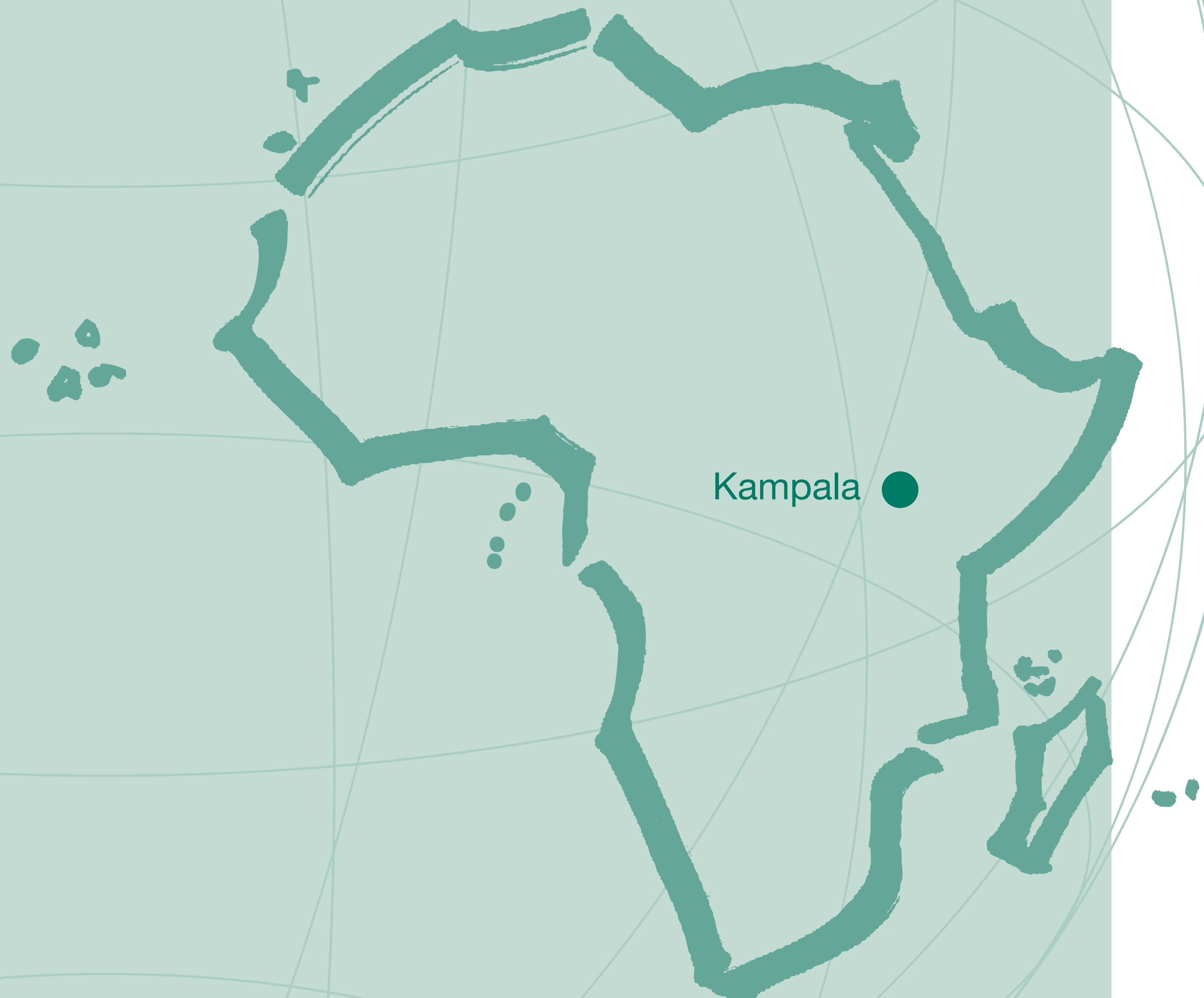
Uganda



key figures

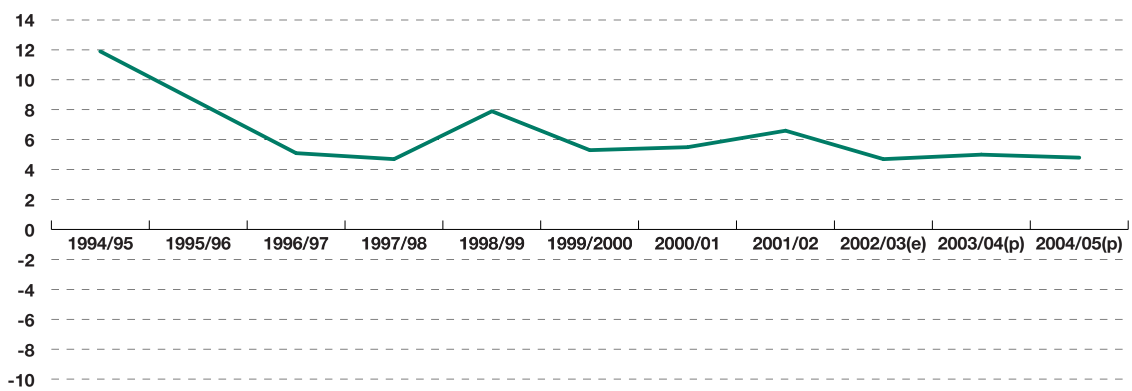
- Land area, thousands of km² 241
- Population, thousands (2002) 25 004
- GDP per capita, $ (2001/2002) 236
- Life expectancy (2000-2005) 46.2
- Illiteracy rate (2001) 31.2

