



# **PUBLIC DEBT AND OTHER FINANCIAL LIABILITIES MANAGEMENT FRAMEWORK**

## **FY2018/19-FY2022/23**

MINISTRY OF FINANCE, PLANNING AND ECONOMIC DEVELOPMENT

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Ministry of Finance, Planning and Economic Development

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## LIST OF ABBREVIATIONS

<b>AO</b>	Accounting Officer
<b>ATM</b>	Average Time to Maturity
<b>ATR</b>	Average Time to Re-fixing
<b>BoU</b>	Bank of Uganda
<b>CCS</b>	Commitment Control System
<b>CPIA</b>	Country Policy and Institutional Assessment
<b>DSA</b>	Debt Sustainability Analysis
<b>EAC</b>	East African Community
<b>EDS</b>	External Debt Strategy
<b>GDP</b>	Gross Domestic Product
<b>GoU</b>	Government of Uganda
<b>HIPC</b>	Heavily Indebted Poor Country
<b>IFMS</b>	Integrated Financial Management System
<b>IMF</b>	International Monetary Fund
<b>MDRI</b>	Multi-lateral Debt Relief Initiative
<b>MoFPED</b>	Ministry of Finance, Planning and Economic Development
<b>MTDS</b>	Medium-Term Debt Management Strategy
<b>PDMF</b>	Public Debt Management Framework
<b>PPG</b>	Public and Publicly-Guaranteed
<b>PPP</b>	Public Private Partnerships
<b>PV</b>	Present Value
<b>SWG</b>	Sector Working Group
<b>NDP</b>	National Development Plan
<b>DS</b>	Debt Strategy
<b>FY</b>	Financial Year
<b>LoS</b>	Letters of Support
<b>PFMA</b>	Public Finance Management Act
<b>CFR</b>	Charter of Fiscal Responsibility
<b>FRS</b>	Fiscal Risk Statement
<b>IRR</b>	Internal Rate of Return
<b>PIMS</b>	Public Investment Management System
<b>GFS</b>	Government Financing Strategy
<b>SOEs</b>	State Owned Enterprises
<b>SPV</b>	Special Purpose Vehicle
<b>UFC</b>	Uganda Consolidated Fund
<b>CFF</b>	Contractor Facilitated Financing
<b>ECAs</b>	Export Credit Agencies
<b>PD</b>	Primary Dealer
<b>DMO</b>	Debt Management Office

<b>DMFAS</b>	Debt Management & Financial Analysis System
<b>CL</b>	Contingent Liability
<b>MDAs</b>	Ministries, Departments & Agencies
<b>CSD</b>	Central Securities Depository
<b>DC</b>	Development Committee
<b>PSC</b>	Private Sector Credit
<b>IFI</b>	International Financial Institution

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## Foreword

In pursuit of our growth and development aspirations, the Government of Uganda mobilizes both domestic and external financing. In doing so, Government has a duty to deliver value for money of taxpayers and strives to ensure that sovereign public debt remains sustainable, in the short to long term.

The Country's development ambitions reflected in the National Vision Framework consists of six-five-year National Development Plans. The first National Development Plan (NDPI) as well as the National Development Plan (II) were financed using traditional sources largely through domestic revenues, foreign concessional and domestic borrowing. This Public Debt Management Framework 2018 (PDMF 2018) will guide the financing of part of the second and subsequent NDPs.

Uganda's development objectives have now considerably surpassed the current domestic and externally mobilised resources; this therefore necessitates the continuous exploration of new, alternative and innovative financing sources while ensuring that our debt remains sustainable. As such, Government has set clear procedures and principles in this framework to guide the contracting of such new and traditional financing mechanisms.

The country's **public debt management policy framework** is provided in the Medium Term Debt Management Strategy (MTDS), Debt Sustainability Analysis (DSA) and the Public Debt Management Framework (PDMF). The latter superintends over the other two debt documents.

I therefore urge all MDAs of Government to use this PDMF 2018 to guide debt acquisition, utilisation and management to solve the discordant relationship between debt sustainability, economic growth and development. The prudent utilization and management of borrowed resources will help avoid a repeat of situations that necessitated debt relief under the Heavily Indebted Poor Country (HIPC) and Multilateral Debt Relief (MDRI) Initiatives that commenced in April 1998.

I am confident that the implementation of this 2018 PDMF will ensure that Government financing priorities are met bearing in mind the cost-risk trade off, while maintaining debt sustainability.



Matia Kasaija (M.P)

**MINISTER OF FINANCE, PLANNING AND ECONOMIC DEVELOPMENT**

## EXECUTIVE SUMMARY

This 2018 Public Debt Management Framework is the fifth in a series of debt policies since 1991. It defines principles, strategies and benchmarks that will guide public debt decisions over the next five-year period until FY2022/23.

The previous Public Debt Management Framework (PDMF 2013-2018) registered successes as well as shortfalls. While external debt remained sustainable, there were significant increases in the thresholds towards the upper limits. On the other hand, domestic debt rose significantly over the same period, yet the risks embedded in the domestic debt portfolio significantly reduced.

In 2018 the stress tests on the external debt portfolio indicators, particularly the present value of external debt to exports revealed that Uganda was vulnerable to slow export growth. Exports are an important source of foreign currency used to service the country's foreign debt obligations. This vulnerability caused a decline of Uganda's credit risk rating from low to moderate risk. At the same time, Uganda downgraded under the Country Policy Institutional Assessment (CPIA) from a Strong to Medium performer of this framework, Government shall over the life of this framework ensure adherence to the set cost and risk debt benchmarks to improve our CPIA<sup>1</sup>.

The 2018 PDMF's broader objective is to ensure that the Government's financing needs are met bearing in mind the cost-risk trade-off while maintaining debt sustainability over the medium to long-term horizon. The specific objectives are to achieve sufficient, timely and effective financing for Government projects; a fully developed and functional domestic financial market; debt sustainability of public sector debt; and efficient utilisation of all borrowed resources.

As an overarching framework, this PDMF 2018 offers generic principles that will guide the contracting and use of public debt, including guaranteed and non-guaranteed debt. It also delivers procedures that will guide both external and domestic debt, as well as measures to further the development of the domestic debt market. This PDMF introduces benchmarks and limits for assessment of the cost and risk of the external and domestic debt portfolio and contingent liabilities. The framework further offers qualitative thresholds for debt sustainability, target ranges for risk management and composition of debt. These parameters will form the assessment criteria for the performance of this very framework.

Given the overarching nature of this framework, it was deemed prudent to provide a section on Domestic Arrears. This chapter was prepared based on the FY2018/19 Domestic Arrears Strategy of the MoFPED. In terms of scope, these arrears consist of unpaid bills that remain outstanding beyond the fiscal year in which they were incurred. These debts arise from delayed payment of expenditure categories such as court awards, pensions, salaries, and suppliers to government, among others. In line with a policy decision taken in 2016, Government prioritised the settlement of verified arrears-starting with pension and gratuity. Going forward, this framework has provided a three-front approach to deal with the challenge of domestic arrears: measure to mobilize resources to clear existing stock of arrears; measures to ensure that the budgeted resources are not diverted; and measures to prevent the creation of new arrears.

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<sup>1</sup> Please note that prudent debt management can only partially influence outcomes regarding a country's CPIA. Other factors considered include governance issues and corruption tendencies.

This framework also recognizes the different forms of contingent liabilities relevant in estimating the total liability exposure of government. The scope of this framework is limited to legally binding government loan guarantees as well as non- guaranteed public debt. The work developed on contingent liabilities will complement the 2018 guidelines on the same subject. This framework partly guides that before provision of a Government guarantee, it shall be ascertained that the proportion of publicly guaranteed debt to GDP does not surpass a threshold of 5%. The framework also provides for a 3-stage vetting criteria that shall be followed to determine the creditworthiness of any beneficiary institution.

The risk management section identifies and provides remedial action to the different risks embedded within and outside the public debt portfolio. This chapter has been prepared with a view to minimising the costs and risks that are embedded in the public debt portfolio. In doing this, emphasis was placed on identifying the different risks and devising their mitigation measures before they fall due. This framework also guides on roles of the Debt Management Unit/Office in managing debt risks as well as procedures to monitor and evaluate the risks of Government debt.

The Public Debt Management Framework 2018 provides the institutional roles of the various responsible centres that coordinate the different processes of contracting debt as well as the management of public debt. It further provides for mechanisms for debt reporting. Overall, this debt framework contains a set of principles, guidelines, qualitative benchmarks and legal framework within which public debt shall prudently be contracted, utilised, monitored and managed over its lifespan until FY 2022/23.

# CHAPTER ONE: INTRODUCTION

This Public Debt Management Framework (PDMF) delivers a wider range of financing instruments to include a mix of both the traditional sources (concessional and non-concessional). It further consolidates a set of all-inclusive and alternative financing options, including but not limited to commercial debt, Public-Private Partnerships, and Eurobond issuance. This Framework sets out the overall policy, benchmarks, legal and institutional framework for acquisition, utilization and management of public debt.

## 1.1 Background

The Government of Uganda has been preparing debt frameworks since 1991. At the time, these debt documents were referred to as strategies until 2007. Therefore, the first 3 strategies focused on debt sustainability and relied on highly concessional financing.

- i. The first, known as the External Debt Strategy (EDS) was prepared in 1991 with a view to attain debt relief. The EDS 1991 was revised in 1995, with emphasis placed on reduction of the debt burden. It was hoped that Uganda's external debt stock and debt service burden would be substantially reduced by the delivery of enhanced assistance<sup>2</sup>.
- ii. Following HIPC I and II and the Multilateral Debt Relief Initiative (MDRI), a revised Debt Strategy 2007 (DS 2007) was published and was in use until 2012. The DS2007 majorly focused on achieving an appropriate level of external debt sustainability at minimum cost.

The Public Debt Management Framework (PDMF) 2013 was the successor framework to the Debt Strategy (DS 2007) and it also aimed at ensuring that the level of debt remained sustainable and emphasized the need to meet Government's financing requirements at minimum costs. During its period of execution, the PDMF 2013 registered a mixture of achievements and shortfalls as discussed hereunder:

- a) For the period up to the end of FY2017/18 total public debt remained sustainable on the evidence of PV of total debt stock/GDP, which stood at 27.1% against a threshold of 50% of the East African Monetary Union Macroeconomic Convergence Criteria, and Public Debt Management Framework (PDMF) 2013.
- b) Whereas external debt remained sustainable, there were significant increases in its thresholds towards the upper limits and breaching levels.
- c) Domestic debt rose significantly throughout the period of the PDMF 2013. All, but one of the domestic debt sustainability benchmarks of domestic debt to Gross Domestic Product (GDP) were breached because of sustained issuance of costly domestic debt. In contrast the domestic debt of the country met all the risk targets for the debt portfolio and the framework achieved a reduction in risks contained in the domestic debt portfolio.

