IPF
INSTITUTE OF PUBLIC FINANCE

TRANSPARENCY, ACCOUNTABILITY AND PARTICIPATION (TAP) IN PUBLIC DEBT BUILDS BETTER FOR SERVICE DELIVERY

A Citizen Guide on Public Debt

March 2023

Table of Contents

Definition of Terms

Debt - The amount that a country owes its lenders

Domestic debt - debt owed to lenders within the country.

External debt - debt owed to lenders outside of a country.

Debt service - amount required to cover payment of interest and principal payments on public debt.

Grants - Funds provided to a government that do not need to be repaid.

Revenue - money collected by a government from taxes and other sources such as fees, charges and royalties to fund public expenditures.

Fiscal deficit - Difference between total government revenue and total expenditures.

Net financing - Refers to government's borrowing needs for a specific fiscal year.

Exports - goods and services that are produced in one country and sold to another.

1. Overview

This document offers a broad guide for citizens to understand public debt in Kenya by providing simplified answers to key questions on public debt. The guide was motivated by the need to increase citizen engagement on public debt decisions in Kenya. It is based on our view that strengthening citizen voice in public debt could influence public debt decisions, and consequently lead to a more sustainable debt policy that is in the public interest.

This guide is developed as part of a project on Transparency, Accountability and Partnership (TAP) in public debt undertaken by the Institute of Public Finance (IPF), in collaboration with Christian Aid. The project's goal is to promote increased engagement in the public debt conversation in Kenya and the region.

2. Key Questions on Public Debt

2.1 Why does the government borrow?

The government borrows to finance its budget when its funding needs are higher than revenues. There are two main types of public debt: external debt (government borrowing from lenders outside of the country) and domestic debt (government borrowing from lenders within the country).

A debt that supports social and infrastructure spending can result to higher income and in the end balance out the cost of debt service

Why does the government spend more money than it takes in? Public debt allows a country to raise funds for key development projects that are too expensive to pay for all at once. Just as people take out loans to pay for expensive goods and services like education or building a house, a government also takes out loans to pay for expensive investments, like highways or new energy projects.

Of course, just like ordinary people, the government can also borrow for goods that are not a good investment. An individual might borrow money to spend on alcohol or gambling, rather than to pay for school. A government might borrow to invest in projects that do not promise a good return, too.

2.2 Why should the public pay attention to government debt?

A county's gross debt or public debt is the total amount that a country owes its creditors, whether domestic residents or foreigners. It is the responsibility of the public to ask questions about how governments want to use the money they are borrowing, because that money eventually has to be repaid with our tax revenues. If the government makes good choices about how to invest debt, then the economy will grow and generate more tax revenue that can help to repay the debt. For example, if the government invests in roads that make it easier to trade, the economy can grow. But if the money that governments raise is used poorly, then the economy may not grow, and our taxes will go up without much benefit to us from that debt we have to repay. For example, if the government builds shoddy roads that are unusable, or that do not connect people in ways that facilitate trade.

Even if the government makes good choices about what to spend money on, it can still take on too much debt that it cannot easily repay. This will affect the economy but also the lives and taxes that our children have to pay. It follows that the public should pay attention both to what the government uses debt for, and how much debt is taken on (and under what conditions).

2.3 When and how does the government decide on how much to borrow?

The Medium-Term Debt Strategy (MTDS), Annual Borrowing Plans and Annual Debt Management Report answer two key questions on public debt every year:

i. How much did the government borrow in the past one year?
ii. How much does the government intend in the coming years?

The main goal of Medium-Term Debt Strategy (MTDS) is to ensure that the government borrows at the lowest cost while maintaining risks at a manageable level. A debt management strategy can help the government make prudent choices based on the analysis of risks and cost of borrowing.

The decision on how much the government will borrow is determined by the expected fiscal deficit (the difference between revenue and expenditure) in the Budget Policy Statement (BPS). To see what this looks like, consider Table 1. This table gives complete information on government borrowing for the FY 2022/23 as well what it borrowed in the previous year (FY 2021/22).

How do we read this table? First, we need to know what "net financing" refers to financial resources(borrowing/savings) that the government absorbs from other sectors; if negative it means the government borrows from other sectors of the economy and if positive it means that the government has a surplus an therefore saves. Then, we can look at the total spending the government wants to do, which is row D. The difference between that spending and the revenue and grants covered in B and C gives us the amount that the government needs to borrow (net financing, or "the deficit). These figures are given in local currency and as a share of the overall economy (GDP).

