THE REPUBLIC OF UGANDA

Public Debt Management Framework

2013

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MINISTRY OF FINANCE, PLANNING AND ECONOMIC DEVELOPMENT

FOREWORD

Nearly two decades ago, Uganda's debt had peaked to unsustainable levels such that the economy did not have the capacity to meet its debt obligations. Fortunately, Uganda became the first country to qualify for debt relief under the Heavily Indebted Poor Country (HIPC) Initiative in 1998 and subsequently under the Enhanced HIPC in 2000. In 2006, Uganda benefited from another form of debt relief under the Multilateral Debt Relief Initiative (MDRI). All these debt reliefs eased Uganda's debt service obligations and our debt position has since remained sustainable.

Past Debt Strategies all emphasized debt sustainability and prioritized grant and concessional financing against any other form of financing. This Public Debt Management Framework 2013 (PDM2013) builds on previous Debt Strategies, and provides for a wide scope of debt management and financing alternatives to include a combination of concessional, non-concessional external and domestic financing. **The PDM2013 sets out the objectives, principles, guidelines and quantitative benchmarks and limits within which government will operate, and that will guide the contracting and management of government debt while maintaining a high degree of debt sustainability. The policy framework also provides guidelines to ensure that Uganda's borrowing is geared towards promoting rapid economic growth and ensures that most borrowing is contracted for projects that will yield high rates of return while maintaining Uganda's debt sustainability.** In summary, the PDM2013 sets out the overall policy, legal and institutional framework within which debt will be incurred, used and managed.

Consistent with this Public Debt Management Framework, a **"Medium Term Debt Management Strategy (MTDS)"** shall be prepared annually to inform each year's Budget financing decisions and to complement future publications alongside each year's Budget. The MTDS annual review shall incorporate an assessment of developments in the macroeconomic and fiscal outlook and the risk-cost trade-offs of alternative strategies to meet government's financing requirements and shall consider, *inter alia*, the impacts of alternative strategies on our debt sustainability and management indicators.

By formulating this policy framework, Uganda wants to take advantage of favourable domestic and external credit-market developments, in an organized manner that is consistent with government's primary debt policy objective of ensuring that the level of public debt remains sustainable, both in the medium- and long-term horizon while being mindful of the future generations.

While no debt policy can adequately capture the immense details required in public debt management, this policy framework provides clear direction to the contracting and management of public debt in Uganda and will be a necessary reference point for Ministries, Departments and all Government of Uganda Agencies (MDA's) in the financing of government programs across sectors.

I have no doubt that implementation of this Public Debt Management Framework 2013 will go a long way in enabling government to meet its financing requirements at the minimum cost possible subject to a prudent degree of risk, facilitating the government's plans to increase investment in projects with high returns to growth and socio-economic development while maintain a high degree of debt sustainability.

Maria Kiwanuka
MNISTER OF FINANCE PLANNING AND ECONOMIC DEVELOPMENT

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LIST OF ABBREVIATIONS

AfDB	African Development Bank
ALD	Aid Liaison Department
AO	Accounting Officer
ATM	Average Time to Maturity
ATR	Average Time to Re-fixing
BoU	Bank of Uganda
BPED	Budget Policy and Evaluation Department
BTTB	Background to the Budget
CCS	Commitment Control System
CPIA	Country Policy and Institutional Assessment
CSD	Central Securities Depository
DB	Directorate of Budget
DEA	Directorate of Economic Affairs
DMU	Debt Management Unit
DSA	Debt Sustainability Analysis
EAC	East African Community
EDS	External Debt Strategy
FMSD	Financial Management Services Department
GDP	Gross Domestic Product
GoU	Government of Uganda
HIPC	Heavily Indebted Poor Country
I&IA	Inspection and Internal Audit Department
IDA	International Development Association
IFRS	International Financial Reporting Standards
IPD	Implicit Public Debt
IFMS	Integrated Financial Management System
IMF	International Monetary Fund
LIC	Low Income Country
MCPC	Monetary and Credit Policy Committee
MDRI	Multi-lateral Debt Relief Initiative
MEPD	Macroeconomic Policy Department
MoFPED	Ministry of Finance, Planning and Economic Development
MOPS	Ministry of Public Service
MOU	Memorandum of Understanding
MTDS	Medium-Term Debt Management Strategy

MTEF	Medium Term Expenditure Framework
PAF	Poverty Action Fund
PDM2013	Public Debt Management Framework 2013
PEAP	Poverty Eradication Action Plan
PFAA	Public Finance and Accountability Act
PPG	Public and Publicly-Guaranteed
PPP	Public Private Partnerships
PV	Present Value
RTGS	Real Time Gross Settlements
SWG	Sector Working Group
TSD	Treasury Services Department

EXECUTIVE SUMMARY

The Public Debt Management Framework 2013 (PDM2013) is the 4th in the series of debt policy documents, in the form of Debt Strategies, that have seen Uganda's debt remain sustainable. The PDM2013 sets out an expanded scope for debt management; introduces important reforms to the use of debt; expands the coverage of debt instruments and other liabilities; and provides quantitative benchmarks and limits. The overall purpose of the PDM2013 is to guide the contracting and management of central government financial liabilities while being mindful of debt sustainability. This Policy Framework sets out the overall policy, legal and institutional framework within which debt will be incurred, used and managed.

