September 7, 2001
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 01/30

10:00 a.m., March 26, 2001

Contents

Decisions Taken Since Previous Board Meeting

Executive Board Attendance

S. Sugisaki, Acting Chairman

Executive Directors	**Alternate Executive Directors**
S.M. Al-Turki	A.S. Alosaimi
	A.S. Al Azzaz, Temporary
A. Barro Chambrier	D. Ondo Mañe
	P.R. Fenton, Temporary
	W.-D. Cho, Temporary
	S. Antic, Temporary
	R. von Kleist, Temporary
	C.A.E. Sdralevich, Temporary
	M.P. Bhatta, Temporary
	V. Bhaskar, Temporary
	J. Sipko, Temporary
	T. Elkjaer, Temporary
	L. Redifer, Temporary
	G. Bauche
	M.R. Shojaeddini, Temporary
	I. Zakharchenkov, Temporary
	R. Villavicencio, Temporary
S. Pickford	M. Walsh, Temporary
	A. Maciá, Temporary
	I. Usman
A.S. Shaalan	A.F. Al-Faris
	S.A.K. Bakhache, Temporary
	A.Y.T. Wong, Temporary
	P.A. Nijsse, Temporary
	K. Harada, Temporary
	R. Maino, Temporary

A. Mountford, Acting Secretary
J. Prust, Acting Secretary
W.T. Davidson, Assistant
M. Schulte, Assistant

Also Present

IBRD: R. Brigish, S. Kahkonen, Africa Region Office; F. Hadad-Zervos, Middle East and North Africa Region Office. African Department: G.E. Gondwe, Director; J. Fajgenbaum, Deputy Director; G. Kalinga, A.Y. Kyei, C.J. McAuliffe, P.O. Sakho, R. Van Til. External Relations Department: A. Gaviria, C.N. Lotze. Fiscal Affairs Department: M.G. Inchauste. Legal Department: B. Steinki. Middle Eastern Department: P. Chabrier, Director; A.H.M. Alabdulrazzaq, U. Fasano. B. Guerami, K. Nashashibi, V.C. Thai. Monetary and Exchange Affairs Department: A.M. Andrews, O. Nyawata. Policy Development and Review Department: M.J. Fetherston, M.T. Hadjimichael, S.M. Tareq. Secretary's Department: L. Hubloue, P. Ramlogan. Advisors to Executive Directors: J.M. Abbott, J.A. Chelsky, V. de los Santos, S.S. Farid, N. Guetat, J.M. Jones, Liu F., Y. Patel, K. Sakr, C.-P. Schollmeier. Assistants to Executive Directors: J.G. Borpujari, S. Boucher, N. Burnashev, I.- K. Cho, G. De Blasio, E. González-Sánchez, S.K. Keshava, E. Kornitch, T.-M. Kudiwu, J.K. Kwakye, D. Merotto, E. Nyambal, Y. Saito, S. Sharipova, A. Sutt, D. Vogel, D.B. Waluyo, N. Yeritsyan.

1. UGANDA—2001 ARTICLE IV CONSULTATION; POVERTY REDUCTION AND GROWTH FACILITY—THIRD ANNUAL ARRANGEMENT—REVIEW, AND WAIVER OF PERFORMANCE CRITERIA; AND POVERTY REDUCTION STRATEGY PAPER—PROGRESS REPORT AND JOINT STAFF ASSESSMENT

The Executive Directors considered the staff report for the 2001 Article IV consultation with Uganda, the second review under the third annual arrangement under the Poverty Reduction and Growth Facility (PRGF), and Uganda's request for waiver of performance criteria (EBS/01/33, 3/12/01; and Cor. 1, 3/23/01), together with the poverty reduction strategy paper progress report prepared by the government of Uganda (EBD/01/29, 3/12/01; and Cor. 1, 3/15/01) and a paper containing the joint staff assessment of the poverty reduction strategy paper progress report (EBD/01/28, 3/12/01; and Cor. 1, 3/15/01). They also had before them a statistical appendix (SM/01/91, 3/19/01).

The staff representative from the African Department (Mr. Kalinga) submitted the following statement:

> Presidential elections were held on March 12, as provided in the Constitution. The incumbent, President Museveni, won the elections in the first round with 69.3 percent of votes, followed by Dr. Kizza Besigye, who received 29.4 percent of the votes. The other four contenders received the remaining 1–2 percent of the votes. The counting of the votes was completed within 48 hours. Although the elections were held in a relatively peaceful atmosphere, there were widespread reports of vote rigging and intimidation of voters. Dr. Besigye has refused to accept the results of the elections and has asked the Supreme Court to nullify the election results.
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> The initial statement issued by the Danish Ambassador, in his capacity as the Chairman of the Post-Referendum Support Group (PRSG), indicated that the donor community generally supported the election process and was of the view that the voters got the candidate they had voted for. The donors acknowledged also that the six presidential candidates were able to campaign throughout the country and to present their policies through the media. However, they noted the statement issued by the NGO Election Monitoring Group–Uganda indicating that, while overall the election process was generally fair, there were incidences of fraud and voter intimidation that marred the later stages of the presidential campaign. The donors indicated that they would await the Electoral Commission's response to the charges of mismanagement of the election process that have been raised by the Election Monitoring Group–Uganda.
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> Since the March 12 elections, the Minister of Finance has confirmed that the stance of economic policies outlined in the Letter of Intent remains valid. The staff will continue to monitor the situation closely, particularly the reactions of donors to political developments.

Mr. Usman submitted the following statement:

My Ugandan authorities are appreciative of the efforts made by the staff to produce the set of documents for today's discussion. They have found the discussions on the Article IV consultation and the second review under the third annual arrangement under the PRGF, as well as the exchange of views on the progress being made in the context of the poverty reduction strategy to be constructive and helpful in further strengthening their dialogue with the Fund. They view the staff report as reflecting a fair evaluation of the recent economic developments in Uganda and are broadly in agreement with its conclusions. They also welcome the joint assessment of the country's PRSP progress report 2001, prepared in cooperation with the staff of the World Bank.

In the recently held elections in the country, the incumbent President was re-elected and the ruling party retained power in the government. My authorities intend to use this opportunity to redouble their efforts in order to ensure further progress towards macroeconomic stability and stronger and sustainable growth that would significantly impact on poverty reduction. No doubt, financial support from the donor community will continue to play, for the time being, a key role in facilitating the authorities' difficult task of pursuing the course of reform and poverty alleviation.

The progress made on both the adjustment and reform fronts has been steady over the years and much credit is due to the authorities' firm determination in implementing sound financial policies and strong structural reforms. As a result, Uganda was among the first countries to benefit from the original HIPC Initiative and the only one so far, to have reached the completion point under the enhanced HIPC.

Economic performance over the past year and the implementation of the 2000/01 program need to be evaluated against the backdrop of the situation of insecurity persisting in parts of the country and in the subregion, and the 2001 presidential and parliamentary elections. Also, Uganda's economy has in the recent past suffered the effect of the adverse external environment reflected in the 15 percent deterioration in its terms of trade in 2000/01 in addition to the 14 percent decline endured in the previous year. The decline in economic activity can also be associated with lower coffee production which was seriously affected by the outbreak of the wilt disease and a 36 percent drop in export prices. As a result, real GDP growth reached 5 percent, somewhat below the program target of 6 percent. This nevertheless robust result in output growth for 2000 was mainly secured by the strong rebound in other food crop production, to which many farmers are increasingly turning, as an alternative providing higher market returns. Despite the depreciation of the shilling and the significant increase in the prices of imported petroleum products with retail prices rising by 9–2 percent, the 12 month rate of inflation through December 2000, was contained at 4.2 percent.

Although the external sector remained under substantial pressure as a result of exogenous shocks and a sharp decline in coffee export earnings, a higher than projected level of donor support assisted in the buildup of foreign reserves to about five months of imports of goods and services.

During the first half of the program period, fiscal performance in general, responded to the expectations, with the overall deficit, before grants, being limited to 4.3 percent of GDP. A larger than anticipated inflow of donor budgetary support, owing to late disbursements during the preceding program period, covered not only the deficit but also allowed net repayments to the banking system.

Despite the authorities' efforts to prudently manage the budgetary resources, weaknesses in expenditure management persisted, in particular, those at local government level, leading to the emergence of new domestic arrears. To address these problems the authorities intend to reinforce the operational capacity of the Commitment Control System (CCS), which was also extended to cover the development budget since October 2000.

Monetary policy was directed to pursuance of its central objective of price stability. Although monetary management has been complicated by the shift in the composition of monetary aggregates in favor of foreign currency-denominated deposits, the use of open market operations has assisted in limiting their expansionary effect.

Notwithstanding the unfavorable environment under which the authorities have been implementing the reform measures, they managed to observe most of the quantitative performance criteria and benchmarks for end-September 2000 and end-December 2000, with the exception of the accumulation of new budgetary arrears, on account of failure by some ministries to effectively control commitments. All structural performance criteria and most structural benchmarks have also been met, although a few of them with a slight delay owing to technical reasons. In this regard, the authorities are hopeful that the Board will give favorable consideration to their request for waivers for the missed performance criteria.

The authorities have demonstrated for well over a decade their commitment to the adjustment effort by the firm implementation of a wide range of stabilization and structural measures, at times, in an environment that has not been supportive. They intend to redouble their efforts during the remainder of the fiscal year, in part to address the setbacks faced during the earlier part of the year. Moving forward, the authorities now intend to focus their actions on strengthening institutional and implementation capacity especially at the local government level, minimizing the cuts in essential development expenditures in the face of the shortfall in revenue and unanticipated higher expenditures, maintaining a prudent monetary policy geared to support the inflation objective, and closely monitoring the financial situation of some troubled banks.

The overall fiscal deficit, excluding grants, is now expected to increase by 1.0 percent of GDP, mainly on account of the effects of the sharp depreciation of the local currency. The authorities intend to make use of the contingency reserve and cuts on nonessential expenditures to accommodate the unanticipated outlays arising from the supplementary appropriations and higher interest payments. The deficit will however, be financed by external resources, allowing the government to hold a stronger than envisaged position with the banking system. Improvements in revenue performance are expected to result from measures to strengthen tax administration to enhance the efficiency of tax collection and reduce smuggling. To this effect, a new Acting Commissioner-General of the Uganda Revenue Authority (URA) has been appointed and additional budgetary resources have been committed to the authority with a view to strengthen its capacity. A separate bill proposing an amendment to the Customs Law to remove the provision for granting exemptions by the Minister of Finance will be placed before parliament by June 2001. Other specific measures to raise additional revenue include the appointment of a working group by the Ministry of Finance to develop a medium-term strategy to enhance the revenue effort.

On the expenditure side, the authorities will be stepping up their efforts to control public spending in less essential areas in order to ensure that high priority is given to accommodating increased social expenditure and investment. To this end, the budget management system will continue to be strengthened, including through the enhancement of the operation of the CCS and imposition of stiffer penalties for misleading and misreporting of over commitments. Starting from next fiscal year, in order to ensure that essential development expenditures are protected, the authorities intend to take measures to limit the use of the contingency reserve to fund unanticipated outlays.

Given the shortfalls encountered in the first half of the fiscal year in attaining some of the output and outcome indicators set under the Poverty Eradication Action Plan (PEAP), the authorities have already taken measures to overcome some of the constraints. In this regard, they simplified the entry requirements to the teaching services thus allowing an increased number of teachers to be recruited. Also the procedures for newly recruited civil servants to access the payroll has been streamlined. Given the role of the local governments as main providers of social services, and in light of the existing weaknesses in accounting for budgetary resources, the authorities are planning to conduct workshops on the preparation of monthly accounts at the district and sub-county levels to improve their capacity to report and sensitize them about the importance of enhancing accountability.

In view of the recent price developments, the authorities will continue to monitor closely the behavior of the monetary aggregates and are committed to tightening monetary policy if required to attain the inflation target. The Bank of Uganda (BOU) is firmly determined to strengthen its supervisory role to ensure the solvency of the banking system. Prudential regulations will be strictly enforced through annual on-site inspections of all banks. The exchange rate will continue to be market determined and BOU's intervention will be limited to maintaining orderly conditions in the foreign exchange market. In this respect, the authorities would welcome Fund's technical assistance to review the conduct of monetary and exchange rate policy.

As in the past, the authorities will continue to work towards further liberalization and streamlining of Uganda's trade regime. In this context, they have undertaken among other measures to remove the special protection given to textiles and to gradually eliminate some excise duties in the context of regional arrangements. Their decision to postpone the elimination of the protection accorded to sugar industry has been based on the recommendation of the study of the effects of this protection and out of concern to find an alternative to safeguard the social benefits currently provided by the industry.

Having reached the completion point under the enhanced HIPC Initiative, Uganda is now in the process of concluding the bilateral arrangements with its creditors on the terms agreed with the Paris Club. The release of the resources from the debt relief will strengthen the authorities' capability to pursue their goal to eradicate poverty. The implementation of the government's strategy in this regard, has led to impressive results so far, as denoted in the PRSP progress report. Household consumption has risen significantly and income poverty has been on the decline. The proportion of the population living below the poverty line declined from 56 percent in 1992 to 35 percent in 2000. At this pace, and with the maintenance of prudent policies, the government's objective to reduce poverty to 10 percent by 2017 appears to be well within reach.

However, the benefits of improved living standards were not equally distributed across the population, with the poorest decile reaping less than half of the benefits obtained by the richest decile. It was also reflected in the widening of regional inequality as well as of the urban-rural gap. While the reasons behind these factors are not yet fully understood, the authorities agree with the staff that a further analytical work is necessary, which they will attempt to address in future progress reports. In the meantime, and given that the majority of poor live in the rural areas, the government's strategy is to accord high priority to rural development. To this end, they intend to speed up the implementation of the Plan for the Modernization of Agriculture which focuses on improving the conditions for small-scale farmers.

The authorities recognize that the gains from growth have not been evenly distributed and that the eradication of poverty, particularly in the rural areas, will require a substantial strengthening of the institutional capacity to ensure that basic services do effectively reach the poor and make a difference in their lives, although reasonable progress has been made to date. To ensure that the resources made available for poverty reduction are efficiently used for the intended purposes, the authorities, in addition to taking measures to improve the financial management, will carry out annual expenditure tracking studies to monitor actual spending.

Despite Uganda's economic and social achievements, my authorities are fully aware that much more remains to be done, particularly to improve living standards for the poor. Their commitment to continue on the path of reform remains unabated and they are firmly determined to maintain the momentum in the implementation of their poverty eradication strategy. They stand ready to adopt all necessary measures to ensure that the program objectives are achieved.

Mr. Djojosubroto submitted the following statement:

With the implementation of the Poverty Eradication Action Plan (PEAP), the poverty level in Uganda has been reduced significantly to 35 percent in 2000 from 44 percent in 1997. We commend the authorities' determination to lower the level to 10 percent by 2017.

Although the poverty level is declining, income disparity has increased substantially across regions and between genders. The income gap between the rural and urban population is widening and most women in the rural areas continue to live in poor conditions. The development strategy therefore needs to emphasize both growth and equity with special attention paid towards women in the rural areas. As most of those living below the poverty line depend on agriculture, the development strategy should aim at modernizing the agricultural sector.

Women constitute 75 to 80 percent of agricultural labor in Uganda. But their access to basic services and decision making is insignificant. The authorities may therefore wish to consider introducing special programs for women, such as micro credit for women in the rural areas similar to the model initiated by Bangladesh which has been adopted by many other developing countries.

