

Uganda's Debt Sustainability: Is it a Cause of Concern?

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Abstract

This article analyses the debt sustainability exercise undertaken by Uganda in determining whether it provides solutions to Ugandan authorities in the management analysis, it does not seem to guide public debt management; instead, it is used to justify additional public borrowing by use of established public debt thresholds. If Uganda was to use the debt sustainability tool for public debt management, the challenges the country associated risks; poor costing of projects; slow economic growth; low domestic revenue

performance in the projection period could be overstated, as the Debt Sustainability Analysis (DSA) tool does not take into account policy/programme implementation; although public institutional strength is taken into account by use of the Country Policy and Institutional Assessment (CPIA) rating. Therefore, the more general lesson from the DSA results is that new borrowing even on concessional terms should be pursued with caution, based on prudent economic projections and in recognition of the country-

Key words: Debt Sustainability Analysis, Debt Sustainability Tool, Fiscal Deficit, Public Debt Management

Introduction

Uganda has undergone a series of debt repayment challenges before. In 2000, shortly after having been declared eligible for substantial support under the enhanced Highly Indebted Poor Country (HIPC) Initiative, Uganda experienced a sharp and unexpected rise in its Net Present Value (NPV) of debt-to-exports ratio, exceeding the HIPC threshold of 150% by some 50 percentage points (International Monetary Fund, 2003). While this did not necessarily mean that Uganda's debt was unsustainable, by virtue of relatively low debt service ratios, it demonstrated the fragility of the country's debt dynamics. This was at a time when the country was accessing highly concessional loans.

An IMF study in 2003 indicated that although Uganda had been receiving aid and Foreign Direct Investments (FDI) of nearly 12 per cent of GDP, its residual financing gap of about 3.5 per cent of GDP contributed some 10 percentage points annually to its NPV of debt-to-exports ratio. In addition, when export earnings fell by more than 11 per cent in 1999/00, which is just one-third of the standard deviation over the past 10 years, the endogenous debt dynamics added another 20 percentage points to Uganda's NPV of debt-to-exports ratio in that year.

While these developments clearly illustrated the volatility of Uganda's NPV of debt-to-exports ratio, they did not suggest a worsening debt position. Given the effective average interest rate of less than 1%, Uganda's debt ratio was trending downwards from the high levels in 1999/00, since the average export growth did not fall much below 7 per cent (compared with a 10-year historical average of nearly 17 per cent).

However, this instability in the debt ratio to exports creates difficulties in designing appropriate borrowing strategies since at that time stabilizing the NPV of debt-to-exports ratio at 100 per cent required export growth of nearly 13 per cent a year, with the other variables unchanged.

In 2005 the Multilateral Debt Relief Initiative (MDRI) provided for 100 per cent relief on eligible debt from three multilateral institutions (IMF, World Bank and African Development Fund) to a group of low-income countries, including Uganda. The initiative aimed to help eligible countries advance toward the Millennium Development Goals (MDGs) *focused on halving poverty by 2015* (International Monetary Fund, March 2016).

According to IMF statistics (2016), Uganda's debt service declined from US\$ 185 million in 2005 to US\$ 44.8 million in 2011 through this initiative. The major concern is the projected rise to US\$ 557 million in 2017. Similarly, the debt service to exports ratio declined from 5.2 per cent in 2005 to 1.8 per cent in 2014. Again the rise in 2017 is projected at 4.8 per cent. Debt service to GDP also declined from 1.6 per cent in 2005 after the MDRI to 0.8 per cent in 2014, but is projected to rise to 2% (International Monetary Fund, October 2016).

However, the debt initiatives which are neither designed nor intended to be permanent mechanisms can only support but not guarantee sustainability going forward. This underscores the importance of pursuing policies in the future that are consistent with debt sustainability, particularly once debt initiatives run out.

Many of the issues relevant for debt sustainability in low-income countries are the same as in other countries; however, some other factors play a role. A framework for assessing debt sustainability in low-income countries was designed to provide a basis for better informed and more disciplined assessments of sustainability. It lays bare the macroeconomic assumptions underlying medium-term projections of the debt dynamics and subjects these assumptions to stress tests ((International Monetary Fund, 2002).).

