THE ROLE OF PARLIAMENT IN PUBLIC DEBT OVERSIGHT IN KENYA

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Foreword

The COVID-19 crisis continues to have a dramatic impact on the economy and public finances of many countries, forcing national governments to substantially increase borrowing. Debt can be an important mechanism to ensure speedy response to crisis situations like the pandemic, to invest in infrastructure projects or to help reach the Sustainable Development Goals. At the same time, the social cost of unsustainable debt can be devastating, particularly for women and marginalized groups.

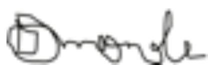
While budgeting, borrowing, and spending are under the purview of the government, the parliament has the important role of acting as an effective counterbalance so that sound decisions are taken that bring short and long-term benefits to citizens. This can include strong fiscal oversight, specific public debt legislation and mechanisms for legislative debt management and oversight which ensure that decisions impacting citizens' future are transparent and accountable.

This report is part of a National Democratic Institute (NDI) program that highlights the critical role that parliaments have in public debt management and oversight, and assists parliamentarians and parliamentary staff in accessing the required knowledge and tools to exercise their legislative and oversight role with regards to public debt management.

In Kenya, the parliament's role with respect to fiscal responsibility and debt management is enshrined in the constitution making it all the more pressing for the legislature to play a central role in reinforcing public debt transparency and accountability. Against a backdrop of increasing public debt levels and strains on Kenyan fiscal stability, this report is intended to provide members of parliament and staff with background on the history of public debt in Kenya and the public debt legal framework, as well as practical suggestions for future improvements.

The Institute acknowledges Dr. Charles Munene Gachoki, Dr. Stephen Njaramba and Dr. George Mbugua Kariuki for compiling and putting together the information in this report and the contribution made by the NDI-Kenya and Washington DC staff in contextualizing and editing the report.

NDI is a non-profit, non-partisan, non-governmental organization that works in partnership around the world to strengthen and safeguard democratic institutions, processes, norms and values to secure a better quality of life for all. NDI has worked in 156 countries since its inception in 1983. Since 1993, NDI has supported Kenyan efforts to strengthen democratic institutions and advance democratic reforms, including political party development and dialogue, issue-based policy development, women, youth and PWD inclusion and engagement, citizen and international election observation and political and electoral reform initiatives.



Dennis Omondi
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Abbreviations and Acronyms

BAC	Budget and Appropriation Committee
BPS	Budget Policy Statement
BROP	Budget Review and Outlook Paper
CBK	Central Bank of Kenya
CS	Cabinet Secretary
CSOs	Civil Society Organisations
DSA	Debt Sustainability Analysis
DSSI	Debt Service Suspension Initiative
EAC	East African Community
ECF	Extended Credit Facility
EFF	Extended Fund Facility
ERS	Economic Recovery Strategy
FDI	Foreign Direct Investment
FY	Financial Year
GDP	Gross Domestic Product
GFC	Global Financial Crisis
HIPC	Highly Indebted Poor Countries
IMF	International Monetary Fund
IPU	Inter-Parliamentary Union
LIDCs	Low Income Developing Countries
MTDMS	Medium-Term Debt Management Strategy
MTEF	Medium-Term Expenditure Framework
MTP	Medium-Term Plan
NIMES	National Integrated Monitoring and Evaluation System
NPV	Net Present Value
OAG	Office of the Auditor General
PAC	Parliamentary Accounts Committee
PBO	Parliamentary Budget Office
PDMS	Public Debt Management Strategy
PEV	Post-Election Violence
PFM	Public Finance Management
PIC	Public Investment Committee
PPG	Public and Publicly Guaranteed
PPP	Purchasing Power Parity
REER	Real Effective Exchange Rate
SAPs	Structural Adjustment Programs
SFAC	Special Funds Account Committee
SGR	Standard Gauge Railway
SSA	Sub-Saharan Africa
SWGs	Sector Working Groups
UNDP	United Nations Development Programme

Executive Summary

Kenya is drowning in public debt and is likely facing debt distress. This has largely resulted from the enlarging budget deficit, unproductive expenditures and large, costly and risky investments. Public debt is having a far-reaching effect on the economy as more than 50 percent of the public revenue is being used to service the debts annually. Public debt also risks overburdening future generations. The public debt portfolio in Kenya demonstrates a complex and risky financial structure that is generating instabilities in the balance of payments and resulting in an uncompetitive and unproductive domestic economy. Out of the total public debt, external debt accounts for over 52 percent. Parliament is mandated by law to develop a debt management legal framework and oversee the disbursement and expenditure of public debt as well as examine the trend of the public debt.