A **"Medium Term Debt Management Strategy (MTDS)"** shall be prepared annually, to inform each year's Budget financing decisions and to provide Government's detailed financing strategy for the 5-year Medium Term period, which shall be consistent with the provisions set out in the Public Debt Management Framework. The MTDS will be reviewed annually and the detailed financing strategy for the year ahead will set out, *inter alia*, the total amount to be raised through each available borrowing instrument in order to meet the annual budget financing requirement.

The **main strategic objectives for Public Debt policy** in Uganda are:

(i) to meet Government's financing requirements at the minimum cost, subject to a prudent degree of risk;

(ii) to ensure that the level of public debt remains sustainable, both in the medium and long term horizon while being mindful of the future generations; and

(iii) to promote the development of the domestic financial markets.

The PDM2013 expands the scope of debt from the traditional concessional financing to alternative means of financing (still to be contracted at minimum cost and risk). These include but not limited to; non-concessional financing and borrowing from the domestic market to help meet financing needs for infrastructure development. This scope also recognises the liabilities that arise out of obligations under Public Private Partnership (PPP) arrangements, and other forms of non-debt direct and contingent liabilities. Under this Debt Policy Framework, Government will recognise these liabilities as they materialise, and publicly disclose contingent liabilities as appropriate.

The Strategy provides key quantitative thresholds which will act as benchmarks for compliance. Amongst these, a key threshold is that the present value of public debt to GDP ratio will not exceed 50% at any time during the implementation of the PDM2013. Details of the overarching objectives, principles and limits within which debt operations are to be executed are embedded in this document.

PDM2013 also sets out Government's commitment to conducting debt policy in line with the principles of openness, transparency and predictability by, *inter alia*; publishing a regular Debt Statistical Bulletin, an annual Debt Management Report, and regular Treasury Bond auction calendars. To further improve the conduct of debt management, the MoFPED intends to set up a Debt Management Unit within the Ministry with the intention to centralise all debt management functions and to provide a concentrated central body of expertise with clear overall responsibility for debt management.

Finally, it is stressed that the contracting of debt shall continue to be conducted only in the context of continued efforts to increase domestic revenue mobilisation and to improve the efficient and effective use of all resources irrespective of their source.

CHAPTER 1 - Introduction

Past Debt Strategies have, to some extent, generally covered a broad scope of debt management that included debt policies, debt limits, and debt terms; primarily focusing on debt sustainability. The Public Debt Management Framework 2013 (PDM2013) retains this strong focus on debt sustainability and shall be supplemented with an annual rolling medium-term debt management strategy (MTDS)[1]. The Debt Policy Framework sets out the overall policy, legal and institutional framework within which debt will be incurred, used and managed. It details the objectives, principles, guidelines and quantitative benchmarks to guide debt policy and to enhance transparency and accountability. It also broadens the scope for debt management beyond traditional explicit external and domestic debt; to include implicit debt and contingent liabilities such as those arising from public private partnerships.

This policy framework is an integral part of the Government's overall macroeconomic framework, and encompasses fiscal policy, monetary policy, cash management, debt management, and financial market development considerations.

1.1 The Public Debt Policy Strategic Objectives

The objectives are:

1. to meet Government's financing requirements at the minimum cost, subject to a prudent degree of risk;
2. to ensure that the level of public debt remains sustainable, over the medium- and long-term horizon while being mindful of the future generations; and
3. to promote the development of the domestic financial markets.

Objective (1) is the primary <u>debt management</u> objective. A given financing requirement, in line with the overall Medium Term Fiscal Framework (MTFF) and consistent with

[1] The MTDS focuses more explicitly on the characteristics of the debt portfolio, by outlining the government's preferred composition of the debt portfolio taking into account the cost-risk trade-offs inherent in debt management and the broad plan through which it intends to implement to achieve the preferred portfolio composition.

objective (2), will be met in the most cost-effective way, taking into account GoU's risk appetite.

Objective (2) is the primary objective of debt policy. The objective of ensuring debt sustainability will be met through both appropriate fiscal policy decisions and debt management decisions.

Objective (3) makes it clear that GoU will in its debt management operations seek to promote the development of a well-functioning and vibrant domestic debt market.

1.2 Scope of Debt

The scope of debt covered in this Debt Strategy is Public and Publicly Guaranteed Debt (PPG). This includes external debt, which is defined as debt denominated in foreign currency, and domestic debt, contracted either through explicit or implicit borrowing. Domestic debt is defined as the stock of Shilling-denominated liabilities excluding the stock of domestic arrears, and is taken to incorporate Shilling-denominated central government securities. The scope of implicit debt covered includes accrued rights under the Public Service Pension Scheme, and contingent liabilities such as loan guarantees by Government and those arising from Public Private Partnerships.

Domestic arrears, treated separately in this Part, refer to bills remaining outstanding beyond the fiscal year in which they are incurred. For capital projects, arrears refer to outstanding certificates[2] after project completion. Notwithstanding, under article 159 (7) of the 1995 Constitution, a loan includes any form of borrowing in respect of which moneys from the Consolidated Fund or any other public fund may be used for payment or repayment. Therefore, while domestic arrears would in principle form part of Uganda's public debt, a separate treatment is accorded in this Debt Strategy especially because of the way domestic arrears materialise.

[2] Certificates are in effect a notice of obligation for Government to pay a contractor for having met a certain agreed output.

