



PARLIAMENT OF UGANDA

**REPORT OF THE COMMITTEE ON NATIONAL ECONOMY ON THE
PROPOSAL BY GOVERNMENT TO BORROW USD 100 MILLION
(APPROXIMATELY UGX 380 BILLION) FROM THE DOMESTIC MARKET TO
FINANCE CLASSIFIED EXPENDITURE UNDER MINISTRY OF DEFENCE
AND VETERAN AFFAIRS FOR FY 2018/19**

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Office of the Clerk to Parliament
Parliament Building
Kampala

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MARCH 2019

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1.0 INTRODUCTION

A Motion for a Resolution of Parliament to authorize Government to borrow up to USD 100 million (UGX 380 billion) from the domestic market to finance classified expenditure was presented to the House by the Hon. Minister of Finance, Planning and Economic Development on 18th December 2018, and was accordingly referred to the Committee on National Economy for consideration. The Committee considered and scrutinized the request in accordance with **Rule 175(2)(b)** of the Parliamentary Rules of Procedure.

2.0 METHODOLOGY

2.1 Meetings

The Committee held meetings with the following:

- i. The Minister of Finance, Planning and Economic Development;
- ii. The Minister of Defence and Veteran Affairs; and
- iii. The Parliamentary Sub-Committee on Classified Expenditure.

2.2 Documentary Review

The Committee studied and made reference to the following documents:

- i. The Minister of Finance, Planning and Economic Development's Brief to Parliament on the loan request;
- ii. The letter from the Minister of Finance, Planning and Economic Development on domestic borrowing for classified expenditure under the Ministry of Defence and Veteran Affairs for FY 2018/19, dated 13th December 2018 (Ref: DPI 184/253/05); and
- iii. Supplementary Schedule 2, FY 2018/19.

3.0 BACKGROUND

The Defence and Security Sector plays a vital role in defending and protecting people and their properties, the sovereignty and territorial integrity of Uganda, as well as ensuring peace and security for socio-economic development. It ensures that Ugandans enjoy freedom from threats, intimidation and other pressures from within or outside the country that would undermine the basic rights and welfare, the territorial integrity of the State, and the functioning of the systems of governance.

While the sector's capabilities have improved over time, there remain significant issues that need to be addressed. The current peace and security that the country enjoys need to be consolidated, promoted and developed with focus on security of the country from any form of aggression, peace-building and conflict management, through improving the capability of defence and security forces, and enhancing the defence and security infrastructure, among others.

Parliament approved UGX 32,707.82 billion for expenditure during FY 2018/19. Out of this, UGX 9,517.9 billion was to be financed through borrowing (UGX 7,734 billion is from external financing and UGX 1,783 billion domestic borrowing). By December 2018, UGX 605 billion (34%) had been raised from the domestic market leaving a balance of UGX 1,178 billion (66%).

Of the approved budget for the Ministry of Defence for FY 2018/19, UGX 640.82 billion was approved for classified expenditure, of which the GoU appropriation is UGX 637.56 billion while the externally financed appropriation is UGX 3.25 billion. It should be noted that externally financed budget is for the UPDF Peacekeeping Mission in Somalia (AMISOM) while the GoU appropriation is distributed across various programs under the Ministry of Defence across the Country.

On 19th February 2019, the Hon. Minister of Finance tabled before Parliament a supplementary budget request which include UGX 380 billion to finance classified expenditure requirements. The source of financing this additional budgetary requirement is through additional domestic borrowing amounting to UGX 380

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billion. It should be noted that defence classified expenditure has been growing over time - from UGX 347 billion in FY 2017/18 to UGX 640 billion earlier on approved for FY 2018/19. This additional borrowing will see the budget for classified expenditure grow to UGX 1020 billion representing 34% of the total defence budget for FY 2018/19 (incl. new proposed borrowing).

