



UGANDA

TECHNICAL ASSISTANCE REPORT—DEVELOPING THE CHARTER FOR FISCAL RESPONSIBILITY

September 2017

This Technical Assistance Report on Uganda was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed on April 2015.

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Uganda

Developing the Charter for Fiscal Responsibility

Tom Josephs, Racheeda Boukezia, and Fazeer Sheik Rahim

Technical Assistance Report | April 2015



I N T E R N A T I O N A L M O N E T A R Y F U N D

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ABBREVIATIONS AND ACRONYMS

BOU	Bank of Uganda
DEA	Department for Economic Affairs
EAC	East Africa Community
EAMU	East Africa Monetary Union
FAD	Fiscal Affairs Department
GDP	Gross Domestic Policy
MEPD	Macroeconomic Policy Department
MoFPED	Ministry of Finance, Planning, and Economic Development
PBO	Parliamentary Budget Office
PDMS	Public Debt Management Strategy
PFM	Public Financial Management
UBoS	Uganda Bureau of Statistics

PREFACE

In response to a request from the Ministry of Finance, Planning, and Economic Development (MoFPED), an FAD technical assistance mission visited Kampala during the period March 10 to 19th, 2015, to provide advice on developing the “Charter for Fiscal Responsibility”. The mission was led by Tom Josephs, with Racheeda Boukezia (both FAD) and Fazeer Rahim (AFRITAC East). This technical assistance was provided with financial support from the multi-donor Managing Natural Resources Trust Fund (MNRW).

At MoFPED, the mission met with Mr. Keith Muhakanizi, Permanent Secretary/Secretary to the Treasury; Mr. Lawrence Kiiza, Director of Economic Affairs; Dr. Albert Musisi, Commissioner, Macroeconomic Policy Department; and Mr. Moses Kaggwa, Commissioner, Tax Policy. The mission held workshop sessions with a range of MoFPED staff, including from the Department of Economic Affairs (DEA), the budget and tax policy departments, and the Accountant General’s office, on fiscal policy objectives, fiscal risks, and petroleum revenue policy frameworks. A number of meetings were held with the Macroeconomic Policy Department (MEPD) staff working on the development of the draft Charter for Fiscal Responsibility, organized by Mr. Obadia Turinawe and Ms. Lily Sommer. At the Bank of Uganda, the mission met Mr. Adam Mugume, Executive Director, Research. The mission appreciates the excellent cooperation of the authorities.

The mission is also grateful to the guidance and support provided by Ms. Ana Lucia Coronel, the IMF’s Senior Resident Representative in Kampala, and Ms. Caroline Ntumwa, Economist in the IMF office. Thanks are also due to Ms. Winifred Bisamaza from the IMF office for administrative and logistical support.

EXECUTIVE SUMMARY

Publication of a “Charter for Fiscal Responsibility” at the start of each new Parliament is a requirement of Uganda’s new PFM Act. The Charter should set out measurable medium-term objectives for fiscal policy, and explain the methodology, data, and procedures by which performance against the objectives would be measured. Previous FAD missions provided general advice on the content of the Charter. This mission worked with MoFPED to develop the current draft of the Charter, focusing on some key outstanding issues: the choice of fiscal objectives; procedures governing deviations from the objectives; dealing with future petroleum revenues; and reporting and operational requirements. Recommendations in these areas are summarized in Table 1.

Current plans are to base the core fiscal objectives on the East Africa Monetary Union (EAMU) convergence criteria, by setting a target for the overall general government deficit of 3% by 2020–21 and an annual debt ceiling of 50% GDP on a net present value basis. This approach has several advantages: these objectives already have strong political backing; they are relatively clear and simple; they are achievable on the basis of recent projections; and because the deficit target is on a medium-term basis, it provides flexibility to avoid pro-cyclical policy, at least until the target year is reached. However, the objectives would not provide a hard constraint on policy in the years until 2020–21. Current projections suggest Uganda would have significant headroom below the debt ceiling and the deficit target would only apply in 2020–21. Therefore, these objectives would not provide a backstop against pressure for excessively loose fiscal policy in this period, and could lead to the need for a costly and probably unrealistic one-off fiscal adjustment in 2020–21 to meet the deficit target.

MoFPED should therefore consider augmenting these objectives with additional targets, such as an interim target for the deficit and/or a lower debt ceiling. These targets could be chosen so as to allow planned infrastructure investment to take place, but would provide a backstop against pressures for additional expenditures that may risk putting the public finances on an unsustainable path. It is suggested that further discussions take place on these options with the IMF staff team in the context of developing the latest fiscal projections. Additional supplementary targets could also be included on increasing revenues, meeting existing guidelines on financing, and phasing out central bank borrowing in line with the EAMU Protocol requirement.

The PFM Act specifies circumstances under which the government can deviate from the fiscal objectives. Such “escape clauses” should only be used in the face of severe and unforeseen shocks. Therefore, the Charter should establish strict and transparent procedures for invoking and approving the use of the escape clause, and require publication of a plan showing how the objectives will be met again after a transitional period.

Uganda may become a significant petroleum producer over the next decade, but there is significant uncertainty around the timing and size of associated revenue. This uncertainty means the first Charter should not include specific fiscal objectives aimed at managing petroleum revenues. However, it should be used to establish the key principles on which the petroleum revenue management framework would be based. In particular, it should establish the principle that the fiscal objectives would govern all outflows of revenue from the Petroleum Revenue Fund. MoFPED should use the time before production starts to develop its analytical capacity in this area and develop policy options. FAD and AFRITAC East can provide further technical assistance in this area.