While the PDMF 2013 maintained a strong focus on debt sustainability, it represented a notable change from the fundamentals of broad debt policy and guided the utilisation of debt. It for example guided that Government of Uganda (GoU) would continue to borrow for social services development under highly concessional terms. The PDMF 2018 will preserve all the aforementioned aspects, and seek to

<sup>2</sup> This was in the form of reduction, rescheduling or cancellation of the principle or the interest or both on debt.

address all gaps identified in the performance assessment of PDMF 2013. In this regard, this framework provides benchmarks and limits on the assessment of the external debt portfolio risk and contingent liabilities. It also provides a new section that will guide the management of risks embedded in the total public debt portfolio.

The PDMF 2018 guides the Medium Term Debt Management Strategy (MTDS) and the Debt Sustainability Analysis (DSA), Public-Private Partnership Policy and the 2015 Public-Private Partnership Act for the lifetime of the framework. This PDMF 2018/19-2022/23 is the successor framework to the PDMF 2013/14-2018/19 and is the fifth in a series of debt frameworks. Borrowing under this framework shall fund expenditures that aim to enhance economic growth, production and productivity - with a high rate of economic return. It will also prioritise social sectors with a high propensity to increase the wellbeing of the Ugandan population.

## 1.2 Public Debt Policy Strategic Objectives

The overarching objective of this debt framework is ensuring that government's deficit is financed bearing in mind the cost-risk trade-off while maintaining debt sustainability over the medium to long term horizon and ensuring efficient utilisation of the borrowed resources.

Therefore, the specific objectives are:

1. Ensure that the government's deficit is financed in a timely and cost-effective manner, subject to keeping risks at an acceptable level
2. Support the development and functioning of the domestic financial market
3. To ensure that the level of public debt remains sustainable, over the medium to long term horizon

**Objective (1) Ensure that the government's deficit is financed in accordance with Government Financing Strategy in a timely and cost-effective manner, subject to keeping risks at an acceptable level** is a primary debt management objective. It emphasizes that borrowing will take into account Governments cost- risk trade-off. The objective is cognizant of the need for Government to expedite the settlement of any outstanding obligations to avoid domestic arrears.

**Objective (2) Support the development and functioning of the domestic financial market** is a secondary objective. It offers alternate sources of financing if concessional borrowing sources dry out. It spurs institutional and regulatory development within the financial sectors. It makes it clear that GoU will aim for a well-developed and functioning domestic debt market in its debt management operations.

**Objective (3) to ensure that the level of public debt remains sustainable, over the medium to long-term horizon** is a secondary objective that portrays this debt framework as a fiscal policy tool covering the level of debt. This objective communicates Government's intention to focus on keeping the country's debt within sustainable levels.

## 1.3 Scope of Debt

The scope of this Public Debt Management Framework will build on the existing coverage of debt, and shall for the period of this framework, include Debt disbursed and outstanding, Undisbursed debt<sup>3</sup>, Verified domestic arrears, Implicit and Explicit contingent liabilities.

<sup>3</sup> Government will monitor the level of undisbursed debt to inform new borrowing.

Therefore, the scope of debt covered in this Framework is Public and Publicly Guaranteed Debt (PPG), and other financial liabilities.

This includes:

1. External Debt
  - Disbursed and outstanding denominated in foreign currency. For a liability to be included in External Debt stock it must be an outstanding obligation of actual current, and not contingent, liabilities that require payment(s) of principal and/or interest by the debtor at some point(s) in the future.
  - Undisbursed External debt, which includes all commitments not yet drawn from the creditors.
2. Domestic Debt, defined as the stock of Uganda shilling-denominated liabilities excluding the stock of domestic arrears and incorporates Uganda shilling-denominated central government securities.
3. Contingent liabilities, including loan guarantees and non-guaranteed borrowing of MDAs.
4. Domestic arrears refer to bills accrued by Government Ministries and Agencies that remain outstanding beyond the fiscal year in which they are incurred. For capital projects, arrears refer to outstanding certificates<sup>4</sup> after project completion. Domestic arrears in principle form part of Uganda's public debt<sup>5</sup>, although they are accorded a separate treatment in this Framework because of the way they materialise.

#### 1.4 Current legal framework

This section provides an overview of the existing legal framework and its relevancy to Uganda's debt structure. It identifies gaps that need to be addressed and proposes ways to firmly anchor this debt framework within the existing laws.

Uganda's legal framework on debt management is laid out in the Constitution of Uganda, the Public Finance Management Act (PFMA) 2015, the Treasury Bills Act 1969, the Bank of Uganda (BoU) Act 2000, the Charter of Fiscal Responsibility (CFR), and the Local Government Act (1997).

- 1) **The Constitution of the Republic of Uganda 2005:** Articles 159-160 guide GoU on the sourcing, processing and payment of public debt.
- 2) **The Public Finance Management Act (PFMA 2015):** Articles 36-43, provide guidance on the authority to raise loans, management of risks embedded in public debt, management of costs related to loan acquisition, guarantees of loans and their reimbursement, repayment, and management of projects funded by loans and grants. Furthermore, article 5, provides for the laying of the Charter for Fiscal Responsibility. In line with provisions of the article 4 (2b) of the Act, the Charter articulates the principles upon which fiscal policy is based that include; the maintenance of prudent and sustainable levels of public debt.

<sup>4</sup> Certificates are in effect a notice of obligation for Government to pay a contractor for having met a certain agreed output.

<sup>5</sup> Under article 159 (7) of the 1995 Constitution, a loan includes any form of borrowing in respect of which money from the Consolidated Fund or any other public fund may be used for payment or repayment.

- 3) Ensuring debt sustainability now and in the future is one of the objectives under this debt management framework.
- 4) **Treasury Bills Act 1969<sup>6</sup>**: Provides guidance on the issuance of Government Treasury Bills, their custody, as well as rules on the form, method, terms, and management of Treasury Bills and their repayment.
- 5) **Bank of Uganda Act 2000**: This Act does not provide explicit guidance on public debt in its current form. However, given the ongoing amendments of the Act, it will guide on the roles, functions and mandate of the Ministry of Finance, Planning and Economic Development (MoFPED) and the Bank of Uganda (BoU) regarding the conduct of Government treasury securities during the life of this framework.
- 6) **Local Government's Act<sup>7</sup>**: Part VIII of this Act elaborates the financial provisions for Local Governments. These include but not limited to; budgetary powers and procedures, grants from government, borrowing powers and procedures for local governments, financial years and its operations, financial and accounting regulations for local governments. In the context of this framework, the Act guides on non-guaranteed borrowing.
- 7) **Charter for Fiscal Responsibility (2016)**: Section 6.5 requires the MoFPED of the GoU to include a Fiscal Risk Statement (FRS) in the annual Budget Framework Paper of the Minister. The FRS needs to identify and analyse risks in public debt management and specific risks such as loans and guarantees, PPP, natural disasters and any other contingent liabilities. Section 6.6 requires the FRS to include a strategy for managing the fiscal risks, including Government's decisions on bearing, mitigating and absorbing the risks identified.

However, the PFMA 2015 and all the other regulations fall short of prescribing the framework for public sector debt. During the life of this debt framework, the Debt Management Office shall ensure anchoring it in the Public Finance and Management Act 2015, through the on-going amendments.

### 1.5. Structure of the Document

There are 7 remaining parts of this debt framework; Chapter 2: General Principles and Benchmarks for acquisition, management and utilisation of debt; Chapter 3: External Debt Framework; Chapter 4: Domestic Debt Framework; Chapter 5: Domestic Arrears; Chapter 6: Contingent Liabilities Framework; Chapter 7: Risk Management Structure; and Chapter 8: Institutional and Reporting structure.

<sup>6</sup> <https://ulii.org/ug/legislation/consolidated-act/194>

<sup>7</sup> <http://www.molg.go.ug/sites/default/files/LOCAL%20GOVERNMENTS%20ACT.pdf>

## **CHAPTER TWO: PRINCIPLES FOR ACQUISITION, AND UTILISATION OF PUBLIC DEBT AND CONTINGENT LIABILITIES**

### **2.1 Principles for Acquisition and Utilisation of Public Debt**

To support the achievement of Public Debt Strategy Objectives, while also addressing the risk and cost constraints of alternative financing options, the following principles will guide the contracting and use of public debt:

- i. Government of Uganda shall work towards raising its tax-to-GDP ratio to the Sub-Sahara Africa's (SSA) average of 15.1%, compared to the current level of 14.38%; as part of Uganda's Financing Strategy to limit on borrowing.
- ii. As a priority, borrowing will be for highly productive investments and GoU will seek to secure direct economic and financial return as well as social-economic benefits.
- iii. GoU shall access temporary advances from the Bank of Uganda and must settle all outstanding obligations of the BoU within that financial year.
- iv. Public debt operations will meet the principles of openness, transparency and predictability.
- v. Government shall borrow on un-concessional terms only where the project's Internal Rate of Return (IRR) is greater than the interest rate charged on credit.
- vi. Financing of new projects shall be in line with the Public Investment Management System (PIMS) processes.
- vii. Government of Uganda, through the debt office, shall monitor undisbursed loan amounts and this shall form part of the criteria of assessment of sectors' new borrowing.
- viii. In the determination of the appropriate means of funding, this framework shall follow the Government's Financing Strategy.
- ix. Government's borrowing shall be consistent with the National Development Plans, Vision 2040 aspirations, the East African Community (EAC) Vision 2050. As well as the other regional and international development frameworks where Uganda is a signatory.
- x. To ensure the sustainability of Uganda's debt, Government shall ensure that the present value of government debt as a proportion of GDP does not exceed 50% of GDP, in line with the Macroeconomic Convergence Criteria on debt under the EAC Monetary Union Protocol.
- xi. There shall be a clear separation of securities issued for monetary and fiscal policy purposes. The Bank of Uganda and the MoFPED shall conduct both issuances in a harmonised manner.
- xii. At the end of each FY, there will be a full year-end review of debt management performance and an annual Debt Management Report shall be published, in line with best international practice.

## 2.2 Principles for Management of Guaranteed Debt

- i. Guarantees issuance will be to priority sectors that have been identified in the National Development Framework/Plan as being of ‘national strategic importance’ and are expected to deliver a net positive broader economic benefit for the country.
- ii. To mitigate exposure from guarantees, GoU shall consider loan guarantees to Public Corporations/ State-Owned Enterprises (SOEs) basing on the sustainability criteria<sup>8</sup>. Only institutions that have the capacity to service their debt shall be considered for any borrowing.
- iii. All guarantee beneficiaries shall be required to be audited at least once during their lifetime, by the Auditor General or a recognized and accredited audit firm.
- iv. Guarantees shall only be provided if;
  - The proceeds of the underlying loan are earmarked to fund mainly development expenditure.
  - The underlying loan shall be utilized for undertakings that are in line with the sector plans and strategies
- v. Any entity requesting for a guarantee must have existed for at least 5 years, except for the case of a Special Purpose Vehicle (SPV) under Public-Private Partnership (PPP) arrangements. The assessment will be according to the PPP Act.
- vi. There shall be no provision of guarantees to private individuals since this may raise considerable risks relating to accountability, transparency and prudent use of public resources.
- vii. The sector line Ministry shall be involved in the formulation and monitoring of projects for which funds are acquired.
- viii. GoU shall charge a guarantee fee of 0.3%<sup>9</sup> per annum on the guaranteed entity. This shall be charged on the nominal value guaranteed and shall be payable on the issue date. Fees to be reviewed annually depending on the performance of the beneficiary or in case of breach of covenants between the beneficiary and GoU. The proceeds from these fees shall be deposited into the special account established by GoU.