Borrowing by the Government of Kenya is governed by the Constitution (2010), the Public Finance Management (PFM) Act, 2015 and the national fiscal policy. The Constitution of Kenya and the PFM Act provide the legal framework for public debt management and borrowing. Due to the significant growth and complexity of public debt in Kenya, a public debt policy was prepared in the year 2020. According to Article 211 of the constitution, Parliament may pass legislation on borrowing prescribing the terms of borrowing and imposing reporting requirements. The cabinet secretary for the National Treasury is also required to present information concerning any loan or guarantee within seven days after either House of Parliament so requests by resolution. The guiding principle of borrowing is espoused in Section 50(1) of the PFM Act. It stipulates that in guaranteeing and borrowing money, the national government shall ensure that its financing needs and payment obligations are met at the lowest possible cost in the market, which is consistent with a prudent degree of risk, while ensuring that the overall level of public debt is sustainable. A requirement for parliament, as provided in Section 15(2)(d) of the PFM Act, is that the national debt limit is set. The National Treasury should ensure that the limits are maintained at sustainable levels, which means that the set margins should not be exceeded at any given time. According to Section 15(2)(c) of the PFM Act, a key fiscal principle is that borrowing should be used only for the purpose of financing development expenditure and not for recurrent expenditure.

To ensure accountability, Section 32 of the PFM Act provides that each year, a report is prepared by the CS-Treasury to parliament on the total number of loans guaranteed that particular year with details of the parties, the interest rates and terms of repayment for the loan. The legal framework is meant to promote prudent and sound debt management practices for both national and county governments to enhance effectiveness and transparency in public finance. Despite this elaborate legal framework, this study has established that the actual position is that once parliament passes the Finance Bill annually, the only time it gets involved in debt management is when the audit report from the OAG is made available, which could take as long as three years.

The following are some of the observations from the study:

i. Public participation in the public debt management process as required by the law is hardly carried out. A draft policy to actualise this was started in 2018 but is yet to be finalised. Parliament has been unable to enact this legislation as they fail to prioritize it.
ii. Despite the existence of a public debt ceiling as set by parliament, its role in debt management is merely a legal limit but not a sustainability indicator. This is demonstrated by the fact that the limit is changed any time the executive wishes to have it changed and, therefore, it fails to control the public debt burden.
iii. Section 49 of the PFM Act is silent on who should ratify public loans once they are raised by the CS-Treasury. This is the biggest gap in law such that the Treasury acts unilaterally in the procurement of public loans.
iv. The CS-Treasury does not willingly provide debt-related information to parliament and when they make a request, the National Treasury provides incomplete information.
v. Members of parliament lack the capacity for meaningful debate on debt. They are confronted with a lot of paperwork on debt and budget and have limited knowledge to interpret the outputs and the information therein.
vi. Although the parliamentary accounts committee (PAC) and parliamentary investments committee (PIC) have the mandate to summon any public officer concerning public finances, more often than not, cabinet secretaries do not appear in person or fail to attend to the sermons of the house committees as the parliamentarians give their political allegiances. Additionally, sanctions have not been effectively applied to the public officials for ignoring the summons.
vii. Persistent increase in the budget deficit has resulted in a disproportionate rise in public debt in comparison to the GDP growth rate. External borrowing has surpassed domestic borrowing with the cost of borrowing spiking due to the government's increased preference for commercial loans. With the country unable to generate adequate foreign reserves to facilitate the settlement of external debt, Kenya is being forced to borrow to pay the maturing foreign obligations.
viii. Kenya's real effective exchange rate (REER) has been on an appreciating trend in recent years and has suffered weak export performance. Kenya continues to use its monetary policy to manage its exchange rate, arguably to safeguard against the risk of the exchange volatility. However, it denies the country its initial markets access as the prices domestically become expensive and foreign prices are deemed lower. The result is that the exports are not stimulated, and the imports keep on rising. This has put the country in a state of constant borrowing in order to pay for its import of goods and services.