Uganda

UGANDA IS MAINTAINING STRONG ECONOMIC performance, although economic growth now appears to have stabilised at a lower rate than seen in recent years. Real GDP growth hit 4.7 per cent in 2002/03, compared to an average growth of 6.9 per cent over the period 1994/95 - 2001/02, and is expected to remain around that level, at an estimated 5 per cent in 2003/04 and 4.8 per cent in 2004/05. Uganda's inability to replicate recent high-income growth could be attributed to a lack of significant expansion of agricultural output. The government follows a pro-market economic strategy. Improving domestic revenue mobilisation, coupled with the strong external aid support, and prudent expenditure management contributed to stability in fiscal performance; these successes are expected to be maintained in 2003/04 and 2004/05. However, maintaining confidence in the budgetary process may require the government to control supplementary budget appropriations. Prudent monetary management has also contributed to success in controlling inflation; the rate of inflation is expected to remain stable and low in 2003/04 and 2004/05. Volatility in interest rate movements and the exchange rate of the shilling are creating some instability in the financial markets however. The external payments situation has improved as a result of a current account deficit, which is expected to be maintained in 2003/04 and 2004/05. The improvement in the current account balance has contributed to rising external reserves. The current external debt situation would demonstrate the success of the enhanced HIPC initiative if some concern were not emerging about debt sustainability. The government is taking measures to transform the economy including efforts to attract private sector participation in the energy sector. However, progress in the privatisation programme remains rather slow. The political climate is stable, although it is still undermined by security problems related to cattle rustling, rebel activity in Northern Uganda and urban crime and terrorism. According to external sources, corruption is very high, but the government is taking measures to improve governance.

Strong economic performance remains, although economic growth now appears to have stabilised at a lower rate than seen in recent years.

Figure 1 - Real GDP Growth

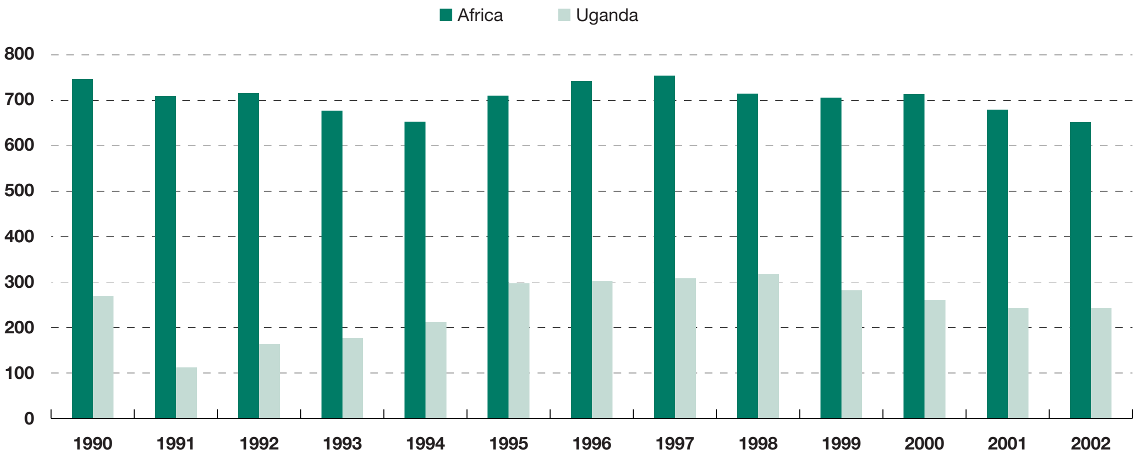


Source: IMF and domestic authorities' data; projections based on authors' calculations.

Recent Economic Developments

Uganda's recent economic performance appears to have stabilised. The growth rate of real GDP began to slow down in 1999/2000, reaching 4.7 per cent in 2002/03, well below the annual growth target set in the country's Poverty Eradication Action Plan (PEAP).

Figure 2 - **GDP Per Capita in Uganda and in Africa** (current $)



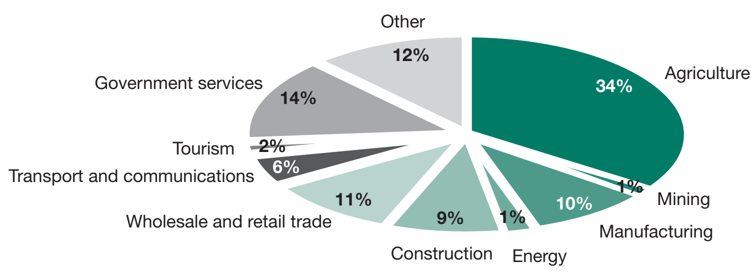
Source: IMF.

The lower growth recorded in 2002/03 was due in part to adverse weather conditions the agricultural sector. In addition, economic growth in 2002/2003 was hampered by delays in the construction of the Bujagali hydro-electric project, the major infrastructural project that had been expected to boost economic activity during the year. Growth is expected to remain stable at an estimated 5 per cent in 2003/04 and projected at 4.8 per cent in 2004/05. The inability of the Ugandan economy to replicate the high growth rates of the recent past is probably due to the lack of expansion in the agricultural sector.

In 2002/03, the prolonged dry season, especially in the second half of the year, reduced the growth of the agricultural sector. Agriculture accounted for about 40 per cent of GDP in 2002/03, and increased by only 2.2 per cent, compared to an increase of 4.8 per cent in the preceding year. In particular, food crop production was much lower than in the previous year, increasing by just 0.5 per cent in 2002/03 following the drought and delayed rains in some parts of the country. The lower food crop output offset a strong growth in cash crop production, especially coffee and cotton production, which benefited from favourable weather in the central and eastern regions. Cash crop production registered a growth rate of 9 per cent in 2002/03 compared with 6.7 per cent in 2001/2002. Output from the other agricultural sub-sectors – livestock, fisheries and forestry – remained stable on the previous year's levels. Slow growth in agriculture during 2002/03 was a challenge to the government's Plan for the Modernisation of Agriculture and the Strategic Export Programme; this major programme was in its second year in 2002/03, and was expected to spearhead expansion in income growth. The government is revamping the programme, and in 2003/04 is restructuring the National Agricultural Research Organisation in an effort to enhance the participation of the private sector, local government structures and communities in research implementation.

