FOR GOD AND MY COUNTRY

**OFFICE OF THE
LEADER OF THE OPPOSITION**

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21/9/21

OPPOSITION RESPONSE TO THE CHARTER OF FISCAL RESPONSIBILITY FOR FY2021/22 – FY2025/26

PRESENTED BY
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SEPTEMBER 2021

1.0 INTRODUCTION

The Charter for Fiscal Responsibility for FY2021/22 – 2025/26 presents a unique opportunity to reform Uganda's public financial management, put measures in place to make the national budget more credible and ensure fiscal sustainability.

Realistic and achievable fiscal (revenue and expenditure) rules will contribute to instilling confidence in the economy and set the scene for accelerated economic recovery as the country recovers from the effects of Covid-19.

In a bid of actualizing the role of keeping government in check, studying government policies and advancing alternatives, the Opposition in Parliament analysed the Charter for Fiscal Responsibility that was laid in Parliament on 9th September 2021. This was done in line with Section 6E of the Administration of Parliament Amendment Act, 2006.

The Opposition in Parliament hereby present a response to the proposed Charter for Fiscal Responsibility for FY2021/22 – 2025/26 as well as alternative fiscal objective rules.

2.0 TIMELINESS OF THE CHARTER

Section 5(1) of the Public Finance Management Act demands that the Minister responsible for Finance submits to Parliament a Charter of Fiscal Responsibility not later than three months after the first sitting of Parliament after a general election.

Given that the first sitting of the 11th Parliament was held on held on 24th May 2021, the Charter should have been submitted on 24th August 2021. To the contrary the Charter was submitted on 9th September 2021. This is a violation of the Public Finance Management Act.

On this basis Section 78 of the Public Finance Management Act should be evoked to compel the Minister responsible for Finance to make a report to Parliament detailing the reasons responsible for the delay in laying the Charter.

3.0 PRINCIPLES OF FISCAL OBJECTIVES

Section 4(2) of the Public Finance Management Act sets the principles of fiscal objectives contained in the Charter of Fiscal Responsibility.

Section 4(3) specifically demands that the Charter of Fiscal Responsibility should consist of measurable fiscal objectives. The Section sets 5 principles onto which fiscal objectives would be set. The five Principles include:

a) Sufficiency in revenue mobilisation to finance Government programmes;
b) Maintenance of prudent and sustainable levels of public debt;
c) Ensuring that the fiscal balance, when calculated without petroleum revenues, is maintained at a sustainable level over the medium term;
d) Management of revenues from petroleum resources and other finite natural resources for the benefit of current and future generations; and
e) Management of fiscal risks in a prudent manner.

The principles set in Section 4 (2) form the foundation of the Opposition in Parliament's response to the Charter of Fiscal Responsibility for FY2021/22 – 2025/26. Each in turn will be deliberated upon and alternative fiscal objective rules advanced.

3.1 SUFFICIENCY IN REVENUE MOBILISATION TO FINANCE GOVERNMENT PROGRAMMES

Both the expired and proposed Charter are silent on this principle. No single measurable fiscal objective rule has been set for this principle. Hence a violation of Section 4(3) of the Public Finance Management Act.

Setting a fiscal rule for this principle is so critical for it is the basis of achieving the proposed fiscal objectives on public debt, fiscal balance and petroleum fund transfers. It would also contribute to the improvement in tax policy administration.

Tax Register

The absence of the Rule will limit the potential of enhancing revenue collection particularly from the informal sector. A greater portion of revenue is collected from taxes particularly raised from tax payers in the formal sector through Pay as You Earn (PAYE) and Value Added Tax (VAT). The tax register consists of only 1,783,493 tax payers as of FY2020/21. This has grown from 902,339 tax payers in FY2015/16[1]. This translates to annual average growth of 176,231. The growth is mainly comprised of individuals other than companies.

Unfortunately, the informal sector which employs majority of the population and generates approximately 51% of Gross Domestic Product (GDP) marginally contributes to tax revenue[2]. The failure to attracting them into the tax sphere is mainly attributed to corruption, poor business incubation, bureaucratic tendencies of tax collectors and prohibitive taxes.

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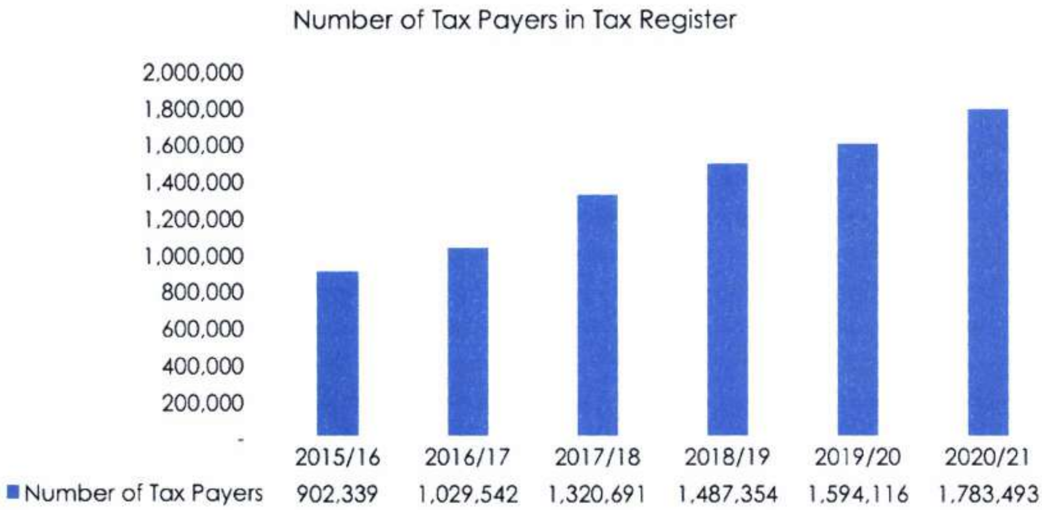
[1] Uganda Revenue Authority,2020. Annual Revenue Performance Report FY2019/20

[2] Ministry of Finance, Planning and Economic Development, 2019. Domestic Revenue Mobilization Strategy

Figure 1: Graph showing growth of tax register in the FY2015/16 – 2020/21



Source: URA

Tax Initiatives

Government expenditures far exceed its revenue. The overall fiscal deficit has increased from UGX 3.733 trillion in FY2016/17[3] to UGX 13.412 trillion[4] in FY2020/21. This translates to an increment of 72%. This has not been helped by the investment in ineffective tax initiatives. For instance, as one of the means of addressing the revenue gap, Parliament approved UGX 106 billion for Digital Stamps in FY2019/20 (UGX 45.67 billion) and FY2020/21(UGX 60.85 billion). This investment was to yield a total revenue contribution of UGX 47.74 billion over 5 years[5]. Unfortunately, due to ineffective tax initiatives, the tax to GDP ratio has not improved yet. For the last 10 years between 2009 and 2019, it has averaged at 12% against estimated potential ranging between 20 – 26% of revenue to GDP[6]. In the last 10 years, the average growth of tax to GDP has averaged at about 0.3%.

