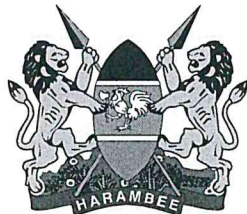


Approved
SNA
21/6/23



REPUBLIC OF KENYA

THE NATIONAL ASSEMBLY

THIRTEENTH PARLIAMENT (SECOND SESSION)

PUBLIC DEBT AND PRIVATIZATION COMMITTEE

REPORT ON THE CONSOLIDATED FUND SERVICE
EXPENDITURES UNDER THE FY 2023/24 BUDGET ESTIMATES

JUNE 2023


	
THE NATIONAL ASSEMBLY PAPERS LAID	
DATE: 21 JUN 2023	DAY: WED
TABLED BY:	HON. DR. MAKALI MULU
CLERK AT THE TABLE:	Mrs. MIRIAM MOBO

Table of Contents

List of Acronyms and Abbreviations	3
Annexures	4
CHAIRPERSON'S FOREWORD	5
Acknowledgements	6
PREFACE.....	8
Establishment and Mandate of the Committee	8
Membership of the Committee	8
Committee Secretariat.....	9
Parliamentary Budget Office.....	9
2.0. OVERVIEW OF THE CONSOLIDATED FUND SERVICES (CFS) EXPENSES	10
2.1. Domestic Debt Service Expenses	10
2.1. External Debt Service	10
2.3 Pensions Expenditure	11
2.4. Salaries, Allowances & Others.....	11
2.5. Guaranteed Debt.....	11
3.0. SUBMISSIONS BY STAKE HOLDERS.....	12
3.1. The Central Bank of Kenya	12
3.2. The Office of the Auditor General.....	14
3.3. Controller of Budget.....	16
3.4. The National Treasury.....	17
4.0. OBSERVATIONS.....	19
5.0. RECOMMENDATIONS.....	20

List of Acronyms and Abbreviations

CBK	Central Bank of Kenya
CBR	Central Bank Rate
CFS	Consolidated Fund Services
DSA	Debt Sustainability Analysis
FY	Financial Year
MTDS	Medium Term Debt Management Strategy
OCOB	Office of the Controller of Budget
OAG	Office of the Auditor General

Annexures

Annex 1	Adoption Schedule
Annex 2	Committee Minutes
Annex 3	Stakeholder Submissions
Annex 4	Received Memoranda
Annex 5	Newspaper advertisements calling for memoranda

CHAIRPERSON'S FOREWORD

The Consolidated Fund Services (CFS) expenditures in the Budget Estimates represent direct charges on the Consolidated Fund as specified in the Constitution and several Acts of Parliament. These include expenditure on public debt service, pensions, salaries for holders of constitutional offices and guaranteed debt. In line with Article 221(7) of the Constitution, these expenditures are exempted from the Appropriations Act.

The FY 2023/2024 Budget Estimates include CFS expenditures amounting to Ksh. 1.836 trillion. These include public debt service expenditures amounting to Ksh. 1.625 trillion, pension expenditures amounting to Ksh. 189.09 billion, expenditures related to the Kenya Airways PLC guaranteed debt of Kshs. 17.19 billion, and salaries and allowances for independent and constitutional offices, along with other miscellaneous costs which amount to Kshs. 4.74 billion.

Examination of the Consolidated Fund Service Expenditures (CFS), FY 2023/24

In line with the mandate of the Committee as to oversight Consolidated Fund Services, the Committee has examined the Consolidated Fund Services (CFS) expenditures and has prepared a report to the House for consideration and adoption.

In reviewing the CFS expenditures, the Committee held productive deliberations with key stakeholders and received their submissions. These include the Office of the Controller of Budget, the Office of the Auditor General and the Central Bank of Kenya. The Committee also held discussions with the National Treasury before the report was finalized.

Key Recommendations

Arising from these consultative engagements, the Committee has made the following recommendations:

- i. That, in line with the fiscal consolidation plan, any in-year adjustments to the FY 2023/2024 budget estimates undertaken by the National Treasury should be within the approved 2023-2024 fiscal deficit limit of 4.4 percent of GDP in order to mitigate against unplanned borrowing.
- ii. That, in line with the House resolutions on the Medium-Term Debt Management Strategy 2023, in FY 2023-2024, the National Treasury should adhere to the approved 50:50 mix of domestic to external borrowing and any deviation in the funding strategy should be approved by the National Assembly.
- iii. That, fifteen (15) days after the end of each quarter in each financial year, the National Treasury should submit to the National Assembly, a quarterly report on the status of all CFS expenditures, indicating actual expenditures compared to budgeted expenditure.
- iv. That, for any in-year CFS expenditure adjustments in FY 2022/2023 as well as in subsequent budget cycles going forward, the National Treasury should report the

overdraft facility as well as all expenditure related to guaranteed debt as separate and substantive components of public debt servicing expenditures and not under the salaries and allowances component of the CFS.