The Charter should also be used to develop transparent fiscal reporting requirements and establish the role of fiscal objectives in underpinning the annual budget process. The report includes recommendations aimed at establishing good reporting practices and improving the transparency and realism of the medium-term fiscal forecasts. It also recommends how the Charter can set out the role of fiscal objectives in guiding the policy-making process. Alongside this, the new PFM regulations should be able to address weaknesses in the budget process, identified by previous FAD missions. Further FAD technical assistance could be provided in this area if required.

Table 1. Uganda: Summary of Recommendations for Developing the Draft Charter

No.	Recommendation	Lead	Time
2.1	Augment the core objectives by adding binding additional or interim targets, aimed at providing a backstop against demands for excessively loose fiscal policy in the period before 2020–21.	MEPD	First draft: May 2015. Final decision: Feb 2016.
3.1	Consider including supplementary targets on revenue, on achieving the guidelines on financing and debt in the 2013 Public Debt Management Strategy, and on phasing out central bank borrowing. Supplementary targets on fiscal risks could also be considered for future Charters.	MEPD Tax policy Debt	First draft: May 2015. Final decision: Feb 2016.
4.1	The Charter should provide additional detail on the procedures and reporting requirements when invoking the escape clause and on the contents of the transition and adjustment plan.	MEPD	May 2015
5.1	The first Charter should reaffirm the key principles that will be used to establish the petroleum revenue policy framework, and require the Charter to be updated with specific fiscal objectives once there is greater certainty around the timing and size of oil revenues.	MEPD	May 2015
5.2	MoFPED should use the time before production starts to develop its capacity on oil revenue forecasting, long-term projections, and risk analysis, and on public investment management. FAD and AFRITAC East can provide further technical assistance in these areas if necessary.	DEA	On-going
6.1	Use the Charter to provide further detail on the definition and data sources for the fiscal objectives and projections that are consistent with international standards and EAC definitions; establish robust and transparent forecasting practices; and specify minimum requirements for the fiscal risk statement.	MEPD	May 2015
6.2	Use the Charter and PFM regulations to underpin the role of fiscal objectives in guiding policy-making through the budget process.	DEA Budget	May 2015

I. INTRODUCTION

1. Uganda has recently passed a new PFM Act which requires the government to publish a “Charter for Fiscal Responsibility” within three months of the start of each Parliament after a general election. The next election takes place in February 2016 and MoFPED is, therefore, working on preparing a Charter that would be ready for approval shortly after, and would cover the period from 2016–17 to 2020–21. To support this process, under Uganda’s Policy Support Instrument with the IMF, there is a structural benchmark for the Charter to be finalized internally by MoFPED in May 2015.

2. The PFM Act specifies that the Charter should set out measurable fiscal objectives for fiscal policy, and explain the methodology, data, and procedures by which performance against the objectives would be measured. A key decision to be taken through the Charter is, therefore, the choice of medium-term fiscal objectives, which would provide top-down guidance for fiscal policy-making through the next Parliament. The Charter will also need to establish key fiscal reporting requirements, and provide detail not specified in the PFM Act on the procedures through which fiscal policy will guide the annual budget process.

3. Previous FAD missions have supported the development of the PFM Act and the Charter.¹ In particular, a May 2014 report gave initial advice on the content of the Charter and provided a draft template. The authorities have since developed a draft which follows this template in many areas. This report does not repeat the general advice provided previously, but instead concentrates on key outstanding issues arising in workshop sessions and discussions with the MPED team responsible for producing the Charter. Specific comments were also provided on the draft Charter produced by the MPED team, which is well developed in most areas. The remainder of the report provides advice on developing the draft Charter in the following areas:

- The choice of core and supplementary measurable medium-term fiscal objectives.
- The definition and use of “escape clauses”, which allow the government to deviate from the fiscal objectives under specific circumstances.
- The establishment of a fiscal policy framework for petroleum revenues.
- Issues related to fiscal reporting and operations.

¹ See: *Toward an Integrated Legal Framework for Public Financial Management*, FAD, December 2010; *Implementing the Public Financial Management Bill*, FAD, May 2014; *Drafting the Public Finance Management Regulations*, FAD, October 2014.

II. CORE MEDIUM-TERM FISCAL OBJECTIVES

4. The PFM Act requires that the Charter sets out medium-term “measurable fiscal objectives” consistent with the fiscal principles established in the Act. The authorities are currently considering adopting the East Africa Monetary Union (EAMU) convergence criteria as the core fiscal objectives: a ceiling on the overall general government deficit of 3% of GDP; and a ceiling on gross public debt of 50% of GDP, on a net present value (NPV) basis. Under the EAMU Protocol, to meet the convergence criteria these objectives would need to be achieved for at least three years ahead of 2024. The authorities are considering setting a target for reaching the 3% deficit in 2020/21, while applying the debt ceiling on an annual basis. At the time of the mission, in 2014–15 Uganda’s central government deficit was estimated at -6.8 per cent, while public debt was estimated at 25 percent of GDP on an NPV basis (see Figure 1).

