**The Institute of Certified Public Accountants of Kenya**

# POSITION PAPER

# ON

# PUBLIC DEBT MANAGEMENT: A CASE FOR KENYA

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## Acronyms

GDP – Gross Domestic Product

IMF – International Monetary Fund

MTDS - Medium-Term Debt Strategies

PDMO - Public Debt Management Office

BPS – Budget Policy Statement

KES – Kenya Shilling

US$ - United States Dollar

PFM - Public Finance Management

ISB – International Sovereign Bond

PV – Present Value

PPG – Public and Publicly Guaranteed Debt

CRA – Commission on Revenue Allocation

## INTRODUCTION

To spur economic growth, spending is essential. In most cases though, what a country collects within its jurisdiction is almost never enough, necessitating it to spend more. When public expenditure surpasses public revenue, it results in fiscal deficit. Public debt is thus required to finance the deficit. The government can either borrow internally (domestic debt), externally (foreign debt) or both. Public debt expressed as a percentage of Gross Domestic Product (GDP) has for a long time been used as a measure of public debt sustainability. However, evidence indicates that it should not be the only measure. Japan for example registered the highest debt-to-GDP ratio in the world at 251.9% in 2020 although the debt is still considered sustainable while Kenya is already considered highly risky at 66.7 in the same period.

Therefore, other factors such as revenue performance of an economy, the export markets and whether transparency and accountability is observed in public resources management should be considered. Ineffective monitoring of public debt may lead to it accumulating to unsustainable levels and expensive loans being contracted requiring government resources to be diverted towards interest payments. This increasingly leads to crowding out of public investments and leaves less resources for investment in areas that are important for human development such as the health sector.

Sub-Saharan African countries are experiencing a high investor confidence post-the 2008/2009 financial crisis that has led to high capital inflows. This has mainly been from commercial creditors in what is known as investments in Eurobonds as well as non-traditional bilateral creditors such as China. These economies' public debt has been significantly fueled by loans from these new entrants and has largely been spent on infrastructural projects. For example, Rwanda's public debt was attributed to 3 large projects which were: the construction of the Kigali Convention Center (KCC) in 2016, expansion of the national airlines and construction of a new airport to handle cargo and increased passenger loads (International Monetary Fund, 2018).

The period between 2013/14 - 2018/19; marked an exponential growth of the Kenya's public debt. The country witnessed a more than double increment in total public debt where it grew by about 145%. External loans grew by 178% and domestic loans by 117%. In nominal terms, total public debt grew from about KES 2.4 trillion in 2013 to KES 5.8 trillion by end of 2018/2019, a difference of KES 3.4 trillion. This represented a significant increment as compared to the years between 2002/03 – 2007/08 whose growth in total public debt was from KES 696.5 Billion in fiscal year 2002/03 to KES 870.6 billion in fiscal year 2007/08 (Central Bank of Kenya, 2003-2018).

The implementation of the annual budgets have also failed to adhere to proposals contained in the medium-term debt strategies (MTDS) which until 2020, served as the policy framework for public debt. For example, between the financial years 2013/14 – 2015/16, the annual budgets deviated from the MTDS by an average of about 20%. Such a situation erodes the credibility of the MTDS and also undermines transparency. After the rebasing of the country's economy to a low-middle income country, Kenya contracted its first Eurobond in June 2014, with the latest one being contracted in May 2019. However, there are no publicly available reports to indicate which projects these amounts have been used for. Similarly, there is evidence that part of the amount has been used to repay external loans (Central Bank, 2016). Until June 2011, the currency composition of the country's external debt did not have the Chinese Yuan, a factor that changed from 2012 when the Yuan became prominent. Additionally, according to the annual public debt management report of the FY 2019/20, by June 2020, more than 65% of the country's external debt was US$ denominated which exposes the country to exchange rate risk.

These developments have significantly changed the structure of public debt in Kenya. For example, by the end of 2019 the structure of external debt was as shown in table 1 below;

*Table 1: Structure of external public debt*

| Source | 2010 | 2019 |
|---|---|---|
| Multilateral | 66% | 20% |
| Bilateral | 30% | 33% |
| Commercial | 4% | 37% |

*Source: Public Debt Management Office, 2020.*

The source of external debt has greatly shifted from multilateral lenders to commercial lenders and a slight increase in bilateral sources. In addition to that, domestic commercial banks accounted for about 50% of the total domestic public debt implying that increasingly, the government has crowded out private sector investments. Based on these developments, Kenya's public sector debt sustainability analysis indicated that by the year 2019, the country had surpassed two thresholds, which were; the present value of public sector debt to revenue ratio and debt service to revenue and grants ratio (IMF,2020).

This implied that the growth in revenue compared to that in public debt had been shrinking. This, and other additional factors led the IMF to revise Kenya's risk of external debt distress from moderate to high in the debt sustainability analysis of May 2020. The revenue performance is further expected to worsen owing to the recent expansionary fiscal measures as well as the decline in the country's economic activities due to the shocks experienced in the global supply chains, the country's application of lockdown and national-wide curfew. In the FY 2020/21, the national government expects to collect KES 1.52 trillion and pay out KES 904 billion as debt service, further implying a possible compromise in service delivery. All these developments in public debt leave the country's public finance environment extremely vulnerable and there will be need for more intensive macro-fiscal adjustments than was initially planned for the economy to recover.

## KENYA'S PUBLIC DEBT MANAGEMENT AND LEGAL FRAMEWORK

Melecky (2007) defines policy and Legal framework in Public Debt Management to comprise the legal institutions and norms of a country that regulate public sector debt and includes both public and private laws. In Kenya, the Constitution of Kenya, 2010 serves as the supreme law and it is effected by the Public Finance Management (PFM) Act of 2012 and PFM National Government regulations which define public debt and provide the consolidated fund as the account under which it is to be charged.

Additionally, these laws establish important institutions and their functions with regards to public debt such as the Parliament, Auditor General, Public Debt Management Office. In Kenya, public debt has been defined as all financial obligations attendant to loans raised or guaranteed and securities issued or guaranteed by the national government.