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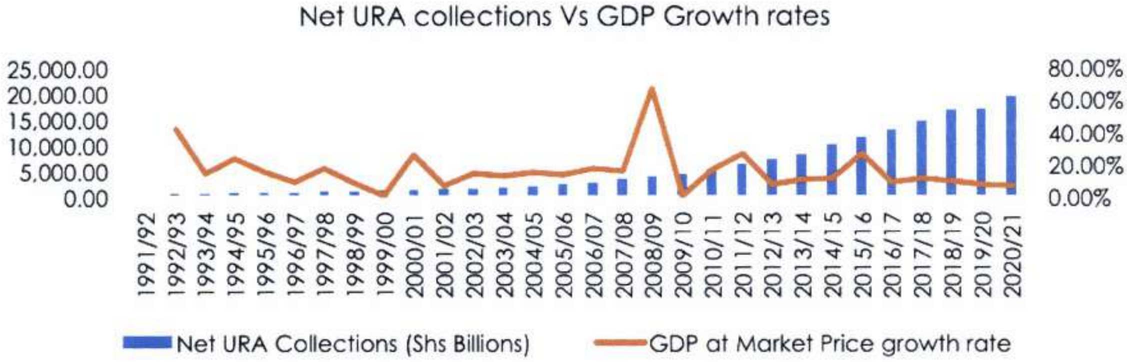
[3] Ministry of Finance, Planning and Economic Development, 2017. Annual Budget Performance Report FY2016/17

[4] Ministry of Finance, Planning and Economic Development, 2021. Economic and Fiscal Update – August 2021

[5] Parliament of Uganda, 2019. Report of the Budget Committee on the Annual Budget Estimates for FY2019/20

[6] Ministry of Finance, Planning and Economic Development, 2019. Domestic Revenue Mobilisation Strategy 2019/20 – 2023/24

Figure 2: Graph showing net tax collections against GDP for the period FY1992/93 – 2020/21

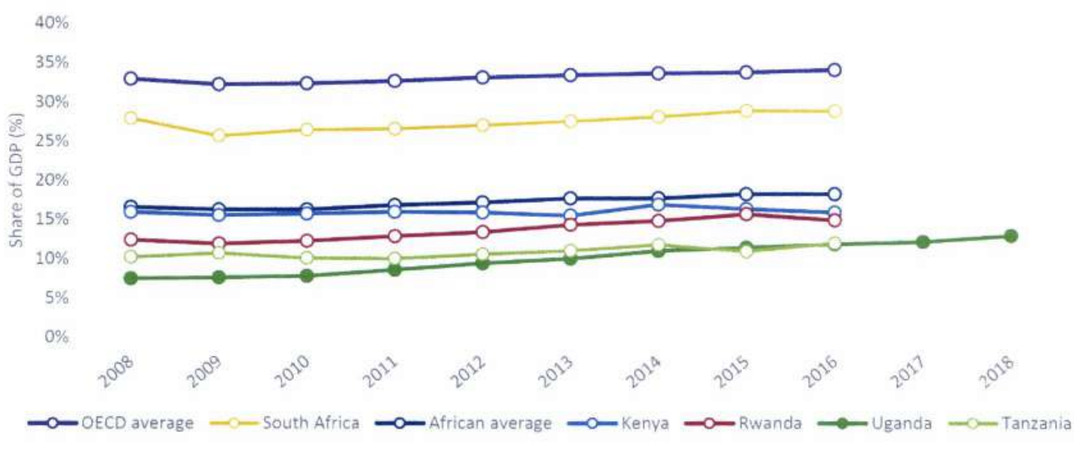


Source: URA

Tax to GDP Ratio

Uganda ranks the lowest tax to GDP amongst peers in the East African Community (EAC) and Common Market for Eastern and Southern Africa (COMESA). For instance, Uganda's tax to GDP ratio is 12.5% as compared to 16.9% of COMESA[7]. This mainly attributed to unstable tax regime, reactionary tax measures, discretional tax incentives, tax deepening, negative public perception and inadequate tax research among others.

Figure 3: Uganda's Tax to GDP in comparisons to peers for period 2008 – 2018



Source: MoFPED

[7] ibid

Discretional Tax Incentives

Uganda's tax capacity is threatened by discretional tax incentives inform of tax holidays and expenditures. In the 10th Parliament, concerns were raised regarding tax expenditures to BIDCO, AYA investments, Steel and Tubes Industries, Quality Chemicals and Southern Range Nyanza textiles among others. The exemptions have led to foregone revenue of UGX 21.5 trillion in only 5 years from FY2016/17 – 2020/21. The tax arrears of FY2020/21 amounting to UGX 7.7 trillion are higher than funds appropriated for domestic refinancing amounting to UGX 7.4 trillion. Unfortunately, most of the beneficiary companies exist the economy when the tax exemptions halt.

Table 1: Revenue foregone in FY2016/17 – 2020/21

Exemptions Category	FY 2016/17 (UGX Bn)	FY 2017/18 (UGX Bn)	FY 2018/19 (UGX Bn)	FY 2019/20 (UGX Bn)	FY2020/21 (UGX Bn)
Total income tax Loss	391.85	453.79	1,009.84	851.21	2,358.67
VAT Exemptions	815.15	1,323.55	1,434.34	1,855.49	2,195.34
Customs Tax Exemptions	960.02	912.46	1,716.37	2,065.15	3,168.51
Total Exemptions	**2,167.02**	**2,689.80**	**4,160.55**	**4,771.85**	**7,722.52**

Source: URA

Stock of Tax Arrears

The stock of assessed tax arrears is gradually rising with minimal recovery. It has grown from UGX 2.1 trillion in FY2016/17 to UGX 4.1 trillion in FY2020/21. The largest contributors to tax arrears are non-government institutions which are engaged in manufacturing, wholesale and construction sub-sectors. Worryingly these sub sectors also account for UGX 3.7 trillion (20.4%) which is the largest share of outstanding private sector credit amounting to UGX 18.1 trillion at the end of FY2020/21[8]. No wonder infrastructural developments such as factories have failed to spur growth and pay workers low wages that range in between UGX 3,000 – 5,000 per day.

Table 2: Status of Tax Arrears in FY2016/17 – 2020/21

Tax Arrears (UGX, Bn)	FY2016/17	FY2017/18	FY2018/19	FY 2019/20	FY 2020/21
Non-Government Arrears	1,828.86	2,478.44	2,776.15	2,864.70	3,715.59
Government Arrears	132.15	77.57	749.25	19.58	396.18
Customs Tax arrears	169.67	115.05	99.41	105.24	78.32
Total Arrears	**2,130.68**	**2,671.06**	**3,624.81**	**2,989.52**	**4,190.10**

Source: URA

[8] Ministry of Finance, Planning and Economic Development, 2021. Economic and Fiscal Update

Proposed Fiscal Rule

CHARTER FISCAL RULE	***PROPOSED ALTERNATIVE RULE***
None	♦ ***Maintaining growth of Tax to GDP ratio above 16%***

Given the enumerated issues regarding revenue mobilisation, it is essential that the Charter sets a fiscal rule to satisfy Section 4 (2) of the Public Finance Management Act i.e. sufficiency in revenue mobilisation to finance Government programmes.

The following fiscal rule should be adopted.

- ***Maintaining growth of Tax to GDP ratio above 16%***

This fiscal rule is consistent with the core objective of the Domestic Revenue Mobilisation Strategy for FY2019/20 – 2023/24. Setting and adhering to this rule would ensure that authorities responsible for both tax policy and administration aim at deploying a higher-level proficiency in tax targeting and collection efforts. As already demonstrated, the number of tax payers is growing much faster rate than tax collections reflecting a gap in policy and administration of our tax system.

