KENYA'S PUBLIC DEBT PROFILE

PREPARED BY:
INSTITUTE OF PUBLIC FINANCE KENYA LTD

About IPFK

The Institute of Public finance Kenya (IPFK) is an independent think tank based in Nairobi. The Institute's mandate is to further the ideas of transparent, accountable, equitable, efficient, and fiscally disciplined public finance management systems for improved service delivery and economic development in Kenya and in the region through research, training, and capacity strengthening.

Our Vision

The vision of IPFK is to be a think tank that delivers unquestionable evidence for Public Finance Management policy and action

Our Mission

Providing quality advice and engagement to enhance **e**quity, **r**esponsiveness and **T**ransparency, **A**ccountability and **P**articipation (**TAP**) of Public Finance Management systems.

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FORWARD

The analysis of Kenya's public debt profile is aligned to IPFK's Strategic Focus: TAP (Transparency, Accountability and Public Participation) 2021-23 number five on opening the dark corners of the budget, particularly those related to state-owned enterprises, contingent liabilities, and debt, to ensure greater public debate and oversight of PFM decision-making in these areas. The study was undertaken through analysis, scrutiny, and interpretation of publicly available information on public debt, categorization of loans, and tracking the performance of some of them. The information generated from the research will inform debt transparency and accountability work for IPFK and other partners and key stakeholders working in this space for improved social services financing. The study assesses the capacity of Kenya to take on new loans, without compromising fiscal space for gender-responsive budgeting, equitable economic growth, and development.

The study comes at a time when the COVID-19 pandemic has severely affected resource mobilization and increased pressure for increased public expenditure to cushion the citizens and businesses against the negative impacts of the pandemic. We are also sharing these findings at a time when the International Monetary Fund (IMF) has downgraded Kenya's debt carrying capacity from strong to medium signaling increased liquidity risks due to the government spending a larger share of the country's taxes on debt repayment at the expense of provision of critical services such health care, education, electricity, agriculture, and cash transfers to the people with disabilities and the elderly. The country has also breached all three public debt sustainability thresholds for overall debt and two out of four in external debt. Kenya's debt

structure has significantly changed in favor of expensive commercial loans against the multilateral debt which has concessional terms such as low-interest rates, longer grace, and repayment periods. The last decade (2010-2020) saw the country's public debt from commercial lenders rise from a 4% share of external debt in 2010 to 30% in 2020 leading to a sharp increase in the cost of debt servicing and financial risks. Public debt from multilateral lenders declined from 66% share in 2010 to 33% in 2020 while the share of loans from bilateral lenders has generally remained the same at around 33%.

The government expenditure on interest payment has also increased from Ksh 121 billion in 2013 when President Kenyatta took power to Ksh 537 billion in 2022 when he will conclude his second term. Total government expenditure has moved from Ksh1 trillion in 2013 to Ksh3.7 trillion in 2022 representing a 270% growth for the period. The country's total ordinary revenue on the other hand has increased by 130% over the same period; from Ksh 777 billion in 2013 and is expected to hit Ksh1.8 trillion in 2022.

In the financial year 2021/22; Kenya's expenditure on debt service repayment is set to hit the one trillion mark for the first time. The National Treasury projects that KRA will collect Ksh1.8 trillion in taxes and spend about Ksh1 trillion on debt service repayment inclusive of interest and principal redemption and transfer about Ksh 370 billion to counties as equitable share. The Ksh 430 billion left is not enough for the executive (Ksh1.9 trillion), the Parliament (Ksh 38 billion), and the Judiciary (Ksh 18 billion) hence the acquisition of more public debt to fund the deficit is inevitable.

The Institute is committed to continually generate reliable and unquestionable evidence to support evidence-based advocacy, transparency, and public engagement in public debt matters. We look forward to working collaboratively with the national government agencies particularly the Public Debt Management Office (PDMO), the National Assembly, county governments, partners, and all other stakeholders for better management of the country's public debt without compromising on delivery of social services to the poor and marginalized sections of our population who fully depend on public services.

Mr. James Muraguri

Chief Executive officer

Institute of Public Finance–Kenya

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ABBREVIATIONS AND ACRONYMS

AfDB	Africa Development Bank
AG	Attorney General
EABN	East Africa Budget Network
EAC	East African Community
ECF	Extended Credit Facility
EFF	Extended Fund Facility
CoB	Controller of Budget
CoK	Constitution of Kenya
CRA	Commission on Revenue Allocation
DPO	Development Policy Operation
DSA	Debt Sustainability Analysis
MTDS	Medium Term Debt Management Strategy
GoK	Government of Kenya
PDMO	Public Debt Management Office
FY	Financial Year
GDP	Gross Domestic Product
ILO	International Labour Organization
IMF	International Monetary Fund
KNBS	Kenya National Bureau of Statistics
KRA	Kenya Revenue Authority
MTP	Medium-Term Plan
OSIEA	Open Society Initiative for Eastern Africa
PFM	Public Finance Management
PDMO	Public Debt Management Office
PPP	Public-Private Partnership
RCF	Rapid Credit Facility
SOE	State-Owned Enterprise

EXECUTIVE SUMMARY

The outbreak of the COVID19 pandemic led to an increase in the stock of public debt in the East African Community (EAC) States. The Countries contracted new loans as they put measures in place to control the spread of the virus. Kenya, like many other developing countries, has been facing high competition for public resources in its efforts to offer public services. The public expenditure is always greater than the public revenue. This has necessitated borrowing either domestically or externally to offset the budget deficits.

Economic theories of public debt point out the importance of public debt in correcting market behavior and bringing about economic stabilization. Public debt helps countries during periods of emergencies such as Covid-19, natural disasters, or wars and supports large public investment projects such as infrastructural projects with medium and long timeframes.

Over the years Kenya's budget has expanded year on year to hit Kshs 3.66 trillion in 2021/2022 (Republic of Kenya, 2021). In addition, there has been a mismatch between government expenditures and revenues. The continued increase in Government spending and the shortfall in tax revenue targets have resulted in increased borrowing both locally and externally.

The Country's total budget has been growing steadily across the years. This is mainly due to the ever-growing public wage and expenditure on non-essentials such as travel, training, and advertisements. Discussions in this report have led to the conclusion that the Government needs to adhere to its plans and fiscal consolidation measures. This will not only promote fiscal discipline but also reduce the public debt stock.

CHAPTER ONE

INTRODUCTION

1.1 Background

The outbreak of the COVID19 pandemic led to an increase in the stock of public debt in the East African Community (EAC) States. The Countries contracted new loans as they put measures in place to control the spread of the virus. The pandemic saw an increase in public spending amidst shrinking revenue performance leading to increasing budget deficits that put the financing of the social sectors at risk. The Institute of Public Finance Kenya, together with partners from the East Africa Budget Network (EABN) with the support of the Open Society Initiative for Eastern Africa (OSIEA) is undertaking a study on Kenya's debt profile.

1.2 Importance of Public Debt

Borrowing is a key source of funding, especially in developing countries. Kenya is not exceptional, due to high competition for public resources and services, the public expenditure is always greater than the public revenue. This has necessitated borrowing either domestically or externally to offset the budget deficits. In addition, government revenues and expenditures are affected by business cycles and frequent shocks such as the 2009 global financial crisis. Moreover, public debt helps countries during periods of emergencies such as Covid-19, natural disasters, or wars and supports large public investment projects such as infrastructural projects with medium and long timeframes. Thus, the government is forced to incur debt to cushion its citizens and the whole economy against these unforeseen eventualities. Without public debt, the implication is that the government would have to increase taxes or cut government expenditure, this is not only unpopular but would also punish citizens especially the most

vulnerable population. Public debt has far-reaching effects on the economic development and wellbeing of the people. If governments can utilize public debt prudently it can enhance economic stability and improve the welfare of the citizens.

Economic theories of public debt point out the importance of public debt in correcting market behavior and bringing about economic stabilization; for example, the International Monetary Fund (IMF) and World Bank supports are aimed at stabilizing the balance of payments. As a fundamental macroeconomic indicator, public debt assumes a key role in achieving a sound macroeconomic environment as it is a key tool in formulating both monetary and fiscal policies (Minea & Parent, 2012; Matiti, 2013; and Babu et al. 2015). Economic literature also advocates for borrowing to accelerate capital accumulation and economic growth as well as creating equity between the current and future generations. The economic literature on public debt addresses the questions of why we should care about the public debt, and whether it is increasing or decreasing. This is because debt is future tax and therefore the future generations either have to retire the debt or refinance it. In either way, there is a transfer from future taxpayers to bondholders because even if the debt is refinanced, interest payments must be made to new bondholders. Thus, the burdens and benefits of public debt must be shared equitably between the current and future generations. Article 201 of the Constitution of Kenya (CoK), 2010 and Public Finance Management (PFM) Act, 2012 on principles of public finance are anchored on these theories.

1.3 Report Rationale, Methodology and Scope

Over the years, Kenya's budget has expanded year on year to hit Kshs 3.66 trillion in 2021/2022 (Republic of Kenya, 2021). In addition, there has been a mismatch between government

expenditures and revenues as observed in the continued increase in government spending and the shortfall in tax revenues as Kenya Revenue Authority (KRA) falls short of its revenue targets and is complemented by increased borrowing both locally and externally. Furthermore, the expenditures on Interest Rate payments have been increasing gradually and reducing resources available for development expenditures. This has exerted great pressure on the already deteriorating fiscal space.

Public borrowing has become an important source of budget financing in Kenya as the local revenues continue to fall short of the government expenditure requirements to fulfill key development goals as outlined in Kenya Vision 2030, Big Four Agenda, and the Medium-Term Plans (MTPs). Over the past decade, Kenya has been running on budget deficits leading to increased borrowing to finance the deficits. This has led to an increase in public debt stock. Kenya's Public debt stock has increased from Ksh 0.51 trillion in June 2000 to Ksh 6.69 trillion in June 2020, and Kshs. 7.35 trillion in February 2021. Though the increase in public debt between June 2020 and February 2021 is partly attributed to increased borrowing to contain the COVID-19 pandemic, this trend is worrying and raises the question of the sustainability of Kenya's public debt. There has also been public concern about the increasing public debt in Kenya.

It is against this background that the IPFK considers it necessary to conduct an independent and objective study on Kenya's debt profile. This study involved a review of various government reports on public debt, public expenditure and revenue, budgets, and other policy documents on public debt and borrowing. Data was also collected from the Central Bank of Kenya (CBK),

KRA, and the Kenya National Bureau of Statistics (KNBS). The data was analyzed and the descriptive statistics are presented and discussed accordingly.

