23 February 2021

Memorandum on the Budget Policy Statement 2021 Public Debt Crisis – Policy Options for Kenya

The *Okoa Uchumi campaign*[1] is a civil society platform committed towards working with stakeholders to resolve Kenya's public debt crisis. The campaign advocates for balanced and equitable budgets as a means of achieving debt sustainability and economic inclusion. The campaign seeks to bolster constitutional safeguards in public debt management and to push for the accountability of political leaders in public debt management.

The country has witnessed an exponential growth in the total public debt. The main driver of Kenya's public debt is the budget deficit which has been growing in absolute terms and as a share of GDP.[2] It seems that the country has no control of how large the deficit is and it changes significantly even within one budget cycle. That is indicative of poor fiscal policies that seem not to get our revenue projections and expenditure priorities right.

Kenya is Facing a Public Debt Crisis

1. According to the Medium-Term Debt Strategy 2021, as at end December 2020 Kenya's public debt stood at Kshs 7,281.6 billion or US$ 65.6 billion equivalent to 65.6 percent of GDP. Total external debt was Kshs. 3,792.8 billion (34.2% of GDP) while total domestic debt was Kshs. 3,488.8 billion (31.4% of GDP).

2. Whereas the Budget Policy Statement (BPS) 2021 paints a rosy picture of fiscal position, declining tax revenue as a share of economic activity coupled with increasing expenditure has contributed to a widening fiscal deficit. The fiscal deficit as a share of GDP increased from about -6.1% in 2013/14 to -7.9% in 2019/20. The ballooning fiscal deficit has resulted in rapid debt accumulation between 2013 and 2020.

3. Debt servicing expenditures have become the main driver of the fiscal deficit presenting a non-discretionary expenditure, with distortionary macroeconomic impacts, disruptions to the budget making and cash flow planning processes and ultimately reduces the resources available for long term expenditure. (See Annex 1 attached)

4. This points towards failure of the fiscal consolidation efforts and towards a continued increase in the risk and costs to debt portfolio.

[1] This memorandum by Okoa Uchumi Public Debt Campaign was prepared with support from the Institute of Economic Affairs Kenya (IEA), Institute for Certified Public Accountants Kenya (ICPACK), International Budget Partnership Kenya (IBPK). Okoa Uchumi Coalition partners include – Kenya Tuitakayo Movement, Katiba Institute, National Taxpayers Association, Transparency International Kenya, CRAWN Trust, Interreligious Council of Kenya, Okoa Mombasa, International Budget Partnership Kenya, Institute of Public Finance Kenya, Social Justice Centers, Ni Sisi, East Africa Tax Governance Network, The Institute for Social Accountability

[2] https://ieakenya.or.ke/publications/notes/charts-on-kenya-s-public-debt

5. Revenues have been on the decline against a growing expansionary budget and resultant budget deficit forcing increased borrowing most of it domestically. Tax revenue targets set by the Treasury have become increasingly unrealistic. The deviation between actual and printed estimates tax revenue increased from 5 percent in 2016/17 to 21 percent in 2019/20. Increasing deviation is evident among all the major taxes. The deficit amounts are growing but the adjustments in year are even more and that is concerning. (See Annex 2)

Year (Billions)	Deficit in the Proposed Budget in the BPS	Deficit in the Approved Budget	Deficit in the Revised Budget	Increase in the deficit within the year	Deficit in the Actual Budget
2014/15	-367	-417	-732	76%	-533.9
2015/16	-533.2	-640.5	-732.6	14%	-544.1
2016/17	-555.4	-775	-871.6	12%	-709.4
2017/18	-582.4	-594.3	-670.4	13%	-624.2
2018/19	-638.2	-608.1	-760.6	25%	-734.9
2019/20	-629.9	-673.6	-789.9	17%	-828.5
2020/21 (Current FY)	-614.1	-898	-1048.9	17%	
2021/22	-983.7				

6. Ksh 624 Billion of Debt is untraceable: A significant proportion of Kenya's capital expenditure is funded through loans. Debt equity is often defined by the need to ensure there is fair distribution of inter-generation debt obligations. However, it is also important to look at what investments/projects are funded by loans and whether they are fairly distributed across the country. Current publicly available information does not fully show how all debt is distributed across government MDAs. For example, in 2019/20, capital expenditure that was funded through lines marked as loans was only Ksh 261 billion but the national debt in the same year grew by Ksh 885 billion. Therefore, we are only able to analyze the expenditure of about one third of loans. In what sectors, projects, budget support areas are the rest of the resources used? Transparency on the sectors that benefit from the loans will open up and facilitate debates on its spending and the fairness of that expenditure.

