



Uganda Debt Network (UDN)

**Regulatory Framework for Public Borrowing and
Public Debt Management in Uganda**

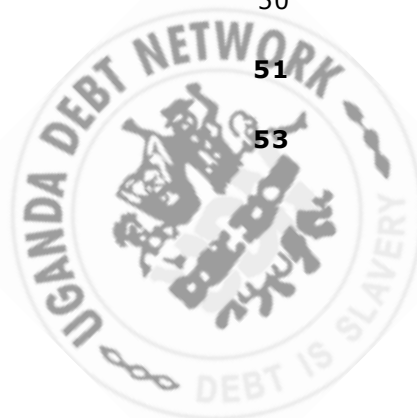
A Review and Analysis of its Effectiveness

September 2008

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Acronyms

ADF	African Development Fund
AfDB	African Development Bank
AO	Accounting Officer
BOU	Bank of Uganda
CCS	Commitment Control System
CSOs	Civil Society Organizations
CPIA	Country Policy and Institutional Assessment
DSA	Debt Sustainability Analysis
EDS	External Debt Strategy
GDP	Gross Domestic Product
GOU	Government of Uganda
HIPC	Heavily Indebted Poor Country
IDA	International Development Association
IFMS	Integrated Financial Management System
IMF	International Monetary Fund
LIC	Low Income Country
MDRI	Multi-lateral Debt Relief Initiative
MFSC	Micro-Finance Support Centre
MoFPED	Ministry of Finance, Planning and Economic Development
MOU	Memorandum of Understanding
MTEF	Medium Term Expenditure Framework



NPV	Net Present Value
NWSC	National Water and Sewage Corporation
PAF	Poverty Action Fund
PIU	Project Implementation Unit
PPDAA	Public Procurement and Disposal of Assets Authority
PEAP	Poverty Eradication Action Plan
PFAA	Public Finance and Accountability Act
SWG	Sector Working Group
UA	Units of Account equivalent to US \$ 1.45
UDN	Uganda Debt Network
UEB/ UMEME	Uganda Electricity Board/ UMEME
Ug. Shs.	Uganda shillings
UTL	Uganda Telecommunications Ltd

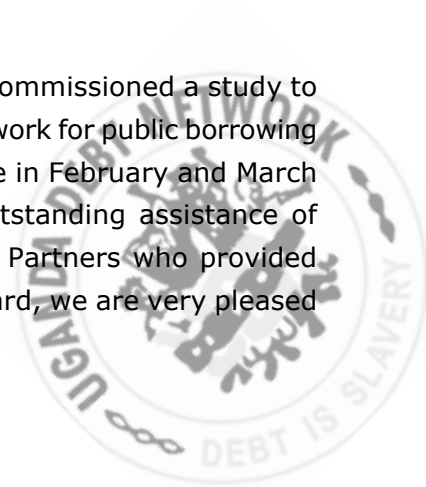


Acknowledgements

The Uganda Debt Network (UDN) was formed in 1996 to campaign for debt relief for Uganda. Two years later, it was registered as a non-Governmental Organization (NGO) under the NGO Registration Statute. In 1999, the UDN was incorporated as a limited liability company with no share holding under company law of 1964.

The current UDN mission is to promote and advocate for pro-poor policies and full participation of poor people in influencing poverty-focused policies, monitoring the use of public resources and ensuring that public resources, including borrowed funds are prudently managed in an open and transparent manner. In collaboration with other CSOs/NGOs, it was able to bring the debt issue into the public arena and international policy debate. Its **current** advocacy efforts are geared at ensuring effective and efficient public debt management, efficient use of debt relief savings, minimizing the cost of borrowing, avoiding recurrence of another debt crisis and making the Government accountable for use of borrowed funds.

It is against this background that UDN commissioned a study to review and analyze the regulatory framework for public borrowing in Uganda. The review, which took place in February and March 2008, has had the full support and outstanding assistance of Government officials and Development Partners who provided information in various ways. In this regard, we are very pleased



to extend our appreciation for the assistance provided by; Messrs. Keith Muhakanizi, Deputy Secretary to the Treasury; Lawrence Kiiza, the Director of Economic Affairs; Lawrence Semakula, Commissioner for Financial Management Services and Ms. Maris Wanyera, Commissioner for Macroeconomic Policy, and Mr. Fred Matyama of the Ministry of Finance, Planning and Economic Development. The review also received outstanding assistance from Mr. Wasswa Kajubi, Director of TEDD at the Bank of Uganda and Mr. Nsimbe Bulega of the Ministry of Agriculture, Animal Industry and Fisheries.

Last but not least, we would like to pay special tribute and extend special thanks to Honourable Members of Parliament for having an enormous influence in the shaping of our thinking on the important issue of the legal and institutional framework for debt management in Uganda. These include Hon. William Okecho, Chairman, Budget Committee; Hon. Kaddunabi, Chairman, Committee on Finance and the Economy and Hon. Nandala Mafabi, Chairman, Public Accounts Committee.

We are eternally indebted to all those who assisted by talking to us or referring us to relevant sources of information.



Executive Summary

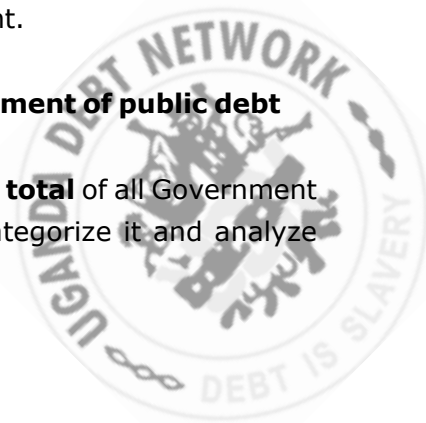
Introduction

This document is an outcome of the UDN review and analysis of the regulatory framework for public borrowing in Uganda. In the review, we examined Uganda’s obligations and trends in external borrowing and the extent to which public borrowing and debt management conform to laws and policies for efficient public finance management. While the stock of debt is low due to the debt write-off provided under the HIPC and the MDRI, public borrowing does not conform to the legal and institutional framework, which can easily lead to Uganda’s slide back to acquisition of unsustainable debt.

We assessed the roles and the transparency levels of various stakeholders in contracting, management and utilization of debt. We also considered the relationships and dialogue between donors and CSOs on one hand and Government agencies on the other. We then made recommendations on the ways and means UDN can use the recommendations to enhance its advocacy role and improve debt management in government.

Definition, composition and measurement of public debt

Public debt is defined as the **cumulative total** of all Government borrowing less repayments. We also categorize it and analyze



each category. In our analysis, public debt includes external and domestic liabilities, although each of these sources has different macroeconomic effects and costs on the economy of the borrowing country. It also includes payment arrears and Government guarantees.

Measures of indebtedness:

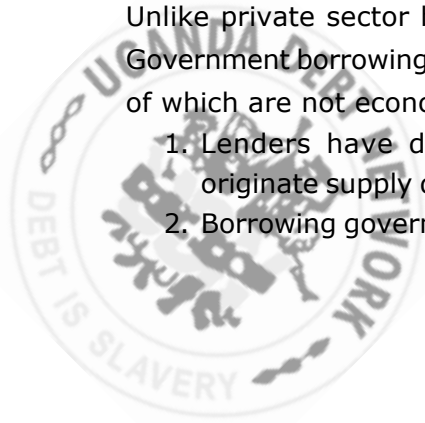
- The ratio of scheduled debt payments to exports of goods and services; this measures the impact of debt servicing obligations on the foreign exchange cash flow
- The ratio of scheduled (or actual) interest payments to exports of goods and services; this measures the current cost of the debt stock; and
- Total outstanding debt as a ratio of GDP (or of exports of goods and services); this reflects the long-term sustainability of the debt burden.

Evolution of debt and the stock of public debt in Uganda

We try to explain the appetite for excessive public borrowing that often leads to unsustainable debt and make tabular presentation of the stocks and trends of public debt in Uganda since the late 1990s.

Unlike private sector borrowing where market discipline rules, Government borrowing is dependant on a number of factors some of which are not economic. Here are some of these factors:

1. Lenders have diverse objectives for lending and may originate supply driven loans
2. Borrowing governments get tempted to borrow excessively



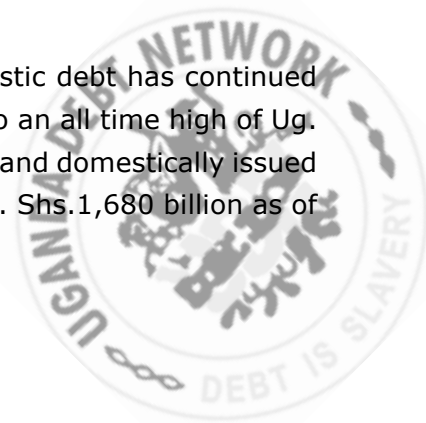
because the tax burden created for future generations may count for little against the benefits enjoyed by the Government's current constituents

3. Governments borrow excessively because they anticipate bailouts that lead to moral hazard problems that reduce the borrower's incentive to maintain solvency
4. Borrowing has been increasing in the case of Uganda and other developing countries because it was thought that continued large-scale borrowing to finance public expenditure would reduce poverty.

There are other reasons outside the control of Government that can lead to unsustainable debt and other economic costs such as deterioration in the terms of trade (relative fall in export earnings and rise in import prices). Needless to say that it is some, if not all of these reasons that led to excessive borrowing, resulting in the accumulation of unsustainable debt, manifested in default in repayments, and followed by crises with economic and social costs in Uganda.

For some of the above reasons, we find that external debt had risen to an unsustainable stock of US \$ 4.464 billion in 2005/06 before falling back to US \$ 1.468 billion in 2006/07 following the Multilateral Debt Relief Initiative (MDRI).

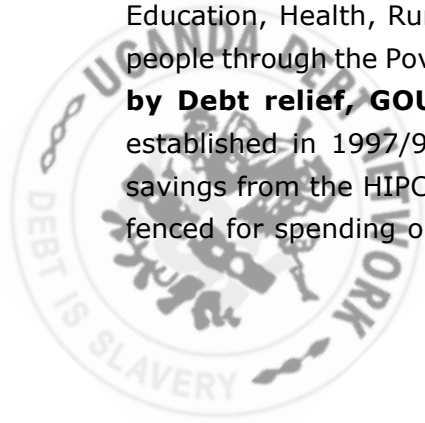
But, uninterestingly, we find that domestic debt has continued to surge. Domestic arrears have risen to an all time high of Ug. Shs. 623.7 billion at the end of 2006/07 and domestically issued debt had reached an all time high at Ug. Shs.1,680 billion as of June 2006.



Assessment of the effectiveness of public debt and debt relief on growth and poverty reduction efforts

Although high levels of debt can depress growth and jeopardize poverty reduction programs, empirical evidence suggests that external debt slows growth only after its face value reaches a threshold level estimated to be about 50% of GDP (or in NPV terms, 20%-25% of GDP). **Therefore**, the fact that the pre-MDRI stock of Uganda’s external debt stood at 61% of GDP means that it (the external debt) was most probably hurting growth and poverty reduction and it implies that substantial provision of debt relief under the HIPC initiative would directly add to growth. Indeed the positive effects of debt relief under the HIPC may already be reflected in the higher growth rates that Uganda experienced in the post-HIPC years. External debt also affects growth indirectly through its effect on public investments. While the stock of external debt may not depress public investment, the cost of servicing debt does.

These issues have important implications for the design of planning and budgeting policies. In order to make its public spending effective in promoting growth and poverty reduction, Uganda has been directing most resources to public investments in Education, Health, Rural Roads and Water; and to the poorest people through the Poverty Action Fund (PAF). The PAF **[funded by Debt relief, GOU and Donor grants and loans]** was established in 1997/98 initially to ensure that the budgetary savings from the HIPC multilateral debt relief initiative are ring fenced for spending on poverty reduction in recognition of the

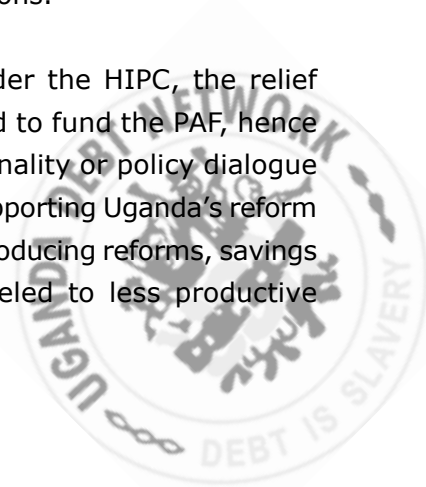


fact that basic services in Uganda had long been under-funded. The PAF contains a set of expenditure areas, which directly and indirectly reduce poverty.

