© 2006 International Monetary Fund

January 2006
IMF Country Report No. 06/24

Uganda: Ex Post Assessment of Performance Under Fund-Supported Programs and Public Information Notice on the Executive Board Discussion.

In the context of the IMF Executive Board's discussion on the Ex Post Assessment of Uganda's performance under Fund-supported programs, the following documents have been released and are included in this package:

- the staff report on the Ex Post Assessment of Performance Under Fund-Supported Programs for Uganda, prepared by a staff team of the International Monetary Fund, which 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 government of Uganda or the Executive Board of the IMF.

- a Publication Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 8, 2005, discussion of the staff report.

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

UGANDA

Ex Post Assessment of Performance Under Fund-Supported Programs

Prepared by a staff team from AFR, FAD, MFD, PDR, and RES Departments[1]
with participation of DFID

Authorized for distribution by the African Department and the
Policy Development and Review Department

June 23, 2005

Contents | Page

I. Introduction and Overview 3

II. Assessment of Fund Involvement, 1994-2004 4
- A. Objectives of Fund Programs 4
- B. Program Performance 4
- C. Program Conditionality and Compliance 21
- D. Program Design and Implementation Lessons 23
- E. Collaboration with the World Bank and Other Donors 27

III. Policy Challenges for the Medium Term 28

IV. Strategy for Future Fund Involvement 30

Tables

1. Performance Under the ESAF/PRGF-Supported Programs, 1994/95-2004/05 33
2. Comparison of Selected Financial Soundness Indicators of the Banking Sector, 2000-04 35
3. Structural Conditionality Under the ESAF/PRGF Arrangements, 1994-2004 36
4. Quantitative Performance Criteria and Benchmarks Under ESAF/PRGF Arrangements 37
5. The Millennium Development Goals and Targets 38

---

[1] The team comprised Mr. Gupta (head), Mr. Mikkelsen, Mr. Peiris (all AFR), Mr. Op de Beke (PDR), Ms. Gonzalez (FAD), Mr. Yokobori (MFD), Mr. Tressel (RES), and Mr. Beynon (DFID).

Contents Page

Figures

1. Cumulative Net Donor Flows and IMF Program Access 3
2. Average Real GDP Per Capita Growth, 1990-2004 4
3. Selected Macroeconomic Indicators-Annual Projected and Actual 5
4. Domestic Debt, Interest Rates, and Inflation 6
5. Private Sector Credit of GDP....8
6. Banking Sector Assets to GDP 8
7. Overall Balance Excluding Grants 8
8. Real and Nominal Effective Exchange Rate....9
9. Evolution of Debt Under the HIPC Initiative 10
10. Domestic Revenue Comparison....12
11. Size of the Public Sector....13
12. Shares in World Trade 17
13. Coffee and Nontraditional Exports, 1998-2003....17
14. Evolution of Broad Economic and Political Institutions 18
15. Public Expenditure and Social Priorities 19
16. Shares in Intra-Africa Trade 27

Boxes

1. The Impact of Rainfall on Economic Growth....6
2. The Macroeconomic Policy Challenge of Large Aid Inflows 11
3. How Effective is Decentralization in Uganda?....15
4. Does the PAF Cover All Poverty Spending?....20
5. Has There Been a Setback in Poverty Reduction? 21

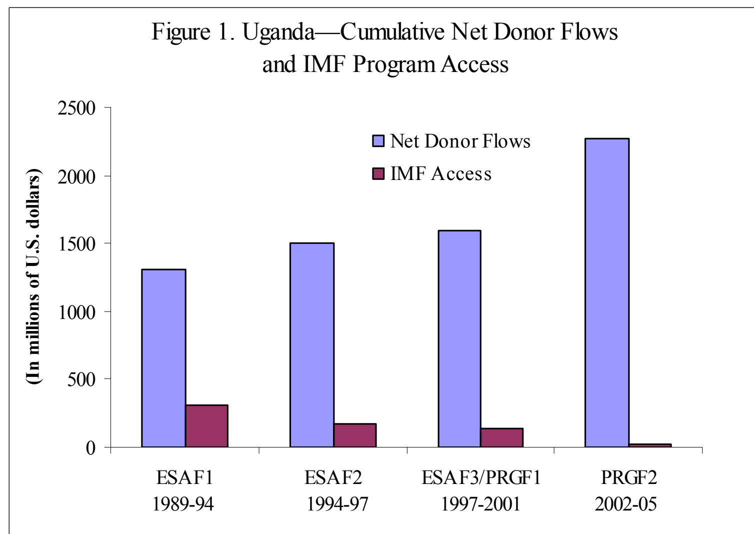
I. Introduction and Overview

1. **The Ugandan economy posted an impressive postconflict recovery in the late 1980s with the return to stable political and security conditions.** The foundation for the economic turnaround was laid when the National Resistance Movement, under the leadership of President Museveni, assumed control of the government in 1986. In the early 1990s, Uganda launched an ambitious reform program marked by strong macroeconomic stabilization, liberalization of key markets and sectors—including the foreign exchange market and the coffee and banking sectors—and privatization of several public enterprises. The return of the Asian community and other Ugandans who had fled the country during the previous regimes also contributed to the economic recovery.

2. **Since 1987, the Fund has supported Uganda's reform efforts on an almost continuous basis.** There were four consecutive Fund-supported arrangements between 1987 and 2001.[2] Following a short hiatus of about a year, the Fund approved, in September 2002, a low-access three-year PRGF arrangement that is scheduled to expire in September 2005. Uganda received debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative in 1998 and under the enhanced HIPC framework in 2000.

3. **The mid-1990s represent a break from previous programs for several reasons**. First, Fund assistance to Uganda declined sharply in the 1990s, while donor support rose gradually (Figure 1). Second, the focus of Uganda's economic policies shifted toward poverty reduction, culminating in the launch of its first Poverty Eradication Action Plan (PEAP) in June 1997. Finally, 1994 marks the beginning of the democratization process; elections were held in March 1994 for the Constitutional Assembly that concluded in parliamentary and presidential elections in 1996. This paper thus assesses Uganda's performance under Fund-supported programs since 1994 and draws lessons for future Fund engagement.

Figure 1. Uganda—Cumulative Net Donor Flows and IMF Program Access



[2] The first was under the Structural Adjustment Facility (June 1987-April 1989), the next two under the Enhanced Structural Adjustment Facility (ESAF, April 1989-June 1994 or ESAF1and September 1994-November 1997 or ESAF2); and the fourth one under an ESAF/Poverty Reduction Growth Facility (PRGF, November 1997-March 2001 or ESAF3/PRGF1).

II. Assessment of Fund Involvement, 1994-2004

A. Objectives of Fund Programs

4. **In the early 1990s, programs (ESAF1 and ESAF2) targeted macroeconomic stability through fiscal consolidation and the creation of conditions for sustained private sector growth**. The programs encompassed measures to liberalize domestic prices as well as financial and trade sectors. In addition, the programs sought to curtail the role of the government, mainly through a large-scale privatization of public enterprises, civil service reform, and the establishment of a market-based system for allocating foreign exchange.

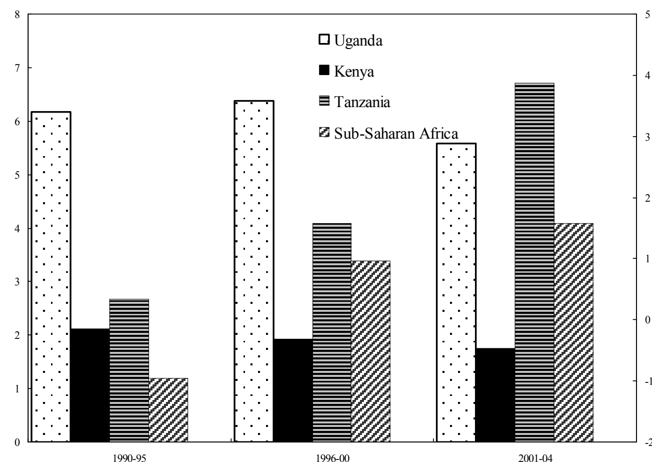
5. **The emphasis shifted to poverty reduction in the 1997-2001 program (ESAF3/PRGF1).** While continuing to target robust growth and macroeconomic stability, the program also aimed to loosen the fiscal stance to permit higher spending on human capital and infrastructure so as to enhance the efficiency of the private sector. This shift was facilitated by an improved external outlook and stepped-up donor support for priority sectors. In addition, the program called for structural and institutional reforms (including in the legislative and judicial areas) and good governance.

6. **The 2002-05 program (PRGF2) reaffirmed the authorities' commitment to poverty reduction** in the context of the Millennium Development Goals (MDGs) while seeking to revive economic growth. The program stressed the continued implementation of reforms already initiated and sought fiscal consolidation—following the looser fiscal stance of the preceding years—to release resources for private investment and reduce growing donor dependence. In addition, the program placed greater emphasis on governance issues.

B. Program Performance

Macroeconomic performance

Figure 2. Uganda: Average Real GDP Per Capita Growth, 1990-2004

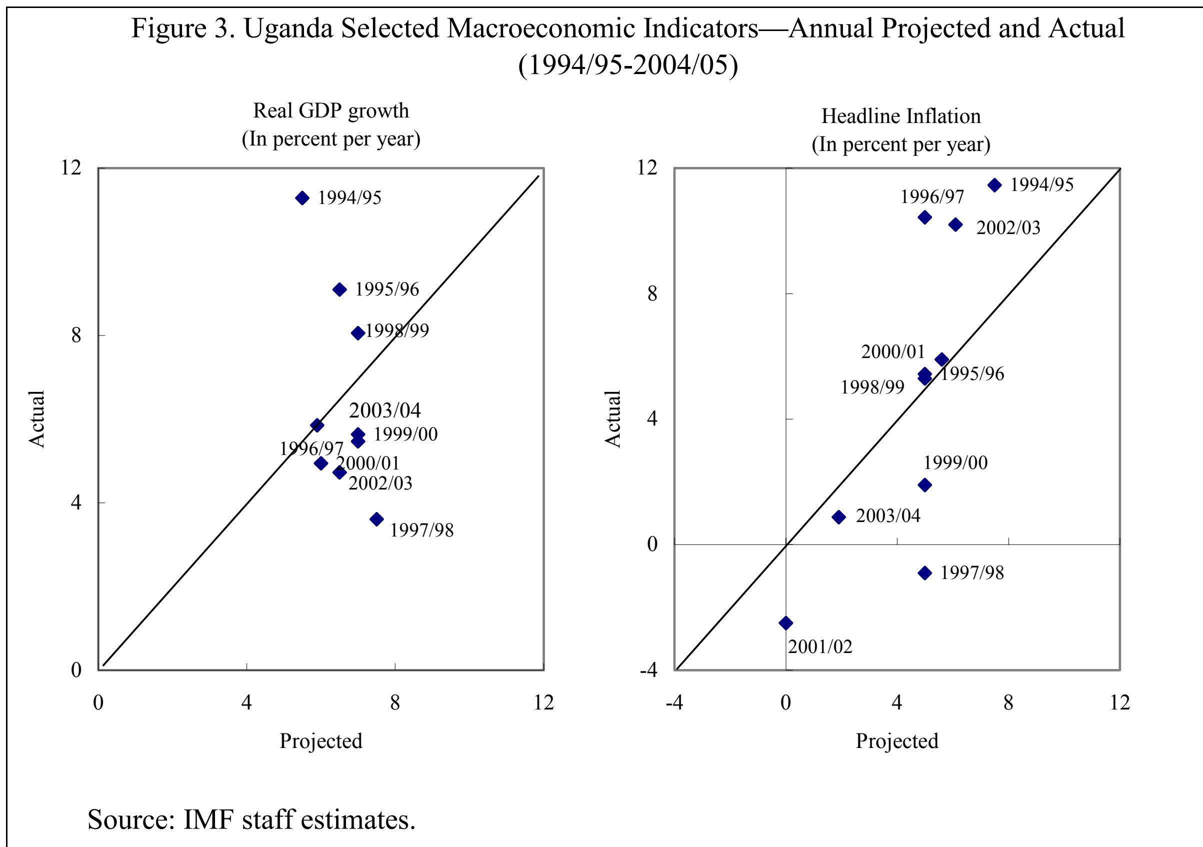


Source: Sub-Saharan Africa Regional Economic Outllook database.

7. **Uganda's annual average growth rate of about 6½ percent over the past decade was exceptional,** given that Uganda is a landlocked country and has been buffeted by deteriorating terms of trade since the mid-1990s (Figure 2). The growth projections in the programs have been comparatively conservative and have not displayed the systematic over optimism that has characterized many PRGF-supported programs (Figure 3), (Table 1). While Uganda is one of

the few countries in sub-Saharan Africa (SSA) that has sustained recent surges in economic growth,[3] real GDP growth has slowed to about 5-5½ percent in recent years—a pattern also observed in other postconflict countries.[4] Moreover, economic growth remains vulnerable to external and natural shocks—including rainfall—because of the large share of agriculture in the economy (Box 1).

Figure 3. Uganda Selected Macroeconomic Indicators—Annual Projected and Actual (1994/95-2004/05)



Source: IMF staff estimates.

---

[3] See "Sub-Saharan Africa Regional Economic Outlook,".

[4] See Paul Collier and Ande Hoeffler, "Aid, Policy, and Growth in Post-Conflict Societies," Policy Research Working Paper No. 2902 (Washington: World Bank, 2002).

Box 1. The Impact of Rainfall on Economic Growth

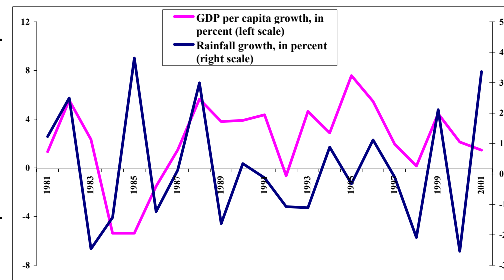
The Ugandan economy is highly dependent on agriculture, which constitutes 40 percent of GDP. In addition, a large share of manufacturing firms process agricultural products.

Exogenous factors, such as weather, have an impact on real GDP per capita growth. A simple regression of real GDP per capita growth on changes in annual rainfall and export prices was estimated for 1980-2001 to illustrate the impact of weather on real GDP per capita growth. Data on rainfall are from Miguel, Satyanah, and Sergenti (2004), and those on the commodity price index are from Cashin, Cespedes, and Sahay (2002).[1] A dummy variable for the civil war period 1984-86 was included in the regression (see table).