## 2.3 Principles for Management of Non- Guaranteed Debt

All public institutions that intend to borrow should seek permission from the Minister of Finance, Planning and Economic Development before acquiring any loan. Permission will be through the issuance of a Letter of Support (LOS)<sup>10</sup> for an entity that must have existed for at least 5 years.

- i. The beneficiary institutions shall be public or publicly aided and therefore GoU should be a full/ part controller of the institution (majority or minority shareholder).
- ii. Consideration for any borrowing as per the PFM Act 2015 shall be only to institutions that have the capacity to service their debt. Credit risk quantification of the beneficiary institution in Table 3 will apply.

<sup>8</sup> Sustainability of an institution shall be assessed based on Credit risk quantification/ benchmarks set in this framework

<sup>9</sup> This shall be charged on the nominal value guaranteed.

<sup>10</sup> A Letter of Support is a form of parental support generally issued by an institution in support of a subsidiary or fellow group member (the borrower), that is borrowing money.

- iii. The proceeds of the underlying loan shall be earmarked to fund development expenditure and not recurrent expenditure.
- iv. The sector line Ministry shall be involved in the assessment and monitoring of projects for which funds are acquired.

**Table 1: General table on Public Debt**

<b>Total Debt Quantitative Sustainability and Risk Benchmarks</b>		
	<b>Benchmark</b>	<b>June 2018</b>
Present Value of External debt stock / GDP	<30%	17.6%
Present Value of Domestic debt stock / GDP	<20%	13.3%
Present Value government debt stock / GDP	<50%	30.9%
Total Domestic debt interest payments / Total revenues (excluding grants)	< 12.5%	13.3%
Total Domestic debt interest payments / Total expenditure	< 10%	9.6%
Foreign currency-denominated debt as a share of total debt	< 80%	67.9%
Sovereign Credit Rating	Improve	<b>B+</b> (Standard & Poor) <b>B</b> (Fitch)

## CHAPTER THREE: EXTERNAL DEBT FRAMEWORK

### 3.1 External Debt Guidelines

To date Uganda's external debt has primarily been contracted on concessional terms. This framework will focus on providing guidelines to facilitate prudent external government borrowing for highly productive fixed capital investments. The section also brings to the fore benchmarks against which the performance assessment of this framework on external debt shall be based.

To achieve the debt management framework objectives, the following specific guidelines and their respective quantitative limits are cardinal.

1. Government shall continue to pursue concessional borrowing as the preferred means of meeting external financing requirements. Otherwise, depending on the level of concessionality, the following guidelines shall apply;
  - a) Social Service projects shall be financed at concessional<sup>11</sup> terms.
  - b) Consideration for non-concessional<sup>12</sup> borrowing will only be for financing of projects that will provide an economic rate of return greater than the interest rate charged and,
  - c) Issuance of highly non-concessional and commercial borrowing, such as a Eurobond, will only be to finance projects that not only provide a higher economic return than the interest rate on the credit, but also enable GoU to generate sufficient fiscal return<sup>13</sup> to meet the cost of the loan, and foreign currency to service the debt.
2. GoU will be cognizant of the risk ratings under the Debt Sustainability Analysis (DSA) framework for every next Financial Year (FY) borrowing plan.
3. The primary focus of external borrowing will be on productive sectors with the capacity to yield high economic and financial returns and enhance productivity. These include; energy, roads, minerals, oil and gas, water for production and railway transport infrastructure.
4. The minimum amount for any external borrowing shall be US\$10 million. The intention is to maximise the benefits of any external borrowing while minimising costs related to contracting the loan.
5. Government shall continue to borrow from the traditional sources as well as the non-traditional. The non-traditional sources will include but not limited to emerging development partners including China, Philanthropists, Islamic financing e.g. Sukuk bonds, Pan African Banks, International Capital Markets e.g. Eurobonds. Government shall also where appropriate explore the financing modalities of Contractor Facilitated Financing (CFF), Export Credit Agencies (ECAs) and PPPs.
6. Interest rate risks: Government shall continue to prioritise the contraction of external debt on fixed interest rates during the lifetime of this framework.

<sup>11</sup> Terms with a minimum grant element of 35%

<sup>12</sup> Non-concessional loans must provide a grant element of not less than 25%

<sup>13</sup> This means financial returns are expected, and the project being financed should start generating revenues for government within a period of not more than 5 years

7. Foreign exchange rate risk will be captured and monitored with a focus on the ratio of foreign currency debt to total debt. GoU intends to ensure that the proportion of foreign currency debt in total debt does not rise above a maximum of 80% over the lifetime of this in the agenda.
8. To limit the extent to which GoU resources are required to meet interest payments, GoU will aim to ensure that the ratio of total nominal interest payments (on domestic and external debt combined) to total government revenue (excluding grants) does not exceed 15%.
9. Depending on the nature of the project, and in line with Government's financing strategy, the guidelines set in 1 to 8 above shall be applied as appropriate.

### 3.2 External Debt Operational Sustainability Indicators

The country's debt sustainability assessment shall be against a set of solvency and liquidity ratios, as highlighted in Table 2. Solvency indicators determine the country's ability to meet its external debt obligations in the future. The liquidity indicators, on the other hand, determine the country's ability to pay its debt now.

**Table 2: External Debt Sustainability Thresholds**

External Debt Sustainability Benchmarks	Thresholds	June 2018 DSA Outturns
<b>Solvency Ratios (%age)</b>		
Present Value of External Debt to GDP (PV/GDP)	30	17.5
Present Value of External Debt to Export of Goods & Services (PV/XGS)	150	90.1
<b>Liquidity Ratios (%age)</b>		
Total External Debt Service to Export of Goods and Service (TDS/XGS)	25	5.8
Total External Debt Service to Domestic Budget Revenue (TDS/XGS)	35	7.8

## CHAPTER FOUR: DOMESTIC DEBT FRAMEWORK

This section sets out the framework for managing GoU's domestic debt, incorporating: the overarching policy framework for domestic debt issuance; the principles and a set of operational guidelines, including quantitative limits.

Under the PDMF 2018, Treasury securities issuance will be conducted primarily for fiscal and cash management purposes. The principles, guidelines and benchmarks set out below will ensure that issuance for fiscal policy purposes will be consistent with safeguarding debt sustainability, and a prudent level of risk.

### 4.1 Principles of Domestic Debt Borrowing

The following principles will guide the issuance and management of domestic debt:

- (a) The annual Budget will clearly set out the volume of net Treasury securities issuance to be conducted for fiscal policy purposes each year, and how the proceeds will be used. Planned net issuance must be fully consistent with the programmed path of the fiscal deficit, and the volume of planned issuance forms of all other financing.
- (b) BoU shall issue its own instruments for monetary policy purposes, but the issuance must be closely coordinated with MFPED and clearly separated from the issuance for fiscal policy purposes.
- (c) Domestic debt operations will be conducted to meet the principles of openness, transparency and predictability as well as domestic market development.
- (d) Domestic debt operations must be coordinated with Cash Management to ensure good management of government cash or liquidity throughout the financial year.

### 4.2 Domestic Debt Operational Guidelines and Benchmarks

This section sets out guidelines and quantitative benchmarks, consistent with the principles set out above, which are designed to help achieve the PDMF 2018 objectives, and against which, the performance of domestic debt will be monitored and assessed in the future.

#### 4.2.1 Operational Guidelines for Domestic borrowing requirements

##### a) Fiscal policy

Each year's annual Budget will clearly set out the size of net domestic government securities issuance in the context of the medium-term fiscal framework. GoU will ensure that the domestic borrowing requirement is fully-funded by the issuance of government securities.

Total net securities issuance allowed in any one financial year (excluding any issuance for monetary policy purposes) will be limited to that set out in the Budget and approved by Parliament. If unforeseen fiscal pressures emerge during a financial year, and it is deemed desirable and prudent to accommodate some of those fiscal pressures by taking on additional domestic debt, Government will seek Parliament's approval to conduct a higher level of debt issuance than was approved in the Budget.

**b) Monetary policy**

The BoU will conduct monetary policy primarily using fine-tuning instruments (that is repos and reverse repos). Proceeds from primary issuance of securities for monetary policy will be deposited in a separate, blocked account, to which GoU will not have access for fiscal policy purposes. Bank of Uganda will bear the costs of these operations.

**c) Cash management**

Cash management operations – that is, the process of ensuring that GoU always has just enough cash available to meet its expenditure needs as they arise – will be conducted using Treasury Bills issuance with maturities less than 1 year. This will benefit monetary policy and the net liquidity injections by GoU should be reduced. Within the timeframe of this framework, GoU should reduce the issuance of Treasury Bills with less than 1-year maturity for fiscal purposes and focus on using them for Cash Management.

**4.2 Domestic Debt Sustainability Benchmarks**

The medium-term fiscal framework and the domestic borrowing requirement within that should be set to ensure that the following domestic debt sustainability benchmarks are met each year. These are set to ensure the level of domestic debt is consistent with ensuring overall debt sustainability. These benchmarks apply in every year of this Debt Strategy, and regardless of the purposes for which debt is issued. It should also be noted that these benchmarks are limits, not targets – i.e. they do not indicate that GoU should or will issue debt to increase the value of the indicators up to the benchmark value. Fiscal policy is the main determinant of the below benchmarks, exceeding the benchmarks set below means that GOU debt is moving towards unsustainable levels.

**Table 3:** Domestic Debt Sustainability Benchmarks

<b>Total Debt Quantitative Sustainability and Risk Benchmarks</b>		
	<b>Benchmark</b>	<b>June 2018</b>
Present Value of Domestic debt stock / GDP	< 15%	13.3%
Total domestic debt interest payments / Total revenues (excluding grants)	< 12.5%	13.3%

**Domestic debt stock / GDP:** Uganda’s domestic debt stock to GDP as at end FY2017/18 was 13.3%. Considering the high cost of domestic debt outstanding, Government shall ensure that the present value of government domestic debt as a proportion of GDP does not exceed the 15% to ensure the sustainability of Uganda’s debt.

**Domestic Interest Cost / Domestic Revenue (excluding grants):** This benchmark shows the proportion of the domestic revenue that goes into servicing domestic interest costs. Since donor grants are inherently subject to uncertainty, the interest cost of domestic debt is considered in relation to the domestically-raised component of the budget only.

If GOU spent more than 12.5% of its domestic revenue on interest payments, then there would not be enough funds for other critical GOU expenditures. However, the current domestic interest cost to domestic revenue as of June 2018 was 13.3%, which has significantly constrained other expenditure. Therefore, Government will aim to reduce the level of interest cost to revenue to below 12.5% over the next 5 years.

