

INTERNATIONAL MONETARY FUND



Staff Country Reports

Uganda: 2006 Article IV Consultation and Staff Report for the 2006 Article IV Consultation, First Review of the Policy Support Instrument, Request for Waiver of Assessment Criteria, and Request for a Three-Year Policy Support Instrument—Staff Report; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Uganda

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2006 Article IV consultation with Uganda, the first review of the Policy Support Instrument, request for a waiver of assessment criteria, and request for a three-year Policy Support Instrument, the following documents have been released and are included in this package:

- the staff report for the combined 2006 Article IV Consultation, First Review of the Policy Support Instrument, Request for Waiver of Assessment Criteria, and Request for a Three-Year Policy Support Instrument, prepared by a staff team of the IMF, following discussions that ended on October 11, 2006, with the officials of Uganda on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 1, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its December 15, 2006, discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.
- a statement by the Executive Director for Uganda.

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

Letter of Intent sent to the IMF by the authorities of Uganda*
Memorandum of Economic and Financial Policies by the authorities of Uganda*
Technical Memorandum of Understanding*

*Also be included in Staff Report

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

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INTERNATIONAL MONETARY FUND

UGANDA

Staff Report for the 2006 Article IV Consultation, First Review of the Policy Support Instrument, Request for Waiver of Assessment Criteria, and Request for a Three-Year Policy Support Instrument

Prepared by the African Department

Approved by Robert Corker and Mark Plant

December 1, 2006

Main topics. This report recommends completion of the first review under the Policy Support Instrument (PSI) and approval of a new three-year PSI.

Electricity crisis. Uganda's electricity-generation capacity has fallen to about half of peak demand, a crisis brought on by delayed hydroelectric investment and a regional drought. Emergency measures are now being put in place and new dam construction is about to start.

Infrastructure gap. Uganda's roads, railroads, and other infrastructure are insufficient to support future growth. MDRI debt relief provides an opportunity to scale up investment, but project implementation needs to improve.

Participants. The mission met with President Museveni, Finance Minister Suruma, Bank of Uganda Governor Tumusiime Mutebile, other government officials, and representatives of the private sector and the international community. The mission team comprised Messrs. Green (head, AFR), Mikkelsen, Gershenson (both AFR), Espejo (PDR), and Jonas (FAD). Mr. Selassie, the Fund's resident representative in Kampala, participated in the discussions. Mr. Ukpong, senior advisor to Mr. Gakunu, attended policy meetings.

Selected Issues Paper. A joint selected issues paper was prepared for the 2006–07 Article IV consultations with Kenya, Tanzania, and Uganda.

Article VIII status. Uganda has accepted the obligations under Article VIII, sections 2, 3, and 4 and maintains an exchange system free of restrictions on the making of payments for current international transactions.

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EXECUTIVE SUMMARY

- **PSI Performance.** All quantitative assessment criteria for the first PSI review were observed, but quantitative indicative targets on domestic arrears and administrative expenditures were not met. In addition, two structural assessment criteria were not met: one was implemented with a slight delay and the other with a slight deviation from plan. The authorities are taking steps to address the unresolved slippages.
- **New PSI.** The authorities request a new three-year PSI. The main objectives of the program are to sustain macroeconomic stability and to alleviate constraints on growth. Tackling the ongoing electricity crisis, other infrastructure deficiencies, and low financial intermediation will be key program objectives. Other structural measures will address domestic arrears, including measures not completed in the first PSI, and debt management.
- **Macroeconomic policies.** Sound economic policies during the last 15 years have resulted in one of the best records in Africa, although per capita growth and poverty reduction have slowed in recent years. While there are growing calls for more government intervention to stimulate growth, the government remains committed to prudent fiscal and monetary policies and market-based reforms, as evidenced by the government's success in maintaining fiscal discipline in 2005/06, despite spending pressures arising from the electricity crisis, higher oil prices, and the elections.
- **Recent developments.** While economic growth and Uganda's external position were largely consistent with program assumptions in 2005/06, an acute electricity crisis threatens macroeconomic performance. Extensive power cuts have mostly hurt manufacturing and a few other energy-dependent sectors. Inflation was slightly above projections through September due to higher energy costs.
- **Political developments.** Economic prospects could significantly improve from an end to the 20-year conflict in northern Uganda. Peace talks were restarted earlier this year and discussions for a permanent peace agreement are ongoing. President Museveni was reelected in February 2006.
- **Key risks.** Further delays in augmenting electricity capacity could undermine the economy. Moreover, the full economic impact of the current situation is not yet known. Growth and revenue projections could be revised downward. The expected increase in agriculture production may not materialize, as the sector remains very sensitive to adverse weather conditions.

I. INTRODUCTION

1. **To build on the impressive economic gains of the past 15 years**, Uganda needs to maintain macroeconomic stability, strengthen infrastructure development, improve governance and institutions, and remove remaining administrative bottlenecks for businesses. As an immediate priority, the government must resolve the ongoing electricity crisis.
2. **At the conclusion of the 2004 Article IV consultation, Executive Directors commended Uganda’s impressive growth and poverty reduction, but noted that progress had started to taper off.**¹ They encouraged Uganda to launch a second wave of reforms to boost per capita growth and reduce poverty. The authorities were in agreement with these recommendations and pursued policies broadly consistent with Fund advice (Box 1).

Box 1. 2004 Article IV Key Policy Recommendations and Implementation

Fund policy recommendations centered on fiscal consolidation, structural reforms, and sterilization mix. The Fund and the authorities agreed that **fiscal consolidation** would remain an essential element of macroeconomic management, and this has been reflected in the authorities’ Medium-Term Expenditure Framework. The Fund stressed the importance of **structural reforms**, such as improving governance and reviving the public administration reform program; this sentiment was shared by the authorities, but progress remained slow. Consistent with the Fund’s recommendations, the authorities adjusted their **sterilization mix** in favor of foreign exchange sales, contributing to lower interest rates and an increase in private sector borrowing.

3. **The authorities have requested a three-year PSI to support of their near- and medium-term policies.** The preference to move to a multi-year relationship was already envisaged at the time of the request for the current PSI, when discussions on substantive medium-term policies were postponed until after the presidential and parliamentary elections of February 2006. Uganda remains a strong candidate for a PSI with its longstanding track record of prudent macroeconomic policies, ample foreign exchange reserves, and low external debt, particularly after the recent Multilateral Debt Relief Initiative (MDRI).

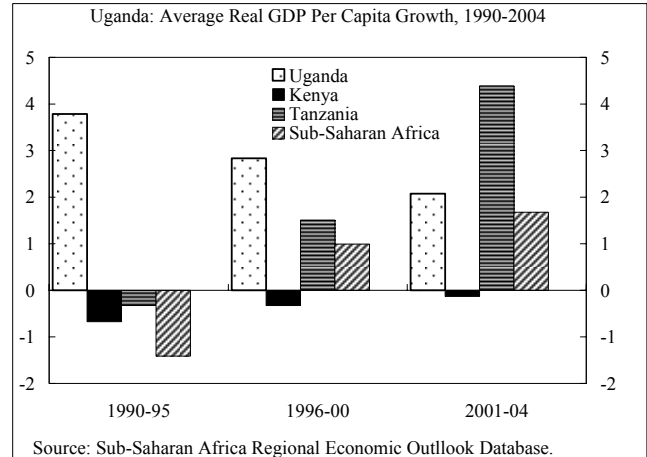
¹ See the relevant Public Information Notice 05/66 <http://www.imf.org/external/np/sec/pn/2005/pn0566.htm>.

II. MACROECONOMIC PERFORMANCE JEOPARDIZED BY INFRASTRUCTURE GAP

A. Macroeconomic Performance

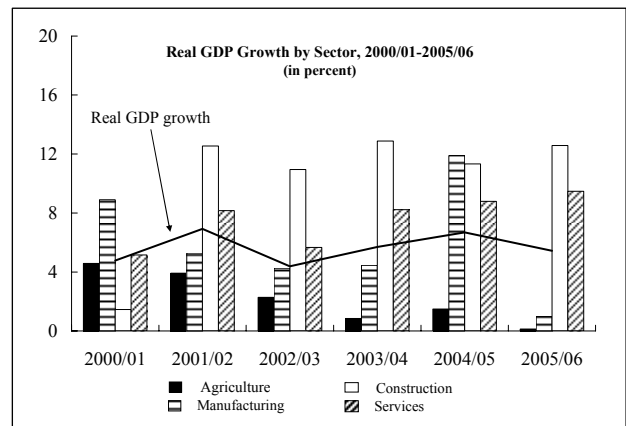
4. Uganda's macroeconomic performance over the past 15 years has been exceptional.

Per capita GDP growth exceeded the average in sub-Saharan Africa and international reserves were rebuilt following the earlier period of civil unrest. Sound macroeconomic policies contained debt and brought about price stability, key factors in Uganda's growth and poverty reduction record. Donors have consistently funded a significant part of public spending. The appropriately flexible exchange rate regime allowed Uganda to weather fluctuations in coffee prices and aid inflows while retaining international competitiveness. Most markets were liberalized, and the banking system and state-owned enterprises were privatized. Poverty rates came down, and social spending was increased.



5. **More recently, however, per capita growth has tapered off and poverty reduction stagnated.** Apart from slower economic growth, poverty trends were adversely affected by declining terms of trade (in the late 1990s) and widening income inequalities. The fall in per capita growth is explained by a dwindling contribution from the positive post-conflict catching up effects, relatively low productivity growth, and very high population growth.² Uganda's annual population growth—now over 3 percent—is one of the highest in the world.

6. **An acute electricity crisis threatens Uganda's macroeconomic performance.** The regional drought in 2005/06 reduced Uganda's already inadequate hydropower-generating capacity, resulting in a production gap of nearly one-half of demand. In consequence, businesses and consumers

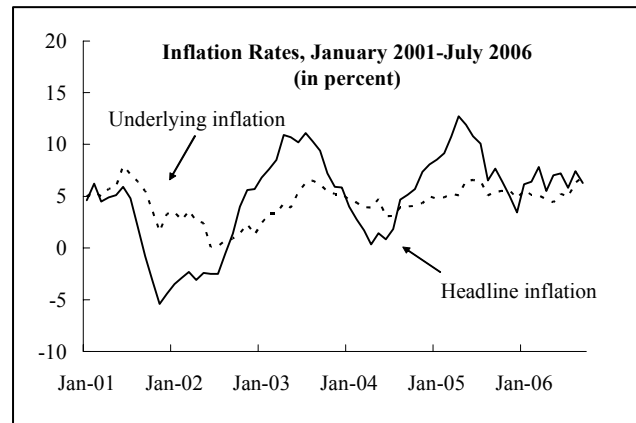


² See Chapter 1 in *Uganda—Selected Issues and Statistical Appendix* (Country Report No. 05/172).

were forced to endure prolonged service cuts, with some shifting production to times when power is available and larger businesses relying on high-cost backup generators. Manufacturing, high-value agriculture (flowers), and processing industries (fish) are most affected by power cuts, and profits in these industries are being squeezed. Measured GDP growth in 2005/06 (5½ percent) was largely unaffected because of these short-term coping strategies and because of the methodology used in estimating GDP.³

7. The electricity crisis has had a more immediate impact on inflation and the trade balance.

Underlying inflation, which excludes food, moved close to 7 percent in the 12 months through September because of energy prices and several one-time factors. In 2005/06 the trade deficit widened because of higher oil prices and diesel fuel import volumes for thermal power generation, notwithstanding a rise in export earnings driven by a 50 percent increase in world coffee prices. The wider deficit drove down the reserve import cover to about 5½ months at end-2005/06, although financing was not a concern because net donor support remained above 8 percent of GDP. The MDRI debt relief will augment the government's resource envelope in the short and medium term (Box 2).



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B. Constraints to Growth

8. Discussions with the authorities and private sector representatives emphasized several medium-term growth constraints:

- Inadequate electricity generation and distribution.** The present situation with extensive load-shedding blackouts is not sustainable. For several years, Uganda's generating capacity, which is based on relatively inexpensive hydropower, has increasingly fallen short of demand. The recent drought conditions have exacerbated the problem, with hydroelectric production cut in half to about 100 megawatts (MW). Efforts to build a dam at Bujagali were delayed several times by planning errors and

³ Official GDP statistics in Uganda may not fully capture the decline in value added stemming from increased costs. As in many other African countries, they are based on production volume indices and therefore they do not reflect the recent increase in energy input costs.

environmental concerns (since addressed). Temporary diesel generators (100 MW) were recently added to the power grid, helping to reduce load shedding. The cost of the crisis was worsened by high world oil prices.

Box 2. MDRI Debt Relief: Allocation of Available Resources

The IMF, the World Bank, and the African Development Fund (AfDF) granted debt relief to Uganda under the Multilateral Debt Relief Initiative (MDRI). The IMF debt relief will have a significant impact in the 2006/07 budget, while the flow impact of World Bank and AfDF relief is expected to be spread out over a longer period due to longer grace periods and maturities. However, the net flow effect of the debt relief from the World Bank could be small as future IDA allocations may be lower than previously envisaged.

The government has decided to allocate IMF debt relief to projects in energy infrastructure starting with the 2006/07 budget. The World Bank and the AfDF debt relief could be incorporated in the 2007/08 budget framework to support the achievement of MDGs. The AfDF relief is expected to be delivered before end-2006.

Debt Relief Under MDRI
(millions of SDRs, unless indicated otherwise)

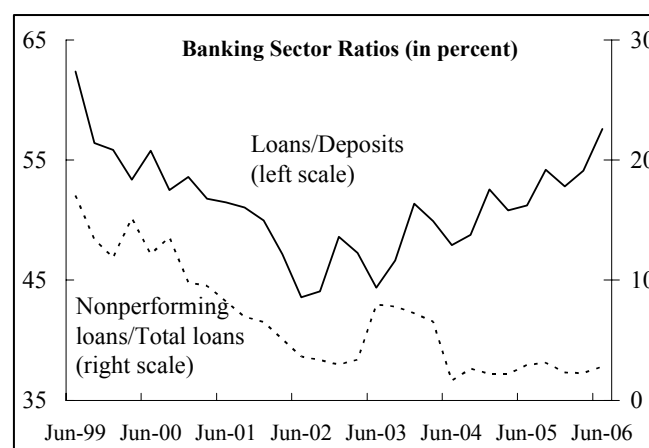
	Stock	Flows		
		2005/06	2006/07	2007/08
IMF	88	16	27	18
World Bank 1/	1,707	0	30	32
AfDF 2/	351	3	3	3
Total	2,146	18	60	53
Total (% of GDP)	33.0	0.3	0.9	0.7

1/ Net flows could be lower due to changes in IDA allocations.

2/ Debt relief to be delivered by end-2006. Flow relief shown in calendar years.

- **Poor transportation network.** Uganda's indicators for road and railway infrastructure are among the worst in Africa. Given the country's landlocked status, this poses considerable cost disadvantages, with some exporters turning to high-value goods that can be transported by air freight. Rural areas are also faced with an infrastructure deficit that prevents easy access to local markets, particularly for food crops and fish. These represent close to 25 percent of GDP.

- **A shallow financial sector.** Although the situation has improved somewhat in recent years after the restructuring of a major bank and a reduction in nonperforming loans, financial intermediation remains low. Credit to the private sector (currently at about 8 percent of GDP) is low compared with neighboring countries (particularly Kenya) and the average for sub-Saharan Africa.



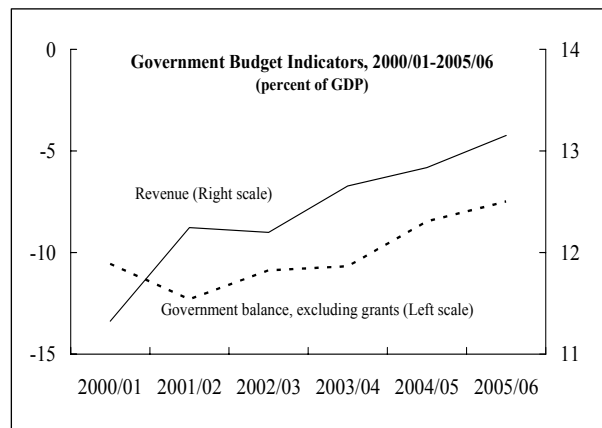
The need for financial deepening is also reflected in the persistent high spread between lending and deposit rates for most customers. This problem derives from relatively low financial savings, as well as some inadequate institutional arrangements on which financial activity depends. Notwithstanding a successful microfinance sector, which is an important contributor to poverty alleviation in the larger cities and along the main highways, access to credit is a particular problem in the rural areas.

- **Corruption and governance problems.** According to Transparency International's Corruption Perception Index, Uganda ranked 117 out of 158 countries and in the lower half of sub-Saharan countries. Recent investigations into mismanagement of Global Fund money and irregularities in government procurement have illustrated the need to strengthen policies in this area, but, on the positive side, the government's willingness to take on difficult cases. The successful restructuring of the Ugandan Revenue Authority (URA) has resulted in improved governance and increased tax collection.

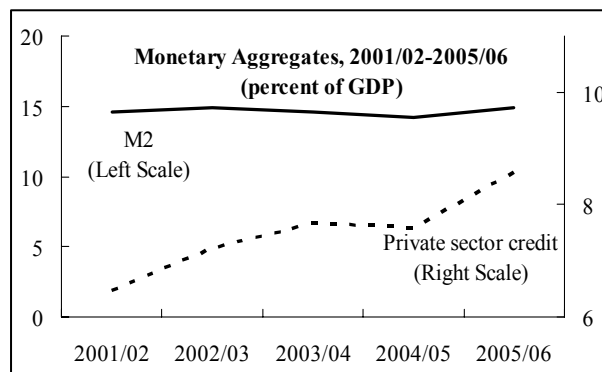
III. THE PSI REVIEW— MOSTLY ON TRACK, BUT SOME DELAYS AND SLIPPAGES

9. **All quantitative assessment criteria for end-June 2006 were met, but several indicative targets were not observed (Table 6).** The indicative target on minimum expenditures under the Poverty Action Fund was reached, but public administration spending was about U Sh 50 billion (0.2 percent of GDP) above the ceiling due to unanticipated election costs and a salary increase for parliamentarians. Reported domestic arrears under the commitment control system (CCS) were above the indicative target (U Sh 13 billion), despite efforts to limit new arrears and progress in related structural measures (see below). Reporting of CCS arrears remains a problem, but should improve as teething problems with the new computerized system are resolved and as efforts to enforce existing rules are strengthened.

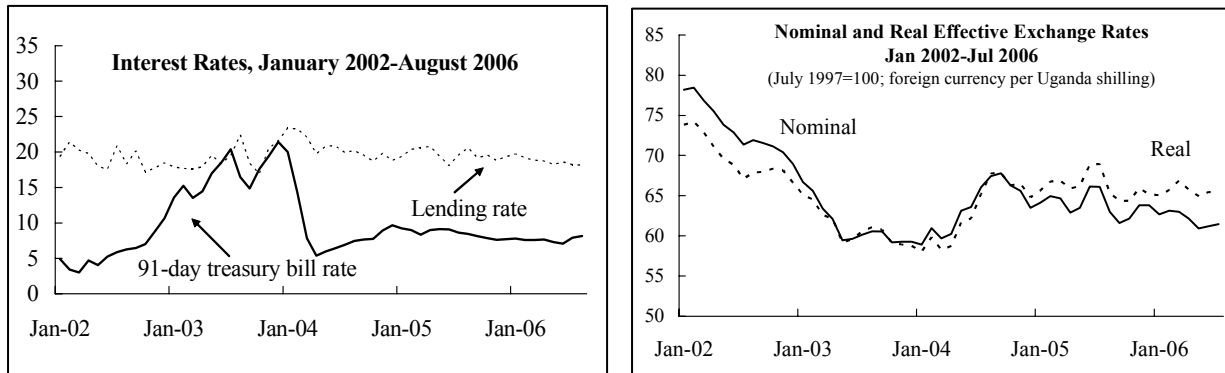
10. **Fiscal developments in 2005/06 were broadly in line with the program and its consolidation objective (Table 2).** The overall deficit ratio, excluding grants, declined by 1 percentage point to 7.5 percent of GDP, reflecting both higher tax revenues and lower donor-financed development expenditures. Improved tax administration and new tax measures helped to boost domestic revenue. In particular, international trade and value-added taxes performed well. Budget grants fell by more than 1 percent of GDP, reflecting temporary delays in IDA grants and scaled-back budget assistance from other donors after the arrest of the main opposition candidate in the run-up to the elections.



11. **Monetary policy management, with its continued focus on using foreign exchange sales as the primary liquidity sterilization tool, helped interest rates to decline further.** Base money was below the program ceiling and the stock of net international reserves of the Bank of Uganda exceeded the program floor by a large margin (Table 3). Credit to the private sector increased by 28 percent, and the share of nonperforming loans



remained low. The nominal effective exchange rate depreciated by 4 percent in 2005/06, but the real effective rate stayed roughly unchanged.



12. **Progress continued in implementing the structural program, but not as originally envisaged (Table 7).** Two structural assessment criteria were not completed on time and three structural benchmarks were not observed. The assessment criterion on repayment of old arrears was met, but the strategy paper for avoiding domestic arrears was submitted to Cabinet with a delay. This reflected a more ambitious paper than initially planned and the need to fine tune the approach proposed. Provisions for arrears payment in the 2006/07 budget were doubled, but the allocated amount fell just short of that envisaged due to the urgent needs of the electricity sector. There has been progress in meeting the structural benchmarks, including on submitting budget contingency regulations (completed) and preparing guidelines on contracting, managing, and monitoring external debt. Verification of all old (pre-CCS) arrears is nearly complete, but missing personnel records has slowed verification of military arrears. The Uganda Development Bank increased lending by a small amount before its new management team was in place.

IV. MEDIUM-TERM POLICY CHALLENGE—MAINTAIN MACROECONOMIC STABILITY AND ADDRESS INFRASTRUCTURE DEFICIENCIES

13. **Uganda's key medium-term challenge is to sustain economic growth at a rate consistent with significant poverty reduction.** The authorities at the highest levels are committed to macroeconomic stability through achieving prudent fiscal and monetary policies and market-based reforms. As outlined in Uganda's Poverty Eradication Action Plan (PEAP), sustaining higher growth will depend on finding ways to scale up transportation infrastructure and utilities, improve access to rural finance and SMEs, remove barriers to investment, and continue to focus on education as Uganda's young population enters the labor force.

14. **The public policy discourse affirms the need to maintain macro stability, but there are also growing calls for government intervention in a few areas.** Some would like tax incentives as a way to attract more foreign investment, while others would like government support for rural savings institutions and other financial services. At this point, the authorities are only contemplating limited tax incentives and experimentation with promoting financial services for the rural poor. The authorities also see regional cooperation as a means of spurring development. As outlined below, the establishment of the East African Community (EAC) has expanded the local market and given the countries involved a forum for policy discussions on further economic integration.