- v. That, the National Treasury should ensure timely payment of pensions to pensioners, and prioritize the prompt disbursement of employer contributions under the Public Servants Superannuation Scheme (PSSS).
- vi. That, in the next budget cycle 2024/2025, the National Treasury should submit explanatory notes on the CFS expenditure along with the budget estimates for FY 2024/2025.
- vii. That, by 31st December 2023, the Office of the Auditor General should undertake a special audit on pensions relating to pensioners paid through the Crown Agents Bank in the UK and submit a report to the National Assembly within the stipulated timeframe.

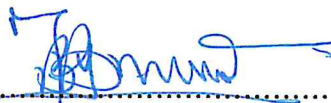
Acknowledgements

The Committee extends its gratitude to the Office of the Speaker, the Office of the Clerk of the National Assembly for the support extended in fulfilling its mandate of reviewing the Consolidated Fund Service Expenditures for FY 2023/24. Sincere gratitude is also extended to the National Treasury, the Office of the Controller of Budget, the Office of the Auditor General and the Central Bank of Kenya, for honouring the invitation and providing critical information.

Finally, the Committee would like to appreciate the Parliamentary Budget Office and the Directorate of Appropriations, Audit, and other Select Committees for the extensive technical assistance provided in the review of the Consolidated Fund Service Expenditures and the finalization of this report.

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

SIGNED



HON. (DR.) MAKALI MULU M.P
VICE-CHAIRPERSON, PUBLIC DEBT & PRIVATIZATION COMMITTEE

21.06.2023

DATE

PREFACE

Establishment and Mandate of the Committee

The powers of each House of Parliament to establish committees and to make standing orders for the orderly conduct of its proceedings are provided for under Article 124 of the Constitution of Kenya, 2010. For critical oversight over matters relating to public debt and debt guarantees, public-private partnerships and privatization of national assets, standing order 207A establishes the Public Debt and Privatization Committee with specific mandates among which is to:

- i. Oversight public debt and guarantees, pursuant to Article 214 of the Constitution
- ii. Examine matters relating to debt guarantees by the National government;
- iii. Oversight Consolidated Fund Services excluding audited accounts;
- iv. Examine reports on the status of the economy in respect of the public debt;
- v. Oversight public-private partnership programmes by the national government in respect of the public debt; and
- vi. Oversight privatization of national assets

This Committee is therefore mandated, among other functions, to examine the Consolidated Fund Service Expenditures and propose recommendations to the House for adoption.

Membership of the Committee

The Public Debt and Privatization Committee as currently constituted, comprises of the following Members of Parliament: -

CHAIRPERSON

Hon. Abdi Shurie, M.P.
Balambala Constituency
Jubilee Party

VICE-CHAIRPERSON

Hon. (Dr.) Makali Mulu M.P
Kitui Central
Wiper Party

Hon. Junet, Mohamed S.N. CBS. M.P
Suna East Constituency
ODM Party

Hon. Mohamed, Abdikadir Hussein, M.P
Lagdera Constituency
ODM Party

Hon. Omboko Milemba M.P
Emuhaya Constituency
ANC Party

Hon. Suleka, H. Harun. M.P
Nominated
UDM Party

Hon. (Dr.) Irene Kasalu M.P
Kitui County
Wiper Party

Hon. Chege Njuguna M.P
Kandara Constituency
UDA Party

Hon. Kwenya, Thuku Zachary, M.P
Kinangop Constituency
Jubilee Party

Hon. Abdi Ali Abdi, M.P
Ijara Constituency
NAP-K

Hon. Kipkoros, Joseph Makilap M.P
Baringo North Constituency
UDA Party

Hon. Letipila, Dominic Eli, M.P
Samburu North Constituency
UDA Party

Hon. Aden Daud, EBS, M.P
Wajir East Constituency
Jubilee Party

Hon. Kirwa, Abraham Kipsang, M.P
Mosop Constituency
UDA Party

Hon. (Dr.) Daniel Manduku, M.P
Nyaribari Masaba Constituency
ODM Party

Committee Secretariat

In the preparation of this report, the committee was facilitated by the following staff:

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Ms. George Mbaluka
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Parliamentary Budget Office

The Committee also received technical support from the following staff of the Parliamentary Budget Office:

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Ms. Julie Mwithiga
Fiscal Analyst I

2.0. OVERVIEW OF THE CONSOLIDATED FUND SERVICES (CFS) EXPENSES

1. The projected expenditure towards Consolidated Fund Services for FY 2023/2024 is estimated at Kshs. 1.836 trillion, compared to an allocation of Kshs.1.553 billion in FY 2022/23, translating to an increase of Kshs. 283.4 billion. The increase is largely driven by servicing of public debt stock. Overall, it is projected that by June 2027, the CFS expenditure will hit the Kshs. 2.2 trillion mark.
2. In FY2023/2024, public debt service expenditures are estimated to amount to Kshs. 1.625 trillion, accounting for 89 percent of the total Consolidated Fund Services (CFS) expenditure. Compared to the CFS expenditure for 2022/23, the expenditure have increased by Kshs. 265 billion. The increase in debt service expenses is largely due to an increase in external debt service expenditure from Kshs. 362.2 billion in FY 2022/23 to Kshs. 622.47 billion, occasioned by a one-off payment of a maturing Sovereign bond of Kshs. 241.75 billion, among other expenditures.
3. CFS expenditures also include pension expenditures which in FY 2023/24 will amount to Kshs. 189.09 billion (10 percent of CFS expenditures). Other expenditures include payment for the Kenya Airways PLC guaranteed debt (Kshs. 17.19 billion) and expenditures related to salaries and allowances for independent and constitutional offices along with other miscellaneous costs, amounting to Kshs.4.74 billion.