Rainfall has a significant and large effect on real GDP per capita growth. Half a standard deviation fall in the growth rate of rainfall is associated with a 0.59 percentage point decline in per capita growth in the same year and a 0.6 percentage point decline in the following year. Moreover, rainfall is very volatile: the annual standard deviation is 19 percent.

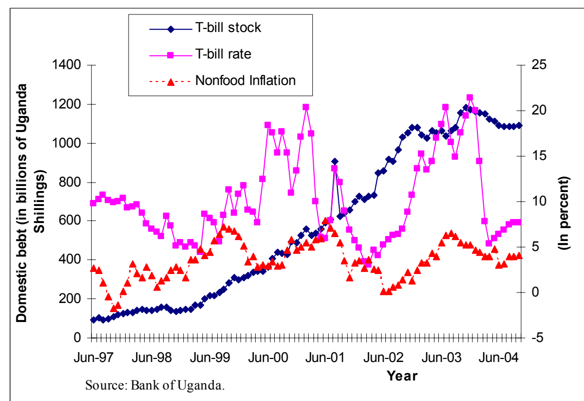
Dependent Variable: Real GDP per capita growth 1980-2001

Variable	Coef.	Std. Err.	t-Stat.	p value
Growth in rainfall	0.057	0.028	2.05	0.06
Lagged growth in rainfall	0.060	0.029	2.07	0.06
Dummy 1984-1986	-0.076	0.013	-6.05	0.00
Lagged export unit price	0.019	0.017	1.10	0.29
Nb. of observations	20			
R- squared	0.73	Adj. R-squared		0.664



[1] E. Miguel, S. Satyanah, and E. Sergenti, "Economic Shocks and Civil Conflict: An Instrumental Variables Approach," *Journal of Political Economy*, Vol. 112 (2004); and Paul Cashin, Luis Cespedes, and Ratna Sahay, "Keynes, Cocoa, and Copper: In Search of Commodity Currencies," IMF Working Paper No. 02/223 (Washington: International Monetary Fund, 2002).

Figure 4. Uganda: Domestic Debt, Interest Rates, and Inflation



Source: Bank of Uganda.

8. **Uganda was broadly successful in containing annual inflation to 5 percent during the program period under review.**[5] It reduced consumer price inflation from an average of 26 percent under ESAF1 to 7 percent a year under ESAF2 (Table 1). However, inflation was higher than programmed (as were both base and broad money) under ESAF2, reflecting larger-than-anticipated net credit to the government as well as the impact of the coffee price boom.[6] Attempts by the

[5] Operationally, IMF-supported programs and the Bank of Uganda (BOU) generally targeted nonfood inflation at less than 5 percent, which meant that the BOU did not adjust monetary policy to offset temporary, weather-induced supply shocks experienced in the agricultural sector.

[6] This indicates that central bank sterilization operations were probably insufficient.

Bank of Uganda (BOU) to neutralize liquidity injections from compensating depositors of banks closed during 1998/99 led to a jump in both domestic debt and interest rates under ESAF3/PRGF1 (Figure 4).[7] The monetary policy framework switched to targeting base money under PRGF2, allowing the authorities to better deal with the inflationary repercussions of coffee price spikes and aid inflows.[8]

9. **Until recently, credit to the private sector increased very little** (Figure 5), and still remains below the level found in many other SSA countries.[9] While the banking sector has accumulated assets, most of this increase is attributable to rises in banks' holdings of government securities rather than to an increase in private sector credit (Figure 6).[10] These holdings have fallen since the privatization of the Uganda Commercial Bank (UCB) in 2002.[11] The banks still have a preference for liquid and low-risk assets, reflecting high credit risk, a weak environment for contract enforcement, limited access to borrowers' information, and a widespread lack of collateral. Interest rate spreads are high, at about 20 percent, and they have not dropped below 16 percent over the past six years, reflecting high overhead costs, high cost of credit recovery, and insufficient competition. Depositors receive close to negative real interest rates on savings deposits, which may be affecting the savings behavior of rural households.

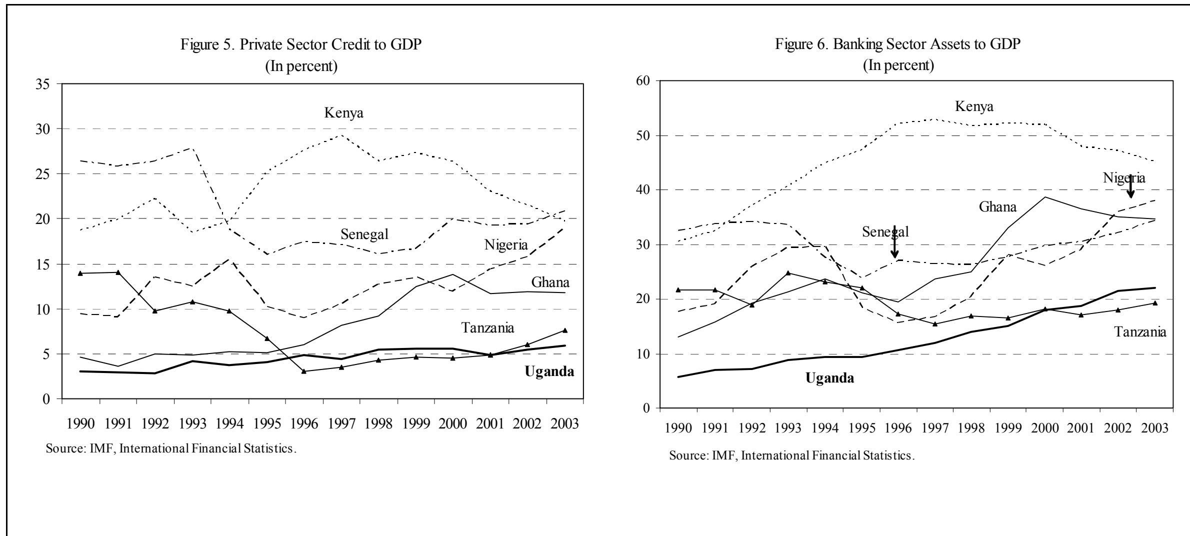
[7] The other factors that likely to have contributed to the interest rate volatility are low confidence in the system, weaknesses in the BOU operations, and shallowness of local markets.

[8] Under net domestic assets (NDA) targeting, unanticipated increases in donor financed projects could lead to excessive monetary expansion, since the central bank would not be obliged to undertake sterilization operations. In contrast, base money targeting, which assumes full sterilization of unanticipated inflows, could cause an unwarranted tightening in the short term and an increase in interest rates if money demand is larger than anticipated.

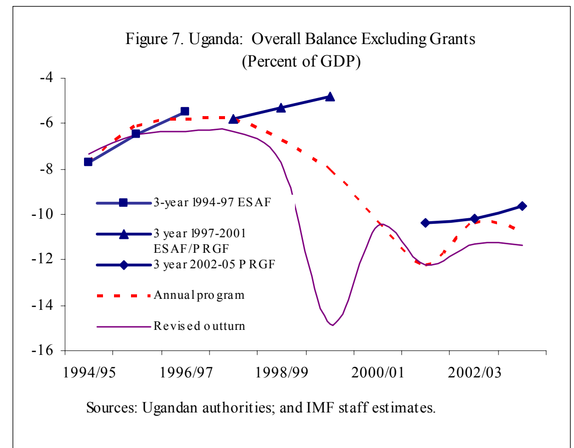
[9] This is partly explained by the weak supervisory framework, bank failures, and directed lending between the 1970s and the early 1990s. A thorough restructuring of the banking system was required before lending could resume.

[10] The widening fiscal deficit also contributed to an increased supply of government securities (see paragraph 10).

[11] The share of treasury bills in bank portfolios grew rapidly from 6 percent in 1995 to 34.2 percent in 2002, but has declined to 22 percent in September 2004, reflecting the recent pickup in private sector lending. On the role of the privatization of the UCB in spurring competition, efficiency, and credit growth, see David Hauner and Shanaka Peiris, "Bank Efficiency and Competition in Low Income Countries: the Case of Uganda" forthcoming in the IMF Working Paper series.



10. **Since 1994, efforts directed at fiscal consolidation have yielded mixed results** (Figure 7). The fiscal consolidation under ESAF2 fell short of program targets measured both in terms of the overall deficit including and excluding grants. Both revenue shortfalls, partly reflecting over optimism of revenue projections, and expenditure overruns in nonpriority areas—often implemented through supplementary budgets to finance spending of the State House and other powerful units of the public administration—contributed to this outcome. Although ESAF3/PRGF1 initially targeted fiscal consolidation, the fiscal stance was relaxed in the midst of the program to accommodate higher expenditures on elections, defense, social sectors, and development.[12] In 1999/2000, expenditure overruns peaked partly because of the lease purchase of a jet for the president, the recapitalization of the BOU,[13] and the compensation to private sector depositors of banks closed in 1998/99.[14] This caused the overall deficit, excluding grants, to exceed program projections by 7 percent of GDP, while the deficit,



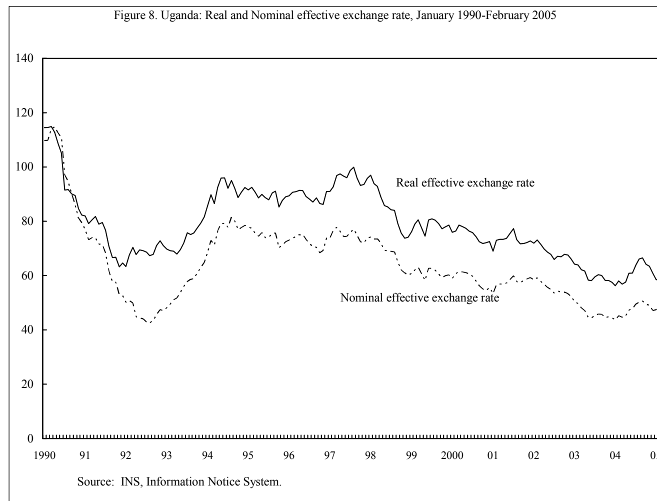
[12] Annual revisions to program targets widened the overall balance excluding grants by 2.3 percent of GDP, with spending rising by 3.5 percent of GDP over the program period.

[13] The 1999/2000 deficit incorporates the costs of recapitalization of the BOU incurred three years earlier.

[14] The 2000/01 program targeted a fiscal adjustment of 4.4 percent of GDP—smaller than the 1999/2000 increase in fiscal deficit of about 6 percent of GDP. The envisaged fiscal adjustment was thus smaller than one-off increase in expenditures of 6 percent of GDP in 1999/2000.

including grants, was higher than the program target by 8 percent of GDP. Expenditure overruns led by larger-than-envisaged externally financed development outlays,[15] overspending by powerful units of the public administration, and discretionary financial support to certain private enterprises have persisted in the current program.[16]

11. **A market-based exchange rate system has provided flexibility in the face of fluctuating coffee prices and large donor inflows** (Box 2). It has allowed Uganda to retain international competitiveness in its core export products and to maintain a cushion against exogenous shocks. The real effective exchange rate (REER) depreciated steadily as the price of coffee fell between 1994 and 2003. The downward trend was interrupted by a brief episode of aid-induced exchange rate appreciation in 2001 and later in 2004. The nominal effective rate has tracked the REER almost perfectly (Figure 8).



12. **Managing the macroeconomic consequences of higher aid inflows has, at times, posed challenges**. The BOU has intervened frequently to smooth the exchange rate. In the past, for fear of an REER appreciation when terms of trade were trending down, it released only a part of foreign aid inflows to the market, resulting in a large increase in international reserves. Treasury bills were issued to absorb liquidity and mitigate the inflation potential, causing interest rates to rise. While this policy may have reduced exchange rate volatility and provided a comfortable level of international reserves,[17] questions have arisen about the mix of instruments for absorbing large aid flows and their effects on lending by banks to the private sector. This policy has also caused domestic public debt to rise, which currently stands at about 10 percent of GDP. More recently, the BOU has used a mix of foreign

[15] The program's quantitative fiscal performance criteria fully accommodated externally financed project expenditures on the grounds that they were usually disbursed to commercial banks and had a relatively large in-kind and import content.

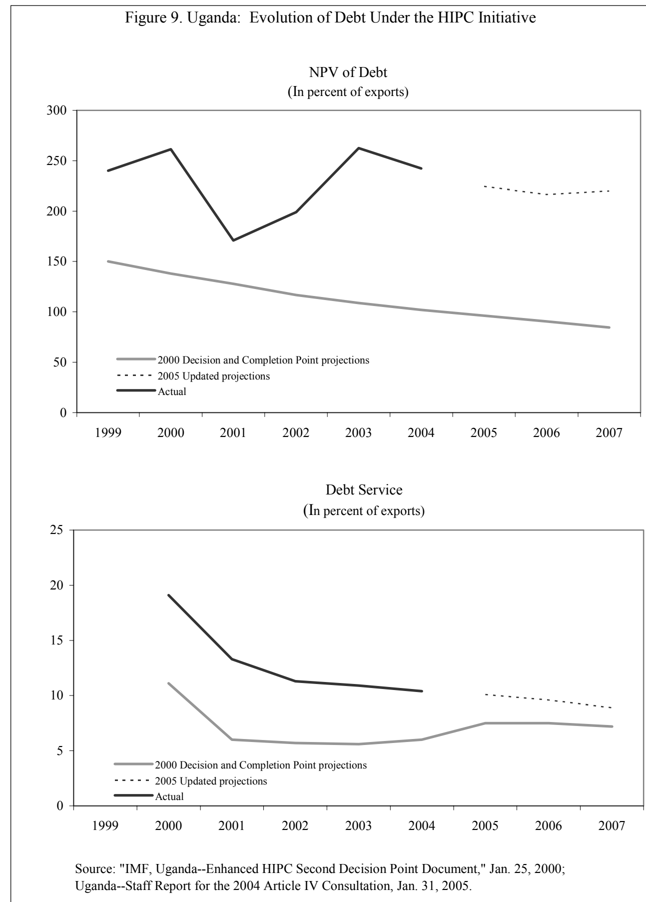
[16] On average, overall deficits including and excluding grants exceeded annual program projections by over 1 percent of GDP between 1994/95 and 2003/04.