In view of the above findings, the study makes the following recommendations:

i. The need for a draft policy and regulations on public participation as stipulated by the PFM Act. Parliament should give power to the public in deciding on public borrowing by enacting public participation law.
ii. Regular capacity building to political parties, political leadership, CSOs and the public on the role of parliament in oversight, legislation and representation regarding budget and public debt. In addition, CSOs, NGOs and development partners need to run programmes that empower the public on the need to ensure that their elected representatives play their oversight role. This can be achieved through community training and public awareness

campaigns. This can also be done by CSOs and NGOs through training of budget champions who would, in turn, educate members of the public on the budget-making process, mobilize the public to attend and effectively participate in public hearings and the submission of memoranda to parliament.

iii. Parliament needs to put a threshold on the number of supplementary budgets. Supplementary budgets should be allowed only under unforeseen and emergency situations.
iv. Parliament needs to ratify all new loans before they are procured in order to improve public debt reporting and strengthen public debt transparency. Loans with non-disclosure clauses need to be avoided or vetted by the parliament before acquisition.
v. The parliamentary budget office (PBO) needs to carry out more research, analysis and modelling. This is to enable the office to produce useful reports based on universal models that can be used by parliament to adequately make critical oversight decisions. In addition, building of the capacity of PBO and, in particular, their technical capacity to enable them to fully unpack the budget documents with and for the members of parliament.
vi. Review of the PFM Act needs to provide for a timeline for the audit and reporting of public debt by the auditor general.
vii. The threshold to guaranteed loan and judgement criteria on the loans guaranteed by the national government should be made clear. Over-guaranteeing to non-credible government institutions needs to be curtailed. State-owned enterprises with a guaranteed loan should not access new loans until the current loan is paid up.
viii. Strengthen the capacity of public officers to ensure effective public participation in the budget-making process and monitoring.
ix. Commitment fees as an expense which is lost for not drawing down on the loans is on the rise. Legislation on these commitments is required. Commitments to loans should only happen once the programs and projects are ready for implementation. This will then reduce wastages incurred through commitment fees and, therefore, eliminate the gap between budgeted and actual public debt.
x. A resolution duly be moved and passed by parliament as provided for in Section 15(2)(d) of the PFM Act setting the national indebtedness limits and pegged on real economic performance. This is to ensure that the public debt is sustainable, and the set margins should not be exceeded at any given time unless approved by parliament.
xi. Borrowing should be used only for the purpose of financing development expenditure and not for recurrent expenditure in accordance with Section 15(2)(c) of the PFM Act. This law needs to be enforced by the parliament.
xii. Regulate the proportion of public debt financed by commercial loans as per Section 50(1) of the PFM Act.
xiii. Enforce the country's exchange rate closer to its equilibrium and purchasing power parity.

Methodology

The study used various methods to collect information and was guided by the objectives of the study. These objectives were to analyse the public debt situation by looking at the history of Kenya's debt and to review the legal framework underpinning parliamentary budget and debt processes outlining the oversight role of parliament with a view of identifying gaps. The third objective was to review the current parliamentary oversight practice to identify areas that require strengthening parliamentary budget and public debt oversight. Data in response to COVID 19 was also included in the study.

Chapter 1 involved desktop research examining documents from the government of Kenya specifically the economic surveys of various years and the Central Bank of Kenya reports to give analysis of the public debt situation in Kenya. This traces back to 1963. It should be noted that one of the key challenges is availability of official government data.

Chapter 2 examined the legal framework on public debt in Kenya by scrutinizing the Public Finance Act, the Constitution of Kenya and various legislation around public debt. Apart from what the law speaks to, application of legislation has also been discussed.

Chapter 3 was formulated from drawing from the desktop research in chapters 1, 2 and key informant interviews with different stakeholders. These included members of parliament and key civil society organizations that work in the governance and accountability sector.

Chapter 4 on summary and recommendations of the study was drawn from desktop research, informant interviews and expertise of the different actors.

Process

Information was collected from September 2021 to January 2022. A fact checking exercise by public finance management experts was carried out between February and May 2022. Peer review of the study was carried out in June 2022. The NDI Kenya and Washington DC teams continuously reviewed the document until publication.

1.0 Background

Public debt is all financial obligations attendant to loans raised and securities issued or guaranteed by the national government[1]. Citizens, as taxpayers, are required to provide funds through taxation for payment of the principal amount and interest on the debt. Borrowing by the state happens when the government floats bonds either internally from banks, organisations and individuals or externally from other countries, foreign private funds or international financial institutions. Whereas **internal debt** is accumulated within the country, public borrowings from other denominated currencies, other than the home currency, constitute **external debt**.

Internal loans are issued in the domestic currency, while **external loans** are issued in foreign currencies (whether the creditor is local or foreigner). External public borrowing is largely acquired to permit the import of real resources and enables the country to consume more than it produces. Developing economies tend to turn to foreign borrowing mainly due to the underdeveloped domestic money market[2] and the need to have a debt structure that balances both the risk and cost of public debt. An important feature of external debt is that usually foreign exchange resources of the borrowing country increase when the loans are received in terms of foreign currencies. However, when it comes to the repayment of such loans, commonly referred to as debt servicing, foreign exchange reserves are depleted to that extent. The worst case is when foreign exchange reserves are not adequate, which must be earned through exports, which leads to further borrowing in foreign markets to service the external loans.