5. Using the EAMU objectives as the basis for Uganda’s domestic fiscal rules has a number of advantages:

- There is a strong *political commitment* to the EAMU Protocol, which was signed by the President of Uganda and has recently been ratified by Parliament. Further, the debt ceiling is already established as a guideline in the government’s 2013 Public Debt Management Strategy. International experience shows that fiscal objectives are most effective when backed with a strong political commitment.
- The objectives on the deficit and debt meet a number of the *criteria for effective fiscal rules* set out by the IMF and discussed with MEPD staff during the mission workshop.² They are relatively clear and simple to communicate and they would be verifiable on the basis of regularly reported statistics. Establishing the deficit ceiling on a medium-term basis also provides the flexibility to avoid pro-cyclical fiscal policy decisions, at least until the target year is reached. Similarly, Uganda currently has sufficient room beneath the debt ceiling to avoid the risk of pro-cyclical policy with regard to this objective.
- On the latest published IMF fiscal projections available at the time of the mission, the objectives would be *achievable* over the medium term (see Figure 1).

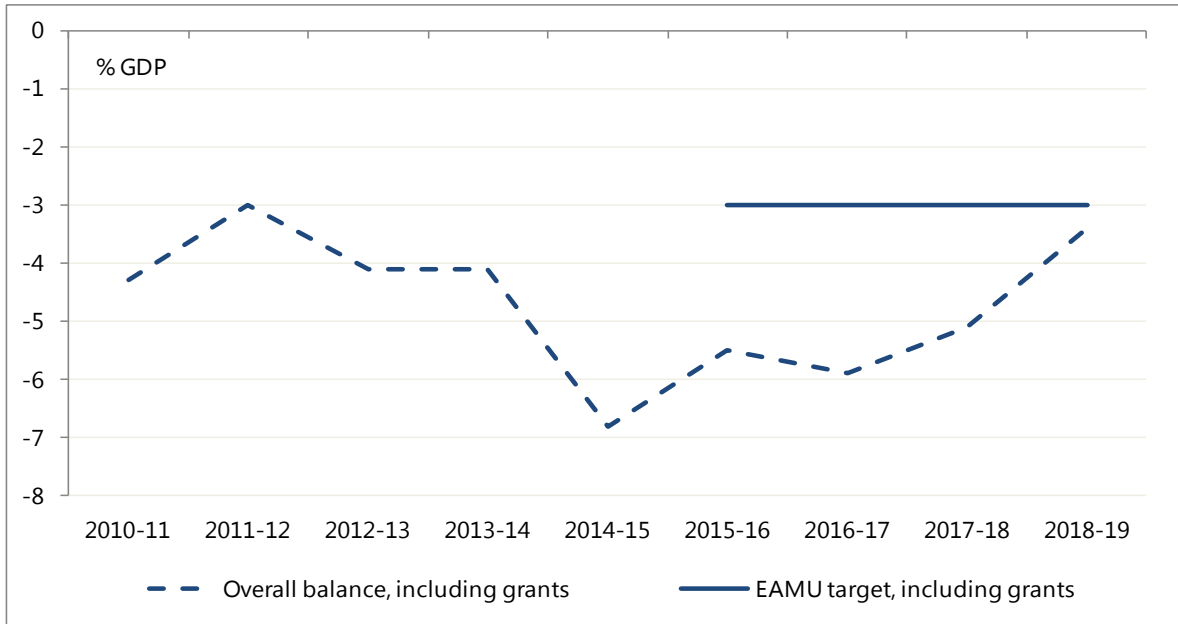
6. While the use of the EAC convergence criteria has a number of advantages, there is a risk they will not provide an effective constraint on fiscal policy in the period before 2020/21. As Figure 1 shows, current projections suggest Uganda has significant head-room below the 50% debt ceiling. Further, using a medium-term objective for the deficit provides flexibility to avoid pro-cyclical policy, but also means there is no hard constraint on fiscal policy on an annual basis. In theory, the government could run large deficits in the years up to 2020/21 as long as its medium-term projections show a return to 3% by 2020–21. This could encourage

² For discussion of the criteria for effective fiscal rules see: *Fiscal rules in response to the crisis - toward the ‘next generation’ rules*, Schaechter, A. et al, IMF Working Paper, 2012; *Fiscal rules - anchoring expectations for sustainable public finances*, Fiscal Affairs Department, IMF, 2009.

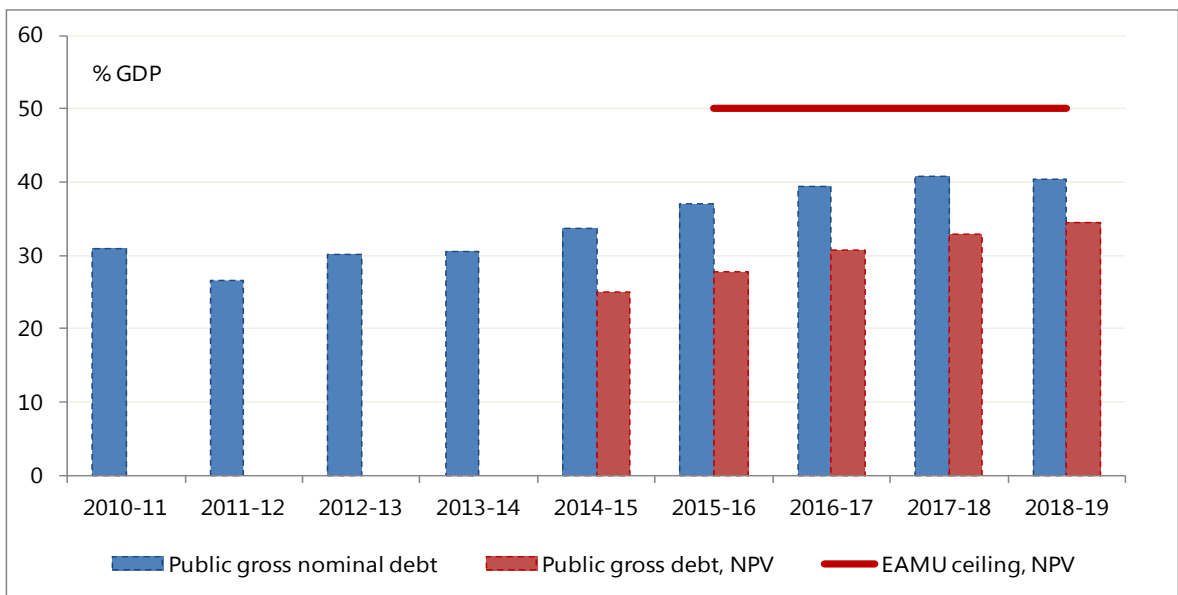
high deficits in the intermediate period and risks, meaning that a large fiscal adjustment could be necessary in 2020–21 to meet the objective. An adjustment of this type, risks destabilizing the economy and could also require an abrupt reduction in investment or other expenditure.