2.1.Domestic Debt Service Expenses

4. In FY 2023/2024, domestic debt service comprising interest and redemption expenditures is projected to stand at Kshs.1.003 trillion. Interest servicing expenditures have increased on account of reopened/reissued domestic bonds and will amount to Kshs. 628.28 billion. Notably, a further increase in domestic interest is forecasted over the medium term with domestic debt service expenditures projected to peak at Kshs. 730 billion by FY 2025/2026; accounting for 62 percent of total debt servicing expenditures.
5. Redemption expenditure on the other hand, will amount to Kshs. 374.5 billion; a decline by Kshs. 86.9 billion from the 2022/2023 level. The decline in domestic debt redemption, from Kshs. 461.4 billion to Kshs. 374.54 billion indicates an improvement in debt servicing expenditures as this reduction does not last into the medium term.

2.1.External Debt Service

6. External debt service is estimated at Kshs. 622.47 billion, a 72% increase from the 2022/2023 level by Kshs. 260 billion. At this level, external debt servicing will account for only 20 percent of total redemption expenditures despite external debt accounting for 52 percent of total debt stock. This is due to the high concessional nature of the current profile of external debt stock.
7. External debt redemption in FY 2023/24 will increase on account of the expected maturity of the Debut Sovereign Bond (USD 2 billion) worth Kshs. 241.75 billion. Redemption expenditure is expected to remain elevated in the medium term due to servicing of other international sovereign bonds over the medium term notably, tranches of the 2.0 USD 2018 Sovereign Bond worth Kshs.37.4 billion and Kshs.38.6 billion which will mature in FY 2024/25 and FY 2025/26, respectively.

2.3 Pensions Expenditure

8. Pensions expenditure will amount to Kshs. 189.09 billion in FY 2023/24; an increase of Kshs. 16.45 billion from the FY 2022/2023 amount of Kshs. 172.64 billion. This is mainly attributed to an increase in ordinary pension payments to Kshs. 91.23 billion in FY 2023/24 from Ksh. 82.93 billion in FY 2022/23, occasioned by an increase in the number of retiring public officers (12,290) particularly retiring civil servants and military personnel. Furthermore, in FY 2023/2024, pensioners are expected to receive the next biennial pension increase at the rate of 3% as from 1st July 2023. Other factors include revised pension claims for teachers and anticipated new pension claims.
9. Also included in pension payments are employer contributions under the Public Servants Super-Annuation Scheme (*PSSS*) that was introduced in 2021 as a contributory pension scheme for public servants. Under this scheme, civil servants contribute 7.5 percent of their basic pay and the employer contributes 15 percent. The PSSS along with the ordinary pension scheme account for 60 percent of total pension expenditures under CFS expenditures.
10. With regard to other pension expenditures, pension payment to the UK government through the Crown Agents Bank is expected to reduce by 72 percent from Kshs. 150 million in the FY 2022/2023 to Kshs. 42 million in FY 2023/2024.

2.4. Salaries, Allowances & Others

11. Salaries and allowances and other miscellaneous expenditures are expected to increase by 2 percent from Kshs. 4.62 billion to Kshs. 4.73 billion. These are mainly salaries to the President, Deputy President and other Commissioners and independent office holders. Their salaries and allowances are set by the Salaries and Remuneration Commission (SRC) as provided for under Article 230(4)(a) which gives the commission the powers to set and regularly review salaries and benefits of all state officers. The variation in this component is informed by reviews of the SRC in its various circulars.

2.5. Guaranteed Debt

12. Article 213 of the Constitution and Section 58 of the PFM Act authorize the national government to give loan guarantees to state/private entities upon approval by Parliament. National Government guarantees are offered to encourage lenders to extend credit to institutions. If the institution is unable to meet the payments when they fall due, the government will shoulder the payments. As such, guarantees form part of the public debt stock as defined under Article 214 of the Constitution. As at June 2022, the total outstanding guaranteed debt was Kshs.145.36 billion. The guarantees are provided to the following institutions: Kenya Airways PLC (Kshs. 77.82 billion); Kenya Ports Authority (Kshs. 33.5 billion); and KenGen LDT (Kshs. 33.9 billion).
13. The Kenya Airways PLC guarantee became a liability to the government in FY 2022/2023 and payments have been charged to the consolidated fund since. In FY 2023/2024, Kshs. 17.2 billion will be charged to meet KQ debt payments. By June 2027, a total of Kshs. 61.3 billion will be paid on the same. Since these are taxpayer resources, value for money review is being undertaken.