[17] See Michael Atingi Ego and Rachel Kaggwa Sebudde, *Measuring Efficiency of a Market in Transition: The Ugandan Foreign Exchange Market*, Bank of Uganda Working Paper 03/02 (Kampala: BOU, 2003); (http://www.bou.or.ug/Measuring%20Efficiency.pdf).The interest rate volatility was also driven by weaknesses in the BOU's operations and sudden shifts in monetary stance.

exchange sales and treasury bills to sterilize aid inflows, which has made interest rates less volatile.

13. **Almost all HIPC debt relief committed was delivered; nonetheless, the external debt ratios have not fallen as envisioned**. The ratio of the net present value (NPV) of Uganda's external debt to exports was first reduced in 1998 to 196 percent under the original HIPC framework and, subsequently, in 2000 was projected at 138 percent under the enhanced framework. Immediately following the second completion point, the export price of coffee—already on a downward trend—dropped precipitously. As a result of falling coffee price, the depreciation of the dollar, and a lower discount rate, the NPV of debt to exports—instead of improving gradually relative to the HIPC target of 150 percent—deteriorated: the ratio rose to 171 percent in 2001 and 263 percent in 2003 and, as of January 2005, was projected to remain at 210-225 percent for the next 10 years (Figure 9). Around two-fifths of the increase can be attributed to new multilateral debt, another two-fifths to exchange and interest rate changes, and the remaining to the lower export base. Even though Uganda's external debt ratios remain high, its debt-service obligations after HIPC Initiative debt relief are manageable.[18] Debt service in relation to exports—a cash-flow indicator—improved from 19.1 percent in 2000 to 10.9 percent in 2003. Uganda's external debt management capacity was assessed in 2002 and improvements pursued under subsequent programs. In 2005, the emphasis was placed on establishing a mechanism for monitoring of debt.

Figure 9. Uganda: Evolution of Debt Under the HIPC Initiative



Source: "IMF, Uganda--Enhanced HIPC Second Decision Point Document," Jan. 25, 2000; Uganda--Staff Report for the 2004 Article IV Consultation, Jan. 31, 2005.

[18] See Uganda Staff Report for the 2004 Article IV Consultation, Fourth Review Under the Three-Year Arrangement Under the PRGF, and Request for Waiver of Performance Criteria, IMF Country Report No. 05/183.

Box 2. Uganda: The Macroeconomic Policy Challenge of Large Aid Inflows 1/

Large aid inflows pose macroeconomic policy challenges for recipient countries. How these challenges are resolved determines the effectiveness of aid in raising growth and reducing poverty. Aid is "absorbed" when net imports rise, resulting in an increase in the non-aid current account deficit. When aid is "spent" by the government, it increases the fiscal deficit net of aid. The policy response to an aid-surge consists in deciding the extent to which aid is absorbed and spent, and in coming up with an appropriate monetary policy. To the extent that aid is spent, particularly on nontraded goods, but not absorbed in the form of higher imports, an appreciation of the real exchange rate may result through higher inflation.

Uganda's net aid inflows jumped by about 9 percent of GDP in 2000/01 as donors began supporting its PEAP. Net aid in Uganda comprises traditional aid inclusive of debt relief.[2] Much of the aid increase comprised program assistance, and the aid was spent largely on recurrent expenditures. Only a small part of the aid translated into rising imports, and thus absorption fell short. The resulting injection of domestic liquidity was countered by treasury bill sales, which kept inflation largely under control. The nominal and real effective exchange rates continued to depreciate, in line with declining terms of trade, and the BOU's decision to use a part of the foreign exchange from aid to augment official reserves.

Uganda managed to spend most of the aid inflow rather swiftly, helped by its quick disbursing nature. While the flexible exchange rate system served Uganda well throughout this episode, it would have done so better if the authorities had relied more on sterilization through the foreign exchange market rather than the domestic money market. It would have meant a slower nominal (and real) depreciation—and possibly even an appreciation, but also less crowding out of credit to the private sector through the surge in interest rates. The BOU drew lessons from this experience and adopted a policy of better mixing domestic and external sterilization.

Uganda: Macroeconomic Management of Aid Inflows

Absorption and spending (In percent of GDP)	**Pre-Aid-Surge 1999-2000**	**Aid-Surge 2000-2003**
Net aid inflows	6.7	12
Non-aid current account	-10.1	-11.4
Non-aid capital account	3.8	0.5
Change in reserves (- = increase)	-0.4	-1.1
Expenditures (excl. external interest)	22.2	24.7
Recurrent	11.9	14.0
Capital	8.8	10.4

	1997/98	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**
			(In percent of GDP)			
Memorandum items:						
Net aid inflows 1/		6.5	6.8	15.5	10.5	9.9
Gross aid inflows		10.0	11.1	16.3	14.6	12.4
Of which: program aid		2.5	3.6	8.3	7.6	6.7
net private inflows		3.0	3.2	2.8	3.2	3.3
Inflation (In percent a year)	5.8	0.2	5.8	4.5	-2.0	5.7
REER (change in percent; - = depreciation)	2.2	-13.0	0.0	-6.5	-1.7	-10.6
NEER (change in percent; - = depreciation)	0	-14.0	-3.2	-6.9	2.3	12.7
Terms of trade (change in percent; - = deterioration)		-10.7	-17.3	-10.6	-3.0	2.9

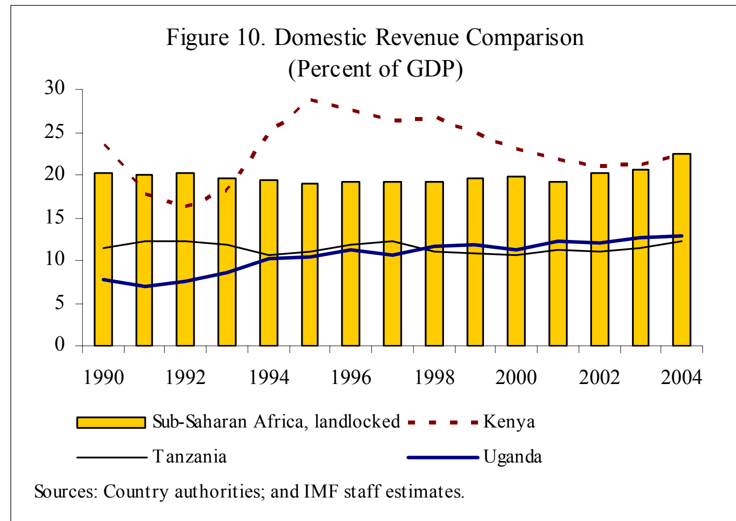
1/ Defined as gross aid inflows plus debt relief (HIPC) minus debt service plus arrears accumulation.

1/ Uganda is one of the cases analyzed in *The Macroeconomics of Managing Increased Aid Inflow: Experiences of Low-Income Countries and Policy Implications,* IMF/Policy Development and Review Department (forthcoming). The data are taken from various Fund staff reports.

Structural reforms

Fiscal sector

14. **Under its Fund-supported programs, Uganda regularly missed its domestic revenue targets, typically by about ½-1 percent of GDP, although the magnitude of shortfalls declined over time.** Uganda implemented its most ambitious tax policy measures during ESAF2—with improved income tax design, which broadened the tax base, simplified the tax structure, reduced exemptions, and streamlined investment incentives. It eliminated income tax holidays in 1997 as well as discretionary exemptions in indirect taxes in 2001, although tax exemptions continue to undermine the tax base to some extent.[19] The introduction of the value-added tax (VAT) in 1996—a key program reform—led to disappointing results, because of relatively broad exemptions and zero-rating that not only complicated its administration but also reduced its revenue capacity.[20] As a result, the assumed improvements in revenue-to-GDP ratio did not materialize under ESAF3/PRGF1. In the aggregate, Uganda's revenue performance remains substantially below that of other landlocked SSA countries (Figure 10).



15. **Weaknesses in revenue administration persist.** The authorities repeated attempts to improve the efficiency of and curb corruption within the Uganda Revenue Authority (URA) have not yielded the expected results. In 2001, several reforms implemented in 1999 were reversed. Notably, the Large-Taxpayers Unit (LTU) established in 1999, was subsequently closed. The current program required the URA to prepare and implement a strategy to increase tax collections and to undertake measures to combat corruption, but compliance with these measures was weak, suggesting a continued lack of ownership. In 2004, the

---

[19] The Minister of Finance, Planning, and Economic Development has the authority to waive or vary taxes under Article 152 of the Constitution; this authority has been used occasionally in recent years. However, under Clause 2 of the same Article, the Minister is required to periodically report to Parliament on how this authority has been exercised.

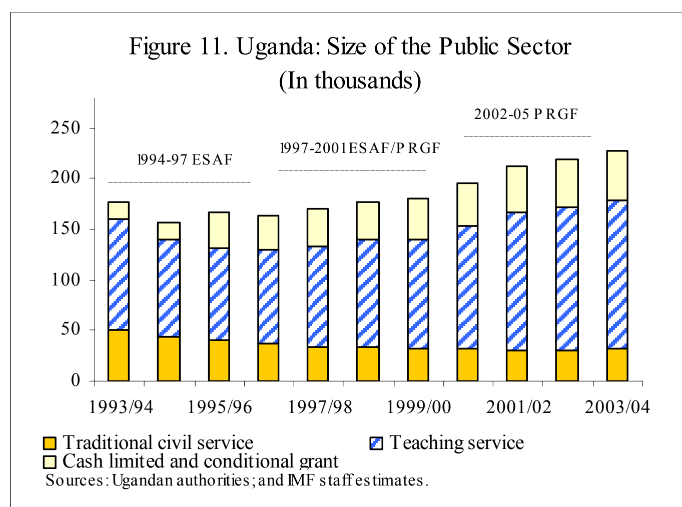
[20] The coverage of the VAT is limited. Roughly, two-thirds of the VAT is collected on imported goods. VAT collections are 4 percent of GDP, implying an efficiency ratio of about 24 percent—significantly below the 30-32-percent average of several other African countries that have introduced a VAT.

authorities committed to restructuring the URA along functional lines, as recommended by the Fund.

16. **Public expenditure management (PEM) reforms have taken time, but have led to important achievements in the building of budgetary institutions**. Budgeting practices at the central and local governments improved significantly throughout the 1990s under the lead of the World Bank and with limited Fund technical assistance. Uganda's achievements included the adoption of an organic budget law, the development of a rolling three-year medium-term expenditure framework (MTEF), the incorporation of sectorwide approaches into budgeting, and the strengthening of procedures under the Public Finance and Accountability Act 2003.

17. **However, the problem of domestic arrears has persisted, distorting expenditure composition, and threatening fiscal sustainability.** The problem became evident in 1996/97, when a first official report revealed the existence of a large stock of arrears. Since then, Fund-supported programs have sought to tackle this problem; however, Uganda's compliance with program conditionality on the accumulation of new arrears, the clearing of the outstanding stock, and the creation of a unit for their systematic monitoring and verification, has been weak. While the authorities established the Commitment Control System (CCS) for nonwage, nonpension spending in the late 1990s, arrears have continued to accumulate because of lax enforcement of CCS and related penalties and because of the practice of accommodating the spending needs of powerful ministries by cutting cash releases to other government units. Control, clearance, and verification of arrears on spending not included in the CCS—such as wages and pensions—are weak. In addition, the stock of pension arrears surged with their revaluation in the late 1990s. By end-June 2004, the total stock of arrears at the central government level—much of it unverified—was estimated at 3½ percent of GDP; no information is available on arrears due from local governments.

Figure 11. Uganda: Size of the Public Sector
(In thousands)



Sources: Ugandan authorities; and IMF staff estimates.

18. **Uganda's civil service reform recorded significant success in the early 1990s, but reforms have not been carried forward since then.** The civil service reform, implemented in cooperation with the World Bank and other donors,[21] achieved its goal

[21] In parallel, the authorities also implemented a program to demobilize the army, seeking to discharge and relocate about 50 percent of the armed forces to reach a size of about 45,000 by 1994/95. Uganda completed the demobilization plan under ESAF2, but this achievement was reversed during the second half of the 1990s, as veterans were rehired in 1996/97 in light of the worsening security situation in northern Uganda and, later on, during the armed conflict with the Democratic Republic of Congo. These developments, coupled with

of reducing the size of the civil service by more than half between 1990 and 1994/95. It also improved performance incentives by raising and rationalizing salaries and by monetizing noncash benefits. By 2003/04, however, the size of the civil service exceeded the 1994/95 target by 80,000 employees (that is, by 53 percent). The increase was led by the need for additional teachers—about 49,000—to meet the objectives of the Universal Primary Education (UPE) program but other employment in districts rose by nearly 35,000, in part because the number of districts continues to increase (Figure 11). During this period, there was a modest retrenchment of central government staff—by about 11,500 employees. The current program has unsuccessfully tried to revive second-generation reforms of the civil service and of wages, but the authorities have continuously missed program targets related to the preparation and design of reform strategies in this area.

19. **Uganda's decentralization, aimed at promoting the efficient delivery of public services through local participation, was unduly rapid, given weak capacity at the subnational government level** (Box 3). Between 1997/98 and 2002/2003, grants to the highest local government tiers—comprising districts and municipalities—increased from 18 percent to 39 percent of the central government budget (Figure 9). However, the central government's capacity to monitor the use of the resources transferred to local governments remains weak, because the local authorities are required to submit quarterly reports on the execution of only a fraction of central government transfers and because the quality and timeliness of their reports to the central government is generally poor. Moreover, National Integrity Surveys have identified significant leakages, reflecting a lack of political accountability at the subnational level.[22] To help address these problems, Fund-supported programs have included measures to strengthen budget preparation and reporting by local governments, but with mixed results. The expenditure tracking surveys and information campaigns initiated in the late 1990s have enhanced transparency and accountability at the district level and raised the share of resources that reach their intended purposes.[23] The decentralization strategy, however, has paid scant attention to fostering the local capacity to raise revenues.

---

adjustments to wages, raised defense wage bill from an average of ½ of the 1 percent of GDP in 1994/95-1996/97 to 1 percent of GDP between 1997/98-2003/04.