The share of expenditures, which are included in the PAF in total public spending, excluding donor projects, increased from 17% in 1997/98 to 24% in 1998/99 and 1999/00, to 31% in 2000/01, and to about 38% in subsequent years. PAF has thus provided a clear and easy-to-monitor way of demonstrating the claim that the budget in Uganda is pro-poor, giving a justification for increased borrowing and an accounting framework for the HIPC debt relief savings. Additionally, all new items that enter PAF have to be justified in terms of their effects on poverty reduction, which gives sector ministries an incentive to focus on the impact of their services on the poor.

Donors and CSOs alike have generally recognized the PAF as important; and in fact some donors have maintained that the commitment to increase funding to the PAF is of decisive importance in securing more budget support. This was probably the main reason for an increasing share of PAF funding by Government of Uganda (GOU) contributions.

However, unlike the relief received under the HIPC, the relief provided under the MDRI is not targeted to fund the PAF, hence the concern that without donor conditionality or policy dialogue with CSOs which play a positive role in supporting Uganda's reform agenda and which are instrumental in introducing reforms, savings from the MDRI are likely to be channeled to less productive

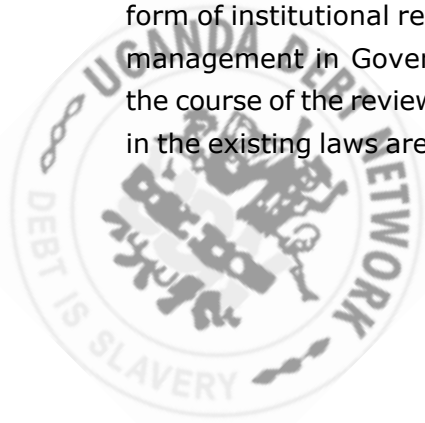


government expenditures thereby jeopardizing future growth and poverty reduction.

Regulatory framework for public borrowing and public debt management in Uganda

The acquisition of debt is enshrined in Uganda’s Constitution of 1995, the Public Finance and Accountability Act (PFAA) of 2003, the Budget Act (2001) and the Bank of Uganda (BOU) Statute. These laws of Uganda, in turn, accord several institutions of Government different mandates in the acquisition, management and utilization of public debt. The Constitution provides for power of the Government to borrow under Article 159. The Public Finance and Accountability Act specifies how loans may be raised and guaranteed and details the responsibility of several Government agencies including Parliament and the Ministry of Finance in Part 111 of the Act. The Budget Act requires periodic reporting on loans and it sets conditions under which domestic debt may be issued for financing the operations of a Government agency. Both the PFAA and the Bank of Uganda Statute authorize the Bank to issue domestic debt in the conduct of monetary policy.

In addition to the laws, there are other regulatory frameworks in form of institutional regulations, and committees for public debt management in Government Ministries and other agencies. In the course of the review, we found out that some of the provisions in the existing laws are ignored and/or flouted from time to time.



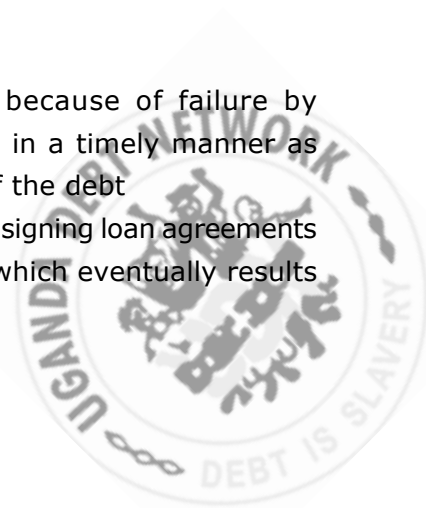
Roles and responsibilities of Government agencies, donors, CSOs and the issue of transparency and accountability in debt acquisition, management and accountability

We examined the roles and responsibilities of Government agencies and officials and the extent to which those roles are effectively carried out. We assessed the extent to which Government agencies facilitate each other and the wider community. We found out that the Government has set up institutional mechanisms for proper management of external public debt; but it has not done the same for domestic debt issuances. We also examined the different roles donors and CSOs can play in making government accountable and its actions effective.

We have recommended actions and/or mechanisms that give state agencies the flexibility and the incentive to act in the public interest while restraining from arbitrary actions and therefore ensuring they are transparent and accountable. These include partnerships with donors and CSOs and provision of official information to them.

We have one case study in our review. The case study provided evidence that:

- Public debt accumulates, in part, because of failure by Government agencies to utilize debt in a timely manner as commitment fees and to the stock of the debt
- Government is flouting its own laws by signing loan agreements without the approval of Parliament, which eventually results



into delays in the use of loans and subsequent of increases in commitment fees

- Government projects are not well prepared and analyzed before borrowing, which results into delays in implementation and/or leads to cancellation of some project components as well as commitment fees.

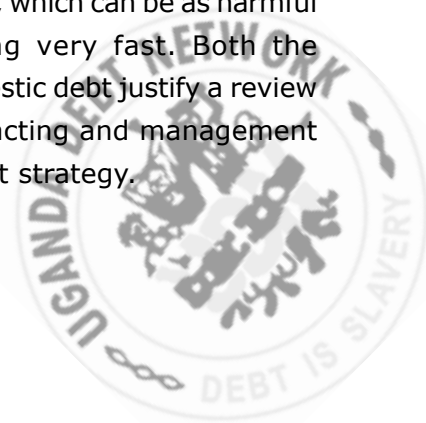
Lastly, we make recommendations, in Chapter 9 that can be used to improve public debt contracting, management and utilization in Uganda.



1. Introduction

Uganda's total debt stock at the end of FY 2006/07 was approximately 4,633 billion shillings¹, or 23% of GDP, of which external debt constituted approximately 12% of GDP. In terms of nominal numbers, **domestic arrears** amounted to 540 billion shillings, **domestic debt in the form of Government securities** amounted to 1,680 billion shillings, and **external public debt** was approximately 2,413 billion shillings. This stands in stark contrast to the pre-MDRI picture at the end of 2005/06, when external debt amounted to approximately 8,360 billion shillings, or 79% of the total debt stock, which was much higher as a percentage of GDP, at approximately 61%.

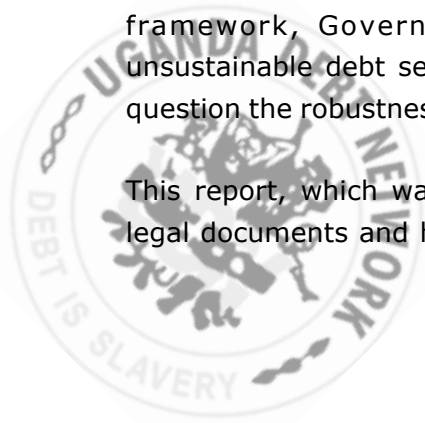
Both the HIPC Initiative and MDRI have helped Uganda in increasing poverty-focused public expenditures and in widening the agenda for poverty reduction. The initiatives, especially the MDRI, have also made the country creditworthy by reducing the debt burden. However, Uganda's current creditworthiness can be potential for yet another slide into a debt trap arising out of lenders comfort. Moreover, domestic debt, which can be as harmful as external debt, has been increasing very fast. Both the creditworthiness and the fast rising domestic debt justify a review of the regulatory frameworks for contracting and management of public debt and a call for a fresh debt strategy.



At the time of constitutional changes in Uganda during the mid-1990s, Uganda had already experienced the debt crisis of 1990, following the country's failure to service its debt from the late 1980s. Not surprisingly therefore, the acquisition of debt is enshrined in Uganda's Constitution of 1995, the Public Finance and Accountability Act (PFAA) of 2003, the Budget Act (2001) and the Bank of Uganda (BOU) Statute, 1993. These laws of Uganda, in turn, accord several institutions of Government different mandates in the acquisition, management and utilization of public debt. The Constitution provides for power of the Government to borrow under Article 159. The PFAA specifies how loans may be raised and guaranteed and it details the responsibility of several Government agencies including Parliament and the Ministry of Finance in Part 111 of the Act. Section 13 of the Budget Act requires periodic reporting on loans and states conditions under which domestic debt may be issued for financing the operations of a Government agency. Both the PFAA and the Bank of Uganda Statute authorize the Bank to issue domestic debt in the conduct of monetary policy.

In addition to the laws, there are other regulatory frameworks in form of institutional regulations, and committees for public debt management in Government Ministries and other agencies. In spite of the availability of the legal and institutional regulatory framework, Government has continued to accumulate unsustainable debt several times in the past, which puts into question the robustness of the existing framework.

This report, which was compiled after reviewing the relevant legal documents and holding discussions with various officials,

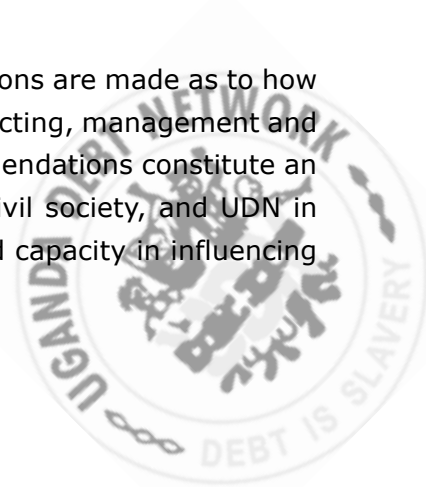


defines public debt, its composition and measurement in Chapter 2. It discusses the genesis, evolution and current degree of Uganda's indebtedness in Chapter 3 and tries to briefly assess its impact on growth and poverty in Chapter 4. The assessment in Chapter 4 has limitations as both growth and poverty reduction are a result of both Government and non Government interventions. Moreover, the impact of debt and debt relief cannot be easily distinguished from the impact of other financial resources on growth poverty reduction The report examines the current regulatory framework for public borrowing and public debt management in Chapter 5 and assesses the roles and responsibilities of Government agencies and officials in the process of contracting, management and utilization of public debt in Chapter 6.

Chapter 7 assesses the roles and responsibilities of Civil Society Organizations and donors in influencing governance in contracting, management and utilization of public debt.

Chapter 8 provides a case study on contracting, management and utilization of the Fisheries Development loan from the AfDF and lessons learned.

In the closing Chapter 9, recommendations are made as to how the Government can improve the contracting, management and utilization of public debt. These recommendations constitute an integral part of the ways and means civil society, and UDN in particular, can strengthen advocacy and capacity in influencing Government actions.

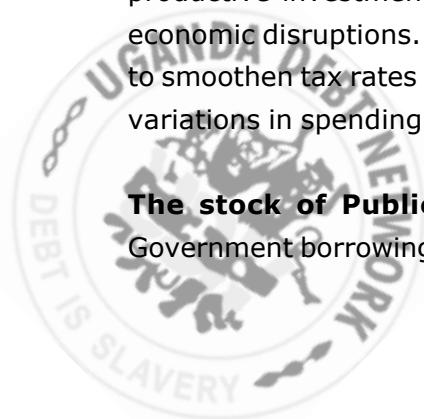


2. Definition, measurement and composition of public debt

The Government collects revenues mainly from taxes and spends the money in purchasing goods and services as well as making income transfers to the public. Very rarely, however, do the figures of revenues and expenditures of the Government coincide; when the expenditures exceed revenues, we say that the Government is running a budget deficit.

In general, the Government finances its deficit by borrowing domestically or externally. This is justified because budget deficits boost total demand and output through a net injection into the circular flow of incomes. Moreover, a deficit to finance capital investment expenditure helps to lay the basis for future output as long as there are private domestic savings or foreign savings willing to finance it in a non-inflationary way and to the extent that such borrowing can be repaid from revenues generated by public investments made with the borrowed funds. Borrowing is also justified because it can help countries grow faster by financing productive investments, and it can also cushion the impact of economic disruptions. Such borrowing can help the Government to smoothen tax rates over time, enabling it to ride out transitory variations in spending needs or in the revenue base.

The stock of Public Debt is the **cumulative total** of all Government borrowing less repayments. The stock of public debt



increases when there is a budget deficit and falls when there is a budget surplus. More technically said, the stock of debt at the end of a given period is broadly equal to debt at the end of the previous period/year, augmented by net debt-creating flows - that is, by new disbursements minus amortization (repayment of principal). It should be noted however that, in the first place, debt stocks are subject to valuation adjustments owing to the fact that debt is contracted in many currencies. Secondly, interest is sometimes capitalized adding to the stock of debt any unpaid interest obligations (interest arrears). Thirdly, outstanding debt is sometimes cancelled or written-off as has been the case with a number of developing countries including Uganda.