3.2 MAINTENANCE OF PRUDENT AND SUSTAINABLE LEVELS OF PUBLIC DEBT

The expired Charter had set out to maintain public debt in net present value terms below 50% of GDP. Of which net present value of external debt is maintained below 30% of GDP and net present value of domestic debt is maintained below 20% of GDP.

In the course of the Charter, public debt was reported using a mixture of measures i.e. present value and nominal values. It should be noted that when present value is used, the debt value was within target. However, public debt when measured in nominal terms, it exceeds 50% of GDP.

Table 3: Status of Public Debt in FY2018/18 – 2020/21

FY	2018/19	2019/20	2020/21	2021/22 (Projection)
Nominal debt to GDP	35.3	41	49.9	52.4
PV of Debt to GDP	26.7	31.8	39.3	41.7

Source: PBO

Public Debt Targeting

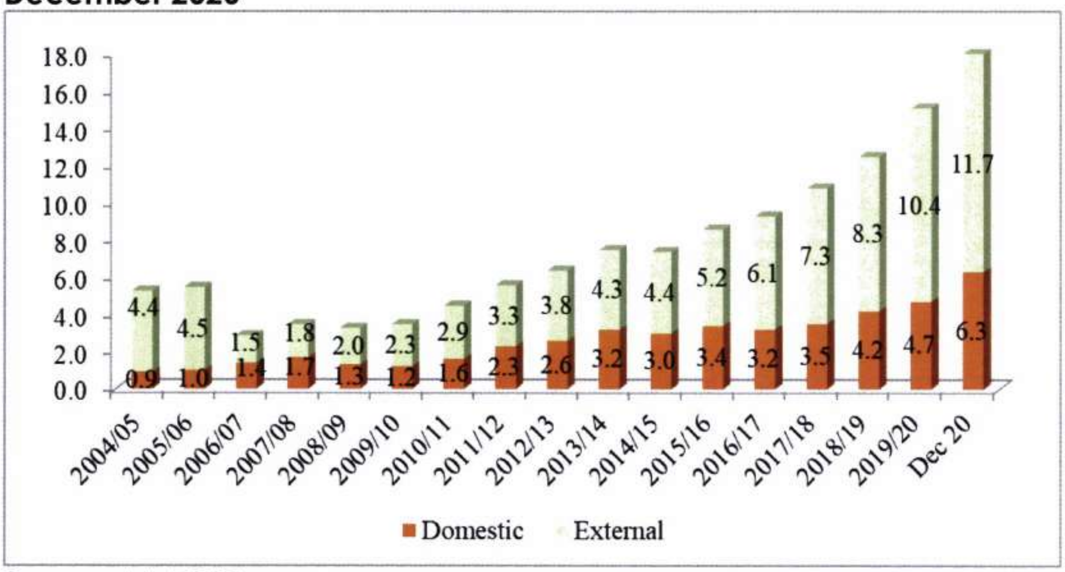
The proposed objective 1 fiscal rule regarding *"total public debt in nominal terms is reduced to below 50% of GDP by financial year 2025/26"* is totally defective. Commitment cannot be made to a trend instead of an absolute target upon which government would be held accountable. Rather it raises a risk that public debt will rise further and Parliament would be side stepped without necessitating approval for deviation. This points to the intention of government in as far maintaining status quo of operations.

Escalating Public Debt

Irrespective of the measurement terms and proposed targets, it is not the Charter that reduces public debt but the undertakings of government. To the contrary, with the proposed fiscal rule the irresponsible government expenditures will continue to influence the rising of public debt at astronomical rates. The total public debt has risen from USD 2.9 billion in 2006/07 to USD 17.96 billion (UGX 65.57 trillion) in December 2020[9]. This translates to an increment of 84%. The drop in debt stock between FY2005/06 and FY2006/07 is attributed to debt relief initiative towards the Heavily Indebted Poor Countries (HIPC) not improved financial discipline.

Based on the trend of public debt for the last 15 years, it is unconceivable that during the Charter period the levels will be brought down. Rather public debt will continue to rise if a stringent fiscal rule on public debt is not set to guide government operations.

Figure 4: Graph showing Public Debt Stock Trend from FY2004/05 to December 2020



Source: MoFPED

[9] Ministry of Finance, Planning and Economic Development, 2021. Medium Term Debt Management Strategy 2021/22 – 2024/25

Composition of Public Debt

A huge portion of the public debt stock is externally financed. It amounts to USD 11.7 billion (UGX 42.61 trillion) translating to 65% of public debt stock while domestic debt amounts to USD 6.3 billion (UGX 22.96 trillion) translating to 35%.

Disturbingly, undisbursed external debt amounts to USD 4.55 billion which translates to 38% of external debt.

The undisbursed loans attract huge commitment fees that would have been used to deliver services to the citizens. For instance, in FY2019/20 the Auditor General noted UGX 9.241 billion was spent as commitment fees for undisbursed funds of only 3 loans[10]. This averages to UGX 3 billion.

There are about 93 ongoing loan financed projects[11]. Assuming commitment fees are to be paid for undisbursed funds for each of them, they would amount to UGX 279 billion. This is equivalent to budgets of about 9 local governments. This elaborates the extent of wastages of the country's committed debt.

Debt Management Costs

Relatedly the costs of debt management are eroding a huge chunk of funds from service delivery. These take first call on the budget. Over the years debt management costs have risen from UGX 8.58 trillion in FY2017/18 to UGX 15.11 trillion. This is an increment of 43%. The costs are mainly driven by domestic debt particularly debt refinancing also known as debt roll over. Simply put, this is debt deferment.

Debt rollover is a huge cause of concern as noted by the Auditor General for no redemption of domestic debt was made at all in the period FY2017/18 – FY2019/20. Hence 75% of the domestic borrowing or debt was rolled over or recycled[12]. This makes it harder for the future generation to determine their spending priorities for they are already tied up to huge debt servicing costs.

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[10] Office of the Auditor General, 2021. Report of the Auditor General to Parliament for the Financial Year ended 30th June 2020

[11] Ministry of Finance, Planning and Economic Development, 2021. Report on Public Debt, Guarantees, other Financial Liabilities and Grants for Financial Year 2020/21

[12] Office of the Auditor General, 2021. Report of the Auditor General to Parliament for the Financial Year ended 30th June 2020, Pg. 24

Table 4: Costs of Debt Management in FY2017/18 – 2021/22

Item	Approved Budget FY2017/18 (UGX 000)	Approved Budget FY2018/19 (UGX 000)	Approved Budget FY2019/20 (UGX 000)	Approved Budget FY2020/21 (UGX 000)	Proposed Budget FY2021/22 (UGX 000)
Loan interest	380,386,967	340,832,532	544,648,699	868,934,344	1,054,536,553
Commitment charges	67,026,309	25,837,622	15,614,958	52,824,053	20,678,365
Debt management fees	-	15,000,000	65,000,000	103,461,024	132,133,579
Treasury Bills (interest)	825,212,974	388,436,993	564,955,534	597,502,527	857,066,221
Bonds (interest)	1,246,796,609	1,742,500,000	2,043,700,000	2,361,885,916	2,763,749,759
External debt repayment (Budgeting)	589,773,562	894,059,493	723,318,387	1,228,943,808	1,903,015,501
Treasury Bills Redemption (Budgeting)	3,875,090,529	3,991,800,000	4,514,800,000	5,291,270,998	6,483,239,054
Treasury Bonds Redemption (Budgeting)	1,598,389,600	1,279,688,098	1,847,102,620	2,194,869,972	1,901,472,123
Total	**8,582,676,550**	**8,678,154,738**	**10,319,140,198**	**12,699,692,642**	**15,115,891,155**