Besides poverty and income inequality, Uganda is also seriously affected by HIV/AIDS pandemic. As there are complex interlinkages between poverty, income inequality and health, HIV poses a serious threat to the country's efforts in fighting poverty. Human capital is the most important element for development and, therefore, the country should consider all possible preventive measures to protect its people in the most productive age-group from the dangerous disease that is rapidly spreading across the country. Besides increased delivery of health and education services, extensive programs should be carried out throughout the country to warn the masses about the hazards of AIDS and immunize them against the deadly disease.

Although the country has made significant progress in reducing the level of poverty and sustaining moderate growth, the medium term macroeconomic prospects still remain fragile. The poor fiscal position still remains one of the problem areas where reforms are much needed. In 1999/2000, the budget deficit widened significantly and was projected to only decrease slightly in the year 2000/01. The revenue to GDP ratio declined owing to weak revenue administration and the poor capacity of the local authorities to manage their public finances. It is therefore necessary for the authorities to strengthen and restructure their revenue administration and also build capacity in PEM. Technical assistance should be requested from the Fund in this area.

In the monetary sector, the conditions during the first quarter of 2000/01 were broadly consistent with the inflation objective under the program. The BOU had succeeded in containing underlying inflation to 5 percent by controlling liquidity conditions through a broad range of monetary aggregates. Despite these positive developments, we are concerned with the impact of a sharp depreciation of the shilling on the monetary situation for the remaining quarters of 2000/01. As pointed out in Box 7, the depreciation of the shilling had caused depositors and commercial banks to hedge their exposures by shifting into foreign currency deposits and loans, which increased quite substantially in the second half of 2000. Thus, the composition of foreign currency-denominated deposits in broad money (M3) have exceeded the program target since June 2000, to a level which is slightly above that of currency outside bank. This reflects a shift in the composition of monetary aggregates, which in turn would complicate the management of monetary policy in the near future as the reliability of these aggregates as indicators of the domestic monetary conditions weaken. Given that Uganda has a market-determined exchange rate system, we underscore the need for the authorities to adopt policies that can maintain relative stability in the exchange rate that will be conducive for the management of monetary policy, domestic inflation and the country's trade competitiveness. In this regard we support the authorities request for Fund technical assistance to review the present conduct of monetary and exchange rate policy.

With regard to the financial sector, we commend the authorities for the positive developments in the banking sector, in particular the moves to raise the banks' capital adequacy ratios as part of the authorities' efforts to build a sound financial system. It is encouraging to see that BOU has already undertaken measures to strengthen the functioning of the banking system, including intensifying its surveillance of banks. Nevertheless, even though banks' compliance with prudential regulations and governance have been slow, no bank has been penalized for such non-compliances. In this context, we strongly encourage the BOU to act on its commitment to rigorously enforce the banking regulations and enhance its bank supervision capability.

We are pleased to note that Uganda, with the support of the World Bank and other donors, is initiating major energy sector projects to generate adequate energy for domestic consumption as well as for export to the neighboring countries. The country, thus can boost its economy through the proper utilization of its hydropower resources in the coming years.

With these remarks we support the authorities request and the staff recommendations for waivers for non-observance of the performance criteria and completion of the second review of the third annual arrangement under the PRGF.

Mr. González-Sánchez submitted the following statement:

We congratulate the staff for the comprehensive set of papers on Uganda, as well as Mr. Usman for his informative preliminary statement. External shocks—in the form of a drastic deterioration of the terms of trade—have continued to negatively affect Uganda's economy, although their effects on economic activity are expected to be partially offset by the positive effect of the exchange rate depreciation on non-coffee products and the recovery of food crop production. In this context, the authorities are to be commended for the relatively strong economic performance of the country's economy in recent years, the moderate consumer price inflation—in spite of the sharp increase in petroleum products and the depreciation of the domestic currency against the U.S. dollar—and the effective implementation of structural reforms and the Poverty Eradication Action Plan (PEAP). Multiple challenges remain—as shown, among other factors, by the unequal distribution of the benefits of improved living standards, and the widening of the rural-urban gap—but the authorities have demonstrated their willingness to reduce poverty and their commitment to economic stability.

We share in general the staff's appraisal, and would like to make the following comments. Concerning the financial system, we consider that the actions taken by the authorities to strengthen the financial system are steps in the right direction, although more remains to be done, including the adequate compliance with prudential regulations and governance and the re-privatization of the Uganda Commercial Bank Ltd. Technical assistance of the Fund aimed at the strengthening of the financial system will be useful.

Particularly noteworthy is the authorities strategy to combat the HIV/AIDS pandemic, which has lead to significant declines in HIV prevalence rates. Uganda's case is one of the few success stories in the war against HIV/AIDS, and we consider that valuable lessons can be derived for other countries in similar conditions.

There has been a substantial fall of the new budgetary over commitments, which is welcome, as budget management is strengthened, however, these over commitments were contrary to program understandings. Although some of these over commitments might have been unavoidable, we learn from the staff's report that some of the arrears can be avoided with prudent management of budgetary resources, therefore, we encourage the authorities to take appropriate measures to improve the budget's management. As budget management is particularly weak in local governments, and given that local authorities are now the main providers of social services, it is of utmost importance to strengthen the capacity of local authorities to manage budgets and implement projects. In this respect, we welcome the authorities' intention to reinforce the operational capacity of the Commitment Control System, as well as the plans to conduct workshops to improve the capacity of local governments in the budget administration.

Uganda faces a difficult outlook. Coffee export prices at low levels, uncertainty concerning petroleum import prices and political tensions in the sub region give shape to the external front, while in the domestic front the wilt disease has severely damaged the coffee crop and there is insecurity related to the political instability in the sub region. In this framework, fiscal prudence and a cautious monetary policy are essential for economic stability.

The country also needs the support of the international community, and the Fund must stand ready to attend the Bank of Uganda's request for technical assistance in the area of monetary and exchange rate policy. Concerning the latter, the flexible exchange rate system currently in place in Uganda has proved to be a useful tool to mitigate the recent adverse external shocks. We concur with Mr. Usman that the recent re-election of the incumbent President provides a opportunity to continue the efforts aimed at macroeconomic stability and poverty reduction We welcome the authorities comprehensive institutional framework to deal with governance, transparency and accountability issues in the public sector. This is an appropriate measure considering the persistence of corruption.

We support the authorities' request for waivers for the performance criteria for September and December 2000, and the completion of the second review of the third annual arrangement under the PRGF, and encourage them to address the deviations of these structural clauses from the original program. We wish the authorities success in their policy endeavors.

Mr. Shaalan and Mr. Bakhache submitted the following statement:

Progress toward fiscal and external sustainability, higher growth and lower poverty has been steady and substantive in Uganda as evidenced by the positive developments in these areas over the past several years. Prudent financial policies, including a flexible exchange rate system, along with the successful implementation of a number of structural reforms has helped improve the resilience of the economy. Indeed, overall economic performance in 2000/2001, although somewhat weaker than originally projected, continued to be broadly in line with what was envisaged under the program in spite of the adverse impact of the terms of trade shock. Notwithstanding this improvement, the economy remains dependent on foreign concessional flows—which also helped contain the impact of the TOT shock—and is highly vulnerable to external shocks. We are encouraged that the authorities are well aware of the need to maintain the current momentum of adjustment and reform as reflected in their desire to request a new PRGF arrangement following the expiration of the current one, which we support.

Regarding the current arrangement, we have no difficulty agreeing to the requested waivers and the completion of the second review under the third annual PRGF arrangement. The breach of performance criteria relating to outstanding arrears and accumulation of arrears should be addressed expeditiously and we are encouraged by the authorities' action in this regard.

We are broadly in agreement with the staff's analysis and policy recommendations and will briefly comment on some of the issues covered in the staff report, and address a couple of issues relating to the Poverty Reduction Strategy Paper Progress Report and the Joint Staff Assessment.

Turning to the Article IV report and the second review under the third PRGF, we would like to emphasize the importance of maintaining disciplined financial policies at a time when the country is facing the compounded effect of external and internal shocks. The fiscal framework has been appropriately revised to account for the effect of the exchange depreciation on external payments. Given that the negative effect of slower than projected growth on revenues is likely to be offset by the positive effect of the shilling's depreciation, the targeted deficit appears to be achievable. The authorities will need to focus their efforts on enhancing revenue performance including by controlling evasion, limiting exemptions as well as strengthening the Uganda Revenue Authority. Regarding budget management, we are encouraged by the steps taken to include the development budget under the Commitment Control System. Among other relevant measures in this connection, spending commitments need to be contained within set limits in order to avoid further accumulation of arrears. The credibility of the budgetary process is critical for enhancing confidence in the economy. Also, in this regard, the use of emergency cuts to reduce pressures on the budget need to be guarded against as these cuts could also jeopardize essential development spending. Given the increasing role of local governments in the provision of social services we welcome the efforts to strengthen the budget management and reporting system at the district level as well as the efforts to streamline donors' requirements regarding establishing separate bank accounts for projects.

Good progress in improving the banking system and strengthening the bankruptcy law was made. However, regarding the solvency of banks, footnote 17 of the staff report suggesting that banks capital may be overstated is worrisome. Improving the central bank's supervisory capability and its ability to enforce regulation ought to be given high priority with a view to further enhancing the soundness of the banking system. We concur with the staff's assessment of monetary policy and the objective of technical assistance to help the authorities in refining the framework for the conduct of monetary and exchange rate policy, with special attention to rising U.S. dollar-denominated assets.

On the PRSP progress report, we are in broad agreement with the Fund and World Bank staff assessment particularly on the significant progress made in reducing the incidence of poverty. The report also points to some evidence of rising inequality that the staff suggest should be addressed by adjusting the poverty strategy. Here, it is worth noting that inequality has risen between rural and urban areas and between the north and the south. Regarding the latter, the lack of security in the north is a possible contributory cause. As for the rural-urban inequality, it is essential that in attempting to address this phenomenon, the authorities maintain the high premium they have placed on implementing policies aimed at enhancing productivity and efficiency in the economy and hence its growth prospects. The staff's recommendation to accord a high priority on rural development by improving conditions for small-scale semi subsistence farmers is appropriate. Beyond this, we believe that caution should be exercised in trying to address rising inequality when its underlying causes are not clearly identified for the following reasons. First, it is essential to avoid government interventionist policies which may adversely effect economic efficiency and consequently harm Uganda's growth prospects. Furthermore, the limited capacity of the government to identify the reasons for inequality, devise policies to address it, and effectively implement them, should also be a consideration.

Uganda's poverty reduction strategy has been carefully prepared in a broad participatory manner and is clearly yielding good results. The authorities should be commended for their efforts in including various segments of the population in devising the strategy. While the participatory process is a demanding task that is resource and time intensive, Uganda's poor appear to be reaping the benefit of their input and the input of other groups to the strategy. We were somewhat surprised, however, that the progress report was also prepared in a participatory process. While we believe that the input of civil society could be quite beneficial and should be considered in revising the strategy, we are less certain about the extent to which the preparation of the progress report requires participation and more importantly whether it is necessary.

Mr. Daïri and Mr. Kwakye submitted the following statement:

We thank the staff for the excellent reports, and Mr. Usman for his helpful preliminary statement. Despite the severe deterioration in its terms of trade, Uganda continues to demonstrate an impressive record of program implementation and commitment to reform, bringing marked benefits to its economy and broad sections of the people. The authorities have strengthened budgetary and monetary management and increased the momentum on structural reforms. Despite these achievements, however, the authorities are still confronted with fundamental structural obstacles and policy challenges. The economy remains fragile and vulnerable to external and internal shocks, while poverty remains rife and deep. The key policy tasks for the authorities are therefore to consolidate macroeconomic stability, accelerate growth, and deepen poverty alleviation.

Budget management has continued to improve, exemplified by a marked reduction in new budgetary over-commitments, extension of the expenditure control mechanism to the development budget, and improved tracking of poverty-reducing spending under the Poverty Action Fund (PAF). The authorities are also to be commended for increasing transparency and accountability in public resource management. These positive achievements, however, seem to be clouded by persisting shortfalls in revenue effort, which threaten the realization of the medium-term program objectives. Further strengthening of the domestic revenue base is therefore critical and, to that end, we join the staff in calling for accelerated implementation of tax administration reforms, including strengthening the Uganda Revenue Authority (URA) and building capacity for financial management both at the national and local levels. Furthermore, an early elimination of discretionary tax exemptions is essential to increase transparency and avoid distortion of the incentive structure.

Monetary policy continues to be successful in containing inflation within the target levels. It is particularly encouraging to see that government indebtedness to the banking system is to decline sharply through 2004. This will allow for a welcome increase in private-sector credit without compromising monetary and inflation targets. A new challenge facing monetary policy is how to deal with the surging foreign exchange-denominated deposits and donor resources, and we support the authorities' request for technical assistance to help in refining the existing framework for the conduct of monetary and exchange rate policy. Technical assistance in foreign exchange market management will also be helpful to ensure that the market functions efficiently, and that Uganda maintains a competitive exchange rate to foster export growth and diversification and reduce the country's vulnerability to developments in world commodity markets.

Measures taken by the authorities to strengthen the banking system have led to improved asset quality and solvency of banks, thereby reducing financial risk and potential crisis. Further strengthening of banking supervision is, however, required to ensure strict enforcement of prudential regulations. The Financial Institutions Bill, which is meant to increase the powers of the Bank of Uganda (BOU) to enforce prudential regulations, is therefore appropriate and should be implemented without delay. Fund technical assistance in banking supervision will also be required to help the BOU to deal with the rising level of foreign currency exposure of banks in the face of the sharply depreciating local currency.

As the staff rightly point out, realizing the growth targets is crucial to achieving the medium-term program objectives. In our view, the key program components required to attain these high levels of growth include: accelerating structural and institutional reforms, improving external competitiveness, and increasing economic diversification. We are pleased to note that the authorities intend to pay attention to creating an enabling environment for private sector participation in the economy, using the Medium-Term Competitiveness Strategy (MTCS) as the main vehicle. The objectives of the MTCS are laudable, especially in focusing on increasing public investments in infrastructure, restructuring the financial sector, and improving capacities of legal and regulatory institutions. Increased private sector participation in the economy through accelerated privatization and speedier implementation of the MTCS, and implementation of the Plan for Modernization of Agriculture (PMA) will help to quicken the pace of diversification of the economy. At the same time, an active program for export promotion is required, and, for that purpose, the establishment of a Technical Task Force to "select strategic areas for export promotion" is well thought-out.

Regarding poverty alleviation, we are impressed by the recent achievements, as indicated in the PRSP/PEAP progress report. Barring data limitations, it is evident that the incidence of poverty has declined dramatically during 1992-2000. We are, however, concerned that programs implemented so far have benefited the more well-off and urban dwellers, with less benefits to the poor and rural dwellers. It is therefore reassuring that the authorities duly recognize this shortcoming and plan to take necessary corrective measures. Restoring security to the north is critical to reducing poverty in that area, as it continues to lag behind the rest of the country. Furthermore, the poverty-reducing strategy needs a strong rural-development component. The PMA is therefore relevant as a vehicle for modernizing and diversifying agricultural production to boost the incomes of rural farmers.

We agree with Mr. Usman that “financial support from the donor community will contribute to play, for the time being, a key role in facilitating the authorities’ task of pursuing the course of reform and poverty alleviation.” Given Uganda’s strong track record and the authorities’ renewed commitment to further adjustment and reform, we support the waiver requested by the authorities and completion of the PRGF review. We also view Uganda’s poverty alleviation strategy as sound and deserving of continued Bank and Fund concessional assistance.