Public debt includes external and/or domestic liabilities, although each of these sources has different macroeconomic effects and costs on the economy of the borrowing country. It also includes payment arrears and Government guarantees.

In this paper, the stock of public debt in Uganda includes arrears, domestic debt arising out of Government domestic borrowing, foreign borrowing and Government guaranteed debt as the guarantees constitute contingent liabilities on the part of Government.

In developing countries like Uganda, external borrowing constitutes the **major** source of public borrowing. When a country **borrow**s **abroad**, it must devote a sizeable portion of its export earning to servicing foreign debt, which in turn limits the amount of foreign exchange available for financing imports. Therefore, in

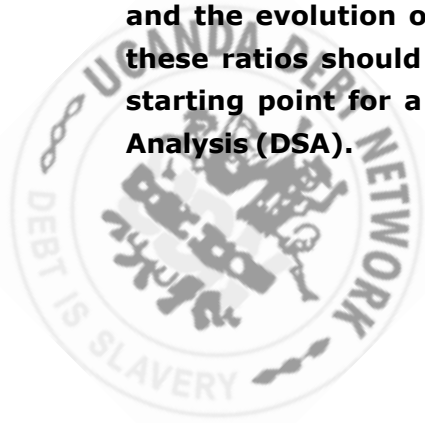


assessing the cost of external debt service, it is useful to relate these costs to total exports of goods and services.

In practice, there are three ratios that are used to measure the debt burden:

- The ratio of scheduled debt payments to exports of goods and services; this measures the impact of debt servicing obligations on the foreign exchange cash flow
- The ratio of scheduled (or actual) interest payments to exports of goods and services; this measures the current cost of the debt stock; and
- Total outstanding debt as a ratio of GDP (or of exports of goods and services), this reflects the long-term sustainability of the debt burden.

Although the ratios are helpful in signaling possible debt problems, the economic circumstances of countries with similar ratios may differ. As such, whether a country will be able to service its debt depends upon its existing debt overhang as well as the prospective path of its fiscal deficits and the evolution of its repayment capacity. Therefore, these ratios should be used with caution and only as a starting point for a country-specific Debt Sustainability Analysis (DSA).



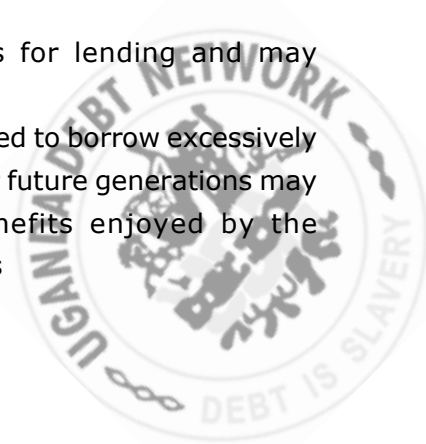
3.0 Evolution of Public Borrowing and the stock of public debt in Uganda

As already said in the foregoing, borrowing is justifiable. However, a rising debt burden is very costly. It can complicate economic management and in the longer run, it can reduce the resources available to Government for financing other areas of the Government budget. In extreme circumstances, the Government may not be able to finance repayments of both the principal and interest which can trigger a crisis of budget and balance of payments; and the impact of such a crisis can be severe on macroeconomic stability, economic growth and poverty reduction.

So why do Governments borrow excessively?

Unlike private sector borrowing where market discipline rules, Government borrowing is dependant on a number of factors some of which are not economic. Here are some of these factors:

- 1.** Lenders have diverse objectives for lending and may originate supply driven loan
- 2.** Borrowing Governments get tempted to borrow excessively because the tax burden created for future generations may count for little against the benefits enjoyed by the Government's current constituents

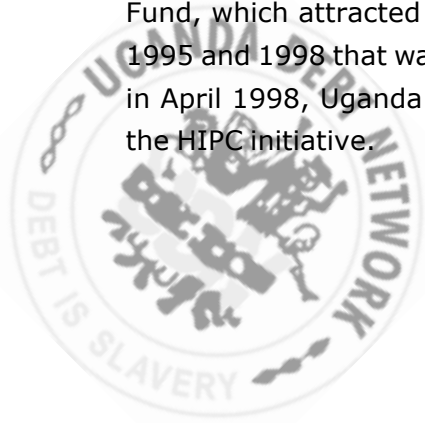


3. Governments borrow excessively because they anticipate bailouts that lead to moral hazard problems that reduce the borrower's incentive to maintain solvency
4. Borrowing has been increasing, in the case of Uganda and other developing countries because it was thought that continued large-scale borrowing to finance public expenditure would reduce poverty.

3.1 External debt

In 1995, Government revised its external debt strategy, with much greater emphasis on reduction of the debt burden through improved concessionality and increased grant support. New legal and institutional arrangements were also introduced to streamline procedures for contracting new loans, including centralization of the process in the MFPED, and better monitoring and reporting of the public debt. At the same time, the 1995 Constitution of the Republic of Uganda formally vested all power to borrow in the Minister responsible for Finance and all power to approve new loans in Parliament.

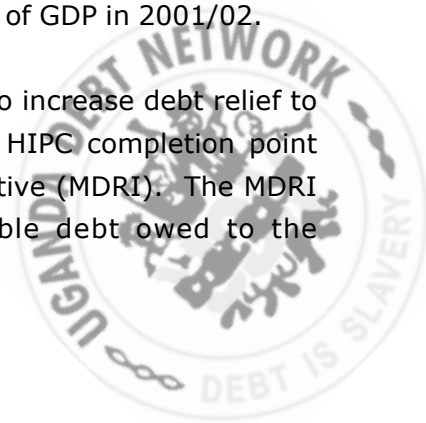
The 1995 strategy was also augmented by the Multilateral Debt Fund, which attracted contributions of US\$135 million between 1995 and 1998 that was used to service multilateral loans. Later, in April 1998, Uganda became the first country to benefit from the HIPC initiative.



Pre-HIPC (1996/97) nominal value of Government's external debt stock was US\$3.7 billion and the Net Present Value (NPV) of debt to exports ratio was 243%. Under HIPC, Uganda received debt relief amounting to US\$347 million in NPV terms, of which 79% was due from multilateral creditors. Following the sharp post-HIPC fall in the NPV debt to exports ratio, due mainly to a deterioration of the country's terms of trade, Uganda qualified to receive and actually got extra relief under the Enhanced HIPC initiative. The total relief extended to Uganda by the two HIPC initiatives was approximately US\$1 billion in NPV terms.

From FY 2000/01, continued large-scale borrowing to finance the implementation of the Poverty Eradication Action Plan (PEAP) as well as an unforeseen strong decline in world coffee prices, led to a further marked deterioration in Uganda's external debt sustainability following the enhanced HIPC initiative. The situation was not helped by slow disbursement of several loans suggesting that borrowing was not aligned with sectors' absorptive capacity. This resulted in costly commitment fees [commitment fees are payable on loan balances that are not yet disbursed/utilized] on un-disbursed debt. From a wider macroeconomic perspective, the large scale of new external borrowing also failed to take into account the critical need for Government to reduce the size of its fiscal deficit, which peaked at 12.3% of GDP in 2001/02.

In July 2005, the G8 countries agreed to increase debt relief to poor countries that had reached their HIPC completion point under the Multilateral Debt Relief Initiative (MDRI). The MDRI provided 100% cancellation of eligible debt owed to the



International Development Association (IDA), the International Monetary Fund (IMF) and African Development Fund (AfDF)¹. IMF relief was delivered on 1st January 2006 and it included all debt contracted before 31st December 2004, while the IDA relief was effective from 1st July 2006 for all debt contracted before 31st December 2003. The African Development Fund relief was also provided effective 31st December 2006 for all disbursed and outstanding debt owed to the ADF by end December 2003. In total, Uganda received approximately US \$ 3.0 billion as can be seen from Table 1 below.

The full implementation of MDRI has helped to deliver faster and deeper relief to Uganda and to achieve debt sustainability, after reducing the NPV of external debt to exports ratio to around 50 percent in 2006/07, well below the joint IMF/World Bank revised policy-dependent threshold for sustainability of 200 %².

Table 1 shows Uganda’s Debt Stock between Fiscal years 1997/98 and 2006/07. **Table 2** shows Uganda’s Debt Service from 1967/68 to 2006/07 while **Table 3** shows provisional estimates of Commitments, disbursed and un-disbursed amounts by individual creditor.

¹ MDRI does not currently cover debts owed to IBRD, the African Development Bank or other MDBs. It differs from the HIPC initiative, in that MDRI does not include debt relief by any bilateral and commercial creditors.

² The IMF/World Bank now use the Low-Income Countries (LIC) DSA methodology. The sustainable threshold for individual countries is based on the ranking of each country’s policies and institutions according to the latest World Bank Country Policy and Institutional Assessment (CPIA). Uganda is ranked as a ‘strong performer’, which means that its policy sustainability threshold (200 per cent) is higher than for ‘weak performer’ countries.

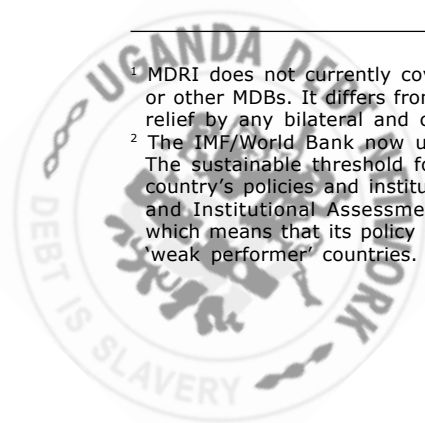


Table 1: Uganda Debt Stock as of 30th June (in thousands of US \$)

Creditor Category	1997/8	1998/9	1999/0	2000/1	2001/2	2002/3	2003/4	2004/5	2005/6	2006/7
Total Multilateral	2,826.79	2,782.63	2,936.27	2,893.27	3,314.35	3,718.59	4,011.16	4,041.10	4,147.60	1,180.41
Total Non Paris Club	423.58	361.71	332.59	344.66	370.14	367.26	380.74	306.23	241.76	215.10
Total Paris Club	325.00	288.16	260.62	131.48	111.36	125.53	69.07	70.39	69.62	66.19
Total Other Creditors	56.23	67.08	50.47	28.12	3.52	-	-	3.93	5.40	6.37
Grand Total	3,631.60	3,499.57	3,579.94	3,397.53	3,799.37	4,211.39	4,460.98	4,421.66	4,464.38	1,468.08

Source: Ministry of Finance Planning and Economic Development (MoFPED)

Table 2: Debt Service, including Debt Relief (in thousands of US \$)

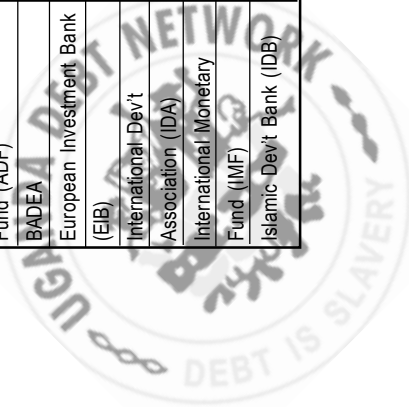
Creditor Category	1996/7	1997/8	1998/9	1999/0	2000/1	2001/2	2002/3	2003/4	2004/5	2005/6	2006/7
Total Multilateral	107.12	111.15	110.91	98.20	114.03	109.93	120.58	139.12	161.65	158.01	
Total Non -Paris Club	22.25	26.32	29.64	13.86	12.16	3.53	5.37	4.88	5.45	32.25	
Total Paris Club	12.38	10.92	18.08	15.57	18.14	14.87	14.80	17.77	19.32	26.28	
Total Other Creditors	14.16	6.24	5.11	5.80	1.77	5.30	5.16	6.00	6.29	5.29	-
Grand Total	155.91	154.63	163.74	133.43	146.10	133.63	145.91	167.77	192.70	221.83	-

Source: Ministry of Finance Planning and Economic Development (MoFPED)

Table 3: Provisional Summary of Stock, Un-disbursed amount, Outstanding Amount and Arrears of External Debt

