MEMORANDUM TO THE FINANCE AND PLANNING COMMITTEE OF THE NATIONAL ASSEMBLY ON THE BUDGET ESTIMATES 2020/21

Public Debt and Budget Financing

This memorandum was prepared as a submission to inform deliberations on the proposed budget estimates for 2020/21 that are currently under review in the National Assembly. It was prepared by civil society organizations that focus in the public finance space in Kenya.

Introduction

Kenya has already been ranked at high risk of debt distress by IMF[1] due to the impact of COVID-19 pandemic. The disease is worsening the existing vulnerabilities, specifically, the limited fiscal space occasioned by revenue shortfalls amid rising expenditure pressures. The country has consistently failed to meet its revenue targets due to unrealistic revenue projections.

This has led to in-year borrowing and may also imply foregoing services equivalent to the amount of revenue that has not been met. Ordinary revenue is expected to decline in the FY 2020/21 due to the impact of the COVID-19 pandemic on economic activities and the tax measures being implemented to cushion Kenyans from the effects of the pandemic.

The executive arm of the national government on the other hand has fueled growth in government expenditure leading to the widening fiscal gap. The government is accumulating more debt to support its response to COVID-19. It has already received a $739 million loan from the IMF[2] and $50 million from the World Bank.[3] Additionally, National Treasury established the COVID-19 Emergency Response Fund which is mostly financed through donations from well-wishers and is managed separately from the Consolidated Fund. However, these resources are not adequate to mitigate the COVID-19 crisis. National Treasury must use all means to protect and boost its limited resources in order to slow down, stop the pandemic and avert economic collapse.

Submission Summary

The amount repaid as public debt is increasing amid reduced revenue collections owing to the recent tax laws amendments and a large government expenditure fueled by the executive arm.

The National Treasury needs to make available additional financing for COVID-19 response by:

i. Seeking debt relief from all its creditors.

ii. Adjusting the national budget 2020/21 FY to curb non-priority expenditure including suspension of non-essential large infrastructure projects while being cautious not to divert spending from existing essential health services and other crucial needs.

[1] https://www.imf.org/en/Publications/CR/Issues/2020/05/11/Republic-of-Kenya-Request-for-Disbursement-under-the-Rapid-Credit-Facility-Press-Release-49405

[2] https://www.imf.org/en/News/Articles/2020/05/06/pr20208-kenya-imf-executive-board-approves-us-million-disbursement-address-impact-covid-19-pandemic

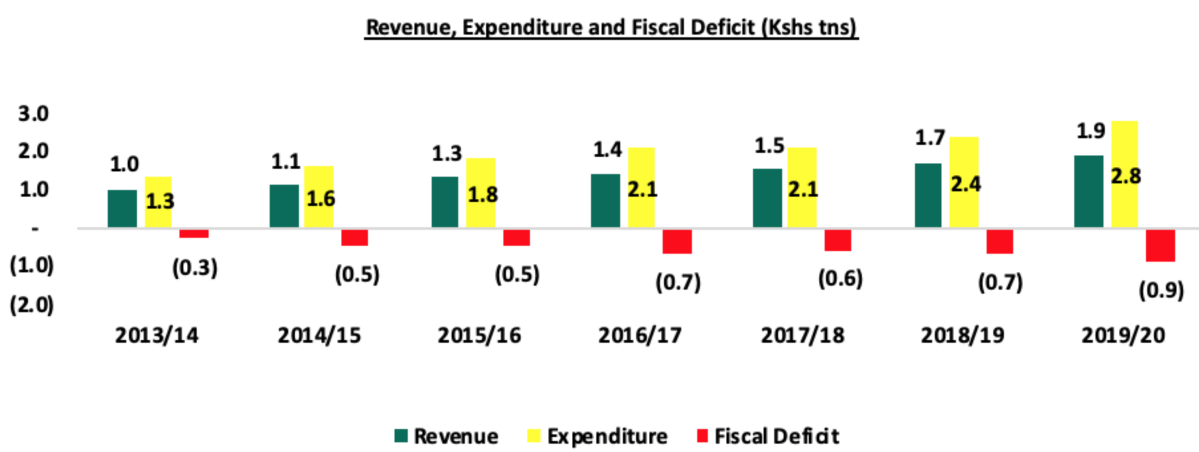
[3] https://www.worldbank.org/en/news/press-release/2020/04/02/kenya-receives-50-million-world-bank-group-support-to-address-covid-19-pandemic

iii. Prioritizing economic stimulus/relief through the national budget to address immediate health needs, income needs and recovery from the pandemic specially to cushion small businesses in the informal sector worst hit by the pandemic.

