UGANDA DEBT NETWORK

ISSUES PAPER ON UGANDA'S DEBT STATUS

June 2002/2003 – June 2011/2012

February 2013

A) Background to Uganda Debt Network

Uganda Debt Network (UDN) was formed to support the campaign for debt relief for Uganda and to actively participate in the global debt relief campaign being promoted worldwide by Civil Society Organizations under the Jubilee2000 coalition; Uganda at the time was being promoted as a pioneer candidate to benefit from the Highly Indebted Poor Countries (HIPC) Initiative by the World Bank and International Monetary Fund (IMF).
Since 1998 the organization has expanded its scope of work from debt relief campaign to advocate for good governance by empowering the community empowerment to demand for transparent accountability from their local leaders. This has enabled the organization, its constituents and stakeholders to engage at high levels of advocacy and policy influence. UDN works in 22 districts and 78 sub-counties; as well as having engagements with various Government MDAs at Central and Local Governments, CBOs at the local level, other CSOs, Parliament; etc on issues of service delivery, public sector accountability, budget processes and policy options.

B) Introduction

Uganda has partly relied on external borrowing to finance infrastructure development and poverty reduction initiatives in the past. Uganda was the first beneficiary from the Highly Indebted Poor Countries (HIPC) Initiative in 1998. During Pre-HIPC (1996/97), External Debt stock was US$3.7Bn but she received debt relief worth US$347Mn of which 79% was due from multilateral creditors. In 2006, the Multi-lateral Debt Relief Initiative (MDRI) provided 100% debt cancellation reducing Uganda's debt stock to $1.6bn but as at June 2010, debt was at US$4.3Bn.By end of March 2011, Uganda's external debt exposure was U$4.76bn out of which, $2.83b was debt outstanding and disbursed and U$1.93b was committed but yet to be disbursed. By March 2012, Uganda's debt exposure was U$5.6 Bn which is on an increasing trend as a result of borrowing to finance priorities identified in the NDP.

Uganda's economic policies broadly aim at maintaining macroeconomic stability and promoting private sector-led economic growth. Whereas economic growth rates have been high over the years, domestic tax revenues have remained inadequate to finance Government budget. To avoid a potential macro-economic distortion effects, therefore, the Government's increases in money supply have had to be "sterilized", mainly through either sale of foreign exchange or domestic debt through issuance of Government treasury securities. Equally, due to inadequate budget discipline, there has been increasing trends in supplementary expenditures, additional cash limits, intra-year reallocations, delayed releases and accrual of domestic arrears. Domestic arrears therefore constitute a key expenditure for Government and are an important aspect of domestic debt.

In 2011 and 2012, UDN carried out a review and analysis of Uganda's debt status (external and Domestic) and its implications to the economy from 2002/03 to 2011/12. The studies involved key informants from Government MDAs which included; Bank of Uganda, MoFPED (Macroeconomic department and accountant General), Office of Auditor General and Parliament of Uganda. The reports were disseminated in a public dialogue where additional recommendations were made on how to improve on debt management.

UDN therefore seeks to share these recommendations with Members of Parliament for possible action and/or dialogue with you especially for adoption/furtherance of advocacy with the view to improve debt management to sustainable levels. This would enable prudent use of borrowed resources translating into Uganda's growth and development efforts and eventual actual poverty reduction, especially amongst the poor men, women and any other marginalized sections of citizens across the country.

C) Legal Framework for Domestic Debt Management in Uganda

UDN acknowledges Government's efforts and success in establishing an enabling legal and regulatory framework governing debt management in Uganda. The different laws confer rights and responsibilities upon different Government agencies in borrowing, use and management of borrowed resources. The mandate of the Government to borrow from any source to finance Government expenditures is derived from;

a) The Constitution of Uganda (1995) - Article 159
b) The Public Finance and Accountability Act (2003)
c) The Budget Act (2001)
d) The Bank of Uganda [BOU] Act (2000)
e) The Treasury Bills Act (1969)
f) The Debt Strategy 2007 (which expired in 2012) which outlines an institutional framework, with duties and responsibilities in the public debt management.