[22] Omar Azfar and Jeffrey Livingston, "Federalist Disciplines or Local Capture? An Empirical Analysis of Decentralization in Uganda" 200 unpublished; Department of Economics, Bentley Colleage, 2004; and Klaus Deininger and Paul Mpuga, "Does Greater Accountability Improve the Quality of Delivery of Public Services? Evidence from Uganda," World Bank Policy Research Paper 3277 (Washington: World Bank).

[23] Ritva Reinikka and Jakob Svensson, "Fighting Corruption to Improve Schooling: Evidence from a Newspaper Campaign in Uganda," *Journal of the European Economic Association*, forthcoming.

Box 3. How Effective is Decentralization in Uganda?

Decentralization in Uganda was initiated in the mid-1990s, guided by the Local Government Statute of 1993, the 1995 Constitution, and the 1997 Local Government Act. The origins for its support can be traced to the end of the civil war in 1987. The purpose of decentralization was to transfer to local governments the responsibility of delivering most public services, while retaining the overarching policymaking role for the central government.

The provision of most public services has been devolved to the local governments, but little attention has been paid to strengthening their revenue base. By 2001, districts and municipalities—the highest local government tier—were executing about 23 percent of total budget expenditure and 73 percent of core poverty-reduction spending under the Poverty Action Fund (PAF), and these shares have continued to rise. Given meager local revenue collections—amounting to less than 1 percent of GDP—districts are provided with substantial resources from the center, in the form of "conditional grants" and "equalization transfers." Conditional grants are assigned to specific services, including those funded under the PAF. Unconditional transfers, which are more modest, are used mainly to cover administrative costs.

Public expenditure management and reporting capacity of the local governments are weak. As a result, there are significant differences between budgeted amounts and outturns, in part because of intrayear reallocations between sectors relative to the annual budgets. Further, there is no cash planning or commitment control system to prevent the emergence of arrears, and unofficial reports suggest that these continue to accumulate, including on wages and pensions. Annual accounts are available only with a long lag, while independent auditing has not been extended to lower-level local governments.

The additional reporting requirements instituted in the late 1990s have yielded mixed results. In particular, districts are required to submit monthly reports of receipts and expenditures, accompanied by a bank reconciliation statement, for every account through which conditional grants are processed. Conditional grants used to finance PAF spending are subject to even more stringent conditions to assure donors about the use of resources—including the submission of quarterly work plans and execution reports by the districts, detailing expenditures made and the associated activities undertaken on the basis of agreed work plans prior to each quarterly release of resources.[1] Cash releases under some conditional grants—including those for the PAF—are subject to the submission of reports. But the reports are often of poor quality and produced with a delay. Although the compliance rate has improved for in-year submission of the reports—with about 86 percent of districts submitting on time—the rate is significantly lower—at an average of 40 percent—for submitting the final accounts. The Fiscal Decentralization Strategy (FDS), adopted in 2002, aims to tackle these problems.

1/ The World Bank provided financial and technical support.

Financial sector

20. **Under Fund-supported programs, Uganda liberalized interest rates progressively, restructured the banking system, and put into place a strengthened regulatory framework.** The interest rate liberalization started in 1992; by June 1994, all interest rates in Uganda were market-determined. In 1993, a new financial institutions bill and the BOU charter were enacted, which, among other things, clarified the role of the BOU as the supervisor of the banking system and assigned it the primary responsibility for formulating and implementing monetary policy. The Deposit Insurance Fund was established in 1994, covering small depositors, but the regulatory framework was still weak and the

banking system was plagued by a high share of nonperforming loans (NPLs). Under ESAF2, the authorities began addressing this problem by restructuring weak banks, notably the UCB, and by establishing the Non-Performing Assets Recovery Trust (NPART). Supervision became effective under ESAF3/PRGF1, with the strengthening of inspection and intervention procedures. The NPL ratio declined from close to 50 percent in 1994 to 2.6 percent in 2004 (Table 2). The regulatory regime was further strengthened in 2004 with the introduction of a risk-based approach and the enactment of the new Financial Institutions Act, which delineated corporate governance requirements, including insider lending and large loan exposures. In addition, the Microfinance Deposit-Taking Institutions (MDI) Act in 2003 appropriately extended the BOU's supervision to those microfinance institutions qualified to take deposits from the public. The Uganda Insurance Commission, established to regulate the insurance sector, recently began on-site inspections with the assistance of the World Bank.

Public enterprise reform

21. **The privatization and restructuring of public enterprises was largely successful.** Since the start of the privatization program in 1992, 115 of 150 enterprises have been divested or liquidated. However, in some cases, the process was needlessly long, slowing economic recovery. This was the case of the UCB, whose shares were sold to a reputed international bank in 2002 with a delay of almost a decade,[24] and the Uganda Development Bank (UDB), where the transaction is still pending. These delays have partly affected the growth of bank credit to the private sector. In addition, delays in reforming the energy sector, particularly the unbundling of the Uganda Electricity Board (UEB), and in forming public-private partnerships in the power sector have contributed to current electricity shortages.

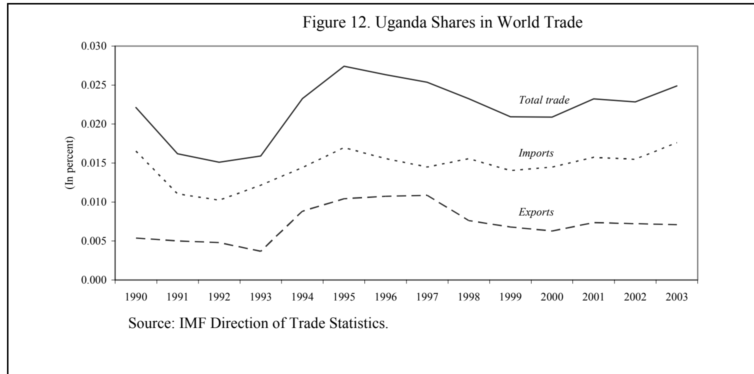
Exchange and trade systems

22. **The liberalized exchange rate system has facilitated trade and helped the authorities to deal with exogenous shocks.** In 1994, after freeing the exchange rate, Uganda completed the liberalization of the exchange and payments system by accepting the obligations of Article VIII of the IMF's Articles of Agreement. With the inception of the interbank market, the BOU effectively liberalized foreign exchange trading by terminating surrender requirements, abolishing auctions and direct sales of foreign exchange, and ceasing the announcement of official rates. The average monthly turnover in the broad foreign exchange market grew steadily to US$400 million. Since 1994, the monthly variation in the U.S. dollar exchange rate has been noticeably less.

[24] This was partly due to the failure of its initial privatization in 1998 and its renationalization.

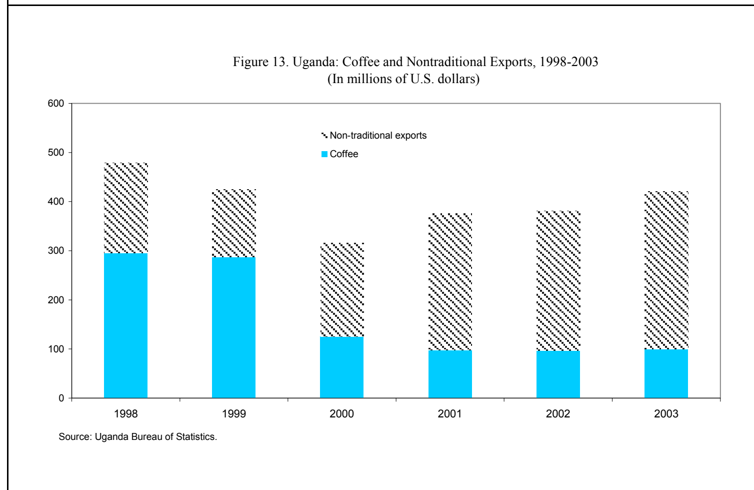
23. **Uganda's trade liberalization facilitated an increase in overall exports and a shift to nontraditional exports.** The rationalization of customs tariffs proceeded rapidly, from a six-rate to a three-rate structure (with the top rate falling to 15 percent from 50 percent), and most surcharges and nontariff barriers were eliminated.[25] An increasingly large proportion of goods—such as raw materials and machinery—were classified under the zero-tax bracket.[26] Although the authorities reimposed selective excises on sensitive goods, this was allowed under several regional trade arrangements to which Uganda belongs.[27] In 2005, the EAC customs union was launched, and Uganda revised its tariff structure, raising its common external tariffs while removing discretionary excises and other charges, keeping average protection rates broadly unchanged. Against this background, the share of Uganda's exports in world trade increased some 40 percent, and that of nontraditional exports in total exports doubled during the program period (Figures 12 and 13).

Figure 12. Uganda Shares in World Trade



Source: IMF Direction of Trade Statistics.

Figure 13. Uganda: Coffee and Nontraditional Exports, 1998-2003
(In millions of U.S. dollars)



Source: Uganda Bureau of Statistics.

---

[25] The program accommodated an export tax on coffee earnings in the mid-1990s.

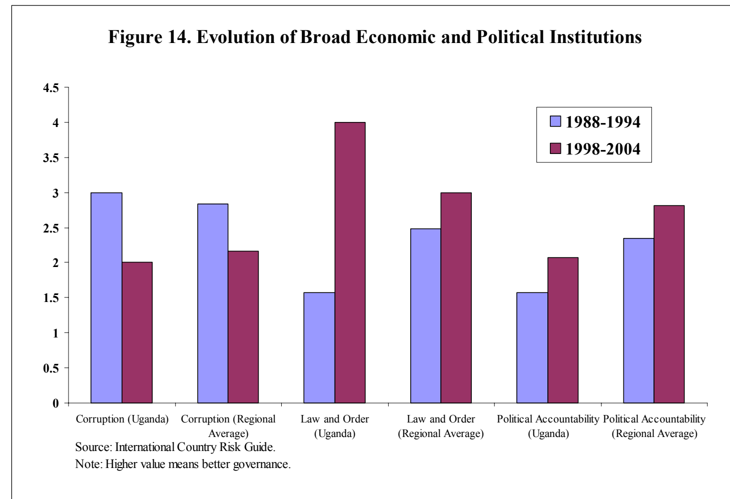
[26] As a result, taxes on international trade fell from over 3 percent of GDP in the early 1990s to nearly 1 percentage point of GDP in recent years.

[27] These include the Regional Integration Facilitation Forum (RIFF), the Common Market for Eastern and Southern Africa (COMESA), and the East Africa Community (EAC).

Institutional reform

Institutions for sustaining growth and policy effectiveness have strengthened since the late 1980s, but corruption is perceived to have increased and affected the macroeconomic performance (Figure 14). The enforcement of property rights has significantly improved since the mid-1990s, [28] and is now above the average for SSA countries. Political accountability has also risen, although it remains below the regional average. However, corruption is above the regional average, according to the UN Economic Commission for Africa.[29] [30] The World Bank's investment climate survey has identified corruption as one of the major constraints on firms' growth, and there is some evidence that bribery payments have negatively affected firms' growth in Uganda.[31] Moreover, Uganda's Auditor General has estimated that about 20 percent of the value of public procurement is lost through corrupt practices.[32] Various studies corroborate that leakages from public funds are large.[33]

Figure 14. Evolution of Broad Economic and Political Institutions



Source: International Country Risk Guide.
Note: Higher value means better governance.

24. **The regulatory costs of doing business are generally below the regional average, but cumbersome procedures and infrastructure bottlenecks remain.** According to the

---

[28] The *International Country Risk Guide (ICRG)* index of law and order measures the strength and impartiality of the legal system and observance of the law. This and other similar indices are imperfect indicators of institutions and therefore need to be interpreted with caution.

[29] The *ICRG* defines corruption as "distorting the economic and financial environment, reducing the efficiency of government and business by enabling people to assume positions of power through patronage rather than ability, and introducing inherent instability into the political process."

[30] Synopsis of the 2005 *African Governance Report*, United Nations Economic Commission for Africa.

[31] Raymond Fisman and Jakob Svensson, "Are Corruption and Taxation Really Harmful to Growth? Firm Level Evidence," World Bank Policy Research Paper 2486 (Washington: World Bank, 2000).

[32] Republic of Uganda, *Country Integrated Fiduciary Assessment*, (Washington: World Bank, 2004).

[33] See Ritva Reinikka and Jakob Svensson, "Local Capture: Evidence from a Central Government Transfer Program in Uganda," *Quarterly Journal of Economics*, May 2004; and Ritva Reinikka and Jakob Svensson, "Survey Techniques to Measure and Explain Corruption," World Bank Policy Research Paper 3071 (Washington: World Bank, 2003).

World Bank business environment data, the monetary costs of regulations are generally lower in Uganda than in other SSA countries. However, the costs stemming from poor transportation (road and rail), an erratic power supply, closing businesses, and rigidities in the labor market are well above the regional average. Further, procedures remain cumbersome, especially to start a business or to register property. These impediments, together with discriminatory investment incentives, have discouraged foreign investment in activities that add value.

Selected Countries: Barriers to Doing Business

	Days to Start Business	Flexibility-of-Firing Index[1]	Production Lost in Shipment, Average (In percent)	Output Lost to Power Outages, Average (In percent)
Ethiopia	44	29	1.0	5.6
Kenya	61	16	2.0 [2]	9.3
Mozambique	153	64	0.6	2.0
Nigeria	44	36	...	3.3
Uganda	36	50	2.4	6.3
Zambia	40	40	3.9	4.5
India	88	45	...	...
China	46	57	1.2	2.0

Sources: Foreign Investment Advisory Service, Costs of Doing Business Study; and World Bank's Investment Climate Assessments.
1/ A lower value indicates a greater ease in firing workers.
2/ For domestic shipment. For international shipments, the average production lost is 1.4 percent.