Figure 1. Uganda: Projections for the Overall Balance and Debt

Projections from December 2014 suggest Uganda is on a path toward achieving the EAMU balance target



And has significant headroom beneath the EAMU 50% debt ceiling on an NPV basis



Source: IMF, Third Review Under the Policy Support Instrument, December 2014.

7. MoFPED should therefore consider introducing interim or additional constraints on fiscal policy in the period until 2020–21. Any additional constraint could be chosen so as to still allow room for planned infrastructure investment over the medium term, but would provide a backstop to help MoFPED counter pressure for additional expenditures, which could risk putting the public finances on an unsustainable path. An additional constraint could also increase the credibility of the fiscal objectives with external analysts and the markets. One option would be the use of an intermediate deficit target for around midway through the five-year period of the Charter. This could take the form of a point target midway through the period or a commitment to a smooth path of deficit reduction. For example, a target of 4% GDP for 2018–19 would be achievable on the basis of the December 2014 projections, but would help provide a backstop against the risk of slippage resulting in the need for a large fiscal policy adjustment in 2020–21.

8. Another option would be to establish a lower ceiling for debt, to provide an additional constraint on policy and to provide a buffer against the risk of a shock, which would put at risk the achievement of the EAC ceiling. For example, previous FAD missions have suggested a debt ceiling of 40% of GDP would provide such a buffer while still allowing current investment plans to be delivered. Further discussion on appropriate interim targets could take place in the context of the IMF’s next staff visit in April of this year, using the latest agreed fiscal projections.

Recommendation (2.1): Augment the core objectives by adding binding additional or interim targets, aimed at providing a backstop against demands for excessively loose fiscal policy in the period before 2020–21.

III. SUPPLEMENTARY MEDIUM-TERM FISCAL OBJECTIVES

9. **The core fiscal objectives, set out above, could be accompanied by a set of supplementary objectives.** These can be used to help promote sound fiscal policy and wider good practice in public financial management. As with the rest of the Charter, the approval of Parliament would be required if the government wanted to change the supplementary targets. However, it may be appropriate for some supplementary objectives to be defined in the Charter as indicative rather than binding, as discussed further below. There are three areas where supplementary objectives could be considered in Uganda:

- **Revenue:** The PFM Act includes a fiscal principle on “*sufficiency of revenue mobilization to finance Government programmes*”, which is not explicitly addressed by the core fiscal objectives set out above. Moreover, the EAMU protocol includes an indicative target for raising the tax-GDP ratio to 25% GDP, which is well above current levels in Uganda. Therefore, a supplementary objective could be included for raising the tax-GDP ratio over the medium-term. However, as set out in the May 2014 FAD report, it would be vital that the target was not used as the basis for fiscal and expenditure plans, given the difficulty of achieving such targets and the inherent volatility of revenue. The Charter should establish in the methodology section that fiscal plans should be based on prudent and realistic revenue forecasts, rather than an assumption that any revenue objective will be met. For similar reasons, it would also be appropriate for this to be an indicative rather than binding objective.
- **Domestic and external financing and debt:** The government’s 2013 Public Debt Management Strategy (PDMS) sets out a number of guidelines around the composition of the financing requirement and debt. These are important issues which are central to sustainable fiscal policy management in Uganda. The Charter could usefully underpin this by including a general supplementary objective that the guidelines in the PDMS and the annual Medium-term Debt Strategy are observed. Further, in line with the requirements of the EAMU protocol, this could include a commitment to fully phase out government borrowing from the Bank of Uganda by 2024, with details on transitional arrangements provided in the new PFM regulations.
- **Fiscal risks:** The PFM Act includes a fiscal principle on “*management of fiscal risks in a prudent manner*” and requires the publication of a fiscal risks statement, discussed further below. This could be reinforced with specific objectives on managing important sources of risk. For example, some countries have introduced specific caps on the issue of government guarantees, the size of public-private partnership (PPP) commitments, and other contingent

liabilities that are not captured in public debt statistics.³ Before establishing such objectives, further analysis would be needed to understand the current size of such commitments in Uganda, which will also be needed for the fiscal risks statement. The introduction of a specific objective could be considered for future Charters.

