

REPORT

TRANSPARENCY AND ACCOUNTABILITY IN PUBLIC DEBT MANAGEMENT IN KENYA: THE EUROBOND

SUBMITTED TO:



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EXECUTIVE SUMMARY

The Rise of Eurobond Issuance by African Countries

Public debt has financed budget deficit and various infrastructural projects in most African countries for decades contributing towards the growth of their economies¹. However, some countries accumulated debts to unsustainable levels stunting the growth of their economies². Prior to 1995, the African countries relied on domestic borrowing, external debts which included concessional, and non-concessional loans from bilateral lenders such as Paris Club members and non-members, multilateral institutions such as African Development Bank (AfDB), World Bank (WB), and International Monetary Fund (IMF)³. These loans often came with conditionalities attached to them and complex acquisition procedures. This partly pushed African countries to look for alternative sources of funding such as bond issuance in international financial markets.

Eurobonds are bonds which are denominated in foreign currency, in most cases US dollars, and countries can easily access large amounts of financing by issuing them without much conditionalities attached⁴. In 1995, South Africa was the first African country to venture into international financial markets to issue Eurobonds⁵. The second African country to issue Eurobonds was Seychelles in 2006⁶. Thereafter, there was a spike of Eurobond issuance by African countries.

Eurobond Issuance in Kenya

Eurobond issuance has become a significant component of Kenya's national debt. Due to increased budgetary constraints and the need to protect the domestic economy against the crowding out effects of domestic borrowing, Kenya has increasingly embraced Eurobonds issuance from 2014. Kenya has so far issued 4 Eurobonds between 2014 and 2021. The first sovereign bond floated was valued at US\$ 2.2 billion or Kshs.250 billion was issued in two tranches. The second was valued at Ksh. 175 billion, the third Eurobond raised was Ksh.343 billion and the fourth Ksh. 112 billion. The government has proposed a fifth Eurobond of Ksh.105.6 billion for the financial year 2021/2022. On underwriters, JP Morgan and Citigroup stand out as the preference of the Kenyan government, having been engaged in the four issues of the Eurobonds⁷ others include Citi Bank, QNB Capital, Barclays and Standard Bank⁸.

¹ The African Legal Support Facility (ALSF): *Understanding Sovereign Debt Options and Opportunities for Africa*. <https://www.alsf.int/publication/RB2ymma0.pdf>

² The African Legal Support Facility (ALSF): *Understanding Sovereign Debt Options and Opportunities for Africa*. <https://www.alsf.int/publication/RB2ymma0.pdf>

³ https://media.africaportal.org/documents/A_Cautious_Tale_of_Zambias_International_Sovereign_Bond_Issuances_4o38QrI.pdf

⁴ http://slettgjelda.no/assets/docs/Bond-to-happen_Debt-Justice-Norway.pdf

⁵ <https://www.bu.edu/gdp/2021/10/22/bond-eurobond-tracking-african-eurobonds-issued-between-2006-2021/>

⁶ <https://www.bu.edu/gdp/2021/10/22/bond-eurobond-tracking-african-eurobonds-issued-between-2006-2021/>

⁷ <https://allafrica.com/stories/202106170041.html>

⁸ Institute of economic affairs <https://ieakenya.or.ke/download/eurobond-facts-and-figures-kenyas-experience-from-2014-2019/>

Use of Eurobond Proceeds and Repayment Concerns

Prudent public debt management requires that the public debt proceeds are invested in projects with higher economic rate of returns than the cost of the public debt⁹. This guarantees the country's ability to repay the public debt when due. Consequently, of great concern, is Kenya's use of her Eurobond proceeds, the limited information available indicate that the funds have been mainly used to finance budget deficit, repay maturing Eurobonds, and invested in infrastructure projects that do not give immediate returns. Considering the maturity profile of Eurobonds, which is relatively short¹⁰, it is clear that the manner in which the Eurobond proceeds are used in Kenya means that the debt cannot repay itself hence may be unsustainable in the long term. Due to the short maturity profile of Eurobonds, Kenya will be faced with a concentration of maturing Eurobond obligations between 2024 and 2028¹¹.

The Office of the Auditor General (OAG) in its analysis reported that the proceeds from Kenya's first Eurobond issue could not be traced within the domestic economy.¹² For the National Treasury to have disbursed a huge external loan, the biggest ever, without expenditure tracking raised even more queries. Further, there were two Eurobonds issued in 2018 and 2019 which a majority of the Kenyan public are not aware of how they were spent within the economy, despite the constitutional provisions requiring public participation, openness and accountability in financial matters.¹³

It is against this background that The Institute for Social Accountability (TISA) through the *Okoa Uchumi Campaign* commissioned this study to establish the accountability standards and requirements set out in the Constitution of Kenya 2010, and the Public Finance Management Act 2012 on public debt management with focus on Eurobond issuance for advocacy for legal reforms and accountability in the use of public debt.

The main objective of the assignment was to formulate advocacy strategies for transparency and accountability in commercial debt borrowing and management in Kenya with a focus on the Eurobond. The study adopted desk review approach which involved gathering secondary data that already exists from publications of government: The 2010 Constitution; the Public Finance Management Act (PFM) of 2012; Public Finance Management Regulations 2015; Central Bank, National Treasury; Auditor General, Controller of Budget; Parliament Budget Office; and non-governmental institutions CSOs, International Financial Institutions etc.

The Risks and Best Practice Accountability, Transparency Standards and Practices on Eurobond Borrowing and Management

The major risks in Eurobond borrowing include exchange risks, debt servicing burden, and misuse of Eurobond proceeds.

⁹ <https://cytonn.com/uploads/downloads/h12019-ssa-eurobond-performance-note.pdf>

¹⁰ <https://cytonn.com/uploads/downloads/h12019-ssa-eurobond-performance-note.pdf>

¹¹ <https://cytonn.com/uploads/downloads/h12019-ssa-eurobond-performance-note.pdf>

¹² [Special Audit Report on the Proceeds and Utilization of Euroboand 2019.pdf \(parliament.go.ke\).](https://www.parliament.go.ke/Special-Audit-Report-on-the-Proceeds-and-Utilization-of-Euroboand-2019.pdf)

¹³ Article 201(1)(a) of the Constitution provides that there shall be openness and accountability, including public participation in financial matters

Exchange Risks: Borrowing in a foreign currency comes with exchange risks and the extent to which debt is foreign currency dominated is usually considered a determinant of output, capital flows and exchange rate.¹⁴

High Interest rate Risk: Sovereign bond yields are significantly influenced by global volatility, commodity prices and global liquidity—all factors that are out of the control of the sub-Saharan economies in question¹⁵.

The legal Risks: The legal risks associated with Eurobond usually come in case of default. Sovereign bonds are public contracts closely linked to the functioning of the State. They typically lack an express choice-of-law provision, and are often deemed to be subject to the sovereign bond holder's law¹⁶

The risk of excessive Debt Accumulation: The increase in borrowing by the government through Eurobonds and other bilateral lending arrangement are likely to expose the Country to debt distress.

Risk of Misuse of Proceeds: Since funds from Eurobond are not subject to any checks and balances by the creditors and comes in the form of 'general budget support', there is usually the danger of misuse of the funds, especially as both Parliament and the citizens have not effective mechanisms for monitoring and evaluating the use of the funds.

The following findings were drawn from the desk review:

On the Transparency and Accountability Standards and Requirements Set Out in the Kenya's Legal Framework

The Constitution of Kenya 2010: Chapter Twelve of the Kenya's Constitution titled "Public Finance" provides the overarching guidelines for the management of public finance and apportions powers and roles to different authorities, bodies and agencies. More particularly, Article 201 of the Constitution lays down the principles of public finance.

Public Finance Management Act: The Public Finance Act (PFM Act) aims at providing for the effective management of public finances by the national and county governments; the oversight responsibility of Parliament and county assemblies; the different responsibilities of government entities and other bodies, and for connected purposes.¹⁷ Its principal objective include ensuring that public finances are managed both at the national and at the county levels, in accordance with the principles set out in the constitution and also that public officers who are given responsibility for managing the finances are accountable to the public for the management of those finances through Parliament and County Assemblies.¹⁸

The Public Finance Management Regulations 2015: The Public Finance Management Regulations 2015(PFMR) were enacted under section 205 of the Public Finance Management Act and are meant to operationalize the Act. The Regulations are meant to among other things,

¹⁴ http://slettgjelda.no/assets/docs/Bond-to-happen_Debt-Justice-Norway.pdf

¹⁵ Gevorkyan, A.V., & Kvangraven, I.H. (2016). Assessing Recent Determinants of Borrowing Costs in Sub-Saharan Africa. ERN: Other Microeconomics: Welfare Economics & Collective Decision-Making (Topic).

¹⁶ https://www.researchgate.net/publication/309516958_Eurobonds_Legal_Design_Features

¹⁷ See the Preamble

¹⁸ Section 3

provide means of administering the powers vested in the Cabinet Secretary for the National Treasury under the Constitution, the Act and any other related legislation, and also to harmonize and standardize their application throughout government service in controlling and managing the finances.¹⁹ With regards to openness and accountability regulation provides that all the public shall be provided with full access to financial information in a timely manner for purposes of seeking public input.

The United Nations Conference on Trade and Development (UNCTAD) Principles on Promoting responsible Sovereign Lending and Borrowing

The UNCTAD Principles on Promoting responsible Sovereign Lending and Borrowing are an attempt to create a body of acceptable practices that can create proper administration of Eurobonds and reduce the misuse of the resultant funds. They prescribe responsibilities for lenders and borrowers. The responsibilities cover *Agency, Informed Decisions, Due Authorization, Responsible credit decisions*, Project financing, International Cooperation, Debt Restructurings, Binding Agreements, Transparency, as well as monitoring. It important to note that although the UNCTAD Principles are not binding, they are generally considered soft law on sovereign debt crisis prevention and have widely been recognized as such in the international arena and at national levels.²⁰

The Actors and Processes in the Eurobond Issuance, Planning, Implementation, and Reporting Process

The actors and the process of Eurobond Issuance: World Bank's Guidance Note in Issuing International Bonds lays down the processes to be followed in the issuance of international bonds. These six key steps namely Pre-Phase, Selecting Advisors & Executors, Documentation, Investor Communication and Relations, Execution and the After-Issuance Phase.²¹

Violations of the Best Practice Standards in Kenya's Eurobond Issuance

Lack of transparency accountability and openness: Kenya's issuance of Eurobond has been quite opaque. The cost of engaging the underwriters has not been disclosed. For instance, it has not been clear how underwriters are often selected, the proceeds have not been adequately accounted for.

Lack of a sinking fund putting the country at risk of default in Eurobond repayment in case of economic shocks: The National Assembly is yet to give approval for the creation of a fund as required by the PFM Act 2012²². This puts the country at a high risk of debt default especially in times of distress such as economic shocks.

Inadequate sharing of Eurobond issuance information. Kenya has not shared sufficient information on Eurobond issuance process, key stakeholders namely parliamentarians and the

¹⁹ Regulation 4

²⁰ <https://unctad.org/topic/debt-and-finance/Sovereign-Lending-and-Borrowing>

²¹ <https://documents1.worldbank.org/curated/en/491301554821864140/pdf/Issuing-International-Bonds-A-Guidance-Note.pdf>

²² <https://www.businessdailyafrica.com/bd/markets/capital-markets/parliament-delays-creation-kitty-for-debt-payment-3558008>

Civil Society have not been furnished with adequate information on the loan contract and the use of the Eurobond proceeds, contrary to the constitutional requirements²³.