Some of these Acts need to be amended to enable efficient management of debt. For instance, the PFAA (2003) should be reviewed to prescribe specific penalties/punitive measures for public servants who commit Government to borrowing over and above allocated budgetary resources. The Debt Strategy of 2007 also needs to be reviewed since the existing on expired in 2012. The harmonization of these regulations on debt management would greatly improve on debt sustainability if implemented as required.
UDN also appreciates the role of the different Government Ministries Departments Agencies (MDAs) which include the Office of the President, Ministry of Finance Planning and Economic Development, Bank of Uganda, Parliament of Uganda, Accountant General, Auditor General and Arrears Committee among others.

D) External Debt - National Debt and Economic Development

Limited economic resources encourage states to borrow to finance Government expenditures and public investments especially for infrastructure development. However, the expanded use of debt financing is often constrained by the debt capacity. In Uganda, external borrowing has long been a source of finance for Government for its annual budget expenditure. Given Uganda's level of economic development and the limited tax base, external debt financing will continue to constitute an important part of budget financing as long as domestic revenues fall significantly short of expenditures given that donor grants alone cannot meet the shortfall. Government has continued to borrow to finance priority infrastructure investments identified under the NDP for enhancing development[1]. However, an increase in external borrowing raises the cost of macroeconomic management to the economy since the external debt burden inevitably raises Government's future external debt repayments, reducing the resources available to it to finance other areas of the budget. To avoid a debt crisis, the Government's Debt Strategy ought to ensure long-term debt sustainability, minimum cost to Government of external financing, and prioritizing borrowing for productive sectors.

Uganda's External Public Indebtedness History: 1980 – March 2012

Year	Uganda's External Debt	Description	Explanation
1980	$732.7m	External debt	Debt accumulation in the absence of an effective debt management strategy amidst Government financial indiscipline.
1990	$2.2bn	External debt crisis	Government ran out of foreign exchange for servicing its external debt obligations due to decline in the terms of trade from falling world coffee prices.
1991		1st External Debt Strategy developed	Focused on: - The pursuit of debt relief - How to approach each creditor for rescheduling. - Limiting overall borrowing - Prioritizing grant financing and encouraging more concessional loans.
1995		Revision of External Debt Strategy	Greater emphasis on giving preference to concessional loans and increased grant support
1998	$700mn	Debt Relief	Highly Indebted Poor Countries (HIPC) (1) Initiative
2000	$1.3bn	Debt Relief	Debt relief under the HIPC (2) Initiative
2005	$4.5bn	**Debt Accumulation**	**External Debt after HIPC Initiatives**
2005	$3.4bn	Debt relief	Under the Multilateral Debt Relief Initiative, the International Monetary Fund provided 100 per cent debt relief on all debt incurred by Uganda[1].
March 2007	$1.1bn	Uganda's external total debt	After MDRI's 100 per cent debt cancellation to Uganda
2007		Debt Strategy (2007) developed	- Managing external and domestic borrowing - Borrowing for investments that will generate growth and employment
2009	$4.0bn		**External Debt Accumulation**
2011	$5.4bn	External debt exposure	$2.83b is debt outstanding and disbursed - $48m (1.7%) are arrears of principle - $34m (1.2%) are arrears of interest $2.6b is committed but yet to be disbursed
March 2012	$ 5.6bn	External debt exposure	- $3.10Bn is debt outstanding and disbursed - $2.57Bn is committed but yet to be disbursed Borrowing increased to finance NDP priorities identified for enhancing development
	Debt Strategy (2007) expired		To be reviewed
2013	Debt Strategy (2007) expired		Review is on-going - MoFPED
	Arrears on Uganda's Foreign Debt		
31st March 2011	$82m[2]	Amount of arrears on Uganda's external debt[3]	- $48m relate to principle - $34m relate to interest

Source: Compilation from various Sources and Government Reports (MoFPED, BoU, IMF, World Bank and Government Agencies and ADB)

E) External loan absorption - (key stakeholders)

