Seventieth Sovereign Debt News Update: The IMF Executive Board approves SDR 180.5 million to Uganda: Implications for Debt Sustainability

By:

The African Sovereign Debt Justice Network

March 13, 2023

On 17 January, 2023, the Executive Board of the International Monetary Fund (IMF) concluded the combined second and third reviews under the Extended Credit Facility (ECF) Arrangement for Uganda. In addition, the Executive Board granted a waiver of non-observance of a performance criterion on the stock of net international reserves of the Bank of Uganda. In December 2022, Uganda and IMF staff had reached an agreement for the combined second and third reviews of its 36-month Extended Credit Facility. Approval of the combined second and third reviews enables the immediate disbursement of the equivalent of SDR 180.5 million, about US$240 million, bringing the aggregate disbursement-to-date to US$625 million.

The ECF Arrangement for Uganda for a total of SDR 722 million (200 percent of quota) or about USD 1billion was approved by the Executive Board on June 28, 2021, with the aim of supporting the near-term response to the COVID-19 pandemic and boost more inclusive private sector-led long-term growth. Reforms focus on creating fiscal space for priority social spending, preserving debt sustainability, strengthening governance, and enhancing the monetary and financial sector frameworks.

In December 2022, the IMF forecast that Uganda's economy would grow by 5.3% in the 2022/23 fiscal year starting last July, down from a 6.0% growth forecast issued in March 2022. However, in recent years, Uganda has been taking on increasingly large amounts of debt, particularly from China, to finance energy, transportation and other infrastructure with officials banking on expected oil revenue to clear the debt. As at the end of 2022, according to Uganda’s Central Bank, the portion of domestic revenues Uganda was using to service its public debt rose to 30% in the year to October from 24% in the same period two years earlier and was putting undue pressure on the country’s public finances. The Central Bank of Uganda noted that the rising cost of debt repayments meant there was growing liquidity pressures on the domestic revenues to finance the domestic debt liabilities at the expense of other priority budgetary items.

Presently, the country's total debt stands at about $21 billion, and is projected to hit 53% of gross domestic product before easing by fiscal year 2024/25 (July-June), according to the estimated budget for the financial year 2023/24 released by the Ministry of Finance. The rise in foreign debt servicing is largely due to the maturity of non-concessional loans. In addition, the debt service/export ratio is also projected to increase beyond the 20 percent threshold between financial years 2021/2022 to 2025/2026. In the financial year 2022/2023, the government noted imports plus foreign debt servicing would require about USD 1.8 billion which would further reduce international reserves.

The country’s 2023/24 budget noted that out of the almost 50 trillion Uganda Shillings (approx. 13.4 billion) projected budget, the country will spend almost nine trillion Uganda Shillings (approx. 9 billion) on debt repayment and servicing. This represents 16 percent of the whole 2023/2024 financial year budget. Although the budget notes that the debt will level off to below 50 percent in the financial year 2025/2026.

Over the medium term, external debt payments are projected to increase due to the increase in commercial loans over the last few years. Interest payments are projected to amount to 6.135 trillion Uganda Shillings (approx. USD 1.6 billion), equivalent to 2.9 percent of GDP. Of this, 5.227 trillion Uganda Shillings (approx. USD 1.3 billion) are projected for domestic interest payments while 907.9 billion Uganda Shillings (approx. USD 243 million) will be foreign interest payments and commitment fees. Most of the government borrowing is towards investment in infrastructure.

In its March 2022, report, the IMF noted that although Uganda's debt is still moderately manageable, nonetheless, it has started entering danger zones especially if the oil revenues don't start flowing as anticipated in 2025. The report added that Uganda must strive to move away from a growth model based on debt-financed public spending that has emphasized infrastructure, with one where the private sector leads economic growth, supported by the state through investments in human capital and targeted regulations to promote green and inclusive growth that reduces inequality and ensures sustainability.

Nonetheless economists and politicians alike have already raised red flags. Opposition critics and even the central bank have previously warned the rising debt is financing profligacy by officials while also diverting an increasing amount of funds to debt servicing instead of critical priorities. With a public debt of over 50% of the Gross Domestic Product (GDP), the Deputy Governor of the Bank of Uganda, Michael Atingi-Ego, has on several occasions cautioned Uganda's Members of Parliament against approving loans that do not to spur the growth of the economy. Concerns have also been raised on whether Uganda is able to meet its debt repayment obligations, with Uganda's MPs questioning the sustainability of the country's current public debt, claiming the government is not sure of the source of funds to repay back the loan. Uganda can expect to experience further increases in its fiscal deficit and public debt that will undermine its economic potential. This is largely due to fiscal complacency, profligacy, and incomprehensive debt sustainability diagnostics that mainly rely on ambiguous concepts such as the net present value of debt.

This makes it hard to reconcile the alleged safety of Uganda’s public debt with a sharp rise in debt stock.

Even so, the country’s Finance Ministry officials say the government's debt is still manageable and that the credit is being used to fund essential infrastructure that is needed to drive growth. This is corroborated by the IMF Debt Sustainability Analysis (DSA) Report. Over the years, however, an accumulation of evidence suggests that Uganda may be caught up in a “public debt safety trap” in which a favourable debt position based largely on DSA results falsely signals that the country has more fiscal headroom to borrow, especially when debt is still below the set national or international limit. Consider the following.

First, during the past few years, Uganda’s borrowing decisions have been made mainly by reference to the debt rule and because Uganda’s debt is projected to be sustainable over a 20-year forecast period. Due to the over-reliance on DSA results to inform borrowing decisions, the debt increased from UGX 29.6 trillion (34.6 percent of GDP) in 2015/16 to UGX 69.5 trillion (47 percent of GDP) in 2020/21. The favourable DSA results increased the borrowing appetite for non-concessional financing because of the perceived safety of Uganda's total public debt, which is mainly concessional. Second, the fiscal pendulum continued to swing toward deficit spending to accommodate emerging spending needs that were not budgeted earlier. The practice of implementing "supplementary budgets" signalled that the government could always reallocate money from other spending units or borrow to meet emerging spending needs.

These two examples show that relying on DSAs alone is harmful because countries such as Uganda tend to disregard other possible indicators or warning signals of impending risks to debt sustainability. Debt sustainability analyses that overlook other external and internal macroeconomic (fiscal and monetary) factors, which are not captured in the LIC-DSF, as well as the quality of government spending, can lead to unrealistic assessments. Therefore, getting out of the public debt safety trap requires a holistic view of debt sustainability. This includes, first, thoroughly understanding the external and internal macroeconomic environment and its relationship with debt sustainability. This is mainly because sound debt management is more effective when linked to a credible macroeconomic framework that promotes economic stability and sustainability. Second, ensuring sound and good fiscal management minimises riskier debt portfolios and reduces a country’s vulnerability to shocks. Third, strengthening the link between budgetary or debt management and monetary policy, especially in a climate of increasing domestic debt and inflation. Fourth, a longer-term objective, improving the institutional environment by reducing corruption, promoting fiscal transparency, rewarding accountability, and enforcing fiscal rules.

View online: Seventieth Sovereign Debt News Update: The IMF Executive Board approves SDR 180.5 million to Uganda: Implications for Debt Sustainability