*Table 2: PFMA Provisions on Public Debt Management*

| Section | Provision |
|---|---|
| 49-65 | Prescribes for the receipt & use of grants & loans; guaranteeing loans, lending money; establishes a fully-fledged Public Debt Management Office (PDMO) in the National Treasury |
| 49 | Authority for borrowing by the National Government |
| 50 | Obligations and restrictions on national government guaranteeing and borrowing- Parliamentary approval. Guarantee of debt shall be done in terms of criteria agreed with the Intergovernmental Budget and Economic Council (IBEC) |
| 55 | Establishes the office of the Registrar of the National Government Securities under PDMO. Securities issued by or on behalf of the national government shall be published & publicized |
| 62 – 63 | Establishes and empowers PDMO with objects of minimizing debt financing costs, maintaining reliable debt data, prepare annual and medium-term debt strategy |

## CURRENT PUBLIC DEBT SITUATION IN KENYA

Statistics from the Central Bank of Kenya reveal that between the year 2001 and 2019, Kenya's Gross Domestic Product (GDP) grew by an average of about 5.0% while public debt grew by an average of 17.8% in the same period. The country recorded a high of 8.4% economic growth rate in 2010 while the highest public debt growth rate of 103.1% was experienced in the year 2019. In the year 2019, the economy grew by 5.4%, a drop from 6.3% in 2018. This decline in growth was as a result of under-performance in the agriculture sector, due to poor rains, and weaker private investment as government investment continued to crowd out the private sector.

The economy is further expected to decline to 0.6% in 2020 due to the COVID-19 pandemic and a further deterioration in the agricultural sector due to the locust invasion that was experienced earlier in the year (National Treasury, 2021 and IMF,2020). The pandemic also led to the IMF revising the country's risk of external debt distress from moderate to high. As at the end of the financial year 2019/20, total public debt stood at KES 6.69 trillion representing about 74.3% of the recently revised public debt ceiling of KES 9 trillion while the latest public debt statistics indicate that the country's public debt stood at Ksh. 7.25 trillion as at November 2020 which translates to about 80.6% of the recently revised debt ceiling.

## IS KENYA'S PUBLIC DEBT SUSTAINABLE?

A sustainable public debt is a situation whereby the government can be able to repay its public debt without interfering with the proposals in the annual budget. The following discussions will reveal whether Kenya's public debt is sustainable or otherwise.

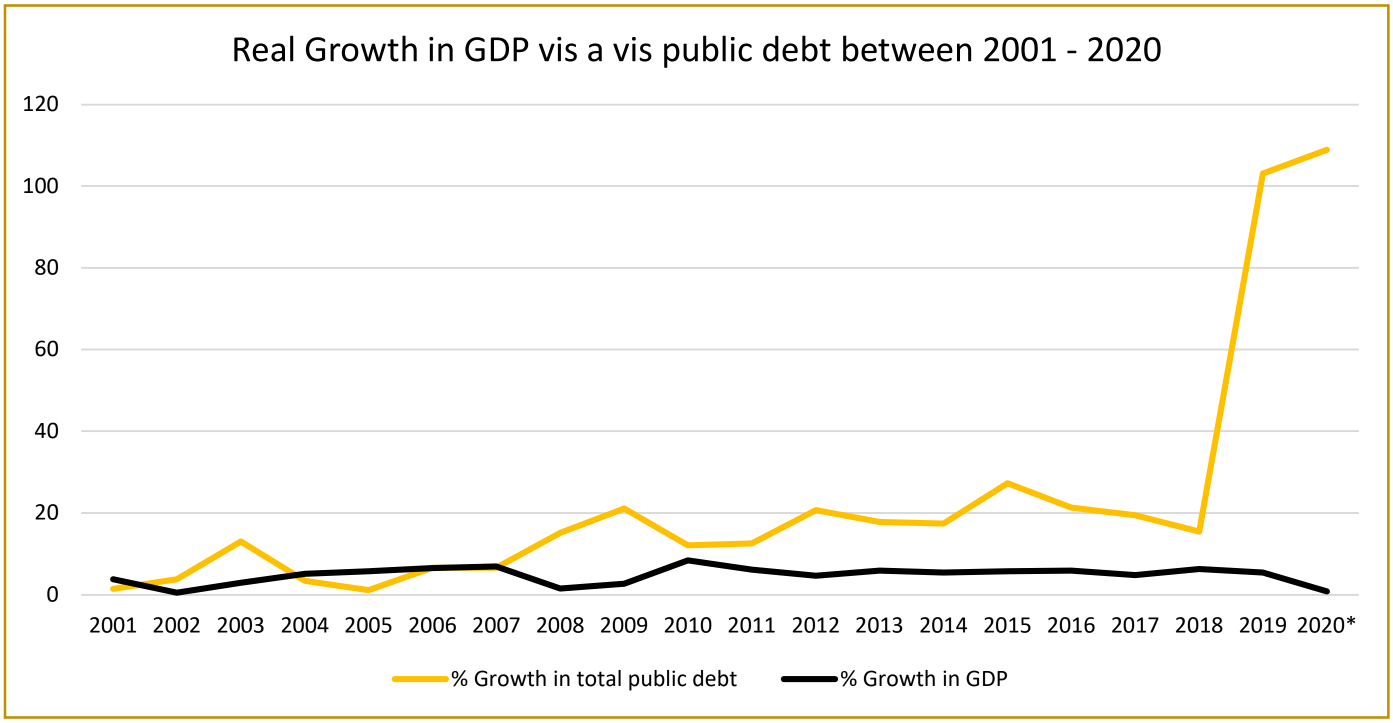



*Figure 1: Growth in GDP and public debt between 2001 – 2020*
*Source: Central Bank of Kenya*

Statistics above demonstrate a worrying trend of steady debt accumulation over the years. The figure for the year 2020 is a projection of the growth rates based on data from the IMF and Kenya's 2020 BROP. From the year 2007, the growth rate of public debt has always been higher than that of the Gross Domestic Product (GDP). The country's GDP indicates a stable growth rate of an average of 4.9%. However, economic dips have been observed during the election period after which the country has always recovered.

Kenya is expected to hit the lowest economic growth since 2002 of 0.8% while public debt is expected to grow by 109% in 2020 due to the effects of COVID-19 which have subsequently led to a reduction in economic activities and contractual of additional loans. This comes after the country's stock of public debt increased by 103.1% in 2019, which represented the highest growth rate in the period under review. The amount incurred as public debt should be channeled towards sectors that will bolster the economy to address the mismatch between the rate at which the economy and public debt is growing. This may contribute to the realization of meaningful economic development.

