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

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

- the staff Report for the fifth review under the three-year arrangement under the Poverty Reduction and Growth Facility, request for waiver of performance criterion, and extension of arrangement, prepared by a staff team of the IMF, following discussions that ended on May 13, 2005, with the officials of Uganda on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 23, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Press Release summarizing the views of the Executive Board as expressed during its July 8, 2005 discussion of the staff report that completed the request and review.

- a statement by the Executive Director for Uganda.

The documents listed below have been separately released.

Joint Staff Advisory Note of the Poverty Reduction Strategy Paper
Letter of Intent sent to the IMF by the authorities of Uganda*
Memorandum of Economic and Financial Policies by the authorities of Uganda*
Poverty Reduction Strategy Paper
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

Fifth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Request for Waiver of Performance Criterion, and Extension of Arrangement

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

Approved by Siddharth Tiwari and Anthony Boote

June 23, 2005

- Discussions for the fifth review under the Poverty Reduction and Growth Facility (PRGF) arrangement were held in Kampala during April 28-May 13, 2005. The attached letter from the Minister of Finance, Planning, and Economic Development (Appendix I) reviews performance under the program and sets out the policies for the remainder of 2004/05 (July-June) and 2005/06. The authorities are requesting a waiver for one quantitative performance criterion and an extension of the PRGF arrangement from September 12 to December 31, 2005, so as to allow sufficient time to complete the sixth and final review of the program.
- The staff team comprised Messrs. Nowak (head), Mikkelsen, and Peiris (all AFR), Mr. Espejo (PDR), and Ms. Gonzalez (FAD). The team was assisted by Mr. Allum, the Senior Resident Representative in Uganda. The mission was also joined by Messrs. Gillingham and El-Said (both FAD), who conducted a poverty and social impact analysis (PSIA) of alternative tax measures. The mission met with President Museveni; the Prime Minister, Mr. Nsibambi; the Minister of Finance, Planning, and Economic Development, Mr. Suruma; the Governor of the Bank of Uganda, Mr. Tumusiime-Mutebile; and other senior government officials. The mission coordinated its work with an overlapping World Bank mission.
- Uganda is undergoing a transition to a multiparty system in the run-up to the next presidential and parliamentary elections in March 2006. The government has presented to parliament a draft constitutional amendment bill that proposes to eliminate the two-term presidential limit and adopt a multi party electoral system. Despite attempts earlier in the year to establish a ceasefire in the northern part of the country, the Lord’s Resistance Army (LRA) has resumed its campaign; the number of internally displaced persons arising from this conflict remains significant.
- This report will be discussed together with an Ex Post Assessment of Uganda’s Performance Under Fund Programs, a Joint Staff Advisory Note for Uganda’s Poverty Eradication Action Plan, and a Financial System Stability Assessment update.

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EXECUTIVE SUMMARY

- **Macroeconomic performance has been good in 2004/05 (July-June).** Despite the effects of a prolonged dry spell, real GDP growth is expected to remain at around 6 percent and nonfood inflation at about 5 percent. The external current account deficit has been stable at close to 13 percent of GDP, but international reserves have continued to rise, reflecting an increase in donor inflows.

- **The fiscal program is broadly on track.** Based on preliminary information, the overall deficit, excluding grants, is expected to decline from 11.1 percent of GDP in 2003/04 to 9.7 percent of GDP in 2004/05, which is well within target. Revenue performance was better than programmed. However, domestic arrears continued to accumulate during the first half of the fiscal year.

- **Performance relative to the program performance criteria and benchmarks has generally been satisfactory.** All quantitative performance criteria for December 2004, with the exception of that on the accumulation of domestic arrears, were observed. The structural performance criterion and two of the four benchmarks through March 2005 were also met.

- **The primary focus of Uganda's economic reform program is to sustain growth and make further inroads into poverty reduction.** The strategy for achieving this is set out in the revised Poverty Eradication Action Plan, which was launched recently. Over the next three years, the aim is to reduce the fiscal deficit, excluding grants, by about 3 percentage points of GDP to free up resources for the private sector, help lessen aid dependency, and ensure that the external debt situation remains manageable.

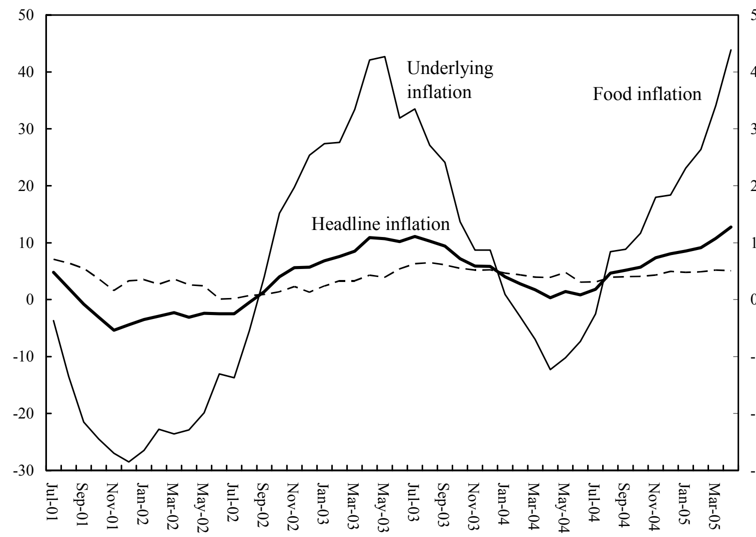
- **The outlook for 2005/06 remains favorable.** Real GDP growth is expected to increase to about 6½ percent, reflecting a rebound in agricultural output and an expansion in power generation. Fiscal policy will aim to reduce the budget deficit, excluding grants, to nearly 9 percent of GDP, while a decline in nonfood inflation to about 4 percent is envisaged. International reserves are targeted to remain at comfortable levels. The fiscal target will be achieved through the adoption of a comprehensive tax policy package, combined with steps to hold back recurrent expenditure.

- **The structural reform effort is continuing.** In the fiscal area, reforms will focus on improving efficiency at the Uganda Revenue Authority and strengthening expenditure monitoring and control mechanisms. The structural program also aims at fostering a more efficient and deeper financial system, completing the privatization program, and strengthening anti-corruption policies.

I. Recent Economic Developments and Performance Under the Program

1. **Uganda's macroeconomic performance has been good.** Despite the effects of a prolonged dry spell on agricultural output and power generation, real GDP growth is expected to remain at around 6 percent in 2004/05 (July-June). The economic expansion has been led by strong output increases in the construction and communication sectors and by continued growth in exports (Table 1 and Figure 1). Driven by a jump in food prices, headline inflation has accelerated to double-digit figures; nonfood inflation, on the other hand, has remained at about 5 percent. Despite higher commodity prices and export volumes, the external current account deficit, excluding grants, should remain relatively high in 2004/05, at close to 13 percent of GDP, largely because of an increase in fuel imports. International reserves, however, have continued to rise in response to an increase in donor inflows and reluctance by the Bank of Uganda (BOU) to sell foreign exchange, rather than treasury bills, for sterilization purposes. As a result, treasury bill rates have risen moderately, although volatility in rates, which had hitherto been a problem, has been dampened through better liquidity management. The real exchange rate has remained relatively stable over the past year.

Uganda: Inflation Rates, July 2001-April 2005
(12-month percentage change)



Source: Ugandan authorities.

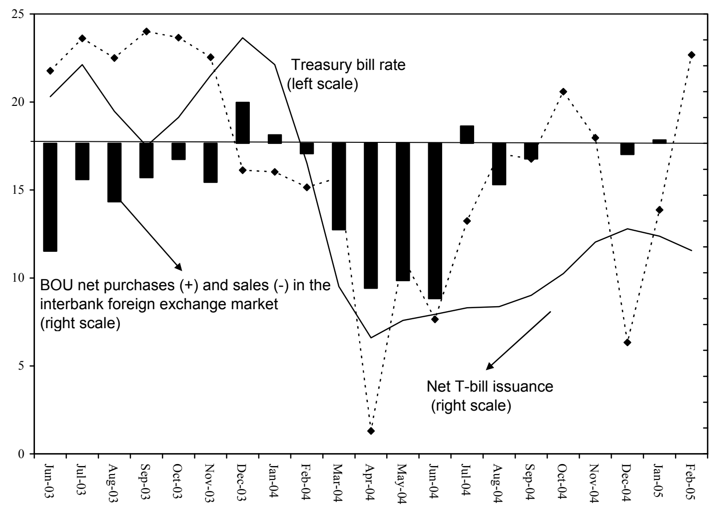
2. **The stabilization effort has been underpinned by fiscal restraint.** The overall deficit, excluding grants, is expected to decline from 11.1 percent of GDP in 2003/04 to 9.7 percent of GDP in 2004/05, which is well within the program target (Table 2). Revenue collections have been slightly higher than projected, reflecting strong performance in income tax and value-added tax (VAT) collections. Overall expenditure has remained in line with program projections. Higher outlays to finance wage increases in the education and health sectors, as well as increased operational needs by the public administration (the indicative target on administration outlays for end-March was exceeded), have been offset by spending cuts in nonpriority areas. Core social outlays, which are ring-fenced under the Poverty Action Fund (PAF), were below their indicative floor through March; this shortfall reflected delayed releases of PAF resources to the districts that are now being expedited, and the target for the fiscal year as a whole is expected to be met.

3. **Certain aspects of public expenditure management, however, have remained disappointing.** Arrears continued to accumulate during the first half of the fiscal year on

nonwage, nonpension expenditures under the Commitment Control System (CCS). While the verification of arrears for June 2004 was completed as programmed, the intra-year verification process scheduled for end-December has encountered significant capacity constraints. Implementation of the Integrated Financial Management System (IFMIS) has also faced implementation problems in the pilot ministries and districts, and the accumulation and size of the stock of domestic pension arrears remains a concern.[1]

4. **The monetary program has remained on track** (Table 3). To avoid imposing undue pressure on the exchange rate, the BOU cut back on its foreign exchange sales until March 2005, thereby placing the burden of fiscal sterilization operations largely on open market operations. This added some upward pressure to interest rates, despite the reduction in the budget deficit. The pursuit of monetary restraint has been aided by the phased transfer of some donor project accounts from commercial banks to the BOU.

Uganda: Interest Rates, Treasury Bill Issuance and Foreign Exchange Sales, June 2003-February 2005
(Annualized yield, USh billions, and US$ millions)



Source: Bank of Uganda.

5. **Performance relative to the program performance criteria and benchmarks has generally been satisfactory.** All quantitative performance criteria for December 2004, with the exception of the accumulation of domestic arrears under the CCS, were satisfied. Based on preliminary information, all quantitative benchmarks for March 2005, except for the target on domestic arrears, were also observed (Table 1 in Appendix I, Attachment I). Reasonable progress has been made in implementing the structural reform program. The restructuring of the Uganda Revenue Authority (URA) has proceeded particularly well. The structural performance criterion on amending the regulations for the Public Finance and Accountability Act was satisfied, and two of four benchmarks through March 2005 were met. The benchmark relating to the sale of minority shares of the Uganda Development Bank (UDB) was not observed for reasons indicated below.

[1] The outstanding stock of pensions and gratuity arrears is estimated at USh 313 billion (2.1 percent of GDP) as of end-June 2004. These arrears represent about 60 percent of the total stock of arrears of the central government.

II. Policy Framework

A. Overview

6. **The primary focus of Uganda's economic reform program is to sustain broad-based growth and to make further inroads into poverty reduction.**[2] The government recognizes that continued financial support from the donor community is critical in this effort, but it also realizes that success ultimately depends on the establishment of a sound and predictable financial environment in which private sector activity can flourish. Success further depends on continued diversification of the export base and integration of the economy into the global marketplace. Meeting these objectives will require a multi dimensional policy response. Continued fiscal restraint will be needed to lower real interest rates and maintain a competitive exchange rate, while monetary restraint will help provide price stability. The stabilization effort must be reinforced by reforms that lower the cost of doing business in Uganda, render the regulatory framework more business-friendly, and improve economic governance. In time, fiscal consolidation through enhanced revenue mobilization will help lessen aid dependency and ensure that the external debt situation remains manageable. Public expenditure management reforms will seek to secure better value for money in spending and help achieve further progress in meeting the MDGs (Table 7).

7. **Over the medium term, annual real GDP growth is expected to remain at about 6 percent on average, while inflation will be kept below 5 percent**. On the basis of current aid projections and expenditure priorities, the fiscal deficit, excluding grants, is projected to decline by about 3 percentage points of GDP over the next three years. This improvement will be underpinned by an increase in the revenue effort of 0.5 percent of GDP a year. The strengthened fiscal position should be mirrored in a gradual narrowing of the external current account over the medium term (Table 5). Official international reserves will be maintained at comfortable levels above 6½ months of imports of goods and services.

8. **The government will continue to exercise prudent management of its external debt.** In particular, it will seek to replace loans with grants to ease the external debt burden. The ratio of debt (NPV basis) to exports is projected to remain high for a number of years, although it will decline slightly to 185 percent by end-2008 (Appendix V). This ratio is above the HIPC Initiative threshold of 150 percent, but below the threshold of 200 percent for strong policy performers established under the new guidelines for the debt-sustainability framework. Uganda has made additional attempts to finalize remaining HIPC debt-relief agreements with the creditors involved, but has made little substantive progress (Table 8).

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[2] These goals are set out in the revised Poverty Eradication Action Plan (PEAP), which constitutes Uganda's PRSP and was publicly launched in May 2005. A Joint Staff Advisory Note (JSAN) is being circulated in parallel with this report.

B. Macroeconomic Outlook and Policies for 2005/06

9. **The program for 2005/06 has been formulated on the expectation that GDP growth will increase to about 6½ percent.** This reflects a rebound in agricultural output and an expansion in power generation. Fiscal policy will aim to reduce the budget deficit, excluding grants, by nearly 1 percent of GDP relative to the target for 2004/05, while the central bank will target a decline in underlying inflation to about 4 percent. The external current account deficit, excluding grants, is projected to remain at about 13 percent of GDP, which is consistent with a viable medium-term debt position.

Fiscal policies and reform

10. **The agreed budget framework for 2005/06 targets a fiscal deficit, excluding grants, of 9.2 percent of GDP.** This deficit is somewhat higher than envisaged at the time of the fourth review because of increased aid inflows. The target will be achieved through the adoption of a comprehensive tax policy package, combined with steps to hold back recurrent expenditure. Tax revenues are projected to increase by 0.5 percentage points of GDP to 13.1 percent of GDP. Additional revenues from the scheduled phasing out of income tax holidays to enterprises and new tax measures amounting to 0.6 percent of GDP will more than offset revenue losses from the East African Community (EAC) customs union.[3] The budget includes one-time expenditures related to parliamentary elections amounting to 0.3 percent of GDP.

11. **The main components of the tax package are:**

- an increase in the VAT rate from 17 to 18 percent;
- an increase in excises on imports of petrol and diesel of about USh 50-70 per liter;
- an increase in the excise tax on cellular phone airtime from 10 to 12 percent;
- an increase of 15 percent in a range of fees and licenses; and
- the introduction of a new specific excise duty on imported and locally produced sugar

A poverty and social impact analysis (PSIA) conducted by the Fiscal Affairs Department (FAD) indicates that the poverty incidence of the main tax measures should be moderate (Box 1).

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[3] EAC revenue losses are projected to about 0.3 percent of GDP in 2005/06. These losses are explained by a shortfall in customs revenue on trade with the EAC, the elimination of excises and fees currently charged on imports regardless of origin, and changes in import valuation procedures. On the other hand, there will be gains from the increase in the Uganda's Common External Tariff (CET) from 20 to 25 percent, although these latter gains will likely diminish as transitory tariffs on Kenyan imports are phased out within the next five years.

Box 1. Social Impact of Indirect Tax Changes

FAD undertook a poverty and social impact assessment (PSIA) of two options for increasing VAT revenue: (1) raising the rate from 17 to 18 percent; and (2) broadening the coverage of the VAT by eliminating the exemptions for petroleum products. As background, it is worth noting that the VAT regime includes a number of goods and services that are either exempt or zero-rated. In addition, establishments with annual revenue of less than USh 50 million are also exempt.

Summary of findings

The mission used the national household survey in conjunction with an input-output model of the economy to (1) evaluate the incidence of the current indirect tax scheme; and (2) evaluate some policy options designed to increase revenue. Among its main findings were the following:

- The base on which indirect taxes are collected is quite narrow. Roughly two-thirds are collected on imported goods. The remainder of the VAT is collected in a few key sectors, and the remaining excise taxes are collected on a few key domestic products that are produced by only 10–12 firms.

- The estimated incidence of the current indirect taxes is roughly proportional to total spending, although slightly higher for the highest quintile of the welfare distribution. The VAT by itself is mildly regressive, and excises taxes are mildly progressive.

- In addition to increasing the basic VAT rate and broadening its base, the mission also analyzed an increase in petroleum product excises as a possible alternative to applying the VAT to these goods. The latter option was included to reflect the fact that the current VAT is, to a large extent, a border tax and that an increase in the excise tax would be much easier to administer.

- The three options had very different estimated effects:

    - The increase in the VAT rate is mildly regressive and results in a relatively small increase in the tax burden for households at all levels of welfare and in both rural and urban areas. Substantial revenue gains would require more than a one percentage point increase in the VAT.

    - The VAT on petroleum products yielded unexpectedly little revenue because the structure of the input-output matrix implies that the petroleum sector will be able to claim substantial VAT credits once it loses its exemption (exempt producers cannot claim credits for VAT paid on inputs since they are not required to collect the VAT on their output).

    - Finally, a 10 percent increase in petroleum product excises yields more revenue than the other two options. As with excise taxes as a group, the incidence of increased excises on petroleum products is mildly progressive.

- Increases in VAT or excise tax rates are a complement to, rather than a substitute for, improved tax administration. It is quite likely that efforts to improve tax administration could provide a significant increase in revenue.