Non adherence to the principle of prudent borrowing: which requires that the country go for the borrowing options with the lowest cost possible. By issuing Eurobonds that have a relatively higher interest rates, the principle of prudent borrowing is violated hence the overall level of national debt may not be sustainable.

RECOMMENDATIONS

Review of the current legal framework on public debt management: Review of the current legal framework to incorporate the nitty-gritties of the Eurobond issuance such as appointment of advisors and legal team, negotiations for favourable coupon rates, refinancing, payment of the principle, and accountability.

Strengthening the role of oversight bodies on Eurobond borrowing: Legislation to give parliament and other oversight bodies such as CSOs and citizens express powers to offer checks and balances on Eurobond borrowing.

Establishment of a ‘sinking fund’ for debt repayment: The National Assembly should fast-track the creation of the sinking fund to aid in debt repayment in times of distress.

Extensive export promotion: Extensive export promotion to earn the country foreign income and boost the foreign exchange reserve whose role in debt servicing is critical.

Legislations to promote alternative sources of funding development projects: Legislations to ease regulations on the involvement of the private sector in the development projects through Public Partnerships and joint ventures.

Effective and efficient national budgeting: only immediate public expenditure needs should be factored in the budget to reduce wasteful budgeting and enhance prioritization of budgetary items to reduce the growing budget deficit.

Sound macroeconomic policy with robust debt management: To avert the high risk of the country plunging into debt distress considering the growing financial needs of the country hence the need for further public borrowing.

Need for clearer and transparent government accounting procedure for Eurobond proceeds: Since the Eurobond proceeds are initially held in offshore accounts, there is need for clear information on where they are held, how long it should take before they are transferred to the exchequer account, for ease of pinpointing delays. Further, there should be regular updates on the balance held in the offshore account, and proper authorization of any withdrawal to curb misuse of the funds.

The underwriters should ensure the bonds issued are in compliance with Kenya’s debt management policy: They should assess the terms and ensure that the loan agreements are

²³ http://slettgjelda.no/assets/docs/Bond-to-happen_Debt-Justice-Norway.pdf

enforceable under Kenya's jurisdiction, assess the borrowing terms and ensure is within the country's debt service capacity.

There is need for the country to maintain good diplomatic relations with other countries: Owing to the cross-border nature of the Eurobond, in case of any malpractice in the process of bond issuance, transparency issues may be handled at international level, this can only be effective in an environment of good diplomatic ties.

Conclusion

There are clear provisions for transparency and accountability with regards to public debt management in Kenya which were based on conventional borrowing from multilateral and bilateral lenders. Some of them have not been strictly adhered to by the government when borrowing and managing loan proceeds. With the advent of Eurobond, which has a unique process of issuance, there is need for amendment of the current legislations, and enactment of new laws that factor the uniqueness of Eurobond borrowing to enhance accountability and transparency in the process of its issuance.

1.0 BACKGROUND

1.1 Context

1.1.1 The Rise of Eurobond Issuance by African Countries

Public debt has been key in financing budget deficit and various infrastructural projects in most African countries for decades contributing towards the growth of their economies²⁴. However, some countries accumulated too much debt to levels that were unsustainable contributing to stunted growth of their economies²⁵. Prior to 1995, African countries relied on domestic borrowing; external debts which included concessional and non-concessional loans from bilateral lenders such as Paris Club members and non-members, multilateral institutions such as African Development Bank (AfDB), World Bank (WB), and International Monetary Fund (IMF)²⁶. These loans often came with conditionalities attached to them and complex acquisition procedures. This partly pushed African countries to look for alternative sources of funding such as bond issuance in international financial markets.

In 1995, South Africa, was the first African country to venture into international financial markets to issue Eurobonds²⁷. These are bonds which are denominated in foreign currency, in most cases US dollars, and countries can easily access large amounts of financing by issuing them without much conditionalities attached²⁸. The second African country to issue Eurobonds was Seychelles in 2006²⁹. Thereafter, there was a spike of Eurobond issuance by African countries. More countries followed queue in issuing Eurobonds, specific examples include Nigeria, Zambia, Senegal, Angola, Gabon, Côte d'Ivoire, Kenya, and Tanzania, not in any orders, and Uganda also expected to issue Eurobond, at least 20 out of the 48 sub Saharan African countries have issued Eurobonds³⁰. In terms of actual figures, by July 2021, African

²⁴ The African Legal Support Facility (ALSF): *Understanding Sovereign Debt Options and Opportunities for Africa*. <https://www.alsf.int/publication/RB2ymma0.pdf>

²⁵ The African Legal Support Facility (ALSF): *Understanding Sovereign Debt Options and Opportunities for Africa*. <https://www.alsf.int/publication/RB2ymma0.pdf>

²⁶ https://media.africaportal.org/documents/A_Cautious_Tale_of_Zambias_International_Sovereign_Bond_Issuances_4o38QrI.pdf

²⁷ <https://www.bu.edu/gdp/2021/10/22/bond-eurobond-tracking-african-eurobonds-issued-between-2006-2021/>

²⁸ http://slettgjelda.no/assets/docs/Bond-to-happen_Debt-Justice-Norway.pdf

²⁹ <https://www.bu.edu/gdp/2021/10/22/bond-eurobond-tracking-african-eurobonds-issued-between-2006-2021/>

³⁰ <https://www.brookings.edu/opinions/financing-africa-moving-beyond-foreign-aid-to-issuing-eurobonds/>

countries had issued Eurobonds worth at least USD 136 billion. The advent of Covid-19 pushed African countries to issue more Eurobonds, in 2021 they issued Eurobonds worth \$11.8 billion which specific countries shared as follows Egypt USD 3.75 billion, Kenya USD 1 billion, Ghana USD 3 billion, Benin USD 1 billion, Senegal USD 0.8 billion, Ivory Coast EURO 0.85 billion, and Cameroon EURO 0.7 billion³¹. Table 1 presents a list of sampled Sub Saharan Africa countries' issued Eurobonds focusing on the coupon rate, bond yield, and tenor between 2011 and 2018.

Table 1: Eurobonds Issued by Sampled Sub Sahara African Countries (2011 – 2018)³²

Country	Issue Tenor yrs	Issue Date	Coupon	Beginning of 2019 Yeild	End of 2019 Yield
Ghana	31	16/05/2018	8.60%	10.00%	8.60%
Senegal	30	13/03/2018	6.80%	8.30%	7.30%
Nigeria	30	28/11/2017	7.60%	9.20%	7.70%
Kenya	30	28/02/2018	8.30%	9.80%	7.90%
Zambia	12	30/07/2015	9.00%	14.70%	17.40%
Nigeria	12	23/02/2018	7.10%	8.80%	7.10%
Senegal	10	30/07/2014	6.30%	6.90%	4.70%
Kenya	10	24/06/2014	6.90%	8.30%	5.50%
Zambia	10	14/04/2014	8.50%	13.30%	19.40%
Senegal	10	13/05/2011	8.80%	6.00%	3.70%
Zambia	10	20/09/2012	5.40%	15.70%	20.70%
Kenya	10	28/02/2018	7.30%	9.00%	6.80%
Ghana	10	08/07/2013	7.90%	8.40%	5.70%

Source: Cytonn, 2019³³

Based on the interest rates in Table 1, it has been observed that African countries pay higher interest rates on borrowing than their peers in the same category of credit risk or macroeconomic fundamentals from outside the continent³⁴. This amounts to an unwarranted penalty on African countries owing to investor bias cost, which was estimated at USD 2.2 billion as at 2015, an amount which would have been invested in the continent for infrastructure development³⁵.

³¹ <https://www.bu.edu/gdp/2021/10/22/bond-eurobond-tracking-african-eurobonds-issued-between-2006-2021/>

³² <https://cytonn.com/uploads/downloads/h12019-ssa-eurobond-performance-note.pdf>

³³ <https://cytonn.com/uploads/downloads/h12019-ssa-eurobond-performance-note.pdf>

³⁴ Michael Olabisi, Howard Stein, Sovereign bond issues: Do African countries pay more to borrow?, Journal of African Trade, Volume 2, Issues 1–2, 2015, Pages 87-109: <https://www.sciencedirect.com/science/article/pii/S2214851515000079>

³⁵ Michael Olabisi, Howard Stein, Sovereign bond issues: Do African countries pay more to borrow?, Journal of African Trade, Volume 2, Issues 1–2, 2015, Pages 87-109: <https://www.sciencedirect.com/science/article/pii/S2214851515000079>

Therefore, Eurobond issuance may not be giving African countries the cheaper alternative source of borrowing and may need to be approached with caution. Table 1 shows that Zambia is the only African country whose Eurobond yield rose as captured in the 2019 yields, for the 2012, 2014, and 2015 issues increased by 5.0%, 6.0%, and 2.7% respectively³⁶. The higher premium was mainly attributed to the country's growing fiscal deficit, depreciation of domestic currency (Kwacha), and increasing debt level, which also led to downgrading of her credit ratings by Moody's,³⁷. It is worth noting that these challenges are not just unique to Zambia, majority of sub-Saharan Africa countries are already grappling with the same, and in medium term, they may get to Zambia's level. This raises concerns about the sustainability of Eurobond borrowing by these countries.

The volatile macroeconomic environment in Africa raises more questions about sustainability of Eurobond borrowing in the continent. Further, considering that a few African countries have already defaulted on Eurobond barely five years after venturing in sovereign bond issues, Seychelles defaulted in 2008, Ivory Coast in 2011 due to disputed elections that led to violence, and Mozambique in 2017³⁸. These countries have since attempted to develop much better macroeconomic and debt management policies. This notwithstanding, a number of African countries are still vulnerable to default especially those that have accumulated so much debts from China such as Angola, Ethiopia and Kenya³⁹. Chinese loans may not provide debt relief opportunities such as those provided by Paris Club members. This was witnessed during the Covid -19 pandemic when Chinese lenders declined to grant Kenya extension of debt repayment holiday.

The main advantages attributed to issuance of Eurobonds include ease of access, ability to raise large amounts of funds, relatively low interest rates (only in the short-term subject to favorable market conditions), absence of conditionalities attached⁴⁰. However, for Eurobond borrowing to be sustainable, the borrowing countries must guarantee strong sustained economic growth, political stability, prudent macroeconomic management, and low cost of borrowing, it is worth

³⁶ <https://cytonn.com/uploads/downloads/h12019-ssa-eurobond-performance-note.pdf>

³⁷ <https://cytonn.com/uploads/downloads/h12019-ssa-eurobond-performance-note.pdf>

³⁸ <https://www.bondvigilantes.com/insights/2020/01/can-africas-wall-of-eurobond-repayments-be-dismantled>

³⁹ Zambia sits in this camp). (<https://www.bondvigilantes.com/insights/2020/01/can-africas-wall-of-eurobond-repayments-be-dismantled>

⁴⁰ http://slettgjelda.no/assets/docs/Bond-to-happen_Debt-Justice-Norway.pdf

noting that these are some of the key challenges faced by African countries. Eurobond issuance may not be a sustainable source of finance for a number of African countries in the medium and long term, many countries are at a high risk of plunging into debt distress or default. Worse still, bondholders are largely private companies and financial institutions which, in case of mass debt default or distress by African countries, are unlikely to offer debt relief services - Highly Indebted Poor Country (HIPC) initiative and Multilateral Debt Relief Initiative (MDRI) - witnessed in 1990s that restored debt sustainability in Africa⁴¹. The question therefore arises on whether Eurobond issuance is a sustainable sovereign borrowing option for African countries?