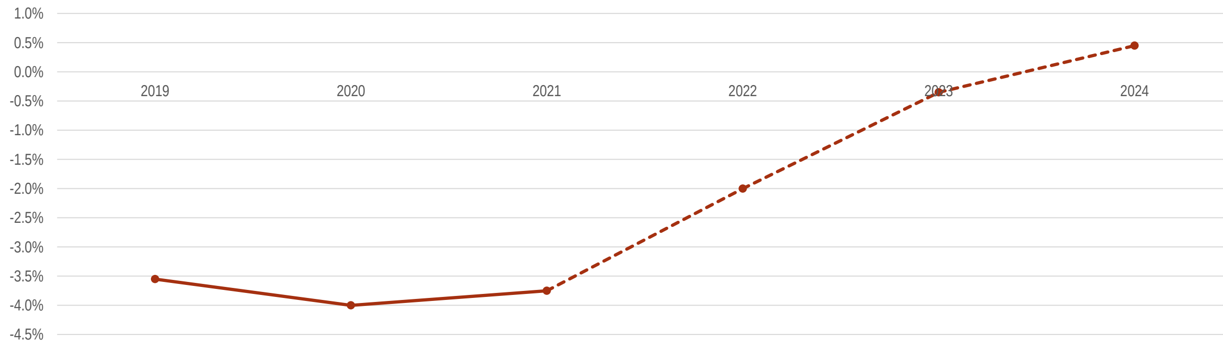
7. Whereas government has identified the need to reduce the ratio of domestic to external borrowing as a percentage of GDP from 57:43 to 27:73, negotiations under the IMF's external Debt limit Policy, the Treasury instead proposes a domestic to external borrowing ratio of 79:21. The IMF conditions are set to compound the situation and set Kenya, and experts warn that increased domestic borrowing will lead to economic collapse similar to the Greece example.

Given this alarming situation we urgently appeal to Parliament to take prompt and decisive action to save the country from imminent default and economic collapse. We hereby propose five urgent measures for adoption by Parliament to save the country from imminent collapse.

Options:

8. **Reduce the budget deficit in the BPS 2021 by half.**

The primary balance as a share of GDP is one of the parameters that can signal the capacity of the country to sustain the debt levels. The debt stabilizing balance required to keep debt constant in 2021 at the end of 2020 level is 2.1 percent of GDP which is higher than the BPS 2021 primary balance as a share of GDP estimated at -4.0 percent for 2020. Projections by the BPS show that public debt is going to continue to increase unless there are measures put in place to improve the primary balance by either increasing the total revenues or reducing expenditures**.**



Parliamentary Budget Office February 2021

Measures to reduce the deficit: Stop to all new projects, all corruption projects, slow down on legacy projects, review all tax exemptions, curb non-essential/wasteful expenditure, lower transfers to state owned enterprises, hold all bail outs of non-performing SoEs. Aim for a balanced budget.

9. **Debt Transparency:** Public spending is vulnerable not only to waste and misuse, but also to fraud. "Sunlight is the best policy" for preventing corruption and maintaining high standards of integrity in the use of public funds.[3] Due to transparency gaps in the budget, it is not possible to account for two thirds of public debt expenditure. This implies that debt repayments may be higher than stated and also implies there may be high levels of unaccounted expenditure due to corruption. Parliament should ensure the following:
    a) The National Treasury should include details of all loans in the budgets estimates under the MDAs estimates as well as the project amount, location and status of projects.
    b) All MDA's to disclose assets and liabilities relating to PPPs.
    c) The Treasury/Attorney General to disclose all debt related contracts.
    d) Treasury to avail a schedule detailing the debt relief savings and ringfenced (Covid related) expenditure priorities.
    e) An independent and comprehensive audit of all loan's expenditures.