## REVIEW OF THE EFFECT OF FISCAL DEFICIT ON PUBLIC DEBT SUSTAINABILITY

Findings from a study in Serbia on 'Consequences of Fiscal Deficit and Public debt in financing the public sector' indicated that a growing budget deficit which is dominantly financed from external sources created a crisis in public finances and its accumulation did not contribute to economic development[1]. Table 3 below shows an analysis of Kenya's budget and the attendant debt per fiscal year. Between the years 2000 to 2006, the financing of Kenya's debt from external sources had been on a downward trend and this had a positive correlation to the budget deficit and a negative correlation with economic growth. This trend began reversing after the global financial crisis of 2008/09. **Therefore, the current public debt crisis in Kenya could be attributed to the high deficit financing from external sources**. However, according to the BPS 2021, the government intends to reverse this by developing its domestic market and exploring other sources of possible financing options such as the issuance of Green bonds.

**Table 3: Budget Deficit vs Public Debt in Kenya**

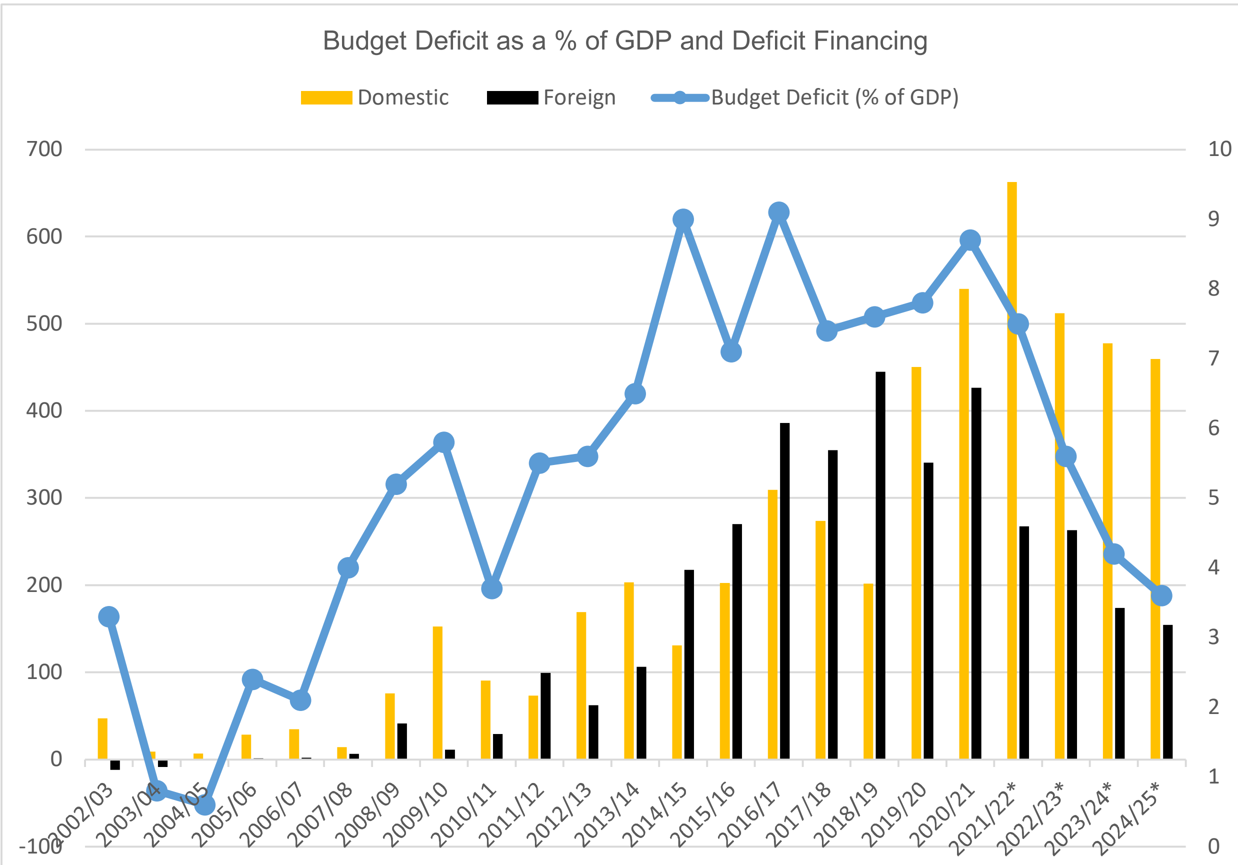
| Financial Year | Total Expenditure (Ksh billion) | Total Revenue (Ksh billion) | Budget Deficit (Ksh billion) | Budget Deficit (% of GDP) | Budget Deficit Financing (Ksh billion) | |
|---|---|---|---|---|---|---|
| | | | | | Domestic | Foreign |
| 2002/03 | 264.1 | 225.7 | 35.8 | 3.3 | 46.9 | -12.1 |
| 2003/04 | 282.2 | 270.9 | 9.8 | 0.8 | 8.8 | -8.9 |
| 2004/05 | 303.4 | 304.6 | 7.3 | 0.6 | 6.7 | 0.6 |
| 2005/06 | 382.8 | 331.3 | 36.5 | 2.4 | 28.3 | 1.3 |
| 2006/07 | 419.6 | 388.5 | 36.6 | 2.1 | 34.7 | 2 |
| 2007/08 | 534.8 | 457.7 | 67.9 | 4 | 13.9 | 6.3 |
| 2008/09 | 595.7 | 506 | 117 | 5.2 | 75.9 | 41.1 |
| 2009/10 | 718.6 | 560.8 | 166.8 | 5.8 | 152.5 | 11.1 |
| 2010/11 | 817.1 | 679.5 | 117.8 | 3.7 | 90.4 | 29.1 |
| 2011/12 | 915.9 | 734.4 | 181.5 | 5.5 | 73.2 | 99.4 |
| 2012/13 | 1,107.20 | 866.5 | 240.6 | 5.6 | 168.9 | 62.2 |
| 2013/14 | 1,297.80 | 1,001.40 | 309.1 | 6.5 | 203 | 106.1 |
| 2014/15 | 1,610.80 | 1,110.50 | 483.3 | 9 | 130.9 | 217.5 |
| 2015/16 | 1,804.50 | 1,284.40 | 474.6 | 7.1 | 202.3 | 269.9 |
| 2016/17 | 2,146.30 | 1,463.60 | 697.7 | 9.1 | 309.2 | 386.2 |
| 2017/18 | 2,146.70 | 1,550.10 | 632.4 | 7.4 | 273.71 | 354.98 |
| 2018/19 | 2,433.70 | 1,721.40 | 721.1 | 7.6 | 201.74 | 444.85 |
| 2019/20 | 2,565.40 | 1,753.50 | 791.2 | 7.8 | 450.37 | 340.43 |
| 2020/21 | 2,864.53 | 1,849.21 | 966.58 | 8.7 | 540.09 | 426.5 |
| 2021/22* | 3,010.03 | 2,033.93 | 930.05 | 7.5 | 662.77 | 267.28 |
| 2022/23* | 3,201.99 | 2,379.72 | 775.34 | 5.6 | 512.2 | 263.15 |
| 2023/24* | 3,495.62 | 2,796.35 | 651.17 | 4.2 | 477.39 | 173.78 |