Poverty reduction

25. **The composition of public expenditures has shifted toward poverty reduction.** Under ESAF2, spending on Priority Program Areas, comprising primary education and health, road maintenance, agricultural extension and research, and law enforcement, received a boost with the adoption of the UPE program in 1996. Allocations for poverty reduction increased further with the launch of the PEAP in 1997/98 and with the establishment of the "virtual Poverty Action Fund (PAF) (Box 4) to monitor and track poverty-reducing outlays. The formation of the PAF has encouraged donors to provide aid in the form of budget support. Spending in the PAF rose from 2 percent of GDP in 1997/98 to

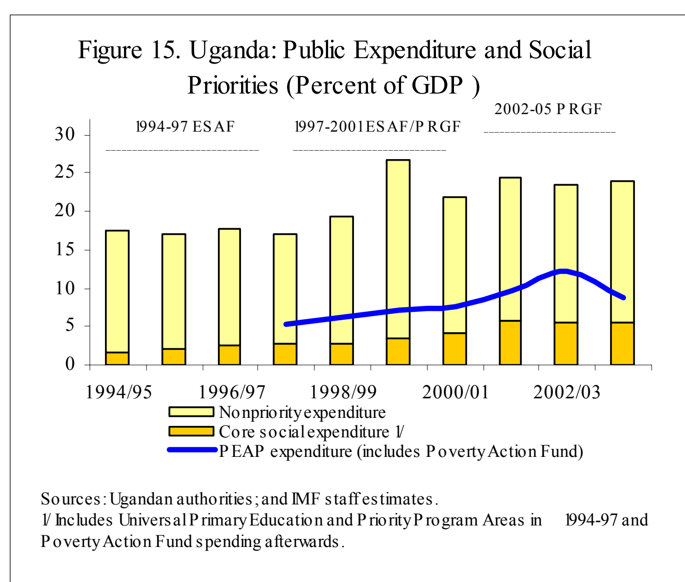


Figure 15. Uganda: Public Expenditure and Social Priorities (Percent of GDP)

Sources: Ugandan authorities; and IMF staff estimates.
1/ Includes Universal Primary Education and Priority Program Areas in 1994-97 and Poverty Action Fund spending afterwards.

5½ percent of GDP in 2003/04, and PEAP-related spending increased from about 5¼ percent to about 9 percent of GDP in 2003/04 (Figure 15).[34]

Box 4. Does the PAF Cover All Poverty Spending?

Uganda was one of the first countries to employ a *virtual* fund for tracking poverty-reducing expenditures—the PAF. Poverty-reducing programs are identified within the existing classification structure during budget preparation and are ring-fenced for tracking purposes. PAF activities are routinely reported to parliament and are included in the documentation submitted for the adoption of the annual budget. However, the PAF does not cover all poverty-reducing expenditures in the PEAP.

The PAF has allowed the authorities to protect priority poverty-reducing spending from potential cuts.

PAF programs are subject to strict eligibility criteria and monitoring requirements. For a program to be in the PAF, it must (i) be in the PEAP; (ii) be directly reducing poverty; (iii) deliver a service to the poor—with the program addressing the needs of the poorest 20 percent of the population—and (iv) have a well-developed implementation plan. In this context, each government unit responsible for executing a PAF program must submit, before the beginning of each financial year, a detailed annual budget and a work plan. Further, the units are required to prepare quarterly reports documenting progress against the targets in the annual work plan and update the plans on this basis.

While the PAF has succeeded in catalyzing aid inflows, it continues to be subject to operational weaknesses. First, 70-80 percent of PAF resources are allocated to districts through "conditional grants," which require the submission of the quarterly reports as a condition for their release. However, weaknesses in districts' capacity have undermined the submission of reports, often delaying the release of PAF resources. Second, the embedding of the PAF within the public expenditure management process could be improved. At present, neither the budget vote structure nor the chart of accounts transparently identifies the expenditure items covered by the PAF.

26. **Since 1992, the incidence of poverty in Uganda has declined significantly** (Box 5). A 2001 study indicated that the share of the poor in the total population fell from 56 percent in 1992 to 34 percent in 1999/2000, owing mostly to strong growth performance. Although more recent study suggests that poverty may have increased since 1999/2000, the staff of the World Bank is of the view that this outcome is not statistically robust. Indeed, it is likely that poverty either remained broadly unchanged between 1999/2000 and 2002/03 or that, as measured by nonmonetary indicators of poverty, it declined.

[34] PEAP-related expenditures include outlays on education, health, roads and maintenance, agriculture, water, justice, and law and order.

Box 5. Has There Been a Setback in Poverty Reduction?

Uganda achieved significant poverty reduction through the 1990s. A 2001 household survey reported that poverty declined from 56 percent in 1992 to 34 percent in 1999/2000.[1] The central region experienced the sharpest fall in poverty, while the northern region lagged behind, owing mainly to security problems. The major contributor to poverty reduction was Uganda's strong growth performance. The elasticity of poverty with respect to growth is about 1-1¼.[2] That is, most of the 2½ percentage point average annual decline in the incidence of poverty between 1992 and 2000 can be attributed to growth.[3]

A new assessment suggests that these achievements may have suffered a setback in recent years. The 2002/03 household survey shows that income poverty increased to 38 percent of the population from 34 percent in 1999/2000. The increase appears to be driven by the slowdown in real GDP growth, the deterioration in the terms of trade (especially in agriculture), and the high population growth rates. The rise in poverty was particularly pronounced for households dependent on agriculture (from 39 percent to 49 percent). The largest increase in poverty occurred in the eastern region, while the highest incidence rates (63 percent) were observed in the conflict-ridden north. Income inequality, measured by the Gini coefficient, rose in all regions from 0.39 to 0.43, but is particularly high in urban areas.

The 2002/03 survey subsequent analysis has concluded that these results are not robust. For instance, alternative nonincome measures of welfare show a marked improvement between 1999/2000 and 2002/03. The World Bank has noted that the samples used in the 1999/2000 and 2002/03 household surveys may not be consistent.[3] The Bank has thus concluded that the earlier survey may have understated the poverty level. It is then likely that poverty either remained roughly constant between 1999/2000 and 2002/03 or, based on the nonmonetary poverty measures, it declined.

1/ Simon Appleton, *"Poverty in Uganda, 1999/2000: Preliminary Estimates for the UNHS,"* University of Nottingham (Nottingham, United Kingdom, 2001).
2/ Simon Appleton, "Changes in Poverty and Inequality, 1992-97: Assessing Outcomes for Comprehensive Development Framework," Bath, United Kingdom (University of Bath, 1999).
3/ This is because (i) the 2002/03 survey used a new framework based on a new census, and (ii) the 1999/2000 survey suffered from a sample size bias.

C. Program Conditionality and Compliance

27. **Fiscal conditionality dominated all of Uganda's Fund-supported programs**. Altogether, its three arrangements included 130 structural conditions (prior actions, performance criteria, and benchmarks, Table 3), with benchmarks constituting nearly 70 percent of all conditions. Prior actions and performance criteria shared the remainder. Fiscal conditionality, primarily focusing on tax policy and administration, accounted for nearly 40 percent of the total conditions. Moreover, fiscal reforms were supported by several quantitative targets in ESAF3/PRGF1 and PRGF2 (Table 3).[35] The remainder of the structural conditions covered private sector development, public enterprise privatization and restructuring, and the financial sector. ESAF2 and ESAF3/PRGF1 also included benchmarks

[35] Including ceilings on the issuance of promissory notes and accumulation of new budgetary arrears by the central government, and minimum nonwage spending on priority program areas.

on public sector and civil service reform; such conditions, however, do not appear in the current program.

28. **The number of structural conditions was significantly higher in the second and third programs.** While conditionality has generally remained within the Fund's core areas of competency, there has been no reduction in either the scope or the number of conditions as programs have evolved. Altogether, the number of structural conditions averaged 14 a year, compared with 10 for all PRGF-supported programs during 2001-03. For the second and third programs, the average number of conditions was even higher, at about 16.

Uganda: Number of Waivers Under
ESAF/PRGF Arrangements, 1994-2005

	ESAF 1994-97	ESAF/PRGF 1997-2001	PRGF 2002-05
Quantitative conditionality	0	1	6
Structural conditionality	0	5	8
Total	0	6	14
Memorandum item:			
Number of test semesters	6	7	4

Sources: IMF staff reports 1994-2005

29. **Overall, Uganda's fulfillment of conditions has deteriorated over time, with the number of performance criteria and structural benchmarks met on time falling.** While Uganda met all performance criteria during ESAF2, the number of waivers increased to 6 in ESAF3/PRGF1 and to 14 in PRGF2.[36] Uganda's failures to avoid an accumulation of new domestic arrears and to meet the targets on net domestic assets (in PRGF2) explain the increase in waivers. Slippages on several structural benchmarks contributed to a modest delay in the conduct of the fourth review under PRGF2. About 80 percent of the structural measures—including prior actions, benchmarks, and performance criteria—were met either on time (70 percent) or with some delay (10 percent). The remainder were either not met or met with a delay of more than six months. While Uganda's overall performance was roughly the same in the first two programs, performance deteriorated in PRGF2, where 40 percent of the structural conditions were either not met, or met with a delay of more than six months. This deterioration in performance was evenly distributed across sectors, although the targets on expenditure management (arrears monitoring and reduction) and implementation of the URA reforms were more frequently not observed.

[36] Note that the significant increase in waivers in PRGF2 took place over a shorter program period than in previous arrangements.

D. Program Design and Implementation Lessons

Program design lessons

30. **The sequencing of the authorities' reforms for achieving macroeconomic stabilization has been largely appropriate, and programs have been reasonably flexible in accommodating changing macroeconomic circumstances.** Uganda achieved stabilization before the beginning of ESAF2, and substantive structural reforms in both fiscal and monetary areas were implemented in the preceding programs to support stabilization objectives. Program targets have been adjusted to reflect new information and have provided an effective framework for donors to channel resources for poverty reduction. However, the annual revisions of ESAF3/PRGF1 program targets accommodated a fiscal stance that was looser than needed to increase higher poverty spending. In particular, the programs did not require that expenditure overruns in nonpriority areas be fully offset by expenditure cuts. As a result, fiscal adjustment has remained protracted during PRGF2 because of the need to create room for rising poverty-reducing spending and because of expenditure pressures from public administration and defense. Furthermore, higher aid inflows have led to upward pressure on the exchange rate and domestic interest rates, thereby hindering somewhat the growth of export and manufacturing sectors.[37] The large donor inflows (financing about 50 percent of total government expenditures) have also made the country aid-dependent, but fiscal and current account deficits (before grants) are likely to persist in the near term given on-going efforts to reduce poverty and to achieve the MDGs.

31. **The design of quantitative conditionality in Fund-supported programs was sufficiently flexible.** Since ESAF2, programs have monitored the fiscal stance through a ceiling on net credit to the government, adjusted for disbursements from official donors, except for earmarked donor-funded development projects. The programs have thus not constrained externally financed project spending, including in social sectors. Over time, an enhanced focus on public expenditure management practices and the composition of public spending has led to the use of quantitative conditionality in these areas, including through ceilings on the flow of arrears and on the issuance of promissory notes. Although the authorities are still grappling with the issue of arrears, the performance criterion on arrears—particularly the zero ceilings on their flow—was impractical to comply with. Ceilings were applied to the size of the civil service under ESAF2 and have been applied to total public administration expenditures in more recent programs. A floor on PAF spending aimed at ring-fencing poverty-reducing outlays was also introduced. Finally, the targets on the central bank balance sheet were adapted to program objectives and macroeconomic conditions.

32. **The total number of structural conditions in all Uganda's Fund-supported programs was high, suggesting there is scope to streamline them**. PRGF2 did not significantly streamline structural conditionality as envisioned under the 2002 guidelines.[38]

---

[37] See Uganda—Selected Issues and Statistical AppendixIMF Country Report No. 05/172.

[38] See Guidelines of Conditionality.

There also appears to be scope for moving away from a large number of process-oriented conditions to more focused results-driven conditions.[39] A rough assessment suggests that the number of process-oriented conditions has increased over time; they constitute about two-thirds of total structural conditions in the current program, up from one-half in ESAF2.

Key implementation lessons

33. **The government's commitment to reforms appears to have eroded despite a well-articulated PEAP.** The excessive number of waivers granted under PRGF2 also reflects Uganda's waning commitment. Incentives to implement bold reforms appear to have receded in a post-debt relief era, indicating "reform fatigue" on the part of the authorities.

34. **Addressing productivity and growth performance, while mitigating the impact of exogenous shocks, will be important tasks for the Ugandan government**. Evidence suggests that the contribution of total factor productivity (TFP) growth to real GDP growth has been relatively small since 1970, while the high population growth has limited per capita growth.[40] This is surprising given the progress made in liberalizing markets and trade. However, this is probably attributable to the relatively small share of the tradable sector and slow growth of subsistence agriculture. The Ugandan economy also remains vulnerable to exogenous shocks, such as variations in rainfall and in the terms of trade. More resources should be directed to infrastructure, particularly in rural areas and marketing and other services provided to farmers. In this regard, the Plan for Modernization of Agriculture (PMA) needs support. The insecurity created by the 17-year conflict in the north has affected a large proportion of Uganda's poor and aggravated regional disparities. The strategy for the power sector also needs support because it is inadequate for achieving the medium-term goals of sustainable growth and poverty reduction.

35. **Under its three programs since 1994, Uganda has made commendable progress in strengthening the banking system, but intermediation increased only modestly.** The importance of banking sector reforms was recognized at an early stage, but implementation was slow. [41] Forceful action to restructure the banking system and strengthen incentive structures did not take place until the late 1990s, and financial stability was achieved only in the early 2000s, almost 10 years after the onset of the financial sector reforms. While the emphasis on setting up a prudential framework was appropriate, the programs could also have included measures to foster private sector access to bank credit at an earlier stage by improving companies and the land registry, the insolvency regime, and information sharing on borrowers' credit history, as identified by the Financial Sector Assessment Program

---

[39] Examples of process-oriented conditions in PRGF2 include submitting to cabinet a plan to reduce government expenditures, preparation of a business plan for the URA, and adoption of a plan to clear the stock of pension arrears.

[40] See Uganda—Selected Issues and Statistical AppendixIMF Country Report No. 05/172.

[41] "Uganda—Enhanced Structural Adjustment Facility—Policy Framework Paper, 1994/95-1996/97".

(FSAP). Reform of the nonbank financial institutions, such as the Housing Finance Corporation of Uganda and the Uganda Insurance Commission, and their regulatory framework was largely overlooked in the programs. The insurance industry continues to hold a large share of illiquid assets in real estate. Similarly, the National Social Security Fund (NSSF), repository of the largest pool of financial savings in the country, suffers from poor performance, with negative real returns, and a significant share of contributions absorbed by administrative expenses and fraud.[42] While oversight of the NSSF and privatization of UDB were identified by the FSAP and included as conditions under PRGF2, these reforms have been delayed. Despite the growing number of microfinance institutions (MFIs), gaps remain in the provision of credit for agriculture and for small and medium-size enterprises.

