UGANDA DEBT NETWORK

Plot 153/155, Ntinda-Nakawa Road,P.O. Box 21509, Kampala
Tel: 256-414-543 974, Fax: 256-414-534 856 Email: info@udn.or.ug; website: www.udn.or.ug

CIVIL SOCIETY STATEMENT

ON

Government Proposal to borrow US$483m, from the EXIM Bank of China for the construction of the 183mw Isimba Hydropower Project and the Isimba-Bujagali Interconnection Project

Presented to the Parliamentary Committee on National Economy

9th December 2014

1.0 INTRODUCTION

Pursuant to the 1995 Constitution of Uganda, Article 38 1) and 2) gives citizens the right to participate in Government affairs through Civil Society Organizations (CSOs), their representatives or individually. Again as per Article 159 of the Constitution, the Ministry of Finance, Planning and Economic Development (MoFPED) is seeking parliamentary approval to borrow US$ 482,578,142.32 from the Export-Import (EXIM) Bank of China to finance the construction of Isimba Hydropower Project (HPP) and Isimba-Bujagali Interconnection project. The total project cost for the Isimba HPP is US$ 567,738,990.96 of which Government will contribute 15% (US$ 85,160,848.64) and the EXIM Bank of China will provide 85% (US$ 482,578,142.32).

In line with UDN's mandate to promote prudent generation of public resources, utilization and accountability, UDN is also aware that Article 159 (2)of the 1995 Constitution of Uganda empowers Parliament to approve Government borrowing. UDN therefore wishes to share concerns and proposals for the effective management the Isimba Project loan.

Overview of Uganda Debt Network (UDN)

UDN is a national 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. UDN works in 24 districts and in 86 sub-counties at the local levels with Local Governments and Community Based Organizations. At the national level, the organization engages with various Government Ministries, Departments and Agencies including Parliament, Bank of Uganda, Inspectorate of Government, MoFPED and Ministry of Local Government; on issues of efficient and effective service delivery outcomes, public sector accountability, budget priorities and policy options.

2.0 WHAT INFORMED CSOs' POSITION ABOUT THE ISIMBA PROJECT LOAN?

We have reviewed the following documents:

a) The Public Debt Management Framework (PDMF), 2013;

b) The Commercial Contract for Engineering Procurement and Construction (EPC) between Government and China International Water & Electric Corporation (CWE);

c) The Memorandum of Understanding between Government and CWE;

d) The draft Preferential Buyer Credit Loan Agreement;
e) The report on Public Debt, Grants and Guarantees for FY2013/14;
f) Borrowed from the UDN experience of having been established initially for public debt advocacy which enabled Uganda become the first country in the world to attain debt cancellation under the Highly Indebted Poor Countries Initiative (HIPC 1 and 2), Multilateral Debt Relief Initiative (MDRI). UDN has continued to carry out advocacy activities around debt and public accountability related issues at national and Local Governments in Uganda and beyond.

3.0 CIVIL SOCIETY CONCERNS

With reference to the constitutional mandate to Parliament to approve loans, we have the following concerns and proposals to share with you for discussion and action as our Members of Parliament, about the proposed Isimba Project loan;

3.1 Consistence of the project with the National Development Framework.

We appreciate that the National Development Plan (NDP) FY 2010/11-2014/15 identifies the construction of large hydropower plants and their associated works as one of the key strategic interventions to unlock some of the constraints to economic growth and development for Uganda. The NDP identifies 4 key strategic areas under the Electricity Sub-sector: 1) Power Generation; 2) Transmission and Distribution; 3) Rural electrification and Renewable Energy Development; and 4) Regional Inter-connection.

Recommendation: *In principle, we as members of Civil Society support the expeditious construction of the Hydropower projects listed under the NDP, e.g. Karuma, Ayago II and Isimba. This will accelerate Uganda's development agenda as per the NDP, Vision 2040 and sector investment plans, and enable the Ministry of Energy and Mineral Development to fulfill its mandate*[1]*.*

3.2 Consistence of borrowing terms and conditions of the proposed loan with the PDMF 2013.

Debt Concessionality

According to Article 2 of the draft Preferential Buyer Credit Loan Agreement, the Lender (EXIM Bank of China) is to make available to the Borrower (GoU) a loan facility in aggregate principle an amount not exceeding US$482,578,142.32 subject to the following financial terms:

[1] To Establish, Promote the Development, Strategically Manage and Safeguard the Rational, Sustainable Exploitation, Utilization of Energy, Mineral Resources for Social, and Economic Development.

i. Rate of interest applicable to the loan shall be 2% per annum;
ii. A one-off management fee of 0.25% of the principle loan facility (US$1,206,445.50)
iii. Commitment fee of 0.25% on undisbursed but available amount per annum.
iv. The maturity period shall be 240 months (20 years). Grace period shall be 60 months (5 years) and repayment period shall be 180 months (15 years).
v. No grant as part of the loan facility.