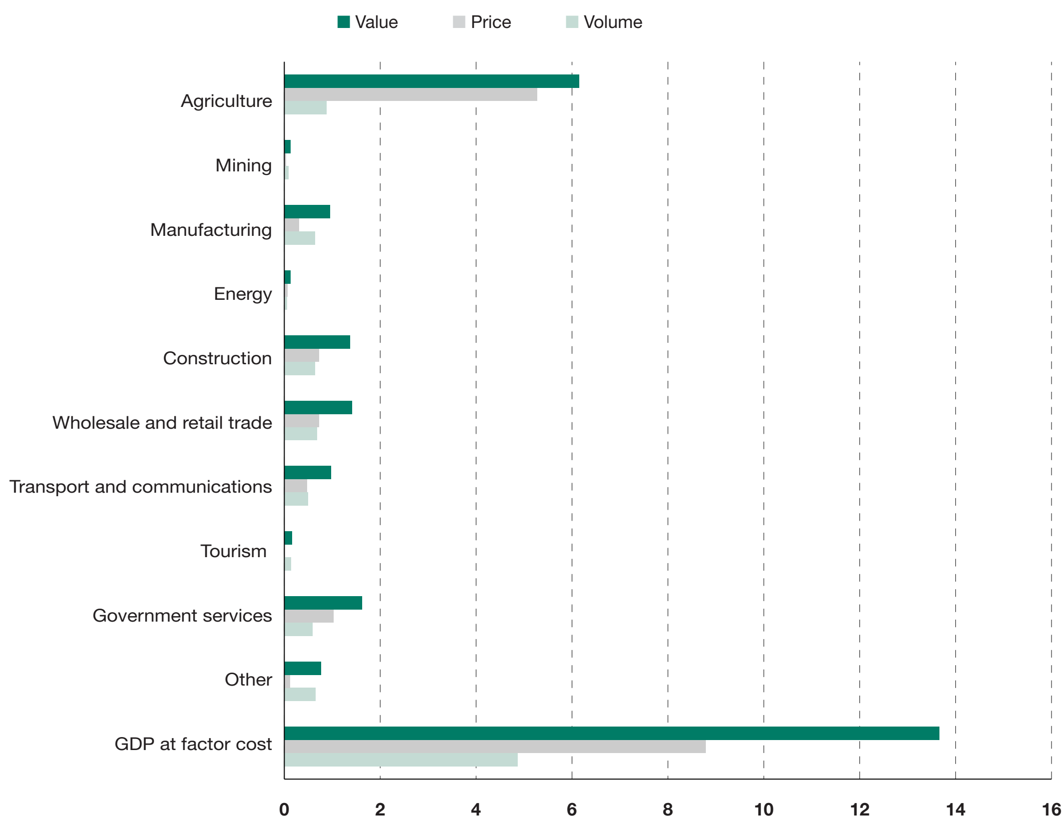
Industrial activity in Uganda is underpinned by manufacturing, which contributed to about 10 per cent of GDP in 2002/03. Since recording its highest growth rate of 14.2 per cent in 1998/99, manufacturing activity has remained mixed. In 2002/03, manufacturing growth rate was 6.6 per cent, slightly above the 6.3 per cent recorded in the previous year. Trends in the manufacturing growth rate since 1998/99 indicate that informal sector manufacturing, which contributes about 30 per cent of total manufacturing value added, has had a lower growth rate, averaging about 4.7 per cent, while formal sector manufacturing has tended to fluctuate around a higher average. In 2002/03, the manufacturing of some consumables, such as edible oil and fats, wheat flour, sugar and soft drinks, saw improved production. On the other hand, other consumables such as beer, cigarettes and footwear, usually considered luxuries in times of economic hardship, saw reduced production, reflecting a

Figure 3 - **GDP by Sector in 2002/2003**



Source: Authors' estimates based on domestic authorities' data.

Figure 4 - **Sectoral Contributions to GDP Growth in 2002/2003**



Source: Authors' estimates based on domestic authorities' data.

contraction in private consumption. The output of other products such as cement, clay bricks and tiles also increased in response to higher construction activity. Within the industrial sector, mining and quarrying achieved a significant growth rate of 11.5 per cent in 2002/03. Similarly, the construction sub-sector rose by 9.7 per cent in 2002/03 from 7.8 per cent in the preceding year. A rise in private construction of residential and commercial buildings lay behind the strong growth performance of both sub-sectors.

The government has put in place a number of initiatives to boost industrial production in 2003/04. In particular, several incentives were granted in 2003 to woo investors to industrial zones. These incentives included a ten-year corporate tax holiday; duty exemption on raw materials, plant and machinery and other inputs; no export tax on goods exported; exemption of withholding tax on interest on external loans; and relief from double taxation for repatriated dividends.

In the service sector, transport and communication's services continue to grow at a robust rate. In 2002/03, the sub-sector expanded by 9.7 per cent. Growth in this sub-sector was mainly driven by expansion in the telecommunications sub-sector, which grew by 20.5 per cent. The telecommunications sub-sector, which is now fully privatised and liberalised, saw significant expansion particularly in mobile and public phone usage. The number of telephone subscribers in Uganda has risen by over 100 per cent, from 230 000 in 2000 to 500 000 in 2003.