The debt profile report contains five sections: the first section is on macroeconomic context and outlook that gives an overview of the recent and predicted conditions of Kenya's macro-economy, including trends and vulnerabilities by implication, and the potential of the country to manage its public debt. It also shows how the economy was fairing during Pre-COVID 19 period. The second section of the report presents the trends in revenue and expenditure aggregates and fiscal balances. The third section provides the Country's overall debt situation and gives in-depth information on the categorization of public loans, their performance, and services. Sections four and five outline the public debt legal and institutional framework and the conclusion, respectively. The study provides evidence that will be used to push for more accountability and transparency in the contracting, utilization, and management of borrowed funds.

CHAPTER TWO

MACROECONOMY

2.1 Introduction

This section presents an overview of the recent and predicted condition of Kenya's macro-economy, including trends and vulnerabilities by implication, the potential of the country to manage its public debt, and the state of the economy in the Pre-COVID 19 period. This is based on annual GDP growth, poverty, sectoral contribution, and GDP forecasts.

2.2 Economic Growth and Outlook

Economic growth in Kenya has been robust and stable since the global financial crisis; however, economic growth was estimated to slow down to around 0.6 percent in 2020 from 5.4 percent in 2019 (Republic of Kenya, 2021). In the year 2019, the real GDP growth declined to 5.4 percent down from 6.3 percent in 2018. This implies that even prior to the outbreak of the Covid-19 pandemic, Kenya's economy was under recession. This trend of the real Gross Domestic Product (GDP) growth is presented in figure 2.1.

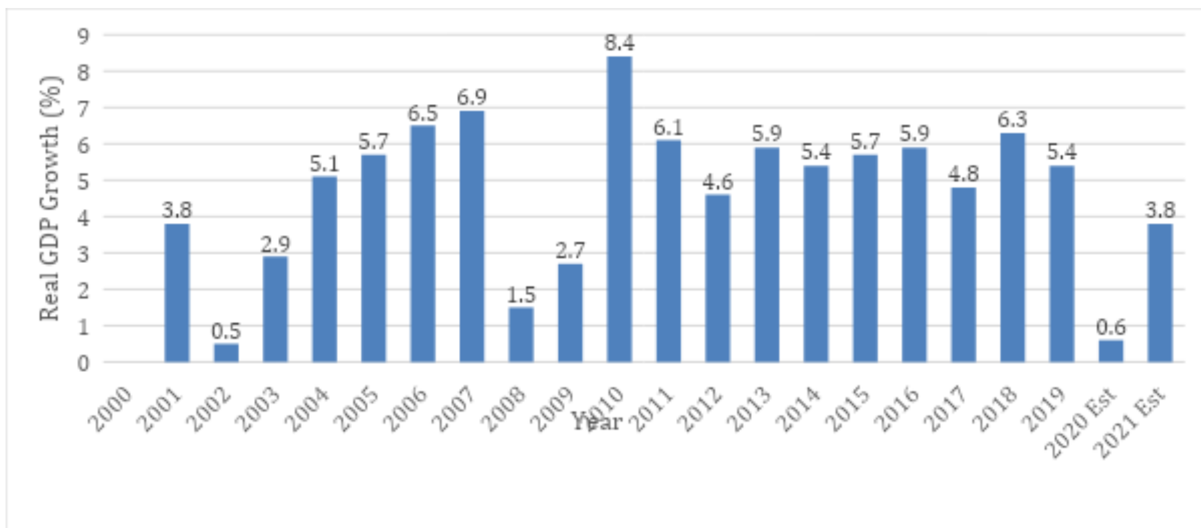

Figure 2.1: Trends in Kenya's Economic Growth 2000 - 2021

Source of data: KNBS, National Treasury and CBK

The outbreak of the Covid19 pandemic in 2020 adversely affected the economy. The swift Covid-19 containment measures disrupted normal lives and livelihoods and to a greater extent businesses and economic activities. Consequently, the economy was estimated to slow down to around 0.6 percent in 2020 from a growth of 5.4 percent in 2019. However, the economy is projected to recover and grow at 3.8 percent in 2021 and above 6.0 percent over the medium term (Republic of Kenya, 2021).

2.3 Sectoral Contribution to GDP

The sectoral contribution to GDP is shown in figure 2.2. The agricultural sector recorded an improved growth of 6.3 percent in the third quarter of 2020 compared to the same period in 2019 with a growth of 5 percent. This was supported by an increase in tea production, export of fruit, and sugarcane production (Republic of Kenya, 2021).

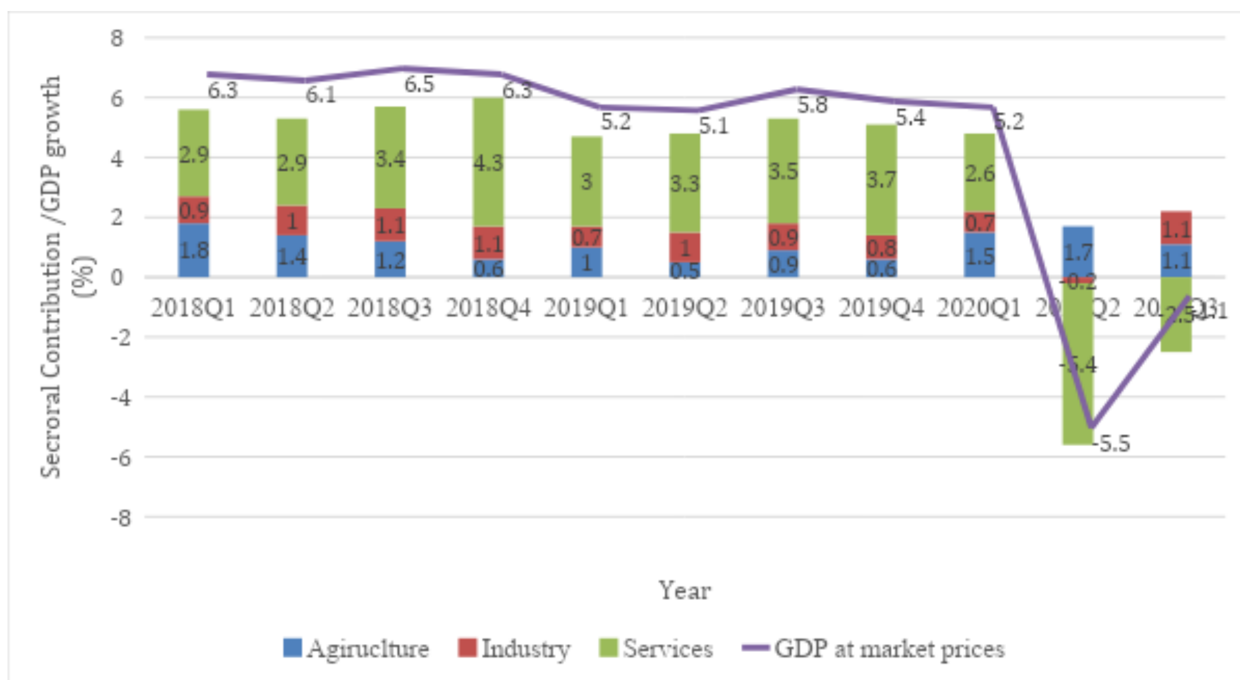

Figure 2.2: Sectoral Contribution to GDP

Source of Data: KNBS and National Treasury

The agricultural sector contributed 1.1 percent to the GDP in the third quarter of 2020. The non-agricultural sector contracted by 2.5 percent in the same period due to the outbreak of the Covid-19 pandemic. Service sub-sector contracted by 4.7 percent in the third quarter of 2020 as compared to 6.7 percent in the previous period, this was due to a decline in accommodation and food services (57.9 percent), education (41.9 percent), and wholesale and retail trade by 2.5 percent. The industry sub-sector grew by 4.2% in the third quarter of 2020. This was a drop from 5.1% in the same period in 2019 and was due to declining activities in the electricity and water supply and manufacturing sub-sector as shown in figure 2.2.

2.4 Poverty

On poverty reduction, Kenya experienced a 23% reduction in poverty headcount. The reduction in poverty that was experienced was driven by rural areas, with poverty stagnating in urban

areas. The rate reduced slightly but in absolute terms, urban poverty increased from 2.3 m to 3.8 m due to population growth. Between 2005 and 2015, the 22 percent growth in GDP per capita coincided with a 23% reduction in poverty headcount. The reduction in poverty is broadly in line with EAC progress, although poverty in Kenya remains above Uganda and Tanzania, and Rwanda has been progressing more rapidly. International Labour Organization (ILO) employment data, which shows low and stagnant employment levels over the period and a fall in youth employment, suggest that the growth generated poverty reduction would have been greater if employment had been higher. Progress in rural areas was a result of agriculture being a major contributor to poverty reduction in Kenya (World Bank, 2019). Inequality remains prominent, although there has been a reduction in income inequality. Kenya's inequality is less than in Uganda (the opposite being true in 2005). Data notes: 1. Poverty headcount ratio at national poverty lines (% of the population). 2. GINI index (World Bank estimate). For both datasets, no regional averages are available due to different years of surveys; therefore, we have included neighboring countries for comparison. Dates slightly differ but the comparison remains valid. The comprehensive poverty report shows that 53% of the population in Kenya is multidimensionally poor, deprived in realization of at least 3 basic needs, services, and rights. Additionally, more than 27 % of the population in Kenya is poor in monetary and multidimensional terms.

CHAPTER THREE

REVENUES, EXPENDITURES AND FISCAL DEFICITS

3.1 Introduction

This section presents the trends in government revenue and expenditure aggregates and fiscal balances.

3.2 Government Revenues Performance

A major cause of the increase in public debt is failure to meet revenue targets necessitating borrowing other than cutting expenditure or increasing taxes. The government's ordinary revenue targets keep growing each financial year and these have not been achieved as indicated in figure 3.1.

