initiative assistance would fall to 9.8 percent of GDP.

13. Tax policy measures of at least U Sh 34 billion (0.3 percent of GDP) are needed to meet revenue targets. In this regard, the value-added and excise tax regimes will be reviewed and revenue enhancing measures will be proposed in the budget for 2003/04. The fees and rates for nontax sources of revenue will also be reviewed with the aim of raising revenue. In addition, collection of debts and obligations falling due to the government is critical for

obtaining adequate resources. In particular, government loans to utilities and private enterprises, including those made through agencies and trusts, must be serviced in a timely manner.[1]

14. Improved tax administration is critical to both increasing government revenue and improving the business environment. URA management will follow up on the conclusion of the investigation into corruption in the URA by the judicial commission of inquiry (JCI), with the pursuit of an aggressive campaign to restore the integrity of the institution. Staff found to have committed wrongdoing will be disciplined or dismissed. To assure continued vigilance against corruption, a unit will be established in the office of the Inspector General of Government (IGG) to identify future cases of improper conduct and to review staff's asset declarations. At the same time, the URA will recruit qualified new staff, implement a training program for both new and existing staff, and obtain the necessary tools and equipment, including the implementation of the computerization strategy, so that a professional and effective URA staff will be able to efficiently apply the law. URA management will submit a business plan for 2003/04 and will agree with the Ministry of Finance on a set of objective indicators to monitor improvements in tax administration.

15. As regards expenditure, the expansion in the budgets of a number of line ministries would need to be curtailed to accommodate the increase in defense spending. The government views the reduction of public administration expenditure as a central element of its strategy to maintain spending on poverty-related and economic priority areas. To achieve this objective, the government has developed an action plan for streamlining public administration expenditures to be implemented starting in 2003/04. The budget for public administration, which had expanded rapidly in recent years, will thus be reduced to U Sh 362 billion in 2003/04. Based on these actions, the government requests a waiver for the missed structural performance criterion for end-December 2002 on this matter. Defense spending will increase to not more than U Sh 311 billion (2.4 percent of GDP) in 2003/04.

16. The government will also take steps to clear the outstanding stock of domestic arrears and to prevent the accrual of new arrears and future contingent liabilities. The government will set its commitment to clear the stock of nonpension domestic arrears in the budget speech. Pension arrears will be dealt as part of a comprehensive plan to reform the public service pension scheme that will be defined during the fiscal year 2003/04. To assure the financial sustainability of the pension system, recommendations of the pension study completed in 2001/02 will be implemented. Also a list of contingent liabilities will be complied and updated on a quarterly basis, starting from end-June 2003.

17. For the benefits of the programs on productivity, poverty reduction, and security to be fully realized, it is essential to improve the effectiveness of government spending. Hence, the government will build on the progress made thus far with expenditure management through

[1] At the same time, arrears to these borrowers should be settled.

the commitment control system (CCS). The Ministry of Finance will ensure that all provisions of the CCS are strictly adhered to, including the clearing of all expenditure over-commitments sustained in any one quarter by the end of the subsequent quarter, the imposition of penalties for incorrect or misleading monthly returns, and that regular audits of the CCS will be carried out by the Internal Auditor/Auditor General's Office at each line ministry/department. Also the computerization of the CCS will be extended to six line ministries in 2003/04 and to all ministries the following year.

18. With the decentralization of much of the delivery of social services, it is also critical that local governments improve the effectiveness of their operations. To complement steps being taken to strengthen tendering procedures, it is necessary to clarify and enforce the accounting, reporting, and monitoring of local governments. Government could also offer support to local governments that seek to enforce their own manual CCS procedures. To help with the follow-up needs of the CCS in the national government and to build up the accounting, reporting, and monitoring procedures and capacity at the local level, while the new integrated financial management system is being rolled out over the next several years, the government will request the assistance of a technical advisor.

19. Monetary policy will be aimed at keeping inflation low. While this task will be facilitated by the narrowing of the fiscal deficit, the monetary authorities will adhere strictly to the reserve money program. Growth in base money during 2003/04 is programmed to be 11.3 percent, while broad money (M2), excluding foreign exchange deposits, and commercial bank credit to the private sector are projected to grow by 15 percent and 14 percent, respectively. The BOU will further enhance its monetary and exchange rate policy instruments to assure a stable environment for the financial and external sectors.

20. As the foreign exchange market stabilizes and the need to sterilize liquidity declines, the size of the regular daily sales will be adjusted according to seasonal patterns and the liquidity injected. Foreign exchange interventions by the BOU will be limited under the program to those required to counteract disorderly market behavior subject to the program's overall ceiling. The liquidity management framework will be further enhanced by improving coordination with the Ministry of Finance, ensuring timely reconciliation of check float numbers, and minimizing the unwarranted use of the rediscount window.

21. In the financial sector, the BOU will continue to consolidate the advances made in banking supervision, regulation, and the health of the banking system. Increasing confidence in the banks has generated strong growth in deposits over the past two years, and, more recently, a revival in lending to the private sector. The BOU will continue to monitor the credit risk of financial institutions and ensure strict compliance with the prudential requirements on credit concentration and single borrower limits.

22. Access to financial services will be enhanced by the approval by parliament in November 2002 of the Microfinance Deposit-Taking Bill. Passage of the new Financial Institutions Bill (FIB)—which addresses identified problems in the current code—should improve public confidence in the banking system and further strengthen the regulatory and

supervisory framework by introducing prudential provisions consistent with international standards and ensuring prompt bank interventions and other corrective actions deemed necessary by the regulatory and supervisory authorities. To prevent money laundering, which would undermine the integrity of Uganda's financial system, an Anti-Money Laundering Bill has been drafted and circulated to commercial banks for comments before being submitted to cabinet. This would fill an important gap in the legal framework governing the financial sector by introducing specific legislation for the control of money laundering. In the meantime, the BOU has issued guidelines for the commercial banks to follow and will continue to carefully monitor banking activity.