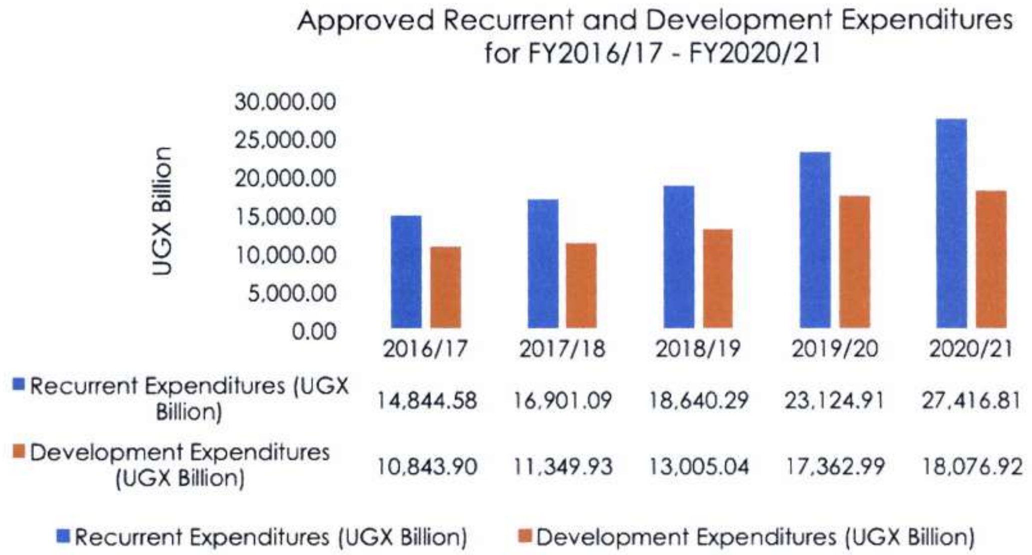
Source: MoFPED and OLOP

Recurrent Expenditures

Unfortunately, a huge portion of the mobilized and committed debt is spent on recurrent expenditures rather than development which spurs growth. The items that are prioritized for spending that are responsible for the escalating public debt are largely consumptive in nature. They include interest payments, wages, workshops, travel inland and abroad among others.

Worryingly, the country's tax revenues are insufficient to fund country's recurrent expenditures. For instance, the projected revenue outturn for FY2020/21 amounting to UGX 19.43 trillion is far short of recurrent expenditures of that financial year amounting to UGX 27.41 trillion.

Figure 5: Graph showing Recurrent and Development Expenditures in FY2016/17 – 2020/21



Source: MoFPED and OLOP

Classified Expenditures

Of great concern too is the fact that debt has been committed towards classified expenditures whose budget allocations take a huge share of national budget with limited scrutiny. They are a regular target of supplementary budgets in every financial year.

Major beneficiaries of classified expenditures include the Votes of Office of the President, State House, Ministry of Defence, Ministry of Internal Affairs, Inspectorate of Government, Ethics and Integrity, Financial Intelligence Authority, Uganda Police Force, External Security Organisation and Directorate of Government Analytical Laboratory.

During budget allocations, classified expenditures are more prioritized that budgets of Local Governments where most of public services are delivered. For instance, in FY2020/21 the approved budget of UGX 3.21 trillion for classified items is equivalent to 79% of the approved total budget of Local Governments amounting to UGX 4.02 trillion.

Table 5: Budget Trends of Classified Expenditures and Assets in FY2015/16 – 2020/21

FY	Classified Expenditure (UGX '0000)	Classified Assets (UGX '0000)	Total Classified Items (UGX '0000)
2015/16	733,301,552	-	**733,301,552**
2016/17	441,057,307	-	**441,057,307**
2017/18	450,513,835	95,083,769	**545,597,604**
2018/19	779,357,228	154,986,219	**934,343,447**
2019/20	367,132,253	2,228,340,580	**2,595,472,833**
2020/21	393,714,725	2,822,536,712	**3,216,251,437**

Source: MoFPED and OLOP Computation

Proposed Fiscal Rules

CHARTER FISCAL RULE	***PROPOSED ALTERNATIVE RULE***
Total Public Debt in Nominal terms is reduced to below 50% of GDP by Financial Year 2025/26	***a) Liquidity Targeting*** ◆ *Ratio of Public Debt Management Costs to Total Revenues is less or equal to the ratio of Total Revenue to Market Price GDP.* ◆ *Growth rate in Recurrent spending not exceeding the percentage of Revenue (excluding Oil revenue) to GDP.*
	b) Government Financing ◆ *Ensure funding of not less than 70% of development requirements of local governments over a 5-year period would be fitting.*
	c) Supplementary Expenditures ◆ *Maintaining supplementary budgets within 5% of approved budgets.*

a) Fiscal rule targeting Liquidity

The proposed Charter of Fiscal Responsibility does not commit to any quantitative benchmark on debt sustainability, beyond which it would be judged to have missed the target. The last Charter had a clear benchmark of *maintaining public debt in net present value terms below 50% of GDP. Of which the net present value of external debt was to be maintained below 30% of GDP and the net present value of domestic debt maintained below 20% of GDP.*

The proposed Charter refers to a desired trend of Public Debt in Nominal Terms reducing below 50% of GDP over time. It does not set an absolute mark beyond which the target would have been missed.

It would be prudent that the Charter commits to an absolute target, the basis of which assessment of performance can be made. If for any circumstances, the target may be missed, the Minister can come back to Parliament for approval of deviation from the Charter.

Fiscal rules ought to be introduced that assess debt sustainability based on ability to raise sufficient liquidity to repay debt. The current measure of debt stock to GDP ratio measures only the solvency of the country i.e. ability to pay in the long run. Solvency does not give a clear indication of the country's ability to meet its immediate debt repayment obligations.

In order to have a clearer stand of the country's ability to meet its debt obligations while at the same time raising enough financing for National Development Plan III core projects, the following fiscal rules should be incorporated into the Charter:

- *Ratio of Public Debt Management Costs to Total Revenues is less or equal to the ratio of Total Revenue to Market Price GDP.*
- *Growth rate in Recurrent spending not exceeding the percentage of Revenue (excluding Oil revenue) to GDP.*

b) Fiscal rule for Local Government Financing

The proposed fiscal objectives only cover central government neglecting the local governments. Aware that 85% of public services are delivered through local governments, it would be prudent that a fiscal rule is set to guarantee their financing. This would be in line with the decentralization policy stipulated in Article 176 of the Constitution of the Republic of Uganda. Absence of a fiscal rule is largely responsible for the deplorable funding and quality of service delivery in local governments.

There is need to ensure sustainable funding of local governments. This would require every local government to have a 5-year development plan that is aligned to the National Development Plan.

