EXAMINING UGANDA'S CURRENT DEBT BURDEN

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1.0. Preamble

To realize Uganda's growth and development, the government mobilizes both external and domestic resources to finance various development projects and programmes. Uganda has existing policies and legal frameworks that guide debt acquisition, utilization, management, and Public-Private Partnerships. These include the; Constitution of Uganda, the Public Finance Management Act (PFMA) 2015, the Treasury Bills Act 1969, the Bank of Uganda (BoU) Act 2000, the Charter of Fiscal Responsibility (CFR), the Local Government Act (1997), Medium Term Debt Management Strategy 2015/16 - 2019/20, Public-Private Partnership Policy, 2015 Public-Private Partnership Act and the Public Debt Management Framework[1].

Although it is considered an ideal decision for the government to entirely rely on domestic revenue, public debts are sometimes sought to bridge the gap between tax revenues and expenditures. According to the Debt Sustainability (DSA) Report 2018/19, Uganda has witnessed an escalation in the debt threshold due to increased government borrowing to finance key infrastructure developments such as the transport, oil and gas sector among others. The higher average interest rates on debt on public debt have also led to an increase in public debt.

In FY 2019/2020, debt accumulation was worsened by the impact of the outbreak of the COVID-19 pandemic on the economy and the containment measures enacted to curb the spread of the disease. The COVID-19 outbreak and the disease containment measures enacted (lockdown) resulted in a slowdown in both global and domestic economic activity, leading to large revenue shortfalls. Moreover, Government's emergency response to the COVID-19 shock led to additional expenditure pressures towards the health sector and enhancing the welfare of the vulnerable during this period[2] . The combination of a revenue shortfall and increase in expenditure led to additional borrowing.

1 Public Debt Management Strategy
2 Debt Sustainability Analysis Report 2019/2020

A significant proportion of the infrastructure projects is financed using loans from external development partners on both concessional and non-concessional terms. The projected increase in debt accumulation highlights the need for Government to exercise caution when taking on new debt while prioritizing concessional financing over non-concessional resources[3].

According to the Bank of Uganda, in the FY2019/20 Uganda's debt had surpassed the threshold level with a provisional total debt stock at 53.697 trillion Shillings by the end of April 2020. This is a 13.7 percent increase compared to July 2019.

In May 2020, IMF approved a disbursement of USD 491.5m as emergency assistance to Uganda to respond to the COVID-19 pandemic and in June 2021, the IMF released another US$1 Billion loan to Uganda under the Extended Credit Facility[4]. The three-year financing package will support the short-term response to the COVID-19 crisis and help sustain a post-crisis inclusive recovery. Reforms will focus on creating fiscal space for priority social spending, preserving debt sustainability, strengthening governance, and enhancing the monetary and financial sector framework.

This policy brief examines the nature of Uganda's current debt, debt priorities, and recommendations to the government.

2.0. Uganda's Current Public Debt.

According to the Uganda Vision 2040, the government aspires to transform the economy from peasantry to a middle-income status as indicated in the National Development Plans I, II, and the recently launched NDP III. This is believed to be achievable through investment in infrastructure development in the forms of electricity, roads, and innovations. Therefore, this has prompted the government to commit a lot of resources both domestic and external resources in form of loans.

