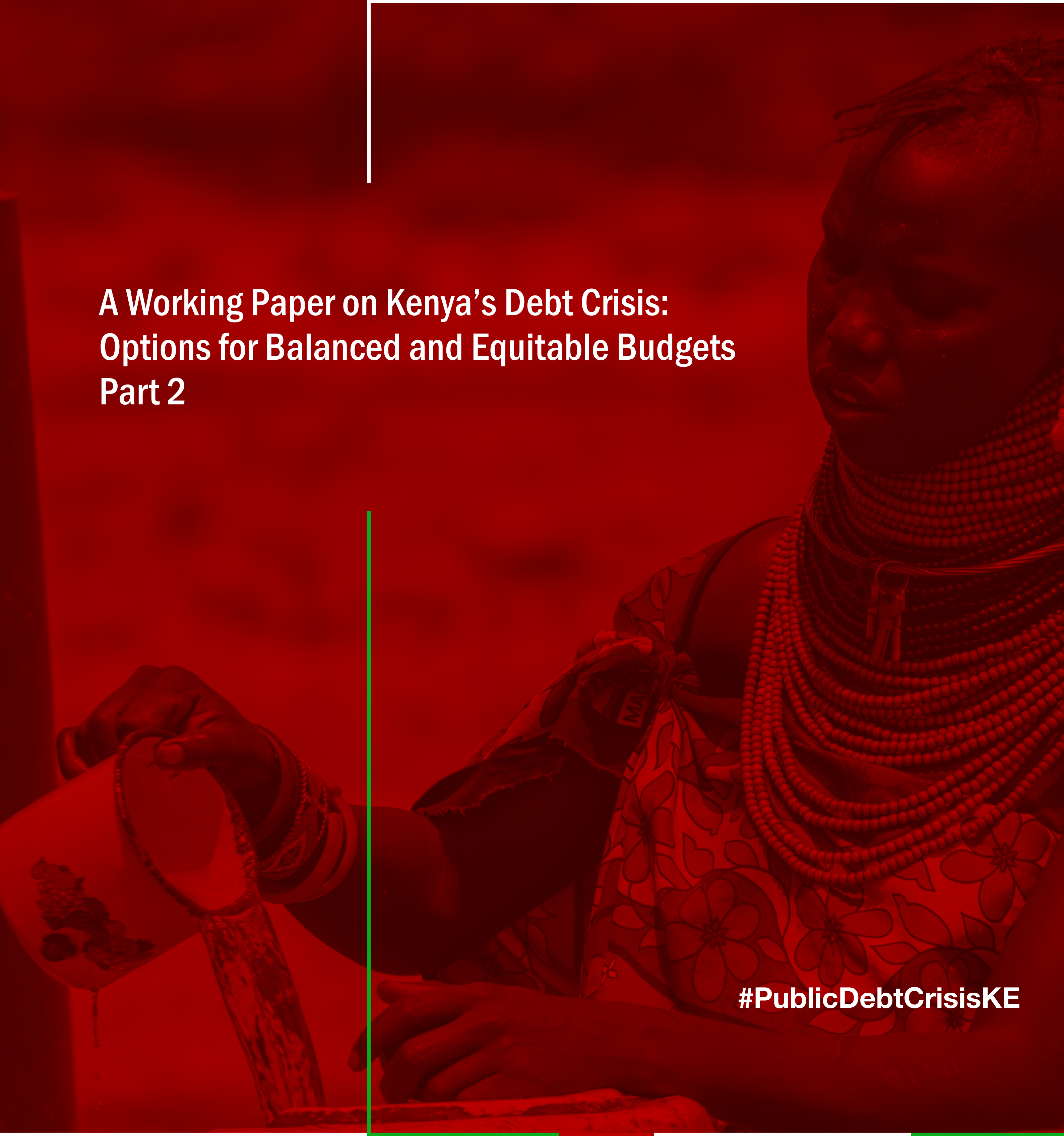
Okoa Uchumi Campaign



A Working Paper on Kenya's Debt Crisis: Options for Balanced and Equitable Budgets Part 2