### 4.3 Portfolio risk management benchmarks

As there is a trade-off between cost and risk, GOU aims to borrow at a minimum cost subject to an acceptable level of risk. The portfolio risk management benchmarks guide the country's domestic debt risk exposure. They are used to guide the composition of domestic debt issuance and mitigate the level of refinancing risk, which is the risk that government may not be able to raise new debt at affordable interest rates to pay back maturing debt.

**Table 4:** Domestic Debt Risk Benchmarks

Risk Management Benchmarks		June 2018
Percent maturing within 1 year	< 30%	36.2%
Percent maturing in each year after year 1	< 15%	14.1%; 10.3% for maturities in 2 and 3 years respectively, and the remainder for maturities beyond 3 years.
Average Time to Maturity (ATM) (years):	> 5 Years	3.8 years

The benchmarks above will be used to guide the country's domestic debt risk exposure, and assess debt management performance. The benchmarks are each discussed below.

**Percent Maturing in One Year:** 36.16 percent of the current domestic debt is estimated to be maturing in the next twelve months. The benchmark for the percentage of domestic debt maturing in one year set in PDMF 2018 is 30%, down from 40% in PDMF 2013.

**Percent maturing in each year after year one:** Under PDMF 2018, the share of the domestic debt portfolio maturing in any year after year one (the coming twelve months) will be capped at 15%. As at June 2018, 14.05 percent and 10.33 percent will mature in the next 12 months and 24 months, respectively. This risk control measure helps prevent rollover risk from being simply shifted to a later period, for example from year one to year two.

**Average Time to Maturity (ATM):** As at June 2018, the ATM stood at 3.8 years, indicating the average life for the current domestic debt, which is lower than the target of 5 years that will be pursued under PDMF 2018 to lower the refinancing risk exposure.

GoU will monitor the full shape of the redemption profile. GoU will take note of concentrations of large maturities in small periods of time –which will be managed through operations such as debt swaps and debt buy-backs. The redemption profile shall be assessed before new issuances are made to evenly ration redemptions<sup>14</sup> across the maturity structure of the domestic debt portfolio.

### 4.4. Measures to develop the Securities Market

Domestic markets are a vital source of stable, sustainable finance and underpin a private sector associated with employment and economic growth.

The underdeveloped domestic market significantly reduces liquidity and elevates transaction costs. These inefficiencies limit price discovery and hamper investors' ability to diversify risk. Consequently, there is a struggle to allocate capital efficiently and channel funds to investments with the highest return to capital. Domestic firms pay a premium for capital, reducing investment, growth, and job creation, while foreign investors are deterred by higher costs and greater risk.

<sup>14</sup> The redemption profile as at December 2018 is provided as Annex 3 of this document

A deep and efficient domestic debt market can address these issues while simultaneously helping to mitigate the impact of capital-flow volatility, reducing a country's reliance on foreign debt, and increasing its resilience to economic and banking system crises. This will also allow local institutional investors such as pension funds and insurance companies to invest long-term capital other than government debt and cash deposits.

The development of the domestic debt market is critical on the account of reducing concessional financing and risks associated with large and volatile capital flows. Developing and strengthening our financial sector resilience through developing the domestic debt market is the focus of this framework.

This framework seeks to support the development and functioning of the securities market by diversifying the domestic market and attract institutional investors such, as pension funds and insurance companies. We envisage that investors will participate in longer-dated Government instruments, which will reduce the in the domestic debt portfolio.

The measures below will be undertaken to support the continued development of the Treasury securities market, including measures to improve openness, transparency and predictability:

- a) The Budget for each fiscal year will set out clearly the net issuance of securities that is planned for fiscal purposes for the upcoming fiscal year, and – combined with redemptions – the total, gross volume of securities issuance planned for the financial year ahead.
- b) GoU will publish quarterly issuance targets in order to promote openness, transparency and predictability as well as domestic market development.
- c) GoU will publish any changes to the planned volume of issuance and the issuance calendar as soon as practically possible through press releases. GoU may also publish additional information to the market where this would improve predictability and transparency, and thus contribute to improving stability of market demand and lowering issuance costs.
- d) GoU in coordination with the BoU will also maintain a regular dialogue with Treasury securities investors by holding quarterly investor round tables.
- e) GoU will create a debt section on its website to make it easier for investors to access information on government debt and the issuance of domestic debt securities.
- f) At the end of each FY, there will be a full year-end review of debt management performance; in line with best international practice, this will be published in an annual Debt Management Report.
- g) To further support improvements in debt management, the yield curve will be lengthened by issuing longer-term Treasury Bonds, by introducing 20-year Treasury Bonds, and infrastructure bonds for productive projects.
- h) GoU will pursue a benchmark bond programme – reopening select past securities to create a liquid secondary market in those securities, thus reducing the liquidity premium charged on Treasury securities and lowering government debt interest costs. Debt buybacks and swaps will be used to appropriately manage the associated rollover risks, as well as aim to reduce the number of different bonds outstanding.

- i) GoU will continue to conduct the issuance of Treasury securities to investors solely through competitive auctions.
- j) GoU will improve coordination between the Central Bank and the Debt and Cash Directorate.
- k) GoU will establish efficient coordination mechanisms between debt management and monetary policy, fiscal and budget planning processes as well as cash management.
- l) MFPED will establish efficient coordination mechanisms for financial market development to facilitate private sector access to capital.
- m) Given a small-retail investor base that is largely institutional and dominated by the banks and pension fund(s), MFPED will work towards broadening and deepening this investor base.
- n) In collaboration with the BoU, MFPED will raise the level of awareness by educating the public on government securities.
- o) Government shall encourage non-resident investors to participate in the security market.
- p) MFPED in coordination with BOU will create the ability for retail investors to buy government securities using the Mobile Money Platform.
- q) GoU will also harmonize the Withholding Tax charged on government securities with the EAC regional rates.
- r) MFPED in coordination with BOU will introduce a fully-functioning Primary Dealership system that sets the right incentives for Primary Dealers to fulfil their obligations.
- s) MFPED in coordination with BOU will set up a Secondary Market Trading Platform to improve price discovery and increase liquidity in the market.
- t) Government will prepare guidelines to streamline the operationalisation of tap sales (treasury operations beyond the auction calendar) and private placements (a sale of stocks, bonds, or securities directly to a private investor, rather than as part of a public offering).
- u) The MFPED shall in collaboration with the BoU, pursue and implement switches with a view to swapping early maturing domestic debt instruments with long-dated debt instruments to improve government's debt sustainability position.

## CHAPTER FIVE: DOMESTIC ARREARS

### 5.1 Policy on Domestic Arrears

Domestic Arrears refer to the amount by which a government has fallen behind in its payment of interest and principal on debt to lenders within its own country.

Domestic arrears consist of unpaid bills that remain outstanding beyond the fiscal year in which they were incurred. In contrast to other forms of debt, domestic arrears pose serious risks to the economy particularly through their impact on:

- (i) The welfare of pensioners and existing employees to whom emoluments are owed,
- (ii) Private firms whose liquidity positions are undermined exposing them to the risk of business failure and foreclosure,
- (iii) The increase in government's cost of doing business given that suppliers are inclined to bid higher charges to mitigate against risks of delayed payments, and
- (iv) Budget implementation, given that arrears constitute off-budget expenditures that may most likely fall outside priority areas set by Government.

Domestic arrears in Uganda are a long-standing challenge in response to which, Government has over the years put in place several measures to address the problem. These include:

- (i) The introduction of the Commitment Control System (CCS) in 1999,
- (ii) Strengthening the legal framework surrounding the Public Financial Management system with special provisions entrenching the CCS
- (iii) Formulation of a comprehensive domestic arrears strategy as part of the 2007 Public Debt Strategy;
- (iv) Introduction public financial management systems and reforms such as the Integrated Financial Management System (IFMS), Planning and Budgeting System (PBS), decentralization of the salary and pension payrolls, all aimed at strengthening budgeting and expenditure controls.

### 5.2. Situational Analysis

The current stock of domestic arrears excluding Local Governments is estimated at UGX 2.7598 trillion and has registered an annual growth rate of 39% over the last three years. Arrears have increased under each expenditure category; the key areas being court awards, pensions, salaries, general goods, services, and development expenditure. By composition, court awards have the largest share of 28% followed by pensions at 22%, General Goods and services at 18% and Development Expenditure arrears at 15%. A table summarising the current state of domestic arrears attached as annex I.

A policy decision was taken in 2016 to address the identified key drivers of arrears. In line with this strategy, the pension and gratuity arrears amounting to about UGX 536.4 billion for veterans were prioritised. However, survivors of previous national armies remain a major contributor to the recent escalation in the stock of arrears. The rise in the stock of new arrears has been occasioned by:

- a) In-year budget cuts due to revenue shortfalls and supplementary expenditures;
- b) Under budgeting for fixed costs;
- c) Failure to operate within the appropriated resource envelope;
- d) Diversion of appropriated funds through mischarges;
- e) Early closure of the IFMS at the end of the FY which limits time for representing bounced payments, enhancement of salaries without matching resources by universities; and
- f) Weak and ineffective commitment control system.

### **5.3. Guidelines for Management of Domestic Arrears**

Due to the unprecedented level of domestic arrears and the nature of their causes, this section identifies preventive and remedial measures needed to eliminate the existing stock of arrears, while keeping any future arrears to a minimum sustainable level.

Government will employ a three-front approach over the course of this framework as explained below:

#### **5.3.1. Mobilizing resources to clear the existing stock of arrears**

Extinguishing the existing stock of arrears estimated at UGX 2.9 trillion within the next 4 years will necessitate an increase in the arrears budget of about UGX 300 billion to UGX 600 billion, starting with Fiscal Year 2019/2020<sup>15</sup>. To increase the arrears budget, Government shall;

- i. Ensure the financing of domestic arrears through programmed growth in the resource envelope
- ii. Prioritize pensions and salaries on account of their impact on poverty reduction, utilities on account of the associated risk to disruption in essential public service delivery; arrears that attract penalties and interest costs and the settlement of arrears on a first –in- first out basis.

#### **5.3.2. Measures to ensure that the budgeted domestic arrears resources are not diverted**

This approach is to avert the diversion of earmarked resources to finance other current obligations. The following measures shall be enforced to limit the diversion of arrears resources:

- a) **A domestic arrears stock-taking and verification exercise** shall be undertaken with the objective of establishing a single comprehensive database capable of providing the following information for each arrear claim: agency, creditor, date when the liability became effective, contractual terms including penalties/ interest for non-payment. Going forward, the arrears database shall be integrated into IFMS by implementing the contracts management module with the capacity to hold information on commitments (including multi-year commitments), liquidations, payments, payment due dates, and payments in arrears.
- b) **Detailed Budget Allocation** – The allocation of resources for arrears currently stops at the vote level, broken down by arrears sub-category. This has left Accounting Officers (AOs) with a lot of room to divert resources. The allocation of resources in the arrears budget, therefore, will be expanded to show age and will be backed by a list of eligible creditors provided by the Accountant General. Requests for releases for domestic arrears will have as an attachment, a schedule of creditors drawn from this eligible creditor list.