Creditor Name	Drawings, Stock 31-dec-07	Un-disbursed 31-dec-07	Outstanding Excl. arrears 31-dec-07	Stock of Arrears of Principal 31-dec-07	Stock of Arrears of Interest 31-dec-07	Outstanding Incl. Arrears Total 31-dec-07
Grand Total	1,831,017,860.41	1,080,585,771.07	1,499,926,300.45	53,471,789.64	36,882,827.40	1,590,280,917.35
Bilateral Total	342,183,690.67	29,629,676.11	154,521,606.96	52,323,581.31	36,641,137.09	243,486,325.22
Bilateral Non Paris Club						
China	-	29,611,533.69	-	-	-	-
India	50,633,586.00	-	24,031,487.00	-	-	24,031,487.00
Iraq	4,566,153.22	-	-	2,605,827.26	-	6,364,767.47
					3,758,940.21	
Kuwait fund	26,346,443.00	-	26,346,443.00	-	-	26,346,443.00
Libya	95,000,000.00	-	24,700,000.00	-	-	24,700,000.00
Nigeria	9,000,000.00	-	-	-	-	14,746,000.00
				9,000,000.00	5,746,000.00	
Pakistan	1,234,569.84	-	-	1,234,569.84	1,376,813.75	2,611,383.58
Saudi Arabia-Saudi Fund	10,160,010.55	-	9,026,750.65	-	-	9,026,750.65
South Korea-Exim Bank	5,455,937.64	-	5,455,937.64	-	-	5,455,937.64
Tanzania	35,157,136.55	-	-	35,157,136.68	-	58,251,796.75
					23,094,660.20	
U.A.E (Abu Dhabi Fund)	5,844,419.96	-	-	3,122,961.26	2,664,722.93	5,787,684.19

	243,398,256.75	29,611,533.69	89,560,618.28	51,120,495.04	36,641,137.09	177,322,250.28
Total Bilateral Non Paris Club						
Bilateral Paris Club						
Austria	28,852,360.51	-	22,018,216.91	-	-	22,018,216.91
France-Credit Nationale	11,862,679.02	-	8,421,603.87	1,203,086.27	-	9,624,690.13
Norway-Eksportfinans	1,453,229.71	-	435,968.91	-	-	435,968.91
Spain-ico	48,556,832.66	-	32,154,446.81	-	-	32,154,446.81
Sweden-Svenska Handelsbanken	8,060,332.03	18,142.42	1,930,752.18	-	-	1,930,752.18
Total Bilateral Paris Club						
Total Bilateral Paris Club	98,785,433.92	18,142.42	64,960,988.67	1,203,086.27	-	66,164,074.94
Multilateral Creditors	1,487,935,969.74	1,050,956,094.96	1,344,979,033.49	1,148,208.33	241,690.31	1,346,368,932.13
African Development Bank (ADB)	31,123,302.15	0.00	5,109,757.49	-	-	5,109,757.49
African Development Fund (ADF)	175,508,882.06	318,987,495.59	175,487,765.13	-	-	175,487,765.13
BADEA	19,816,805.24	8,560,888.40	14,708,251.54	-	4,681.51	14,712,933.05
European Investment Bank (EIB)	183,720,762.76	10,891,512.00	110,171,375.24	-	-	110,171,375.24
International Dev't Association (IDA)	847,175,782.29	577,177,706.23	846,638,962.29	-	-	846,638,962.29
International Monetary Fund (IMF)	9,470,880.00	-	9,470,880.00	-	-	9,470,880.00
Islamic Dev't Bank (IDB)	12,619,945.31	8,863,165.20	7,514,972.00	-	-	7,514,972.00



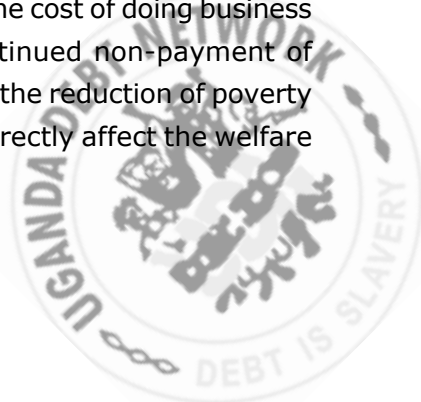
Nordic Development Fund (NDF)	56,936,906.94	29,165,779.25	53,849,830.29	-	-	53,849,830.29
PEC Fund	23,586,065.14	-	20,354,025.14	1,148,208.33	237,008.80	21,739,242.27
The Intern. Fund for Agric. Dev't. (IFAD)	127,976,637.86	97,309,548.29	101,673,214.39	-	-	101,673,214.39
Private Banks (or Other Fin. Institutions)	-	425,660.00	-	-	425,660.00	
East African Development Bank (EADB)	898,200.00	-	425,660.00	-	-	425,660.00

Source: MFPEd

3.2 Domestic Arrears

Domestic arrears are outstanding bills that remain unpaid beyond the fiscal year in which they were incurred. For development projects, arrears are unpaid certificates after project completion. These arrears are an integral part of public debt in Uganda because under Article 159 (7) of the Ugandan Constitution, a loan includes any form of borrowing in respect of which moneys from the Consolidated Fund or any other fund may be used for payment or re-payment.

In contrast to other forms of public debt, domestic arrears **result from poor management of public expenditure**. They are unplanned and pose a number of risks to the Ugandan economy. First, the accumulation of domestic arrears complicates budget planning and 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 the private sector firms by denying them needed liquidity and cash flow yet these firms are the private sector that is the engine of Uganda's growth. Thirdly, businesses are forced to impose a premium on their contracts with Government or charges to mitigate risks associated with delayed payments, which increases the cost of doing business with the private sector. Fourth, the continued non-payment of pension arrears is a major impediment to the reduction of poverty among the population as these arrears directly affect the welfare of pensioners and their dependants.



Government has in the past attempted to address the domestic arrears problem through a number of public expenditure management reforms that include the introduction of the Commitment Control System (CCS), the adoption of a pre-payment system for utilities, and the introduction of an Integrated Financial Management System (IFMS). Despite these measures, the stock of domestic arrears continues to grow. The following **Table 4** summarizes the Government Arrears position from 1997/98 to date.



Table 4: Government Domestic Arrears Position from 1997/98-2006/07 (billions Ug Shs)

Years	Non-CCS							CCS						
	Court Awards	Pensions (estimate)	Gratuity	Salary (estimate)	UEB/UMEME	NWSC	UTL	Rent	Int. Org	Other	Dev't	Total		
97/98& before		57.0	0.0	0.0	0.0	0.0	0.0	0.5	9.9	0.3	0.0	67.6		
1998/99	1.0	-	0.0	0.0	0.0	0.0	0.0	4.1	9.3	1.7	0.1	16.1		
1999/00	1.8	9.4	0.0	0.0	0.0	0.0	0.0	2.0	0.4	8.9	2.3	24.8		
2000/01	1.0	120.5	0.1	0.0	0.0	0.1	0.1	0.5	1.7	3.7	0.1	127.8		
2001/02	2.3	-	7.7	0.0	0.1	-	0.0	1.3	-	3.9	-	15.2		
2002/03	2.0	-	1.0	0.0	0.5	-	0.0	0.1	0.5	1.0	0.0	5.2		
2003/04	0.6	12.5	0.0	0.0	0.1	0.0	1.3	0.2	4.7	4.8	0.1	24.3		
2004/05	40.1	38.9	3.9	0.0	1.7	0.3	0.8	2.2	14.2	17.8	23.4	143.4		
2005/06	15.3	38.3	2.3	4.0	5.4	0.6	0.5	4.4	13.6	30.2	3.1	117.7		
2006/07 (estimate)	0.0	38.3	0.0	0.0	0.0	0.3	0.0	0.0	0.9	41.8	0.1	81.4		
Total	64.2	314.9	15.1	4.0	7.8	1.3	2.6	15.2	55.2	114.1	29.3	623.7		

Source: MFPEd

3.3 Domestic Debt

Domestic debt – **defined as Government securities excluding the stock of domestic arrears** – has the same effect on the economy as any other type of debt. It can crowd out private sector borrowing, give rise to inflationary pressures and in excess amounts, it constrains the provision of public services as the cost of servicing the debt takes away resources that could otherwise finance public expenditure. Although domestic debt has represented a relatively small portion of Uganda’s total debt portfolio in the past, the recent MDRI has created a situation where the **two main debt portfolios** (external and domestic debt) are closer in size than at any other time before. This shift represents a marked change in the composition of the public debt and highlights the importance of establishing a domestic debt strategy.

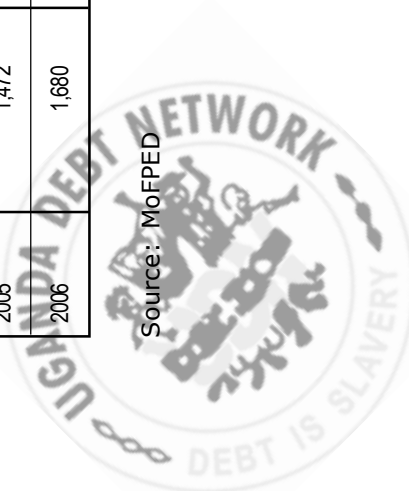
Uganda’s stock of domestic debt has grown rapidly in the last six years, outpacing growth in GDP and total domestic credit. **Table 5** shows the evolution of Uganda’s domestic debt since 2000 vis-à-vis other key macroeconomic indicators. From approximately 320 billion Uganda shillings in June 2000, domestic debt rose to a stock level of approximately 1.68 trillion shillings by end-June 2006.



Table 5: Domestic Debt in billions of Uganda shillings

Period (end June)	Stock of public Domestic Debt	Annual % change in Public Debt	Total Domestic Credit	Cost of Public Domestic Debt (Ushs.Br)	GDP	Debt/ GDP	Debt / PSC	Fiscal deficit excl grants
2000	319		899	30	8,950	3.60%	55%	
2001	545	71%	1180	59	9,971	5.50%	86%	-10.20%
2002	730	34%	1392	91	10,240	7.10%	110%	-12.30%
2003	997	37%	1846	118	11,771	8.50%	117%	-10.40%
2004	1,163	17%	2149	193	13,190	8.80%	118%	-10.00%
2005	1,472	27%	2602	174	15,176	9.70%	130%	-9.00%
2006	1,680	14%	2977	183	17,234	9.70%	130%	-7.20%

Source: MoFPED



3.4 Contingent Liabilities

Contingent liabilities usually arise from explicit and implicit guarantees, including legal entitlements that commit Government to particular levels of support. Available information indicates that there are:

- Loan guarantees of US \$ 5.50 million to Phenix Logistics Ltd; and of US \$5.2 million to the Islamic University in Uganda.
- Demand/Revenue guarantees in the Bujagali Private Public Partnership (PPP) contract
- Under-funded entitlements under the Public Servants' Pension Scheme and
- Uncalled capital where Government has taken shares in Phenix Logistics, Munyonyo Resort and Tri-Star

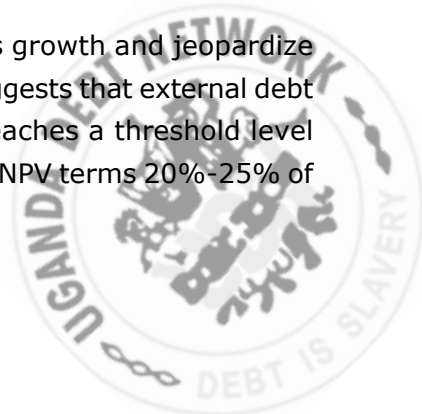
It is not possible to describe the significance and value of these contingent liabilities, as information relating to them is scanty. It was also not possible to establish if these were the only guarantees.



4. Assessment of the effectiveness of public debt and debt relief on the overall growth and poverty reduction efforts

In theory, external debt can help foster growth and poverty reduction provided that it is used to finance investment. When there is excessive borrowing, a country's debt exceeds its ability to repay, and expected debt service is expected to be an increasing function of the country's output level. Thus, some of the returns from investing in the domestic economy are effectively 'taxed away' by foreign creditors. The debt burden can also depress growth by increasing uncertainty about the actions and policies Government will resort to in order to meet its debt service obligations. This theoretical literature thus suggests that foreign borrowing has a positive impact on investment and growth up to a certain level beyond which its impact is adverse. External debt service (in contrast to debt stock) can also potentially affect growth by crowding out public investment and/or altering the composition of public spending.

Although high levels of debt can depress growth and jeopardize poverty reduction, empirical evidence suggests that external debt slows growth only after its face value reaches a threshold level estimated to be about 50% of GDP (or in NPV terms 20%-25% of GDP).

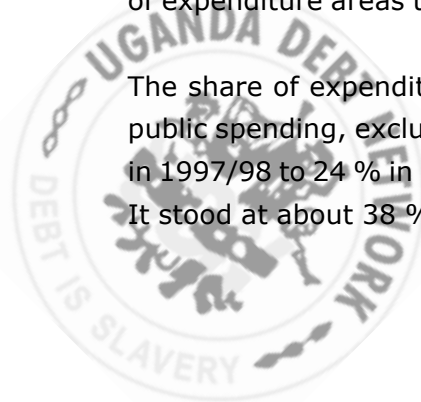


Given the fact that pre-MDRI stock of Uganda's external debt stood at 61% of GDP, it was most probably hurting growth and poverty reduction and it implies that substantial provision of debt relief under the HIPC initiative would directly impact on growth. Indeed the positive effects of debt relief under the HIPC may already be reflected in the higher growth rates that Uganda experienced in the post-HIPC years.