A fiscal objective should be set that targets to:

- *Ensure funding of not less than 70% of development requirements of local governments over a 5-year period would be fitting.*

c) *Fiscal rule for Supplementary Expenditures*

Supplementary budgets have over the years become a financial nuisance in Uganda. Majority of the requests have been found not to have been adequately scrutinized. Consequently, the Constitution provision of accessing 3% of annual budget as supplementary expenditure without prior approval of Parliament has grossly been abused over the years. Those that require prior approval have also been found to be wanting for they rarely satisfy the supplementary criteria of being unavoidable or unforeseeable. This has been highlighted on several occasions in reports of Parliament and Auditor General.

To help tame prevailing supplementary budget indiscipline and subsequently trigger fiscal consolidation, a fiscal rule should be considered that targets to:

- *Maintaining supplementary budgets within 5% of approved budgets.*

3.3 ENSURING THAT THE FISCAL BALANCE, WHEN CALCULATED WITHOUT PETROLEUM REVENUES, IS MAINTAINED AT A SUSTAINABLE LEVEL OVER THE MEDIUM TERM

Both the expired and proposed Charter point to continuation of the same financial indiscipline path. Hence the proposed fiscal rule of overall fiscal balance including grants gradually adjusting to a deficit not exceeding 3% of non-oil GDP by FY2025/26 is untenable.

As earlier mentioned, the proposed commitment cannot be made to a trend instead of an absolute target upon which government would be held accountable. If approved, Parliament would be side stepped without necessitating approval for deviation. This too points to the intention of government in as far maintaining status quo of operations.

It is also imperative to note that while government sought to maintain fiscal deficit of not greater than 3% of GDP by FY2020/21, never was the target achieved in the life span of the Charter. To the contrary, the fiscal deficit was rising gradually from 3.30% in FY2016/17 to 9.0% in FY2020/21. The fiscal deficit has deteriorated at an average of 1.43%.

Table 6: Fiscal Deficit outturn and Projections in Charters of Fiscal Responsibility and National Development Plan III

	OUTTURN					PROJECTIONS				
FY	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
CFR	-3.30%	-4.10%	-4.90%	-7.10%	-9.00%	-6.40%	-5.20%	-4.60%	-4.20%	-3.00%
NDP III			-5.35	-6.18	-6.55	-5.95	-5.29	-4.07	-2.97	

Source: PBO

Based on past performance particularly low domestic revenue mobilization and elevated public spending, the fiscal deficit without undertaking efforts for fiscal consolidation is bound to worsen to debt relief levels.

Besides the fiscal deficit pathway projected in the proposed Charter is rugged and illogical. Its projections in FY2021/22 should have started at fiscal deficit of 9% not 6.40%. This is a drop of 2.6%. This is untenable given that each financial year the fiscal deficit depreciates by an average of 1.43%.

The proposed Charter projections also violate Section 5(1)(a)(i) of the Public Finance Management Act. The fiscal objective on fiscal balance and its projections are not consistent with the projections set in the National Development Plan III.

Proposed Fiscal Rule

CHARTER FISCAL RULE	***PROPOSED ALTERNATIVE RULE***
The overall fiscal balance including grants should gradually adjust to a deficit not exceeding 3.0% of non-oil GDP by financial year 2025/26	◆ *Growth rate in Recurrent spending not exceeding the percentage of Revenue (excluding Oil revenue) to GDP*

Government of Uganda has significantly missed the target set on the budget deficit or fiscal balance set out in the last Charter of Fiscal Responsibility for FY2016/17 – 2020/21.

It would be prudent for Parliament to set fiscal rule that only gives room for fiscal authorities to meet set deficit targets by capping allowable expenditure growth limits. To achieve the desired fiscal balance in line with Section 4 (2)(c) of the Public Finance Management Act, expenditure growth should be in line with GDP growth. This implies that rise in spending is financed by growth in tax revenue.

By default, expenditure increases are supposed to be in line with growth in revenue collections. The intent is to prevail over the runaway fiscal deficit to the initial ceiling target of 3% of GDP. To prevail over recent acceleration in spending, a simple nominal target on spending must be introduced.

The rule would cap the growth rate of recurrent spending. This would ensure that the government uses revenue windfalls for investment rather than increasing consumption and wages. It would also reign in on growth of wasteful expenditures.

Tanzania uses a similar recurrent expenditure cap.[13] *The appropriate expenditure anchor is annual growth rate in recurrent spending not exceeding the projected Domestic Revenue excluding Oil Revenue.*

The following fiscal rule should replace that the one that has been proposed in the Charter:

- *Growth rate in Recurrent spending not exceeding the percentage of Revenue (excluding Oil revenue) to GDP.*

3.4 MANAGEMENT OF REVENUES FROM PETROLEUM RESOURCES AND OTHER FINITE NATURAL RESOURCES FOR THE BENEFIT OF CURRENT AND FUTURE GENERATIONS

The Charter introduces a new rule on petroleum fund transfers that was not in the expired Charter. It seeks to set aside a maximum of oil revenue worth 0.8% of the preceding year's estimated non-oil GDP outturn to be transferred to the Consolidated Fund for budget operations. The balance shall be transferred to the Petroleum Revenue Investment Reserve.

Status of Petroleum Fund

For the period between FY2014/15 and 2019/20, the Petroleum Fund has been credited with a total of UGX 669.69 billion. Of this, UGX 580.30 billion was withdrawn from the Fund as budget support to finance the budget between FY2017/18 – FY2019/20. Hence the Fund was nearly depleted for the funds to be withdrawn were determined at the discretion of the Ministry of Finance, Planning and Economic Development.

Table 7: Petroleum Fund Deposits and Withdrawals in FY2014/15 – 2019/20

Financial year	Deposits	Withdrawals	Purpose of withdrawal
2014/15	119,323,709,754	0	
2015/16	133,099,656,037	0	
2016/17	238,433,505,737	0	
2017/18	62,988,471,916	125,300,000,000	Budget support
2018/19	56,739,539,082	200,000,000,000	Budget support
2019/20	59,105,854,932	255,000,000,000	Budget support
	669,690,737,458	**580,300,000,000**	

Source: OAG

[13] Aisha Adam and David Mihalyi, 2017, Optimizing Ghana's Fiscal Rule

It is also critical to note that based on Production Sharing Agreements with oil companies, government committed to reimburse all recoverable costs when production commences. So far, the Auditor General has verified costs for the period 2001 – 2011 amounting to USD 935.69 million (equivalent to about UGX 3.47 trillion)[14]. The amount for the period 2012 to date is yet to be verified by the Auditor General. These are recorded as contingent liabilities. This contradicts Section 74(1) of the Public Finance Management Act which states that the financial assets of the Petroleum Fund including present or future financial assets should not be earmarked, pledged, committed, loaned out, or otherwise encumbered by any person or entity. The fund cannot be used to provide credit to government, or any other person or entity; act as collateral for debts, guarantees, commitments or other liabilities of any person or entity; or borrowing.

During the FY2020/21, UGX 134.9 billion was paid into the Fund as capital gains tax and stamp duty from the sale of Tullow Uganda Limited shares to Total EP Uganda. As of December 2020, the fund had a balance of UGX 221.4 billion[15]. In the approved budget of FY2021/2022, UGX 200 billion has been appropriated and will be withdrawn from the Fund leaving a balance of just UGX 21 billion.