10. Overall, a balance should be struck between using the supplementary objectives to support wider fiscal management and ensuring the Charter is focused and achievable.⁴

Including too many supplementary objectives risks diluting the clarity and focus of the Charter and undermining its credibility if the objectives are not met. Further, including several supplementary targets risks requiring the Charter to be frequently updated as economic circumstances change. Updates to the Charter should be kept to a minimum otherwise the objectives within it will quickly lose credibility.

Recommendation (3.1): Consider including supplementary objectives on revenue, on achieving the guidelines on financing and debt in the 2013 PDMS, and on phasing out central bank borrowing. Supplementary objectives on fiscal risks could also be considered for future Charters.

³ In Kenya, a ceiling on the stock of government guarantees is set in line with the PFM Act of 2012. The ceiling in 2013/14 was set at KSh200 billion (4 percent of GDP). In the UK, the government has recently introduced a nominal ceiling on total commitments related to PPP contracts over the period from 2015–16 to 2019–20.

⁴ The May 2014 FAD report suggests that supplementary objectives could be included on the management of petroleum revenue. However, as set out in Section III, given the current uncertainty around the timing of the start of oil production, it is suggested that at this point the Charter sets out the broad principles that will guide petroleum revenue management rather than establish a number of specific objectives.

IV. ESCAPE CLAUSES

11. The PFM Act includes a clause establishing circumstances under which the government may deviate from the core fiscal objectives. Many countries set out such “escape clauses”, allowing fiscal objectives to be temporarily suspended in the event of an exceptional and unforeseeable shock. With sufficiently robust and transparent conditions and approval procedures, this can be a useful mechanism for allowing flexibility in the face of shocks while not undermining the credibility of the fiscal rules. Annex 1 provides examples of the type of escape clauses used by countries around the world.

12. To ensure the escape clause is only invoked in appropriate circumstances, the Charter should be used to establish more robust and transparent procedures. Escape clauses are intended to be used only in the event of significant and unforeseen shocks, not in response to normal variation in economic and fiscal outcomes compared to the forecast. Therefore, there should be strict and transparent procedures in place to ensure they are not used inappropriately. In particular, there are two areas where further detail should be provided in the final draft of the Charter:

- **The procedure for approving the use of the escape clause.** Currently the Act states that the escape clause can be invoked by the Minister with approval of Parliament. The Charter should establish a more transparent process by requiring the Minister to publish a statement to Parliament explaining: (i) the reasons for invoking the escape clause; (ii) how it corresponds to the circumstances specified in the Act; (iii) why it cannot be addressed by using the Contingency Fund, other funding mechanisms, or a fiscal adjustment within the objectives; and (iv), for how long the government expects to deviate from the fiscal objectives.
- **A transitional plan for returning the fiscal position to compliance with the fiscal rules.** The Act currently requires the government to publish a report within thirty days of invoking the escape clause. The Charter should provide further detail on the requirements of this report. In particular, it should include a new set of medium-term fiscal plans and projections which show how the government intends to return to compliance with the fiscal objectives, including any new policy measures it intends to enact. This would replace the previous medium-term fiscal framework and should be approved by Parliament.

13. Some countries and regions have formulated numerical criteria for the circumstances under which the escape clause could be triggered. In the case of Uganda, the trigger is currently defined in the Act as: *“where Uganda experiences a natural disaster, an unanticipated severe economic shock, or any other significant unforeseen event that cannot be funded from the Contingency Fund or other funding mechanism provided in the Act or using prudent fiscal policy adjustments.”* This is consistent with the trigger events typically used in escape clauses around the world, as shown in Annex 1. An example of numerical criteria is the West Africa Economic and Monetary Union, where the definition of a severe economic shock is

growth of three percentage points below the average of the past three years. However, the risk is that tightly defined criteria can seem arbitrary and could rule out the use of the escape clause in the face of severe shocks that do not qualify but still create a significant deviation from the fiscal objectives. Further, there is a risk of defining the criteria on the basis of specific economic data that is not available on a timely basis and/or can be subject to significant revisions. For example, currently annual GDP outturn data from the Uganda Bureau of Statistics (UBoS) is only available with a lag of around one year, which would limit its use in triggering an escape clause. Quarterly GDP data is available more quickly, but has been subject to significant revision in the past. Overall, this approach is not recommended for Uganda.

14. Some countries also require some form of independent verification of whether the conditions for triggering the escape clause have been met. Often this role is assigned to an independent fiscal council such as a Parliamentary Budget Office (PBO). The remit of the PBO in Uganda is to provide independent and objective analysis of the budget to Parliamentarians, but unlike other PBOs it does not currently publish reports to a wider audience. This suggests that while the PBO should provide advice to Parliament on the escape clause in line with its current objectives, its remit would need to be widened and its capacity enhanced before it should be given a formal independent verification role.

Recommendation (4.1): The Charter should provide additional detail on the procedures and reporting requirements when invoking the escape clause and on the contents of the transition and adjustment plan.

V. PETROLEUM REVENUE MANAGEMENT

15. Uganda will potentially become a significant oil producer over the next decade, but the timing and the value of future government revenues from oil is currently uncertain.

Analysis suggests that significant flows of government revenue are unlikely to start until, at the earliest, the very end of the period of the first Charter.⁵ Given this uncertainty, the first Charter is unlikely to need fiscal objectives which specifically address the use of oil revenues. There is a risk that such objectives specified at this point would not be appropriate once greater information becomes available, for example around the size of revenues and the likely length of the production horizon. Additionally, objectives framed around oil revenues at this point would introduce unnecessary complications to the objectives and create the scope for confusion among stakeholders.