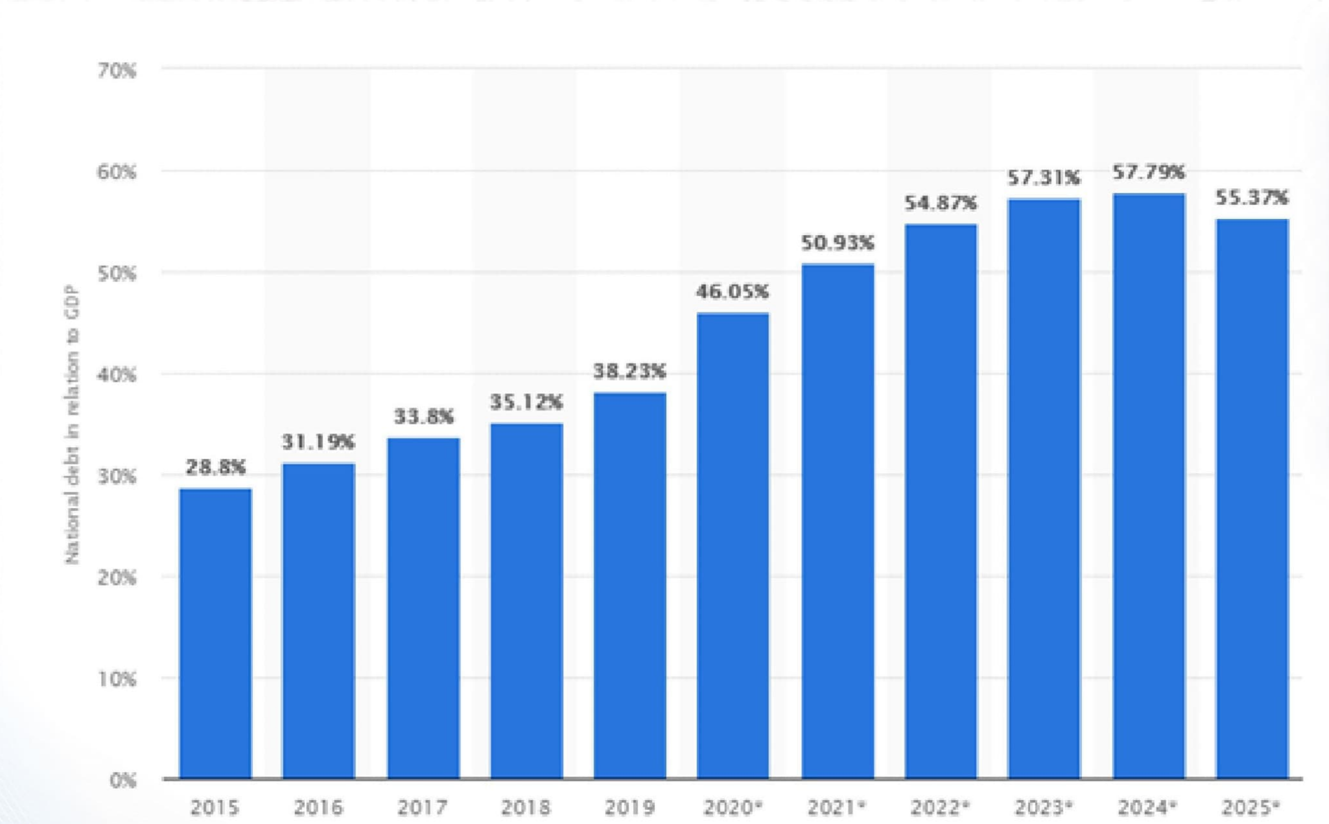
Over the last 5 years, there has been a consistent desire for government to enhance Uganda's productive capacities through infrastructure development, and this has been the major driver of the increase in the country's debt. By the end of June 2019, the stock of total public debt amounted to US$ 12.55 billion of which external debt was US$ 8.35 billion (approx. UGX 30.85 Trillion), and domestic debt was US$ 4.2

[3] Public Debt Reports MTDS 19-20

[4] https://www.imf.org/en/News/Articles/2021/06/28/pr21197-uganda-imf-executive-board-approves-ecf-arrangement-for-uganda

billion (UGX 15.51trillion[5]) . At the end of December 2019, Public debt stood at USD 13.5 billion of which USD 8.75 billion are from external sources[6] . This is as a result of an increase in government expenditures hence Uganda witnessed a widening fiscal deficit in 2019.

The public sector debt rose from 35.3 percent in FY 2018/19 to 41.0 percent in FY 2019/20. Of this, external debt contributed 28.1 percent of GDP, while domestic debt contributed 12.9 percent of GDP. This was as a result of the impact of the outbreak of the COVID-19 pandemic on Uganda's economy. Due to the pandemic, the government issued measures to curb the spread of the disease, and among these was the lockdown, Uganda's economic activities were brought to a standstill leading to huge revenue shortfalls and increased expenditures towards the health sector to ensure containment of the virus. Hence additional borrowing due to increased government expenditure and reduced revenue collections.