Mr. Kelkar submitted the following statement:

The performance of the Ugandan economy has provided reassuring evidence of the continued commitment of the authorities to sound macroeconomic policies as well as the implementation of the PEAP. As pointed out by Mr. Usman in his helpful preliminary statement, despite adverse conditions including deterioration in the terms of trade, growth has been encouraging though lower than projected. Inflation has been moderate. The poverty level has come down to 35 percent, a decrease consistent with the projections under the PEAP. Only a few performance criteria and benchmarks have not been met. We therefore support the completion of the second review and the waivers requested. We are in broad agreement with the staff appraisal and will therefore focus on a few issues only.

The revenue/GDP ratio, at less than 12 percent, has not changed substantially over the past five years. This is below the corresponding level in comparator countries. Given the substantial gap between the current spending levels and those felt necessary to implement the overall PRSP/PEAP, we join the staff in urging for a continued focus on revenue enhancement. We support the efforts of the authorities to improve collection efficiency through modernizing the URA, but also urge them to consider the staff suggestions for expansion of the tax base as well as introducing major reforms in the tax administration system including on the issue of exemptions.

With agriculture contributing significantly to the Ugandan economy and employment, and the need to focus on the removal of rural poverty, this sector singles itself out for increased attention. While Box 5 indicates an increase in outlay for this sector from PAF expenditures, Table 2.3 in the progress report shows that level of commitment has remained steady over the past three years—at about 1.5 percent of total public expenditure. It is not clear what the absolute increase in commitment in this sector has been. Also, has the composition of this expenditure changed significantly? Similar questions arise for expenditure in the health and education sectors also. We invite the staff comments. We also join the staff in urging that the authorities implement the Plan for Modernization of Agriculture as early as possible. We urge the authorities to implement this plan in a differential manner with increased emphasis on the poorer regions.

We commend the authorities for their impressive Progress Report, which highlights the significant advancement made in the implementation of the PEAP/PRSP. One strong feature is the underpinning of the PEAP/PRSP by the MTEF—which effectively costs the program and forces a prioritization of the various options available. This reinforces the budget constraint and ensures the realistic setting of targets. We also commend the increasing emphasis placed on outputs and outcomes in the formulation of the MTEF—especially in the critical social sectors. This approach would address important issues like the reported drop in the quality of education despite the sharp increase in access. We therefore agree with the staff that the progress report is a sound basis for continuing concessional assistance from the Fund.

It is encouraging to see that the progress report is candid about the weaknesses in implementation. The growth in inequality, the differential rates in regional growth, as well as the slippages in a number of targets in the education and health sectors cause concern. It is worrying that the poverty rate in the North has actually increased over the past three years. Though Chapter 6 of the report does discuss these issues, we would have been happier if the precise steps the authorities propose to take to address these deficiencies had been incorporated.

We are concerned with the statement on page 10 that "some donor project financing is still not incorporated fully into the MTEF process and is not fully consistent with sector development strategies and implied allocation of financial resources." Once they have expressed their views through the consultation process, we would urge that donors coordinate their efforts and provide assistance only through the budget. Reporting requirements could also be simplified using this mechanism. Table 4 indicates that 456 monthly reports (135 relating to Primary Health Care alone) were required from district authorities as part of the monitoring effort for disbursing funds from the PAF. This appears to be an unacceptably high demand on district resources.

The authorities are to be commended for their commitment and organization of a coordinated national response to the HIV/AIDS pandemic. While it is heartening to note that the prevalence amongst adults has recorded a fall; the sweeping impact of HIV/AIDS on the economy remains a major risk to the success of the program. This is compounded by the lack of adequate facilities in government health institutions resulting in their lower utilization, when compared to private facilities. The staff have pointed out that a funding gap exists in the $180 million program to fight the disease, which will be met by 'new donors.' The size of this funding gap is not clear. Will it affect the pace of implementation of the program in the immediate future if it is not met? The staff may like to comment.

The fragile security situation within the country and in the region poses risks to the program. Apart from being weighed down by unproductive security related expenditures, factors like the greater poverty level and poorer social infrastructure in these areas compound the difficult task faced by the authorities. In view of the critical dependence of the PEAP on donor support, the latest staff statement on the recent election process also raises concerns. We are confident that the authorities will seek early resolution of these sensitive issues.

We wish the authorities success in their challenging policy endeavors.

Mr. Barro Chambrier submitted the following statement:

At the outset, I would like to thank the staff for their excellent papers and Mr. Usman for his useful preliminary statement. Despite generally unfavorable international environment, Uganda continues to have strong economic growth, moderate inflation and good external position. This strong economic performance combined with the implementation of a broad-based Poverty Reduction Strategy have helped the government make significant inroads in reducing poverty. I endorse the staff appraisal for the conclusion of Article IV and the second review under the third Annual Arrangement under the PRGF. Likewise, I support the waiver of the performance criteria. In the fight against poverty, Uganda needs the assistance of the international community and, the PRSP being implemented continues to provide a sound basis for concessional financial assistance. I will focus my comments on three main areas: fiscal consolidation, structural reforms and poverty alleviation in the context of the HIPC Initiative.

Fiscal consolidation. Fiscal deficit widened substantially in 1999/2000 owing to adverse impact of the terms of trade shock on both revenue and expenditure and lower than expected revenue collection. The fall in revenue was more than offset by donor budgetary support that helped protect essential poverty-related expenditure, achieve the fiscal stance and maintain macroeconomic performance. Although the outlook of donor budgetary support remains favorable, the sustainability of the poverty reduction strategy will depend on progress in strengthening the domestic revenue efforts. Significant improvement in Uganda's revenue performance will require major tax administration reforms and expansion of the tax base. In this regard, I welcome the strengthening of the Uganda Revenue Authority (URA) and encourage the authorities to speed-up efforts to remove the remaining discretionary income tax and customs duty exemptions. On the expenditure side, the budget has become more poverty-focused and more closely linked to expected outcomes. I welcome the introduction of consolidated quarterly reports, the inclusion of development budgets under the Commitment Control System (CCS) and the actions to strengthen the budget management and reporting system at the district level. Likewise, I appreciate the intention of the authorities to carry out expenditure tracking studies for a more proactive budget management. However as noted by the staff, weaknesses in the implementation of the CCS and the accumulation of domestic arrears are matters of concern. Strong control of expenditure is critical for budget consolidation in particular in the context of decentralization and the implementation of poverty reduction strategy. Sound budget management requires building capacity for financial management, especially at the local level.

Structural reforms. As noted in the PRSP and the Poverty Eradication Action Plan (PEAP), a real GDP growth of 7 percent a year is needed to underpin the achievement of the government's poverty reduction objectives. As a small open economy, Uganda's growth prospects depend critically on the depth and pace of structural reforms. I commend the authorities for reforms initiated in key sectors such as power, telecommunications and the banking sector. I also welcome the government's comprehensive framework for dealing with good governance, transparency and accountability in the public sector, especially in the area of budget management and public accounts. However, I regret that the sweeping power given to the parliament and the Auditor General to exercise control over public spending have had no follow-up to date. As regards the persistence of corruption in the civil service, while recognizing that part of the problem lies with low remunerations, I concur with the staff that stronger determination and signals from the authorities and better prioritization of the activities of the Office of the Inspectorate of Government in investigating corruption are likely to improve performance.

Poverty Alleviation. As noted in the PRSP Progress Report, the Ugandan authorities are on track to reach international development goals of reducing by half the proportion of people living below poverty line by 2015. Indeed, improvement in the delivery of key services to the poor in areas such as education, health and water sanitation and other rural activities has helped reduce the proportion of people living below poverty line which declined from 56 percent in 1992 to 35 percent in 2000. Notwithstanding this impressive performance, Uganda still faces major challenges, including the capacity of local authorities to develop and manage budgets and to implement programs, the mechanisms for monitoring performance by district, supply constraints for effective delivery of services in key areas such as primary education or water and sanitation, and the widening of regional and gender inequality. These challenges call for continued efforts to resolve security problems, emphasis of poverty reduction actions in rural areas and concerted efforts to build an efficient and transparent civil service capable of providing essential developmental services throughout the country.

In light of Uganda's satisfactory performance, I agree to the completion of the Second Review under the Third Annual PRGF. I am convinced that the Ugandan government's commitment to reforms will reinforce the sustainable, non-inflationary growth path of the economy and result in lasting benefit to the population.

Extending his remarks, Mr. Barro Chambrier expressed his support for the second review of the third annual arrangement under the PRGF and the completion of the Article IV consultation. Uganda continued to have strong economic growth, moderate inflation, and a good external position, which had given the authorities the opportunity to make significant progress in reducing poverty. However, the situation was still fragile, as could be seen with regard to fiscal consolidation. In that context, one had to take into account the adverse impact of the terms of trade shocks on both revenue and expenditure. The lower-than-expected revenue collection reflected the fragility of Uganda's economy and the need for better revenue mobilization, which was low compared with the standard in other African countries. The deficit was covered by donor support, but there was a need to strengthen the Uganda Revenue Authority and remove discretionary exemptions. It was also important to improve expenditure management, especially at the district level.

On monetary policy, Mr. Barro Chambrier supported the technical assessment's views on the need to refine the way monetary and exchange rate policy were conducted. It was reassuring that the inflation objective had been attained. The negative effect of the slower-than-projected revenue growth could be offset by the depreciation of the shilling. Although that depreciation was expected to be temporary, it had caused depositors in commercial banks to hedge their exposure by shifting into foreign currency deposits. The resulting change in the composition of the monetary aggregates needed to be carefully monitored, and it was important to give the central bank the appropriate means to strengthen the supervision of the banking system.

On structural reform, Mr. Barro Chambrier welcomed the efforts to improve governance, transparency, and accountability in public management, and agreed that the authorities needed to combat corruption further. On poverty alleviation, while there had been progress, there was a need to increase capacity at the local level and to address the tracking system for budgetary savings. The proposed national strategic framework to combat HIV/AIDS should be endorsed, and the staff position on the security situation was commendable, particularly the statement that the authorities were confident that Uganda's involvement in the DRC had achieved its objective of weakening the fighting group so that it no longer posed a threat to Ugandan security. He would strongly encourage the authorities to follow the Lusaka arrangement.

Mr. Pickford made the following statement:

> This is a set of high quality reports, and I would like to thank the staff for the efforts that have gone into producing them. I endorse the staff's assessments and support the proposed waivers. The joint staff assessment (JSA) of the PRSP is a particularly good report, and I fully endorse its conclusions. This is the sort of report that we had hoped would result from an ongoing relationship between the staff and authorities. The JSA picks up three important themes for Uganda: public expenditure management, public service delivery, and the importance of poverty-reducing growth.

Uganda's policy stance over the last years has been appropriate in the face of shocks. It has maintained prudent fiscal policies and pressed ahead with structural reforms despite the adverse effects of the terms-of-trade shock. The fact that the Ugandan economy continues to grow relatively strongly shows that it is reaping the benefits of previous structural reforms.

The strong growth and increased donor inflows in response to Uganda's sound policies have resulted in increased budget allocations to the social sectors. This is one important reason why poverty levels have continued to fall, from 54 percent at the beginning of the 1990s to 35 percent last year. However, more needs to be done.

I also welcome the recent action by the government in withdrawing troops from DRC, which should help to ensure that military spending is kept below the ceiling.

Given the backdrop of strong policy performance, I support the proposed waivers. New domestic budgetary arrears have accrued in three ministries, as the staff report points out. The level is relatively small, at about $2 million. Overall, the Commitment Control System seems to be working reasonably well and is starting to reduce the overall stock of arrears. Extending the CCS to cover the development budget is also welcome, and I expect the good progress in enhancing public expenditure management systems to continue, but would join the staff in encouraging the authorities to act decisively in cases of underreporting of commitments. It would be advisable for the authorities to extend the coverage of the CCS to district as well as central government expenditure as soon as possible. A significant share of social spending now takes place at the district level, thus extending the CCS to that level of government will be particularly important.

On the revenue side, I share the staff's assessment of the capacity of the Uganda Revenue Authority, and agree with the calls for greater transparency in the tax system. The level of protection given to the local sugar industry is a concern; a firm date should be set for the removal of the present protection levels. Overall, the revised fiscal framework is sound. It balances the need to maintain appropriate financing from the budget with adequate financing for private sector development. Strong donor flows in response to the confidence in Uganda's macroeconomic and budget management systems and the government's focus on reducing poverty have more than offset the widening of the fiscal deficit, and reserves have increased. In that regard, I do not see a need for further fiscal tightening.

Despite the good performance since the early 1990s, it is clear that Uganda will continue to rely on external donor flows for the medium term. As Uganda needs to maintain the confidence of donors and private investors, I consider a Fund-supported program a seal of approval on the country's macroeconomic management. Therefore I support Uganda's request for a successor three-year PRGF-supported program and broadly endorse the authorities' emphasis on improved revenue efforts, trade and pension reform, fiscal decentralization, and expenditure management at the district level, as well as the second generation reforms to enhance productivity and promote growth.

Uganda has been, in some respects, a test case for the Fund's new approach to dealing with the poorest countries, and I am encouraged by the fact that we continue to see good results in the face of adverse shocks.

Mr. Liu Fushou made the following statement:

At the outset, I would like to thank the staff for the well prepared papers and Mr. Usman for his helpful preliminary statement. The Ugandan authorities are commended for their sound macroeconomic polices and impressive performance over the past several years. Despite the severe deterioration in the terms of trade, growth has been encouraging though lower than projected. Inflation has been moderate and gross international reserves have been maintained at a comfortable level. The strong economic performance, along with significant progress in implementing a broad-based poverty reduction strategy has helped substantially to reduce the incidence of poverty. We therefore fully support the completion of the second review and the waivers requested. We are in broad agreement with the staff appraisal and will make a few brief comments for emphasis only.

First, on the fiscal front, we welcome the progress made in tax administration. The authorities are also commended for increasing transparency and accountability in public resource management. However, the sustainability of the poverty reduction strategy will depend on progress in strengthening the domestic revenue efforts. Therefore we join the staff in calling for the continued implementation of tax administration reforms, including strengthening the Uganda Revenue Authority, and building on financial management capacity. Regarding budget management, we welcome the introduction of consolidated quarterly reports, the inclusion of development budgets under the Commitment Control System, and the efforts to strengthen budget management and the reporting system at the district level.

Second, on monetary policy, we are pleased to note that conditions during the first half of the fiscal year were broadly consistent with the inflation objective under the program. The Bank of Uganda continues to be successful in containing inflation within target levels. Concerning the new challenge in dealing with the marked increase in U.S. dollar-denominated deposits and donor resources, like Mr. Daïri and Mr. González-Sánchez, we support the authorities' request for technical assistance to help in refining the framework for the conduct of monetary and exchange rate policy.

Finally, with regard to the financial sector, we commend the authorities for the positive developments in the banking sector. We are pleased that the Bank of Uganda has already taken steps to strengthen the banking system, including intensifying its surveillance of banks. However, further strengthening of banking supervision is necessary to enhance the soundness of the banking system. Technical assistance from the Fund in this area will be useful.

With these remarks, we wish the authorities every success in the future.