16. However, once there is greater certainty it will be important that the Charter is updated to introduce objectives aimed at managing oil revenues. The May 2010 FAD mission suggested using an objective for the non-resource fiscal balance to manage the use of petroleum revenues. The target level for the objective should be based on analysis aimed at establishing an appropriate balance between using the oil revenues to fund investment in the domestic economy, versus saving revenues to establish a stabilization buffer and for the use of future generations. This remains a sensible basis for policy and is consistent with the Government's 2012 "Oil and Gas Revenue Management Policy" which states that the government would use an objective for the "*non-oil and non-grant budget deficit...complemented by a limit on the growth of Government expenditures*". It is also consistent with the fiscal principles on petroleum revenues established in the PFM Act.⁶

17. While specific objectives do not need to be set out in the first Charter, it should reaffirm the principles that will be used as the basis for the petroleum revenue policy framework. The Charter should reaffirm that the framework would be based on the relevant fiscal principles in the PFM Act and would be consistent with the 2012 policy paper. It should state that the fiscal policy objectives provided in the Charter would be used to determine the annual flow of all revenues out of the Petroleum Fund, and that these objectives would strike an appropriate balance between saving and using revenues for domestic investment. Finally, it should include a requirement that the Charter will be updated to establish the specific operational objectives once there is certainty around the flow of revenues. This can use the existing clause in the PFM Act that allows the government to update the Charter in accordance with the fiscal policy principles and with the approval of Parliament.

⁵ See the forthcoming report of the March 2015 FAD mission on fiscal regimes for extractive industries in Uganda.

⁶ The fiscal principles in Article 4 (2), include (c): "ensuring that the fiscal balance, when calculated without petroleum revenues, is maintained at a sustainable level over the medium term"; and (d): "management of revenues from petroleum revenues and other finite resources for the benefit of current and future generations"

18. MoFPED should also use the time before oil production starts to develop its capacity to produce the analysis necessary to frame its oil revenue management policy.

These issues and FAD modeling tools were discussed at a workshop during the mission with MoFPED staff. Box 1 summarizes the key issues and potential next steps.

Box 1. Uganda: Petroleum Revenue Management: Key Issues and Next Steps

The arrival of significant revenues from petroleum production will create significant challenges for macro-fiscal and PFM management in Uganda. International experience shows that without careful management, a boom in natural resource revenues can risk increasing macroeconomic volatility, undermining the competitiveness of the rest of the economy, and generating unsustainable and inefficient public expenditure. A number of IMF publications have analyzed international experience and provide advice on best practice in preventing such problems from emerging.¹

Uganda has already taken a number of steps toward establishing a petroleum revenue management framework. The 2012 “Oil and Gas Revenue Management Policy” discusses good practice in a number of key areas, and the PFM Act sets out fiscal policy principles related to the sustainable use of revenues for the benefit of current and future generations. The PFM Act also establishes a Petroleum Revenue Fund, and establishes that withdrawals from the fund shall only be made through the annual budget process and subject to the same oversight and Parliamentary approval as other public money.

The Charter and the PFM Act regulations should be used to further develop good practice in this area. The first Charter should be used to establish the principle that the fund will support the implementation of the fiscal policy framework, with outflows to the budget and transfers to the savings fund governed by fiscal objectives set out in future Charters. The PFM regulations should be used to bolster the oversight, governance and transparency of the fund, in line with recommendations made in the May and October 2014 FAD reports. FAD and AFRITAC East could potentially provide further review or technical assistance on the development of the PFM regulations in this area.

The development of specific fiscal policy objectives for the use of petroleum revenues requires a strong analytical underpinning. A focus of MoFPED’s work over the next couple of years should be to develop its analytical capacity in this area. Analysis of long-term fiscal sustainability requires estimates of the volume and value of resource reserves, and long-term projections of revenue flows under a number of alternative price and production scenarios. Medium-term fiscal and revenue forecasts will be needed to underpin the medium-term fiscal framework and guide policy decisions. Finally, the volatility and uncertainty around natural resource revenues increases the importance of fiscal risk analysis. FAD and AFRITAC East can provide further technical assistance in these areas. For example, further training can be provided on the use of FAD’s model of fiscal policy frameworks in resource-rich developing countries, which was introduced at workshops during the mission.

It will also be important that Uganda develops a strong framework and capacity for public investment management. It makes sense for a developing country to use a portion of resource revenues to finance domestic investment aimed at boosting development. However, such investment must be carefully managed and targeted to ensure that it is effective and not wasted. Moreover, it must be appropriately phased in order to avoid potentially destabilizing macroeconomic effects.

¹ *Macroeconomic Policy Frameworks for Resource-Rich Developing Countries*, IMF, 2012; and Daban, T. and Helis, J., 2010, *A Public Financial Management Framework for Resource - Producing Countries*, IMF Working Paper.

Recommendation (5.1): The first Charter should reaffirm the key principles that will be used to establish the petroleum revenue policy framework, and require the Charter to be updated with specific fiscal objectives once there is greater certainty around oil revenues.

Recommendation (5.2): MoFPED should use the time before production starts to develop its capacity on oil revenue forecasting, long-term projections, and risk analysis, and on public investment management. FAD and AFRITAC East can provide further technical assistance in these areas if necessary.

