Uganda: Tentative Work Program

Action	Date
Executive Board conclusion of the 2002 Article IV consultation	January 2003
Mission to conduct the first review of the PRGF-supported program	March 2003
Executive Board discussion of the first review of the PRGF-supported program	May 2003

©International Monetary Fund. Not for Redistribution

INTERNATIONAL MONETARY FUND
Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 03/35
FOR IMMEDIATE RELEASE
March 20, 2003

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

IMF Concludes 2002 Article IV Consultation with Uganda

On February 12, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Uganda.[1]

Background

Since the conclusion of the last Article IV consultation in March 2001, Uganda has continued to implement disciplined financial policies and sound structural reforms that have helped to sustain robust economic growth despite an adverse external environment. In 2001/02 (July–June), real GDP growth increased to 6.6 percent, boosted by highly favorable weather conditions for agriculture and a surge in construction activity from a pick up in investment. A sharp drop in food crop prices resulted in negative headline inflation of -2.5 percent during the year, while underlying inflation, which excludes food crop prices, dipped to 0.1 percent. Thus far in 2002/03, real GDP growth has slowed down to about 5½ percent, as weather conditions deteriorated and delays to the Bujagali hydroelectricity project dampened construction activity. Headline inflation has risen to 5.8 percent, as food prices rebounded by 20 percent, while underlying inflation increased to 1.4 percent (December 2002).

Implementation of the Poverty Eradication Action Plan (PEAP) continues to be a central element of government policy, with the long-term goal of reducing the incidence of poverty to less than 10 percent of the population by 2017. The real GDP growth achieved to date has contributed to the

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

©International Monetary Fund. Not for Redistribution

reduction of the incidence of poverty to 35 percent of the population in 2000 from 44 percent in 1997 (and 56 percent in 1992).

Notwithstanding an improved revenue performance, the overall fiscal deficit, excluding grants, widened by 2 percentage points to 12.7 percent of GDP in 2001/02, as government spending rose sharply. The overall fiscal deficit is expected to narrow by 1½ percentage points of GDP in 2002/03. Revenue collections have generally been on target through the first half of the fiscal year, and total spending limits are expected to be respected, despite the recent announcements of considerably higher-than-budgeted defense spending. As a result, while the overall deficit is expected to be in line with the program, outturns for unprotected programs are likely to deviate substantially from budget intentions. These large fiscal deficits are almost completely financed by donor assistance.

The reserve money program implemented by the Bank of Uganda (BOU) has served well in maintaining low inflation. However, large sterilization operations needed to absorb liquidity generated by large fiscal deficits have complicated monetary and exchange rate policies. In 2001/02 net issues of treasury bills rose 3½ percent of GDP and net official interventions in the foreign exchange market reached 4 percent of GDP, owing mainly to sterilization operations. New monetary and exchange rate policy operating procedures implemented in April 2002, have facilitated sterilization operations and reduced volatility in interest and exchange rate movements. Still, reserve money growth exceeded targets in 2001/02, leading to increased emphasis by the BOU in mopping up the excess liquidity and firm adherence to reserve money program in 2002/03.

The health of the banking system has continued to strengthen. In 2002, the privatization of the Uganda Commercial Bank (UCB) and its merger with a sound international bank was completed. Banking supervision has been increasingly more vigorous, with on-site inspections being stepped up substantially; as a result, one small bank was intervened and merged with a healthy institution and another was recapitalized. As a result of these actions, the performance indicators for the banking system have continued to improve. On January 1, 2003, new capital requirements came into effect, doubling the minimum paid-up capital to Ugandan Sh 4 billion.

Reflecting the deterioration in terms of trade in recent years, the external current account deficit, excluding grants, widened substantially, before narrowing to 13.4 percent of GDP in 2001/02. In particular, export earnings increased for the first time in three years, as continued growth in noncoffee exports exceeded the loss to coffee exports from the collapse in world coffee prices, and net private transfers surged. Thus far in 2002/03, both coffee and noncoffee exports have shown strong growth, suggesting an improvement in Uganda's international competitiveness, but a falling back of private transfers to historically normal levels is expected to lead to a widening of the external current account deficit. The current account deficit has been more than financed by increased donor assistance, including debt relief under the Highly Indebted Poor Countries (HIPC) Initiative, and private capital inflows, allowing for increases in gross international reserves to six months of imports.

The falling export receipts in recent years have led to a deterioration in external debt indicators. Assuming the full delivery of assistance under the HIPC Initiative, the ratio of the net present value (NPV) of external debt to exports reached 190 percent at end-June 2002, and is projected to peak at 195 percent in 2002/03. There was much progress in reaching agreements with creditors on the

©International Monetary Fund. Not for Redistribution

delivery of HIPC assistance in 2001/02, including debt relief beyond HIPC by Paris Club members. Recently, the governments of India, Libya, and the Republic of South Korea have pledged to participate in the HIPC Initiative and it is expected that agreements on delivery of assistance will be forthcoming. However, Uganda has had difficulty in securing agreements for HIPC Initiative debt relief from some non-Paris club creditors.