Against this background, African countries may urgently need to consider some critical policy actions, both in the short term and long term. Key short-term policy actions may need to be aimed at attaining macroeconomic stability, upholding debt sustainability, prudent use of debt proceeds and investment in productive projects. The long-term policy actions may need to focus on advancing domestic capital institutions and markets, and the liberalization of capital accounts⁴².

1.1.2 Eurobond Issuance in Kenya

Funding from the Eurobond is increasingly becoming a significant component of Kenya's national debt. Due to increased budgetary constraints and the need to protect the domestic economy against the crowding out effects of domestic borrowing, Kenya has increasingly embraced Eurobonds issuance from 2014. This has been made possible by the ever-expanding international financial markets' activities. Kenya has so far issued 4 Eurobonds between 2014 and 2021. The country's appetite for these foreign currency-based syndicate loans seems to be growing unabated. Most of processes from the first Eurobond in 2014 to the latest one in 2021, have been shrouded in mystery. The Office of the Auditor General (OAG) in its analysis reported that the proceeds from Kenya's first Eurobond issue could not be traced within the domestic economy.⁴³ Further, there are two Eurobonds issued in 2018 and 2019 which members of the public are not aware of how their proceeds were spent within the economy. This flies in

⁴¹ The African Legal Support Facility (ALSF): *Understanding Sovereign Debt Options and Opportunities for Africa*. <https://www.alsf.int/publication/RB2ymma0.pdf>

⁴² <https://www.brookings.edu/opinions/financing-africa-moving-beyond-foreign-aid-to-issuing-eurobonds/>

⁴³ [Special Audit Report on the Proceeds and Utilization of Eurobond 2019.pdf \(parliament.go.ke\)](https://www.parliament.go.ke/Special-Audit-Report-on-the-Proceeds-and-Utilization-of-Eurobond-2019.pdf).

the face of Constitutional provisions requiring public participation, openness and accountability in all fiscal matters on the part of the government of the day.

The first sovereign bond floated by the Kenyan government at the international money markets was valued at US\$ 2.2 billion (Kshs.250 billion) was issued in two tranches. The first and the second tranches of US\$ 1.4 billion (Kshs.176 billion at the time) and US\$815 million (Kshs. 74 billion) respectively⁴⁴. The government pushed for the Eurobond to reduce pressure on domestic borrowing, which was expected to reduce domestic interest rate, and promote private sector borrowing and investment⁴⁵. The government executed two transactions from the offshore account into which the US\$2.2 billion had been credited⁴⁶. It paid off a pending loan of US\$604 million (Kshs. 53 billion) and then transferred US\$394 million (Kshs. 35 billion) to the exchequer. The rest of the funds in the account have never been accounted for to date, a clear contravention of section 12 (2) of the Public Finance Management Act of 2012, that requires National Treasury to promote transparency and effective management of public finance, and Article 201 (c), (d) and (e) the Constitution 2010 which requires prudent and responsible spending of public resources⁴⁷.

The government, successfully raised the second Kshs. 175 billion through a Eurobond sale. It is pertinent to note that of the Ksh.175 billion, Kshs. 53.2 billion was used to pay off a syndicate loan that was due, making the government to incur debts to repay the already maturing debts. The third Eurobond the government raised was Ksh.343 billion with a further 112 billion, as the fourth. The government has proposed a fifth Eurobond of Ksh.105.6 billion for the financial year 2021/2022. Table 2 shows the proceeds from the issuance of the four Eurobonds.

⁴⁴ Africa Centre for Open Governance; *Inside Kenya's Inability To Fight Corruption*: <https://africog.org/state-capture-foils-uhurus-anti-corruption-campaign/>

⁴⁵ Ndi. (2015). Eurobond Accountability, Facts, Figures and Questions. <https://www.kara.or.ke/Eurobond%20Facts%20Figures%20Questions.pdf>

⁴⁶ Republic of Kenya. (2021). Auditor General's Report on the Financial Statement for the National General for Financial Year 2017/2018. <https://www.google.com/search?client=firefoxbd&q=Auditor+General%27s+Report+on+the+Financial+Statement+for+the+National+General+for+Financial+Year+2017%2F2018>

⁴⁷ Republic of Kenya. (2010). The Kenya Constitution 2010. https://www.constituteproject.org/constitution/Kenya_2010.pdf?lang=en

Table 2: Kenya’s Eurobond Issuance (2014 -2021)

Year	Month	Amount (USD)	Tranche Amount (USD)	Repayment Period (Years)	Interest rate (%)
2014	June	2.0 Billion	500 Million	5	5.875
			1.5 Billion	10	5.0
	December	750 million	250 Million	5	5.0
			500 Million	10	5.9
2018	February	2.0 Billion	1.0 Billion	10	7.25
			1.0 Billion	30	8.25
2019	May	2.1 Billion	900 million	7	7.0
			1.2 Billion	10	8.0
2021	June	1.0 Billion	1.0 Billion	12	6.3

Source: Author’s compilation based on National Treasury data.

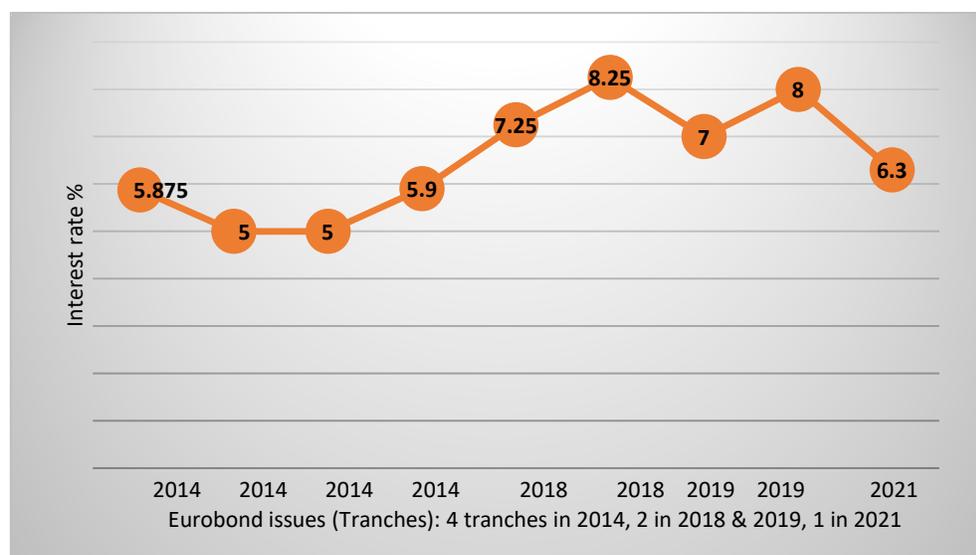


Figure 1: Trend of Kenya’s Eurobond servicing cost (Interest rate %) 2014 -2021

Graph 1 presents the trend of the cost of servicing Eurobond debt issued by Kenya from 2014 to 2021. The graph shows that the interest rate charged on the country’s Eurobond has been fluctuating on an upward trend, an indication of increasing cost of debt servicing over time.

1.1.3 Use of Eurobond Proceeds and Repayment Concerns

Prudent debt management requires that the debt proceeds are invested in projects with higher economic rate of returns than the cost of the debt⁴⁸. This guarantees the country's ability to repay debts when due. Consequently, of great concern, is Kenya's use of her Eurobond proceeds, the limited information available indicate that the funds have been mainly used to finance budget deficit, repay maturing Eurobonds, and invested in infrastructure projects that do not give immediate returns. Considering the maturity profile of Eurobonds, which is relatively short⁴⁹, it is clear that the manner in which the Eurobond proceeds are used in Kenya means that the debt cannot repay itself hence may be unsustainable in the long term. Due to the short maturity profile of Eurobonds, Kenya will be faced with a concentration of maturing Eurobond obligations between 2024 and 2028 as shown in graph 1⁵⁰.

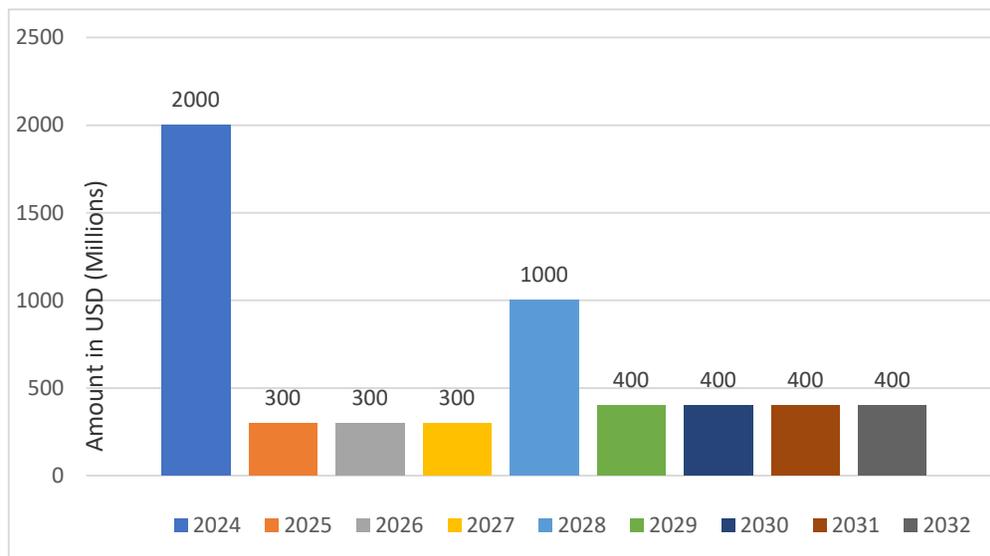


Figure 2: The Maturities Schedule for Kenya's Eurobond Issued in 2014 and 2018⁵¹

Figure 2 shows that Kenya will make a payment of USD 2.0 Billion in 2024 when the Eurobond issued in 2014 for a 10-year period will be due. Further, the country will be paying annually

⁴⁸ <https://cytonn.com/uploads/downloads/h12019-ssa-eurobond-performance-note.pdf>

⁴⁹ <https://cytonn.com/uploads/downloads/h12019-ssa-eurobond-performance-note.pdf>

⁵⁰ <https://cytonn.com/uploads/downloads/h12019-ssa-eurobond-performance-note.pdf>

⁵¹ <https://cytonn.com/uploads/downloads/h12019-ssa-eurobond-performance-note.pdf>

USD 300 Million from 2025 for the 7-year Eurobond issued in 2019 and due to mature in 2027. Over the same period, the 10-year Eurobond issued in 2018 is set to mature in 2028⁵².

1.1.4 The Eurobond Issuance Process in Kenya

The cabinet secretary for finance floats the sovereign bond in the international money markets on behalf of the government if the loans and terms and conditions are set out in writing and in accordance with fiscal responsibility principles. In the borrowing, the government has to follow the constitution on principles guarding public finances by following the constitution and any other relevant legislation and laws by not exceeding limits set out in law. The funds are borrowed for as approved by parliament in accordance with section 12 of the Public Finance Management Act of 2012 that guides oversight on national government finances.

The government through the cabinet secretary for the national treasury should give timely, transparent and credible information on public debts to the public. The expenditure should be reflected in the quarterly financial statements as required by law. Fiscal responsibility principle by public finance management act requires that the national government's borrowings be used only for the purpose of financing development expenditure and not for recurrent expenditure. This principle must be adhered to by the government without any political interference.