15. **In line with the PEAP, the baseline medium-term framework** envisages annual real GDP growth of 6 to 7 percent and inflation of 4 to 5 percent. The projected growth pickup assumes that

investment in electricity and critical infrastructure

projects, as well as

expanded financial

services, will raise

economic growth by

allowing further gains in

nontraditional sectors—

such as flowers and

fish—and growth by

SMEs that rely on the

electric grid. Past financial sector reforms

combined with new supportive measures are

expected to lead to a more dynamic financial

sector that serves a wider group of private

enterprises. Infrastructure improvements

coupled with higher private investment should

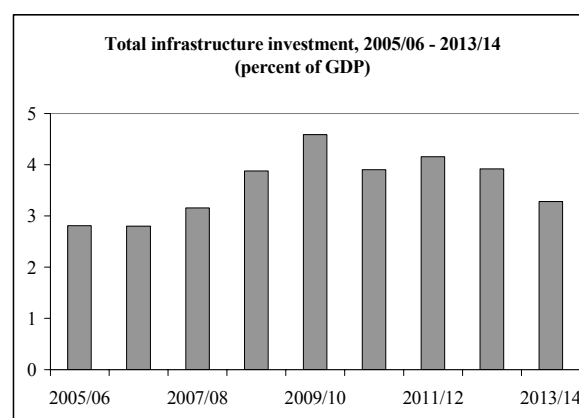
allow the economy to absorb the fast-growing

population. Uganda's expanded education

opportunities should also help raise

productivity.

Central government operations and energy crisis (Percent of GDP)				
	2005/06	2006/07	2007/08	2008/09
Revenue	13.2	13.6	14.1	14.6
Grants	6.6	6.6	5.1	4.7
Expenditure	20.6	22.3	22.0	21.8
o/w: energy crisis	--	1.1	0.8	0.7
Emergency	--	0.7	0.3	0.3
Energy Fund	--	0.4	0.5	0.4
Overall balance (excl. grants and energy)	-7.5	-7.7	-7.1	-6.5



16. **The framework is conditioned on** (i) addressing the electricity sector's supply and demand imbalance; (ii) construction of new roads and other infrastructure; and (iii) strengthening the financial system, and (iv) further domestic revenue mobilization, together with spending discipline and prioritization. Absent scaling up of grants, the authorities would consider borrowing for well-defined infrastructure projects.

17. **The staff sees the medium-term framework as feasible, but with some risks.** The overall strategy of supporting private sector growth through continued emphasis on sound macroeconomic policies, better infrastructure, financial sector development, and regional cooperation is appropriate. But while timely completion of infrastructure projects is key to success, careful project selection and implementation would be essential, along with appropriate financing and avoidance of adverse macroeconomic consequences and a rapid buildup of debt. Interventionist policies should also be measured given that experience in Uganda and other countries suggests that tax incentives and direct support to the financial sector can be costly and ineffective.

A. Solving the Electricity Crisis

18. **The government is implementing a two-part solution to the crisis.** It is installing temporary diesel (thermal) generators to replace capacity lost because of drought conditions, promoting energy conservation, and reducing the currently high distribution and billing losses. Further ahead, it will complete construction of new hydropower plants at Bujagali and Karuma:

- One half of the planned 200 MW thermal generating capacity has already been installed and loadshedding has been reduced. Capital and operating costs of the thermal generators would be financed over the next four years through the already implemented doubling of the average electricity tariff, the government's own resources, and a World Bank loan. The approximately 100 percent increase in tariffs in 2006 is expected to cover about one-third of the costs of running these generators and puts tariffs in line with the expected marginal cost of producing power with the Bujagali plant. Further tariff increases may be needed if world oil prices rise.
- The Bujagali project is in the late planning stages and would be financed through a public-private partnership arrangement. Approval by the private consortium and financing partners is expected in early 2007. When electricity production begins in about four years, Uganda would decommission its diesel generators, but projections indicate that the supply—demand gap would not be fully closed.

- The Karuma dam and a heavy fuel oil power station (part of the emergency project) would be needed to meet anticipated demand in the medium term. As with Bujagali, Karuma is downstream on the Nile and would utilize water already flowing from Lake Victoria. The government is keen to move ahead quickly to avoid future electricity shortages, promote growth, and have power for rural electrification. The government's energy fund (US\$55 million in the 2006/07 budget) would provide seed money, but more resources will be needed.

19. **Oil reserves were recently discovered in Uganda (Box 3).** At this stage, proven reserves are small, but could help meet a part of Uganda's demand in the future. The government is committed to transparency policies and proper accounting procedures.

Box 3. Oil Exploration: Prospects and Policy Implications

Oil has been discovered in the Lake Albert region in western Uganda. Continuing exploration there—under production-sharing agreements—could attract additional investments.

If extraction proves to be economically viable, oil production could amount to about a half of current demand by 2009. The government is conducting a detailed feasibility study of oil extraction—including cost estimates—to be completed by early 2007. Depending on the amount of recoverable reserves, the government could build an on-site mini refinery (at a cost of about US\$200 million) and a thermal power plant. The financing options have not yet been finalized, but a private-public partnership contract might be used.

The government is working on specific transparency and accounting procedures for the prospective oil industry. The objectives are to administer oil production efficiently; ensure transparency in the management, operations, and accounting of the oil-generated resources; and protect the environment in the oil-producing areas.

B. Dams and Roads—Macroeconomic Considerations⁴

20. **Construction of large infrastructure projects, including the Bujagali and Karuma dams, will require both domestic and external resources.** The program incorporates the estimates for the full Bujagali dam, ongoing road construction, and some funds for Karuma (ring-fenced savings at the Bank of Uganda). These are sustainable in terms of financing and imports, and are necessary to maintain economic growth in the 6-

⁴ The Bujagali and Karuma dams are listed in the PEAP as is road construction and maintenance.

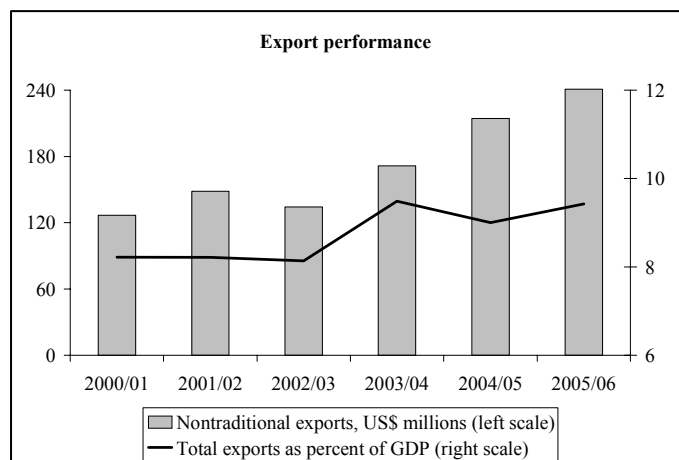
7 percent range in the medium term. Fiscal space for completion of Karuma and other projects could be created through a mix of the following:

- changes in priorities within recurrent and development spending allocations, including donor-financed projects;
- concessional financing, provided that debt sustainability is preserved (see below);
- nonconcessional financing could be considered as a last resort and only if a specific project can be shown to be economically viable;
- drawing down government deposits at the BOU, including the new Energy Fund. This would cause a monetary expansion unless matched by a decline in BOU international reserves; and
- domestic bond financing, with due consideration for domestic debt sustainability.

21. **MDRI debt relief has given Uganda room to borrow externally, and prudent fiscal policies have kept domestic debt low.** The DSA baseline scenario, which is consistent with the baseline macroeconomic projections through 2009 and historical public investment and borrowing thereafter, shows that Uganda's debt would remain below threshold levels through the long-term DSA period. The alternative DSA scenario incorporates a higher investment path, including the Karuma dam and road projects. It shows debt ratios rising well above current post-MDRI levels and close to threshold levels in the stress tests. Thus, the cautious approach to new borrowing envisaged in the government's draft debt strategy is warranted to avoid future debt distress.

22. **Large infrastructure investment projects would likely be import intensive.** Import spending on these projects will reduce their claim on domestic resources (limiting the risk of inflation). Because these projects are expected to be mostly financed through external resources, current projections over the three-year program period show a comfortable level of reserves at about five months of import cover.

23. **The envisaged infrastructure projects could contribute to real exchange rate appreciation.** The current level of the real exchange rate—supported by the independently floating exchange rate regime—seems appropriate for competitiveness, as



evidenced by growth of nontraditional exports. In the near term, appreciation pressures could come if domestic production cannot meet demand for nontraded goods required for infrastructure construction and other donor-funded projects. These near-term pressures will need to be closely monitored. In the medium term, higher productivity growth may lead to a real exchange rate appreciation, but this would not be a problem from the perspective of competitiveness.

24. **Much depends on improved project execution.** Procurement problems, inability to enforce contracts, and limited implementation capacity have delayed the completion of a number of important infrastructure projects in the past, including Bujagali. Such implementation problems will need to be addressed promptly.

C. Broadening the Financial Sector

25. **The financial system needs to be deeper and more accessible.** Over the past several years, Uganda has created a well-capitalized and profitable banking sector that provides short-term financing to large customers at rates close to treasury bill yields. Uganda has also fostered a dynamic microfinance sector. More remains to be done, including reforms to promote long-term financing, reduce the cost of borrowing for SMEs, and bring financial services to rural areas.

26. **Staff stressed the importance of strengthening the institutional framework of the financial sector.**⁵ As recommended in the 2005 FSAP Update, a credit reference bureau, a revamped insolvency legislation, and a national identity card system would reduce the cost of credit, especially to SMEs (MEFP, paragraph 26). The credit reference bureau is nearly operational, but procurement of identity cards has been suspended pending an investigation into procurement irregularities. Other challenges are:

- **Enhancing the availability of long-term financing.** The authorities are completing the restructuring of the Uganda Development Bank (UDB) to enable it to provide long-term financing for sound projects on a sustainable basis and without government interference. The new Board is in place and the management team is being finalized (completing a benchmark under the first PSI). The planned restructuring of the legal framework for insurance and pension companies, together with the establishment of a new supervisory body to cover these and any other financial institution not currently supervised, would further contribute to expanding the supply of long-term financing (MEFP, paragraph 28).

⁵ See the chapter on private sector credit in the accompanying selected issues paper.

- **Expanding financial services in rural areas.** The authorities are developing a plan that would facilitate the presence of member-owned Savings and Credit Cooperatives (SACCOs) in each sub-county. The initiative would provide modest incentives to newly formed SACCOs and bolster their accounting capabilities to safeguard deposits. A legal framework defining the licensing and supervisory procedures for SACCOs will also be developed (MEFP, paragraph 27).

27. **The staff emphasized the risks associated with policies to increase UDB lending and some elements of the rural finance initiative.** International experience with local development banks is mixed, particularly in cases with subsidized lending and political interference in lending decisions. It is therefore essential that the UDB in practice be independently managed and that its operations be limited until a supervisory body has been established. Similarly, the rural finance strategy must be closely monitored to safeguard SACCO depositors, who are mostly poor farmers. Rural financing in developing countries carries a high risk, since the income of farmers tends to be very sensitive to changes in the external environment. It will therefore be important to move slowly on the development of SACCOs to gain the needed experience.

D. Regional Integration

28. **In the context of coordinated Article IV discussions for the three EAC countries, the authorities and staff agreed that regional integration within the EAC presents an opportunity to bolster growth prospects.** EAC objectives include trade promotion and eventually some form of monetary integration. The EAC customs union was established in 2005 to form a larger market and improve the framework for policy discussions. Trade tariffs within the EAC have been reduced, yet the level of trade protection outside of the union remains significant. Consequently, when the common external tariff is reviewed in 2009, the efficiency benefits of a lower tariff will need to be weighed against possible revenue losses. It was also agreed that coordinated investment incentives were desirable, but that rates needed to be calibrated to each country's circumstances. The longer-term objective of a common currency arrangement will be difficult to achieve because of diversity in the EAC economies.

29. **Enhanced tax incentives to attract more foreign investment are under consideration (MEFP, paragraph 20).** EAC partners Kenya and Tanzania provide tax holidays to companies operating in Export Processing Zones (EPZs), and potential foreign investors continue to press Uganda to provide similar benefits. While well-targeted and administered incentives can make some difference, badly designed or overly generous incentives such as significant cuts in corporate taxes could put revenue collection and macro stability at risk. Moreover, they could lead to rent seeking behavior, especially if implemented before the URA modernization program has been completed. The staff urged

caution, emphasized the desirability of close regional cooperation, and argued that the best way forward would use the country's scarce resources to improve infrastructure.

V. PSI—POLICIES FOR 2006/07

A. Macroeconomic Policies

30. **With the installation of more electricity generation capacity and recovery in agriculture, macro conditions are projected to improve in 2006/07.** Real GDP growth is projected at 6¼ percent, while average underlying inflation is expected to climb temporarily to about 6 percent for this period, reflecting increases in energy-related prices.

31. **The 2006/07 budget aims for continued fiscal consolidation in line with Uganda's Medium-Term Expenditure Framework (MTEF),** albeit at an appropriately slower pace than initially envisaged because of the electricity crisis. While the overall deficit, excluding grants, is expected to widen by over 1 percent of GDP, excluding energy crisis spending the deficit is projected to remain almost unchanged compared with 2005/06. Elements of the fiscal program include:

- An expected increase in tax collections by 0.4 percentage points of GDP on the basis of efficiency gains and new measures introduced with the 2006/07 budget (increases in excise taxes and fees, MEFP paragraph 13), despite downward pressure on corporate taxes related to the electricity crisis.⁶ The efficiency gains will be achieved through the ongoing modernization at the URA (MEFP, paragraph 19). Efficiency gains have improved revenue mobilization since URA modernization began, and an IMF technical assistance report estimates that the modernization could yield 1½ to 3 percent of GDP in revenue gains over the next five years. The Government's decision to address the problem of tax payment on government procurement should also help boost tax compliance (MEFP, paragraph 16).
- Domestic financed energy crisis spending of 1 percent of GDP, of which about one-half is earmarked for a ring-fenced energy fund. Spending from this fund for the Karuma project is expected to begin in 2007/08. MDRI debt relief, has been earmarked for temporary subsidies to the energy sector. In addition, foreign financed energy crisis spending amounts to about 0.3 percent of GDP.

⁶ The package is estimated to yield additional revenues of 0.3 percent of GDP. It includes a new tax treatment of treasury bill interest income; a wider application of presumptive withholding taxes; and selected increases of excise and import taxes.

- An increase in primary school teacher salaries and provisions to start universal post primary education.
- Onetime spending for the October 2007 Commonwealth Heads of Government Meeting.
- Doubling of provisions for domestic arrears clearance to 0.8 percent of GDP, in line with the strategy to eliminate all domestic arrears over the next 3-4 years.
- Negative net domestic financing of about 1 percent of GDP.

32. **The monetary program will continue to target base money while aiming to bring underlying inflation back to 5 percent or below.** The BOU will accommodate the recent rise in demand for currency associated with increased use of shillings for transactions purposes in neighboring countries. At the same time, the base money program will be sufficiently tight to target underlying average inflation below 5 percent for 2007/08, notwithstanding an expected outturn for 2006/07 closer to 6 percent due to higher energy prices.

33. **The BOU will continue to employ a mix of foreign exchange sales and open market operations to sterilize foreign exchange inflows.** It will primarily rely on the former by targeting foreign exchange sales consistent with program targets for international reserve accumulation. There is little scope for large-scale open market operations because of the limited capacity of the domestic financial market to absorb government borrowing. In the short term, however, the BOU is reluctant to rely solely on foreign exchange sales because this could risk excess volatility in the relatively shallow foreign exchange market. The BOU will intervene in the foreign exchange market only to smooth out short-term fluctuations and refrain from countering macroeconomic fundamentals.

B. Structural Policies

34. **The PSI will support Uganda's structural reform agenda outlined above, including follow up on measures not completed under the first PSI.** For the remainder of the 2006/07 financial year, particular attention will be given to the following public expenditure management issues:

- Reducing the accumulation of new domestic arrears (MEFP, paragraph 15). The Cabined has recently adopted a new arrears strategy, with the objectives to (i) clear the existing stock of arrears within 3 years; and (ii) strengthen existing initiatives to prevent new arrears. New arrears have been accumulated even under the CCS/IFMS system, pointing to the lack of discipline. Thus, the new strategy focuses appropriately on strict discipline and punitive actions against the accounting officers

involved in violating the CCS. The authorities will publish quarterly a “shame list” of violators. Utility arrears would be addressed by sufficient budgetary allocation for utility bills and prepayment systems, while new pension arrears will be prevented by including recurrent pension among spending priorities that must be fully budgeted for.

- Completing the verification of pre-CCS arrears (mainly military pensions) and continuing repayment of old arrears (U Sh 149 provision in the 2006/07 budget).
- Strengthening the public expenditure management systems at the subnational level, including implementation of IFMS for local governments (MEFP, paragraph 22).
- Implementing the Debt Management Strategy aimed at preserving debt sustainability by limiting borrowing to electricity, transportation, and water projects. The domestic arrears strategy outlined above has been combined with strategies for domestic and external borrowing into a single paper. The package is being reviewed by the IMF and development partners before submission to cabinet and implementation.

C. Program Monitoring

35. **For monitoring performance under the three-year PSI**, quantitative assessment criteria, quantitative indicative targets, and structural assessment criteria and benchmarks have been set (MEFP, Tables 1 and 2). The quantitative targets will be monitored on a semi-annual basis and include net credit to the central government from the banking system, base money, and net international reserves of the BOU. Targets to be monitored on a continuous basis include nonaccumulation of external arrears, contracting or guaranteeing of new nonconcessional external debt, and new short-term external debt. The standard provisions on the exchange system and trade issues that apply to the use of the Fund’s financial resources will apply as continuous assessment criteria under the PSI. The assessment dates for the first year will be end-December 2006 and end-June 2007 and will be followed by reviews.

36. **At the request of the authorities, the safeguards assessment is being updated.** Staff determined that the BOU has strengthened its safeguards framework in most areas. Recommendations have been made to improve the BOU's legal framework.

VI. STAFF APPRAISAL

37. **Uganda has a long record of strong macroeconomic performance and structural reform.** High economic growth and reasonable price stability have been supported by responsible fiscal policy, prudent monetary management, a sound banking sector, and substantial donor assistance. The economy has also been largely deregulated and most parastatals privatized. These conditions have contributed to improved living standards for

Uganda's fast-growing population and investments in health and education. In recent years, however, per capita growth has tapered off and declines in poverty rates have stagnated. To regain high, sustainable growth and rekindle poverty reduction, there is a need to scale up investment in infrastructure and deepen the financial sector.

38. **The staff agrees that addressing Uganda's infrastructure bottlenecks is a high priority, but that careful attention must be paid to financing and macroeconomic considerations.** The government's two-stage approach to the electricity crisis is already paying off with the installation of temporary generators. The staff supports the financing package for these, including higher tariffs and temporary government subsidies, and the Bujagali hydroelectric dam public—private partnership. Other infrastructure projects—the Karuma dam and roads—need to be well planned and financed to the extent possible through grant scaling up, domestic savings, concessional borrowing, and in exceptional cases, commercial loans. The DSA shows that there is room for borrowing. The cautious approach outlined in the proposed debt strategy strikes an appropriate balance between the need to borrow to address infrastructure needs and the risk of a rapid debt buildup.

39. **Uganda's independently floating exchange rate regime continues to provide an appropriate framework for macroeconomic management, but the effective value of the Uganda shilling needs to be monitored carefully.** In the near term, there is a risk that demand for nontraded goods from donor assistance and infrastructure spending could lead to a Dutch disease-type of real appreciation. The Bank of Uganda's emphasis on foreign exchange sales for liquidity management mitigates this risk. Successful implementation of the envisaged infrastructure projects could cause a real exchange rate appreciation. But to the extent that this is accompanied by higher productivity growth, this need not be a problem for competitiveness. Effective project selection and implementation are key to achieve the required rise in productivity.

40. **Uganda's financial sector needs deepening to build on recent improvements in the banking sector.** Over the past several years, the government and the Bank of Uganda have restructured the commercial banks and established first-rate supervision of deposit institutions. However, sources for long-term capital need to be developed, and the government is working on new supervision and legal arrangements for this sector. The government has also restructured the UDB, which will now be operating on commercial principles. In addition, the government has decided to assist member-owned savings societies with technical support to bring savings accounts and eventually loans to underserved rural areas. In both cases, it will be important for the government refrain from directing lending that could undermine these institutions.

41. **Staff urges caution in introducing tax incentives to attract investments.** The experience from other countries is mixed and in the given situation, the best way forward for

Uganda would be to use the country's scarce resources to improve its deteriorating infrastructure.

42. **The staff welcomes Uganda's efforts to advance regional integration.** The EAC customs union, established in 2005, should promote regional trade and provide a forum for discussion of other trade policies and advancement of regional financial integration. However, the long-term goal of a common currency arrangement will be difficult to achieve due to the diversity of the EAC.

43. **The staff recommends completion of the first review under the PSI.** It supports the authorities' request for waivers for the nonobservance of assessment criteria on (i) submitting a new arrears strategy to cabinet (observed with a delay) and (ii) the provision of U Sh 155 billion for domestic arrears repayment in the 2006/07 budget, which was reduced by a small amount, U Sh 6 billion, in the final budget along with almost all discretionary votes to help address the energy crisis. All quantitative assessment criteria were observed. The authorities are continuing to address the slippages relative to several indicative targets, including by paying old domestic arrears and identifying new measures to limit new accumulations.

44. **The staff supports the authorities' request for a new three-year PSI.** Following national elections in early 2006, the government has mapped out an economic program for the next five years. The program aims at maintaining macroeconomic stability through continued prudent fiscal, monetary, and exchange policies. As in the past, these would set the basis for private sector-led growth.

45. **The main risks to the economic program are further delays in restoring electricity capacity or shortfalls in financial support to the sector.** Adverse external developments—a drop in coffee or other export prices—could hurt the economy, but as in the past would be manageable in the short run because of Uganda's adequate reserves. And domestically, food production will continue to be sensitive to unfavorable weather conditions. Medium-term risks center on delays in hydroelectric dam construction, lackluster progress in broadening the financial sector, undue government intervention in the economy, and the failure to meet ambitious tax revenue target and maintain strict spending discipline. These would postpone needed gains in productivity, divert resources from infrastructure investment and education, and leave the economy unable to provide jobs for Uganda's fast growing population.

46. Executive Board endorsement of Uganda's request for support under the PSI would automatically place Uganda on the 24-month Article IV consultation cycle.