Low-income countries like Uganda are characterized by their dependence on volatile aid flows; the importance of concessional debt; the nature of the shocks to which they are subject like fiscal indiscipline; and constraints on their ability to generate the revenues necessary to repay their debts.

This makes Uganda's current debt dynamics a major concern both in the medium to long term under current policy frameworks.

Causes of Increasing Debt in Uganda

Borrowing decisions made in the recent past, especially to finance infrastructure projects in the National Development Plan (NDP), were premised on returns on growth although this has not materialized due to their long-term nature to register significant economic returns (Ministry of Finance Planning and Economic Development, March 2016). Some of the specific factors that explain the divergence between debt and economic growth include: (i) vulnerability to exogenous shocks, such as adverse terms of trade or weather, (ii) waste of resources due to policy deficiencies, poor governance, and weak institutions, (iii) inadequate debt management reflected in unrestrained borrowing at unfavourable terms or on less concessional terms, (iv) refinancing policies of creditors, especially from Export Credit Agencies motivated, in part, by the desire to promote their own exports. Others include:

- Foreign-exchange constraints that were experienced in FY 2015/16 when government borrowed US\$ 200 million from the Regional PTA bank to support import requirements in the national budget (Ministry of Finance Planning and Economic Development, September 2016). This also reflected the limited degree to which domestic factors of production can be transformed into the foreign exchange required for debt service and financing of imports.
- Fiscal constraints: The fiscal deficit averaging 4 per cent between 2011-2016 reflected the government's limited ability and capacity to tax in order to meet debt service on top of other expenditure priorities in the National Development Plan. The tax to GDP ratio in Uganda has averaged at 12 per cent in the period 2011-2016, lower than EAC regional average of 20 per cent (Parliamentary Budget Office, December 2016).
- Limited fungibility of resources, for example, due to earmarking of revenues for sub-national governments and agencies or restrictions on the use of foreign aid for debt service especially where foreign aid is explicitly tied to particular projects or uses, thus reducing the government's ability to shift resources toward debt service (International Monetary Fund, 2003).
- Rollover constraints, reflecting the difficulty of smoothly refinancing debt-service humps (International Monetary Fund, 2003)
- Political or moral considerations, associated with the resources allocated to debt service in relation to social or poverty-related expenditure (International Monetary Fund, 2003).

2.0 Objectives of the Paper

The severe economic and social implications for Uganda's rising debt highlight the importance of drawing the right lessons. The question is whether debtor countries like Uganda have learnt from past mistakes.

There are still many factors that could make Uganda susceptible to debt-servicing difficulties, including its high vulnerability to shocks; policy deficiencies and weak institutions; limited administrative and debt-management capacity; and political risks.

In the light of these considerations, a cautious approach to new borrowing may be warranted, together with recognition of a greater role for grants to support the development agenda, Sustainable Development Goals, without leading to an unsustainable accumulation of debt.

In assessing debt sustainability—the requirement that indebtedness be kept in line with a country’s capacity to repay—several considerations are particularly relevant to low-income countries. These countries are generally characterized by reliance on official flows and by various structural weaknesses and vulnerabilities that adversely affect their growth potential.

High debt itself can be an obstacle to growth, as argued in the debt overhang literature. While implementation of good policies can greatly reduce the implicit tension between financing needs and debt sustainability; the article explores this in the context of Uganda.

Based on these considerations, this article discusses beyond a one-dimensional measure of debt sustainability. It proposes sustainability of Uganda’s debt using a menu of indicators including the NPV of debt and debt service relative to exports, revenues, and GDP, and their evolution over time under realistic macroeconomic assumptions. Interpretation is made based on the outcome of such an analysis relative to empirical thresholds as well as in identifying Uganda’s key constraints, both in normal and stressful times.

Methodology

In 2005 the International Monetary Fund (IMF) and the World Bank developed an analytical tool that analyses public and external debt sustainability for Low Income Countries (LICs) called the Debt Sustainability Framework (DSF). The analytical tool has undergone a number of reviews to ensure adequacy in the light of changing circumstances in LICs (International Monetary Fund, November 2013) .