23. The government remains committed to reforming the private pension system. Stakeholders, which include members of parliament, are currently discussing a way forward and will soon present proposals to government. Repeal of the National Social Security Fund (NSSF) statute in the near future would be difficult without carrying out prior consultation and sensitization of parliament. Government will seek to work closely with members of parliament to design an effective bill that will support sound financial practices by the NSSF, building on last year's replacement of the NSSF senior management team with finance professionals, and will aim at submitting a bill for parliamentary approval by end-December 2003. Government will also seek prompt and proper disclosure of NSSF accounts and the institution of measures to ensure that best practices in investment of the funds are adhered to. On these grounds, the government seeks a waiver for the missed performance criterion for submission to parliament of a bill for the repeal of the current NSSF Statute by end-March 2003. It will also be necessary to take steps to build up the capacity of the Capital Markets Authority, so that it can eventually play a greater role in nonbank financial regulation and supervision.

24. External sector policies are aimed at enhancing Uganda's international competitiveness and achieving a more sustainable external position over the medium term. The focus is on increasing productivity in the export sector and developing new markets for Ugandan products, including regional integration and improved access to the U.S. and European Union. Private sector activity in both traditional and nontraditional exports has picked up, supported by various donor projects and advances in monitoring standards. The Plan for the Modernization of Agriculture (PMA), a key element in the implementation of the PEAP, is currently being implemented, with advisory services expected to reach farmers' cooperatives in 188 subcounties during 2003/04, nearly double that of the previous year. The government has complemented the PMA with immediate direct government support to selected agricultural products under the strategic exports program (SEP), in order to accelerate an expansion and broadening of the export base.[2] The PMA and SEP have been largely, though not entirely, protected from budget cuts.

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[2] The crops that receive support are coffee, cotton, tea, fish, livestock, and horticulture. Textile manufacturing and information technology are also supported by the SEP.

25. The government has participated actively in reestablishing the East African Community (EAC) with Kenya and Tanzania. This should open up regional markets for Ugandan goods, particularly food crops that were previously limited to the domestic market. The arrangements for a customs union are expected to be finalized by November 2003, and should take effect shortly thereafter. Efforts are aimed at improving the EAC's transportation and telecommunications networks. The government also remains committed to further trade liberalization in the context of the World Trade Organization (WTO).

26. Uganda's external debt sustainability position is set to improve over the medium term, especially if the International Development Agency's (IDA) were to provide substantial amounts of assistance in the form of grants, rather than loans, and solid growth in exports (8 percent a year). The ratio of the net present value (NPV) of external debt to exports is projected to decline from 193.5 percent in 2002/03 to 186 percent by 2004/05, assuming the full delivery of assistance under the HIPC Initiative on outstanding debt. Some progress has been made in obtaining debt relief from India and securing agreements of HIPC Initiative assistance, mainly through negotiations with the OPEC Fund and the announcement that, by the end of 2003, Japan will revise its laws to allow full debt forgiveness. Additionally, Pakistan, Libya and South Korea have recently pledged to provide relief on official debt. The government will be requesting the modalities for providing this soon. Little progress has been made in securing agreements for HIPC Initiative relief from some non-Paris Club creditors, while others, primarily commercial creditors, have won litigations against the government to recover claims of US$40 million. To improve debt management, we will develop a plan for computerizing and linking the debt database systems of the Ministry of Finance and the BOU to allow greater coordination in debt monitoring and analysis.

27. Privatization is a key element of the structural measures aimed at enhancing the business environment in Uganda. Looking ahead, critical transportation links will be upgraded, by offering a long-term concession for the operation, maintenance, and expansion of the Ugandan railroad possibly in conjunction with the national railroads of Kenya and Tanzania. Initial discussions on a joint concession with the Kenyan railway have already begun. A 20-year concession for operating the electricity generating company was finalized in December 2002 and negotiations for the operating concession for the distribution company are expected to be concluded by June 2003. Although with some delay, a privatization advisor has been contracted for the sale of the Uganda Development Bank (UDB). The government remains committed to privatizing the UDB, or failing that, liquidating the institution. Pending divestiture, the UDB will not engage in any new lending, including on-lending on behalf of the government or the BOU.

28. To expand private sector investment activity, with a view to increasing value added from Uganda's resource base and gaining a foothold for exports to the United States under the African Growth on Opportunity Act (AGOA), the government has granted investment incentives to some selected investors on an ad hoc basis. To ensure that these incentives meet their objectives, the government will request periodic accounting of the allocated funds. Government policy, however, is to phase out all ad hoc incentives and to move to a more harmonized system of incentives for the EAC. To this end, the government has requested

technical assistance from the Fund and the World Bank to review the structure of incentives in the three EAC countries. It will await the results of that review before introducing any new measures.

29. The BOU has taken steps to meet the recommendations of the recent safeguards assessment by the IMF. The financial statements for the year ended June 30, 2002 have been finalized—with some delay, owing to the implementation of IAS 39—and the accounts were approved by the BOU Board and submitted to the Auditor General. It is expected that the audited financial statements, which were completed and signed by BOU officials in April 2003, will be published by end-June 2003. With effect from June 2003, audited financial statements will be finalized within three months of the end of the financial year, as required by the BOU Statute. In addition, the BOU Board approved the Internal Audit Charter and terms of reference of the Board's audit committee in February 2003, at which time a three-member audit committee was set-up. A reorganization of the Internal Audit Department to fully operationalize the audit committee was completed in April 2003.