[1] https://cyberleninka.ru/article/n/consequences-of-fiscal-deficit-and-public-debt-in-financing-the-public-sector

| Financial Year | Total Expenditure (Ksh billion) | Total Revenue (Ksh billion) | Budget Deficit (Ksh billion) | Budget Deficit (% of GDP) | Budget Deficit Financing (Ksh billion) | |
|---|---|---|---|---|---|---|
| | | | | | Domestic | Foreign |
| 2024/25* | 3,762.90 | 3,099.81 | 613.79 | 3.6 | 459.52 | 154.27 |

Source: *CBK, Annual Reports 2020, 2019,2018,2017,2016,2015,2014,2012,2009 & National Treasury BPS 2021,2020,2019,2018,2017,2014*

Figure 2: Budget deficit expressed as a % of GDP vis a vis sources of financing




Source: National Treasury, BPS 2014 - 2021 and Central bank of Kenya, Annual Reports 2009 - 2020

Kenya's budget deficit as a percentage of its GDP shows an upward trajectory as shown in the figure above. Between the FY 2002/03 to FY 2012/13, the deficit expressed as a percentage of GDP averaged at about 3.55%, majorly financed from domestic sources. However, between the FY 2013/14 to FY 2021/22, the deficit averaged at about 8.84% representing a difference of about 5.29%, majorly financed by external borrowing. Particularly, in FY 2021/22, the country's fiscal deficit is projected to be 7.5%, a figure that is comparatively higher than those in countries like

Japan (5.1%), Germany (4.4%) and France (7.4%) but lower than those in the USA (11.6%) and the UK (13.3%) [2]. The country's fiscal deficit is lower than South African (14%).

## Performance of ordinary Revenue and its implication on public debt

*Table 4: Comparison in budgeted and actual national government revenue between FY 2015/16 and 2020/21*

| FY | Estimated Ordinary Revenue (in KES billion) | Actual Ordinary Revenue (in KES billion) | Deviation (in KES billion) | % Deviation of actual ordinary revenue from original estimates |
|---|---|---|---|---|
| 2015/16 | 1,184.37 | 1,152.54 | 31.83 | 2.7% |
| 2016/17 | 1,311.32 | 1,306.57 | 4.75 | 0.4% |
| 2017/18 | 1,489.63 | 1,365.06 | 124.57 | 8.4% |
| 2018/19 | 1,588.13 | 1,499.76 | 88.37 | 5.6% |
| 2019/20 | 1,615.38 | 1,573.42 | 41.96 | 2.6% |
| 2020/21 | 1,523.50 | NA | NA | NA |
| 2021/22 | 1,775.62 | NA | NA | NA |
| Average | | | | 3.9% |

*Source: Quarterly Economic and Budget Review 4th quarter 2020, BROP 2020 and DORB 2021*

The table above indicates that the Kenya Revenue Authority has persistently failed to meet its revenue targets, with an average deviation of 3.9%. The highest deviation was experienced in the FY 2017/18 at (8.4%) with the least deviation growth of 0.4% being registered in 2016/17. During the issuance of the 2020 budget statement, the CS National Treasury and Planning indicated that the national government projected to collect KES 1.63 trillion in FY 2020/21. However, this was later revised to KES 1.52 trillion in the Budget Review and Outlook Paper 2020. The implication of the failure to meet revenue targets is that the national government would either forego offering the services equal to the deviation or incur an unplanned public borrowing hence altering the original plans contained in the annual budgets.

*Table 5: Public debt servicing as a percentage of ordinary revenue for the period between FY 2015/1 and FY 2020/21*

| FY | Total Public Debt Service (in KES billion) | Ordinary Revenue (in KES billion) | (Public debt service/ordinary revenue) in % |
|---|---|---|---|
| 2015/16 | 397.03 | 1,184.37 | 33.5% |
| 2016/17 | 466.51 | 1,311.32 | 35.6% |
| 2017/18 | 621.76 | 1,489.63 | 41.7% |
| 2018/19 | 870.62 | 1,588.13 | 54.8% |
| 2019/20 | 696.55 | 1,615.38 | 43.1% |
| 2020/21 | 904.70 | 1,523.50 | 59.4% |
| 2021/22 | 1,174.01 | 1,775.62 | 66.1% |

*Source: Programme Based Budgets 2015/16 -2020/21 and Quarterly Economic and Budget Review 4th quarter 2020, DORB 2021*

[2] https://www.mof.go.jp/english/budget/budget/fy2021/01.pdf

The table above indicates a growing rate of public debt servicing as a percentage of ordinary revenue. It is expected that in the current FY 2020/21, for every KES 100 collected as tax, KES 59 will be used to repay public debt leaving only KES 41 for other national government functions. A further projection by the National Treasury through the Division of Revenue Bill 2021 indicates that this figure will increase to 66.1% of the ordinary revenue. This indicates that the country is in a vulnerable position due to the high debt repayment.