Executive Board Assessment

Executive Directors commended the Ugandan authorities for their sustained pursuit of sound financial policies and structural reforms, which have led to robust economic growth and macroeconomic stability despite an often adverse external environment. They commended as well the development and consistent implementation of a comprehensive country-owned poverty reduction strategy, which has contributed to a significant reduction in the incidence of poverty in Uganda. However, Directors noted that attaining Uganda's long-term goals for poverty reduction would require higher rates of economic growth, underpinned by stepped-up private investment, strengthened mobilization of domestic resources, improved governance structures and budget management at all levels of government, and strengthened financial intermediation.

Directors agreed that controlling the fiscal deficit is critical in order to maintain macroeconomic stability and contain pressures on real interest rates and the exchange rate. Given the expenditure needs of the country, major efforts will have to be placed on revenue mobilization to reduce the deficit and the heavy dependence on external aid. While welcoming the authorities' plans to strengthen tax administration, Directors emphasized that tax policy measures may be needed as well to achieve the desired revenue increase over the medium term.

Directors commended the authorities for the progress made in budget management and urged them to maintain the integrity of the budget process. They considered this important for enhancing transparency and accountability, for building the trust of the donor community and increasing the share of direct budget support, and for attracting foreign investment. Directors expressed concern that, in recent years, supplementary appropriations have resulted in the composition of government spending deviating substantially from budget intentions and in under-financing of unprotected social and economic programs. They noted with concern that, in the fiscal year 2002/03, in light of the security problems in the north of the country, defense spending will be considerably higher than budgeted. In this context, they welcomed the ongoing defense review, and urged the authorities to expedite the streamlining of expenditure on public administration with a view to improving efficiency and freeing resources for poverty-related and development spending. Directors agreed that donors need to underwrite these efforts by improving the timeliness and predictability of their support, and by better integrating such support with the budgetary process. Directors also expressed concern about the large and growing stock of domestic arrears, and urged the authorities to develop a strategy to gradually eliminate them in an orderly manner.

©International Monetary Fund. Not for Redistribution

In light of the increased role of local government in the delivery of public services, Directors encouraged the authorities to develop a clear reform agenda for decentralization and an action plan to enhance the reporting, monitoring, and accountability of local government operations; and to rationalize the institutions involved in the decentralization process.

Directors noted that the flexible exchange rate regime has served Uganda well, helping to absorb terms-of-trade shocks while preserving external competitiveness, and that monetary policy has succeeded in keeping inflation low. The mopping up of banks' excess reserves and the implementation of new sterilization and liquidity management procedures have enhanced the stability of the domestic money and foreign exchange markets. Directors welcomed plans to further develop repurchase operations and introduce longer-dated government paper, which would enhance the effectiveness of liquidity management.

Directors commended the authorities for taking steps to improve the soundness of the financial sector, as recommended by the financial system stability assessment report. They expressed satisfaction with the supervisory actions that have been taken against noncompliant, undercapitalized, or nonviable financial institutions. To further strengthen the financial system, Directors urged the authorities to expedite passage of the Financial Institutions Bill and the Micro-Finance Deposit-Taking Institutions Bill, and to establish the legal framework and monitoring structures for anti-money laundering and anti-terrorism financing. Directors also stressed the importance of increasing the level and efficiency of financial intermediation to support investment and economic growth. This calls for measures to increase competition, lower intermediation costs, develop microfinance institutions to facilitate access to credit in rural areas, and promote the development of long-term lending instruments. Directors noted that the restructuring of the National Social Security Fund will be an important step, and hoped that the required parliamentary approval will be obtained.

Directors expressed concern that Uganda's external sector remains weak and that the external debt indicators continue to deteriorate, while acknowledging that this reflected mainly a prolonged deterioration in terms of trade. They welcomed the authorities' focus on gradual fiscal consolidation and measures aimed at expanding and diversifying the export base. However, they cautioned against the use of ad hoc investment incentives to achieve these goals and urged the authorities instead to work toward a harmonized system of taxation and incentives for the East African Community. They supported the authorities' plans to improve the infrastructure as a means of lowering transport costs.

Directors noted with satisfaction that in the past year, Uganda was able to sign agreements with a number of creditors on the delivery of HIPC Initiative assistance, and that additional relief should be forthcoming from several other creditors that have recently pledged relief on official debt. They regretted, however, that some non-Paris Club creditors have not provided debt relief to Uganda as envisaged in the HIPC Initiative, and that some creditors have filed lawsuits against the government. They encouraged the authorities to continue to seek agreement with creditors and urged all creditors to join the HIPC Initiative for Uganda.

©International Monetary Fund. Not for Redistribution

Directors commended the authorities for having put in place a comprehensive legal and regulatory structure for strengthening governance and transparency. They emphasized the need to vigorously follow up on the anti-corruption efforts underway and to ensure adequate funding for the Inspector-General's office. They observed, in particular, the need to address governance issues in the Uganda Revenue Authority and at the level of the local governments.

Directors encouraged the authorities to continue to address the weaknesses in the production and dissemination of statistics, and supported their requests for technical assistance in this area.

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.

©International Monetary Fund. Not for Redistribution