Since under internal debts, borrowing takes place within the country, the availability of total resources does not arise. This is because borrowing will simply imply transferring resources from the individuals and institutions to the Treasury. Similarly, payment of interest for repayment of principal of internal loans would transfer resources from taxpayers to bond-holders. An internally held public debt, thus, represents only a commitment to affect a certain transfer of purchasing power among the people within the country. It, therefore, has no direct net money burden as such[3]. It amounts to a redistribution of income in the community from one section to the other. On the other hand, external debt leads to a transfer of wealth from the lender nation to the borrower nation. Prudent utilization of public borrowings is requisite to enhance economic growth and development resulting in repayments of the public debt. However, imprudent use of borrowed resources burdens the economy, particularly future generations.

The debt portfolio in a country can contain a complex and risky financial structure that can generate an unstable balance of payments, currency risks and general financial instability

1 Article 214, Constitution of Kenya (2010).

2 Ugo Panizza, *Domestic and External Public Debt in Developing Countries*, United Nations Conference on Trade and Development Discussion Paper (United Nations, March 2008), https://unctad.org/system/files/official-document/osgdp20083_en.pdf.

3 J.M. Keynes, "The German Transfer Problem," *The Economic Journal 39*, no. 153 (March 1929): 1-7, https://academic.oup.com/ej/article-abstract/39/153/1/5283233?redirectedFrom=fulltext.

rendering economies vulnerable to external shocks. Many countries seek to support their financial structures by establishing, where possible, portfolio guidance related to the desired currency composition, duration and maturity structure of the debt to control these risks.

Historically, some of the known propagators of economic crises have included poorly structured debt in terms of their maturity, currency composition, interest rate as well as commitment liabilities. For example, a large volume of short-term debt that does not have a fixed rate of interest, i.e., floating-rate debt, has seriously exposed governments to fluctuations in the financial market, such as the Mexican financial crisis. Foreign currency debt has also been noted to lead to exchange rate risks.

In reducing the risks emanating from public debt, prudent debt management, along with sound policies for managing contingent liabilities, is required[4]. In a representative democracy, the burden of oversight of prudent debt management is with the parliament. In such democracies, parliament develops a debt management legal framework, approves debt management policy, oversees the president and makes sure that the Treasury does not expose the country to a financial crisis. Effective parliamentary oversight is therefore not only key to enhancing government's transparency and accountability, but also for efficient management of expenditure and revenue in the budget. Parliament must also put in place a sound public debt management strategy (PDMS) to ensure that optimal debt is acquired to fund budget deficits at minimal cost while ensuring the debt-related risks are practical over the medium and long term. For a PDMS to work effectively, it needs to be bolstered by a robust legal framework. A good public financial management law should cover the authorization status of debt, servicing of debts, debt ceilings, the purpose for which the debt is acquired, the relationship of institutions and the requirements for control, audit and reporting.

1.1 Public Debt Situation in Kenya

Over the last decade, government spending grew exponentially, outpacing its revenues. This has necessitated regular borrowing resulting in the accumulation of public debt.

1.1.1 Evolution of Public Debt in Kenya

This section traces the public debt situation in Kenya since the country attained its independence in 1963. The public debt figures are presented as a percentage of gross domestic product (GDP). The figures are also compared with economic growth over the same period as shown in Table 1.1.

4 D. S. Hakura, "Back to Basics: What is Debt Sustainability?" *Finance & Development 57*, no. 003 (September 2020): 60-61, https://www.imf.org/en/Publications/fandd/issues/2020/09/what-is-debt-sustainability-basics.

Table 1.1: Evolution of Kenya's Public Debt and Economic Growth

Period	Public Debt (% of GDP)	Public Debt Annual Growth Rate (%)	Annual GDP Growth (%)	Political Regime
1963-1980 (Annual Average)	28.2	-	6.91	Jomo Kenyatta/Moi
1981-1990 (Annual Average)	51.3		4.80	Moi
June 2002	59.2	1.31	0.5	
June 2003	61.53	13.4	2.9	Kibaki
June 2007	43.7	1.54	6.9	
June 2012	34.26	9.8	4.6	
June 2013	35.66	15.96	3.8	Uhuru Kenyatta
June 2017	51.94	21.76	3.8	
June 2019	56.63	15.27	5	
June 2020	62.25	15.24	-0.3	
June 2021	68.22	15.20	2.9	

Source: Kenya Economic Survey (various issues)

Table 1.1 allows one to draw several scenarios relating to the growth of public debt as a percentage of GDP and economic growth, as well as how they coincide with the different political regimes since independence. It should be noted that economic growth is essential for any economy to cater for improvements in welfare and fiscal stabilization and for an economy to raise enough resources for debt repayments. In situations where the growth in public debt outpaces the economic growth (increasing total debt as a percentage of GDP), there is always a high risk of debt distress.