*Table 6: Interest payments on debt as a % of tax revenues*

| Financial Year | Tax revenue (KES Billions) | Estimated Interest on Public debt (KES Billions) | Interest on Public debt/Tax revenue (%) |
|---|---|---|---|
| 2014/15 | 1,001.43 | 167.37 | 16.71 |
| 2015/16 | 1,108.17 | 195.24 | 17.62 |
| 2016/17 | 1,253.46 | 250.79 | 20.01 |
| 2017/18 | 1,311.69 | 305.06 | 23.26 |
| 2018/19 | 1,440.21 | 399.98 | 27.77 |
| 2019/20 | 1,573.42 | 437.2 | 27.79 |

*Source: Kenya Gazette, Statement of Actual Revenues and Exchequer Issues for 2015 – 2019, Quarterly Economic and Budget Review 4th quarter 2020 and Programme Based Budgets 2014/15-2018/19.*

Table 5 above shows Kenya's actual tax revenues, interest payment estimates made on public debt and public debt interest expressed as a percentage of tax revenues. Within a duration of five years, Kenya's interest payment on her public debt had increased by roughly about 161% from KES 167.37 billion in 2014/15 to KES 437.2 billion in 2019/20. This implies that the cost of the country's loans has been increasing at an exponential rate. It should be noted that this is the period when Kenya's economy was rebased to low-middle income and at the same time, the period when the country started contracting Eurobonds. This period has also been marked by an increase in external commercial debt and bilateral loans from new countries such as China.

## ANALYSIS OF PUBLIC DEBT SUSTAINABILITY PRE-COVID 19, DURING COVID-19 AND PROJECTIONS ON THE SAME POST-COVID 19

*Table 7: Public sector debt and external debt sustainability analysis for the period 2015 – 2023*

| Indicators | IMF DSA thresholds (Strong performer and a LMIC) | 2015 | 2016 | 2017 | 2018 | 2019 | 2020* | 2021* | 2022* | 2023* |
|---|---|---|---|---|---|---|---|---|---|---|
| PV of public debt-to-GDP ratio | 74 | 45.8 | 50.6 | 49.0 | 60.6 | 57.6 | 61.3 | 63.4 | 63.9 | 63.6 |
| PV of public debt-to-revenue and grants ratio | 300 | 231.8 | 275.9 | 235.7 | 299.6 | 313.9 | 338.1 | 356.6 | 357.4 | 351.3 |
| Debt service-to-revenue and grants ratio | 30 | 33.3 | 36.3 | 38.2 | 42.3 | 53.5 | 53.8 | 68 | 74.5 | 71.5 |
| PV of PPG External debt–to-GDP ratio | 55 | 21.7 | 24.8 | 25.9 | 31.4 | 27.6 | 26.8 | 27.9 | 27.8 | 27.6 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| PV of PPG External debt–to-exports ratio | 240 | 118.5 | 163.8 | 165.4 | 191.1 | 225.2 | 288.1 | 260.6 | 258.5 | 255.2 |
| PPG External Debt Service-to-exports ratio | 21 | 7.6 | 9.0 | 16.5 | 19.9 | 31.4 | 27.5 | 25.9 | 25.5 | 24.4 |
| PPG External Debt service-to-revenue ratio | 23 | 6.8 | 7.1 | 13.3 | 16.2 | 21.3 | 14.5 | 15.9 | 15.7 | 14.8 |

*Source: IMF,2020*

Kenya's public sector debt sustainability analysis indicates that as of 2019, the country's public debt had breached three prudent thresholds. This indicates that pre-COVID 19, public debt sustainability was already deteriorating, majorly due to the deterioration of government revenues. It is expected that post COVID-19, sustainability of public debt will worsen. This is attributed to application of expansionary fiscal measures such as reduction in income tax and Value added tax and increase in transfer payments by the government. In addition to these measures, the country's economic activities have also declined further implying that revenues and by extension Gross Domestic Product (GDP) will decline. Due to the pandemic, the country has also increased its stock of public debt, although, most has been acquired under concessionary terms from the IMF, the World Bank and the African Development Bank.

On 2nd April 2020, Kenya received KES 5.26 billion from the World Bank, this was followed by acquisition of KES 78.56 billion from the IMF on 6th May 2020 and within the same month, the World Bank again credited Kenya KES 106.80 billion. On the 22nd of May, the country received a loan of KES 22.10 billion from the African Development Bank (AFDB). This led to more accumulation in Kenya's public debt by KES 212.72 billion as shown below:

*Table 8: Analysis of increment of public debt from multilateral lenders during COVID-19 period*

| | Source | Total additional public debt from IMF, World Bank and AFDB | Exchange rate for US$ and the Euro | Total additional public debt from IMF, World Bank and AFDB (KES bn) | Domestic (KES bn) | External (KES bn) | Total Public Debt (KES bn) |
|---|---|---|---|---|---|---|---|
| March 2020 | CBK Website | | | | 3,070.189 | 3,212.634 | 6,282.823 |
| 2nd April 2020 | World bank | US$ 50 million | 105.19(as at 2/4/2020) | 5.26 | | | |
| 6th May 2020 | IMF | US$ 739 million | 106.3091(as at 6/5/2020) | 78.56 | | | |
| 20th May 2020 | World Bank | US$ 1.00 billion | 106.8(as at 20/5/2020) | 106.80 | | | |
| 22nd May 2020 | AFDB | Euro 188 million | 117.55 (aa at 22/5/2020) | 22.10 | | | |
| May 2020 | CBK website | | | | 3,153.143 | 3,496.428 | 6,649.572 |
| Growth | | | | 212.72 | 82.954 | 283.794 | 366.749 |