If we read the table carefully, we can see that the fiscal deficit was expected to decline in the FY 2022/23. Why? The table shows that this was mainly because the government expected to collect more revenue in 2022/23 than in 2021/22. You can see this by comparing line B for the two years. Line D shows that the government expected to spend more in 2022/23 than in 2021/22, but it expected much more revenue. This would mean a lower deficit and less borrowing.

Remember that these are just projections. There are usually changes during the year, and the government might be wrong about its revenues. Therefore, we also must look back after the year is over and check whether the government did what it said it would or not.

As mentioned above, government borrows domestically or externally; to finance the Ksh 863 billion fiscal deficit in the FY 2022/23, the government planned to borrow Ksh 582 billion from the domestic market and Ksh 281 billion would be borrowed from the external market.

What does this mean? Domestic debt primarily comes from treasury bills and treasury bonds which are sold to Kenyan citizens and banks, while external debt mainly comes from foreign investors (for example Eurobonds), commercial banks (for example syndicated loans), the International Monetary Fund, the World Bank and the African Development Bank (AfDB).

Table 1: Net Financing Requirements

		FY 2021/22		2024/25 BPS Ceilings		Change	Growth
		Amount (Ksh. Billion)	% of GDP	Amount (Ksh. Billion)	% of GDP	Amount (Ksh. Billion)	
A =(B+C)-D	**Net Financing Requirements**	(1,031.2)	8%	(862.9)	6.2%	168.3	16%
B	**Total Revenue**	2, 192.0	17%	2,462.36	17%	270.4	12%
C	**Total Grants**	62.92	0.50%,	33.32	0.2%	-29.6	-47%
D	**Total expenditures**	**3,286.1**	**26%**	**3,358.6**	**24%**	**72.5**	**2%**

Source: 2022/23 ABP (page 1)

Why should we care about this mix of financing sources? Different types of debt come with different risks, costs and conditions. Domestic loans are borrowed in Kenya shilling (Ksh), and therefore they do not carry the risk that the value of the shilling suddenly drops. External loans do carry such risks, because they are usually borrowed and must be repaid in dollars. If the shilling drops in value, it would imply that for the same amount of dollars, we would require to forfeit more kenya shillings than expected. The loan repayment therefore becomes more expensive. Moreover, some kinds of loans come with conditions, such as those from the IMF, but they may be cheaper than commercial loans that come without conditions. The government has to consider these factors and decide how much to borrow externally and domestically, and how much to borrow from different kinds of lenders. For example, in 2022, the government decided that it would target a ratio of 68:32 of domestic to external debt to minimize the risks and lower the cost of borrowing. In 2023, it shifted: proposing a 50:50 ratio of domestic to external debt. According to the government, this mix would reduce both the cost and risk of borrowing, considering the performance of global financial markets.

Again, it is important to evaluate whether the government complies with its borrowing plan. We will do this with the help of Table 2. Generally, the table indicates that the government has not always achieved the ratio of the external debt to domestic debt projected in the MTDS. For example, in the FY 2021/22, the government had targeted to borrow 73 percent of debt from domestic market and 27 percent from the external market but borrowed 85 percent and 15 percent from the domestic and external markets respectively. This then means that risk and cost of borrowing changed. For example, while the government may have reduced the risk of borrowing in foreign currency through increased borrowing in Ksh, it risked reducing the amount of resources available for the private sector to borrow domestically.

If the government borrows year after year, it leads to accumulation of debt, which then gives a country's debt stock. Debt stock is the total debt that a country holds at a given time. Table 2 below gives Kenya's debt stock as reported in the 2022 Annual Debt Management Report. The debt has increased every year because the government has been running on a fiscal deficit.

From table 3, we see that total debt increased from 59 percent of GDP to 68 percent of GDP between June 2018 and June 2021. We observe a decline to 67 percent in June 2022, but this decline is because Kenya's GDP increased faster than the public debt.

2.4 How much debt is too much?

According to the International Monetary Fund, [1]

> *A country's public debt is considered sustainable if the government is able to meet all its current and future payment obligations without exceptional financial assistance or going into default (International Monetary Fund)*

Table 2: MTDS Targets against actual borrowing (percent)

Borrowing source		FY2018/19	FY2019/20	FY2020/21	FY2021/22
External	**MTDS**	57	38	28	27
	Actual	58	28	19	15
	Deviation	-1	10	9	12
Domestic	**MTDS**	43	62	72	73
	Actual	42	72	81	85
	Deviation	1	-10	-9	-12

Source: 2023 MTDS, pg 3

[1] https://www.imf.org/en/Publications/fandd/issues/2020/09/what-is-debt-sustainability-basics#:~:text=A%20country's%20public%20debt%20is,assistance%20or%20going%20into%20default.