CHAPTER 2 - Principles and Guidelines For Debt Management

2.1 Previous Debt Strategies and Objectives

The past Debt Strategies in Uganda have all prioritized debt sustainability while emphasizing reliance on highly concessional financing. The first External Debt Strategy (EDS), prepared in 1991, was in pursuit of debt relief. This was revised in 1995, placing huge emphasis on reduction of the debt burden. Following a series of debt reliefs under HIPC and the MDRI, a revised Debt Strategy 2007 (DS2007) was prepared and published, effective for the five years to 2012. The overriding objectives of the DS2007 were: (i) to ensure medium- and long-term external debt sustainability; (ii) to ensure consistency between the level of external financing and the wider macroeconomic objectives of fiscal consolidation and reduced aid dependency; (iii) achieve the desired and appropriate level of external financing at minimum cost to Government; and (iv) prioritise borrowing for productive sectors.

While the key objective for the PDM2013 remains to ensure debt sustainability, the Strategy represents a shift, however, from the fundamentals of broad debt policy to include the key uses of debt. As a strategy, GoU shall continue to borrow for social services development under highly concessional terms. Notwithstanding, the main purpose for borrowing under this PDM2013 framework is to fund expenditures that aim to enhance economic growth and productivity, with a high rate of economic return. As part of this the framework, in addition to the traditional concessional financing, provides principles and guidelines to domestic borrowing, Public Private Partnerships (PPPs) and Contractor Facilitated Financing (CFF).

<u>Note</u> that CFF terms could be concessional, less concessional, or non-concessional, and so are inherently captured in the financing options set out below. In addition, the government's direct financial commitments under PPPs can be financed through domestic financing, non-concessional loans, or a combination of both, and therefore also do not require a specific financing option in addition to those set out below.

The remainder of this Chapter covers: a set of principles that underpin debt policy; and a set of operational guidelines and quantitative limits (in general terms, and in specific terms for External and Domestic financing). These are set out in turn below.

2.2 General Debt Strategy Principles

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

1. The contracting of debt will be part of GoU's broader strategy for increasing the availability and effective use of resources – in particular, GoU will continue to prioritise efforts to raise Uganda's tax-to-GDP ratio, and improve the value-for-money that is achieved in public spending.

2. As a priority, borrowing must be for highly-productive fixed capital investments and GoU will seek to secure direct financial and economic returns.

3. Debt management operations will meet the principles of openness, transparency and predictability.

4. GoU will fully-fund its borrowing requirement each year – with no borrowing from the Bank of Uganda over each financial year as a whole.

2.3 General Operational Guidelines and Benchmarks

This section lays out a set of guidelines and quantitative benchmarks/indicators that will guide aggregate debt policy, to support the delivery of the objectives and principles set out above. To complement the aggregate guidelines and benchmarks below, more specific guidelines on external and domestic debt are set out in Sections 2.3 and 2.4 below. Government will aim to ensure that all the quantitative benchmarks set out in this Debt Strategy are met in every individual year of the 2013 Debt Strategy. The guidelines and benchmarks/indicators are:

(1) 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,** which is consistent with the macroeconomic convergence criteria on debt, under the EAC Monitory Union Protocol

(2) In order to enhance asset formation, productivity and competitiveness, borrowing shall be prioritized over the five year period of this Strategy, to the following sectors: **Works & Transport, Agriculture, Water and Energy.**

(3) 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%**.

(4) Interest rate risks: The policy shall continue to contract debt on fixed interest rates during the lifetime of this Debt Strategy.

(5) **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 framework.

The table below summarises the quantitative guidelines discussed above, and compares them to the estimated value for end-FY2012/13.

Total Debt Quantitative Sustainability and Risk Benchmarks		
	Benchmark	**June 2013**
Present Value of External debt stock / GDP	**<30%**	**11.1%**
Present Value of Domestic debt stock / GDP	**<20%**	**11.2%**
Present Value government debt stock / GDP	**<50%**	**22.4%**
Total Domestic debt interest payments / Total revenues (excluding grants)	**< 15%**	**12.1%**
Total Domestic debt interest payments / Total expenditure	**< 10%**	**8.5%**
Foreign currency-denominated debt as a share of total debt	**< 80%**	**62.1%**
Sovereign credit rating	Maintain or improve	**B+** (Standard &Poors) **B** (Fitch)

2.3.1 Reporting Framework

The reporting under the PDF2013 shall follow the reporting requirements under relevant legislations governing public debt management and policy

a) Annual Budget and financing plan

The Annual Budget will continue to clearly set out GoU's net and gross domestic and external financing requirements, and specific financing plan, for the year ahead, consistent with the Medium-Term Debt Management Strategy.

b) Annual Debt Management Report

The MoFPED will expand the Loans, Guarantees and Grants Report to be published and submitted annually to Parliament to include; a comprehensive portfolio review, and cost and risk analysis of Central Government outstanding debt. The report will also include, *inter alia*, an evaluation of how debt management activities have complied with the objectives, principles and guidelines set out under this framework, the Medium-Term Debt Management Strategy, and with the annual year-ahead Budget financing plan.

c) Semi-annual Debt Statistical Bulletin

The MoFPED will prepare and publish on our website a debt statistical bulletin, on a semi-annual basis (in March and September each year), covering domestic and external central government debt and loan guarantees. The bulletin will provide information on central government debt stocks (broken down by creditor, residency classification, instrument, currency, interest rate basis, and residual maturity), debt flows (principal and interest payments), debt ratios and indicators, and risk measures of the debt portfolio

d) Debt Sustainability Analysis (DSA)

The MoFPED shall continue to conduct an annual debt sustainability analysis, and publish the findings on the MoFPED website.

