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Press Release:

IMF Executive Board Completes the First Review under the Policy Support Instrument for Uganda and Approves a New Three-Year Policy Support Instrument
December 15, 2006

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Uganda: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

November 29, 2006

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

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.

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

[1] Uganda's latest PEAP and Joint Staff Advisory Note were considered by the Executive Board in July 2005 (EBD/05/74). An implementation report is currently being prepared and is expected to be made available to the IMF and other partners in mid-2007.

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.
Assessment criteria	(In billions of Uganda shillings)			
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
Indicative target	(In billions of Uganda shillings)			
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 USh 27 billion at end-June 2005.

Table 2. Uganda: Structural Assessment Criteria and Benchmarks[1]

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.

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 due[2] 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 financing[3] 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.

[2] Debt service due is defined as pre-HIPC Initiative debt service due, but from 2003/04 onwards, this excludes HIPC Initiative debt rescheduling.
[3] 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.[4] Nonconcessional borrowing is defined as loans with a grant element of less than 35 percent, calculated using average commercial interest rates references (CIRRs) published by the Organization for Economic Cooperation and Development (OECD). In assessing the level of concessionality, the 10-year average CIRRs should be used to discount loans with maturities of at least 15 years, while the 6-month average CIRRs should be used for loans with shorter maturities. To both the 10-year and 6-month averages, the following margins for differing payment periods should be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–25 years; and 1.25 percent for 30 years or more. The ceiling on nonconcessional external borrowing 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

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

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 bodies[5] 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 .

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[5] 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;	Monthly	5 weeks

Table 1. Summary of Reporting Requirements

Reporting institution	Report/Table	Frequency	Submission lag
	(iv) new nonconcessional external borrowing; and (v) net international reserves		
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 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.	Monthly	6 weeks
	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