The Development of No Development: Analysis of Uganda's Debt Burden and Its Sustainability

Benard Cankara

The Development of No Development: Analysis of Uganda's Debt Burden and Its Sustainability

Policy Brief No. 008/EM/08/2022

By

Benard Cankara

PhD Researcher of Public Policy & Governance, Kyambogo University and Holds a Master's Degree in Research and Public Policy from Uganda Christian University

Citation: Cankara, B. (2022). The Development of No Development: Analysis of Uganda's Debt Burden and Its Sustainability/ Policy Brief No. 008/EM/08/2022

Key Words: Development, Debt, Debt Burden and Sustainability

© EM 2022, all rights reserved

Published by

Efficacy Methodology

P.O Box 102888, Kampala.
Plot 2388 Namanve, Jinja Rd.
Email: info@efficacymethodology.org
Website: www.efficacymethodology.org

Table of Contents

List of Acronyms 4

Abstract 5

1.0 Introduction 6

2.0 Uganda's Context 8

i) **Revenue Generations** 9

ii) Interest and Debt Re-Payment 9

iii) Fiscal Consolidation Strategy 10

iv) Quality of Government Investment and Spending 10

3.0 Global Contexts 11

4.0 Policy Recommendations 11

5.0 About Efficacy Methodology 13

List of Acronyms

BoU : Bank of Uganda

ECA : Export Credit Agencies

EM : Efficacy Methodology

GDP : Gross Domestic Product

IDA : International Development Association

IMF : International Monetary Fund

SMEs : Small and Medium Enterprises

UGX : Uganda Shillings

Abstract

This economic policy paper analyses Uganda's debt burden and its sustainability. A secondary literature review and desk-based research was used. The paper dives deep into understanding the drivers of debt in Uganda's context and discusses four critical aspects of debt management: i) Revenue Generation, ii) Interest Re-payment, iii) Fiscal Consolidations Strategy and iv) the Quality of Government Investment and Spending. The researcher argues that the rapid increase in debt over the last five years indicates a worrying trajectory and could lead to financial distress in both the medium and long term. Thus, it suggests five policy recommendations to government for consideration: i) Priority investment and the quality of public investment ii) Cut expenditure on budget head that do not translate into revenue generation stream iii) Reduce domestic borrowings from the commercial banks iv) Set a national debt ceiling and v) Increase revenue generation.

1.0 Introduction

Development of no development has become a common economic dilemma in most emerging economies. While many countries appear to be making progress, poverty remains high. According to World Bank (2020)[1], poverty had increased to 48.4% in 2019 and rose much higher during the Covid-19 period. At the center of the national development plans for most African countries in sub-Sahara Africa, lies a huge debt burden. A report by the IMF (2021)[2] indicates that South Africa, Guinea Bissau, Eritrea, Ghana, Togo, Sierra Leone, Gabon, Congo, Angola, Mozambique, Kenya and Zambia all have debt and GDP of over 70% above the thresholds of 56% (IMF) and 64% (World Bank). Thus, there is actual loss in annual real growth of 0.02% points resulting in *"development of no development"*. According to Pandey (2021)[3], sub-Sahara Africa now has a combined debt burden of $702 billion making Africa the most indebted continent.

No doubt, Africa still is a playing field for the world's leading economies. Today, most developed countries use debt or financial assistant as an instrument to demonstrate their global superiority. According to Usman (2021)[4], China is still the leading lender to Africa's public sector. Between 2000 to 2019, China had advanced loans amounting to $153 billion to African mainly focusing on capital infrastructures but that figure is beginning to decline gradually. Conflictingly, a recent report by Debt Justice (2022)[5], indicates that African countries owe three times more to Western firms and banks than China. The report shows that Western firms charge high interest rate at 5% than the Chinese banks at 2.7%. Thus, only 12% of African debt is owed to China as compared to 35% to the West. Similarly, the United States' interest in Africa remains a priority. According to White & Case LLP (2021), in 2020, Export Credit Agencies (ECAs) provided US$35.3 billion

[1] World Bank Data Bank (2019). Poverty and Equity Report

[2] IMF (2021). Africa's debt burden threatens to slow post-COVID economic recovery

[3] Pandey, K. (2021). Sub-Saharan Africa's debt burden increased to record $702 billion in 2020 — highest in a decade. https://www.downtoearth.org.in/news/economy/sub-saharan-africa-s-debt-burden-increased-to-record-702-billion-in-2020-highest-in-a-decade-79703

