Proposed Guidelines for Loan Scrutiny and Approval Process in Uganda

Shared with Parliamentary Committee on National Economy

September 2017

ACRONYMS

EAC	East African Community
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Countries
LICs	Low Income Countries
MDAs	Ministries Departments and Agencies
MDRI	Multilateral Debt Relief Initiative
MoFPED	Ministry of Finance Planning and Economic Development
NDP	National Development Plan
PAD	Project Appraisal Document
PIP	Project Implementation Plan
PPPs	Public Private Partnerships
PPAs	Priority Program Areas
UDN	Uganda Debt Network

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1.0 INTRODUCTION

External public debt is sustainable when it can be serviced without resorting to exceptional financing like, debt relief.

Good international practices for overall debt sustainability in Low Income Countries (LICs) recommends an external debt stock to Gross Domestic Product (GDP) ratio of not more than 30 percent[1]. ***Public debt stock to GDP ratio of below 40 percent*** for Uganda is appropriate, given that the East African Community (EAC) convergence criteria debt threshold is 50 percent[2].

Uganda's development efforts have been boosted by borrowing financial resources domestically and externally for infrastructure and other development ventures.The Debt burden, however, became overwhelming in the ***late 1990s,*** which saw the ***global Jubilee campaign*** movement efforts for ***external debt cancellation for developing nations*** across the world. ***Poor creditworthiness*** as a result of debt unsustainability of a country discourages investment in an economy and creates difficulties in accessing funds from the international Capital Market.

Any proposal by government to borrow should demonstrate its intent, linkage to ***national development goals, objectives and undertake a cost-benefit analysis.*** This helps to establish the level of returns to the economy in the short, medium and long term. Its worth to that the accumulation of public debt degrades a country's creditworthiness in the long run.

1 Debt Management Office, Nigeria – External Borrowing Guidelines (2008 – 2012), pg 4 http://www.dmo.gov.ng/oci/publications/docs/External%20Borrowing%20Guidelines%20%282008%20-%202012%29.pdf

2 MoFPED (2014). Report on Public Debt, Grants and Guarantees, FY 2013/14, Pg 12

In Uganda, Parliament is entrusted with the responsibility of approving external loans that are proposed by the Government. Apparently, guidelines for loan scrutiny ,approval process, and benchmarks to inform parliamentary debate and borrowing decisions are scattered in different policy documents. This situation calls for the need to have a comprehensive guiding document.

2.0

Overview of Uganda Debt Network (UDN)

UDN is a policy advocacy organisation that was formed in 1996 to campaign for debt relief for Uganda under the Heavily Indebted Poor Countries (HIPC) Initiative of the World Bank and International Monetary Fund upon which Uganda became the first country in the world, to qualify for debt relief.

UDN also played an active role in advocating for debt cancellation under the Multilateral Debt Relief Initiative (MDRI) in 2006; where again, Uganda benefited from 100% external debt cancellation of multilateral debt.

UDN values responsible borrowing and has continued to advocate for prudent utilisation of borrowed and other public resources. This, inter alia, has been through tracking and monitoring of HIPC-funded resources initially under Poverty Action Fund (PAF) that supported poverty reduction Priority Program Areas (PPAs)[1] since FY 1996/07; and accountability of other public sector resources in Uganda to-date.

1 These include; Universal Primary Education, Rural Feeder Roads , Plan for Modernization of Agriculture (especially NAADS), Primary Health Care and Water and sanitation

UDN works to contribute towards a prosperous Uganda, with sustainable, equitable development and a high quality of life for the people.

Its mission is 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 at national level, directly in 24 districts and in 83 sub-counties across Uganda. This work is done through partnerships with Local Governments, CSOs and nurturing Community Based Organizations. At the national level, the organization engages with various Government Ministries, Departments and Agencies (MDAs), on issues of service delivery, public sector accountability, budget policy options, as well as anti-corruption strategies.

3.0

Efforts by Parliamentary Department of Research Services

UDN wishes to appreciate the Department of Research Services at Parliament for drafting a guide for loan scrutiny and approval process which is currently being used by the Parliamentary Committee on National Economy for reference.

3.1 Proposed Guidelines for Loam scrutiny and approval by Parliament

The draft Parliamentary guidelines highlight the following:

a) The responsible centres/institutions and their responsibilities.

b) Main loan reference documents which include;

   i) A brief from the Minister of Finance on the loan request to Parliament

   ii) Project Appraisal Document (PAD)

   iii) Draft Loan Financing Agreement

   iv) The Project Implementation Plan (PIP)

c) Rationale, relevance, effectiveness, efficiency, environmental impact, equality, terms and conditions, and sustainability.

d) Other methodologies used during loan scrutiny e.g.

   i) Joint participatory loan appraisal of parliamentary and beneficiary sectoral committee.

   ii) Loan appraisal with project beneficiaries.

   iii) Reviews of; On-going loan projects specific to the beneficiary sector, Budget performance of the beneficiary sector, Audit reports on previous/on-going loan projects, Audit reports of the implementation Agency, Project reports for multi-year phased projects and Project monitoring reports (Quarterly, Half year and annual).