10. **Review IMF conditionalities:** there is an urgent need to review the conditionalities under External Debt Limit Facility through an analysis of comparative lessons from other jurisdictions, scenarios and make informed contributions into the facility agreement.

11. **Legal reforms:** We recommend a few urgent legal reforms to strengthen oversight over public debt management.
    a) Strengthen the independence of the PDMO.

[3] https://www.oecd.org/gov/budgeting/best-practices-budget-transparency.htm

b) Ensure all loan agreements are approved by parliament including agreements with IFI's such as the WB and IMF.
c) Ensure all loan proceeds are ringfenced to specific projects or expenditure items.
d) Ensure MDA's publish the list of assets and liabilities annually as part of the consolidated financial report (audit report).
e) Ensure all projects are included into the BPS based on an approved feasibility plan.

12. **Violations and omissions by the Cabinet Secretary:** It is a matter of grave concern that current debt reporting practices do not adequately comply with the Constitutional and statutory requirements for disclosure. For instance, the Cabinet Secretary Treasury has not complied with the 2020 directive by the Budget and Appropriations Committee to provide information on the list of public projects that benefited from debt financing. Treasury is required by law to publish an annual report on all exemptions and concessions. – not done. It is also noteworthy that the recently published debt register is out of date and is missing crucial information. There is also a dearth of information surrounding national infrastructure programs. Since ethe adoption of the national debt strawy in June 2020, the treasury has not taken any step to secure the independence of the PDMO. Parliament needs to consider a motion of censure against the Cabinet Secretary.

13. **Debt Strategy Risk analysis:** Treasury publishes fiscal risks, but the depth of reporting could be further improved. Parliament should ensure regular detailed reports on the status of debt restructuring and its potential impact. Treasury needs to provide details on the risks associated with respective PPP's due to the magnitude of such projects.

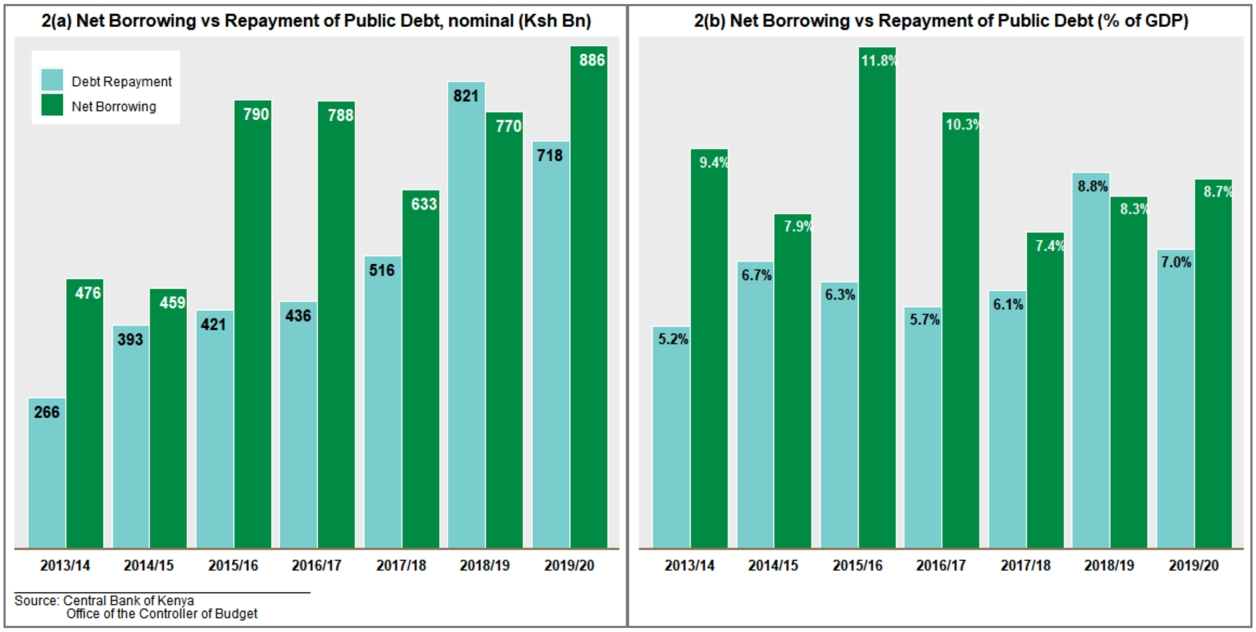
14. **Debt Ceiling:** Kshs. 9 Trillion debt ceiling passed by parliament in 2019 will be surpassed by 2022. The assumptions of the current debt ceiling of Kshs 9 Trn do not take into account debt sustainability principles. Treasury needs to adopt a debt ceiling that factors future debt service obligations and the size of the economy as the indicator of the ability to service the debt is preferrable. There is need to expand the national debt coverage to include counties, non-guaranteed debt contracted by the extra budgetary units, and State-Owned Enterprises.