#PublicDebtCrisisKE

The ***Okoa Uchumi campaign*** **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.**

Overview

Over the last decade, expensive commercial and bilateral debt has flooded into Kenya. Driven by the government's drive to finance large national flagship projects, coupled with the failure of international development lending standards, investments have largely prioritised profit over the country's development needs. Projects of questionable viability have been irregularly prioritised in what has come to be known as budgeted corruption. The government has imprudently accepted large, costly and risky investments, without transparency in decision-making. As a result, *Kenya* is drowning in debt, and in *May 2020* was rated at 'high' risk of debt distress by the *International Monetary Fund (IMF)*. This situation has been compounded by the grave impacts of the *COVID-19* pandemic. Unless the government and the international community take urgent action to resolve *Kenya's* public debt crisis, the country's hard-won development gains are at risk, and the poorest in *Kenya* are likely to bear the brunt of the economic fallout for generations to come.

This discussion is part of civil society's contribution towards the resolution of the debt crisis in Kenya and is presented in two papers. The first paper presents a diagnosis of the public debt problem and analyses the trends, drivers, scale of the problem and gives options for its resolution. The second presents civil society's proposals to government and international lenders as our contribution to the resolution of Kenya's public debt problem and the political economy that has fuelled it.

This paper is structured around five chapters. The first chapter looks at Kenya's debt management policies and trends since independence. Chapter 2 focuses on Kenya's debt relationship with China and the significance of the SGR related loans in the present debt crisis. Chapter 3 delves into the drivers of onerous debt in Kenya and points towards the intersection of interests between international and multinational lenders and local corruption in fuelling corruption led-borrowing. The next chapter considers the policy options available to Kenya and the political considerations around each. The paper concludes that imprudent political decisions driven by high level corrupt interest are the ultimate cause of Kenya's debt crisis.

Part II: A Civil Society Agenda

Kenya finds itself in public debt distress on account of the irresponsible accumulation of public debt under the Jubilee administration. Tackling Kenya's public debt crisis calls for a fundamental political shift on the part of Kenya's Government (both the National Executive and Parliament), and international actors engaged in the country. There are three paths out of distress: growth, adjustment, and relief. This paper outlines some of the opportunities available to Government to get public debt under control, and outlines some steps that Government needs to take to address Kenya's burgeoning public debt and stave off the imminent crisis.

1. Increase transparency and accountability to increase analysis and scrutiny of existing and future debts

The Government of Kenya should act with urgency to:

a. Ensure public disclosure of all past and future contracts involving sovereign debt and sovereign guarantees.
b. The Central Bank of Kenya to release official repayment calendars of all public debt, including amounts due for the coming 5 years.
c. Disclose to Parliament all public contracts that could result in an increase in public debt and making these contracts publicly available.
d. Hold annual public hearings on all new and ongoing public debt operations. These must take place in both the National Assembly and Senate, and in a public setting open to the media and civil society.
e. Strengthen checks and balances on investment and public debt decisions. The assumption of any significant public debt should require an ex-ante report to Parliament, accompanied by a viability report that projects its impact and income generation. These documents must be publicly available. Bond issuances also need to be subject of Parliamentary control and public oversight.

2. Debt Relief

Kenya's 2020 bilateral debt repayments amount to US$1.5bn. While COVID-19 represents an additional and serious challenge, it is also an opportunity for lenders to afford Kenya debt relief and new financing.

In the wake of the COVID-19 crisis, there have emerged a range of international initiatives offering debt relief and emergency funding which Kenya could take advantage of to gain much needed fiscal head room.
We recommend the swift and decisive action by government to capitalise on these opportunities.