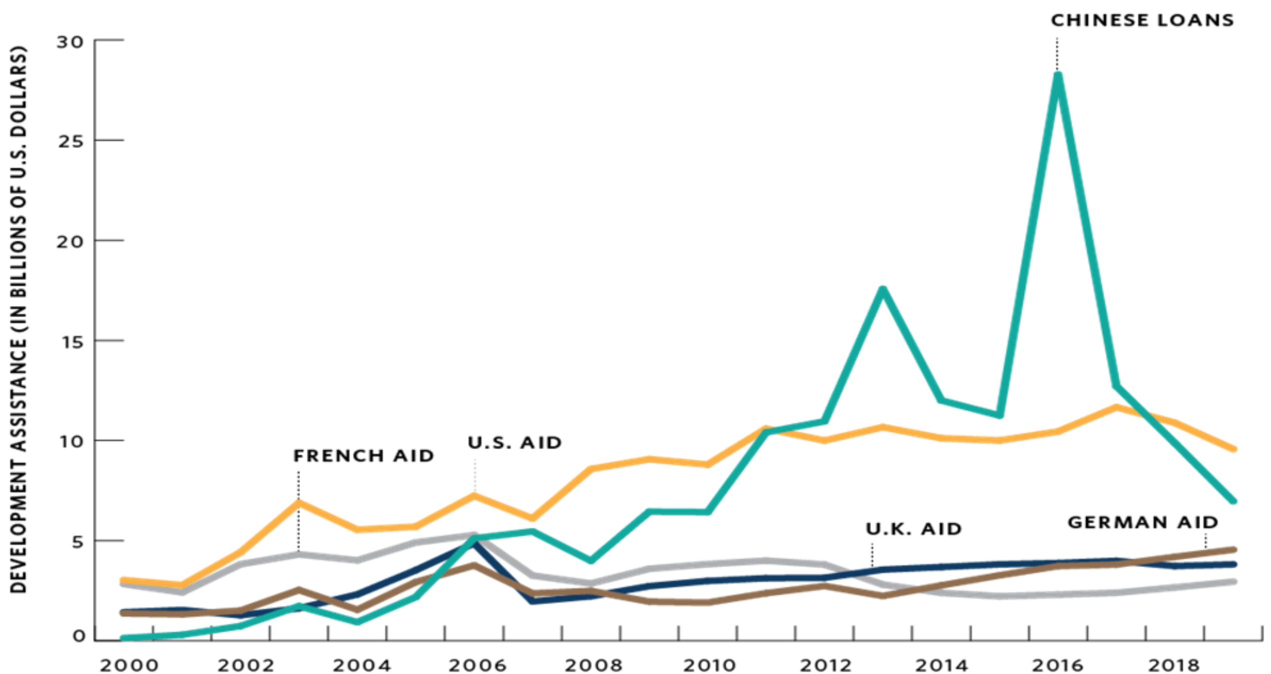
[4] Usman, Z. (2021). What Do We Know About Chinese Lending in Africa? https://www.aiddata.org/how-china-lends

[5] Debt Justice (2022). New report discredits popular narrative, reveals how African countries are three times more indebted to Western firms than to Chinese lenders. https://africa.businessinsider.com/local/markets/african-countries-are-three-times-more-indebted-to-western-firms-than-to-chinese/9g4ly6f

for water and sanitation, healthcare and green financing projects in Africa. Generally, Africa remains more attractive for business in the 21st century but continues to suffer high debt burden.

In East Africa, the trend of indebtedness is equally worrying. The EAC now owes a combined debt of over $100 Billion to China, the West and development partners. According to Global Development Policy Center (2020)[6], Chinese loans within the East African Community remain high at $ 18.4 billion with a larger part of the loan focusing on Transport, Power and ICT Infrastructure. According to the World Bank (2021), Kenya and Tanzania have the highest debt burden followed by Uganda, Rwanda and Burundi, however, it is Kenya and Burundi who are in a serious financial distress stemming from debt to GDP of 70% and 60% respectively.

FIGURE 1
China's Lending Is Large But Shrinking



SOURCE: Author's calculations from Chinese Loans to Africa Database, Version 2.0, published by the China Africa Research Initiative and Boston University Global Development Policy Center (2021), retrieved from https://chinaafricaloandata.bu.edu; and "Total Official Development Flows by country and region (ODF)," OECD.Stat, https://stats.oecd.org, retrieved on May 10, 2021.

[6] Global Development Policy Centre (2020). Chinese Loans to Africa Database. https://www.bu.edu/gdp/chinese-loans-to-africa-database/