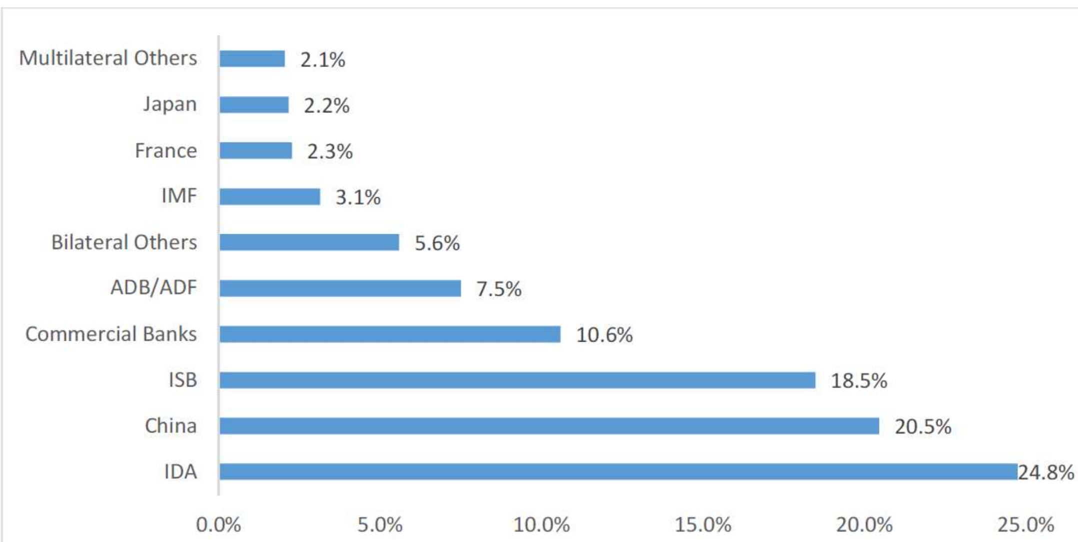
| | | | | | | | |
|---|---|---|---|---|---|---|---|
| % Growth | | | | | 2.70 | 8.83 | 5.84 |

*Source: IMF, World Bank and AFDB website,2020*

The table above shows the growth in the country's public debt during within the first two months after it recorded its first positive case of COVID-19 from its multilateral lenders. Total public debt had increased by 5.84%, much of which was contributed to by growth in external debt which grew by 8.83%. Important to note is that the three major multilateral lenders accounted for 75% of the increment in external debt and 58% of the increment in total public debt. Given that the importance of accountability by the government cannot be over-emphasized, it is important that it observes the principles of transparency in the management of the borrowed amount for effective and efficient utilization of these funds.

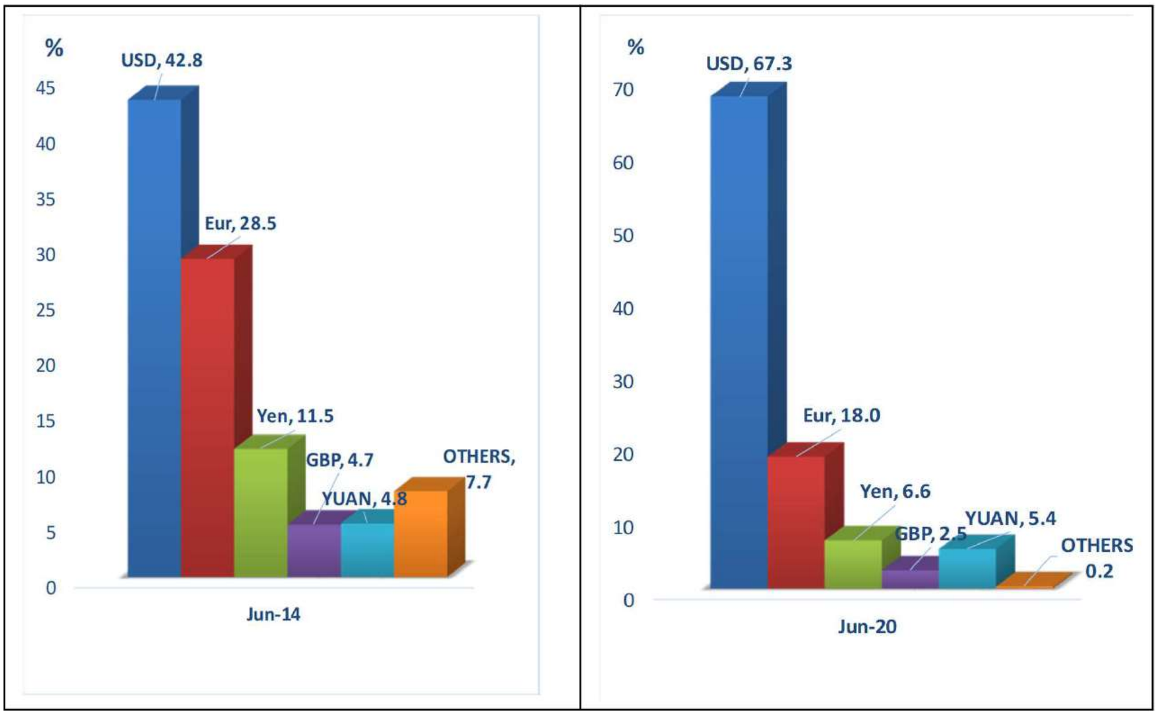
## KENYA'S MAJOR CREDITORS AND EXTERNAL CURRENCY COMPOSITION OF EXTERNAL LOANS

The figure below classifies Kenya's major creditors as at the end of June 2020.




Source: Annual Public Debt Management Report, 2019/2020, National Treasury

The World Bank, China, International Sovereign Bond (ISB) holders and Commercial Banks are the major creditors each with weights of 25%, 21%, 19% and 11% respectively. This signifies the over-reliance of loans from the new bilateral lender, China and commercial loans from foreign investors. This could explain the high cost of the country's external debt.




*Source: Annual Public Debt Report, 2019/2020, National Treasury*

Most of Kenya's external debt are currently US$ denominated as compared to six years ago. This exposes the country to exchange rate risk, especially when a major shock occurs like the COVID-19 pandemic that has led to deterioration of the country's shilling. The implication of this is that the nominal debt would increase leading to more of the country's revenue being diverted towards debt servicing.

## HOW DOES KENYA COMPARE WITH OTHER COUNTRIES?

Table 8 and figure 4 below compares Kenya's Public debt as a percentage of its GDP to other countries in the world and in East Africa Region.