- Uganda has no social safety net that would automatically—or with minimal adjustment—compensate the poor for increases in indirect taxes. Because the additional burden of the changes to the VAT and excises is quite small, it would not be efficient to design and implement special measures. Rather, the focus should be on developing a safety net that would alleviate poverty in a more comprehensive fashion, regardless of the cause

12. **Increases in donor-financed development outlays will be matched by savings elsewhere.** In particular, following a marked increase in 2004/05, salaries will be raised only moderately, and new hiring limited to priority personnel in the education and health sectors. Greater emphasis on foreign exchange, rather than treasury bill, sales by the BOU will also help contain the interest bill.[4] Priority is to be given to programs promoting agricultural productivity growth and to new infrastructure investments (especially in the power sector).

13. **Structural fiscal reforms focus on continuing to improve efficiency at the Uganda Revenue Agency (URA).** The implementation of these reforms is already well advanced. The government has approved the new functional organization for the URA, in line with Fund recommendations, and the Commissioner General has been appointed. Staff positions are being rationalized and filled transparently, and a code of conduct has been disseminated. Additional reforms include an amendment of the URA Act, further strengthening of the large tax payer office, and expansion of the IT strategy (Memorandum of Economic and Financial Policies (MEFP), paragraph 14). FAD is continuing to provide technical assistance on a regular basis to help implement the reforms.

14. **The government is aware of the recurrent problems that have plagued the system for monitoring and controlling domestic arrears, and it is determined to address them expeditiously.** To this end, it will implement measures to improve the functioning of the CCS and IFMIS, as recommended by the recent FAD technical assistance report (MEFP, paragraph 12). To tackle the problem of pension arrears, the authorities have established a strategy within the MTEF to halve the outstanding stock by 2007/08, with a view of clearing arrears in full by the end of the decade. Avoiding a further accumulation of pension arrears will be helped by the future implementation of a contributory public pension scheme and enhanced pension budgeting and monitoring of the pension-roll. The problem of nonpension arrears is, however, likely to persist in the absence of a strong commitment at the highest political levels to make the expenditure control system work. In this connection, the president and the prime minister emphasized to the mission that existing regulations prohibiting accounting officers from exceeding budget ceilings would be strictly enforced.

15. **To create additional space in the budget for critical infrastructure and other growth-promoting programs, the authorities are moving ahead with public sector reform.** The government is developing a common public sector pay scale and will also prepare, by September 2005, a policy paper on how to control the size of the public administration and ensure greater cost efficiency, including in nonwage recurrent expenditures (MEFP, paragraph 13); pay policy and related actions are now covered under a World Bank Poverty Reduction Support Credit (PRSC). On fiscal decentralization, the authorities will, with assistance from the Fund, continue to strengthen local government administration (MEFP, paragraph 16).

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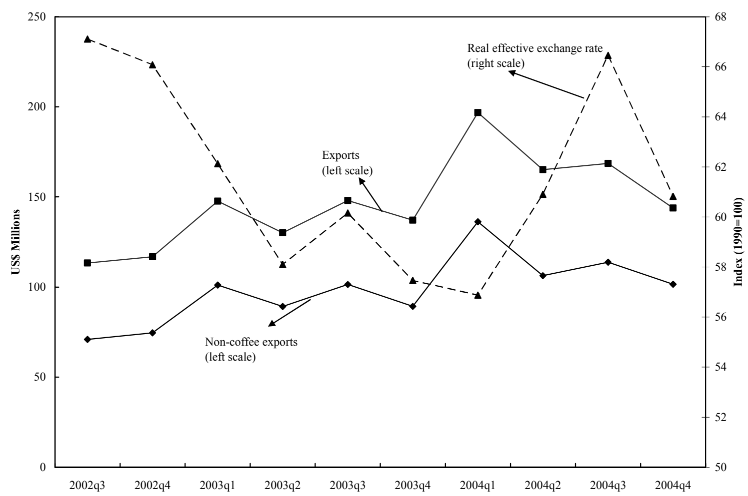
[4] Interest payments will, nonetheless, rise in 2005/06 as a result of expanded open market operations undertaken during the course of 2004/05.

16. **The government will continue to protect social spending.** Core poverty reducing outlays ring-fenced by the PAF will remain broadly constant at about 5.4 percent of GDP over the medium term (thus increasing slightly as a share of total expenditures). Broader measures of social expenditure are also expected to be stable over the next three years, at about 11 percent of GDP.

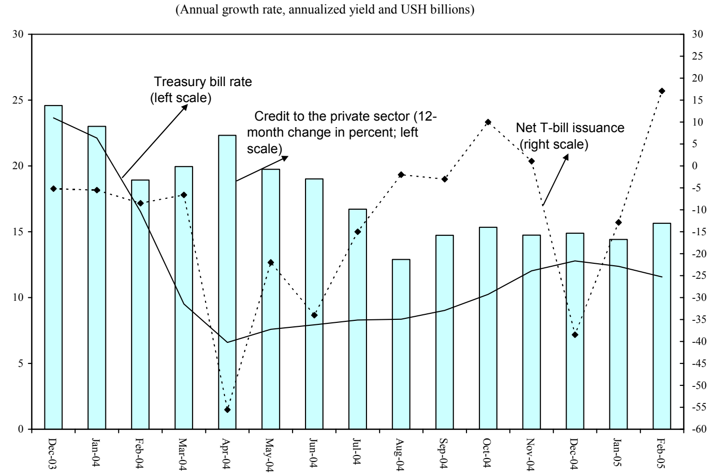
Monetary and financial sector policies

17. **The monetary program will continue to target base money, which is programmed to expand by 13 percent in 2005/06.** This approach, in conjunction with pursuit of a flexible exchange rate policy, has proven effective in sterilizing the liquidity impact of donor-financed government project spending and in keeping inflation comfortably under control. The program does not call for a tightening of monetary policy in response to the recent rise in inflation, since it was primarily driven by a weather-related surge in food prices. The central bank will continue to respond primarily to anticipated movements in underlying inflation. The BOU intends to resume sales of foreign exchange for sterilization purposes because export and real exchange rate developments suggest that the economy remains internationally competitive. In concert with fiscal restraint, reduced reliance on net treasury bill issuance will help ease pressure on interest rates and free up resources for the private sector. The program, therefore, envisages a pickup in private sector credit growth from 16 percent in 2004/05 to about 20 percent in 2005/06 and to nearly 24 percent in 2007/08.

Uganda: Export Performance and Real Effective Exchange Rate, Q3 2002-Q4 2004



Uganda: Private sector credit, treasury bill rates and treasury bill issuance , December 2003-February 2005
(Annual growth rate, annualized yield and USH billions)



Source: Bank of Uganda.

18. **Any significant step-up in foreign donor inflows is likely to add some upward pressure on the real exchange rate.** The authorities will monitor the situation closely to ensure that international competitiveness is not unduly affected. Recent export performance

(volumes have grown by an average of 9 percent over the past two years) suggests that Uganda's competitive position is at present not a cause for concern.

19. **The authorities have initiated a phased transfer of project accounts from commercial banks to the BOU.** This will help in the mopping up of domestic liquidity and also reduce the fiscal costs of open market operations. So far, the transfers have proceeded smoothly.

20. **The banking system remains healthy.** Prudential ratios of the banking sector have continued to evolve soundly (Table 4). In particular, the banks remain highly capitalized and nonperforming loans represent less than 3 percent of total exposure. The Financial Sector Assessment Program (FSAP) update indicates that the sector is robust to significant interest and exchange rate shocks, although banks may be vulnerable to credit risk arising from large exposures to individual borrowers.

21. **The authorities are implementing a number of the recommendations of the FSAP update and MFD technical assistance missions to help foster a more efficient and deeper financial system.**

- Regulations have been issued to establish a credit reference bureau, which is an important element for improving access to the financial system.
- Various steps are being taken to expand financial market development, such as introducing the use of forward market transactions.
- Regulations for the Financial Institutions Act (2004) have been issued and an Anti-Money Laundering Bill has been submitted to parliament.
- The National Social Security Fund (NSSF) is now subject to BOU supervision until such time as an independent pension regulator is set up. In addition, steps are being taken to increase the number of professional members on its Board.
- Preparations are under way to liberalize the private pension system and transform public service pensions from a defined benefit to a defined contributory system in 2006/07.

22. **The government has experienced a delay in selling a minority share in UDB.** This was necessary to allow additional time to build a deeper and broader consensus among the main stakeholders. The intention now is for the cabinet to approve by September 2005 an offer for the sale of a minority share and the installation of a private management team (MEFP, paragraph 18).

Trade policy

23. **Expanding and diversifying the export base is central to the government's strategy of achieving a sound external position over the medium term.** Implementation of the EAC customs union should help improve regional roads, railway, and communications infrastructure, which, in turn, will boost Ugandan exports. The government would like to see a reduction in the common external tariff schedule with its partner countries, while looking at

ways to coordinate EAC obligations with the Common Market for Eastern and Southern Africa (COMESA). The government is also considering a draft bill to establish export-processing zones (EPZs) that parallel those in the other EAC countries. In doing so, every effort will be made to ensure that the tax and regulatory frameworks governing the EPZs are consistent with international best practices and Uganda’s implementation capacity. To avoid revenue leakages, a proper ring-fencing of the zones will be required through strict enforcement of tariff and other tax regulations; it will also be important to avoid income tax holidays.

Other structural policies

24. **The privatization program, which the authorities see as a vehicle for efficiency gains, is almost complete.** Of the remaining public enterprises to be privatized, only a few are significant in size. A majority share in the National Insurance Corporation (NIC) is about to be sold, while preparations are being made to privatize the public water and sewerage enterprise. The government is finalizing a joint concession contract for the Uganda Railway Corporation and the Kenya Railway Corporation by September 2005. To increase power generation, the government is negotiating with a public-private partnership for construction of the hydropower project at the Bujagali Falls, and a thermal power plant is being commissioned.

25. **The government recognizes the need to combat corruption to increase confidence in public institutions.** It recently launched a national anti-corruption strategy that seeks to strengthen anti-corruption legislation and codes of conduct and to improve government procurement practices and financial control systems. Implementing reforms at the URA is a part of this strategy, as are actions that are being taken to increase the power and independence of the Inspector General of Government (MEFP, paragraph 20). The World Bank is taking the lead in this area in the context of the PRSC.

III. Extension of Arrangement, Program Monitoring, and Risks

26. **The PRGF arrangement is scheduled to expire on September 12, 2005.** To accommodate the final program review, the government is requesting that the arrangement be extended to December 31, 2005. This final review will assess Uganda’s performance with respect to quantitative performance criteria and indicative targets for June 2005 and structural performance criteria and benchmarks through September 2005 (MEFP, Tables 1 and 2). The attached Technical Memorandum of Understanding (Appendix I, Attachment II) provides details on how program implementation will be monitored.

27. **Uganda has established a prolonged record of satisfactory policy implementation, but there are, nonetheless, some downside risks to the future success of the program.** As further donor assistance is received, a greater onus will fall on the budget to manage these resources effectively and ensure that they are put to good use. Unless there is a substantive supply response to the increase in outlays on social services and economic infrastructure, Uganda will be faced with the adverse macroeconomic consequences of higher government spending, namely, an intensification of inflationary pressures, high real interest rates, and an uncompetitive exchange rate. It will also be particularly important that fiscal

prudence be maintained during the presidential and parliamentary elections scheduled for March 2006. Moreover, continued insecurity in northern Uganda and the Great Lakes region could undermine fiscal management and threaten the overall business climate and deter private investment. Insufficient progress in addressing corruption could impede private investment and interrupt donor support. Continued delays in increasing installed power capacity would further dampen Uganda's growth prospects.

IV. Ex Post Assessment of Uganda's Fund-Supported Programs

28. **An ex post assessment of Uganda's performance under Fund-supported programs was discussed on May 26, 2005 with the authorities.**[5] The authorities were in broad agreement with the thrust of the assessment. They expressed particular concern over the persistence of high interest rates and their impact on growth and agreed with a finding of the report that past programs could have focused more on boosting access to bank credit. The authorities also agreed with the importance of raising additional revenues, but emphasized the significant difficulties involved in this effort. On domestic arrears, they noted that the persistent problem of incurring arrears not only reflected weaknesses in the commitment control system, but also unexpected statutory spending claims (like court awards) that had led to spending reallocations. Regarding future relations with the Fund, the authorities took note of the possibility of a nonborrowing arrangement, but indicated that further internal consideration of the matter would be required.

V. Staff Appraisal

29. **Uganda's performance under the program has improved and all key macroeconomic targets were met**. Growth has been sustained at relatively high levels, despite the impact of a prolonged dry spell, and underlying inflation has been kept under control. Following the slippages reported at the time of the last review, fiscal policy has now been brought back on track, although regrettably domestic arrears have continued to accumulate and priority spending has been running somewhat under target. The implementation of structural reforms has been reasonably good, although there have been delays in the sale of minority shares in UDB and in streamlining the public administration.

30. **The main challenge for Uganda is to maintain high growth rates and make further inroads in alleviating poverty.** This will require persevering with the stabilization effort and working to improve the investment environment by lowering the cost of doing business and squarely addressing governance issues. Uganda must also effectively manage relatively large inflows of foreign aid, which are presently equivalent to over 10 percent of GDP. To avoid crowding out private investment and export activities, the government should continue with the process of budget deficit reduction by stepping up the domestic revenue effort and cutting fat in the recurrent budget. So that budget spending generates a sufficient supply response, the government should also ensure that aid is allocated to the most economically and socially productive purposes.

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[5] www.imf.org

31. **The fiscal program for 2005/06 is consistent with these objectives.** It envisages a reduction in the deficit of about 1 percent of GDP relative to the program target in 2004/05, largely in response to the adoption of a package of tax measures. This reduction is a little less than previously envisaged, but provides a smoother adjustment profile and remains consistent with the overall macroeconomic objectives and debt sustainability. The revenue effort is to be supported by further reforms in the URA. The staff commends the government for taking these important revenue-raising initiatives during the run-up to national elections. The call on additional expenditure remains high, particularly for additional infrastructure investments to eliminate supply bottlenecks; to create space for these investments, the growth in recurrent spending, especially on public administration, will need to be capped. Fiscal policy will also focus on enhancing expenditure management, particularly through stronger enforcement of regulations controlling domestic arrears.

32. **The BOU will, quite appropriately, continue to pursue base-money targeting, in conjunction with a flexible exchange rate regime.** This approach has served the country well, ensuring that the domestic liquidity impact of aid inflows is sterilized, that inflation is kept under control, and that reserves are maintained at comfortable levels. The authorities are encouraged to resume foreign exchange sales for sterilization purposes, since continued reliance on open market operations will keep interest rates unduly high and crowd out private sector investment. The impact of these sales on the real exchange rate will need to be closely monitored.

33. **The healthy state of Uganda's banking system has contributed to overall financial stability.** The banks are highly capitalized and their nonperforming loan portfolios are very small by developing country standards. The authorities are taking further steps to improve the functioning of the banking system and deepen access to credit, such as the introduction of a credit reference bureau. The delay in addressing problems at the UDB was unavoidable because of the need to forge sufficient support for its divestiture. Now that a consensus for action has been established, the staff would urge the authorities to move quickly in selling a minority share in the bank and installing a private management team.

34. **The EAC customs union is a useful vehicle for promoting intra regional trade.** The staff would, nonetheless, stress the importance of reducing the common external tariff over time as a means of fostering greater international competitiveness and minimizing potential problems with trade diversion. Uganda should also work with its EAC neighbors to harmonize tax regimes and ensure that its EPZs meet best practices. In particular, to avoid weakening the revenue collections, the EPZs should be ring-fenced by strictly implementing tariff and tax law regulations and by avoiding income tax holidays.

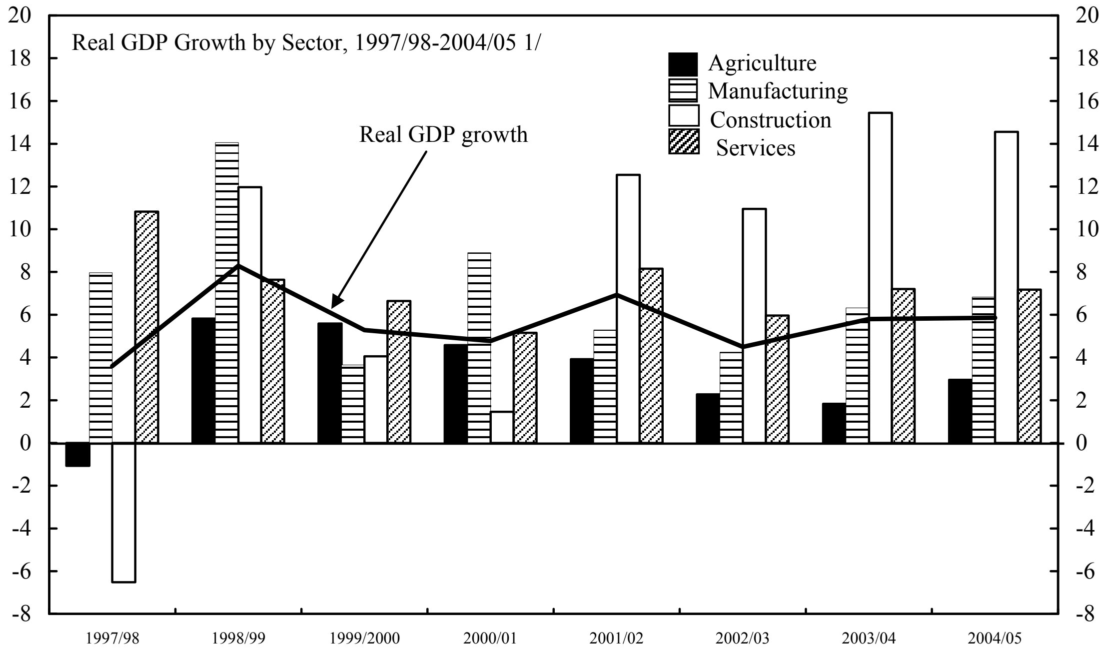
35. **The incidence of corruption remains a serious constraint on business development.** Overall, progress in addressing governance issues has been slow, despite marked progress in a few areas, most notably reform of the URA. The government recently launched an anti-corruption strategy that includes plans to strengthen the powers of the Inspector General of Government. This is an important step in the right direction that the government should implement with vigor, but much remains to be done.