Table 1. Uganda: Quantitative Performance Criteria and Benchmarks Under the Program for 2002/03 and 2003/04 1/ 2/ 3/

	Sep. 30, 2002 4/		Dec. 31, 2002 5/		Mar. 31, 2003 4/	June 30, 2003 5/	Sep. 30 2003 4/	Dec. 31, 2003 5/,6/	Mar. 31 2004 4/,6/	June 30, 2004 5/,6/
	Prog.	Outturn	Prog.	Outturn	Prog.	Prog.	Prog.	Prog.	Prog.	Prog.
	(In billions of Uganda shillings; end of period)									
Cumulative change from end-June 2002 for 2002/03, Cumulative change from end-June 2003 for 2003/04										
Ceiling on the increase in base money liabilities of the Bank of Uganda	-4.6	-19.8	53.9	51.3	46.6	49.5	9.7	84.0	81.7	77.5
Ceiling on the increase in net claims on the central government by the banking system	172.8	143.6	-94.0	-118.2	31.9	-17.4	127.6	155.3	215.1	79.5
Ceiling on the issuance of promissory notes by the government 7/	0	0	0	0	0	0	0	0	0	0
Minimum expenditures under the Poverty Action Fund (including the Universal Primary Education component of development expenditures) 7/	141.9	126.5	299.5	283.8	464.1	647.3	151.8	327.3	502.1	712.8
Accumulation of new domestic budgetary arrears of the central government 8/ 9/	0	...	0	2.7	0	0	0	0	0	0
Ceiling on public administration expenditure 7/	57.7	59.8	125.4	118.4	188.1	250.8	56.5	123.0	184.5	246.0
	(In millions of U.S. dollars; end of period)									
Ceiling on the stock of external payments arrears 8/	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 5/	0	0	0	0	0	0	0	0	0	0
Minimum increase in net international reserves of the Bank of Uganda 10/	-55.1	-39.1	135.5	187.4	94.2	106.7	-36.3	16.1	-22.1	45.2
Revised program, June 2003	...	...	...	...	...	66.7	...	...	...	...

1/ Fiscal year begins on July 1.
2/ The performance criteria and benchmark targets under the program, and their adjustors, are defined in the Technical Memorandum of Understanding (TMU).
3/ The outturns are adjusted based on the adjustors defined in the TMU.
4/ Benchmarks.
5/ Performance criteria.
6/ Indicative targets.
7/ Indicative target throughout the program.
8/ Continuous performance criterion.
9/ For the purpose of program monitoring, audits of arrears by the the Audit General/ Internal Auditor's Office of the Ministry of Finance, Planning, and Economic Development audits of arrears are to be used to determine the new arrears. However, the end-December audit was not available and information from the Commitment Control System (CCS) was used for the first review of the program. While the CCS shows that new arrears exceeded the zero limit, it covers only part of the budget and it is possible that additional arrears were accumulated.
10/ The program figures for the performance criterion and benchmarks for September 2002 to March 2003 reflect a correction from the figures approved by the Board on September 13, 2002. Inadvertently, the targets for increases in gross international reserves had been reported in the previous program document. The present figures correctly refer to the corresponding targets for increases in net international reserves.

Table 2. Uganda: Structural Performance Criteria and Benchmarks, and Status of Implementation Under the Programs for 2002/03 and 2003/04

Performance Criteria/Benchmark	Policy Measure	Date of Implementation	Implementation Status	Comments
		Fiscal		
Performance criterion	Submit to cabinet a plan to reduce government expenditures, drawing from the Presidential Committee's report on Effective Public Administration Budgeting, indicating (a) initial measures to be taken immediately, (b) measures that require prior notification of affected parties, to be taken in 2003/04, and (c) measures that may require a constitutional amendment.	December 31, 2002	Observed late	A series of measures to be included in the 2003/04 budget proposal was agreed upon by cabinet in March 2003.
Benchmark	Production of a business plan for the Uganda Revenue Authority (URA) that will spell out its strategy for improving tax collection and associated costs.	September 30, 2002	Observed	
Benchmark	Verification of domestic budget arrears outstanding as at end-June 2002	March 31, 2003	Observed	.
Performance criterion	**Announce plan to clear the outstanding stock of nonpension domestic arrears.**	**June 30, 2003**		**New measure**
Benchmark	**Develop a time-bound plan to clear the stock of pension arrears as part of a comprehensive plan to reform the public service pension scheme.**	**December 2003**		**New measure**
Benchmark	**Develop the annual business plan for implementing tax administration measures in 2003/04, in accordance with the URA's 5-year corporate plan, and a plan for the completion of the computerization of the URA.**	**June 30, 2003**		**New measure**
Benchmark	**Establish a unit in the IGG to identify and investigate cases of improper conduct and corruption by URA or staff.**	**June 30, 2003**		**New measure**
		Fiscal decentralization		
Benchmark	Produce aggregated local government financial statistics for 2000/01 fiscal year.	September 30, 2002	Observed	
Benchmark	**Produce aggregated local government financial statistics for 2001/02 fiscal year.**	September 30, 2003		**New measure**

Table 2. Uganda: Structural Performance Criteria and Benchmarks, and Status of Implementation Under the Programs for 2002/03 and 2003/04

Performance Criteria/Benchmark	Policy Measure	Date of Implementation	Implementation Status	Comments
		Financial sector		
Performance criterion	Submit to Parliament a bill to repeal the National Social Security Fund (NSSF) Statute to pave the way for regulation of the NSSF by the Bank of Uganda (BOU).	March 31, 2003	Not observed	Government to build support in Parliament for the bill. Measure to be implemented by December 31, 2003.
Benchmark	Development by all banks of a Capital Compliance Plan detailing proposals for complying with January 2003 capital requirement for minimum paid-up capital.	September 30, 2002	Observed	
Benchmark	Assign the privatization of UDB to the Privatization Unit and engage a privatization advisor to handle the privatization.	December 31, 2002	Observed late	Assigned to the privatization unit on time. Selection of privatization advisor finalized in March 2003.
Performance criterion	Privatize Uganda Development Bank (UDB).	June 30, 2003	...	
		Safeguards Assessment Report		
Benchmark	**Publish the audited financial statements of the BOU for the year ended June 30, 2002.**	**April 30, 2003**	**...**	**New measure** **The audited financial statements were completed and signed by BOU officials in April 2003. They are expected to be published by end-June 2003.**
Benchmark	**Publish the audited financial statements of the BOU for the year ended June 30, 2003.**	**September 30, 2003**	**...**	**New measure**
Benchmark	**BOU and the Ministry of Finance enter into a Memorandum of Understanding to ensure that unrealized gains will be excluded from the distributable profits.**	**June 30, 2003**	**...**	**New measure**

Uganda—Technical Memorandum of Understanding
(June 9, 2003)

I. Introduction

1. This memorandum defines the quantitative benchmarks and performance criteria described in the memorandum of economic and financial policies (MEFP) for the 2002/03 and 2003/04 financial program that would be supported by the IMF Poverty Reduction and Growth Facility (PRGF), and sets forth the reporting requirements under the arrangement.