4.0

Proposed additional guidelines for loan scrutiny and approval by Uganda Debt Network

UDN shared this document with the Ministry of Finance Planning and Economic Development (MoFPED) and their input has been included

We also wish to share it with Parliament for discussion and consideration as a comprehensive document and eventual adoption for future reference in the process of loan approval.

To approve a loan to finance an investment project, below are the UDN proposed additional guidelines to the above for adoption by Parliament.

1. **Generational equilibrium/use of domestic resources for public expenditure:** Financing for public expenditure projects should utilize available domestic revenue before resorting to public borrowing. Uganda must own her development to above average expenditure with a view of reducing debt resource dependency. Excessive borrowing could lay a debt repayment burden on the future generation in Uganda, instead of saving resources for investment. Any Government expenditure before loan acquisition should be financed by available resources. Then, investment expenditure on the project for which a loan is borrowed can be financed by debt investment pay-offs.

2. **Comprehensive financial cost assessments for loan proposals:** The financial cost assessment should indicate that domestic economic conditions and the international framework are favourable for utilizing a proposed loan and even to finance the said project. A comprehensive analysis of the cost and risk benefit trade-offs of acquiring an external loan in terms of foreign-currency debt should be conducted. Parliament should therefore establish the cost of servicing the entire loan by the end of the loan period in absolute terms before its approval. At the same time, the MoFPED should include a comprehensive portfolio review cost and risk analysis of Central Government outstanding debt. The report should have an assessment of how debt management activities have complied with the objectives, principles and guidelines set out under the Debt Management Framework.

3. **Consistency with National Development Agenda:** Each loan proposal has to be consistent with the existing National Vision, Public Debt Management Framework and the National Development Plan (NDP). The benefits of proposed loans to citizens should be assessed individually. The rate of growth of new debt disbursements therefore, should correspond with the economy's ratio of debt-to-GDP, exports, forward looking Debt Sustainability Analysis and government revenue to ensure debt sustainability.

   DSA Report (2015, p.8) acknowledges stagnation in growth of export receipts while a trend analysis noted that Uganda's economy has registered negative Balance of Payments in at least the 3 previous years including less than 50% of the import bill within 12 months to March 2016 arising from a large international trade imbalance[1].

4. **Loan acquisition based on an annual borrowing plan**
   a) Parliament should make reference to Government's annual borrowing plan which should provide information on effective counterpart funding mechanisms, planning and budgeting for all procured loans. Approved loans should also have approved Project Implementation Plans. It is paramount that all Government external borrowing proposals for the next fiscal year be submitted not later than 6 months preceding that year to the MoFPED for incorporation into the borrowing plan

1 MoFPED, Background to the Budget FY 2014/15, p.42; National Budget Speeches, FY 2015/16, p.6 and FY 16/17, p.3

for the coming year. This will ease planning and incorporation of the proposed external loan into the draft annual budget/ Budget Framework Paper to Parliament for approval for the forthcoming financial year.
Borrowing $48Mn for Inland Port on Lake Victoria shores: Current Government borrowing is aimed at financing infrastructure projects in the NDP II and the Uganda Vision 2040 to enhance productivity and economic growth.

b) Effective planning will also discourage piece-meal borrowing from the same lender because each loan process has financial, time and labour costs which raise the cost of loan management. Loans for sector projects with similar characteristics under a single lender should be negotiated at once to avoid incurring repeated cost/benefit attributes. In case of contracting foreign contractors, they should sub-contract local companies to carry out manageable tasks to enhance skills development for maintaining the projects when foreign contractors have returned to their home countries. This, however, should not be the case when the same creditor may be offering different terms for different loans since combining the assessment may be risky and could misguide decision making.

5. **Debt structure assessment:** Parliament should always refer to the debt structure from the MoFPED for assessment before approving a loan[2]. Debt structure assessment involves different elements including currencies in which the debt is contracted, interest rate amounts to be paid on the loan as well as terms and conditions of the loan. The performance of these components and the Public Debt Management Framework that ensures debt sustainability relies greatly on the relationship of debt management in a clear macroeconomic framework[3]. This is to ensure that the level and increasing rate of the public debt will not result in a governmental insolvency.

2 Debt structure explains the relationship of Government gross debt to GDP; by sector of debt holder, by Debt instruments diversification, by Maturity debt profile (initial and remaining maturity), by currency of issuance, and guarantees granted by government to non-government units.

3 According to the NDP II, 2015/16 – 2019/20, Uganda's focus is on a macroeconomic framework which upholds growth majorly driven by public and private investment with substantial spending in infrastructure development; b) emphasis on domestic resource mobilization coupled with other sources of financing domestically and externally; and c) through non-public sources of financing eg PPP, direct private sector investments (domestic and foreign) and CSO contributions.