Table 1. Uganda: Selected Economic and Financial Indicators, 2003/04–2007/08 1/

	2003/04	2004/05	2005/06		2006/07	2007/08
	Act.	Act.	Prog.	Act.	Proj.	Proj.
GDP and prices (percent change)						
Real GDP	5.7	6.7	6.0	5.4	6.2	6.5
Headline inflation (average)	5.0	8.0	6.5	6.6	5.8	4.2
Underlying inflation (average)	5.0	4.7	4.9	5.2	6.1	4.0
External sector (percent change)						
Terms of trade (deterioration –)	5.7	1.9	13.7	18.2	-0.6	-4.6
Real effective exchange rate (depreciation –)	-8.5	11.3	...	-1.3	...	...
Money and credit (percent change)						
Broad money (M2)	10.0	12.1	14.5	18.9	13.8	13.0
Domestic credit	-5.8	-4.8	2.3	7.2	2.9	6.5
Credit to the central government 2/	-12.9	-10.0	-8.6	-4.8	-7.4	-4.3
Private sector credit	19.0	13.9	25.5	28.3	22.9	22.0
Savings and investment (percent of GDP)						
Domestic investment	22.3	21.1	23.4	23.1	24.7	25.0
Public	5.2	4.5	5.2	4.4	5.6	5.3
Private	17.1	16.6	18.2	18.7	19.2	19.7
National savings (excluding grants)	11.3	10.6	12.0	13.2	12.1	11.0
Public	-5.5	-3.9	-3.1	-3.0	-3.3	-2.6
Private	16.8	14.5	15.1	16.3	15.3	13.6
External sector (percent of GDP)						
Current account balance (including grants)	-1.2	-2.1	-4.0	-4.1	-5.7	-8.5
Net donor inflows	11.4	8.9	9.8	8.4	9.9	8.3
Current account balance (excluding grants)	-11.0	-10.6	-11.4	-9.9	-12.7	-14.0
External debt (including Fund)	60.6	50.7	47.8	43.0	15.7	16.9
External debt-service ratio 3/ 4/	10.1	9.8	11.5	5.6	4.3	4.1
Government budget and debt (percent of GDP)						
Revenue 5/	12.7	12.8	12.9	13.2	13.6	14.1
Grants	9.0	7.9	6.8	6.6	6.6	5.1
Total expenditure and net lending	-23.3	-21.3	-21.7	-20.6	-22.3	-22.0
Overall balance (including grants)	-1.7	-0.6	-2.0	-0.9	-2.2	-2.8
Overall balance (excluding grants)	-10.7	-8.5	-8.8	-7.5	-8.8	-7.9
Stock of domestic debt	9.6	9.8	8.5	9.1	7.7	6.1
Memorandum items:						
Nominal GDP (billions of Uganda shillings)	13,190	15,176	17,536	17,234	19,307	21,374
Average exchange rate (U Sh per US\$)	1,935	1,738	...	1,825	...	...
Treasury bill yield (percent)	14.1	8.5	...	7.8	...	...
Overall balance of payments (US\$ millions)	211	240	121	251	194	81
Gross foreign exchange reserves (months of next year's imports of goods and services)	5.8	5.6	5.9	5.3	5.3	5.2

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

1/ Fiscal year begins in July.

2/ Percent of M3 at start of the period.

3/ Percent of exports of goods and nonfactor services.

4/ Including Fund obligations; reflects actual debt service paid.

5/ Including unidentified revenue measures in 2006/07 and 2007/08.

Table 2. Uganda: Fiscal Operations of the Central Government, 2003/04–2008/09 1/

	2003/04	2004/05	2005/06		2006/07		2007/08	2008/09
	Act.	Act.	Prog.	Actual	Prog.	Proj.	Proj.	Proj.
	(Billions of Uganda shillings)							
Total revenue and grants	2,858	3,146	3,456	3,403	3,682	3,894	4,112	4,576
Revenue	1,669	1,948	2,263	2,267	2,643	2,619	3,019	3,468
Tax	1,550	1,828	2,146	2,142	2,518	2,474	2,860	3,296
International trade taxes	135	162	195	227	202	254	288	321
Income taxes	437	560	674	653	763	800	923	1,063
Excises	447	498	554	567	602	617	649	688
Value-added tax	531	608	724	716	816	803	905	1,014
Additional revenue effort	0	0	0	0	136	0	95	210
Nontax	119	121	116	125	125	145	159	173
Grants	1,188	1,198	1,193	1,136	1,039	1,274	1,093	1,108
Budget support	816	811	712	713	555	718	565	571
Of which: MDRI	...	...	...	229	...	...	...	...
Project grants	372	387	481	424	485	557	528	537
Expenditures and net lending	3,077	3,233	3,809	3,557	4,168	4,314	4,712	5,165
Current expenditures	1,867	1,978	2,151	2,234	2,377	2,358	2,477	2,686
Wages and salaries	683	774	835	867	878	975	1,006	1,085
Interest payments	264	229	295	250	337	250	307	315
Other current	921	975	1,020	1,117	1,162	1,133	1,164	1,386
Development expenditures	1,095	1,187	1,534	1,262	1,523	1,734	1,818	2,016
Donor-supported projects	655	700	993	743	990	1,040	1,110	1,062
Domestic-financed	439	487	541	519	533	694	708	954
Of which: add'l energy crisis spending	...	...	...	...	0	203	180	160
Net lending and investment	34	-8	-26	-29	-25	-2	-2	-7
Other spending 2/	81	75	151	117	293	224	420	470
Overall balance								
Including grants	-219	-86	-353	-154	-486	-421	-601	-589
Excluding grants	-1,407	-1,285	-1,546	-1,290	-1,525	-1,695	-1,694	-1,696
Excl. grants and add'l energy spending					-1,525	-1,492	-1,514	-1,536
Financing	99	53	353	68	486	421	601	589
External financing (net)	299	127	496	273	529	592	654	576
Disbursement	427	285	690	466	750	770	842	763
Budget support	57	11	110	76	244	287	261	238
Project loans	370	274	579	390	506	483	581	525
Amortization (-)	-143	-162	-181	-149	-177	-127	-151	-150
Exceptional financing	15	4	-13	-44	-44	-51	-37	-40
Domestic financing (net)	-200	-74	-143	-204	-43	-171	-37	-40
Bank financing	-307	-260	-243	-135	-113	-242	-159	-86
Nonbank financing	107	186	100	-69	70	71	106	98
Errors and omissions/financing gap	120	33	0	85	0	0	0	0
<i>Memorandum items:</i>								
MDRI spending	...	...	...	...	...	56	86	86
MDRI debt relief from IDA	...	...	...	...	...	4,772	...	...
MDRI debt relief from the AfDF 3/	...	...	...	...	...	981	...	...

Table 2. Uganda: Fiscal Operations of the Central Government, 2003/04–2008/09 1/ (concluded)

	2003/04	2004/05	2005/06		2006/07		2007/08	2008/09
	Act.	Act.	Prog.	Actual	Prog.	Proj.	Proj.	Proj.
	(Percent of GDP)							
Total revenue and grants	21.7	20.7	19.7	19.7	19.0	20.2	19.2	19.3
Revenue	12.7	12.8	12.9	13.2	13.6	13.6	14.1	14.6
Tax	11.8	12.0	12.2	12.4	13.0	12.8	13.4	13.9
International trade taxes	1.0	1.1	1.1	1.3	1.0	1.3	1.3	1.4
Income taxes	3.3	3.7	3.8	3.8	3.9	4.1	4.3	4.5
Excises	3.4	3.3	3.2	3.3	3.1	3.2	3.0	2.9
Value-added tax	4.0	4.0	4.1	4.2	4.2	4.2	4.2	4.3
Additional revenue effort	0.0	0.0	0.0	0.0	0.7	0.0	0.4	0.9
Nontax	0.9	0.8	0.7	0.7	0.6	0.8	0.7	0.7
Grants	9.0	7.9	6.8	6.6	5.4	6.6	5.1	4.7
Budget support	6.2	5.3	4.1	4.1	2.9	3.7	2.6	2.4
Of which: MDRI	...	...	...	1.3	...	...	...	...
Project grants	2.8	2.5	2.7	2.5	2.5	2.9	2.5	2.3
Expenditures and net lending	23.3	21.3	21.7	20.6	21.5	22.3	22.0	21.8
Current expenditures	14.2	13.0	12.3	13.0	12.3	12.2	11.6	11.3
Wages and salaries	5.2	5.1	4.8	5.0	4.5	5.0	4.7	4.6
Interest payments	2.0	1.5	1.7	1.5	1.7	1.3	1.4	1.3
Other current	7.0	6.4	5.8	6.5	6.0	5.9	5.4	5.8
Development expenditures	8.3	7.8	8.7	7.3	7.9	9.0	8.5	8.5
Donor-supported projects	5.0	4.6	5.7	4.3	5.1	5.4	5.2	4.5
Domestic-financed	3.3	3.2	3.1	3.0	2.8	3.6	3.3	4.0
Of which: add'l energy crisis spending	...	...	...	...	0.0	1.1	0.8	0.7
Net lending and investment	0.3	-0.1	-0.2	-0.2	-0.1	0.0	0.0	0.0
Other spending 2/	0.6	0.5	0.9	0.7	1.5	1.2	2.0	2.0
Overall balance								
Including grants	-1.7	-0.6	-2.0	-0.9	-2.5	-2.2	-2.8	-2.5
Excluding grants	-10.7	-8.5	-8.8	-7.5	-7.9	-8.8	-7.9	-7.2
Excl. grants and add'l energy spending	...	...	...	...	-7.9	-7.7	-7.1	-6.5
Financing	0.8	0.4	2.0	0.4	2.5	2.2	2.8	2.5
External financing (net)	2.3	0.8	2.8	1.6	2.7	3.1	3.1	2.4
Disbursement	3.2	1.9	3.9	2.7	3.9	4.0	3.9	3.2
Budget support	0.4	0.1	0.6	0.4	1.3	1.5	1.2	1.0
Project loans	2.8	1.8	3.3	2.3	2.6	2.5	2.7	2.2
Amortization (-)	-1.1	-1.1	-1.0	-0.9	-0.9	-0.7	-0.7	-0.6
Exceptional financing	0.1	0.0	-0.1	-0.3	-0.2	-0.3	-0.2	-0.2
Domestic financing (net)	-1.5	-0.5	-0.8	-1.2	-0.2	-0.9	-0.2	-0.2
Bank financing	-2.3	-1.7	-1.4	-0.8	-0.6	-1.3	-0.7	-0.4
Nonbank financing	0.8	1.2	0.6	-0.4	0.4	0.4	0.5	0.4
Errors and omissions/financing gap	0.9	0.2	0.0	0.5	0.0	0.0	0.0	0.0
<i>Memorandum item:</i>								
MDRI spending	...	...	...	...	...	0.3	0.4	0.4
MDRI debt relief from IDA	...	...	...	...	...	24.7	...	...
MDRI debt relief from the AfDF 3/	...	...	...	...	...	5.1	...	...

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

1/ Fiscal year begins in July.

2/ Includes contingency and arrears.

3/ MDRI debt relief in 2006/07 includes projected AfDF relief, which has not been delivered as of August 2006.

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

	2003/04	2004/05	2005/06		2006/07	2007/08
	Act.	Act.	Prog.	Act.	Proj.	Proj.
Monetary survey						
Net foreign assets	2,371	2,648	3,323	3,074	3,543	3,606
Net domestic assets	217	163	-49	198	143	495
Claims on public sector (net) 2/	97	-168	-414	-292	-534	-693
Claims on private sector	1,010	1,150	1,535	1,475	1,813	2,212
Other items (net) 3/	-891	-819	-1,170	-986	-1,137	-1,023
Money and quasi-money (M3)	2,587	2,811	3,275	3,272	3,685	4,101
Broad money (M2)	1,925	2,158	2,471	2,565	2,919	3,298
Foreign exchange deposits	662	653	803	707	766	803
Bank of Uganda (BOU)						
Net foreign assets	1,680	2,051	2,561	2,614	3,078	3,093
Net domestic assets	-871	-1,123	-1,514	-1,568	-1,865	-1,740
Claims on public sector (net) 2/	-472	-832	-992	-1,189	-1,359	-1,341
Of which: MDRI	...	...	...	-229	...	...
Claims on commercial banks	99	87	169	132	147	147
Other items (net) 3/	-497	-377	-691	-511	-653	-546
Base money	810	928	1,047	1,046	1,213	1,354
Currency outside banks plus cash in vaults	605	699	767	838	977	1,076
Commercial bank deposits with BOU	205	230	279	208	236	277
<i>Memorandum items:</i>			(12-month change, percent)			
Base money 4/	28.4	14.6	12.8	12.7	16.0	11.6
M3	9.0	8.7	16.5	16.4	12.6	11.3
Credit to the private sector	19.0	13.9	25.5 5/	28.3	22.9	22.0
			(Units indicated)			
M3-to-GDP ratio (in percent)	19.6	18.5	18.7	19.0	19.1	19.2
Base money multiplier (M2/base money)	2.38	2.32	2.36	2.45	2.41	2.44
Credit to the private sector (in percent of GDP)	7.7	7.6	8.8	8.6	9.4	10.3
Gross reserves of BOU (in millions of U.S. dollars)	1,135	1,326	1,386	1,408	1,577	1,641

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

1/ Fiscal year begins in July.

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

3/ Including valuation and the BOU's claims on private sector.

4/ The daily average of June of each financial year is used to calculate the annual percentage change.

5/ This change does not correspond to the difference between the 2005/06 programmed amount and the 2004/05 outturn, because the 2004/05 outturn had been subsequently revised.

Table 4. Uganda: Balance of Payments, 2003/04-2008/09 1/
(Millions of dollars)

	2003/04	2004/05	2005/06		2006/07 Proj.	2007/08 Proj.	2008/09 Proj.
			Prog.	Act.			
Current account	-81	-183	-379	-384	-581	-949	-1,022
Trade balance	-674	-838	-1,025	-1,102	-1,278	-1,552	-1,641
Exports, f.o.b.	647	786	863	890	1,029	1,096	1,172
Of which: coffee	114	145	201	173	206	201	203
Imports, f.o.b.	-1321	-1,624	-1,888	-1,991	-2,307	-2,648	-2,813
Of which: oil	-139	-158	-225	-290	-358	-374	-380
Services (net)	-241	-320	-352	-384	-383	-411	-427
Income (net)	-123	-168	-160	-135	-133	-146	-171
Of which: interest on public debt	-39	-38	-35	-36	-18	-30	-31
Transfers	957	1,143	1,159	1,237	1,213	1,161	1,217
Private transfers	290	401	464	687	497	550	607
Of which: nongovernmental organizations	164	248	211	530	333	366	402
Official transfers	667	742	695	550	715	611	609
Of which: Budget support	360	402	330	184	336	235	235
Project support	192	223	259	232	295	276	276
HIPC grants	62	81	53	81	45	59	58
Capital and financial account	222	324	500	643	775	1,030	1,149
Capital account	0	0	0	125	3,053	0	0
Of which: MDRI debt relief 2/	0	0	0	125	3,053	0	0
Financial account	222	324	500	517	-2,278	1,030	1,149
Foreign direct and portfolio investment	232	257	301	257	312	422	606
Other investment	-10	89	199	260	-2,590	608	543
Medium- and long-term	148	69	283	184	-2,702	498	440
Of which:							
Public sector (net)	148	71	273	174	-2,712	361	315
Disbursements	222	164	371	255	408	439	392
Project support	191	158	312	214	256	303	270
Budget support	31	6	59	42	152	136	122
Amortization due	-74	-93	-98	-82	-3,120	-79	-77
Private sector (net)	0	-2	10	10	10	137	125
Short-term	-157	20	-84	76	112	110	103
Errors and omissions	69	99	0	-8	0	0	0
Overall balance	211	240	121	251	194	81	126
Financing	-211	-240	-121	-251	-194	-81	-126
Central bank net reserves (increase = -)	-219	-242	-102	-228	-169	-64	-106
Of which: gross reserve change	-170	-191	-60	-83	-169	-64	-106
<i>Memorandum items:</i>							
Coffee export volume (millions of 60-kg. bags)	2.6	2.5	2.6	2.1	2.5	2.6	2.7
Coffee price (U.S. cents per kg.)	74.5	96	129	137	139	131	126
Net donor support	779	778	924	789	1,013	924	873
Of which: Budget support	391	409	389	226	488	371	357
Project support	384	380	570	446	551	579	545
Total HIPC debt relief	87	91	66	78	110	99	91

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

1/ Fiscal year begins on July 1.

2/ MDRI debt relief in 2006/07 includes projected AfDF relief, which has not been delivered as of September 2006.

Table 5. Uganda: Medium-Term Macroeconomic Framework, 2004/05–2008/09 1/

	2004/05 Act.	2005/06 Act.	2006/07 Proj.	2007/08 Proj.	2008/09 Proj.
National income and prices					
Real GDP (percent change)	6.7	5.4	6.2	6.5	6.5
Per capita GDP (2004/05 US\$)	327	334	344	354	366
Underlying average inflation (percent change)	4.7	5.2	6.1	4.0	4.0
Gross domestic investment (percent of GDP)	21.1	23.1	24.7	25.0	25.9
External sector (percent of GDP, unless indicated otherwise)					
Current account balance (including grants)	-2.1	-4.1	-5.7	-8.5	-8.4
Net donor inflows	8.9	8.4	9.9	8.3	7.2
Current account balance (excluding grants)	-10.6	-9.9	-12.7	-14.0	-13.4
NPV of debt-to-exports ratio (percent)	179.1	33.3	30.8	58.8	72.1
Government budget and debt (percent of GDP)					
Revenue 2/	12.8	13.2	13.6	14.1	14.6
Grants	7.9	6.6	6.6	5.1	4.7
Total expenditure and net lending	21.3	20.6	22.3	22.0	21.8
Overall balance (including grants)	-0.6	-0.9	-2.2	-2.8	-2.5
Overall balance (excluding grants)	-8.5	-7.5	-8.8	-7.9	-7.2
Stock of domestic debt	9.8	9.1	7.7	6.1	5.3
Credit to the private sector (percent of GDP)	7.6	8.6	9.4	10.3	10.7
Gross foreign exchange reserves (months of next year's imports)	5.6	5.3	5.3	5.2	5.0

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

1/ Fiscal year begins in July.

2/ Including unidentified revenue measures in 2006/07 and 2007/08.

Table 6. Uganda: Quantitative Assessment Criteria and Indicative Targets for end-March and end-June 2006 1/ 2/
(Cumulative change from the beginning of the fiscal year, unless otherwise stated)

	March 31 3/				June 30			
	Prog.	Adj. Prog.	Actual	Observed (√)/ Not Observed (x)	Prog.	Adj. Prog.	Actual	Observed (√)/ Not Observed (x)
Assessment criteria								
	(Billions of Uganda shillings)							
Ceiling on increase in base money liabilities of the Bank of Uganda 4/	98.8	113.8	91.3	√	118.6	133.6	107.2	√
Ceiling on increase in net claims on the central government by the banking system	86.6	277.2	-38.2	√	-242.7	-33.0	-39.3	√
	(Millions of U.S. dollars)							
Ceiling on the stock of external payments arrears incurred by the government or the Bank of Uganda 5/	0.0	0.0	...		0.0	0.0	0.0	√
Ceiling on new nonconcessional external borrowing with maturities greater than one year contracted or guaranteed by the government or the Bank of Uganda 5/ 6/								
Bujagali hydropower plant	400.0	400.0	0.0	√	400.0	400.0	0.0	√
Other	0.0	0.0	0.0	√	0.0	0.0	0.0	√
Ceiling on new external debt with maturity up to one year contracted or guaranteed by the government or the Bank of Uganda 5/ 7/	0.0	0.0	0.0	√	0.0	0.0	0.0	√
Minimum increase in net international reserves of the Bank of Uganda	4.1	-11.7	256.5	√	103.1	82.3	227.6	√
Indicative targets								
	(Billions of Uganda shillings)							
Stock of domestic budgetary arrears under the Commitment Control System (CCS) 8/	27.0	...	...		21.0	...	34.0	x
Minimum expenditures under the Poverty Action Fund (including the Universal Primary Education component of development expenditure)	631.2	631.2	615.1	x	857.1	857.1	867.6	√
Ceiling on public administration expenditure	172.9	172.9	...		232.1	232.1	279.5	x

1/ The assessment criteria and indicative targets under the program, and their adjusters, are defined in the technical memorandum of understanding (TMU).

2/ Fiscal year begins on July 1.

3/ Indicative targets.

4/ For March and June 2006, cumulative changes from the average of June 2005, as defined in the TMU.

5/ Continuous assessment criterion.

6/ Cumulative change from January 1, 2006.

7/ Excluding normal import-related credits.

8/ Arrears incurred after end-June 2004. The stock amounted to US\$ 27 billion at end-June 2005.

Table 7. Uganda: Structural Assessment Criteria and Benchmarks for January – December 2006¹

Policy Measure	Date of Implementation	Implementation Status
Structural Assessment Criteria		
1. Minister of Finance, Planning and Economic Development will submit to Cabinet a strategy paper for avoiding new CCS arrears in line ministries that accumulated arrears in 2004/05 in excess of U Sh 0.5 billion. The paper will list policy objectives with cost estimates.	End-May 2006	Done with delay
2. The allocation for payments of group (A) verified arrears will be increased to U Sh 155 billion in the 2006/07 budget. ²	End-June 2006	U Sh 149 billion allocated
3. Repayment of U Sh 79 billion of group (A) arrears during 2005/06. ²	End-June 2006	Done
Structural Benchmarks		
4. Provide for clearing arrears that accumulated during 2005/06 within the 2006/07 budget as a first call on respective sector ceilings.	At the time the budget is submitted to Cabinet	Done
5. Complete verification of all pre-CCS arrears.	End-June 2006	In process but not completed
6. Submit to Parliament the Public Finance and Accountability (Contingency Fund) regulations.	End-June 2006	Done
7. Until the new management of Uganda Development Bank (UDB) is in place and supervision arrangements are completed, net lending by the UDB will not be increased.	Continuous	New board is in place and the management team is being finalized; supervision arrangements have not been completed; net lending was increased by a small amount
8. The Minister of Finance will approve and implement guidelines on contracting, managing, and monitoring external debt.	End-June 2006	Document prepared but has not been signed by the Minister.

¹ Assessment criteria also apply on a continuous basis to the standard provisions on the exchange and trade issues that apply to programs supported by the Fund's financial resources.

² Group (A) arrears comprise the stock of pre-CCS, non-CCS, and CCS arrears incurred before end-June 2004.

Table 8. Uganda: Selected Banking Sector Information, June 2003-June 2006

	2003		2004		2005		2006
	June	Dec.	June	Dec.	June	Dec.	June
(Billions of Uganda shillings)							
Adjusted assets	2,723	2,896	3,184	3,294	3,526	3,659	3,841
Liquid assets	1,292	1,314	1,279	1,538	1,374	1,558	1,179
Tier I	237	219	276	313	311	348	379
Tier II	33	38	32	30	26	32	36
Total capital	270	257	309	343	337	380	416
Risk weighted assets (RWA)	1,317	1,515	1,624	1,674	1,881	2,076	2,271
Nonperforming assets (NPA)	59	61	14	21	33	29	41
Loans and advances	741	847	884	977	1,114	1,258	1,450
Foreign exchange advances	189	212	218	267	327	384	450
Foreign exchange deposits	708	746	806	817	838	786	815
Deposits	2,109	2,210	2,396	2,438	2,549	2,595	2,741
(Percent)							
Return on average assets	3.5	4.5	5.0	4.3	3.4	3.6	3.5
Core capital/ RWA	18.0	14.4	17.0	18.7	16.5	16.8	16.7
Total capital/ RWA	20.5	16.9	19.0	20.5	17.9	18.3	18.3
NPAs/ total advances	8.0	7.2	1.6	2.2	2.9	2.3	2.8
Loan loss provision/ NPA	46.8	76.5	139.6	97.8	78.0	103.8	93.7
Liquid assets/ total deposits	61.3	59.5	53.4	63.1	53.9	60.0	43.0
Advances/ deposits	35.1	38.3	36.9	37.4	43.7	48.5	52.9
Foreign exchange exposure/ core capital 1/	6.1	23.0	4.7	-2.0	-2.7	-2.7	-8.7
Foreign exchange advances/ foreign exchange deposits	26.7	28.4	27.0	32.6	39.1	48.8	55.2

Source: Ugandan authorities.