3.0. SUBMISSIONS BY STAKE HOLDERS

3.1. The Central Bank of Kenya

a) The role of the Central Bank of Kenya in the Debt Market

14. The Central Bank of Kenya (CBK) is the principal agent in the issuance of domestic debt which constitutes about 20 percent of total receipts to the Exchequer. The associated interest payments on domestic debt account for a significant share of the Consolidated Fund Service (CFS) expenditures. The Central Bank of Kenya also pays external debt service on behalf of the national government. The debt service, comprising principal and interest payments, constitutes 88 percent of total CFS expenditures.
15. There are significant debt vulnerabilities arising from the high debt service to revenue and exports ratios. The CBK observed that the budget deficit projection of 4.1 percent of GDP in the 2023/2024 budget estimates indicates a positive fiscal consolidation program which could address the vulnerabilities arising from public debt. To this extent, the CBK supports the proposed revenue enhancement measures as well as reduction in government expenditure by 0.9 percent of GDP as favourable measures for fiscal consolidation.
16. The CBK points out that the decrease in domestic debt redemption by Kshs.86.9 billion is due to previous measures implemented by the Central Bank to lengthen the maturity profile of the domestic debt through issuance of medium to long-term treasury bonds. Further, amortization of external debt is expected to increase significantly due to redemption of the USD 2.0 billion Eurobond (equivalent to Ksh. 241.8 billion).
17. The CBK further observed that CFS expenditures are expected to continue exerting pressure on the government budget with debt service consuming more than 50 percent of total revenue. Interest payments alone consumed 30 percent of revenue in FY 2022/23.

b) Capacity of the domestic market to finance the FY 2023/24 Budget

18. The financing of the FY2023/24 budget deficit is largely from domestic sources. Net domestic borrowing is expected to increase to Kshs. 521.5 billion in FY2023/24 up from the revised target of Kshs. 434.9 billion in FY 2022/23, leading to an expected increase in domestic borrowing by Kshs. 98.3 billion. On the other hand, net foreign financing is projected to decrease to Kshs. 198.6 billion from Kshs. 395.8 billion largely due to the redemption of the USD 2.0 billion Eurobond (equivalent to Kshs. 241.8 billion).
19. The CBK notes that the capacity of the domestic market to support the elevated financing needs is limited. Indeed, over the last two years, the domestic market has not met its target and only managed to raise 89 percent of the borrowing programme target in FY 2021/2022 and 57.3 percent (Ksh. 249.1 billion) of the FY 2022/2023 borrowing target as at May 31, 2023. Tight domestic liquidity conditions continue to prevail due to the delayed budgeted external financing against a backdrop of elevated global inflationary pressures, heightened geopolitical tensions and significant financial market volatility.
20. Looking forward, muted T-bill and T-bond maturities in June 2023 and expected external inflows (Syndicated loan, World Bank DPO) are expected to support domestic liquidity conditions and accelerate financing towards meeting the borrowing target. Market engagement will continue to be sustained through the Bond Market Forum with the National Treasury and

the CBK continuing to enhance coordination in debt management and market development initiatives.

21. The CBK posits that the domestic borrowing target for FY2023/24 is quite ambitious due to limited market capacity. The higher borrowing target is likely to have a disproportionately negative impact on yield curve stability and market confidence, risking contagion across the total value of the outstanding debt stock. The CBK therefore proposed a downward revision of the target to factor in the prevailing liquidity conditions, external environment and support overall market stability.
22. The CBK further proposes the following to mitigate the risks:
 - i. Exploring external financing options with an optimal mix of concessional and commercial funding,
 - ii. Effective liquidity management, and
 - iii. Dealing with concentration risks in domestic debt market.
23. Additionally, aligning the fiscal framework and the Medium-Term Debt Management Strategy 2023, which seeks to raise 50 percent financing from both external and domestic sources, will minimize costs and risks on public debt.

c) Utilization of Overdraft Facility

24. The Government overdraft facility at the CBK is intended to provide temporary accommodation to the Government by offsetting fluctuations between receipts from budgeted revenue and payments (CBK Act S.46(1)(2)). The facility is limited to 5 percent of the gross recurrent revenue of the Governments previous years audited accounts. The current limit is Kshs. 80.05 billion. As at June 2nd 2023, available space was Kshs.1.08 billion since Kshs.78.96 billion had been utilized.

d) CBK initiatives and reforms to support development of the domestic debt market