<sup>15</sup> UGX. 400bn has been provided to cater for domestic arrears in the FY 2019/20 National Budget

- c) **Enhancing the Chart of Accounts to permit detailed performance reports.** Detecting non-compliance with the arrears strategy calls for real-time information on performance. Itemization for domestic arrears within the chart of accounts is limited to a few expenditure categories. To improve on the tracking of arrears payments, Government shall ensure that distinct items are introduced in the chart of accounts for each of the arrears sub-categories.
- d) **Strengthened Accountability** – All AOs will be required to submit a Domestic Arrears Payments Accountability Return (DAPAR) as proof of payment as per the release schedule. This shall be submitted to MoFPED within 30 days after the release of funds.
- e) **Protection from in-year Re-allocations** – The budget provision for domestic arrears will be protected from cuts or re-allocations during the implementation year. Given that all virements are effected in consultation with MoFPED, there will be zero tolerance by Government (Directorate of Budget) for any requests for reallocations from the arrears items. To support this-in respect of the IFMS, the Accountant General will ensure that arrears codes are excluded from the source accounts for the virements budget.

### 5.3.3 Prevent creation of new arrears

The plan to prevent new arrears shall be threefold as detailed below:

#### a) Credible and realistic budgets

- i. Government shall ensure that adequate budgetary provisions are allocated to fixed or unavoidable commitments defined to include *pensions, salaries, utilities, rental obligations, subscription to international organizations and multi-year contracts in the development budget*. A robust framework for estimating these commitments will be put in place to these outlays to have a first call on the resource envelope; the same way debt service obligations are treated.
- ii. Operationalization of the Contingencies Fund – The contingencies fund as provided for in the PFMA 2015, shall be operationalized to act as a buffer against increased expenditures as a result of emergencies such as natural disasters.

#### Strengthening the Commitment Control System (CCS)

- i. There is a resurgence in utility arrears attributed to the reluctance by the Ministry of Defence, the Uganda Police Force, and the Uganda Prisons services to embrace the CCS- prepayment system for their utilities. Government shall as a matter of priority, roll out the prepayment systems for water and electricity to these agencies. The CCS is a payment system for government services used by most ministries to implement a prepayment system for telephones, electricity and water supply.
- ii. The Integrated Financial Management Systems (IFMS) will be rolled out to all Central government and Local Governments as a measure to control arrears accumulation. The IFMS, an IT budgeting and accounting system has an inbuilt CCS to manage Public Expenditure.

#### b) Sanctions

- i. **Sanctions on errant officers** – Cabinet vide minute 49 (CT2006) resolved that authority must be sought by Accounting Officers from Cabinet or Permanent Secretary and Secretary to Treasury (PS/

ST) to over-commit government beyond their respective cash limits. However, no sanctions were proposed against AOs who violate the CCS. To enforce this directive, Cabinet shall reserve the authority to sanction- in a manner deemed appropriate, to reign in errant officers.

- ii. **Budget penalties on errant ministries** – CCS defaulting ministries’ budgets will be cut by an amount equivalent to the accumulated CCS arrears for the previous fiscal year. The resources shall be earmarked centrally to the settlement of arrears.

#### 5.4. Benchmark for the Domestic Arrears Strategy

The schedule below will be utilised over the life of this framework to assess the performance of Domestic Arrears. The Proposed allocations for FY2019/20-FY2022/23 are envisaged to sufficiently cater for all the resource requirements for the liquidation of the existing stock of arrears, and these shall act as performance benchmarks/indicators.

**Table 5:** Resource requirements for the liquidation of the existing stock of arrears

Category	Stock June 2017	Appr. Arrears Budget 17/18	Budget Est. 18/19	Proposed Allocations			
				2019/20	2020/21	2021/22	2022/23
Domestic Arrears Total	2,759.8	300.9	300.9	600.0	600.0	600.0	358.1
o/w Pensions & Gratuity	613.2	99.6	49.6	200.0	263.9	-	-
o/w Salaries	42.6	21.6	4.7	16.3	0.0	-	-
o/w Court Awards & Comp	769.3	40.0	90.1	100.0	100.0	200.0	239.2
o/w Development	410.6	43.0	11.9	100.0	100.0	155.7	0.0
o/w Contr. Int Org	167.8		11.6	43.4	43.4	69.3	-
o/w Rent	17.4	6.8	8.6	2.0	-	-	-
o/w Utilities	136.8	17.0	72.4	47.5	-	-	-
o/w General Goods and Services	502.7	72.8	44.9	65.1	67.0	149.3	103.6
o/w taxes	99.5	-	7.2	25.7	25.7	25.7	15.3
<b>Possible Options for raising resources</b>							
Option	Pros		Cons				
Option 1: Raise resources in cash from existing current resource envelope	Ensures that does not incur further penalties or interest		Reduces fiscal space for other priorities				
Option 2: Finance by borrowing from either domestic or foreign market with the proceeds earmarked for arrears	Does not increase a country's level of indebtedness since it has the effect of replacing one form of liability with another		Increases the interest cost bill to the budget				
Option 3: Securitization of arrears e.g through issuance of of promisory notes, treasury bills or bonds to creditors	(i) Allows govt to select a debt maturity structure and repayment profile that best matches its financing needs. (ii) has the benefit of contributing to the development of financial markets as the creditors could liquidate the securities through trades on the secondary market		(i) moral hazard of incentivising MDAs to continue creating arrears; (ii) interest costs to the budget, (iii) trading in the secondary market at a discount undermines the working capital of creditors				

Source of data: FY2018/19 Domestic

## CHAPTER SIX: CONTINGENT LIABILITIES FRAMEWORK

### 6.1 Strategy on Contingent Liabilities

Contingent liabilities pose a fiscal risk to the government. A contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of an entity. These contingent liabilities may result in expenditure by the government to settle the confirmed obligation of the entity.

Article 159(1) and 159(2) of the Constitution, Sections 23, 36 and 39 of the Public Finance Management Act (2015) and the Charter for Fiscal Responsibility (2015) provide the Ministry with the mandate to manage, monitor and report on contingent liabilities. The Public Debt Management Framework 2018 therefore also recognizes contingent liabilities, as they are relevant in estimating the total liability exposure of government.

There are two types of contingent liabilities:

1. *Explicit contingent liabilities*: these are possible government obligations defined by contract or law. The government is legally mandated to settle the obligation if the beneficiary fails to settle their dues. Most common explicit contingent liabilities are loan guarantees, government-back guarantee schemes, legal proceedings and termination clauses in PPPs.
2. *Implicit contingent liabilities*: these are possible government obligations not bound by contract or law (referred to as non-guaranteed debt). They are rather political or moral obligations and arise from public expectations of government intervention or when the opportunity cost of not intervening is considered to be unacceptable. Examples are; financial system bail-outs, natural disasters, non-guaranteed debt of State-Owned Enterprises, Local Governments and publicly-aided institutions. Important to note: The Government does frequently issue authorizations-to-borrow to public entities, but that this authorization does not entail a guarantee for the borrowing.

The scope of this framework has been limited to legally-binding government loan guarantees as well as non-guaranteed debt issued to different public or publically-aided institutions. A framework and guidelines on other contingent liabilities are currently being developed.

### 6.2 Explicit Contingent Liabilities Policy on Guaranteed Public Debt

A loan guarantee is an agreement in which Government commits to repaying the financial liabilities of another entity should that entity default. Guarantee arrangements are formalised by guarantee agreements between the government and all parties involved. A guarantee is contingent upon the guarantee beneficiary's primary contractual obligation.

In the guarantee arrangement, the following three parties shall be identified;

1. *Guarantor*: the government
2. *Guarantee beneficiary*: the entity that intends to borrow
3. *Guaranteed entity*: the creditor

To ensure that Uganda’s total Public debt exposure remains sustainable, Government shall ensure observance of the benchmark below:

**Table 6: Publicly Guaranteed debt risk indicator**

Ratio	Thresholds	June 2018
% of Nominal Publicly Guaranteed Debt to GDP	5%	0.19%

It is, however, prudent to note that the above ratios may differ depending on the characteristics of different institutions as well as operational mechanisms.

### 6.3 Credit Risk Quantification/ Benchmarks of Beneficiary Institutions

MoFPED shall analyse the financial statements of each institution that intends to borrow, to ascertain their ability to remain solvent and sustainable after the acquisition of a required loan.

Below are the financial ratios benchmarks:

**Table 7: Quantification benchmarks of the beneficiary’s credit risk**

Ratio	Benchmark
Debt stock (both existing & new)/ Assets	< 30%
Debt Service/ Revenue <sup>1</sup>	< 15%
Current ratio: (Current assets/ Current liabilities)	>1

### 6.4 Implicit Contingent Liabilities

Whereas implicit contingent liabilities like non-guaranteed debt may not carry any explicit legal obligation, the authorisation given by the Minister of Finance must be drafted carefully. This is because political and moral obligations may arise from expectations that the Government will intervene when the public entity authorized to borrow is in default.

The authorisation letter should state explicitly that no legal obligation is implied for the Government and the letter should state that the authorisation is **not a guarantee**. Therefore, the management boards or committees of the beneficiary entities shall be required to fully take on any financial obligation. In this arrangement, GoU will not be liable for any outstanding payments arising from transactions for which these authorisations are issued.

#### 6.4.1 Management of Contingent Liabilities arising out of Public-Private Partnerships (PPPs)

PPPs are arrangements characterized by joint working between the public and private sectors. Private Partnerships (PPPs) are guided by the PPP Act 2015, and are an alternative source of infrastructure funding, that also support the private sector. However, PPP arrangements can be very complex and the fiscal risk they expose the government to can be difficult to measure and monitor. This, therefore, requires careful project preparation, competitive bidding and review of proposed PPPs before a PPP Agreement is signed. The review should properly identify and assess all the obligations tagged to both the Government and the private party.

Contingent Liabilities arising out of PPPs include Minimum revenue guarantees, Early Termination payment commitments (including Force Majeure Termination), Debt assumption commitments, and direct credit guarantees. These types of commitments are explicitly set out in the PPP Agreement.

In practice, the management of such contingent liabilities can be divided into two stages (1) the PPP Project Development Stage which covers the identification of potential projects and the assessment of their risks and, (2) the PPP Project Operational Stage which includes the ongoing management and monitoring of PPPs and their contingent liabilities;

#### **6.4.2 Management of Contingent Liabilities-During the PPP Project Inception**

- a. All PPP projects shall be prepared, approved and implemented, in line and accordance with the PPP Act 2015.
- b. A process to identify, quantify, and allocate project risk should be undertaken to determine the best mechanism to mitigate them.
- c. Risk allocation; when considering the appropriate risk allocation and risk analysis for a PPP Project, Government shall bear only those risks that it can best manage.
- d. PPP agreements shall be approved by the Cabinet

#### **6.4.3 Management of Contingent Liabilities -During the PPP Project Operational Stage**

- a. The PPP Unit shall be responsible for central monitoring of PPPs as well as work with MoFPED to ensure informed decision- making and ongoing risk management.
- b. The PPP Unit shall maintain a register of Contingent Liabilities, capturing all the underlying contractual obligation details e.g. for a minimum revenue guarantee, details of the guarantor and borrower, and the revenue levels, plus all relevant information on the subject.
- c. MFPEP shall publish PPP contracts and their contingent liabilities, along with other Public debt information.