Annex 1: Kenya is in debt distress[4]

Kenya was already showing signs of debt distress even before the onset of COVID-19 pandemic. Debt servicing charges as indicated in the chart below were mostly higher than Net Borrowing, an indication of the high debt obligations that were falling due.

Figure: Trends in Net Borrowing and Repayment (Nominal)

[4] Source Institute for Economic Affairs



In 2019/20, Ksh 718 Bn amount of debt was repaid compared to Ksh 886 Bn that was borrowed, suggesting that part of the reason for borrowing is to settle the debt obligation that have matured. One clear reason explaining this phenomenon is the falling revenues which as a share of GDP plummeted from 19.2% in 2013/14 to 16.8% in 2020/21. The conundrum of the falling revenues and rising debt servicing charges have led to a surge in the *Debt Service ratio to Tax Revenue* from 30% in 2013/14 to 49% in 2020/21. In a nutshell, this means that while in 2013/14 for every Ksh 100 that was collected from Taxes at least Ksh 30 was utilised in the repayment of the debt charges, this has since risen to at least Ksh 49.

The current macroeconomic indicators paint a grim picture with regards to economic performance and debt position. The economic projections of the expansion of the total output are at a meagre 0.8% while the debt level is projected to rise sharply due to recent external borrowing for economic stimulus package to address the negative effects in the aftermath of the pandemic. The tax revenues are highly projected to fall due to the sharp slowdown in the traditionally resilient services sector. A combination of these factors is likely to lead to debt distress.

Table 1: Debt Sustainability Analysis, April 2020

Indicator	Threshold (%)	Actual			Actual		
		2017	2018	2018	2020	2021	2022
PV of public debt to GDP ratio	**74**	49	48.6	57.6	61.3	63.4	63.9
PV of public debt to revenue & grants ratio	**300**	235.7	226.6	313.9	338.1	356.6	357.4
Debt service-to-revenue & grants ratio	**30**	38.2	42.3	33.4	53.8	68.0	74.5

IMF Country Report No. 20/156

As shown in Table 1, the debt sustainability analysis by the International Monetary Fund, reveals a deterioration in the debt level and debt services. On one hand, this is the adversely impacted by the global economic shock but on the other, increased utilization of external commercial financing in the recent past. Solvency indicators for the PV of external debt-to-GDP ratio and PV of total public debt-to-GDP ratios are firmly below the indicative threshold/benchmark under the baseline scenario. However, there are breaches of one solvency indicator (i.e., the present value (PV) of external debt-to-exports ratio) and one liquidity indicator (i.e., the external debt service-to-exports ratio) above the thresholds under the baseline scenario.