External debt also affects growth indirectly through its effect on public investments. While the stock of external debt may not depress public investment, the cost of servicing debt does.

These issues have important implications for the design of planning and budgeting policies. In order to make its public spending effective in promoting growth and poverty reduction, Uganda has been directing most resources to public investments in Education, Health, Rural Roads ,Water and to the poorest people using the Poverty Action Fund (PAF). The PAF **[funded by Debt relief, GOU and Donor grants and loans]** was established in 1997/98 initially to ensure that the budgetary savings from the HIPC multilateral debt relief initiative are ring fenced for spending on poverty reduction in recognition of the fact that basic services in Uganda had long been under-funded. The PAF contains a set of expenditure areas that directly and indirectly reduce poverty.

The share of expenditures that are included in the PAF in total public spending, excluding donor projects, increased from 17 % in 1997/98 to 24 % in 1998/99 and 1999/00, to 31 % in 2000/01. It stood at about 38 % in subsequent years up to 2006/07. PAF



has thus provided a clear and monitorable way of demonstrating the claim that the budget in Uganda is pro-poor, giving a justification for increased borrowing and an accounting framework for the HIPC debt relief savings. Additionally, all new items, which enter PAF, have to be justified in terms of their effects on poverty reduction, which gives sector ministries an incentive to focus on the impact of their services on the poor.

Donors and CSOs alike have generally recognized the PAF as important. In fact some donors have maintained that the commitment to increase funding to the PAF is of decisive importance in securing more budget support. This was probably the main reason for an increasing share of PAF funding by Government of Uganda (GOU) contributions.

However, unlike the relief received under the HIPC, the relief provided under the MDRI is not targeted to fund the PAF. Hence the concern that without policy dialogue with CSOs which play a positive role in supporting Uganda's reform agenda and are instrumental in introducing reforms, savings from the MDRI are likely to be channeled to less productive government expenditures thereby jeopardizing future growth and poverty reduction.



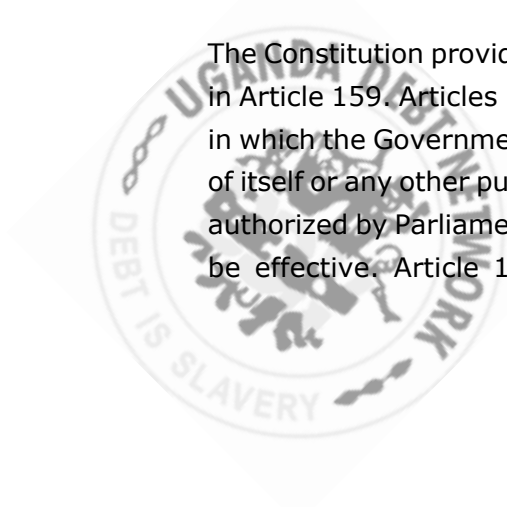
5. The regulatory framework for public borrowing and public debt management in Uganda

While trying to understand the existing regulatory framework for public borrowing, we perused documentation including the existing laws, and regulations. We also spoke to the officials responsible for public borrowing and debt management at the Ministry of Finance, Bank of Uganda and the Parliament in order to understand the existing institutional arrangements within Government.

5.1 Legal Framework

The power of the Government to borrow is enshrined in Uganda’s 1995 Constitution, the Public Finance and Accountability Act of 2003, the Budget Act (2001) and the Bank of Uganda Statute (1993). These laws of Uganda, in turn, give several institutions of Government different mandates in the acquisition of debt.

The Constitution provides for power of the Government to borrow in Article 159. Articles 159 (1), (2) and (3) provide for the manner in which the Government may borrow, guarantee loans on behalf of itself or any other public institution, authority or person. Unless authorized by Parliament, no loan terms and conditions can come be effective. Article 159 (4) requires Government to present

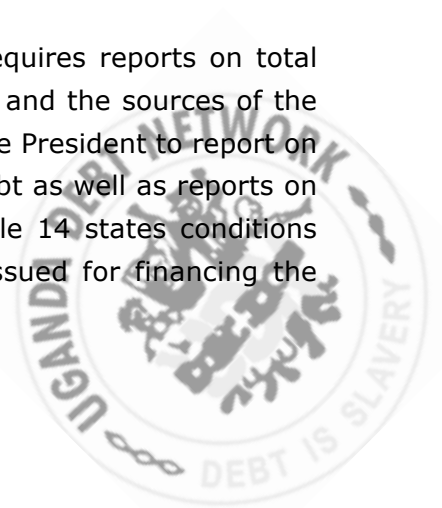


information concerning any loan as is necessary to show the extent of total indebtedness of the country, the provisions made for servicing of the loans and the utilization and performance of the loans.

The Public Finance and Accountability Act (PFAA) specifies how loans may be raised and guaranteed and it details the responsibility of several Government agencies including Parliament and the Ministry of Finance in Part 111 of the Act. Article 20 (1) vests the authority to raise money by loan and to issue guarantees solely in the Minister responsible for Finance. Article 20 (2) vests the power to negotiate terms and conditions of loans in the Minister and Article 20 (3) vests the power of loan approvals in the Parliament of Uganda, with the exception of loans raised for **treasury and monetary policy arrangements**.

Article 26 of the Public Finance and Accountability gives the Minister responsible for Finance the power to guarantee loans, with the approval of Parliament. Article 29 of the same Act specifies reporting mechanisms to Parliament concerning funds to be repaid and borrowed each year.

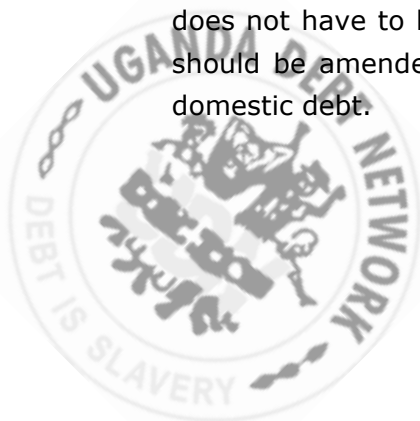
Article 13 of the Budget Act (2001) requires reports on total principal amount and interest on loans and the sources of the loans. The same article also requires the President to report on provisions made for servicing public debt as well as reports on loan performance and utilization. Article 14 states conditions under which domestic debt may be issued for financing the operations of a Government agency.



The Bank of Uganda Statute authorizes the Bank to issue domestic debt in the conduct of monetary policy and in Section 5 (2) (e) to be manager of public debt.

Best practices around the world evince that debt management legislation should clearly assign authority to a single person usually the Minister responsible for Finance, to select the instruments necessary for borrowing, produce a debt management strategy, assign debt limits (if no limit is set by law), usually with a reference to a sustainable debt strategy. The legislation should also define the role of the Central Bank so that issuance of treasury securities cannot be confused with monetary policy operations. It is clear from the legislation and findings from discussions that:

- While the Minister of Finance is, by law, the only one that selects instruments for borrowing in Uganda, and rightly so, he has **failed** to have a successful debt management strategy and to assign debt limits and
- While Article 20 of the PFAA rightly excludes loans raised for monetary policy management purposes from scrutiny of Parliament, the very law wrongly excludes scrutiny of treasury securities from Parliamentary approval as though treasury securities are not a borrowing instrument. As the Government does not have to borrow to finance a fiscal deficit, the law should be amended to provide for proper management of domestic debt.



5.2 Institutional Framework

Existing measures to regulate foreign borrowing

In the current set up, several Government agencies play different important roles in contracting, management and utilization of loan funds. The roles of the different Government agencies are summarized in the following Table 6.

Table 6: Institutional Responsibilities in External Debt contracting, management and Utilization

Assigned responsibility/ activity	Responsible Agency
Contracting	
Identification of overall external financing needs	MFPED
Conducting Debt Sustainability Analysis (DSA)	MFPED
Advising on overall external debt policy	MFPED
Identification of priority projects	SWGs
Submission of project proposals to Development Committee (by 31 st December)	SWGs
Scrutinizing and approving new projects (January to June)	MFPED/ (Development Committee)
Identifying donor(s) and negotiating financing details	MFPED
Analyzing terms and conditions of proposed new borrowing	MFPED
Presenting Cabinet Memorandum followed by Cabinet briefing to Parliament, for each new loan	Minister for Finance
Agreeing on loans to be submitted to Parliament	Cabinet

Seeking Parliamentary Approval	MFPED & Relevant Ministry/Agency
Approving new loans	Parliament
Providing opinion on the legality external borrowing	Attorney General
Keeping Inventory of loan agreements and loan data	MFPED & BoU

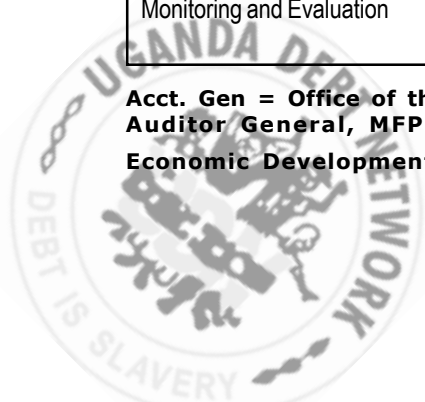
Management of loans

Effecting external debt service repayments/debt servicing	MFPED & BoU
Maintaining and updating parallel loan ledgers	MFPED & BoU
Recording and monitoring Government external loan disbursements on a loan-by-loan basis	MFPED/Acct. Gen
Reviewing and approving withdrawal applications by issuing audit warrants	MFPED/Acct. Gen
Examining and issuing audit certificates on project expenditures	OAG
Presenting information related to external borrowing to Parliament before 15th June, as specified in Budget Act	MFPED

Loan Utilization/ Project Management

Procurement of Project/Programme inputs and implements	Sector agency/PPDAA
Supply of goods and services to the beneficiaries	Sector Agency
Monitoring and Evaluation	MoFPED/OPM & Sector Agency

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



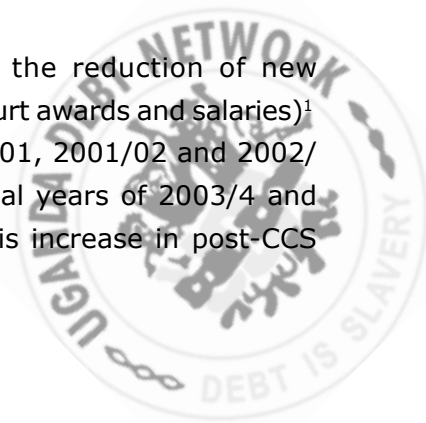
Existing measures to prevent the accumulation of domestic arrears

Government has in the past attempted to address the domestic arrears problem through a number of public expenditure management reforms that included the introduction of the Commitment Control System (CCS), adoption of a prepayment system for utilities, and the introduction of an Integrated Financial Management System (IFMS).

The Commitment Control System

The CCS was introduced in FY 1999/00 for the Recurrent Budget and in the second quarter of FY 2000/01 for the Development Budget. The CCS provides guidelines that prohibit Accounting Officers (AOs) from committing Government in excess of the quarterly expenditure limits and cash releases. It also requires Accounting Officers to settle all financial commitments within 30 days. Suppliers are encouraged to lodge complaints with MFPED if this 30-day period is not complied with. The Public Finance and Accountability Act (2003) also empower the Secretary to the Treasury to take punitive actions against Accounting Officers who violate the CCS.

The CCS contributed considerably to the reduction of new domestic arrears (excluding pensions, court awards and salaries)¹ after its introduction in 1999/00, 2000/01, 2001/02 and 2002/03. However, in the subsequent financial years of 2003/4 and 2004/05, arrears increased again². This increase in post-CCS



arrears arose both from the limited coverage of the CCS system **[The CCS did not cover all Ministries and Agencies]** as well as the violation of the CCS by errant Accounting Officers (AOs). Accounting Officers also attempted to evade the system by understating the commitments and bills as the right declaration did not result in increased resources for their Ministries/agencies.