Uganda contracts loans from Bilateral and Multi lateral sources. However, loan absorption has remained low thereby undermining timely implementation of projects for which these resources are borrowed. A study conducted on external debt in 2011 by UDN from Government institutions and departments concerned with loan contraction that loan absorption is poor due to the following reasons;

1 Energy and Mineral Development, Works and Transport, Education and Health
2 Julius Kapwepwe: The CHALLENGES of DEBT SUSTAINABILITY in AFRICA: The CASE of UGANDA
3 Estimated Figures
4 The arrears are for Non-Paris club bilateral creditors namely Tanzania, Abu Dhabi Fund, Nigeria and Iraq

- Long procurement processes leading to delayed commencement of projects.
- Creation of more districts affecting resource allocation to facilitate quality service delivery and loan funded project implementation.
  - Inadequate and delayed payment or remittance of funds to implementing agencies like districts.
- Poor project planning and appraisal coupled with Limited Capacity of contractors.
- Inadequate capacity of the private sector to undertake large infrastructure development projects.
- Lack of transparency in procurement which makes activity implementation to be suspended and delayed affects implementation.

F) Uganda's External Debt and Impact on Economic Development and Poverty Reduction Efforts

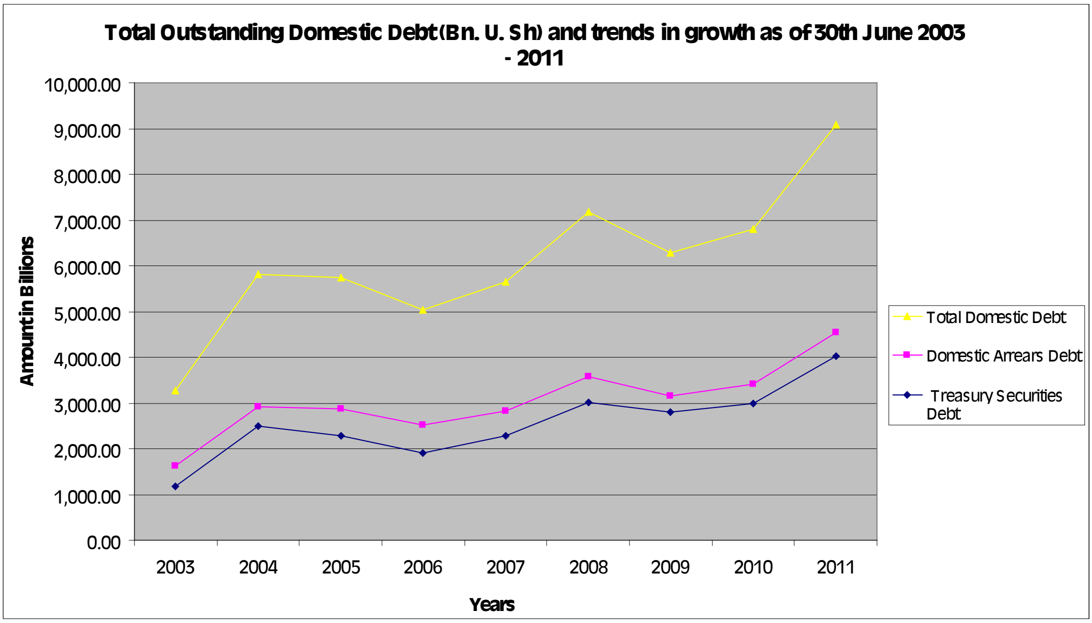
External debt financing can contribute significantly to economic development and poverty reduction efforts especially if the terms and conditions are concessional (favourable) and its committed in productive sectors. However, heavy indebtedness has a number of negative implications for Government budgeting and the economy as a whole.

1. Raises Government's expenditure on external debt servicing in terms of interest and principle loan repayments. Huge amounts of debt servicing have the impact of diverting locally generated resources from financing economic development and poverty reduction initiatives to meeting external loan obligations. In the long run, an increasing external debt burden inevitably raises Government's future external debt repayments, reducing the resources available to it to finance other areas of the budget.