2.4 External Debt Policy Framework

To date, Uganda's external debt has primarily been contracted under concessional terms. This Debt Strategy mandates that external financing shall continue to be primarily focused on concessional borrowing with a waiver for a degree of non-concessional borrowing, under appropriate, strict conditions (in particular, that any such borrowing be for highly-productive fixed capital investments; see below).

Government will focus on borrowing for purposes that will enhance productivity and economic growth, and generate an economic return. In order to achieve the Debt Management Framework Objectives (1) and (2) *(i.e. meeting financing requirements at minimum cost subject to prudent risk; and ensuring debt sustainability),* the following specific principles and guidelines including the respective quantitative limits are cardinal.

2.4.1 External Debt Policy Principles

Achievement of the set objectives under this PDF2013 requires a clear, transparent strategy – as embodied in the set of underlying principles to guide the contracting and use of external public debt, and specific guidelines, set out below.

a) Government shall continue to pursue concessional loans as the preferred means of meeting external financing requirements.

b) GoU will seek to achieve the most beneficial and cost-effective terms and conditions for external financing.

c) External borrowing will be primarily focused on productive sectors and those interventions that will enhance productivity. Some borrowing, on highly concessional terms, will continue to be sought for social services projects/programmes to help meet Government's social services delivery objectives.

d) Non-concessional borrowing will only be considered for financing of projects that will provide an economic rate of return greater than the interest rate charged. Any highly non-concessional loans, such as a Eurobond, will only be issued to finance projects which not only provide a higher economic return than the interest rate on the loan, but which also enable GoU to generate a sufficient fiscal return to meet the cost of the loan.

e) The following conditions shall apply to all new external borrowing:

   (i) Loans for social service delivery and development must be highly concessional i.e. **"IDA comparable or better terms (40 year maturity, 10 year grace period, 0.75% interest)** or with a grant element[3] of not less than 50%.

   (ii) Loans for projects intended to enhance productivity but on less concessional terms than those in (i) above must provide **terms with a minimum of (23 year**

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[3]*The grant element measures the concessionality (softness) of a loan and reflects the financial terms of a transaction: interest rate, maturity (interval to final repayment) and grace period (interval to first repayment of capital). It is calculated as the difference between the face value of a loan and the discounted present value of the service payments the borrower will make over the lifetime of the loan, expressed as a percentage of the face value.*

maturity, 6 year grace period and interest rate p.a. of not more than 2%) or a grant element of not less than 35%.

(iii) Non-concessional loans must provide **a grant element of not less than 25%**

(iv) Non-concessional financing and any other external financing options, other than those in i) **and** *ii) above,* ***shall*** *only be used to finance financially and economically* viable projects, where financial returns are expected, and the project being financed should start generating revenues for government within a period of not more than 5 years.

(v) For major infrastructure projects, GoU may consider a Eurobond issue where such large multilateral and/or bilateral external financing may not be available for terms in (i) to (iv) above.

(vi) Government may on occasion need to contract a large loan in a single year to finance a major project under the National Development Plan. In this case, the Present Value of GoU's debt to GDP ratio should not exceed 50% (nor must any other quantitative limit be breached – see below).

(vii) The minimum amount for any external borrowing shall be US$5 million. This is intended to maximise the benefits of any external borrowing while minimising costs related to contracting the loan.

f) Contractor Facilitated Financing (CFF) is an option of mobilizing external financing where the Government allows contractors to facilitate the process of sourcing for financing required to undertake projects from Financial Institutions. Under this approach, Contractors are required to submit bids (technical and financial) to Government and the best bidder is selected not only on the technical **competences but also on who offers the most acceptable terms of financing, consistent with the conditions set in the Debt Strategy 2013.**

To the extent possible, the external financing terms to be considered for CFF shall be comparable or better than those in the conditions e)(i) to e)(iii) above, which shall apply to all external borrowing. Acceptability of loan terms shall be judged on the following terms of financing:

- Maturity period
- Interest rates, penalty charges, commitment fees etc.

- Grace and repayment period; and
- Any other requirements of the potential financier.

The above loan terms shall have to be signed off by both the financing institution and the contractor, and stamped by an official seal of both parties.

2.4.2 Operational Guidelines and Benchmarks

The Country Policy and Institutional Assessment (CPIA[4]) framework considers sustainability of a country's debt against pre-determined thresholds, referenced to the country's institutional strength and quality of policies assessed under the CPIA framework. Notwithstanding the thresholds under the CPIA for Uganda, the 2013 Public Debt Strategy sets the PV of debt-to-exports of goods and services (PV/XGS) threshold to 150% for better planning and hedging. The other thresholds are maintained as follows:

External Debt Sustainability Benchmarks	**Thresholds**	**2013 DSA Results**
Solvency Ratios (%age)		
Present Value of External Debt to GDP (PV/GDP)	**30**	**9.0**
Present Value of External Debt to Export of Goods & Services (PV/XGS)	**150**	**37.8**
Present Value of External Debt to Domestic Budget Revenue (PV/DBR)	**300**	**68.0**
Liquidity Ratios (%age)		
Total External Debt Service to Export of Goods and Service (TDS/XGS)	**25**	**2.2**
Total External Debt Service to Domestic Budget Revenue (TDS/XGS)	**35**	**4.0**

External Debt Portfolio Risks: Although the bulk of the external debt portfolio comprises of concessional loans, there are costs and risks associated with it, and new sources of external financing (particularly less-concessional and market borrowing) open up new cost and risk considerations. The benchmarks above set out a framework within which to manage cost, risk and sustainability considerations. Important risks to consider related to Uganda's external debt portfolio include currency and rollover risks.