A. Base Money

2. **Base money** is defined as the sum of currency issued by Bank of Uganda (BOU) and the commercial banks' deposits in the BOU. The commercial bank deposits include the statutory required reserves and excess reserves held at the BOU and are net of the deposits of closed banks at BOU and Development Finance Funds (DFF) contributed by commercial banks held at BOU. Under this definition, the end-June 2002 base money was estimated at U Sh 630 billion. The base money limits for the 2002/03 program will be cumulative changes from end-June 2002, and the base money limits for the 2003/04 program will be cumulative changes from end-June 2003, and will be monitored from the monetary authority balance sheet, provided to the IMF by the BOU.

B. Net Claims on the Central Government by the Banking System

3. **Net claims on the central government** (NCG) by the banking system is defined, as the difference between the outstanding amount of bank credits to the central government and the central government's deposits with the banking system, excluding deposits in project accounts. Credits comprise bank loans and advances to the government and holdings of government securities and promissory notes. The component of credit to government in the form of securities and promissory notes will be calculated based on data from balance sheets of the monetary authority and commercial banks. This will be adjusted for any discrepancy between the stock of Treasury bills recorded on the Central Depository System (CDS) and stock of Treasury Bills recorded on the commercial banks balance sheets.[1] The limits on the change in net claims on the central government by the banking system will be cumulative from end-June 2002 for the 2002/03 program, and end-June 2003 for the 2003/04 program.

C. Net International Reserves of the Bank of Uganda

4. **Net international reserves (NIR)** of the Bank of Uganda 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

[1] The monetary authority values the securities and promissory notes at issue price, while some commercial banks value securities and promissory notes at face value although they should be reporting at cost value.

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 Bank of Uganda and include outstanding IMF purchases and loans.

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

D. Expenditures Under the Poverty Action Fund

6. The expenditures under the Poverty Action Fund (PAF) include both wage and nonwage current expenditures under the PAF, and domestic development expenditures under the PAF. The minimum expenditures under the PAF are defined as 95 percent of the budgeted expenditures under the PAF, which cumulatively are U Sh 141.9 billion for end-September 2002, U Sh 299.5 billion for end-December 2002, U Sh 464.1 billion for end-March 2003, and U Sh 647.3 billion for end-June 2003 for the 2002/03 program. The minimum expenditures under the PAF are defined as 95 percent of the budgeted expenditures under the PAF, which cumulatively are U Sh 151.8 billion for end-September 2003, U Sh 327.3 billion for end-December 2003, U Sh 502.1 billion for end-March 2004, and U Sh 712.8 billion for end-June 2004 for the 2003/04 program.

E. New Domestic Budgetary Arrears of the Central Government

7. The nonaccumulation of new domestic payment arrears is a continuous performance criterion under the program. 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; (ii) unpaid and due personal claims, including, wages and salaries; and (iii) unpaid debt service due on government debt. For the purpose of program monitoring, the Audit General's/Internal Auditor Office's of the Ministry of Finance, Planning and Economic Development audits of arrears at end-December 2002 and at end-June 2003 shall be used to determine the new arrears created in the first six months and during the entire 2002/03 fiscal year, respectively, and the Audit General's/Internal Auditor Office's of the Ministry of Finance, Planning and Economic Development audits of arrears at end-June 2004 shall be used to determine the new arrears created during the entire 2003/04 fiscal year. The result of these audits should be available not later than 7 weeks following the close of the covered period. These audits should include all arrears regardless of whether or not the area of expenditure is covered by the Commitment Control System (CCS).

F. Ceiling on Public Administration Expenditures

8. The quarterly expenditure limits for the public administration sector are U Sh 57.7 billion for the first quarter to end-September 2002, U Sh 125.4 billion for the second quarter

to end-December 2002, U Sh 188.1 billion for the third quarter to end-March 2003, and U Sh 250.8 billion for the fourth quarter end-June 2003. The quarterly expenditure limits for the public administration sector during 2003/04 are U Sh 56.5 billion for the first quarter to end-September 2003, U Sh 123.0 billion for the second quarter to end-December 2003, U Sh 184.5 billion for the third quarter to end-March 2004, and U Sh 246.0 billion for the fourth quarter end-June 2004. For the purpose of program monitoring, the public administration sector includes the following votes: Office of the Prime Minister (004) (excluding development), Foreign Affairs (006), Missions Abroad (0A0), MFPED (008) (excluding URA, Contingency, Accountability, and Development), URA (008), State House (002), Public Service (005), Public Service Commission (027), Local Government (025) (excluding development), Mass Mobilization (034), Office of the President (001) (excluding ISO/ESO and E&I), Specified Officers-Salaries (300), Parliamentary Commission (315), Local Government Finance Commission (033), Uganda Human Rights Commission (347), Electoral Commission (349). Any supplementary allocation to votes in the public administration sector that would exceed program ceilings will be accommodated by cuts to votes belonging to other categories within this same sector.

G. Promissory Notes

9. A promissory note is a written promise by the government to pay a debt, where government is defined as the central government[2], 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.