2.0 Uganda's Context

Uganda has not been spared from the lucrative loan deals being advanced by China, US, development partners, the world Bank and the International Monetary Fund as appetite at the Ministry of Finance, Planning and Economic Development (MoFPED) grows. According to Biryabarema (2021)[7], the total public debt of Uganda amounted to $15.27 billion at the end of June 2020, $20.8 billion by October 2022 (BoU) and it's projected to reach 54% of GDP by June 2023. Notably, in the last 5 years, Uganda's debt sharply grew from 32% to 47% between 2015 and 2021 (EPRC,2022). This indicates complacency in restricting borrowing and following the deficit rule. Uganda's main debt comes from the International Development Association ($3.4b), China Exim bank ($2.6b) and African Development Bank ($1.4b) excluding grant agencies. Uganda has in the past heavily relied on the concessional loans from the IDA which are interest free. However, recent trajectory indicates more inclinations to domestic commercial bank loans which might be very difficult to sustain and subsequently disrupts economic growth. According to the Auditor General (2020), government's non-concessional loans borrowed from commercial banks had spiked over the past three years, growing from just UGX 192.6b in the 2017/18 to UGX 2.8 trillion for the period ended June 2020. According to MoFPED (2021), 81% (UGX 22,520 billion) of domestic borrowing were treasury bonds (long term domestic debt) which was an increment from 76% in the previous year. This drift has a direct adverse implication on the economy as government compete with the private sector over loans exacerbating the risk of economic stagnation which could create liquidity crisis. This can potentially limit financial access by the private sector and subsequently affect economic growth. While, according to Ministry of Finance, Planning and Economic Development (2022), Uganda's debt level is still sustainable. However, a debt level of above 50% as projected by 2023 should worry Ugandans. According to Public Finance Management (2022), the fiscal complacency and the political will to limit debt makes it worrying. To fully appreciate Uganda debt risk, this paper explores four critical issues that are linked to Uganda's debt burden to

[7] Biryabarema, E. (2021). Uganda projects public debt to surge. https://www.reuters.com/article/uk-uganda-debt-idUSKBN2AB1BU

fully understand its sustainability or unsustainability: i) Revenue Generation ii) Interest Re-payment iii) Fiscal Consolidations Strategy iv) the Quality of Government Investment and Spending

i) Revenue Generation

According to the World Bank (2020), Uganda collects only between 13% and 14.4% to the GDP ratio which is low. Thus, Uganda can only finance 49% of its national budget. Additionally, Uganda's revenue collection has been declining at an average rate of 3.36% since the outbreak of Covid-19. The World Bank (2020), projected that Uganda would experience a -1.36% of revenue collection in the financial year 2022/23. *(Researchers calculations from the World Bank data projections)*. Thus, the risk of not repaying loan increases particularly because of narrow revenue collection base. This means Uganda's debt at over 50% is unsustainable in the medium term. However, according to Grant Thorton (2022)[8], revenue collection is projected to increase by 19.4%. Additionally, if the revenue stream from the oil production is well managed then Uganda may not experience financial distress, however, Uganda's historical low level of public accountability and corruption doesn't guarantee oil revenue cushioning its debt burden.

ii) Interest and Debt Re-Payment

This is a very critical element of debt sustainability. According to the East African (2021), 96.7 per cent of Uganda's total domestic revenue goes to debt serving annually. For instance, the projections for 2021/22 financial year, revenue collection projection was at $5.88 billion as compared to debt servicing at $5.66 (UGX 20.9 trillion). At this level, it clearly indicates inappropriate borrowing which is not sustainable. Of what use if you spend all you collection on debt re-payment? Currently, Uganda has been borrowing from the domestic commercial banks, and the more it does that it will gradually sink the

[8] Grant Thorton (2022). Uganda Budget Review. https://www.gtuganda.co.ug/globalassets/1.-member-firms/uganda/media/pdf-documents/gt_budget_booklet_2022.pdf

economy into financial distress. The debt servicing burden has risen to $15.27 billion at end of June 2020, up from $ 12.55 billion at the end of June 2019. Of this, $10.45 billion was external debt, while domestic debt was $4.82 billion. According to Deliote (2022)[9], 74% of Uganda's budget on recurring expenditure is going towards interest repayments. Thus, Uganda's debt continues to become unsustainable stemming from government's uncontrol thirst for loans.

iii) Fiscal Consolidation Strategy

Government of Uganda has previously adopted policies intended to increase revenue mobilizations (Mawejje, 2018)[10] and strategies to reduce government deficit, but this has not registered significant success majorly due to the impact of the emergence of the Covid-19 pandemic in early 2020. For instance, Uganda has not been efficient in responding to rising prices of basic commodities and timely payment of public servants. This indicates a gap in the current fiscal consolidation strategy. According the World Bank, there are inconsistencies in the prudent fiscal and debt management to support the fiscal consolidation agenda. Additionally, while government is implementing strategies such as merging of governmental agencies to cut down recurring expenditure, its implementation is facing resistance both politically and institutionally making it very difficult to achieve expenditure reduction to a level that can significantly impact on debt and the national budget.

iv) Quality of Government Investment and Spending

These are very important aspects of debt sustainability. Uganda has been prioritizing security and

[9] Deloitte (2022). Uganda Budget Highlights 2022/23 Accelerating recovery. Sustaining growth. https://www2.deloitte.com/content/dam/Deloitte/ug/Documents/tax/Uganda%20Budget%20Highlights%202022-23.pdf

