UGANDA DEBT NETWORK

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Performance of Uganda's Debt Portfolio and Development Challenges; *Key Lessons*

Issues paper

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Introduction

Pursuant to the development objectives, Uganda mobilizes financial resources from different sources domestically and externally. The overarching legislative and policy frameworks for public debt management are the Public Debt Management Framework (2013), Public Finance Management Act (2015), Medium Term Debt Management Strategy (MTDS) 2015/16- 2019/20, PPP policy and the 2015 PPP Act. However, Uganda's debt burden is gradually deepening as debt build up is increasingly getting discordant with debt sustainability and economic growth. Heavy borrowing in recent years has tested Government's prudence in fiscal utilization and management of borrowed resources from the time of debt relief under the HIPC Initiatives resulting into a series of debt relief in the 1990s and 2000s.

In March 2011, Uganda's debt was US$4.29bn[1] and it is expected to increase beyond US$ 13bn in FY 2017/18 hence raising debt costs. A report by Bank of Uganda (June, 2016) noted that public debt stock stood at Shs46.1 trillion approximately US$13billion by April 2016, which was about 52% of GDP (including commitments undisbursed), already beyond the 50% threshold and is pushing the country into another debt trap. The level of sustainability notwithstanding, is unhealthy for an economy aspiring to reach mid-income status with a debt position that is more than half of its GDP.

While Government has consistently reported that debt portfolio is sustainably below the requisite thresholds (which seems to catalyze further borrowing), domestic borrowing is also increasingly getting costly. This is reportedly because Government is focused on addressing infrastructural constraints in order to increase economic efficiency and reduce the cost of doing business. As the gap between domestic savings and investment widens, and debt and interest costs accumulate government will mostly likely be forced to borrow more to re-finance maturing debt obligations[2].

Issues of Concern on Uganda's Debt Management

1. ***1. Increasing external public loan financing attracting high commitment fees.*** External borrowing has risen over the years from USD 2.86 billion in FY 2008/09 to USD 9.66 billion FY 2015/16[3]. New borrowings for FY 2015/16 are dominated by the AfDB, WB and China

[1] MoFPED (2011). Report on Loans, Grants and Guarantees for FY 2010/11

[2] Kehinde, Sunday James, Awotundun D. A. Debt Burden and Nigerian Development Vol 2, Issue 9 Sept 2012, pg 15

[3] MoFPED (2016), Report on Public Debt (Domestic and External Loans), Guarantees and Other Financial Liabilities and Grants for Financial Year 2015/16, Pg.10

(Exim Bank) respectively at 48%, 28% and 10%[4]. However, undisbursed loans tantamount to higher commitment fees (MoFPED, Report FY 2015/16)[5]. The Auditor General's report (Dec 2016) alarmed on the un-disbursed debt which stood at Sh.18.1 trillion with commitment charges of Sh.20.9 billion to be paid hence resulting in increased debt servicing. Failure to absorb borrowed funds within the specified timeframe leads to an increase in the cost of debt to inform of commitment fees and fines. Because of financing development through increased indebtedness, the government is now confronted with a huge debt cost burden hence the sustainability of Uganda's debt is questionable.

2. ***General declining loan disbursement rate, but China registers positive growth*** : The level of disbursed loans declined from 63% in FY 2007/08 to 51% in FY 2015/16[6]; yet between FY 2007/8 and 2014/15, Government paid a sum of USD 26.8m in form of commitment charges on undisbursed loans[7]. Government signed 96 loan agreements from January 2010 to June 2016, worth USD 8.8 billion dollars with China having the largest credit portfolio at 29% of the total loans, followed by the World Bank (27%), African Development Bank (21%) and the rest of the creditors account for 23%[8]. However, the overall loan disbursement rate is only 25%, with varied performance against different creditors, sectors, programs and specific projects. The Auditor General's finding in FY 2014/15 report[9] highlighted that the sampled 73 active loans were still underperforming with absorption levels below 50%.