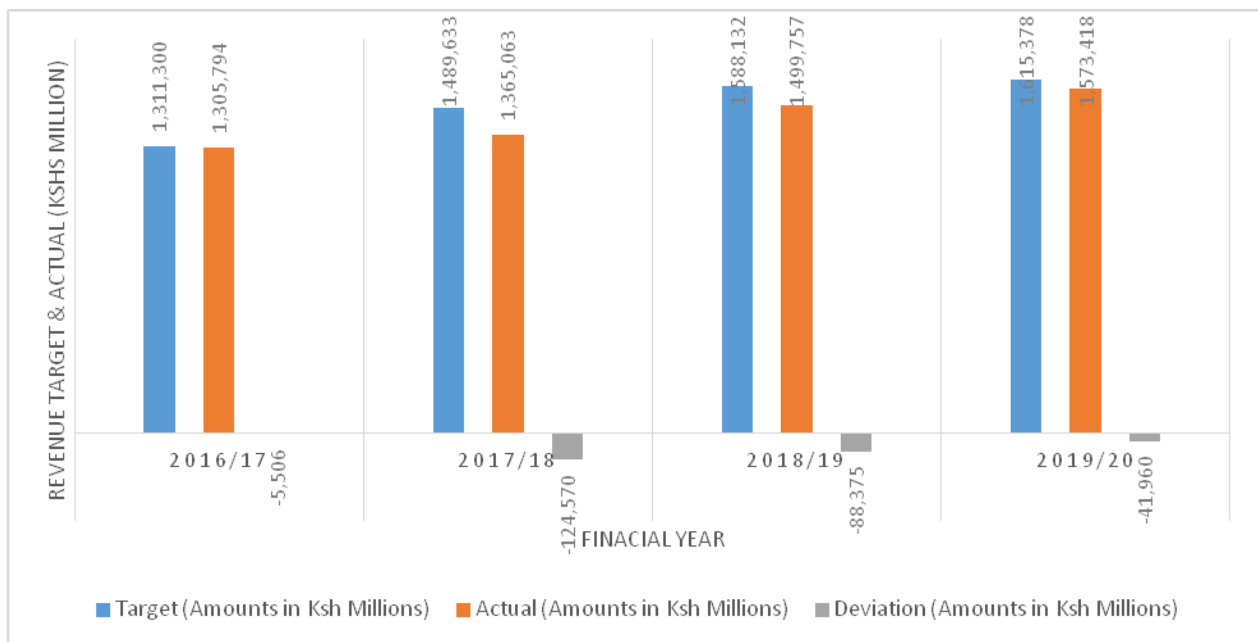

Figure 3.1: Ordinary Revenue Performance 2016/17-2019/20

Source of Data: National Treasury

As indicated in figure 3.1, the government failed to achieve its targets in the pre-covid-19 period, an indication that the government's revenues are ambitious or a poor estimate of the tax base. Revenue collection during the third quarter of FY 2019/ 20 was relatively low owing to the tax relief measures introduced by the government to cushion individuals and businesses from the impacts of the Covid-19 pandemic. In the current financial year, the government had a target of Ksh 1.63 trillion for its ordinary revenues. This was revised downwards to Ksh 1.59 trillion when the government prepared its first supplementary budget. This paints a picture of the weaknesses in the way revenue targets are set and collected in the country. The government is hopeful that the revenue performance will improve following the opening of the economy and the reversal of the tax relief measures.

The shortfalls in revenue collection led to widening fiscal deficits that necessitated the need to borrow which led to a rise in the public debt in the Country. In most instances, the underperformance of revenues leads to the preparation of supplementary budgets which revise the targets downwards. This has been the case year in year out. Ultimately, missed revenue targets and increasing fiscal deficits have the likelihood of crowding out development in the Country. This has an impact on service delivery in the Country as priority will be given to debt servicing.

3.3 Government Expenditure

The Country's total budget has been growing steadily across the years. This is mainly due to the ever-growing public wage and expenditure on non-essentials such as travel, training, and advertisements. The recurrent expenditure and the Consolidated Fund Service receive the lion's share of this budget. Various sectors have not been able to fully utilize the funds allocated

to them. On average, the sectors absorbed at least 86 percent of the budget allocated to them in the period between FY 2014/15 and FY 2019/20. The development budget is more underspent compared to the recurrent budget. Some of the challenges facing budget implementation include the late disbursement of donor funds for capital projects. In addition, the covid-19 pandemic saw the reprioritization and reallocation of resources.

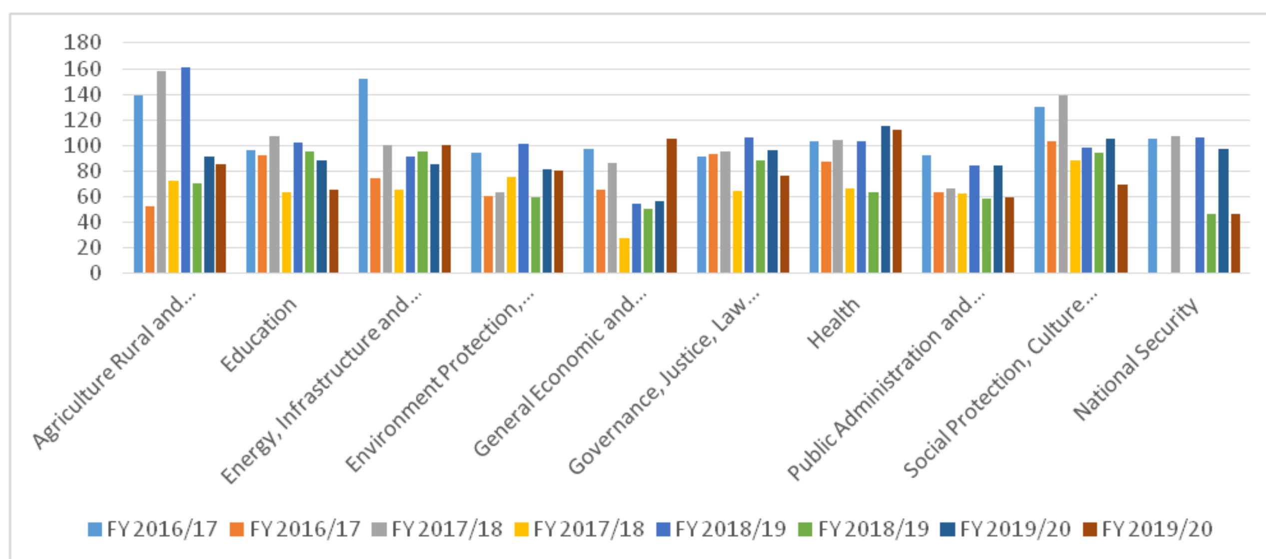

Figure 3.2: Sector Experience Performance FY 2016/17-2019/20

3.4 Fiscal Deficits

Fiscal deficits are brought about when the government is spending more than it's collecting in terms of its revenue. The Country's fiscal deficits have been growing year in year out often due to excessive expenditure pressures coupled with revenue shortfalls. The situation has been made worse by the outbreak of the Covid-19 pandemic as the government had to concentrate its efforts on controlling the spread of the disease. The Covid-19 pandemic containment measures increased government expenditure while at the same time reduced government revenue. The fiscal deficits often lead to an increase in the public debt stock as the government

has to borrow both domestically and externally to finance the deficit. The persistent fiscal deficits in the government budget in each financial year as shown in table 3.1 are often a result of excessive expenditure pressures coupled with revenue shortfalls.

Table 3.1Trends of Fiscal Deficits and Projection

Year (Billions)	Deficit in the Proposed Budget in the BPS	Deficit in the Approved Budget	Deficit in the Revised Budget	Increase in the deficit within the year	Actual Deficit (Billions)
2014/15	367	417	732	76%	471.57
2015/16	533.2	640.5	732.6	14%	474.57
2016/17	555.4	775	871.6	12%	697,26
2017/18	582.4	594.3	670.4	13%	607.97
2018/19	638.2	608.1	760.6	25%	721.06
2019/20	629.9	673.6	789.9	17%	791.18
2020/21	614.1	898	1,048.9	17%	
2021/22	983.7				

Source of the Data: National Treasury

From table 3.1 actual budget deficits are way above the approved budget estimates. Though they are approved through supplementary budgets, this is a clear indication of poor planning or

a case of fiscal infidelity. The government needs to adhere to its plans and fiscal consolidation measures. This will not only promote fiscal discipline but also reduce the public debt stock.

As a share of GDP, the fiscal deficit has been growing from FY 2017/18 to the current financial year and this is expected to decline from FY 2021/22. Noting that the government had set the deficit at 7.5 percent of the GDP in the current financial year and later revised it to 8.7 percent, it is doubtful that the Country will achieve the target set for the coming financial year. Figure 3.3 shows the fiscal deficit as a percentage of GDP from FY 2016/17 to FY 2019/20 and the projections from FY 2020/21 to FY 2024/25.

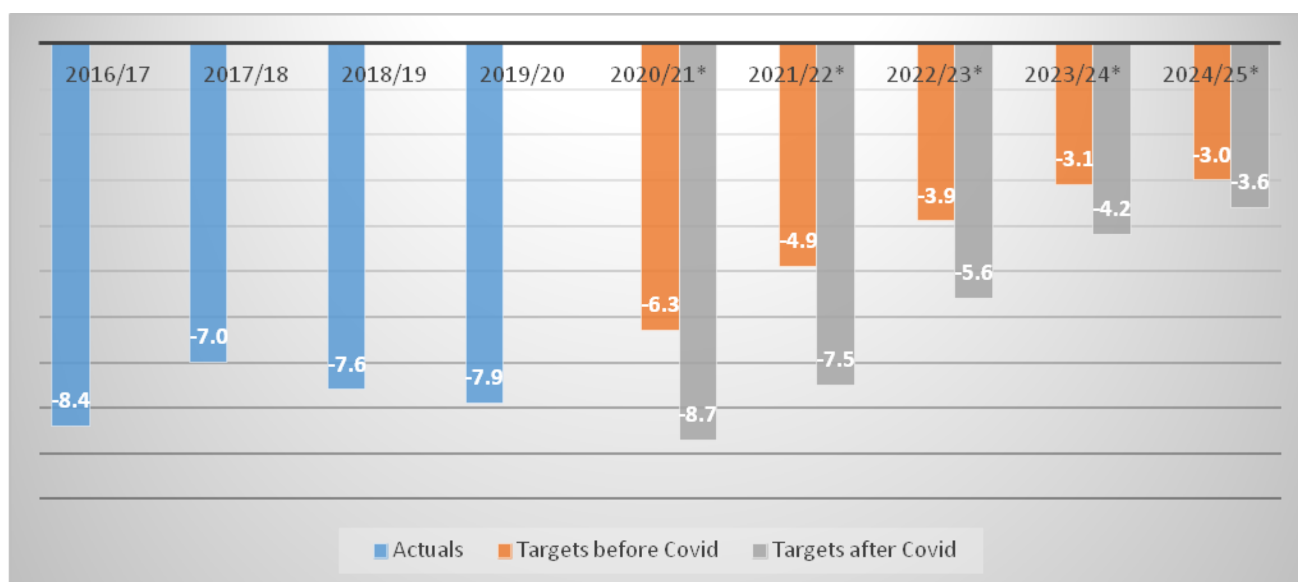

Figure 3.3: Fiscal Deficit as a share of GDP

Source: National Treasury

Figure 3.3 shows that the fiscal deficit as a share of the GDP was projected to decline in the current financial year from 6.3 percent of the GDP to 3 percent in FY 2024/25. However, the National Treasury has since revised these targets upwards due to the pandemic. This is based on

the impact it has had on the economy and the time that will be required to recover fully. This is an indication that public debt will increase each year up to 2024/25. The deficit as a share of GDP for Kenya is greater than the growth of GDP. This implies that debt will keep on growing. It calls for prudent fiscal management to reverse this trend and to keep public debt within sustainable levels. Relatively, a high fiscal deficit in the recent past is the key driver of debt accumulation in Kenya. Thus, reducing fiscal deficit remains a key to stemming public debt accumulation and maintaining debt at sustainable levels.