1/ Foreign exchange exposure is calculated using the short-hand method.

Table 9. Uganda: Millennium Development Goals

	1990	1995	2001	2004
Eradicate extreme poverty and hunger.	2015 target = halve 1990 \$1 a day poverty and malnutrition rates			
Percentage share of income or consumption held by poorest 20 percent	...	...	5.9	...
Prevalence of child malnutrition (percent of children under 5)	23.0	25.5	22.8	...
Population below minimum level of dietary energy consumption (percent)	23.0	25.0	19.0	...
Achieve universal primary education.	2015 target = net enrollment to 100			
Net primary enrollment ratio (percent of relevant age group)	...	87.3	...	98.4
Youth literacy rate (percent of ages 15-24)	70.1	74.7	79.4	76.6
Promote gender equality.	2015 target = education ratio to 100			
Ratio of girls to boys in primary and secondary education (percent)	76.8	81.0	95.0	97.1
Ratio of young literate females to males (percent of ages 15-24)	75.8	80.4	85.0	86.1
Share of women employed in the nonagricultural sector (percent)	43.2	...	...	...
Proportion of seats held by women in national parliament (percent)	12.0	17.0	18.0	25.0
Reduce child mortality.	2015 target = reduce 1990 under-5 mortality by two-thirds			
Under-5 mortality rate (per 1,000)	160.0	156.0	145.0	137.8
Infant mortality rate (per 1,000 live births)	93.0	92.0	85.0	80.2
Immunization, measles (percent of children under 12 months)	52.0	57.0	61.0	91.0
Improve maternal health.	2015 target = reduce 1990 maternal mortality by three-fourths			
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	880.0	...
Births attended by skilled health staff (percent of total)	38.3	37.8	39.0	...
Combat HIV/AIDS, malaria, and other diseases.	2015 target = halt, and begin to reverse, AIDS, etc.			
Prevalence of HIV, female (percent of ages 15-24)	...	...	4.6	...
Contraceptive prevalence rate (percent of women ages 15-49)	4.9	14.8	22.8	...
Number of children orphaned by HIV/AIDS (thousands)	...	...	880.0	...
Incidence of tuberculosis (per 100,000 people)	161.1	...	324.0	401.6
Tuberculosis cases detected under DOTS (percent) 1/	...	...	44.4	43.0
Ensure environmental sustainability.	2015 target = various			
Forest area (percent of total land area)	25.9	...	21.3	18.4 2/
Nationally protected areas (percent of total land area)	...	9.7	9.7	...
CO2 emissions (metric tons per capita)	0.0	0.0	0.1	...
Access to an improved water source (percent of population)	45.0	...	52.0	...
Access to improved sanitation (percent of population)	...	...	79.0	...
Develop the Global Partnership for Development.	2015 target = various			
Fixed line and mobile telephones (per 1,000 people)	1.6	2.0	13.5	44.5
Personal computers (per 1,000 people)	...	0.5	2.8	4.3
General indicators				
Population (millions)	17.8	20.9	25.1	27.8
Adult literacy rate (percent of people ages 15 and over)	56.1	...	...	66.8
Total fertility rate (births per woman)	7.2	6.9	...	7.1
Life expectancy at birth (years)	45.7	43.1	...	48.9

Source: World Development Indicators database, July 2006.

1/ Percentage of estimated new infectious tuberculosis cases detected under the directly observed treatment, short course case detection and treatment strategy.

2/ Data for 2005.

APPENDIX I. UGANDA—POLICY SUPPORT INSTRUMENT

Attached hereto is a Letter from the Minister of Finance, Planning, and Economic Development dated November 29, 2006 (the “Letter”), with an annexed Memorandum of Economic and Financial Policies (the Memorandum) and Technical Memorandum of Understanding (the Technical Memorandum), requesting from the International Monetary Fund a policy support instrument (the “Instrument”), and setting forth:

- (a) the objectives and economic and financial policies (the “Program”) that the authorities of Uganda intend to pursue during the period of the Instrument;
- (b) the policies and measures that the authorities of Uganda intend to pursue during the first year of the Instrument, including a quantified macroeconomic framework for the first 12 months under the Instrument; and
- (c) understandings of Uganda with the Fund regarding reviews that will be made of progress in realizing the objectives of the Program.

To support these objectives and policies, the Fund approves this Instrument for a period from December 15, 2006 to December 14, 2009 in accordance with the following provisions, and subject to Decision No. 13561-(05/85) (10/5/05) on Policy Support Instruments:

1. Uganda’s implementation of the Program will be assessed by the Fund through reviews:
 - (a) the first and second reviews are scheduled to be conducted by April 30, 2007, and October 31, 2007 respectively, as specified in paragraph 6 of the Letter.
2. In the absence of any requisite waivers of nonobservance being granted, a review will not be completed if:
 - (a) With respect to any review:
 - (1) at any time during the period of this Instrument:
 - (i) the ceiling on the stock of external payments arrears incurred by the government or the Bank of Uganda;
 - (ii) the ceilings on new nonconcessional external borrowing with maturities greater than one year contracted or guaranteed by the government or the Bank of Uganda; or

- (iii) the ceiling on new external debt with maturities of up to one year contracted or guaranteed by the government or the Bank of Uganda, as specified in Table 1 of the Memorandum and further specified in the Technical Memorandum was not observed; or
- (2) at any time during the period of this Instrument, Uganda:
- (i) imposes or intensifies restrictions on payments and transfers for current international transactions, or
 - (ii) introduces or modifies multiple currency practices, or
 - (iii) concludes bilateral payments agreements that are inconsistent with Article VIII, or
 - (iv) imposes or intensifies import restrictions for balance of payments reasons.
- (b) With respect to the first review:
- (1) the data as of December 31, 2006 indicate that:
- (i) the ceiling on the increase in base money liabilities of the Bank of Uganda;
 - (ii) the ceiling on the increase in net claims on the central government by the banking system; or
 - (iii) the minimum increase in net international reserves of the Bank of Uganda, as specified in Table 1 of the Memorandum, and further specified in the Technical Memorandum was not observed; or
- (c) With respect to the second review:
- (1) the data as of June 30, 2007 indicate that any of the ceilings or minimums referred to in paragraph 2(b)(1)(i)-(iii) above, and as specified in Table 1 of the Memorandum and further specified in the Technical Memorandum, was not observed.
- (2) any of the following structural assessment criteria was not observed:
- (i) by May 31, 2007, verify the amount of pension payments due and prepare a review of pension payment and accounting systems, and make recommendations for changes if necessary; or

- (ii) by June 30, 2007, allocate U Sh 300 billion for payments of group (A) verified arrears,

as specified in Table 2 of the Memorandum and further specified in the Technical Memorandum.

3. In accordance with paragraph 6 of the Letter, Uganda will provide the Fund with such information as the Fund requests in connection with the progress of Uganda in implementing the policies and reaching the objectives of the Program.

4. In accordance with paragraph 6 of the Letter, during the period of this Instrument, Uganda will consult with the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director of the Fund requests such a consultation. These consultations may include correspondence and visits of officials of the Fund to Uganda, or representatives of Uganda to the Fund.

APPENDIX I—ATTACHMENT I
UGANDA: LETTER OF INTENT

Kampala, Uganda
November 29, 2006

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

Dear Mr. de Rato:

On behalf of the Government of Uganda, I would like to inform you of the progress we have made under our economic program backed by the International Monetary Fund's Policy Support Instrument (PSI) and request continued cooperation through a new three-year PSI.

All quantitative assessment criteria for the first review under the PSI were observed. Notwithstanding the drought conditions which have reduced our hydroelectric generation capacity sharply and the adverse effects of high oil prices, macroeconomic performance and policies remained strong in 2005/06. Fiscal developments were broadly in line with the program objective of fiscal consolidation, and monetary policy targets were met.

We made progress on the structural front as well. The assessment criterion on repayment of old arrears was observed and the assessment criterion on submitting the arrears strategy paper to Cabinet was observed albeit with delay. However, the assessment criterion on provision for arrears payments in the 2006/07 budget was not observed. The payment amount, however, fell short of the envisaged target by U Sh 6 billion, which we re-allocated to meet the emergency in the energy sector.

In light of the progress achieved in the implementation of the program, the Government of Uganda requests waivers for nonobservance of the assessment criteria on submission of the arrears strategy paper to Cabinet and on provision for arrears payments in the 2006/07 budget.

To better align program targets with our medium-term development needs, the Government of Uganda wishes that the current PSI be canceled immediately after the first review and that a new three-year PSI better aligned to the fiscal year commence immediately thereafter. The new PSI is described in the attached Memorandum of Economic and Financial policies (MEFP). The policies outlined in the MEFP are based on addressing Uganda's infrastructure needs in an environment of continued fiscal consolidation and implementation of the broader policy agenda as envisaged in the Poverty Eradication Action Plan.

The Government of Uganda believes that the policies set forth in the MEFP are adequate to achieve the objectives of our PSI program. Given our interest in macroeconomic stability, we stand ready to take additional measures as may be necessary to achieve needed objectives. Our PSI proposes assessment criteria for the performance target dates of end-December 2006 and end-June 2007 for the first and second reviews, which are expected to be completed by end-April 2007 and end-October 2007, respectively. We stand ready to work with the Fund and other development partners in the implementation of our program and will consult in advance should revisions be contemplated to the policies contained in the PSI.

The Government of Uganda authorizes the publication and distribution of this letter, its attachments, and all reports prepared by Fund staff regarding the current PSI review and the new PSI.

Sincerely yours,

/s/

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

APPENDIX I—ATTACHMENT II
UGANDA: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES
(JULY 2006—JUNE 2009)

1. The Government of Uganda is committed to achieving sustained economic growth and poverty reduction. The strategy to achieve these goals is set out in the Poverty Eradication Action Plan (PEAP)¹ and relies on prudent macroeconomic policies and structural changes. The Government and the International Monetary Fund (IMF) are cooperating on the economic program through a three-year Policy Support Instrument (PSI). This memorandum of economic and financial policies (MEFP) reviews the performance under the current PSI and describes policies and targets for 2006/07 (July-June) and the medium term.

I. PERFORMANCE UNDER THE PSI

2. The Government continued to implement sound economic policies during 2005/06. Despite severe electricity shortages related to the drought and high fuel prices, these efforts resulted in healthy economic growth and continued price stability.

3. **Real GDP growth is estimated at 5½ percent in 2005/06.** The construction and communications sectors maintained strong growth, while manufacturing and agriculture output was subdued because of electricity shortages and difficult weather conditions, respectively. Underlying (core) inflation, which excludes food prices, was just above 5 percent. International reserves of the central bank remained comfortable equivalent to 5½ months of import cover.

4. **Fiscal performance was in line with the program.** The overall budget deficit, excluding grants, continued its declining trend to 7.5 percent of GDP in 2005/06, below the deficit targeted under the program. Tax collection continued to be strong because of reforms at the Uganda Revenue Authority (URA) and tax measures. While recurrent spending was higher than envisaged, development spending were lower due to delays in donor-financed projects. Despite efforts to improve expenditure management, domestic arrears continued to accumulate. The Government, however, repaid more than U Sh 80 billion of outstanding arrears.

¹ Uganda's latest PEAP and Joint Staff Advisory Note were considered by the Executive Board in July 2005 (Country Report No. 05/308). An implementation report is currently being prepared and is expected to be made available to the IMF and other partners in mid-2007.

5. **The monetary program was on track.** The target for base money growth was met. A combination of tight fiscal policy and on the use of an appropriate instrument mix for liquidity sterilization led to continued decline in interest rates, which in turn promoted a rise in private sector credit. The banking sector remains healthy with a very low level of nonperforming loans.

6. **Progress was made in implementing the structural program.** The two structural assessment criteria through June were met, albeit one with a small delay. The third was not observed but by a small margin and with no material impact on the program.

II. OBJECTIVES AND POLICIES FOR THE THREE-YEAR PSI

7. **Our overriding economic objective is to regain the high rates of growth we enjoyed in the mid-1990s.** Continued macroeconomic stability is a necessary condition for meeting this challenge. At the same time, scaled up infrastructure investment will be required to raise productivity. Policies will therefore focus on macro stability, education through the post primary level, modernizing Uganda's infrastructure—particularly in electricity generation, roads and railways—deepening the financial sector to bring down interest rates for small and medium-size enterprises, strengthening Uganda's business-friendly environment, and providing better incentives for the private sector. In this way, Uganda can achieve an increase in annual GDP growth to 6-7 percent, while maintaining low inflation.

8. **The macroeconomic outlook depends critically on a solution to the present electricity crisis.** Reflecting the current drought conditions and policy missteps, electricity generating capacity has declined to about one-half of peak demand. The Government has decided on a two-part solution to this problem: (i) in the near term, install temporary thermal power generators to increase capacity by 100 MW, promote energy conservation, and reduce the currently high distribution losses; and (ii) in the medium term, complete construction of new hydropower plants at Bujagali and Karuma and then Aragon. These measures will result in an increase in electricity tariffs. In addition, savings in other parts of the budget and support from development partners are required to solve the electricity crisis.

III. THE POLICY AGENDA FOR 2006/07

9. **During 2006/07 the Government will focus on policies consistent with its medium-term objectives.** To this end, fiscal consolidation will continue, albeit at a slower pace than initially envisaged because of the electricity crisis, monetary policy will target an inflation rate of five percent or less, and structural measures will aim at building a competitive economy, especially in rural areas. The Government will also begin to phase in universal post-primary education.

10. **With the installation of additional electrical generators, macro conditions are expected to improve in 2006/07.** Real GDP growth is projected at about 6 percent, while underlying inflation is projected to remain close to 5 percent. The external current account deficit, excluding grants, is projected to increase, partly reflecting higher fuel imports.

A. FISCAL POLICY

11. **The Government's fiscal priorities** are to: (i) implement the approved 2006/07 budget; (ii) improve the monitoring and control of domestic arrears and reducing their stock; and (iii) continue implementing the modernization program of the URA.

12. **The 2006/07 budget provides for emergency energy spending, new infrastructure investment, and arrears repayment.** The deficit, excluding grants and emergency energy spending, is projected at 7.1 percent of GDP. The main expenditure initiatives include:

- New electricity-related spending of 1.1 percent of GDP. About 0.5 percent of GDP of the spending is earmarked for a new Energy Fund, which will be ring-fenced for future dam construction. The remainder will be used to subsidize new thermal generators.
- Additional investment in roads.
- A one-third increase in primary school teacher salaries and funding for the first phase of universal post-primary education.
- A near doubling in the budgeted allocation for domestic arrears payments to U Sh 149 billion.
- Provisions for the Commonwealth Heads of Government Meeting in 2007.

13. **Domestic revenue collections are expected to rise by 0.4 percent of GDP** on the basis of efficiency gains at the URA and increases in some taxes and fees. Grants are

projected to remain at 6½ percent of GDP. Net external borrowing is projected at about 3 percent of GDP, implying virtually no need for domestic financing.

14. **The Government is committed to settling all domestic arrears, which amount to about U Sh 610 billion.** While this burden is very large, we plan to address our obligations in upcoming budgets as an urgent priority by finding savings elsewhere in the budget. Our overall strategy is to pay old arrears first from the central budget, while requiring spending ministries to honor arrears incurred during the 2005/06 and 2006/07 budgets from their own current resources. To reduce the stock of arrears, we will (see Table 1):

- Repay U Sh 149 billion of verified obligations incurred before June 2004 as provided in the 2006/07 approved budget. This allocation will be increased to U Sh 300 billion and 330 billion in 2007/08 and 2008/09, respectively.
- Within the allocations above, we will repay at least U Sh 100 billion of verified pension arrears each year starting 2007/08. Government will announce a payment schedule based on a priority ordering (by age of pensioner, widows etc.). This timed approach recognizes the importance attached to honoring pensioners but also our budgetary realities.

15. **Government will make an effort to avoid the accumulation of new arrears through strict budget discipline and timely payment of pensions and wages.** In addition, implementation of CCS/IFMS will be enforced and strengthened. To this end, the Government will:

- enforce the strategy that was recently adopted by Cabinet. The Ministry of Finance will also submit to Cabinet a paper restating the policy that requires arrears accumulated in 2005/06 be paid out of spending ministry funds already allocated for 2006/07;
- continue to submit to Cabinet quarterly CCS reports prepared by the Treasury Inspectorate, including details of ministries' arrears; and
- allocate sufficient funds for verified pension obligations.

With the help of the above measures, we will reduce the stock of CCS arrears accumulated since end-June 2004 to a level of U Sh 25 billion by end-June 2007. These margins will allow for unanticipated nonpayment of some commitments incurred for technical reasons.

16. **The Government has taken steps to address the problem of government tax on its procurement.** A special account has been set up in the BOU that will be used to make government tax payments to the URA. The Government will ensure that sufficient funds are

allocated to this account, and will address any remaining problems of government tax compliance as needed.

17. **The Government is embarking on public sector pay reform.** The Ministry of Public Service has produced a plan to revise public sector pay scales, to be implemented when resources permit. Higher pay for government scientists and researchers is also under review to retain them in Uganda. The Ministry of Public Service is also reviewing public pensions, with due attention to the longer-term budgetary and financial market implications. As with pay reform, changes in the public pension system will depend on the availability of resources. To avoid new pension arrears, the authorities will verify the amount of pension payments due and prepare a review of pension payment and accounting systems by May 2007.

18. **The Government will strengthen mechanisms to ensure value-for-money in the implementation of public projects by strengthening the monitoring and evaluation functions, as well as service delivery.** Consequently, the government will prepare a detailed plan to enhance the effectiveness of spending and service delivery.

19. **The reform process in URA will continue.** In the coming years, the URA will further increase domestic revenue collection, including by improving taxpayer registration; centralization of data on custom, VAT, and income tax payers; more frequent audits of tax compliance; and interconnectivity and sharing of information with countries in the region about incoming trade traffic.

20. **The Government is reviewing investment incentives.** Under consideration are Export Processing Zones (EPZs) as implemented in neighboring countries and a reduction in the corporate tax rate. Any new policy will be designed in line with the following principles: (i) avoid a significant erosion of the tax base so that our objective of increasing the tax to GDP ratio is achieved; (ii) cease granting discretionary tax preferences; (iii) implementation will take place as budgetary resources permit and taking into account the URA's capacity to monitor compliance; (iv) work with EAC partners to harmonize tax incentives to the extent possible so that mutually damaging tax competition is avoided.

B. DECENTRALIZATION

21. **The effective implementation of the fiscal decentralization strategy (FDS) is intended to improve government services.** The Government is currently strengthening the public expenditure management systems at the subnational level, including IFMS implementation and roll-out programs for local governments.

22. **We are currently considering ways to strengthen local government finances.** Abolition of the graduated tax, which was a key revenue source for local governments, has been compensated by mainly by additional transfers from central government. Some urban areas are collecting a local property tax to supplement central government transfers. The Government is looking at other options, including ways to tax consumption, but the scope for locally generated revenue in rural areas will remain limited until farmers are lifted out of subsistence agriculture.

C. MONETARY AND FINANCIAL SECTOR POLICIES

23. **The authorities are committed to keeping annual average underlying inflation below 5 percent** through the reserve money targeting framework. For the remainder of 2006/07, the BOU will monitor base money closely in view of the recent increase in demand for currency associated with increased use of the shilling for transactions purposes in the neighboring countries. The BOU will continue to manage liquidity using an appropriate instrument mix. Subject to the conditions in the foreign exchange market, BOU will continue to use sales of foreign exchange to sterilize donor inflows.

24. **The BOU is pursuing the tools needed for a future inflation targeting framework.** A quarterly GDP index is under development by UBOS, as well as a new measure of underlying (core) inflation that would more accurately capture inflationary trends. The new CPI index will be monitored for a transition period of six months before it is published. The BOU will also start producing on a six monthly basis a monetary conditions report that would relate current economic trends to monetary operations and the inflation target.

25. **The Government remains committed to a market-based financial system.** All deposit banks, excluding Post Bank of Uganda (PBU), have been privatized and, with the establishment of a strong regulatory framework, we have a solid banking system that is providing expanding credit to the private sector. We have recently licensed five micro finance deposit-taking institutions (MDI) that are bringing services to smaller enterprises and individuals who were not being served by the commercial banks.

26. **To further promote the availability of financial services and lowering borrowing costs, several initiatives are planned.** The recently established credit reference bureau should help making loans more available. The effectiveness of the credit bureau will be enhanced with the expected introduction of the national identity cards in 2007/08. Further, the Government intends to implement the remaining key recommendations of the Financial Sector Assessment Program (FSAP) update, including:

- strengthening the corporate insolvency regime, including the submission to cabinet by end-June 2007 of new insolvency legislation that gives creditors the right to commence bankruptcy procedures;
- strengthening institutional capacity of the commercial court and of Official Receiver; and
- addressing deficiencies in the land and company registries.

27. **Improving the availability of financial services in rural areas is an important objective.** Such services are being provided by member owned Savings and Credit Cooperatives (SACCOs), but we are concerned that they are not adequately supervised and lack basic accounting skills. To safeguard member deposits in these institutions, we are considering options to regulate SACCOs. In the meantime, we will ask Postbank Uganda (PBU) to assist by bolstering accounting capabilities of SACCOs. Aside from this limited assistance, we expect SACCOs will be self-supporting, and any lending to SACCOs for on lending will be based on existing initiatives and resources already allocated in the 2006/07 budget and in the MTEF. We will ensure that these actions are consistent with the existing regulatory and supervisory framework as contained in the Financial Institutions Act 2004 and its implementing regulations.

28. **Further development of the nonbank financial sector will make long-term loans more available for housing and business expansion.** Over time, long-term capital might also be used to finance infrastructure projects. Government has approved a plan to strengthen the Uganda Development Bank (UDB) so it can be operated along commercial principles, including providing loans that carry market-based interest rates. Government will not interfere with or direct activities of the UDB. We also plan to restructure the legal and regulatory framework for insurance and private pension companies, as these are the natural source of long-term credit. The new supervisory body, which will be established before end-December 2007, would cover insurance and pension companies, development banks (including UDB), the NSSF, and any financial institution not under the statutory supervision of the BOU. The new environment will ensure that pensions and other savings entrusted to these companies are prudently managed.