25. The CBK indicated that it has undertaken the following key initiatives to facilitate ongoing reforms aimed at further development of the domestic debt market:
 - a) **Issuance of a range of medium to long-term bonds:** The Average Time to Maturity (ATM) for Treasury bonds lengthened to 8.9 years from 7.9 years in June 2020, while the ratio of Treasury bills to bonds improved to 15:85 from 30:70 in June 2020, significantly mitigating debt-refinancing risk.
 - b) **Modernizing market infrastructure:** The upgrade of the CBK Central Securities Depository (DhowCSD) is nearing completion. The DhowCSD system is a versatile market infrastructure that will transform Kenya's financial markets by improving market liquidity, enhancing operational efficiency in the domestic debt market, further promoting market deepening, broader financial inclusion through expansion of digital access, capital market growth, and positioning Kenya as the preferred financial hub in the region.
 - c) **Automation of access to government securities:** CBK rolled out TMD in February 2020, a digital channel for retail investors to access government securities through mobile phones, and Internet Banking platform for institutional investors.
 - d) **Sustained market engagement and stakeholder collaboration:** CBK has enhanced coordination with the National Treasury on debt and market development initiatives –

including debt reprofiling through switch operations, and improved market engagement through the Bond Market Forum, which has been instrumental in developing one of the fastest growing bond markets in Africa.

- e) **Implementation of liability management operations to lower debt refinancing risk:** CBK successfully conducted switch auctions in June 2020 and December 2022. The inaugural switch in June 2020 was driven by the appeal of the product to the investor pool, close engagement with stakeholders, attractive features in the destination bond and sustained consistent messaging by CBK to the market that helped strengthen confidence and credibility.

26. The CBK further gave the following policy recommendations for FY 2023/24 and the medium term:

- a) Stay the course on the fiscal consolidation plan;
- b) Explore non-debt creating financing options for public investments;
- c) Increase efficiency of public spending;
- d) Refinancing expensive debt with debt on more favourable terms.
- e) Frequent reporting and monitoring including to the relevant Committees of the National Assembly; and
- f) Continue to support the market development initiatives.

3.2. The Office of the Auditor General

27. The Office of the Auditor General has the mandate to provide financial oversight at all levels and arms of government. Article 229 of the Constitution of Kenya mandates the office to audit the accounts of any entity that is funded from public funds and public debt.
28. The OAG observed that Consolidated Fund Services (CFS) expenditure is one of the biggest expenditure lines in the budget. In the budget for the financial year 2021/2022, 38% of the gross estimated expenditure was budgeted for meeting the National Government's recurrent expenditure and 18% for development expenditure. Consolidated Fund Services, including repayments of public debt accounted for an additional 34%, while County Governments estimated expenditure accounted for 10% of the gross expenditure.
29. In terms of actual expenditure, data for the net actual expenditure with respect to the Consolidated Fund Services expenditure for the period 2017/2018 to 2021/2022 indicates that the expenditure has grown from Kshs. 583.45 billion in 2017/2018 to Kshs. 1.197 trillion in 2021/2022. This represents a 105% increase in the last five years.
30. The office of the Auditor General raised concern over the growing level of public debt in Kenya. In particular, debt has grown by 77% over the five (5) years, raising from Kshs. 4.80 trillion in 2017/18 to Kshs. 8.48 trillion in FY 2021/2022. The outstanding amount of Kshs. 8.48 trillion as at FY 2021/2022 represents 84.8 percent of the maximum Kshs. 10 trillion ceiling. The OAG further indicates that according to data from the National Treasury, public debt for FY 2022/23 is presently at 93.9 percent of the maximum Kshs. 10 trillion ceiling.
31. Expenditure on public debt has increased from Kshs. 516.93 billion reported in FY 2017/18 to Kshs. 1.041 trillion in FY 2021/2022. This growth is attributed to increase in public debt interest

payments and public debt redemptions. In 2021/2022, public debt accounted for 87% of CFS expenditure.

32. Audits undertaken by the Office of the Auditor General pertaining to accountability and sustainability of public debt expenditure raised the following concerns:

- i. The status of public debt is only included as an annexure in the Consolidated Fund Statement of Expenditure with no financial statements prepared to show the debt position. Consequently, it is not possible to ascertain the amount redeemed and current value and therefore the validity of the public debt expenditure.
- ii. There is non-disclosure of all obligations guaranteed by the national government. Notably, the loans guaranteed by the national government on Kenya Airways (Ksh. 88.3 billion), KenGen (Ksh. 24.5 billion), KPLC (Ksh. 9.9 billion), Kenya Ports Authority (Ksh. 33.5 billion) were not reported in financial year 2022.
- iii. There is non-disclosure of loans and overdrafts held by other national and county government entities as well as other government liabilities such as pending bills/accounts payable and pension arrears.
- iv. The government continues to pay commitment fees on undrawn amounts in respect of loans signed between the Government of Kenya and foreign lenders for the loans that had not been drawn. Recent data from the Controller of Budget indicates that within the first half of FY 2022/2023, the National Treasury paid commitment fees of Kshs.680.03 million. The Office recommended that the National Treasury ensures projects are ready for execution before committing the government with the credits and should also involve key stakeholders during pre-lending.
- v. The cost of domestic debt has become more expensive than the cost of external borrowings. Interest on internal debt for FY 2021/2022 stood at Kshs.378 billion (74% of total finance costs) whereas that of external debt stood at Kshs.132 billion (26% of total finance costs).
- vi. There are dormant/non-performing loans where recipients have defaulted on the repayment obligation. As at 30th June 2022, the portfolio of non-performing loans stood at Kshs.218.8 billion. This exposes the government to risks of legal suits.
- vii. Debt servicing is prone to foreign exchange loss exposure on payment of external debt. Recent data from the controller of budget indicates that in the first half of FY 2022/2023, Kshs.3.43 billion was approved to cover shortfalls in external debt payments due to foreign exchange fluctuations. The office recommended that the national government considers hedging mechanisms to address foreign exchange risks.