CHAPTER FOUR

PUBLIC DEBT

4.1 Introduction

This section provides Kenya's overall debt situation and gives in-depth information on the categorization of public loans, their performance, and services.

4.2 Public Debt Trend

Kenya’s public debt in nominal terms as of the end of December 2020 stood at Ksh. 7,281.6 billion, equivalent to 65.6 percent of GDP and about Ksh. 1.7 trillion below the statutory ceiling of Ksh 9.0 trillion (Republic of Kenya 2012). This implies that to accommodate the fiscal deficit in the FY 2021/22 and into the medium term, the statutory debt limit has to be expanded. This is already proposed in the 2021/22 Budget statement. This raises doubts about the government’s commitment to reducing the debt. Table 4.1 shows the level of public debt in Kenya as of the end of December 2020.

Table 4.1: Kenya's Debt as at end of December 2020 (Kshs. billion)

Category	Amount (Kshs Billion)	% of Total Debt	% of GDP
External debt	3,792.80	52	34
Domestic debt	3,488.80	48	31
Total Public Debt	7,281.60		65.6
GDP	11,100.00		

Source of Data: National Treasury, 2021

Total external debt was Ksh. 3,792.8 billion (34.2 percent of GDP) while total domestic debt was Ksh. 3,488.8 billion (31.4 percent of GDP). The National Treasury has already proposed an expansion of the current statutory debt ceiling to accommodate the fiscal deficits in Financial Year 2021/22 and into the medium term. The trend of Kenya's public debt is shown in Figure 4.1.

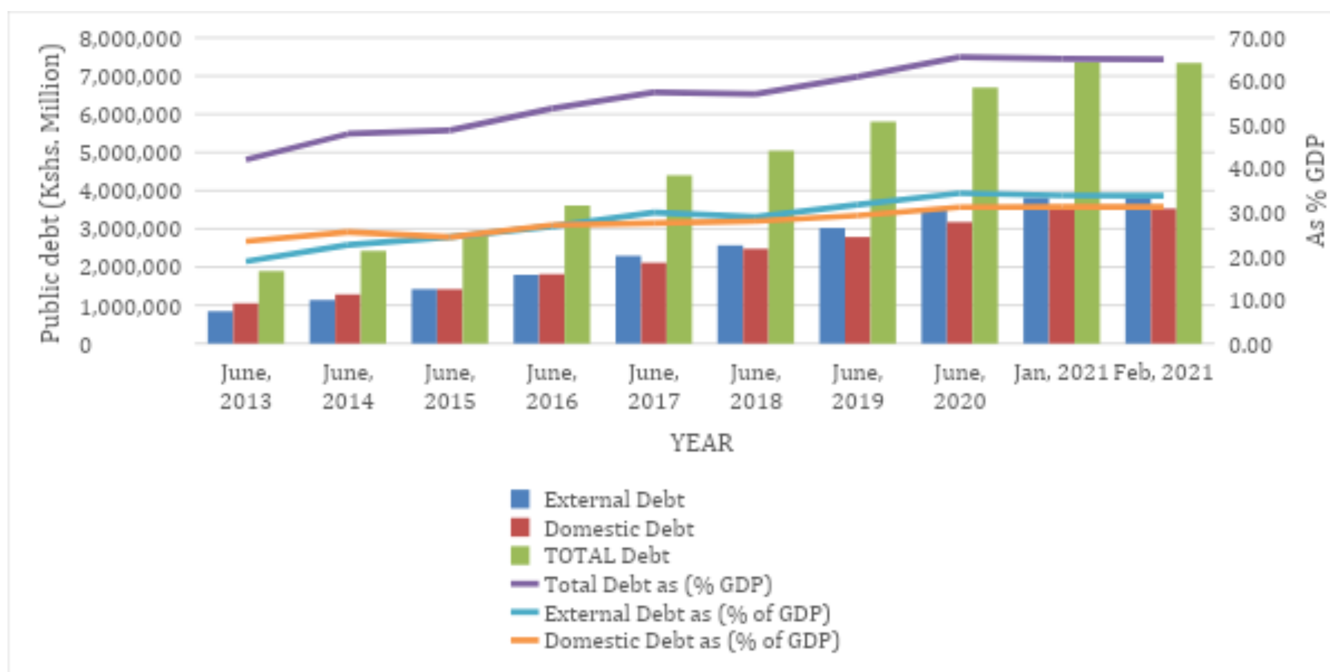

Figure 4.1: Trends in Kenya's Total Public Debt June 2013 - Feb 2021

Source of the data: National Treasury

Kenya's public debt stock increased from Ksh 1.894 trillion in June 2013 to Ksh 6.693 trillion in June 2020. This reflects a 253.4 percent growth in the overall nominal public debt. This is double the growth in the nominal GDP over the same period. Over the same period, external debt increased from Kshs. 843,562 million Kshs. 3,515,812 million while the domestic debt increased from Kshs 1,050,555 to Kshs 3,177,526 million. Kenya's public and publicly guaranteed debt increased by 15.2 percent during the FY 2019/20, with domestic and external debt increasing by 14.1 percent and 16.3 percent, respectively.

The increase in domestic debt was mainly facilitated by a 27.0 percent increase in Treasury bonds which is in line with the Government's objective of achieving a 70:30 ratio of Treasury bonds to Treasury bills in order to reduce the refinancing risk (National Treasury, 2020). This

goal was accomplished through the issuance of medium and long-term Treasury bonds as well as a 364-day Treasury bill switch to a 6-year Infrastructure bond. Consequently, Treasury bills decreased by 6.9 percent to KSh 907.7 billion in June 2020 from KSh 975.3 billion in June 2019. In addition, the domestic debt maturity for all securities improved from 4.94 years in June 2019 to 5.46 years in June 2020, with the average maturity of bonds rising to 7.9 years (CBK, 2020).

Kenya's public and publicly guaranteed external debt increased to KSh 3,515.8 billion in June 2020 and stood at Kshs 3,814.3 billion in February 2021. This was majorly on account of two Development Policy Operations (DPO) in July 2019 (USD 750 million) and May 2020 (USD 1.0 billion) from World Bank and the IMF Rapid Credit Facility (RCF) in support of COVID-19 interventions. The proportion of debt owed to multilateral lenders increased by 7.3 percentage points while that of commercial creditors and bilateral lenders decreased by 4.9 percentage points and 2.4 percentage points, respectively, as the Government sought to restructure external debt through concessionality to reduce its refinancing risk (CBK, 2020).

Figure 4.1 shows that both the domestic and external public debts have an increasing trend but as of June 2017, the external debts surpassed the domestic with a widening margin to February 2021. This was due to an increase in commercial, bilateral, and multilateral debts incurred especially in the year 2020 to cushion the economy against the effect of the Covid-19 pandemic. The government policy targets a 60:40 external to domestic debt mix although this ratio has never been met.

The ratio of public debt to GDP rose to 65.6 percent in June 2020 from 62.4 percent in June 2019 (CBK, 2020). This increase in public debt was due to external loan disbursement and

uptake of domestic debt during the period to address the pandemic. As a share of GDP, public debt peaked at 65.6 percent of the GDP in June 2020, thereafter, declined to 65.2 percent in January 2021 and 65.1 percent of the GDP in February 2021. There is no economic limit to public debt provided the citizens are willing to pay for a high primary surplus. Debt ratios have reached 200% of GDP or more in some countries without defaulting. However, defaults at lower debt levels were common before the 19th century and still occur in developing and emerging economies. Reinhart, Rogoff, and Savastano (2003) claim that 'debt intolerance' can set in at low debt-to-GDP ratios and that debt has negative consequences on growth when the debt ratio reaches 90 percent of GDP for developed economies and 60 percent in emerging economies. However, there is a big controversy on these thresholds.

The National Treasury's debt management strategy sets the debt strategy target mix of 60:40 i.e. external to domestic debt mix. Kenya has been unable to meet this debt strategy target mix which stood at 52.5:47.5 in June 2020. This is shown in figure 4.2.

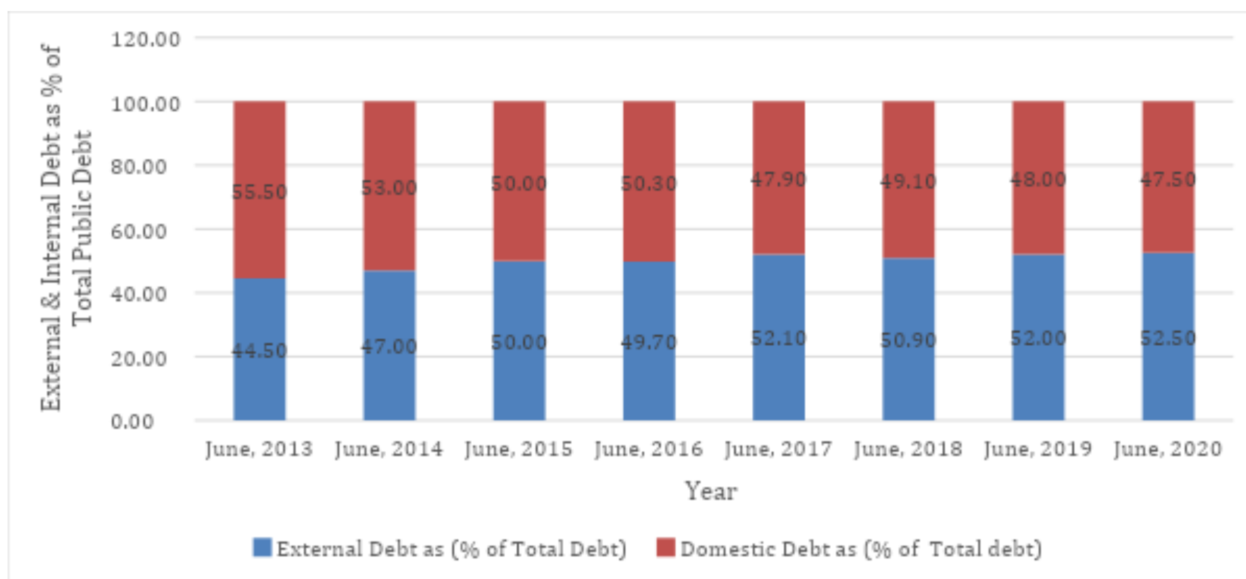

Figure 4.2: Public Debt Mix for June 2013 - June 2020

Source of Data: The National Treasury

As of June 2020, external debt was Ksh 3.52 trillion while domestic debt amounted to Ksh 3.18 trillion indicating a 52.5:47.5 mix. This was a slight improvement from 48:52 recorded in June 2019. Figure 4.2 shows that the share of domestic debt portrays a downward trajectory from June 2013 to June 2020. The share of domestic debt to total public debt declined from 55.5 percent in June 2013 to 47.5 percent in June 2020. This is attributed to favorable borrowing terms which match government borrowing with Kenya's loan portfolio (Republic of Kenya, 2016).