D. OTHER STRUCTURAL REFORMS

29. **The Government is addressing the shortage in power generation with urgency.** The Government is currently finalizing the bid process and financing arrangements for the Bujagali hydropower project and intends to start the planning process for the construction of a second hydropower project at Karuma. Until the Bujagali plant becomes operational in 2010/11, our generating capacity will be increased through more expensive thermal power

generation. With the end users covering only part of the higher costs of this intermediate measure, the Government will continue subsidizing the power sector to allow for a more gradual increase in electricity tariffs. However, all subsidies will expire after the commissioning of the Bujagali plant. The investments in the power sector will be financed as follows:

- The envisaged near-term measures to expand thermal power generation would cause an annual revenue shortfall in the power sector of about US\$120 through 2010/11, assuming that oil prices stay at current levels and electricity tariffs at pre-June 2006 levels. The revenue shortfall would be financed by a combination of higher tariffs and direct government support, of which a part will be provided by the World Bank. The average tariff was increased by 37 percent in June 2006 and by about 42 percent in November 2006 (a completed prior action). These adjustments are in line with the ERA tariff path that is consistent with a fully funded electricity sector and the approved 2006/07 budget.
- The Bujagali hydropower plant is expected to be financed through a combination of private and public funds. The Government's contribution will be (i) loan guarantees of about US\$400 million issued to the commercial lenders; and (ii) construct the transmission line linking the project to the existing grid (a US\$50 million investment to be financed by the African Development Bank). The final agreements for the project are expected to be signed early 2007.
- With respect to the Karuma hydropower plant, the financing arrangements are yet to be finalized. The cost of the project is estimated at about US\$400 million. Financing options include a combination of (i) a reallocation within development spending; (ii) additional donor support; and (iii) use of the Energy Fund and other government deposits.

Commercially viable oil reserves have recently been discovered in Uganda. The Government is implementing internationally recognized accounting, auditing, and financial reporting procedures in the development and production stages. The Government is committed to manage these resources transparently and consistent with macroeconomic stability.

III. MEDIUM-TERM MACROECONOMIC POLICIES

30. **Fiscal space has been provided in the medium term to finance investments in infrastructure, including the Karuma hydropower project.** The fiscal policy framework aims therefore to reduce further the fiscal deficit, excluding grants and energy-related spending, and increase domestic revenue. This strategy will help to crowd-in the private

sector, and thereby provide a boost to export and private investment performance. The success of this strategy will depend on strong annual increases in government revenues, notably through an improvement in tax administration, coupled with a better allocation and efficiency of expenditures. In line with the MTEF, the Government will target an increase in domestic revenue of 1.5 percent of GDP during the three-year program.

31. **The Government is committed to avoiding the accumulation of an unsustainable debt burden over the medium term.** To this end, the Government recently adopted guidelines on external debt management. These guidelines establish clear procedures for contracting, managing, and monitoring external debt according to best practices and selecting high productivity projects. The recent implementation of the Multilateral Debt Relief Initiative (MDRI) resulted in a sharp decrease of Uganda's external debt. The Government will continue to pursue prudent fiscal and monetary policies and exercise caution in contracting external debt by using grants and then concessional loans. Nonconcessional borrowing or loan guarantees will be limited to the power sector.

Table 1. Uganda: Quantitative Assessment Criteria and Indicative Targets for December 2006 - June 2008 1/
(Cumulative change from the beginning of the fiscal year, unless otherwise stated) 2/

	Dec. 31 2006 Prog.	Mar. 31 2007 3/ Prog.	June 30 2007 Prog.	June 30 2008 3/ Prog.
(In billions of Uganda shillings)				
Assessment criteria				
Ceiling on the increase in base money liabilities of the Bank of Uganda 4/	174	171	167	141
Ceiling on the increase in net claims on the central government by the banking system	-219	-50	-242	-159
(In millions of U.S. dollars)				
Ceiling on the stock of external payments arrears incurred by the government or the Bank of Uganda 5/	0	0	0	0
Ceiling on new nonconcessional external borrowing with maturities greater than one year contracted or guaranteed by the government or the Bank of Uganda 5/ 6/				
Bujagali hydropower plant	400	400	400	400
Other	0	0	0	0
Ceiling on new external debt with maturity up to one year contracted or guaranteed by the government or the Bank of Uganda 5/ 7/	0	0	0	0
Minimum increase in net international reserves of the Bank of Uganda	186	83	169	64
(In billions of Uganda shillings)				
Indicative target				
Stock of domestic budgetary arrears under the Commitment Control System (CCS) 8/	...	...	25	10
Minimum expenditures under the Poverty Action Fund (including the Universal Primary Education component of development expenditure)	504	777	1,062	1,122

1/ The assessment criteria and indicative targets under the program, and their adjusters, are defined in the technical memorandum of understanding (TMU).

2/ Fiscal year begins on July 1.

3/ Indicative targets.

4/ For December 2006, March 2007, and June 2007, cumulative changes from the average of June 2006; for June 2008, cumulative changes from the average of June 2007, as defined in the TMU.

5/ Continuous assessment criterion.

6/ Cumulative change from December 1, 2006.

7/ Excluding normal import-related credits.

8/ Arrears incurred after end-June 2004. The stock amounted to US\$ 27 billion at end-June 2005.

Table 2. Uganda: Structural Assessment Criteria and Benchmarks¹

Policy Measure	Date of Implementation
Prior Action	
1. Electricity tariffs to rise in line with the ERA tariff path that is consistent with a fully funded electricity sector and the approved 2006/07 budget.	November 1, 2006
Structural Assessment Criteria	
2. For 2007/08 budget, allocate U Sh 300 billion for payments of group (A) verified domestic arrears. ²	End-June 2007
3. Verify the amount of pension payments due and prepare a review of pension payment and accounting systems, and make recommendations for changes if necessary.	End-May 2007
Structural Benchmarks	
4. Introduce a system to verify overdue payments from all relevant government entities within 8 weeks of the end of each quarter.	End-April 2007
5. Submit to cabinet new insolvency legislation.	End-June 2007
6. Establish a new supervisory body for financial institutions not under the statutory supervision of the BOU. This will include private and public pension funds, insurance companies, and the Uganda Development Bank.	End-December 2007
7. Introduce national identity card system.	End-February 2008

¹ Assessment criteria will also apply on a continuous basis to the standard provisions on the exchange and trade issues that apply to programs supported by the Fund's financial resources.

² Group (A) arrears comprise the stock of pre-CCS, non-CCS, and CCS arrears incurred before end-June 2004.

APPENDIX I—ATTACHMENT III
UGANDA: TECHNICAL MEMORANDUM OF UNDERSTANDING

A. Introduction

1. This memorandum defines the targets described in the memorandum of economic and financial policies (MEFP) for the first two years of the July 2006–June 2009 financial program that would be supported by the IMF Policy Support Instrument (PSI), and sets forth the reporting requirements under the instrument.

B. Base Money

2. Base money is defined as the sum of currency issued by Bank of Uganda (BOU) and the commercial banks' deposits in the BOU. The commercial bank deposits include the statutory required reserves and excess reserves held at the BOU and are net of the deposits of closed banks at the BOU and Development Finance Funds (DFF) contributed by commercial banks held at the BOU. The base money limits will be cumulative changes from the daily average of June 2006 to the daily average of December 2006, March 2007 and June 2007, and cumulative changes from the daily average of June 2007 to the daily average of June 2008.

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

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

D. Net International Reserves of the Bank of Uganda

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

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

E. Ceiling on Domestic Budgetary Arrears of the Central Government

6. The stock of domestic payment arrears under the Commitment Controls System (CCS) will be monitored on a quarterly basis. Domestic payments arrears under the CCS are defined as the sum of all bills that have been received by a central government spending unit or line ministry delivered in that quarter, and for which payment has not been made within 30 days under the recurrent expenditure budget (including rents and utilities) or the development expenditure budget. For the purpose of program monitoring, the monthly CCS reports, which will include arrears accumulated at IFMIS and non-IFMIS sites, prepared by the Treasury Inspectorate will be used to monitor arrears. Arrears can be cleared in cash or through debt swaps.

7. The payments of pre-CCS, non-CCS, and CCS arrears accumulated up to end-June 2004 (“group A arrears”) are covered by specific budget allocations for 2006/07 and 2007/08. The program ceiling on the stock of CCS arrears only covers accumulation of arrears after end-June 2004 (“group B arrears”). According to the verified report prepared by the Internal Audit Office, this stock of arrears is estimated to U Sh 27 billion as of June 2005.

F. Adjusters

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

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

Schedule A: Budget Support Plus Total HIPC Initiative Assistance (Cumulative billions of Uganda shillings, beginning July 1 of the fiscal year)				
Quarter	Dec 31, 2006	Mar. 31, 2007	June 30, 2007	June 30, 2008
Budget support, including HIPC Initiative grants	572	643	1,004	825

10. The ceiling on the increases in NCG will be adjusted downward (upward) and the floor on the increase in NIR will be adjusted upward (downward) by the amount by which debt service due⁸ plus payments of external debt arrears less deferred payments (exceptional financing) falls short of (exceeds) the projections presented in Schedule B. Deferred payments are defined to be (i) all debt service rescheduled under the HIPC Initiative; and (ii) payments falling due to all non-HIPC Initiative creditors that are not currently being serviced by the authorities (that is, gross new arrears being incurred).

Schedule B: Debt Service Due, Before HIPC Initiative Assistance (Cumulative billions of Uganda shillings, beginning July 1 of the fiscal year)				
Quarter	Dec 31, 2006	Mar. 31, 2007	June 30, 2007	June 30, 2008
Debt service due before HIPC, excluding exceptional financing	104	138	210	242

11. The ceiling on the increase in NCG will be adjusted downward (upward) by any excess (shortfall) in nonbank financing⁹ less payment of domestic group A arrears relative to the programmed cumulative amounts presented in Schedule C. For the purpose of this adjuster, payment of domestic group A arrears cannot exceed the programmed amount by more than U Sh 45.0 billion.

⁸ Debt service due is defined as pre-HIPC Initiative debt service due, but from 2003/04 onwards, this excludes HIPC Initiative debt rescheduling.

⁹ Comprising the check float and the change in government securities and government promissory notes held by the nonbank sector. The change in government securities held by the nonbank sector will be calculated from the data provided by the Central Depository System (CDS).

Schedule C: Nonbank Financing Minus Repayment of Domestic Arrears (Cumulative billions of Uganda shillings, beginning July 1 of the fiscal year)				
Quarter	Dec 31, 2006	Mar. 31, 2007	June 30, 2007	June 30, 2008
(A) Nonbank financing	-31	-42	71	106
(B) Domestic arrears repayment	82	119	149	300
(C) Total = (A) – (B)	-113	-161	-78	-194

12. The base money ceiling will be adjusted upward up to a maximum of U Sh 15 billion in December 2006, March 2007, June 2007, and June 2008 if the average amount of currency issued by the BOU exceeds those projected in Schedule D.

Schedule D: Currency Issued by the BOU (Cumulative billions of Uganda shillings, beginning July 1 of the fiscal year)				
Quarter	Dec 31, 2006	Mar. 31, 2007	June 30, 2007	June 30, 2008
Currency issued by BOU	134	137	139	99

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

13. The assessment criterion on short-term debt refers to contracting or guaranteeing external debt with original maturity of one year or less by the government or the Bank of Uganda. Excluded from this assessment criterion are normal import-related credits. The definition of “debt” is set out in paragraph 17.

14. The program includes a ceiling on new nonconcessional borrowing with maturities greater than one year contracted or guaranteed by the government, statutory bodies, or the BOU.¹⁰ Nonconcessional borrowing is defined as loans with a grant element of less than 35 percent, calculated using average commercial interest rates

¹⁰ Contraction is defined as approval by a resolution of Parliament as required in Section 20(3) of the Public Finance and Accountability Act, 2003

references (CIRRs) published by the Organization for Economic Cooperation and Development (OECD). In assessing the level of concessionality, the 10-year average CIRRs should be used to discount loans with maturities of at least 15 years, while the 6-month average CIRRs should be used for loans with shorter maturities. To both the 10-year and 6-month averages, the following margins for differing payment periods should be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–25 years; and 1.25 percent for 30 years or more. The ceiling on nonconcessional external borrowing or guarantees is to be observed on a continuous basis. The coverage of borrowing includes financial leases and other instruments giving rise to external liabilities, contingent or otherwise, on nonconcessional terms. Excluded from the limits are changes in indebtedness resulting from refinancing credits and rescheduling operations, and credits extended by the IMF. For the purposes of the program, arrangements to pay over time obligations arising from judicial awards to external creditors that have not complied with the HIPC Initiative do not constitute nonconcessional external borrowing. For the purposes of the program, the Bujagali project is defined as the hydroelectric dam and related equipment located at the dam site.

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

(a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has

the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property. (b) Under the definition of debt set out in point 9(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

16. The ceiling on the accumulation of new external payments arrears is zero. This limit, which is to be observed on a continuous basis, applies to the change in the stock of overdue payments on debt contracted or guaranteed by the government, the BOU, and statutory bodies¹¹ from their level at end-June 2006. It comprises those external arrears reported by the Trade and External Debt Department of the BOU, the Macro Department of the Ministry of Finance that cannot be rescheduled because they were disbursed after the Paris Club cutoff date.

H. Monitoring and Reporting Requirements

17. The authorities will inform the IMF staff in writing at least ten business days (excluding legal holidays in Uganda or in the United States) prior to making any changes in economic and financial policies that could affect the outcome of the financial program. Such policies include but are not limited to customs and tax laws (including tax rates, exemptions, allowances, and thresholds), wage policy, and financial support to public and private enterprises. The authorities will similarly inform the IMF staff of any nonconcessional external debt contracted or guaranteed by the government, the BOU, or any statutory bodies, and any accumulation of new external payments arrears on the debt contracted or guaranteed by these entities. The authorities will on a regular basis submit information to IMF staff with the frequency and submission time lag as indicated in Table 1. The information should be mailed electronically to AFRUGA746@IMF.ORG.

¹¹ This definition is consistent with the coverage of public sector borrowing defined by the Fund (includes the debt of the general government, monetary authorities, and entities that are public corporations which are subject to the control by government units, defined as the ability to determine general corporate policy or by at least 50 percent government ownership).

Table 1. Summary of Reporting Requirements

Reporting institution	Report/Table	Frequency	Submission lag
I. Bank of Uganda	Issuance of government securities.	Weekly	5 working days
	Interest rates on government securities.	Weekly	5 working days
	Operations in the foreign exchange market and daily average exchange rates.	Weekly	5 working days
	Consumer price index.	Monthly	2 weeks
	Balance sheet of the BOU, consolidated accounts of the commercial banks, and monetary survey. The Internal Audit Department (IAD) of the BOU will review the reconciliations of monetary survey data with the financial records and the audited financial statements. Any revisions to monetary survey data, in line with the recommendations of the IMF safeguards mission, will be documented and reconciled with the previous presentation to ensure accurate reporting.	Monthly	4 weeks
	Statement of (i) cash balances held in project accounts at commercial banks; (ii) total value (measured at issue price) of outstanding government securities from the Central Depository System (CDS); and (iii) the stock of government securities (measured at issue price) held by commercial banks from the CDS.	Monthly	6 weeks
	Summary of (i) monthly commodity and direction of trade statistics; (ii) stock of external debt, disbursements, principal and interest, flows of debt rescheduling and debt cancellation, arrears, and committed undisbursed balances—by creditor category; and (iii) composition of nominal HIPC Initiative assistance, disaggregated into grants, flow rescheduling, and stock-of-debt reduction by creditor.	Monthly	6 weeks
	Summary of external debt, external arrears, and committed undisbursed loan balances by creditor.	Quarterly	6 weeks
	Standard off-site bank supervision indicators for deposit money banks.	Quarterly	4 weeks
	Summary table of preliminary program performance comparing actual monthly outcome with adjusted program targets for (i) base money; (ii) net claims on central government by the banking system; (iii) stock of external arrears; (iv) new nonconcessional external borrowing; and (v) net international reserves	Monthly	5 weeks
II. Ministry of Finance	Summary of central government accounts. Revenues shall be recorded on a cash basis. Expenditures shall be recorded when checks are issued, except for domestic and external debt-service payments, cash transfers to districts, and externally funded development expenditures. Expenditures on domestic interest will be recorded on an accrual basis and external debt service will be recorded on a commitment basis (i.e., when payment is due). Cash transfers to districts will be recorded as expenditures of the central government when the transfer is effected by the BOU. Expenditures on externally funded development programs will be	Monthly	6 weeks

Table 1. Summary of Reporting Requirements

Reporting institution	Report/Table	Frequency	Submission lag
	recorded as the sum of estimated disbursements of project loans and grants by donors, less the change in the stock of government project accounts held at the BOU and domestic commercial banks.		
	Summary of outstanding stock of group (B) domestic arrears. Group (B) arrears comprise the stock of CCS/IFMS arrears incurred after end-June 2004.	Quarterly	6 weeks
	Summary of contingent liabilities of the central government. For the purpose of the program, contingent liabilities include all borrowings by statutory bodies, government guarantees, claims against the government in court cases that are pending, or court awards that the government has appealed.	Quarterly	6 weeks
	Detailed central government account of disbursed budget support grants and loans, HIPC support, and external debt service due and paid.	Monthly	4 weeks
	Detailed central government account of disbursed donor project support grants and loans.	Monthly	6 weeks
	Statement on new loans contracted during the period according to loan agreements.	Quarterly	6 weeks
	Updated national accounts statistics (real and nominal) according to UBOS and medium-term projections.	Quarterly	4 weeks

APPENDIX II—UGANDA: RELATIONS WITH THE FUND
(As of October 31, 2006)

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

II. General Resources Account:	SDR Million	% Quota
Quota	180.50	100.0
Fund holdings of currency	180.51	100.0

III. SDR Department:	SDR Million	% Allocation
Net cumulative allocation	29.40	100.00
Holdings	0.36	1.23

IV. Outstanding Purchases and Loans:	SDR Million	% Quota
Enhanced Structural Adjustment Facility (ESAF)/Poverty Reduction and Growth Facility (PRGF) arrangements	6.00	3.32

V. Financial Arrangements:

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
PRGF	09/13/2002	01/31/2006	13.50	13.50
ESAF/PRGF	11/10/1997	03/31/2001	100.43	100.43
ESAF	09/06/1994	11/09/1997	120.51	120.51
ESAF	04/17/1989	06/30/1994	219.12	219.12

VI. Projected Payments to Fund

(based on existing use of resources and present holdings of SDRs)

	Overdue	Forthcoming				
		<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
Principal		0.00	0.00	0.00	0.00	0.20
Charges/interest		0.30	1.20	1.21	1.20	1.20
Total		0.30	1.20	1.21	1.20	1.40

VII. Implementation of HIPC Initiative:

	<u>Original framework</u>	<u>Enhanced framework</u>	<u>Total</u>
Commitment of HIPC assistance			
Decision point date	4/23/1997	2/7/2000	
Assistance committed (1999 NPV terms) ¹			
Total assistance (US\$ million)	347.00	656.00	
<i>Of which:</i> Fund assistance (US\$ million)	68.90	91.00	
Completion point date	April 1998	May 2000	
Delivery of Fund assistance (SDR million)			
Assistance disbursed to the member	51.51	68.10	119.61
Interim assistance	...	8.20	8.20
Completion point balance	51.51	59.90	111.41
Additional disbursement of interest income ²		2.06	2.06

VIII. Implementation of MDRI Assistance

I. Total Debt Relief (SDR Million) ³	87.73
<i>Of which:</i> MDRI	75.85
HIPC	11.88

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

² Under the enhanced Initiative for Heavily Indebted Poor Countries (HIPC Initiative), an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

³ The Multilateral Debt Relief Initiative (MDRI) provides 100 percent debt relief to eligible member countries that are qualified for the assistance. The debt relief covers the full stock of debt owed to the Fund as of end-2004 which remains outstanding at the time the member qualifies for such debt relief. The MDRI is financed by bilateral contributions and the Fund's own resources, as well as the resources already disbursed to the member under the HIPC Initiative (see Section VII above).

II. Debt Relief by Facility (SDR Million)

<u>Delivery Date</u>	Eligible Debt		
	<u>GRA</u>	<u>PRGF</u>	<u>Total</u>
January 2006	N/A	87.73	87.73

IX. Safeguards Assessments

Under the Fund's safeguards assessment policy, the Bank of Uganda (BoU) was subject to a safeguards assessment with respect to the PRGF arrangement, which was approved on September 13, 2002. Since that assessment, the BoU has strengthened the safeguards framework, including timely finalization and publication of the financial statements, establishing a functioning audit committee, regularly reconciling monetary data, and formalizing the follow-up of implementation of internal and external audit recommendations. The authorities requested an update of the safeguards assessment in the context of the PSI. A mission took place in September 2006; staff determined that the BOU has strengthened its safeguards framework in most areas

X. Exchange Rate Arrangement

The official exchange rate is determined on the interbank market for foreign exchange. As of October 31, 2006, the official exchange rate was U Sh 1,819.8 per U.S. dollar. The exchange system is free of restrictions on the making of payments and transfers for current international transactions. Uganda is classified as an independently floating exchange rate regime.

XI. Article IV Consultation

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

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

XII. Policy Support Instrument (PSI)

Uganda initiated a 16-month PSI with the Fund in January 2006.

XIII. Technical Assistance

Uganda has received extensive technical assistance from the Fund in recent years.⁴

An FAD mission visited Kampala in April 1998 to advise the authorities on public service pension reform issues, and another mission visited Kampala in September 1998 to assist the authorities in improving customs administration procedures. A resident advisor in the area of local government budgeting began a six-month assignment in August 1998, which was subsequently extended to October 1999. An FAD resident advisor on budgeting and commitment control commenced a six-month assignment in November 1998, which was extended until June 2002. In October 2000, an FAD mission visited Kampala to provide technical assistance in tax policy and administration. A joint Bank/Fund TA mission visited Kampala in October 2003 to help harmonize tax investment incentives among the member countries of the EAC. An FAD TA mission on tax administration also visited Uganda in October 2004 to develop a comprehensive reform plan for the Uganda Revenue Authority (URA), followed by visits in April 2005 and April–May 2006. Two FAD resident advisors (coordinated through AFRITAC-East) are currently in the field assisting the implementation of a CCS at the local government level and the Fiscal Decentralization Strategy.

A STA multisector statistics mission visited Kampala in December 1998 to conduct a comprehensive assessment of Uganda's macroeconomic statistics, including data compilation and dissemination, and to provide recommendations for improvements. Follow-up STA missions in national accounts and money and banking statistics visited Kampala in March–April 2000 to examine the status of implementation of the previous recommendations. A STA mission on government financial statistics (GFS) visited Uganda in December 2001 to assist authorities in improving fiscal reporting by establishing regular reporting systems that are aligned with the *GFS Manual 2001*, as well as ensuring consistency within monetary sector data for the government. A follow-up mission on GFS visited Uganda in May 2003. A mission visited Uganda during February–March 2002 to review balance of payment statistics and the progress in implementing the recommendations of the multisector mission of 1998 and of the national accounts mission of 2000 with respect to the measurement of goods imports. A follow-up mission on balance of payments statistics visited Uganda in August 2003. Uganda is participating in the General Data Dissemination System (GDDS) and its metadata were initially posted on the Fund's Dissemination Standards Bulletin Board in May 2000. A STA mission was in Uganda during February 2005 to prepare a data ROSC.

⁴ For a description of technical assistance provided prior to 1998, see the staff report for Uganda's request for a three-year arrangement under the PRGF (Country Report No. 02/213).