The DSF is a standardized framework for conducting debt sustainability analysis in LICs. Its main objectives are to: guide a country’s borrowing decisions; provide guidance to creditors’ lending operations; and for policy prescriptions. The Debt Sustainability Analysis (DSA) is undertaken annually to explicitly assess the risk of external debt distress and generally guide management of public debt (International Monetary Fund, 2002).

The DSF has two components, namely: external DSA and the Public DSA. The external DSA covers total external debt in the economy, owed by both private and public sectors. The Public DSA covers total debt of the public sector for both domestic and external debt. The public external debt captures both external debt owed by government and external debt guaranteed by government for the private sector or government parastatals. This sub category is what is referred to as Public and Publically Guaranteed (PPG) external Debt.

DSAs include external risk rating where an explicit assessment of a country’s risk of external debt distress is made. The risk is based on PPG external debt analysis, implying that the private external debt is less emphasized in LICs. The justification of emphasizing PPG in the analysis is largely due to historical reasons where PPG external debt has been the largest component of debt in LICs and largest source of risks.

Where there are vulnerabilities related to private external debt or public domestic debt, an assessment of the overall risk of debt distress is undertaken. This is meant to complement the external risk rating by highlighting the sources of risk that the external risk rating does not capture. The overall risk assessment is intended to guide macroeconomic and structural policy of a country.

This article analyses Uganda's debt sustainability using the debt sustainability framework established by IMF and the World Bank. The article defines debt burden indicators and looks at the steps taken in undertaking a DSA for low income countries, focusing on Uganda.

Debt Burden Indicators

Debt sustainability is analyzed by assessing the projected evolution of a set of debt burden indicators over time. Debt burden indicators in the Debt Sustainability Framework (DSF) consist of ratios of debt stock or debt service relative to repayment capacity measures (GDP, exports or domestic revenues).

The ratios of debt stock relative to repayment capacity measures represent future obligations of a country, reflecting risks to solvency; while debt service ratios indicate the likelihood and possible timing of liquidity risks.

The ratios are therefore categorized as solvency and liquidity ratios in the DSF, and measure the following:

Solvency Ratios

- i) Present value (PV) of Public and Publically Guaranteed (PPG) external or public debt to GDP. The ratios for both external and public DSA compare the debt burden with the resource base.
- ii) PV of PPG external debt to exports of goods and services. This is a measure used in the external DSA to compare the debt burden with the country's capacity to generate foreign exchange receipts.
- iii) PV of PPG external or public debt to domestic revenue. These ratios compare the debt burden with public resources available for repayment. A significant increase would suggest budgetary challenges in servicing debt.

Liquidity Ratios

- i) PPG external debt service to exports. This ratio is evaluated in the external DSA, indicating how much a country's export revenue is used to service debt.
- ii) PPG external or public debt service to domestic revenue. This ratio indicates how much a country's domestic revenues are used for debt service payments, and captures the vulnerabilities of debt service to variations in revenues.

3.2 Undertaking a DSA

Undertaking a DSA entails the following procedures chronologically.

i) Construction of the Macroeconomic Framework

Under this, realistic, consistent macroeconomic projections are undertaken using macroeconomic models to help assess the impact of planned investment on growth.

The DSA is as good as the macroeconomic framework that underlies it. If the projections are unrealistic, then this will lead to inaccurate and misleading results in the DSA (International Monetary Fund, 2003).

ii) Data Input into the DSA Framework

Historical data covering 10 years, and projections covering the next 20 years are entered in the DSA template. Such projections include new PPG external borrowing, along with the terms of borrowing.

iii) Assessment of Risks within the External And Public DSAs

Under the External DSA, comparison is made between projected evolution of PPG external debt indicators to the thresholds in the baseline scenario and under stress test. In case remittances are high, they are included in the base case and compared to the remittance adjusted thresholds. At this point, the risk of external debt distress is determined. In case of a borderline situation, another methodology, called the probability approach, is utilized.