Pensions and Gratuities

33. Pensions and Gratuity increased from Kshs.63.1 billion in 2017/2018 to Kshs.152.98 billion in 2021/2022 representing an increase of Kshs.89.88 billion or 142% over a five-year period. In 2021/2022, the government introduced the Public Service Superannuation scheme which is a contributory scheme. This has contributed to the increase in pensions and gratuity expenditure and the overall growth in CFS payments over the period. The Office of the Auditor General observed that as of 30 June, 2022, the National Treasury had failed to remit an amount of Kshs.7.88 billion relating to employer's contribution.

34. The April 2019 Performance Audit Report on Administration of Public Service Pensions Scheme, noted that pension paid to Asian and European pensioners who retired due to Africanization of public sector after independence in 1963, is paid through the Crown Agents Bank, a United Kingdom based organization. However, no returns are submitted to authenticate the existence of the pensioners.
35. The Performance Audit report of 2019 had also identified lack of procedures to identify deceased pensioners and dependents. The audit revealed that the Pensions Department continued to pay into the accounts of deceased pensioners and dependants for a period ranging from one month to seven years. To this extent, the Office of the Auditor General recommends that the National Treasury enforces follow up by the Pensions department on filing of life certificates to identify deceased pensioners and dependants so as to ensure that payment is only made to legitimate persons. Further, the National Treasury should reengineer the Pension Management Information System to ensure it has integrity. The system should also interface with the government's Integrated Personnel Payroll Database (IPPD) to ensure tracking of government employees on the payroll.

3.3. Controller of Budget

36. The Controller of budget made the following pertinent observations relating to the CFS expenditures:
- i. **High Debt Service Costs:** In 2022, the total debt service as a percentage of revenue was estimated at 47.9 percent; implying that for every Kshs.100 collected as tax revenue, Kshs. 47.9 was used to service debt. This leaves only 52.1 percent of the tax revenue to finance development programmes aimed at reducing poverty and improving access to essential services like healthcare and education.
 - ii. **Budgeting for guaranteed debt under Salaries, Allowances and Miscellaneous (SAM):** The inclusion of guaranteed debt in this component of the CFS budget could result in an undercast in total debt stock of the country, overstated Salaries, Allowances and Miscellaneous budget and inaccurate reporting. The CoB further observed that the budget figures for salaries in FY 2022/23 were much higher than the actual salaries.
 - iii. **Liquidity cash flow constraint/ revenue shortfalls:** The National Treasury has struggled to meet its overall revenue targets, leading to delays in cash disbursements. Additionally, high debt service costs have crowded out cash to other programmes. Avoiding commitment costs, overdraft interest, and penalties and interest arising from delays in settlement could reduce the overall strain.
 - iv. **Public debt repayment distress:** The IMF debt sustainability analysis (DSA) for 2022 established that Kenya was in breach of four of the six indicative thresholds for debt burden indicators, namely: Present Value (PV) of debt to GDP ratio; PV of public debt to revenue and grants ratio; and the PV of Public and Publicly Guaranteed Debt (PPG) External debt to exports ratio. This places the country at a high risk of debt distress.
 - v. **Foreign currency debt exposure:** The depreciation of the Kenya shilling against the US dollar has led to an increase in the debt stock and debt repayments (principal & interest). The country's average debt is estimated to increase by Ksh. 40 billion every time the shilling drops a unit against the dollar.

- vi. **Utilization of borrowed funds:** The controller of budget indicate that government borrowing was most likely used to fund recurrent expenditure contrary to the provisions of section 15 of the PFM Act, 2012. Indeed, the utilization of revenue proceeds from loans cannot be exclusively traced during exchequer requests, and most requests relate to recurrent expenditure.