Since the 2001 FSAP, MFD's TA to Uganda has focused on liquidity management, exchange rate intervention, central bank accounting and auditing, and banking supervision. The authorities have effectively used TA advice on these topics, and they have made good use of an MFD resident advisor, who took up her initial appointment in mid-July 2001. The advisor was fully integrated into the supervision function and has been involved in all aspects of the work, including participating in on-site examinations. Her contract was extended through July 2004, and the authorities are now in the process of selecting a new MFD resident advisor to follow up on the progress made so far. MFD has fielded two TA missions (July 2001 and January 2002) to assist the authorities with liquidity management and address the problems of interest rate volatility and exchange rate interventions. The BOU has started implementing the recommendations made in the report, and now clearly separates sterilization operations and liquidity management; however, they are still having problems with interest rate and exchange rate volatility and have requested follow-up TA in this area. In March and September–October 2002, MFD provided TA to improve central bank accounting and the Bank of Uganda's accounting manual. A TA evaluation visit was conducted in June 2003, and an MFD mission following up on monetary and exchange rate operations, public debt, and liquidity management was conducted in March 2004. An FSAP update mission was conducted in November 2004 and focused on access, outreach, and stability issues, which also updated progress made since the last FSAP. Finally, a TA mission on enhancing the effectiveness of monetary policy implementation and developing financial markets was conducted in August 2005.

XIV. Future Technical Assistance Priorities

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

XV. Resident Representative

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

APPENDIX III—UGANDA: RELATIONS WITH THE WORLD BANK GROUP
(As of August 15, 2006)

I. PARTNERSHIP IN UGANDA’S DEVELOPMENT STRATEGY

1. Uganda’s development strategy is based on the revised Poverty Eradication Action Plan (PEAP)¹ launched in May 2005. This medium-term national planning framework guides government policy both at the sectoral and district level and has been used as the basis for Uganda’s Poverty Reduction Strategy Paper presented to the Boards of the World Bank and IMF in May 2000. The revised PEAP, along with a Joint-Staff Advisory Note were presented to the Boards of the World Bank and IMF in June 2005.

2. The revised PEAP aims at accelerating economic growth, reducing poverty and inequality, and improving human development. It has five pillars: (i) economic management; (ii) production, competitiveness and income; (iii) security, conflict-resolution, and disaster management; (iv) good governance; and (v) human development.

3. The Fund and the Bank support the government of Uganda to implement the revised PEAP. In February 2006, the Fund’s support to Uganda changed into a Policy Support Instrument (PSI), following completion of the second three-year arrangement under the Poverty Reduction and Growth Facility. Under the PSI, the Fund continues to support macroeconomic and financial sector stability, which falls under the first pillar in the revised PEAP. In addition, the Fund addresses structural issues in tax administration, budget management, local government finances, financial sector deepening, and development of statistics systems. On the other hand, the Bank is supporting the implementation of revised PEAP through structural and sectoral reforms. The Bank’s support comprises budget and project support, with an equal emphasis on analytic work and technical assistance.

II. BANK GROUP STRATEGY

5. The World Bank's assistance to Uganda is elaborated in the Uganda Joint Assistance Strategy (UJAS). The UJAS is a direct response to the Government of Uganda’s revised PEAP, and puts into practice the principles of the 2005 Paris Declaration on Aid Effectiveness. The strategy was prepared in 2005 by the World Bank and a group of six development partners, including the African Development Bank, the UK’s Department for International Development, Germany, the Netherlands, Norway, and Sweden. Because it represents the core strategy of the development partners for 2005–09, other partners are encouraged to join.

¹ The PEAP, first prepared in 1997 is a dynamic document and was revised in 2000 and 2004.

Consequently, Austria, Denmark, the European Commission and Ireland have signed up to the strategy. The UJAS was approved by the Bank's Board in January 2006.

6. Within the UJAS, the Bank emphasizes direct budget support by financing the PEAP through annual Poverty Reduction Support Credits (PRSCs). The first Poverty reduction Support Credit (PRSC1) for Uganda was approved by the Bank's Board in May 2001. Since then, the country has received four more PRSCs. The fifth PRSC for US\$135 million was approved by the Bank's Board on January 17, 2006 and was the first to support the revised PEAP. Whereas previous PRSCs were for \$150 million, PRSC5 was reduced by 10 percent to reflect the Bank's concerns about expenditure overruns in the public administration budget. For future PRSCs, the Bank will work with government to ensure that such overruns do not escalate into fiscal indiscipline.

7. Another form of direct budget support is debt relief. In addition to the Heavily Indebted Poor Countries (HIPC) initiatives², Uganda is eligible for 100 percent debt relief under the Multilateral Debt Relief Initiative (MDRI) approved by the World Bank Board on March 28, 2006. The initiative, which became effective July 01, 2006, will cancel Uganda's IDA debt amounting to US \$ 2.7 billion.

8. Specific Bank support to the five pillars of the revised PEAP, through a combination of lending and analytical activities, is outlined in paragraphs 9-15.

9. **PEAP/PRSP Pillar 1—Economic Management:** Consistent with the objective of macro stability with rapid private sector-led growth, the Bank's activities under this pillar aim to support government to broaden the domestic revenue base, strengthen public expenditure and budgetary management, streamline the intergovernmental fiscal transfer system to facilitate gradual fiscal decentralization, enhance the results orientation of sector expenditure programs, strengthen monitoring and evaluation, and maintain external debt at sustainable levels. In addition, the Bank supports the development of a legal and regulatory framework for pensions, capital markets and the insurance sector to increase access to term finance.

10. **PEAP/PRSP Pillar 2—Enhancing production, competitiveness, and incomes:** Under this pillar, the Bank's activities aim to promote an efficient and competitive private sector by improving the investment climate; and to increase efficiency in agricultural, fisheries and forestry production while preserving environmental sustainability. The Bank is, therefore, supporting government to improve the investment climate to achieve four main objectives: (i) strengthening the policy and regulatory environment (i.e. the medium term competitiveness

² Uganda reached completion point for the HIPC in April 1998 and for the Enhanced HIPC in May 2000.

strategy, investment code, export processing zone law, new companies act); (ii) building infrastructure (e.g. industrial park and power generation stations); (iii) strengthening institutions (e.g., Uganda Investment Authority, commercial courts, land registry, etc.); and (iv) supporting small and medium term enterprises through business development services and increased access to finance.

11. The Bank's support for agricultural production is through a demand-driven National Agricultural Advisory Services Project and the second Agricultural Research and Training Project. The second Lake Victoria Environmental Protection project, the second Protected Areas Management and Sustainable Use project and the second Environmental Management and Capacity Building project, also support the sector to address sustainability issues. Furthermore, the PRSCs support the implementations of government's plan for modernization of agriculture, from which several undertakings are prior actions.

12. The Bank also supports infrastructure development, in particular power, roads and other utilities. In the power sector, the Fourth Power project aims to increase power supply and strengthen capacity to manage reform, while the Energy for Rural Transformation project intends to develop Uganda's rural energy and information technology. Further, the Bank will support both the proposed thermal generation extension to address short term capacity deficits and the \$600 million Private Power Generation (Bujagali) project through private public partnerships. In the road sector, the Bank supports the government's ten-year Road Development Program through a series of road sector projects. The reform of other utilities and divestiture of the remaining public enterprises have been supported by the Privatization and Utility Sector Reform Project. On a regional basis, the Bank advises on implementation of the Nile Basin Initiative.

13. **PEAP/PRSP Pillar 3—Security Conflict-Resolution and Disaster Management.** To reduce regional disparities, the Northern Uganda Social Action Fund (NUSAF) targets the poor districts of northern and eastern Uganda, which are yet to benefited from economic reform and liberalization. Once the conflict ends, the Bank will scale-up NUSAF to include reconstruction works. Furthermore, the Bank is undertaking analytical work on the North including: development of a peace, recovery and development plan, risk and vulnerability assessment, public expenditure review, land-use PSIA, and concept note on development and productivity in the North.

14. **PEAP/PRSP Pillar 4—Good Governance.** The Bank supports the government's efforts to increase efficiency of commercial justice courts; to improve governance, especially to fight corruption through increased accountability and transparency; and to implement broad-based public sector reform. This support is through the PRSCs, in which a variety of cross-cutting public sector management reforms are implemented. These include reforms in public

procurement, financial management, public sector pay, payroll and personnel management, and anti-corruption legislation. Work on financial accountability through the second Economic and Financial Management Project and Local Government Development Project (LGDP) complements these efforts. Furthermore, the Public Service Performance Enhancement project aims at transforming the public service to make it affordable, efficient and accountable.

15. **PEAP/PRSP Pillar 5—Human Development.** The Bank supports the government's efforts to improve access to, and quality of, education, healthcare, and water and sanitation services, primarily through the PRSCs work within sector programs. In addition, the Bank's HIV/AIDs Control Project supports local initiatives to provide prevention, treatment, and care. Support under this pillar is critical to furthering Millennium Development Goals (MDGs).

III. BANK PORTFOLIO

16. As of June 30, 2006, Uganda's portfolio included 22 Bank-supported projects, with total net commitments of US\$1,044 million. US\$601 million of this amount was not yet disbursed.

17. For the fiscal year 2006/07, projects in the pipeline include PRSC6 (US\$150 million), Thermal Power Generation project (US\$75 million), Kampala Institutional and Infrastructure Development project (US\$ 32 million), Private Power Generation project (US\$55 million), Local Government Service Delivery (US\$100 million), second Lake Victoria project (US\$ 40million), and Kampala Solid Waste Management project(US\$4.0 million). In fiscal year 2005/06, PRSC5(US \$135 million), Public Service Enhancement Program (US \$ 70 million), the East African Trade and Transport facilitation project(US\$ 27 million), Millennium Science Initiative Project (US\$10 million) were approved by the Board. In fiscal year 2004/05, PRSC 5 (US\$150 million grant), Road Development Program Phase 3 (US\$107.6 million, of which US\$40 million is grant), and Private Sector Export Competitiveness Project Phase 2 (US\$70 million), totaling US\$327.6 million, were approved by the IDA Board.

IV. BANK-FUND COLLABORATION IN SPECIFIC AREAS

18. The IMF and World Bank staffs collaborate their support to the government's reforms. Specific areas of this collaboration include:

- **Poverty reduction strategy paper** - The Bank and Fund are assisting government to implement its poverty reduction strategy. The staffs of the two institutions prepare joint assessments of the Poverty Reduction Status Paper(PRSP) or the PRSP progress reports.

- **Debt sustainability analysis** - The staffs of the Bank and Fund continue collaborating on issues related to the Heavily Indebted Poor Countries and the Multilateral Debt Relief initiatives and prepare joint debt sustainability analysis(DSA) for the country. The Uganda DSA, last updated in November 2005, will be updated during 2006/07.
- **Public expenditure management** - The Bank, Fund, and other donors support government's institutional and policy reforms to improve public expenditure management. The Fund is leading the dialogue on fiscal policy, while the Bank is focusing on strategic expenditure allocation and efficiency of public expenditures through public expenditure reviews and PRSC dialogue. The staffs of the two institutions prepare annual reports on the HIPC Initiative poverty-reducing spending and evaluate the quality of public expenditure management in Uganda. The Bank and other donors support the implementation of the action plan for the Country Integrated Financial Assessment report prepared in 2004/05.
- **Financial sector reform** - The Bank and Fund completed a Financial Sector Assessment Program update in March 2005. This joint assessment forms the basis for Bank and Fund support to government implement additional financial sector reforms. In addition to PRSCs dialogue, the Bank will support these reforms through a demand-driven capacity building component of the Public Service Capacity Enhancement Project. The work is closely coordinated with the Fund PSI support, which focuses on enhancing supervisory capacity for the financial sector and selected aspects of pension reform.
- **Trade reforms** - The Bank and Fund are working closely to assist Uganda in establishing a pro-growth trade framework. Both institutions are involved in the dialogue on trade reforms in the context of the East African Community. In 2005/06, the Bank completed a diagnostic trade integrated study. The Bank will support the implementation of measures identified in the study to address both external and internal constraints to trade. Such efforts will supplement those in the East African Trade and Transport Facilitation project, which becomes effective in 2006/07.

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

APPENDIX IV—UGANDA: STATISTICAL ISSUES

Uganda participates in the General Data Dissemination System (GDDS); its metadata were initially posted on the Fund's Dissemination Standards Bulletin Board in May 2000. Partial updates of real and external sector metadata were completed in August 2005.

An STA mission visited Uganda in February 2005 to prepare a data ROSC and the results were published in July 2006. It assessed data compilation and dissemination practices against international standards in national accounts, prices, government finance, and balance of payments statistics; the monetary and financial statistics were not assessed.

Real sector statistics

The 2005 data ROSC mission found that the national accounts do not follow up-to-date international standards and have a limited scope, but do use international classifications and a generally adequate base for recording. The mission recommended undertaking an agricultural census supplemented with annual sample surveys and an economy-wide business survey at least every five years, supplemented with annual sample surveys. Compilation of the consumer price index conforms to international standards, but is of limited scope; the mission recommended expansion of coverage to rural areas, along with updating the reference and weight base to 2003–04. No wholesale or producer price indices or labor market information are produced. Technical assistance in real sector statistics is provided through the regional center (Africa Regional Technical Assistance Center East, AFRITAC East).

Government finance statistics

The 2001 Government Finance Statistics (GFS) technical assistance mission discussed several data classification issues with the Ministry of Finance and proposed a summary framework for reporting according to the *GFS Manual 2001 (GFSM 2001)* framework. A 2003 follow-up mission identified some weaknesses in the proposed new chart of accounts. A revised chart of accounts was implemented for use by all budgetary central government and local government units from July 1, 2004. Uganda commenced reporting GFS data compiled according to the *GFSM 2001* framework for the 2004 GFS Yearbook. However, data coverage is limited to the budgetary central government and local government accounts and excludes the activities of extrabudgetary central government units and the National Social Security Fund. The data ROSC mission echoed these findings and recommended migration to the *GFSM 2001*.

Monetary and financial statistics

In February 2006, a monetary and financial statistics mission found that Uganda's monetary statistics are basically sound from the point of view of data integrity and timeliness.

However, there are a number of areas where improvements are needed to align the data with the recommendations of the *Monetary and Financial Statistics Manual (MFSM)*.

The detailed balance sheet of the Bank of Uganda (BOU) is well designed for producing the analytical data; however, (1) reverse repos between the BOU and commercial banks are not classified as advances to banks, (2) there is some inconsistency among departments in the BOU in determining which foreign assets belong in reserve assets; (3) loans and advances are presented net of provisions for loans losses; (4) the proper classification of many positions of the Development Finance Department is difficult because the main classification used in the accounts is the original source of funds, rather than which unit the BOU has a claim on or liability; and (5) the economic and accounting nature of administered and internally managed funds of the BOU is unclear.

The principal issue with regard to the quality of the data of other depository corporations (ODCs) is the exclusion of two classes of depository corporations from the monetary survey. At present, the monetary survey covers the balances of the BOU and the commercial banks only. However, there are also seven credit institutions and four microfinance institutions that accept deposits. The 2006 mission, therefore, recommended that the depository corporations sector be defined to include these deposit-taking corporations, and that their deposits be included in the monetary aggregates.

The mission developed a detailed draft of the Standardized Report Form (SRF) for the BOU. This included recommended classifications for all items in the BOU balance sheet, and annotated commentary on these items. With respect to the SRF for ODCs, the mission reviewed a draft of the new report for collection of data from ODCs, and suggested further revisions that were necessary for compilation of data in accordance with the *MFSM*.

External sector statistics

The ROSC mission found that the balance of payments statistics broadly follow the fifth edition of the *Balance of Payments Manual (BPM5)*, but that there are some departures from recommended definitions, scope, and classifications. The mission urged completion of the conversion to the *BPM5* and the development of new source data and estimation techniques in the following areas: exports of freight and imports of passenger transportation, compensation of employees, direct investment abroad, portfolio investment and financial derivatives. International trade data could be improved by incorporation of results from the Survey of Informal Cross-Border Trade and greater use of trade partner country data sources.

UGANDA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(As of November 16, 2006)

	Date of Latest Observation	Date Received	Frequency of Data ⁵	Frequency of Reporting ⁵	Frequency of Publication ⁵	Memo Items	
						Data Quality – Methodological Soundness ⁶	Data Quality – Accuracy and Reliability ⁷
Exchange rates	07/13/06	07/14/06	D	D	D		
International reserve assets and reserve liabilities of the monetary authorities ¹	05/31/06	07/14/06	M	M	M		
Reserve/base money	07/31/06	10/16/06	D	D	M		
Broad money	07/31/06	10/16/06	M	M	M		
Central bank balance sheet	07/31/06	10/16/06	M	M	M		
Consolidated balance sheet of the banking system	07/31/06	10/16/06	M	M	M		
Interest rates ²	10/30/06	11/9/06	M	M	M		
Consumer price index	October 2006	Nov. 2006	M	M	M	O, LO, O, O	O, O, LO, O, O
Revenue, expenditure, balance and composition of financing ³ —central government	June 2006	July 2006	M	M	M	O, LNO, O, LO	O, O, O, O, LO
Stocks of central government and central government-guaranteed debt ⁴	June 2006	July 2006	M	M	M		
External current account balance	Mar. 2006	June 2006	A	Q	Q	LO, LO, LO, LO	LO, O, O, O, LO
Exports and imports of goods and services	Mar. 2006	June 2006	M	M	M		
GDP/GNP	2005/06	June 2006	A	A	A	LO, LO, O, LO	LO, O, LO, O, O
Gross external debt	Dec. 2005	May 2006	M	Q	...		

¹ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

² Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ Including maturity composition.

⁵ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

⁶ Reflects the assessment provided in the data ROSC published on July 21, 2006 based on the findings of the mission that took place during February 9-22, 2005. For the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

⁷ Same as footnote 6, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

APPENDIX V—UGANDA: JOINT BANK-FUND DEBT SUSTAINABILITY ANALYSIS¹

Having achieved debt sustainability, the authorities are planning to address long-overdue infrastructure constraints aiming at reaching high economic growth. The Joint DSA assesses the challenges and trade-offs of increasing public investment and maintaining the hard-achieved debt sustainability.

1. **Uganda has achieved debt sustainability by implementing sound macroeconomic policies and receiving debt relief.** The HIPC and MDRI debt relief have improved Uganda's debt sustainability outlook substantially by leading to a drastic reduction in Uganda's debt burden indicators (see Box 1)². Thus, all debt burden indicators are below their policy-dependent thresholds: Uganda's NPV of debt-to-exports ratio will decrease to 31 percent in 2006/07 from 179 percent in 2004/05 while the debt service to export ratio will sharply decline to 4 percent in 2006/07 from 16 percent in 2004/05. Uganda's NPV debt-to-GDP ratio will be reduced to 5 percent in 2006/07 from 24 percent in 2004/05.
2. **Uganda's current risk of debt distress is low, and based on this fact the authorities are planning to address infrastructure constraints.** The authorities are planning to build the Bujagali hydropower plant to help address power shortage constraints, as it will contribute to a steady and secure supply of energy while strengthening private sector confidence. The authorities are still negotiating with a private consortium the terms, conditions, and guarantees for financing Bujagali. The Government intends to start the planning process for the construction of a second hydropower project at Karuma.
3. **The Joint DSA assesses an increase in investments** for hydroelectric power in a four-year period between 2007/08 and 2010/11. The DSA assumes that the government contracts or guarantees debt on commercial terms up to US\$400 million. The DSA assumes that the government would finance by borrowing or providing guarantees on commercial terms with annual average disbursements of about 0.8 percent of GDP. Thus, the baseline scenario shows the impact of partial public financing of the construction of infrastructure on commercial terms. Debt indicators would be lower if a greater proportion of these investments were financed on concessional terms. In addition, it is assumed that multilateral and bilateral official debt would be contracted on concessional terms.

¹ During the review mission, the staff discussed with the authorities the basic assumptions of the scenario shown in this appendix, and its implications for debt accumulation and debt management strategy. Prospective oil production has not been incorporated in the DSA, as the scale of production needs to be determined (Box 3).

² The AfDF will deliver its share of debt relief by end-2006.

I. EXTERNAL DEBT SUSTAINABILITY ANALYSIS³

4. **Under the baseline scenario, Uganda’s debt burden indicators are below their policy-dependent thresholds during the projection period.** The NPV of debt-to-GDP ratio is projected to increase to 13 percent in 2016/17, a level that is well below its policy-dependent threshold of 50 percent, while dropping to 10 percent by the end of the projection period. Uganda’s NPV of debt-to-exports ratio in 2016/17 will stand at 87 percent, below its policy-dependent debt burden threshold of 200 percent. Debt service is manageable through the projection period, reflecting the delivery of HIPC and MDRI assistance. Debt service payments will be at their peak of 6 percent of exports in 2013/14.

Box 1. Macroeconomic Assumptions

Real GDP growth averages 6.3 percent between 2006/07 and 2026/27, higher than its ten-year historical average by 0.5 percent and lower than the Government’s projection of 7 percent, recognizing the current constraints imposed by the power shortage. Higher investment in energy and roads is expected to lead to subsequent increase in production.

Exports of goods and services are projected to grow about 8 percent on average between 2006/07 and 2026/27, driven largely by an increase in the export volume of non-traditional exports and some higher volume increase in fish and maize, and cotton and coffee resulting from recovering plantation areas.

The current account deficit (excluding interest payments) in terms of GDP will be above its historical average of 4.5 percent by about 3 percent of GDP between 2006/07-2011/12 on the account of higher imports related to the construction of Bujagali, and is projected to decrease to an average of 6.2 percent thereafter.

Fiscal policy. Tax revenues are assumed to increase gradually from 13 percent of GDP 2004/05 to 15 percent of GDP in 2012/13 and to 16 percent in 2015/16. With grants tapering off to 3 percent of GDP, noninterest expenditures are projected initially to decline to about 17.5 percent of GDP and then to increase to about 19 percent of GDP, consistent with a primary balance close to zero in the outer years.

Official external loan financing is projected to amount to US\$590 million on average throughout the entire projection period. The DSA assumes that IDA will support Uganda through the projection period with lending operations.

5. **Macroeconomic shocks would worsen Uganda’s NPV of debt-to-exports ratio significantly.** If exports grow less by one standard deviation in 2007/2009, Uganda’s NPV of debt-to-exports ratio would increase to 147 percent in 2011/12. Thus, an export shock and low growth performance would have a significant impact on debt sustainability, as it would put the Ugandan economy at a high indebtedness level for a prolonged period of time.

³ Uganda’s policies and institutions rank as a “strong performer” according to the World Bank’s Country Policy and Institutional Assessment (CPIA). Debt burden thresholds for strong performers are NPV of debt to GDP ratio of 50 percent, NPV of debt-to-exports ratio of 200 percent, NPV of debt to revenue ratio of 300 percent, debt service to exports ratio of 25 percent, and debt service to revenue ratio of 35 percent.

Uganda's NPV of debt-to-GDP ratio and debt service ratio would nonetheless remain below their policy-dependent thresholds.

6. **An alternative scenario has been developed to reflect higher government investment in infrastructure.** For illustrative purposes, this scenario assumes additional new borrowing of US\$1.5 billion during the first decade, and US\$3.5 billion for the 20-year period projection, over and above what is assumed in the baseline through a blend of concessional and nonconcessional financing. Under this scenario, Uganda's NPV of debt-to-exports ratio would be higher than in the baseline scenario by 31 percentage points to 118 percent in 2016/17. If these investments coincided with a shock to exports, this ratio would rise further to 184 percent. These results points to the need of scaling up donor support to finance infrastructure projects until a steady high economic growth materializes.