Mr. Al Azzaz made the following statement:

Uganda's continued commitment to adjustment and reform is most encouraging. The overall economic performance in 2000/2001 was broadly in line with what's been envisaged under the program with most of the quantitative performance criteria and structural benchmarks being observed. The challenge ahead is to continue with sound policies to sustain economic growth while preserving macroeconomic stability. In this connection, I am reassured by Mr. Usman's preliminary statement that the authorities are aware of these challenges and committed to adhere to the program. This chair, therefore, supports the completion of the second review of the third annual arrangement under the PRGF along with the requested waivers.

Here, I will add a few comments.

On the fiscal front, enhancing revenue performance is critical in view of the low revenue to GDP ratio. The steps to reform the tax administration system, and broaden the tax base are important for strengthening the budgetary position and ensuring the sustainability of the poverty reduction strategy. Over the medium term, the implementation of the information technology strategy, improving VAT and non-tax collections should further improve the revenue position. The authorities also need to speed up the enactment of legislation that would eliminate discretionary exemptions.

On the expenditure side, strengthening the effectiveness of budget management is needed to reverse the recent widening of the fiscal deficit and avoid cuts in basic services and key development projects. In this connection, like the staff, I urge the authorities to press ahead with capacity building at the district level.

In the financial sector, strengthening banking supervision and enhancing the observance of prudential requirements are priorities. In this connection, I welcome the Bank of Uganda efforts to improve its supervision capability and upgrade the skills of its staff. I also welcome the request for technical assistance to strengthen banking supervision.

On trade policy, the recent removal of the special protection accorded to the textile industry and the elimination of some excise duties are encouraging. I also welcome the authorities renewed commitment to further liberalize the Sugar industry at an early date.

With regard to PRSP progress report and joint staff assessment, I broadly concur with the joint staff appraisal. Indeed, the implementation of the poverty reduction strategy has proceeded well as evidenced by the decline of the poverty level. In this regard, I share Mr. Usman's view that at this pace and with the maintenance of prudent policies, reducing poverty to 10 percent by 2017 appears to be achievable. Here, the heightened focus on agriculture is appropriate in view of the high level of poverty in rural areas. In this regard, I agree with the staff on the need for speedy implementation of the Plan for Modernization of Agriculture.

With these comments I wish the authorities further success.

Mr. Sdralevich made the following statement:

At the end of the three-year PRGF, we can say that overall the results obtained by Uganda are positive. Macroeconomic stability has been maintained, the structural reform process has been advanced, and poverty—albeit with some shadows—has been reduced. So, despite some pitfalls along the way, the program has been successful. Looking ahead, economic conditions will be difficult, but we are encouraged by the fact that the authorities seem well aware of the challenges, and by the resilience of the economy to external shocks, as evidenced by the high growth maintained despite the significant worsening of terms of trade and a still non-diversified economic structure.

With regard to this review, we broadly agree with the staff's appraisal and with the various interventions and preliminary statements of other Chairs, so our comments will focus only on the fiscal sector and on the poverty strategy paper progress report.

Fiscal performance in the first half of 2000/01 has in the whole evolved as envisaged under the program, even though it must be noted that this achievement has been reached in part through undesired under spending in wages and salaries. In general, we find three areas of concern in relation to the fiscal sector. First, there is a danger of slippages arising from systematic over commitments by line ministries, as was the case recently. Second, budgetary controls at the local level seem to be deficient, and this problem may become even more pressing in the future. We urge the authorities to extend the system of controls already in place, the CCS above all, to reduce these sources of fiscal vulnerabilities. Third, while the deviation in arrears is not significant, the missed structural performance criterion on the verification of arrears has broader importance for the maintenance of fiscal discipline. The verification should be completed as soon as possible; we wonder if the staff could please report on its progress.

Poverty reduction shows a mixed picture, as illustrated by the candid progress report. We have three main concerns here. First, while poverty headcount has improved during the 1990s, inequality has increased, and the poverty in the rural areas has deepened. In this regard, we join the staff in recommending further analysis to address these issues as well as the role of gender, which is tightly intertwined with poverty, particularly in the countryside. Second, we are worried by the conclusion that the PRSP/PEAP is under funded. While costing must obviously be improved, the under funding points to the need to keep the fiscal sector under close control, as remarked above, and especially to increase revenues as remarked by other Chairs. Third, service delivery has increased but, as underlined by the staff, its quality has been affected in all sectors, particularly in health. We urge the authorities to pay more attention to this crucial aspect of service delivery, and in particular, we share the staff's call for an improvement of the immunization situation.

But, as I said at the outset, the picture remains positive, and let me conclude by congratulating the authorities for their achievements, and by supporting the review and the proposed waivers.

Mr. Nijsse made the following statement:

Despite the severe impact of the terms of trade shock on Uganda's economy, the authorities should be commended for their steadfast implementation of sound economic policies which led to the maintenance of strong economic growth under difficult economic circumstances. Nevertheless, the recent events highlight Uganda's continued vulnerability to external shocks. The authorities therefore need to intensify structural reforms, including governance and transparency, to accelerate economic growth which is essential for reducing poverty. I broadly share the staff's assessment and I will limit my remarks to a few areas.

On fiscal policy, I can go along with the programmed loosening of the fiscal stance in light of the impact of the depreciation on project imports and interest payments and taking into account the sufficiency of donor budgetary support. I would like, however, to underscore the importance of strengthening revenue collection in an effort to mobilize resources in the fight against poverty and to attain fiscal sustainability. It is rather disappointing that for many years now the ratio of revenue to GDP remains rather constant at 11 percent. I encourage the authorities to intensify their efforts in tax reform, address governance weaknesses and rationalize tax exemptions. Expenditure control should also be strengthened in the context of efforts to increase the efficiency of government spending and reallocate resources toward increased social spending. In this regard, it is encouraging that the strategy against HIV/AIDS seems to be bringing some tangible results. Together with the improvement of budget management, implementation capacity at the local level should be strengthened further to combat corruption, taking also into account the growing importance of local governments in the provision of social services.

In the area of monetary policy, the authorities should remain vigilant following the upward pressure on prices associated in part with the depreciation of the shilling. A cautious monetary policy is needed to safeguard that competitiveness gains associated with the nominal depreciation of the currency results is not offset by higher inflation.

Looking at the current account balance, there is clearly a need to strengthen export capacity and attain greater diversification so as to limit the impact of external shocks on the country's export capacity. Without tangible results in this area, the exchange rate will continue to be under periodic pressure, especially when donor support eventually subsides. The maintenance of substantial amount of reserves is certainly called for under the circumstances but it should not be considered as an alternative to the structural reforms needed to ensure the long term viability of the external current account.

In the banking sector, I welcome the recent efforts to strengthen prudential supervision, including the strengthening of the bankruptcy law. A steadfast implementation of banking regulations and the law is essential to rectify current shortcomings in the observance of prudential requirements. Having said this, it is reassuring that asset quality appears to have strengthened further notwithstanding the impact of external shocks on the economy. Could the staff account for the reasons behind this outcome? Can the staff also provide an assessment of the potential risks for the banking system as a result of the increase in foreign exchange loans (given the potential for a depreciation of the currency and assuming that income is generated in local currency)?

As regards poverty, the authorities should be commended for their efforts. It is indeed reassuring that the PRSP is yielding some tangible results in terms of the reduction in head count and income poverty. It is also particularly worthwhile to note that the recent negative economic disturbances have not led to a deterioration in poverty. I welcome the first annual progress report and in particular its focus on remedial measures to address weaknesses identified in the implementation of the PRSP. I can also endorse the authorities' plan to revise the PEAP every three years on the basis of a poverty status report (PSR). To make further gains in the fight against poverty, the authorities should address the rising inequality in the country and secure peace and stability in the north. They should also further strengthen the monitoring of government programs by engaging more fully the civil society.

With these remarks I support the proposed decision.

Mr. Fenton made the following statement:

I shall begin with the Article IV report and PRGF review.

Other speakers have already noted Uganda's accomplishments during the period under review, so I will not repeat them. Rather, I will focus on the areas where we would encourage the authorities to make further progress as a matter of priority. Our concerns relate in general to governance. While progress has been made, good governance and transparency remain a challenge in Uganda. For instance, the weak revenue collection during the period was attributable, to an important extent, to weak management of the Uganda Revenue Authority (URA), as well as, to the prevalence of discretionary exemptions and delays in implementing reforms. The absence of transparency in the use of public resources at the district level, non-existent investigations of cases of suspected corruption, and a growing lack of public confidence in the police are also symptomatic of weak governance and a lack of transparency. A lack of capacity and accountability at the district level of government is particularly worrisome, given the importance of this level of government in poverty reduction efforts. It will take sustained efforts to strengthen governance at the district level, we urge the authorities to undertake these efforts as soon as possible.

We also think that Uganda's military activity in the Democratic Republic of the Congo continues to represent a disproportionate response to security concerns. The staff report notes that the Ugandan authorities think that the LRA and the ADF no longer pose a threat to Ugandan security. We find this statement to be incongruent with Uganda's continued, and fairly extensive, involvement in the DRC. We encourage Uganda to respect in full the Lusaka agreement. The encouragement that this would provide to regional peace efforts would be as beneficial to Uganda as any other country, particularly as continued conflict reduces incentives for investment in the region. It would also represent a more productive use of scarce resources.

Our concerns notwithstanding, we support the granting of the requested waivers and the completion of the PRGF review.

Turning to the PRSP Update and Joint Staff Assessment, Uganda is the first country to prepare a PRSP Progress Report, and it has set a good standard for other countries to follow. The progress report provides solid analysis of Uganda's successes, as well as an honest and realistic assessment of areas where progress is not yet apparent. We agree with the authorities that the PRSP is a living document, and we are broadly satisfied with the iterative nature of the consultation and policy planning processes.

Like Mr. Pickford, I also found the Joint Staff Assessment of the PRSP helpful. I was particularly struck by the observations that, while the economic growth in the 1990s translated into a reduction in income poverty, inequality has increased, especially after 1997—both in terms of the size distribution of income and among the regions. Perhaps most distressingly of all, given that 96 percent of the people living below the poverty line reside in rural areas, the rural-urban gap has widened. I wonder if this is attributable to the adverse terms of trade shock, or are other factors at work. I strongly agree with the staff that further analytical work leading to specific policy advice should be a priority.

Uganda's continued vulnerability to external shocks, and the resulting importance of diversification, are highlighted in the Progress Report. A more detailed discussion of progress on trade reform would have been useful to include in the Progress Report. We will look forward to more information on the government's progress in trade reform and economic diversification in future Progress Reports.

Finally, we still have concerns related to Gender Equality. We are pleased to note that the UNHS data suggest Uganda is close to eliminating gender differences in primary education enrolment rates. The government of Uganda has demonstrated a strong political commitment towards gender equality in education and should be congratulated for this achievement. Aside from the Education sector strategy, however, gender considerations are largely absent from the Progress Report. We agree with the staff that gender equality should be an integral and explicit part of Uganda's poverty reduction efforts, and we encourage the authorities to ensure that gender is an integral part of its development agenda, particularly in the agricultural sector.

Ms. Redifer made the following statement:

We basically agree with the positive assessment put forward by many of the other Directors in their statements today. So I'll just be very brief and focus on a few issues.

We support the completion of the review and the extension of waivers. I wonder if the staff can comment more fully on the nature of the over commitments, specifically is there any evidence that they relate to election run-up spending or to military spending?

With regard to the PRSP progress report, I would like to echo Mr. Pickford's, Mr. Sdralevich's and Mr. Fenton's comments, particularly on the need to reduce poverty in rural areas and an intensified focus on gender issues. With regard to the JSA, I would like to echo Mr. Pickford's comments that this is a good example of what we would like to see in terms of staying up-to-date on PRSP implementation.

The authorities' commitment to macroeconomic reforms is notable. This is evident in Uganda's ability to deal successfully with the external oil price shocks and the coffee blight disease of the past year. They could have had a much more devastating impact on the economy if the authorities had not managed it well.

Obviously, as outlined in the staff report, there are still substantial areas on which to work. Public expenditure management through the regional level, increasing revenues, and the other areas that Directors have outlined. One area we would like to underscore is the need for progress in resolving the outstanding issues surrounding the four intervened banks. We are encouraged that the authorities are moving to reprivatize Uganda Commercial Bank. More generally, attention is needed to address the vulnerabilities outlined in the staff report.

The question of a new program to the side, we would encourage the authorities to begin focusing on developing their capacity to manage macroeconomic policy themselves, with an eye to the day when Fund involvement is no longer necessary.

Mr. Bauche made the following statement:

Uganda's major macro-indicators remain relatively robust with GDP growth projected at 5 percent for 2000/01 and inflation contained at below 5 percent. On the fiscal front, the picture is less convincing with a widening of the overall deficit in 2000/01, partly owing to the impact of the exchange rate depreciation on imports as well as to external payments, but also, and more essentially, to the absence of major improvements in revenue collection, whose targets for 2001/02 and the following years could, in our view, be more ambitious.

As we indicated during the previous review, the fact that the performance criterion relative to the non-accumulation of domestic arrears has been missed once again, is unfortunate since this problem is now a recurrent issue. However, we welcome indications in the report on the satisfactory progress made in implementing the Poverty Eradication Action Plan and improvements in budget management even though fiscal management at the local level is still an area of concern. This will be important to help maintain

> the momentum in efforts to further reduce the poverty level and devote sufficient means to the fight against the HIV pandemic.
>
> Overall, despite weaknesses on the fiscal front, the program appears to be broadly on track and the requested waivers and the proposed decision could be acceptable. However, my authorities have serious concerns on the pending issue of possible illegal exploitation of resources in the DRC. A report by the UN panel of experts is about to be issued to the Security Council sometime this week. The first indications that my authorities have on this report are that its conclusions may confirm an active involvement by Uganda in such operations. That would mean an absence of transparency on the actual resources allocated to military expenditures and would involve strong governance issues. For these reasons, my authorities are not in a position today to have a firm view on the proposed review and therefore, they have instructed me to be recorded as abstaining.
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> Needless to say, I strongly agree with Mr. Fenton and Mr. Barro Chambrier on the importance of a full and speedy implementation of the Lusaka agreement. That will be of the utmost importance in this chair's position regarding future relations between Uganda and the Fund.

Mr. Barro Chambrier noted that there was still a high level of poverty in rural areas, and asked the staff to assess the sustainability of poverty reduction in the context of the HIPC Initiative, given the low level of domestic revenue mobilization.

The staff representative from the African Department said that outlays in the agricultural sector remained relatively low compared with overall poverty expenditures. The strategy for the modernization of agriculture completed in 2000 was currently being translated into more concrete operational programs, and the work was not expected to be completed until 2002 or later. Even in the World Bank program on the Poverty Reduction Support Credit (PRSC), the interventions for the agricultural sector did not come in the first and second year, but would begin to take full force in the third year. That had been the pattern for most of the programs, for example those in education and health; support typically started slowly but picked up when most of the programs that underpinned those sectors' activities had been fully worked out.

On the extent of the under funding regarding HIV/AIDS, the staff representative reported that, at the time the staff report had been prepared, the under funding had been estimated by the authorities to be $100 million. However, that estimate had been made before the World Bank support for HIV activities had been approved. That amounted to about $50 million and was supposed to underpin the interventions in this area. The staff was therefore not sure whether the entire $100 million had now been mobilized, but the understanding was that there would be adequate funding in the following year to meet program needs. The numbers would be examined in the context of the preparation of the medium-term expenditure program for the subsequent budget, in which the Fund staff would participate.

The staff would then be able to report back to the Board as to whether the total amount had been met or some shortfall remained.