This Financial Year, as part of the appropriation, the Net Domestic Financing of UGX 1,783 billion was approved. However, an urgent need has arisen, which requires financing classified expenditure of USD 100 million (approximately equivalent to UGX 380 billion). This expenditure was not budgeted for and is a fiscal deficit, since it is over and above the approved budget for this FY 2018/19. These funds are required immediately, and since they cannot be raised by an increase in tax collection or external borrowing, all of which take long to accomplish, hence the request to borrow locally.

4.0 OBJECTIVE OF THE PROJECT

The main objective of this project is to strengthen the capacity of the government to protect the country. The specific objectives of this project are:

- i. To improve the capability of Uganda's defence and security forces ; and
- ii. To enhance Uganda's defence and security infrastructure.

5.0 CONSISTENCY OF THE PROJECT WITH THE COUNTRY STRATEGY

The National Development Plan (NDP II) Defence and Security Sector objectives include: improvement of the capability of defense and security forces, strengthening of internal and external security, enhancement of defense and security infrastructure, enhancement of research and development, enhancement of production for wealth creation and self-sustainability, establishment of national service, improvement of administration, policy and planning. Since the classified expenditure is meant to finance development related expenditure, it is associated with the third objective of enhancing defense and security infrastructure.

This particular objective has three interventions namely:

- i. Develop and maintain Air Force physical infrastructure
- ii. Construct and renovate administrative and operational Infrastructure
- iii. Develop and maintain defence and security welfare infrastructure

The Committee got assurance from the Parliamentary Sub-Committee on Classified Expenditure that these requirements are consistent with the Country's Strategy laid out in the NDP II.

6.0 PROJECT COST AND FINANCING

The total budget for additional classified expenditure is estimated to be USD 100 million (UGX 380 billion) to be financed by borrowing from the domestic market.

7.0 PROJECT INSTITUTIONAL IMPLEMENTATION

The project will be implemented by the Ministry of Defence and Veteran Affairs, with its Permanent Secretary as the Accounting Officer responsible for managing the supply contract.

8.0 BUDGETARY IMPLICATION

Government has requested for supplementary funding for classified expenditure of UGX 380 billion FY 2018/19. The budget for classified expenditure under the Ministry of Defence will increase to UGX 1,020.82 billion from UGX 640.82 billion approved for FY 2018/9. This will then increase the overall Ministry of Defence budget to UGX 2,385.16 billion from UGX 2,005.16 billion approved in FY 2018/19.

Consequently, this will see the budget deficit grow by additional UGX 380 billion, resulting in growth in Net Domestic Financing requirement to UGX 2,163 billion in FY 2018/19 from UGX 1,783 billion earlier on approved by Parliament. In addition, the domestic interest cost will increase by approximately UGX 39 billion from UGX 2,132 billion approved for FY 2018/19 to UGX 2,171 billion.

9.0 THE LOAN AND THE CURRENT DOMESTIC DEBT SITUATION

The stock of domestic debt has increased from UGX 5,424.89 billion in FY 2016/17 to UGX 13,386 billion in FY 2017/18 (*Table 1*).

Table 1: Domestic Debt Stock at Cost, UGX billion

	FY 2011/12	FY 2012/13	FY 2013/14	FY 2014/15	FY 2015/16	FY 2016/17	FY 2017/18
T-Bills	2,112	2,097	2,731	3,025	3,358	3,149	3,523
% of Total	41%	39%	38%	32%	31%	27%	26%
T-Bonds	2,979	3,326	4,482	6,316	7,526	8,447	9,863
% of Total	59%	61%	62%	68%	69%	73%	74%
Total	5,091	5,424	7,213	9,341	10,884	11,595	13,386

Source: DPI, MoFPED (January, 2019)

With an extra borrowing of UGX 380 billion, the Net Domestic Financing (NDF) this FY 2018/19 is expected to rise from UGX 1,783 billion that was approved in the current FY 2018/19 budget, to UGX 2,163 billion. The domestic debt stock is expected to reach UGX 15,549 billion as at the end of FY 2018/19, based on this additional borrowing of UGX 380 billion when approved by Parliament.