2 An increase in external borrowing raises the cost of macroeconomic management to the economy. A large deficit tends to appreciate the exchange rate, as more donor foreign exchange flows into the economy, and to raise interest rates, as the Bank of Uganda sells more Government securities to ensure that the inflow of donor financed Government expenditure does not raise inflation. An appreciated exchange rate is damaging to export-led growth, as exporters receive fewer Shillings for each dollar they earn, and high interest rates are detrimental for private sector development as a whole, as they raise the cost of doing business and reduce access to credit. In addition, the increased sale of Government securities raises Government's domestic debt stock, increasing domestic interest payments and increasing the vulnerability of the Government budget to a domestic debt crisis.

G) Uganda's Domestic Debt Stock

Domestic debt consists of treasury securities (Bills and bonds) and domestic arrears commitments. As of 30th June 2011, the total domestic debt was UGX 4.5359 trillion. This comprised of UGX 4.0205 trillion (88.6%) in form of treasury instruments and UGX 515.4 Billion (11.4%) in form of domestic arrears. Between June 2003 and June 2011, the domestic debt stock increased by 177.9%, which is equivalent to an average annual growth rate of 16.6%



Source: BOU statistics, Office or the Auditor General Reports (2004-2011)

As of 30th April 2011, the total domestic debt resulting from issuance of Government securities by Bank of Uganda for monetary purposes was UGX 3.87 trillion, of which treasury bills accounted for UGX1.63 trillion (42%), while treasury bonds accounted for UGX 2.24 trillion (58%). Total domestic arrears have increased from UGX 454.6bn in 2003 to 515.4b[2] in 2011, representing a 13% growth. However, total domestic arrears peaked in 2006, where the total outstanding domestic arrears were Uganda shillings 622bn. Over the last nine years, domestic arrears (excluding salary & pension) constituted about 58.6% while salary and pension arrears constitute about 41.4% of the total domestic arrears.

Government securities, the total interest paid to holders of these securities has been increasing over the years, from an annual cost of UGX 271.4bn in 2007/8 to UGX 514.7bn in 2011/12 and a projected value of UGX 713.9bn in 2012/13. Therefore over a three year period, interest due on Government securities will almost double from UGX 327.2bn in 2010/11 to an estimated UGX 713.9bn in 2012/13. This represents an increase of 57.6% in 2011/12 and a projected increase of 38.7% in 2012/13. Considering the 2012/2013 budget, the estimated interest payable on domestic debt of UGX 713.9 billion in 2012/13, is higher than the total budget for; Agricultural sector of UGX 406.1 billion, Water and Environment sector of UGX 365.9 bn, and Justice/law and Order sector of UGX 499.2 bn. This implies that servicing of domestic debt annually is more costly than total resource envelope allocated to some Government ministries.
Whereas external debt is significantly higher than domestic debt (almost twice as much), the interest paid on external debt is significantly lower than that paid on domestic debt, ranging between 14% and 21% between 2007/8 and 2010/11. In other words, this shows that domestic debt is more costly than external debt in terms of payment, despite its smaller size. However, the external debt is long term in nature and largely on concessional terms.

5. 2011 estimate excludes salary and pension arrears, whose audited values are not yet available.

H) Challenges in the Management of Domestic Debt in Uganda

Although the enabling legal framework governing domestic debt management is in place, UDN is concerned about the increasing levels of arrears as evidenced from the study. This is because unsustainable domestic debt levels have gross effects on Uganda's development efforts especially with respect to the poor and marginalised citizens.

1. Treasury bonds and bills

Government uses some of the resources raised through treasury bills and bonds to fund the national budget. Use of these resources for fiscal purposes contradicts the essence of using treasury bills and bonds as instruments of monetary policy [controlling inflation]. Direct access to such resources is not transparent as Parliament has no control over it and use of such resources.

2. Lack of Parliamentary approval of domestic debt

Treasury bills and bonds issued for monetary purposes and domestic arrears are not approved by the Parliament. This is logical since monetary policy management require high flexibility and arrears are incurred at the end of each financial year but the aspect of management and reporting ought to be improved.

