



ISER

Facilitating Social Justice

INITIATIVE FOR SOCIAL AND ECONOMIC RIGHTS



FUNDING PUBLIC SERVICES REMAINS THE BEST USE FOR UGANDA'S NEW SPECIAL DRAWING RIGHTS ALLOCATION

DECEMBER 2021

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INTRODUCTION

In August 2021, the IMF Board of Governors approved¹ a new \$ 650-billion-dollar general allocation of Special Drawing Rights (SDR) to all member countries to help them grapple with the pandemic and fund their recovery. This followed sustained advocacy by civil society including the Initiative for Social and Economic Rights (ISER) who argued that developing countries lacked fiscal space to be able to respond to the pandemic.² As an allocation, Uganda received \$ 490 million³ USD (Ugx. Shillings 1.7 trillion) of these newly issued funds.

In simple terms, the SDR is an “international reserve asset”, created by the IMF in 1969. International reserves are those currencies and assets that countries use to meet their Global settlements. Say for example, if the Ugandan Government was to purchase doses of the Pfizer vaccine from the USA, such a transaction cannot be settled in Ugandan shillings. Rather, the Government would have to cash in on US dollars or other internationally accepted currencies to complete this settlement. These, would in this case, constitute international/foreign reserves.

A new SDR issuance, in lay man terms, is akin to the IMF printing new money which then gets distributed amongst its member countries. This is why, SDRs are considered as additional debt-free resources that come at no cost or repayment obligations to their recipient countries. In addition, SDRs do not come with any conditionalities attached to them and thus governments are at the discretion to use them as they see fit.

This recent SDR issuance by the IMF was informed by the fact that many countries globally were faced with a large fiscal gap in comparison to what they needed to effectively fight the pandemic; provide safety nets to their populations; and support their businesses and economies to recover. As indicated within IMF's economic outlook report of April 2021, for Sub-Saharan Africa (SSA), the region's low-income countries were faced with additional external funding needs to a tune of \$245 billion over 2021–25. The IMF further stated that the region could only cover a portion of these needs on its own⁴ noting that a new general SDR allocation was essential in strengthening the crisis response and swiftly boosting the reserves of all members.

Uganda was in particular faced with a large spending gap that accounted for 10 percent of the

¹ <https://www.imf.org/en/News/Articles/2021/07/30/pr21235-imf-governors-approve-a-historic-us-650-billion-sdr-allocation-of-special-drawing-rights>

² Open Letter to G20 Finance Ministers and the IMF:
Civil Society Organizations Call for Quick Special Drawing Rights Allocation

³ <https://www.imf.org/en/Topics/special-drawing-right/2021-SDR-Allocation>

⁴ <https://www.imf.org/en/Publications/REO/SSA/Issues/2021/04/15/regional-economic-outlook-for-sub-saharan-africa-april-2021>

Country's GDP as of June 2021.⁵ This shrinking fiscal space kept the Country's health system largely underfunded. Government was on average contributing only 16 percent⁶ of the entire current health spending, leaving the rest to be carried on by households. Furthermore, owing to a shortage in funding, the Government's new social protection measures still fell short of what was required. An example was the COVID - 19 cash transfer program that according to research by ISER was simply "a drop in the ocean."⁷ The same can be said for the country's public education system which now places many children at the risk of not returning to school.

The SDR is an unconditional reserve asset and countries choose how to use them. Once SDRs are allocated, countries face two major choices: maintain them as part of their foreign exchange reserves or use them: part or all of them. They can also use them to service debt or on operations and transactions involving the IMF, for instance payment of interest on and repayment of loans, quota increase payments. Given the unprecedented nature of this crisis, this policy brief examines why they must be used to fund stronger public services like health and education.

MAKE USE OF THE COUNTRY'S NEW SDR ALLOCATION TO FUND STRONGER PUBLIC SOCIAL SERVICES.

Given the above context, we wish to call on the Government to make use of the country's new SDR allocation to fund stronger public services for the achievement of a just and inclusive recovery. Our call to Government is that a timely decision be undertaken to channel these resources to the Finance Ministry for public spending than rather having them held as reserves. Specifically, these should be used to fund current public health facilities and public school needs and as well provide support to the most vulnerable. Below, we provide some arguments to back the above proposal:

1. UGANDA'S RESERVE HOLDING REMAINS ADEQUATE ENOUGH

The country has an option to keep SDRs as reserves to act as buffer in times of declining balance of payments to support efforts by the Central Bank to maintain exchange rates at stable levels.

However, the latest 2021 annual report by the Bank of Uganda shows the country's reserve position is stable and it has to date accumulated reserves enough to cover 5.4 months of imports.⁸

⁵ <https://www.finance.go.ug/sites/default/files/The%20Budget%20Speech%20for%20FY%202021-2022.pdf>

⁶ <https://databank.worldbank.org/source/world-development-indicators>

⁷ A Drop in the Ocean: Uganda's Covid 19 Cash Transfer, <https://iser-uganda.org/publications/policy-and-advocacy-briefs/505-a-drop-in-the-ocean-uganda%E2%80%99s-covid-19-cash-transfer>

⁸ https://www.bou.or.ug/bou/bouwebsite/bouwebsitecontent/publications/Annual_Reports/All/Annual-Report-2021.pdf

This actually now lies within the agreed benchmarks under the East African Community. Such a reserve holding is adequate enough to support the Central Bank's intervention in case there is need to smoothen out any exchange rate volatility. This leaves us flexibility to use excess reserve holdings for other national priorities that at the moment remain very critical, particularly public health services and education. Even with foreign portfolio inflows, at the moment, accounting for a great share of these reserves, there is no indication our reserve position will be detrimentally impacted. The current reserve position therefore does not warrant sacrificing the need to fund other public healthcare, education and social protection priorities.

