Approved for tabling in the House.
SNA
15/2/2022



REPUBLIC OF KENYA

KENYA NATIONAL ASSEMBLY

TWELFTH PARLIAMENT – SIXTH SESSION

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# REPORT OF THE BUDGET AND APPROPRIATIONS COMMITTEE ON THE 2022 MEDIUM TERM DEBT MANAGEMENT STRATEGY

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FEBRUARY 2022

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## CHAIRPERSON'S FOREWORD

The 2022 Medium Term Debt Management Strategy (MTDS) was tabled in the National Assembly on Thursday, 2nd December, 2021 pursuant to Section 33(1) of the Public Finance Management Act, 2012 and Standing Order 232(1). In line with Standing Order 232(6), the MTDS was committed to the Budget and Appropriations Committee to examine and make recommendations for approval by the House. I am pleased to inform this House that the Committee has adequately fulfilled its mandate. It is therefore my honour to present to this House, the committee's report on the 2022 Medium Term Debt Management Strategy (MTDS).

It is important to note that this is the first time the committee is submitting a separate report on the Medium Term Debt Management Strategy. Previously, the practice of the committee was to submit one report encompassing recommendations on the Budget Policy Statement (BPS) and the Medium Term Debt Management Strategy (MTDS). However, the committee decided to change the approach in order to broaden the understanding on effects of borrowing and public debt accrual, on economic growth, taxation and intergenerational income equity.

The 2022 MTDS provides the basis of the chosen strategy for financing the fiscal deficit of Kshs 846.1 Billon for FY 2022/23, as contained in the 2022 BPS. The MTDS evaluates various borrowing strategies, taking into account the inherent risks in the existing debt stock. The purpose of this evaluation is to ensure specific debt management objectives are met. These include: i) reduction of cost and risk, ii) development of domestic market institution and iii) ensuring equitable sharing of debt burden between current and future generations.

The strategy provided in the 2022 MTDS is a shift from previous borrowing strategies as it favours the domestic market over the external to finance the budget. This will cushion the debt stock from volatility in the global financial markets. In addition to the borrowing mix, the 2022 MTDS has proposed a raft of measures to promote development of the domestic market and institutions in order to enhance domestic market efficiency and provide sufficient access to credit finance by both the public and private sectors. These reforms include, among others: enhancing market infrastructure through automation, a new central securities depository system by the CBK, publication of auction rules and guidelines for government securities market, enhancement of treasury bonds benchmark program and setting up of over-the-counter trading platform to complement the Nairobi Securities Exchange.

## PROCEDURE FOR REVIEW OF THE 2022 BUDGET POLICY STATEMENT

The Committee held extensive discussions with the National Treasury and examined the critical aspects of the 2022 MTDS, taking into account the current debt stock and previous medium-term debt strategies. The recommendations arising from these deliberations have been incorporated in this report. Once approved, the 2022 MTDS is expected to inform the country's borrowing strategy in the coming financial year and over the medium term.

## ACKNOWLEDGMENTS

The Committee wishes to thank the Office of the Speaker, the Office of the Clerk of the National Assembly, and the Parliamentary Budget Office for the support extended in fulfilling its mandate of reviewing the 2022 Medium Debt Management Strategy. The committee is also grateful to the National Treasury for honouring the invite to be a part of this critical process of reviewing the MTDS.

It is, therefore, my pleasant undertaking, on behalf of the Budget and Appropriations Committee, to table this report and recommend it to the House for adoption.

**SIGNED**

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**HON. KANINI KEGA, CBS, M.P.**

**CHAIRPERSON, THE BUDGET AND APPROPRIATIONS COMMITTEE**

……15/2/22……………………………

**DATE**

THE NATIONAL ASSEMBLY

DATE: 15 FEB 2022

TABLED BY:

## PREFACE

### 1. Establishment and Mandate of the Committee

1.1. Article 221 (4 and 5) of the Constitution and Section 7 of the Public Finance Management Act, 2012 provide for the establishment of a Committee of the National Assembly whose main role is to take the lead in budgetary oversight by the National Assembly.

1.2. Pursuant to this constitutional provision, Standing Order 207 establishes the Budget and Appropriations Committee with specific mandates as follows:

i. Investigate, inquire into and report on all matters relating to coordination, control and monitoring of the national budget;
ii. Discuss and review the budget estimates and make recommendations to the House;
iii. Examine the Budget Policy Statement presented to the House
iv. Examine bills related to the national budget including appropriation bills;
v. Evaluate tax estimates, economic and budgetary policies and programmes with direct budget outlays; and
vi. Examine the Division of Revenue Bill.