Table 1 - **Demand Composition** (percentage of GDP)

	1995/96	1999 /2000	2000/01	2001/02	2002/03(e)	2003/04(p)	2004/05(p)
Gross capital formation	**18.1**	**19.8**	**19.9**	**21.6**	**21.5**	**21.5**	**21.7**
Public	6.3	6.4	6.3	6.7	5.4	5.4	5.4
Private	11.8	13.4	13.6	14.8	16.1	16.1	16.3
Consumption	**97.8**	**93.6**	**94.2**	**93.9**	**94.1**	**94.1**	**93.3**
Public	11.3	13.7	14.0	14.8	15.5	15.5	15.2
Private	86.6	79.9	80.2	79.1	78.6	78.6	78.0
External sector	**-15.9**	**-13.4**	**-14.2**	**-15.4**	**-15.6**	**-15.6**	**-15.0**
Exports	13.2	10.5	11.3	11.4	13.6	13.6	14.3
Imports	-29.1	-24.0	-25.4	-26.8	-29.2	-29.2	-29.3

Source: IMF and domestic authorities' data; projections based on authors' calculations.

The Ugandan economy has maintained a structure of demand, characterised by relatively high consumption, especially private consumption. In 2002/03, consumption levels remained at a relatively high share of GDP, due to a slight increase in public consumption. The level of investment in 2002/03 exceeded 20 per cent due to the high inflows of foreign savings. It is anticipated that capital formation will continue to remain relatively high in 2003/04 and 2004/05.

Macroeconomic Policy

Fiscal and Monetary Policy

Uganda is pursuing a relatively tight fiscal policy that aims to underpin private sector development. Within the government's overall economic policy objective of promoting rapid, broad-based and sustainable economic growth, fiscal policy is geared to ensure that the private sector is not crowded out of key domestic markets by excessive demand from the public sector. The government's medium-term fiscal strategy entails a gradual reduction in the fiscal deficit. This is intended to reduce the amount of liquidity needed to finance the fiscal operations, and thereby ease the pressure on domestic financial markets.

In 2002/03, the government made considerable headway in reducing the budget deficit. The overall deficit was equivalent to 3.3 per cent of GDP, compared with 4.5 per cent of GDP in the preceding year. Efforts to enhance revenue mobilisation and expenditure control are expected to lead to near stability in the fiscal outcome in 2003/04 and 2004/05. The overall fiscal deficit is estimated at 3.5 per cent of GDP in 2003/04 and projected to fall to 3.2 per cent of GDP in 2004/05.

In 2002/03, tax revenues increased to 11.9 per cent of GDP compared to 10.8 per cent of GDP in 2001/02. The government is determined to maintain the mobilisation of domestic resources for funding the budget. In the 2003/04 budget, additional tax measures and improvements in tax administration were announced, which are expected to increase tax revenue

Table 2 - **Public Finances** [a] (percentage of GDP)

	1995/96	1999/2000	2000/01	2001/02	2002/03(e)	2003/04(p)	2004/05(p)
Total Revenue and grants[b]	**15.7**	**17.1**	**18.4**	**18.5**	**19.7**	**19.8**	**19.6**
Tax revenue	10.6	10.4	10.2	10.8	11.9	12.1	12.1
Grants	4.5	5.8	7.6	6.8	7.1	7.0	6.8
Total expenditure and net lending[b]	**17.8**	**24.1**	**20.0**	**22.9**	**23.0**	**23.3**	**22.8**
Current expenditure	21.9	23.7	25.6	27.8	15.4	13.5	13.2
Excluding interest	*20.9*	*22.6*	*24.3*	*26.3*	*13.8*	*11.6*	*11.4*
Wages and salaries	3.0	4.2	4.3	5.1	5.3	5.1	5.0
Interest	1.1	1.1	1.2	1.4	1.6	1.9	1.7
Capital expenditure	7.7	8.8	9.0	9.5	9.9	9.8	9.9
Primary balance	**-1.0**	**-6.0**	**-0.4**	**-3.1**	**-1.7**	**-1.6**	**-1.5**
Overall balance	**-2.0**	**-7.0**	**-1.7**	**-4.5**	**-3.3**	**-3.5**	**-3.2**

a. Fiscal year begins 1 June.
b. Only major items are reported.
Source: IMF and domestic authorities' data; projections based on authors' calculations.

to 12.1 per cent of GDP. The fiscal operations continue nevertheless to depend heavily on donor assistance, with grants accounting for 36 per cent of total revenue in 2002/03, a proportion that will only marginally decline in 2003/04 and 2004/05.

Government expenditure was maintained at about 23 per cent of GDP in 2002/03. However, expenditure in 2002/03 varied considerably across sectors, with some sectors consistently diverging above target at the expense of others. In particular, defence expenditure significantly exceeded the budget, motivated by the continued instability in the north, according to the government. Other sectors that exceeded their budget allocations included water and public administration. The situation created budgetary pressures met by the reallocation of resources. This reallocation created a situation of uncertainty and thus impaired the capacity of other ministries, including agriculture, education, health, law and order, to deliver services, and weakened their Commitment Control System. However, core priority areas of the budget, notably the Poverty Action Fund (PAF), were protected from budget cuts. Such reallocation, however, has the adverse effect of undermining confidence in the budget process among the various stakeholders, not least the donors whose contributions are crucial. The Public Finance and Accountability Act 2003, which was passed by parliament in July 2003, may limit the incidence of supplementary expenditure, by requiring parliamentary approval prior to the release of any supplementary funds.