## CHAPTER SEVEN: RISK MANAGEMENT STRUCTURE

The Medium Term Debt Management strategy is the main framework for managing risks within the Government's public debt portfolio. The objective of this risk management section is to ensure that the risks and costs associated with the public debt portfolio and overall debt management are minimised.

The chapter also identifies the different risks embedded in the public debt portfolio; measures, principles and benchmarks that will guide government's debt risk management decisions over the period of this framework.

### 7.1 Public Debt Portfolio and overall Debt Management Risks

As of December 2018, the public debt portfolio risks were as follows:

#### i. Rollover/ refinancing risk.

Rollover risk refers to the uncertainty that debt may require refinancing at an unusually high-interest cost or cannot be refinanced at all. The maturity structure or profile of Government debt is an important source of identifying rollover/refinancing risk. The rollover risk is higher when the maturity profile is concentrated on or around a particular maturity and when the maturity profile is short with large individual redemptions. The major indicators of rollover risk include Average Time to Maturity (ATM)<sup>16</sup> and the Redemption Profile.

At the end of December 2018, the ATM had reduced to 10.9 years from 11.8 years at December 2017 on account of a reduction in the ATM of external debt whose new debt was acquired at shorter maturities. The total debt maturing in one year as a percentage of total debt increased from an average (domestic and external) of 12.8% to 13.8% due to an increase in the issuance of short term dated instruments. Specifically, domestic debt maturing in one year increased from 32.5% to 36.6% of total domestic debt.

On the other hand, the redemption profile describes the maturity structure of the debt portfolio and provides a clear picture of concentrations of redemption which may be hidden under the ATM, since the ATM is an average.

Refinancing risk is more pronounced for domestic debt as indicated in the redemption profile in Annex: 3 due to the large share of outstanding short-term T-bills. As a result, close to 36.6% of domestic public debt will come due in 2018 and will have to be re-financed.

#### ii. Interest Rate Risk.

The interest rate risk is associated with the cost of servicing the Government's new or existing floating debt, stemming from potential changes in domestic and foreign interest rates. For both domestic and foreign currency debt, changes in interest rates affect debt servicing costs on new issues when fixed-rate debt is refinanced and on floating rate debt at the rate reset dates.

Interest rate risk is commonly assessed by Average Time to Re-fixing (ATR), Debt re-fixing in 1yr (percentage of total), and Fixed-rate debt (percentage of total). Therefore, the ATR shows on average,

<sup>16</sup> ATM provides an indicator for the average life of debt. It measures the average length of time it takes for debt instruments to mature and therefore the extent of the refining risk exposure. A long ATM implies lower refinancing risk exposure and vice versa.

the time it takes principle payments to be subject to a new interest rate. A shortening of ATR<sup>17</sup> suggests that the debt portfolio is on average, facing a new interest rate more frequently and exposed to re-fixing shocks.

As at December 2017, Uganda's public debt portfolio was dominated by fixed interest rate debt with 97.3% of the portfolio constituting fixed interest rate debt. This implies that only 2.7% of the portfolio was composed of variable rate debt

### **iii. Foreign exchange rate risk**

Foreign exchange rate risk also known as foreign currency risk relates to the volatility in exchange rates, stemming from a depreciation in the external value of the domestic currency. As at December 2017, 67% of the GoU's public debt portfolio was denominated in foreign currency. This poses a significant foreign currency risk that requires appropriate management.

### **iv. Contingent risks**

Guarantees and other contingent liabilities represent potential financial claims against the Government that have not yet materialized, but that could trigger a financial obligation or liability under certain circumstances. Government had accumulated six (6) guarantees amounting to USD110.23 million as at December 2017.

Experience indicates that these contingent liabilities can be very large, particularly when they involve recapitalization of the banking system by the Government or Government obligations that arise from poorly designed programs for the privatization of its assets. If structured without appropriate incentives or controls, contingent liabilities are often associated with moral hazard for the Government, since making allowances ahead of time can increase the probability of these liabilities materializing. This framework will seek to address the risk embedded in all probable explicit and implicit contingent liabilities related to Government.

### **v. Credit risk**

Relates to the risk of non-performance by borrowers on loans or other financial assets or by a counterparty on financial contracts. This risk is particularly relevant in cases where debt management includes the management of liquid assets. It may also be relevant in the acceptance of bids in auctions of securities issued by the government as well with contingent liabilities, and in derivative contracts entered into by the debt manager. A country's credit risk is assessed by its credit rating. Uganda's credit rating as at December 2017 was a B+.

### **vi. Operational risk.**

Operational Risk includes a range of different types of risks, such as transaction errors in the various stages of executing and recording transactions that is debt recording, disbursement and debt service; inadequacies or failures in internal controls, or in systems and services; reputation risk; legal risk; security breaches; or natural disasters that affect public debt.

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<sup>17</sup> The Debt Management Office will work towards realizing a shorter ATR in a falling interest rate environment or during high interest rate volatility periods.

## vii. Settlement risk

This is the risk that a counterparty (or intermediary agent) fails to deliver a security or its value in cash as per agreement when the security was traded after the other counterparty or counterparties have already delivered security or cash value as per the trade agreement.

## 7.2 General Principles of Risk Management

The Public Debt management framework shall include principles for mitigating cost and risk embedded in the public debt portfolio. Contingent Risks have been sufficiently taken care of in the contingent liability section.

Below are the principles in respect of other categories:

- 1) An assessment of cost and risk on any borrowing shall be undertaken before a decision is made.
- 2) The government shall follow the MTDS as its main risk management plan. This shall be utilised alongside other instruments, including but not limited to the financial derivatives
- 3) Derivatives<sup>18</sup> shall be recorded in the Debt Management and Financial Analysis System (DMFAS) to ensure proper functionality and handling of the instrument.

The following shall guide **the process of undertaking derivative transactions**:

- i. The middle office of the DMO shall analyse and advise about the necessity, purpose, and viability and monitor the risks associated with: (a) financial derivative transaction, (b) refinancing/ rollover risk, (c) contingent liability risks/ on lending, and any other relevant risks to debt portfolio.
  - ii. To minimise the foreign exchange risk, the Middle office of the DMO shall periodically assess the country's debt profile and advise on the need for a financial derivative i.e. the transaction shall be demand, rather than supply, driven.
  - iii. Involve legal advisors at all stages of the transaction – from negotiations to the conclusion with the counterparty.
  - iv. The middle office of the DMO shall be responsible for assessing and monitoring the risks associated with any derivative transaction
  - v. The Back office shall be responsible for entering derivative transactions into the DMFAS from the associated legal agreements while the middle office shall validate the data.
- 4) GOU shall undertake Interest rate risk management through hedging in an environment of rapidly rising interest rates<sup>19</sup>backed by sound legal documentation, which shall indicate, but not be limited to the purpose(s) for the derivative transaction.
  - 5) The government shall, at its discretion and based on need, explore and apply the options on risk management listed in table 4.

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18 A derivative is a contract between two or more parties whose value is based on an agreed-upon underlying financial asset (like a security) or set of assets (like an index). Common underlying instruments include bonds, commodities, currencies, interest rates, market indexes and stocks.

The most common examples of derivative instruments are Forwards, Futures, Options and Swaps

19 Rapidly rising interest rate environment shall mean an increase in variable reference interest rates e.g. LIBOR at >1% p.a.

### **7.3 Guidelines to monitor and evaluate the risks for government's debt**

- i. The debt structure shall to the extent feasible, be modified through the MTDS and aligned towards the most risk minimising ratio during the life of this framework.
- ii. Ensure the implementation of the relevant portfolio benchmarks on currency composition, duration, and maturity structure of the debt to guide the future composition of the portfolio.
- iii. The debt management office shall ensure an appropriate mix for both fixed and floating interest rate debt depending on the cost, risk and availability of the financing
- iv. Ensure adherence to cost-effective cash management policies (as set out the cash management guidelines) to ensure a high degree of certainty for the country's financial obligations as they fall due.
- v. Conduct periodic evaluations of the country's debt portfolio to identify and manage the expected cost and risk in the government debt portfolio.
- vi. Conduct regular stress tests of the debt portfolio basing on the economic and financial shocks to which the Government and the country are potentially exposed.
- vii. Harmonise general government operations so that fiscal and monetary management is coherent for sound macroeconomic management.

## 7.4 Risk Mitigation Measures

**Table 8: Summary of risks and proposed mitigation measures**

<b>Risk</b>	<b>Liability Management Operation</b>
Refinancing risk/rollover risk	<ul style="list-style-type: none"> <li>-Smooth maturity profile by well-planned primary market</li> <li>-Regular use of buybacks and exchanges to reduce the size of short-term debt</li> <li>-Use of amortizing bonds/debt</li> </ul>
Funding liquidity risk and market liquidity Risk	<p><b>Funding liquidity risks:</b></p> <ul style="list-style-type: none"> <li>-Use of cash buffers and contingency credit lines</li> </ul> <p><b>Market liquidity risk:</b></p> <ul style="list-style-type: none"> <li>-Issuance in key maturity segments; concentrate on small number of instrument types; transparency to reduce</li> <li>-Use of buybacks and bond exchanges to contribute to trading in on-the-run issues</li> </ul>
Interest rate risk	<ul style="list-style-type: none"> <li>-Draw clear targets for issuance of fixed/floating rate instruments in primary market issuance</li> <li>-Interest rate derivatives (hedging, swaps, forwards, futures etc.) to change interest rate structure and duration</li> <li>-Changes in portfolio composition to manage interest rate sensitivity</li> </ul>
Exchange rate risk	<ul style="list-style-type: none"> <li>-Limits for overall foreign exchange risk and benchmark</li> <li>-Use of bond exchanges to achieve a targeted mix of local and</li> <li>-Use of cross-currency swaps or optionality in loan agreements (where they exist)</li> <li>-Use of foreign exchange derivatives to hedge other foreign exchange risk deriving from other instruments such as foreign-currency bonds or CP, as well as assets</li> </ul>
Credit risk	<ul style="list-style-type: none"> <li>-Alerting fiscal authorities of the need to take appropriate action and address market concerns so sovereign bond yields and credit default spreads are reduced</li> <li>-Government shall take into consideration the IMF Program, and DSA's ratings before drawing the borrowing plan for the subsequent FY</li> </ul>
Counterparty risk for derivative transactions and assets on the balance sheet	<ul style="list-style-type: none"> <li>-Counterparty credit risk limits</li> <li>-Monitoring of counterparty creditworthiness and adequate posting of collateral</li> </ul>
Legal risk	<ul style="list-style-type: none"> <li>-Use of standard legal agreements</li> <li>-Sound internal processes and a legal strategy for the use of collective action and pari- passu clauses; consistent application of cross-default and negative pledge clauses</li> </ul>
Operational risk	<ul style="list-style-type: none"> <li>-Internal structure that delineates responsibilities</li> <li>-Well-documented internal processes and systems</li> <li>-Four-eye principle and well-trained staff</li> <li>-A risk management culture that rewards reporting of failed processes or close calls</li> <li>-Use of standardized platforms such as DMFAS program</li> </ul>
Contingent risk	<ul style="list-style-type: none"> <li>-Management of guarantees</li> <li>-Risk assessment of new guarantees, on-lending and CLs</li> </ul>