3. Limited information on Domestic Debt

The Budget Act (2001) requires the President to cause to be presented to Parliament information relating to the total level of indebtedness and guarantees of the state each financial year; the reporting on aspects of domestic debt is inadequate. Informants from some key Government institutions were not willing to be interviewed and quoted as sources of information. Some of them completely refused while those who accepted requested to remain anonymous. In addition, reporting on domestic debt by the Auditor General is not consistent. Whereas there is consistent reporting on non-employee related arrears, the same cannot be said of employee cost related arrears.

4. Poor adherence to existing debt management control systems

While the PFAA identifies mechanism for minimising and avoiding domestic arrears in form of unpaid suppliers/creditors (non-employee arrears), adherence to the Commitment Control System (CCS) is poor. In addition, there seems to be no deterrent action taken by Government against accounting officers violating these guidelines. In addition, there is also inadequate budget discipline as evidenced by regular supplementary budgets presented to Parliament for approval and financing by different MDAs. This budget indiscipline was re-echoed by the MoFPED during the budget speak for FY 2012/13.

5. Unsystematic documentation of domestic arrears

There is no single Government published or primary source with information on domestic arrears. Where some reports indicate non-employee related arrears, employee arrears were missing. In some cases the information presented is contradicting as it does not add-up to the total declared domestic debt. Pieces of information on domestic debt from can only be extracted from different Government documents such as annual Government audit reports and historical data from published documents to get data on missing information. For contradicting data[3], one source had to be selected and indicated accordingly. Additionally, a review of ministerial policy statements revealed that it is only Ministry of Public Service that reports clearly the total outstanding arrears. The documentation of arrears (private sector and employee costs) is not streamlined and consistent. For example, the figures presented in some Government reports on the same aspects are contradicting. This poses a potential problem to the Government because the outstanding domestic arrears could easily reach unsustainable levels.

6. Domestic Arrears

For purposes of control and elimination of domestic arrears, the Government chose the following:

a) Running a cash budget: This way, different votes can only spend what they have but not as they would wish. Accordingly, some of the unnecessary commitments which result into increased domestic debt would be avoided. Whereas it is largely being followed, there are still loopholes as some of the steps are bypassed by the accounting officers as evidenced by persistent accumulation of domestic arrears.

b) Decentralised management of arrears to the different votes. The MDAs and District Service Commissions are supposed to be responsible for whichever arrears they might create. However this approach has largely not worked since MDAs continue to accrue arrears.

I) Factors Leading to Continuous Accumulation of Domestic Arrears

A review of various reports and key informant interviews point to a number of factors that are contributing to the continuous accumulation of domestic arrears.

a) Fiscal indiscipline as a result of Government failure to stick within the programmed budget. For each accounting unit, the CCS prohibits entities from entering into commitments unless funds are available; but the Ministry of Works and Transport reported domestic arrears in the FY 2009/2010 of UGX 415,818,218 million and during the FY 2010/11, a total of UGX.10, 500,000 million was settled, leaving outstanding arrears of UGX.405, 318,218 million as at 30th June 2011. The Ministry did not make any provision for settlement of domestic arrears in the 2010/2011 budget estimates. However, the Ministry spent a total Shs.122, 444,208 million to clear outstanding bills which had not been provided for in the 2010/2011 budget. These outstanding bills are not declared in the financial statements of FY 2009/10 as payables.