Table 2: Joint Bank-Fund Debt Sustainability Analysis, April 2020

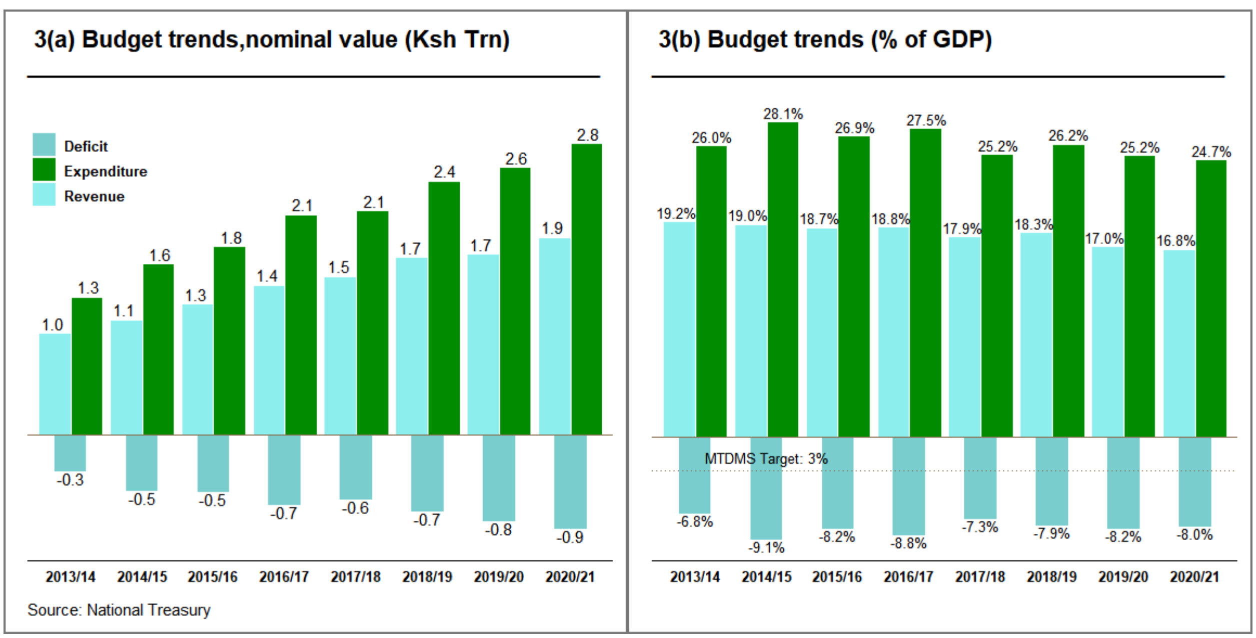
Risk of external debt distress	High
Overall risk of debt distress	High
Granularity in the risk rating	Sustainable
Application of judgment	No

IMF Country Report No. 20/156

As summarized in the table above, despite Kenya's debt remaining sustainable, the risk of debt distress has moved to high from moderate due to the impact of the global COVID-19 crisis which exacerbated existing vulnerabilities. The COVID-19 crisis has led to a sharp decline in export and economic growth.

Annex 2. Increased budget deficit[5]

The main driver of the public debt is the budget deficit which has been increasing both in absolute terms as shown in Figure 3 (a) and as a share of GDP as shown in Figure 3 (b).



[5] Source: Institute for Economic Affairs

Ambitious budgets in the wake of falling revenues has constrained fiscal space, leading to increase in the budget deficit which has risen from Ksh 0.3 Trn to Ksh 0.9 Trn between 2013/14 and 2020/21 respectively. As a share of GDP, the budget deficit is now 8%, much larger than the target of 3% as per the Medium-Term Debt Management Strategy of 2020.

Annex 3

Relevant Access to Information provisions

Article 201	There shall be openness and accountability, including public participation in financial matters.
Article 211 (2)	Within seven days after either House of Parliament so requests by resolution, the Cabinet Secretary responsible for finance shall present to the relevant committee, information concerning any particular loan or guarantee, including all information necessary to show: • the extent of the total indebtedness by way of principal and accumulated interest. • the use made or to be made of the proceeds of the loan. • the provision made for servicing or repayment of the loan; and • the progress made in the repayment of the loan.