With respect to underwriters engaged in processing of Eurobond, JP Morgan and Citigroup stand out as the preference of the Kenyan government, having been engaged in the four issues of the Eurobonds⁵³. The other underwriters that have been engaged include Citi Bank, QNB Capital, Barclays and Standard Bank⁵⁴. The countries choice for the two lead underwriters, JPMorgan⁵⁵ and Citi⁵⁶, headquartered in New York, may be in line with the common global practice where Eurobond issuers tend to prefer underwriters based in the country in whose currency the bond is denominated⁵⁷. This is because underwriters local to the currency are thought to enjoy some degree of competitive advantages for underwriting services such as investors' preference for

⁵² <https://cytonn.com/uploads/downloads/h12019-ssa-eurobond-performance-note.pdf>

⁵³ <https://allafrica.com/stories/202106170041.html>

⁵⁴ Institute of economic affairs <https://ieakenya.or.ke/download/eurobond-facts-and-figures-kenyas-experience-from-2014-2019/>

⁵⁵ <https://www.google.com/search?client=firefox-b-d&q=jp+morgan+headquarters>

⁵⁶ <https://www.citigroup.com/citi/about/countries-and-jurisdictions/united-states-usa.html>

⁵⁷ <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp550.pdf>

home currency denominated securities and their dominant market position⁵⁸. This notwithstanding, the lead underwriters must be selected through a competitive tendering process where cost of the services is one of the key considerations to be checked⁵⁹. However, in Kenya, the information on the selection criteria for the Eurobond underwriters is not available to the public, it is not clear whether a competitive process has been followed and cost consideration has also been factored.

1.1.5 Allocation of Kenya's First Eurobond proceeds to Ministries, Departments and Agencies (MDAs)

There have been inconsistencies by the government on how the money was spent with claims that up to Kshs.120 billion was used partly to pay pending bills to road contractors and partly for budget support and even recurrent expenditure⁶⁰. The cost of nine projects in the energy sector were inflated to justify the Eurobond that showed overruns of nearly Kshs. 50 billion. Rural electrification of public schools was said to have cost Kshs. 34 billion rather than the Kshs. 9.9 billion that had been budgeted. An unbudgeted item for the 2013/2014 financial year, military modernization, gobbled up another Kshs.62.8 billion. The National Treasury reports also showed that Eurobond money was received and spent in the 2013/14 financial year. But given that the Eurobond money was received in the last week of 2013/2014 financial year, it would not have been possible for it to be spent in that year. There was no drawdown until the first week of July, which was the start of the 2014/15 financial year.

Table 3 shows the allocation of the Eurobond funds to Ministries, Departments and Agencies (MDAs). The Table shows that the state department for infrastructure received huge amount of 64.37 billion shilling, however the state department for fisheries received the least amount. During allocation of the funds, public participation was not carried out as required by section 35(2) of the PFM Act 2012. The only reporting of the use of Eurobond proceeds is the schedule of allocations tabled in parliament by the cabinet secretary for treasury showing that all the proceeds were exhaustively allocated to ministries.

⁵⁸ <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp550.pdf>

⁵⁹ <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp550.pdf>

⁶⁰ Africa Centre for Open Governance; *Inside Kenya's Inability To Fight Corruption*: <https://africog.org/state-capture-foils-uhurus-anti-corruption-campaign/>

Table 3: First Eurobond’s Proceeds Allocations to Ministries, Department and Agencies (MDAs)

Ministries, Department and Agencies (MDAs)	Amount (Kshs. Billion)
State department of Infrastructure	64.37
Ministry of Energy and petroleum	21.07
State department of water and irrigation	15.06
State department of agriculture	14.21
State department of livestock	2.50
State department of fisheries	1.24
Ministry of sports, culture and arts	1.28
Ministry of ICT	2.93
State department of education	6.21
Ministry of land, housing and urban development	9.17
State department of planning	44.57
State department of EAC, commerce and tourism	2.61
State department of science and technology	8.97
Ministry of industrialization and enterprise development	2.72

Source: National Treasury, 2015

The detailed accounting for the use of the first Eurobond proceeds shown in Table 1 has been disputed by key oversight stakeholders such as CSOs, some members of the National Assembly, non-elected leaders such as a section of church leaders among other. The main complaint is that the National Treasury initially gave contradicting accounts as to how the money was used and failed to table a list of projects that were financed using the funds⁶¹. The Auditor General also raised critical audit queries on how the money was used after failing trace the Eurobond proceeds in the documented government expenditures⁶². Therefore, there is a likelihood that part of the Eurobond proceeds could have been diverted by some corrupt individuals for personal gain. It is also important to note that the National Treasury has not provided detailed account of how the subsequent Eurobond proceeds have been used.

⁶¹ https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3187272

⁶² <https://www.internationalbudget.org/wp-content/uploads/how-can-government-foreign-debt-be-made-more-transparent-ibp-brief-2017.pdf>

The Government is reluctant or unable to provide information on the projects funded. The auditor general report also showed that two years after the proceeds from the Eurobond had been allocated to ministries, the government could not still account for the funds as there were no records of such expenditures as initially claimed by the government, clearly showing lack of transparency and accountability. For the Treasury to have disbursed a huge external loan, the biggest ever, without expenditure tracking raised even more queries.

It is against this background that The Institute for Social Accountability (TISA) through the *Okoa Uchumi Campaign* commissioned this study to establish the accountability standards and requirements set out in the Constitution of Kenya 2010, and the Public Finance Management Act 2012 on public debt management with focus on Eurobond issuance for advocacy for legal reforms and push for political accountability around violations that may have occurred between 2014 to 2021.

2.0 OBJECTIVES AND SCOPE OF THE STUDY

2.1 Objectives of the study

The main objective of the assignment was to formulate advocacy strategies for transparency and accountability in commercial debt borrowing and management in Kenya with a focus on the Eurobond. More specifically, the assignment involved:

- i) To establish transparency and accountability standards and requirements set out in the Constitution 2010, Public Finance Management Act 2012, and Public Finance Management Regulations 2015, and any other relevant laws.
- ii) Highlight the risks and identify best practice accountability and transparency standards and practices on Eurobond borrowing and management.
- iii) Identify the actors and processes in the Eurobond issuance, planning, implementation, and reporting process. Assess their performance in ensuring compliance with requirements identified under (1 and 2). Identify best practices, gaps and risks.
- iv) Based on (3) make recommendations for advocacy intervention.
- v) Generate a policy brief and accompanying petition.

2.2 Scope of the study

- i) Interpretation of terms of reference.
- ii) Design of research approach, methodology, tools, work plan outlining process, timeframes, and budget.
- iii) Undertake data generation, literature review and analysis of information gathered.
- iv) Prepare study report of the findings written in clear, coherent, concise manner, and provide recommendations for action.
- v) Validation of findings.
- vi) Generate a policy brief and accompanying petition.

3.0 METHODOLOGY

The study adopted desk review approach to answer the objectives of the assignment.

3.1 Desktop Reviews

Desktop reviews involved gathering secondary data that already exists from publications of government: The 2010 constitution; the Public Finance Management Act (PFM) of 2012; Public Finance Management Regulations 2015; Central Bank, National Treasury; Auditor General, Controller of Budget; Parliament Budget Office; and non-governmental institutions CSOs, International Financial Institutions and free access data on the internet inter alia. The desktop reviews were useful in understanding the nature of Eurobond, the process of issuance, the international best practice, and loopholes in the processes. Best case examples were also documented and reviewed. The documents were reviewed, the information gathered was analyzed and a synthesized, and recommendation drawn accordingly.

3.2 Quantitative Analysis

Information gathered was transformed into quantitative data for effective analysis for evidenced decision making. The following statistical software were used for analysis: Statistical package for Social Sciences (SPSS) and Excel.

3.3 Limitations of the Desk Review

Information gathered through desk review is liable to miss details, components, and may underreport on the specific issues required. It is also important to acknowledge that the comprehensiveness of data may seem to vary by different sources. Consequently, the conclusions and recommendations should also be considered with caution.

4.0 LITERATURE REVIEW

4.1 The Eurobond

The term “Eurobond” was originally defined as a bond which was issued outside the domestic market of the currency in which they were denominated⁶³. Broadly, the term has overtime broadened to encompass international bond issuances generally. The term is therefore applied to all international commercial financing through bond issuances.

4.2 The actors and the process of Eurobond Issuance

World Bank’s Guidance Note in Issuing International Bonds lays down the processes to be followed in the issuance of international bonds. These six key steps namely Pre-Phase, Selecting Advisors & Executors, Documentation, Investor Communication and Relations, Execution and the After-Issuance Phase.⁶⁴This section looks at these stages vis-a-vis Kenya Eurobond issuance with a view to assessing what the actors complied with the requirements.

The Pre-Phase (STEP 1)

According to the World Banks’s guidance Eurobond issuance should ideally be managed as part of standard debt management processes and well-anchored in a medium-term debt management strategy. In this regard, firstly, a task force should carefully explore whether a Eurobond issuance fits the fiscal framework and does not jeopardize debt sustainability of the issuer. Additionally, Eurobond should be taken within the framework of a medium-term debt management strategy.

The key responsibilities of the task force at this stage should include ensuring that analyses about an international bond issuance are reflected in the medium-term debt management strategy, coordination with the Central Bank, developing and maintain a technical understanding of international bond issuance processes, documentation and pricing, collecting market information from the investment banks and internally reporting on it, selecting lead managers, selecting

⁶³ The African Legal Support Facility (ALSF): *Understanding Sovereign Debt Options and Opportunities for Africa*. <https://www.alsf.int/publication/RB2ymma0.pdf>

⁶⁴<https://documents1.worldbank.org/curated/en/491301554821864140/pdf/Issuing-International-Bonds-A-Guidance-Note.pdf>

legal counsel, preparing and coordinating documentation, in cooperation with macro-fiscal and legal departments, Assigning operational responsibilities and selecting agents.⁶⁵

Selecting Advisors & Executors (Step 2)

Banks and advisors are supposed to pitch and lobby to the highest levels of government to get a mandate to lead manage a Eurobond issue. The issuer has to select and engage four main types of advisors and/or executors when issuing in the international capital markets. The first two are optional: an independent advisor and a rating advisor. The other two play a key role in the transaction: the group of lead-managers and the external legal counsel. After a description of their role, some criteria for selection are provided.⁶⁶

Documentation (Step 3)

The main official document for a bond offering is the (base) prospectus. Which has a summary, risk factors, such as rating outlook, macro-fiscal risks and also political and security risks that might ultimately affect the capacity to service the debt., e form of the notes, the conditions of the notes and the final terms, information about the issuer, Selling restrictions and technical aspects of the issuance are described, such as the book-entry clearance systems (DTC, Euroclear, Clear stream), taxation issues, and other general information, like listing.⁶⁷

Investor Communication and Relations (Step 4)

Transparent communication and predictability are essential for all stakeholders and especially investors.

Execution (Step 5)

The operation concludes with the signing and settlement, finally resulting in the transfer of funds.

