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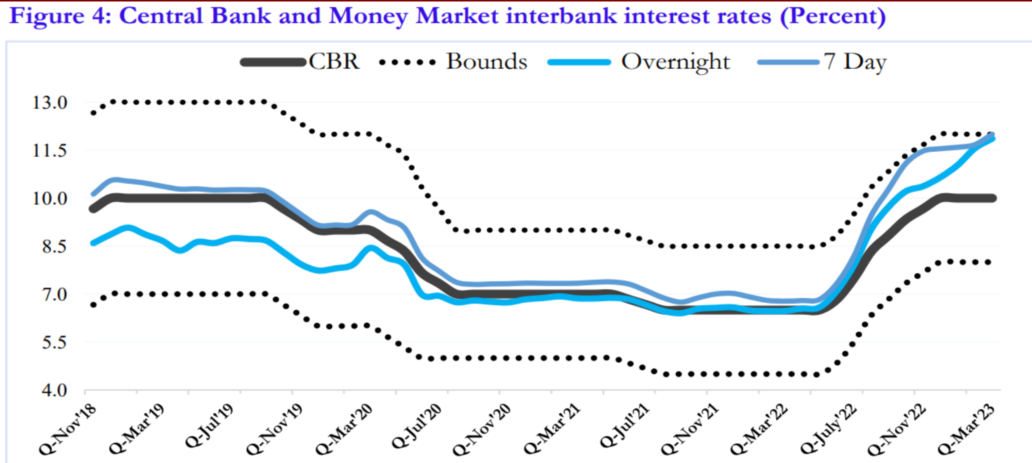
GOVERNMENT SHOOTS ITSELF IN THE FOOT BY RESORTING TO DOMESTIC PUBLIC DEBT

1. Preamble

As the government of Uganda continues to struggle to manage its ever-increasing domestic public debt, which has now grown to shs. 86.35 trillion, equivalent to approximately 49.6 percent of the country's gross domestic product (GDP). According to the Bank of Uganda' State of the Economy report, it was noted that interest payments on public debt now took on the largest share of tax revenue thus "clouding out other priority budgetary items."

2. BOU Castigates Government Borrowing Model

Figure 4: Central Bank and Money Market interbank interest rates (Percent)



Source: Bank of Uganda

The same BOU report highlights that there were a number of factors that contributed to the country's debt increasing rapidly in recent years.

One of the contributing factors to the country's slow economic growth have to do with the effects brought about by Covid-19 and the Russia-Ukraine conflict that have brought a lot of financial struggles that have only continued to widen the debt burden and lower the standards of living which in turn have forced the government of Uganda to rely heavily on borrowing most especially internally at high interest rates.

This has brought about unnecessary competition between the private sector and government that

borrow from the same sources. This ordinarily does more harm than good and hurts the economy further, given the limited sources of funding internally. In 2018, the Uganda Bureau of Statistics noted that "the rising public debt is posing a risk to the private sector's access to credit and expansion." When a large portion of a country's debt is held in domestic currency, any fluctuations in the

currency's value can have serious consequences.

If the value of the shilling were to continue to drop, the government would be faced with a much higher debt burden than it had previously anticipated, putting further strain on an already overburdened economy.

The risk of inflation is also still evident. If the country continues to rely heavily on domestic borrowing to finance its budget deficits this increases money supply and ultimately fuels inflation. It erodes the value of a country's currency and leads to the decline in the standard of living for its citizens.

3.Mother Hen Competes with Her Chick – Government Crowding Out Local Investors

Domestic debt can crowd out private investment, as lenders may prefer to lend to the government rather than the private sector. This can lead to a decline in private investment which can negatively affect the economic growth of the country. Internal borrowing by government implicitly is at the expense of SMEs; These are the very same sources that SMEs solely depend on. Note that while it has been generally recognized that SMEs are key drivers of development and constraining them is counterproductive. Furthermore, domestic debt has a shorter maturity compared to foreign debt which means that the government may have to refinance its debt more frequently. This can be risky if the government is unable to roll over its debt. International Monetary Fund (IMF) 7advises that "the shorter maturity of domestic debt creates risks if market sentiment turns negative, interest rates rise, or there is a need to roll over loans at higher costs.

4. Recommendations/conclusion

To avert these domestic borrowing challenges, UDN recommendations as follows:

1) Through implementing tax reforms that aim to broaden the tax base, reduce tax exemptions, and crack down on tax evasion, Government should increase revenue collection which can be done by reducing the country's debt burden through increased revenue collection.
2) Improving on debt management should be prioritized. By government improving its debt management practices to ensure that debt is contracted at the lowest possible cost, this could be used for productive purposes and this would include ensuring that debt is contracted for projects that have a high economic return and that debt is serviced in a timely manner.
3) Government should boost its private sector participation by encouraging the participation in infrastructure development and other sectors of the economy. This will not only help to reduce the burden on the government but also stimulate economic growth.

In conclusion, regardless of the approach government may take in the future in addressing this situation, it is clear that it should act quickly when it comes to addressing the risks posed by its current debt portfolio. Failure to do so is likely to lead to default, and this will have serious implications for Uganda's economic future with potentially devastating consequences for its citizens.In the continuous efforts to devise better debt management strategies, the fundamental question that remains is: *does domestic borrowing put the citizens at the forefront or periphery?*

Above; UDN and other CSO partners participating in the National Budget Month FY 2023/24 meeting at the Ministry of Finance headquarters.

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