Lack of Investment Profile

It should be noted that Uganda lacks an investment profile to guide and profile infrastructural and developmental projects eligible for financing by petroleum revenue. Hence criteria of what constitutes a suitable infrastructural and developmental project is not defined. The investment profile will be essential in informing the Petroleum Revenue Investment Policy issued by the Minister of Finance under Section 63(1) of the Public Finance Management Act.

Selective Extractive Revenue Targeting

The proposed fiscal rule is commendable for it satisfies the recommendation of the Auditor General to set fiscal rule for petroleum revenue[16]. It also partly satisfies a principle in Section 4(2) of the Public Finance Management Act. The principle relates to management of revenues from petroleum resources and other finite natural resources for the benefit of current and future generations. However, the proposed fiscal objective rule only addresses management of petroleum revenue neglecting other finite natural resources particularly minerals.

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[14] Ministry of Finance, Planning and Economic Development, 2020. Petroleum Fund Annual Audited Financial Statements for the year ended 30 June 2020.

[15] Ministry of Finance, Planning and Economic Development, 2021. Half Year Macroeconomic & Fiscal Performance Report Financial Year 2020/21

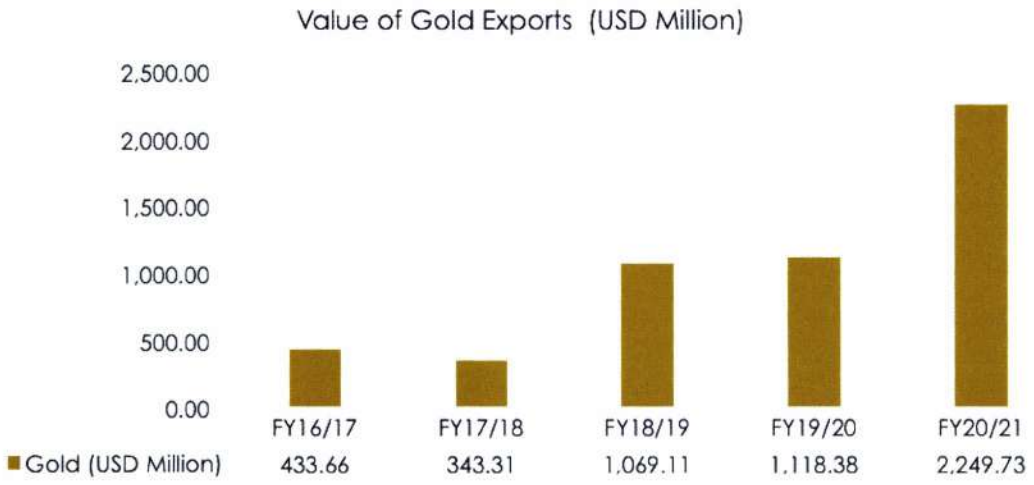
[16] Office of the Auditor General, 2021. Report of the Auditor General to Parliament for the Financial Year ended 30th June 2020.

This underplays the contribution of mining sector to the economy. It has been reported that in FY2020/21, mineral products were the main export item earning Uganda USD 3,681.12 million out of total export earnings of USD 5,259.12 million.

Critical to note is the fact that most of the mineral earnings are attributed to gold exports. In FY2020/21, Uganda earned USD 2,249.73 million which translates to 61% of the mineral exports.

The spike in gold exports is attributed to the development of refining facilities which mainly receive import inputs from Tanzania, Zimbabwe, Zambia and South Sudan[17]. The refineries include African Gold Refinery, Simba Gold Refinery, Bullion Gold Refinery, Metal Testing and Smelting Company Limited, and Aurnish Gold Refinery[18]. They operate under free zone and manufacture under Bond[19].

Figure 5: Graph showing value of Gold Exports in FY2016/17 – 2020/21



Source: BoU and OLOP

It is also important to note that while the values of gold exports were rising, they are nearly whipped out by gold imports. Hence there is need to improve the gold trade balance.

[17] Ministry of Finance, Planning and Economic Development, 2021. Background to the Budget for FY2021/22

[18] Ministry of Energy and Mineral Development, 2020. Sector Performance Report

[19] Ministry of Energy and Mineral Development, 2020. Directorate of Geological Surveys and Mines Performance Report for FY2019/20

Table 8: Gold Deposits and Withdrawals in FY2014/15 – 2019/20

Year	Imports (UGX)	Exports (UGX)	Re-exports (UGX)
2010	1,223,125	204,963,696	62,351,966,273
2011		745,379,518	15,751,185,208
2012		497,216,000	22,187,885,306
2013		2,044,973,209	6,238,703,028
2014		463,659,818	
2015	420,493	125,425,873,900	
2016	304,097	845,089,240,008	
2017	294,776	1,397,305,211,760	653,038,200
2018	1,262,772,739,579	1,728,609,719,808	
2019	3,745,902,404,317	4,657,889,674,568	
2020	725,531,713,981	690,911,238,303	
TOTAL	**5,734,209,100,368**	**9,449,187,150,588**	**107,182,778,015**

Source: MEMD

Proposed Fiscal Rule

CHARTER FISCAL RULE	***PROPOSED ALTERNATIVE RULE***
A maximum of oil revenue worth 0.8% of the preceding year's estimated non-oil GDP outturn shall be transferred to the Consolidated Fund for budget operations. The balance shall be transferred to the Petroleum Revenue Investment Reserve (PRIR) for investment in accordance with the Public Finance Management Act (2015) as amended	***Intervention*** *Develop a comprehensive investment profile*
None for mineral revenue	◆ *Withdrawals from the Minerals Fund for purposes of financing the budget are capped at 0.8% of the previous year's non-extractive resources to GDP. The balance shall be transferred to the Non- Oil (Minerals) Fund*

While there's a dedicated Fund for Petroleum Revenues, it should be noted that Revenues from other minerals is not distinctively collected and managed for the benefit of today and future generations.

Considering the above, a Fund for investment and management of Non-Oil Mineral Wealth of Uganda should be established. The following is proposed as the appropriate fiscal rule for the use of such funds for purposes of financing the Budget:

- *Withdrawals from the Minerals Fund for purposes of financing the budget are capped at 0.8% of the previous year's non-extractive resources to GDP. The balance shall be transferred to the Non- Oil (Minerals) Fund.*

Recommendation on projects that are to be financed by Extractive Resources Revenue – Petroleum and other Minerals

We recommend that Government through this Charter, commits to undertake a study to produce an investment profile for guiding infrastructural and developmental projects eligible for financing by petroleum fund and minerals fund.

3.5 MANAGEMENT OF FISCAL RISKS IN A PRUDENT MANNER

Section 4(3) of the Public Finance Management Act demands that the Charter sets measurable indicators for the management of fiscal risks. Unfortunately, no fiscal rule was set to guide the management of fiscal risks.

The Public Finance Management Act provides a criterion that qualifies a risk that may lead to deviation from the objectives of the Charter. Section 7(1) of the Act anticipated risks arising from a natural disaster (not man made), unanticipated severe economic shock or unforeseen event that cannot be funded from the Contingency Fund, other funding mechanisms admissible under the Act or fiscal policy adjustments. Therefore, before any deviation it must be ascertained whether these response mechanisms have been exhausted.