H. Adjusters

10. The NIR target is based on assumptions regarding import support, assistance provided under the Heavily Indebted Poor Countries (HIPC) Initiative, and external debt-service payments. The NCG target, in addition to being based on the two aforementioned assumptions, is also based on assumptions regarding domestic nonbank financing of central government fiscal operations. On a cumulative basis, from July 1, 2002, the Uganda shilling equivalent of import support plus HIPC assistance will amount to U Sh 73.9 billion at end-September 2002; U Sh 526.4 billion at end-December 2002; U Sh 629.0 billion at end-March 2003; and U Sh 816.0 billion at end-June 2003. On a cumulative basis, from July 1, 2003, the Uganda shilling equivalent of import support plus HIPC assistance will amount to U Sh 76.5 billion at end-September 2003; U Sh 294.9 billion at end-December 2003; U Sh 391.2 billion at end-March 2004; and U Sh 696.2 billion at end-June 2004. Debt service due, before assistance under the Highly Indebted Poor Countries (HIPC) Initiative,

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

excluding debt service owed to creditors that have not yet reached agreement on the delivery of HIPC assistance is programmed at U Sh 54.4 billion at end-September 2002; U Sh 92.3 billion at end-December 2002; U Sh 157.6 billion at end-March 2003; and U Sh 205.3 billion at end-June 2003. For the 2003/04 program the debt service due, before assistance under the Highly Indebted Poor Countries (HIPC) Initiative, excluding debt service owed to creditors that have not yet reached agreement on the delivery of HIPC assistance is programmed at U Sh 50.3 billion at end-September 2003; U Sh 104.6 billion at end-December 2003; U Sh 154.4 billion at end-March 2004; and U Sh 201.3 billion at end-June 2004.

11. The ceiling on the cumulative increase in NCG will be adjusted downward (upward), and the floor on the cumulative increase in NIR of the Bank of Uganda will be adjusted upward (downward) by the amount by which import support, grants and loans, plus HIPC assistance, exceeds (falls short of) the projected amounts. 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 payments inclusive of debt service financed with HIPC assistance plus the debt service payments on court awards regarding external arrears falls short of (exceeds) the projections of debt service due before assistance under the Highly Indebted Poor Countries (HIPC) Initiative, excluding debt service owed to creditors that have not yet reached agreement on the delivery of HIPC assistance.

12. The ceiling on the increase in NCG will be adjusted downward (upward) by any excess (shortfall) in nonbank financing[3] less payment of domestic arrears accumulated prior to introduction of the CCS (up to a maximum amount of U Sh 50.2 billion) relative to the programmed cumulative amounts of minus U Sh 130.5 billion at end-March, 2003; and minus U Sh 40.0 billion at end-June, 2003. The nonbank financing programmed for 2003/04 are, cumulative from end-June 2003: negative U Sh 75.3 billion at end-September, 2003; negative U Sh 103.6 billion at end-December 2003; negative U Sh 87.9 billion at end-March 2004; negative U Sh 25.0 billion at end-June 2004. Furthermore, NCG will be adjusted downward by the amount by which expenditures under the Poverty Action Fund (PAF) fall short of 95 percent of the cumulative budgeted amounts of U Sh 149.3 billion at end-September 2002; U Sh 315.3 billion at end-December 2002; U Sh 488.6 billion at end-March 2003; and U Sh 681.5 billion at end-June 2003. The cumulative budgeted amount of PAF from end-June 2003: U Sh 159.8 billion at end-September 2003; U Sh 344.5 billion at end-December 2003; U Sh 528.5 billion at end-March 2004; U Sh 750.3 billion at end-June 2004.

13. If excess reserves of the commercial banks increase on account of a shortfall in the cumulative quarterly flows of private sector credit relative to programmed amounts of U Sh 26.7 billion end-March, 2003; and U Sh 66.5 billion end-June 2003, and 12-month

[3] Comprising check float and the change in government securities and government promissory notes held by the nonbank public.

underlying inflation is below 4.5 percent, the base money ceiling will be adjusted upward up to U Sh 9 billion. The base money ceiling will not be adjusted upward if the underlying 12-month inflation exceeds 4.5 percent.

14. The Development Finance Department (DFD) of BOU provides export credit guarantee schemes (ECGS) to commercial banks. As of March 23, 2003 the outstanding ECGS's amounted to U Sh 2.35 billion, of which U Sh 1.0 billion will expire before June 30, 2003. These contingent liabilities fall due on the BOU balance sheet, therefore do not affect the program targets for the NIR and the NCG.

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

15. The program includes a ceiling on new nonconcessional borrowing with maturities greater than one year contracted or guaranteed by the government, statutory bodies, or the Bank of Uganda. 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 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 observes 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.

16. The definition of debt, for the purposes of the limit, is set out in point 9, of the Guidelines on Performance Criteria with Respect to External Debt (Executive Board's Decision No. 12274-(00/85), August 24, 2000). It not only applies to the debt as defined in Point 9 of the Executive Board decision, but also to commitments contracted or guaranteed for which value has not been received. The definition of debt set forth in No. 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements reads as follows: (a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary

exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property. (b) Under the definition of debt set out in point 9(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

17. The ceiling on the accumulation of new external payments arrears is zero. This limit which is to be observed on a continuous basis, applies to the change in the stock of overdue payments on debt contracted or guaranteed by the government, the Bank of Uganda and by statutory bodies[4] from their level at end-June 2002. It comprises those external arrears reported by the Trade and External Debt Department of the BOU, Macro Unit and Parastatal Monitoring Unit of the Ministry of Finance that cannot be rescheduled because dispersed after the Paris Club cutoff date.

J. Monitoring and Reporting Requirements

18. The authorities will inform the IMF staff in writing at least 10 (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 Bank of Uganda, or any statutory bodies, and any accumulation of new external payments arrears on the debt contracted or guaranteed by these entities.

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

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[4] This definition is consistent with the coverage of borrowing defined by the Fund (Public Sector Debt—defined as at least 50 percent owned by the government regardless of whether the debt is formally publicly guaranteed) for the Public Sector and Public Finance and Accountability Bill 2002 (Part V — Control of the Finances of State Enterprises).

20. Bank of Uganda 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 BOU will review the reconciliations of monetary survey data to the financial records and the audited financial statements.