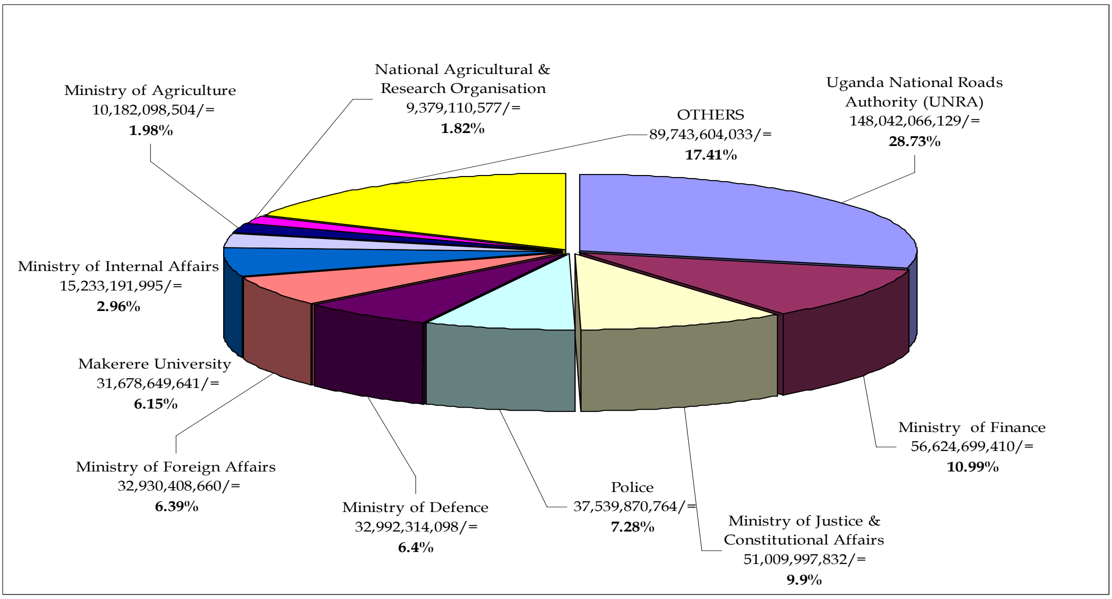
b) Under-budgeting for fixed expenses (like utilities). For example in the FY 2010/2011, whereas the Ministry of Justice and constitutional affairs records showed outstanding domestic arrears amounted to UGX.114,577,576,352 billion, the approved budget for domestic arrears for the FY 2010/11 was only UGX.10,822,969,000 billion resulting into a funding gap of UGX.103 billion. Therefore, the amount allocated was too small to offset the outstanding domestic arrears debts and yet arrears outstanding for long period attract interest which in turn increases the amount of arrears to be paid.

c) Discussions with key informants revealed that arrears due to utility bills emanate from the fact that the Medium Term Expenditure Framework (MTEF) ceiling does not allow adequate budgeting for utilities, and this is a major cause for accumulation of arrears since increase in the allocation to utilities means reduction in allocation to other areas/sectors.

J) Government Agencies with the High Domestic Arrears: June 2011

According to the 2010/11 Auditor General's Report, out of the 99 votes audited, MDAs had accumulated some domestic arrears (excluding salary and pension) despite the fact that these arrears accumulation is prohibited by the PFAA (2003). Ten (10) Votes/MDAs contributed 82.6% of the total outstanding domestic arrears as represented in the pie-chart below.

MDAs with the biggest share (figures and percentage) of Domestic Arrears as at 30th June 2011



Source: Auditor General's Report, 2010/2011-Vol 2

6 For example, whereas the Ministry of Public Service Policy statement 2006/07 indicate that pension arrears were 284.4 billion Uganda shillings, the Auditor generals report indicates a value of 328.3 billion Uganda shillings. In the same year, the outstanding arrears submission to Ministry of Finance was 298.

K) Recommendations

To improve debt management and ensure sustainability a number of proposals are made to include the following;

1. Review the National Debt Strategy, 2007, align it to the NDP and implement the new Debt strategy. The revised strategy should include guidelines on Public Private Partnerships, clear definitions of criteria to be used in the assessment of the loan proposals by the various MDAs including parliament.

2. There is need for separation of the monitor (Treasury) from the MoFPED (Monitored) as this would ease the implementation of what is recommended by Parliament. This however is not the case as Treasury is so mixed up with finance, with the budgetary function being led by the Directorate of Budget unlike the common practice in other countries where it belongs to Treasury. This would improve the overall efficiency of the budgeting and resources management, and therefore the domestic debt.

3. a) Borrowing should be limited to priority sectors through an elaborate consultative process using a transparent criterion and should be made public. Such prioritise would include; identification of priority areas, commissioning feasibility studies and developing detailed proposals and technical designs in preparation for commencement of implementation upon approval of loan request. A lot of borrowed money is spent on public administration which is not productive.