4.3 Domestic Debt

Domestic debt instruments comprise of government securities (treasury bonds and treasury bills) pre-1997, Government debt, and Government Overdraft facility at the Central Bank of Kenya to be used by the Government of Kenya for cash management purposes (Republic of Kenya, 2019). Figure 4.3 presents the composition of domestic debt for the period June 2013 to June 2020.

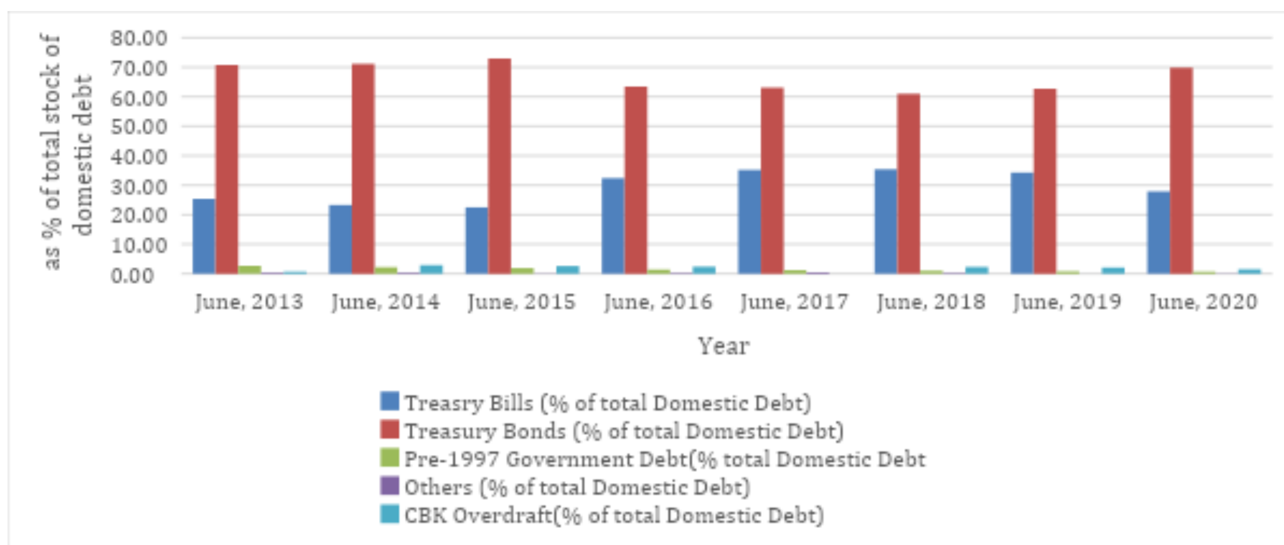

Figure 4.3: Composition of Domestic Debt in Kenya 2013 -2020

Source of Data: The National Treasury

Government securities dominate Kenya's domestic debt mix. In June 2020, Treasury bills and Treasury bonds accounted for 97.8 percent of total domestic debt. Treasury bonds constitute the largest share of the domestic debt stock. This is in line with the government policy of reducing Treasury Bills which pose refinancing risk since they are short-term (CBK, 2020). The government securities debt mix is illustrated in figure 4.4.

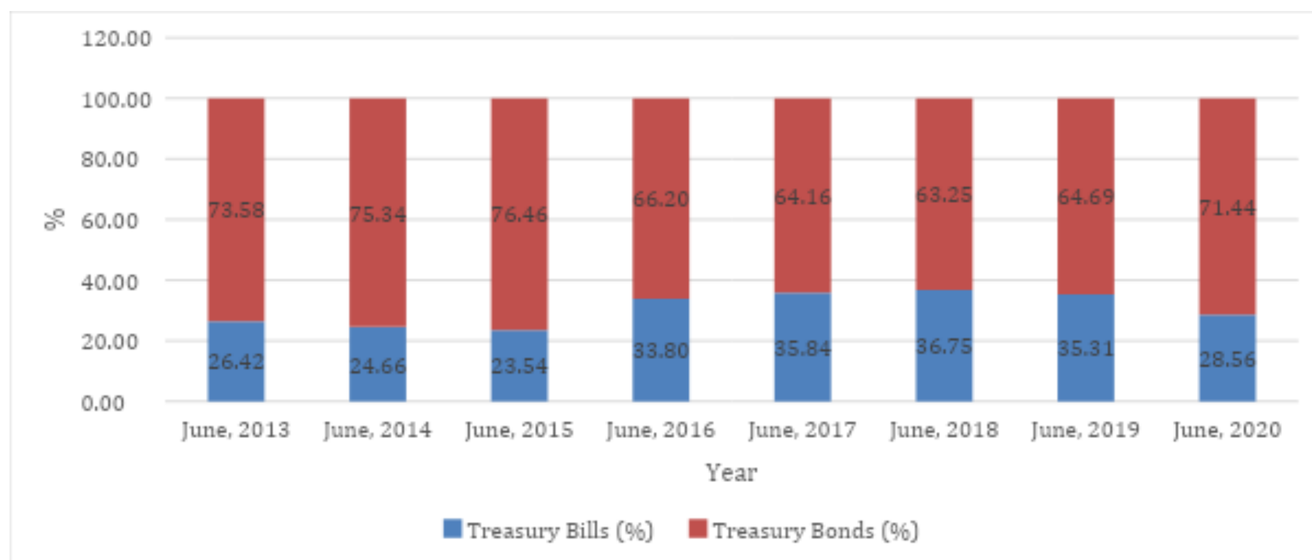

Figure 4.4: Domestic debt mix of Treasury bills and Treasury bonds 2013 -2020

Source of Data: The National Treasury

Figure 4.4 shows that Treasury Bills issuance has been on the decreasing trend from July 2017 to the same period in 2020. This is due to an increase in maturity from 4.94 years in 2019 to 5.46 years in 2020. However, pre-2017 government debt remained fairly low about 1.2 percent and below. Treasury Bonds issuance is on an increasing trend over the period. This is in order to achieve the government's objective of maintaining Treasury Bills to Treasury Bonds ratio of 7:3 to avoid the risks of refinancing. This was achieved through the issuance of medium- and long-term bonds and also converting 364-day treasury bills into 6-year infrastructure bonds to finance development projects (CBK, 2020).

The domestic debt mix of Treasury Bonds and Treasury Bills stood at 71:29 in June 2020 against the domestic debt strategy target mix of 80:20 (Republic of Kenya, 2020). Treasury Bills debt increased from 23.54 percent in June 2015 to 36.75 percent in June 2018 before dropping to 29 percent in June 2020. Large shares of Treasury Bills can pose a restructuring and refinancing risk

since Treasury Bills are short-term and are used as a cash management tool. It is important to note that Kenya's domestic debt is mainly held by commercial banks. On average, commercial banks hold more than half of Kenya's domestic debt. This could increase the risk of crowding out of private sector investments due to credit shortages and the effects of domestic borrowing on the interest rates. Studies conducted in other jurisdictions revealed a substantial adverse effect of state borrowing over private credit with a crowding-out effect of more than one to one (Lau, Tan & Liew,2019). The crowding out effect arises when the rate of domestic interest increases to reduce the spending habit of private investments, thereby reducing the initial increase in total investment spending in the domestic economy Yule, 2013).

The government has not been able to meet all its debt management targets. This questions the reliability and validity of the government estimates and their commitment to the attainment of their own set targets. This increases fiscal risk and undermines fiscal consolidation policies.

4.4 External Debts

Kenya's public and publicly guaranteed external debts are on the increasing trend to around Kshs. 3,515.8 billion in June 2020. This is due to two Development Policy Operations (DPO) incurred in 2019 amounting to USD 750 million and in 2020 of USD 1 billion from World Bank as well as IMF RCF (CBK, 2020). Figure 4.5 shows the trends and the composition of external debt from June 2013 to June 2020.

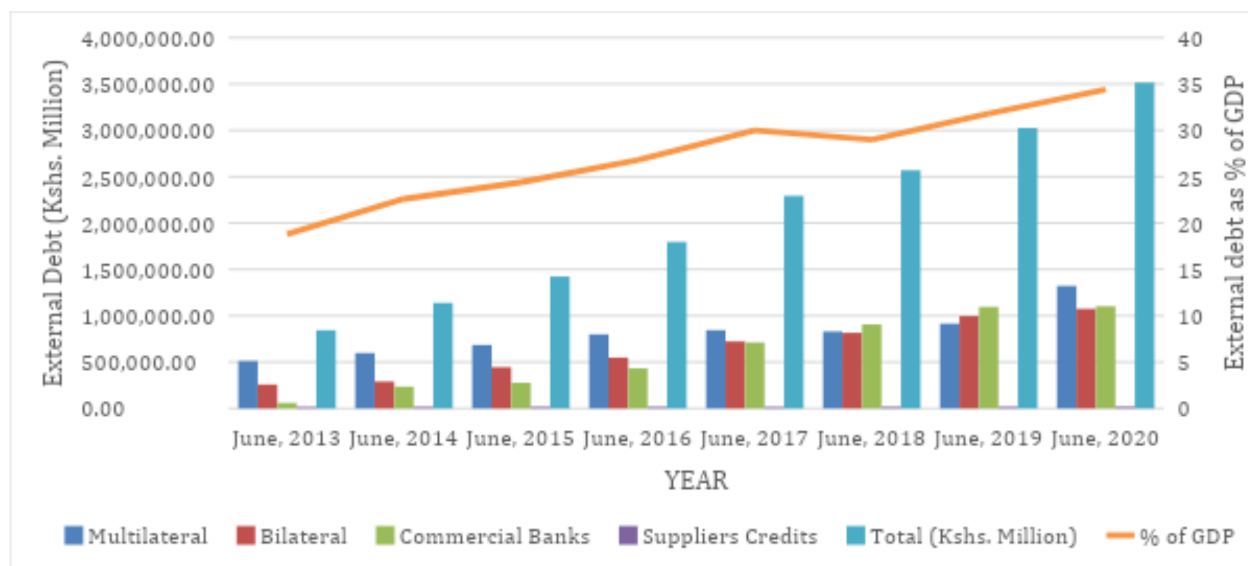

Figure 4.5: Trends and composition of external debts 2013 - 2020

Source of Data: The National Treasury

Figure 4.4 shows that Kenya's external debt is on the increasing trend from June 2013 to the same period in 2020. The external debt has increased from Kshs. 843.6 billion in June 2013 to Ksh. 3,515.6 billion in June 2020. As a percent of GDP, the share of external debt has increased from 18.8 percent to 34.4 percent over the same period. The increase in external debt is due to the issuance of sovereign bonds, commercial syndicated loans, an increase in bilateral credits, and foreign exchange rate fluctuations. The share of commercial debt in total external debt has been from 2013 to 2020. This growth in commercial loans can be attributed to the issuance of Eurobonds in 2014 and 2018 to support the government budget as well as finance infrastructure projects. The increase in commercial debt stock can also be attributed to the depreciation of foreign exchange. This is not good for debt sustainability because commercial loans are costly.