Monetary policy is focused on achieving domestic price level stability. In financial year 2002/03, monetary management faced two main challenges: first, how to sterilise adequately domestic money creation arising from donor-funded government expenditure; and, second, how to contain inflationary pressures following a rebound in food prices caused by the lower food crop production. In an effort to improve liquidity management, the Bank of Uganda (BOU) changed the modalities for the operations of the Repurchase Agreements (REPOs) market from being administratively determined by the Bank to a market-determined rate auction. Under the new arrangement, the BOU announces the maturity desired to transact and the volume. In the year to June 2003, broad money supply (M3) grew by 23.9 per cent compared with 11.3 per cent the preceding year. Net claims on the central government declined by 18.7 per cent, after having risen earlier in the year owing to delayed disbursement of some programmed donor inflows. Private sector credit growth was also strong at 25.7 per cent in the year to June 2003, compared to 16 per cent between 1999/2000 and 2001/02. In 2002/03, improvements in loan recoveries contributed to increase lending to the private sector. In spite of this sharp increase, it remains a major concern that the financial system is not meeting the needs of vital areas in the private sector for poverty reduction. Trade and other sectors catering mainly to importers continue to be the major recipients of credit within the private sector, while lending to agriculture, where the bulk of the population earn a living, remains rather low.

The monetary authorities have achieved some success in controlling inflation. The underlying inflation, which excluded food crop prices, has remained relatively stable, recording 2.9 per cent in 2002/03, below the annual average of 4 per cent over the 1998/99-2001/02 period. However, in 2002/03, the annual average rate of inflation rose significantly to reach 8.4 per cent, from -2 per cent in the previous year. The rate of inflation is expected to revert to historically lower rates, at an estimated 4.7 per cent in 2003/04 and 4.5 per cent in 2004/05, as the difficult food situation experienced in 2002/03 subsides.

Movement in the foreign exchange rate of the shilling and domestic interest rates continue to demonstrate the instability of Uganda's financial markets. On the foreign exchange market, the shilling depreciated by about 10.3 per cent between April 2002 and April 2003, compared with 1.04 per cent during the same period the year before. The pressure on the shilling during 2002/03 was due to speculation at the height of the Iraq war and the perceived possibility that Uganda would not receive programmed World Bank Poverty Reduction Support Credit. These factors, coupled with sporadic increases in petroleum prices, compelled dealers to speculate on further depreciation of the shilling. Since April 2003, relative calm has been restored in the foreign exchange market. The depreciation in the nominal effective exchange rate during 2002/03 drove depreciation in the real effective exchange rate by 6.6 per cent by February 2003, compared with an appreciation of 2.5 per cent over the same period during the previous year. Reflecting underlying movements in the exchange rate, in June 2003 the rate on the benchmark 91-day Treasury bill rose significantly to reach 14.5 per cent compared with 5.4 per cent in June 2002. In line with the increasing rate on the Treasury bill, commercial banks increased their prime lending rates in 2002/03.

External Position

Uganda maintains its policy of liberalised external trade. The government remains committed to further trade liberalisation in the context of the World Trade Organisation (WTO). Uganda is also committed to the process of regional integration as a major strategy for widening its markets, enhancing investment opportunities and strengthening its bargaining power in the international market. The East African Community (EAC) is the focal point of this regional integration process. Uganda, Tanzania and Kenya signed the protocol establishing the East African Community Customs Union on 2 March 2004. However, considerable differences remain between the member states on the customs union. Regarding the Common External Tariff (CET), Uganda unilaterally decided to adopt a 20 per cent rate for finished goods, while Kenya and Tanzania stuck with the more protectionist 25 per cent. Originally, the member states had proposed a 0-10-25 CET tax regime, with the zero rate applying to raw materials, 10 per cent to intermediate goods and finished goods being taxed at 25 per cent. The member states also agreed that while trade between Uganda and Tanzania will become fully liberalised with the realisation of the customs union, a surcharge will be applied on a specific list of products from Kenya owing to its generally more advanced industrial base. Uganda is also seeking to become a full and active member of the bigger trading bloc COMESA, where it has yet to join the Free Trade Area of zero tariffs on goods produced in member countries.

Uganda has a low export base hinged on a few traditional commodities: coffee, cotton and tea. The government is aiming to expand and diversify the export base through a Strategic Export Programme (SEP), which is providing strategic intervention in support of expanding traditional exports and non-traditional exports, such as horticulture, livestock and fish.

The external position of the country has remained relatively stable because of some improvement in exports and a recent turn around in the terms of trade in favour of Uganda. In 2002/03, the current account deficit remained at an estimated 6.9 per cent of GDP, the same as in the preceding year, with a contraction in the commodity trade deficit. The relative stability in the current account in view of capital inflows has enabled external reserves to increase to the equivalent of 5.8 months of imports of goods and services at end-2003. In 2002/03, the total value of commodity exports rose substantially by about 14.9 per cent to represent 9.3 per cent of GDP. The gain in the value of exports was due essentially to a recovery in world prices of Uganda's exports. Earnings from coffee exports increased by nearly 28 per cent as a result of an almost 26 per cent increase in price and a 1.6 per cent increase in volume. Non-coffee export earnings also increased by about 12 per cent. Notable increases in non-coffee exports earnings were registered in tobacco, which increased by 58 per cent due to increased export volumes. Fish export earnings increased by about 12 per cent because of improved average unit price. Tea exports also increased due to increased volumes and prices. On the negative side, up to June 2003, Uganda faced a decline in the international price of cobalt, which was so severe Kasese Cobalt Company Limited of Uganda suspended exports of its product. Imports of goods increased in 2002/2003 to 18.4 per cent of GDP from 18.2 per cent of GDP the year before. The outlook on the external payments is further contraction of the trade deficit, which may help improve the current account balance. The trade deficit is estimated to fall to 8.8 per cent of GDP in 2003/04 and further to 8.3 per cent of GDP in 2004/05. This outcome depends on improvements in exports, as the level of import remains stable.