Through the period, 69 out of the total active loan projects (96) had loan disbursement levels below 50% while 28 loans of 96 had 0% disbursement. For instance, the Islamic University - Supplementary Loan - L-0475 that was signed on 29th May 2010 with an expiry date of 31st December 2013 had zero disbursement as of 30th June 2016. Since FY 2013/14, China has been registering a positive growth in loan disbursement from 9.4% to 60% in FY 2015/16[10] yet most Chinese loans are bi-laterally acquired on non-concessional terms which are highly costly to the economy.

3. ***Flouting counterpart standard affecting loan performance and increasing debt management challenges:*** Although GoU has tried to ensure that counterpart funding for external projects does not exceed 11%, there are a number of portfolios whose counterpart commitments stand at 63.3%. For instance, whereas within the transport sector, the World Bank charged 0.72% (Transport Sector Development Project) as counterpart, China charged 26.47% (e.g. for Entebbe Expressway project). Meanwhile, AfDB required a 63.3% counterpart funding

[4] Ministry of Finance, Planning and Economic Development Loan agreement performance report, , June 2016

[5] Ibid

[6] Ministry of Finance, Planning and Economic Development Loan agreement performance report, , June 2016

[7] Auditor General's Report (2015), Annual Report for the Audit year ended December 2015. Value for Money Audit, - volume 5, pg 233.

[8] BADEA, EIB, France, Germany, IFAD, Japan, Kuwait, OPEC, South Korea and Saudi Arabia

[9] Office Auditor General. Follow up Audit Report on the Utilisation of external Public Debt December 2015, pg 17. This same report is also found in the Auditor General's Report (2015), Annual Report of the Auditor General for the Audit Year Ended December 2015. Value for Money Audit, - VOLUME 5,

[10] MoFPED Report on Public Debt (domestic and external loans), Guarantees, other financial liabilities and grants for FY 2015/16

on the Markets and Agricultural Trade Improvement Project 2 (MATIP II) project (Contract period: 28th July 2015 – 30th June 2020) and a 15.5% counterpart funding on the Higher Education Science and Technology Project (HEST) project (Contract period: 5th July 2013 – 30th June 2018). Acquiring such loans and committing to provide counterpart funding against the standard results in debt management challenges.

4. ***Missing assessment documents of the economic and financial rate of return of loans:*** The PFMA 2015 section 36 (5) emphasizes that Parliament analyses the economic implications and budget proposals, approves acquisition of external financing and monitors utilization. The Auditor General's report of 2015 on the Value for Money Audit for FY 2013/14 indicated that of the 35 sampled loans, only two (2) loan proposals had been technically evaluated and analysed by MoFPED Debt Management Unit (DMU). Again in 2014[11] his findings revealed that loans worth USD 817 million which were secured on non-concessional terms since June 2013, had no backing assessment documents of the economic and financial rate of return as required by the Public Debt Management Framework (PDMF), 2013. This portrays limited level of transparency in dissemination of key information about loan-supported projects to various stakeholders but also impairs the picture of economic returns the country would obtain. It's noteworthy that the non-functionality of a Project Appraisal Department has contributed to poor project planning, appraisal and design.

5. ***Loan Effectiveness:***

a) *Limited fulfilment of Creditor conditions:* Some creditor terms and conditions hugely impact on loan effectiveness eg payment of a 1% loan management fee upfront, VAT waiver, depositing of minimum required funds on the repayment reserve account as is, for instance, required by EXIM Bank of China. In his report (2016), the Auditor General found that government was still challenged in meeting operational conditionalities (preconditions to loan effectiveness) within the creditor stipulated timelines as it took an average of 308 days thus delaying the first loan disbursement to the projects[12]. This delay affects the loan absorption process hence accumulated project related costs.

b) *Loans signed before Parliamentary approvals:* Parliament is responsible for approving new loans that government intends to acquire in a given year, as provided for in Article 159 (2) of the constitutions of Uganda 1995 (as amended). However, some loans are periodically signed before Parliamentary approval which affects and sometimes delays loan effectiveness. Reasons for delayed approvals range from; timing for borrowing especially nearing the election period or recess, amount of work and time Parliament spends scrutinising the loans, assessment of economic viability, among others[13]. Between 2011 and 2012 about 5