### 2. Membership of the Committee

2.1. Pursuant to Standing Order 207(2), the Budget and Appropriations Committee as currently constituted comprises of the following Honourable Members:

| MEMBER | CONSTITUENCY | PARTY |
|---|---|---|
| 1. **Hon. Kanini Kega, CBS, M.P. – Chairperson** | Kieni | Jubilee |
| 2. **Hon. Benard Masaka Shinali, M.P. – Vice Chairperson** | Ikolomani | Jubilee |
| 3. Hon. CPA John Mbadi, EGH, CBS, M.P. | Suba South | ODM |
| 4. Hon. Emmanuel Wangwe, CBS, M.P | Navakholo | Jubilee |
| 5. Hon. Fatuma Gedi Ali, CBS, M.P. | Wajir County | PDR |
| 6. Hon. Wangari Mwaniki, OGW, M.P | Kigumo | Jubilee |
| 7. Hon. CPA Moses K. Lessonet, CBS, M.P | Eldama Ravine | Jubilee |
| 8. Hon. Samwel Moroto, M.P. | Kapenguria | Jubilee |
| 9. Hon. Millie Odhiambo, M.P. | Suba North | ODM |
| 10. Hon. Richard Onyonka, M.P | Kitutu Chache South | Ford Kenya |
| 11. Hon. (Dr.) Makali Mulu Benson, M.P. | Kitui Central | Wiper |
| 12. Hon. Twalib Bady, M.P. | Jomvu | ODM |
| 13. Hon. Jude Njomo, M.P. | Kiambu Town | Jubilee |
| 14. Hon. Sarah Paulata Korere, M.P. | Laikipia North | Jubilee |
| 15. Hon. Josephine Naisula Lesuuda, OGW, M.P. | Samburu West | KANU |
| 16. Hon. Alfred Kiptoo Keter, M.P | Nandi Hills | Jubilee |
| 17. Hon. Sakwa Bunyasi, M.P. | Nambale | ANC |

| MEMBER | CONSTITUENCY | PARTY |
|---|---|---|
| 18. Hon. Florence Chepng'etich Koskey Bore, M.P. | Kericho County | Jubilee |
| 19. Hon. James Gichuki Mugambi, M.P. | Othaya | Jubilee |
| 20. Hon. Danson Mwashako, M.P. | Wundanyi | Wiper |
| 21. Hon. (Eng.) Mark Nyamita, M.P. | Uriri | ODM |
| 22. Hon. Paul Abuor, M.P | Rongo | ODM |
| 23. Hon. Mercy Wanjiku Gakuya, M.P. | Kasarani | Jubilee |
| 24. Hon. CPA Francis Kuria Kimani, M.P | Molo | Jubilee |
| 25. Hon. Samuel Atandi, M.P | Alego Usonga | ODM |
| 26. Hon. Joseph Manje, M.P | Kajiado North | Jubilee |
| 27. Hon. Marselino Arbelle, M.P | Laisamis | Jubilee |

## 3. Committee Secretariat

**The committee Secretariat is comprised of the following:**

| | | |
|---|---|---|
| 1. | Mr. Joseph Ndirangu | Fiscal Analyst I/ Clerk of the Budget and Appropriations Committee |
| 2. | Mr. Danson Kachumbo | Fiscal Analyst I/ Clerk of the Budget and Appropriations Committee |
| 3. | Mr. Benard Omondi | Serjeant-at-arms |
| 4. | Mr. Eugene Luteshi | Audio Officer |
| 5. | Mr. George Mbaluka | Office Assistant |

The Committee also received technical support from the Macroeconomic Analysis and Statistics department of the Parliamentary Budget Office; under the leadership and guidance of the Director Ms. Phyllis Makau, OGW; the Senior Deputy Director, Dr. Martin Masinde; and the Deputy Director, Mr. Robert Nyaga.

# I. INTRODUCTION

1. Article 201 (C) of the Constitution provides that the burdens and benefits of the use of resources and public borrowing, should be shared equitably between present and future generations. This places a requirement therefore, for prudent and sustainable management of costs and risks related to public borrowing. To this extent, the Medium Term Debt Management Strategy has been designed as a public finance management tool to facilitate decision making based on; i) the evaluation and management of public debt related risks and ii) fiscal deficit financing through a cost-risk analytical framework. The MTDS links financing of fiscal outlays with macroeconomic policy and maintenance of sustainable debt levels.

2. The 2022 Medium Term Debt Management Strategy has been prepared subject to Section 33 and Section 64(2) of the Public Finance Management Act, 2012; as well as PFM Regulations 184 & 185. Under these provisions, the MTDS is required to provide the following information:
   i. the total stock of debt as at the date of the statement;
   ii. the sources of loans made to the national government and the nature of guarantees given by the national government;
   iii. the principal risks associated with those loans and guarantees;
   iv. the assumptions underlying the debt management strategy; and
   v. Analysis of the sustainability of the amount of debt, both actual and potential.