6. **Assessment of previous performance of Government Agencies:** Government Ministries, Departments and Agencies (MDAs) have had a track record of accumulated unutilized loans with limited progress achieved on same issues raised in several Auditor General's reports (2010 – 2015) surrounding poor loan absorption capacities. This is attributed to poor; feasibility studies, project management, procurement bottlenecks, financial management as well as Monitoring and Evaluation of projects. All these are characterized by a large number of uncoordinated and un-harmonized monitoring systems within specific sectors. Low absorption capacity attracts commitment charges. This causes financial loses as it is a cost to government which should be saved for allocation to finance public service delivery. Therefore, a clear assessment of the performance of a contracting government entity on utilization of previous loans should be conducted and shared with Parliament to ensure value for money for a proposed loan especially if it is the same entity seeking a new loan.

7. **Short loan appraisal process:** Delayed loan appraisal process leads to loss of funds by Government through payment of commitment fees. Such interuptions cause delayed implementation of loans past their ideal closing date. The loan appraisal process should take not more than 12 months through all the institutions entrusted with the process. Such institutions include Cabinet, Parliament and the Solicitor General. .

8. **Approval of loans for multiple uses:** Parliament should prioritize the approval of loans where a project benefits various sectors instead of having a specific project for one sector. Whereas, Multi-sectoral loans are difficult to co-coordinate, an integrated multi-sectoral guideline to approach loan appraisals and approval in such categories needs to be developed for effective implementation. This would save time and money..

9. **Joint monitoring Plan and Unit:** In order to ensure value for money, the MoFPED and line Government agencies need to provide a mechanism for monitoring the implementation of a proposed loan. A joint monitoring plan and unit of any project comprising representatives from Parliament, line Government agency,

MoFPED and the creditor should be set up. This will improve the implementation and monitoring of the project loan in order to achieve project objectives.

10. **Review of Non-Governmental Alternative loan proposal evaluation:** An inclusive scrutiny of the loan proposals is vital to ascertain whether the economy actually needs to borrow; can manage the repayment schedule with the resultant increase in national debt, and if the conditions are acceptable. An alternative assessment report of a Government proposed loan by, Civil Society for example, provides an independent view of the new proposed loan and improves the evaluation for its effectiveness. This will require availing all documentation concerning the proposed loan to facilitate the evaluation process leading to a comprehensive alternative analysis for consideration during parliament's review process of the said loan. This independent analysis report will help to guide future decision making on loan contraction and disbursement. The democratic scrutiny of new loans is important in ensuring greater and joint oversight to avoid escalation in public debt stock. It will also save a situation of debt overhang[4] which discourages investment in the economy and creates difficulties in accessing funds from the International Capital market.

11. **Debt Concessionality:** With regard to Government's commitment to maintain debt sustainability, major new borrowing should largely be considered on concessional terms[5]. This shall also be consistent with borrowing terms and conditions of the proposed loan with the existing Public Debt Management Policy. Analysis should be subjected to;

    i) Rate of interest applicable to the loan per annum;

    ii) Management fees of the principle loan facility if applicable.

    iii) Rate of Commitment fees on disbursed and undisbursed loans amount per annum.

    iv) Maturity, grace and repayment periods.

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4 National debt stock exceeding its future repayment capacity

5 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%. Check IMF literature.

v) Grant element of the loan facility from donors should exceed 35 percent.

vi) External Debt Risk arising from exposure to foreign currency risk resulting into associated fiscal losses[6]. In order to minimize this risk, the proportion of foreign currency debt to total debt should be within the threshold of the existing Public Debt Management Framework.

12. **Non-concessional Borrowing:** Government should only borrow at non-concessional terms to finance projects that will provide an economic rate of return greater than the interest rate charged. The financial terms of 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.

13. **Pursuance of Public Private Partnerships (PPPs):** The institution of a PPP Framework is currently in its last stages but Parliament should seek to promote an integrated and inclusive development drive by considering strengthening of PPPs interventions during loan appraisal and approval processes. Some projects for infrastructural and human capital development; and other huge undertakings requiring large sums of financial resources, should be run on a PPP basis, as an alternative to public sector financing. The implementation of a PPP framework will be effective if regulated according to the standards of the required Law and policy framework since it is envisaged to minimise costs incurred through the process of project appraisal and implementation[7].

6 Foreign currency risk is monitored with a focus on the ratio of foreign currency external debt to total public debt

7 The PPP Bill 2012 was passed by Parliament in July 2014 but was referred back by the President for Amendment and currently before Parliament for discussion.

5.0

CONCLUSION

Preference in borrowing needs to be focused towards creditors that provide national programme support for development. Government agencies intending to borrow must demonstrate that they have not over-borrowed or even take into account other sources of revenue, as appropriate. Agencies will be required to provide cash flow statements that will enable the appropriate authority to determine the viability and sustainability of their borrowing.

VISION

A Uganda where public resources are prudently, sustainably and equitably managed.

MISSION

To generate advocacy expertise that influences people-based and accountable public resource management in Uganda.

UGANDA DEBT NETWORK
Plot 153/155 Ntinda Road, Ntinda,
P.O. Box 21509 Kampala-Uganda
Tel: 0414- 533840/543974,
Email: info@udn.or.ug,
Website: www.udn.or.ug
@ugandadebtnet
Uganda Debt Network