**Table 9: Risk Management target ranges**

Cost and Risk Indicators		Dec-17	Jun-18	As at end 2022
		Current	Target ranges	
<b>Cost of Debt</b>	External interest payments as a % of GDP	0.3	0.5	0.6-0.7
	Domestic interest payments as a % of GDP	1.8	1.8	1.7-1.8
	Total interest payments as a % of GDP	2.1	2.3	2.4
<b>Refinancing Risk</b>	External Debt maturing in 1yr (% of Total)	3.1	2.9	2.8-3.8
	Domestic Debt maturing in 1yr (% of Total)	32.5	36.2	28.0-32.0
	Debt maturing in 1yr (% of Total)	12.8	13.6	7.5-12.0
	ATM External Portfolio (Years)	15.6	15	15.0-16.0
	ATM Domestic Portfolio (Years)	4	3.8	5.0-6.0
	ATM Total	11.8	11.4	12.2-12.3
<b>Interest Rate Risk</b>	External Debt re-fixing in one year as a (% of Total)	7.1	8.9	10.2-11.2
	Domestic Debt re-fixing in one year as a (% of Total)	32.5	36.2	22.7-26.8
	Debt re-fixing in one year as a (% of Total)	15.5	17.6	20.8
	Floating Rate debt as a % of Total	2.7	4.2	6.8
	Fixed rate Debt as a % of Total	97.3	95.8	93.2
<b>FX Risk</b>	FX Debt as a % of Total	67.1	67.9	80
	ST FX Debt as a % of Reserves	5.8	6.5	7.0-8.0

## **CHAPTER EIGHT: CURRENT INSTITUTIONAL AND REPORTING FRAMEWORK FOR PUBLIC DEBT MANAGEMENT**

### **8.1 Institutional Framework**

This institutional framework encompasses all responsible centres that coordinate the process of debt, from sourcing to approval, acquisition and management. These are as follows:

#### **1) The Ministry of Finance, Planning and Economic Development (MoFPED)**

The MoFPED underwent a restructuring exercise that gave birth to the creation of a Debt Management Office (DMO) in April 2017. The DMO has the Front, Middle and Back Offices.

The Front Office is responsible for mobilization of external resources, the Middle office coordinates domestic debt issuances and general public debt management, while the Back Office is responsible for debt recording and servicing.

The Ministry, therefore, executes its debt mandate through the DMO, and its core functions include; identification of the overall budget financing needs, prudent management of Government's public debt portfolio, and debt sustainability. The debt portfolio is managed by analysing different financing strategies, through the formulation of an annual Medium Term Debt Management Strategy (MTDS). This informs the Government's choice of a strategy that provides a portfolio that is manageable in terms of cost and risk. On the other hand, a Debt Sustainability Analysis (DSA) is undertaken annually by the MoFPED to assess how Uganda's current level of debt and prospective new borrowing would affect not only its ability to service its debt but also establish debt sustainability going forward. Finally, the Ministry advises on the overall debt policy.

The Ministry presents borrowing requirements to Cabinet and Parliament for authorization or approval as may be necessary in accordance with the laws, regulations and policies in force. It also spearheads loan identification, appraisal, analysis, negotiation and re-negotiations of terms and conditions of public debt and, signing of debt agreements.

The Accountant General's Office is part of the DMO and it operates a Debt Management and Financial Analysis System (DMFAS) for recording and reporting domestic and external public debt. It maintains a debt amortization schedule that shows the opening balance, additions in the year, repayments and closing balance for each loan or credit. The Accountant General processes debt service payments, monitors and reports on loan disbursements and obtains details of all financial assets of Government for computation of the country's net debt position. The Accountant General is also responsible for loan drawdowns (signing of loan withdraw applications).

#### **2) The Bank of Uganda**

The Central Bank of Uganda provides advice on debt management per the Bank of Uganda Act, 1993. Within the debt acquisition process, the BoU is delegated the responsibility of determining the type of domestic debt to issue, the asset mix, the calendar, the volumes to be issued and issuing of domestic debt in a given year. BoU also maintains an up-to-date database (DMFAS and CSD) of the country's indebtedness and assesses how Uganda's current level of debt and prospective new borrowing would

affect the country's ability to service its debt.

### **3) The Cabinet**

The Cabinet, as part of the Executive, reviews individual loans to check for their consistency with the Public Debt policy, the National Development Plan (NDP), the ruling party manifesto and Government's priorities with a view to increasing service delivery, economic growth and development of the country.

### **4) The Parliament**

The Parliament is responsible for approving new loans that the Government intends to acquire and approving the amount to be borrowed domestically in a given year, as provided for in Article 159 (2) of the Constitutions of Uganda 2005 (as amended).

### **5) Other Ministries, Departments and Spending Agencies (MDAs)**

Ministries Departments and Agencies (MDAs), through their Sector Working Groups, identify projects to be funded and prepare project proposals which are submitted for consideration by MoFPED. The MDAs also participate in all consultations and negotiations of all loan agreements for projects and programmes under their jurisdiction, in line with the National Development Plan.

### **6) The Ministry of Justice and Constitutional Affairs**

This Ministry performs its functions through two offices as follows:

#### **i. Solicitor General**

The Solicitor General provides legal support and advice throughout the loan acquisition process, including comments on the legality of a project, and provides support during Cabinet and Parliamentary approval to offer clarification on any matters. The Solicitor General also forms part of the loan negotiations team.

#### **ii. Attorney General**

The Attorney General gives a legal opinion on the loan agreements after Parliamentary approval and signing of the agreement. The legal opinion is a no objection on behalf of GoU to the terms of the signed agreement and it is against this opinion that the loan becomes effective.

Table 9 summarizes the different responsibility centres and their roles and duties in the execution of Uganda's debt policy, performance evaluation, contracting new project financing, recording, reporting, and repayment of the loan portfolio.

**Table 10: Responsible Centres in the Process of Debt Approval, Acquisition and Management**

Assigned responsibility/ activity	Stakeholder
Identify overall financing needs	MoFPED
Undertake Debt Sustainability Analysis (DSA)	MoFPED & BOU
Advise Government on overall Public debt policy	MoFPED
Identify priority projects/ Submit project proposals to Development Committee (DC)	NPA/SWGs
Scrutinise and approve new projects	MoFPED (DC)
Identify donor and negotiate financing details – NB. In some cases, projects submitted to the DC already have donors attached, as planned by SWGs. A few projects are essentially donor-driven.	MoFPED
Analyse terms of proposed new borrowing	MoFPED
Present Cabinet Memorandum to Cabinet, followed by Cabinet Brief to Parliament, for each new loan	Hon. of MoFPED
Agree on loans to be submitted to Parliament	Cabinet
Brief to Parliament seeking Approval	MoFPED
Approve new loans	Parliament
Provide opinion on the legality of each Loan Agreement	Minister for Justice/ Attorney General
Inventory of loan agreements	MoFPED
Effect debt service repayments	MoFPED
Maintain and update parallel loan ledgers	MoFPED/BoU
Record and monitor Government external loan disbursements on a loan-by-loan basis, including borrowing and repayment terms, and external grant disbursements	MoFPED
Review and approve withdrawal applications by issuing audit warrants	MoFPED
Service Government debt payments	MoFPED
Monitor project execution	MoFPED
Manage Government’s overseas project bank accounts	MoFPED
Examine and issue audit certificates on project expenditures	Accountant General Office

## **8.2 Reporting of Public Debt and Contingent Liabilities**

Debt reporting and evaluation under the PDMF2018 shall follow the reporting requirements under relevant GoU legislation and international best practices regarding the governance of public debt management. The following publications shall provide evaluation, management and reporting frameworks of Public Debt:

### **i. Report on Public debt, Guarantees and other Financial Liabilities of Government**

This publication shall provide a comprehensive report on Government's loans, grants, guarantees and other financial liabilities. The report shall further evaluate Government's borrowing and compliance with the objectives, principles and guidelines under this Framework. MFPED shall annually produce, publish and submit this report to Parliament.

### **ii. The Medium-Term Debt Management Strategy**

This debt management strategy is a medium-term plan (3-5 years) that government intends to implement to achieve its desired debt portfolio subject to cost and risk trade-off as set out in this Framework. The plan shall include a comprehensive portfolio review of the existing debt stock, performance of the previous financial year. It will also provide the financing strategy for the proceeding financial year that represents government's cost-risk trade-off preference. MFPED shall annually produce and semi-annually evaluate the MTDS.

### **iii. Debt Statistical Bulletins**

The bulletins will provide information on central government debt stocks (broken down by creditor, residence classification, instrument, currency, interest rate basis and maturity), debt flows (principle and interest payments), debt ratios and indicators and risk measures of the debt portfolio. The bulletins shall be prepared and published quarterly.

### **iv. Public Debt Portfolio Analytical Reports**

Produced quarterly alongside the Debt Statistical Bulletins and they will provide a report on public debt portfolio and cost and risk analysis of the existing debt.

### **v. The Debt Sustainability Analysis Report**

The DSA report will highlight the country's ability to service its debt now and in the future. MFPED shall produce and publish the report annually.

### **vi. Report on Contingent Liabilities**

During the life of this framework, MFPED shall on a quarterly and annual basis identify, register, and disclose both implicit and explicit Contingent Liabilities. An annual report shall be written and published. The report shall among others, quantify the expected cost and maximum probable loss and ascertain the probability of default. This will act as an early warning system of any future budgetary pressures.

## ANNEX 1: GLOSSARY

1. **Average Time to Maturity (ATM)** provides an indicator of the average life of debt. It measures the average length of time it takes for debt instruments to mature and therefore the extent of the refinancing risk exposure. A long ATM implies lower refinancing risk exposure and vice versa.
2. **Average Time to Refix (ATR):** ATR provides a measure for the average length of time it takes for interest rates to be reset. The longer the period, the lower the interest rate exposure.
3. **A contingent liability** is a possible obligation that arises from past events whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of an entity.

### 4. Constitution of the Republic of Uganda (1995)

Uganda's current legal framework for debt management is anchored in the Constitution of the Republic of Uganda. Article 159(1) of the Constitution gives the GoU the authority to borrow from any source. The Article qualifies this power by requiring for such borrowing to be expressly approved by Parliament. Similarly, the GoU has the power to issue a guarantee when authorised by or under an Act of Parliament. Article 159(2) states that "Government shall not borrow, guarantee, or raise a loan on behalf of itself or any other public institution, authority or person except as authorized by or under an Act of Parliament." Such an Act of Parliament "shall provide that the terms and conditions of the loan shall be laid before Parliament and shall not come into operation unless they have been approved by a resolution of Parliament" (Article 159(3)(a)).