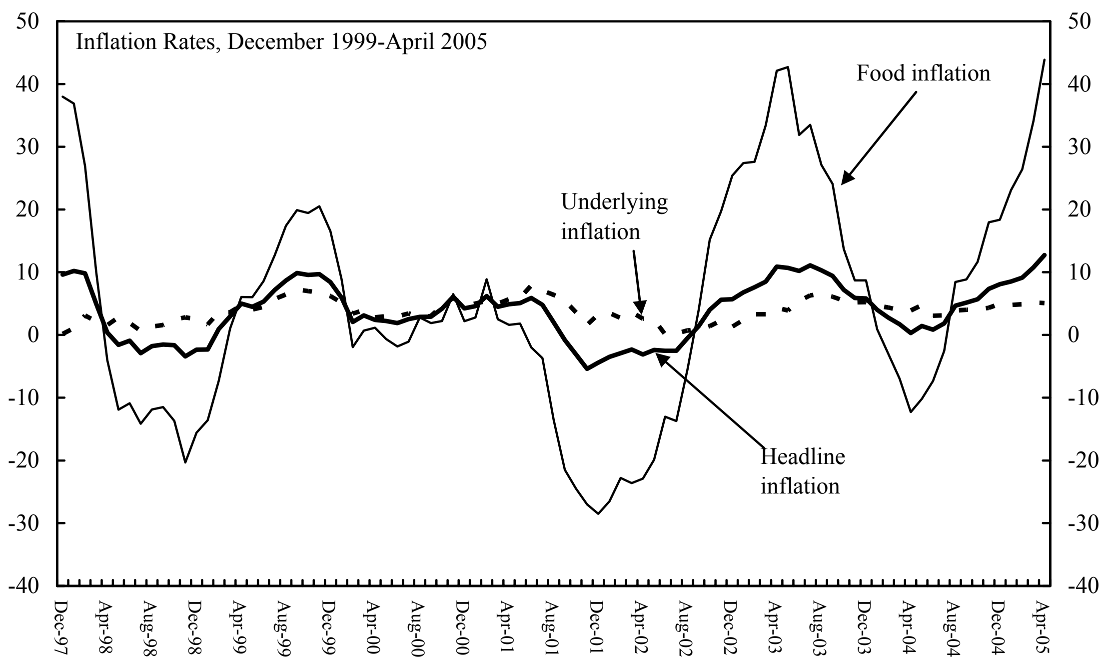
36. **Uganda's external debt stock is close to the upper bound of what can reasonably be considered manageable.** The debt dynamics are, moreover, highly vulnerable to external shocks, such as a decline in coffee prices. The situation underscores the importance of pressing ahead with the growth and export diversity strategy and with efforts to mobilize aid in the form of grants rather than loans.

37. **The government is requesting a waiver for its nonobservance of the performance criterion relating to the accumulation of domestic arrears.** The staff supports this request in view of the improvement in overall program performance and of the government's indication that it will make every effort to pay down the arrears by end-June 2005. It also supports the request for an extension of the arrangement in order to accommodate completion of the sixth and final program review.

38. The staff welcomes the intention of the authorities to make public the staff report, the letter of intent, and the MEFP.

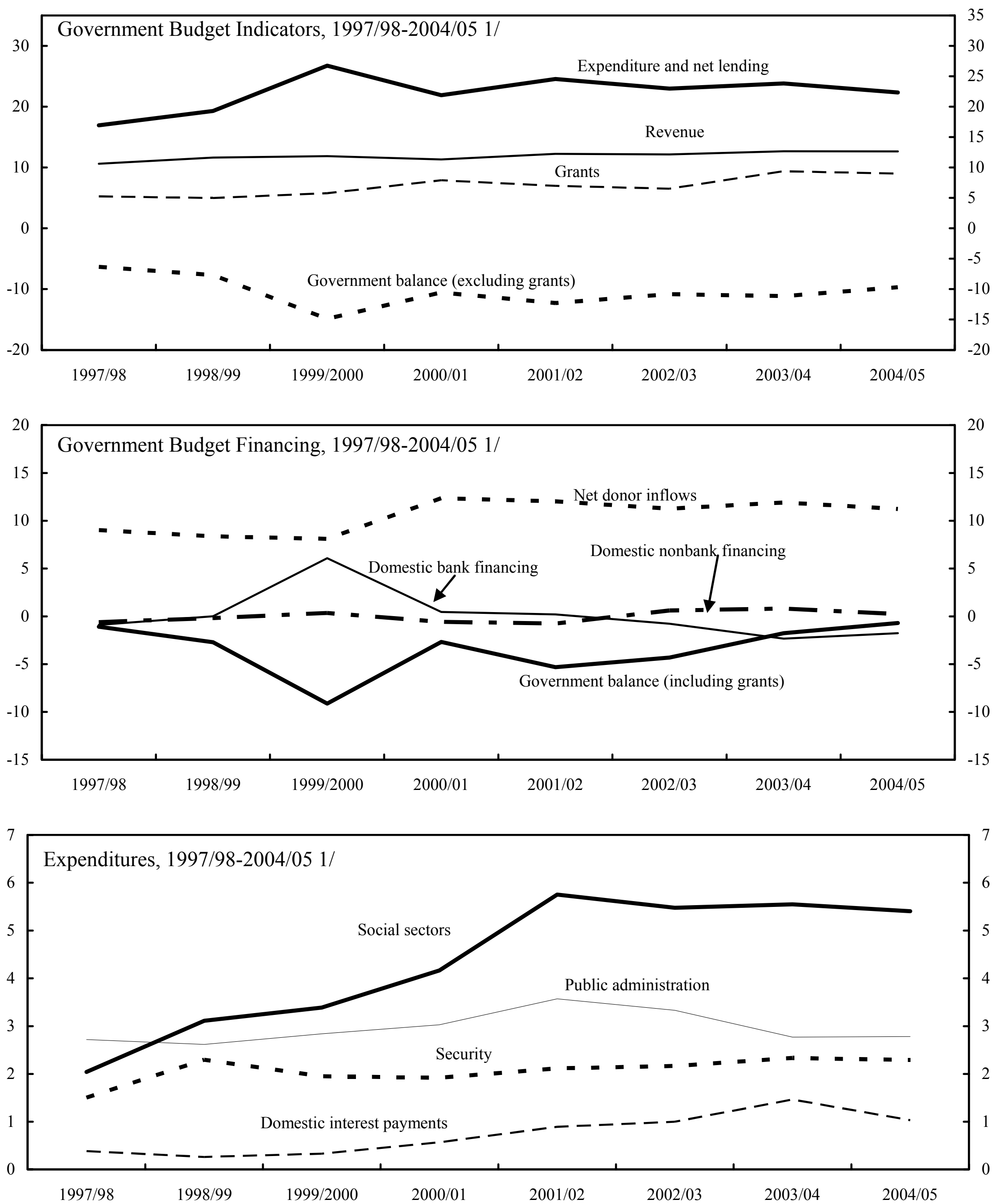
Figure 1. Uganda: Real Sector Indicators 1/
(Annual percentage changes)





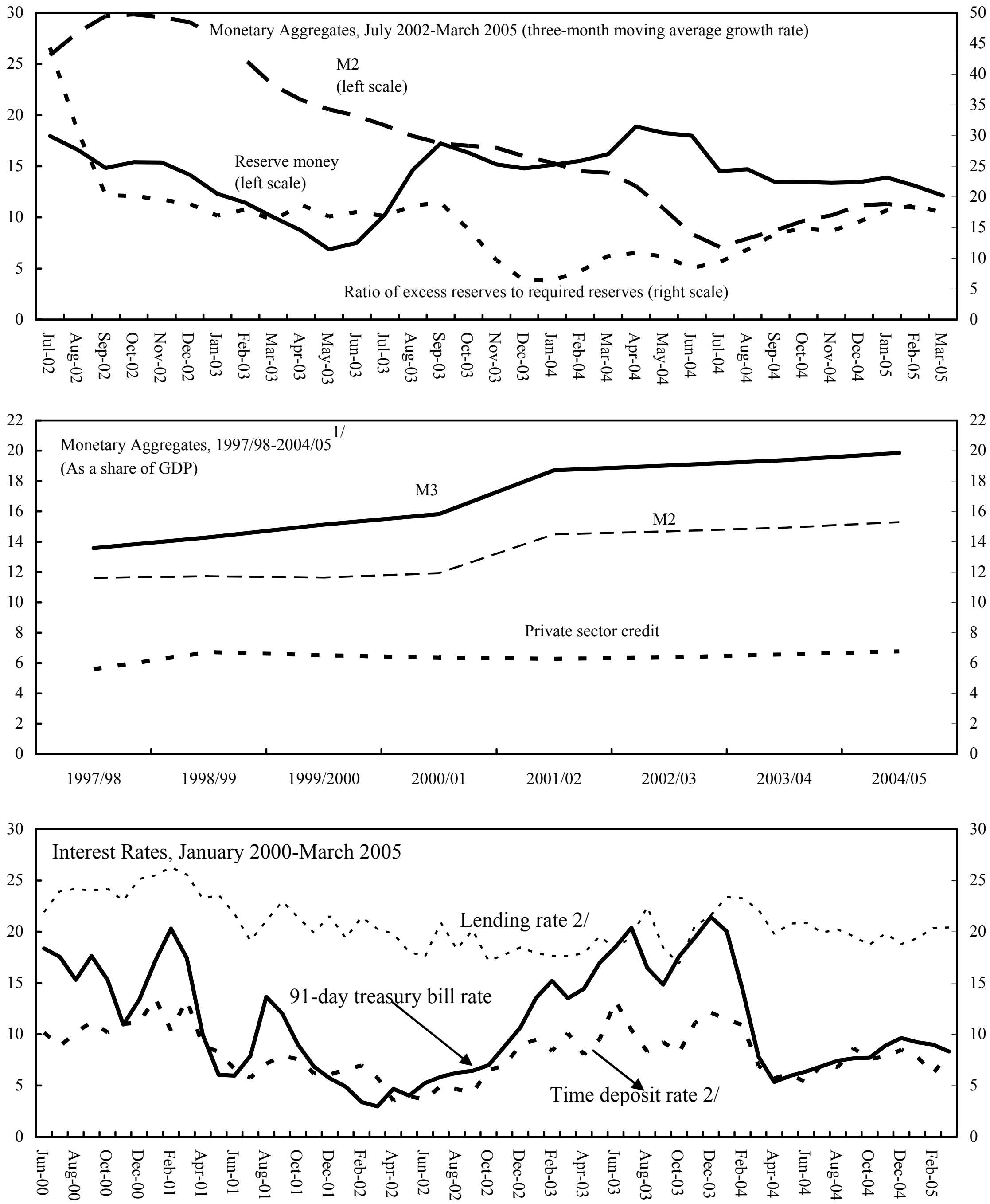
Sources: Ugandan authorities; and IMF staff estimates.
1/ Fiscal year begins in July .

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



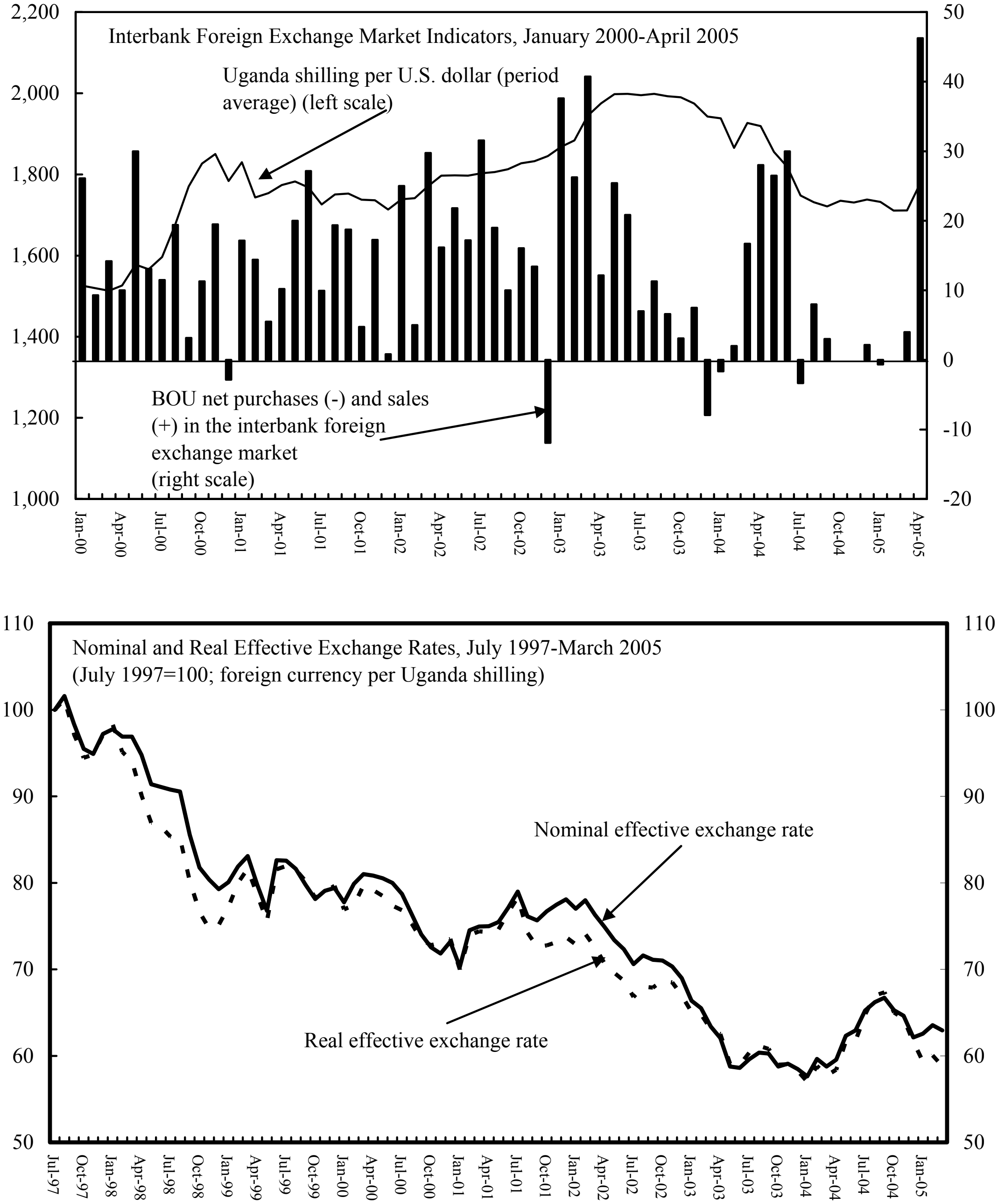
Sources: Ugandan authorities; and IMF staff estimates.
1/ Fiscal year begins in July.

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



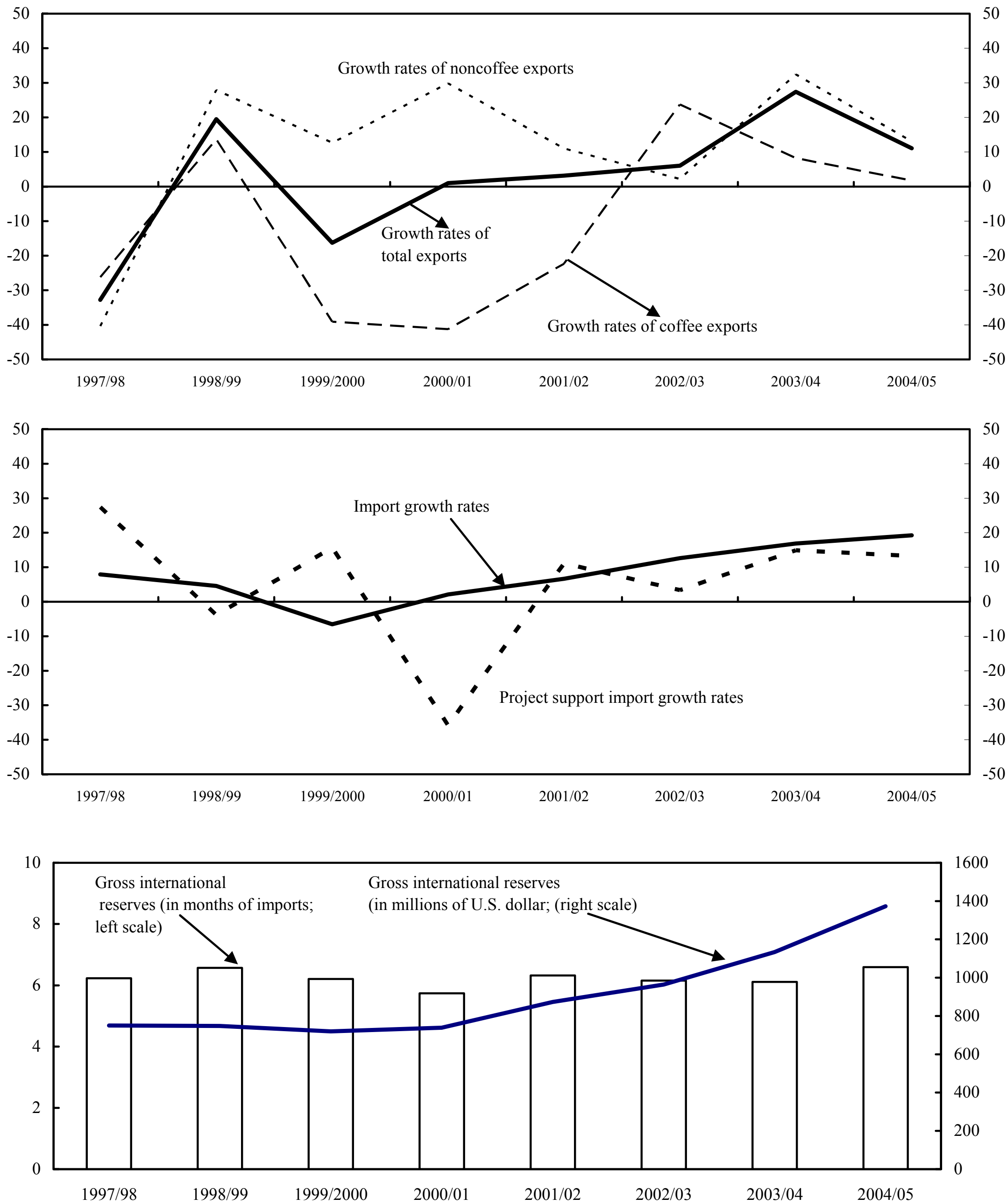
Source: Uganda authorities; and IMF staff estimates.
1/ Fiscal year begins in July.
2/ Weighted averages of assets and liabilities denominated in Uganda shillings.