*Table 9: Public debt sustainability comparison between Kenya and other countries globally for the Year 2020*

| Country | Public Debt to GDP in 2020 (%) |
|---|---|
| Japan | 266.2 |
| The United States of America | 131.2 |
| France | 118.7 |
| Canada | 114.6 |
| The United Kingdom | 108.0 |
| Germany | 73.3 |
| Zambia | 97.7 |
| Ghana | 73.3 |
| Kenya | 66.7 |
| South Africa | 65.3 |

| | |
|---|---|
| Nigeria | 34.8 |

*Source: , December 2020, Ministry of Finance; Article IV, IMF 2020 and 2019.*

The table 8 above shows that in comparison to other advanced countries, Kenya's public debt to GDP ratio was relatively lower. When compared to African countries, Kenya ranks after Zambia and Ghana but is slightly above South Africa and Nigeria. Although Zambia's debt to GDP ratio was below Japan's at 97.7%; in November 2020, it became the first country in the Sub-Saharan Africa to default on its public debt during the COVID-19 era. Therefore, this may not be the best measure of debt sustainability. Advanced economies' revenue base is wide as they have strong manufacturing sectors like the Toyota Industry in Japan. Nigeria on the other hand is among the major oil-exporting countries in the world. This indicates revenue and exports play a role in determining whether a country's public debt is sustainable.

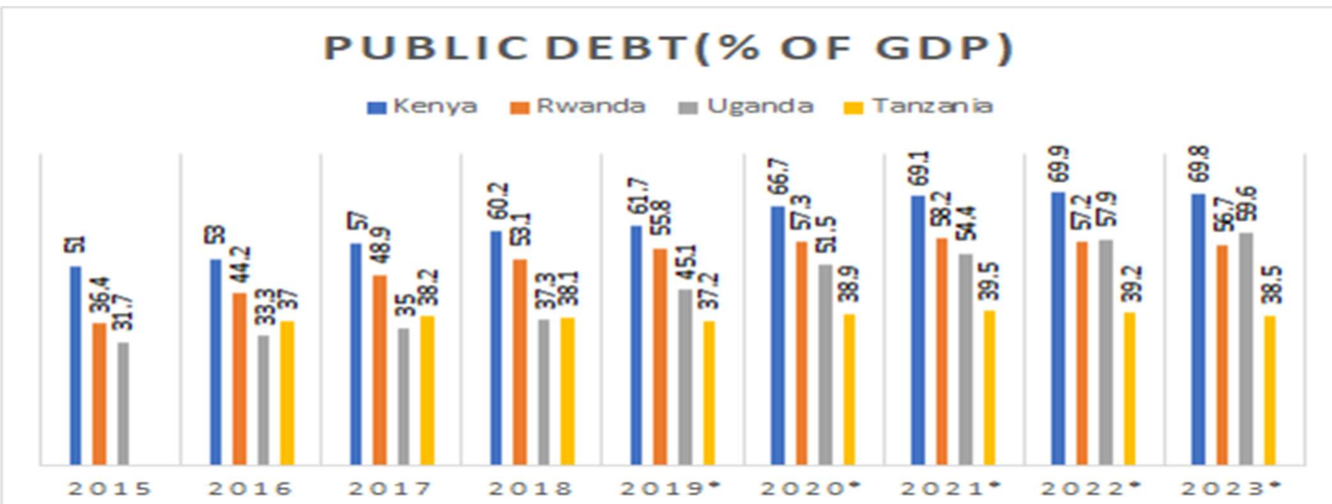



*Figure 3 : Public Debt as a % of GDP of EAC countries*
*Source: IMF*

Kenya's public debt as a percentage of GDP has been on an increasing trend from 51 in 2015 to 61.7 in 2019 and in 2020, the figure is projected to increase to 66.7. Despite the increment, the figure has firmly remained below the indicative threshold of 70. However, in comparison to its other East African Community member countries such as Rwanda, Uganda and Tanzania, it has the highest public debt presented as a percentage of GDP, followed by Rwanda and Uganda and lastly Tanzania whose ratio is the least. The IMF projects that the ratio will increase in the medium term before declining in 2023. However, historically IMF forecasts have been too optimistic and thus it is expected that the country will breach the indicative threshold of 70 in the medium-term.

## EMERGING ISSUES IN KENYA'S PUBLIC DEBT IN 2021

### 1. Public debt Repayment Moratorium

In January 2021, Kenya was among the countries which benefited from public debt moratorium from the Paris Club of major economies. The Paris Club is a group of officials from major creditor countries whose role is to find coordinated and sustainable solutions to the payment difficulties experienced by debtor countries. This is a time-bound suspension of debt service due from 1st January to 30th June 2021 that is expected to save the country a total of about Ksh. 32.9 billion within this period. This came with conditions requiring the National Treasury to fully disclose all its public debt information by including debt owned by parastatals and counties in the calculation of the country's public debt, which is a win-win situation since public debt projections will hence-forth be based on more accurate figures.

This additional debt is expected to be about Ksh. 3.4 trillion. Such an inclusion however, will see the country surpassing its Ksh. 9 trillion debt ceiling which will further jeopardize the sustainability of the country's debt. In addition to this, Kenya secured a debt repayment moratorium from China which will save it Ksh. 27 billion ($245.23 million) in the period to June 2021. The Institute notes that it is unclear whether with the uptake of the moratoria will have additional cost on the country in terms of interest payments within those six months. It is thus imperative that the information on this be disclosed so that the real impact of this can be assessed and determined.

### 2. County Borrowing

The promulgation of the constitution of Kenya 2010 saw the creation of two-tier system of government, the national and the county governments with distinct functions. The main source of revenue for counties has been the equitable share from the national Treasury. Other sources of funds include local revenue (Own source revenue) and conditional grants. However, most of these funds go into recurrent expenditure leaving very little for development expenditure. This coupled with the non-performance of own-source-revenue, worsens the situation. This implies there is need for additional finance for counties to unlock the huge potential of devolution. Counties could consider alternative sources of financing like the issuance of bonds, asset-based securities and public -private partnership rather than majorly relying on the National Government.

Although the PFM Act 2012 provides that counties may borrow on condition that they are guaranteed by the national government and upon approval by the respective county assembly, their credit-worthiness has to be assessed prior. It was for this reason that in 2019 the World Bank Group, in collaboration with the Commission for Revenue Allocation (CRA) launched County Creditworthiness Academy, an intensive one-week capacity building workshop for County government financial officials to master the underlying principles of creditworthiness and hence enable counties source for additional funds to bridge the funding gap. Nine counties, who were prequalified by the Commission for Revenue Allocation (CRA) using objective criteria, were trained in the Academy. The staff in attendance included chief financial officers, treasurers, revenue directors and planners. The nine counties included Samburu, Nandi, Bungoma, Makueni, Meru, Mombasa, Laikipia, Lamu and Kisumu. Later, Nyandarua County was added after receiving a clean audit report from the auditor general. Recently in the year 2021, Laikipia county was allowed to raise funds from the private sector to finance its ambitious transformational projects. This would be by issuing an infrastructural bond.