The thresholds under the external DSA are as follows:

Table 1: PPG External Debt Thresholds

Quality of Policies and institutions (CPIA)	PV of PPG external debt in % of			PPG external debt service in % of	
	GDP	Exports	Revenue	Exports	Revenue
Strong	50	200	300	25	22
Medium	40	150	250	20	20
Weak	30	100	200	15	18

Source: IMF, 2013

It is also inevitable to consider undertaking, separately, the analysis of the projected evolution of private external debt to assess risk. If it is found that the risks are significant, then they should be highlighted in the assessment of the overall risk of debt distress.

iv. Report Writing

The report on a country's DSA could be a full DSA report or an updated form which entails main changes to the macroeconomic projections; external and public DSA; and the conclusion. In the case of Uganda, the Ministry of Finance, Planning and Economic Development (MFPED) publishes a copy of the full DSA report annually.

Findings from Uganda's DSA Exercise

Macroeconomic Framework Assumptions

The macroeconomic framework assumptions that underpinned Uganda's DSA for 2016 was as follows:

Table 2: Macroeconomic Framework for Uganda's DSA Exercise

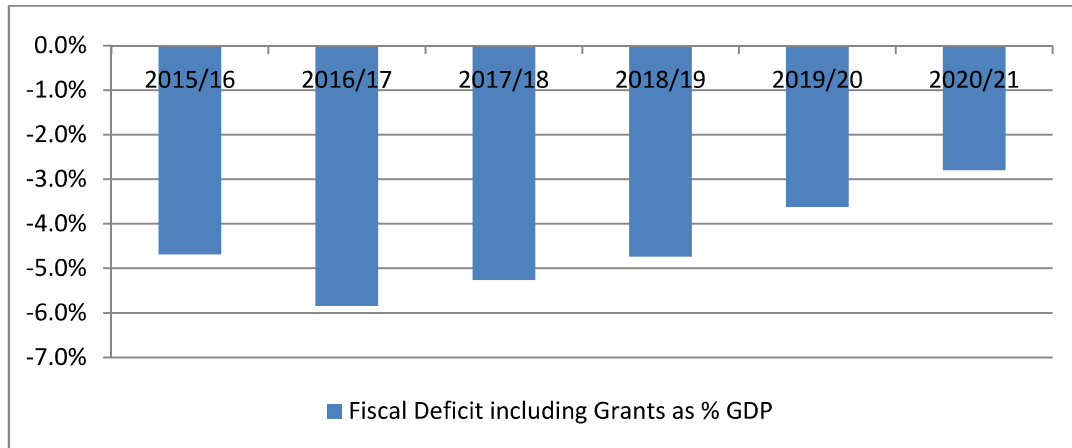
Macroeconomic Indicators	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
FDI/GDP	1.7	1.8	2.3	3.3	3.3	3.7
Real GDP growth	4.8%	5.0%	5.5%	6.0%	6.7%	6.7%
Annual Headline Inflation	6.6%	5.4%	4.8%	4.9%	5.0%	5.0%
Fiscal Deficit/GDP	-6.2%	-7.8%	-6.6%	-4.6%	-4.6%	-3.52%
Revenue/GDP	13.5%	14.0%	14.6%	15.4%	15.4%	15.9%
Govt Expenditure/GDP	17.9%	20.2%	19.8%	18.7%	18.7%	18.0%
Aid/GDP	5.4%	4.4%	4.2%	3.1%	2.8%	2.4%
Fiscal Deficit Excl Grants as % GDP	-6.2%	-7.8%	-6.6%	-5.9%	-4.6%	-3.5%
Fiscal Deficit incl Grants as % GDP	-4.7%	-5.8%	-5.3%	-4.7%	-3.6%	-2.8%
Financing	3982.0	5469.2	5439.4	5468.3	4686.3	4012.3
External Financing net	2494.0	4920.0	4407.8	4861.8	4126.6	3458.2
Domestic Financing	1899	677	1032	607	560	554

Source: Ministry of Finance, Planning and Economic Development, 2016

The macroeconomic assumptions indicate a financing mix between domestic (17%) and external debt (83%) on average over the medium-term projections. This implies that over the medium term, government will opt majorly for external debt to finance its budget deficit. However, the projections do not indicate the level of concessionality (concessional or non-concessional) of external debt to be contracted. Level of concessionality would indicate the trend of new external borrowing biased towards non-concessional compared to concessional terms, as is with most LICs.