Multilateral debts have also increased from Kshs 511.8 billion in 2013 to Kshs. 1,321.6 billion in June 2020. This was attributed to the government contracting concessional debt from the World Bank, IMF, IBRD, and AfDB. This is in accordance with the government debt strategy of contracting debt on concessional terms (Republic of Kenya, 2020). Multilateral debt increased by 7.3 percent from June 2019 to June 2020 while that of commercial creditors increased by 4.9 percent and bilateral debt increased by 2.4 percent over the same period. This is because the government sought to restructure external debt through concession to reduce the risk of refinancing (CBK, 2020).

Kenya's external debts mature at different times depending on the terms of agreement and the amount of debt incurred. The remaining maturity period for the public and publicly guaranteed external debts is shown in figure 4.6.

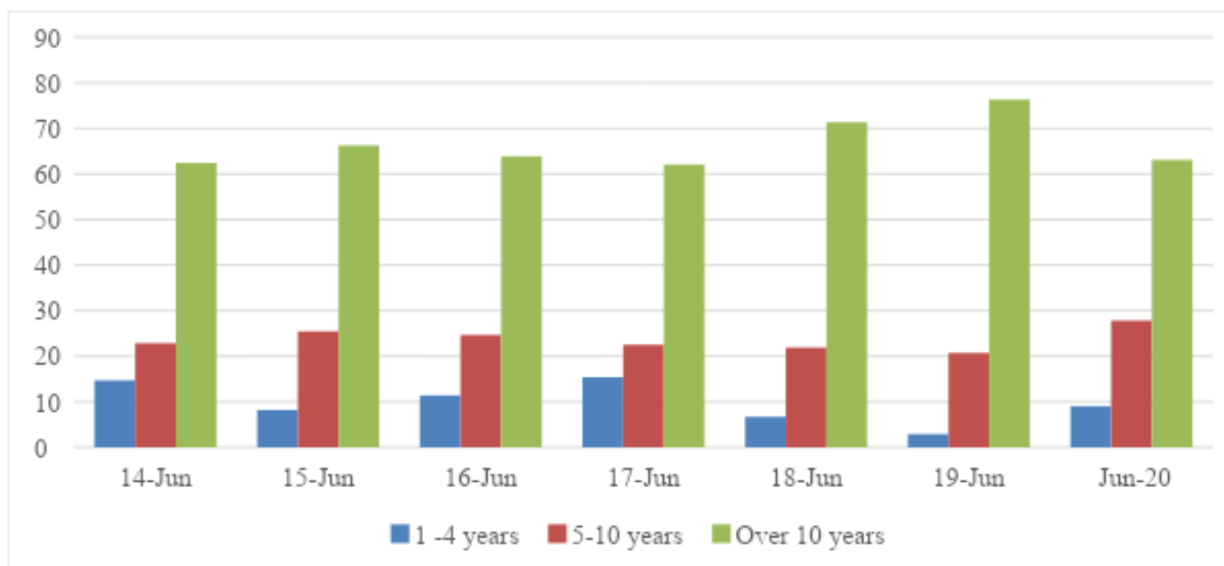

Figure 4.6: Remaining Maturity Period

Source of Data: The National Treasury

The figure shows outstanding debt by maturity structure in terms of 1-4 years, 5-10 years, and over 10 years. The outstanding external debt with the remaining maturity period of over 10 years constitutes the largest amount followed by 5-10 years and lastly 1-4 years. This is due to renegotiations and concessions of these loans by the lenders such as the IMF and World Bank. The public and publicly guaranteed external debts with the longest remaining maturity period allow the incurring country enough time to reorganize and honor debt obligations so as to have a good rating in the international market.

In conclusion, the accumulation of external debt poses a high risk of debt distress particularly in Kenya where primary exports are declining coupled with exchange rate volatility. This affects the inflow of the foreign exchange necessary to repay the external debt. In most cases, governments are forced to borrow to retire debts. In addition, depreciation of the Kenya Shilling poses a fiscal risk. This is because 50 percent of the public debt is held in external currencies (Republic of Kenya, 2021). Thus, any depreciation of the Kenya Shilling translates to a rise in public debt stock and an increase in debt service costs over and above the budget in local currency.

4.5 Public Debt Service

Kenya's public debt service includes cumulative interest and other charges on domestic and external debt for the year 2019/20 which increased by 15.8 percent and 17.9 percent, respectively. Despite the increase in external interest payments, total external debt service decreased during the FY 2019/20 due to a significant reduction in principal repayments as there were no one-off repayments of commercial loans during the financial year (CBK, 2020). Figure 4.7 shows public debt service from January 2015 to January 2020 as a percentage of total debt service, revenue, exports, respectively. It also shows domestic debt service as a percentage of total debt service and total external debt service as a percentage of total debt service.

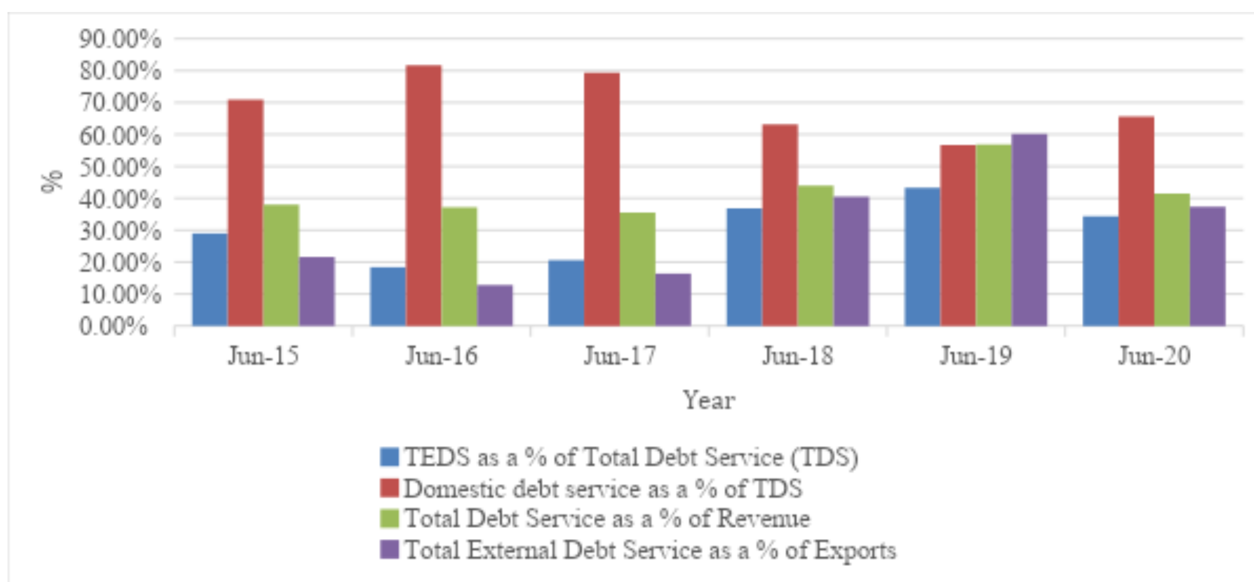

Figure 4.7: Trend of public Debt Service

Source of Data: National Treasury

Public debt service has been increasing but the largest share comprises the domestic debt service due to the higher cost of domestic debt (Figure 4.7). The share of domestic debt service increased from 70 percent in January 2015 to a high of 81.6 percent in January 2016. The

increase in domestic debt service was partly driven by the increased uptake of Treasury Bills and higher service cost of Treasury Bonds in some years. Domestic debt service as a percentage of total debt is the highest with a decreasing trend implying that the government has concentrated so much on domestic debt servicing at the expense of other debts. As a share of export, external debt service increased from 21.6 percent in January 2015 to a high of 60.1 percent in January 2019. This is mainly attributed to the increased uptake of commercial loans over time. This debt distress risk indicator has yet breached the IMF threshold for middle-income countries.

4.6 Debt ceiling

Debt ceilings/limit determines the maximum amount of debt that a government can undertake. Often, they are imposed by governments as part of measures to ensure fiscal discipline and promote debt sustainability. Thus, debt targets are set below debt ceilings to create a buffer between the actual debt levels and the specified ceiling. Governments may impose debt ceilings in nominal terms (specified in absolute numbers of specific currency) or relative terms (expressed as a percentage of GDP). Most countries express their ceiling in relative terms. However, Denmark, the US, and recently Kenya use nominal debt limits. As such, the country's legal framework ought to be precise in terms of the type of ceiling envisioned.

4.7 Debt Sustainability Analysis

Kenya’s debt remains highly susceptible as the risk of debt distress has moved from low risk in 2017 to moderate risk in 2018 and now approaching high risk in 2020 due to the impact of the Covid-19 pandemic which has exacerbated the existing vulnerabilities. The level of export and

economic growth has declined sharply due to the Covid-19 pandemic which requires a strong fiscal response to address. Kenya's overall public debt has increased recently to about 65.6 percent by end of 2020 and most of the debt remains on concessional terms but the commercial component of debt has also increased. Composite Indicator (CI) shows that Kenya has a strong debt carrying capacity which determines the Public and Publicly Guaranteed (PPG) external debt indicative thresholds and total public debt benchmarks.

Global shock resulting from COVID-19 has breached the threshold under the baseline scenario in 2020-2024. The present value of the Public and Publicly Guaranteed (PPG) external debt-to-export ratio breaches the indicative threshold of 240 percent in 2020-2024 as exports have been hit by global shocks. The trend is gradually declining over the period as exports recover from global shocks. The Present Value of the PPG external debt-to-GDP ratio remains firmly below 55 percent. Total public debt as a share of GDP is expected to increase through 2022 on the backdrop of the COVID-19 pandemic, then decline gradually over the medium term to long term and later remain fairly below the benchmark as shown in table 4.2;

Table 4.2: Total Public Debt Sustainability

		Actual					
Indicators	Threshold	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
PV of debt-to-GDP ratio	70	49	48.6	57.6	61.3	63.4	63.9
PV of public debt-to revenue & grants ratio	300	235.7	226.6	313.9	338.1	356.6	357.4

PPG debt-to-export ratio	21	27.5	25.9	25.5	24.4	36.1	24.1
PPG debt service-to-revenue ratio	30	38.2	42.3	33.4	53.8	68	74.5

Source: IMF, 2020

From table 4.2 it shows that the PV of debt to GDP ratio is below the indicative threshold of 70 percent in 2017–2022, implying Kenya's total debt is sustainable and the country can honor its debt by GDP raised. However, the PPG debt to export ratio is above the threshold implying that exports earnings cannot meet the debt incurred by the country as Kenya's exports of goods and services have been hit by the global COVID-19 shock, but the ratio gradually declines over the remaining projected period as exports are expected to recover from the global shock. The PV of PPG debt service to revenue is above the threshold of 30 and hit the highest level of 74.5 in 2022; similarly, the scenario is the same for the PPG debt to export ratio. However, the PV of public debt to revenue is below the threshold in 2017 and 2018, thereafter, increases steadily in 2019 from 313.9 to 357.4 in 2022. This implies that revenue generated cannot meet the debt obligations of the country and hence debt servicing. Hence, the analysis of public debt shows a deteriorating trend. Consequently, the total debt position is expected to improve over the projected period.