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[11] Annual Report of the Auditor General for the Financial Year ended 30th June 2014, Volume 5: Value For Money Audit Report, March 2015, page 143-144

[12] Office of Auditor General. Follow-up Audit Report on the utilization of external Public Debt , Dec 2015, pg 25

[13] Follow up Audit Report on the utilization of external Public Debt- Office of the Auditor General (OAG), Dec 2015, page 26-27

loans were signed prior to parliamentary approval; but only one performed to its fullness[14]. This remains a cost to citizens in terms of loan repayment when outright expected performance falls short.

c) *Procurement delays* contribute to determining the level of effectiveness of loan disbursements. For instance, loan disbursements were on average delayed by 356 days in infrastructural related projects as a result of procurement of works, designs and project consultants[15]. Among the sampled projects, the average procurement delays in days were as follows; MoE (338), MoH (241), MoLG (261), MoWT (421), UETCL (573) and REA (650). The construction of 14 bridges in northern and eastern Uganda was a case in point having taken 1,129 days to hire a Supervising consultant and 926 days to procure works. Some delays in the procurement process arise from actions of whistle blowers who are protected by the PPDA law as they lodge complaints with the project donor leading to halting of project implementation to allow for investigation. For example, the tender for upgrading of Kigumba-Bulima-Kabwoya road funded by the AfDB was halted by PPDA following a complaint from a whistle blower who alleged that M/s Chongqing International Construction Company (CICO) misrepresented its experience record for 6 projects in their bid; and that the award to China Railway No.5 Engineering Group Company Ltd (CR 5) for Lot 2 was contrary to the Instructions to Applicants and Instructions to Bidders No. 4.3 on conflict of interest[16]. The complaint was received on 1st September 2014 and the projected was delayed for over a year following a report of misrepresentation of facts by Ernst and Young which translated into project extension, thus projects suffering multiple time overruns that subsequently translate into more cost overruns.

6. ***Mismatch between Infrastructure investment budgets and increased capacity to invest.*** External resources finance a bigger share of some of Uganda's investment sectoral budgets: Public infrastructure sectors particularly works and transport, energy, and mineral development are increasingly funded from external sources, respectively by 38% and 87% in FY 2016/17 as a share of respective sector Budgets[17]. They jointly account for 66.4% of the total external financing (including grants) implying that the government is prone to accepting the tough loan conditions set by creditors and donor partners. In 2017/18 proposed Budget, the works and transport sector will be 51% funded from external sources while energy sector will be funded from 82%. Increased allocations to infrastructure sectors are at a trade-off of others sectors including the

[14] Office of the Auditor General. Follow up Audit Report on the utilisation of external Public Debt- Office of the Auditor General (OAG), December, 2015, Page 25-26

[15] Follow u Audit Report on the utilisation of external Public Debt, December 2015-Office of Auditor General, page 28-29.

[16] The complaint was received on 1st September 2014 and PPDA issued its recommendations to UNRA on 27th October 2014.

[17] Approved Revenue and Expenditure estimates (Various) and Background to Budget for each year (Various)

human development. However, implementation gaps continue to prevail. According to Uganda's 7th Economic Update of the World Bank report (April, 2016), there is concern that Uganda's public investments are falling short of generating the desired economic return. The report notes that every dollar invested in Uganda's infrastructure yielded less than a dollar (i.e. only 0.8) worth of economic activity.

7. ***China loans Dominate credit portfolio***. China loans dominate the credit portfolio from non-concessional sources. By June 2016, China had undisbursed loans totalling to USD 1,457,061,076 which represents 15% of the total undisbursed loans signed over the period (January 2010 and June 2016). However, the overall China loan performance is 27% for loans between 2011 and 2015. For instance, Karuma dam loan records indicate that its performance was at 13% and had also suffered challenging bidding process in court as the procurement of the contractor was undertaken through the signing a Memorandum of Understanding between GoU and Sino-hydro in June 2013[18]. On the Kampala - Entebbe Express Highway - while the project loan was signed in 2011, the loan effectiveness happened after 370 days. This in part explains the project extension of implementation timelines by a year to end of 2016. However, the disbursement levels remained at only 65% and the project is expected to be completed end of 2017. The project has also been marred by other implementation challenges, in part attributed to the single source procurement method and acquisition of right of way.