The After-Issuance Phase (Step 6)

⁶⁵ Ibid

⁶⁶ Ibid

⁶⁷ Ibid

4.3 The Risks on Eurobond Borrowing and Management

The major risks in Eurobond borrowing include exchange risks, debt servicing burden, and misuse of Eurobond proceeds. This section will address these risks by focusing primarily on Kenya's past Eurobond issuances as well as experiences from other countries in Africa.

i) Exchange Risks

It has been noted that borrowing in a foreign currency comes with exchange risks and the extent to which debt is foreign currency dominated is usually considered a determinant of output, capital flows and exchange rate.⁶⁸ Eurobond is issued in a currency other than the domestic currency of the issuer. Consequently, any drop in the value of the domestic currency against the currency in which the Eurobond is denominated increases the cost of servicing the debt. This limits the borrowing country's ability to use devaluation as a measure to correct balance of payment deficit. In addition, it is risky for developing countries that are prone to domestic currency depreciation against the major world currencies in which Eurobond is often denominated such as US Dollar, Euro, and Yen. For example, Kenya issued her fourth Eurobond in June 2021 when the exchange rate of shillings against the US dollar was 106⁶⁹, six months later, in December the same year, the shilling was trading at 113 per dollar⁷⁰, this translates to higher cost of debt servicing for the country. According to the World Economic Forum, The risks of international currency borrowing are high as opposed to those of domestic currency borrowing even though the latter usually have relatively short maturity periods (about five years), which is a potential source of liquidity risks.⁷¹ For instance, during 2015 the Ghanaian cedi lost over 40% of its value vis-à-vis the US dollar leading to a surge in the nominal value of its \$750 million 2007 Eurobond to over \$3 billion in 2015.⁷² In Kenya, the 10-year paper maturing in 2024 has seen its yield fall to 3.09 percent from 3.92 in January, while that of the seven-year bond maturing in 2027 has fallen to 4.73 percent from 4.86 in the period, while yield on the 10-year bond that matures in 2028, by 19 basis points to 5.03 percent. The 13-year bond

⁶⁸ http://slettgjelda.no/assets/docs/Bond-to-happen_Debt-Justice-Norway.pdf

⁶⁹ <https://www.centralbank.go.ke/rates/forex-exchange-rates/>

⁷⁰ <https://www.centralbank.go.ke/rates/forex-exchange-rates/>

⁷¹ <https://www.weforum.org/agenda/2016/02/overview-of-the-sub-saharan-african-eurobond-market/>

⁷² Ibid

sold in June this year at 6.3 percent has also seen its secondary market yield fall to 6.09 percent.⁷³

ii) High Interest rate Risk

Some studies have shown that yields on African sovereign bonds are closely correlated with the global capital markets' volatility, changes in the price of the borrower main commodity export and the interest rate on US T-bills, a benchmark for accessing global liquidity. That sovereign bond yields are significantly influenced by global volatility, commodity prices and global liquidity all factors that are out of the control of the sub-Saharan economies in question⁷⁴. Further, recent issues of Eurobonds have been oversubscribed by averagely three times, an indication that the interest rates offered have been high (lucrative to bondholders)⁷⁵. The average coupon rate for Eurobond issued by Kenya and Zambia are 6.51% and 6.9% respectively, which is way too high compared to the average for developed countries which is below 2%⁷⁶. If well negotiated, countries can successfully issue bonds at slightly lower interest rates hence reduce the cost of repayment. One of the issues that this elicits is whether the above violates constitutional and legal principles on prudent and cost-effective borrowing. Article 201(d) of the constitution is to the effect that there must be prudence and responsibility in the use of public money. Further Article 211(1) mandates Parliament to enact legislation to prescribe the terms on which the national government may borrow. The PFM Act is one such legislation and it provides in section 50(1) that the national government shall ensure that its financing needs and payment obligations are met at the lowest possible cost in the market which is consistent with a prudent degree of risk, while ensuring that the overall level of public debt is sustainable. It therefore follows that by issuing Eurobonds whose average interest rates are higher than average, Kenya's National Treasury has been violating both the constitution and the PFM Act since this does not amount and effective and prudent borrowing.

⁷³ <https://www.businessdailyafrica.com/bd/economy/kenya-eurobond-yields-mixed-performance-3552876>

⁷⁴ Gevorkyan, A.V., & Kvangraven, I.H. (2016). Assessing Recent Determinants of Borrowing Costs in Sub-Saharan Africa. ERN: Other Microeconomics: Welfare Economics & Collective Decision-Making (Topic).

⁷⁵ <https://theconversation.com/african-countries-arent-borrowing-too-much-theyre-paying-too-much-for-debt-131053>

⁷⁶ https://media.africaportal.org/documents/A_Cautionary_Tale_of_Zambias_International_Sovereign_Bond_Issuances_4o38QrI.pdf

The second issue is that the Eurobond interest rates are in fact extremely high compared to concessional loans. For instance, in June 2021 the World Bank approved \$750 million in development policy financing for Kenya at an interest rate of 1.35%.⁷⁷

The third issue is, whether this cost of borrowing was approved by Parliament. Section 50(5) gives Parliament power to provide for thresholds for the borrowing entitlements of the national government and county governments and their entities. This ‘threshold’ certainly should include Parliament examining the potential interest rates accompanying the loans in issue, and ensuring that these rates reflect the prudence requirements in the Constitution, and probing the likely effect of higher interests on the countries debt servicing efforts.

The question of interest rates on external loans have been discussed in Parliament. According to the Hansard of 4th March 2021 where it was noted that some of the loans especially Eurobond have had excessively high interest rates between 7-8 per cent.⁷⁸

iii) The legal Risks

There are several legal risks associated with Eurobond usually. First is the risk that comes in case of default. Sovereign bonds are public contracts closely linked to the functioning of the State. Countries such as the United Kingdom, Germany, France and the United States issue all of their debt under their own law and subject to the jurisdiction of their own courts. Sovereign bonds typically lack an express choice-of-law provision, and are often deemed to be subject to the sovereign bond holder’s law⁷⁹ One of the key legal risks in case of default is the involvement of vulture funds who usually buy up cheap bonds on the secondary market before suing the borrower for payment. This was the case in Argentina where bondholders sued Argentina following default.⁸⁰ The question then is, doesn’t this create challenges in terms of choice of law and additional costs should there be litigation.?

The second aspect of these risks deal with the Eurobond contractual arrangements. Most of the Eurobond contracts or indentures have terms which in most cases are not available for scrutiny

⁷⁷ <https://www.worldbank.org/en/news/press-release/2021/06/10/kenya-receives-750-million-boost-for-covid-19-recovery-efforts>

⁷⁸ <http://www.parliament.go.ke/sites/default/files/2021-03/Hansard%20Report%20-%20Thursday%2C%204th%20March%202021%20%28P%29.pdf>

⁷⁹ https://www.researchgate.net/publication/309516958_Eurobonds_Legal_Design_Features

⁸⁰ <https://finance.yahoo.com/news/exasperated-us-appeals-court-tosses-151530885.html>

by the public in the borrowing country. For instance, some contracts have thresholds whereby a borrower cannot restructure the debt without the concurrence of the creditors. This in the long run negates the agency of the borrowing countries. A practical illustration of this is the Zambian case where Zambia had difficulties repaying its \$42.5m Eurobond coupon. In 2020 Zambia government had requested that bondholders grant it a deferral of interest payments until April 2022 as it struggled with the dual burdens of fighting the pandemic and a limping economy. But the creditors rejected the request.⁸¹

The risk of excessive Debt Accumulation

In the last seven years the government of Kenya has issued four Eurobonds, netting a total of Sh880 billion (\$7.85 billion), the latest of which was the \$1 billion (Sh112 billion) raised in June 2021. As of June 2021, the external debt from Kenya accumulated to roughly four trillion Kenyan Shillings, approximately 35.9 billion U.S. dollars. The value was equivalent to 52 percent of the country's total debt⁸². After 2013, Kenya's public debt stock has increased at an alarming rate, in early 2019, this forced the government to push for revision of the previous debt ceiling of 50% of GDP to an absolute figure of Kshs. 9.0 trillion⁸³, there is already debate of reviewing the current debt ceiling to a higher figure because of the growing debt stock partly contributed by Eurobond issues and refinancing.

According to the International Monetary Fund (IMF) Debt Sustainability Analysis, (DSA) Kenya has generally enjoyed strong access to international capital markets, and staff projections assume limited reliance on market financing over the coming three years and roll-over of existing Eurobonds. The DSA however suggests that Kenya is susceptible to export and exchange rate shocks; more prolonged and protracted shocks to the economy would also present downside risks to the debt outlook.⁸⁴The increase in borrowing by the government through Eurobonds and other bilateral lending arrangement are likely to expose the Country to debt distress.

⁸¹ <https://www.aljazeera.com/economy/2020/11/13/zambia-will-not-pay-overdue-eurobond-coupon-finance-minster-says>

⁸² <https://www.statista.com/statistics/1223191/cumulative-external-debt-of-kenya/>

⁸³ <https://cytonn.com/topicals/kenyas-public-debt-2>

⁸⁴ <https://www.imf.org/-/media/Files/DSA/external/pubs/ft/dsa/pdf/2021/dsacr2172.ashx>

iv) *Risk of Misuse of Proceeds*

Since funds from Eurobond are not subject to any checks and balances by the creditors and comes in the form of ‘general budget support’, there is usually the danger of misuse of the funds, especially as both Parliament and the citizens have not effective mechanisms for monitoring and evaluating the use of the funds. According to the Office of the Auditor General (OAG) Special Audit Report on the Proceeds and Utilization of Eurobond, the utilization of the 2014 Eurobond proceeds could not be traced to specific development projects with the national treasury explaining that some of the funds were ‘fungible’. The implications of the above include misappropriation as there is no specific projects targeted and also no accountability mechanisms. This can be addressed by linking borrowing to specific projects.

v) *Risk of Spending Eurobond Proceeds on Short-term Non-productive expenditures and Passing the Repayment burden to the Future Generation*

Since countries can easily access large amounts of financing by issuing Eurobonds without much conditionalities attached⁸⁵, they tend to spend the proceeds on short-term non-productive expenditures including Eurobond refinancing. This results to heavy debt burden in future, and allocation of significant proportion of revenue towards debt servicing, and reduction of the revenue dedicated towards development expenditure. For instance, African countries like Kenya, Gabon, Benin, Ghana, Egypt, Côte d’Ivoire, and Morocco have used Eurobond proceeds to fund budget deficit and repay maturing bonds⁸⁶. Continued refinancing of Eurobonds only means that the debt burden will be passed to the future generation which will not have benefited from the debt.

vi) *Risks of Repayment Rigidity in Times of Distress*

The bond holders are non-residents, therefore posing the difficulty of rolling over the debt in times of distress⁸⁷. In the advent of Covid 19, African countries, specifically Kenya, were initially reluctant to take up the multilateral debt suspension offer by the World Bank, IMF, G20,

⁸⁵ http://slettgjelda.no/assets/docs/Bond-to-happen_Debt-Justice-Norway.pdf

⁸⁶ Misheck Mutize in his article, “African Governments Have Developed a Taste for Eurobonds: Why It’s Dangerous,” <https://theconversation.com/african86governments-have-developed-a-taste-for-eurobonds-why-its-dangerous-165469>

⁸⁷ The African Legal Support Facility (ALSF): *Understanding Sovereign Debt Options and Opportunities for Africa* <https://www.alsf.int/publication/RB2ymma0.pdf>

and Paris club members for fear of breaching terms of Eurobond contact⁸⁸. Eurobonds default clauses considers seeking debt moratorium or non-repayment of any external debt as default, and requires the bond issuers to immediately pay the entire value of the outstanding Eurobond in case of breach⁸⁹. Further, Majority of the Eurobonds lack collective action clauses⁹⁰, which allow supermajority of bondholders to agree to a debt restructuring that is binding to all other bondholders of contrary view⁹¹, this leaves bond issuers with limited or no option at all for debt restructuring when faced with economic shocks like the ongoing corona pandemic.

vii) Risk of Depletion of Foreign Exchange Reserve

Eurobond is generally denominated in foreign currency. The four issues of Eurobond by Kenya have been denominated in USD. Therefore, repayment of the sovereign bonds requires use of foreign currency. Countries need sufficient foreign reserve to meet their external debt obligations⁹². Data from the Central Bank of Kenya indicate that the country's foreign exchange reserve was declining towards the end of 2021. In November 2021, the reserves dropped from 9.09 billion dollars to 8.87 billion dollars⁹³. A further sustained depletion of the foreign reserve may put Kenya at a risk of failing to meet her external debt obligations including Eurobonds.