[4]*The current external debt sustainability thresholds under the framework applicable for Uganda (which is that for countries assessed to be "high-performers") are: i) PV of debt to GDP (PV/GDP) – 50%, ii) PV of debt-to-exports of goods and services (PV/XGS) – 200%, iii) PV of debt-to-domestic budget revenue excluding grants (PV/DBR) – 300%, iv) total debt service-to-exports of goods and services (TDS/XGS) – 25%, and v) total debt service-to-domestic budget revenue (TDS/ DBR – 35%).*

a) **Rollover risk issues:** Owing to long grace periods and back loaded amortisation schedules, the current external loans portfolio, composed of largely concessional loans, does not exhibit significant refinancing risks. Nonetheless, if shorter-term, non-concessional borrowing is undertaken, clear guidelines shall be developed to be followed in order to avoid any bunching up of payments that may result in rollover risks.

b) **Currency Risk Issues:** Given the country's current external debt portfolio, with all loans contracted at fixed interest rates, currency risk is by far the most important risk that deserves due attention. Specific benchmarks for currency composition to mitigate the effects of currency risk shall be provided annually while providing details and strategies for the budget financing requirement.

2.5 Domestic Debt Policy Framework

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

2.5.1 Domestic Debt Policy Framework

Under the 2007 Debt Strategy, domestic debt issuance was conducted only for monetary policy purposes, with no explicit issuance conducted for fiscal policy purposes, or for cash management purposes. Reflecting the needs and opportunities created by developments in Uganda's macroeconomic circumstances, particularly the continued growth of Uganda's financial sector and the introduction of the inflation targeting 'lite' monetary policy framework, PDF2013 introduces significant reforms to the policy framework for the issuance of domestic debt.

Under the PDF2013, Treasury securities issuance will be conducted primarily for fiscal policy 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. The focus of monetary policy will be on secondary market operations (repos, reverse repos and direct secondary market sale and purchase of securities)

2.5.2 Domestic Debt Strategy Principles

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

1. 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 forms of all other financing.

2. GoU will fully-fund its domestic borrowing requirements - with no borrowing from the Bank of Uganda over each financial year as a whole.

3. Any Treasury securities issuance for monetary policy purposes must be closely coordinated with and clearly separated from issuance for fiscal policy purposes.

4. Domestic debt operations will be conducted to meet the principles of openness, transparency and predictability.

2.5.3 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 PDF2013 objectives, and against which the performance of domestic debt policy will be monitored and assessed in future.

2.5.3.1 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 this issuance of government securities.

Total net securities issuance allowed in any one 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 over the course of a financial year, and it is deemed desirable and prudent to accommodate some of those fiscal pressures by taking on additional 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.

c) Cash management

Cash management operations – that is, the process of ensuring that GoU always has cash available to meet its expenditure needs as they arise – will be conducted using Treasury securities issuance. In addition to the benefit of more fully insulating monetary conditions from fiscal operations, this reform also has the additional benefit of supporting greater activity in the Treasury Bill market, and in so doing to further strengthen development of the financial sector.

2.5.3.2 Domestic Debt Sustainability Benchmarks

In setting its domestic borrowing requirement, GoU will 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, and with private-sector led economic growth. These benchmarks – discussed in turn below and details of their definitions in the Glossary – 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.

Domestic Debt Sustainability Benchmarks		
	Benchmark	**End June 2013**
Present Value of Domestic debt stock[5] / GDP	**<20%**	**12.2%**
Domestic interest cost / Domestic revenue (excluding grants)	**<15%**	**12.1%**
Domestic interest cost / Total Government Expenditure	**<10%**	**8.5%**
Domestic debt stock / Private Sector Credit	**<75%**	**74.6%**
Sovereign credit rating	Maintain or improve	**B+ (Standard &Poors)** **B (Fitch)**

[5] Nominal value of domestic is a proxy to the Present value of domestic debt

Domestic debt stock / GDP: Uganda's estimated domestic debt stock to GDP as at end-FY2012/13 is 11.1 percent. However, this figure does not take into account the burden on the budget or potential crowding out of the private sector – and so needs to be supplemented with additional sustainability indicators.

Domestic Interest Cost / Domestic Revenue (excluding grants): Currently this ratio is estimated at 10.7 percent as end-FY2012/13 against the set benchmark of <15 percent. 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.

Domestic Interest Cost / Total Government expenditure: The estimate for end-FY2012/13 is 7.5 percent compared to the set benchmark of <10 percent. The ratio provides an indication of the extent to which available resources are used to meet finance costs at the expense of growth-enhancing activities.