36. **Over time, corruption has cut into government revenues and led to wasteful spending, thereby affecting Uganda's macroeconomic performance.** Enduring corruption at the URA has hampered revenue collection, PEAP implementation, and Uganda's self-reliance and eroded the public's confidence in institutions. However, corruption concerns were not explicitly brought into program conditionality until the current program. Previously, Fund-supported programs focused on restructuring the URA, curbing arrears, and eliminating directed credits. With donors expressing concerns about rising corruption, a failure to implement anticorruption policies could harm future aid. A high level of political commitment to reducing corruption is required, especially with regard to the implementation of the Leadership Code and strengthening the Inspectorate General of Government.

37. **Uganda's implementation of URA reforms has been patchy.** The reform program for the URA was well designed, but weakened at the beginning of PRGF2. The overall sequencing of measures was broadly appropriate, and adequate emphasis was placed on the preparation of key reforms—such as the introduction of the VAT. Nevertheless, compliance with many structural measures was weak. The Fund could have taken a firmer stance when critical reforms were reversed in 2001—in particular, the dismantling of both the new functional structure in the URA and the LTU. There was an expectation on the part of the Fund that URA reforms would be addressed in the course of PRGF2. It appears that rising aid inflows diverted the attention of the authorities from addressing the weaknesses in the tax administration.[43] There is some cross-country evidence to suggest that an increasing share of grants in total aid lowers domestic revenues, particularly in countries where institutions are relatively weak.[44]

---

[42] The NSSF has recently been transferred from the Ministry of Gender and Labor to the Ministry of Finance and will be subject to BOU supervision.

[43] See Deborah Brautigam and Stephen Knack, "Foreign Aid, Institutions, and Governance in Sub-Saharan Africa," *Economic Development and Cultural Change*, Vol. 52 (2004), pp 255-85.

[44] See Chapter 14 in Sanjeev Gupta, Benedict Clements, and Gabriela Inchauste, editors, *Helping Countries Develop: the Role of Fiscal Policy* (Washington: IMF, 2004).

38. **Tax policy reforms in Fund-supported programs were adequate, well sequenced, and comprehensive, but have slowed over time because of weak ownership.** Uganda made significant progress in strengthening the design of the income tax and in repealing income tax holidays in the 1997 Income Tax Act. Program measures on indirect taxation were generally sound, although both tariff and excise policy were subject to excessive discretion and volatility, and some weaknesses in the VAT were not successfully addressed through program conditionality. In addition, the persistence of (limited) discretionary tax exemptions has continued to undermine the tax base. Finally, programs did not stress local governments' strengthening of revenue collection, despite Uganda's implementation of an ambitious decentralization program.

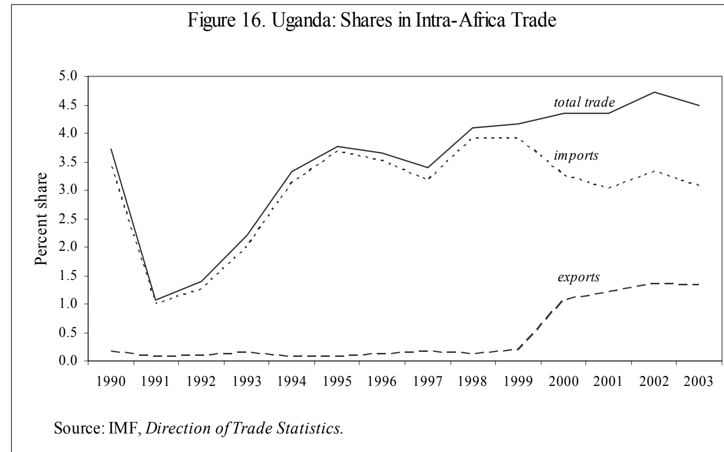
39. **Public expenditure reforms have had both successes and failures.** On the one hand, the combination of fiscal adjustment in the early 1990s coupled with rising public spending for priority sectors has yielded positive results, not only in terms of macroeconomic stability but also in terms of poverty reduction. This occurred despite a consistent pattern of expenditure overruns over the last decade. The PAF has attracted a considerable amount of donor support, which has been channeled to priority areas. On the other hand, the authorities' record of implementing expenditure measures has varied. For instance, the programs did not prevent the excessive number of supplementary budgets that modified expenditure priorities and led to accumulation of domestic arrears. At the early stages of ESAF2, the authorities exhibited a commendable commitment to increasing the efficiency of public services—including by rationalizing the size of the public service. However, the speed with which both the decentralization process and the poverty-reduction program took off in 1997 highlighted risks to the strategy. While programs tried to adapt quickly to the new circumstances, measures to strengthen budget formulation, execution, and reporting at the local government level were implemented only gradually, peaking in the early stages of PRGF2. In the meantime, there was some misuse of public resources. Although the Fund remains engaged in capacity building by providing technical assistance to Uganda, it has attached few conditions to strengthening of the revenue-raising and public expenditure management capacity of local governments.

40. **The Ugandan authorities could have paid more attention to reforming the noncontributory civil service pension scheme, because of the risks it presents.** In the late 1990s, a revaluation of pensions generated a surge in pension arrears, which continue to accumulate because of inadequate budgetary allocations for their clearance and ineffective management of the pension roll. The benefit formula provides replacement rates that are generous vis-à-vis international standards. The rising cost of public pensions can derail improvements in the composition of public spending and threaten fiscal sustainability.

41. **Fund technical assistance (TA) has been relatively more effective in the financial sector.** Through its TA, the Fund has been broadly successful in assisting the authorities in establishing a relatively well-designed tax system—but some loopholes remain. The performance of the URA, especially in earlier programs, was uneven despite a large amount of Fund TA. Similarly, Fund TA has not had a significant impact on monitoring and

preventing arrears. And, although Uganda has made good use of Fund TA in the financial sector, including liquidity management, the Fund provided no TA, apart from mission participation by an expert, to bolster bank supervision in ESAF2 and ESAF3/PRGF1, when tackling the large stock of NPLs was a high priority. FSAP and FSAP update have been useful in enumerating priority structural reforms for making the financial sector more resilient, efficient, and competitive.

42. **In recent years, Uganda's trade policy has excessively centered on regional trade arrangements.** Despite membership in COMESA and the EAC, Uganda's trade within the region has not expanded (Figure 16). This is in part because machinery and transport equipment account for approximately three-fourths of total (global) African imports and partly because product complementarity among African countries is rather low.[45] Moreover, where the trade arrangements overlap, they have imposed conflicting obligations on Uganda in its dealings with other member countries. By creating incentives to export to markets within the EAC, Uganda's trade policy has implicitly imparted an import-substitution bias.



43. **Poverty and social impact analysis (PSIA) has generally not been undertaken in Uganda, at least not to inform the program design.** A PSIA exercise examining the impact of Uganda's Strategic Exports Program (SEP) was undertaken in 2003, supported by the World Bank and the U.K.'s Department for International Development, but had limited direct impact in reshaping the (ongoing) SEP. A series of studies were undertaken to inform the revision of the PEAP, but no further PSIAs have been undertaken to date.[46] A Fund team carried out a PSIA on the impact of changes in VAT rates in May 2005.

E. Collaboration with the World Bank and Other Donors

44. **The Fund has collaborated closely with the Bank in Uganda, but some areas have received less attention than they should have.** The World Bank took the lead in

---

[45] See Yongzheng Yang and Sanjeev Gupta, "Regional Trade Agreements in Africa: Past Performance and the Way Forward," IMF Working Paper 05/36 (Washington: IMF, 2005).

[46] PSIAs on the recent Land Act and the Bujagali project supported by the World Bank and donors were not completed or failed to produce timely and usable output.

supporting Uganda on agriculture, civil service reform, education and health, financial sector development, decentralization, energy, public expenditure management, public enterprise reform and privatization. Although reforms in these areas—including those targeted under the first Poverty Reduction Support Credit (PRSC) in 2001—were critical, the Fund and the Bank could have paid greater attention to promoting ownership of an appropriate growth-oriented strategy for agriculture and ensuring its implementation as well as reforming public pensions and the NSSF. Further, the Bank should revisit the civil service and pay reform in the aftermath of fiscal decentralization.

45. **The Bank has played a pivotal role in coordinating aid inflows through Consultative Group (CG) and Strategic Program for Africa (SPA) meetings.** The Bank is working with some other donors on a Uganda Joint Assistance Strategy (UJAS), to better coordinate development assistance. The Bank and the Fund have been jointly assisting the government in preparing and implementing the PEAP, conducting Debt Sustainability Assessments (DSAs), tracking poverty-reducing spending, and conducting financial sector assessments.

46. **Other donors and creditors have also been very active in Uganda**. The United Kingdom, the Netherlands, Ireland, Sweden, Norway, and Germany have also provided budget support tied to the PRSC, while the European Commission and the African Development Bank budget support programs are also closely harmonized with the PRSC. Sound macroeconomic management remains an important requirement for the donors' provision of budget support. Donors have also supported structural and institutional reforms in budget management and taxation, education and health, and legal and judicial areas; supported private sector and rural development; and assisted with capacity building. This means that both the Fund and the Bank would need to work closely with other donors in supporting Uganda.

III. Policy Challenges for the Medium Term

47. **The key challenge for Uganda is to revive and sustain growth so as to reduce poverty.** In this regard, it should adopt a strengthened policy framework, which should focus on promoting productivity growth, reducing vulnerability to external shocks, diversifying the economy to high value-added activities, and expanding private sector participation in the economy. This will require a gradual fiscal consolidation, further liberalizing the trade regime and maintenance of a level playing field, as articulated in the revised PEAP. Although at current trends, Uganda is likely to meet several MDGs (Table 5), a continuing slowdown in growth could jeopardize its achievement of the income-poverty goal. It has already recorded an impressive performance in reversing the incidence of HIV/AIDS, and the results of recent interventions to combat malaria and other diseases are positive. Controlling family size in conjunction with enhancing the access of women to education and health services should help bring down maternal and infant mortality rates.

48. **A stable macroeconomic environment is necessary for sustaining high growth rates.** Uganda's challenge is to alleviate constraints in absorbing donor inflows while

ensuring macroeconomic stability. In this regard, what is needed is a careful sequencing of structural reforms to ease supply constraints and deepen domestic financial markets to enhance financial intermediation and the economy's capacity to absorb large donor inflows. More attention would need to be paid to developing indirect monetary instruments. Government spending financed by aid might threaten fiscal sustainability, undermine international competitiveness and export diversification efforts, and raise the cost of finance for the private sector. This concern has led the authorities to advocate a policy of gradual fiscal consolidation, supported (rather than led) by the Fund. The issue of aid-financed public spending in Uganda deserves continued research and analysis, with much depending on returns to such spending and the sensitivity of exports and private investment to changes in exchange and interest rates.[47] There are various ways (for example, by enhancing expenditure efficiency and increasing domestic revenues) in which the authorities can create fiscal space to accommodate higher spending on social sectors and infrastructure, without any adverse consequences for macroeconomic stability and fiscal sustainability.[48]

49. **Uganda and its partners should take steps to enhance aid effectiveness.** The authorities should strive to strengthen the public expenditure management and procurement systems, including at the local government level. This would ensure that resources reach their intended purposes and reassure donors that their funds are well spent. These efforts should be accompanied by better donor coordination to reduce the administrative burden on the authorities. The UJAS should help in this regard. A larger share of aid in the form of budget support would promote ownership and reduce the administrative requirements for the authorities.

50. **A rising domestic revenue-to-GDP ratio would allow higher spending on poverty programs.** A stronger revenue effort would have many positive spillover effects. First, it would assuage pressures to withdraw liquidity stemming from government operations, thereby mitigating the crowding out of private sector operations. Second, it would facilitate higher spending on poverty programs, reduce aid dependency over time, and strengthen fiscal sustainability.

51. **Enhancing the public sector's transparency and accountability is essential for improving the business environment and promoting private sector growth**. The authorities should curb corruption by implementing the Code of Conduct for URA staff, enforcing the Leadership Code, and imposing criminal sanctions for corrupt practices on government officials. The BOU's independence should be strengthened by avoiding state guarantees or other forms of financing to particular individuals or firms. Moreover, there is

---

[47] See C. Adam and D. Bevan, "Aid and the Supply Side: Public Investment, Export Performance and Dutch Disease in Low-Income Countries," Department of Economics, University of Oxford Working Paper (Oxford, United Kingdom, 2004). They demonstrate that productivity increases arising from public infrastructure can mitigate the Dutch disease effects of aid flows in Uganda.

[48] See Peter S. Heller, "Understanding Fiscal Space," IMF Policy Discussion Paper 05/4 (Washington: International Monetary Fund).

an immediate need to implement a civil service reform, while ensuring appropriate staffing for social sectors. Reducing the costs of starting and closing a business and registering land titles is also important.

52. **There is scope for improving the efficiency of public spending.** The government should direct a share of public resources to basic infrastructure (railway, and the power sector) by cutting nonpriority spending, such as in public administration.[49] More resources should be directed toward agriculture, in particular, rural infrastructure and the services provided to farmers. The focus thus far has been on raising spending on poverty-reducing programs. The lack of adequate and functioning infrastructure, including at the regional level, is a serious obstacle to Uganda's medium-term growth prospects.

53. **Uganda should be encouraged to actively participate in multilateral trade liberalization together with other EAC and COMESA members, rather than liberalization only within existing trade arrangements.** Available evidence suggests that trade expansion spurs economic growth and sustains growth accelerations.[50] Since Uganda's trade within the region remains quite small, it should also consider lowering its trade barriers with the rest of the world by pursuing a reduction in the EAC common external tariff.[51] The recommendations of the Diagnostic Trade Integration Study on Uganda under the Integrated Framework will be available later in the year and should form the basis for fostering trade and increasing value in the country. Moreover, Uganda should pursue regional integration by participating in regional infrastructure projects and by enhancing labor mobility.

54. **Uganda's Fund-supported programs cannot overlook the macroeconomic repercussions of the conflict in the north**. Besides exerting pressure on expenditures and causing budget overruns, the conflict has depressed agricultural output in the north and has contributed to the recent worsening of income distribution. Its consequences have also been felt beyond Uganda's borders.