37. To this extent, the Controller of Budget proposed the following policy recommendations:

- i. **Establishment and operationalization of a sinking fund:** The country can contribute to the fund in the years leading up to debt maturity. This will soften the hardship of a significant revenue outlay when it falls due and also avoid charges due overdraft facility.
- ii. **Fiscal consolidation:** This can be achieved by reducing budget deficits and debt accumulation. In Addition, measures are required to improve loan disbursements and curtail commitment fees annually.
- iii. **Maintain public debt at a sustainable level:** In the short run, domestic borrowing might be better than external borrowing due to the volatility in the forex market. On the other hand, domestic debt interest is unbearably expensive, averaging above 13 per cent, and increased domestic borrowing increases the risk of crowding out private investment and the forex market. A delicate balance must therefore be maintained.
- iv. **Progress report on capital projects:** To enhance oversight and transparency, maintain regular progress reporting to oversight institutions on capital projects financed through debt financing. The report should include feasibility studies and details of commitment fees, if any.
- v. **Pensions and Gratuities:** Adequate measures should be taken to fast-track pension and gratuities conversion from defined benefits to defined contributions. In addition, the proposal in the BPS to have a pension arrangement that covers the workforce in both formal and informal payrolls should be actualized.
- vi. **Securitization of pending bills:** The proposed securitization of pending bills presents a dilemma. On one hand, it will solve the problem of pending bills and on the other hand, it will create a new problem by increasing the debt stock repayment of the new structured debt.
- vii. **Transparency in CFS Management:** There should be measures to enhance transparency and accountability in managing CFS expenditures, including conducting regular audits, publishing financial reports, and promoting citizen participation in budgetary processes.

3.4.The National Treasury

The National Treasury made the following submissions to the Committee:

- 38. Public debt stock:** According to data provided by the National Treasury, as at 30th March 2023, gross public debt was estimated at Ksh.9,634.1 billion (66 percent of GDP in nominal terms); a Kshs.488.1 billion increase from the end of December 2022 level of Kshs.9,146.0 billion (67 percent of GDP in nominal terms). This amount comprises an external debt amount of Kshs. 5,092.5 billion (52.9 percent of total debt) and a domestic debt amount of Kshs.4,541.6 billion (47.1 percent of total debt).

39. **Financing the 2022/23 fiscal deficit:** The National Treasury has submitted proposals for financing the anticipated deficit of Kshs. 663.5 billion in the FY 2023/2024 budget estimates. This includes the proposals to borrow and other forms of public liability including commitment fees that are budgeted for. As per the FY 2023/2024 Budget Estimates fiscal framework, external debt disbursement is estimated at Kshs. 607.1 billion, of which Kshs. 475.6 billion will be used for external debt repayment, leaving a net foreign financing of Kshs. 131.5 billion. The net domestic financing will be Kshs. 532.0 billion. The external financing and domestic financing for FY 2023/24 will be Ksh. 607.1 billion and Ksh. 532 billion respectively. This is close to the 50:50 percent financing strategy approved in the FY 2023/24 Medium Term Debt Management Strategy (MTDS). Notably, the share of fiscal deficit to GDP is expected to decline in the medium term due to the fiscal consolidation plan.
40. **Domestic debt service:** domestic debt service relates to payments of interest and redemptions to Treasury bonds and bills, pre-1997 government overdraft loan, miscellaneous (advertisement), government overdraft and commissions to CBK. The target for domestic debt borrowing for the fiscal year 2023/2024 is assumed at Kshs.532 billion. The interest rate for the issuance of treasury bonds are assumed at an average of 15 percent per annum while the interest rates on Treasury bills for 91 days, 182 days and 364 days average at 11 percent per annum based on the prevailing market conditions.
41. **External debt service:** In preparation of the external debt service projections for both interest and principal, the National Treasury relies on the Debt Management System (CS-DRMS) to extract the debt service flows in foreign currencies for each individual loan. The exchange rate is assumed to continue depreciating at an average rate of 1.16 percent in line with IMF program under the Extended Credit Facility (ECF) and the Extended Fund Facility (EFF). With regard to interest rates assumptions, floating exchange rates are assumed to remain close to the current levels in the medium term. With regard to rollovers, it is assumed that concessional debt will be rolled over at existing terms with no assumption on new commercial debt in FY 2023-2024; and that the commercial ISB maturing in 2024 will be rolled over with a coupon of 11 percent based on the coupon of the Republic of Egypt (B3/WB+) most recent issuance in March 2023.
42. **Guaranteed debt and Miscellaneous:** On the Kenya Airways Ltd (KQ) guarantee, the National Treasury indicated that the government has made total payments amounting to USD 94.9 million of which principal payments amount to USD 82.6 million and the total interest payments amount to USD 12.3 million. The current outstanding loan balance as at end of April 2023 is USD 402.9 million.
43. **Subscriptions to international organisations:** Until 2017, the Government through the National Treasury has been paying share subscription to international organizations under various legislations. In the 2023/2024 budget estimates, there is no budget for the subscriptions under the CFS as the National Treasury awaits a realignment of the legislations governing subscriptions to international organisations.
44. **Pension Expenditures:** The increase in ordinary pension expenditures is primarily due to the biennial pension increase; the expected new retirees within the period; late submissions from MDAs of claims and the remaining portion of revised claims for teachers who retired between 1997 and 2003. Notably, the refund to the UK government has decreased from Kshs.150 million to Kshs.41 million due to a reduction in the surviving number of pensioners paid through the

Crown Agents Bank in the UK to 242 due to natural attrition. It is noted that the estimated budget for employer contribution to the public service superannuation scheme (PSSS) declined by Kshs.3.43 billion due to a return to baseline from a spike in FY 2022/2023 occasioned by reallocation to cater for outstanding employer contributions for the months of April, May and June 2022.