Government tends to rely less on the domestic market for its deficit financing since it is more expensive in terms of interest costs, in support of private sector development through access of cheaper credit. This policy stance means that government will offer less support in the development of the domestic debt market.

The fiscal adjustment in Uganda is guided by the charter of fiscal responsibility approved by Parliament where fiscal deficit as a percentage of GDP should converge to 3% by 2021. Figure 1 below provides a path of the fiscal adjustment.



The fiscal adjustment seems to be smooth, although it may not be realistic as it does not fully support the need to address large infrastructure gaps, pressures stemming from important social needs, and low tax base that limits the scope for increasing revenue.

GDP growth projections averaging 6% over the medium term assumed that the scaling up of public investments would be implemented efficiently and on time, without being mindful of the recent past performance and trends of economic growth. A report by the Parliamentary Budget Office (2016) indicates that economic growth in Uganda is largely driven by consumption; and with projected subdued domestic demand in 2017, coupled with poor project implementation, generating less returns (World Bank, April 2006)), growth dividends will be suppressed in comparison to projections.

On the external side under the macroeconomic projections, FDI increases from 1.7 per cent of GDP in 2016 to a medium-term average of 2.9 per cent of GDP up to 2021. While FDI helps finance a current account deficit without creating debt, it can lead to an increase in the import of capital goods and once the investment matures, outflows in form of profits and dividends start to occur (International Monetary Fund, 2003) . Therefore debt sustainability should not be achieved by financing current account deficits with unrealistic large non-debt creating inflows of foreign direct investments (FDI) as a share of GDP.

Assessment of Risks within the External and Public DSAs

DSA results indicate that Uganda's external public and publicly-guaranteed debt is found to be sustainable over both the medium and long term as indicated in Table 3.

Table 3: Summary of External Debt Sustainability Assessment

	CPIA Thresholds (%)	2016	2017	2018	2019	2020	2021	2022	Long term average
Solvency Ratios									
PV of External Debt to GDP	40	11.75	15.07	18.59	21.03	22.88	22.82	21.28	13.09
PV of Dom. Debt to GDP	20	12.82	12.91	12.60	11.80	10.96	10.27	9.31	6.35
PV of Public Debt to GDP	50	24.57	27.98	31.19	32.84	33.84	33.08	30.60	19.44
PV of External Debt to Exports of Goods and Services	150	64.10	74.80	101.35	115.68	128.93	138.55	106.42	63.73
PV of External Debt to Dom. Budget Revenue	250	85.85	106.26	127.74	141.57	148.99	143.91	130.12	74.58
Liquidity Ratios									
Debt Service to Exports of Goods and Services	20	2.07	2.47	3.99	5.76	8.00	9.74	8.29	6.88
Debt Service to Dom. Budget Revenue	20	2.77	3.51	5.03	7.05	9.24	10.11	10.13	8.01

Source: IMF, 2013 and Authors' Computations

The solvency and liquidity ratios all fall below their indicative thresholds throughout the projection period. The PV of external public and publicly guaranteed (PPG) debt to GDP doubles from 11.75% in 2015/16 to a peak of 22.88% in 2019/20, before reducing to 8.7% at the end of the projection period (2036/37). Even at its peak, this indicator is well below the Public Debt Management Framework (PDMF) threshold of 30% (Ministry of Finance, Planning and Economic Development, 2013) and the indicative threshold for CPIA medium performers of 40%.

The present value of debt service to revenue ratio, which averages 8% in the long term, is driven by short maturities of domestic debt, as well as low tax revenue collections.

Figure 2b indicates PV Debt to GDP compared to the historical trends of growth of debt and shows that current projections remain above the historical average in both the short and medium term. However, the projections remain below the threshold even after a one-time depreciation shock. This reflects the largely concessional nature of Uganda's debt stock.

The economy's ability to pay external debt using export revenue weakens in the short to medium term because export growth is slow, while government accumulates more debt compared to the historical average. However, in the long run, the country's position to repay debt from export improves as debt accumulation declines as shown in **Figure 2c** where export growth picks up.