a. Public Finance Management Act

Section 31	The Cabinet Secretary shall submit to Parliament, every four months, a report of all loans made to the national government, national government entities and county governments, in accordance with Article 211(2) of the Constitution. Where either House of Parliament is canvassing a matter relating to the national debt, the Cabinet Secretary shall submit to Parliament, a report of all loans made to the national government, national government entities, and county governments, not later than seven days after receiving a request to do so from either House of Parliament. At the end of every four months, the Cabinet Secretary shall submit a report to Parliament stating the loan balances brought forward, carried down, drawings and amortizations on new loans obtained from outside Kenya or denominated in foreign currency, and such other information as may be prescribed by regulations, specifying: • the names of the parties to the loan. • the amount of the loan and the currency in which it is expressed and in which it is repayable. • the terms and conditions of the loan, including interest and other charges payable and the terms of repayment. • the amount of the loan advanced at the time the report is submitted. • the purpose for which the loan was used and the perceived benefits of the loan; and such other information as the Cabinet Secretary may consider appropriate.
Section 33	The Cabinet Secretary to submit the national government debt management strategy over the medium term to Parliament annually on or before the 15th of February in each year, with respect to its actual liability and potential liability in respect of loans and guarantees and its plans for dealing with those liabilities. The Cabinet Secretary shall include in the statement the following information: • the total stock of debt as at the date of the statement.

	• the sources of loans made to the national government and the nature of guarantees given by the national government. • the principal risks associated with those loans and guarantees. • the assumptions underlying the debt management strategy; and • an analysis of the sustainability of the amount of debt, both actual and potential.
Section 38(1)	The Cabinet Secretary shall submit to the National Assembly the following other budget documents for each financial year—(a) a budget summary that includes— (i) a summary of budget policies including policies on revenue, expenditure, debt, and deficit financing;
Section 63	Functions of the debt management office to include: • Maintaining a reliable debt data base for all loans taken by the national government, county governments and their entities including other loans guaranteed by the national government. • Prepare and implement the national government borrowing plan including servicing of outstanding debts.
Section 64 (2)	The Public Debt Management Office shall prepare and submit to the Cabinet Secretary and the Commission on Revenue Allocation the following reports: • the Medium-Term Debt Management Strategy consistent with the Budget Policy Statement. • the government borrowing plan for the approved Annual Budget. • the statistical and analytical reports on debt and borrowing; and • the annual performance reports of the Public Debt Management Office. The reports referred to in subsection (2) shall be published and publicized and a copy of each sent to each county government.

b. Public Finance Management Regulations 2015

Regulation 46(6)	The National Treasury shall publish and publicize the quarterly liquidity position reports reflecting the impact of revenue collection efforts, spending and public debt operations on the cash position of government.
Regulation 194(1)	Functions of the Public Debt Management Office • prepare annual debt management report which shall include outstanding guarantees, outstanding lending, and government on-lending by Government. • to keep timely, comprehensive, and accurate records of outstanding Government debt, guarantees and lending in an appropriate database. • prepare and publish debt statistical bulletins regularly. • prepare forecasts on Government debt servicing and disbursements as part of the yearly budget preparation. • compile, verify and report on all Government debt arrears and design a strategy for the settlement of those arrears;
Regulation 199	National government entities and each County Treasury and shall submit to the National Treasury a report on public debt in a format prescribed by the Accounting Standards Board within two months after the end of the financial year. The report to be submitted shall include at the minimum the following information — (a) review of previous year's financing of budget deficit. (b) composition of domestic debt. (c) composition of external debt.