The PDMF 2013 permits Government to borrow at non-concessional terms for financing of projects that will provide an economic rate of return greater than the interest rate charged. Amongst other areas, a non-concessional loan must provide a grant element of not less than 25% and start generating revenues for government within a period of not more than 5 years.

The financial terms of the proposed Isimba loan facility indicate that the proposed borrowing is non-concessional. Concessional borrowing is characterized by over 25 year maturity periods, over 5 year grace periods, less than 1% interest rates and a grant element of not less than 35%. Therefore, using the IMF's grant element[2] calculator, the grant element of this proposed loan facility is approximately 26.71%.

Recommendations:

i) In order to effectively assess the viability of this proposed project, Parliament should be availed with the approximate economic rate of return for the proposed project by MoFPED.

ii) Given the rather hidden high cost of non-concessional debt financing, Parliament should minimize approval of non-concessional loans as the perceived benefits could be much less than the costs of debt financing.

3.3. Debt Sustainability

Uganda's total public debt exposure as at end-March 2014 was approximately US$ 9.47 billion. Of this, total external debt exposure stood at US$ 6.65billion[3], with US$ 4.18billion (63%) of total debt disbursed (DOD) and US$ 2.47 billion (37%) being loan commitments not yet disbursed. Domestic debt stock totaled Shs.7,213.5 billion (or US$ 2,823.9 million). The domestic debt levels also seem to pose a serious adverse challenge to the level of fiscal space for Uganda.

[2] The grant element is defined as the difference between its nominal value (face value) and the sum of the discounted future debt-service payments (net present value) to be made by the borrower, expressed as a percentage of the face value of the loan.
[3] Refer to MFPED report on Public Debt, Grants and Guarantees for FY2013/14

It's envisaged that the Isimba and Karuma project loan facilities will contribute an additional 8.6% points to Uganda's debt to GDP ratio[4]. With a June 2014 Present Value of Debt to GDP ratio of 22.6%, the project loans will increase the ratio to 31.2%. Although, this is within the prudential threshold of 50% as prescribed in the PDMF 2013; Uganda's debt exposure is expanding exponentially and the country could slide into debt distress levels and unsustainability in the near future. This could attract debt restructuring processes and initiatives which are equally costly.

According to Article 4 of the draft Preferential Buyer Credit Loan Agreement, the source of the debt repayment and servicing after commissioning will be the proceeds of tariff revenues paid by consumers of electricity. The electricity tariffs will therefore reflect the full cost of the project loans and the related financing costs. We as Civil Society are concerned that this risks increasing the already high electricity costs even higher, to the detriment of the consumers- household and industrial.

Recommendation: *Uganda's debt is expanding exponentially and tending to a non-concessional direction. It is imperative that Parliament critically considers this trend within the overall framework of continued borrowing, versus rationalization of national resources and multiple sector players at times with rather duplicate roles. Parliament needs to ensure that Uganda borrows at concessional terms and the projects realize a high positive return on investment, to enable an effective loan repayment record.*

3.4 External Debt Risk

Incurring cumulative external debt will surely expose Uganda to foreign currency risk. Prudent macroeconomic policies have often been compromised by the fiscal consequences of losses associated with these exposures.

Foreign currency risk is monitored with a focus on the ratio of foreign currency external debt to total public debt. In order to minimize this risk, the proportion of foreign currency debt in total debt should not rise above a maximum of 80%, according to the PDMF 2013.

Taking into account the Isimba HPP loan request (principal only), the total public debt exposure will expand to US$ 9.95 billion; of which total external debt exposure will be US$ 7.13 billion. This would imply that foreign currency risk measure would increase to 72% which would be closer to the prudential threshold of 80%; yet this is outside the proposed borrowing for the railway, refinery plant and others. Continued borrowing of

[4] According to the MFPED

this nature will further risk the Bank of Uganda to a draw down on the reserves, to enable debt payback. Such will expose Uganda to shocks and overall macroeconomic distortions.

Recommendation: *Parliament should ensure that the prudential threshold of 80% as per the PDMF 2013 is never surpassed. It is important to consider the possible macro-economic implications or risks of increased external borrowing over and above the prudential thresholds while making approvals. We need to first exhaust the Energy Fund, recover public stolen funds, rather than simply look at borrowing as the easier window every time we have to finance a project.*

3.5 Eventual total cost of the proposed project to Uganda Government.

The table below presents the estimated eventual total cost of the Isimba HPP.