# II. KENYA'S PUBLIC DEBT STOCK

2. As at September 2021, the public debt stock amounted to Kshs. 7.99 trillion; a 19 percent increase from the June 2020 debt stock level. Of this amount, domestic debt accounted for 48 percent of the debt stock whereas external debt accounted for 52 percent. Further, at this level, the debt stock accounts for 88.8% of the Kshs. 9 trillion Debt Ceiling and has a Present Value(PV) of Public Debt-to-GDP ratio of 64.2 against a threshold of 55.

3. Going forward, forecasts by both the National Treasury and the Parliamentary Budget Office indicate that by June 2022, the debt stock will range between Kshs. 8.6 trillion and Kshs. 8.8 trillion. Further, it is estimated that by end of 2024, the public debt stock will have crossed the Kshs. 10 trillion mark. Thus, without an amendment to the ceiling, the government would have to maintain a balanced budget over the medium term. Taking into account the existing expenditure needs and with no significant increase in revenue collection, an amendment to the ceiling may be necessary in order to ensure that these needs are met.

## III. 2022 PROPOSED FISCAL FRAMEWORK & THE FISCAL DEFICIT

4. The 2022 Budget Policy Statement envisages the expenditure projections for the next fiscal year to amount to Kshs. 3.34 trillion (for both the national and county governments). This is against total revenue projection estimated at Kshs. 2.4 trillion; thereby creating a fiscal deficit of Kshs. 846 billion to be financed through borrowing.

5. The 2022 BPS projects a gradual reduction in the fiscal deficit over the medium term on account of fiscal consolidation measures. However, the reality is that expenditure pressures due to election related spending, implementation of a new administration manifesto and increased demand for social service delivery could make it difficult to reduce public spending. Indeed, the committee noted that rising debt servicing expenses have led to a gradual reduction of the fiscal space leading to even more borrowing in order to finance expenditure. It is estimated that the current debt stock of Kshs. 7.99 trillion as at September 2021, will incur Kshs. 1.36 trillion in debt servicing expenditures (63% of FY 2022/2023 total ordinary revenues).

## IV. THE 2022 & MEDIUM-TERM DEBT MANAGEMENT STRATEGY OF CHOICE

6. To finance the deficit, the MTDS recommends a cost and risk strategy based on a mix of external and domestic sources as follows:
   i. Gross Foreign Financing – 25%, and, Gross Domestic Financing - 75%
   ii. Net Foreign Financing – 32% and Net Domestic Financing - 68%

7. The committee observed that whilst the gross financing strategy is expected to remain relatively constant, the net financing strategy has undergone a paradigm shift resulting in a greater role for the domestic market in FY 2022/2023 deficit financing. The ratio of net foreign financing to net domestic financing shifted from 57:43 (with net financing dependent on external financing) in the 2021 MTDS; to 32:68 (with net financing dependent on domestic financing) in the 2022 MTDS. The aim of this strategy is to cushion budget financing from the uncertain flow of external debt financing and to enhance development of the domestic market.

8. Already, government financing is dependent on domestic financing as observed through previous deviations from existing annual strategies in favour of domestic financing. Whilst this is critical for domestic market sustainability, the committee noted that if it is not coupled with adequate market reforms, it could exert pressure on the domestic financial market and increase borrowing costs.

9. Notably, a review of the MTDS indicates a higher interest rate risk and refinancing risk of the domestic debt portfolio compared to external debt. These risks are attributed to domestic debt having a much lower Average Time to Maturity (6.9 years) compared to external debt (10.8 years); a higher rate of debt maturing within one year (25.9%) compared to external debt (5.2%); and a higher Weighted Average Interest Rate (at 11.1%) compared to that of the external debt portfolio

(2.9%). Coupled with the frequency and increasing size of debt servicing, these domestic debt risks could affect medium term fiscal sustainability and slowdown the pace of economic recovery.

10. On the external side, the borrowing strategy mostly targets to access concessional financing as the current levels of debt servicing would not be favourable for commercial financing. Currently, the external debt redemption profile is low due to its concessional composition as well as the Debt Servicing Suspension Initiative (DSSI). According to the MTDS, between January to June 2021, the DSSI yielded debt servicing suspension of Kshs. 46.5 billion to be paid over 6 months. However, refinancing needs are expected to spike in 2024, 2028 and 2048 due to maturing international sovereign bonds.

11. The committee observed that the 2022 MTDS has not provided measures on how the incurrence of commitment fees will be managed. According to the annual public debt management reports, a total of Kshs. 14.3 billion commitment fees was incurred between June 2016 and June 2021. Increasing debt commitments will have a significant impact on current debt stock, future fiscal space and borrowing strategy.