On the participatory framework followed for PRSP progress report, the staff representative noted that Uganda had for some time involved a large cross-section of interest groups in the preparation of key features of its development programs, even before the Fund or the Bank had introduced the PRSP. Those groups included local authorities, NGOs, universities, and the donor community. It was in the authorities' interest to continue to use such a mechanism because it produced good results. The staff had tried to accommodate that existing framework and ensure that its own efforts on the work program and the PRSP process took into account the government's established practices.

With regard to the issue of the budgetary overcommitment, the staff representative noted that, in 1998/99, the size had equaled 1.3 percent of GDP. It had then been felt that an undertaking on the part of the government to reduce such over commitments should be an integral component of establishing budgetary discipline. In the last two years, these overcommitments had been small. It had been argued by many experts in the area that such levels of overcommitments could be consistent with normal frictions in any budget system, and that it might be unrealistic to expect no overcommitment. One problem was that the Fund and the Bank were working toward a programmatic approach to budgeting, where donors would be encouraged to finance the agreed medium-term framework instead of individual programs. A key component of ensuring that both the donor community and other interest groups would be confident that the programs were closely adhered required that sectoral composition of the initial budget should not differ from the final outcome. The staff would therefore work with the authorities to see how best to combine that aim with the recognition that bringing overcommitments to zero might not be realistic.

On the nature of the overcommitments and on whether they reflected defense appropriations or election overspending, the staff representative stated that a small amount of about US$0.5 billion was related to defense. The larger portion involved presidential travel, which the staff had discussed with the president, and the outcome of court cases, which had proved difficult to budget for and which were normally covered by the contingency mechanisms built into the program.

Regarding the weaknesses of budgetary management at the local level, the staff representative reminded Directors that Uganda was going through a difficult period and that the authorities were building a district administration capacity from nothing. The legislation providing for the establishment of a local capacity structure to manage programs had been approved in 1995, and the building of the mechanisms and institutions to carry it out had only started in 1997. It was expected that emerging problems would be addressed, in part, through technical assistance from the Fund, and the World Bank. The initial focus of the Bank's PRSC, which would be discussed by the Bank Board, would be public expenditure management at the district level and the strengthening of the delivery of public services.

The assumption in the program was that the Auditor General would verify the arrears by end-December 2000 and the results would be available to the staff by about April 1, 2001, the staff representative reported. In the past it had been agreed that the verification would take one year. In the current case, the staff had been more ambitious and suggested that it should take only six months. As the Ministry of Finance did not have the capacity to undertake the review of the public accounts for the previous year, the auditor general was doing that.

Regarding the risk to the banking system from the increase in foreign loans and deposits, the staff representative explained that in the past, all foreign currency denominated deposits had been covered by corresponding deposits by the banks in their external accounts abroad. In the last quarter there had been a pickup in foreign loans extended. The new requirement was that foreign loans could only be extended against foreign deposits. The only issue was that, when foreign loans were involved, a more intricate analysis was required by the Bank of Uganda's banking supervision department. The staff's understanding was that the new management of the Bank of Uganda recognized the issue and had put considerable effort into dealing with it. In addition, some 90 percent of foreign loans had been extended by four foreign-owned banks with good risk assessment capacity. Those banks were supervised by their own headquarters and by the Bank of Uganda. Therefore, the increase in foreign loans and deposits was not a major problem, although it could become an issue if such operations were to become extensive or if the activities were extended to domestic banks.

On the U.N. report on the exploitation of resources in the Congo, the staff representative reported that, according to the donor community in Uganda, the report did not mention the Ugandan government but said that some Ugandan individuals had been involved. The staff had been assured by donors that their loan programs to Uganda would not be affected by the report.

On the sustainability of the poverty reduction strategy, the staff representative stressed that this was a critical issue. The staff would devote considerable attention to that in the next program. Given that the revenue ratio was much lower than the expenditure ratio, numerous questions still had to be answered. Those matters were high on the staff's agenda for the following year. It was hoped that considerable technical assistance could be provided in that area before the staff would present the next program to the Board.

Mr. Barro Chambrier considered that, in view of the evidence presented by the staff on the squandering of resources in the DRC by Ugandan nationals, there was a duty for the Fund to convey a strong message to the authorities and remind them of their responsibility in that regard.

Mr. Bakhache clarified that his concern over the participation of civil society had not related to the development of the strategy but to the preparation of the progress report. In that context, the usefulness of the involvement of civil society was questionable.

Mr. Pickford considered it important that the authorities should not be left in any doubt of how strongly the Board felt about the exploitation of resources in the DRC by Ugandan nationals. While he had not yet seen the U.N. report, it was likely that the issue did not only concern Uganda, given that a number of countries were involved in the DRC. The

Fund should send a consistent message with regard to the importance the institution attached to resolving that issue.

Regarding the importance of strengthening revenue performance, Mr. Pickford stressed that it was an important aspect and supported the suggestion that the Fund send a TA mission to begin planning measures that could be undertaken in that regard, as improved revenue collection would be a crucial step for Uganda to move to the next phase.

Mr. Bauche said that he would expect that any upcoming staff mission to Uganda should deliver a clear message to the authorities with regard to the exploitation of resources in DRC by Ugandan nationals. Although the U.N. report was not yet available, it appeared that it singled out the behavior of a number of individuals responsible for such action. It was important that the Board's message be conveyed with consistency to other countries that might be involved in the DRC.

The staff representative from the Policy Development and Review Department, commenting on the participation of civil society in the preparation of progress reports for the PRSP, noted that Uganda had complied with and exceeded the recommendations and guidelines or preferences of the IMF and the World Bank in that regard. Also, Uganda was ahead of any other country with regard to performance and also with regard to progress in the context of the PRSP. It was the only country that had already reached a completion point. While the Bank and the Fund had not issued any formal guidelines with respect to progress reports, if asked to provide any guidance they would recommend civil society participation in that context. If the idea of preparing the PRSP in a participatory process served the purpose of promoting ownership and accountability, it would only be natural to explain to the people of a country the outcome of that strategy at the time when the results were known. The staff would therefore be inclined not only to welcome participation at that stage, but also to encourage it and to maintain the participatory process at the point of the evaluation of performance. That was particularly useful, if it provided answers to the concerns raised by the various groups during the preparation of the PRSP. It would also serve to evaluate jointly weaknesses and corrective measures for the future. There was hence great merit in the participatory process that had been practiced in Uganda.

On Mr. Barro Chambrier's comment on the sustainability of the revenue situation, the staff representative strongly agreed with the concerns raised in that regard. In the general context of program design, that was one of the weak spots in many African countries and in other developing countries as well.

On the question of how to reconcile the several Fund-supported programs that Uganda had already had, the staff representative noted that, regrettably, the level of per capita income in Uganda remained at about $300 despite the strong growth in recent years, which was far too low to allow any strong expansion in government revenue. At the same time, the largest part of the country's exports was in primary commodities, which limited the tax base. In view of that, the staff had—in past programs as well as under the current program—placed great emphasis on minimizing exemptions from taxation and on improving governance.

The issue with regard to the structural performance criterion for September was on the replacement of the head of the Uganda Revenue Authority, the staff representative noted. It was a fairly unusual step for a Fund-supported program to single out an individual position. However, that responded to the staff's concerns about governance, which was also shared by the authorities. The next program would focus on the issue of improved revenue collection in particular.

Mr. Maciá made the following statement:

> Uganda has been able to sustain economic growth and mitigate poverty levels despite the armed conflict in the region, shocks in agriculture and trade, and an unstable security situation. For the period 2000/01, growth should remain at a healthy 5 percent of GDP, as currency depreciation benefits non-coffee cash-crop exports, and weather assists in the rebound of food crop production. As lower export volumes and prices have affected coffee revenues, the current account has continued to deteriorate.
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> Budgetary resources remained strong given grants and loans, and the overall deficit was kept at expected program levels, despite higher wages and salaries, and lower revenue collection during the first half of 2000/01. The budget expenditures framework has been improved under the METF program since the early 1990's. Nonetheless, fiscal management continues to require controls on over commitments, quarterly expenditures ceiling, the expansion of the CCS to cover development outlays, and stricter controls on the PAVE program. In addition, the fiscal stance calls for continued improvements in tax administration, the VAT base needs to be widened, and dealing with legislation to curtail exemptions in taxes and customs should be accelerated.
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> Substantial improvement is noted in poverty eradication as reported through household surveys, the PEAP's 2001 latest review, and the detailed explanation of accomplishments contained in the PRSP progress report. Looking ahead, authorities recognize the need to continue the consultation process, reinforce ownership, and face the challenges under the PEAP/PRSP program, which aims to reach higher economic growth level, eradicate poverty inequalities, find prompt solution to the armed conflict, and improve the security situation in the most affected rural regions, among other important issues.
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> The authorities have to be commended for the effectiveness in which they have improved the level, quality, and coverage of government services. In addition to the augmentation of resources towards pro-poor programs, they have, indeed, provided for greater success in education, disease control, water supply, access to prescription medication, greater growth in household consumption, and reduction of poverty. Despite economic uncertainties, and exogenous factors that may affect Uganda's push-forward efforts to sustain the needed growth levels, quality of life has been improved, and poverty

incidence has been greatly reduced. Needless to say that decentralization of expenditures calls for stringent accountability systems, while resources use-and-output require adequate monitoring and control systems, and prioritization and cost-effectiveness measures also call for further improvement within the PRSP/PEAP program.

The external sector of the economy can become a serious obstacle to economic stability. The sharp deterioration in terms of trade mainly owing to the fall in coffee prices increased the current account deficit and depreciated significantly the exchange rate. In such circumstances, the pass-through of the devaluation, together with a highly expansive monetary policy would lead to inflationary pressures far beyond projected levels. Do the staff think that the monetary stance is appropriate?

The challenge is to sustain a stable macroeconomic environment for the medium term, which is crucial to the strategies envisioned in the PRSP/PEAP program. A 7 percent GDP growth level is a prerequisite to attain the program's goals. In addition, the government must push ahead the PMA program, accelerate its implementation targeting primarily the rural sector with the assistance being provided by IDA and the Fund. The land issue needs to be addressed promptly, together with infrastructure improvements, agricultural extension services, rural credit, and agricultural diversification programs. The gender disparity issue calls for priority attention as women are the main pillar for agricultural labor, mainly in food crops, and nontraditional export sectors. Private sector involvement is vital to the MTCS program to enhance their participation and investment, strengthen production activities, and enhance the sector's competitiveness.

Given the track record of Uganda, this chair concurs with the staff's recommendation on the request for the waivers and completion of the PRGF review. We commend the Ugandan authorities on their endeavors.

Mr. von Kleist made the following statement:

Uganda's performance during the past few years has been good, and, as other speakers have noted, despite a sometimes challenging external environment, real growth remains relatively robust, consumer prices are stable, and poverty rates are declining. We commend the authorities for these achievements.

The picture is not complete, however, without mention of the failings. It is regrettable that the Board is required to grant further waivers in order to complete this review, but I draw hope from the staff's assurances that actions are underway to address the deviations. These include in particular the repeated failure to comply with the non-accumulation of domestic arrears, which unfortunately means that the authorities did not gain a tight grip on expenditures during the span of the program.

It is also regrettable, as other speakers have mentioned, that the success in poverty reduction has been limited to cities, while some rural areas—the northern region in particular—have even seen a deterioration in poverty. While the rise in social spending may be welcome and necessary, it is worrying that such an increase has only been possible through increases in the budget and the current account deficit. This cannot be the basis for debt sustainability. Moreover, as others have mentioned, the fight against corruption must remain high on the authorities' agenda.

A key sentence on page 29 of the staff report sums up the policy requirements facing the authorities well. It says: "The projected macroeconomic outcome depends on the continued implementation of disciplined fiscal and monetary policies in the context of a floating exchange rate regime that allows the exchange rate to play an important role in the economy's adjustment to the terms-of-trade shocks." There is nothing to add to this, except that the effects of exchange rate flexibility on domestic prices and foreign-denominated debt must be kept in mind.

I would like to echo the remark by Ms. Redifer that the authorities should begin to plan for times without Fund assistance. Uganda has received uninterrupted concessionary financing from the Fund since 1989, which already stretches the Fund's mandate.

With these remarks, I support the proposed decision.

Mr. Maino made the following statement:

As we are in general agreement with the staff appraisal and with other Directors' views expressed so far, especially on the issues related to the fiscal performance and the PRSP progress, we would like to comment on only two important points namely, on the Medium-Term Competitiveness Strategy and on the financial sector:

On the Medium-Term Competitiveness Strategy: As it was underscored by the staff, the execution of this plan constitutes the right vehicle to achieve higher rates of economic growth in Uganda. Mr. Kelkar noted that any weaknesses in implementing this strategy would surely delay the adjustment and reconstruction process. We agree with this view. In this regard, the acceleration of structural and institutional reforms should foster private sector participation in the economy and more effectively use of the price system mechanism in the allocation of resources. At the same time, improving external competitiveness and further underpinning the enactment of an expanded trade lies at the heart of Uganda's long-term policy strategy to achieve sustainable growth. It is exactly here where the newly established Technical Task Force for export promotion has a clear role in selecting strategic areas for export diversification and development. The trade regime has been recently liberalized. As we mentioned for the case of South Africa a week ago, regional economic cooperation calls today for more and better coordination and more and better harmonization in customs and tax administration with trade partners in the area and with other non-area partners. Therefore, we encourage the government to intensify the focus on trade by promoting regional economic cooperation. In this regard, facilitation of market access and support for more level playing field for developing countries' exports in a possible new general round of trade negotiations within the WTO, is essential.

Financial sector: We concur with Mr. Djojosubroto on the need to advance a consistence incentive system in the financial sector, including enforcement of prudential banking regulation in cases of non-compliance. The BOU has an important role at this stage of development by intensifying bank surveillance, by undertaking the remaining necessary measures to strengthen the functioning of the banking system and by enforcing regulations and supervision capabilities

Given Uganda's track record and the efforts made to enforce the poverty alleviation strategy we support the waiver requested by the authorities and the completion of the PRGF review. The financial support from the donor community, and especially the concessional assistance of the Bretton Woods institutions is essential at this stage of adjustment and reform.

Mr. Sipko made the following statement:

We concur with the staff appraisal and appreciate the comprehensive preliminary statement prepared by Mr. Usman. Although the Ugandan economy is vulnerable on external and internal shocks, the authorities are to be commended for keeping stable macroeconomic environment, and continued the poverty reduction. Notwithstanding a positive track record in both above-mentioned areas, the authorities are still facing substantive challenges in the fiscal side and in poverty reduction, especially at the local levels. Let me turn to the issues in the area of poverty alleviation.

As far as medium-term prospect is concerned, the economy is still fragile and vulnerable to external shocks. We share the same opinion as the other Directors that crucial for poverty reduction is to follow the target for the economic growth. In this context acceleration of structural reform and institution reforms, improving external competitiveness , and increasing economic diversification is needed. We welcome that the authorities' intentions to create a basic conditions for private sector development in the economy, using the Medium-Term Competitiveness Strategy as a main vehicle.

Even though the public management system has been strengthened in recent years through the introduction Commitment Control System (CCS), recurrent budget over commitments remain. We encourage the authorities to enhance the operation of the CCS and thus to facilitate the monthly audits of over commitments and verified the accumulation of domestic arrears by an independent body.