Table 3: Debt Stock a percent of GDP

Debt Type	Jun-18	Jun-19	Jun-20	Jun-21	Jun-2022*
Total Gross Domestic	29.2	29.7	31.2	32.7	33.6
Total External debt	30.2	32.3	34.6	35.4	33.7
Total debt	**59.4**	**62**	**65.8**	**68.1**	**67.3**

Source: 2022 Annual Debt Management Report, page 12

Table: External Debt Sustainability: Key indicators show that Kenya is not exporting enough to manage its debts for the long-term

Indicators	Thresholds	2022	2023	2024	2025	2026	2027
External debt to GDP ratio	40	26.6	26.8	26.1	25.6	25.1	25.0
External debt to export ratio	180	221.5	208.6	195.9	186.5	179.8	175.4
Debt service to export ratio	15	22.6	20.5	29.6	21.1	19.2	15.8
Debt service to revenue ratio	18	15.7	15.2	22.3	16.5	15.2	12.6

2023 MTDS, page 16

This sound obvious, but how do we know whether a country can meet its obligations? Usually, we look at a few indicators such as those in the table below to see how worried we should be.

How do we read this table? The column headed thresholds gives the value (or a ceiling) for different debt ratios that Kenya's debt must stay within for it to remain sustainable. For example, the threshold for the ratio of external debt to GDP is 40, looking at the values for the period 2022-2027 Kenya's debt is within the threshold for this indicator. However, looking at the rest of ratios Kenya's debt is either above or is going to be above for the coming years. In the case of external debt service to revenue, Kenya's threshold is 18 but the IMF's projection is that it will 22 in 2024. Similarly, debt service to export ratio is consistently above the threshold of 15. When a country undertakes too much debt, it us unable to deliver public services, and risks being unable to repay the loans.

2.5 What is the impact of government borrowing on delivery of public services?

As we have seen, debts may be used for investments that lead to enhanced growth and public welfare. However, when a country accumulates too much debt, it has to use a lot of the revenue it generates each year to repay that debt. As debt stock increases, the government must commit more and more of its annual revenue to repaying the debt. As creditors come to doubt whether a government can repay its debts, they may demand higher interest rates on any new debt. As a result, the government spends more on debt service. In addition, if a country defaults on its debt, it may make it harder to borrow, or more expensive, in the future. However, when the cost of servicing debt becomes very high, this may have a negative impact on the rest of the budget, including social spending. This suggests that the public should keep an eye on how much of the budget is going to debt repayment and speak out when that figure becomes so high that it dwarfs other important spending.

The table below is one way to check for this. It compares major social spending with revenue and debt service costs. The table shows that around half of government revenue is consistently being used to pay for debt service, while the total spent on education, health and social protection is generally less than 40 percent of the budget.

High level of debt repayment reduces the amount of government revenue available for the government to spend on essential services (such as health, social protection, and education). Spending on health, education and social protection as percent of ordinary revenue all declined by 1 percent between FY 2020/21 and FY 2021/22, while debt service to ordinary revenue ratio increased by 7 percent. This is especially worrying because the Constitution of Kenya, 2010 requires the government to meet its debt obligations before incurring any other expenditure. As shown in the table above, the government has been committing more and more resources on repaying debt compared to spending on health, education, and social protection. This can affect access to quality education and healthcare, especially by the poor who rely on public amenities. there has been reported delay in disbursements of cash to the vulnerably including the elderly and persons living with disabilities (probably because the government has to settle its debt obligations first); such delays have a negative impact on household spending and welfare.