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



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

Figure 5. Uganda: External Sector Indicators, 1997/98-2004/05 1/
(Annual growth rates in percent, unless otherwise indicated)



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

Table 1. Uganda: Selected Economic and Financial Indicators, 2002/03–2007/2008 1/

	2002/03	2003/04 Est.	2004/05 CR 05/183	2004/05 Proj.	2005/06 CR 05/183	2005/06 Proj.	2006/07 Proj.	2007/08 Proj.
	(Annual percentage change, unless otherwise indicated)							
National income and prices								
GDP at constant prices	4.5	5.8	5.4	5.9	6.2	6.6	5.6	5.6
GDP deflator	10.0	5.5	4.8	9.4	3.8	4.7	4.4	4.3
GDP at market prices								
(in billions of Uganda shillings)	11,798	13,168	14,610	15,149	16,107	16,981	18,737	20,646
Consumer prices								
Headline (end of period)	10.2	0.9	6.2	12.4	3.5	0.6	4.0	4.0
Underlying (end of period)	5.4	3.1	4.3	5.9	4.0	3.1	4.0	4.0
Headline (average)	5.7	5.0	5.9	8.2	3.5	4.5	4.0	4.0
Underlying (average)	2.4	5.0	4.1	4.5	4.0	4.2	4.0	4.0
External sector								
Exports (volume)	-6.2	8.2	7.6	9.8	7.9	5.4	6.0	6.9
Imports (volume)	7.9	9.0	8.5	13.9	9.0	12.3	7.7	6.8
Terms of trade (deterioration -)	9.2	8.0	-4.8	-3.7	1.7	3.4	2.2	1.9
Average exchange rate								
(Uganda shillings per U.S. dollar)	1,883	1,935	...	...	...	...	...	...
Effective exchange rate (average)								
Nominal (depreciation -)	-12.7	-10.1	…	…	…	…	…	…
Real (depreciation -)	-10.6	-8.5	…	…	…	…	…	…
	(Annual changes in percent of beginning-of-period stock of money, unless otherwise indicated)							
Money and credit								
Net foreign assets	28.5	11.3	10.0	19.3	14.3	14.3	9.5	13.9
Net domestic assets	-5.2	-2.3	4.8	-4.2	0.9	0.6	5.2	0.6
Domestic credit	4.9	-5.8	4.6	-3.7	3.4	2.7	5.1	0.7
Central government	-4.8	-12.9	-1.3	-10.3	-4.0	-4.9	-4.3	-10.1
Private sector	9.7	6.8	6.1	6.8	7.5	7.7	9.4	10.8
Money and quasi money (M3)	23.3	9.0	14.8	15.0	15.2	14.9	14.8	14.6
M2	17.3	10.0	14.8	15.0	15.5	15.2	14.8	14.6
Velocity (GDP/M2) 2/	7.3	7.2	7.0	7.3	6.7	7.1	6.8	6.6
Interest rate (in percent) 3/	9.6	14.1	...	...	...	...	...	...
	(In percent of GDP at market prices)							
National income accounts								
Gross domestic investment	20.5	22.9	23.3	23.8	24.1	24.5	24.6	25.2
Public	4.7	5.0	5.4	5.2	4.9	5.4	5.0	5.1
Private	15.8	17.9	17.9	18.6	19.2	19.1	19.6	20.1
Gross domestic savings (excluding grants)	6.5	11.0	11.1	11.1	12.9	11.8	13.2	14.1
Public	-6.1	-6.1	-4.6	-4.6	-3.6	-3.9	-3.0	-1.9
Private	12.7	17.1	15.7	15.7	16.5	15.7	16.1	16.0
Gross national savings (including grants)	14.2	21.2	19.2	20.6	18.7	19.0	19.4	20.5
External sector								
Current account balance								
(including official grants)	-6.3	-1.7	-4.1	-3.2	-5.4	-5.5	-5.2	-4.7
(excluding official grants)	-14.0	-12.0	-12.2	-12.7	-11.2	-12.8	-11.6	-11.2
External debt (including Fund)	62.9	60.3	51.6	49.6	52.1	49.5	48.5	47.4
Government budget								
Revenue 4/	12.2	12.7	12.8	12.6	12.9	13.1	13.6	14.1
Grants	6.5	9.4	8.0	9.0	5.8	6.9	6.1	6.3
Total expenditure and net lending	23.0	23.8	22.8	22.3	21.4	22.4	21.5	21.0
Government balance (excluding grants)	-10.8	-11.1	-10.0	-9.7	-8.5	-9.2	-7.9	-6.9
Government balance (including grants)	-4.3	-1.8	-2.0	-0.7	-2.7	-2.3	-1.7	-0.6
Domestic balance	-5.2	-5.2	-4.0	-3.6	-3.0	-2.9	-2.6	-2.0
Net foreign financing	4.3	2.3	1.9	2.2	3.2	3.0	2.4	2.3
Domestic bank financing	-0.8	-2.3	-0.2	-1.8	-0.7	-0.9	-0.8	-1.9
Domestic nonbank financing	0.6	0.8	0.3	0.2	0.2	0.2	0.2	0.1
Net donor inflows	11.3	11.9	9.6	11.2	8.7	10.0	8.5	8.5
Debt indicators	(In percent of exports of goods and nonfactor services, unless otherwise indicated)							
Net present value of external debt 5/	247.1	204.1	224.5	185.7	216.6	186.1	186.3	185.1
External debt-service ratio 6/								
Including Fund obligations	8.0	10.0	9.8	10.0	10.3	10.7	10.1	7.5
Excluding Fund obligations	2.4	4.4	4.7	4.9	6.0	6.4	6.8	5.4
Stock of domestic debt (in percent of GDP)	9.0	9.6	9.7	10.2	9.2	9.3	7.9	6.4
Interest on domestic debt (in precent of GDP)	1.0	1.5	1.3	1.0	1.3	1.4	1.4	1.2
	(In millions of U.S. dollars, unless otherwise indicated)							
Overall balance of payments	112	214	80	285	128	169	107	182
External payments arrears (end of period)	0	0	0	0	0	0	0	0
Gross foreign exchange reserves	964	1,135	1,167	1,373	1,243	1,491	1,540	1,698
(In months of imports of goods and nonfactor servic	6.2	6.1	6.2	6.6	6.2	6.8	6.6	6.9

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

1/ Fiscal year begins in July.

2/ Nominal GDP divided by average of current-year and previous-year end-period money stocks.

3/ Weighted annual average rate on 91-day treasury bills.

4/ The revenue projections are based on a revenue target as a share of GDP, and accordingly, include unidentified revenue measures in 2006/07 and 2007/08.

5/ NPV ratios from 2002/03 are based on CIRRs (discount rate) and exchange rates at June 2003. In relation to the current year of exports of goods and services.

6/ The debt-service ratios reflect actual debt service paid, that is, after debt relief including that attributable to the HIPC Initiative, deferment of payments to non-Paris Club creditors with whom bilateral agreements have not yet been reached, and the settlement of arrears.

Table 2a. Uganda: Fiscal Operations of the Central Government, 2003/04–2007/08 1/

	2003/04	2004/05		2005/06		2006/07	2007/08
		CR 05/183	Proj.	CR 05/183	Prog.	Proj.	
	(In billions of Uganda shillings)						
Total revenue and grants	2,903.6	3,039.1	3,277.3	3,011.7	3,406.6	3,701.6	4,223.5
Revenue 2/ 3/	1,669.2	1,864.6	1,915.5	2,085.4	2,230.6	2,556.6	2,920.2
Tax	1,550.5	1,739.6	1,800.6	1,969.7	2,113.6	2,429.2	2,783.7
International trade taxes	135.3	146.1	151.6	168.4	183.6	184.4	185.0
Income taxes	436.9	539.3	564.3	615.4	698.0	803.7	923.1
Excises	447.2	518.8	497.8	567.8	560.0	584.1	629.9
Value-added tax	531.0	535.4	586.9	585.7	671.9	737.6	807.3
Additional revenue effort	0.0	0.0	0.0	32.5	0.0	119.4	238.3
Nontax	118.7	125.0	114.9	115.7	117.0	127.4	136.5
Grants	1,234.4	1,174.4	1,361.8	926.3	1,176.0	1,145.0	1,303.3
Budget support	801.5	747.8	864.0	542.7	611.4	637.6	785.0
Project grants	432.9	426.7	497.8	383.6	564.7	507.4	518.3
Expenditures and net lending	3,135.6	3,325.1	3,383.5	3,448.7	3,799.2	4,027.7	4,338.8
Current expenditures	1,865.3	1,968.0	1,922.0	1,998.2	2,148.4	2,272.0	2,357.9
Wages and salaries	683.0	771.6	773.2	778.5	835.2	878.4	933.4
Interest payments	261.8	253.2	217.9	271.4	293.2	331.1	315.3
Domestic	192.8	193.5	156.1	208.2	231.8	262.6	243.2
External interest	69.0	59.7	61.9	63.2	61.4	68.5	72.0
Transfers to the Uganda Revenue Authority	59.2	57.7	59.7	58.5	68.0	66.1	69.2
Other current	861.3	850.5	871.2	889.8	952.0	996.3	1,040.1
Additional spending 4/	0.0	35.0	0.0	0.0	0.0	0.0	0.0
Development expenditures	1,155.3	1,322.7	1,342.1	1,320.6	1,557.2	1,523.4	1,691.9
Donor-supported projects	716.1	821.7	861.3	816.2	1,016.2	909.8	929.3
Domestic	439.2	501.1	480.7	504.4	541.0	613.6	762.5
Net lending and investment	33.8	-43.6	-9.7	-28.0	-26.4	-25.4	-26.0
Other	81.2	155.0	119.7	157.9	120.0	257.8	315.0
Of which: domestic arrears repayment	46.7	91.6	55.0	85.0	85.0	120.0	200.0
Unidentified expenditure measures 6/	0.0	-76.9	0.0	0.0	0.0	0.0	0.0
Cash Balances							
Overall balance							
Including grants	-231.9	-286.0	-106.2	-437.0	-392.6	-326.1	-115.3
Excluding grants	-1,466.3	-1,460.5	-1,468.0	-1,363.3	-1,568.6	-1,471.1	-1,418.6
Primary balance							
Including grants	29.9	-32.8	111.8	-165.6	-99.4	5.0	200.0
Excluding grants	-1,204.5	-1,207.2	-1,250.0	-1,091.9	-1,275.4	-1,140.0	-1,103.3
Financing	99.8	286.2	106.2	437.0	393.6	326.1	115.3
External financing (net)	299.8	284.2	335.4	515.2	510.2	443.9	482.2
Disbursement	427.4	426.6	476.6	684.2	680.3	635.5	643.6
Budget support	57.0	31.6	38.9	239.1	228.8	233.2	232.6
Project loans	370.3	395.0	437.7	445.1	451.5	402.4	411.0
Amortization (-)	-143.4	-146.4	-143.5	-145.7	-157.1	-161.7	-171.5
Exceptional financing	15.8	4.0	2.3	-23.3	-13.0	-30.0	10.1
Domestic financing (net)	-200.0	2.0	-229.3	-78.2	-116.7	-117.8	-366.9
Bank financing	-307.0	-35.0	-266.3	-118.2	-146.7	-147.8	-396.9
Bank of Uganda	-279.6	-147.2	-483.0	-130.0	-162.7	-33.2	-224.7
Commercial banks	-27.4	112.2	216.7	11.9	16.0	-114.6	-172.3
Nonbank financing	107.0	37.0	37.0	40.0	30.0	30.0	30.0
Errors and omissions/financing gap	132.2	-0.2	0.0	0.0	0.0	0.0	0.0

Sources and footnotes: See Table 2b.

Table 2b. Uganda: Fiscal Operations of the Central Government, 2003/04–2007/08 1/

	2003/04	2004/05		2005/06		2006/07	2007/08
		CR 05/183	Proj.	CR 05/183	Prog.	Proj.	
	(In percent of GDP)						
Total revenue and grants	22.1	20.8	21.6	18.7	20.1	19.8	20.5
Revenue 2/ 3/	12.7	12.8	12.6	12.9	13.1	13.6	14.1
Tax	11.8	11.9	11.9	12.2	12.4	13.0	13.5
International trade taxes	1.0	1.0	1.0	1.0	1.1	1.0	0.9
Income taxes	3.3	3.7	3.7	3.8	4.1	4.3	4.5
Excises	3.4	3.6	3.3	3.5	3.3	3.1	3.1
Value-added tax	4.0	3.7	3.9	3.6	4.0	3.9	3.9
Additional revenue effort	0.0	0.0	0.0	0.2	0.0	0.6	1.2
Nontax	0.9	0.9	0.8	0.7	0.7	0.7	0.7
Grants	9.4	8.0	9.0	5.8	6.9	6.1	6.3
Budget support	6.1	5.1	5.7	3.4	3.6	3.4	3.8
Project grants	3.3	2.9	3.3	2.4	3.3	2.7	2.5
Expenditures and net lending	23.8	22.8	22.3	21.4	22.4	21.5	21.0
Current expenditures	14.2	13.5	12.7	12.4	12.7	12.1	11.4
Wages and salaries	5.2	5.3	5.1	4.8	4.9	4.7	4.5
Interest payments	2.0	1.7	1.4	1.7	1.7	1.8	1.5
Domestic	1.5	1.3	1.0	1.3	1.4	1.4	1.2
External Interest	0.5	0.4	0.4	0.4	0.4	0.4	0.3
Transfers to the Uganda Revenue Authority	0.4	0.4	0.4	0.4	0.4	0.4	0.3
Other current	6.5	5.8	5.8	5.5	5.6	5.3	5.0
Additional spending 4/	0.0	0.2	0.0	0.0	0.0	0.0	0.0
Development expenditures	8.8	9.1	8.9	8.2	9.2	8.1	8.2
Donor-supported projects	5.4	5.6	5.7	5.1	6.0	4.9	4.5
Domestic	3.3	3.4	3.2	3.1	3.2	3.3	3.7
Net lending and investment	0.3	-0.3	-0.1	-0.2	-0.2	-0.1	-0.1
Other	0.6	1.1	0.8	1.0	0.7	1.4	1.5
Of which: domestic arrears repayment	0.4	0.6	0.4	0.5	0.5	0.6	1.0
Unidentified expenditure measures 6/	0.0	-0.5	0.0	0.0	0.0	0.0	0.0
Cash Balances							
Overall balance							
Including grants	-1.8	-2.0	-0.7	-2.7	-2.3	-1.7	-0.6
Excluding grants	-11.1	-10.0	-9.7	-8.5	-9.2	-7.9	-6.9
Primary balance							
Including grants	0.2	-0.2	0.7	-1.0	-0.6	0.0	1.0
Excluding grants	-9.1	-8.3	-8.3	-6.8	-7.5	-6.1	-5.3
Financing	0.8	2.0	0.7	2.7	2.3	1.7	0.6
External financing (net)	2.3	1.9	2.2	3.2	3.0	2.4	2.3
Disbursement	3.2	2.9	3.1	4.2	4.0	3.4	3.1
Budget support	0.4	0.2	0.3	1.5	1.3	1.2	1.1
Project loans	2.8	2.7	2.9	2.8	2.7	2.1	2.0
Amortization (-)	-1.1	-1.0	-0.9	-0.9	-0.9	-0.9	-0.8
Exceptional financing	0.1	0.0	0.0	-0.1	-0.1	-0.2	0.0
Domestic financing (net)	-1.5	0.0	-1.5	-0.5	-0.7	-0.6	-1.8
Bank financing	-2.3	-0.2	-1.8	-0.7	-0.9	-0.8	-1.9
Bank of Uganda	-2.1	-1.0	-3.2	-0.8	-1.0	-0.2	-1.1
Commercial banks	-0.2	0.8	1.4	0.1	0.1	-0.6	-0.8
Nonbank financing	0.8	0.3	0.2	0.2	0.2	0.2	0.1
Errors and omissions/financing gap	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items (in percent of GDP, unless otherwise noted):							
Identified domestic revenue measures	...	...	...	...	0.6	...	...
Total defense expenditures	2.3	2.4	2.3	2.2	2.0	1.9	1.8
Total public administration expenditure	2.8	2.8	2.8	2.9	2.7	2.5	2.4
Poverty Action Fund	5.5	5.7	5.4	5.4	5.3	5.4	5.4
Total HIPC assistance	1.3	1.3	1.0	0.9	0.8	0.8	0.7
Nominal GDP at market prices	13,168	14,610	15,149	16,106.8	16,981	18,737	20,646

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

1/ Fiscal year begins in July.
2/ The revenue projections are based on a revenue target as a share of GDP, and accordingly include unidentified revenue effort.
3/ Revenue projections for 2004/05 onwards include collections costs due to EAC.
4/ Includes projected supplementary expenditures to accommodate priority needs in 2004/05.
5/ Estimated arrears in goods and services accumulated under the CCS.
6/ In 2004/05, cuts to accommodate: supplementary expenditure pressures, increase in primary teacher wages and clearance of CCS arrears in goods and services.