VI. FISCAL POLICY OPERATIONS AND REPORTING

19. The PFM Act requires that the Charter include an explanation of the methodology and data used to measure the performance of the government against the fiscal objectives.

This suggests that the Charter should include details of the definition of the fiscal indicators used as objectives, wider fiscal reporting requirements, and detail of how the fiscal objectives will be used to guide the operation of fiscal and budget-policy making. A number of issues should be further developed in the final draft of the Charter:

- **Specification of the fiscal indicators:** This should refer to the relevant international standards and be consistent with the definitions and methodologies established by the EAC. The EAC intends to use as the convergence criteria a measure of the fiscal balance covering general government in accordance with GFSM. To be consistent with this, the MoFPED will, therefore, need to accelerate work in Uganda to ensure that a robust general government measure of the fiscal balance is available by the time the Charter is published.
- **Specification of data sources:** This should include the source of the data underpinning the economic and fiscal projections, including, for the avoidance of any doubt, the institution that is responsible for producing the data, such as the UBoS, and the report in which it is found.
- **Forecasting practices:** The PFM Act includes requirements for the content of the medium-term economic and fiscal forecasts in the budget documentation and the in-year economic and fiscal updates. The Charter should reaffirm these requirements and specify additional good practices aimed at boosting the transparency and realism of the forecast. Specifically, the Charter should include requirements that: (i) the forecast is based on prudent and realistic assumptions; (ii) key forecast assumptions are compared to those of independent external forecasts and any large differences are explained; (iii) there is a comparison with the previous government forecast and an explanation of key changes; and (iv) the forecast is subject to internal scrutiny via review by a cross-department technical group⁷, and that it is accompanied by a statement from the Minister and Secretary to the Treasury attesting to its reliability and completeness (consistent with a wider requirement in the PFM Act).
- **Fiscal risk statement:** The PFM Act includes a requirement that the government publish a fiscal risk statement as part of the Budget Framework Paper. The Charter should specify some minimum requirements for the fiscal risk statement, which should be consistent with the template agreed by the EAC working group on fiscal issues.⁸ This includes: macroeconomic

⁷ This could include technical staff from the tax policy, budget and debt management divisions of MOFEPD, and externally from the Bank of Tanzania and the Revenue Authority, among others.

⁸ For further detail and the proposed fiscal risk statement template see the report of the workshop on public financial management in EAC partner states, January 2015, EAC/TFR/PFM/01/2015.

risk analysis including the sensitivity of the fiscal projections to changes in key macroeconomic variables; analysis of the government's exposure to specific fiscal risks such as civil service pensions, loans and guarantees, public-private partnerships, and natural disasters; analysis of risks from the financial position of public corporations and sub-national government; and a discussion of institutional risks such as data quality and capacity constraints. Further, there should be a discussion of the government's strategy for managing these risks.

20. The Act also requires that the Charter is published alongside an economic and fiscal update document. This should provide a detailed medium-term fiscal framework (MTFF) which shows how the fiscal objectives in the Charter will be met on the basis of the economic, fiscal, and policy assumptions that underpin the MTFF. These assumptions should be stated explicitly in the economic and fiscal update document, so that they can be compared with outturns in the future, which will help explain the deviation of future fiscal outcomes from the original projections.

21. The Act and the Charter will create additional demands on the DEA and wider MoFPED. A recent AFRITAC East mission assessed analytical capacity in the ministry against these new demands. A summary of the main recommendations is provided in Box 2.

22. The PFM Act provides detail on the annual budget process and the role of the fiscal objectives in providing the top-down guide to policy-making. A robust budget preparation, approval, and execution process is vital if the fiscal objectives are to be effective in guiding policy. The Charter should therefore emphasize the key elements of this, in particular that: (i) the Budget Framework Paper (BFP) sets out medium-term expenditure limits consistent with the fiscal objectives and is approved by Parliament; (ii) the annual expenditure limits and revenue policies in the budget are consistent with the BFP; (iii) the budget execution procedures ensure these limits are respected; and (iv) in-year reporting includes an assessment of progress against the fiscal objectives. The PFM Act regulations should also be used to develop a robust budget process and address weaknesses in some areas of the PFM Act, following the recommendations in the May 2014 and October 2014 FAD reports. A desk-based review by FAD and AFRITAC East of the draft regulations and potentially a further technical assistance mission could be provided if required.

Box 2. Uganda: Delivering the New Analytical Requirements of the Public Financial Management Act

An AFRITAC East technical assistance mission in January 2015 assessed the readiness of the Directorate of Economic Affairs (DEA) in MoFPED to address the new reporting and analytical requirements of the PFM Act.⁹ It concluded that the DEA is well placed to comply with the majority of the requirements. In particular, five-year forecasts of macroeconomic and fiscal variables, including GDP, government debt, revenues, and expenditures are already routinely published. An existing MoU between MoFPED and the BOU formalizes their respective roles and responsibilities in preparing the forecasts. However, some areas for development were identified:

- The revised budget calendar brings forward most activities by two to three months and necessitates that the first round of macroeconomic forecasts be prepared earlier. This will require coordination with UBoS to ensure that GDP releases are brought forward;
- New internal processes need to be set up to produce: (i) a statement on tax expenditure; (ii) bi-annual fiscal performance reports; (iii) a fiscal risk statement; and (iv) in the future, forecasts of petroleum revenues and the operation of the Petroleum Fund; and
- The Budget Framework Paper needs to document the methodologies used in preparing forecasts and systematically explain changes in forecasts and forecast errors. Currently, GDP and revenue forecasts are produced using bottom-up approaches. These approaches rely heavily on forecast judgment but internal and external scrutiny (in particular from UBOS and BOU) on these judgments is currently limited and should be enhanced. This would improve the ability to explain judgments and forecast deviations. Some additional forecasting models will be needed; in particular, two models developed by AFRITAC East can be used to support the main GDP forecasting model.