Although the government's poverty eradication strategy has been implemented, income inequality is still rising and accentuating poverty in the north. In this context, an additional and more profound analysis is needed. In order to improve the present situation, we urge the authorities to adopt additional measures in rural areas, including agricultural productivity. This is instrumental in determining how the authorities will be able to implement its Plan for the Modernization of Agriculture to promote rural development. Therefore, it is crucial to improve financial accountability, as well as planning and budgeting processes at the district levels. In this context we urge the authorities to improve the transparency and to intensify their combat against fraud.

Finally, based on the steps being taken by the authorities to address deviations of structural clauses from original program understandings, we support the authorities' request for waivers of performance criteria for September and December 2000 that were non observed, and recommend completion of the second review of the third annual arrangement under the PRGF.

Mr. Elkjaer said that large donor support was possibly a disincentive to strong revenue collection. That issue needed to be looked at in the context of securing donor confidence in the future.

The staff representative from the African Department reported that the government and all parties working on Uganda considered it essential to extend the Commitment Control System to districts, but that could be done properly only when credible budgeting and accounting systems had been established and there was a capacity to monitor and implement it. Currently, the main focus was on streamlining the budget system and building such capacity. When that task would be completed, hopefully in one or two fiscal years, the next phase would be to establish CSAs in the districts. That would be the logical follow-up to the work that was currently being done.

Regarding the staff's view on monetary policy, the staff representative reported that the authorities had tightened monetary policy further since the staff report had been issued. The interest rate had been increased in February and early March and Treasury rates had risen to about 20 percent. That was the level that had prevailed in June when there had been a small currency crisis, and was too tight in the staff's view. There was a need for a more thorough debate in the context of the forthcoming technical assistance mission on both the exchange rate and monetary management before embarking on a new program. That would also help define the rules and the instruments that the Bank of Uganda could use for monitoring and implementation.

The staff appraisal outlined all of the areas that the authorities should watch, both at the macroeconomic and the microeconomic level, the staff representative reported. In the period immediately ahead, the question was how to manage existing resources and to maximize gains; therefore, the focus had to be on proper accountability at the local, district, and central government levels. At the microeconomic level, it was also critical to provide sufficient resources to key institutions like the Uganda Revenue Authority so that it could be prepared to enhance revenue collection in the period ahead. One of the critical problems that the URA had faced was the in adequacy of budgetary resources to undertake its tasks. Those issues would be corrected by the new management team that was being assembled by the authorities. One of the central measures to ensure that budget outcomes corresponded closely with intentions was better coordination of revenues and expenditures. Progress on that hinged on the stability as well as the strength of the revenue collection efforts. The staff was addressing those issues both over the near- and medium-term.

Mr. Usman thanked Directors for their comments and assured them that all areas of concern that had been mentioned would be communicated to the authorities. The staff had answered most of the issues raised, and it was hoped that the next mission would be able address any additional matters.

The Acting Chairman made the following summing up on the conclusion of the Article IV consultation:

> Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for the continued implementation of prudent financial policies and structural reforms, which have helped to sustain strong economic growth, low inflation, and a comfortable level of foreign reserves, in spite of a sharp deterioration in Uganda's terms of trade. The strong economic performance combined with determined implementation of the poverty reduction strategy has contributed to the reduction in the incidence of poverty. Directors were concerned, however, that inequality has increased and regional disparity in poverty has widened. They also observed that weaknesses in the capacity of local governments to manage their budgets and to develop and execute programs could undermine the achievement of the poverty reduction objectives, and they welcomed the actions that the authorities are taking to correct these weaknesses.
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> Directors commended the authorities for succeeding in keeping the fiscal program on track, while preserving budgetary allocations for poverty reduction programs, despite the worse-than-envisaged external environment. They urged the authorities to ensure that the remaining weaknesses in the

expenditure management system are addressed and that the sound management of fiscal operations is sustained to support both the broader developmental goals and a disciplined monetary policy. While noting the importance of external resources to the implementation of Uganda's poverty reduction strategy, Directors underscored the urgent need for determined efforts to significantly raise revenue collection, which is crucial to the long-run viability of the poverty reduction strategy. They therefore welcomed the measures to strengthen revenue, primarily in the area of tax administration, including the decision to appoint a new top management team for the Uganda Revenue Authority (URA). Noting the delay in enacting legislation to eliminate the discriminatory income tax and customs duty exemptions, Directors urged the authorities to take action in these areas promptly.

Directors welcomed the authorities' efforts to strengthen expenditure management through measures to enhance monitoring and control, including the extension of the Commitment Control System (CCS) to the development budget. The expenditure management system still suffers from weaknesses, however, that have contributed to the recent accumulation of domestic arrears. Directors therefore urged the authorities to strictly enforce all the provisions under the CCS, including the penalties for noncompliance, enhance political oversight over the operations of sensitive ministries, and improve revenue and expenditure forecasting. Directors also underscored the importance of keeping defense outlays to the budgeted level.

Directors commended the authorities for implementing a transparent budget and public accounts system, but expressed concern at the limited contribution of the system to combating corruption thus far. They urged the authorities to strengthen the inspectorate and criminal investigation branches of the government to facilitate thorough follow-up of the recommendations of the audit reports. Directors also encouraged the authorities to proceed expeditiously in developing an effective accounting and reporting system at the local government level, where most of the poverty reduction expenditures are undertaken.

Directors commended the authorities for the progress achieved in bank restructuring, including the closure of insolvent banks, the recapitalization of weak banks, and the restoration of profitability to the Uganda Commercial Bank. They underscored the importance of enforcing strictly bank regulations and the law to ensure that any remaining flaws in the observance of prudential regulations are expeditiously rectified. In this context, they welcomed the ongoing actions to strengthen further the bank supervision department of the Bank of Uganda. They welcomed the authorities' decision to reprivatize the Uganda Commercial Bank Limited (UCBL) in the near future and in a transparent manner.

Directors supported the authorities' policy of maintaining a market-determined exchange rate, but emphasized that its success depends on the continued implementation of disciplined monetary and fiscal policies. They welcomed the Bank of Uganda's request for technical assistance from the Fund to advise on refinements in the framework for the conduct of monetary and exchange rate policy.

Directors commended the authorities on progress made in trade liberalization, including the elimination of the special protection accorded to the textile industry. They encouraged the authorities to take, at an early date, the final steps needed to complete the trade reform agenda, including by elimination of the temporary duties on selected imports.

Directors welcomed Uganda's participation in the Fund's experimental case studies on standards, as well as the steps taken by the authorities to upgrade the institutions and systems consistent with the standards. They also welcomed the improvements in the coverage and quality of statistical data, and in enhancing the coordination between the data-compiling agencies.

It is expected that the next Article IV consultation will be held on the standard 12-month cycle.

The Acting Chairman made the following summing up on the use of Fund resources:

Directors noted that Uganda's performance under the Arrangement under the Poverty Reduction and Growth Facility (PRGF) has remained satisfactory. They welcomed the comprehensive PRSP Progress Report, which highlights new information on poverty trends, reviews progress and problems in implementing the PRSP, and identifies remedial actions.

Directors commended the authorities for allocating significant budgetary outlays to poverty reduction programs, for linking budgetary allocations explicitly to outcome targets, and for developing mechanisms to monitor progress in achieving the targets of the poverty reduction strategy. They welcomed the recent steps to address the weak capacity of local governments to develop and manage budgets, implement programs, and monitor performance, as well as the recruitment problems in the health and education sectors, and stressed that effective resolution of these issues is essential to the achievement of the PRSP objectives. Directors expressed concern at the rising inequality, in particular between rural and urban areas and between the north and the rest of the country. They called for adjustments in the strategy, based on a thorough analysis of the causes underlying this trend. It was also noted that improving the security situation in the north will be important for efforts to reduce the incidence of poverty in the area.

In completing the second review of the third annual arrangement under the PRGF, Directors noted that most of the performance criteria and benchmarks were met and that adequate steps have been taken to address the few deviations from program targets. Referring to the summing up of the Article IV Consultation, Directors urged the authorities to step up their efforts to enhance revenue collection and to enforce the expenditure management provisions aimed at containing domestic arrears. They also called for an early enactment of the new Financial Institutions Bill and elimination of the discriminatory excises levied on selected imports.

The Executive Board took the following decision, with one abstention from Mr. Bauche:

Poverty Reduction and Growth Facility—Third Annual Arrangement—Review, and Waiver of Performance Criteria

1. Uganda has consulted with the Fund in accordance with paragraph 2(f) of the third annual arrangement under the Poverty Reduction and Growth Facility (PRGF) for Uganda (EBS/99/212, Sup. 2, 12/14/99) and paragraph 4 of the letter by the Minister of Finance, Planning and Economic Development dated August 21, 2000 (EBS/00/176, 8/23/00) in order to review program implementation.

2. The letter of the Minister of Finance, Planning, and Economic Development dated March 9, 2001, shall be attached to the third annual arrangement under the PRGF for Uganda, and the letters dated November 19, 1999 and August 21, 2000 shall be read as supplemented and modified by the letter dated March 9, 2001.

3. The Fund decides that,

(a) the second review contemplated in paragraph 2(f) of the third annual arrangement under the PRGF for Uganda is completed; and

(b) Uganda may request the disbursement of the third loan under the third annual arrangement, notwithstanding the nonobservance of the performance criteria specified in paragraph 2(d)(i)(a) of the arrangement on domestic arrears and in paragraph 2(b)(iii) on the verification of the stock of domestic government arrears by December 31, 2000, on the condition that the information provided by Uganda on performance under these criteria and on the implementation of the prior actions specified in Table 2 attached to the letter by the Minister of Finance, Planning and Economic Development dated March 9, 2001 is accurate. (EBS/01/33, 3/12/01)

Decision No. 12454-(01/30), adopted
March 26, 2001

Poverty Reduction Strategy Paper—Progress Report

The Fund has reviewed the 2001 Progress Report of Uganda's Poverty Reduction Strategy Paper (EBD/01/29, 3/12/01), and determines that, based on this PRSP progress report, the Poverty Reduction Strategy of Uganda continues to provide a sound basis for Fund concessional financial assistance. (EBS/01/33, 3/12/01)

Decision No. 12455-(01/30), adopted
March 26, 2001

2. OMAN—2001 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 2001 Article IV consultation with Oman (SM/01/87, 3/9/01), together with a statistical appendix (SM/01/88, 3/13/01).

The staff representative from the Middle Eastern Department (Mr. Fasano) submitted the following statement:

The authorities recently informed the staff that the investment to expand the liquefied natural gas (LNG) output from 5.3 million tons in 2001 to almost 10 million tons by 2004, would be postponed temporarily. However, the staff does not see a need to change the policy recommendations in the staff appraisal. Details of the estimated impact on key variables of postponing the project can be provided to the Board upon request.

The authorities also informed the staff that they only intended to issue a PIN, as had been the case since the 1998 consultation, the staff representative noted.

Mr. Shaalan submitted the following statement:

The Omani economy has performed remarkably well over the past decade despite wide fluctuations in world oil prices. Real GDP grew at an annual average of 5 percent and inflation was low virtually throughout the decade. Furthermore, non-oil exports increased at an annual rate of 15 percent and now constitute about 25 percent of total exports. This successful economic performance was underpinned by the pursuit of strong macroeconomic policies and the prudent use of the country's relatively limited oil resources to achieve rapid social and educational development and to lay the groundwork for significant economic diversification. The latter objective has been pursued through an ambitious investment program, centered around the recently completed liquefied natural gas and port projects. At the same time, the Omani authorities continue to make important progress on other economic reforms, aimed at the promotion of domestic and foreign investment and the expansion of the role of the private sector in the economy.

After a small decline in 1999, real GDP rebounded strongly in 2000. With the recovery in oil prices and the coming-on stream of the LNG project, the external accounts also improved significantly, with the current account shifting to a large surplus in 2000. This improvement allowed the replenishment of the State General Reserve Fund (SGRF) by more than double the amounts that had been withdrawn during 1998-99, when oil prices had fallen substantially. Total official foreign assets, including the Central Bank of Oman's (CBO) reserves, currently stand at the comfortable level of about 30 percent of GDP and are projected to reach more than 50 percent in a few years.

Fiscal performance improved significantly in both years. After the large deficit of 1998, the overall balance shifted to a surplus, reaching 12 percent of GDP in 2000, which allowed the repayment of short term debts incurred in 1998 as well as the sizeable buildup in official foreign assets referred to earlier. The non-oil fiscal deficit also declined sharply and in 1999 stood at the lowest level in a decade. Strong expenditure rationalization and revenue generating measures accounted for this improvement. While total expenditure was virtually unchanged in nominal terms since the mid-nineties, revenue measures included a temporary 10 percent tariff surcharge which was removed at the beginning of 2000.

On the monetary side, the authorities continued to pursue a prudent monetary policy in support of the exchange rate peg and macroeconomic stability. To reign in private consumption which was expanding rapidly, the CBO tightened personal credit policy in early 1999 by limiting personal loans to 30 percent of total bank loans. As a result, private credit growth was halved by the end of 1999 and is still on a downward trend. In addition, net credit to the government has been declining significantly with the repayment of government debt and the increase of its deposits with the CBO. As a result, broad money has been increasing by a moderate annual rate of 6 percent.

Oman's financial sector remains sound and well supervised. Banks prudential regulations were further strengthened in 1999 by introducing new regulations to increase provisions for unrealized losses in stock investments. This, as well as the end of a tax holiday which was granted to some banks to encourage mergers, contributed to a slowdown in profit growth in the sector.

The health of the banking sector, however, continues to be robust; the capital adequacy ratio remains above the 12 percent requirement, while non-performing loans stand at a low 6 percent and are well provisioned. A new Banking Law was enacted in December 2000, in line with international best practices, to further strengthen the sector. In addition, the CBO conducted a self-assessment of its supervisory system and practices which confirmed compliance with the Basel Core Principles. The authorities intend to launch a Financial Sector Assessment Program (FSAP) as a part of their efforts to continue to identify areas to address so as to enhance the soundness of the financial sector.

Turning to structural issues, it should be noted that the number of Omani new entrants to the job market has been increasing by some 5 percent annually in recent years. To help absorb this high rate, the authorities continue to pursue the "Omanization" plan which aims at the replacement of expatriate workers with nationals without undermining productivity. The plan focuses on training and dissemination of labor market information. At the same time, the quotas for national employment continue to be applied with flexibility. In addition, the wage gap between nationals and expatriates has declined across the different sectors as shown in Table 8 of the Statistical Appendix.

As noted earlier, enhancing the role of the private sector has been a cornerstone in the authorities' development strategy. All new major projects, including in LNG, fertilizer, and shipping and transit facility projects are owned jointly with the private sector and are under private management. Furthermore, privatization efforts are ongoing in all sectors. In particular, it should be noted that the privatization of the power generation sector, which is at an advanced stage, is one of the most comprehensive in the region.

As indicated in Box 2 of the staff report, the structural reform agenda of the Omani authorities is ambitious. A number of reforms have already been implemented and others are being introduced to promote the private sector and further improve the business environment. For example, the commercial law was recently amended to enhance competition and a commercial court was established to process commercial litigations in an efficient and speedy manner. Furthermore, corporate governance was strengthened by introducing new regulations enhancing transparency and the accountability of the board of directors of listed companies. To attract foreign investment, the authorities have also adopted a new law which allows 100 percent foreign ownership of industrial companies and includes a significant reduction in the taxation of foreign companies, as a part of a medium term plan to apply a single low rate of taxation to all companies. Oman also offers various incentives to foreign investors. The authorities have started to rationalize these incentives but are of the view that they should not be reduced much below incentives offered by other countries.