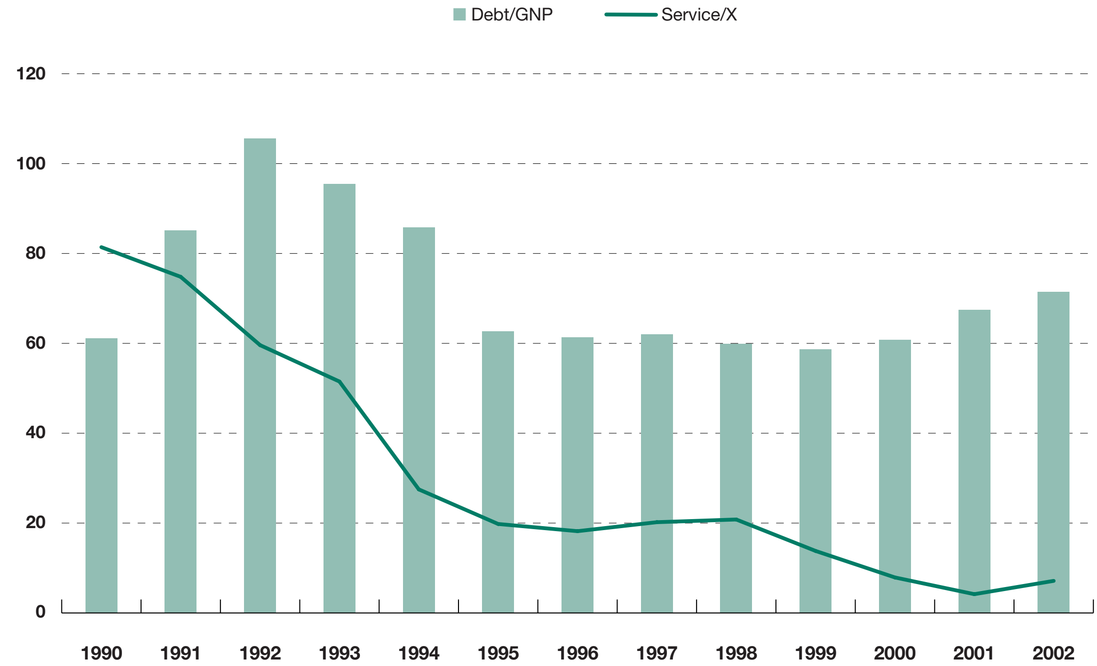
Table 3 - **Current Account** (percentage of GDP)

	1995/96	1999/2000	2000/01	2001/02	2002/03(e)	2003/04(p)	2004/05(p)
Trade balance	-11.4	-8.9	-9.2	-10.2	-9.1	-8.8	-8.3
Exports of goods (f.o.b.)	10.7	7.7	7.8	8.0	9.3	10.0	10.5
Imports of goods (f.o.b.)	-22.2	-16.6	-17.0	-18.2	-18.4	-18.8	-18.8
Services	-4.3	-4.0	-4.4	-5.6	-5.6		
Factor income	-0.8	-2.2	-2.3	-2.2	-2.4		
Current transfers	14.2	8.1	8.8	11.2	11.4		
Current account balance	**-2.3**	**-7.0**	**-7.1**	**-6.8**	**-5.8**		

Source: IMF and domestic authorities' data; projections based on authors' calculations.

The total external debt of Uganda at the end of 2002 stood at $3.90 billion. The country's external debt situation so far demonstrates the advantages of the enhanced HIPC initiative. Over the years, from 1998 to 2002, total HIPC debt service relief per annum has almost doubled from $45 million to $88 million. This has reflected a corresponding fall in the debt burden as indicated by the fall in total debt service to exports from 16 per cent in 1998 to 8 per cent in 2002. This ratio is expected to remain well below the indicative HIPC target range of 15-20 per cent over the near future. Nonetheless, other indicators of the debt burden have remained high raising some concerns about the sustainability of the debt. The ratio of the debt stock to GDP has continued to rise from 61.9 per cent in 1998 to about 69.5 per cent in 2002. A study by the Uganda Government and the Macroeconomic and Financial Institute of Eastern and Southern Africa (MEFMI) has indicated that the present value of Uganda's debt to exports in 2002 was 185.5 per cent, which was again higher than the threshold value of 150 per cent used under the HIPC initiative to classify countries external debt position as sustainable. The major causes of the current debt sustainability issue are the inability of exports earnings to rise substantially, and the non-delivery of HIPC debt relief by some non-Paris Club creditors. The government has made some progress in obtaining debt relief from India and securing agreements of HIPC assistance by the OPEC Fund. Additionally, Pakistan, Libya and South Korea have recently pledged to provide relief on official debt. The government is hoping to derive debt relief from Japan, following the announcement that, by the end of 2003, Japan will revise its laws to allow full debt forgiveness. On the other hand, commercial creditors have won litigations against the government to recover claims of

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports of goods and services)



Source: World Bank.

$40 million. To improve debt management, the government has developed a plan for computerising and linking the debt database systems of the Ministry of Finance and the BOU to allow greater co-ordination in debt monitoring and analysis.

Structural Issues

The Ugandan government has set as its highest priority in the medium term the transformation of the economy through expansion of production, diversification, quality control, and value addition to its products for both domestic consumption and for exports. Towards this end, the government is implementing further reforms through the *Medium Term Competitiveness Strategy for the Private Sector (MTCS) (2000-2005).* The government is focusing attention on the elimination of barriers to private sector growth and to increasing the efficiency of investment in the economy. The MTCS also focuses on infrastructural provision, the strengthening of the financial sector, strengthening of commercial justice, institutional reforms to promote business growth, improvement of the business environment for micro and small enterprises, and promotion of measures to enhance exports. The government is taking steps to harmonise incentives granted in order to attract and expand private sector investment activity. In 2003, in addition to incentives aimed at attracting investors into industrial production, the government granted investment incentives to some selected investors. To ensure that these investment incentives meet their objectives, the government requested periodic accounting of the allocated funds. The policy of the government, however, is to phase out all ad hoc incentives and to move to a more harmonised system of incentives within the framework of the EAC.