However, should the country experience severe terms of trade shocks, the present value of debt to exports will exceed the threshold of 150 in FY 2020/21 – FY 2021/22 to reach 169.2. Using the probability approach, this is temporary because the baseline (at 138.5) is below the 145 level as recommended by IMF (International Monetary Fund, November 2013)

Figure 2d shows a solvency ratio of the present value of external debt to revenue. The figure also indicates the ratio being within its threshold of 250, although a high depreciation shock will exert pressure on debt repayment in foreign currency terms.

Figures 2e and 2f refer to liquidity ratios. These also remain within the thresholds, although they increase rapidly in the medium term. A rise in debt service in the medium term in line with the historical trend is due to the rundown of grace periods for both non-concessional and concessional debt up to 2021 and thereafter starts to decline in the long term as shown in Figure e.

Therefore from the above demonstration, Uganda is considered a low risk country in terms of its rating. However, there are serious vulnerabilities that government needs to address related to depreciation of the shilling and potential deterioration of terms of trade.

To gauge the sensitivity of the baseline scenario to shocks and changes in assumptions, the DSA applies a series of standardized stress tests (Painchaud & Stucka, 2011). The impact of stress tests is channeled in two ways: through changes in the evolution of indebtedness and through changes in the capacity to repay. There are two types of stress tests: **alternative scenario** and **bound tests**. Bound tests are temporary shocks that last one or two years, after which modified variables return to their baseline values.

The External DSA has two alternative scenarios and six bound tests, as indicated in the tables below for the case of Uganda's 2016 results. This article illustrates with an example on how to analyze stress tests

A1: is the alternative historical scenario that generates an alternative path of debt by freezing four key variables at their 10-year historical averages. They include the non-interest current account balance, net FDI, real GDP growth and the GDP deflator in US dollar terms.

The historical scenario causes debt burden indicators to deteriorate, reflecting a decline in the measure of the capacity to repay (nominal GDP) in conjunction with an increase in indebtedness.

Table 4 indicates that if Uganda maintained its 10-year GDP growth path, then PV of debt to GDP will improve to 16 per cent in 2018, when compared to the baseline projection of 19 per cent, but worsens in the longer term to 20 per cent onwards compared to the base case of 14 per cent in 2027. The 10-year average GDP growth will have a proportional increase in exports and revenues. Shocks to the non-interest current account balance and net FDI increase the financing needs met by additional public external borrowing (on less favourable terms), which starts to increase in 2019 to 24 per cent of GDP against the baseline of 21 per cent. The additional borrowing leads to an increase in indebtedness and more debt service payments, as indicated in the deterioration in the debt burden indicators, where debt to exports reaches 132 compared to the baseline levels of 116 in 2019; debt to revenue ratio reaches 161 compared to the base case of 142 in 2019, as indicated in **Table 4**

B1 bound test simulates a temporary shock to real GDP growth. In 2018-2019, real GDP growth is set to its 10-year historical average minus one standard deviation; thereafter it returns to its baseline projection. Table 4 indicates that this shock on Uganda has a permanent impact on the level of real GDP and nominal GDP affecting Public Sector revenue. The lower tax revenue results in a wider non-interest (primary) fiscal deficit and therefore increased financing needs and additional borrowing from baseline levels of 23 per cent to 24 per cent in 2020. Additional borrowing leads to increased level of indebtedness and more debt service, increasing to 10 per cent of revenue compared to a baseline case of 9 per cent in 2020 as shown in **Table 4b**.

Table 5: Public Debt Thresholds

Quality of policies and institutions (CPIA)	PV of total Public debt in % of
	GDP
Strong	74
Medium	56
Weak	38

Source: IMF, 2013

DSA results indicate that Uganda's Public debt is found to be sustainable over both the medium and long term as indicated in Table 6.