45. **Salaries of constitutional office holders:** The FY 2023/2024 budget estimates is Kshs.4.73 billion to cater for the personnel costs arising from the office holders of various constitutional offices.
46. **Maturing International Sovereign Bond in June 2024:** The maturing sovereign bond in June 2024 is USD 2 billion equivalent to approximately Kshs. billion 277.9 billion. This bond has a coupon/interest cost of 6.875 percent. In light of the depreciating exchange rate the National Treasury expects the Kenya Shilling equivalent of this bond in June 2024 to be slightly higher than the current Kshs.277.9 billion. Notably, the prevailing high interest rates in the international debt capital markets coupled with the country's rating means that Kenya is likely to rollover the June 2024 Sovereign Bond Maturity at a higher interest cost.

4.0. OBSERVATIONS

47. **Arising from the submissions above, the committee made the following pertinent observations:**
- i. The proposed budget estimates for FY 2023/2024 contained a fiscal deficit of 4.1% of GDP. However, the approved FY 2023/2024 estimates increased the fiscal deficit to 4.4% of GDP. While this is still within the fiscal consolidation path approved in the 2023 Budget Policy Statement, the committee cautions against in-year budget adjustments that could expand the deficit further. Notably, it is not clear how this additional expenditure will be financed but it is highly likely that this may be through additional borrowing.
 - ii. The financing structure in the budget estimates deviates from the approved debt strategy mix of 50:50 for domestic and external borrowing; with domestic borrowing expected to be the primary source of loan financing for FY 2023/2024, despite carrying a high cost and risk impact. Indeed, as indicated in the submission by CBK, the domestic market has not met its target in the last two financial years and only managed to raise 89 percent of the borrowing programme target in FY 2021/2022 and 57.3 percent (Ksh. 249.1 billion) of the FY 2022/2023 borrowing target as at May 31, 2023. As such, dependence on the domestic market can only be undertaken under high interest rate conditions if the budget is to be financed under the set modalities. This will increase domestic debt service expenditures thereby constraining fiscal space for other budgetary expenditures.
 - iii. Borrowing along the medium to long term spectrum has been challenging given the preference of the market for short term treasury bills which has seen the performance rates for long-term instruments fall.
 - iv. The Public Servants Superannuation Scheme (PSSS) has been facing challenges with regard to delayed employer contributions. The efficient management of the scheme is critical as this was intended to ease the pensions burden on the government in the future as well as benefit retirees through improved returns and prompt payment upon retirement.
 - v. There is no policy document to guide on expenditures under the Consolidated Fund Services.

- vi. The inclusion of guaranteed debt in the budget for Salaries, Allowances and Miscellaneous (SAM) is understating the total debt stock for the country.
- vii. Quarterly reports by the Controller of Budget have revealed that the budgeted figures for salaries in FY 2022/23 were much higher than the actual salaries. Thus the salaries and allowances budget may be overstated.
- viii. The slow pace of implementation of house resolutions is slowing down policy reforms.

5.0. RECOMMENDATIONS

48. In view of the foregoing, the committee recommends as follows:

- viii. That, in line with the fiscal consolidation plan, any in-year adjustments to the FY 2023/2024 budget estimates undertaken by the National Treasury should be within the approved 2023-2024 fiscal deficit limit of 4.4 percent of GDP in order to mitigate against unplanned borrowing.
- ix. That, in line with the House resolutions on the Medium-Term Debt Management Strategy 2023, in FY 2023-2024, the National Treasury should adhere to the approved 50:50 mix of domestic to external borrowing and any deviation in the funding strategy should be approved by the National Assembly.
- x. That, fifteen (15) days after the end of each quarter in each financial year, the National Treasury should submit to the National Assembly, a quarterly report on the status of all CFS expenditures, indicating actual expenditures compared to budgeted expenditure.
- xi. That, for any in-year CFS expenditure adjustments in FY 2022/2023 as well as in subsequent budget cycles going forward, the National Treasury should report the overdraft facility as well as all expenditure related to guaranteed debt as separate and substantive components of public debt servicing expenditures and not under the salaries and allowances component of the CFS.
- xii. That, the National Treasury should ensure timely payment of pensions to pensioners, and prioritize the prompt disbursement of employer contributions under the Public Servants Superannuation Scheme (PSSS).
- xiii. That, in the next budget cycle 2024/2025, the National Treasury should submit explanatory notes on the CFS expenditure along with the budget estimates for FY 2024/2025.
- xiv. That, by 31st December 2023, the Office of the Auditor General should undertake a special audit on pensions relating to pensioners paid through the Crown Agents Bank in the UK and submit a report to the National Assembly within the stipulated timeframe.

SIGNED

HON. DR. MAKALI MULU, MP.

VICE-CHAIRPERSON, PUBLIC DEBT & PRIVATIZATION COMMITTEE

21.06.2023

DATE