Domestic debt stock / Private Sector Credit (PSC): Limiting this ratio to 75% in each year, it ensures that the government's domestic debt stock will not grow faster than the stock of PSC. The end-FY2012/13 ratio estimate is 75.1 percent

2.5.3.3 Benchmarks for cost minimisation subject to risk

The objectives of interest cost minimisation and risk management must be considered together; whilst GoU will aim to minimise both cost and risk as far as possible, there is often a direct trade-off between the two. In attempting to minimise domestic debt costs it is therefore necessary to also ensure that the level of risk incurred – for example in terms of refinancing risk, market risk, liquidity risk and operational risk – is also prudently managed.

Risk Management Benchmarks		**End June 2013**
Percent maturing in 1 year	**< 40%**	**57.2%**
Percent maturing in any year after year 1	***< 20%***	**17.0%; 11.6%, for maturities in 2 and 3 years respectively, and remainder for maturities beyond 3-years**
Ratio of bonds/bills	**70/30**	**62.0/38.0**
Average Time to Refix (ATR) (Years)	**>3 Years**	**1.8 years**
Average Time to Maturity (ATM) (years):	**>3 Years**	**1.8 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 in turn below.

These benchmarks primarily focus on refinancing risk – that is, the exposure of the debt portfolio to unusually higher interest rates at the point at which debt is being refinanced (or, in extreme cases, being unable to fully refinance maturing debt).

Average Time to Maturity (ATM): The end-FY2012/13 estimated ATM is 1.7 years, indicating an average life for the current domestic debt which is lower than the target of 3 years that will be pursued under PDF2013 to lower the refinancing risk exposure.

Percent Maturing in One Year: 57.2 percent of the current domestic debt is estimated to maturing in the next twelve months while 17 percent and 16 percent of the debt is estimated to mature in 2 years and 3 years respectively. The benchmark for the percentage of domestic debt maturing in one year set in PDF2013 is 40%, down from 50% in DS2007.

Percent maturing in any year after year one: Under PDF2013, the share of the domestic debt portfolio maturing in any year after year one (the coming twelve months) will be capped at 20%. This risk control measure helps prevent rollover risk from being simply shifted to a later period, for example from year one to year two.

Share of Bonds/Bills: The target ratio for the Bonds/Bills mix was set at 60/40 in DS2007, and closed the FY2012/13 at 62.3/37.7. The share of Bonds to Bills under PDF2013 is revised to 70/30 to help underpin the increased issuance of longer term instruments relative to shorter term instruments.

Average Time to Refix (ATR): Using the stock of government securities as of end-June 2013, ATR is estimated at 1.7.

GoU will also monitor the full **shape of the redemption profile.** By studying the shape of the redemption profile it is possible to make a qualitative analysis of the refinancing risk of the debt stock. As part of this, GoU will note where there are 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 should be assessed before new issuances are made to evenly ration redemptions across the maturity structure of the domestic debt portfolio.

2.5.3.4 Measures to support the development of the Treasury securities market

Measures 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) A Bond issuance calendar will be published each quarter, setting out the timing and type of securities issuance over the upcoming quarter.

c) MoFPED will publish any changes to the planned volume of issuance and issuance calendar as soon as practically possible. 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. GoU will also maintain a regular dialogue with Treasury securities investors.

d) 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.

e) To further support improvements in debt management, the yield curve will be lengthened by issuing longer-term Treasury Bonds, beginning initially with 15-year Bonds, and infrastructure bonds may be issued.

f) MoFPED will pursue a benchmark bond programme – reopening select past securities in order 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.

g) MoFPED will continue to issue Treasury Bonds with only fixed coupon payments, rather than floating coupon payments.

h) MoFPED will continue to conduct the issuance of Treasury securities to investors solely through competitive auctions.

2.6 Domestic Arrears Management

The accumulation and continued non-payment of arrears poses significant risks to Uganda's economy. Firstly, the accumulation of arrears distorts budget implementation. As arrears constitute off-budget expenditures, they may easily channel resources to non-priority areas. Secondly, domestic arrears arising from non-payment of bills and invoices threaten the survival of private firms by undermining their liquidity positions. Businesses are forced to impose a premium on charges to mitigate risks associated with delayed payments, increasing the fiscal cost of doing business with the private sector. Furthermore, the continued non-payment of pension arrears is a major impediment to the reduction of poverty levels as these arrears directly affect the welfare of Uganda's pensioners. These have been perpetuated by a number of weaknesses notably: 1)The continued provision of a domestic arrears budget serves as an incentive for the creation of new arrears; and 2)Lack of commitment to the implementation of measures to stem the creation of new arrears. In view of these challenges that have constrained the existing arrears management framework. **The new framework for managing domestic arrears is to be based on the following principles:**

1. Restrict the traditional domestic arrears budget to court awards which in practice are unpredictable and difficult to budget for ex-ante without being pre-judicial

2. All other arrears to be dealt with on a rolling basis within the budgets of the responsible MDAs. This is consistent with the current treatment of the other categories of domestic debt. Additionally, this treatment has in-built penalties on the errant MDAs and ensures prompt clearance of domestic arrears as a first call on MTEF resources

3. The prepayment system will be expanded to all other utilities including water and electricity.

4. Fixed costs will have a first call on the MTEF.

5. **Transparency** –a “shame list” for those ministries and Accounting Officers who over commit government without authority be published on a quarterly basis.

6. **Subscriptions to international organisations** –memberships to international organizations be rationalised to scale back on the level of outlays on this expenditure item.

CHAPTER 3 - Institutional and Legal Framework

This Chapter first provides a brief overview of the existing legal framework and institutional arrangements, and then the future planned institutional framework.