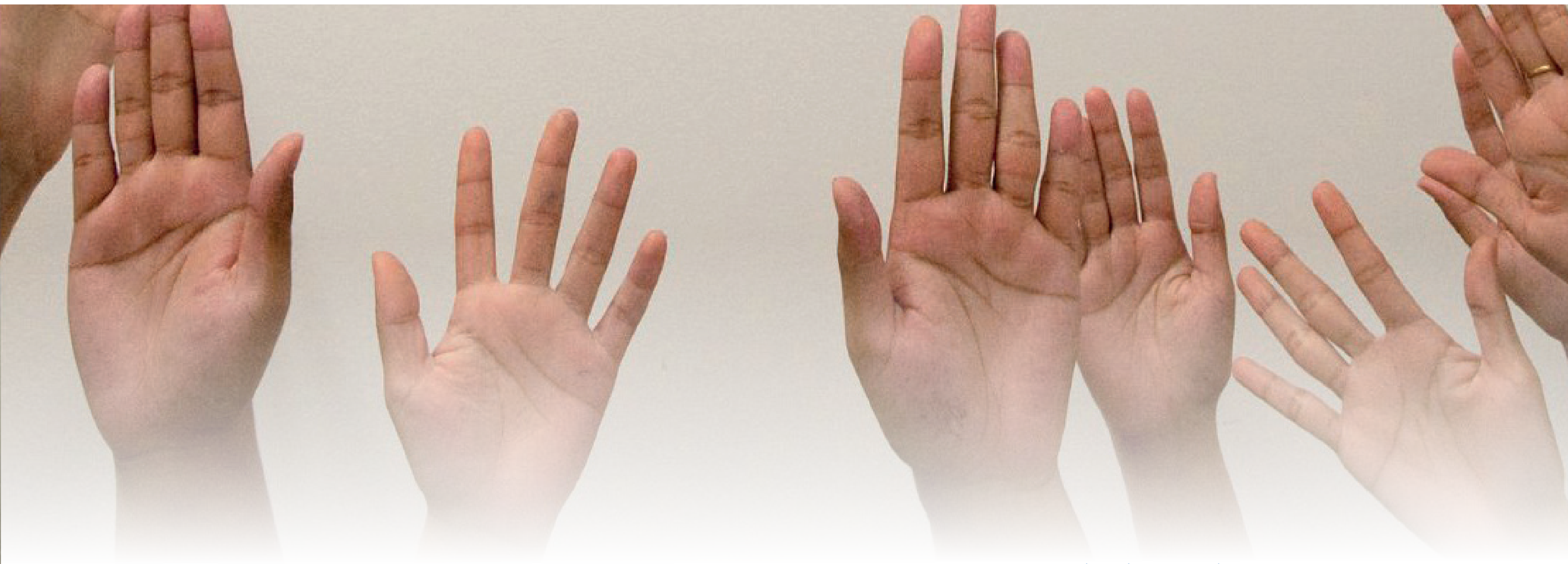
Table: Government Spending on Debt Service, Health, Education and Social protection

	2018/19	2019/20	2020/21	2021/22
Total Debt Service	850.1	651.5	780.6	917.8
Health	74.53	108.50	105.78	110.09
Education	454.83	464.64	470.84	514.67
Social protection	31.30	40.95	31.50	35.56
Ordinary Revenue	1,440.2	1,427.5	1,484.8	1,917.9
Percent of Ordinary Revenue				
Total Debt Service	59%	46%	53%	48%
Health	5%	8%	7%	6%
Education	32%	33%	32%	27%
Social protection	2%	3%	2%	2%

Data Source: National Treasury

2.5 Where can citizens get information about public debt?

Document Name	Key Contents	Date Available
Medium Term Debt Management Strategy (MTDS)	Total debt, Sources of loans, debt management strategy, ssustainability of debt	February 2023
Annual Borrowing Plans (ABP)	Sources of government borrowing over one year	July 2022
Monthly Debt Bulletins	Monthly borrowing and monthly debt service	December 2022
Annual Debt Management Report	Total public debt, debt service, credit rating and investor relations	FY 2021/22
External Public Debt Register	External borrowing by source, external debt by creditor, external debt by currency, and projects and programmes financed through external debt	June 2021



3. How can citizens participate in debt decisions?

As provided for in the Kenya's PFM legal and institutional framework, the public has an opportunity to participate in debt decisions in areas highlighted below:

i. At the formulation stage, citizens and non-state actors have an opportunity to submit their input on the Budget Policy Statement once the National Treasury has released it for public comments.

ii. The public can also submit its input on Medium-term Debt Management Strategy (MTDS) between February 15 and 18 once the National Treasury submits it to the National Assembly.

iii. The Commission on Revenue Allocation (CRA) and the Intergovernmental Budget and Economic Council in accordance with Section 33(4) of the PFM Act, 2012 have the mandate to public and publicize the MTDS which then creates an opportunity for the citizens to scrutinize government's borrowing policy.

The National Assembly through the Budget and Appropriations Committee (BAC) and the Public Debt and Privatization Committee called for public input through submission of memoranda on the 2023 BPS and the 2023 MTDS, respectively. However, there has been limited public participation in public debt matters due to limited capacity and awareness among citizens. Similarly, the national government and county governments have allocated minimal resources and time to public participation. Further, there are clearly mechanism and channels for public participation at both levels of government.

4. Conclusion

Historically, the government of Kenya has not fully involved citizens in public debt decisions and use of borrowed resources. Yet it is ordinary Kenyans, especially the poor, that will bear the cost of an increasing debt burden through reduced social spending, lower growth, and higher taxes. A greater role of the public in debt decisions is therefore needed to push for better public debt management and in the use of public resources. However, this cannot be achieved without access and proper understanding of public debt information. Parliament should also play a greater role to ensure that Kenya's debt is sustainable through legislation and oversight of the executive.