viii) Fees and Transaction costs

Apart from interest payment costs, the issuer of the bond must also pay fees and transaction costs for legal and financial services rendered when processing Eurobond. Zambia incurred a transaction cost of 1.4 million USD for the Eurobond issued in 2021⁹⁴.

ix) Risk of Debt Default

Challenging macroeconomic environment faced by sub-Saharan Africa countries, including Kenya, characterized by growing budget deficit, worsening current account balance, high

⁸⁸ <https://www.downtoearth.org.in/blog/economy/why-african-countries-are-reluctant-to-take-up-covid-19-debt-relief-72544>

⁸⁹ <https://www.downtoearth.org.in/blog/economy/why-african-countries-are-reluctant-to-take-up-covid-19-debt-relief-72544>

⁹⁰ http://slettgjelda.no/assets/docs/Bond-to-happen_Debt-Justice-Norway.pdf

⁹¹ https://en.wikipedia.org/wiki/Collective_action_clause

⁹² Misheck Mutize in his article, "African Governments Have Developed a Taste for Eurobonds: Why It's Dangerous," <https://theconversation.com/african-governments-have-developed-a-taste-for-eurobonds-why-its-dangerous-165469>

⁹³ [https://www.centralbank.go.ke/uploads/weekly_bulletin/1023949040_Weekly%20CBK%20Bulletin%](https://www.centralbank.go.ke/uploads/weekly_bulletin/1023949040_Weekly%20CBK%20Bulletin%20)

⁹⁴ https://media.africaportal.org/documents/A_Cautious_Tale_of_Zambias_International_Sovereign_Bond_Issuances_4o38QrI.pdf

volatility of the country's exchange rate, resulting to growing debt servicing burden signal possibility of future debt default if no urgent measures are taken to adequately address them. Countries that have defaulted on their foreign debt obligations faced some of these challenges a few years prior. For example, Greece defaulted after running a large fiscal deficit for more than five years, Jamaica experienced unsustainable interest payments on its unsustainable debt, Cote d'Ivoire faced political instability after attempted coup and disputed elections which resulted to its default on foreign debt obligations⁹⁵.

Kenya's budget deficit has been on an upward trend in the last three years, as a percentage of GDP, in 2018, 2019, and 2020, the budget deficit grew from 7.02%, to 7.35%, and 8.06% respectively⁹⁶. For the same period, the country's public debt as a percentage of GDP rose from 59.1% to 62.4%, and 65.6% for 2018, 2019, and 2020 respectively⁹⁷. The country is also prone to political instability and other macroeconomic shocks which may hinder her ability to service the growing foreign debts including Eurobonds.

⁹⁵https://media.africaportal.org/documents/A_Cautious_Tale_of_Zambias_International_Sovereign_Bond_Issuances_4o38QrI.pdf

⁹⁶ <https://www.statista.com/statistics/451121/kenya-budget-balance-in-relation-to-gdp/>

⁹⁷ <https://www.centralbank.go.ke/public-debt/>.

5.0 FINDINGS

5.1 Transparency and Accountability Standards and Requirements Set Out in the Kenya's Legal Framework

5.1.1 The Constitution of Kenya 2010

“Public debt” means essentially means all financial obligations attendant to loans raised or guaranteed and securities issued or guaranteed by the national government.

Chapter Twelve of the Kenya's Constitution titled “Public Finance” provides the overarching guidelines for the management of public finance and apportions powers and roles to different authorities, bodies and agencies. More particularly, Article 201 of the Constitution lays down the principles of public finance.

First is openness and accountability, including public participation in financial matters.⁹⁸ Second, public finance system shall promote an equitable society and particularly sharing of the burden of taxation fairly, equitable sharing of the revenue raised nationally between the national and the county governments and ensuring expenditure promotes equitable development of the country including through special provisions for marginalized groups as well as areas.⁹⁹ Third, the burden and benefits of the use of resources and public borrowing are to be shared equally between present and future generations.¹⁰⁰ Fourth, there must be prudence and responsibility in the use of public money.¹⁰¹ Fifth, there must be responsibility in financial management and clarity in fiscal reporting.¹⁰²

Part 3 of Chapter Twelve of the Constitution covers Revenue Raising powers and Public Debt. Under this Part, with regard the borrowing by the national government, the Constitution empowers Parliament to enact legislation to prescribe the terms on which the national government may borrow and also impose reporting requirements.¹⁰³ Further, the Constitution in this part gives Parliament powers to require information regarding government loans from the Cabinet Secretary responsible for finance. The information that can be sought by Parliament

⁹⁸ Article 201(a) of the Kenya Constitution 2010

⁹⁹ Article 201(b) of the Kenya Constitution 2010

¹⁰⁰ Article 201(c) of the Kenya Constitution 2010

¹⁰¹ Article 201(d) of the Kenya Constitution 2010

¹⁰² Article 201(e) of the Kenya Constitution 2010

¹⁰³ Article 211(1) of the Kenya Constitution 2010

includes the extent of the total indebtedness, 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.¹⁰⁴

On charging of the public debt, the Constitution indicates that public debt is a charge on the Consolidated Fund. However also an Act of Parliament may provide for charging all or part of the public debt to other public funds.¹⁰⁵

The information regarding public debt and public finance should indeed be available to the citizens, as this is guaranteed by Article 35(1)(a) which guarantees every citizen's right of access to information held by the State

Pursuant to the Constitution of Kenya 2010, and specifically the provisions highlighted above, Kenya's Parliament have enacted several laws meant to further create transparency in the public debt management. These are the Public Finance Management Act 2012, and the Public Finance Management Regulations 2015. The salient provisions of these laws which relate to public finance are analyzed below.

5.1.2 Public Finance Management Act

The Public Finance Act (PFM Act) aims at providing for the effective management of public finances by the national and county governments; the oversight responsibility of Parliament and county assemblies; the different responsibilities of government entities and other bodies, and for connected purposes.¹⁰⁶ Its principal objective include ensuring that public finances are managed both at the national and at the county levels, in accordance with the principles set out in the constitution and also that public officers who are given responsibility for managing the finances are accountable to the public for the management of those finances through Parliament and County Assemblies.¹⁰⁷

i) The Role of Parliament in Public Finance Management in Kenya

The responsibilities of Parliament with regard to national finance under the Act come through the National Assembly Budget Committee and the Senate Budget Committee. It is instructive that

¹⁰⁴ Article 211(2) of the Kenya Constitution 2010

¹⁰⁵ Article 214 of the Kenya Constitution 2010

¹⁰⁶ See the Preamble

¹⁰⁷ Section 3

one of the responsibilities of the Assembly Budget Committee is monitoring adherence by Parliament, the Judiciary and the national government and its entities to the principles of public finance and others set out in the Constitution, and to the fiscal responsibility principles of the Act¹⁰⁸. Similarly, the Senate Budget Committee in public finances include ‘monitoring adherence by the Senate to the principles of public finance set out in the Constitution, and to the fiscal responsibility principles of the Act.’¹⁰⁹

ii) The Kenya’s National Treasury

Section 11 of the Act is to the effect that the Treasury is responsible for formulation, implementation and monitoring of the macroeconomic policies involving expenditure and revenue. In this regard, the core mandate of the Treasury is to manage the level and composition of national public debt, national guarantees and other financial obligations.¹¹⁰ Further, the National Treasury has the responsibility of design and prescribe an efficient financial management system for the national and county governments to ensure transparent financial management and standard financial reporting as contemplated by Article 226 of the Constitution.¹¹¹

In terms of resource mobilization, the National Treasury has the responsibility of mobilization of domestic and external resources, for funding national and county governments;¹¹² for ensuring efficient financial management system.

As far transparency is concerned, the National Treasury is supposed to promote transparency, effective management, and accountability with regards to public finances in the national government and also to ensure proper management and control of accounting for the finances.¹¹³

Monitoring of the use of public finances is another responsibility of the National Treasury. In this regard, the Act empowers the National Treasury to monitor the management of the finances of public enterprises and investments by the national government and its entities, financial aspects of risk management strategies and governance structures for the national government and

¹⁰⁸ Section 7(d)

¹⁰⁹ Section 8(d)

¹¹⁰ Section 12(b)

¹¹¹ Section 12(e)

¹¹² Section 12(d)

¹¹³ Section 12(2)(c)

national government entities, financial performance of state corporations and to issue guidelines to national government entities with respect to financial matters and monitoring their implementation and compliance.¹¹⁴

Under the PFM Act the Cabinet Secretary can authorize the National Treasury to perform some important function related to accountability in public finance. First the National Treasury can require national government entities to comply with any specified applicable norms or standards regarding accounting practices and budget classification systems.¹¹⁵ Secondly, the National Treasury can require any public officer in the national government to provide information and if necessary, explanations with respect to matters concerning public finance so long this information is not incriminating the person providing it¹¹⁶

iii) Role of Treasury in Budgeting

The National Treasury has the mandate of preparing the Budget policy statement which sets out broad strategic priorities and policy goals that will guide the national government and county governments in preparing their budgets both for the following financial year and over the medium term.¹¹⁷ Essentially, the Budget Policy Statement should include an assessment of the current state of the economy and the financial outlook over the medium term, including macro-economic forecasts, financial outlook with respect to Government revenues, expenditures and borrowing for the next financial year and over the medium term, he proposed expenditure limits for the national government, including those of Parliament and the Judiciary and indicative transfers to county governments, and the fiscal responsibility principles and financial objectives over the medium term including limits on total annual debt.¹¹⁸

iv) The Role of Parliament in Government Loans

The Act provides that the Cabinet Secretary for the National Treasury is supposed to submit to Parliament, every four months, a report of all loans made to the national government, national government entities and county governments.¹¹⁹ Further, when Parliament is canvassing a matter

¹¹⁴ Section 12(2)(h),(i)(j) and (k)

¹¹⁵ Section 13(1)c

¹¹⁶ Section 13(1)(d)

¹¹⁷ Section 25(3)

¹¹⁸ Section 25(4)

¹¹⁹ Section 31(1)

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 from Parliament.¹²⁰

The Cabinet secretary also must submit quarterly reports to Parliament on loan balances brought forward, carried down, drawings and amortizations on new loans obtained from outside Kenya or denominated in foreign currency. This report must specify the names of the parties to the loan, 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 as well as the purpose for which the loan was used and the perceived benefits of the loan.¹²¹

v) *Debt Management Strategy*

The PFM Act has measures with regard to debt management strategy and in this regard the Cabinet Secretary is required to annually submit a report to Parliament indicating with 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.¹²² Further, section 50(8) of the Act gives provision for the National Treasury to set up a “Sinking Fund”, to aid with loan repayments when they are due, upon approval by the National Assembly. However, as at September 2021, the National Assembly was yet to approve the National Treasury’s request of setting up the “Sinking Fund”.

vi) *Issuance of external securities by Kenya government*

The national government shall ensure that its financing needs and payment obligations are met at the lowest possible cost in the market which is consistent with a prudent degree of risk, while ensuring that the overall level of public debt is sustainable.¹²³ In this regard, Parliament is mandated to set limit for borrowing.¹²⁴ Whereas the national government may issue external government securities, for money borrowed or for any other purpose, the Act sets out the

¹²⁰ section 31(2),

¹²¹ Section 31(3)

¹²² Section 33(3)

¹²³ Section 50(1)

¹²⁴ Section 50(2)

conditions under which this may be done.. For instance, any external loans or external government securities issued by the Cabinet Secretary under this section shall be within the borrowing limits set by Parliament.¹²⁵

5.1.3 The Public Finance Management Regulations 2015

The Public Finance Management Regulations 2015(PFMR) were enacted under section 205 of the Public Finance Management Act and are meant to operationalize the Act. The Regulations are meant to among other things, provide means of administering the powers vested in the Cabinet Secretary for the National Treasury under the Constitution, the Act and any other related legislation, and also to harmonize and standardize their application throughout government service in controlling and managing the finances.¹²⁶ With regards to openness and accountability regulation 6 provides that all the public shall be provided with full access to financial information in a timely manner for purposes of seeking public input. To this end the National Treasury is required to arrange for effective public participation during the development of their annual budget estimates including the publication of citizens’ budgets which shall explain and summarize the budget proposals.¹²⁷

The Regulations establishes the Public Finance Management Standing Committees.¹²⁸ The Roles and responsibilities of these committees include prioritization of resource allocation, regular review and monitoring of budget implementation, and risk management.¹²⁹

From the above it is clear that Kenya has a framework for management of public finance including loans obtained externally. This framework lays down the roles, and powers of the National Treasury, the Cabinet Secretary for the Treasury, the Public, and the National Assembly. As shall be seen in part three, the processes leading to Eurobond Issuance in Kenya has, in most cases, not adhered to the requirement set out on the legal framework.