Table 6: Summary of Public Debt Sustainability Assessment

	Debt Strategy Thresholds (%)	2016	2017	2018	2019	2020	2021	2022	Medium Term Average
Nominal Public Debt-to-GDP		33.80	36.97	40.34	41.66	42.55	41.24	37.97	39.22
o/w External		20.99	24.06	27.74	29.86	31.59	30.98	28.66	27.70
o/w Domestic		12.82	12.91	12.60	11.80	10.96	10.27	9.31	11.52
PV of Public Debt-to-GDP	50	24.57	27.98	31.19	32.84	33.84	33.08	30.60	30.59
o/w External	40	11.75	15.07	18.59	21.03	22.88	22.82	21.28	19.06
o/w Domestic	20	12.82	12.91	12.60	11.80	10.96	10.27	9.31	11.52
Total interest Cost-to-Revenue	15	13.76	14.51	14.49	16.18	16.23	17.31	17.14	15.66

Source: PDMF, 2013 and Authors' Computations

The PV of public debt increases from 24.57 per cent in 2015/16 to peak at 33.84 per cent in 2019/20. This increase is driven by external debt to GDP, which doubles between 2019/20 and 2020/21. Throughout the projection period, the PV of public debt remains below the PDMF and EAMU convergence criterion of 50 per cent, which emphasizes the sustainability of Uganda's debt. The higher rate of debt accumulation in the medium term – compared to previous periods – is indicative of Government's deliberate decision to frontload infrastructure investment, a necessary step if Uganda is to achieve the development goals contained in the NDPII.

The low tax revenue collections also affect the ratio of interest cost to revenue, which averages 15.7 per cent in the medium term, above its PDMF benchmark of 15 per cent. This highlights the need to increase the maturity of domestic debt by issuing longer-dated securities; and the importance of enhancing revenue mobilization efforts.

The article undertakes an in-depth analysis to determine the extent of public domestic debt vulnerabilities as public debt to GDP grows, although less rapidly in the medium to long term.

From **Table 6** the PV of domestic debt to GDP is at its highest in 2017, and declines throughout the medium term. This reflects Government's decision to scale back on domestic borrowing. However, domestic debt indicators point towards future risks as indicated in Table 7.

Table 7: Domestic Debt Sustainability Benchmarks

Domestic Debt Indicator	Benchmark	End June 2015	End June 2016
Present Value of Domestic debt stock/GDP	<20%	12.0%	12.8%
Domestic interest cost/Domestic revenue (excluding grants)	<15%	12%	13.8%
Domestic interest cost/Total Government Expenditure	<10%	11.9%	10.1%
Domestic Debt stock/Private Sector Credit	<75%	85.1%	95.0%

Source: PDMF, 2013 and Authors' Computations

The PV of domestic debt to GDP has increased by 0.8 per cent from June 2015 to June 2016.

The ratio of Domestic interest cost to revenue (excluding grants) has increased by 1.8 per cent from 2015 to 2016, and approaching the limit despite remaining within the threshold. The interest cost has increased the burden on domestic revenues, due to the short-term nature of the domestic debt.

The ratio of domestic interest on Government expenditure has exceeded its threshold of 10 per cent, despite following an annual decline by 1.8 per cent.

Domestic debt stock relative to private sector credit experienced an annual increase by 9.9 per cent between 2015 and 2016, and was above the threshold. This will certainly affect private sector credit growth which has implication for economic growth.

Deviations from fiscal objectives are the main risks to debt sustainability. An illustrative scenario with a fixed primary deficit over the projection period indicates a significantly higher PV of public debt-to-GDP ratio, approaching the benchmark level of 56 per cent of GDP in the long run, as indicated in Figure 3.

Figure 3: Debt-to-GDP Ratio under Alternative Scenario

budgetary expenditures. The principle is that, while foreign financing should have a positive impact on investment and growth, the associated debt service tends to work in the opposite direction, with the latter effect becoming stronger as debt grows.