Recommendation (6.1): Use the Charter to provide further detail on the definition and data sources for the fiscal objectives and projections that are consistent with international standards and EAC definitions, establish robust and transparent forecasting practices, and specify minimum requirements for the fiscal risk statement.

Recommendation (6.2): Use the Charter and PFM regulations to underpin the role of the fiscal objectives in guiding policy-making through all stages of the annual budget process.

⁹ *Uganda: Assessing Capacity in Macro-Fiscal Analysis and Forecasting in the Context of Ongoing PFM Reforms*, AFRITAC East, January 2015.

Annex I. Examples of Escape Clauses

Country	Description of escape clause (2012/13)
Brazil (since 2000)	Escape clause is triggered if real GDP growth is below 1 percent over four quarters and in case of natural disaster. Requires Congressional approval.
Columbia (since 2011)	In case of extraordinary events threatening the macroeconomic stability of the country, enforcement of the fiscal rule may be temporarily suspended subject to the favorable opinion of an internal fiscal council headed by the Finance Minister.
Finland (since 2009)	Since 2009, government can temporarily deviate from the Central Government deficit target if structural reforms are undertaken to improve General Government finances in the medium or longer term.
Germany (since 2010)	Escape clause is defined as natural disasters or unusual emergency situations which are outside government control and have a major impact on the financial position of the government. Absolute majority of parliament is needed to trigger the escape clause. Parliament must approve an amortization plan with a specified timeframe for reducing the accumulated deviation.
India (since 2010)	Fiscal rules can be suspended if social and poverty-reducing expenditures fall under 4½ percent of GDP, or health and education spending fail to double as a percent of GDP in a 10 year period. Other escape clauses are national security emergencies and natural calamities, to be declared by the National Assembly.
Jamaica (since 2010)	The fiscal targets may be exceeded on the grounds of national security, national emergency, or such other exceptional grounds.
Kenya (since 2012)	The 2012 PFM Act provides that the government can deviate from their financial objectives where such deviation is necessitated by a major natural disaster or other significant unforeseen event. A deviation is also possible when there is a change in government. A statement explaining the deviation is to be included in the Budget Policy Statement and the triggering of the clause needs to receive approval of the Parliament.
Maldives (since 2013)	Exceptions to the adherence to the fiscal rules are allowed in two instances: (a) natural disaster and (b) economic downturn. A natural disaster is defined where 15 percent of population encounters hardship on account of a natural calamity.
Mexico (since 2006)	Under exceptional circumstances there can be a deficit envisaged in the budget; in particular, if non-oil revenues are below their potential due to a negative output gap, the deficit can be relaxed up to the equivalent of the shortfall.
Norway (since 2001)	Norway targets a non-oil structural deficit of the central government equal to the long-run real return of the Government Pension Fund. Temporary deviations are allowed from the rule over the business cycle and in the event of extraordinary changes in the value of the Fund.
Panama (since 2008)	If real GDP grows by less than 1 percent, the non-financial public sector deficit ceiling can be relaxed to 3 percent of GDP in the first year, followed by a gradual transition to the original ceiling (1 percent of GDP) within 3 years. Escape clause also includes national disaster and national state of emergency.
Peru (since 2000)	If real GDP declines or in case of other emergencies, declared by the Congress at the request of the Executive, the deficit ceiling can be relaxed up to 2.5 percent of GDP. The Executive must specify deficit and expenditure ceilings to be applied during the exception period. In both cases a minimum adjustment of 0.5 percent of GDP is required until the 1 percent deficit ceiling is reached. Moreover, the fiscal responsibility law specifies a three-year transition period to return the rule, accompanied by an adjustment plan approved by Parliament.
Panama (since 2008)	Escape clause allows deviating from the objectives in case of a major recession, banking system bailout, natural disaster, and international guarantee schemes.
Peru (since 2000)	Exceptional budget deficits must be justified (e.g., natural disasters, exceptional slowdown, etc.) and accompanied by a medium-term financial plan in order to correct this situation within the next 3 fiscal years. In the case of the central government this plan must be submitted to parliament.

Country	Description of escape clause (2012/13)
Panama (since 2008)	Government can approve by supermajority a budget deviating from the rule in case of natural disasters or exceptional economic slowdown. These exceptional budget deficits are accompanied by a medium-term financial plan to correct this situation within the next 3 years.
<i>EU member States (since 2005)</i>	The government can approve by supermajority a budget deviating from the budget balance rule in "exceptional circumstances," which are defined in Budget Law as natural disaster, severe recession, and changes in accounting methods. Under the Fiscal Compact, an automatic correction mechanism shall complement the structural balance rule.
<i>WAEMU (since 2000)</i>	Temporary and pronounced shortfall of real GDP (at least 3 percentage points below the average of the previous 3 years) and budget revenue (at least 10 percentage points below the average of the previous 3 years average).

Source: IMF fiscal rules dataset, 2013; Fiscal rules in response to the crisis - towards the "next generation rules" - a new dataset, IMF Working Paper, A. Schaechter et al, 2012.

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