Table 3. Uganda: Monetary Survey, 2003/04–2007/08 1/
(In billions of Uganda shillings; end of period, unless otherwise indicated)

	2003/04	2004/05 CR 05/183	2004/05 Proj.	2005/06 CR 05/183	2005/06 Proj.	2006/07 Proj.	2007/08 Proj.
				Banking system			
Net foreign assets (NFA)	2,371	2,620	2,870	3,046	3,294	3,619	4,166
Net domestic assets	217	357	107	383	126	305	331
Domestic credit	1,107	1,308	1,011	1,410	1,091	1,264	1,289
Claims on public sector (net) 2/	97	157	-175	36	-324	-474	-871
Claims on private sector	1,010	1,150	1,185	1,374	1,415	1,737	2,160
Valuation	-444	-625	-457	-740	-506	-562	-624
Other items (net)	-447	-325	-447	-287	-458	-396	-334
Broad money (M3)	2,587	2,977	2,976	3,430	3,420	3,924	4,497
M2	1,925	2,229	2,214	2,575	2,551	2,928	3,355
				Monetary authorities			
Net foreign assets	1,680	1,852	2,226	2,170	2,566	2,776	3,187
Foreign assets	2,049	2,133	2,505	2,386	2,770	2,919	3,281
Of which: foreign reserves	2,029	2,113	2,485	2,365	2,750	2,899	3,259
Foreign liabilities	369	281	279	216	204	144	93
Of which: liabilitites to IMF	365	277	275	211	200	140	89
Net domestic assets	-871	-930	-1,307	-1,130	-1,529	-1,603	-1,875
Domestic credit	-374	-429	-799	-558	-962	-995	-1,220
Claims on public sector (net) 2/	-472	-515	-956	-644	-1,118	-1,151	-1,376
Claims on commercial banks (net)	99	86	156	86	156	156	156
Valuation	-440	-617	-451	-718	-498	-551	-610
Other items (net)	-81	111	-81	141	-92	-80	-68
Base money	810	922	918	1,040	1,038	1,173	1,312
Currency outside banks plus cash in vaults	605	677	678	757	757	842	935
Commercial bank deposits with Bank of Uganda (BOU)	205	245	240	283	281	331	378
				Commercial banks			
Net foreign assets	690	768	644	876	727	843	979
Net domestic assets	1,368	1,606	1,728	1,883	2,022	2,339	2,699
Domestic credit	1,738	2,051	2,100	2,333	2,396	2,666	2,979
Claims on public sector (net) 2/	570	673	781	680	794	678	505
Claims on private sector	986	1,145	1,161	1,369	1,391	1,713	2,136
Of which: foreign exchange loans	215	224	229	257	261	299	343
Claims on BOU (net)	182	233	158	284	211	275	338
Total reserves	235	275	270	317	315	371	424
Required reserves	227	256	255	294	291	331	378
Excess reserves	-22	-11	-15	-11	-10	0	0
Reservable cash-in-vault	30	30	29	35	34	40	46
Valuation	-3	-8	-6	-22	-8	-10	-14
Other items (net)	-366	-436	-366	-428	-366	-316	-266
Deposit liabilities to nonbank residents	2,058	2,375	2,372	2,760	2,749	3,182	3,678
Shilling deposits	1,396	1,626	1,610	1,905	1,881	2,186	2,536
Foreign currency deposits	662	748	762	855	869	997	1,142
Memorandum items:							
Base money (12-month change in percent) 3/	13.0	13.4	13.0	12.8	13.0	13.0	11.9
Money and quasi money (12-month change in percent)	9.0	14.8	15.0	15.2	14.9	14.8	14.6
Broad money (12-month change in percent)	10.0	14.8	15.0	15.5	15.2	14.8	14.6
M3-to-GDP ratio (percent)	19.6	20.4	19.6	23.1	20.1	20.9	21.8
M2-to-GDP ratio (percent)	14.6	15.3	14.6	17.3	15.0	15.6	16.2
Credit to private sector-to-GDP ratio (percent)	7.7	7.9	7.8	9.2	8.3	9.3	10.5
Currency outside banks-to-M3 ratio (percent)	20.5	20.2	20.3	19.5	19.6	18.9	18.2
Foreign currency deposits-to-M3 ratio (percent)	25.6	25.1	25.6	24.9	25.4	25.4	25.4
Credit to the private sector (12-month change in percent)	19.0	16.0	17.4	19.4	19.4	22.8	24.4
Base money multiplier (M2/base money)	2.38	2.42	2.41	2.48	2.46	2.50	2.56
NFA of BOU (millions of U.S. dollars)	939	1023	1230	1140	1391	1475	1660
Gross reserves of BOU (millions of U.S. dollars)	1135	1,167	1,373	1243	1491	1540	1698
NFA of commercial banks (millions of U.S. dollars)	386	424	356	460	394	448	510
Foreign currency deposit (millions of U.S. dollars)	370	413	421	449	471	530	595
Foreign currency loans (millions of U.S. dollars)	120	124	126	135	141	159	179

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

Table 4. Uganda: Selected Banking Sector Information, March 2002-December 2004

	2002				2003			2004			
	Mar.	June	Sep.	Dec.	Mar.	June	Sep.	Mar.	June	Sep.	Dec.
	(In billions of Uganda shillings)										
Adjusted assets	2,110	2,318	2,255	2,406	2,542	2,723	2,845	3,061	3,184	3,206	3,294
Liquid assets	1,380	1,126	1,142	1,564	1,232	1,292	1,351	1,373	1,279	1,389	1,538
Tier I	208	200	203	211	238	237	239	257	276	295	313
Tier II	24	25	32	29	36	33	34	33	32	29	30
Total capital	232	226	235	240	274	270	273	291	309	325	343
Risk weighted assets (RWA)	906	953	967	1,088	1,209	1,317	1,492	1,519	1,624	1,575	1,674
Nonperforming assets (NPA)	27	19	19	20	24	59	60	58	14	23	21
Loans and advances	533	536	566	661	723	741	774	887	884	891	977
Foreign exchange advances	155	154	153	191	218	189	203	226	218	219	267
Foreign exchange deposits	441	515	489	495	574	708	689	789	806	805	817
Deposits	1,588	1,764	1,763	1,816	1,910	2,109	2,157	2,321	2,396	2,378	2,438
	(In percent)										
Return on average assets	4.1	3.2	3.1	3.0	3.7	3.5	4.0	4.7	5.0	4.8	4.3
Core capital/ RWA	22.9	21.0	21.0	19.4	19.7	18.0	16.0	16.9	17.0	18.7	18.7
Total capital/ RWA	25.5	23.7	24.3	22.1	22.7	20.5	18.3	19.1	19.0	20.6	20.5
NPAs/Total advances	5.1	3.6	3.3	3.0	3.4	8.0	7.8	6.6	1.6	2.6	2.2
Loan loss provision/ NPA	76.8	87.5	81.3	81.5	70.8	46.8	69.8	84.9	139.6	87.8	97.8
Liquid assets/ Total deposits	86.9	63.9	64.8	86.1	64.5	61.3	62.7	59.0	53.4	58.4	63.1
Advances/ Deposits	33.5	30.4	32.1	36.4	37.8	35.1	35.9	38.2	36.9	37.5	37.4
Foreign exchange exposure/ Core capital 1/	5.9	18.1	4.1	4.3	4.0	6.1	2.3	22.6	4.7	5.2	-2.0
Foreign exchange advances/ Foreign exchange deposits	35.3	29.8	31.3	38.6	37.9	26.7	29.5	28.7	27.0	27.2	32.6

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, 2003/04-2007/08 1/
(In millions of U. S. dollars)

	2003/04 Est.	2004/05 CR 05/183	2004/05 Proj.	2005/06 CR 05/183	2005/06 Proj.	2006/07 Proj.	2007/08 Proj.
Current account	-117	-339	-281	-475	-514	-526	-511
Trade balance	-674	-809	-857	-876	-1003	-1032	-1069
Exports, f.o.b.	647	682	719	738	781	847	926
Coffee	114	119	116	134	130	141	157
Noncoffee	533	563	603	605	651	706	769
Imports, f.o.b	-1321	-1491	-1575	-1614	-1784	-1880	-1995
Government-related	-161	-165	-182	-171	-199	-182	-183
Private sector	-1161	-1326	-1393	-1443	-1585	-1698	-1812
Services (net)	-227	-250	-295	-263	-342	-370	-404
Inflows	331	363	357	374	373	384	395
Outflows	-559	-613	-651	-637	-715	-754	-799
Income (net)	-139	-170	-177	-140	-162	-152	-159
Inflows	40	38	41	72	68	83	89
Outflows	-179	-207	-218	-211	-231	-235	-248
Of which: interest on public debt	-39	-35	-37	-36	-34	-38	-39
HIPC savings due to cancellation 2/	6	6	5	5	5	5	4
Transfers	923	890	1047	804	993	1029	1120
Private transfers	225	214	228	296	314	388	409
Of which: nongovernmental organizations	145	160	164	229	238	269	292
Official transfers	698	675	819	508	680	641	711
Of which: project support	224	243	285	209	309	273	273
budget support	360	360	427	237	280	286	359
HIPC assistance 2/	62	68	65	58	54	57	54
Capital and financial account	298	419	567	603	684	632	693
Capital account	0	0	0	0	0	0	0
Financial account	298	419	567	603	684	632	693
Foreign direct investment (FDI)	202	223	299	259	284	302	357
Portfolio investment	28	19	32	21	35	38	42
Other investment	68	177	235	323	365	292	294
Medium and long-term	148	158	200	298	297	265	263
Public sector (net)	148	160	190	293	287	255	248
Disbursements	222	243	272	372	373	342	339
Project support	191	225	250	242	247	216	216
Budget support	31	18	22	130	125	125	122
Amortization due	-74	-84	-82	-79	-86	-87	-90
HIPC savings due to cancellation 2/	16	17	18	15	17	15	14
Private sector (net)	0	-2	10	5	10	10	15
Short-term	-80	19	35	25	68	27	31
Errors and omissions	34	0	0	0	0	0	0
Overall balance	214	80	285	128	169	107	182
Financing	-214	-80	-285	-128	-169	-107	-182
Central bank reserves (- = increase)	-222	-82	-287	-117	-161	-91	-185
Of which: gross reserve change	-170	-34	-238	-75	-118	-50	-158
IMF (net)	-52	-48	-49	-42	-44	-41	-28
HIPC rescheduling 2/	3	2	2	2	2	3	3
Memorandum items:							
Gross international reserves 3/	6.1	6.2	6.6	6.2	6.8	6.6	6.9
Current account balance (in percent of GDP)							
Including official transfers	-1.7	-4.1	-3.2	-5.4	-5.5	-5.2	-4.7
Excluding official transfers	-12.0	-12.2	-12.7	-11.2	-12.8	-11.6	-11.2
Debt service (in percent of exports)							
Before debt relief (including IMF)	19.3	18.7	18.4	14.6	16.6	15.1	13.3
After debt relief (including IMF)	10.0	9.8	10.0	10.3	10.7	10.1	7.5
Coffee price (U.S. cents per kg.)	64.3	65.7	65.7	68.6	68.6	70.9	73.4
Coffee export volume (in millions of 60-kg. bags)	2.4	2.6	2.6	2.7	2.7	2.9	3.1
Exports of goods and nonfactor services	979	1045	1075	1112	1154	1231	1321
(three-year moving average)	816	938	940	1050	1069	1154	1236
Net donor support	811	803	975	765	934	861	924
Of which: import support	391	378	449	367	406	411	482
project support	415	469	535	451	557	489	489
total debt relief including HIPC assistance	87	94	91	58	78	80	76
Net donor support (in percent of GDP)	11.9	9.6	11.2	8.7	10.0	8.5	8.5
Debt service due before HIPC	168	172	174	163	170	166	157
Foreign direct investment—gross inflows (in percent of GDP)	3.6	3.5	3.9	3.5	3.5	3.5	3.8

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

1/ Fiscal year begins on July 1.
2/ The components of debt relief are treated as separate items. HIPC grants are included in import support transfers, debt rescheduling is included in exceptional financing, and debt cancellation is included in amortization.
3/ In months of imports of goods and services of the following year.

Table 6. Uganda: Debt and Debt Service Indicators, 2002/03-2007/08 /1

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
	(In millions of U.S. dollars)					
NPV of total debt 2/	1,894	1,997	1,997	2,147	2,294	2,446
Existing debt	1,894	1,889	1,875	1,857	1,842	1,829
Multilateral	1,717	1,720	1,714	1,704	1,696	1,690
Paris Club bilateral	57	52	48	43	38	34
Non-Paris Club bilateral	98	99	100	100	101	102
Commercial	21	18	14	10	7	3
New debt	…	109	121	290	451	617
Total debt service	79	86	94	100	97	98
Existing debt	79	85	93	98	93	91
Multilateral	65	70	78	82	79	77
Paris Club bilateral	6	7	7	7	6	6
Non-Paris Club bilateral	2	4	4	4	4	4
Commercial	5	5	5	4	4	4
New debt	…	1	1	2	5	7
NPV of debt-to-exports ratio 2/ and 3/	247.1	204.1	185.7	186.1	186.3	185.1
NPV of debt-to-revenue ratio 2/	248.7	231.5	181.9	175.7	166.9	159.2
NPV of debt-to-GDP ratio 2/	30.2	29.3	23.0	23.1	22.8	22.5
NPV of new debt-to-exports ratio 2/ and 3/	…	13.3	12.9	27.2	39.1	49.9
Debt service-to-exports ratio	11.0	10.6	10.0	9.3	8.5	7.9
Debt service-to revenue ratio	10.3	10.0	8.6	8.2	7.1	6.4
	(In millions of U.S. dollars)					
Memorandum items:						
Gross domestic product	6,266	6,806	8,678	9,305	10,074	10,866
Exports of goods and services 4/						
Current year	766	979	1,075	1,154	1,231	1,321
Three-year average	718	816	940	1,069	1,154	1,236
Revenue	761	863	1,097	1,222	1,374	1,537
New borrowing annual flow	328	228	278	379	347	345

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

1/ Assumes full delivery of HIPC relief

2/ NPV ratios from 2002/03 are based on CIRRs (discount rate) and exchange rates at June 2003.

3/ In relation to the current year of exports of goods and services.

4/ Exports of goods and services as defined in IMF *Balance of Payments Manual,* 5th edition, 1993.

Table 7. Uganda: Millennium Development Goals

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

Source: World Development Indicators database, October 2004.

Table 8. Uganda: Status of HIPC Agreements by Creditor 1/

	Enhanced HIPC Relief US$ millions	Agreement to Provide HIPC Relief	Modalities/Comments
Total	655.8		
Total relief agreed upon	630.6		There are agreements to provide 96 percent of the total HIPC Initiative relief committed
Relief not agreed	25.3		4 percent of relief identified under the HIPC Initiative is still subject to negotiations.
Multilateral	545.7		
IDA	356.6	yes	Debt-service reduction on eligible stock outstanding as at 30/6/1999 except on PPFs and IDA administered EEC loan
IMF	90.9	yes	Debt-service reduction on principal of stock outstanding as at 30/6/1999
AfDB/F	59.3	yes	Debt-service reduction commenced January 2002 details at discretion of creditor
IFAD	10.1	yes	Debt-service reduction on eligible stock. IFAD to advise details of application periodically
EU/EIB	14.1	yes	One loan cancelled and another partially canceled
NDF	3.7	yes	Reconciliation complete. Not servicing outside eligible period and awaiting final agreement.
OPEC Fund	5.1	yes	Agreement signed August 2003 for both HIPC I and II but is yet to be approved by parliament
BADEA	4.1	yes	Delivering through rescheduling of all loans outstanding at completion point
EADB	0.7	yes	Agreement signed June 14, 2004 for both HIPC I and II, but is yet to be approved by parliament
IDB	0.5	yes	Delivering through rescheduling of all loans outstanding at completion point
PTA Bank	0.5	no	No decision taken on participation
Shelter Afrique	0.1	no	In June 2003, government paid in full to avoid court action that had been initiated.
Paris Club creditors	73.1		
Austria	6.8	yes	Agreement signed for 18 percent cancellation on post-cutoff debt
Finland	1.1	yes	Cancelled the debt
France	6.7	yes	100 percent cancellation on pre-cut-off date debt. Initially cancelled 18 percent of post-cod debt. Recently signed new agreement for the balance of 82 percent.
Germany	0.4	yes	100 percent cancellation on pre-cutoff debt
Israel	1.9	yes	100 percent cancellation on pre-cutoff debt
Italy	20.3	yes	100 percent cancellation on pre-cutoff and post-cutoff debt
Japan	16.5	yes	Agreed to cancel payments as they fall due
Norway	0.1	yes	Agreement signed for 18 percent cancellation on pre-cutoff debt
Spain	13.5	yes	Agreement signed for 18 percent cancellation on pre-cutoff debt
Sweden	1.7	yes	Agreement signed for 18 percent cancellation on pre-cutoff debt
U.K.	4.0	yes	Agreement signed for 100 percent cancellation for pre-cutoff debt
U.S.A.	0.1	yes	Agreement signed for 100 percent cancellation for pre-cutoff debt
Non-Paris Club creditors	29.0		
UAE	0.3	no	No response
Burundi	0.1	no	Bank/IMF have agreed to facilitate
China	2.8	yes	Written off part of the loan. Negotiating terms for remaining balance 5 loans, 3 remain to be considered after other countries have received relief
India	3.7	no	Cancelled government to government claims of US$4.9 million. Government seeking to obtain relief on US$50.6 million in export guarantees
Iraq	0.0	no	Judgment reached. Court awarded US$6.4 million. Interest to accrue at 2.5 percent until paid. The government of Uganda plans to appeal. Government has requested the holders of the Powers of Attorney to get them renewed by the current Iraq authorities.
Kuwait	6.6	yes	Agreement signed for delivery of old HIPC and enhanced HIPC
Libya	8.2	no	Libya has indicated to the Fund that it will not participate in the HIPC Initiative, but some type of debt relief would be provided. Ugandan authorities are willing to negotiate.
Nigeria	0.9	no	No agreement in place, no communication.
North Korea	0.3	no	Repaid in full before enhanced HIPC Initiative
Pakistan	0.3	no	No response
Rwanda	0.6	yes	Loan has been cancelled
Saudi Arabia	1.5	yes	Agreement signed for provision of enhanced HIPC relief.
South Korea	0.6	yes	Agreement signed October 2003 for delivery of old HIPC and enhanced HIPC
Tanzania	3.2	partial	Bought back 15 percent, balance needs verification
Commercial creditors	8.0		
Italy (Industrial Developmen	0.1	no	Repaid in full before enhanced HIPC Initiative
Panama	0.0	no	Repaid in full before enhanced HIPC Initiative
Spain (Banco Arabe)	0.5	no	Judgment reached. Court awarded US$2.7 million. Government of Uganda has fully paid
U.K.	5.0	no	Judgment reached. Court awarded US$9.4 million. The government of Uganda negotiated a lower settlement figure of US$7.9 million, which was paid in 2003/04.
Yugoslavia (14 Oktobar and Sours Fab Famos)	2.4	no	Judgment reached. Total court award of US$10.3 million. The government of Uganda has fully repaid the court award.