The sustainability of the external debt is also evaluated using the same framework. However, the base scenario thresholds are different. The analysis of Kenya's external debt is presented in table 4.3.

Table 4.3: Kenya's External Debt Sustainability

Indicators	**Thresholds**	**2019**	**2020**	**2021**	**2022**	**2023**

PV of external debt–to-GDP ratio	55	27.6	26.8	27.9	27.8	27.6
PV of external debt– to- exports ratio	240	225.2	288.1	260.6	258.5	255.2
PPG external debt service-to-exports ratio	21	31.4	27.5	25.9	25.5	24.4
PPG external debt service-to-revenue ratio	23	21.3	14.5	15.9	15.7	14.8

Source: IMF, 2020

The table above shows that total external public debt as a share of GDP is projected to increase 27.8 in 2022 on the back of the COVID-19 global shock, and decline to 27.6 in 2023. PV of external debt-to-GDP is projected to remain below the indicative benchmark in PV terms. The PV of external public debt to revenue ratio remains below the threshold and stable over the period implying that the country would honor its debt from revenue raised. However, PPG external debt service to exports ratio is above the threshold but declining over the period to 2023 implying that it is unsustainable. Similarly, PV of external debt to export ratio is above the threshold and increases in 2020 to 288.1, then declines to 255.2 in 2023. Luckily, the debt service-to-revenue ratio is expected to remain stable in the longer term.

Debt as a % GDP is forecast to peak in 2022 and 2023 and then fall indicating that Kenya was already vulnerable before the COVID-19 pandemic struck. This is because it had already breached two of the public debt sustainability indicators and two of the external debt sustainability thresholds. In addition, the budget deficit as a percentage of GDP was already higher than the real growth rate of GDP and interest payments as a percentage of GDP have been increasing. Therefore, it is expected that the situation will worsen now that the country is

in the middle of a pandemic whose impact will continue to be felt in the medium term; the peak is expected in the year 2023. Therefore, the economy requires more intensive macro-fiscal adjustments than was initially planned to recover in order to maintain sustainable debt levels.

CHAPTER FIVE

LEGAL, POLICY AND INSTITUTIONAL FRAMEWORK

5.1 Introduction

In a country, efficient public sector borrowing requires an effective and transparent legal, policy, and institutional framework. This chapter interrogates the role of the legal, policy, and institutional framework involved in public debt acquisition and management in Kenya. Kenya being a devolved government, both the national government and county governments have the power to raise external loans; as such there are different institutions cutting across the nation and the county governments dealing with public debt. The institutions include the legislature, the executive, the central bank of Kenya, the public debt management office, county assemblies, and the county executive committee.

5.2 The Legislature

Best practice requires that the existing law such as the Constitution, PFM Act, or an Act of Parliament accord the legislature power to borrow or act as a guarantor on the government's behalf. In Kenya, the Parliament is responsible for approving new loans that the Government intends to acquire and approving the amount to be borrowed domestically in a given year as provided for in the Constitution of Kenya, 2010 and the PFM Act, 2012. In Kenya, the legislature comprises both the National Assembly and the Senate. However, the Senate has no role on national government public debt unless it affects the county governments. The legislature is

mandated to enact laws on public debt. Its role is to promote public debt sustainability by ensuring the debt levels abide by the set fiscal objectives. The legislature is required to ensure that the National and county governments limit their borrowing to the public debt threshold and purpose of borrowing. The National Treasury sets out the government borrowing levels in the medium-term debt management strategy which is then approved by the parliament. While the parliament lacks powers to approve new borrowings, it should be noted that the parliament approves the annual budget estimates of the National Government.[1]

In the National Assembly's on the budget policy statement and the medium-term debt management strategy for financial year 2020/2021, the National Assembly voiced concerns of Kenya's vulnerability associated with debt service where the debt service to revenue ratio, breached its threshold of 30 percent according to the recent debt sustainability assessment by the IMF and is projected to remain above the threshold over the medium term. In addition, under the external debt sustainability ratios, the debt service to exports ratio has also been breached.[2] The legislature, while raising all these concerns in its reports on public debt management in the country, continues to approve budgets with huge budget deficits thus giving the National Treasury ground to procure more debt to finance the annual budgets. In the current financial year 2020/21, the legislature approved a fiscal deficit of Kshs 614.1 billion in the proposed Budget Policy Statement Ceilings, in the approved budget a fiscal deficit of Kshs 898 billion and Kshs 1048.9 billion in the supplementary budget.[3] It has also failed to hold the

[1] Section 39 of the Public Finance Management Act 2012 Link
[2] REPORT OF THE BUDGET AND APPROPRIATIONS COMMITTEE ON THE BUDGET POLICY STATEMENT AND THE MEDIUM-TERM DEBT MANAGEMENT STRATEGY FOR FINANCIAL YEAR 2020/2021 Link
[3] BPS 2020, Approved PBB 2020-21, Supplementary Budget 2020-21

executive accountable in providing comprehensive information in terms of public debt contracting terms and the debt register. The legislature also approved to move the debt ceiling from 50% of GDP to Ksh. 9 trillion, to which projections show we are close to hitting in the next two financial years.[4]

5.3 The Executive

The executive has the power to raise loans from within and outside the country through the national treasury. The Constitution of Kenya, 2010 grants the authority for all government borrowing to the Cabinet Secretary, National Treasury subject to Parliamentary approval. Further, the Constitution and Section 12 of the PFM Act mandates the National Treasury to manage the level and composition of national public debt, national guarantees and other financial obligations of national government within the PFM framework and develop a framework for sustainable debt control. The National treasury has been mandated to deal with the finances of the country which includes raising loans within and outside the country.[5] All the country's borrowings are initiated by the national government and documents signed by the cabinet secretary in charge of the National treasury.

The cabinet secretary in charge of The National Treasury, is required to 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 212(2) of the Constitution.[6]In addition, the cabinet secretary is required to submit the Medium Term Debt Management Strategy (MTDS) annually which states the debt management strategy of the national

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[4] Business Daily: Treasury to hit Sh9 trillion debt ceiling in two years Link
[5] Article 225(1) of the Constitution Link, Section 11 of the Public Finance Management Act 2012 Link
[6] Link

government over the medium term with respect to its actual liability and potential liability of the loans.[7]

According to legislation, the executive wields all the power to raise loans on behalf of the national government. This implies that the executive does not have to seek permission from anyone to seek loans within or without the country. There is a need to amend the law to provide for Parliament to approve any loan proposals by the executive so that if Parliament is not satisfied by the Executive's reasons for raising the loans, then Parliament can turn the proposal down.

5.3.1 The Public Debt Management Office (PDMO)

International best practice requires that debt functions are centralized in a single office. Centralization of debt functions in one single office or department reduces fragmentation while increasing coordination in debt management (IMF, 2018). In most countries, debt management functions are consolidated under a single office termed as Debt Management Office/Department/Unit. This aids governments to maintain a holistic view on all its debt obligations hence enhancing effective risk management of the overall debt portfolio.

In Kenya, PDMO was established within the National Treasury under Section 62 of the PFM Act with three main objectives. These are: to minimize the cost of debt management and borrowing over the long-term taking account of risk, to promote the development of a market for government debt securities and to ensure equity in the sharing of benefits and costs of public

[7] Section 33 of the public finance Management Act 2012 Link

debt between the current and future generations. The office is mandated to prepare and submit various reports to the Cabinet Secretary for submission to Parliament and Commission on Revenue Allocation. Some of the reports include: The Medium-Term Debt Strategy, the government borrowing plan for approved Annual Budget, statistical and analytical reports on debt and borrowing and report of all loans made to the national government, national government entities and county governments. The overall functions of the PDMO are outlined under Section 63 of the PFM Act and Section 61 of the Debt and Borrowing Policy 2020 to include; carrying out the government's debt management policy of minimizing its financing cost, and maintaining a reliable dataset for all loans taken by the national government. It also includes preparing and updating the medium term debt strategy including debt sustainability analysis, managing financial transactions on public debt and borrowing and supporting county governments and public entities on debt management and capacity development among others. The involvement of the PDMO office is not felt in public debt management as it is overshadowed by the national treasury.

5.4 The Central Bank

The Central Bank of Kenya is established under Article 231 of the Constitution and backed by an act of parliament[8]. The principal objective of the Bank is to formulate and implement monetary policy directed to achieving and maintaining stability in the general level of prices.[9] Other objectives include to formulate and implement foreign exchange policy, hold, and manage its foreign exchange reserves. Within the central Bank there is the Monetary Policy Committee,

[8] Section 3 of the Central Bank of Kenya Act

[9] Section 4 of the Central Bank of Kenya Act

which shall have the responsibility within the Bank for formulating monetary policy and advising the government on its debt ceilings and sustainability of new borrowings.

Section 44 of the Central Bank of Kenya Act provides for CBK to act as fiscal agent and banker to the Government while highlighting its functions. In Kenya, Section 45 of the Central Bank of Kenya Act provides the legal framework for the Bank to manage public domestic debt on behalf of the government. This includes contracting domestic debt through sale of Treasury Bills and Bonds, extending overdraft facilities to the Government, maintaining domestic debt register and making payments of domestic debt. As a Banker to the Government, CBK effects payments to external creditors on specific instructions from the National Treasury.

5.5 The Attorney General's (AG) Office

This is the principal legal adviser to the Government and is responsible for reviewing draft loan agreements to ensure conformity with the relevant legislation. In the Debt Policy and Borrowing Framework, the AG's Office is required to offer advisory services to the National Treasury regarding negotiations, drafting and interpretations of local and international documents, agreements and treaties. Further, where legal opinion is required by a creditor on the validity of loan documents, the AG's office is mandated to advise.

5.6 The Office of Controller of Budget (CoB)

CoB was established under Article 228 of the Constitution of Kenya, 2010 to oversee implementation of the budgets of the National and County governments by authorizing withdrawals from public funds. It is also responsible for issuance of authority to debit the Consolidated Fund Service account to settle government debts and undertake periodic audits of

public debt. The office as outlined in the Debt Policy and Borrowing Framework is mandated to oversee the utilization of budgeted borrowed funds for the national and county governments by authorizing withdrawals from public funds.