[10] Mawejje et al., (2018). THE DISTRIBUTIONAL IMPACTS OF FISCAL CONSOLIDATION IN UGANDA. A Issue of Economic Policy Research Center. file:///C:/Users/JOHNNY/Downloads/144%20The%20distributional%20impacts%20of%20fiscal%20consolidation%20in%20Uganda.pdf

infrastructural development like roads, industrialization and electricity. According to Deloitte (2022), the budget allocation for security stands at UGX 3.987bn. This expenditure doesn't have a direct impact of debt sustainability because it cannot directly generate liquidity to finance debt. Thus, government ought to align its investment and develop a robust public investment management.

3.0 Global Contexts

To further deepen our understanding on dealing with debt, we explore Canada's debt crisis of the 1990s when its debt-to-GDP peak 68.4% in the financial year 1995/6 and the Botswana case. According to Fraser Institute (2020)[11], during that period, debt interest payments in Ontario consumed approximately 15.5 per cent of all provincial government revenue which was worrying and was affecting economic growth and development but they adopted a deliberate fiscal consolidation and a deep annual budget cut of 20% to reduce debt-to-GDP to 8.9 per cent. Although, their debt-to-GDP has also now gone up currently, as noted earlier, Uganda's debt interest repayment is now at 96.7% of her annual revenue collection. Further, in Botswana, a country blessed with mineral resources just like Uganda has focused on the quality of public investment. According to the IMF (2017)[12], Botswana's public investment has been consistently high for the past 25 years coupled with prudent fiscal policy and restrained debt averaging at 10 percent of GDP. This has allowed enough fiscal space for public investment at levels of over 11% of GDP.

4.0 Policy Recommendations

While Uganda's debt is still within a sustainable rage. There are indicators that show it could become unsustainable in the near future. Thus, this paper suggests the following policy recommendations:

i. Priority investment and the quality of public investment. There is an urgent need to improve the general quality of public investment as well has align the priority of Uganda's investment. In the case of Botswana, over 65% of her investment focused on the

[11] Fraser Institute (2020). Ontario's finances—back to the '90s? https://www.fraserinstitute.org/blogs/ontarios-finances-back-to-the-90s

[12] IMF (2017). TECHNICAL ASSISTANCE REPORT—PUBLIC INVESTMENT MANAGEMENT ASSESSMENT. file:///C:/Users/JOHNNY/Downloads/cr17188.pdf

economic infrastructure (e.g., roads, ports, airports, electricity) and social infrastructure (e.g., housing, hospitals, schools, recreation, social protection and human capital development) consistently for 25 years which set the stage for economic growth within the private sector.

ii. Cut expenditure on budget head that do not translate into revenue generation stream like security and channel it to sectors that directly drives performance within the private sector and the economy. This also includes considerable efforts to develop institutional systems that effectively reduce on corruption.

iii. Reduce domestic borrowings from the commercial banks to allow liquidity and easy financial access to the private sector. This is also linked to reduction in the interest rate. This will increase trade volume, production and subsequently boost revenue collection. A reduction in borrowing from China and IDA especially the riskier debt ought to be minimized. This will allow the economy do gradually stabilizes towards a self-financing.

iv. Set a national debt ceiling**.** Government of Uganda should set a national debt ceiling within which it must disciplines its systems, processes, plans and investments. According the IMF (2017), Botswana managed to set a formal debt limit that helped it to managed a GDP growth of 4.8 % with debt below 10% between 1990 to 2006. Since, Uganda is equally in the process of producing its oil resource it could be used to substantially reduce debt dependence if it is well managed.

v. Increase revenue generation. It is important that Uganda deliberately invest in expanding the current tax base to increase revenue collection. Uganda's currently revenue collection does not match with the national development plan thus prompting high demand for debt financing. This has made Uganda to ignore important debt safety rules. Thus, a well-designed debt safety strategy that emphases revenue generation through an economic system thinking approach that appreciates both internal and external macroeconomic environment is critical for debt sustainability.

In conclusion, the rapid increase in government borrowing over the past five years indicates a worrying trajectory. If it continues, Uganda is highly likely to find herself in financial distress position in both the medium and long term.

5.0 About Efficacy Methodology

Efficacy Methodology (EM) is Africa's leading independent nonprofit public policy think tank. Our focus is on Research, Policy and Evaluation. We are strategically working towards establishing collaborative administrative secretariats in Nigeria, South Africa, Ethiopia, Ghana, Botswana and Angola.

© EM 2022, all rights reserved

Published by

Efficacy Methodology

P.O Box 102888, Kampala.
Plot 2388 Namanve, Jinja Rd.
Email: info@efficacymethodology.org
Website: www.efficacymethodology.org