10.0 OBSERVATIONS AND RECOMMENDATIONS

10.1 LEGAL FRAMEWORK:

- i) The Committee noted that;
 - a) the power to borrow or to lend is provided for under Article 159 of the 1995 Constitution. Article 159 of the Constitution is to the effect that Government shall not borrow, guarantee or raise a loan on behalf of itself or any other institution except as authorised by or under an Act of Parliament.
 - b) there is no law governing classified borrowing, and it is the first time Parliament is faced with a scenario where classified borrowing is brought to Parliament for approval.

June 2018. This implies that the domestic debt stock relative to the country's income is on the rise (**Table 2**).

Table 2: Domestic Debt Sustainability Benchmarks

	Benchmark	End June 2017	End June 2018
Present Value of Domestic debt stock/GDP	<20%	13.15%	13.48%
Domestic interest cost/Domestic revenue (excluding grants)	<15%	18.23%	15.58%
Domestic interest cost/Total Government Expenditure	<10%	13.54%	11.20%
Domestic Debt stock/Private Sector Credit	<75%	99.56%	101.13%

Source: BOU, MoFPED Data

The ratio of domestic interest cost to revenue (excluding grants) has declined by 2.7% from the previous year end June 2017 although it remains slightly above the threshold. The interest cost has reduced the burden on domestic revenues, due to Government switch to longer term bonds. The ratio of domestic interest on Government expenditure has exceeded its threshold of 10%. Exceeding the threshold by 1.2% in June 2018 implies that the amount of resources available for allocation to other critical sectors of the economy is constrained.

Domestic debt stock relative to private sector credit increased by 1.6% from June 2017 to June 2018; and exceeded the PDMF threshold. The increase was due to a higher rise in domestic issuance reaching 1.8% of GDP. Exceeding the threshold implies that Government domestic debt is constraining funding to private sector. If this persists, private sector will be out competed by government for credit from the financial system.

Despite the improvements in contracting domestic debt of longer term maturity, Uganda still has a very high percentage (37%) of its domestic debt maturing in one year, exposing the country to significant refinancing risks. The ratio of domestic

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interest on Government expenditure has exceeded its threshold of 10% in the 2013 Public Debt Management Framework. Exceeding the threshold by 1.2% in June 2018 implies that the amount of resources available for allocation to other critical sectors of the economy is constrained. The fiscal space of critical expenditures in the budget is reducing over time and therefore minimizing impact of any fiscal expansion by government.

The Committee therefore recommends that Government should develop and deepen the domestic financial sector to increase participation of the various sections of the economy in the domestic financial markets. This will entail implementation of the Tier IV Microfinance Institutions and Money Lenders Act, 2016, among others. Increase in participation in the domestic financial markets will lower interest charged on domestic issuance.