	(d) on-lent loans and contingent liabilities. (e) debt strategy and debt sustainability. (f) outlook for the medium term; and (g) any commitment fees and penalties paid on any undisbursed amounts of a loan.
Regulation 200	Not later than three months after the end of each Annual debt financial year, the Cabinet Secretary shall prepare and submit an annual report to Parliament on public debt in the format set by the Cabinet Secretary. The annual public debt report under paragraph (1) shall include the following information — (a) Review of previous year's financing of budget deficit. (b) composition of External debt. (c) publicly guaranteed debt. (d) on-lent loans and contingent liabilities. (e) debt strategy and debt sustainability. (f) outlook for the medium term; and (g) any commitment fees and penalties paid on any undisbursed amounts of a loan.
Regulation 205	**Regulation 205** Roles and responsibilities of accounting officers in debt management operations and loan administration For the purposes. of debt management operations and' loan administration, the accounting officers of a national government entity, shall be responsible for the following: (a) preparing project proposals and submitting them for approval to the National Treasury. (b) where authorization has been granted for the project to start, the Accounting Officer shall ensure public disclosure to intended beneficiaries within thirty days of the allocation and disbursement of the loan. (c) after disbursement of loans, the loan recipients accounting officer shall report within fifteen days after the end of each quarter to the intended beneficiaries on the expenditures and performance achieved in relation to the loan. (d) ensuring that during the project identification and design, the intended beneficiaries are involved through the public participatory approach to planning through public forums to enhance leadership, ownership, social accountability and sustainability of the project; (e) preparing expected disbursements profiles. (f) submitting loan disbursement claims for approval by the National Treasury. (g) making comments on draft loan agreement from the National Treasury. (h) participating in all consultations and negotiations of all loan agreements for projects and programmes under their jurisdiction; and (i) implementing, monitoring and evaluating, in close collaboration with the national government entity responsible for National Planning, all projects and programmes within their jurisdiction.

c. **Debt and Borrowing Policy 2020**

Number 3	The PDMO will maintain the public debt register, undertake periodic debt sustainability analysis, prepare statistical and analytical debt reports, and promote dissemination of information on public debt and borrowing.
Number 16 (e)	Borrowing and management of public debt will be responsible and fiscal reporting will be clear.

Number 20	The Controller of Budget will authorize withdrawal of funds for debt management operations – receipts and payments – and prepare reports on public debt and borrowing in accordance with the law.
Number 24	Public debt and borrowing processes will be conducted in a transparent and open manner. In enhancing fiscal transparency, the National Treasury will: - a) Publish and publicize debt reports and information as guided by the relevant laws;
Number 36	In addition, other emerging Debt Sustainability Indicators will be tracked, reported and monitored to provide early warning signals on sustainability of public debt.
Number 42	Debt financed projects will be those that support the achievement of Government policy objectives outlined in public policy statements and reports.
Number 47	The implementing units will work with the National Treasury to ensure Conditions Precedent (CPs) are met first before signing of project financing agreements. During the project implementation period, implementing entities of debt-funded projects will provide quarterly project implementation status reports to the National Treasury.
Number 61	61. The role of the PDMO will include: c) Maintaining the public debt records including the public debt register. d) Preparing public debt management reports;
Number 64	Middle office functions of PDMP include: • Undertake periodic public debt sustainability analysis, portfolio risks and costs analysis and prepare relevant reports. • Prepare periodic analytical and other debt management reports for the Cabinet Secretary. • Prepare statutory debt related reports for the Cabinet Secretary.
Number 65	Back office functions of PDMO include. • Maintain public debt registry. • Maintain a comprehensive and reliable debt database for public debt and grants; Monitor and report disbursement of loans and grants.
Number 68	Debt and Borrowing Reports The PDMO will prepare the following: • The Medium-Term Debt Strategy consistent with the Budget Policy Statement. • The Government borrowing plan for the approved Annual Budget. • Statistical and analytical reports on debt and borrowing. • The annual performance reports of the PDMO. • Report of all loans made to the National Government, County Governments, and their entities. • Report on loan balances, drawings and amortization on new loans obtained outside Kenya or denominated in foreign currency. • Report of all guarantees given by the National Government in a financial year.
Number 104	The PDMO will prepare or facilitate preparation of the following key documents to guide its effectiveness in public debt management functions: Debt statistical reports; Debt Sustainability Analysis Reports; Public Debt Management Reports;
Number 123	Implementation of the Debt and Borrowing Policy The annual debt management report will report on progress in implementation of this policy.

Access to Information Act section 5(e)	Subject to applicable limitations a public entity shall: Upon signing any contract, publish on its website or through other suitable media the following particulars in respect of the contract entered into— 1) the public works, goods acquired or rented, and the contracted service, including any sketches, scopes of service and terms of reference. 2) the contract sum; 3) the name of the service provider, contractor or individual to whom the contract has been granted; and 4) the periods within which the contract shall be completed.

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