Table 1. Uganda: DSA Baseline Scenarios under Alternative Government Investment Program

	2007	2010	2014	2017	2027
NPV of debt-to-GDP ratio					
Baseline scenario	5	12	13	13	10
High investment scenario	5	13	16	17	14
NPV of debt-to-exports ratio					
Baseline scenario	31	83	88	87	68
High investment scenario	31	89	112	118	96
Debt service ratio					
Baseline scenario	4	6	6	5	5
High investment scenario	4	6	11	10	7

Source: Fund staff projections.

7. **Contracting commercial debt should be approached with caution.** While Uganda's debt situation is currently robust, the use of nonconcessional debt would add to Uganda's external debt burden and should be based on a careful selection of objectives and infrastructure projects to minimize debt risks related to external shocks. Overall, the authorities would have to weigh the costs and benefits of nonconcessional borrowing. International community support in providing concessional resources remains critical.

II. FISCAL SUSTAINABILITY ANALYSIS

8. **The fiscal DSA is based on the assumption of continued fiscal consolidation, though initially at a more moderate pace due to the power crisis, and on a gradual**

tapering off of grant inflows. Specifically, it is assumed that emergency budget spending on the energy crisis will amount to about 3 percent of GDP cumulatively in the next three years, and that grants will continue to decline from 6½ percent of GDP in FY 2005/06, before stabilizing at 3 percent of GDP. Domestic budget revenues are projected to increase gradually to 16 percent of GDP, in line with the authorities' policy objective. After a spike related to the energy crisis, noninterest expenditures will decline moderately as a percent of GDP, but then will increase again to about 19 percent of GDP, in line with projected improvement in domestic revenue collection, with primary balance close to zero.

9. **Under the baseline scenario, the NPV of public debt is projected to increase gradually after a sharp decline resulting from MDRI.** It will reach about 20 percent of GDP by the middle of the next decade, and then decline gradually. Debt-service indicators remain manageable, with debt-service peaking at about 10 percent of budget revenues.

10. **Uganda's public debt remains sustainable under alternative scenarios.** Even under the extreme stress test, the NPV of public debt reaches only about 30 percent of GDP in 2016/17, and then declines continuously. Similarly, the stress tests do not indicate any debt service problems.

III. CONCLUSION

11. **The DSA analysis shows that Uganda's public debt remains sustainable under the baseline scenario.** Uganda's public debt has been reduced significantly as a result of the MDRI, and with a prudent borrowing strategy and the continuation of the stability-oriented fiscal policy, debt should remain comfortably low during the projected period. While the alternative scenario shows that Uganda can adopt a higher investment program, caution on borrowing is warranted and concessional financing remains essential.

Table 1a. Uganda: External Debt Sustainability Framework, Baseline Scenario, 2006-2027 1/
(In percent of GDP, unless otherwise indicated)

	Actual		Historical Average 6/	Standard Deviation 6/	Projections								2013-27 Average	
	2005	2006			2007	2008	2009	2010	2011	2012	2007-12 Average	2017		2027
External debt (nominal) 1/	50.6	47.3			17.6	21.5	24.0	26.6	28.1	28.5		27.5	18.9	
o/w public and publicly guaranteed (PPG)	50.6	47.3			17.6	21.5	24.0	26.6	28.1	28.5		27.5	18.9	
Change in external debt	-14.9	-3.3			-29.7	3.9	2.4	2.6	1.6	0.3		-0.4	-1.0	
Identified net debt-creating flows	-14.7	-2.1			0.4	4.3	3.4	4.1	2.7	2.0		1.5	0.7	
Non-interest current account deficit	1.7	3.7	4.5	2.5	5.6	8.4	8.2	8.8	7.7	7.2		6.8	5.7	6.4
Deficit in balance of goods and services	13.3	15.7			16.2	17.6	17.0	18.0	17.1	17.2		17.6	18.5	
Exports	13.8	14.4			15.0	14.6	14.3	14.6	14.8	14.8		14.6	14.4	
Imports	27.1	30.1			31.2	32.3	31.3	32.6	31.9	32.0		32.3	32.9	
Net current transfers (negative = inflow)	-13.1	-13.1	-9.4	4.0	-11.8	-10.4	-10.0	-10.1	-10.2	-10.1		-10.1	-10.1	-10.1
Other current account flows (negative = net inflow)	1.5	1.1			1.2	1.2	1.2	0.9	0.8	0.1		-0.7	-2.7	
Net FDI (negative = inflow)	-2.5	-2.4	-2.1	0.5	-2.6	-3.2	-3.7	-3.5	-3.6	-4.0		-4.0	-4.0	-4.0
Endogenous debt dynamics 2/	-13.9	-3.4			-2.6	-0.9	-1.1	-1.2	-1.4	-1.2		-1.3	-0.9	
Contribution from nominal interest rate	0.4	0.4			0.1	0.1	0.2	0.3	0.4	0.4		0.3	0.2	
Contribution from real GDP growth	-3.4	-2.5			-2.7	-1.0	-1.3	-1.6	-1.8	-1.6		-1.5	-1.1	
Contribution from price and exchange rate changes	-10.9	-1.3			...	...	...	...	...	...		...	...
Residual 3/	-0.1	-1.2			-30.0	-0.4	-1.0	-1.5	-1.1	-1.7		-1.9	-1.7	
o/w exceptional financing	0.0	0.2			0.2	0.2	0.2	0.1	0.1	0.0		0.0	0.0	
NPV of external debt 4/	...	4.8			4.6	8.6	10.3	12.1	13.0	13.0		12.8	9.8	
In percent of exports	...	33.3			30.8	58.8	72.1	82.9	87.5	88.3		87.3	68.1	
NPV of PPG external debt	...	4.8			4.6	8.6	10.3	12.1	13.0	13.0		12.8	9.8	
In percent of exports	...	33.3			30.8	58.8	72.1	82.9	87.5	88.3		87.3	68.1	
Debt service-to-exports ratio (in percent)	15.4	9.9			3.9	3.2	4.8	5.7	6.0	6.3		5.1	4.5	
PPG debt service-to-exports ratio (in percent)	15.4	9.9			3.9	3.2	4.8	5.7	6.0	6.3		5.1	4.5	
Total gross financing need (billions of U.S. dollars)	116.2	255.8			364.7	637.8	632.6	788.1	676.7	595.9		753.8	1063.1	
Non-interest current account deficit that stabilizes debt ratio	16.5	7.0			35.2	4.5	5.7	6.3	6.2	6.8		7.2	6.6	
Key macroeconomic assumptions														
Real GDP growth (in percent)	6.7	5.4	5.7	1.4	6.2	6.5	6.5	6.8	7.1	6.0	6.5	6.0	6.0	6.0
GDP deflator in US dollar terms (change in percent)	20.1	2.5	-0.4	9.5	2.1	2.3	2.5	-1.5	-1.5	1.9	1.0	1.9	1.9	1.9
Effective interest rate (percent) 5/	0.8	0.8	1.0	0.2	0.2	0.7	1.1	1.4	1.5	1.5	1.1	1.0	0.9	1.0
Growth of exports of G&S (US dollar terms, in percent)	24.6	12.6	7.7	15.9	12.6	6.7	6.9	6.9	7.2	7.8	8.0	7.8	7.8	7.8
Growth of imports of G&S (US dollar terms, in percent)	25.5	20.3	7.6	11.7	12.2	12.7	6.0	9.4	3.4	8.2	8.6	8.2	8.2	8.2
Grant element of new public sector borrowing (in percent)	...	...	...	...	47.3	31.2	31.4	33.1	40.5	45.3	38.1	45.9	45.9	45.8
<i>Memorandum item:</i>														
Nominal GDP (billions of US dollars)	8733.8	9442.7			10234.9	11151.7	12177.7	12807.8	13513.5	14594.6		21444.3	46296.6	

Source: Staff simulations.

1/ Includes both public and private sector external debt.

2/ Derived as $[r - g - \rho(1+g)] / (1+g+\rho+g\rho)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that NPV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 1b. Uganda: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2006-27
(In percent)

	Projections							
	2007	2008	2009	2010	2011	2012	2017	2027
NPV of debt-to-GDP ratio								
Baseline	5	9	10	12	13	13	13	10
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	5	7	8	8	8	8	7	10
A2. New public sector loans on less favorable terms in 2007-26 2/	5	9	13	16	18	19	21	18
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	5	9	11	13	14	14	13	10
B2. Export value growth at historical average minus one standard deviation in 2007-08 3/	5	10	14	15	16	16	15	11
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	5	10	13	16	17	17	17	13
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4/	5	12	18	19	20	20	18	12
B5. Combination of B1-B4 using one-half standard deviation shocks	5	12	19	21	22	22	20	13
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	5	12	15	17	18	18	18	14
NPV of debt-to-exports ratio								
Baseline	31	59	72	83	87	88	87	68
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	31	49	55	55	53	53	51	73
A2. New public sector loans on less favorable terms in 2007-26 2/	31	64	89	110	121	127	142	124
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	31	59	72	83	87	88	87	68
B2. Export value growth at historical average minus one standard deviation in 2007-08 3/	31	78	128	142	147	147	140	100
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	31	59	72	83	87	88	87	68
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4/	31	84	122	132	135	134	123	80
B5. Combination of B1-B4 using one-half standard deviation shocks	31	82	128	139	143	142	132	89
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	31	59	72	83	87	88	87	68
Debt service ratio								
Baseline	4	3	5	6	6	6	5	5
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	4	3	5	6	6	6	4	4
A2. New public sector loans on less favorable terms in 2007-26 2/	4	3	4	5	5	6	9	9
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	4	3	5	6	6	6	5	5
B2. Export value growth at historical average minus one standard deviation in 2007-08 3/	4	4	7	8	9	9	9	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	4	3	5	6	6	6	5	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4/	4	3	5	7	7	7	8	6
B5. Combination of B1-B4 using one-half standard deviation shocks	4	3	6	7	8	8	8	6
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	4	3	5	6	6	6	5	5
<i>Memorandum item:</i>								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	44	44	44	44	44	44	44	44

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 2a. Uganda: Public Sector Debt Sustainability Framework, Baseline Scenario, 2005-2027
(Percent of GDP, unless otherwise indicated)

	Actual		Historical Average 5/	Standard Deviation 5/	Estimate						Projections					
	2005	2006			2007	2008	2009	2010	2011	2012	2007-12 Average	2017	2027	2013-27 Average		
Public sector debt 1/	63.9	52.4			26.4	23.9	27.4	29.8	32.1	33.8						
<i>Of which:</i> foreign currency-denominated	50.6	47.3			17.6	21.5	24.0	26.6	28.1	28.5				33.6	26.3	
Change in public sector debt	-3.7	-11.5			-25.9	-2.6	3.5	2.4	2.3	1.7				-0.3	-0.9	
Identified debt-creating flows	-9.4	-4.4			-33.7	-1.2	0.2	-0.6	-1.5	-1.9				-1.6	-1.1	
Primary deficit	-0.3	-0.8	1.7	2.3	-0.5	0.8	1.2	0.4	-0.2	-0.1	0.3			0.0	0.0	0.0
Revenue and grants	18.8	18.3			17.6	18.2	17.3	17.5	17.5	17.7				19.0	19.0	
<i>Of which:</i> grants	7.8	7.0			5.9	6.0	4.6	4.2	4.0	3.7				3.0	3.0	
Primary (noninterest) expenditure	18.5	17.4			17.1	19.0	18.6	17.9	17.3	17.6				19.0	19.0	
Automatic debt dynamics	-8.7	-3.2			-2.6	-1.7	-0.8	-0.7	-1.0	-1.7				-1.5	-1.1	
Contribution from interest rate/growth differential	-4.0	-3.4			-3.1	-0.7	-1.4	-1.5	-1.9	-1.7				-1.6	-1.1	
<i>Of which:</i> contribution from average real interest rate	0.2	-0.1			-0.1	0.9	0.1	0.2	0.1	0.1				0.4	0.4	
<i>Of which:</i> contribution from real GDP growth	-4.2	-3.3			-3.1	-1.6	-1.5	-1.7	-2.0	-1.8				-1.9	-1.5	
Contribution from real exchange rate depreciation	-4.6	0.2			0.5	-1.0	0.6	0.8	0.9	0.1				...	...
Other identified debt-creating flows	-0.4	-0.4			-30.6	-0.3	-0.3	-0.2	-0.2	-0.2				-0.1	0.0	
Privatization receipts (negative)	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0				0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0				0.0	0.0	
Debt relief (HIPC and other)	-0.4	-0.4			-30.6	-0.3	-0.3	-0.2	-0.2	-0.2				-0.1	0.0	
Residual, including asset changes	5.7	-7.1			7.8	-1.4	3.3	2.9	3.7	3.7				1.4	0.2	
NPV of public sector debt	8.8	13.7			13.5	17.5	19.1	20.9	21.7	21.8				21.5	18.5	
<i>Of which:</i> foreign-currency denominated	...	4.8			4.6	8.6	10.3	12.1	13.0	13.0				12.8	9.8	
<i>Of which:</i> external	...	4.8			4.6	8.6	10.3	12.1	13.0	13.0				12.8	9.8	
NPV of contingent liabilities (not included in public sector debt)	...	...			...	...	...	...	...	...				...	...
Gross financing need 2/	9.7	7.0			5.9	6.5	7.2	6.3	4.9	5.8				5.7	5.7	
NPV of public sector debt-to-revenue ratio (percent) 3/	46.9	75.3			76.3	96.0	110.3	119.2	123.6	122.9				113.1	97.3	
<i>Of which:</i> external	...	...			26.1	47.3	59.6	68.9	73.9	73.7				67.3	51.5	
Debt service-to-revenue ratio (percent) 3/ 4/	18.7	13.3			10.1	8.5	10.3	10.0	10.1	9.3				8.0	7.5	
Primary deficit that stabilizes the debt-to-GDP ratio	3.4	10.7			25.4	3.4	-2.3	-2.0	-2.5	-1.8				0.3	0.9	
Key macroeconomic and fiscal assumptions																
Nominal GDP (billions of Uganda shillings)	15,176	17,234			19,307	21,374	23,715	26,102	28,813	31,430				48,536	115,749	
Real GDP growth (percent)	6.7	5.4	5.7	1.4	6.2	6.5	6.5	6.8	7.1	6.0	6.5	6.0	6.0	6.0	6.0	6.0
Average nominal interest rate on forex debt (percent)	0.8	0.9	1.2	0.4	0.4	1.6	1.2	1.5	1.6	1.5	1.3	1.0	0.9	1.0	1.0	1.0
Average real interest rate on domestic currency debt (percent)	59.8	0.3	-1.5	23.9	8.2	10.4	9.1	9.9	6.7	7.0	8.6	10.7	9.3	9.9	9.9	9.9
Real exchange rate depreciation (percent, + indicates depreciation)	-7.7	0.4	2.2	8.4	1.1	...	...	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, percent)	7.8	7.7	5.9	4.4	5.5	4.0	4.2	3.1	3.1	2.9	3.8	2.9	2.9	2.9	2.9	2.9
Growth of real primary spending (deflated by GDP deflator, percent)	-1.0	2.2			16.5	4.3	1.8	3.5	7.8	7.1	6.8	6.1	6.0	6.0	6.5	6.5

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

1/ Gross debt of the central government.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues including grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2b. Uganda: Sensitivity Analysis for Key Indicators of Public Debt 2005-2027

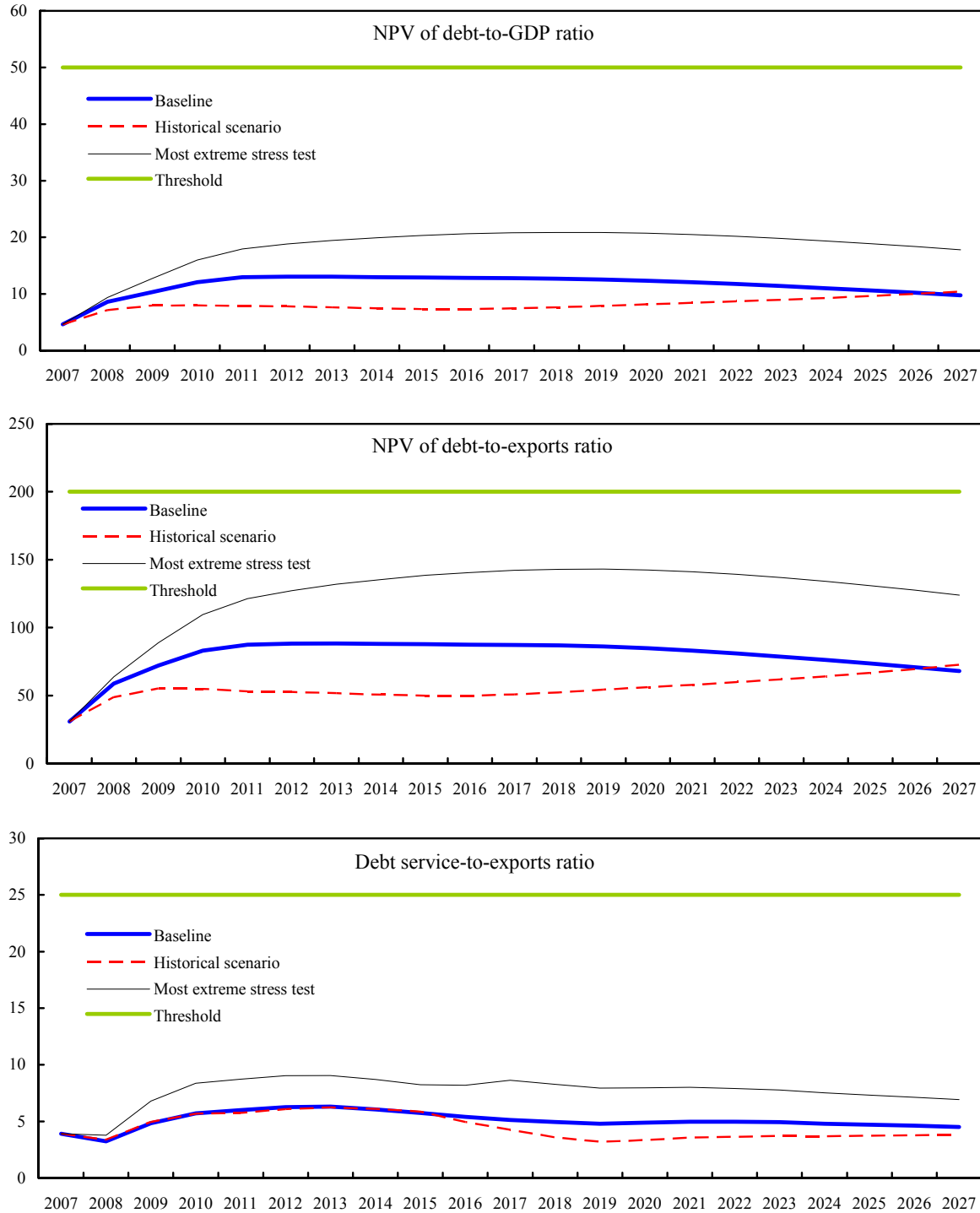
	Projections							
	2007	2008	2009	2010	2011	2012	2017	2027
NPV of Debt-to-GDP Ratio								
Baseline	13	17	19	21	22	22	21	18
A. Alternative scenarios								
A1. Real GDP growth and primary balance at historical averages	13	12	16	19	23	26	33	40
A2. Primary balance unchanged from 2007	13	10	12	13	15	16	15	10
A3. Permanently lower GDP growth 1/	13	11	15	17	19	21	23	26
B. Bound tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-2009	13	12	16	19	21	23	26	27
B2. Primary balance at historical average minus one standard deviation in 2008-2009	13	14	20	22	24	25	25	21
B3. Combination of B1-B2 using one half standard deviation shocks	13	13	18	20	22	24	23	19
B4. One-time 30 percent real depreciation in 2008	13	12	15	17	19	20	19	18
B5. 10 percent of GDP increase in other debt-creating flows in 2008	13	20	24	26	27	29	28	23
NPV of Debt-to-Revenue Ratio 2/								
Baseline	76	96	110	119	124	123	113	97
A. Alternative scenarios								
A1. Real GDP growth and primary balance at historical averages	76	66	92	109	130	147	173	211
A2. Primary balance unchanged from 2007	76	55	69	75	85	93	80	54
A3. Permanently lower GDP growth 1/	76	62	86	97	109	119	121	137
B. Bound tests								
B1. Real GDP growth at historical average minus one standard deviations in 2008-2009	76	64	92	105	119	131	136	143
B2. Primary balance at historical average minus one standard deviations in 2008-2009	76	78	116	126	136	144	131	110
B3. Combination of B1-B2 using one half standard deviation shocks	76	72	106	115	126	134	121	100
B4. One-time 30 percent real depreciation in 2008	76	68	89	97	107	114	103	94
B5. 10 percent of GDP increase in other debt-creating flows in 2008	76	111	137	146	156	163	146	120
Debt Service-to-Revenue Ratio 2/								
Baseline	10	8	10	10	10	9	8	7
A. Alternative scenarios								
A1. Real GDP growth and primary balance at historical averages	10	8	11	11	11	12	12	17
A2. Primary balance unchanged from 2007	10	8	9	8	9	9	7	4
A3. Permanently lower GDP growth 1/	10	8	10	10	10	10	9	11
B. Bound tests								
B1. Real GDP growth at historical average minus one standard deviations in 2008-2009	10	9	11	11	11	11	10	12
B2. Primary balance at historical average minus one standard deviations in 2008-2009	10	8	13	13	12	11	9	10
B3. Combination of B1-B2 using one half standard deviation shocks	10	9	12	12	11	11	9	9
B4. One-time 30 percent real depreciation in 2008	10	9	11	11	11	11	9	9
B5. 10 percent of GDP increase in other debt-creating flows in 2008	10	8	18	13	12	12	10	11

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

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (the length of the projection period).

