The Institute for Social Accountability

Okoa Uchumi Campaign

KENYA DEBT CRISIS: UNPACKING FISCAL CONSOLIDATION

2021

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About this study

- Commissioned by *Okoa Uchumi*

- *Reviewed the debt situation in the country, the tax policy and the International Monetary Fund's fiscal consolidation.*

- Through its recommendations, the campaign seeks to push for political accountability and bolster constitutional safeguards in public debt management to achieve debt sustainability through a balanced and equitable budget.

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Why Kenya is facing a debt crisis

- The study found out that Kenya is increasingly getting into a debt crisis - because of persistent fiscal deficits largely driven by growth in foreign borrowing and expanding imports.
- With constrained access to concessional loans, commercial debt is being used to support government budget and finance infrastructural projects. The country is equally running a current account deficit that is mainly financed by capital inflows from borrowings.

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What did the study find out?

- To avoid the debt trap, Kenya must earn enough foreign income from exports, remittances and other sources if it is to manage its import bill, debt repayments and interest payments.

- In the absence of this, as it is currently, the country gets into a debt trap, that is to borrow even more as the only avenue to increase access to foreign resources. The borrowing spree does not only magnify the external debt problem but also leads to a debt crisis.

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Summary of key findings

The verdict:

Kenya is sliding into debt crisis

Public debt denominated in foreign currency has major risks and their excessive leverage can lead to pressure on the exchange rate and monetary policy distress that give rise to financial crisis.

- This means the country increasingly requires foreign currency for expanding to meet its external liabilities. The liabilities to the rest of the world are growing at an average rate of 20 percent per annum. This is not good for debt sustainability.

- The increase in commercial loans has pushed up the cost and risk of public debt in Kenya.

- This is against the acknowledgement given in the Government's debt and borrowing policy, 2020, which envisage concessional and semi-concessional borrowing to minimize cost, risk and reduce the public debt to a sustainable level.

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The weakness of a strong Kenyan shilling

- A strong Kenyan shilling reduces the competitiveness of exports which could dampen economic growth. Kenyan exports become expensive abroad and imports become cheaper thereby discouraging domestic industries as the share of foreign goods in the domestic market increases.

- Furthermore, a high interest rate which discourages domestic investment and hurts economic growth and employment, is generally associated with short-term inflows of foreign exchange which strengthens the shilling.

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Why Kenya is in a debt trap

- Kenya is not earning enough foreign income from exports and remittances hence it cannot manage its import bill, debt repayments and interest payments.

- With inadequate foreign income, the country is likely to borrow even more as the only avenue to increase access to foreign resources, leading to a debt trap.

- The borrowing spree does not only magnify the external debt problem but also leads to a debt crisis.

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Summary of key findings (*cont*)

- The more Kenya's public debt is in foreign currency, the more it exerts pressure on the exchange rate, making imported goods expensive and out of reach for most Kenyans. For public debt to be sustainable, its growth should remain below that of nominal GDP.

- This public deficit and debt problem are intertwined with the external deficit. This highlights the adverse effects that poor taming of growth in public debt brings.

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Summary of key findings (*cont*)

Kenya's government revenue

70%

of government revenue in Kenya comes from taxation.

There is need to tame tax evasion and corruption rather than increasing taxes from already strained households and businesses.

Source: *Annual public debt Reports 2019/20, 2018/19 and 2017/18*

- Kenyans are overtaxed and any fiscal measure leading to increasing taxes will be unpopular and even if it is effected, it will have no effect on tax revenue and will most likely lead to adverse effects on the economy. Kenya's tax administration measures have been unproductive in enhancing tax revenue over the recent past.

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Role of monetary policy on Kenya's debt crisis

- In recent years, Kenya has suffered weak export performance and has been losing market share since 2013, while the other non-resource intensive Sub-Sahara Africa countries are on average gaining market share.

- This means that the country is running a current account deficit. The decline in exports and expansion of imports by the country is largely associated to competitiveness resulting from poor use of its monetary policy.

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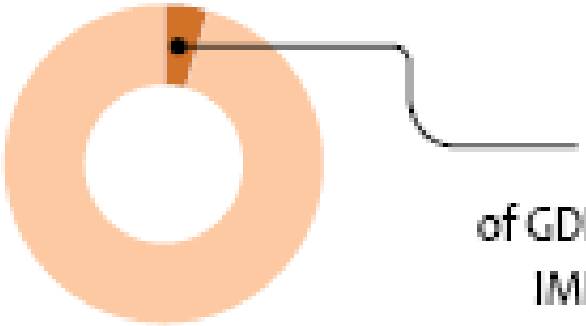
Summary of key findings (*cont*)

Export of goods and services



Net inflows amounted to

4.7%

of GDP in 2020, reflecting government borrowing, including IMF emergency support, borrowing by other financial corporations (non-banks) to manage the deficit.

- **This showcases government's appetite for external commercial borrowing.**
- **Where foreign debt is a must, the Government should move away from the expensive commercial loans.**
- **The ultimate goal should be the reduction of borrowing by taming corruption and misuse of revenue.**

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Summary of key findings (*cont*)

- On borrowing by national government, Article 211(2) of the Constitution provides that when Parliament passes a resolution for borrowing, the Cabinet Secretary for the National Treasury shall present the information in illustration 1.8 concerning any particular loan or guarantee:

What National Treasury should reveal about loans, guarantees

- **Extent of the total indebtednes s by way of principal and accumulated interest**
- **Use made or to be made of the proceeds of the loan**
- **Provision made for servicing or repayment of the loan, and**
- **Progress made in the repayment of the loan**

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Conclusion

- Reducing fiscal deficit remains key to stemming public debt accumulation and maintaining it at sustainable levels.

- The objective is to reduce the fiscal deficits and public debt vulnerabilities and lower Kenya's risk of debt distress from high to moderate in the medium term.

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Study Recommendations

1. More government borrowing needs to be denominated currency
2. Revise monetary policy
3. Where foreign debt is a must, the Government should move away from the commercial loans to avoid exposing the country to risk.
4. The National Treasury should provide a justification beyond reasonable doubt why recurrent balance is financed through external debt.
5. Where foreign debt is a must, the Government should move away from the commercial loans to avoid exposing the country to risk.

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Study Recommendations *(cont)*

6. The National Treasury should provide a justification beyond reasonable doubt why

7. Parliament needs to cap the number of supplementary budgets to a maximum of one, to occur at the mid or end of the financial year.

8. Government borrowing should only be used for the purpose of financing development expenditure and not for recurrent expenditure

9. Commitment to loans should only happen once the programs and projects are ready for implementation

10. Government should stop using taxation merely to fund public spending whereas, in principle, this can be realized through prudent fiscal management.

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Thank you

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