Failing to use the policy space availed by SDRs simply to maintain reserves when reserves are stable would be akin to failing to take your sick child for treatment so as to maintain a healthy bank balance.

2. THE USE OF SDRS WOULD BE A RATHER BETTER MOVE TO ENSURE UGANDA'S DEBT IS KEPT SUSTAINABLE

As the IMF has [noted](#), the SDR allocation “does not negatively impact members’ debt sustainability and could even enhance it by strengthening reserve buffers and resilience.”⁹ In Uganda’s context, it is relevant in two ways:

2.1 Using SDRs Mitigates Additional Borrowing

Uganda’s rising debt has been of increasing public concern as the country approaches the redline. It doubled in 2020 due to Covid 19. By end June 2021, the nominal value of public debt as a percentage of GDP was 48.3%.¹⁰ Debt service to revenue ratio increased to 24.8 percent of her domestic revenue.¹¹ It is therefore imperative that we curb the acquisition of new debt.

That said, we are still in the eye of the storm and recovery must be financed. Drawing upon SDRs offers some form of debt relief since they provide Uganda with policy and fiscal space to finance her needs given the unprecedented health and economic crisis without having to acquire new loans.

⁹ IMF, Guidance Note for Fund Staff on the Treatment and Use of SDR Allocations, Policy Paper No. 2021/059, <https://www.imf.org/en/Publications/Policy-Papers/Issues/2021/08/19/Guidance-Note-for-Fund-Staff-on-the-Treatment-and-Use-of-SDR-Allocations-464319>

¹⁰ <https://www.bou.or.ug/bou/bouwebsite/bouwebsitecontent/publications/QuartelyStateofEconomy/publications/Quarterly-Economic-Reports/2021/Sep/State-of-Economy-Report-September-2021.pdf>

¹¹ <https://www.bou.or.ug/bou/bouwebsite/bouwebsitecontent/publications/QuartelyStateofEconomy/publications/Quarterly-Economic-Reports/2021/Sep/State-of-Economy-Report-September-2021.pdf>

2.2 Interest Costs from Drawing on the SDR Allocation Remain Negligible when Compared to Financing Costs from Government Borrowing Additional Loans

While a country's decision to draw down her SDR allocation comes with an interest cost (now at 0.07 percent),¹² this remains negligible when compared to the financing costs that would be borne by Government if it opted for rapid condition free loans from the bond and treasury markets with yields as high as 12 percent.¹³ Moreover the Government could still dodge incurring this interest cost by opting to drawdown an equivalent of other reserve assets in place of the SDRs.

3. USING THESE RESOURCES TO FUND HEALTH, EDUCATION, AND SOCIAL PROTECTION DOES NOT BREACH THE SPENDING LIMITS SETFORTH WITHIN THE EXTENDED CREDIT FACILITY

Away from using these resources to fund broader budget priorities, an outright ring-fencing of their use for public health, education, and social protection would eliminate any worries around the potential breach of Government's commitments within the Extended Credit Facility arrangement (ECF). Concern has been that the use of these SDRs for budget support would jeopardize the government's spending commitments reached upon under the current Extended Credit Facility arrangement (ECF) with the IMF. As it can be noted that under this \$1 billion loan arrangement to Uganda, the government committed to keep her spending under control within the first year of the program.¹⁴ This is not a significant concern since the reform program allows for an increase in social spending as well as on healthcare and education from 21.5 percent to 24 percent of total public spending.

MAINTAIN TRANSPARENCY, PARTICIPATION AND ACCOUNTABILITY IN THE USE OF SDRs.

It is important to have transparency, participation and accountability in the use of SDRs. This includes transparency in Bank of Uganda's Bank's balance sheet and other forms of fiscal transparency to ensure strong governance and anti-corruption. Government must engage transparently and main active meaning participation of with Parliament and CSOs as it decides on SDR use and allocation.

CONCLUSION

With the growing inequalities in access to healthcare and education, it therefore remains critical that the Country's new SDR allocation is urgently used to fund public social services and provide social protection. Any new borrowing to fund government spending while the Country holds onto her excess reserves doesn't in this case seem to be an optimal decision given that efforts are underway to maintain sustainable debt levels.

¹² https://www.imf.org/external/np/fin/data/sdr_ir.aspx

¹³ Bank of Uganda, Annual Report 2021, https://www.bou.or.ug/bou/bouwebsite/bouwebsitecontent/publications/Annual_Reports/All/Annual-Report-2021.pdf

¹⁴ <https://www.imf.org/en/News/Articles/2021/06/28/pr21197-uganda-imf-executive-board-approves-ecf-arrangement-for-uganda>

RECOMMENDATIONS

Government

- Bank of Uganda should urgently channel these resources to the Finance Ministry.
- Ring fence these funds towards funding public health, education and social protection.
- Refrain from using these funds to support private actors in any of the above sectors.
- Engage parliament, civil society and other stakeholders on the decision to appropriate these funds.
- Publish annual reports on the fiscal use of these funds.
- Refrain from using these funds to meet external debt obligations.

Parliament

- Parliament should play a stronger oversight role around the use of these funds.

IMF

- IMF should publish regular annual reports in support of efforts to track the use of these funds.





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