12. The 2022 MTDS further indicates that a series of domestic market reforms will be undertaken. These include enhancing market infrastructure through automation of processes and deployment of a new central securities depository system by the CBK; publication of auction rules and guidelines for government securities market; enhancement of Treasury bonds benchmark program; setting up of over-the-counter trading platform to complement the Nairobi Securities Exchange; and sustained stakeholder engagement and collaboration. It is noted however, that there is no information provided relating to the status of implementation of reforms contained in previous MTDS documents.

## V. PUBLIC DEBT SUSTAINABILITY ANALYSIS

13. Debt sustainability analysis compares debt burden indicators to thresholds over a 20 -year projection period. If a debt burden indicator exceeds its indicative threshold, then there is a risk of experiencing some form of debt distress. The objective of Debt Sustainability Analysis (DSA) is to evaluate a country's capacity to finance its development agenda and service the ensuing debt without unduly large adjustments that may compromise its macroeconomic stability and/or that of its economic partners.

14. The overall DSA for Kenya indicates that Kenya's public & publicly guaranteed debt estimated at Kshs. 7.99 trillion, has already breached some sustainability thresholds comprising of both solvency and liquidity sustainability ratios. The breached thresholds include; i) PV of Public Debt-to-GDP ratio, ii) PV of Public debt-revenue and grants ratio, iii) PV of PPG External Debt-to-Exports ratio, and iv) PPG debt service-to-exports ratio. Indeed, without a change of fiscal/debt

policy, the country is gradually moving towards breaching all the sustainability thresholds with an increasing likelihood of debt distress in the future. Thus, concerted effort on fiscal consolidation is required to bring debt back to sustainable levels.

## VI. COMMITTEE OBSERVATIONS

15. The following is a summary of key committee observations:

i. Section 33 of the PFM Act requires that the stock of debt indicated in the MTDS should be at the date of the statement (in this case September 2021 whereby total debt amounted to Kshs. 7.99 trillion). However, the stock of debt indicated in the 2022 MTDS debt status is for June 2021 (Kshs. 7.7 trillion). Thus, there is a possibility that the 2022 MTDS has underestimated the debt risks.

ii. In order to maintain fiscal sustainability at such high debt levels, sound fiscal policy/management should work in tandem with economic structural transformation to achieve high economic growth rate. The 10% economic growth rate target under the Vision 2030 Economic Pillar should therefore be considered as a critical factor in debt management.

iii. By the end of FY 2021/22, the fiscal space under the Ksh. 9 trillion debt ceiling is likely to be insufficient to finance the fiscal deficit forecasted for FY 2022/23, which estimated to amount to Kshs. 846 billion. If the debt ceiling is not revised, it follows that the fiscal deficit forecast for FY 2022/23 should be revised downwards in order to avoid breaching the debt limit set by Parliament. It is estimated that this requires that the fiscal deficit be adjusted to Kshs. 400 billion or 3% of GDP.

iv. Rising debt servicing expenses have led to a gradual reduction of the fiscal space leading to even more borrowing in order to finance expenditure

v. The domestic financial market is at the core of the deficit financing strategy proposed in the 2022 MTDS despite the domestic debt portfolio having a high interest rate risk and high refinancing risk.

vi. There are recurrent deviations from the annually approved debt strategies and this carries cost and risk implications that are not adequately evaluated. Furthermore, the deviations imply that the MTDS has very limited influence over medium term despite it being a document for long-term public debt management.

vii. The 2022 MTDS has not provided measures on how the incurrence of commitment fees will be managed.

viii. Kenya's public & publicly guaranteed debt estimated at Kshs. 7.99 trillion, has already breached some sustainability thresholds comprising of both solvency and liquidity sustainability ratios. without a change of fiscal/debt policy, the country is gradually moving towards breaching all the sustainability thresholds with an increasing likelihood of debt distress in the future

## VII. COMMITTEE RECOMMENDATIONS

16. Arising from the above deliberations, the committee recommends the following:

### a. Policy recommendations

17. Given the high level of debt stock, enhancement of debt transparency and accountability initiative in line with Article 201 of the Constitution is required. This House therefore resolve as follows:

    i) That, by April 2022 when the national budget is tabled, a full quantification of Kenya's Public debt stock as defined under Article 214 of the Constitution be undertaken. This should include debt disbursed and debt commitments already incurred.

    ii) That, a debt register should be submitted on quarterly basis to Parliament for scrutiny.

    iii) That, by April 2022 when the national budget is tabled, a progress report on all externally funded projects be provided in order to enhance transparency and accountability.

### b. Financial recommendations

18. That, the country's borrowing strategy be approved as contained in the 2022 Medium Term Debt Management Strategy. This should be consistent with the fiscal deficit of Ksh. 400 billion or 3 % of GDP whichever is lower.