Detailed facts

1. Kenya's Current Debt Levels and Debt Profile

Year on year, the national budget has continued to grow, with total expenditure growing at a 6-year Compound Annual Growth Rate (CAGR) of 16.6 percent to an estimated Kshs 2.8 trillion in FY 2019/20 according to the 2020 Supplementary II budget estimates, from Kshs. 1.3 trillion as at the end of FY 2013/14. Revenue growth on the other hand has grown at a slower 6-year CAGR of 13.1 percent to an estimated Kshs 1.9 trillion in FY 2019/20, from Kshs 1.0 trillion as at the end of FY'2013/14. The faster rise in expenses, compared to revenue collected has seen the fiscal deficit widening from Kshs 0.3 trillion (equivalent to 5.6 percent of GDP) in FY 2013/14 to a projected Kshs 0.9 trillion (equivalent to 8.0 percent of GDP) in FY'2019/20 as per the 2020 Supplementary II budget estimates as highlighted in the chart below:



Source: National Treasury

An in-depth analysis of government's expenditure indicates that it has largely been fueled by the executive arm as indicated in the table below.

Government Expenditure	**2019/20**	**2020/21**
Executive	1,947,873	1,778,133
Judiciary	19,202	18,051
Parliament	39,889	36,222
National Government	**2,006,964**	**1,832,406**
Consolidated Fund services	550,063	574,650
County Governments	316,500	316,500
Total	**2,873,527**	**2,723,556**

Source: Budget Policy Statement, 2020 – The National Treasury

Kenya's public debt level has increased to unsustainable levels in the past 5 years from 50.2 percent of GDP in 2015 to an estimated 61.7 percent of GDP in 2019. This is as a result of high deficits mainly due to large capital-intensive infrastructure projects. The budget deficit projected at 7.3 percent of GDP will worsen due to reduction in fiscal revenues and increase in expenditures to fight the spread of COVID-19 and to limit its impact on the economy and the vulnerable. The projected fiscal deficit will be financed by external financing and domestic borrowing estimated at Kshs. 835.9 Billion in the Budget Estimates for 2020/21.[4]

Table 5: Financing of the fiscal deficit

In Kshs. Billion				
	2017/2018	**2018/2019**	**2019/2020***	**2020/2021**
Fiscal Balance (commitment basis excl. grants)	-623.9	-732	-874.2	-859.3
Grants	27.6	19.7	34.5	36.1
Of which: Project grants	22.9	15.4	22.8	33.1
Fiscal Balance (incl. grants)	-596.3	-712.3	-839.7	-823.2
Adjustment to Cash Basis	-34.7	8.7	0	0
Fiscal Balance (incl. grants) Cash Basis	**-631**	**-703.6**	**-839.7**	**-823.2**
Financing	**631.2**	**721.2**	**839.7**	**823.2**
Net Foreign Financing	354.9	414.6	349.9	349.75
Project loans	180.8	222.3	219	241.55
Programme and other concessional Loans	8.5	84.8	246.2	152

Source: Parliamentary Budget Office

The country's economy has been driving on the wheels of debt especially in development projects, with the total national debt as at January 2020 standing at Ksh. 6.2 trillion. This is has so far gone up since COVID-19 pandemic struck. We have seen a gradual rise in risk from low in 2017 to moderate in 2018 and now IMF has raised Kenya's risk of debt distress to high at 61.7 percent of GDP, nearing a debt crisis. This comes at a time when the country is struggling financially due to the health crisis and tremendous debt obligations estimated at Kshs. 904.7 billion in FY 2020/2021[5] falling due.