The Energy Sector is one of the key sectors in the Ugandan economy. The sector contributes to national revenue, foreign exchange and employment generation, in addition to being a vital input into other sectors. The sector in Uganda is regarded as having a great potential of generating employment, following the significant public investment in electricity and the increasing private sector investment in the sector after the liberalisation of the power sub-sector.

The energy sector in Uganda is made up of three sub-sectors namely Power, Petroleum and New and Renewable Sources of Energy. The power sub-sector covers electricity generation, transmission and distribution. The new and renewable sources include woody and non-woody biomass, solar, wind, geothermal and hydrological. The petroleum sub-sector covers both upstream (exploration and development) and downstream (refining, storage, distribution and marketing) industries. The sector is placed under the Ministry of Energy and Mineral Development which deals specifically with the formulation, implementation and monitoring of energy policy. The national energy policy of Uganda is based on the strategy of progressively expanding investment in modern energy production, petroleum exploration and development, rural electrification, the supply of well-priced petroleum products and increasing the efficiency of energy use in all sectors. Energy supply is part of the poverty eradication process, and is geared towards allowing the population to meet one of its basic needs in a sustainable manner.

The per capita energy consumption in Uganda is 0.3 TOE. Modern energy supplies, such as electricity and petroleum products, are accessible to a small percentage of the population. Approximately 94 per cent of the total energy consumption is biomass. Biomass provides almost all energy used to meet basic needs of cooking and water heating in rural and urban households, institutions and commercial buildings. Biomass is also the main source of energy for rural industries. The dominant biomass source of energy is wood fuel accounting for 80 per cent of total energy consumption. Wood fuel in the form of charcoal is consumed particularly in the urban areas while the rural population utilise wood fuel in the form of firewood. However, wood fuel requirements have contributed to the degradation of forests with wood reserves depleting at a rapid rate in many regions. Concerted efforts being made by the private sector, NGOs and the government to conserve biomass resources and reverse the environmental degradation include the promotion of reforestation and improved stoves.

Uganda's electrification rate is very low with grid access of only 5 per cent for the entire country and less than 2 per cent in rural areas. Residential consumers account for about 55 per cent of total electricity consumption as against 24 per cent and 20 per cent by commercial and industrial sectors. About one per cent of the population relies on diesel and petrol generating sets, car batteries and solar photovoltaic (PV) systems. Uganda is endowed with significant hydroelectric potential, particularly along the Victoria and Albert Niles. Uganda's electricity supply is mainly hydro-based. The country has many mini- and micro-hydropower sites that can be developed to supply isolated areas or feed into the national grid. Even with much of the potential unexploited, Uganda exports electricity to neighbouring Kenya, Tanzania and Rwanda. Current hydroelectric power exploitation in Uganda is about 317 MW, compared with a power potential of over 2000 MW. Two major independent power producers, AES Nile Power and Norpak Power Company, are in various stages of setting up larger power plants that will have a combined capacity of 450 MW when completed. The government is currently pursuing two rural electrification projects, namely the Energy for Rural Transformation (ERT) programme and a three-year pilot off-grid solar power project. The ERT is aimed at ensuring increased rural access to modern, clean and affordable energy by 2012.

Petroleum consumption currently stands at about 0.55 million m^3 per annum and has experienced a steady increase of 42 per cent between 1995 and 2001. Petroleum products are obtained entirely through imports. In spite of the absence of petroleum production, the potential hydrocarbon capacity of the rift basin is evident. The principal prospective area for petroleum is the Albertine Graben. It stretches from the border with Sudan in the north to Lake Edwards in the south, a distance of over 500 km. The Graben extends into the Democratic Republic of Congo in some parts. An agreement of co-operation for exploration and exploitation of any common fields between the two countries is in place. There are a number of on-going petroleum-exploration projects in the energy sector to meet the increasing demand of energy in the economy. There are also discussions between Uganda and Kenya to find the best option for implementing the Eldoret / Kampala Oil Pipeline Extension project to minimise the cost of delivery of petroleum products from the seaports.

Concerning renewable energy sources, the average wind speed of about 3 meters per second provides a wind regime sufficient to support wind technology applications. Solar application currently includes solar PV, water heating, cooling and crop drying. The government is currently pursuing a solar PV pilot project through a financing mechanism that makes it possible for both PV consumers and vendors to obtain credit from banks for solar rural electrification. Geothermal energy is a potential alternative to hydro, fossil fuel, and biomass energy resources. Hot springs in the western part of the country around the shores of Lake Albert, with the temperature ranging from 50°C to 100°C, are evidence of the country's geothermal power potential. The estimated national potential, so far untapped, is 450 MW.

Investment opportunities in the energy sector particularly exist in the power sub-sector. Whereas Uganda has plentiful hydropower resource potential, it has one of the world's lowest levels of electricity development. Considerable scope exists for accelerating electrification. The potential for private sector participation in developing mini hydropower dams, and solar photovoltaic systems, biomass and co-generation by sugar and tea factories to provide electricity is quite substantial.

Privatisation remains a key element of the structural measures aimed at enhancing the business environment. Since re-activating the privatisation programme in 1995, as of June 2003, Uganda has divested 74 enterprises out of a total 155 enterprises on the divestiture list. In addition to the divested enterprises, 34 enterprises have been liquidated. The government has taken a number of initiatives to speed up as well as enhance the transparency of the privatisation process. These include the appointment in 2002 of an independent power regulator, the Electricity Regulatory Authority. In addition, in 2002 the government began to concession the Uganda Electricity Generation Company, Uganda Electricity Distribution Company and the Uganda Railway Company to private investors. Preparations for private sector participation in water delivery in urban towns started in 2003; the water systems in 33 urban towns were privatised under an operating lease during the year. Further, in 2003 the government focused attention on critical transportation links by offering a long-term concession for the operation, maintenance, and expansion of the railroad in conjunction with the national railroads of Kenya and Tanzania. In addition, in 2003 a privatisation advisor was contracted for the sale of the Uganda Development Bank (UDB). The government is committed to privatising UDB, or liquidating the institution should privatisation fail. Pending the divestiture, the UDB will not engage in any new lending, including lending on behalf of the government or the BOU.