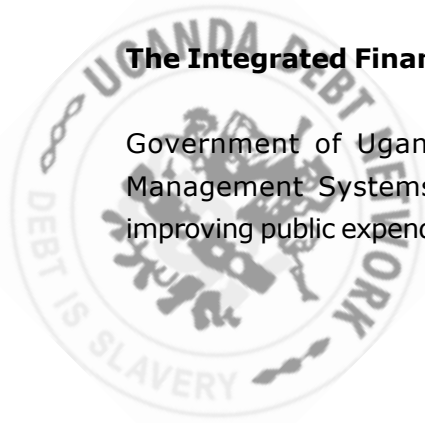
The prepayment system for utilities

The move towards a prepayment system for utilities was first proposed in the 2002/03 budget speech. Since then, only Uganda Telecom Limited (UTL) has made this option available to Government. All ministries were supposed to use the prepayment system and a post-payment system for only Very Important Persons (VIPs) and selected security agencies. While most ministries have adopted the system, there is an increasing tendency to maintain post-payment lines for ineligible officers.

The private power distribution company, M/s UMEME Ltd, has not made any progress towards the introduction of a prepayment system for electricity consumption, largely due to their claim that it involves high capital costs. Continued non-payment of Government electricity bills has partly contributed to UMEME's financial distress.

The Integrated Financial Management System

Government of Uganda introduced an Integrated Financial Management Systems (IFMS) in 2003 with the objective of improving public expenditure management across Central and Local



Governments. The IFMS, an IT based budgeting and accounting system, is part of the wider institutional reforms currently being rolled out, in a phased manner, to all Government agencies and local governments.

The IFMS builds on the CCS into a mechanism for Public Expenditure management, based on the principles of the Public Finance and Accountability Act (PFAA) 2003 and the Budget Act 2001. Under the IFMS, requisitions can only be made when an accounting warrant has been approved and cannot exceed the value of this warrant, ensuring commitments fall within approved warrants and quarterly cash limits. The PFAA 2003 Regulations state that an Accounting Officer is personally liable if he/she commits over and above the approved warrant without prior approval by the Secretary to the Treasury. [Section 37(b) of the PFAA Regulations, 2003]

Existing measures to regulate domestic borrowing

Domestic debt has **not** been guided by an established institutional framework. It is clear, however, that the responsibility for domestic debt management is a shared responsibility between the Ministry of Finance, Planning and Economic Development (MFPED) and the Bank of Uganda (BoU).

¹ For example, there was a significant a reduction of domestic arrears from Ushs. 62.2 billion in 2000/01 to Ushs. 13.9 billion in 2002/03.

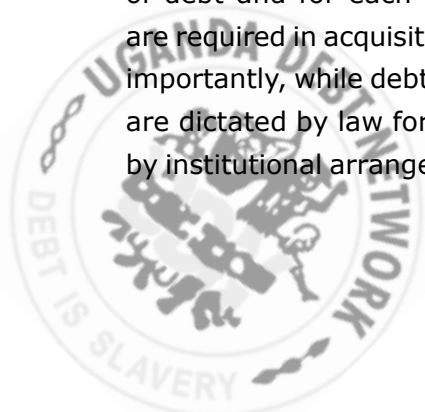
² From Ushs 37.4 billion to Ushs 144.8 billion between 2003/04 and 2004/05, respectively.



6. Roles and responsibilities of Government agencies/officials and the extent to which their actions comply with existing law and procedures in contracting, management and utilization of public debt

The roles and responsibilities of Government agencies in debt contracting, management and utilization are dictated either by the existing legal provisions or the agreed institutional arrangements among the agencies as presented in Chapter 5 above.

It is essential to distinguish between the three functions of debt contracting/acquisition, management and utilization because, in some of the literature, all the three functions are referred to as debt management and in others, the functions are separate though they occasionally overlap. There are, as already said, four types of debt and for each of these, different procedures and steps are required in acquisition, management and utilization. But most importantly, while debt contracting and management procedures are dictated by law for some types of debt, utilization is merely by institutional arrangements.

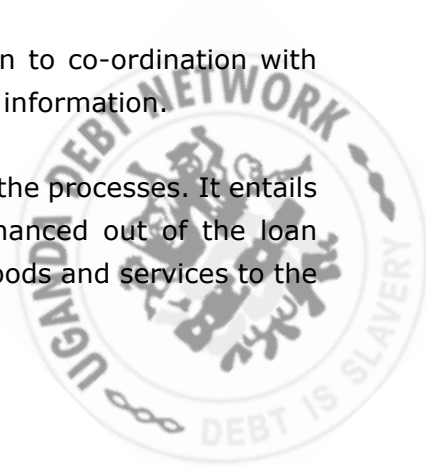


Debt acquisition/contracting spans a whole range of activities from the identification of the need/purpose to which the loan is to be put, the discussions with appropriate financiers/lenders, negotiating and ensuring that the terms and conditions of the requested loan are consistent with the country's debt strategy, approval by the Parliament and signing of a loan agreement. It involves the beneficiary agency of Government/implementing Ministry or Agency, the Ministry responsible of Finance and Parliament.

Debt management involves ensuring that conditions of effectiveness of loan agreements and disbursement of loan funds are fulfilled in a timely manner. It entails preparation and submission of disbursement applications, payments to the suppliers of goods and services financed out of the proceeds of the loan; as well as accounting to the creditors and the responsible government agencies. It also involves proper custody and management of loan funds and data on loan proceeds such as disbursements, repayments, and outstanding amounts. It always involves reporting in accordance with the laws. Public debt management is mainly a function of the beneficiary agencies of Government and the Ministry of Finance and the Bank of Uganda.

This management of public debt is akin to co-ordination with each agency playing its role and sharing information.

Utilization of loans is at the tail end of the processes. It entails procurement of goods and services financed out of the loan proceeds and the delivery of the said goods and services to the

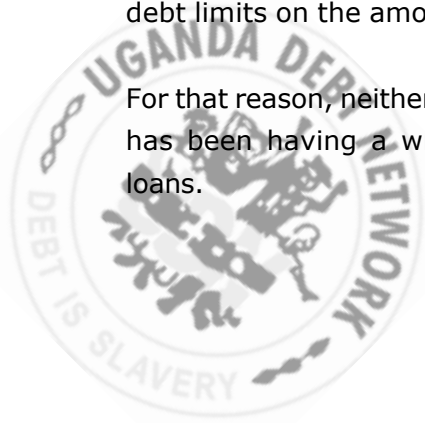


beneficiary population. It is mainly a function of the loan beneficiary agencies who are supposed to ensure that goods and services financed out of the loan reach the beneficiaries/population. It also involves the Uganda Public Procurement and Disposal of Assets Authority (UPPDA).

6.1 Roles and extent of compliance in External Debt management

External and domestic borrowing, unlike domestic arrears, supports Government activities as expenditure priorities are pursued in the face of limited domestic resources. Before it is done, external borrowing is justified by the beneficiary agencies and discussed with and scrutinized by Ministry of Finance before approval of Parliament. Along the chain agencies and officials, by and large, **comply with their legal and institutional roles** albeit in uncertainty due to lack of adequate information and policy frameworks. For example, it is clear from the legislation and our discussions that while the Minister of Finance is, by law, the only one that selects instruments for borrowing in Uganda, and rightly so, he **failed** to have a successful debt management strategy [the last of which was formulated in 1995 and the recent one posted on the internet on 27th December 2007] and to assign debt limits on the amount to be borrowed.

For that reason, neither the Ministry of Finance nor the Parliament has been having a written criteria used to approve or reject loans.



6.2 Roles and extent of compliance in Domestic Arrears management

During discussions with various officials at the MoFPED, it was observed that an arrears strategy exists and has been in existence since 1998 when arrears were first verified. The problem is that it relies on the good will of Accounting Officers (AOs) to use their respective MTEF resource allocations to settle post-CCS arrears. Limiting the arrears budgets to pre-CCS and non-CCS stock of arrears was thus considered sufficient to eliminate the existing stock of arrears. This, unfortunately, has not worked because the increase in post-CCS arrears shows non-compliance to the system by AOs.

As outlined in the foregoing, the legal basis for all Government debt is set out in the Constitution of 1995 and the Public Finance and Accountability Act 2003 (PFAA). The PFAA and accompanying Regulations provide for accountability mechanisms in the management of public finances. The Accountant General is responsible for establishing and maintaining a system of internal controls designed to provide reasonable assurance that the transactions recorded are within his authority and properly record the use of all public funds.

Article 14 of the Budget Act also prohibits Government Agencies from taking credit from any local company or body unless such Government Agency has no unpaid domestic arrears from a debt in a previous year; and has capacity to pay for the expenditure from the approved estimates as appropriated by Parliament for



that financial year. The Act also sets penalties for failure to comply with these legal provisions.

Domestic arrears arise from a combination of factors, but mainly the failure of Government agencies to stick to approved budgets and the relevant legal provisions in the Budget Act and the Public Finance and Accountability Act. The failure also arises from under-budgeting for some expenses, diversion of resources to non-budget expenditures and/or a failure or inability to accommodate in-year budget cuts which become inevitable whenever the Ministry of Finance is faced with revenue shortfalls or when emergencies occur. Government agencies do not co-ordinate their actions and they sometimes simply disregard existing regulations and the law. Even those empowered to reprimand errant officers have not done so.

6.3 Roles and extent of compliance in domestic debt management

To date, the Bank of Uganda has issued domestic debt for monetary policy purposes and perhaps because the Government was not borrowing to finance its expenditure, there has been no urgent need to establish institutional mechanisms to determine Government borrowing requirements under an established institutional framework.



6.4 Roles and extent of compliance in Government guarantees management

The constitution and the Public Finance Act require Parliaments approval of all guarantees. No criteria, however, exist for the consideration and approval of these guarantees. Moreover, some guarantees do not seem to be recorded as evidenced by the contingent liabilities pertaining to the Bujagali Private Public Partnership contract.



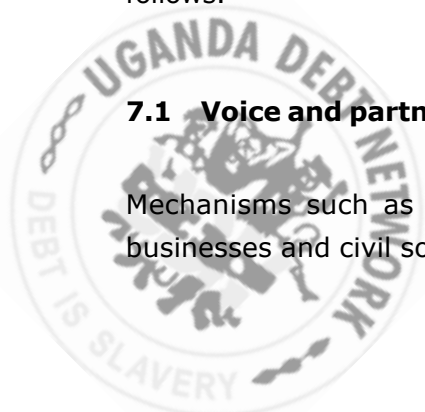
7. The roles of donors and civil society in influencing Governance in contracting, management and utilization of public debt

The Government's power to engage in economic activity is a double-edged sword. While it may use its power to promote the well-being of its citizens, it may also abuse it, to their detriment. Countries therefore need to adopt mechanisms that give state agencies the flexibility and the incentive to act in the public interest while restraining from arbitrary actions and therefore ensuring they are transparent and accountable. There are a few sets of institutional mechanisms that can improve accountability and transparency. These include **restraints and rules as well as voice and partnerships.**

This paper has already dealt with the need and use of restraints and rules [laws and policies] in Chapters 5 and 6 to create an enabling environment for effective public debt management. Chapter 7 will deal with voice and partnerships in what immediately follows.

7.1 Voice and partnerships

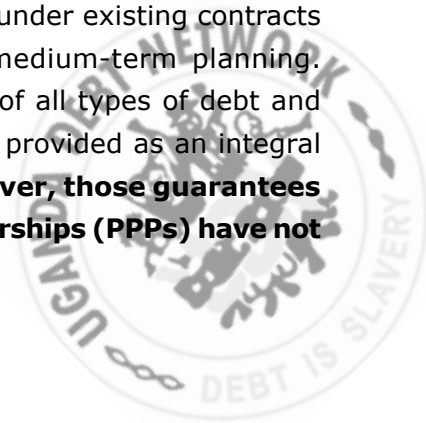
Mechanisms such as public-private deliberations, which give businesses and civil society a voice in state activities and foster



partnerships between the state and its constituents, allow external stakeholders to provide input and oversight and to exert pressure for change. To show accountability and transparency, the Government must not only focus on how to try and improve its performance. It must also try and work with partners to achieve common objectives. It must support CSOs, donors and the private sector by giving them access to all the information they need. It must also allow them participation in discussions and debate. This inclusive approach marshals collective energies to improve service delivery and achieve commonly accepted goals.

With regard to public debt, UDN, in collaboration with other CSO/ NGOs, has engaged Government in improving the contracting and use of public debt. Donors also interact with the Government during project preparation, loan negotiations, periodic supervision missions and mid-term reviews. Therefore, to a certain degree, Government has collaborated in accordance with its policy to cooperate with CSOs in PEAP, Volume 3 and the Partnership Principles.