3.1 Current Legal Framework

The legal framework for Uganda's debt policy and management is set out in the 2005 Constitution, the Treasury Bills Act 1969, the Bank of Uganda Act 2000, the Budget Act 2001, and in the Public Finance and Accountability Act 2003.

Under Article 159 (1) of **the 2005 Constitution,** Government of Uganda can borrow from any source and such borrowing must be expressly approved by Parliament. **Subject to the proposed amendments, the Public Finance and Accountability Act, 2003 (PFAA)** outlines the control and management of public finance, including the regulation of Government borrowing. Section 20 of the PFAA vests the authority to raise money by loan in the Minister of Finance and such loans may be raised in any appropriate form, including Treasury bills and bonds[6]. Consistent with the Constitution, the PFA Act requires such loans to be explicitly approved by a resolution of Parliament. The PFA Act further requires that as part of the presentation of the budget to Parliament, the cost of servicing all loans in the given year should be detailed, as well as the amount expected to be raised from loans and grants during the course of the year. **The Budget Act, 2001** provides the regulatory framework for the planning and reporting function of MoFPED. Section 13 of the Budget Act requires the indebtedness of the State, as well as information relating to guarantees of loans and grants, to be presented to Parliament. The information presented must include the total principal and sources of the debts; the accumulated interest; provision for servicing or repayment; the balance on payment of this provision; and the utilisation and performance of each loan against its objective targets.

The legal framework for public debt management and debt policy development is therefore well entrenched in different Acts of Parliament

3.2 Current Institutional framework for Public Debt Management

While the ultimate authority to raise loans and issue guarantees on behalf of Government is vested in the Minister of Finance (PFAA 2003), several stakeholders play an important role in debt mobilisation and execution. These include: the MoFPED, the BoU, the Office of the Accountant General, Parliament and the line ministries. MoFPED identifies the

[6] As specified in Section 22

overall budget financing needs consistent with the fiscal and debt sustainability frameworks. A Debt Sustainability Analysis (DSA) is carried out annually by the MoFPED as the lead institution, with BoU, 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 MoFPED advises on the overall debt management policy. The roles of the respective stakeholders in contracting new loans and management of the external debt portfolio can be summarised as follows:

Debt policy formation and performance evaluation

Assigned responsibility/ activity	Stakeholder
Identify overall financing needs	MoFPED
Undertake Debt Sustainability Analysis (DSA)	MoFPED & BOU
Advise on overall external& domestic debt policy	MFPED

Contracting new project loans

Assigned responsibility/ activity	Stakeholder
Identify priority projects	SWGs
Submit project proposals to DC (by 31st December)	SWGs
Scrutinise and approve new projects (January to June)	MoFPED (Development Committee)
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
Seek Parliamentary Approval	MoFPED / Relevant Ministry
Approve new loans	Parliament
Provide opinion on the legality of each external loan	Minister for Justice/ Attorney General
Inventory of loan agreements	MoFPED and BoU

Recording, reporting and repayment of loan portfolio

Assigned responsibility/ activity	Stakeholder
Effect debt service repayments	BoU
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
Service Government debt payments and Government guaranteed loans	MoFPED
Monitor project execution	MoFPED
Manage Government's overseas bank accounts	MoFPED
Review and approve withdrawal applications by issuing audit warrants	MFPED
Examine and issue audit certificates on project expenditures	MoFPED
Present to Parliament before 15thJune specified information related to external borrowing (Budget Act 2001)	MFPED

Acct. Gen = Office of the Accountant General; OAG = Office of the Auditor General, MFPED = Ministry of Finance, Planning and Economic Development

3.3 New Legal and Institutional framework

3.3.1 Public Financial Management Bill,

The Public Finance Management Bill (PFM Bill) broadly covers public debt management with detailed provisions for fiscal responsibility, which requires the Minister to maintain a prudent level of Government debt to ensure that the burden of debt is shared between generations. These provisions once enacted, shall strengthen the debt management and debt policy function in Uganda.

3.3.1.1 Debt Management Unit

MoFPED will set up a Debt Management Unit (DMU) within MoFPED, by the end of the fifth year from date of this Public Debt Strategy. The DMU will centralise debt management functions (both domestic and external) – taking on all middle office functions (including overall responsibility for debt analysis and strategy), and back office functions (including processing of payments and record-keeping) – and so providing a concentrated central body of expertise, with clear overall responsibility for debt management. BoU will remain as an agent of GoU, but with its functions limited to only the issuance of domestic debt securities. During the interim, BoU will also continue to manage the back-office functions of operating the CSD and RTGS systems after which, the function shall be transferred to the DMU upon a comprehensive review of the DMU's technical capabilities.

CHAPTER 4 - Management of other Direct and Contingent Liabilities

The recognition of domestic debt liabilities in Uganda has previously been limited to Treasury bills and bonds, operational arrears and government guarantees. There are a number of direct and indirect/implied liabilities that to date had not been recognised or regularly estimated. These include contingent liabilities[7] arising out of different PPP arrangements/contracts; and Implicit Public Debt (IPD)[8].

The Public Debt Strategy 2013 recognises these liabilities, which are relevant to estimating the total liability exposure of government. This is intended to ensure prudent management of direct and contingent liabilities arising from such contracts/arrangement.

Under the PDF2013, the MoFPED will produce and publish annual estimates of contingent liabilities. Contingent liabilities will be recorded, monitored and analysed to determine the current and future budgetary implications, and to provide an early warning system of any future pressures.