First, the 2020 IMF and World Bank Spring meetings saw G20 leaders unanimously agree an unprecedented debt relief initiative This debt suspension initiative (DSSI) saw US$12 Billion of debt relief to 77 eligible countries, from whom all G20 members were to stop collecting debt repayments between May and December 2020.

Second, the World Bank and IMF have significantly expanded emergency funding available to countries, and here there is some better news. Kenya has requested emergency funding from both and received approval for a US$1.23bn disbursement from the IMF, and a US$1bn transfer focused on budget support from the World Bank. Both loans were given as direct transfers to the Government and come on condition of improved transparency and public financial management. Crucially, they provide important breathing space for Kenya.

However, the Kenyan Government has publicly expressed its reluctance to use the DSSI, on the basis that it would damage their credit rating with private lenders and make it difficult for them to refinance private debts in the future. Kenya is also not eligible to apply for the IMF's debt relief scheme, the Containment and Catastrophe Relief Trust, and Multilateral Development Banks are also not currently offering any form of debt relief. The Government has instead indicated its preference for negotiations with bilateral lenders.

Recommendations

The Government of Kenya should act with urgency to:

In the immediate term.

a. **Take advantage of the DSSI** and capitalize on the space it creates for crucial emergency spending and improving transparency and public accountability. Kenya could take advantage of the DSSI, and at the very least, postpone those payments to the period 2022-2024 financial year.

b. **Publicly advocate for further debt relief, especially for World Bank and commercial debts,** by joining other African leaders such as Ethiopia, Ghana, South Africa, Uganda and Senegal.

c. **Immediately institute mechanisms and systems for public oversight** over the debt restructuring process.

d. **Institute a comprehensive and accountable debt restructuring framework,** ensure that the multilaterals' refinancing facility is aligned to constitutional requirements for transparency, accountability, and public participation.

e. **Assess new loans from the World Bank and the AfDB more critically,** as happens with financing from other public and private funders.

3. Fiscal Consolidation

Our research demonstrates that whereas the development budget is one of the primary factors driving debt, government is targeting soft spending instead of scaling down development expenditure. This is exacerbated by tax breaks, exemptions and incentives given to attract foreign investment alongside an expansionary budget.
This is further compounded by budgeted corruption which has witnessed the funding of projects of questionable viability. It emerges that powerful interests are holding government captive, and unless checked will undermine the fiscal consolidation process. To circumvent corrupt interests from undermining the fiscal consolidation process we call upon government to:

Recommendations

The Government of Kenya should act with urgency to:

a. **Institute a transparent public debt recovery strategy** that is accountable to all stakeholders through robust public and stakeholder engagement.
b. **Ringfence emergency funding: Ensure emergency funding for Kenya is not spent on repaying existing debts** but rather on investing in social needs and boosting equitable growth in the medium-term to benefit ordinary citizens and increase the country's future repayment capacity. As debt distress is already high, the IMF should help negotiate a grace period of two years with all public and private creditors, to allow for recovery and growth to be in better shape for future payment.
c. Commit to **investing the resources released from the DSSI and emergency** financing from the WB, IMF and AfDB in health and social protection.
d. **Slow down investment in large infrastructure projects.** This trend is fundamentally undermining Kenya's public finances and economic stability. Evidence tells us that the country cannot absorb the financial long-term impact of any new large-scale investments.
e. **Prioritise investments that boost productivity and create opportunities for lower-income groups.** Kenya must focus on smaller-scale investments, for example to enhance the productivity of SMEs, or support small-scale agriculture to thrive.
f. **Work with realistic economic scenarios that do not underestimate the negative impact of Kenya's public debt, and of the COVID-19 crisis.**

4. Increase Domestic Revenue Mobilisation and make it more progressive

Increasing domestic revenue mobilisation is the only way to ensure public financial stability, by reducing reliance on public debt, to fund progressive public spending and providing a financial base to manage necessary public debt intake sustainably. This will also ensure revenue is raised and redistributed equitably.

