ICPAK POSITION PAPER ON PUBLIC FINANCE MANAGEMENT (NATIONAL GOVERNMENT) (AMENDMENT) REGULATIONS 2019

The information contained in this publication has been prepared by the Institute of Certified Public Accountants of Kenya.

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INTRODUCTION

1. The Institute of Certified Public Accountants of Kenya (ICPAK) is the statutory body of accountants established by the Accountants Act of 1978, and as repealed under the Accountants' Act Number 15 of 2008, mandated to develop and regulate the Accountancy Profession in Kenya. It is also a member of the International Federation of Accountants (IFAC), the global umbrella body for the accountancy profession.

2. Section 8 of the Accountants Act, 2008 stipulates the functions of the Institute as to:
   a) promote standards of professional competence and practice amongst members of the Institute
   b) promote research into the subjects of accountancy and finance and related matters, and the publication of books, periodicals, journals and articles in connection therewith;
   c) promote the international recognition of the Institute;
   d) advise the Examinations Board on matters relating to examinations standards and policies;
   e) advise the Minister on matters relating to financial accountability in all sectors of the economy;
   f) carry out any other functions prescribed for it under any of the other provisions of this Act or any other written law; and
   g) do anything incidental or conducive to the performance of any of the preceding functions

3. Parliament has through Legal Notice No. 155 of 26th September 2019 approved the change to a numerical limit of total public debt of Ksh 9 trillion in place of the current 50 percent of the GDP in net value terms. Parliament argues that this change will allow government to access concessional funding sources, release monies that would otherwise be borrowed by government from Commercial Banks to individuals and MSMEs.

4. This proposal is further contained in the Public Finance Management (National Government) (Amendment) Regulations 2019 that is proposing amendment to the Public Finance Management (National Government) Regulations 2015, Section 26(1)(c) which states that, "the national public debt shall not exceed 50 percent of GDP in net present value terms."

5. The Institute is concerned with the rapid growth in public debt over the years. According to the recent Central Bank of Kenya (CBK) statistics, the country's debt currently stands at Kshs 5.81 trillion, which includes Kshs 3.01 trillion external and 2.79 trillion domestic debt.

6. Kenya, by changing to a numerical limit breaches the East Africa Community ceiling on debt accumulation, that is public debt is equivalent to 50% of the GDP.

Key concerns:

7. The Institute is concerned on the following:

a) **Basis of the proposed numerical ceiling of public debt at Kshs. 9 trillion:**
The National Treasury has not provided the basis for KSHs 9 trillion number. This will raise our debt to near 100% of GDP. In line with Article 201(e) of the Constitution, the basis of this debt level should be clear.

b) **Delinking Debt and Economic Performance:** Just like the conventional banking, access to loans is based on one's ability to pay. In similar manner we are considered opinion that we cannot de-link the measure of an acceptable debt limit with the performance of the economy and ability of the economy to repay (revenue collection). It is imprudent to approve debt without presenting a clear programme on ability to pay. This will conform with Section 15 of the Public Finance Management Act on fiscal responsibility principles.

c) **Purpose for changing to numerical limit of Ksh.9 Trillion:** The National Treasury indicates that the rationale for increasing the limit is for easier computation of debt, debt restructuring through retiring expensive loans and for predictability. However, there is no guarantee that in the absence of extensive regulations, more borrowing (at a cheaper rate) will be used to repay/retire more expensive loans and that the same shall be tracked per development project. Framework on debt repayment should be presented to support any approvals.

d) **Breach of the law:** With the debt levels hitting over 50% of the GDP, the country has already breached Section 26(1)(c) which states that, "the national public debt shall not exceed 50 percent of GDP in net present value terms. Besides, the gazette process in many ways breached the provisions of Art. 201 of the Constitution on openness, accountability and public participation.

e) **National Trust and Standing among other EAC countries:** The Institute is concerned that the proposal breaches the East Africa Community ceiling on debt accumulation, that is public debt is equivalent to 50% of the GDP. This has significant impact on our image as a country with respect to international obligations including the EAC neighbors.

SIMPLE METHODS OF MEASURING PUBLIC DEBT SUSTAINABILITY

8. Over the years, different methods and criteria have been used to determine the desirability and sustainability of borrowing. These include but not limited to:

   (i) Ratio of interest paid on public debt and collected taxes: -This ratio shows to what extent the burden of interest is covered with tax revenues.
   (ii) Ratio of interest and public expenditures: -This indicator shows which share of public expenditures is "tied" due to public debt repayment obligation.
   (iii) The interest/GDP ratio: Interest is put into a ratio with GDP because the tax revenues from which the debt obligation needs to be met depend on GDP.
   (iv) The new borrowing/public expenditures ratio.
   (v) The share of new borrowing (that is, deficit) in GDP, and the share of total debt in GDP
   (vi) Debt-service- ratio
   (vii) Numerical limit

9. Kenya has over the years used internationally recognized sustainability thresholds to determine the sustainability of its debt level as illustrated below:

Table 1: Debt Sustainability Thresholds

Indicator	Threshold	2016	2017	2018	2019	2020
PV of public Sector debt to GDP	70	50.6	55.4	60.6	56.9	53.1

PV of public Sector debt to Revenue	300	270.1	278.6	292.0	275.3	255.5

Source: IMF Country Report No. 18/295, October 2018

10. According to the Budget Policy Statement 2019, Kenya's risk to debt distress has been raised from low to moderate on account of refinancing risks on external debt.