The next section looks at the risks, best practices and accountability standards with regard to Eurobond issuance.

¹²⁵ Section 53A(3)

¹²⁶ Regulation 4

¹²⁷ Regulation 6

¹²⁸ Regulation 18

¹²⁹ Regulation 19

5.2 Best Practice Accountability and Transparency Standards and Practices on Eurobond Borrowing and Management.

5.2.1 The United Nations Conference on Trade and Development (UNCTAD) Principles on Promoting responsible Sovereign Lending and Borrowing

UNCTAD is a permanent intergovernmental body established by the United Nations General Assembly in 1964 with the aim of supporting developing countries to access the benefits of a globalized economy more fairly and effectively and equip them to deal with the potential drawbacks of greater economic integration.¹³⁰ The UNCTAD Principles on Promoting responsible Sovereign Lending and Borrowing are an attempt to create a body of acceptable practices that can create proper administration of Eurobonds and reduce the misuse of the resultant funds. They prescribe responsibilities for lenders and borrowers.

Through these principles, UNCTAD aims to build consensus around a set of internationally agreed principles to prevent irresponsible sovereign financing. This aim is to be achieved through a set of responsibilities for the lenders as well as for the sovereign borrowers. The responsibilities cover *Agency, Informed Decisions, Due Authorization, Responsible credit decisions, Project financing, International Cooperation, Debt Restructurings, Binding agreements, Transparency*, as well as monitoring (see **Box 1 and Box 2**).¹³¹

¹³⁰ <https://unctad.org/about>

¹³¹ UNCTAD Principles on Promoting Responsible Sovereign Borrowing and Lending available at https://unctad.org/en/PublicationsLibrary/gdsddf2012misc1_en.pdf

Box 1: Responsibilities of Lenders

1. **Agency:** Recognizing that government officials involved in sovereign lending and borrowing transactions are responsible for protecting public interest.
2. **Informed Decisions:** a responsibility to provide information to their sovereign customers to assist borrowers in making informed credit decisions
3. **Due Authorization:** a responsibility to determine, to the best of their ability, whether the financing has been appropriately authorized and whether the resulting credit agreements are valid and enforceable under relevant jurisdiction/s.
4. **Responsible credit decisions:** making a realistic assessment of the sovereign borrower's capacity to service a loan based on the best available information and following objective and agreed technical rules on due diligence and national accounts
5. **Project financing:** Lenders financing a project in the debtor country have a responsibility to perform their own ex ante investigation into and, when applicable, post-disbursement monitoring of, the likely effects of the project, including its financial, operational, civil, social, cultural, and environmental implications
6. **International Cooperation:** A duty to comply with United Nations sanctions imposed against a governmental regime.
7. **Debt Restructurings:** In circumstances where a sovereign is manifestly unable to service its debts, all lenders have a duty to behave in good faith and with cooperative spirit to reach a consensual rearrangement of those obligations.

Box 2: Responsibilities of Sovereign Borrowers

1. **Agency:** Governments are agents of the State and, as such, when they contract debt obligations, they have a responsibility to protect the interests of their citizens
2. **Binding Agreements:** A sovereign debt contract is a binding obligation and should be honoured
3. **Transparency:** The process for obtaining financing and assuming sovereign debt obligations and liabilities should be transparent. Governments have a responsibility to put in place and implement a comprehensive legal framework that clearly defines procedures, responsibilities and accountabilities.
4. **Disclosure and publication:** Relevant terms and conditions of a financing agreement should be disclosed by the sovereign borrower, be universally available, and be freely accessible in a timely manner through online means to all stakeholders, including citizens.
5. **Project Financing:** In the context of project financing, sovereign borrowers have a responsibility to conduct a thorough ex ante investigation into the financial, operational, civil, social, cultural and environmental implications of the project and its funding. Borrowers should make public the results of the project evaluation study
6. **Adequate Management and Monitoring:** Debtors should design and implement a debt sustainability and management strategy and to ensure that their debt management is adequate. Debtor countries have a responsibility to put in place effective monitoring systems, including at the sub-national level, that also capture contingent liabilities
7. **Avoiding Incidences of Over-Borrowing:** Governments have a responsibility to weigh costs and benefits when seeking sovereign loans. They should seek a sovereign loan if it would permit additional public or private investment, with a prospective social return at least equal to the likely interest rate.
8. **Restructuring:** If a restructuring of sovereign debt obligations becomes unavoidable, it should be undertaken promptly, efficiently and fairly

5.2.2 The Treaty for the Establishment of the East African Community (EAC Treaty)

The EAC Treaty is part of the Kenya law by dint of section 2 of the Constitution. The Treaty's Chapter Fourteen provides a framework for monetary and financial cooperation in the East African Community. More particularly, Article 82 (1) provides that the Partner States undertake to co-operate in monetary and fiscal matters in accordance with the approved macro-economic policies harmonization programmes and convergence framework of the Community in order to establish monetary stability within the Community aimed at facilitating economic integration efforts and the attainment of sustainable economic development of the Community.¹³² The East African Community Monetary Union Protocol was signed to give effect to the above provision and it envisages macroeconomic convergence within EAC.¹³³ In this regard, the Protocol sets debt ceilings to be used in assessing this macroeconomic convergence. Article 6(2) establishes the criteria for this assessment namely a ceiling for headline inflation is to be 8%, the ceiling on fiscal deficits, including in grants 3% of the GDP, a ceiling for public debt of 50% of GDP, and server cover of 4.5 months of imports.¹³⁴ Further on debt ceiling the Protocol provides that the EAC Partner States, in implementing their fiscal policies, shall one, adjust their net financing to their governments in accordance with the debt ceilings provided and two disclose to the membership the status of their domestic and external debts.¹³⁵

It is important to note that although the UNCTAD principles are not binding, they are generally considered soft law on sovereign debt crisis prevention and have widely been recognized as such in the international arena and at national levels.¹³⁶ Also as regards the EAC Monetary Union Protocol, the parameters in terms of debt ceilings have not been adhered to firstly because the EAC is yet to become a monetary union and secondly because of the powers bestowed on the Kenya Parliament with respect to debt ceiling.

Redress for violations can be sought internationally at the East African Court of Justice which has been established under Article 23 of the EAC Treaty. Article 30 is to the effect that, any person who is resident in a Partner State may refer for determination by the Court, the legality of any Act, regulation, directive, decision or action of a Partner State or an institution of the

¹³² https://www.eacj.org/?page_id=33

¹³³ Article 6(1), East African Community Monetary Union Protocol

¹³⁴ Article 6(2) East African Community Monetary Union Protocol

¹³⁵ Article 9 East African Community Monetary Union Protocol

¹³⁶ <https://unctad.org/topic/debt-and-finance/Sovereign-Lending-and-Borrowing>

Community on the grounds that such Act, regulation, directive, decision or action is unlawful or is an infringement of the provisions of this Treaty. It is important to note that there has been some litigation before the court with regards to debt but the Court is yet to make major pronouncements on them. For instance, one of the cases pending before the court relate to the decision by Kenya to borrow \$2.34 billion (Ksh255.9 billion) from the IMF in April which the litigants are claiming violates the EAC Monetary Union Protocol¹³⁷.

5.3 Violations of the PFM Act and International Best Practice Standards in Kenya’s Eurobond Issuance

i) Violations of the PFM Act in Kenya’s Eurobond Issuance

This section looks at the instances where Kenya’s previous Eurobond issuances have violated Kenya’s public finance and debt management legal framework. (Table 4)

Table 4: Eurobond Issuances and their Violations of the Kenya’s Legal Framework

PROVISIONS OF THE CONSTITUTION, THE PFM ACT, AND THE PFM REGULATIONS	VIOLATIONS IN KENYA’S ISSUANCE OF EUROBONDS
<p>Section 15(2)- Powers of the National Treasury in enforcing fiscal responsibility principles</p> <p>(c)over the medium term, the national government’s borrowings shall be used only for the purpose of financing development expenditure and not for recurrent expenditure</p> <p>(d) public debt and obligations shall be maintained at a sustainable level as approved by Parliament for the national government and the county assembly for county government;</p> <p>(e)fiscal risks shall be managed prudently</p>	<p>Eurobond proceeds have been used to service loans, and finance budget deficits which include recurrent expenditure such as salaries and wages, pensions, interest payments as well as expenses for general maintenance and operations.</p> <p>National borrowing on Eurobond is not sustainable as evidenced by the govt tendency to issue new Eurobonds to repay the one due.</p> <p>There is lack of prudent management of fiscal risks by venturing in issuing Eurobonds which are expensive commercial loans and associated with so many risks including and not limited to exchange rate risks, debt accumulation risks, high interest risks, among others</p>

¹³⁷ <https://www.theeastafrikan.co.ke/tea/news/east-africa/kenya-and-eac-sued-over-usd2-34b-imf-loan-3429776>

<p>Section 15(4)- Ensuring that The National Treasury shall ensure that the level of National Debt does not exceed the level specified annually in the medium-term national government debt management strategy submitted to Parliament.</p>	<p>The debt ceiling was to be exceeded in 2019 by issuing the second Eurobond, hence the government pushed the national assembly to review the debt ceiling in 2019 to an absolute figure of Ksh 9 trillion.</p>
<p>Section 16(1)- Deviation from the Financial objectives-The national government may, with the approval of Parliament, deviate from the financial objectives in a Budget Policy Statement on a temporary basis where such deviation is necessitated by a major natural disaster or other significant unforeseen event.</p>	<p>The national government through the national treasury’s accounting for the expenditure of the first Eurobond issued in 2014 is a violation of this provision. It is a clear deviation from the BPS without approval of the parliament.</p> <p>The first Eurobond was to issue USD 500 million benchmarking bond which was escalated to US\$ 1.5 billion, then to US\$ 2 billion without any evidence of proper authorization by the national Assembly¹³⁸.</p>
<p>Section 17(2) of Public Finance and Management Act, 2012 requires that all money raised or received by or on behalf of the National Government be paid into the Consolidated Fund.</p>	<p>Auditor’s report indicated that Sovereign Bond of USD 1,999,052,872.97 proceeds of Kenya’s first Eurobond issue was deposited in an offshore account¹³⁹, which was against the PFM Act which require money raised or received by or on behalf of the National Government be paid into the Consolidated Fund.</p>
<p>Section 31</p> <p>(1) 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.</p> <p>(2) 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.</p> <p>(3) At the end of every four months, the Cabinet Secretary shall submit a report to Parliament stating the loan balances brought</p>	<p>The national government expenditure reports show that information on the receipt of Eurobond proceeds has been neither clearly and comprehensively reported on nor reconciled — the numbers disclosed in different budget reports are confusing and seem contradictory¹⁴⁰.</p>