GDP growth is projected to accelerate to 6.5 percent in 2001 before slowing to a healthy 4.5 percent annually over the medium term. After rising by 10 percent in 2000, non-oil GDP is projected to grow at a buoyant 5 percent annually. This reflects the expected doubling of LNG exports in 2001 and the implementation of a number of joint venture projects in the pipeline estimated at over US$6 billion, or one third of GDP. The overall fiscal position is projected to remain in considerable surplus over the medium term. On the other hand, the current account is projected to shift into deficit on account of large capital imports before returning to surplus in 2005.

The above projections are based on a gradual reduction in the overall fiscal balance from 10.5 percent of GDP to about 2.5 percent over the medium term in line with the WEO assumption of a decline in the oil prices to US$19.5. The staff recommends a tighter fiscal stance in case oil prices decline to substantially below that level. We have our doubts about the accuracy of any long-term projections of oil prices, including those that are based on historical trends as they have proved to be largely unreliable. We would therefore prefer to base economic policy on the WEO projections and to re-evaluate the situation as they are updated. In any event, the authorities stand ready to take strong measures to address the consequences of any unforeseen decline in oil prices. Their track record is a good testimony of their willingness and ability to take necessary action.

In conclusion, the authorities are determined to continue to pursue the prudent macroeconomic policies which have characterized their economic management over the years and to implement their strategy to diversify the economy and promote the role of the private sector. They value their close relationship with the Fund and wish to thank the staff for their useful analysis and policy advice.

Mr. Kelkar submitted the following statement:

We wish to thank the staff for an excellent report which provides a comprehensive account of the impressive progress made by Oman in recent years and prospective policy challenges faced by the Omani authorities. These remarkable achievements are due to sustained implementation of sound macroeconomic policies and structural reforms over the years which have resulted in price stability in the context of a liberal trade and exchange regime and a stable currency. The authorities deserve to be commended for their stress on diversification of the economy toward a non-oil sector driven growth path. The acceleration of structural reform measures will foster further economic diversification with an improved environment for private sector growth that will create additional employment opportunities for the Omani nationals. We are in broad agreement with the thrust of the staff appraisal. Mr. Shaalan's preliminary statement has also provided useful insights about the skillful management of the Omani economy.

The authorities should be commended for pursuing prudent macroeconomic policies in the backdrop of sharp volatility in international oil prices. When the fiscal and external positions were under pressure due to a sharp decline in oil prices, the authorities acted promptly through expenditure cuts and additional revenue measures. The authorities have rightly used the fiscal surplus of 1999 and 2000 by repaying short-term external and domestic debt, and building up official foreign exchange reserves. However, it has become even more important to introduce new revenue measures to increase non-oil revenues and rationalize expenditure to help achieve medium-term fiscal objectives and macroeconomic stability. The authorities should consider the suggestions of the staff for broadening the tax base and rationalizing subsidies so as to reduce dependence on volatile oil revenues over time.

We commend the authorities for continuing with a prudent stance of monetary policy in support of exchange rate peg which is consistent with the economy's structure and requirements and has helped in maintaining low inflation and market confidence. The present system has served the country well and the authorities have supported it by prudent management. We agree that fiscal discipline and a sound banking system are crucial elements to support the current exchange rate peg.

We urge the authorities to continue with their efforts to develop more indirect monetary instruments to manage liquidity by gradually eliminating existing direct credit controls. The banking system has remained strong and well supervised with high capitalization and a stable level of non-performing loans which are well-provisioned. The authorities deserve to be commended for their continued efforts to strengthen prudential regulations and banking supervision which have enhanced the resilience of the banking system. We welcome the decision of the authorities to participate in the Financial Sector Assessment Program (FSAP).

We are encouraged to note that the authorities are accelerating structural reform measures to strengthen the process of diversification. Box 2 of the staff report (page 26) provides a good overview of the far-reaching economic reform agenda of the authorities. Promotion of private sector activity will create new job opportunities for a rapidly growing workforce.

On the labor market issue, the staff report has noted the measures envisaged by the authorities for increasing employment opportunities for the nationals in the private sector and made useful suggestions for maintaining labor market flexibility. Implementation of an effective training program for the nationals suited towards private sector employment along with giving appropriate weight to market-based policies, and in particular, application of a quota system with flexibility, will maintain the competitiveness of the economy. In this regard, we welcome earmarking of substantial resources for human capital development over the next five years.

In conclusion, we would like to commend the authorities for the excellent management of the economy and wish them continued success in their policy endeavors.

Mr. Shojaeddini submitted the following statement:

We thank staff for a well-written report and Mr. Shaalan for his helpful statement. After experiencing difficulties in 1998 and part of 1999, Oman's economy resumed growth in 2000 at a rate close to its 1990s average. Real GDP growth, amid low inflation, has been supported by stronger oil sector activity and economic diversification in the past few years. Oman's financial position also improved significantly, reflecting the sharp recovery in world oil prices, the coming-on stream of the LNG project, and prudent fiscal and monetary policies adopted by the authorities. The overall fiscal balance improved from a deficit of almost 6 percent of GDP in 1998 to a surplus of about 12 percent by 2000. Total expenditure continued to decline as a percent of GDP during this period, reflecting a decline in both current and capital expenditures. Higher oil prices also contributed significantly to further improvement in the external balance. Moreover, commendable efforts were made in preserving the quality of assets and the soundness of the banking system through high capitalization and strengthened prudential oversight.

Notwithstanding these achievements, the challenges remain in diversification of the economy and job creation for a rapidly growing population. To address these challenges, the authorities have outlined their objectives in the sixth five-year development plan. We welcome these objectives, and given the authorities' strong track record, we are confident that they will be achieved.

The medium-term economic outlook is encouraging. Economic diversification has enhanced medium-term growth prospects. The growth strategy adopted by the authorities is appropriate. This strategy rightly focuses on creating the infrastructure for, and promoting foreign investment in, gas-based industries. Growth will also be supported by downstream activities, such as mining, fisheries, and tourism.

Maintaining a strong fiscal position is the highest challenge facing the authorities. As in many other oil producing countries of the region the fiscal position in Oman remains vulnerable to oil price fluctuations. Oil price uncertainty also shadows the magnitude of fiscal adjustment required for sustainable long-term fiscal position together with assuring intergenerational economic equity. Nevertheless, we agree that there is a considerable scope for fiscal consolidation and the authorities need to move vigorously in that regard.

For achieving fiscal adjustment, both non-oil revenue enhancing and expenditure restraining measures should be implemented. We agree with the staff's view on the measures to mobilize revenue, such as extending excises to selected services, eliminating exemptions and tax holidays, increasing subsidized utility charges, and introducing a broad-based general sales tax. We welcome the steps already taken by the authorities and their efforts in improving the collection of custom duties and other fees. We also welcome the measures envisaged to restrain expenditure. In addition to these measures, we underscore the importance of increasing expenditure efficiency and improving budget implementation, and agree with the staff that restraining the wage bill and substituting a direct transfer for general price subsidies would also support the adjustment effort. The authorities' policy with respect to the SGRF is appropriate, as this fund currently needs to serve the purpose of both revenue stabilization and intergenerational economic equity. The staff proposal to use SGRF for intergenerational saving while accommodating state financing needs by purchasing government securities with its resources is appropriate; however, it would take time to gain public support for its implementation.

On financial policies, the authorities have been successful in maintaining broad money growth under control and a no-inflation environment. While they are understandably cautious about financial sector liberalization, they have taken steps in easing personal credit regulations by eliminating the interest rate ceiling on credit card purchases and allowing banks to lend a higher portion of their portfolio for personal credit. The full liberalization of personal credit should proceed only after prudential regulations are developed and their enforceability assumed. We agree with the staff that financial intermediation in Oman needs to be deepened. We appreciate Appendix II of the report that provides a good overall picture of the Omani banking system; however, there is no reference to Islamic banking in this section. Could the staff comment on the extent of Islamic banking practices in Oman? The efforts in developing indirect monetary policy instruments and the plan to create a monetary policy unit at the CBO are also welcome and we support the authorities' request for technical assistance in this respect. We are pleased to note that a new Banking Law, in line with international practices, was enacted in December 2000 aimed at further strengthening the banking sector, and that the CBO's self-assessment of its supervisory system and practices has confirmed compliance with the Basel Core principles.

On the structural front, it is encouraging to note that the authorities' determination to reform, especially through privatization, has not been weakened by the recent increase in oil revenue. We welcome the progress made in the divestment program of the power sector. The authorities' comprehensive privatization efforts have clearly sent a strong signal on their commitment to promote private sector activity. On the labor market issue, we agree with the staff that the focus should be on a long-term solution with emphasis on education, extensive training programs, and a more efficient labor market.

Finally, we welcome Oman's participation in the GDDS and the FSAP.

Mr. Al-Turki made the following statement:

Oman's economic progress remains impressive. Assisted by oil price recovery since mid-1999, the authorities have steered the economy into renewed growth in a setting of continued price stability, and improved fiscal and external payments positions. The growth outlook is also favorable as infrastructural investments, and the ongoing diversification and restructuring effort, have added to the economy's potential. The continuing challenge is to stay the course and build on the progress already made. I am confident of prospects in that regard in view of the authorities' established reputation for policy vision and adaptability, as detailed in the comprehensive preliminary statement by Mr. Shaalan.

The authorities' policy prudence was again manifest in the substantial channeling of recent oil revenue gains to debt reduction and a build-up of official foreign assets. Let me underscore here that the spending rise last year should be evaluated in the light of the fact that it was preceded by a period of sustained decline of outlays in real terms. Regarding the staff's advocacy of a tighter fiscal stance because of anticipated oil market developments, I share Mr. Shaalan's doubts about the reliability of long-term oil price projections. Indeed, this lesson from past attempts at oil price forecasts has been repeatedly noted in earlier Board discussions. The prudent practice therefore is to reevaluate prospective fiscal policies from time to time in the light of the evolving oil market situation. Given the track record, I am confident that the authorities will remain vigilant and take appropriate actions as needed to both contain spending and increase revenues. Here, the staff report makes useful suggestions for steps that deserve consideration. I welcome in that connection the marked rise envisaged this year for non-oil revenues.

A legacy of monetary policy prudence has contributed to Oman's excellent inflation record and exchange rate stability. While tightening controls was appropriate to rein in the surge in private credit, the staff is right to stress the importance of shifting from direct credit controls to market-led management. On the intermediation process, the authorities can take credit for a well-functioning regulatory and supervision framework that has ensured an efficient banking system. I also welcome the central bank's recent self-assessment of the supervisory system and practices, which is further evidence of the authorities' continuing efforts to deepen and extend the reforms.

Let me add that, like Mr. Shojaeddini, I appreciate the staff's well-written and informative appendix on the Omani banking system. While I agree that it might have been more useful to cover the various banking practices in Oman, including Islamic banking if there is any, it is crucial that all of the country's banks and financial institutions be subject to the same rules and regulations. I welcome in that connection the authorities' decision to carry out a Financial Sector Assessment Program (FSAP) review.

Further diversification of the production base and increased private sector initiatives are essential in view of the need to absorb the country's growing youthful population. The rapid rise in non-oil exports to nearly a quarter of total exports is a testimony of the success of efforts so far in that regard. The high priority for additional structural reforms is a welcome step that should further advance this objective. In that regard, I note particularly the vigor of the privatization drive and the efforts to ensure a business environment conducive to foreign and domestic investors alike. Regarding incentives to foreign investors, I agree with the authorities' emphasis on a regional approach to maintain an appropriate parity with the policies of the neighboring countries.

Let me note that I appreciate the staff's efforts to provide a regional perspective in this report. Indeed, I have stressed in the past the importance of a regional focus in the discussion of country issues in consultation reports. That said, it is important to avoid out of context references that are at best marginal to the country under discussion. This includes, for instance, the potentially misleading references in footnote 11 to Saudi Arabia and the WTO, and in paragraph 16 to Gulf Cooperation Council (GCC) coordination on a general sales-tax initiative for the region.

Finally, the objective of the staff's recommendation on enhancing the effectiveness of the State General Reserve Fund (SGRF) is unclear. The suggested switch from the present direct SGRF financing of the budget to the use of an intermediary step of issuing securities appears to be essentially a cosmetic change. Indeed, the only practical effect would be an accounting alteration that will boost the SGRF holdings with a corresponding offsetting entry in the government budget. I would appreciate the staff's comments on this matter.

With these remarks, I wish the authorities further success.

Mr. Cho made the following statement:

Although the Omani economy has been helped by a strong recovery in oil prices in the world market for the past two years, the authorities should get fair credit for having moved far on economic reforms and the diversification of the economy. Because of their endeavors, major macroeconomic indicators of the Omani economy are now in far better shape, and its dependency on oil revenue has been significantly lessened although it is still above the average for GCC countries. Nevertheless, the staff report has pointed out a couple of areas for the authorities to achieve better performance in the future, and I will limit myself to highlight a few areas for emphasis.

For an oil-dependent economy like Oman, prudence of fiscal management is crucial to ensure against fluctuating changes in external conditions. This applies even more when large amounts of fiscal expenditure are necessary to diversify revenue sources. One solution to this problem is to invite foreign capital to major public projects on an equity participation basis, as strongly recommended by the staff. A more immediate solution, which other Directors suggested, is a more transparent use of savings funds, in particular the SGRF in Oman. It is true the authorities have an intrinsic temptation to draw upon this fund whenever they find shortages in their national budget.

I endorse the recommendation in the staff report that the SGRF should be clearly separate from the budget to ensure the accountability of those responsible for the fund's operation and the transparency of its account. However, the fund should be allowed as a source of social spending if there is a fiscal deficit, but only by purchasing government security debt at the market price. This is desirable not only for securing prudent fiscal management, but also as a way to deepen the financial sector of the Omani economy by establishing a curve in the bond market.

I welcome the staff's assessment that the exchange rate regime is appropriate and effective in Oman. It should be supported by prudent macroeconomic management, on the one hand, and flexibility in both the product and financial markets on the other hand. As for the financial market, I am surprised to hear that the Omani authorities still control domestic interest rates while allowing for an essentially free flow of capital externally. Normally, financial liberalization on the domestic front comes first, followed by an opening of the capital market. This gives time for domestic financial institutions to nurture their competitiveness before exposing themselves to the volatility in the international market. I wonder if the staff have found any weaknesses of Oman's financial institutions because of this sequence of liberalization.

Turning to the labor market, it is understandable that the authorities are concerned about persistent unemployment. Yet setting targets that must be supplemented by the SGRF will only make the unemployment problem worse. There is little incentive for Omani's to train themselves for better jobs, for which the resources of the SGRF should be used. I join the staff in welcoming the authorities' endeavor to human development and economic diversification expressed in the Sixth Five-Year Development Plan.

Finally, I would like to ask the staff to clarify why it has advised the authorities not to bolster the stock market. I understand that the authorities should not repeatedly bail out mismanaged financial firms. But should the SGRF not participate in the stock market either indirectly or directly? I raise this question because the description of the report in paragraph 8 seems to give the impression that the authorities' establishment of a stock fund financed by the SGRF is an attempt to prop-up the market. The SGRF could play a role similar to that of a responsible institutional investor which would contribute to the stability of the stock market if it is properly managed.