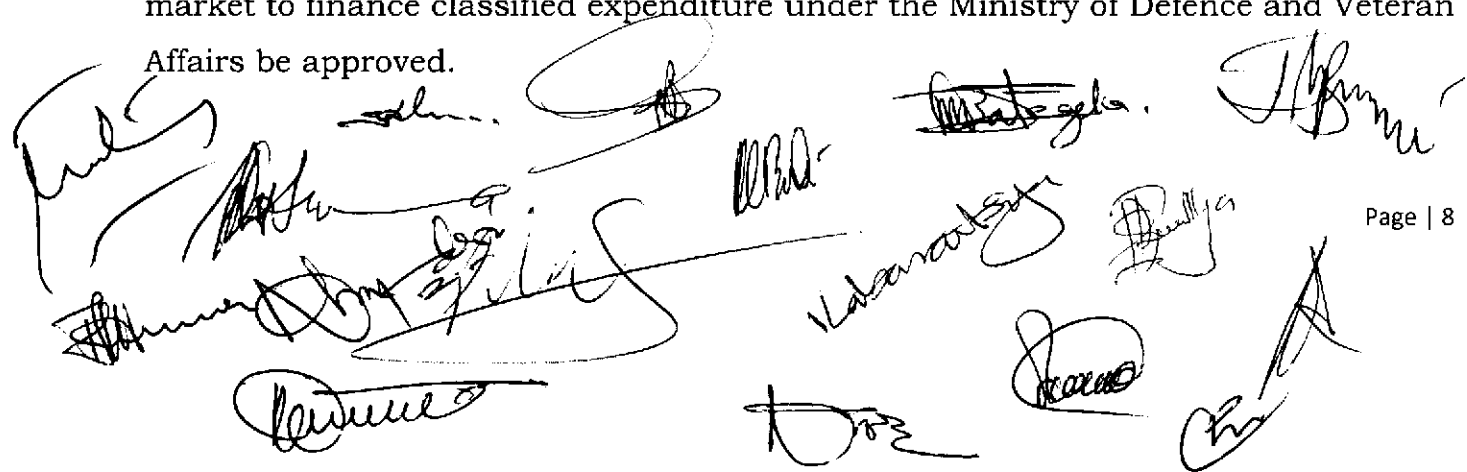
In addition, Government should limit domestic financing of the budget in the short run as the financial markets remain shallow and underdeveloped with limited players in the secondary market. The limited Government borrowing from the domestic market will consequently reduce the interest charged to private borrowers. If Government is to continue borrowing domestically, then it should be on long-term bonds.





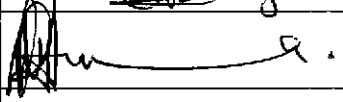

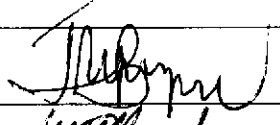
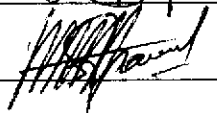
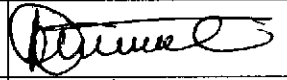
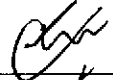
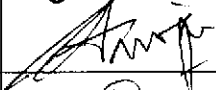
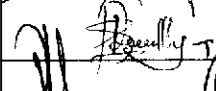

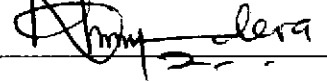
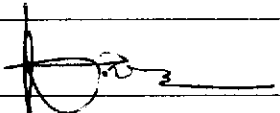
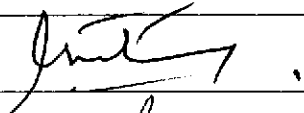
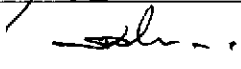
11.0 CONCLUSION:

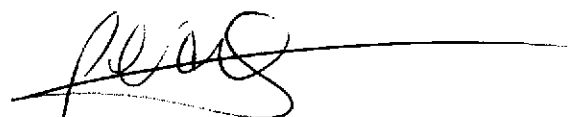


Considering the need to improve the capability of Uganda's Defence and Security Forces and to enhance the defence and security infrastructure, notwithstanding the call for Government to urgently Table a Bill to provide for borrowing for classified expenditure, the Committee recommends that the request by Government to borrow USD 100 million (UGX 380 billion) from the domestic market to finance classified expenditure under the Ministry of Defence and Veteran Affairs be approved.



REPORT OF THE COMMITTEE ON NATIONAL ECONOMY ON THE PROPOSAL BY GOVERNMENT TO BORROW USD 100 MILLION (APPROXIMATELY UGX 380 BILLION) FROM THE DOMESTIC MARKET TO FINANCE CLASSIFIED EXPENDITURE UNDER MINISTRY OF DEFENCE AND VETERAN AFFAIRS FOR FY 2018/19

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38.	Hon. Kutesa Pecos Onesmus	UPDF Representative	<i>[Signature]</i>