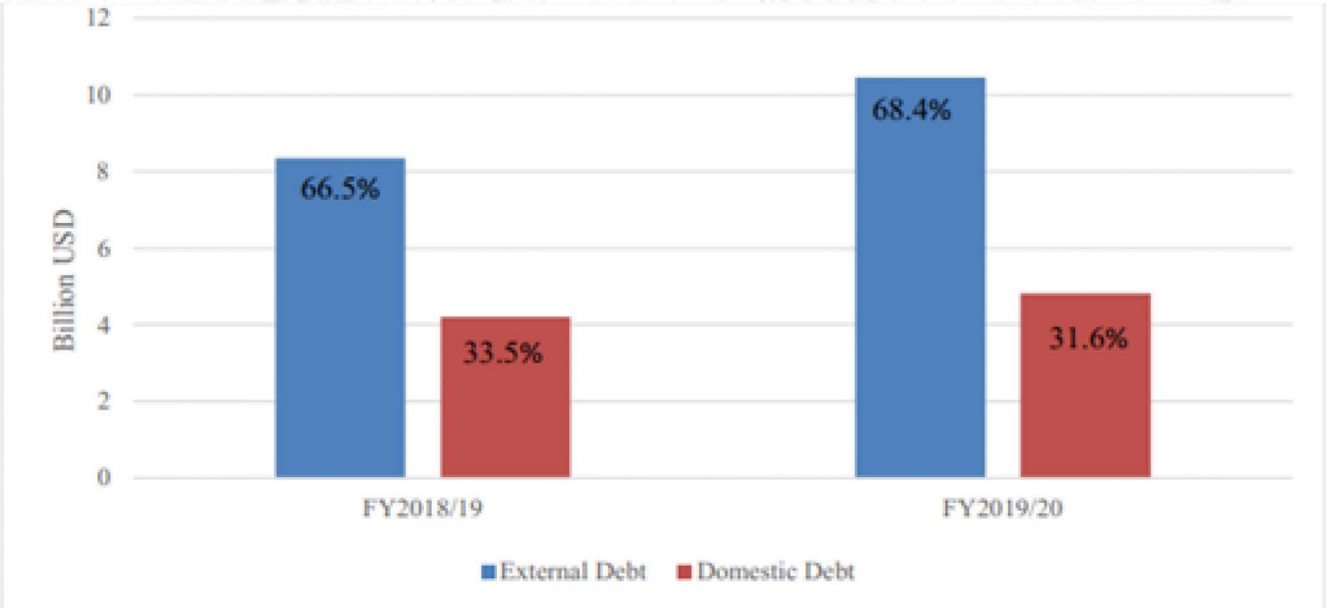
Source of data: www.statista.com

5 The National Budget Framework Paper 2020/21
6 REPORT ON PUBLIC DEBT, GUARANTEES, OTHER FINANCIAL LIABILITIES AND GRANTS FOR FY 2019/20 by MoFPED

This statistic shows the national debt of Uganda from 2015 to 2019, with projections up until 2025, in relation to the gross domestic product (GDP). The figures refer to the whole country and include the debts of the state, the communities, the municipalities, and the social insurances. In 2019, the national debt of Uganda amounted to approximately 38.23 percent of the GDP[7].

3.0. Composition of Uganda's Public debt.

As of June 2020, external debt comprised 68.4 percent of total public debt up from 66.5 percent the previous financial year. The increase in external debt is majorly on account of the COVID-19 related borrowing to meet both the revenue shortfalls that arose and additional expenditure requirements. The share of domestic debt in total public debt reduced from 33.5 percent to 31.6 percent.



Source: MFPED, Ministry of Finance, Planning and Economic Development

General government debt increased from 31% of GDP in 2014 to 44% in 2019[8] as the government has ramped up borrowing for public investments in infrastructure to support broad-based growth and to prepare for oil exports.

7 www.statista.com. Economy and Politics

8 World Bank (2020c) 'World development indicators'. Washington DC: World Bank (http://datatopics.worldbank.org/world-development-indicators/).

4.0. The Anticipated Value of the Current Debt.

The outbreak of the COVID-19 pandemic in 2020 has been a grave concern leading to the accumulation of debt in Uganda, especially to finance the health sector and support the post-recovery of the economy. Therefore, there is a need for the country to seek debt restructuring to incorporate the unprecedented effects of the pandemic.

According to the BFP 2021/22, the country's budget is projected at $12.38 billion of which $5.66 billion will go to debt servicing against the total domestic revenue that is projected at only $5.88 billion. This means that 96.7% of Uganda's total domestic revenue will be spent on debt servicing.

It should be noted that the existence of debt has both social and financial costs i.e. in terms of debt service especially in interest and principal payments. This takes away the available resources needed to achieve major progress in the social sectors of health, agriculture, human capital development among others. If the government invested in human capital development and other social sectors like agriculture, health among others rather than debt repayments these could both fight poverty and create conditions for more economic growth.

It is imperative to underscore, however, that to unlock Uganda's potential, enhance production capacity and increase competitiveness, the government has prioritized the development of the country's infrastructure. Several key infrastructure projects have been financed using borrowed resources, leading to a build-up in public debt in recent years.

This has come with some risks to the debt portfolio, particularly related to the ratio of debt service to revenue, which has grown in recent years as debt contracted has become less concessional. There is thus a need to interrogate how much the priority sectors contribute to the economy in terms of revenues and how long it will take for the sectors to yield dividends that might be required to service the debts.