Contingencies Fund

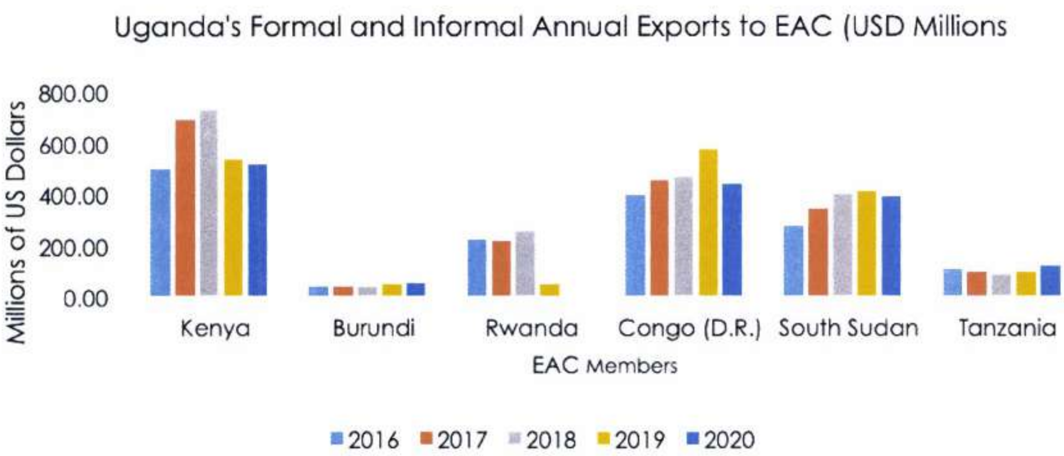
Regarding the Contingencies Fund, it should be noted that it has never been fully funded as required under Section 2 of the Public Finance Management (Amendment) Act. The provision commands that the Contingency Fund is replenished by 0.5% of the appropriated annual budget of the previous financial year. For instance, in this FY2021/22, only UGX 62.070 billion was appropriated instead of UGX 227.47 billion. Hence a shortfall of UGX 165.4 billion.

No wonder, government has always faced challenges in mobilizing funds to respond to emergencies such as COVID-19, floods and mudslides among others across the country. This was a cause of concern as highlighted by the Auditor General for the inadequate funding led to the raising of supplementary budgets which distort the implementation of approved budgets[20].

Foreign Relations

Besides the fiscal risks articulated in the Act, there are other emerging risks arising from diplomatic and security tensions particularly with Rwanda, South Sudan, Burundi and Democratic Republic of Congo. For instance, due to a diplomatic row with Rwanda, total formal and informal exports dropped significantly from USD 261.63 million in 2018 to USD 6.77 million in 2020[21].

Figure 6: Graph showing value of Uganda's formal and informal exports to East African Community in the period 2016 - 2020



Source: BoU and OLOP

Loss Making Public Corporations

Also of concern is the fact that several public corporations operate at losses despite incurring huge debt through on lending from government. Hence, they are unable to service their debt compromising the country's fiscal sustainability. The public corporations are indebted to a tune of over UGX 6 trillion[22]. For instance, the Auditor General noted that Insurance Training college, UEGCL, UEDCL, Bank of Uganda, Post Bank Uganda, UETCL, Uganda

[20] Office of the Auditor General. Report of the Auditor General to Parliament for the Financial Year ended 30th June 2020

[21] Bank of Uganda, 2021. Statistics. https://www.bou.or.ug/bou/bouwebsite/Statistics/Statistics.html Last accessed 19 September 2021

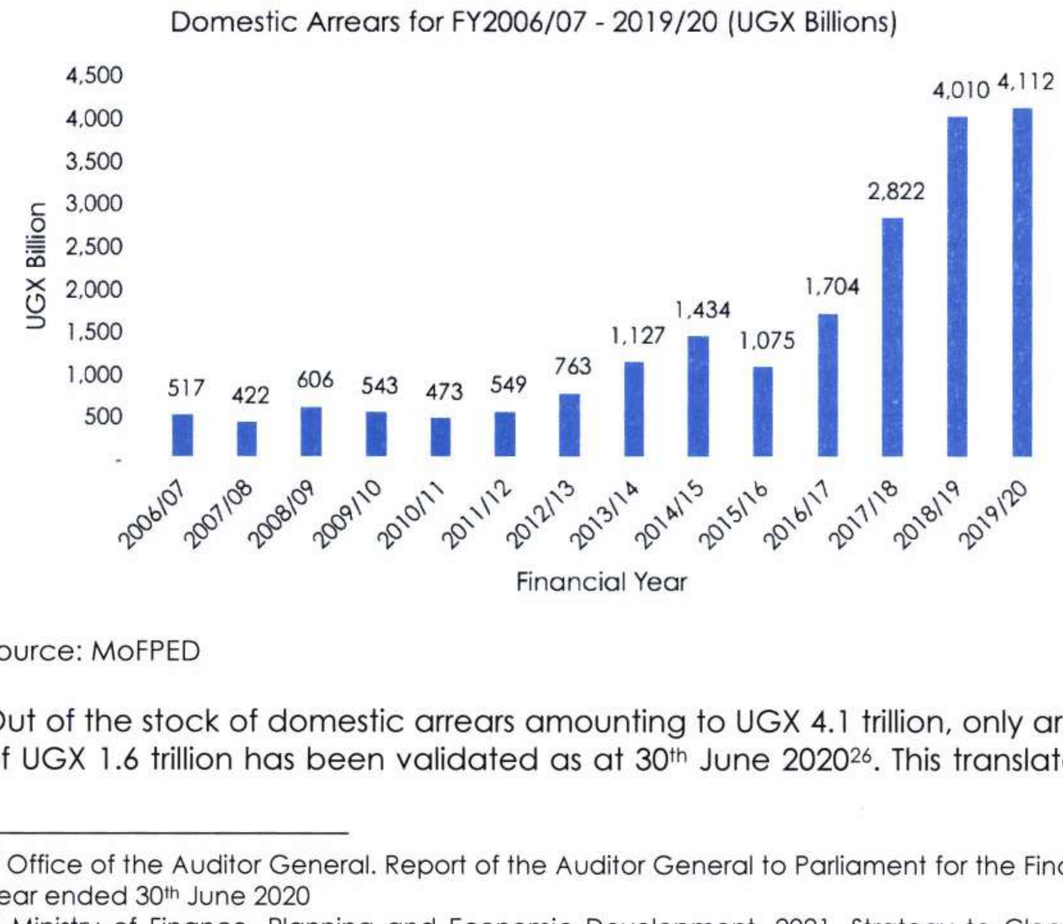
[22] Ministry of Finance, Planning and Economic Development, 2018. Fiscal Risks Statement

National Oil Company, NWSC, Pride Micro Finance and Uganda Civil Aviation Authority lacked sufficient assets to cover their debt[23].

Escalating stock of Domestic Arrears

Lastly, Uganda's fiscal sustainability is also adversely affected by ever-increasing domestic arrears. The total stock has risen from UGX 517 billion in FY2016/17 to UGX 4.1 trillion in FY2019/20[24]. This translates to a growth of 87%. It has been noted that these arrears may be used to circumvent fiscal targets by distorting fiscal deficit, accumulate liabilities of government, undermine budget credibility, increase cost of supplying government by pricing in cost of delayed payments, diminish working capital of suppliers, delay tax payments, compromise welfare of pensioners and erode investor confidence due to inability of government in meeting its obligations[25].