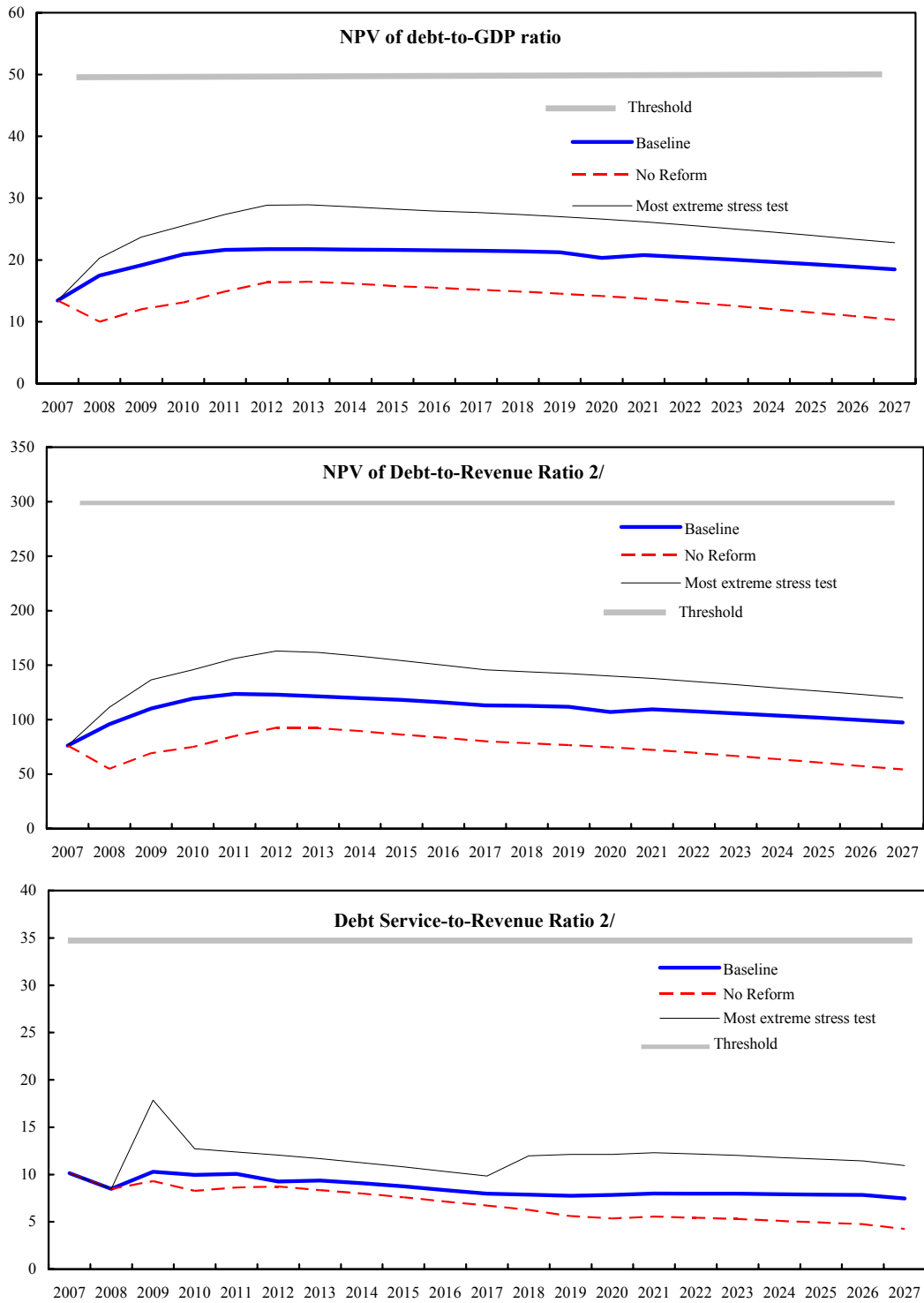
2/ Revenues are defined inclusive of grants.

Figure 1. Uganda: Indicators of Public and Publicly Guaranteed External Debt
 Government Guarantee for Building Bujagali Hydropower Plant
 (In percent)



Source: Staff projections and simulations.

Figure 2. Uganda: Indicators of Total Public and Publicly-Guaranteed Debt, 2007-2027 1/
(Percent)



Source: Staff projections and simulations.

1/ Most extreme stress test is test that yields highest ratio in 2017.

2/ Revenue including grants.



INTERNATIONAL MONETARY FUND

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

IMF Executive Board Concludes 2006 Article IV Consultation with Uganda

On December 15, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Uganda.¹

Background

Uganda's macroeconomic performance over the past 15 years has been exceptional. Per capita GDP growth exceeded the average in sub-Saharan Africa and international reserves were rebuilt following the earlier period of civil unrest. Sound macroeconomic policies contained debt and brought about price stability. Most markets were liberalized, and the banking system and state-owned enterprises were privatized. Poverty rates came down, and social spending was increased. In recent years, however, per capita growth has tapered off. This, together with volatile terms of trade and increasing income inequalities, has had a negative effect on poverty reduction.

An acute electricity crisis threatens Uganda's macroeconomic performance. The regional drought in 2005/06 reduced Uganda's already inadequate hydropower-generating capacity, resulting in a production gap of nearly one-half of demand. In consequence, many businesses and consumers were forced to rely on high-cost thermal generators. Manufacturing and high-value agriculture, most affected by power cuts, and profits in these industries, are being squeezed. While measured real GDP growth in 2005/06 (5½ percent) remained relatively high,

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.

the electricity crisis pushed nonfood inflation slightly above the 5 percent target, and the trade deficit widened because of higher oil prices and diesel fuel import volumes for thermal power generation. The wider deficit drove down the reserve import cover to about 5½ months at end-2005/06, but financing was not a concern because net donor support remained at close to 10 percent of GDP. Debt relief, through the Multilateral Debt Relief Initiative (MDRI), will augment the government's resource envelope in the short and medium term and improve debt sustainability.

Starting in February 2006, Uganda's economic program—based on the Poverty Eradication Action Plan launched in May 2005—has been supported by the IMF's Policy Support Instrument (PSI). Fiscal developments in 2005/06 were broadly in line with the program's consolidation objective. Monetary policy management, with its continued focus on using foreign exchange sales as the primary liquidity sterilization tool, helped interest rates to decline further. Base money was within the program ceiling and the stock of net international reserves of the Bank of Uganda exceeded the program floor by a large margin. On the structural front, progress was made in the repayment of arrears and in preparing guidelines on contracting, managing, and monitoring external debt. Reporting of domestic arrears under the commitment control system remains a problem, but should improve as teething problems with the new computerized system are resolved and as efforts to enforce existing rules are strengthened.

The authorities have requested a new three-year PSI in support of their near- and medium-term policies. The authorities' main objectives are to sustain macroeconomic stability while tackling the ongoing electricity crisis and addressing other infrastructure deficiencies to alleviate existing constraints on growth. Other structural measures under the program will be aimed to enhance financial intermediation and to improve management of domestic arrears and debt.

Executive Board Assessment

Directors commended the authorities' sound macroeconomic management which, together with structural reforms and substantial donor assistance, have supported Uganda's long record of high economic growth and poverty reduction. Directors noted the broadly satisfactory performance of the economy under the PSI. However, concerns were expressed about the slippage in clearing domestic arrears, and Directors welcomed the steps being taken to resolve them.

Directors observed that Uganda continues to face important challenges. Per capita growth has tapered off in recent years and the country remains heavily reliant on donor support while facing severe capacity constraints. Directors underscored that scaling up investment in infrastructure, particularly in the energy sector, deepening the financial sector, and strengthening governance and institutions are key to restoring high, sustainable income growth. In this connection, Directors welcomed the authorities' emphasis on infrastructure in their economic program for 2006/07 and the medium term. They noted that in addressing Uganda's infrastructure bottlenecks, careful attention must be paid to financing and macroeconomic considerations. Infrastructure projects should be financed mainly through grants, domestic savings, and concessional borrowing. Directors supported the cautious approach outlined in the authorities'

proposed debt strategy, which strikes an appropriate balance between the need to borrow to address infrastructure needs and recognition of the risk of a rapid debt buildup.

Directors welcomed the authorities' strategy of continued fiscal consolidation in line with Uganda's Medium-Term Expenditure Framework. They supported continued tax revenue mobilization, including by way of further efficiency gains through the ongoing restructuring of the Uganda Revenue Authority. Directors urged caution in introducing tax incentives to attract investments and called for conserving scarce tax resources to help provide for improvements in infrastructure. Fiscal consolidation will also require a continued focus on strengthening expenditure management, including in the local governments.

Directors agreed that Uganda's independently floating exchange rate regime continues to provide an appropriate framework for macroeconomic management. They supported the Bank of Uganda's continuing emphasis on foreign exchange sales for liquidity management. Directors welcomed the authorities' work on new supervision and legal arrangements to strengthen the banking sector. They underscored the need to develop sources for long-term capital and noted the effort to promote financial services in rural areas, however, they cautioned against directed lending by the government in support of these initiatives.

Looking ahead, Directors emphasized that the authorities' goals of sustained growth and poverty reduction would require a firm commitment to implementing the planned reforms in the public finances, infrastructure, and the financial system. In addition, it will be essential to strengthen governance and efforts against corruption as part of measures needed to improve the environment for private sector participation. Directors welcomed Uganda's efforts to advance regional integration. The recently established East African Community (EAC) customs union should promote regional trade and provide a forum for discussion of trade policies and advancement of regional financial integration.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Uganda: Selected Economic and Financial Indicators, 2002/03–2006/07 1/

	2002/03	2003/04	2004/05	2005/06	2006/07 Proj.
National income and prices (percent change)	-				
GDP at constant prices	4.4	5.7	6.7	5.4	6.2
Nonfood inflation (average)	2.4	5.0	4.7	5.2	6.1
Money and interest rates					
M2 (percent change)	17.3	10.0	12.1	18.9	13.8
Velocity (GDP/M2) 2/	7.3	7.2	7.4	7.3	7.0
Interest rate (percent) 3/	9.6	14.1	8.5	7.8	...
External sector					
Current account balance (percent of GDP)					
(including official grants)	-5.8	-1.2	-2.1	-4.1	-5.7
(excluding official grants)	-13.5	-11.0	-10.6	-9.9	-12.7
Terms of trade (percent change, deterioration -)	7.2	5.7	1.9	18.2	-0.6
Government budget (percent of GDP)					
Revenue	12.2	12.7	12.8	13.2	13.6
Grants	6.5	9.0	7.9	6.6	6.6
Total expenditure and net lending	23.1	-23.3	-21.3	-20.6	-22.3
Overall balance (excluding grants)	-10.9	-10.7	-8.5	-7.5	-8.8
Overall balance (including grants)	-4.3	-1.7	-0.6	-0.9	-2.2
Stock of domestic debt	9.1	9.6	9.8	9.1	7.7
Net donor inflows (percent of GDP)	11.3	11.4	8.9	8.4	9.9
Overall balance of payments (US\$ millions)	112	211	240	251	194
Gross foreign exchange reserves (US\$ millions)	964	1,135	1,326	1,408	1,577
(in months of imports of goods and services)	6.1	5.8	5.6	5.3	5.3

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

1/ Fiscal year begins in July.

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

3/ Annual average rate on 91-day treasury bills.

**INTERNATIONAL MONETARY FUND**EXTERNAL
RELATIONS
DEPARTMENT

Press Release No. 06/281
FOR IMMEDIATE RELEASE
December 15, 2006

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes the First Review under the Policy Support Instrument for Uganda and Approves a New Three-Year Policy Support Instrument

The Executive Board of the International Monetary Fund (IMF) today completed the first review under a 16-month Policy Support Instrument (PSI) for Uganda. The PSI was approved on January 24, 2006 (see [Press Release No. 06/14](#)).

The Executive Board also agreed to Uganda's request to replace the current 16-month PSI with a new three-year PSI, to support their near-and medium-term policies. The new program includes structural measures to spur private sector activity, lower business costs, and improve Uganda's competitiveness. Macroeconomic policies would continue to emphasize stability and sound management of aid flows. Uganda remains a strong candidate for a PSI with its longstanding track record of prudent monetary policies, ample foreign exchange reserves, and low external debt, particularly after the recent Multilateral Debt Relief Initiative (MDRI).

The IMF's framework for PSIs is designed for low-income countries that may not need IMF financial assistance, but still seek close cooperation with the IMF in preparation and endorsement of their policy frameworks. PSI-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners. This is intended to ensure that PSI-supported programs are consistent with a comprehensive framework for macroeconomic, structural and social policies to foster growth and reduce poverty. Members' performance under a PSI is reviewed semi-annually, irrespective of the status of the program ([see Public Information Notice No. 05/145](#)).

Following the Executive Board discussion, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, made the following statement:

“Sound macroeconomic management, structural reforms, and substantial donor assistance supported Uganda's long record of high economic growth and poverty reduction. Per capita growth, however, has tapered off in recent years. To maintain high, sustainable per capita

growth, there is a need to scale up investment in infrastructure, deepen the financial sector, and continue to strengthen governance.

“In addressing Uganda’s infrastructure bottlenecks, careful attention must be paid to financing and macroeconomic considerations. Infrastructure projects need to be well planned and financed to the extent possible through grant scaling up, domestic savings, and concessional borrowing.

“Uganda’s financial sector needs deepening to build on recent improvements in the banking sector. The government is developing new supervision and legal arrangements for the provision of long-term capital and is beginning to promote financial services in rural areas. To sustain these initiatives, it will be important for the government to avoid directed lending.

Sustaining the country’s fiscal performance will require further efforts to boost revenues and strengthen expenditure management. In this context, caution in the government’s efforts to introduce tax incentives to attract investments is warranted. The way forward for Uganda would be to use the country’s scarce resources to improve its infrastructure.

As regards structural reforms, the authorities are encouraged to press ahead with their ambitious agenda, covering the public finances, the financial system, and governance. In addition, the recently established East African Community (EAC) customs union should help promote regional trade and provide a forum for discussion of trade policies and advancement of regional integration.

“The first scheduled review under the Policy Support Instrument (PSI) is completed. As envisaged, the current 16-month PSI is being replaced by a three-year PSI. The latter is based on the approved 2006/07 budget, the Medium-Term Expenditure Framework, and Uganda’s Poverty Eradication Action Plan. The program—which meets the standard of upper credit tranche conditionality—aims at maintaining macroeconomic stability through continued prudent fiscal, monetary, and exchange policies, while preserving debt sustainability. As in the past, these would set the basis for private sector-led growth and continued poverty reduction,” Mr. Kato said.

**Statement by Peter Gakunu, Executive Director for Uganda
and Godwill Efiog Ukpong, Senior Advisor to Executive Director
December 15, 2006**

1. The Ugandan authorities express appreciation to the Executive Board and Management of the Fund for the continued engagement with the country and support of their comprehensive policy agenda. They also thank staff for preparing a balanced and instructive report on the 2006 Article IV Consultation and on the performance of the Ugandan economy under the Policy Support Instrument (PSI). They note the analysis and comments in the staff report and are broadly in agreement with its conclusions and recommendations.

Recent Macroeconomic Developments and Performance

2. The Ugandan authorities have maintained a long record of strong macroeconomic performance and structural reform, a factor which has underpinned GDP growth of 5.5 percent in 2005/06 in spite of severe drought and heightened hydro-based electricity crisis, which significantly constrained agricultural and industrial production. Similarly, sound monetary policy has helped check inflation, with underlying inflation remaining at single digits against a backdrop of high prices of oil and diesel fuel for thermal power generation. The authorities have also been successful in maintaining fiscal discipline in 2005/06, despite spending pressure arising from high energy costs and elections early in 2006, while the level of official international reserves accumulated could cover 5.5 months of imports. The successful conclusion of the Presidential elections bodes well for the strengthening of governance, while peace talks with the rebels are at an advanced stage.

3. The gains from the authorities' sound economic management notwithstanding, a number of challenges still face the Ugandan economy. These include (i) sustaining macroeconomic stability, (ii) stimulating further growth to accelerate poverty reduction, (iii) strengthening infrastructure development, (iv) improving governance and institutions, and (v) removing remaining administrative bottlenecks for private investment. The authorities are fully aware of these challenges and remain committed to maintaining macroeconomic stability and accelerating market-based reforms. They are already taking relevant measures to address identified constraints to growth, including the use of diesel generators on a temporary basis to help solve the problem of inadequate electricity generation and distribution while sourcing long-term funds to complete the building of two dams; revamping road networks to facilitate the movement of goods and services; encouraging financial deepening and lending to the rural poor; and investigating financial mismanagement and restructuring the Ugandan Revenue Authority (URA) to further improve governance.

Performance under the Policy Support Instrument (PSI)

4. In spite of the afore-mentioned challenges, the macroeconomic objectives under the PSI were achieved, with all quantitative assessment criteria for end-June 2006 met. The indicative target on minimum expenditures under the Poverty Action Fund was also reached,

but public administration spending exceeded the ceiling by 0.2 percent of GDP owing largely to unanticipated election costs. The reported domestic arrears under the Commitment Control System (CCS) were above the indicated target. There was, however, an improvement as initial teething problems of computerization of the system were solved. The assessment criterion on repayment of old arrears was met, but the strategy paper for avoiding domestic arrears was submitted with delay as it became more ambitious than originally planned, while provisions for arrears payment in 2006/07 budget have been doubled. Progress was also made in meeting the structural benchmarks, including completion of budget contingency regulations, and preparation of guidelines on contracting and monitoring external debt.

5. Fiscal developments were broadly in line with the program and the consolidation objective. At the same time, prudent monetary policy kept base money growth below the program ceiling, while the stock of net international reserves of the Bank of Uganda (BOU) exceeded the program floor by a large margin. Credit to the private sector increased significantly (28 percent), while strong prudential oversight of the banking system kept the level of nonperforming loans low. Against the backdrop of their firm commitment to reforms and resolute actions already taken to address the slippages relative to some indicative targets, the authorities request waivers for the nonobservance of assessment criteria on (i) delayed submission of a new arrears strategy and (ii) the provision for domestic arrears repayment in 2006/07 because of the imperative to address first a severe drought-induced electricity crisis.

Macroeconomic Policies for 2006/07 and the Medium-Term Policy Challenges

6. A major objective of the Ugandan economic reform program is to maintain macroeconomic stability through the implementation of prudent fiscal and monetary policies and market-based reforms in order to meet the medium-term challenge of sustaining economic growth at a rate consistent with significant poverty reduction. As outlined in the country's Poverty Eradication Action Plan (PEAP), sustaining higher growth would depend on finding ways to scale up transportation infrastructure and utilities, improve access to rural finance, and remove barriers to investment, and continuous focus on education to strengthen the labor force. As a result of the installation of more electricity generation capacity, financial sector reforms with new supportive measures to build a more dynamic financial sector serving a wider group of private enterprises, macroeconomic conditions are expected to improve in 2006/07. Real GDP growth is therefore, projected at 6.25 percent, and underlying inflation at 6 percent, reflecting increases in energy-related prices. In line with the PEAP, the medium-term framework (baseline- which anticipates further macroeconomic improvements) projects an annual GDP growth of 6-7 percent and an inflation rate of 4-5percent.

7. The authorities are aware of the medium term risks associated with the selection and implementation of infrastructure projects as well as with respect to rapid debt buildup and more government intervention in the economy. They are, therefore committed to taking appropriate actions to manage risks effectively, while correcting for market failures as warranted.

Fiscal Policy and Public Sector Reforms

8. The 2006/07 government budget aims at continued fiscal consolidation in line with the country's Medium-Term Expenditure Framework (MTEF), but at an appropriate slower pace than originally contemplated owing to electricity crisis. The overall fiscal deficit (excluding grants) is projected at over 1 percent of GDP, but would remain unchanged compared with the 2005/06, excluding spending on the energy crisis. Tax revenue is estimated to increase by 0.4 percentage points of GDP on account of efficiency gains arising from the modernization of the Ugandan Revenue Authority (URA) and implementation of new measures introduced in the 2006/07 budget, including excise taxes and fees. The government has also decided to address further the problem of tax system reform and public procurement to help boost tax compliance and revenue. In this regard, the authorities consider staff caution against unguarded introduction of tax incentives to attract investment as appropriate, given the associated revenue loss. Improved public expenditure management is being entrenched, including at sub-national levels. At the federal level, items of expenditure are being provided for in the budget, including salary increase for primary school teachers, one-time spending for hosting the Commonwealth Heads of Governments meeting in October 2007, and doubling of domestic arrears clearance to 0.8 percent of GDP.

9. Furthermore, existing initiatives to prevent new arrears have been strengthened through reliance on strict discipline and punitive actions against accounting officers violating the Commitment Control System (CCS). On the whole, while MDRI debt relief has potentially given the country room to borrow externally, prudent fiscal policies have kept domestic debt low and the government's draft debt strategy envisages a cautious approach to new borrowing to avoid future debt distress.

Monetary and Financial Sector Policies

10. The authorities' monetary program will continue to target base money with a view to bringing underlying inflation back to 5 percent or below by 2007/08, compared to an expected inflation outturn of close to 6 percent in 2006/07 owing to higher energy prices. The independently floating exchange rate regime of the BOU continues to provide an appropriate framework for macroeconomic management. The BOU will continue to employ a mix of foreign exchange sales and open market operations to sterilize foreign exchange inflows. In order to deepen the financial sector and help develop sources for long-term capital, following the completion of restructuring of banks, the monetary authority is working on new supervision and legal arrangements for the sector. The restructured Ugandan Development Bank (UDB) will also be operating on commercial principles. The government is expected to implement its decision to assist member-owned savings societies with technical support to bring savings accounts and eventually loans to underserved rural areas. The authorities agree with staff advice on the need to refrain from direct lending that would undermine these banking and financial institutions.

Other Structural Reforms and Policies

11. The authorities have been implementing far-reaching reforms which have so far yielded many positive results. Some of the ongoing structural reform policies aim at ensuring probity and improved governance and thus include quarterly publication of a “shame list” of violators of the CCS; budgetary allocation for public utility bills and prepayment system; and prevention of new and recurrent pension arrears by fully budgeting for them. On the revamping of infrastructure, the authorities are working to secure financing from the World Bank to complete the construction of the Bujagali dam, while planning carefully for the Karuma dam, including possible financing through grants, domestic savings and concessional loans. The authorities are committed, subject to resource constraint, to the promotion of regional integration by revamping railways and roads and improving communication infrastructure to facilitate trade and create better conditions for the private sector to serve as the engine of growth of the economy.

12. My authorities appreciate staff’s effort to examine some very pertinent issues affecting investment inflows, credit to the private sector and trade in the East African countries of Kenya, Uganda and Tanzania in their selected issues paper. The issues raised are very important, given their fundamental policy implications. However, this paper could have benefited more, if staff had shared their findings with the authorities of the three countries before making their final conclusions and presenting this paper to the Board. Therefore, we are not in a position to comment on both the findings and recommendations in the paper, and reserve the right of the authorities of the three countries in accordance with the Fund’s deletion and publication policy.

Conclusion

13. The Ugandan authorities have demonstrated strong commitment to the implementation of sound macroeconomic and structural reforms to improve economic management and induce high growth for poverty reduction and attainment of the MDGs. Going forward, the government budget strategy aims at continued fiscal consolidation in line with MTEF in order to sustain macroeconomic stability, enhance competitiveness and create a favorable environment for private sector-led growth. The success of the strategy will depend largely on the capacity of government to generate more revenue and effectively focus on priority spending, including the financing of infrastructure development to support investment and growth. Ongoing tax reforms and the discovery of oil during the year are expected to significantly enhance revenue generation in the medium term. The authorities are using the financial resources from the MDRI to facilitate the achievement of the PEAP objectives and MDGs in a manner consistent with their fiscal and monetary policies. They are committed to exercising caution in contracting external debt by resorting to grants and concessional loans. They are also committed to avoiding the accumulation of unsustainable debt to maintain debt sustainability. Given their commitment and resolve to continue to implement the PSI program effectively for the benefit of their people, the authorities count on sustained support of the international community, including the Fund, to strengthen their efforts to address the challenges facing the economy. They, therefore, request for waivers for non-observance of an assessment criterion and delayed observance of another as well as

approval of the request for a new three-year PSI.