21. The government will provide the IMF staff with a summary of the fiscal accounts both on a monthly and quarterly basis with a seven-week lag from the end of the reporting month and quarter. Revenues will be recorded on a cash basis as reported by the Uganda Revenue Authority and the MFPED. Expenditures shall be recorded when checks are issued except for domestic and external debt-service payments, cash transfers to districts, and externally funded development expenditures. Expenditures on domestic interest will be recorded on 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 Bank of Uganda. 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 and approved supplementary allocations in each month should be provided to the IMF within 15 days of the end of each month.

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

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

24. Final accounts of the local government authorities for fiscal years 2001/02 will be consolidated by end-September 2003 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 thee monthly reporting requirement by districts will be provided at the same time as the summary status report to the IMF. Any noncompliance by 45 days following the end of a month will result in a reminder letter being sent from the Treasury Inspectorate Department to the District Chairperson. Any noncompliance for an additional month will result in a memorandum being sent from the Commissioner of the Treasury Inspectorate Department to the Budget Director indicating that the Monitoring and Accountability Grants to the noncompliance districts should be discontinued until compliance is restored. A memorandum indicating this action will be sent to each noncompliant district.

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

26. 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: (i) outstanding stock of checks issued by the Uganda Computer Services of the MFPED, disaggregated into checks issued for commitments arising during July 1, 2002 through June 30, 2003, payment of arrears accumulated prior to July 1, 1999, and checks issued to settle intra-ministerial payment obligations; (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.

27. As supplementary information, the Bank of Uganda will provide the IMF staff on a monthly basis, with a seven-week lag from the end of the reporting month, a statement of: (i) cash balances held in project accounts at commercial banks; (ii) total value (measured at issue price) of outstanding government securities from the Central Depository System (CDS); (iii) the stock of government securities (measured at issue price) held by commercial banks from the CDS.

28. The government will provide the IMF staff on a quarterly basis, with a seven-week lag from the end of the reporting quarter, (i) a statement on new loans contracted during the period as per the loan agreement with additional information on disbursement provided within six months, (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.

29. 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, (iii) the monthly composition of nominal HIPC assistance into grants, flow rescheduling and stock of debt reduction by creditor.

30. 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 Bank of Uganda, 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.

31. 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, 2003)

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

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

III. SDR Department:	SDR Million	% Allocation
Net cumulative allocation	29.40	100.0
Holdings	7.18	24.41

IV. Outstanding Purchases and Loans:	SDR Million	% Quota
Enhanced Structural Adjustment Facility (ESAF)/Poverty Reduction and Growth Facility (PRGF) arrangements	183.57	101.7

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	1.50
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 Fund:
Under the Repurchase Expectations Assumptions

	Overdue	Forthcoming				
	3/31/2003	2003	2004	2005	2006	2007
Principal	0.00	28.77	37.48	35.60	30.57	22.43
Charges/interest	0.00	1.19	1.09	0.91	0.74	0.60
Total	**0.00**	**29.96**	**38.56**	**36.50**	**31.31**	**23.02**

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) [1]			
Total assistance (US$ million)	347.00	656.00	
Of which: Fund assistance (SDR million)	51.51	68.10	
Completion point date	April 1998	May 2000	
Delivery of Fund assistance (SDR million)			
Amount disbursed	51.51	68.10	119.61
Interim assistance	...	8.20	8.20
Completion point [2]	51.51	59.90	111.41

VIII. Safeguards Assessments

Under the Fund's safeguards assessment policy, Bank of Uganda (BOU) is subject to a full safeguard 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 BOU has several strengths, some vulnerabilities exist. The safeguards assessment proposed specific measures to address these vulnerabilities as reported in paragraph 25 of the staff report for Uganda.

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 April 30, 2003, the official exchange rate was U Sh 1,987 per U.S. dollar. The exchange system is free of restrictions on the making of payments and transfers for current international transactions.

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

[2] Under the enhanced HIPC Initiative, the nominal amount of assistance disbursed will include an additional amount corresponding to interest on amounts committed but not disbursed during the interim period, calculated using the average return (during the interim period) on the investment of resources held by, or for, the benefit of the PRGF-HIPC Trust.

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 November 1998, MAE held consultations in improving the security of the BOU's automated book-entry system. As a result, a long-term expert has been assisting the authorities on banking supervision issues since July 2001. MAE provided further consultation on the implementation of monetary policy and the coordination of liquidity management and exchange rate intervention in July 2001. Follow-up missions to give operational advice and to address the authorities' outstanding concerns on these issues took place in January and May 2002, respectively. In February and April 2001, joint World Bank/Fund missions visited Kampala as part of the Financial Sector Assessment Program (FSAP). A final report was provided to the authorities in November 2001, and an MAE mission discussed the report with the authorities during the Article IV consultation discussion in November 2002.

XI. Technical Assistance

Uganda has received extensive technical assistance from the Fund in recent years.[3]

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.

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 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 mission visited Uganda during February–March 2002 to

[3] 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.

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.

XII. Future Technical Assistance Priorities

The priorities for Fund 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, and monetary and balance of payments statistical reporting.

XIII. Resident Representative

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

Uganda: Relations with the World Bank Group
(As of May 21, 2003)

I. 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 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 Bank and Fund 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 Bank and Fund support the government's efforts to implement the strategy in a complementary fashion. The Fund 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 fall under the first PEAP/PRSP pillar (creating an environment for economic growth and structural transformation). The structural program of the Fund 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 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 also a heavy focus on analytic work.

II. 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.[4] 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.

5. Consistent with this strategy, the 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

[4] The next CAS is scheduled to be presented to the Board in fiscal year 2003/04 (July–June).