Figure 7: Graph showing value of Domestic Arrears in FY2006/07 – 2019/20



Source: MoFPED

Out of the stock of domestic arrears amounting to UGX 4.1 trillion, only arrears of UGX 1.6 trillion has been validated as at 30th June 2020[26]. This translates to

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[23] Office of the Auditor General. Report of the Auditor General to Parliament for the Financial Year ended 30th June 2020

[24] Ministry of Finance, Planning and Economic Development, 2021. Strategy to Clear and Prevent Domestic Arrears

[25] International Monetary Fund, 2021. Request for a Three Year Arrangement under the Extended Credit Facility – Press Release; Staff Report; and Statement by the Executive Director for Uganda. IMF Country Report No. 21/141

[26] Ministry of Finance, Planning and Economic Development, 2021. Strategy to Clear and Prevent Domestic Arrears

39%. Hence most of the arrears are not validated. They are questionable and cause of concern on how they could have been generated. Only validated arrears are eligible for payment over a period.

Table 9: Validated Domestic Arrears as of 30th June 2020

S/N	CATEGORIES	MINISTRIES	AGENCIES	HOSPITALS	MISSIONS ABROAD	TOTAL	%
1	Court Awards	408,934,787,449	30,296,523,708	-	-	**439,231,311,157**	26.4%
2	Other Recurrent Costs	235,805,874,605	71,516,286,155	977,278,765	163,916	**308,299,603,441**	18.5%
3	Compensations	87,859,209,378	214,311,121,582	-	-	**302,170,330,960**	18.2%
4	Development	83,580,630,054	124,677,466,614	1,558,722,996	-	**209,816,819,664**	12.6%
5	Pension and Gratutiy	89,377,123,999	33,890,590,559	589471220	-	**123,857,185,778**	7.4%
6	Contributions to International Organisations	105,476,167,814	497,855,436	-	-	**105,974,023,250**	6.4%
7	Goods and services	-	71,852,725,715	-	677,209,360	**72,529,935,075**	4.4%
8	Taxes and other deductions	41,325,080,828	4,060,640,563	97,495,834	435,764,018	**45,918,981,243**	2.8%
9	Rent	7,649,272,423	11,121,109,073	-	-	**18,770,381,496**	1.1%
10	Electricity	1,534,233,524	13,853,273,197	748,398,155	-	**16,135,904,876**	1.0%
11	Water	57,240,957	13,926,716,227	435,312,631	-	**14,419,269,815**	0.9%
12	Salary Arrears	1,457,072,609	4,657,492,078	23,699,267	-	**6,138,263,954**	0.4%
13	Telephone	583,845,081	37,076,620	-	-	**620,921,701**	0.0%
	TOTAL	**1,063,640,538,721**	**594,698,877,527**	**4,430,378,868**	**1,113,137,294**	**1,663,882,932,410**	

Source: MoFPED

Proposed Fiscal rule

CHARTER FISCAL RULE	***PROPOSED ALTERNATIVE RULE***
None	***Domestic Arrears*** ♦ *The stock of verified arrears as at 30th June 2020 should be cleared by June 30th June 2023.*

Given the current stock of verified debt of UGX 1.6 trillion, majority of which have been outstanding for so many years, the proposed fiscal rule is that:

- *The stock of verified arrears as at 30th June 2020 should be cleared by June 30th June 2023.*

Aware that more arrears may accumulate in the set period up to June 2023, appropriate penalties to accounting officers who commit Government without evidence of availability of funds should be instituted. This requires commitment by the Minister to prevail over the unfortunate practice of Accounting Officers creating questionable arrears.

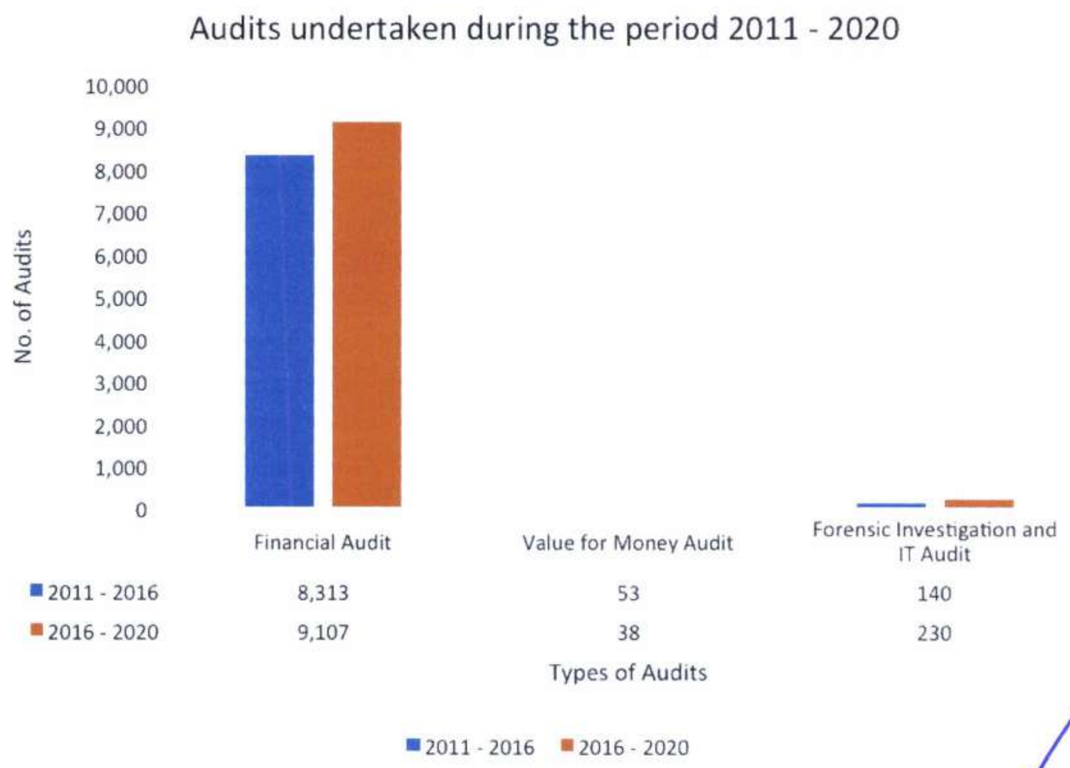
3.6 Other Critical Principles

While Section 4(3) of the Public Finance Management Act excludes Principles regarding consistency of the Medium-Term Expenditure Framework to the National Development Plan as well as efficiency, effectiveness and value for money in expenditure, it would be prudent that measures are set for them.

Emphasis should be placed on setting performance targets for value for money audits. These place emphasis of efficiency and effectiveness of spent public funds more than accountability an aspect that is prioritized by financial and forensic audits.

It has been noted with concern that Value for Money audits are the least undertaken by the Auditor General. For the last 10 years, the Auditor General has undertaken only 91 (0.5%) Value for Money audit compared to 17,420 (97.4%) Financial audits and 370 (2.1%) Forensic Investigation and IT audits.

Figure 8: Graph showing number of Audits undertaken in the period 2011 - 2020



Source: OAG and OLOP

Recommendation

In a bid of enhancing quality in service delivery, it is ideal that in each year Value for Money Audits are not less than 5% of the total number of audits undertaken by the Auditor General.

4.0 CONCLUSION

Parliament is implored to consider and approve the proposed fiscal rules made in this Response for improved financial discipline in Uganda.

I Beg to Move.