COMPARATIVE ANALYSIS USING DEBT-TO-GDP RATIO

11. Globally, it has been demonstrated that that different economies cope with the debt burden in different ways. Sometimes crises appear even at low levels of share in the debt of the gross domestic product (GDP), whereas some economies function very well even when their public debt significantly exceeds the value of the total one-year production in the country. The Table below illustrates this scenario:

Table 2: Public Debt as a percentage of GDP- Select economies

No	Country	Public Debt as % of the GDP as by 2017
1.	Japan	236.40
2.	Greece	181.90
3.	Italy	133.50
4.	Portugal	125.60
5.	Singapore	110.90
6.	Kenya	55.2
7.	Ghana	71.80
8.	Saudi Arabia	17.01
9.	Botswana	15.45

12. Japan, the third world largest economy has the highest public sector. Its debt- to-GDP ratio currently stands at 236.4% and is projected to be around 290 percent of the GDP by 2030. However, given that it's an advanced economy, it is anticipated that its economic growth and other fiscal measures will be sufficient in pushing down its debt levels.

13. Nevertheless, a look at the Greece crisis points to the dangers of high public debt. Indeed, Greece and other countries with higher percentages of debt to GDP such as Ireland and Portugal were not able to refinance their debt without help from international institutions. The situation can be harsh for the middle income and developing economies which are vulnerable to internal and external economic shocks.

14. According to the statistics from the National Treasury, Medium Term Debt Management Strategy 2019, debt sustainability indicators show that Kenya faces a moderate risk of external debt distress due since public debt is estimated at 52.7 percent of GDP which is lower than the World Bank debt sustainability threshold of 70 percent. Kenya public finance management threshold was initially set at 50 per cent of net present value of debt to GDP ratio in line with the East Africa Community debt threshold.

WHAT IS KENYA'S REVENUE PERFORMANCE?

15. In order to effectively execute the budgetary functions of the government, the deficit is plugged in by borrowing to finance the projects that would otherwise not be implemented for lack of funds. The huge infrastructural projects like Standard Gauge Railway takes a huge chunk of the revenue. Similarly, recurrent expenditure that goes to wage bill compounds the problem thereby increasing the appetite to borrow both from domestic and foreign sources. The table below demonstrates the revenue performance;

Table 3: Revenue Performance Table

	2013/14	2014/15	2015/16	2016/17	2017/18
Budget	1,006,862	1,170,529	1,299,912	1,514,989	1,704,503
Actual	974,418	1,113,038	1,235,845	1,403,692	1,650,989
Deviation	(32,444)	(57,492)	(64,067)	(111,297)	(53,514)
Performance rate	97%	95%	95%	93%	97%

Source: Economic Survey, 2017 & 2018, *- Budget Policy Statement, FY 2018/19

PUBLIC DEBT REDEMPTION

16. Public debt repayment obligations and interests charged from the disbursed borrowed loans crowd out service delivery as they are paid from the consolidated funds. Compared with revenue generated, the remaining amount cannot be sufficient to fully fund the government's programmes. For the two financial years, 2018/19 and 2019/20, the budget estimates indicate performance as follows:

Table 4: Public Debt Redemption

Debt	2018/19	2019/20
Interest	399,980,973,122	441,481,154,086
Public debt redemption	470,634,984,624	255,073,007,901
Total	870,615,957,746	696,554,161,987

Source: Budget estimates 2019

17. According to the Controller of Budget, Annual National Government Budget Implementation Review Report for financial year 2018/19, the revised allocation for public debt was Kshs.848.3 billion, recording 30.6% growth compared to Kshs.649.4 allocated in FY 2017/18.

DEBT SERVICING CHARGES AS A PERCENTAGE OF EXPORT EARNINGS

18. Similarly, other factors such as debt servicing charges indicate that Kenya's debt position is not that rosy. For instance, the debt servicing charges as a percentage of export earnings has been increasing since the financial year 2016/17. This was attributable to a faster growth in debt servicing charges compared to the growth in export earnings.