The financial sector has witnessed significant developments since reforms began in 2000. In particular, closure of insolvent banks and enhanced supervision has contributed to significant improvement in the soundness of the banking sector. The degree of improvement in the banking sector is demonstrated by several indicators. Total deposits increased by about 33 per cent between June 2002 and March 2003, while total bank assets rose by 31 per cent over the same period. Furthermore, the ratio of non-performing assets to total assets has fallen from about 8.2 per cent by June 2002 to 2.9 per cent by March 2003. The total core capital of commercial banks has improved by 9.5 per cent between June 2002 and March 2003. The finalisation of Uganda Commercial Bank's (UCB) privatisation and its merger with Stanbic Bank in 2002 contributed significantly to the stability of the banking system, and spurred the expansion of financial intermediation. During 2003, the stability of the banking system was further enhanced by the closure, and subsequent takeover, of one bank and the recapitalisation of another bank. In addition, new capital requirements implemented in 2003 raised the minimum paid-up capital, thus increasing confidence in the financial system. Further, in 2003, significant progress was made in improving the efficiency and security of the national cheque system. An electronic clearing system (ECS), in which the processing and clearing of cheques is automated, was launched. In addition, in order to improve efficiency and strengthen risk management in the national payment system, an Electronic Fund Transfer (EFT) system was introduced in July 2003. The government has also set its eyes on using the Micro-Finance sector as a vehicle for providing market-responsive financial services to the population. To this end, a target has been set for micro-finance practitioners to reach at least 1.3 million economically active poor by 2006.

Political and Social Context

Democracy is deepening as the government continues to take steps to improve its ways of exercising political, administrative, and managerial authority and protecting the basic rights of citizens. However, security problems continue to threaten Uganda's democracy. The country continues to face three main security problems: cattle rustling, rebel activity, and urban crime and terrorism. The number of internally displace persons arising from the conflict with the Lord's Resistance Army (LRA) is estimated at 1.2 million people.

The government's response to these problems has involved alternatively the use of armed force and peace negotiations with the rebel groups. However, the numerous peace initiatives undertaken have so far collapsed reflecting LRA's failure to uphold any agreement. The government has also engaged in improving diplomatic relations with neighbouring countries, as testified by the political rapprochement with the Democratic Republic of the Congo and Rwanda.

The government has invested heavily in good governance to deepen democracy and limit the incidence of corruption, which continues to hold sway in the country. Some steps have been taken to implement the Enforcement of Leadership Code. Several public officials, including a presidential advisor have been dismissed since 2002 for not submitting their asset declarations to the Inspector General of Government (IGG). Moreover, in 2003 the IGG undertook to make the asset declarations of government officials available to the public. Further, the government is pursuing the implementation of the Justice, Law and Order Programme with some success. The programme focuses on improving access to justice, efficiency and effectiveness in the delivery of justice, and the institutional framework for the delivery of justice, as well as combating corruption. Achievements thus far include clearing backlog cases pending at the high court, which fell from 3 150 in 2002 to 1 145 in 2003, with the remaining cases scheduled to be cleared during 2004.

Uganda is pursuing since 1997 the Poverty Eradication Action Plan (PEAP) with the ultimate aim of improving the quality of life of its citizens. The government's efforts are focused on the provision of basic health care, education, water and sanitation, and the sustainable development of natural resources. Over the past few years, the PEAP has helped to improve the quality of life of Ugandans. According to preliminary household survey data, the incidence of poverty rose from 34 per cent in 1999/2000 to 38 per cent in 2002/03, partly due to increasing inequality, while it had previously declined from 56 per cent in 1992.

The government's mid-term review of the Health Sector Strategic Plan in 2003 has confirmed considerable improvement in key health indicators. Immunisation rates continue to improve with DPT3 coverage reaching 63 per cent in 2003, well above the target of 48 per cent set for the year. Staffing levels have also improved and currently, 4 349 nursing assistants have been trained. In addition, HIV/AIDS prevalence has fallen to 6 per cent, thanks to an adequate prevention policy implemented over the past decade, suggesting the government is on course to reducing it to 5 per cent by 2005. The government has granted all district hospitals protection, effective from 2003, as part of the Poverty Action Fund (PAF). Malaria is today the highest cause of morbidity and mortality in the country. Uganda is to receive $35 million through the Global Fund to fight Aids, tuberculosis and malaria, which will boost the availability of key health services in the country. More people are now able to access health care services throughout the country. The attendance at outpatient departments, for example, increased by about 40 per cent between 2001 and 2002. In spite of progress in the heath care system, infant and maternal mortality rates remain persistently high. In order to reduce effectively infant and maternal mortality rates, the government has established a task force on Infant and Maternal Mortality, charged with formulating a comprehensive strategy to address the problem.

The government education policy, which is focused on Universal Primary Education (UPE), is achieving significant results. Because of the increased demand for UPE financing, the national budget allocation to the education sector has increased nominally by about 100 per cent in six years from 20.6 billion shillings ($11 million) when the programme commenced to 46.7 billion shillings ($25 million) in 2002. In response to the budgetary outlay, there has been an improvement in the pupil/classroom ratio in public schools from 106:1 in 2000 to 94:1 in 2002, because of increased construction of new classrooms under the Schools Facility Grant to districts. The pupil/teacher ratio has also improved from 65:1 in 2000 to 54:1 in 2002 following additional recruitment. However, the education system is still plagued by a low retention rate and difficulty in filling vacant posts for teachers, as well as a scarcity of instructional training materials, particularly in science and vocational subjects.