Sources: Ugandan authorities; and IMF staff estimates.

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

Kampala, Uganda
June 20, 2005

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

Dear Mr. de Rato:

1. On behalf of the Government of Uganda, I hereby transmit the attached memorandum of economic and financial policies (MEFP) that sets out the objectives and policies that the Government intends to pursue in fiscal year 2005/06 (July–June), as well as the underlying medium-term macroeconomic policy framework. These are in line with the priorities set out in the revised Poverty Eradication Action Plan (PEAP) and the 2005/06 budget proposal, which was submitted to Parliament on June 8, 2005. The attached technical memorandum of understanding (TMU) defines the targets of the program.

2. In light of the progress achieved in the implementation of the program for 2004/05, and given the supporting details provided in the MEFP, the Government of Uganda requests a waiver for nonobservance of the performance criterion for end-December 2004 on the accumulation of domestic arrears under the Commitment Control System. Every effort will be made to pay off these arrears within fiscal year 2004/05. Moreover, the Government will implement a comprehensive set of measures to strengthen the overall monitoring and control of domestic arrears, as outlined in the MEFP.

3. In support of our objectives and policies, the Government of Uganda hereby requests the release of the sixth disbursement under the PRGF in the amount of SDR 2 million (1.1 percent of quota) upon completion of the fifth review.

4. Looking ahead, the policies set out in the attached memorandum, together with continuing implementation of the broader policy agenda as envisaged in the revised PEAP, aim at achieving high sustainable economic growth and reducing poverty. The performance criteria for the sixth review will be based on the test date of end-June 2005 and are set out in the MEFP, together with structural benchmarks. In order to provide sufficient time to evaluate program performance, the Government of Uganda requests an extension of the three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) to December 31, 2005.

5. The Government of Uganda will provide the Fund with such information as the Fund may request in connection with the progress made in implementing the economic and financial policies and achieving the objectives of the program.

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

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

Sincerely yours,

/ s /

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

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

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

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

VI. Recent Performance Under the PRGF-Supported Program

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

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

A. Fiscal Policy

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

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

B. Monetary Policy

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

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

VII. The Policy Agenda for 2005/06

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

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

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

A. Fiscal Policy

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

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

Public expenditure management

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

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

- The Government will ensure that accounting officers strictly abide by the rules of the CCS, particularly avoiding the accumulation of new arrears.

- The treasury will issue a special circular to line ministries to record all commitments either in manual CCS or IFMIS, as appropriate. The circular will clarify that bills not recorded will not be accepted for verification by the Internal Audit Office after a grace period of 3 months, following the issuance of the CCS or IFMIS monthly reports on overcommitments and unpaid bills.

- The CCS will be expanded to cover all types of nonwage and non-statutory outlays starting July 2005.

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

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

Revenue mobilization

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

- Tabling a bill to Parliament to amend the URA Act by end-June 2005.

- Strengthening the Information Technology (IT) strategy by tendering an IT system to the Domestic Tax Department (DTD) and computerizing customs.

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

B. Decentralization

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

C. Monetary and Financial Sector Policies

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

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

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

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

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

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

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

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

VIII. Medium-Term Macroeconomic Policy Issues

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

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

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

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

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

1/ Fiscal year begins on July 1.
2/ The performance criteria and benchmark targets under the program, and their adjusters, are defined in the technical memorandum of understanding (TMU).
3/ Benchmarks, unless measure is a continuous performance criterion.
4/ Performance criteria.
5/ Cumulative changes from the average of June 2004 and June 2005 for the 2004/05 and 2005/06 program respectively, as defined in the TMU.
6/ Continuous performance criterion.
7/ This item is an indicative target to September 2004 and March 2005, and a performance criteria to December 2004 and June 2005, as defined in the TMU
8/ Indicative targets.

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

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

Uganda: Technical Memorandum of Understanding

A. Introduction

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

B. Base Money

2. **Base money** is defined as the sum of currency issued by Bank of Uganda (BOU) and the commercial banks' deposits in the BOU. The commercial bank deposits include the statutory required reserves and excess reserves held at the BOU and are net of the deposits of closed banks at the BOU and Development Finance Funds (DFF) contributed by commercial banks held at the BOU. The base money limits for 2005/06 will be cumulative changes from the daily average of June 2005 to the daily average of September 2005, December 2005, March 2006 and June 2006, and will be monitored by the monetary authority and provided to the IMF by the BOU.

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

3. **Net claims on the central government** (NCG) by the banking system is defined as the difference between the outstanding amount of bank credits to the central government and the central government's deposits with the banking system, excluding deposits in administered accounts and project accounts with the banking system, including the central bank. Credits comprise bank loans and advances to the government and holdings of government securities and promissory notes. NCG will be calculated based on data from balance sheets of the monetary authority and commercial banks as per the monetary survey. The limits on the change in net claims on the central government by the banking system will be cumulative beginning end-June 2005 for the 2005/06 program.

D. Net International Reserves of the Bank of Uganda

4. **Net international reserves (NIR)** of the BOU are defined for program monitoring purpose as reserve assets of the BOU net of short-term external liabilities of the BOU. Reserve assets are defined as external assets readily available to, and controlled by, the BOU and exclude pledged or otherwise encumbered external assets, including, but not limited to, assets used as collateral or guarantees for third-party liabilities. Short-term external liabilities are defined as liabilities to nonresidents, of maturities less than one year, contracted by the BOU and include outstanding IMF purchases and loans.

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

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

E. Expenditures Under the Poverty Action Fund

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

Schedule A: Minimum PAF Expenditure
(In cumulative billions of Uganda shillings, beginning July 1, 2005)

Quarter	Sep. 30 2005	Dec. 31 2005	Mar. 31 2006	June 30 2006
Expenditure	198.2	415.4	631.2	857.1

F. New Domestic Budgetary Arrears of the Central Government

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

G. Ceiling on Public Administration Expenditures

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

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

Schedule B: Ceiling on Public Administration Expenditures
(In cumulative billions of Uganda shillings, beginning July 1, 2005)

Quarter	Sep. 30 2005	Dec. 31 2005	Mar. 31 2006	June 30 2006
Expenditure	54.3	113.6	172.9	232.1

H. Promissory Notes

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

I. Adjusters

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

11. The Uganda shilling equivalent of import support (grants and loans) plus HIPC Initiative assistance in the form of grants on a cumulative basis from July 1, 2005 onward is presented under Schedule C. The ceiling on the cumulative increase in NCG will be adjusted downward (upward), and the floor on the cumulative increase in NIR of the BOU will be adjusted upward (downward) by the amount by which import support, grants and loans, plus HIPC Initiative assistance, exceeds (falls short of) the projected amounts.

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

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

12. The ceiling on the increases in NCG will be adjusted downward (upward) and the floor on the increase in NIR will be adjusted upward (downward) by the amount by which debt service due[2] plus payments of external debt arrears less deferred payments (exceptional financing) falls short of (exceeds) the projections presented in Schedule D. Deferred payments are defined to be (i) all debt service rescheduled under the HIPC Initiative; and (ii) payments falling due to all non-HIPC Initiative creditors that are not currently being serviced by the authorities (that is, gross new arrears being incurred).

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

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

[2] Debt service due is defined as pre-HIPC Initiative debt service due, but from 2003/04 onwards, this excludes HIPC Initiative debt cancellation.

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

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

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

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

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

15. The program includes a ceiling on new nonconcessional borrowing with maturities greater than one year contracted or guaranteed by the government, statutory bodies, or the BOU[1]. Nonconcessional borrowing is defined as loans with a grant element of less than 35 percent, calculated using average commercial interest rates references (CIRRs) published by the Organization for Economic Cooperation and Development (OECD). In assessing the level of concessionality, the 10-year average CIRRs should be used to discount loans with maturities of at least 15 years, while the 6-month average CIRRs should be used for loans with shorter maturities. To both the 10-year and 6-month averages, the following margins for differing payment periods should be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–25 years; and 1.25 percent for 30 years or more. The ceiling on nonconcessional external borrowing is set at zero and is to

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

be observed on a continuous basis. The coverage of borrowing includes financial leases and other instruments giving rise to external liabilities, contingent or otherwise, on nonconcessional terms. Excluded from the limits are changes in indebtedness resulting from refinancing credits and rescheduling operations, and credits extended by the IMF. For the purposes of the program, arrangements to pay over time obligations arising from judicial awards to external creditors that have not complied with the HIPC Initiative do not constitute nonconcessional external borrowing.

16. The definition of debt, for the purposes of the limit, is set out in point 9 of the Guidelines on Performance Criteria with Respect to External Debt (Executive Board's Decision No. 12274-(00/85), August 24, 2000). It not only applies to the debt as defined in Point 9 of the Executive Board decision, but also to commitments contracted or guaranteed for which value has not been received. The definition of debt set forth in No. 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements reads as follows:

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

17. The ceiling on the accumulation of new external payments arrears is zero. This limit, which is to be observed on a continuous basis, applies to the change in the stock of overdue payments on debt contracted or guaranteed by the government, the BOU, and statutory

bodies[2] from their level at end-June 2005. It comprises those external arrears reported by the Trade and External Debt Department of the BOU, the Macro Department of the Ministry of Finance that cannot be rescheduled because they were disbursed after the Paris Club cutoff date.

K. Monitoring and Reporting Requirements

18. The authorities will inform the IMF staff in writing at least ten business days (excluding legal holidays in Uganda or in the United States) prior to making any changes in economic and financial policies that could affect the outcome of the financial program. Such policies include but are not limited to customs and tax laws (including tax rates, exemptions, allowances, and thresholds), wage policy, and financial support to public and private enterprises. The authorities will similarly inform the IMF staff of any nonconcessional external debt contracted or guaranteed by the government, the BOU, or any statutory bodies, and any accumulation of new external payments arrears on the debt contracted or guaranteed by these entities.

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

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

21. The government will provide the IMF staff with a summary of the fiscal accounts, both on a monthly and quarterly basis, with a seven-week lag from the end of the reporting month and quarter. Revenues will be recorded on a cash basis as reported by the Uganda Revenue Authority and the MFPED. Expenditures shall be recorded when checks are issued, except for domestic and external debt-service payments, cash transfers to districts, and externally funded development expenditures. Expenditures on domestic interest will be recorded on an accrual basis and external debt service will be recorded on a commitment basis (i.e., when payment is due). Cash transfers to districts will be recorded as expenditures of the central government when the transfer is effected by the BOU. Expenditures on externally funded development programs will be recorded as the sum of estimated disbursements of project loans and grants by donors, less the change in the stock of

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

government project accounts held at the BOU and 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 the government, claims against the government in court cases that are pending, or court awards that the government has appealed.

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

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

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

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

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

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

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

Uganda: Relations with the Fund
(As of April 30, 2005)

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	2.97	10.11

IV. Outstanding Purchases and Loans:	SDR Million	% Quota
Enhanced Structural Adjustment Facility (ESAF)/Poverty Reduction and Growth Facility (PRGF) arrangements	119.97	66.46

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	9.50
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 (without HIPC assistance)

	Overdue	Forthcoming				
		2005	2006	2007	2008	2009
Principal	0.00	30.24	30.57	22.43	14.36	9.80
Charges/interest	0.00	1.04	1.05	0.90	0.81	0.75
Total	0.00	31.28	31.62	23.33	15.17	10.55

Projected Obligations to Fund Under the Repurchase Expectations Assumptions (with Board-approved HIPC assistance)

	Overdue	Forthcoming				
		2005	2006	2007	2008	2009
Principal	0.00	20.61	23.80	19.25	13.80	9.80
Charges/interest	0.00	1.04	1.05	0.90	0.81	0.75
Total	0.00	21.64	24.84	20.15	14.61	10.55

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)			
Assistance disbursed to the member	51.51	68.10	119.61
Interim assistance	…	8.20	8.20
Completion point	51.51	59.90	111.41
Additional disbursement of interest income [2]		2.06	2.06

VIII. Safeguards Assessments

Under the Fund's safeguards assessment policy, Bank of Uganda (BOU) is subject to an assessment with respect to the PRGF arrangement, which was approved on September 13, 2002 and is scheduled to expire on September 12, 2005. The assessment was completed on April 13, 2003 and concluded that, although the BOU had several strengths, some vulnerabilities existed. Staff findings, proposed recommendations under program conditionality and other recommendations are reported in IMF Country Report No. 03/213. The authorities have implemented all the recommendations.

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 29, 2005, the official exchange rate was U Sh 1,776.82 per U.S. dollar. The exchange system is free of restrictions on the making of payments and transfers for current international transactions. Uganda is classified as an independently floating exchange rate regime.

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

X. Article IV Consultation

The Executive Board concluded the last Article IV consultation on February 14, 2005. The next Article IV consultation with Uganda will be held on the 24-month cycle, subject to the provisions of the decision on consultation cycles approved on July 15, 2002.

In February and April 2001, joint World Bank/Fund missions visited Kampala as part of the Financial Sector Assessment Program (FSAP). A final report was provided to the authorities in November 2001, an MFD mission discussed the report with the authorities during the Article IV consultation discussion in November 2002, and the Financial System Stability Assessment was prepared for Board discussion in February 2003. In November 2004, a joint World Bank/Fund missions visited Kampala for a FSAP update.

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. A joint Bank/Fund TA mission visited Kampala in October 2003 to help harmonize tax investment incentives among the member countries of the East African Community (EAC). A FAD TA mission on tax administration also visited Uganda in October 2004 to develop a comprehensive reform plan for the Uganda Revenue Authority (URA); a follow-up mission was also conducted in April 2005. Two FAD resident advisors (coordinated through AFRITAC-East) are currently in the field assisting the implementation of a CCS at the local government level and the Fiscal Decentralization Strategy.

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

[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 IMF Country Report No. 02/213.

are aligned with the *GFS Manual 2001*, as well as ensuring consistency within monetary sector data for the government. A follow-up mission on GFS visited Uganda in May 2003. A mission visited Uganda during February–March 2002 to review balance of payment statistics and the progress in implementing the recommendations of the multisector mission of 1998 and of the national accounts mission of 2000 with respect to the measurement of goods imports. A follow-up mission on balance of payments statistics visited Uganda in August 2003. Uganda is participating in the General Data Dissemination System (GDDS) and its metadata were initially posted on the Fund's Dissemination Standards Bulletin Board in May 2000. A STA mission was in Uganda during February 2005 to prepare a data ROSC.

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

XII. Future Technical Assistance Priorities

The priorities for Fund technical assistance in the next few years will be in the areas of tax administration, public expenditure management, especially control and monitoring of public arrears at both central and local government levels, monetary and exchange rate management, bank supervision, national accounts statistics, reporting standards for government finance statistics, monetary and balance of payments statistical reporting, central bank accounting, and audit and debt management.

XIII. Resident Representative

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

Uganda: Relations with the World Bank Group
(As of May 23, 2005)

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 a framework for detailed sector and district plans. Because the PEAP's objectives are fully consistent with those of the poverty reduction strategy paper (PRSP) process, a summary of the revised PEAP was used as a basis for Uganda's PRSP, which was presented to the Boards of the World Bank and Fund in May 2000. Uganda's PEAP/PRSP is based on four pillars: (1) creating an environment for economic growth and structural transformation; (2) ensuring good governance and security; (3) directly increasing the ability of the poor to raise incomes; and (4) directly increasing the quality of life of the poor.

2. A new PEAP has been finalized and official government approval is expected soon. The IMF and Bank staffs are preparing a Joint-Staff Advisory Note (JSAN) on the new PEAP. The new PEAP has five core elements: (1) economic management; (2) production, competitiveness and income; (3) security, conflict-resolution and disaster management; (4) disaster management; and (5) human development.

3. 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 falls under the first PEAP/PRSP pillar. 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.

4. 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 a heavy focus also on analytic work.