The following sub-sections provide details on how IPD and liabilities under PPPs will be managed.

4.1 Implicit Public Debt (IPD)

Implicit Public Debt, unlike contingent liabilities, is a current government obligation arising from a past event where an outflow of funds is certain. However, IPD is often not recognised or estimated by governments. Financial markets the world over are increasingly aware of potential fiscal constraints imposed by IPD, and can adjust the risk premium placed on governments' debt accordingly. Credit rating agencies are also

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[7] *A contingent Liability is: (a) A possibility that arises from past events and whose existence will be confirmed only by the outcome of one or more uncertain future events not wholly within the control of the entity; (b) A present obligation that arises from past events, but does not meet the criteria for recognition as a provision. This is either because an outflow of economic benefit is not probable, or (more rarely) because it is not possible to make a reliable estimate of the obligation.*

[8] The scope of IPD is limited to the pension accrued rights under Uganda's unfunded public service defined benefit scheme as described in the Pension Act (CAP 281-laws of Uganda).

increasingly taking this risk exposure into consideration while evaluating a country's risk rating. Credible estimates and disclosure of IPD is therefore increasingly relevant.

GoU will use the "accrued-to-date-liabilities" method for estimating IPD – which, *inter alia*, provides a reliable pension rights/obligations position at a particular cut-off or reference date. Consistent with International Financial Reporting Standards (IFRS), under this Strategy the presentation of IPD in the financial statement will be treated as a "provision". The amount recognized as a provision will be the best estimate[9] of the expenditure required to settle the present obligation as at the balance sheet date.

4.2 Public Private Partnerships

Public private partnerships (PPPs) are arrangements characterized by joint working between the public sector and private sector. It is possible in many projects to use private sector finance and management expertise to provide services and related assets which would traditionally have been financed and operated by the public sector. A significant challenge with PPPs is the financing arrangements, which can involve both direct and contingent liabilities for government. This section provides guidelines that will be followed to help manage these challenges.

PPP arrangements can be very complex and the fiscal risk they expose government to can be difficult to measure and monitor. This section sets out guiding principles that will be followed in the selection and management of PPPs to manage the direct and contingent liabilities for government from PPPs.

Government obligations under PPP agreements can be of three main forms: direct payments for the delivery of services under the agreement; obligations arising from the termination of the PPP agreement; and the issue of guarantees, indemnities or security on behalf of the private partner.

Government guarantees in PPPs could potentially take many forms, such as financial guarantees or performance guarantees. Government will, as the preferred means of arranging contracts, not incorporate any guarantees in to PPP contracts. However, if any

[9] The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the balance sheet date or to transfer it to a third party at that time *(International Financial reporting Standard "IFRS")*.

guarantees are included, government will clearly identify, calculate and publicly disclose them.

Deciding whether to assume such liabilities and, if so, determining how to value, monitor, and limit them tends to be difficult for most governments. These obligations will be recognised as a liability as required by IFRS, and provisions made in line with IFRS.

Public-private partnerships (PPPs) can potentially incorporate contingent liabilities (relating, for example, to early contract termination or to debt and revenue guarantees). Contingent liabilities are complex, and no single measurement approach can fit all situations. Contingent liabilities are obligations that arise from a particular, discrete event(s) that may or may not occur. The key aspect which distinguishes such liabilities from current financial liabilities (and external debt) is that one or more conditions or events must be fulfilled before a financial transaction takes place. This therefore requires careful project preparation, competitive bidding, and review of proposed PPPs before a contract is signed. The review should properly identify and assess all the obligations to the agreement in a transparent way. Therefore, there is a need to ensure comprehensive monitoring of contingent liabilities to help safeguard the fiscal position.

Finally, as a good practice, it is important to separate the PPP unit from the review of contingent liabilities and other fiscal implications. This is mainly because one of the functions of a PPP Unit may indeed be to promote the use of PPPs, which may hinder the unit's vigilance in limiting contingent liabilities.

The following guidelines, in addition to the above, will be adopted for managing PPP liabilities:

a) The costs and risks of contingent liabilities will be quantified and disclosed.

b) MoFPED will review the direct and contingent liabilities implications of all proposed PPPs, and its clearance will be necessary for all PPP projects.

c) Government should bear only those risks that it can best manage, which generally are those that they can control or at least influence.

d) PPP contracts should be published, along with other information on the costs and risks of the financial obligations they impose on the government.

e) Budgetary systems should recognise the costs of contingent liabilities.

f) A guarantee fund should be used to encourage recognition of the cost of guarantees when they are given, or to help with payments when guarantees are called.

g) As a preferred means of operation, PPP agreements should not include direct government guarantees. Government should charge fees for any guarantees that are granted.

Glossary

1. **Domestic debt stock / GDP:** This is a commonly-used measure of the level of domestic debt relative to the size of the economy.

2. **Domestic Interest Cost / Domestic Revenue (excluding grants):** This ratio captures the budget sustainability of the domestic debt burden. The benchmark captures the relatively higher risk of accumulation of domestic debt in Uganda due to the relatively low level of Domestic revenue to GDP.

3. **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 an indication of 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.

4. **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.

5. **Average Time to Maturity (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 refinancing risk exposure. A long ATM implies lower refinancing risk exposure, and vice versa.

6. **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.

7. **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.

8. **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.

9. **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.