¹³⁸ <https://www.kara.or.ke/Eurobond%20Facts%20Figures%20Questions.pdf>

¹³⁹ <https://www.oagkenya.go.ke/2014-2015-national-government-audit-reports/>

¹⁴⁰ <https://www.oagkenya.go.ke/2017-2018-national-government-audit-reports/>

<p>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—</p> <p>(a) the names of the parties to the loan;</p> <p>(b) the amount of the loan and the currency in which it is expressed and in which it is repayable;</p> <p>(c) the terms and conditions of the loan, including interest and other charges payable and the terms of repayment;</p> <p>(d) the amount of the loan advanced at the time the report is submitted;</p> <p>(e) 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.</p>	<p>According to the Auditor General, the government did not provide a satisfactory accounting for the use of the first Eurobond issue. To date, the Kshs.215,469,626,035.75 is yet to be satisfactorily accounted for¹⁴¹.</p>
<p>Section 49 [Act No. 6 of 2014, s. 4.]</p> <p>49. Authority for borrowing by the national government</p> <p>(1) Subject to provisions of this Act, the Cabinet Secretary may, on behalf of the national government, raise a loan only if the loan and the terms and conditions for the loan are set out in writing and in accordance with—</p> <p>(a) the fiscal responsibility principles and the financial objectives set out in the most recent Budget Policy Statement; and</p> <p>(b) the debt management strategy of the national government over the medium term</p>	<p>Kenya's first Eurobond was to issue USD 500 million benchmarking bond which was further increased to US\$ 1.5 following international market's interest in African sovereign bonds, then to US\$ 2 billion. This increase in amount to borrow was done without any evidence of parliament's approval¹⁴²</p>
<p>Section 50 Obligations and restrictions on national</p>	<p>Kenya went for the fourth Eurobond to settle her debt obligation that was estimated at Kshs. 925 Billion¹⁴³, an</p>

¹⁴¹ <https://www.oagkenya.go.ke/2014-2015-national-government-audit-reports/>

¹⁴² <https://www.kara.or.ke/Eurobond%20Facts%20Figures%20Questions.pdf>

¹⁴³ <https://www.theeastafrikan.co.ke/tea/business/kenya-goes-for-costly-eurobond-3323384>

<p>government guaranteeing and borrowing</p> <p>(1) In guaranteeing and borrowing money, the national government shall ensure that its financing needs and payment obligations are met at the lowest possible cost in the market which is consistent with a prudent degree of risk, while ensuring that the overall level of public debt is sustainable.</p> <p>(2) The national government may borrow money in accordance with this Act or any other legislation and shall not exceed a limit set by Parliament.</p> <p>(3) The national government may borrow money only for the budget as approved by Parliament and the allocations for loans approved by Parliament.</p> <p>(8) Provides for creation of a 'Sinking Fund' by the National Treasury upon approval by the National Assembly.</p> <p>(9) The Cabinet Secretary may, subject to Article 227 of the Constitution and in accordance with national legislation on Public Procurement and Asset Disposal—</p> <p>(a) appoint advisers, agents and underwriters for the purpose of raising loans and issuing, managing or redeeming national government securities; and</p> <p>(b) enter into agreements with the advisers, agents and underwriters appointed under paragraph (a) on the role to be undertaken by them and the remuneration to be paid to them.</p>	<p>indication that the country had earlier borrowed to unsustainable level, hence could not meet her debt obligations without borrowing to repay.</p> <p>The fourth Eurobond was issued when global rating agencies namely S&P, Fitch, and Moody's Investor Service had downgraded Kenya's credit status her due to her debt accumulation against falling revenue collection¹⁴⁴. Therefore, the fourth Eurobond attracted higher premium, against the PFMA provision that borrowing be made at the lowest cost possible and ensuring that the overall of public debt is sustainable.</p> <p>The sinking fund is supposed to be used for debt servicing including Eurobond when they are due. However, the National Assembly is yet to give approval for the fund¹⁴⁵. The absence of a Sinking puts the country at a high risk of debt default especially in times of distress such as economic shocks.</p>
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ii) **International Best Practices in Management of External Debt and its Violations in Kenya**

There are parameters against which the processes in the Kenya Eurobond issuance can be assessed at the international best practices.

¹⁴⁴ <https://www.theeastafrican.co.ke/tea/business/kenya-goes-for-costly-eurobond-3323384>

¹⁴⁵ <https://www.businessdailyafrica.com/bd/markets/capital-markets/parliament-delays-creation-kitty-for-debt-payment-3558008>

Table 5: International Best Practices in Management of External Debt and its Violations in Kenya

International Best Practices in Management of External Debt	Violations in Kenya
For middle-income countries, the recommended debt to GDP ratio has always been 50 per cent,	By end of 2021, Kenya was at about 69%, which will put it at par with developed nations, who borrow in their currencies. ¹⁴⁶
Transparency and public participation in public borrowing.	Transparency in public borrowing in Kenya is still inadequate. Public participation in public borrowing is only at the level of budget making process which is not sufficient. Eurobond issuance in Kenya has not been transparent ¹⁴⁷ and there has not been any form of public participation.
Prudent use of public debt in a transparent and accountable manner	<p>The Auditor General announced that Ksh. 215 billion that were sourced from the sovereign bond could not be accounted for two years after the borrowing¹⁴⁸. The Auditor’s report revealed that although the Treasury stated that the Ministry of Water received Ksh. 11.6 billion, receipts and documentations showing the receipt of that money could not be provided. The government did not provide a list of public projects that were funded by the Eurobond funds¹⁴⁹</p> <p>Investigations demonstrated that the government did not deposit the funds in the consolidated Government Fund as required by the constitution but rather deposited these funds in offshore accounts. The lack of transparency in external borrowing has placed the Kenya’s sovereign debt on unsustainable path¹⁵⁰.</p>

Gaps in international best practice: There is no international legal framework governing debt restructuring when sovereign nations are unable to honor their financial obligations. Under the doctrine of restrictive sovereign immunity creditors can sue states to seek enforcement by the

¹⁴⁶ <https://allafrica.com/stories/202104120150.html>

¹⁴⁷ <https://www.oagkenya.go.ke/document/summary-report-2016-2017/>

¹⁴⁸ Wafula, P. (2018). Audit: Sh215b Eurobond cash unaccounted for. [online] The Standard. Available at: <https://www.standardmedia.co.ke/article/2000215138/audit-sh215b-eurobond-cash-unaccounted-for>

¹⁴⁹ Kegoro, G. (2018). Eurobond scandal puts Jubilee in a difficult situation. [online] Daily Nation. Available at: <https://www.nation.co.ke/oped/opinion/Eurobond-scandal-puts-Jubilee-in-a-difficult-situation/440808-3046654-lwkpisz/index.html>

¹⁵⁰ Ibid

court. Kenya should be careful with external borrowing because the rise of the cost of credit have led to the rise of vulture hedge funds. These vulture funds purchase a country's debt in the secondary market through credit swap for pennies and then move to court seeking the repayment of the whole amount. While the actions of vulture funds can be considered to be legally justifiable, they are immoral because they invariably hold out preventing the restructuring of the debt and as such, they cause the debt crisis on the affected country to ferment¹⁵¹.

¹⁵¹ Arewa OB, Vultures, Hyenas and African Debt: Private Equity and Zambia (2009) 29 Nw. J. Int'l L. & Bus. 643.

6.0 RECOMMENDATIONS AND CONCLUSIONS

6.1 Recommendations

Review of the current legal framework on public debt management: There is need for a review of the current legal framework to incorporate the nitty-gritties of the Eurobond issuance such as appointment of advisors and legal team, negotiations for favourable coupon rates, refinancing, payment of the principle, re-borrowing and provisions for accountability on the use of bond proceeds. Sovereign bond issue being a relatively new phenomenon in Kenya and a number of African countries. The processes involved in its issuance and management are slightly different from the conventional bilateral and multilateral foreign debts that informed the basis of the current legal framework guiding the procurement of foreign debts in these countries.

Strengthening the role of oversight bodies on Eurobond borrowing: There is need for a legislation to give parliament and other oversight bodies such as CSOs and citizens express powers to offer checks and balances on Eurobond borrowing. Such as assessment of the need, amounts to be borrowed, and the usage of the proceeds. Further there is need for more robust and stricter oversight of the usage of Eurobond funds to curb misuse and corrupt practices. One of the ways this can be achieved is through clear identification of the projects to be funded.

Establishment of a ‘sinking fund’ for debt repayment: The National Assembly should fast-track the creation of the sinking fund by the National Treasury to aid in debt repayment in times of distress to save the country from possibility of defaulting in its foreign debt obligations. This should be accompanied by stringent regulations to avoid misuse, such as requiring authorization from parliament before the funds are utilized and regular update of the parliament and members of the public on the status of the funds.

Extensive export promotion: There is need for extensive export promotion to earn the country foreign income and boost the foreign exchange reserve whose role in debt servicing is critical. This will guarantee the country’s ability to sustainably service her foreign debts especially Eurobond which is denominated in foreign currency, US dollar. The earnings from export will also supplement national revenue hence reduce the need for public borrowing.

Legislations to promote alternative sources of funding development projects: There is need for the National Assembly and the National Treasury to agree and pass legislations that will ease regulations on the involvement of the private sector such as Pension Funds in the development projects through Public Partnerships and joint ventures to reduce the need for public borrowing.

Effective and efficient national budgeting: only immediate public expenditure needs should be factored in the budget to reduce wasteful budgeting and enhance prioritization of budgetary items to reduce the growing budget deficit. A reduction in the budget deficit will reduce the public borrowing needs of the country.

Sound macroeconomic policy with robust debt management: There is need for sound macroeconomic policy and more specifically robust debt management to avert the high risk of the country plunging into debt distress considering the growing financial needs of the country hence the need for further public borrowing. Kenya has issued four Eurobonds so far, and there are indications that it will continue issuing more Eurobonds either to meet the growing budget deficit or to repay Eurobonds that are due.

Need for clearer and transparent government accounting procedure for Eurobond proceeds: Since the Eurobond proceeds are initially held in offshore accounts, there is need for clear information on where they are held, how long it should take before they are transferred to the exchequer account, for ease of pinpointing delays. Further, there should be regular updates on the balance held in the offshore account, and proper authorization of any withdrawal to curb misuse of the funds.

The underwriters should ensure the bonds issued are in compliance with Kenya's debt management policy: They should assess the terms and ensure that the loan agreements are enforceable under Kenya's jurisdiction, assess the borrowing terms and ensure is within the country's debt service capacity.

There is need for the country to maintain good diplomatic relations with other countries: Owing to the cross-border nature of the Eurobond, in case of any malpractice in the process of bond issuance, transparency issues may be handled at international level, this can only be effective in an environment of good diplomatic ties.

6.2 Conclusions

There are clear provisions for transparency and accountability with regards to public debt management in Kenya which were based on conventional borrowing from multilateral and bilateral lenders. Some of them have not been strictly adhered to by the government when borrowing and managing loan proceeds. With the advent of Eurobond, which has a unique process of issuance, there is need for amendment of the current legislations, and enactment of new laws that factor the uniqueness of Eurobond borrowing to enhance accountability and transparency in the process of its issuance.