4.

   b) Funding of social services projects using domestically generated revenue as opposed to foreign loans since such project have low economic returns.

   c) Government to borrow to invest in technology transfers in the local sector to improve productivity.

5. a) Government should consider amending PFAA [2003], BOU Act [2000], Treasury Bill Act [1969] and Budget Act [2001] to allow use of generated resources out of issuing treasury bills and bonds for funding the budget and granting parliamentary oversight over generation and use of such resources. These would also require amending the institutional structures to give the MoFPED more responsibilities in deciding the acquisition and allocation of the generated resources.

b) The PFAA (2003) or the implementing regulations should be reviewed to prescribe specific penalties/punitive measures for public servants who commit Government to borrowing over and above allocated budgetary resources. Such an offence could be qualified under abuse of office by the offenders.

6. Government should develop and install an electronic based debt management and monitoring system that should be used by all government Ministries, Departments and Agencies involved in the debt contracting and management.

7. a) All components of domestic arrears debt should be consistently reported in Government Audit Reports and also included in the annual report on loans and grants submitted by the Minister of Finance to Parliament, with adequate details of the outstanding domestic arrears. Therefore, total domestic debt ought to be part of the

report on country's indebtedness at the end of the financial year. MDAs should report on domestic arrears accumulated during the course of the year and explanations should be provided for accumulation of these arrears and propose plans for curbing them. This would enable different agencies playing oversight roles on budget implementation and Parliament to have stronger oversight over domestic debt obligations by the Government.

b) Government should ensure that the clearance of domestic is limited to 12 months after commitment and should be first priority in each year's annual budget allocations to the MDAs. Accounting officers should spend pension and domestic arrears budget allocations in accordance with the Treasury Accounting Instructions and the Financial and Accountability rules and regulations that prohibit the diversion of funds.

8. Review of the tax management system to enable the mobilization of local resources.- Hence government should focus on increasing domestic revenues.

L) Conclusion

Uganda has a relatively adequate legal framework to regulate borrowing with a provision of checks and balances including requirement for parliamentary approval of external loans for each and every loan commitment. The Debt Strategy adopted in 2007 clarifies the institutional arrangement and defines roles and responsibility. However, some concerns exist regarding the operational efficiency of some of the institutions including parliament that is blamed for delays in approving external loan proposals. There are no standard loan approval and appraisal criteria that have to be scrutinized by the various MDAs involved in the loan contracting process. The criteria the Government uses to select projects to be financed through external loans and the selection of creditors to finance a particular project is not well defined. Whereas the external debt has been increasing rapidly, DSA reports by IMF/WB confirm that the debt is still sustainable. This is largely because most of the loans are on concessional terms.

On domestic debt, whereas the institutional framework for the management of treasury securities is properly functioning, that for domestic arrears requires improvements. The legal, policy and institutional framework for treasury bills and bonds are meant to serve as monetary instruments only and not the fiscal policy. However, Government uses part of treasury bill/bond raised resources to fund part of the budget. The use of Treasury bill raised resources is an attempt for Government to have access to resources without approval of Parliament as required for external borrowings. There is need for transparency in access and use of such resources. Parliament oversight over Government domestic borrowing for fiscal purposes is therefore imperative. Adjustments to laws regulating domestic borrowing as stated above will be required for this transparency to take place in acquisition and use of such resources.

Budget indiscipline characterised by mid-year reallocations and supplementary budgets defeat the very essence of the existing laws and budget process. Since the country runs a cash budget, it would be expected that the funds budgeted for a particular vote are disbursed in full to it. However this is not the case as these same funds are reallocated to different MDAs which have supplementary budgets. This is a major contributor to the accumulation of debt arrears.

UDN Vision

A prosperous Uganda with sustainable, equitable development and a high quality of life of the people

UDN Mission

Uganda Debt Network (UDN) is a policy advocacy organization working to promote and advocate for poor and marginalized people to participate in influencing poverty-focused policies, demand for their rights and monitor service delivery to ensure prudent, accountable and transparent resource generation and utilization.

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