- vi) The increasingly adverse effect of debt service on investment and growth has been explained by the anticipation of higher and progressively more distortionary taxes needed to repay the debt, which dampen investors' (after-tax) returns. At a sufficiently high level of debt, the adverse effect dominates, implying that the initially positive relationship between borrowing and investment is reversed. The resulting debt-servicing difficulties, in turn, create expectations that some of the debt will have to be forgiven, thereby discouraging new financing frontiers like China from providing new financing, while reducing Uganda's incentives to pursue sound policies that strengthen their capacity to repay.
- vii) The macroeconomic projections were premised on the assumptions that all projects included in the analysis will generate positive returns to growth of above 5 per cent per annum in the medium term. However, a study carried out by the World Bank indicated that for every US\$ 1 invested in Uganda, less than a dollar is generated from the project due to implementation challenges. This also points at low actual growth rates currently at 4 per cent for FY 2016/17 against the DSA target of 5 per cent.
- viii) Projections for new PPG external debt are premised on pipeline projects whose actual costing is not definite, as feasibility or appraisal documentation has not been concluded. This overstates or sometimes underestimates the costs of externally financed projects, as evidenced from a number of supplementary loan approvals and cost savings realized in other projects. In addition, financing terms are assumed to be constant over the projection period; yet they could vary depending on the creditor or projected credit conditions that may occur. Projects to be considered in the DSA should be those with complete appraisal documents to improve estimation and should be part of the NDP pipeline projects.
- ix) PPG external debt projections underestimate or ignore the importance of contingent liabilities that pose fiscal risks to the national budget. Such liabilities may include guaranteed external debt for private sector companies or state enterprises. Government should consider publishing annually an updated list of contingent liabilities for consideration in the DSA exercise.
- x) The DSF tool emphasizes the external PPG in assessing the external risks of debt distress, paying limited attention to private external debt. While data challenges on private external debt in LICs could constrain debt analysis; use of debt statistics from the balance of payments provides insights in the actual size of private sector external debt. In Uganda, private sector external debt is rising from levels averaging 11 per cent of GDP between FYs 2008/19 and 2010/11 to an average of 17 per cent between FYs 2013/14 and 2015/16. This illustrates the significance of private sector external debt that could create balance of payments pressures by competing with the public sector for foreign exchange; increasing government's exposure to contingent liabilities.

6.0 Conclusion

In a global environment in which many economies have prospered from growing trade and financial integration, countries like Uganda will be left further behind—seemingly unable to put large amounts of net external financing to good use. Although the mounting debt is only one of several factors contributing to slower growth, this experience is a reminder of the challenges that lie ahead in translating new borrowing into growth-enhancing projects and policies.

Uncertainties surrounding development aid, given changes in the USA's position on global trade, BREXIT, the war against terrorism, etc, will further divert development resources.

The recent USA-Africa business summit in June 2017 fronted trade pacts with Africa, meaning a shift from aid-based to trade-based. USA will continue to honour the African Growth Opportunity Act (AGOA), preferring two-way and bilateral agreements to large multilateral agreements. The summit further encouraged African countries to implement the new World Trade Organization's trade facilitation agreement to streamline customs operations, enhance transparency, remove red tape and reduce costs to exporters and importers.

In a related development, the US Commerce Secretary, Wibur Ros, encouraged countries to re-think the procurement process to make decisions based on quality and long-term value, rather than bottom-line cost, a shift that would favour more US companies.

Nevertheless, many weaknesses remain that warrant a cautious approach to new borrowing. First, overoptimistic growth projections risk being repeated, unless there is a deeper understanding of what drives growth and how to foster it in Uganda. While further study may be required, it is clear that many structural reforms will take time to bear fruit; and as evidenced from the CPIA downgrade, the country continues to be characterized by weak institutions, volatile export and production bases, and limited administrative and debt-management capacity. For these reasons, the most general lesson from the DSA results is that new borrowing even on concessional terms be pursued with caution, based on prudent economic projections and recognition of country-specific circumstances and risks.

Uganda's risk of external debt distress remains low. The temporary increase in borrowing is intended to finance public investment, with an objective of enhancing economic growth. However, risks to debt sustainability have increased, as the temporary breach under an export shock scenario illustrates. To mitigate these risks, it is important to ensure efficient project selection and implementation to achieve growth dividends, and improve domestic revenue mobilization. Significant vulnerabilities related to fiscal policy are a source of concern for the overall risk of debt distress. Sticking to the fiscal charter targets remains fundamental in minimizing risks of debt distress.

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