Table 5: Debt Service as a Percentage of Export Earnings

	Debt service Charge on External Debt (Fiscal Year)	Export of Goods and Services (Calendar Year)	External debt service charges as a percentage of export of goods and services

	KSh Million	KSh Million	%
2010/11	31,805.55	885,248.9	3.6
2011/12	35,705.51	947,189.7	3.8
2012/13	45,142.66	945,477.6	4.8
2013/14	98,014.23	992,326.0	9.9
2014/15	112,687.54	1,042,699.82	10.8
2015/16	78,104.86	1,006,155.73	7.8
2016/17	107,226.48	1,079,568.06	9.9
2017/18	234,702.61	1,173,323.04	20.0

Source: Economic Survey

All these factors point to the need for tightening our strategies to control the growing public debt. It is already noted that Public debt portfolio is large and may pose substantial risk to the government's balance sheet and the country's financial stability. If not managed prudently, it poses risks to the budget and large economic losses in future

ICPAK RECOMMENDATIONS

19. The Institute recommends the following:

(i) **Fiscal Consolidation**

The Institute takes note and commends the Government for recognizing the need for fiscal consolidation to reduce budget deficit. The recent expenditure rationalization measures adopted by the National Treasury such as controlling foreign travel, hospitality cleaning and regular audit of the payroll register among others. However, these measures should have tangible targets and outcomes and should not be seen as measures to hinder service delivery. Efficiency gains, not additional funding, is the key to effective implementation of government projects without further accumulation of debt. The 2019/2020 budget has indicated a commitment to fiscal consolidation through limiting government spending as well as enhancing revenue collection. Efficiency gains entail effective utilization of public resources such that the country is able to achieve more with fewer resources

(ii) **Critical review of the progress of existing development projects financed through borrowing:**

The PFM Act provides that Public debt and obligations shall be maintained at a sustainable level as approved by Parliament (for National Government) and County Assemblies (for County Governments). According to the Parliamentary Budget Office (PBO), in order to finance major infrastructural and other flagship project, sustained borrowing needs for the country have quadrupled over the past seven years and as a result, the stock of debt has had an annualized growth rate of 16% for since June 2013 to reach Ksh. 5.4 trillion as at the end of March 2019. If debt is mainly for financing development expenditure as stipulated by section 15(2)(c) of the Public Finance Management Act 2012, then it will be sustainable in the long-run.

An audit of current projects is critical to wipe out white elephant projects. A clear framework for tracing and auditing debt financed projects is needed for equity.

(iii) **Public availability of information on debt management policies and overall national debt book.** The objectives for debt management should be clearly defined and publicly disclosed, and the measures of cost and risk that are adopted should be explained.

(iv) **The government should also consider the following measures to enhance public financial management.**

a) ***Expenditure Vs Revenue:*** In the past few years, public expenditure has been growing at a faster pace than revenue. The major outcome has been huge budget deficits. We should
b) ***Consider PPP framework as a better alternative***: The government ought to enhance these partnerships to tap into the benefits that the contribution of the private sector brings to the economy which will eventually help bring down the level of external debt financing.
c) ***Implementation of budget monitoring reports:*** Act on Auditor General and Controller of Budget recommendations in respect to public debt
d) ***Enhance accountability*** in public and private sectors to free more resources to development
e) ***Audit of the Public Debt Register:*** Establishing the authenticity of the public debt register including the true debt sustainability position is critical. Government sources and the world bank continue to give conflicting statistics of Kenya's debt situation.
f) ***Accounting for debt:*** The public is not sure on the accuracy and completeness of the debt register. National Treasury and Central Bank of Kenya have conflicting statistics on national public debt. The Auditor General in its Report for the Financial Year 2017/18 pointed out misstatements and differences between the financial statements and the confirmed balances. Further**,** Further, a comparison of the statement of receipts and payments and the ledger for the period under review reflected different account balances as indicated below:

Item Description	**Financial Statement Balance KSh.**	**Ledger Balance KSh.**	**Variance KSh.**
Interest Payments on Foreign Borrowings	84,357,487,111	84,725,600,971	368,113,860
Principal Repayment on Domestic Loans	111,700,845,296	294,836,376,343	183,135,531,047
CBK -Pre-1997 Loans	1,110,000,000	2,220,000,000	1,110,000,000
Repayment of Principal from Foreign Lending and On-Lending	141,532,524,729	141,360,882,966	171,641,763
Exchequer Releases	517,161,876,534	-	517,161,876,534

Source: Auditor General Report for National Government- FY 2017-2018

20. As illustrated above, Kenya's public debt has been rapidly growing over the years. The growth of the country's public debt can be attributed to many factors such as supporting the national budget and investment in essential infrastructure projects among others. However, the high level of public debt in Kenya narrows the window for future borrowing and increases vulnerability to fiscal risk in the event of any urgent need for borrowing.

21. The National Government has control of the income and assets of the National Economy through taxation or other measures, the aggregate economic performance is therefore a useful indicator for government debt. Notwithstanding, most economies apply Gross Domestic Product (GDP) as the denominator of the caps on government to-debt-GDP ratio. If GDP Growth lags behind debt growth, this creates a higher debt burden for future generations. Use of this measure shall be in line with Art. 201(c) of the Constitution which stipulates that the burdens and benefits of the use of resources and public borrowing shall be shared equitably between present and future generations.

22. **It is therefore in this regard, that the Institute calls for rejection of this amendment and the use of Debt to GDP ratio which is a realistic measure of the public debt limit, desirability and sustainability.**