ICR Review

Operations Evaluation Department

Report Number : ICRR11391

1. Project Data:		**Date Posted :**	12/03/2002	
PROJ ID :	P002987		**Appraisal**	**Actual**
Project Name :	Sac III	**Project Costs (US$M)**	125	155
Country :	Uganda	**Loan/Credit (US$M)**	125	150
Sector(s):	Board: EP - Central government administration (48%), Banking (19%), Sub-national government administration (12%), Other domestic and international trade (12%), General industry and trade sector (9%)	**Cofinancing (US$M)**	5	5
L/C Number :	CN023			
		Board Approval (FY)		97
Partners involved :	Swedish IDA	**Closing Date**	06/30/1998	10/01/2001
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2. Project Objectives and Components

a. Objectives

The third Structural Adjustment Credit (SAC-III), approved along with the 1997 Country Assistance Strategy, was one of a series of loans that supported Uganda's economic stabilization since 1992. Two earlier Economic Recovery Credits, and two Sector Adjustment Credits (one for agriculture and one for banking) had, *inter alia,* begun reforms in banking and trade, and SAC-III included some additional measures for these sectors.

SAC-III's *primary objective*, however, was long term fiscal sustainability with a better tax structure, administration and expenditure management. SAC-III was accompanied by technical assistance (the second Economic and Financial Management Project) which financed a fiscal management system, to improve Uganda's institutional capacity to carry out the reforms.

b. Components

The main components of SAC-III were:
(1) To increase government revenues from 11.4 percent of GDP in 1995/96 by 1 percent annually and improve the tax structure by (a) improving tax administration (clarifying the role of the Uganda Revenue Authority Board, setting up an independent dispute resolution mechanism etc.) and expanding the tax base (eliminating *ad hoc* exemptions), not by raising tax rates; (b) reducing trade taxes (especially on petroleum) and raising income, VAT and excise taxes; (c) abolishing all non-tariff barriers and having a single, low, uniform rate of about 12 percent by mid-1999; (d) allowing fiscal decentralization by sharing revenue from rental income taxes with local authorities.
(2) To improve the management and efficiency of public expenditures by (a) limiting supplementary budget provisions to 5 percent of expenditures in 1996/97 and 3 percent thereafter and (b) introducing an outcome oriented budgetary process; and (c) better focussing public expenditures on poverty (e.g. increasing agricultural extension); (d) better expenditure management under decentralization; and (e) improving accountability and transparency.
(3) To reduce quasi-fiscal losses and parastatals deficits from 5 percent of GDP in 1994 to 4 percent in 1996/97 by (a) privatizing 85 percent of state owned enterprises (SOEs) by end-1997 including those in power, telecom, water and transport, and (b) eliminating direct and indirect subsidies to commercial SOEs and phase out subsidies to noncommercial SOEs over four years.
(4) To reduce the fiscal costs of financial sector reform by moving non-performing loans from the Uganda Commercial Bank (UCB) that was being privatized into an asset recovery trust (NPART) and recovering at least Ush 25b (38 percent of the claims). The government would also decide how to deal with the largely defunct Uganda Development Bank (UDB).

c. Comments on Project Cost, Financing and Dates

SAC-III had four tranches: (i) $45m upon effectiveness, (ii) $40 in mid-1998 when specified conditions were expected to be met, and two floating tranches of $ 20m each attached to uniform trade tariffs and asset collection conditions. The loan was expected to be fully disbursed by 1998 end; but this was delayed (as was the mid-term review of the IMF's second ESAF) and a $25m supplemental credit was added in November 2000.

3. Achievement of Relevant Objectives:

Progress in achieving SAC-III's objectives was mixed. The agreed measures, and consequently tranche disbursements, were delayed and some waivers were granted. Specifically:

(1) Revenue targets were missed and the culture of noncompliance remains. Tax revenues remained below 11 percent of GDP, rather than increase by 1 percent annually. Expenditures remained high (they surged to 27 percent of GDP in 1999/00), and the IMF reports an overall deficit, excluding grants, of 12.6 percent of GDP in 2001/02. Trade tariff rates remain disparate (0 percent for capital goods and 7 to 15 percent for others) pending negotiations with the East African Community (SAC-III granted a waiver).
(2) Some improvements in fiscal management but supplemental expenditures exceeded the limit in 1998/99 (waiver granted). While education expenditures rose, those on health and agricultural extension did not. There was some fiscal decentralization up to the district level, but not further.
(3) SOEs were privatized (77 percent versus 85 percent sought), but not in water, transport or power where regulations are being improved. ICR reports that SOE subsidies were halved and cash subsidies almost eliminated.
(4) The UCB privatization in April 1998 had to be reversed because of fraud, and it was sold in February 2002; but the SAC-III condition of recovering Ush 25 billion was not met because of poor coordination between UCB and NPART. NPART's mandate was extended by four years, and by April 2002, Ush 30b was recovered. UDB's problems, however, have not been resolved.

4. Significant Outcomes/Impacts:

Uganda maintained macro-economic stability and low inflation, but SAC-III's primary objective of long term fiscal sustainability remains elusive, perhaps because donor generosity (aid flows of 8 to 11 percent of GDP) dilutes the government's incentive to raise revenues.

5. Significant Shortcomings (including non-compliance with safeguard policies):

The primary objective of fiscal sustainability was not achieved, and despite some progress in tax administration, the Uganda Revenue Authority needs considerable improvement before it attains a satisfactory level (the IMF's August 2002 PRGF reports corruption charges). Similarly, sizeable supplemental spending in 1998/99 reveals shortcomings in expenditure management.

The tranche release conditions were poorly prepared in at least two areas: (i) trade measures were inconsistent with long standing East African Community agreements, and (ii) loan recovery targets for the non-performing loans of UCB were set without considering judicial constraints.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Moderately Satisfactory	Long term fiscal sustainability, SAC-III's primary objective, remains elusive. Tax administration and expenditure management are still inadequate (section 3). A "moderately satisfactory" outcome rating must be considered generous: macro-economic stability is not the result of better domestic policies sought by this credit but of large donor support.
Institutional Dev.:	Substantial	Modest	Institutions like the URA remain vulnerable, and the excessive supplementary spending points to only modest improvements in institutions.
Sustainability:	Highly Likely	Likely	Improvements, while likely sustainable, may still require close monitoring by external agencies: so the adjective "highly" is unwarranted.
Bank Performance:	Satisfactory	Satisfactory	
Borrower Perf.:	Satisfactory	Satisfactory	
Quality of ICR:		Satisfactory	

NOTE: ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

1. Rewarding comparatively successful countries with large aid flows may erode the government's incentive to increase tax collections.
2. A well staffed resident mission allowed almost continuous supervision that is required when numerous measures that complement each other are involved.

8. Assessment Recommended? ● Yes ○ No

Why? SAC-III's implementation encountered unexpected delays and difficulties despite several similar adjustment loans that preceded it, so it is important that the Bank draw the right lessons of experience especially since it is now planning budget support loans.

9. Comments on Quality of ICR:

The ICR could have been better structured and more clearly distinguished between the changes underway that were supported by earlier Bank credits (that some tranche release measures ensured) and those begun under SAC-III. The ICR could also have described the macroeconomic situation better, without data inconsistencies (e.g. tax revenue in 1995/96 was 11.4 percent of GDP in the President's report but 9.5 percent in the ICR para 3.3 (ii)) or omissions (e.g. the IMF's PRGF document of August 2002 mentions large domestic arrears, corruption charges in the URA, and military involvement in the DRC which are germane).