Table 10: Public Debt Servicing Expenses

Interest Payments	FY 2018/2019	FY 2019/20	FY 2020/21	FY 2021/22	FY 2022/23	FY 2023/24
Interest - Internal Debt	285,607	301,812	308,424	370,430	382,588	385,662
Interest - External Debt	114,374	131,868	154,684	166,821	173,950	183,692
Sub-Total	399,981	433,680	463,108	537,251	556,539	569,354
Redemptions Payments						
Redemption - Internal Debt	220,352	213,691	261,955	246,810	336,623	357,165
Redemption - External Debt	250,283	121,477	179,640	239,393	257,612	258,457
Sub-Total	470,635	335,168	441,595	486,203	594,235	615,622
Public Debt Service Expenses	870,616	768,848	904,704	1,023,454	1,150,773	1,184,975

Source: FY 2019/20 Budget Estimates & FY 2020/21 Printed Budget Estimates

[4] http://www.parliament.go.ke/sites/default/files/2020-05/Estimates%20of%20Revenue%20and%20Expenditure%20for%20202021.pdf
[5] http://www.parliament.go.ke/sites/default/files/2020-05/Estimates%20of%20Revenue%20and%20Expenditure%20for%20202021.pdf

Public debt servicing as a percentage of Tax Revenue

Financial Year	Tax revenue (KES Billions)	Public Debt Servicing (KES Billions)	Public debt servicing/Tax Revenue (%)
2013/14	893.38	227.58	25.47
2014/15	1,001.43	416.23	41.56
2015/16	1,108.17	421.85	38.07
2016/17	1,253.46	435.72	34.76
2017/18	1,311.69	517.16	39.42
2018/19	1,440.21	826.20	57.37
2019/20 (1st Half)	779.32	416.46	53.44

Source: Kenya Gazette, Statement of Actual Revenues and Exchequer Issues for 2014 – 2020

Further, an analysis of public debt repayment expressed as a percentage of tax revenue over the period 2013/14 to the first half of the FY 2019/20 indicates that public debt repayment as a percentage of tax revenue has more than doubled. This implies that less tax revenues are being used to provide services such as health and education. In FY 2013/14, the country used 25.47 percent of its tax revenue to repay debt, a figure that increased to about 57.37 percent in FY 2018/19. In the first half of FY 2019/20, the country used 53.44 percent of its tax revenue to repay its debt.

Public debt growth rate

Item	2019/20	2020/21	Growth	Rate
Redemption (KSH in Bn)	335.17	441.60	106.43	31.75%
Interest (KSH in Bn)	433.68	463.12	29.44	6.79%
Total Public debt (KSH in Bn)	768.85	904.70	135.85	17.67%

Source: National Treasury - Programme based budget, 2020/21

In the current FY 2020/21, revenue collections are likely to decrease owing to the recent tax laws amendments. On the contrary, public debt repayments will increase by 17.67 percent from Kshs. 768.85 billion in FY 2019/20 to Kshs. 904.70 billion in FY 2020/21. This implies that Kenya's public debt environment is likely to worsen, especially now that the country is at a high risk of defaulting in the repayment of its external debt

Proposition

1. The government should seek debt relief because these obligations are pressing hard on the country's ability to effectively handle COVID-19 crisis.
2. The government should then adjust the national budget 2020/21 FY to curb non-priority expenditure, including suspension of non-essential large infrastructure projects, while being cautious not to divert spending from existing essential health services and other crucial needs.
3. The government should reduce on its executive recurrent expenditure which takes up a huge proportion of the government's expenditure.
4. The government should prioritize economic stimulus/relief through the national budget to address immediate health needs, income needs and recovery from the pandemic specially to cushion small businesses in the informal sector worst hit by the pandemic.

Conclusion

So far, contributions have been made towards addressing the COVID-19 pandemic amounting to about KSH. 181,104,172,350[6] and this is including loans that government has pursued from IMF towards this cause. This amount, together with supplementary budget allocations being done towards the health sector, will go a long way in addressing the pandemic and the effects it has brought about. However, the government should put in place measures to ensure transparency and accountability in the use of these funds. This is to seal any loopholes for corruption and misuse, and ensure that the funds are used effectively for the proposed purpose.

The economic effects caused by COVID-19 shall be felt long after the pandemic is contained. To this effect, we propose that the government puts on hold further borrowing, particularly towards addressing the pandemic. Government should instead ensure strict transparency and accountability measures in place for the effective management of the amounts already donated and realigned towards the health sector to effectively address the sector.

This will give a chance for the country to recover economically from the negative effects that have been caused so far and as well give it a chance to meet its other budgetary commitments. It is therefore important for the government to avoid incurring more debt during this period. The reduction of the executive recurrent expenditure is also likely to reduce the country's fiscal deficit which in turn is likely to reduce public debt stock, maintaining it within sustainable levels.

[6] https://actionfortransparency.org/covid-19/aid/

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