Mr. Wong made the following statement:

We thank the staff for a well-written report that provides a balanced assessment of the Omani economy. We would like to thank Mr. Shaalan for his helpful and comprehensive preliminary statement. Oil windfalls, coupled with prudent macroeconomic policies, has contributed to a strong recovery since mid-1999. The fiscal and current accounts both registered large surpluses in 2000. The Omani authorities rightly took advantage of its strengthened financial position to repay short-term debt and to increase official foreign reserves. We are optimistic about the outlook for the Omani economy and broadly agree with the staff appraisal.

On growth strategy, the authorities are on the right track. This is evident from the country's remarkable macroeconomic performance over the past decade. However, recent experience suggests that short-term fluctuations can be large. The importance of the oil sector in overall activity has changed little over past years. There is considerable scope for achieving a less amplified economic cycle through greater diversification and we thus welcome the authorities' plan to quicken actions and intensify efforts along the lines of Box 2.

On monetary and financial policies, the current arrangements have served the economy well. Inflation has been very low, while the financial sector has enjoyed a high degree of stability. We welcome the strengthened prudential regulations and the new law for the banking sector, which is already sound and highly capitalized. We also welcome the authorities' efforts to develop indirect monetary instruments with a view to moving away from the direct credit control framework. Parallel to this move, over the longer term, policies should be focused on achieving a more market-oriented banking sector that can better direct and mobilize resources to support the country's economic development. In this regard, removal of interest rate controls and personal loan ceilings should be a medium-term goal. Careful planning and implementation, however, are necessary.

On fiscal policy, we appreciate that it is not easy to maintain a steady financial position given the heavy concentration of economic activity in the oil sector. While the structural reforms to engineer a more diversified economy will help over time, we agree with the staff that there is a need to broaden the tax base and rationalize expenditure.

With the above remarks, we wish the Omani authorities continued success in their future endeavors.

Mr. Walsh made the following statement:

Oman has an increasingly liberal and well-regulated economic environment, including a sound and well-run banking sector. WTO accession has been a positive step, and by regional standards the authorities are making great strides in attracting private capital for infrastructure. Recently, as the staff report shows, there has been a clear turn-around in Oman's public finances and balance of payments, thanks to higher oil prices and the start of large-scale LNG exports, which is welcome. Problems do remain, however, and I will focus my comments on two areas: the budget and the labor market.

On the budget, oil prices and LNG exports have pulled Oman back from a pretty difficult budgetary position developed when oil prices were low in 1998 and early 1999. If low prices had continued for another year, there looked to be a real risk of reserves being exhausted and significant financial problems developing. The staff notes in paragraph 14 that the budget could again be vulnerable in the event of another period of low oil prices. If a large deficit obtained and the SGRF is exhausted, even with oil at $16 a barrel, there is a risk of even more serious difficulties if the price of oil were to fall again well below this level.

Oman would benefit from a medium-term fiscal strategy which is able to accommodate quite wide swings in oil prices. This would mean continuing steps to build up non-oil revenues to lessen vulnerability to oil price swings, and tight control of spending in a medium-term framework. Conservative assumptions about oil prices should be used with a very clear strategy for building up reserve holdings in the long term while adjusting them from year to year as oil revenues fluctuate. It is not clear that this sort of strategy exists at present. Is it possible that the Sixth Five-Year Plan outlined in the Royal Decree in January does embody a new approach? It certainly contains welcome general commitments to increase non-oil revenues and to strengthen the SGRF. and it contains baseline assumptions about oil and gas revenues which might form the basis for a medium-term expenditure strategy. Staff comments would be welcome in this regard.

In the absence of a new strategy, the authorities would be well-advised to tackle their weak expenditure control and seek to strengthen the SGRF. This is meant to become a large investment fund that would provide a stream of future income, a hope that has not yet been realized. Rather, the fund has been used in an ad hoc and opaque way to finance budget spending. I endorse the staff's call for strengthening the fiscal positioning, including the detailed suggestions in paragraphs 16 and 31 and their call for a clearer mandate for and a more coherent and open approach to the SGRF as articulated in paragraph 17 and 32.

Turning to the labor market, the staff are right to give labor market issues some attention, but I wonder if their apparent optimism about employment prospects is well-founded. Oman has an exceptionally fast-growing population. The U.N. estimates that the working age population has been growing by around 4 percent per annum in the past decade and will continue to grow at between 3-4 percent per annum over the next decade. This means, by my back-of-the envelope calculations, another 550,000 or so young people, largely Omani nationals, will reach working age in the next ten years, of whom all the males and an increasing proportion of the females will be looking for jobs. That is roughly 300,000 to 350,000 in total. Given that there are only around 200,000 Omanis in employment at present and a total work force of 700,000, this is a significant challenge.

While the measures discussed in paragraph 26 are all desirable and will certainly help improve the readiness and ability of Omanis to take work, will they be enough on their own? Have the staff or the authorities given any thought to the possible use of tax or fees to change the relative cost of employing Omanis and non-Omanis. Looking forward, I urge the authorities to take the opportunity presented by the forthcoming household survey results to think afresh about ways of creating incentives to expand Omani employment.

The staff representative from the Middle Eastern Department, in response to questions and comments from Directors, made the following statement:

On the SGRF, there are two related issues: transparency and the rules under which this fund should work. The authorities have been encouraged to incorporate into their official fiscal statistics the transactions and the flows that are related to the SGRF because, in particular, it will send an important message to the market. In fact, the authorities are trying to encourage private sector led growth, and the private sector needs the appropriate amount of information to make investment decisions. For example, in their official fiscal statistics the authorities have been excluding the transactions of the SGRF and the Oil Fund, and, over the past five years, the budget has consequently shown a deficit. If the SGRF transactions had been included, out of these five years only one or two would have shown a deficit. It would also have shown that the authorities implemented a prudent fiscal policy to support, in particular, the exchange rate regime.

On the controls that the authorities apply on personal loans, the interest rate ceiling is currently relatively high at 13 percent—much higher than the international interest rate and also much higher than the rate that is charged on other types of loans. Because of this high rate, the authorities also place quantitative ceilings on personal loans, while at the same time limiting how much banks can borrow from abroad. Together, these ceilings limit the amount of resources that can be brought from abroad and be used for personal lending.

Regarding the comments in the staff report on stock market intervention, the primary concern of the staff was the government bailout of small investors. As stated in paragraphs 8 and 22 of the staff report, although the authorities insisted that this was a one-off measure, investors may interpret this action as something that could happen again in the future.

On the medium-term fiscal policy and oil price projections, the authorities assume a relatively conservative oil price for the next five years of $18 per barrel. This conservative oil price assumption is used on the revenue side but is not used on the expenditure side. For the 2001 budget, for instance, the authorities used a figure of $18 for revenue, and $20 for expenditure. The staff has suggested that both revenue and expenditure should be based on a conservative assumption.

The World Bank is closely involved with the authorities in dealing with the problems in the Omani labor market. Two significant reports have been issued, and some of their policy recommendations are in the staff report. The reports show that Oman's economy has created a large number of jobs, but only one third of those jobs have been occupied by Omani nationals. The authorities have said that they expect 25,000 graduates per year to enter into the labor market in the next five years, which implies that there is an urgency to implement measures to encourage the employment of Omanis, particularly in the private sector. Since the mid 1990s the government is no longer the first source of employment, which has sent an important message. As Mr. Shaalan mentioned, the wage gap has declined over the past years and this has increased the employability of Omanis. This is a long-term issue that cannot be solved quickly. The authorities are trying to rely on administrative measures, like the quota system (although in a very flexible way), while earmarking large resources for training and education. Over the medium term, this will create the necessary skills in the Omani population to gradually substitute part of the expatriates that currently work in the country.

Finally, a number of Directors have asked if there are Islamic banking practices in Oman, and if so, how do they function. There are no Islamic banks or Islamic banking practices in Oman.

Mr. Abbott remarked that disclosure of information on transactions related to the SGRF would certainly allow private investors to play a more significant role and would enrich the policy dialogue. There were quite a number of medium-term issues to resolve, and the authorities were encouraged to reconsider their decision not to publish the staff report.

Mr. Shaalan made the following concluding statement:

I thank colleagues for their remarks, their encouragement, and their advice, which will be transmitted to the authorities, including Mr. Abbott's recommendation to publish the report. I will limit my comments to three areas: fiscal policy, some remarks on monetary policy, and labor policy.

I was somewhat surprised that not sufficient credit was given to Oman for the fiscal performance that has materialized in 1999 and 2000. I appreciate that it is extremely tempting to attribute these improvements to oil price increases. However, this was not entirely the case in Oman. It is good to note that the overall fiscal balance improved sharply in those two years; but if we take out the impact of oil altogether, we still find an improvement in the budget position. Why did that materialize? As the staff point out, there was strong expenditure rationalization and there were revenue-generating measures, both of which contributed to the strong non-oil fiscal performance.

It is also good to note, Mr. Chairman, that total expenditures remained virtually unchanged in nominal terms in Oman since the mid-1990s. It is true that wages increased substantially in the year 2000, but it is important to keep in mind that consciously and as part of the country's policy, in adjusting the income policy to changes in oil prices, wages have been kept unchanged for a number of years. If you look at annual wage bill increases over the past four years, including the years where there were no wage increases, the average is under 4 percent.

Revenues did decline in the year 2000. In spite of that, non-oil revenue remained higher than its level in 1997 and is projected to increase by more than 20 percent in the year 2001. This is the result of the adoption of new taxes and improvement in the collection of fees and customs. The reason for the decline in the year 2000 was the abolition of the temporary 10 percent import charge.

On monetary policy, I would like to comment on Islamic banking, raised by Mr. Shojaeddini and commented on by Mr. Al-Turki. Islamic banking should be subject to the same rules and regulations and the same supervisory procedures that are applicable to the totality of the banking system, including offshore banks. They should be subject to the same strict rules and regulations as any bank.

Many Directors have remarked on the fact that interest rates continue to be controlled, the quantity and price for consumer credit is controlled, all of which is true. The authorities wanted to control an area of credit expansion that seemed to be worrisome. They will, over the medium term, consider liberalizing the system further.

With regard to labor markets, though I have not seen the figure before, Mr. Walsh is right to state that the working population is growing at 4 percent annually, a very high figure. The authorities are looking into ways to increase incentives for employing Omani nationals. As stated by the staff, this has been done in two ways: (1) the wage gap between expatriates and Omanis is narrowing quite considerably, and (2) the government has reduced the level of public sector employment. Oman has an enviable record of diversification. If I am not mistaken, the non-oil sector contributes over 60 percent of GDP, which is a major change from the past decade.

The Acting Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the strengthening of economic performance since 1999, which was underpinned by rising world oil prices and prudent policies. Real growth recovered in 2000, following a small decline in 1999 largely as a result of the completion of major investment projects. Oman's long record of price stability continued, and the fiscal and the external balances strengthened significantly. Directors commended the authorities' prudent use of additional oil revenues to accumulate assets in the State General Reserve Fund (SGRF) and to retire short-term central government debt in 1999, as well as their ongoing efforts to strengthen the non-oil fiscal balance.

Directors saw further diversification of Oman's oil dependent economy and job creation for a rapidly growing labor force as the main challenges facing the authorities over the medium term. They endorsed the authorities' response to these challenges, which focuses on the development of industries in which Oman has a comparative advantage, such as gas-based industries and tourism; the creation of a business-friendly environment to encourage local and foreign investment; the deepening of the financial sector; the orientation of government expenditure toward education and training; and the broadening of the non-oil revenue base to enhance fiscal resiliency. Directors recognized that the authorities have taken concrete steps in implementing this strategy. They completed the liquefied natural gas and transshipment port projects; moved resolutely on economic reforms, particularly privatization in the power sector; and significantly reduced the bias against foreign corporate ownership. Although the tax bias against foreign investment has declined, Directors suggested that the adoption—in appropriate consultation with other members of the Cooperation Council of the Arab States of the Gulf (GCC)—of a single low corporate income tax rate for both local and foreign companies could help boost investment further.

In view of the projected decline in oil prices in the medium term, and to ensure intergenerational equity in the distribution of the oil and gas wealth, Directors stressed the importance of further strengthening the fiscal position, particularly the non-oil balance. On the revenue side, they encouraged the authorities to increase water and electricity tariffs to cost recovery levels, and—in coordination with other GCC partners—to consider the introduction of other measures to enhance revenue. Directors considered that expenditure restraint is also an important part of the appropriate fiscal strategy. They emphasized the need for targeted transfers to replace price subsidies, and for other steps to increase expenditure efficiency and improve budget implementation. Directors noted that the primary purpose of the SGRF is to preserve resources for future generations. While recognizing that fiscal strategy would naturally need to be reassessed periodically in light of evolving oil sector developments, they generally emphasized that ad hoc recourse to SGRF resources to finance budget deficits is undesirable.

On labor market reforms, Directors agreed with the authorities on the need to increase employment opportunities for nationals in the private sector through training and education while maintaining a flexible policy on the hiring of expatriate workers. They therefore welcomed the large resources earmarked to finance training and education of nationals over the next few years which would lead to an increase in the supply of skills demanded by the private sector and thus promote employment of nationals.

Noting that non-oil export volumes have increased rapidly over the past decade, Directors endorsed the authorities' commitment to the exchange rate peg. They stressed that continued fiscal discipline and a sound banking system will be needed to support the peg, particularly under high capital mobility.

Regarding monetary developments, Directors welcomed recent steps to ease personal credit regulations. They encouraged the authorities—as part of their strategy to rely more on indirect instruments to manage liquidity—to go further and simultaneously remove the interest rate and quantitative ceilings on personal loans in order to increase bank competition and overall economic efficiency. At the same time, they encouraged the banks to develop a modern credit analysis infrastructure.

Noting that the banking system appears to be sound and well-supervised, Directors commended the authorities for their continuous efforts to improve prudential regulations and bank supervision, and supported their decision to carry out a Financial Sector Assessment Program. Directors welcomed the ongoing efforts to improve corporate governance which should help support a recovery in the declining stock market. However, they advised the authorities to resist pressures to prop-up the market, especially through the bailout of investors.

Directors praised the authorities' efforts to improve Oman's statistics. They suggested further enhancing data availability and transparency by publishing comprehensive data on the external debt, the labor market, and the consolidated fiscal accounts, including the financial transactions of the SGRF and the Oil Fund. Directors commended the authorities for their decision to participate in the Fund's General Data Dissemination System (GDDS).

It is expected the next Article IV consultation with Oman will be held on the standard 12-month cycle.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/01/29 (3/23/01) and EBM/01/30 (3/26/01).

3. REVISED MANUAL AND CODE OF GOOD PRACTICES ON FISCAL TRANSPARENCY

The Executive Board approves the revised Code of Good Practices on Fiscal Transparency. (SM/01/76, 3/2/01)

Adopted March 23, 2001

4. REVISED MANUAL ON FISCAL TRANSPARENCY

The Executive Board approves the revised manual on Fiscal Transparency. (SM/01/77, 3/2/01)

Adopted March 23, 2001

5. RETIRED STAFF BENEFITS ACCOUNT—AMENDMENT

The Executive Board approves the proposed amendment to the Retired Staff Benefits Investment Account, in accordance with Attachment I of EBS/01/38, 3/16/01.

Decision No. 12456-(01/30), adopted
March 23, 2001

6. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 98/94, 99/120, and 00/71 are approved.

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors, by an Advisor to Executive Director, and by an Assistant to Executive Director as set forth in EBAM/01/32 (3/22/01) is approved.

APPROVAL: September 14, 2001

SHAILENDRA J. ANJARIA
Secretary