### 5. Charter for Fiscal Responsibility (2016)

Section 6.5 of the Charter for Fiscal Responsibility (2016) requires the MoFPED of the GoU to include a Fiscal Risk Statement (FRS) in the annual Budget Framework Paper of the Minister. The FRS needs to identify and analyse risks in public debt management and specific risks such as loans and guarantees, PPP, natural disasters and any other contingent liabilities. Section 6.6 requires the FRS to include a strategy for managing the fiscal risks, including Government's decisions on bearing, mitigating and absorbing the risks identified.

6. **Debt assumption commitments** – this applies where the Government assumes the debt of the private project company.
7. **Direct credit guarantees** extended to the project companies –the Government may agree to fulfil the obligations of the guaranteed entity if it fails to repay a loan.
8. **Domestic debt stock / GDP:** This is a commonly-used measure of the level of domestic debt relative to the size of the economy.
9. **Domestic debt stock / Private Sector Credit (PSC):** This ratio helps monitor the extent to which government borrowing may be crowding out the provision of credit to the private sector.
10. **Domestic Interest Cost / Domestic Revenue (excluding grants):** This ratio captures the budget sustainability of the domestic debt. The benchmark captures a relatively higher risk of accumulation of domestic debt in Uganda due to the relatively low level of Domestic revenue to GDP.

- 11. Domestic Interest Cost / Total Government expenditure:** This ratio describes the share of total government expenditure that is directed to pay domestic interest costs. This, therefore, provides indicates the extent to which available resources are used to meet finance costs at the expense of growth-enhancing activities. The higher the ratio, the higher will be the risk of holding back economic growth.
- 12. Early Termination payment commitments** (including Force Majeure Termination) – if the PPP Agreement is terminated before the end of the concession, the Government may be required to pay an Early Termination Payment (depending on the underlying cause of the termination). The PPP Agreement will set out the costs to be included in the calculation of the compensation payment to be made by the Government.
- 13. Explicit Contingent Liabilities:** These are specific government obligations defined by a contract or a law. These include; publicly guaranteed debt (loan guarantees), Legal proceedings, etc.
- 14. Implicit Contingent Liabilities:** are not bound by any law or contract but are rather political or moral obligations and sometimes arise from expectations that the government would intervene in the event of a crisis or a disaster. These include; non- guaranteed public debt (debt of SoEs, Local Governments, amongst others).
- 15. Minimum revenue guarantees** – this type of guarantee ensures a minimum level of income for the private party, and the government must cover the difference if the income of the PPP is below the amount agreed in the PPP Agreement. A typical example is a toll-road where after the completion of the project the private partner gains income from charging a toll to the toll-road users, and the government will guarantee the amount of toll revenue received.
- 16. Percent maturing in any year after year one:** To avoid refinancing requirements being particularly concentrated in any single year, it is recommended to spread maturities evenly over the maturity curve. This risk control measure helps prevent rollover risk from being simply shifted to a later period, for example from year one to year two.
- 17. Percent Maturing in One Year:** This is the share of debt maturing in the next twelve months. High proportions are indicative of high levels of interest rate or rollover risk. The risk is more pronounced in less liquid markets.

## **18. The Public Finance Management Act (2015)**

The PFM Act (2015) states clearly that any multi-year financial commitment or contingent liability has to be authorised by the government. In Section 23(1) the Act states “a vote shall not enter into a contract, transaction, or agreement that binds the Government to a financial commitment for more than one year or which results in a contingent liability, except where the financial commitment or contingent liability is authorised by Parliament.

In addition, Section 36(1) vests the authority to raise money by a loan and to issue guarantees in the Minister. The section states “subject to the Constitution, the authority to raise money by loan and to issue guarantees for and on behalf of the Government shall vest solely in the Minister and no other person, public corporation, state enterprise or local government council shall, without the prior approval of the Minister, raise any loan, issue any guarantee, or take any other action which may in any way either directly or indirectly result in a liability being incurred by the Government.”

Section 39(1) of the PFM Act (2015) requires the Minister, with the approval of Parliament, on behalf of the GoU, to guarantee the repayment of the principal and interest and the other charges on a loan raised within or outside Uganda, by; (a) a state-owned enterprise, (b) a local government council, (c) any entity other than a local government council, which is required to be audited by the Auditor General, (d) or any private sector entity. Section 39(2), provides that, the Minister, prior to guaranteeing a loan shall determine that: (a) the intended purpose of the loan is consistent with government policy and is in public interest, and (b) the borrowing entity is capable of servicing the loan.

Section 39(3) states that a guarantee shall not exceed (a) the amount approved by Parliament in the Appropriation Act or Supplementary Appropriation Act of the financial year, or (b) exceed the targets for guarantee specified in the Charter for Fiscal Responsibility. However, no targets for guarantees have yet been defined in the latest official Charter for Fiscal Responsibility (2016). Section 39(4) of the PFM Act (2015) requires that the Minister tables before Parliament, by 1st April of each Financial Year, a report of the existing guarantees which shall include an analysis of the risk associated with those guarantees.

### **19. Local Government Act (1997)**

Section 84 of the Local Government Act (1997) states that a council may from time to time raise loans by way of debenture, issue of bonds, or any other method, in amounts not exceeding 25 percent of the locally generated revenue provided that a local government council demonstrates an ability to meet its statutory requirements.

Borrowing shall be exercised by a local government council:

- (a) with the approval of the Minister if the amount to be borrowed exceeds 10 percent of the total amount the local government council is eligible to borrow,
- (b) after the Auditor General has certified the books of account of the preceding financial year,
- (d) if funds are intended for investment in priority activities as identified by the whole council,
- (e) after the executive committee has given guarantee to the effect that repayment of the loan shall not adversely affect the operations of the local government council and, in particular, meeting the statutory obligations, including salaries.

**Share of Bonds/Bills:** A target for the share of Treasury bonds to bills outstanding within the domestic debt stock acts as a useful rule of thumb to help in achieving the benchmarks for managing refinancing risk.

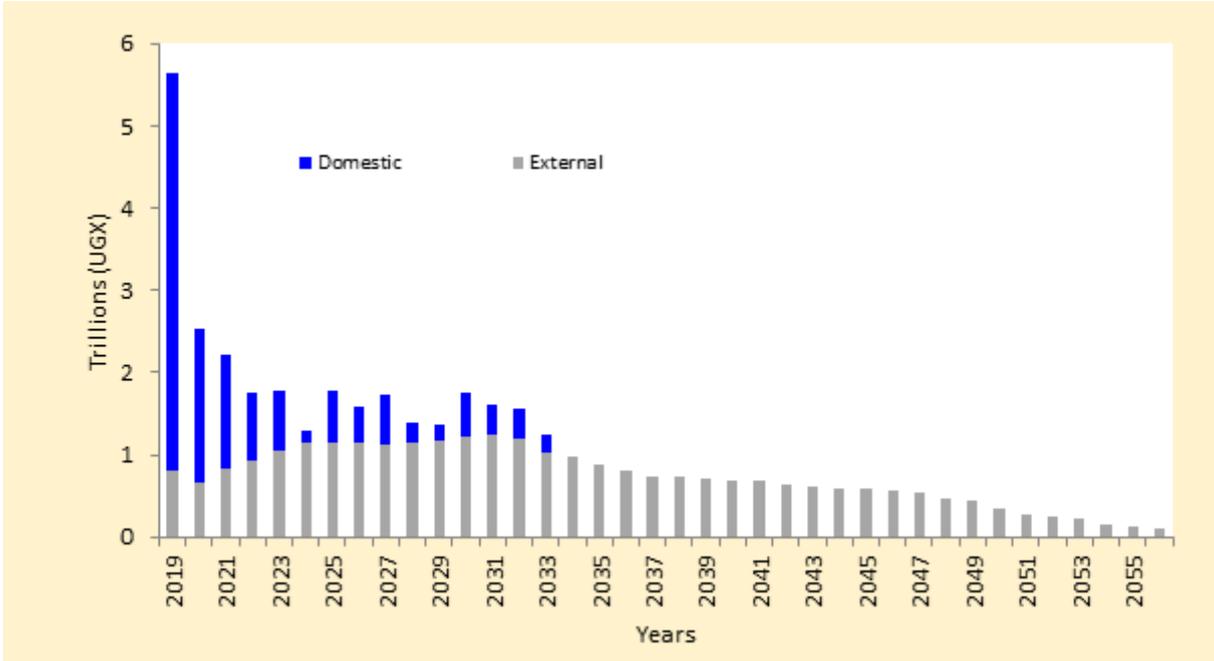
20. The on-lending arrangement is where the Government of Uganda-represented by the Ministers of Finance, Planning and Economic Development obtains a loan (usually concessional financing from an International Financial Institution (IFI) and then passes on the loan principal to another entity (usually a State-Owned Enterprise (SOE)), known as the *Beneficiary*. The loan between GoU and the IFI is called the *Primary Loan* and the on-lend loan between GoU and the Beneficiary is called the *Subsidiary Loan*.

Table 11: Best practices for guarantee fees

Country	Mechanism
<b>South Africa</b>	<b>30bps (0.3%) per annum on the nominal value</b> issued and on a pro-rata basis; <ul style="list-style-type: none"> <li>– Payable on issue date and annually thereafter</li> <li>– Should covenants be broken, the fee can increase</li> <li>– Fees are reviewed annually</li> </ul>
<b>Australia</b>	The guarantee fee rate charged to a borrower represents the difference between a market interest rate for a business of similar risk (credit rating) and the cost of debt obtained from the treasury. <ol style="list-style-type: none"> <li>1. A single rate is charged to all debt irrespective of its term.</li> <li>2. A rate applies to the loan until its maturity or a reset date elected by businesses at the time of establishing each loan.</li> <li>3. Consider credit rating in case of resetting. Where a rate reset is agreed, the prevailing guarantee fee at the time of the reset is that applicable for the credit rating of the corporation.</li> </ol>
<b>Vietnam</b>	The following caps will apply to different types of projects; The guarantee fee is determined by applying the applicable rate to the outstanding capital value of debt and is calculated monthly.
<b>Croatia</b>	The MoF charges each applicant for a guarantee a commission of <b>0.5% on the value of the guarantee</b> . The commission is paid into the guarantee reserves, for repayment of called guarantees.
<b>Sweden</b>	Charges the guarantee fee <b>based on the expected cost</b> unless the parliament explicitly decides otherwise
<b>Norway</b>	Parliament decided that state guarantee schemes should be self-financing, and guarantee fees are charged <b>based on expected costs</b>
<b>Canada</b>	Charges fees that <b>cover the estimated cost of future losses</b> and administrative costs.

# ANNEX 3: REDEMPTION PROFILE AS AT DECEMBER 2018

Figure 1: Redemption Profile as at December 2018



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