IV. Strategy for Future Fund Involvement

55. **Uganda has no prolonged need for Fund financing.** Over the years, Fund financing to support Uganda's reform efforts has declined sharply, and the amount of resources the Fund provides is not needed to support the country's balance of payments**.** In contrast, donor funds cover over one-half of public spending.

56. **Given Uganda's growth challenges, there is a case for continued Fund engagement after the expiration of the current PRGF that goes beyond a regular**

---

[49] This is consistent with findings of the recent donor-funded study by John A. Okidi, Sarah Ssewanyana, Lawrence Bategeka, and Fred Muhumuza, "Operationalizing Pro-Poor Growth in Uganda," October 2004.

[50] See "Sub-Saharan Africa Regional Economic Outlook,".

[51] See Uganda, Third Review Under the Three-Year Arrangement Under the PRGF and Request for Waiver of Performance Criteria IMF Country Report No. 04/289, Box 3, for details on the EAC customs union.

surveillance relationship. One option would be to continue with a low-access PRGF arrangement—the low access warranted by the absence of a clear balance of payments need. The other option would be for Uganda to seek a nonborrowing arrangement, if and when such an arrangement becomes operational; these options would provide policy advice and a basis for continued donor support and mobilizing foreign private investment. Whichever option is adopted, the next Fund-supported program should seek to streamline conditionality while reducing reliance on process-oriented conditions—and link conditionality to the PEAP objectives—ensuring that critical areas are not left uncovered. In this regard, close coordination with the World Bank will be required.

57. **Foreign borrowing would need to be tightly controlled to ensure debt sustainability**. This is because the ratio of NPV of debt to exports is projected to remain high in the medium term. As a result, the bulk of foreign inflows will have to come in the form of grants and their macroeconomic consequences assessed on a continuous basis. The authorities should also focus on further developing the capacity to effectively manage foreign debt; TA from any of its partners, including the Bank, should be high on the agenda.

58. **The Fund should work with the Bank and others to assist Uganda in carrying out trade reforms.** The Fund will need to work with all three EAC countries to progressively reduce the common external tariff. Besides providing TA to Uganda on strengthening domestic taxation, the Fund and other partners should stand ready to provide financial support for the resulting balance of payments and budgetary needs.

59. **The Fund's policy dialogue with the authorities would be buttressed by TA in the core areas of its mandate**. The principal focus of TA should continue to be on fiscal, monetary, and financial sector policy and implementation. A strengthening of institutions in these areas, together with the adoption of good practices, should contribute to promoting transparency and accountability in Uganda's management of public resources. Fund TA will need to be coordinated with other partners, including the World Bank. Fiscal reforms and those directed at enhancing the efficiency of the financial system and strengthening Uganda's liquidity and foreign exchange management capacity should be viewed as priorities for the successor Fund-supported program. These areas have already been identified in the economic management "pillar" of the authorities' revised PEAP.

60. **The following are priorities in the fiscal area:**

- **Improving realism of annual budgets.** This will require avoiding over optimism in annual revenue projections and enhancing the transparency of expenditure demands from different agencies.

- **Strengthening domestic revenue mobilization.** This will require avoiding granting of discretionary tax holidays and selective tax exemptions and undertaking a review of the remaining tax loopholes, all of which have eroded the revenue base and promoted rent-seeking activities and corruption. A strengthening of Uganda's revenue administration should be at the top of the agenda, particularly through the

establishment of a desirable functional structure at the URA, an effective LTU and enforcement of the Code of Conduct for URA staff. Moreover, a comprehensive tax reform at the local government level should be implemented. Programs might consider establishing explicit conditionality on revenue thresholds to ensure that revenue mobilization stays on the radar screen of policymakers.

- **Enhancing the efficiency of public expenditures.** There are three critical areas:
  - A second-generation civil sector and pay reform—led by the World Bank—would help rationalize the public sector and improve incentives for civil service employees, including at the subnational level.
  - The remaining weaknesses in public expenditure management should be addressed by both the Fund and the World Bank. Not only should Uganda prevent the emergence of arrears, but it should also put in place a system to generate transparent information about the status of arrears and clearance. Local governments will need assistance to strengthen their budgeting, execution, and reporting practices so as to ensure that poverty-reducing outlays are executed efficiently and in line with policy objectives.
  - The pension reform should be handled cautiously, with a clear understanding of its potential fiscal costs in the short and medium term and the likely trade-offs associated with different options.

61. **The following are priority areas in the monetary and financial sector:**

- **Improving the efficiency and outreach of the financial system.** A multi-pronged approach is needed to support expansion of private sector credit. The critical elements of the approach are establishing credit reference bureaus, rehabilitating the registries for land and companies, drafting a new insolvency law, and continuously developing the BOU's capacity to license and monitor the performance of commercial banks and nonbank financial institutions, including microfinance deposit-taking institutions.

- **Strengthening liquidity and foreign exchange management.** The maintenance of a stable macroeconomic environment would require the sterilization of excess liquidity that avoids excessive variation in interest rates and a misalignment of the real exchange rate. Liquidity and foreign exchange management techniques need to be strengthened, and both the Ministry of Finance and the BOU require assistance in managing debt and in developing and implementing market strategies.

- **Promoting term financing and developing capital markets.** In this regard, a strengthening of governance, asset management, and investment decision making in the NSSF is critical. This should be supplemented with the establishment of a combined regulatory authority for pensions, insurance, and capital markets. A restructured UDB that avoids directed lending would contribute to the development effort.

Table 1. Uganda: Performance Under the ESAF/PRGF-Supported Programs, 1994/95-2003/04

	ESAF-Supported Program						PRGF-Supported Program			
	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Real GDP growth (percent change)										
Program (original three-year program) 1/	5.5	5.5	5.5	7.5	7.0	7.0			6.5	6.9
Annual program 2/	5.5	6.5	7.0	7.5	7.0	7.0	6.0		6.5	5.9
Actual	11.3	9.1	5.5	3.6	8.3	5.3	4.8	6.9	4.5	5.8
Inflation rate (end of period; percent change)										
Program (original three-year program) 1/	7.5	5.0	5.0	5.0	5.0	5.0			6.1	3.5
Annual program 2/	7.5	5.0	5.0	5.0	5.0	5.0	5.6		6.1	1.9
Actual	11.5	5.4	10.4	-0.9	5.3	1.9	5.9	-2.5	10.2	0.9
Broad money growth (percent change)										
Program (original three-year program) 1/	15.0	...	...	16.0	12.5	12.5			11.0	13.7
Annual program 2/	15.0	14.0	15.0	16.0	17.0	17.0	15.0		11.0	12.5
Actual	48.5	10.5	19.8	23.4	9.4	7.0	18.6	9.9	17.3	10.0
Net credit to government (in percent of beginning-of-period broad money)										
Program (original three-year program) 1/	-11.7	...	...	-7.9	-11.7	-13.7			-0.9	0.8
Annual program 2/	-11.7	-16.4	-21.0	-7.9	-8.6	-5.0	-6.5		-0.9	-2.1
Actual	-21.3	4.6	2.2	-7.5	0.1	42.5	3.2	1.2	-4.8	-12.9
Net credit to the private sector (in percentage of beginning-of-period broad money)										
Program (original three-year program) 1/	6.1	...	...	13.2	13.9	15.2			3.6	4.9
Annual program 2/	6.1	12.8	9.2	13.2	12.0	7.0	7.0		3.6	5.5
Actual	5.1	12.0	2.2	9.9	13.7	0.8	3.8	1.3	9.7	6.8
External current account, excl. off. transfers (percent of GDP)										
Program (original three-year program) 1/	-6.6	-6.7	-6.5	-7.0	-6.3	-5.8			-15.9	-15.4
Annual program 2/	-6.6	-7.9	-7.2	-7.0	-9.2	-9.5	-10.9		-15.9	-13.6
Actual	-6.7	-11.5	-9.1	-13.3	-14.7	-13.3	-13.4	-13.7	-14.0	-12.0
External current account, incl. off. transfers (percent of GDP)										
Program (original three-year program) 1/	-2.3	-2.6	-2.8	-2.2	-2.5	-2.3			-9.8	-9.8
Annual program 2/	-2.3	-3.0	-1.7	-2.2	-3.7	-3.1	-4.1		-9.8	-3.9
Actual	-1.3	-6.8	-4.0	-7.5	-9.4	-7.0	-3.8	-5.3	-6.3	-1.7
Gross offiicial reserves (in months of imports)										
Program (original three-year program) 1/	3.8	4.7	5.3	4.6	4.8	4.9			6.1	6.0
Annual program 2/	3.8	4.3	4.7	4.6	5.0	5.0	5.1		6.1	6.3
Actual	3.2	4.7	5.5	6.2	6.6	6.2	5.7	6.3	6.2	6.1

Table 1. Uganda: Performance Under the ESAF/PRGF-Supported Programs, 1994/95-2004/05 (concluded)

	ESAF-Supported Program					PRGF-Supported Program				
	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Terms of trade (annual percent change)										
Program (original three-year program) 1/	26.5	0.0	2.5	4.8	-0.8	0.1			8.3	2.5
Annual program 2/	26.5	..	-10.7	4.8	-1.8	-3.2	0.6		8.3	2.1
Actual	85.3	-19.7	7.7	-5.8	5.5	-21.3	-20.5	-18.1	9.2	8.0
External debt (in percent of GDP)										
Program (original three-year program) 1/	61.5	63.0	64.1	54.1	51.2	48.6			66.1	65.5
Annual program 2/	61.5	63.2	62.5	54.1	65.6	61.7	64.4		66.1	66.5
Actual	62.8	62.5	60.3	59.2	61.7	65.0	58.8	67.1	66.9	55.7
Overall fiscal balance, excl. grants (in percent of GDP)										
Program (original three-year program) 1/	-7.7	-6.5	-5.5	-5.8	-5.3	-4.8			-10.4	-10.2
Annual program 2/	-7.7	-6.1	-5.8	-5.8	-6.7	-8.1	-10.4		-10.4	-10.7
Actual	-7.3	-6.5	-6.4	-6.3	-7.7	-14.9	-10.6	-12.3	-10.8	-11.1
Overall fiscal balance, incl. grants (in percent of GDP)										
Program (original three-year program) 1/	-3.4	-2.3	-1.8	-1.4	-1.3	-1.3			-3.3	-3.5
Annual program 2/	-3.4	-1.8	-0.9	-1.4	-1.0	-1.4	-2.6		-3.3	-1.0
Actual	-2.8	-2.3	-1.9	-1.1	-2.7	-9.1	-2.7	-5.3	-4.3	-1.8
Domestic revenues (in percent of GDP)										
Program (original three-year program) 1/	9.5	10.8	11.8	11.4	12.0	13.0			12.3	12.8
Annual program 2/	9.5	11.6	12.3	11.4	12.1	12.5	11.6		12.3	12.9
Actual	10.1	10.5	11.3	10.6	11.6	11.9	11.3	12.2	12.2	12.7
Expenditures and net lending (in percent of GDP)										
Program (original three-year program) 1/	17.2	17.2	17.3	17.2	17.3	17.8			22.8	23.0
Annual program 2/	17.2	18.0	18.1	17.2	18.8	20.6	22.0		22.8	23.6
Actual	17.5	17.0	17.7	16.9	19.3	26.7	21.9	24.5	23.0	23.8

Sources: IMF staff estimates.

1/ Original program targets for 1994/1995─1996/97 are based on the request for arrangements under the Enhanced Structural Adjustment Facility (ESAF) (8/15/94); for 1997/98─1999/00, they are based on the request for arrangements under the ESAF (10/24/97); for 2002/03─2004/05 on the request for for a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), 8/29/02.

2/ Revised targets for 1995/96 are based on the request for the second annual arrangement (11/09/95).
Revised targets for 1996/97 are based on the request for the third annual arrangement (11/04/96).
Revised targets for 1998/99 are based on the request for the second annual arrangement (10/28/98).
Revised targets for 1999/00 are based on the request for the third annual arrangement (11/24/99).
Targets are presented for 2000/01 based on the first review under the third annual arrangement (8/23/00) since the ESAF program was extended to March, 2001.
Revised targets for 2003/04 are based on the staff report for the second review under the three-year arrangement under the PRGF (12/17/03).

Table 2. Uganda: Comparison of Selected Financial Soundness Indicators of the Banking Sector, 2000-04
(In percent)

Indicator	Country	2000	2001	2002	2003	2004[1/]
Regulatory capital to risk-weighted assets						
	Uganda	**20.5**	**23.1**	**20.7**	**16.7**	**20.6**
	Ghana	11.6	14.7	13.4	9.3	...
	Kenya	17.6	17.3	17.0	17.3	16.5
	Nigeria	17.5	16.2	18.1	17.8	…
	Senegal	11.1	13.5	12.5	11.5	12.7
	South Africa	12.5	11.4	12.6	12.2	12.7
	Tanzania	21.8	24.1	24.1	20.6	…
	Zimbabwe	44.0	44.5	30.6	16.2	…
Nonperforming Loans to total loans						
	Uganda	**9.8**	**6.5**	**3.0**	**7.2**	**2.6**
	Ghana	11.9	19.6	22.7	18.3	...
	Kenya[2/]	33.3	30.1	29.8	25.6	22.9
	Nigeria	22.6	19.7	21.4	19.8	…
	Senegal	18.1	17.8	18.5	13.3	14.7
	South Africa	4.3	3.2	2.9	2.4	2.2
	Tanzania	17.3	12.0	8.2	4.5	…
	Zimbabwe	19.6	11.4	4.2	4.7	…
Loan loss provisions to nonperforming Loans						
	Uganda	**61.7**	**70.0**	**81.5**	**76.5**	**87.8**
	Ghana[3/]	58.6	46.4	63.6	64.4	...
	Kenya	...	...	...	...	...
	Nigeria	...	...	...	...	...
	Senegal	67.6	70.2	70.5	75.3	70.4
	South Africa	44.0	46.0	54.2	66.1	67.1
	Tanzania	...	...	...	...	...
	Zimbabwe	44.4	28.3	52.8	70.1	...
Return on Assets						
	Uganda	**4.4**	**4.4**	**2.7**	**3.3**	**4.5**
	Ghana	9.7	8.7	6.8	6.4	...
	Kenya	0.5	1.6	1.0	2.3	2.1
	Nigeria	4.0	3.3	2.4	1.7	…
	Senegal	1.7	1.6	1.8	…	…
	South Africa	1.4	1.0	0.8	1.1	1.4
	Tanzania	1.3	1.2	1.8	2.1	…
	Zimbabwe	6.0	5.1	4.0	6.7	…
Return on Equity						
	Uganda	**53.1**	**45.8**	**24.6**	**33.1**	**39.0**
	Ghana	65.7	49.7	36.9	54.0	…
	Kenya	4.9	15.7	10.9	23.2	22.7
	Nigeria	…	43.7	28.1	19.8	...
	Senegal	20.3	18.6	21.1	22.1	22.1
	South Africa	12.0	9.1	6.0	12.1	…
	Tanzania	20.5	21.4	20.6	20.7	…
	Zimbabwe	43.2	42.7	57.7	114.8	…
Liquid assets to total assets						
	Uganda	**60.1**	**63.4**	**63.7**	**43.9**	**43.1**
	Ghana	48.4	42.7	50.8	...	...
	Kenya	29.5	34.4	33.7	33.2	35.7
	Nigeria	51.4	29.2	31.5	27.8	…
	Senegal	…	…	65.1	66.5	66.4
	South Africa	15.2	18.3	14.5	25.9	…
	Tanzania	50.9	56.5	58.0	56.3	…
	Zimbabwe[4/]	53.5	44.8	53.9	29.0	…

1/ Figures are as of end-September for Uganda, end-June for Kenya, end-March for Senegal, and end-April for South Africa.
2/ Figures include interest in suspense. If this is excluded, the Nonperforming Loan figures are estimated to be about 9 percentage points lower for 2004.
3/ Provision to past due loans.
4/ Ratio of liquid assets to total deposits plus short-term liabilities.