8. ***Rising Debt Interest Costs in Uganda and its implications***

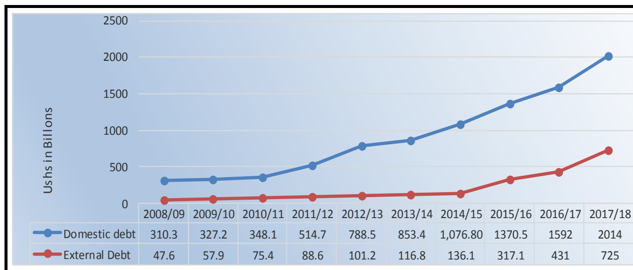
a) *Rising trend of Interest payments*: Uganda's Interest costs on debt are rising alarmingly due to the huge borrowing and associated costs especially domestically to partly finance budget deficits. For instance, interest payments accounted for Shs 309.4billion in FY 2007/2008[19], but Government is set to spend an amount of Shs 2,739billion in FY 2017/18 (with 74% payments on domestic debt and 26% on external debt); an increase of 785.3% in the said period. In the current FY2016/17, total interest payments is expected to amount to Shs. 2,014 billion which is approximately what government will spend on domestic interest payments alone in FY 2017/18 representing an increase of total interest payments of 36% only in one year. A trend analysis of growth in interest payments in the last 10 years[20] notes steady progress in the increase of government expenditure on interest payments with an annual average percentage of 78.5%. This should raise a red-flag to debt managers, advisers and policy makers as such cost burdens deprive other sectors of resources and interest payments as will consume more resources available to address citizens' social recurrent economic needs.

Figure 1: Trend Analysis of Interest payments costs on Uganda's Debt: FY 2008/09 – 2017/18

[18] MoFPED, Loan Agreement performance data, June 2016

[19]MoFPED. National Budget FY 2007/08, June 2007

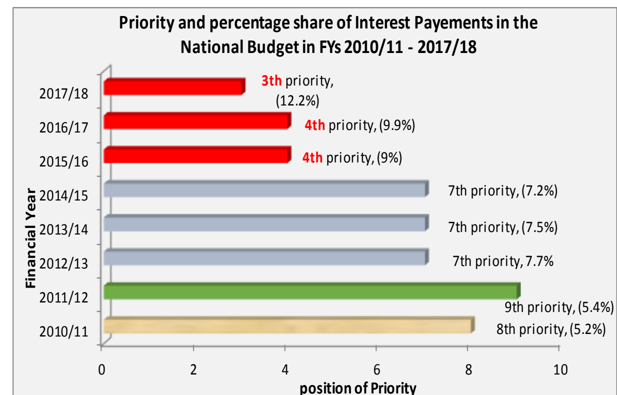
[20] Analysis based on review of various documents from MOFPED: FY 2008/09 – 2017/18



Source: Author's analysis based on review of various documents from MOFPED

b) *Increased prioritization of Interest payments on debt by Government:* Uganda's expenditure on interest payments consumes a huge chunk of national resources thereby cheating human development and service delivery efforts. Interest payments are increasingly becoming a priority, taking 3rd position in the next FY2017/18 (12.2%) compared to 4th position in FY2015/16 and FY2016/17, with an average share of 10.4% of government expenditure. This percentage doubles, triples and even quadruples some estimated sectoral allocations recorded in the NBFP FY2017/18 like, health (5.7%), Agriculture (3.8%), Water and Environment (3.1%), Legislature (2.0%) and Social Development (0.8%). While the budget share of Works and transport, and Energy and Mineral development sector allocations were 18.7% and 11.6% respectively in FY 2016/17, and are expected to take 21.7% and 13.2% in FY 2017/18, they are heavily financed with externally borrowed resources. This implies that though interest payments is ranked 3rd in the next FY 2017/18, it will be financed from domestic revenue which otherwise makes it first priority on government expenditure using locally mobilized resources. Increased borrowing is being driven by infrastructural development but it's highly probable that the cost will soon be financed through additional public debt, further increasing interest payments thereby raising debt sustainability concerns