	US Dollars ($)
GoU Contribution (15%)	85,160,848.64
EXIM Bank Loan Financing Cost	560,184,265.41
O/w Principal Loan	482,578,142.32
O/w Management Fee (0.25%)	1,206,445.50
O/w Interest Costs (15 years)-0.25%	76,399,677.59
Total Estimated Cost	**645,345,114.05 (USD 645 m)**

Source: UDN computations, December 2014

The projection of the eventual costs implies that the cost of the Isimba HPP per Megawatt is about US$ 3.5 million. Although this cost is slightly lower than the Bujagali HPP that was at US$ 3.64 million per megawatt; it will definitely increase the future electricity tariffs by about the same margin of that experienced after the commission of the Bujagali HPP.

Recommendation: *The Ministry of Energy and Mineral Development; and MoFPED should avail Parliament with all documentation and analysis around the project, e.g. with the approximate percentage increment of future commercial and domestic electricity tariffs due to the debt financing cost implication/requirement of the Isimba project.*

3.6 Likely project implementation challenges

a) Land Acquisition

Land acquisition has been a big challenge in timely implementation of large infrastructure projects in Uganda. Cases can be drawn from harmonizing demands from settlers along the Entebbe Express Highway or the Oil Refinery land areas with Government's vision to further the national development agenda.

Recommendations:

i) *Parliament should compel the Ministry of Energy and Mineral Development to ensure that any unresolved land acquisition challenges at the construction sites are rectified and the Resettlement Action Plan (RAP) recommendations for the project are fully implemented and expeditiously. This should act as a precursor or serious conditionality to approval of the project. In addition, to increase land utilization for infrastructure development, land reforms should be carried out to include gazetting and de-gazetting land and resettlement of displaced communities to allow for urbanization.*

ii) *Parliament should also ensure that there has been an effective consultation with the communities around Isimba who will be affected by the project and that such community members have been compensated on agreed terms and resettlement plans.*

b) Low absorption capacity of Loans by MDAs in Uganda

The above remains a debt stock increase challenge, partly due to increased borrowing to finance infrastructure projects identified in the NDP and Vision 2040. The Government of Uganda has a track record of accumulating undisbursed loan amounts, e.g. which increased from US$0.98bn FY 2006/07 to US$ 2.47bn, representing 56% by end of March 2014. This is attributed to low absorption capacity resulting from poor project management, procurement related challenges and poor financial management. Low absorption capacity attracts commitment charges which have since increased by about 164% from US$1.75m in FY 2007/08 to USD 4.1mn paid out in FY 2012/13. Another amount of US$ 3.5m was paid out in form of commitment fees by the end of March 2014. Payment of commitment fees on undisbursed loans distorts national cash flows and amounts to financial loss to Government which could be saved for allocation to finance quality public service delivery.

Recommendations:

Parliament should demand that there is prudent, accountable and commitment to utilizing the resources as soon as they are available for the project implementation. This will safe guard the little resources available for servicing loan and fulfilling foreign interests. Hence;

i) *The Ministry of Energy should provide Parliament with a strategy to address challenges of poor project management, procurement and financial management of the project loan to enable the avoidance of commitment charges on undisbursed loans. It is important to include advance preparation of procurement plans and* *written confirmation that the required counterpart funding is included in the national budget and Medium Term Expenditure Framework for the responsible Government Agency.*

iii) *During implementation, the implementing agents of the loan present progress reports for discussion at least after every 6 months to establish performance and assess value for money. This will act as a monitoring and evaluation strategy.*

c) Project cost overruns

In the previous similar case, the 250MW Bujagali Hydropower project cost sky-rocketed from an initial estimate of US$ 530 million to US$ 902 million. In fact, the 36% subsequent increase in domestic electricity tariffs seems to be partly explained by these cost overruns that have to be recovered.

Recommendations:

i) *Parliament should demand that the MoFPED provides a mitigation mechanism that safe guards the country against possible project cost overruns. The previous case should be a good learning experience to improve on the implementation of the Isimba project loan.*

ii) Parliament should study a possibility whether the Isimba project can eventually be run on a Public Private Partnership basis, as an additional and alternative window to public sector financing of certain projects. This can be done within consideration of the overall debt stock for Uganda and ultimate benefits to the Uganda citizens in an affordable manner. This will guide Government and the citizens on how to handle investments of Isimba nature and others.

4.0 CONCLUSION

It is envisaged that the Isimba HPP shall not only increase the amount of power generated, but will also extend and increase access to electricity and thus contribute towards reducing poverty an improving living standards in Uganda. However, Uganda's public debt exposure is exponentially growing and at this rate the country is at risk of high debt distress in the near future. Uganda's external debt continues to be largely sensitive to borrowing on less favorable terms given the current share of concessional debt of almost 90 percent of the total external debt stock. This inevitably will increase the cost of future debt financing and therefore erode the intended benefits of the projects that are debt financed.