Table 3. Uganda: Structural Conditionality Under the ESAF/PRGF Arrangements, 1994-2004

	ESAF (1994-97)				ESAF/PRGF (1997-2001)				PRGF (2002-05)				Total Number of Conditions in All Three Programs	
	Prior Actions	Performance Criteria	Benchmarks	Total	Prior Actions	Performance Criteria	Benchmarks	Total	Prior Actions	Performance Criteria	Benchmarks	Total	All types of Conditions	Excluding Prior actions
Fiscal reforms	**0**	**2**	**9**	**11**	**4**	**5**	**8**	**17**	**4**	**5**	**13**	**22**	**50**	**42**
Tax policy and administration		2	9	11		3	5	8	3	1	5	9	28	25
Expenditure policy and reform				0				0	1	3	1	5	5	4
Domestic arrears reduction and monitoring				0	4	2	1	7		1	7	8	15	11
Social policies and expenditures				0			2	2				0	2	2
Public sector and civil service reforms		**1**	**4**	**5**	**0**	**0**	**5**	**5**	**0**	**0**	**2**	**2**	**12**	**12**
Private sector development	**0**	**1**	**8**	**9**	**4**	**0**	**11**	**15**	**3**	**3**	**3**	**9**	**33**	**26**
Public enterprise reform			2	2			3	3				0	5	5
Privatization		1	6	7	4		8	12	1	2	2	5	24	19
Governance and anti-corruption								0	2	1	1	4	4	2
Financial sector reform	**1**	**0**	**7**	**8**	**3**	**1**	**3**	**7**	**2**	**2**	**10**	**14**	**29**	**23**
External sector reforms	**0**	**0**	**0**	**0**	**2**	**0**	**3**	**5**	**0**	**0**	**0**	**0**	**5**	**3**
Trade liberalization				0	2		2	4				0	4	2
External arrears				0			1	1				0	1	1
Total number of structural conditions	**1**	**4**	**28**	**33**	**13**	**6**	**30**	**49**	**9**	**10**	**28**	**47**	**129**	**106**
Met on time	1	4	22	27	13	5	20	38	9	3	13	25	90	67
Met with some delay	0	0	0	0	0	1	3	4	0	3	5	8	12	12
Not met/met with delay of more than 6 months	0	0	6	6	0	0	7	7	0	3	8	11	24	24
Test date not reached 1/	...	...	...	...	...	...	...	...	...	1	2	3	3	...

Sources: IMF Staff Reports, 1994-2005.

1/ Includes one performance criterion and two benchmarks in the PRGF (2002-05).

Table 4. Uganda: Quantitative Performance Criteria and Benchmarks Under ESAF/PRGF Arrangements 1/

	ESAF 1994						ESAF 1997								PRGF 2002			
	Dec. 1994 2/	Jun. 1995	Dec. 1995 2/	Jun. 1996	Dec. 1996 2/	Jun. 1997	Dec. 1997 2/	Jun. 1998	Dec. 1998 2/	Jun. 1999	Dec. 1999 2/	Jun. 2000	Sep. 2000 2/	Dec. 2000	Dec. 2002 2/	Jun. 2003 2/	Dec. 2003 2/	Jun. 2004 2/
Performance criteria and benchmarks																		
Ceiling on the increase in net domestic assets of the banking system 3/ 4/	M	M	M	NM	M	M	M	NM	M	M	M	M	M	M	M	M	W	W
Ceiling on the increase in net claims on the central government by the banking system 4/	M	M	M	NM	M	NM	W	NM	W	M	M	M	M	M	M	M	M	W
Ceiling on the stock of external payments arrears	M	M	M	M	M	M	M	M	M	M	M	M	M	M	M	M	M	M
Ceiling on new nonconcessional external borrowing with maturities greater than one year	M	M	M	M	M	M	M	M	M	M	M	M	M	M	M	M	M	M
Ceiling on short-term external borrowing	M	M	M	M	M	M	M	M	M	M								
Minimum increase in net international reserves 4/	M	M	M	M	M	NM	M	M	W	M	W	M	M	M	M	M	M	M
Ceiling on the issuance of promissory notes by the government							M	M	W	NM	M	M	M	M	M	M	M	M
Minimum total revenue collected by Uganda Revenue Authority									M	M								
Minimum nonwage spending on priority program areas 5/									W	M	W	M			NM	NM	NM	M
Accunulation of new budgetary arrears of the central government 6/											W	M	W	NM	W	W	W	W
Ceiling on new lending by the Uganda Development Bank 7/																	M	W
Indicative target																		
Ceiling on public administration expenditure															M	M	NM	NM

1/ M = met, NM = not met, W = not met and waiver was granted.
2/ Performance criteria.
3/ The target was changed to a ceiling on the increase in base money liabilities of the BOU beginning with the PRGF 2002.
4/ Program adjustors for certain contingencies.
5/ This target became the minimum expenditure under the Poverty Action Fund and an indicative target beginning with the PRGF 2002.
6/ Accunulation of new domestic budgetary arrears under the CCS was applied since the completion of the second review of the PRGF 2002.
7/ Continous performance criterion since the second review of the PRGF 2002.

Table 5. The Millennium Development Goals and Targets

Main MDG Goals		Targets	Donors' Assessment 1/ Target possible at current expenditure trends?	Target possible with better policies, institutions, and additional funding?
1. Eradicate extreme poverty and hunger	1	Reduce by half the share of the population living on less than a dollar a day	Yes	Yes, better than MDGs
	2	Reduce by half the share of the population suffering from hunger	Yes	Yes
2. Achieve universal primary education	3	Ensure that all boys and girls complete a full course of primary schooling	No	Yes
3. Promote gender equality and empower women	4	Eliminate gender disparity in primary and secondary education, preferably by 2005, and at all levels by 2015	No. Already met for primary educacion.	Yes
4. Reduce child mortality	5	Reduce by two-thirds the mortality rate of children under 5	No	Uncertain
5. Improve maternal health	6	Reduce by three-fourths the maternal mortality ratio	No	Uncertain
6. Combat HIV/AIDS, malaria, and other diseases	7	Halt and begin to reverse the spread of HIV/AIDS	Yes, already met	Yes, better than MDGs
	8	Halt and begin to reverse the incidence of malaria and other major diseases	Yes	Yes
7. Ensure environmental sustainability	9	Integrate the principles of sustainable development into country policies and programs; reverse loss of environmental resources	No	Yes
	10	Reduce by half the proportion of people without sustainble access to safe drinking water	Yes	Yes
	11	Achieve significant improvements in life of at least 100 million slum dwellers by 2020	No	Yes
8. Develop a global partnership for development	12	Develop further an operating trading and financial system that is rule-based, predictable, and nondiscriminatory. Includes a commitment to good governance, development and poverty reduction, nationally and internationally	Not applicable	Not applicable
	13	Address the least developed countries' special needs. This includes tariff -and quota- free access for their exports, enhanced debt relief for heavily indebted poor countries, cancellation of official bilateral debt, and more generous official development	Not applicable	Not applicable
	14	Address the special needs of landlocked and small island developing states	Not applicable	Not applicable
	15	Deal comprehensively with developing countries' debt problems through national and international measures to make debt sustainable in the long term	Not applicable	Not applicable
	16	In cooperation with the developing countries, develop decent and productive work for youth	Not applicable	Not applicable
	17	In cooperation with pharmaceutical companies, provide access to affordable essential drugs in developing countries	Not applicable	Not applicable
	18	In cooperation with the private sector, make available the benefits of new technologies–especially information and communication technologies	Not applicable	Not applicable

Sources: UN Millennium Development Goals website: www.un.org/millennium goals; IMF and World Bank, and Uganda's Joint Assistance Strategy Paper.

1/ See Uganda, Draft Joint Assistance Strategy Paper (UJAS), FY 2005-09, October 2004.

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 06/6
FOR IMMEDIATE RELEASE
January 26, 2006

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Reviews Uganda's Performance Under Past Fund-Supported Programs

On July 8, 2005, the Executive Board of the International Monetary Fund discussed Uganda's experience with IMF-supported programs since 1994, based on an ex post assessment of long-term program engagement. Ex post assessments are prepared for countries with a longer-term history of Fund-supported programs in order to evaluate the success of past programs and draw lessons for possible future IMF involvement.[1]

Background

The Ugandan economy has posted an impressive postconflict recovery since the late 1980s with the return to stable political conditions and implementation of sound macroeconomic policies. During this time, the Fund has supported Uganda's ambitious reform program on an almost continuous basis. In the mid-1990s, with the stabilization effort largely complete and a comfortable international reserve position established, the primary focus of Uganda's economic policies shifted from macroeconomic stabilization toward poverty reduction. Since then Fund assistance to Uganda has declined, while donor support has risen gradually. Uganda's annual average growth rate of about 6½ percent over the past decade has been commendable, given that Uganda is a landlocked country and has been adversely affected by deteriorating terms of trade since the mid-1990s. The rise in incomes and poverty reducing expenditures contributed to a significant decline in poverty.

The sequencing of the authorities' reforms for achieving macroeconomic stabilization and growth has been largely appropriate. These efforts have resulted in an open and liberalized economic environment with a relatively sound public expenditure management system. The health of the financial system has also substantially improved and a comfortable level of international reserves helped cushion exogenous shocks. The design of quantitative

[1] This PIN summarizes the views of the Executive Board as expressed during the discussion based on the staff report.

conditionality in Fund-supported programs was sufficiently flexible. However, the total number of structural conditions in all Uganda's Fund-supported programs was high, suggesting room for streamlining.

While macroeconomic developments have been broadly in line with program projections and quantitative targets generally met, fiscal outcomes and structural measures have shown a deteriorating performance, particularly after debt relief under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative completion point in 2000. This suggests an erosion in the government's commitment to reforms despite a well-articulated Poverty Eradication Action Plan (PEAP). A recent slowdown in growth and setback to poverty reduction calls for a second wave of reforms to sustain high growth. Over time, corruption has also cut into government revenues and led to wasteful spending, thereby affecting Uganda's macroeconomic performance.

Executive Board Assessment

Directors thought that the ex post assessment (EPA) of Uganda's performance under Fund-supported programs provides a candid assessment and useful lessons for future program design and implementation. Directors agreed that the main medium-term challenge for Uganda is to sustain growth so as to reduce poverty. Given the magnitude of the social and infrastructure spending needs and the importance of reducing aid dependency, further effort is needed to efficiently expand domestic tax revenues. Directors also emphasized the need for careful sequencing of structural reforms to ease supply constraints and deepen domestic financial markets to enhance the economy's capacity to absorb large donor inflows.

Directors supported the staff's assessment that, given Uganda's growth challenges, there is a case for continued Fund engagement after the expiration of the current PRGF.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Uganda: Selected Economic and Financial Indicators, 2003/04–2006/2007 1/

	2003/04 Est.	2004/05 Proj.	2005/06 Proj.	2006/07 Proj.
	(Annual percentage change, unless otherwise indicated)			
National income and prices				
GDP at constant prices	5.8	5.9	6.6	5.6
Consumer prices				
Underlying (average)	5.0	4.5	4.2	4.0
Money and credit				
Money and quasi money (M3)	9.0	15.0	14.9	14.8
M2	10.0	15.0	15.2	14.8
External sector				
Current account balance				
(including official grants)	-1.7	-3.2	-5.5	-5.2
(excluding official grants)	-12.0	-12.7	-12.8	-11.6
Government budget				
Revenue 2/	12.7	12.6	13.1	13.6
Grants	9.4	9.0	6.9	6.1
Total expenditure and net lending	23.8	22.3	22.4	21.5
Government balance (excluding grants)	-11.1	-9.7	-9.2	-7.9
Government balance (including grants)	-1.8	-0.7	-2.3	-1.7
Net donor inflows	11.9	11.2	10.0	8.5
Debt indicators	(In percent of GDP at market prices)			
Net present value of external debt 3/	204.1	185.7	186.1	186.3
External debt-service ratio 4/				
Including Fund obligations	10.0	10.0	10.7	10.1
Stock of domestic debt (in percent of GDP)	9.6	10.2	9.3	7.9
Balance of payments	(In millions of U.S. dollars, unless otherwise indicated)			
Overall balance of payments	214	285	169	107
Gross foreign exchange reserves	1,135	1,373	1,491	1,540
(In months of imports of goods and nonfactor services)	6.1	6.6	6.8	6.6

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

1/ Fiscal year begins in July.

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

3/ NPV ratios from 2003/04 are based on CIRRs (discount rate) and exchange rates at June 2003. In relation to the current year of exports of goods and services.

4/ 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.