(PRSC1) for Uganda was approved by the Board in May 2001. A subsequent arrangement, PRSC2, was approved in July 2002, and PRSC3 is being prepared and is scheduled to be presented to 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 due 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 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 to 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 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 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 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 of 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 microfinance, 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 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 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) complement 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 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. Further, the series of PRSCs provides support to the Government to identify ways to promote agricultural diversification and modernization, mainstreaming of environmental concerns in government programs, land tenure reforms, and expansion of non-farm activities in rural areas. The Second Environmental Management and Capacity Building Project continues support for 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 bio-diversity 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 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.

III. BANK PORTFOLIO

12. The World Bank Group is Uganda's largest creditor. As of April 30, 2003 a total of 99 credits and 9 loans, amounting to US$3.96 billion (including US$3.84 billion from IDA and US$43 million from IBRD), had been approved for Uganda, and total disbursements amounted to about US$2.97 billion (see table below).

IV. Uganda: Financial Relations with the World Bank Group

Statement of Loans and Credits
As of April 30, 2003
(In millions of U.S. dollars)

	IBRD	IDA	IDA Grant	Total
Original principal	43	3,840	75	3,958
Cancellations	277	146	0	146
Disbursement to date	43	2,880	74	2,997
Repayments	35	313	0	348
Undisbursed	0	923	0	923
Exchange adjustment	0	0	0	0
Borrower's obligation	0	2,646	0	2,646

13. Six new projects were approved in FY 02 (Roads Development II, Power IV, Bujagali Hydropower, Decentralized Service Delivery, Environment Management Capacity II, and Rural Electrification), totaling about US$320 million. Three operations (PRSC2, Northern Uganda Social Action Fund, and a Protected Area Management & Sustainable Use Project), totaling US$277 million in terms of new commitments, and a US$4.5 million supplemental credit for the Lake Victoria Environment Management Project have been approved thus far in FY 03. Six projects in FY 01 and four projects in FY 02 were closed.

V. Bank-Fund 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 Fund:

15. **Poverty Reduction Strategy Paper.** The Bank and Fund 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 PRSP progress report on an annual basis.

16. **Debt Sustainability.** The staffs of the Bank and Fund continue collaborating on HIPC-related issues, 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 Bank, Fund and other donors are working closely to provide the government the support needed for institutional and policy reforms. The Fund is leading the dialogue on fiscal policy, while the Bank is focusing on strategic expenditure allocation and efficiency of public expenditures through the work on the public expenditure review and PRSC. The staffs of the two institutions

prepare on an annual basis a report on HIPC tracking of poverty-reducing spending, analyzing the quality of public expenditure management in Uganda and identifying areas needing strengthening.

18. **Financial Sector Reform.** A joint Bank-Fund 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 Fund are supporting the government's efforts to reform the financial sector. The Bank supports through PRSC measures to strengthen the insurance sector, reform the pension system, and develop the legal and regulatory framework for microfinance. The work is closely coordinated with a program supported by the Fund's PRGF, which addresses selected aspects of pension reform.

19. **Trade Reforms.** The Bank and Fund 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 Satu Kahkonen, Country Economist for Uganda (Tel. 473-2170).

Uganda: Social Output and Outcome Indicators, 2000-04

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

Source: Uganda Poverty Reduction Strategy Paper—Progress Report 2002.

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.

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

INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

Press Release No. 03/96
FOR IMMEDIATE RELEASE
June 25, 2003

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes the First Review Under Uganda's PRGF Arrangement and Approves US$2.8 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Uganda's economic performance under the Poverty Reduction and Growth Facility (PRGF) arrangement. As a result, Uganda will be able to draw up to SDR 2 million (about US$2.8 million) under the arrangement immediately.

The Board also granted waivers for the nonobservance of the performance criteria pertaining to the accumulation of new domestic arrears, the submission to cabinet of a plan to reduce government expenditures, and the submission to parliament of a bill to repeal the National Social Security Fund Statute.

Uganda's three-year PRGF arrangement was approved on September 13, 2002 (see Press Release No. 02/41) for SDR 13.5 million (about US$19 million). So far, Uganda has drawn SDR 1.5 million (about US$2.1 million).

The PRGF is the IMF's most concessional facility for low-income countries. It is intended that PRGF-supported programs will in time be 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 PRGF-supported programs are 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 5 ½-year grace period on principal payments.

In commenting on the Board's discussion on Uganda, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chairman, stated:

"Uganda's continued pursuit of macroeconomic stability and a comprehensive poverty reduction strategy has resulted in low inflation and high rates of economic growth and poverty reduction. Improved revenue performance has contributed to substantial fiscal adjustment, and the health of the financial sector continues to improve.

"In the year ahead, the authorities aim to support economic growth and low inflation by containing the fiscal deficit at around the present level. Given the limited availability of budgetary resources and in light of higher defense spending to face the security situation in northern Uganda, it will be critical to meet the budget's revenue target and curb nonpriority spending while increasing poverty-related expenditures. The effectiveness of government spending could be enhanced by strengthening expenditure management systems and streamlining expenditure on public administration.

"Monetary policy will continue to aim at keeping inflation low. A flexible exchange rate policy will be maintained to help protect Uganda's international competitiveness and absorb potential terms of trade shocks. Continued vigilant supervision will be necessary to maintain a healthy financial sector. The recently-approved Financial Institutions Bill and Microfinance Deposit-Taking Bill will be important in this regard. Reform of the pension system and a broadening of the nonbank financial sector would help to mobilize substantial domestic resources for investment.

"Efforts to improve the infrastructure, expand financial intermediation, protect property rights and enforce contracts, and enhance governance are important to improve the investment climate and encourage private sector-led investment and growth," Mr. Sugisaki stated.

Statement by Ismaila Usman, Executive Director for Uganda
June 25, 2003

1. Uganda's economy continues to improve in response to the steady implementation of strong macroeconomic adjustment and structural reforms aimed at creating the conditions for sustained high rates of economic growth and the alleviation of poverty. My Ugandan authorities wish to acknowledge with deep gratitude the invaluable assistance of the international community, including the Fund and the World Bank. The authorities' continued strong commitment to prudent financial policies had been critical for the maintenance of stable macroeconomic conditions. Economic performance has, in general, remained favorable with sustained strong growth in output, relatively low inflation, and reduced internal and external imbalances. Moreover, significant progress was made in structural reforms, including trade liberalization and privatization.