Figure 2 Trend in prioritizing Interest payments on the national budgets:



Source: Author's analysis based on review of various MOFPED Reports[21]

9. ***Management of Uganda's debt within the threshold.*** In March 2011, Uganda's debt was US$4.29bn and it is expected to increase beyond US$ 11bn in FY 2017/18. According to a Bank of Uganda report (June, 2016), public debt stock stood at Shs46.1 trillion approximately US$13billion by April 2016, which was about 52% of GDP, already beyond the 50% threshold and is pushing the country into another debt trap. The Auditor General's Report, (Dec 2016) further noted that the ratio of interest payments to total government revenue reached 16%, beyond the cap set in the Public Debt Management Framework, 2013 of 15%. Yet, he further alarmed on the un-disbursed debt which stood at Sh.18.1 trillion with commitment charges of Sh.20.9 billion to be paid hence resulting in increased debt servicing. Also, the IMF's report (Jan. 2017) on the 7th Policy Support Instrument noted that

[21] BTTBs of respective financial years analyzed

vulnerabilities to debt distress have increased. While Government has consistently reported that debt portfolio is sustainably below the requisite thresholds, with the current, increasing non-concessional, bilateral borrowing trend, debt will definitely not be sustainable in the long run, signalling that future spending will predictably rise even higher.

Recommendations

Parliament should;

1. *Compel Government to slow down borrowing and streamline/sequence already existing loan projects alongside identifying growth drivers in which to invest to generate economic activities. More borrowing may only be advisable unless such debts are used to finance projects that can generate income within a reasonably short period to pay off the debts*
2. *Task MoFPED to provide periodic progress reports of specifically non-performing loans while demanding the step-up of their effective management before acquiring more to ensure effective loan utilization. This will aid avoidance of undesirable consequences of future unsustainable debt.*
3. *Demand for the expeditious establishment of a fully functional project appraisal and evaluation department in the MoFPED. It should be empowered to approve realistic and implementable project designs to be undertaken before sourcing for funds to avoid the unnecessary costs and delays caused by changing project designs during implementation. Independent and competent evaluators should be attached to the unit to re-enforcing capacity but also playing a supplementary oversight role. This will enhance the absorption capacity to ensure full utilization of the funds released.*
4. *Ensure that approval of loans are based on readability of the project with detailed designs, resettlement cost, action plan, and environmental impact assessment as well as guaranteed budgetary provisions for the government counterpart funding (if required).*
5. *Task Government to revamp the financing strategy for the value addition program on Uganda's exports to improve the Balance of payments earnings which have registered a negative trend for at least the 3 previous years;*
6. *Task the MoFPED to provide a clear empirical analysis on the exact contribution of debt to economic growth within the Annual Debt Sustainability Analyses report. This will help to establish Uganda's cost of economic growth and development using borrowed resources.*

Conclusion

Uganda's policy and planning frameworks indicate a projected increase in the use of public debt and PPPs in execution of the NDPII pipeline projects. The recent trend suggest that public debt has grown at a much faster rate than the growth of the economy, implying that there is need for medium term fiscal adjustment if debt is to remain sustainable. Already a number of domestic debt indicators. Both public debt and private debt require a strong public sector and competitive and supporting environment. Public debt can spur leakages and the vivid public investment management weaknesses suggest that Uganda may lose out on the external infrastructural investment dividends. Notably no evidence suggests that any medium to large infrastructure projects have been implemented on time. PPP are innovative ways of financing but can be expensive in weak institutional environment and if the investment is not aligned to the demand. Any further downgrade in credit ratings could compromise attracting credible creditors and also attracting the private sector to partake in the PPPs.