The cost of debt is premised on two indicators i.e. ratio of interest payments to GDP and the weighted average interest rate both expressed as percentages[9]. Interest payments as a percentage of GDP continue to rise, from 2.0 percent by the end of June 2019 to 2.3 percent by the end of June 2020[10].

[9] REPORT ON PUBLIC DEBT, GUARANTEES, OTHER FINANCIAL LIABILITIES AND GRANTS FOR FY 2019/20 AND THE MEDIUM TERM DEBT MANAGEMENT STRATEGY 2020/21 – 2023/24

[10] Debt Sustainability Analysis Report.

This was driven by an increase in the stock of public debt, which led to higher interest payments for both domestic and external debt. Moreover, for the last 3 Financial years, Uganda's budgets have featured huge payments to debt interest rates taking a high percentage compared to other social development sectors such as education, health among others. Interest payments are also projected to increase from 2.9 trillion in 2019/20 to UGX 3.6 trillion in 2020/21. Therefore, if the situation persists, this trend may plunge the country into a debt crisis.

5.0. Effects of Public Debt on Economic Growth.

Public debt can impact the economy either positively or negatively depending on the amount of debt and its purposes. The amount of debt is measured using the debt to GDP ratio therefore if the public debt goes beyond a given threshold, this adversely affects the economy. The economy will only grow positively when the debt level is below the threshold and decline when the debt to GDP exceeds the threshold.

The International Monetary Fund set a 50% debt to GDP ratio for developing countries but Uganda is moving closer to the debt threshold. According to the Auditor General's report by the end of December 2020, Uganda's public debt was at UGX 65.82 trillion from UGX 49 trillion in 2019 with a UGX 16.82 trillion increment. This is a result of the increase in expenditures and a reduction in revenues.

It is important to note that debt plays both a positive and negative role in shaping economic growth. If the government utilized the acquired debts for investment-oriented projects this would have a positive effect on the economy rather than use it for private and public consumption purposes which do not bring returns[11].

6.0. Policy Recommendations

- Prioritize domestic revenue mobilization: During the UN Addis Ababa Financing for Development conference in July 2015, Domestic Resource Mobilization re-emerged as a key source of funding for national development plans for Low-to-Middle Income Countries (LMIC) after countries were in the consensus of the complexity of obtaining development finance from households, businesses, and governments. Domestic Resource Mobilisation can be improved

[11] The Impact of Public debt on Uganda's Economic Growth.

through more efficient taxation and improved management of extractives revenues. Therefore, there is a need to continuously improve the efficiency of revenue administration, and enhancement of institutional and human resource capacities.

- Debt Transparency is key. Uganda's debts should be handled with utmost transparency especially the accumulations of loans as a result of the COVID-19 outbreak. Debt transparency is a cornerstone of accountable, sustainable management of debt that can benefit leaders and citizens alike. Government should declare what amount of debt they receive so that citizens can demand accountability from the responsible parties. There is also a need to ensure that the acquired loans serve the purpose for which they are meant to.

- Conduct Security reviews. There is a need for government to conduct security reviews of national assets to establish the ones that can be attached to the repayments of the respective debts. This would also enable the government to find out whether those sovereign securities have been crystallized under the rules of sovereign finance. The process should also entail a forensic audit of all debt-financed projects for value for money determination.

- Conduct critical research on new tax policies. As the government embarks on widening the tax base, research should be conducted on the new tax policies, their effectiveness, and their implications on the citizens. This should be undertaken to ensure that the tax base will increase hence its sustainability. For example, the recently proposed taxation on all bank withdraws.

- Establish an autonomous debt advisory committee. These should comprise of experts in issues of debt and resource mobilization to provide advisory services to the government in selecting appropriate loans and mechanisms of debt refinancing, develop financial models for fundraising purposes, assists in identifying priority investments and raising debt finance, and provides advice and support on asset securitization and refinancing transactions.

- Widening the tax base. The tax burden has for long been falling on only a small section of the population that is either informal employment or own businesses for which tax assessment is easier. However, the tax base can be lengthened by targeting the sectors that are currently untaxed especially the informal sector by introducing presumptive taxes based on the activities of these sectors. However, this has to be implemented while minimizing the regressive and distortionary effects on the sector.

7.0. Conclusion

Public debt has significant effects on economic growth in both the short and long run which creates a mixed impact on Uganda's economy. At the current rate of borrowing, Uganda is likely to have abating economic growth partially because such public borrowing adversely affects investment. Therefore, the need to ensure that the borrowed funds are efficiently used to finance projects with high potential to unlock the production capabilities of the country.

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