II. Bank Group Strategy

5. The World Bank Group's current Country Assistance Strategy (CAS) for Uganda was approved by the Board on November 16, 2000.[1] The objective of the CAS is to support

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

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. The new PEAP forms the basis for ongoing preparations of a new CAS, the Uganda Joint Assistance Strategy (UJAS), where World Bank, AfDB, Germany, UK, Netherlands, Norway, Sweden are aligning their support around comparative advantages.

6. 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 (PRSC1) for Uganda was approved by the Board in May 2001. A subsequent arrangement, PRSC2, was approved in July 2002, and PRSC3 and PRSC4 were approved by the Board in September 2003 and 2004, respectively. PRSCs support a medium term, with each annual arrangement linked to specific reform actions. The supported by PRSCs aims to improve public service delivery and agricultural production, since basic services critical to development is still inadequate in Uganda and about 70 percent of the population derives its livelihood from agriculture. Services provided, in particular by the public sector, are of poor quality owing to various governance problems and capacity constraints. Also, the enabling environment for private sector and civil society involvement is weak, thus further constraining service delivery and growth.

7. 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:

8. **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 on private sector investments and projects such as the Fourth Power and Bujagali Hydropower aim to address them. 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.

9. 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 the intergovernmental fiscal transfer system. PRSCs also support development of the legal and regulatory framework for microfinance, pension reform, and the strengthening of the insurance sector.

10. **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) complements these efforts.

11. **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 through a demand-driven National Agricultural Services Project and the Second Agricultural Research and Training Project. Furthermore, the series of PRSCs support the government so that it can identify ways to promote agricultural diversification and modernization, mainstreaming of environmental concerns in government programs, land tenure reforms, and expansion of nonfarm activities in rural areas. The Second Environmental Management and Capacity Building Project, the Second Protected Areas Management and Sustainable Use Project, and the second phase of the regional Lake Victoria Project help address the environmental challenges. 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.

12. **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

13. The World Bank Group is Uganda's largest creditor. As of April 30, 2005 a total of 119 credits, including 9 loans, and 5 grants, amounting to US$4.6 billion (US$4.1 billion from IDA, US$0.5 billion in IDA grants, and US$43 million from IBRD), had been approved for Uganda, and total disbursements amounted to about US$3.8 billion (see table below).

IV. Financial Relations with the World Bank Group

Statement of Loans and Credits, as of April 30, 2005
(In thousands of U.S. dollars)

	IBRD	IDA	IDA Grant	TOTAL
Original Principal:	43,200	4,072,831	490,000	4,606,031
Cancellations:	277	153,195	0	153,472
Disbursed:	42,922	3,285,816	431,300	3,760,039
Undisbursed:	0	814,191	73,717	887,908
Repaid:	34,607	395,226	0	429,833
Due:	0	3,241,295	0	3,241,295
Exchange Adjustment:	0	0	0	0
Borrower's Obligation:	0	3,241,295	0	3,241,295

14. In fiscal year FY05, PRSC 4 (US$150 million grant), Road Development Program Phase 3 (US$107.6 million of which US$40 million is grant), and Private Sector Export Competitiveness Project Phase 2 (US$70 million), totaling US$327.6 million, were approved by the IDA Board. In FY04, PRSC3, a Supplemental Credit to the Second Economic and Financial Management Project and the Sustainable Management of Mineral Resources Project were approved. In FY03, PRSC2, the Northern Uganda Social Action Fund, the Protected Areas Management and Sustainable Use Project, and Second Local Government Development Project, and a supplemental credit for the Lake Victoria Environment Management Project were approved. Five projects were closed in FY 2002, six projects were closed in FY 2003, and one project closed in FY 2004.

V. Bank-Fund Collaboration in Specific Areas

15. 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:

16. **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 the PRSP progress report on an annual basis.

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

18. **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 its work on the public expenditure review and PRSC. The staffs of the two institutions prepare, on an annual basis, a report that tracks HIPC Initiative poverty-reducing spending, analyzes the quality of public expenditure management in Uganda, and identifies areas needing strengthening.

19. **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 accounting for 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 these efforts 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 arrangement, which addresses selected aspects of pension reform.

20. **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.

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

Uganda: Statistical Issues

Uganda participates in the General Data Dissemination System (GDDS); its metadata were initially posted on the Fund's Dissemination Standards Bulletin Board in May 2000. Updates of metadata on national accounts and balance of payments statistics were completed in February and August 2004, respectively.

An STA mission went to Uganda during February 2005 to prepare a data ROSC. It assessed data compilation and dissemination practices against international standards in national accounts, prices, government finance, and balance of payments statistics.

Real sector

The March–April 2000 STA mission concluded that Uganda's national accounts were of poor quality, owing to shortages of experienced compilation staff and equipment and a lack of reliable source data for several key economic activities. Consequently, an STA-sponsored long-term national accounts statistics advisor was assigned to the Uganda Bureau of Statistics in April 2001 to assist in the improvement of the national accounts and in the rebasing of all economic statistics. By the conclusion of this assignment, in April 2002, balanced production and expenditure estimates had been prepared, including data from the most recent household survey, and the constant price estimates had been rebased from 1991 to 1997/98 (July–June). In addition, the national accounts and balance of payments estimates of imports and exports were reconciled, and the national accounts methodology improved. Following up on the recommendations of a December 2002 Africa Regional Technical Assistance Center (AFRITAC) mission, further assistance on a regular basis has been provided by AFRITAC to the Uganda Bureau of Statistics.

The consumer price index is of sound quality and is reported promptly for publication in *International Financial Statistics (IFS)*. Neither producer nor wholesale price indices are produced. Reliable and consistent data are not available on employment, wages, or trade volumes.

Government finance

The 2001 Government Finance Statistics (GFS) technical assistance mission discussed several data classification issues with the Ministry of Finance and proposed a summary framework for the reporting of GFS according to the *GFS Manual 2001* framework. The 2003 GFS technical assistance mission found that significant progress had been made in implementing the recommendations of the previous mission, identified some weaknesses in the proposed new chart of accounts, and made further recommendations to improve the quality of GFS. This new chart of accounts was implemented for use by all budgetary central government and local government units from July 1, 2004. Uganda commenced reporting GFS data compiled according to the *GFSM 2001* framework for the 2004 GFS Yearbook. However, data coverage is limited to the budgetary central government and local government accounts. Coverage of GFS statistics currently excludes the activities of extrabudgetary central government units and the National Social Security Fund. Coverage should be improved further to allow compilation of GFS data for the general government sector as a whole. Uganda does not report sub-annual data for inclusion in the IFS.

Monetary accounts

An STA multisector statistics mission to Uganda (December 2–15, 1998) determined that Uganda's monetary statistics, which had been compiled from a bank reporting system, were broadly adequate for policy purposes. However, the quality of data is compromised by various methodological problems, such as an arbitrary application of the residency criterion, an inadequate disaggregation of the resident sector data, a large discrepancy in the reported interbank positions, and misclassifications of some accounting data related to monetary aggregates. To address these issues, the mission recommended that the Bank of Uganda instruct commercial banks to classify accounts according to their clients' properly determined residency and to use a more detailed scheme for disaggregating the resident sector data. The mission also recommended a symmetrical treatment of government lending in the central bank's and commercial banks' data in order to narrow discrepancies in the reported interbank positions. Reclassification of the accounting data was also recommended to facilitate proper measurement of key monetary aggregates, in particular, domestic money supply, claims on central government, claims on the private sector, and foreign liabilities. The follow-up STA mission that visited Uganda during March 29–April 12, 2000, concluded that the Bank of Uganda had implemented most of these recommendations.

Balance of payments

The December 1998 mission recommended that preshipment inspection of imports be maintained and that the automated system for customs data (ASYCUDA) be fully implemented at the customs posts, where it had been introduced, and extended to major crossings on the eastern border. When banks are more fully computerized and commercial bank personnel have been adequately trained in reporting, the monthly bank reporting form should be revised once more to fully conform to the Balance of Payments Manual (5th ed.). Surveys should be introduced to supplement customs- and bank-reported data and to derive more accurate estimates of services and financial transactions. The 2002 mission also noted that the bank reporting system was still seriously inadequate. Given that Uganda dropped controls on financial account transactions in 1997 (for current account transactions, in 1994), major improvements are necessary to deal with weaknesses in the system.

The 2003 mission noted that, although significant progress had been achieved with the implementation of the 2002 mission recommendations, considerable work was still needed to improve the quality of the ITRS data. Measures of private sector liabilities (especially direct investment) remain inadequate.

The data currently reported to the Fund for publication are annual and relatively timely. Data for 2003 were recently submitted and will be published in the 2004 edition of the IFS. Reliable balance of payments data should also be compiled and reported on a quarterly basis.

UGANDA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE AS OF APRIL 30, 2005

	Date of latest observation	Date received	Frequency of Data[5]	Frequency of Reporting[5]	Frequency of publication[5]
Exchange Rates	05/30/05	05/31/05	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	03/31/05	04/29/05	M	M	M
Reserve/Base Money	05/30/05	05/31/05	D	D	M
Broad Money	03/31/05	04/29/05	M	M	M
Central Bank Balance Sheet	03/31/05	04/29/05	M	M	M
Consolidated Balance Sheet of the Banking System	03/31/05	04/29/05	M	M	M
Interest Rates[2]	03/31/05	04/29/05	M	M	M
Consumer Price Index	Apr. 2005	May. 2005	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Mar. 2004	Apr. 2005	M	M	M
Stocks of Central Government and Central Government-Guaranteed Domestic Debt[4]	Mar. 2004	Apr. 2005	M	M	M
External Current Account Balance	June 2004	Oct. 2004	A	Q	Q
Exports and Imports of Goods and Services	Mar. 2004	Apr. 2005	M	M	M
GDP/GNP	2003/04	Oct. 2004	A	A	A
Gross External Debt	6/30/04	Oct. 2004	M	O	...

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] Including maturity composition.
[5] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA) .

Uganda: Debt Sustainability Analysis–Update[15] [16]

Uganda's debt sustainability dynamics remains highly vulnerable to external shocks. Thus, implementing sound macroeconomic policies, consolidating the fiscal deficit, and pursuing comprehensive economic growth and export diversification strategies are key to promoting debt sustainability over the medium term.

The debt sustainability analysis (DSA) update incorporates modifications to the macroeconomic framework and revised WEO projections on commodity prices. The average growth rate of exports for the period 2005-10 has been revised upward to 7.7 percent (6.3 percent in the fourth review of the PRGF[17]) as a result of increasing volume exports. Although increasing oil prices dominate Uganda's short-term import performance, long-term import path remains strongly attached to the steady-state real GDP growth of 6 percent. Long-term nominal GDP in U.S. dollars has been estimated under the assumption that the real exchange rate will remain constant.

Changes in the NPV of debt-to-exports ratio in 2004/05

NPV of debt-to-exports ratio in 2004/05 (Fourth Review)	224
Increase in the discount factor by 0.5 percent	-4
Current year export (replacing three-year average export)	-20
Upward revision of exports	-14
NPV of debt-to-exports ratio in 2004/05 (Fifth Review)	186

The NPV of debt-to-exports ratio is decreasing significantly due to some methodological changes. The DSA for the fifth review is increasing the discount factor to 5 percent, and the debt-to-exports ratio is calculated by using the current-year exports.[18] Both changes decrease the NPV of debt-to-exports ratio by 24 percent. The debt-to exports ratio is further decreased by 14 percent after changes to export projections are included (see above).

Uganda's debt-service obligations are manageable in the baseline scenario, but the external debt sustainability dynamics remains fragile (Tables 1 and 2). The debt service-to-exports ratio decreases from 9 percent in 2005 to 7 percent in 2015 as external financing is provided mainly as grants and concessional loans. The NPV of debt-to-exports ratio will remain at about 186 percent in the period 2005-10 slowly decreasing to 173 percent by 2015. All in all the NPV of debt-to-exports ratio remains above the 150 percent threshold of the

[15] The implications of the recent proposal from the G-8 leading countries for debt cancellation is not incorporated in this analysis.

[16] The results of the DSA-Update are preliminary and subject to changes as they are based on a debt database estimated at June 2003. The upcoming joint DSA will assess the debt sustainability situation with debt data estimated at June 2004 and might include further refinements on loan information.

[17] See IMF Country Report No. 05/183, Appendix V, Table 2.

[18] The DSA of the fourth review (IMF Country Report No. 05/183) used a discount rate of 4.5 percent and a three-year export average to estimate the NPV of debt-to-exports ratio.

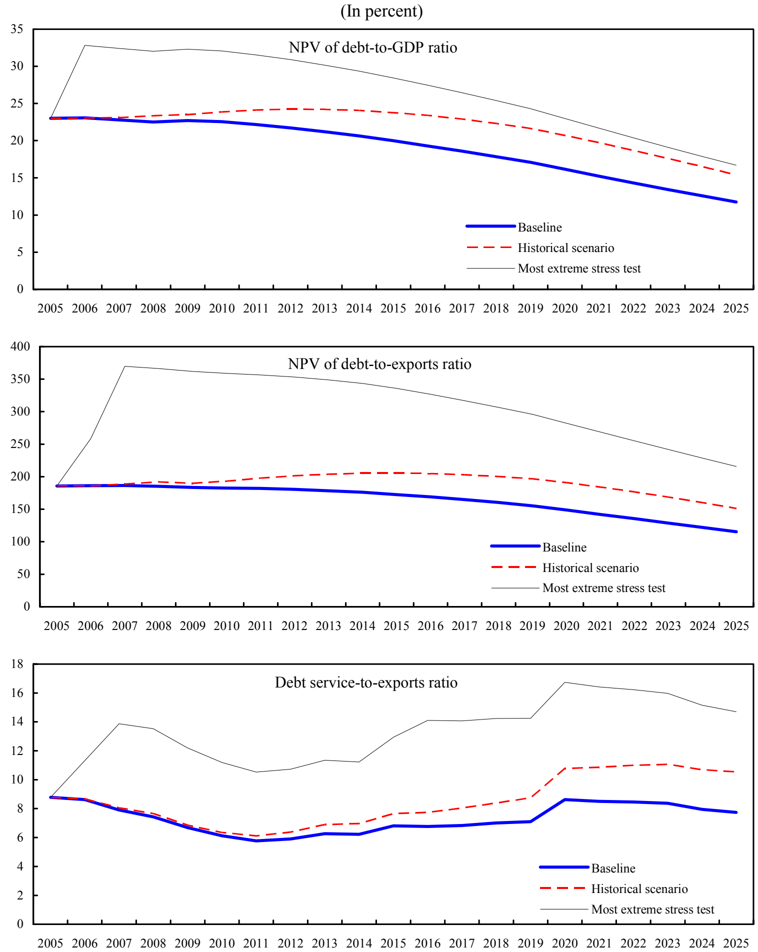
enhanced HIPC Initiative, but below the debt-burden reference threshold of 200 percent for strong policy performers.[19]

In the event of an external shock to Uganda, the debt burden would worsen significantly while the debt-service ratio would remain mostly under control over the medium term (see Figure 1)**.** Bound tests show that the debt sustainability dynamics is highly sensitive to shocks on export performance and a combination of all macroeconomic shocks.

- A two-year shock on the export sector (B2), such as terms of trade shock, has a long lasting effect on debt dynamics due to an export base that is concentrated in few commodities. The NPV of debt-to-exports ratio would increase to 336 percent by 2015 from 186 percent in 2005 (baseline scenario). The export-shock scenario also shows that Uganda's debt servicing capacity is affected in the short term as the debt service-to-exports ratio increases to 13 percent in 2015 from 9 percent in 2005.

- A combination of several shocks (B5) would significantly affect the debt dynamics in the near term as a result of greater macroeconomic instability. The combined shocks would affect debt sustainability negatively by increasing the ratios of debt-to-exports and debt service-to-exports ratios to 245 and 10 percent, respectively, by 2015.

Figure 1. Uganda: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2005-2025
(In percent)



Source: Staff projections and simulations.

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[19] See *Operational Framework for Debt Sustainability Assessments in Low-Income Countries—Further Considerations*.

The debt-to-exports ratio of 186 percent in 2005 does not provide enough assurances that Uganda could embark on a new borrowing strategy because stress tests confirm that its debt position remains highly vulnerable to external shocks. Thus, given the risks of relying mainly on agricultural exports, the export policy should continue to focus on diversifying the export base and strengthening export competitiveness. In addition, implementing a prudent debt management strategy and improving the efficiency of the allocation of donor support will help improve debt sustainability over the long term.