2. While notable progress has been made under the several successive Fund supported programs, my Ugandan authorities recognize that the reform agenda is far from over and that many development challenges still lie ahead. They are, therefore, determined to continue, and if needed, intensify their reform efforts with a view to meet the objective set in the poverty reduction strategy.

Recent Performance under the PRGF Arrangement

3. Performance under the current PRGF arrangement was broadly satisfactory, and with the exception of a few, most of the performance criteria and structural benchmarks were observed. As corrective actions have been taken to address the slippages occurred the authorities are confident that their request for waiver for the missed performance criteria will be considered favorably by the Board.

4. The authorities remained steadfast in their efforts to press on with fiscal consolidation. Revenue performance remained strong as shortfalls in revenues from domestic excises were more than compensated by higher revenue from income tax and VAT. During the course of the year the composition of government spending had to be adjusted as the security problems in northern Uganda compelled the authorities to make supplementary appropriations for defense. In order to contain the deviation of the fiscal deficit from the program target, the authorities contained public spending below program levels during the first half of 2002/03, by undertaking sharp cuts in discretionary nonwage expenditures other than those protected under the Poverty Action Fund (PAF). However, with the suspension and downscaling of donor budget support the consolidation effort was limited to 1.3 percentage points of GDP from the previous year.

5. Monetary policy continued to focus on sterilizing the liquidity injection associated with donor-supported government spending and mopping up commercial bank's excess reserves. Tightened monetary policy helped to keep the underlying inflation under control despite the sharp rise in the prices of food crops and fuel. Credit to the economy expanded significantly compared to previous years. As a result of more favorable terms of trade the

external position strengthened somehow. International reserves remained at a comfortable level, at about six months of imports.

Policies for 2003/04

6. The policy framework for 2003/04 will remain consistent with the Poverty Eradication and Action Plan (PEAP) objectives. Its central goals are to consolidate further macroeconomic stability, promote private sector-led growth, and provide increased resources for priority social sectors. Assuming a return to normal weather conditions, real GDP growth is expected to reach 6 percent, headline inflation is expected to be contained at 2.7 percent as food crop prices are likely to decline in response to recovery in agricultural output.

7. The authorities realize the importance for further reduction in the fiscal deficit to sustain macroeconomic stability and lessen the heavy dependence from external assistance. Therefore, fiscal discipline will remain at the core of the authorities' stabilization efforts. The scope for consolidation is expected to be limited to 0.1 percentage points of GDP, as the country's security needs will continue to exert pressure on government to allocated increased resources for defense and donor budget support will possibly be reduced further. Notwithstanding the tight budget situation, poverty-related outlays are expected to increase to 5.8 percent of GDP. This would be made possible by further curtailing nonessential spending and from savings generated by streamlining public administration expenditures. A number of revenue enhancing measures have also been envisaged to allow revenue to increase by 0.5 percentage points of GDP. Factors contributing to this improvement include: review of the VAT and excise tax regimes; timely collection of debts and obligations falling due to government; and improvement of tax administration which is critical to increase revenue and enhance business environment. With regard to the latter, steps will be taken to increase the efficiency of the URA by reinforcing it with qualified staff and adequate equipment. At the same time, the authorities also intend to follow up on the conclusions of the investigation in the URA undertaken by the judicial commission of inquiry with a view to restore the integrity of the institution. Moreover, measures are being considered to clear domestic arrears. The issue of the pension arrears is expected to be addressed in the context of the reform of the public service pension scheme to be outlined during the course of the year. Most importantly, the authorities attach great importance to expenditure management and as such they are committed to ensure that the provisions of the Commitment Control System (CCS) are strictly complied with by each line ministry. As local governments have been entrusted with the delivery of social services under the PEAP, they will be requested to put into effect adequate accounting, reporting and monitoring procedures.

8. With the main goal of containing underlying inflation to 3 percent, in addition to measures taken by the government, the monetary authorities will be pursuing monetary restraint, and in particular, to adhere strictly to the reserve money objectives. In light of broad money and domestic credit growth the authorities will continue to make use of the treasury and central bank bills to mop up excess liquidity. Improved coordination between the central bank and the Ministry of Finance is considered critical in implementing liquidity management framework to avoid market volatility arising from sterilization operations. Central bank intervention in foreign exchange market is envisaged to be limited to neutralize

disorderly market behavior. The role of the central bank will be further strengthened with further improvements in the supervisory and regulatory framework. The financial system remains basically sound and the new Financial Institutions Bill approved recently will help to further strengthen confidence in the banking system by introducing prudential provisions consistent with international standards.

9. Regarding external sector, the authorities are resolved to enhancing the country's international competitiveness and in diversifying the export base which they judge to be critical to make progress towards improving external position sustainability over the medium term. To this end, the authorities are focusing their efforts in increasing productivity in the external sector, while seeking to diversify the markets for their products. To achieve these goals the government has been implementing with success two important programs that complement each other, the Plan for the Modernization of Agriculture and the Strategic Exports Program. These programs play also an important role in the poverty alleviation efforts and for that reason they have not been greatly affected by recent budget cuts.

10. It is a known fact that debt relief provided under the HIPC Initiative has not entirely produced the expected results in the case of Uganda to reach debt sustainability. Indeed, the NPV of external debt to exports ratio, at about 194 percent, still remains well above the set threshold. Recently there has been some progress towards securing debt relief in terms comparable to those granted under the HIPC Initiative, from non-Paris Club creditors. However progress remains slow with regard to many other creditors. Uganda has also been confronted with cases of litigations moved against the government, essentially by commercial creditors to recover claims.

11. In concluding, my Ugandan authorities are greatly appreciative of the important role the Fund Board, Management and staff have played in the country's adjustment and reform efforts. They look forward to continued close cooperation with the institution in addressing the remaining challenges.