Additionally, to allow the public to make judgments (perspectives and perceptions), the Government has been proactive by providing Government Schedules of Indebtedness and loan guarantees annually. Similarly, payments required under existing contracts are being reported and included in medium-term planning. Information published includes details of all types of debt and explicit Government guarantees and is provided as an integral part of the annual budget speech. **However, those guarantees associated with Public-Private Partnerships (PPPs) have not**



been disclosed and yet, the main fiscal implications of PPPS are guarantees.

Best practices in providing information on public debt involve the publication of the Government balance sheet **as part of the annual budget documentation which the Government is not doing.** The cornerstone for ensuring timely and uniform availability of information on debt is to publish it on the internet where it can be **readily accessed free of charge, which the Government has started to do.**

Consistent with good practices, we found that annually the Minister of Finance lays before the House [Parliament] the Statement on Government total external indebtedness Government guarantees. We also accessed the information on the Ministry's Website and its Resource Centre.

Nevertheless, we were not able to know if the Government holds inclusive discussions that span ministerial boundaries and interests on matters of public debt.



8. Case study on contracting, utilization and management of ADF loan No. 21539000 for the Fisheries Development Project

Government of Uganda borrowed Units of Account (UA) 21 million from the African Development Fund (ADF) for funding a Fisheries Development Project for developing fisheries infrastructure in 2002. The loan Agreement was signed on 14th November 2002 **before approval of Parliament**. Like all ADF loans, it carries a commitment charge of 0.5% on undisbursed amounts and a service charge of 0.75% on outstanding (disbursed) amounts of the loan. In other words, **any delay in utilizing the loan costs money in commitment charges**. The loan agreement typically provides for a grace period of ten (10) years and repayment of principal over forty (40) years.

The loan is funding a project with several components including:

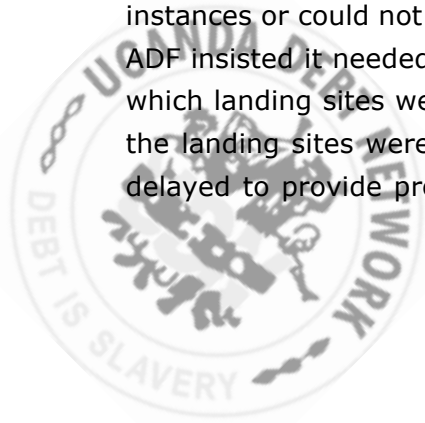
- construction of fish markets
- construction of fish landing sites
- construction of breeding centres and hatcheries
- construction of laboratories and a hostel for use by fish farmers
- a Fisheries Credit Fund for providing loans to fish farmers
- a technical assistance component for consultancies and training.



The first disbursement of the loan funds was made on 2nd February 2005, for an amount equivalent to UA 28,804 which was approximately **two years and four months after signing of the loan agreement**. And by 12th April 2007, only UA 2,799,483 (13%) had been utilized. It is our understanding that about 25% had been utilized as of 4th March 2008. Evidently, there have been delays in utilizing the loan that have direct financial costs in form of commitment charges and other costs related to delayed provision of public services.

First, some of the delays were of a bureaucratic nature. The project had to be managed by a Project Implementation Unit (PIU) and the formation of the unit required recruitment of personnel that necessitates advertising, short-listing, interviewing, etc. **Secondly**, the Government needed to seek a **retroactive loan approval of Parliament without which the lender could not disburse the loan funds**. The Parliament felt it was being used as a rubber stamp and was, for sometime, reluctant to provide its approval for some time.

Thirdly, the loan agreement also required the Government to provide its own land for construction of landing sites and markets. Unfortunately, Government did not own the landing sites in some instances or could not provide land titles. In the meantime, the ADF insisted it needed titles to prove ownership of the land on which landing sites were to be constructed. Moreover, some of the landing sites were owned by Local Governments that also delayed to provide proof of land ownership. In some cases, it

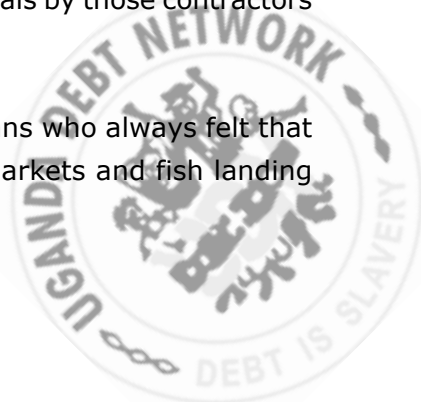


took over two years to provide evidence of land ownership by Districts.

The other major cause of delays was the inability of the Government to manage the Fisheries Credit Fund, originally meant to be disbursed through the Micro-Finance Support Centre (MFSC). The MFSC failed to provide funding to fish farmers through private microfinance institutions because of the very high interest rates they charge. Other credit institutions could not accept to manage a credit meant for only poor fish farmers. Both the Government and the ADF finally agreed to re-think how best to implement this particular component. A consultant was hired but his major recommendation was that it was not possible to manage the Fisheries Credit Fund. Arising out of the delays in project implementation, costs for construction works under the project escalated. Eventually, an agreement was reached between the Government and ADF that the funds allocated under the Fisheries Credit Fund should be re-allocated to civil works under the project.

Lastly, as is typical of civil works, the construction is preceded by architectural consultancy services. These were procured and have in turn helped in the procurement of the civil works and the supervision of construction. However, the tendering processes were halted several times, following appeals by those contractors who did **not** win tenders.

And matters were not helped by politicians who always felt that it was their duty to decide where fish markets and fish landing sites should be constructed.



As a result of the delays, the Government and the ADF have agreed to extend the closing date of the project by two years from 31st January 2008 to 31st January 2010. Management of the project thinks that the about 80% of the project funds will have been disbursed by September 2008.

8.1 Lessons learnt from the case study

- Government Projects are not well analyzed before borrowing, which results into delays in implementation and/or cancellation of some project components. If the Fisheries Development Project had been properly planned and appraised, the Fisheries Credit Fund would probably not have been one of the components of this project and no time and money would have been wasted in studying the component later.
- Government is flouting its own laws by signing loan agreements without Parliament's approval, which eventually result into delays in the use of the very loans. It was not clear from the discussions with officials of the Fisheries Department who the culprit was; but Members of Parliament confirmed that signing before approval happens.
- Debt accumulates partly because of failure to utilize debt in a timely manner. In the case of the Fisheries Development Project, commitment fees at a rate of 0.5% on UA 21 million [equivalent to about US \$s 30.0 million] would accumulate to about US \$s 150,000 per annum.

The following table summarizes loan particulars and use of loan proceeds from signing up to April 2007.



Table 7: Fisheries Development Project

CREDITOR_NAME : ADF
 PROJECT NAME : FISHERIES DEVELOPMENT PROJECT
 LOAN NUMBER : 21539000
 LOAN AMOUNT : UA 21,000,000
 DATE SIGNED : 14.11.2002
 LAST DISBURSEMENT DATE : 31.01.2008
 EXTENDED TO 2010

	Year of Disbursement	Amount disbursed in UA	Amount Amount Ushs.
FY- 2004 /2005	Total	222,999	568,729,525
FY- 2005 /2006	Total	577,105	1,569,911,983
FY- 2006 /2007	Total	1,996,379	5,448,332,810

TERMS:

Commitment Charges 0.5% on un disbursed
 Service Charge 0.75 % on Outstanding (Disbursed)
 Re-payments of Principal start on 1.04.2013 and end on 1.10 2052



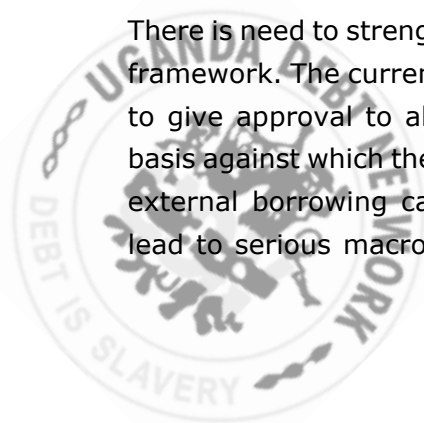
9. Recommendations

From the late 1980s, and early 1990s, donor conditionality played a positive role in supporting Uganda’s reform agenda. Since the mid 1990’s, when Government ownership of the reform agenda was secured, conditionality became less instrumental in introducing reforms. Consequently, policy dialogue with all stakeholders, including CSOs and private sector as well as advisory services assumed a greater role. Besides, PEAP Volume 3 acknowledges the important role of Civil Society and the private sector in service delivery and in contributing to debate.

Against this background and in furtherance of its advocacy efforts, UDN has taken the liberty to examine the extent of Uganda’s current indebtedness, the existing regulatory framework for debt management and is proposing an improvement to the existing legal and institutional framework. The proposals, if adopted by Government, will lay a solid basis for the proper contracting, management and utilization of public debt in Uganda.

9.1 External Debt

There is need to strengthen the existing external debt regulatory framework. The current provisions in the law require Parliament to give approval to all external borrowing without stating the basis against which the approval would be given or denied. Since external borrowing can lead to an unsustainable debt and/or lead to serious macroeconomic costs, **it is important to cap**

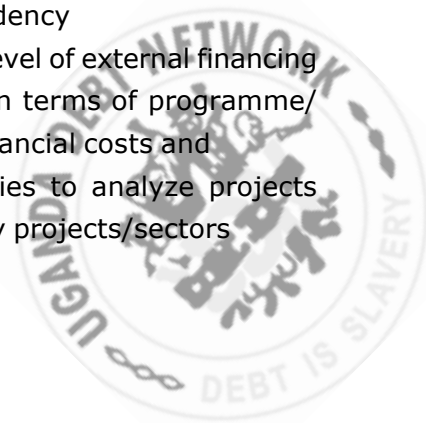


the fiscal deficit (annual borrowing) on a yearly basis and set a limit to the stock of debt since the transitory deficit adds to the stock of debt annually and is sometimes the reason for high interest rates and the high cost of servicing domestic debt. In doing so, the Government can amend the existing legislation to set the limits in the law or force the Minister responsible [for Finance] to assign external debt limits.

Secondly, debt accumulates, in part, because of failure to utilize debt in a timely manner. It is important to ensure that Government does not flout its own laws, by signing loan agreements prior to the approval of Parliament, which eventually results into delays in the use of loans when Government later spends time seeking retroactive approval by Parliament. Additionally, Government Projects should be well prepared and appraised before funds are borrowed to implement them. This will eliminate delays in implementation and cancellation of some project components.

Taking these measures will;

- Ensure medium and long-term **external debt sustainability**
- Ensure consistency between the level of external financing and the **wider macroeconomic objectives** of fiscal consolidation and reduced aid dependency
- Achieve the desired and appropriate level of external financing at **minimum cost** to Government, in terms of programme/project implementation and direct financial costs and
- Put pressure on Government agencies to analyze projects more seriously and borrow for priority projects/sectors



It is extremely important for CSOs to agree with Government as to how relief savings under the MDRI will be used and a monitoring tool to ensure the savings are not diverted.

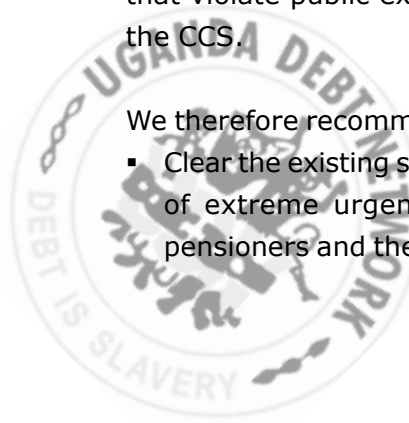
9.2 Domestic Arrears

Domestic arrears arise from a combination of factors, but mainly the failure of Government agencies to stick to approved budget. The failure also arises from under-budgeting for some expenses and/or a failure or inability to accommodate in-year budget cuts which become inevitable whenever Ministry of Finance is faced with revenue shortfalls or when emergencies occur. Quite clearly, Government agencies do not co-ordinate their actions and officials are sometimes simply fraudulent.

There already exists sufficient legal, policy and institutional frameworks to guide the domestic arrears strategy. What is required is to avoid further accumulation of domestic arrears which complicates budget planning and implementation, threatens the survival of the private sector firms and is a major impediment to the reduction of poverty. Moreover, there are provisions under the PFAA, the Budget Act and corresponding Regulations that can be used to impose sanctions on errant Accounting Officers that violate public expenditure management initiatives such as the CCS.