Table 1. Uganda: External Debt Sustainability Framework, Baseline Scenario, 2002-2025 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Estimate	Projections								
	2001/02	2002/03	2003/04			2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2005-10 Average	2014/15	2024/25	2011-25 Average
External debt (nominal) 1/	**65.6**	**62.9**	**60.3**			**49.6**	**49.5**	**48.5**	**47.4**	**47.3**	**46.3**		**38.5**	**21.4**	
Of which: public and publicly guaranteed (PPG)	65.6	62.9	60.3			49.6	49.5	48.5	47.4	47.3	46.3		38.5	21.4	
Change in external debt	5.5	-2.7	-2.6			-10.6	-0.1	-1.1	-1.0	-0.2	-1.0		-1.7	-1.5	
Identified net debt-creating flows	0.9	-0.8	-5.7			-1.7	0.3	0.0	-0.9	0.4	-0.7		0.1	1.9	
Non-interest current account deficit	**4.8**	**5.8**	**1.2**	**4.6**	**3.0**	**3.0**	**5.3**	**5.0**	**4.5**	**4.8**	**4.1**		**4.6**	**5.5**	4.9
Deficit in balance of goods and services	14.4	14.2	13.2			13.3	14.5	13.9	13.6	13.3	12.7		13.2	14.0	
Exports	12.1	12.2	14.4			12.4	12.4	12.2	12.2	12.4	12.4		11.6	10.2	
Imports	26.5	26.4	27.6			25.7	26.9	26.1	25.7	25.7	25.1		24.8	24.2	
Net current transfers (negative = inflow)	-11.3	-10.3	-13.6	-8.5	3.7	-12.1	-10.6	-10.2	-10.3	-9.9	-10.3		-10.3	-10.3	-10.3
Other current account flows (negative = net inflow)	1.7	1.8	1.5			1.8	1.5	1.3	1.2	1.4	1.8		1.8	1.9	
Net FDI (negative = inflow)	**-2.5**	**-2.6**	**-2.4**	**-2.1**	**0.5**	**-2.4**	**-2.4**	**-2.4**	**-2.6**	**-2.6**	**-2.5**		**-2.5**	**-2.5**	-2.5
Endogenous debt dynamics 2/	**-1.4**	**-4.0**	**-4.4**			**-2.3**	**-2.6**	**-2.6**	**-2.7**	**-1.8**	**-2.4**		**-2.0**	**-1.1**	
Contribution from nominal interest rate	0.5	0.5	0.6			0.2	0.2	0.2	0.2	0.2	0.2		0.2	0.1	
Contribution from real GDP growth	-4.0	-2.9	-3.4			-2.5	-2.9	-2.8	-3.0	-2.1	-2.6		-2.2	-1.3	
Contribution from price and exchange rate changes	2.1	-1.6	-1.6			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**4.5**	**-1.9**	**3.1**			**-8.9**	**-0.4**	**-1.0**	**-0.2**	**-0.5**	**-0.2**		**-1.8**	**-3.4**	
Of which: exceptional financing	-0.4	-0.3	-0.1			0.0	0.1	0.2	0.0	0.0	0.0		0.0	0.0	
NPV of external debt 4/	...	...	27.7			23.0	23.1	22.8	22.5	22.7	22.5		20.0	11.7	
In percent of exports	...	...	193.0			185.7	186.1	186.3	185.1	183.4	182.5		172.5	115.4	
NPV of PPG external debt	**...**	**...**	**27.7**			**23.0**	**23.1**	**22.8**	**22.5**	**22.7**	**22.5**		**20.0**	**11.7**	
In percent of exports	...	...	193.0			185.7	186.1	186.3	185.1	183.4	182.5		172.5	115.4	
Debt service-to-exports ratio (in percent)	20.3	19.7	17.1			8.8	8.6	7.9	7.4	6.7	6.1		6.8	7.7	
PPG debt service-to-exports ratio (in percent)	20.3	19.7	17.1			8.8	8.6	7.9	7.4	6.7	6.1		6.8	7.7	
Total gross financing need (billions of U.S. dollars)	277.7	351.6	82.4			144.3	370.4	353.4	302.3	349.3	296.6		530.2	1510.5	
Noninterest current account deficit that stabilizes debt ratio	-0.7	8.5	3.7			13.6	5.4	6.0	5.5	5.0	5.1		6.3	7.0	
Key macroeconomic assumptions															
Real GDP growth (in percent)	6.8	4.7	5.9	6.6	2.2	5.4	6.2	6.1	6.6	4.7	6.0	5.8	6.0	6.0	6.0
GDP deflator in U.S. dollar terms (change in percent)	-3.3	2.6	2.6	0.1	12.4	21.0	0.9	2.0	1.2	1.1	1.3	4.6	2.0	2.0	2.0
Effective interest rate (percent) 5/	0.9	0.8	1.0	1.2	0.3	0.5	0.5	0.5	0.5	0.5	0.6	0.5	0.6	0.7	0.6
Growth of exports of goods and services (in U.S. dollars, in percent)	3.0	8.8	27.7	14.9	32.4	9.9	7.3	6.7	7.3	7.7	7.2	7.7	6.7	6.7	6.7
Growth of imports of goods and services (in U.S. dollar, in percent)	11.2	7.3	13.5	10.7	19.6	18.4	12.2	5.4	6.1	5.7	4.8	8.8	7.9	7.9	7.9
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	56.3	56.4	56.4	56.4	56.4	56.4	56.4	56.9	56.9	56.9
Memorandum item:															
Nominal GDP (billions of US dollars)	5834.5	6266.1	6806.3			8678.5	9304.7	10073.9	10866.1	11495.6	12344.2		18238.7	39815.6	

Source: Staff simulations.

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

Table 2. Uganda: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2005-25
(In percent)

	Estimate	Projections						
	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	**2014/15**	2024/25
NPV of debt-to-GDP ratio								
Baseline	23	23	23	23	23	23	**20**	12
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2006-25 1/	23	23	23	23	23	24	**24**	15
A2. New public sector loans on less favorable terms in 2006-25 2/	23	24	25	25	26	27	**26**	18
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	23	24	24	23	24	23	**21**	12
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	23	24	26	26	26	26	**23**	13
B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07	23	27	31	30	30	30	**27**	16
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/	23	26	28	28	28	28	**24**	13
B5. Combination of B1-B4 using one-half standard deviation shocks	23	28	33	33	33	32	**28**	16
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	23	33	32	32	32	32	**28**	17
NPV of debt-to-export ratio								
Baseline	186	186	186	185	183	182	**173**	115
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2006-25 1/	186	186	189	192	190	193	**205**	151
A2. New public sector loans on less favorable terms in 2006-25 2/	186	195	202	208	212	216	**223**	176
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	186	186	186	185	183	182	**173**	115
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	186	259	370	366	362	359	**336**	216
B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07	186	186	186	185	183	182	**173**	115
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/	186	209	231	228	225	223	**208**	131
B5. Combination of B1-B4 using one-half standard deviation shocks	186	225	271	268	265	262	**244**	154
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	186	186	186	185	183	182	**173**	115
Debt-service ratio								
Baseline	9	9	8	7	7	6	**7**	8
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2006-25 1/	9	9	8	8	7	6	**8**	11
A2. New public sector loans on less favorable terms in 2006-25 2/	9	9	8	8	8	8	**10**	12
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	9	9	8	7	7	6	**7**	8
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	9	11	14	14	12	11	**13**	15
B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07	9	9	8	7	7	6	**7**	8
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/	9	9	8	8	7	7	**8**	9
B5. Combination of B1-B4 using one-half standard deviation shocks	9	9	10	10	9	8	**10**	11
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	9	9	8	7	7	6	**7**	8
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	56	56	56	56	56	56	57	57

Source: Staff projections and simulations.

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

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 05/161
FOR IMMEDIATE RELEASE
July 8, 2005

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fifth Review Under Uganda's PRGF Arrangement and Approves US$2.9 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the fifth review of Uganda's economic performance under the three-year Poverty Reduction and Growth Facility (PRGF) arrangement and approved a disbursement for an amount equivalent to SDR 2.0 million (about US$2.9 million). This would bring total disbursements under the PRGF arrangement to SDR 11.5 million (about US$16.6 million).

Uganda's PRGF arrangement was approved on September 13, 2002 (see Press Release No. 02/41) for SDR 13.5 million (about US$19.5 million).

In completing the review, the Executive Board granted Uganda's request to extend the PRGF arrangement through December 31, 2005, and to waive the non-observance of the quantitative performance criterion relating to the accumulation of new domestic budgetary arrears under the commitment control system. The Executive Board also reviewed Uganda's poverty reduction strategy paper, the *Poverty Eradication Action Plan*, and the associated joint World Bank-IMF staff advisory note. Finally, the Board discussed an ex post assessment of Uganda's performance under Fund-supported programs.

Following the Executive Board's discussion, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, stated:

"The Ugandan authorities have maintained their commitment to sound financial policies to ensure continued macroeconomic stability and robust economic growth. In particular, they are to be commended on meeting their overall fiscal targets in 2004/05, although the accumulation of new domestic arrears remains an issue.

"Looking ahead, the main challenge will be to maintain high economic growth and make further inroads in alleviating poverty. This will require persevering with the stabilization effort and improving the investment environment by lowering the cost of doing business and squarely addressing governance issues. The government's revised Poverty Eradication Action Plan (PEAP), which sets out a comprehensive policy agenda for increasing economic growth and reducing poverty, will help achieve these goals, if fully implemented.

“To avoid crowding out private investment and export activities, the government should continue with the process of budget deficit reduction by stepping up domestic revenue collection and improving prioritization of recurrent expenditures. In this context, the revenue-enhancing measures and the envisaged reduction in the deficit announced in the budget for 2005/06 (July-June) are important steps in the right direction. The revenue effort should be supported by continued implementation of reforms at the Uganda Revenue Authority (URA). It will also be important to create sufficient space for productive investment through capping the growth in recurrent spending, especially on non priority public administration outlays. In addition, it will be important to ensure that inflows of foreign aid are allocated to the most economically and socially productive purposes.

“The authorities’ commitment to strengthen public expenditure management and improve the quality of government spending is welcome. To this end, the authorities need to strictly enforce regulations and control the accumulation of domestic arrears.

“The authorities have maintained a sound monetary policy aimed at keeping inflation low. The Bank of Uganda (BOU) should continue to undertake foreign exchange sales as appropriate for sterilization purposes, as over reliance on open market operations with treasury bills would keep interest rates at unduly high levels and crowd out private investment. Vigorous supervision has contributed to the healthy state of Uganda’s banking system. Additional policy steps that are envisaged, including the introduction of a credit reference bureau, should further improve the functioning of the banking system and deepen access to credit. The government should expedite efforts to divest interests in Uganda Development Bank and install a private management team.

“There is a crucial need to improve governance and reduce corruption in Uganda. There have been improvements in certain areas, most notably reforming the URA, but progress in addressing governance issues has been slow. In this respect, the authorities should vigorously implement the anti-corruption strategy.

“The creation of the EAC customs union should help promote intra-regional trade. However, it would be important to reduce the common external tariff over time as means of fostering greater international competitiveness and minimizing potential problems with trade diversion. The authorities should ensure that the proposed establishment of export-processing zones meets international best practices,” Mr. Kato said.

Statement by Peter Gakunu, Alternate Executive Director for Uganda and Jason Milton, Senior Advisor to Executive Director July 8, 2005

1. The Ugandan authorities thank Management and staff for their continuous support and policy advice offered under the current and past programs. The engagement with the IMF facilitated the authorities' efforts to stabilize the macroeconomic environment and pursue growth-oriented policies needed to reduce poverty and achieve the Millennium Development Goals (MDGs). The country reached the completion point under the Enhanced HIPC Initiative, which enabled it to obtain substantive external debt relief. This notwithstanding, the country's debt position remains unsustainable, which increased the authorities' resolve and commitment to continue to implement strong policies and reforms in the period ahead. The authorities request a waiver for the nonobservance of the performance criteria relating to the accumulation of arrears, as well as the extension of the program to December 31, 2005, in order to complete the sixth and final review.

Growth performance

2. The authorities fully recognize that strong growth is key to reducing poverty and achieving the MDGs. They have, therefore, continued to implement sustainable macroeconomic policies and structural reforms to achieve these goals. Growth performance since 1994/95 has on average been higher than 6½ percent, and this performance is expected to continue for the rest of this decade, notwithstanding the recent slightly slower pace of growth. Growth performance from 2005/06 onwards will be boosted by strong export performance, increased agricultural output, increased generation of electricity, as well as regional initiatives such as improving regional roads, railways, and communications infrastructure. While the ex-post assessment viewed Uganda's "barriers to do business" compared to other countries to be mixed, our authorities will continue to improve the business environment, since they recognize the importance of the private sector in achieving sustainable growth. To this end, the government is committed to the establishment of a sound and predictable financial environment in which private sector activity can flourish and recognize that continued financial support from the donor community will be critical.

Fiscal policy and debt sustainability

3. Fiscal policy has been aligned to meeting the objectives of the current program. In this connection, the budget deficit is projected to decline significantly in 2004/05. In addition, the authorities are determined to further reduce the budget deficit over the medium term, through a combination of measures to improve revenue performance, and tighter expenditures controls. On the revenue side, VAT will be increased, as well as excise duties and fees and charges. These measures would, however, not unduly increase the tax burden on

the poor, which is consistent with the findings of the poverty and social impact analysis (PSIA) study that was conducted by the Fiscal Affairs Department.

4. The authorities have made significant progress in strengthening the budget planning and control systems, notwithstanding the slippages that occurred pertaining to the accumulation of arrears. The authorities have brought fiscal policy back on track and have pledged to make every effort to pay all the domestic arrears during fiscal year 2004/05 and to implement measures to strengthen the overall monitoring and control of domestic arrears. In addition, they will ensure strict adherence to the existing regulations prohibiting accounting officers exceeding budget ceiling. By implementing these revenue and expenditure measures, the authorities hope to ensure sustainable fiscal policy.

5. Uganda has benefited from comprehensive debt relief under the Enhanced HIPC Initiative. However, external debt sustainability has not yet been attained, and it is unlikely that it will be achieved over the medium to long-term. In order to ensure no further deterioration of the debt position, and to secure overall macroeconomic stability, the authorities are implementing prudent debt management policies. However, in the long run, strong policies, sustained GDP growth, reduced poverty and attaining the MDGs, would only be possible once the country permanently exits from an unsustainable external debt position.

Monetary, exchange rate and financial policies

6. The authorities have been successful in implementing their monetary policy framework with the view to maintaining a low and stable inflation rate, while pursing a flexible and competitive exchange rate. They considered low inflation as an important element in their efforts to ensure better quality of life for the poor, since the poor are normally more severely affected by high inflation rates. Although Uganda's inflation rate has recently increased sharply because of higher food prices, the authorities consider this increase as a temporary phenomenon. Most importantly, the underlying inflation rate has remained at a low level. The monetary authorities are committed to sustaining this monetary policy stance.

7. The authorities remain committed to maintaining a flexible exchange rate. In light of the upward pressure on the exchange rate, based on strong private sector inflows, the use of foreign exchange sales for sterilization purposes was not the preferred option of the authorities, since this would have not only created additional upward pressures on the rate, but also resulted in instability in the market. To this extent, therefore, there was an increased use of domestic securities in the liquidity management during the financial year 2004/5. Because of the decline on the upward pressure of the exchange rate, the authorities resumed the sale of foreign exchange for sterilization purposes in the last two months. They are, however, committed to using both domestic securities and sale of foreign exchange for liquidity management, but in a manner, that does not created instability in either market. At

present, the authorities feel comfortable with the competitiveness of the exchange rate and the level of reserves.

8. The recently completed FSAP underscored the overall strength of Uganda's financial system. The banking system is considered strong and well capitalized, and nonperforming loans as a ratio of total exposure is low, even compared to most emerging market countries. The authorities will address the risks pertaining to over-exposure to individual borrowers, through increased supervision.

Structural reforms

9. Uganda has been implementing ongoing structural reforms for more than a decade with a view to creating an environment supportive of economic growth and poverty reduction. The reform program has been successfully implemented particularly in the financial sector, as regards the privatization of enterprises, and concerning exchange rate and trade liberalization. The implementation of fiscal reforms has not been met with the same level of success compared to other sectors of the economy, and pursuing these reforms will be the focus of the authorities' efforts in the period ahead. In particular, the government is implementing measures to improve the efficiency of the Uganda Revenue Authority and to strengthen expenditure monitoring and control mechanisms. The authorities will also endeavor to complete their privatization program, and implement the FSAP recommendations, including those related to Anti-money Laundering, and pension reforms. The delay in selling a minority share in the UDB was to allow additional time to build a deeper and broader consensus among the main stakeholders. The government fully recognizes the damaging effect of corruption on the economy, including in the fiscal area and official institutions. The government is addressing corruption through the adoption of strong anti-corruption legislation and strengthening the power of oversight bodies such as the Inspector General of Government.

Poverty reduction strategy

10. The key focus of Uganda's policy initiatives has been to address poverty. While progress has been made on this front the authorities are fully aware of the daunting challenges that still lie ahead. Over the last decade, the focus of public spending shifted towards poverty reduction and during the 1990s the level of poverty declined. The authorities are eager to vigorously pursue their efforts to reduce poverty, as highlighted in Uganda's Poverty Eradication Action Plan (PEAP). According to the Joint Staff Assessment, the PEAP, which was prepared by government after broad based consultation with all major stakeholders and civil society, constitutes a comprehensive and well-balanced strategy to achieve accelerated growth and poverty reduction. However risks such as inequality of income distribution and corruption could slow down the implementation of the PEAP. In recognizing these challenges, the authorities will redouble their efforts in addressing any shortcomings.

Ex-Post Assessment

11. The Ex-Post Assessment focused on progress made by Uganda after more than a decade of almost uninterrupted participation in Fund supported programs. During this period, the authorities, with IMF support, stabilized the macroeconomic environment based on the implementation of an ambitious reform agenda and significant donor financial support. Progress has been made in addressing acute poverty in the country, particularly during the 1990s, and the authorities are keen to see a resumption in poverty reduction. This will be achieved with the strategy formulated in the PEAP, which makes provision for increased participation of the private sector in the economy and higher social sector related spending.

12. The EPA highlights that the level of structural conditionality in Fund supported programs for Uganda was higher than the average for all PRGF programs, and that Uganda's record in implementing these conditionalities became weaker in latter programs. This finding is significant, since it underscores the view that the implementation of the Fund's policy of streamlining conditionality is less than satisfactory. We would urge staff to ensure that Fund guidelines relating to streamlining conditionality is implemented consistently and equitably for all program countries, while promoting country ownership of programs and policies.

Concluding remarks

13. Uganda benefited from its relationship with the IMF and is eager to continue with it. The authorities welcome the assessment of their policy framework by conducting ROSC exercises, the FSAP, EPA and JSA. These reports underscore the country's record of accomplishment on reforms, but also point out the prevailing risks that could hinder efforts to sustain growth, reduce poverty and achieve the MDGs. The country is grateful for the consistent and generous support by the donor partners both in terms of aid flows and debt relief under the Enhanced HIPC Initiative. The authorities will support efforts to provide further debt relief that will ensure a permanent exit from unsustainable debt, and which will contribute to achieving the MDGs.