5.7 County Government's borrowing framework

The county government borrowing framework is stipulated in the Constitution of Kenya, 2010, the PFM Act, 2012, and the County Governments Act, 2012. The overarching legal mandate for counties to borrow is outlined in Section 212 of the Constitution of Kenya, 2010. The county governments are given a window to borrow in Section 212 of the Constitution subject to the Nation Government's guarantee and county government's assembly approval. This is affirmed in Section 8 of the County Governments Act, 2012 where the county assembly is mandated to approve the county borrowing in accordance with Section 212 of the Constitution. The constitutional provision on county borrowing is operationalized by various sections of the PFM Act, 2012. Section 58 of the PFM Act grants powers to the Cabinet Secretary in charge of The National Treasury to guarantee loans of county governments and other borrowers on behalf of the national government subject to Parliamentary approval. The Cabinet Secretary guarantees the loan under the caveats as per Section 58(2) of the PFM Act.

5.5 Key Laws and Policy Documents

The following key laws and Policy documents guide public debt management in Kenya:

a) **Public Debt and Borrowing Policy, 2020**. The policy is meant to act as a guideline for debt management practices of the National government including the issuance process, management of the debt portfolio, and adherence to various laws and regulations governing debt contracting and management. With this

policy, there will be an improvement in the quality of decisions, better articulation of policy goals, clearer guidelines for the structure of debt issuance, and a demonstration of commitment to long-term capital and financial planning.

b) **The Medium-Term Debt Management Strategy (MTDS).** It is published every year as required by the Public Finance Management (PFM) Act, 2012 (33 (2)) and it should be consistent with that year's Budget Policy Statement. The MTDS evaluates the costs and risks of several alternative financing options under specific macroeconomic assumptions, and shock scenarios to determine a financing option that is feasible. The MTDS is prepared to take into account the terms of any anticipated borrowing, the type of borrowing, and the attendant risks or shocks that may impact the government's ability to meet its debt obligations, taking into account new developments in the market.

c) **The Constitution of Kenya, 2010**. The Constitution of Kenya is the supreme law of the Republic of Kenya. One of the key salient elements of a sound Public Debt Management legal framework is the scope of public debt (Awadzi, 2015). This entails the definition, relevant public debt institutions, and public debt instruments representing liabilities. The Constitution of Kenya, 2010, under Article 214(2), defines public debt to comprise all financial obligations attendant to loans raised or guaranteed and securities issued or guaranteed by the national government. In addition, it outlines that the National Government can raise or guarantee loans under the terms and conditions prescribed by an Act of Parliament.

d) **Public Finance Management (PFM) Act 2012 and Public Finance Management Regulations 2016.** An ACT of Parliament to provide 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.

e) **Finance Act**- an ACT of Parliament to amend the laws relating to various taxes and duties and for matters incidental thereto. This is the law that operationalizes the government budget.

f) The Central Bank of Kenya Act, 2014- An Act of Parliament to establish the Central Bank of Kenya and to provide for the operation thereof; to establish the currency of Kenya and for matters connected therewith and related thereto.

CHAPTER SIX

CONCLUSION AND RECOMMENDATIONS

6.1. Conclusion

The build-up of public debt has been more pronounced in the period between 2013 and 2020 compared to the pre-2013 period. Total public debt accumulation between June 2013 and December 2020 is Kshs 5.458 trillion, six times the amount accumulated between 1963 and 2012. Increased debt accumulation is partly attributed to increased infrastructure investment and implementation of the Constitution of Kenya 2010.

The Kenya government has been unable to meet its own set targets on public debt management and sustainability. For example, the attainment of the external to domestic debt strategy mix of 60:40 has been a great challenge for the country. The share of domestic debt in total public debt has been higher than the targeted 40 percent share. As of June 2020, the share of domestic debt stood at 48 percent. This poses the risk of crowding out private investment since most of Kenya's domestic debt is mainly held by commercial banks. In addition, the domestic debt strategy mix is 80:20, for treasury bonds to treasury bills. Even though this target has never been attained, it has improved over time and stood at 71:29 as of June 2020. On the external debt, the share of commercial loans in total external debt has been increasing in the last seven years driven by the need to support infrastructure projects and other elements in the government budget. The share of commercial debt stood at 30.5 percent in June 2020. This could adversely affect the risk of debt distress. It is also risky and costly given that these debts are held in foreign currency. Equally important to note is that public debt increases the domestic interest rates by crowding out private investment (Lau, Tan & Liew, 2019). It also increases the use of fiscal and financial resources through debt servicing costs that would otherwise be reserved for private investment to boost economic growth. In principle, government borrowing affects the economic growth of a country through the lending rate on the private investment component of real economic output (Anyanwu, Gan, & Hu, 2018).

In general, Kenya seems to have a sound legal framework for debt. However, there are issues that can be addressed to ensure that PDM is effective. First, there is a need for the government to adhere to fiscal responsibilities where borrowing is paramount. This will ensure that the government does not exceed its borrowing limits. Secondly, Parliament should be independent

and do its budgetary responsibility without influence by the executive. Right now the national assembly is an extension of the executive in the sense that what the executive wants will always sail through the Parliament. There is a Parliament captured by the executive. Thirdly, while the Kenyan PDM allows for contingent liabilities, guarantees, and loans, it does not provide comprehensive coverage of other contingent liabilities. As such, it is important to increase the scope of such liabilities to cover liabilities that arise from court judgements, natural disasters such as flooding and droughts. Lastly, issues of prudent use of public debt, coupled with transparency and accountability are essential in ensuring that borrowed funds achieve development goals or are spent on the intended projects and programs so as to avoid wastage. This would enhance value for money. Though one of the principles of public finance is transparency and accountability, in reality, the issue of public debt in Kenya is treated with a lot of secrecy in the National Treasury. There has been no public participation in public debt issues in Kenya.

Debt sustainability analysis is crucial for a country, including Kenya, to ensure that debt is taken based on the country's carrying capacity and repayment ability. Kenya's public debt is not sustainable based on the fact that some thresholds have been breached already, an indication of a high risk of debt distress. In addition, Kenya's move to IMF Extended Credit Facility (ECF) and the Extended Fund Facility (EFF) already approved is an indication of public debt distress in Kenya. Kenya lacks political goodwill and commitment to public debt reduction. This is demonstrated by Parliament's consistent approval of relatively high budget deficits in the recent past and intention to expand the debt ceiling. The issue of political goodwill and commitment is very important in public debt management and sustainability. For example, the case of

Botswana ensures adherence and compliance to its debt ceilings. Similarly, although Chile struggled with debt problems in the 1990s, political goodwill, fiscal council, and fiscal rules have played an important role to get back to overcoming her debt problems. For Kenya, the establishment of debt rules, revenue rules, and balanced budget rules are a step in the right direction, hence focus should be turned to ensuring implementation of the rules and the need to strengthen the country's capacity to undertake DSA. However, historically Kenya has been very poor in adhering to its own rules and policy.

Public debt interest payments have been increasing at a rate higher than the growth in ordinary government revenue and GDP. A substantial proportion of the Government budget allocation is to service public debt, leaving inadequate financial resources for social development programs. To deal with the problem of the public debt and debt servicing increasing every day without limit, an actual ceiling of Ksh 9 trillion was set. However, the national treasury has proposed expansion of this ceiling to finance the 2012/2022 budget and medium-term budget. There are several legislations and institutions in Kenya which should be adequate to deal appropriately with the ballooning public debt, however, that is not the case and the important question is how we put public debt growth back in control.

It is equally clear that according to legislation, the executive wields all the power to raise loans on behalf of the Kenyans, this also implies that the executive does not have to seek permission from anyone to incur loans locally or externally. There is a need to amend the law to provide for the parliament approval of any public borrowing. The problem of ballooning debt has equally been caused by a lack of accountability and punishment mechanisms. There are no strong accountability mechanisms in place for the treasury and executive to be held accountable for

their unchecked borrowing which ensures that the public debt keeps rising no matter the consequences. There is a need to put in place accountability mechanisms with stringent and punitive punishment for breach of legislation on public debt.

6.2 Recommendations

To facilitate dialogue between civil society and governments, the public debt register should be open to the Kenyan public for scrutiny. Such a register should be comprehensive and must contain all relevant information about the public debt in Kenya like the creditors when the debt was contracted, the amount involved, how much has been paid, and the outstanding balance. This will enhance transparency and accountability on the management and sustainability of public debt. However, given the Kenya government's hesitancy to embrace the imperative of freedom to information and public participation it may still be a long way before the Kenyan civil society and public at large can consider themselves a necessary part of the public debt management.

In order for the operationalization of the public debt and borrowing policy to be effective, it is necessary for the Kenya government to institute legal reform measures that should regulate external and domestic debt contracting. This needs to go beyond addressing the challenges associated with overdraft procedures and mechanisms to structure and composition of public debts as well as the cost and risk of the debt portfolio within acceptable tolerances. It is also important to review the existing legislation to align it to the policy.

Parliament should play its budgetary role without undue influence by the executive. According to the Constitution of Kenya 2010, budget making and approval is the responsibility of the

National assembly. Ensuring balanced budgets and adhering to fiscal consolidation measures is key to reducing the public debt burden to Kenyans.

Continuous participatory monitoring and evaluation of the domestic debt situation should be carried out so as to allow for continuous tracking of public debt. The annual public debt report should be participatory and should check the public view on the status of Kenya's public debt. This is not the case now as this report is prepared by the DPM office alone. The government of the day is a trustee of the citizen and there it incurs debt on behalf of its citizen hence the need to involve them. Even the parliament as the representative of the general public is rarely consulted during public debt contracting.

The office of the controller of budget, the office of the auditor general, and the parliament in its oversight role should ensure that borrowed funds are used for the purpose for which they were borrowed. By enhancing transparency and accountability, debt can effectively be used to achieve the development goals and other macroeconomic objectives of the nation. These legal institutions must enhance good governance. This is because good policies and rules will not yield the expected benefits unless it is supported by a legal framework and organizational arrangements that promote its implementation.

There is also a need to have mechanisms in place to ascertain whether the public debt acquired will positively impact economic growth. There is a need for legislation for a cost-benefit analysis to ascertain whether the debt being acquired will be beneficial to the country. Measures to ensure that debt-funded development projects are completed long enough before the maturity of the debt are required. This will ensure that the debt-funded projects are productive during

the servicing of the debt. In addition, the cost-risk analysis of alternative borrowing plans can inform fiscal and monetary policy, and that the debt management strategy is a key component in financial market development.

Kenya must handle the implementation of IMF conditionalities and structural reforms with a lot of caution. This is because these IMF and World Bank conditionalities are aimed at macroeconomic stability and have very little if any on social and human development. The experience is that these reforms are anti-poor and have adverse effects on the most vulnerable section of the population.

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