The Government of Kenya should act with urgency to:

a. Seal revenue and expenditure loopholes through a program of increased stakeholder engagement, transparency, and accountability at both national and county levels.
b. Urgently review the regime of tax exemptions and incentives provided to corporates and multi-national companies, based on a cost-benefit analysis.
c. Make all revenues from the extractives industry fully transparent and subject to domestic tax legislation.
d. Implement a new top rate of income tax of 35%, in line with the proposal by the National Treasury.
e. Introduce a new wealth tax that would include taxing “gifts” as ordinary income
f. Increase the rate of capital gains tax to the same level as income tax rates from the current rate of 5% and instead graduate the rates based on the income thresholds. For instance, income of above KES 564,709 to attract a 30% rate.

5. Other relevant actors must also take action:

a) **The International Financial Institutions (IFIs)**

- Should take more concerted action to support Kenya through these unprecedented times. This means: **The IMF recommending and supporting a reprofiling and restructuring of Kenya's existing** public **debts.** This is crucial given that according to the recent Debt Sustainability Framework assessment that the country is now considered at 'high risk of debt distress', as well as the compounding impact of COVID-19 on growth and revenue collection.
- **The World Bank and African Development Bank suspending Kenya's public debt repayments during the COVID -19 crisis.** This means at least suspending payments and providing some form of relief to Kenya.
- **The IMF ensuring upcoming and emergency funding for Kenya is not spent on repaying existing public debts** but rather on investing in social needs and boosting equitable growth in the medium-term to benefit ordinary citizens and increase the country's future repayment capacity. As debt distress is already high, the IMF should help negotiate a grace period of two years with all public and private creditors, to allow for recovery and growth to be in better shape for future payment.
- **Working to realistic economic scenarios that do not underestimate the potential negative impact of Kenya's public debt, and of the COVID-19 crisis.**
- **Ensuring enhanced transparency is part of any agreements,** including public disclosure of all new debt contracts.

b) **Bilateral and private lenders should:**

- **Provide the debt suspension already agreed under the G20 DSSI and be ready to go beyond it.** This means moving from public debt suspension to public debt cancellation and applying measures beyond the current timeframe by including public debt repayments in the 2020 – 2022 period.
- **Take concerted action to avoid sharp crises hitting Kenya** in the short- or medium-term, to avoid a situation where the country's inability to make repayments triggers a deep economic crisis. All options, including reprofiling, moratorium, and freezing interest rates must be factored in for a potential crisis management dialogue.

c) **The G20 should:**

- Review the DSSI initiative and go beyond it. This means moving towards public debt cancellation, including private creditors in the deal, and ensuring the international community take steps towards an integrated mechanism for debt restructuring that allows a country in distress to quickly negotiate with all involved parties.
Speed and collective buy-in are essential for a positive result when debt restructuring is necessary.
- Promote concerted action to curb and stop tax dodging and tax evasion.

6. Political Accountability

The evidence points towards blatant violations of constitutional safeguards by public officers through the repeated circumvention of planning and budgeting processes through politically orchestrated processes.
Reports demonstrate that the productivity of several of these investments is questionable and their economic viability questionable. **Against this background we call upon civil society actors to immediately:**

a. Work with the relevant authorities including the auditor general's office to institute a social evaluation processes to assess the viability of public debt financed projects in the county and make recommendations as a basis for continued funding.
b. Work with the relevant bodies to institute an investigation into the responsible state and public officers who aided the undermining and violation of public finance and investment laws in the country.
c. Work with relevant authorities to investigate the parliamentary oversight failures and propose appropriate action.
d. Work with relevant authorities to investigate the dual roles played by IFI's in development policy and public debt financing and the extent to which
these have undermined citizen voice and sovereignty and make recommendations to ensure the role of IFI's in Kenya's development landscape is aligned to the Constitution of Kenya and accountable to the people of Kenya.

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