**Possible Implications of Borrowing by Counties**

a) The initiative will act as an incentive for the counties to generate more revenues because for them to access the credit from the capital markets, they must demonstrate their capacity to generate their own revenue as this will demonstrate their ability to pay.

b) It will also ensure prudent use of resources as the audit reports will form part of the critical documentation for the counties to qualify for the credit facility.

c) For any county to qualify to borrow from the capital markets, they will have to demonstrate their creditworthiness. This will instill confidence in development partners who will invest in the counties encouraging development.

d) In case of failure or delay to repay the loans by the counties, this will aggravate our debt stock since the national government is the guarantor of the borrowed funds.

e) It may also lead to diversion of the funds to other functions other than the intended.

f) There is also the risk of misappropriation of the funds.

**3. The US$ 2.4 Billion Loan from the IMF**

The global economy suffered an unprecedented shock following the COVID-19 Pandemic which economists argued that it would plunge the global economy into a severe contraction of about 5.2% in 2020, representing the deepest recession since the second world war (World Bank, 2020). Kenya was no exception to this. The Kenyan economic growth projections for the year 2020 dipped to 0.6% from about 6% due to the revenue losses incurred as a result of the expansionary fiscal policy measures, the implementation of country-wide curfew and lockdown and the global supply chain shocks. Due to these factors including the under-performance of key sectors such as the tourism, agricultural and trade sectors, the country's risk to debt distress was revised from moderate to high risk. However, the IMF projections for the year 2021 were positive with Kenya expected to rebound at a 7.6% growth rate.

Notwithstanding the recovery, uncertainty remains in a robust return to the path of strong, sustainable, and inclusive growth. Following this and in order to build back better, the IMF conducted virtual missions to Kenya to undertake negotiations on a combined 38-month program under the Extended Fund Facility (EFF) and Extended Credit Facility (ECF) arrangements between December 2020 and February 2021.

The IMF argued that without this kind of assistance, Kenya would have to aggressively cut spending on investment and social programs, which would make it more difficult to achieve a durable and inclusive recovery. This came with conditionalities to the Kenyan authority of fiscal consolidation which include reversal of the temporary tax cuts that were introduced at the start of the shock which ended at the start of 2021 and a combination of revenue mobilization and spending rationalization measures that will reduce the fiscal deficit (which in FY 2020/21 stood at 8.7% of GDP) to 3.6% of GDP by fiscal year 2024/25. On April 2nd 2021, IMF Board approved 38-month arrangement for Kenya in an amount equivalent to US$2.34 billion to support the next phase of Kenya's COVID-19 response and address the urgent need to reduce debt vulnerabilities. This approval enables immediate disbursement of about US$307.5 million, usable for budget support.

However, this led to upheaval among Kenyans who took it upon themselves to address the IMF directly requesting them to stop the entire process, citing corruption and compromised service delivery due to debt servicing consuming more than half of collected revenue. (According to the Division of Revenue Bill 2021, public debt servicing is expected to take up about 66.1% of ordinary revenue). This indicates erosion of trust in the government which if not addressed might compromise the reputation of the government.

To address this, we suggest that the government should move with speed and

- Practice transparency and accountability: Now more than ever before, the government should avail all data, on everything to the public. For example In Boston, citizens can use an app to report city fixtures like potholes, broken streetlights which need repair. The city uses the data to dictate maintenance, and once fixed, the person responsible takes a photo and sends it to the citizen who reported the fault. It gives citizens the sense that real people are fixing these problems and the city found, that when citizens receive photos of the repair they asked for, they are more likely to report future issues.
- Effective citizen participation: The government should be objective and involve citizens in policy-making decisions. This is because, when people participate in policymaking, they are more likely to understand the complexities faced by government.
- Practice better governance: Studies from the OECD indicates that better governance can help build or restore public trust. To this end, the government must be seen to fight corruption at all levels and without fear or favour in order to restore public trust.

## CONCLUSION

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.

Although Kenya is performing relatively well compared to its neighbours, it is at a vulnerable state due to the current expensive loans from commercial and new bilateral creditors amid poor-performing revenues. The situation is expected to worsen due to the current pandemic that has had devastating effects on economies such as the global supply chain shocks and declined economic activities. There is also lack of transparency and accountability by the government which is likely to lead to mismanagement of these funds.

## RECOMMENDATIONS

The Institute recommends the following:

1. Revenue collection: there is need for stronger strategies to enhance revenue collection such as sealing existing tax loss loopholes and widening the tax base. This may ensure that the country can comfortably be able to service its public debt as well as meet the revenue targets.
2. Enhance accountability in public and private sectors to free more resources to development. The government must decisively deal with wastages in utilization of public resources. We must also reign in on corruption that threaten service delivery and could derail realization of the Big Four Agenda.
3. The National Treasury and Planning to practice accountability by availing information on the utilization of the COVID-19 loans to citizens in a disaggregated manner. This will promote transparency and ensure that the loans are used in an efficient and effective manner.
4. Kenya should diversify its exports and the market for the same to increase its foreign exchange reserves and hence minimize on the exchange rate risk.
5. The National Treasury should consider the option of public-private-partnership (PPP) in financing future development projects to reduce over-reliance on loans.
6. The Central Bank of Kenya through the Nairobi Securities Exchange should adopt climate-friendly financing such as the issuance of green and blue bonds. This will serve to build back a better, robust and sustainable economy.
7. The National Treasury should adopt a balanced budget in the medium-term to bring down the high budget deficit and hence reduce the current debt vulnerabilities.
8. The National Treasury should set a budget line for the COVID-19 vaccination and move with speed to inoculate citizens in the five counties under the one zoned area. This is because the lockdown in these five counties, not only affect economic activities in these counties, but also in the rest of the counties. The faster the country is opened-up the better since the KRA would then maximize on its revenue collection and the only safe way to achieve this is by intensifying the inoculation process in these highly disease-infected areas.

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