We therefore recommend to Government as follows:

- Clear the existing stock of verified domestic arrears as a matter of extreme urgency. They are hurting the private sector, pensioners and their dependants

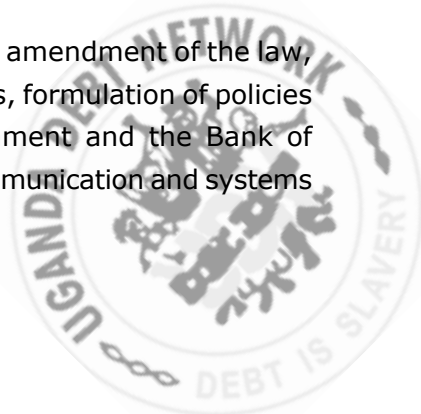


- Expand coverage of the CCS to all Government agencies
- Force UMEME to install a pre-payment facility as was done by Uganda Telecom LTD (UTL)
- Reprimand Accounting Officers who violate CCS, fail to settle arrears within thirty (30) days and divert resources meant for payment of arrears

9.3 Domestic Debt

A well-defined strategy for issuing domestic debt needs to be developed to provide a stable and sustainable source of domestic financing of Government requirements and minimize interest costs and risks associated with public domestic debt. The strategy should also support the development of a well functioning market for Government securities and define the role of the Bank of Uganda so that issuance of treasury securities cannot be confused with monetary policy operation. **Currently, Article 20 of the PFAA rightly excludes scrutiny of Parliament from loans raised for monetary policy management purposes, but the very law, wrongly, excludes scrutiny of treasury securities. As the Government does not have to borrow to finance a fiscal deficit, the law should be amended to provide for proper management of domestic debt.**

Attaining appropriate objectives requires amendment of the law, issuance of debt management regulations, formulation of policies and taking actions by both the Government and the Bank of Uganda including building channels of communication and systems for monitoring performance.



9.4 Contingent Liabilities

It is important to publish quantitative estimates of the potential impact of Government guarantees based on the probability that they will be called; and to state the significance, purpose and nature of these liabilities for accountability and probity.

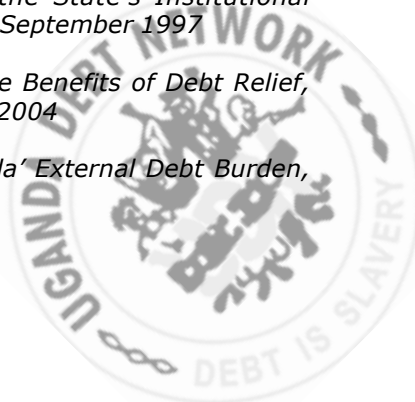
9.5 Information and Partnerships

Mechanisms such as public-private deliberations, which give businesses and civil society a voice in state activities and foster partnerships between the state and its constituents, allow external stakeholders to provide input and oversight and exert pressure for positive change. To show accountability and transparency, the Government must not only focus on how to try and improve its performance. **It must also try and work with partners to achieve common objectives. It must support CSOs, donors and the private sector by giving them access to all the information they need.** It must also allow them participation in discussions and debate. This inclusive approach marshals collective energies to improve service delivery and achieve commonly accepted goals.



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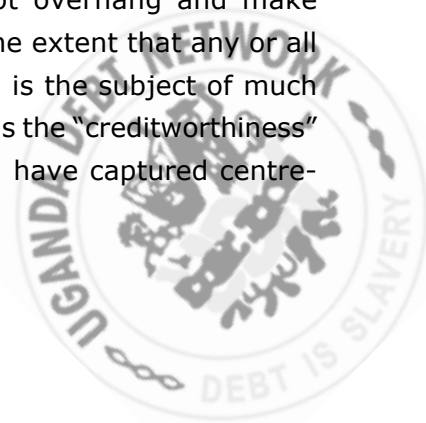
Annex I: Terms of Reference

Review and Analysis of the Effectiveness of the Regulatory Framework for Public Borrowing and Public Debt Management in Uganda

Background and Rationale

Uganda is among the Highly Indebted Poor Countries (HIPC) and has largely benefited from various debt relief initiatives geared at ensuring that the countries external debt is sustainable. From 1980s to-date Uganda has benefited from a number of debt relief and cancellation initiatives under the Paris Club, HIPC and Multilateral Debt Relief (MDR)¹ initiatives. Of all these, the MRDI in 2005² brought glamour of hope for Uganda. The external debt currently stands at US \$ 1.1 billion (March 2007) from US \$ 4.3 billion in 2005.

The main objectives of the HIPC Initiative and MDRI were to help Uganda increase poverty focused related expenditures, boost economic growth by reducing the debt overhang and make countries creditworthy once again. To the extent that any or all of these objectives have been achieved is the subject of much academic and civil society debate, but it is the “creditworthiness” issue and its related implications which have captured centre-stage in policy debates.

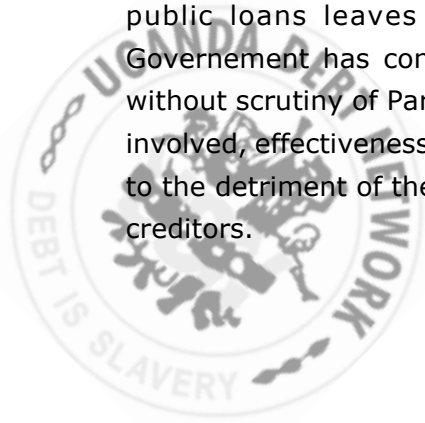


A key concern is that Uganda will re-accumulate debt all over again to unsustainable levels. This is because significantly lower debt ratios mean that Uganda will become attractive to borrowers once again. This concern is compounded by a rapidly changing creditor landscape. For instance between Feb – May 2007, Parliament of Uganda approved close to US \$ 561million.

In addition, a lot of emphasis has been placed on curtailing the external debt with little or no attention on the domestic debt. For stance, by 2006 the domestic debt has risen to US\$ 1.53 billion. The accumulation of the domestic debt, does not only pose a challenge on Uganda's development, it also cast doubts on the countries regulatory framework on public borrowing.

Whereas the Constitution (1995, art 152), the Public Finance and Accountability Act (2003, Arts 20-30) clearly spell out how the country should contract public debt, there are concerns on the manner in which the country has continued to accumulate the public debt. Issues relating to lack of transparency and openness on loan contraction, utilisation and management have continued to dominate public debate.

Furthermore, the role of Parliament in scrutinizing and approving public loans leaves a lot to be desired. In most cases, Government has contracted debt (especially domestic ones) without scrutiny of Parliament. Even when Parliament has been involved, effectiveness and value of some of the loans is minimal to the detriment of the tax payers who have to pay back to the creditors.



Since inception, UDN has been involved in advocacy on debt relief and prudent management of public resources. In collaboration with other CSOs/ NGOs, the organisation was able to bring the debt issue into the public arena and international policy debate. UDN's current advocacy efforts are geared at ensuring effective and efficient public debt management. The process of acquiring, contraction and utilisation of public debt should be built on transparency and effective regulatory framework. This will enhance legitimacy and systematic acquisition of public debt for effective and equitable development.

Given the above background UDN would like to carry out a review and analysis of the regulatory framework for public borrowing in Uganda. The study will provide UDN with information to support the debt advocacy and lobbying strategy for regulating external borrowing, for ensuring efficient use of debt relief savings, for minimizing reckless borrowing and recurrence of the debt crisis, and for making the government accountable for borrowed fund and their utilization.

Goal

The process of acquiring, contraction and utilisation of public debt is based on transparency and effective regulatory framework, in order to achieve sustainable development for Uganda.

Purpose

To generate an evidence base, build support among policy makers and provide practical recommendations for strengthening the regulatory framework for public borrowing in Uganda.



Specifically the study should be able to:-

- a) Examine Uganda's debt obligations and trend in external borrowing since HIPC 1 (1997), including the trends in contractual debt commitments, the actual disbursements, and the debt stock.
- b) Determine the extent to which public borrowing and debt management conform to the policies, procedures and strategies for efficient public finance management.
- c) Assess the level of engagement, role and responsibility of various stakeholders in the process of acquiring, utilisation and management of public debt.
- d) Assess the relationships and dialogue between donors, partner governments and civil society, and the spaces and processes for dialogue and decision making on public debt
- e) Assess the level of accountability and transparency in acquisition, utilisation and management of public debt.
- f) Examine the implications of the current public debt management legislation and management on the overall growth and poverty reduction efforts.
- g) Provide at least one Case Study on acquisition, utilisation and management of at least on public loan in any sector of the economy.
- h) Identify and suggest ways and means by which civil society and UDN in particular can strengthen her advocacy role and capacity to influence public borrowing in Uganda.

Outputs and timing

The outputs for the study will include

- a) A technical and financial proposal detailing conceptual and

- theoretical frameworks, methodology, rationale; a work plan with timetable; budget: before 15th January , 2008, to be discussed and agreed and updated as required
- b) A synthesis report (maximum 30 pages including annexes) exhibiting deeper and rigorous analysis and clearly thought out and well presented arguments: finalized by 15th March, 2008. The synthesis report should:
 - i. Be well written with references and acknowledgement of sources of materials that are referred to in the text, end notes and bibliography at the end of the report.
 - ii. Have a table of contents and list of tables, glossary and list of acronyms if any.
 - iii. Contain an executive summary, and a section on key findings, conclusions and recommendations.
 - iv. Recommendations for Parliament, Executive and Donors towards strengthening public debt management in Uganda.
 - c) A policy brief and/or presentations on emerging findings. These outputs should be tailored to specific events and audiences during the dissemination of findings
 - d) Two seminars for discussing the draft report of findings and dissemination of findings

Timing

The study should be completed by 15th March, 2008.



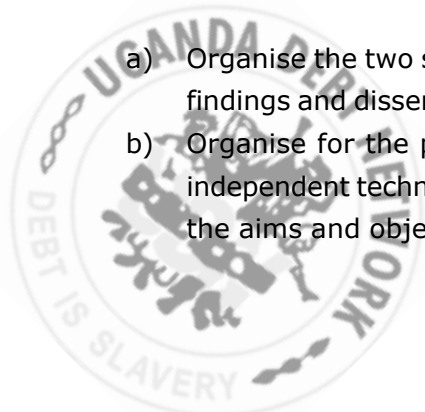
Tasks and responsibilities

Consultant

- a) Carry out the review and analysis of the effectiveness of the regulatory framework for public borrowing and public debt management in Uganda within the time table
- b) Produce a synthesis report (maximum 30 pages excluding annexes) exhibiting deeper and rigorous analysis and clearly thought out and well presented arguments
- c) Present the report in two seminars for discussing the draft report of findings and dissemination of findings
- d) Respond to the comments from the peer reviewers and discussion seminars in a coherent and timely manner
- e) Provide practical conclusions and recommendations that UDN can use in its lobby work with key policy makers such as Cabinet, Parliament and Donors on management of public debt.
- f) Submit a hard copy and 1 soft copy (word format) of the report to UDN.
- g) The responsibility for writing the report lies entirely with the consultant.

Uganda Debt Network (UDN)

- a) Organise the two seminars for discussing the draft report of findings and dissemination of findings
- b) Organise for the peer review of the report by at least two independent technical people to ensure that the report meets the aims and objectives and is of high quality.



- c) Will edit and publish the report of findings in a format decided by the Secretariat.
- d) Disseminate the report in formats in a series of briefs and/or presentations on emerging findings. These outputs should be tailored to specific events and audiences during the dissemination of findings.

Method and principles

The study should be based on in-depth analysis, using secondary data, individual and focus group interviews with stakeholders and where appropriate use of the relevant research in the area and rapid assessments using secondary data, interviews as needed, as well as findings from other research and studies.

The case study should focus on practical lessons and experience, particularly of emerging good practice or bad practice in public debt acquisition, utilisation and management that could act as a guide for policy makers and practitioners.

Reporting

The consultant will report to the Executive Director. However, for day to day activities the consultant shall work closely with the Senior Policy Officer

Competencies

The Consultant should have skills and experience in the following areas:

- Policy aptitude and experience in debt issues and policy engagement



- Understanding and experience of the Uganda debt management, donor policies and debt relief
- Research/communication skills and experience, with working with civil society
- Qualitative and participatory research skills

¹ In July 2005, G8 governments made a bold announcement that they had agreed to cancel up to US\$55bn owed by some of the world's most impoverished and indebted nations: Benin, Bolivia, Burkina Faso, Cameroon, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Sao Tome & Principe, Senegal, Sierra Leone, Tanzania, Uganda, Zambia

² This includes debts to three multilateral institutions: the IMF, World Bank and ADB. As of 30 March 2005, Uganda's total external debt was US\$4.65 billion. Of this amount, US \$ 3.9 billion or 84% of the total debt stock is owed to IDA (World Bank), ADB and IMF. This means that US \$ 700 million or 16% of the total debt stock outstanding as at March 2005 is not covered by the deal.