The period between 1963 and 1980 shows an episode of low public debt associated with a growing economy[5]. The average public debt was at 28.2 percent of GDP against an average of 6.91 percent growth in GDP. This period was largely under President Jemo Kenyatta. Despite the economy experiencing oil shocks in 1973 and an offer boom and the collapse of the East African Community in 1979, there was minimal debt accumulation. The economy also recorded a relatively high level of annual GDP growth. As such, the county's debt situation was comparatively sustainable.

Between 1981 and 2002, there was an increased accumulation of public debt with low levels of economic growth. This period was under President Moi. During the same period, Kenya experienced drought in 1984, political instability in 1982, structural adjustment programs (SAPs) between 1992 and 2000, the Goldenberg scandal, suspension of foreign aid and the rapid depreciation of the Kenya shilling that led to an increase in the accumulated nominal debt.

5 Benson Kiriga, Hellen Chemnyongoi, and Peris Wachira, *Discussion Paper No. 245 of 2020 on Optimization of Public Debt and Its Impact on Kenya's Economic Growth* (The Kenya Institute for Public Policy Research and Analysis, 2020), https://repository.kippra.or.ke/bitstream/handle/123456789/3059/DP245.pdf?sequence=1&isAllowed=y.

From the year 2003 to 2012 under President Kibaki, there was a decrease in public debt stock as a percent of GDP associated with a growing economy. Kenya's public debt to GDP ratio declined from 61.53 percent (June 2003) to 34.26 percent (June 2012). As a result, the percentage annual economic growth rate was above the annual growth rate in debt. This implied that the country's debt situation was stable. Kibaki's government implemented the Economic Recovery Strategy for Wealth Creation (ERS), a reduction in budget deficits and the implementation of the medium-term plan (MTP). The prudent macroeconomic management sailed the economy through the 2008 global financial crisis (GFC) and the 2007/2008 post-election violence (PEV)[6].

The period between 2013 and 2021 under President Uhuru Kenyatta witnessed an incessant increase in the stock of public debt. The incremental growth in public debt did not realize commensurate economic growth, hitting a rock bottom negative GDP growth in 2020[7]. During this period, Kenya's public debt to GDP ratio increased from 35.66 percent (June 2013) to 68.22 percent (June 2021). The increase in debt to GDP ratio was driven largely by spending on infrastructure projects thereby increasing fiscal deficits and raising debt vulnerabilities and more recently, increased big spending on COVID-19-related interventions. The growth of public debt has been explosive, and above the GDP growth with a total public debt stock increasing from Ksh. 1.894 trillion (June 2013) to Ksh. 7.712 trillion (June 2021). This reflects a 307 percent growth in the overall public debt against a 112.8 percent growth in the nominal GDP over the same period. Kenya is likely facing debt distress. The country's debt carrying capacity was revised from strong in 2017 to medium in 2020[8]. This has necessitated the government to seek assistance and implement a fiscal consolidation program supported by the International Monetary Fund (IMF) and the World Bank.

1.1.2 Public Debt Composition in Kenya

Kenya's public debt comprises both domestic and external debt. Treasury bonds are the main source of domestic borrowing, while external sources are comprised of multilateral, bilateral and commercial borrowing. From 1963 to the mid-1990s, external debt accounted for over 90 percent of total debt. The debt portfolio changed with the freezing of external funding by the World Bank in the 1990s to force the country to adopt the structural adjustment programmes (SAPs). This resulted in great improvement in the domestic debt market, and by June 2000 external debt accounted for 65 percent of total public debt. By June 2010, domestic debt accounted for 53.86 percent and remained over the 50 percent mark up to June 2016. The government of Kenya demonstrated a commitment to shift debt composition to domestic debt to minimize risk exposure due to fluctuations in the foreign exchange rate associated with the external debt portfolio. However, after June 2016, the trend reversed with external debt funding from the eurobond and project support financing (PSF). By June 2021, external debt accounted for 52 percent of total public debt, as depicted in Figure 1.1[9].

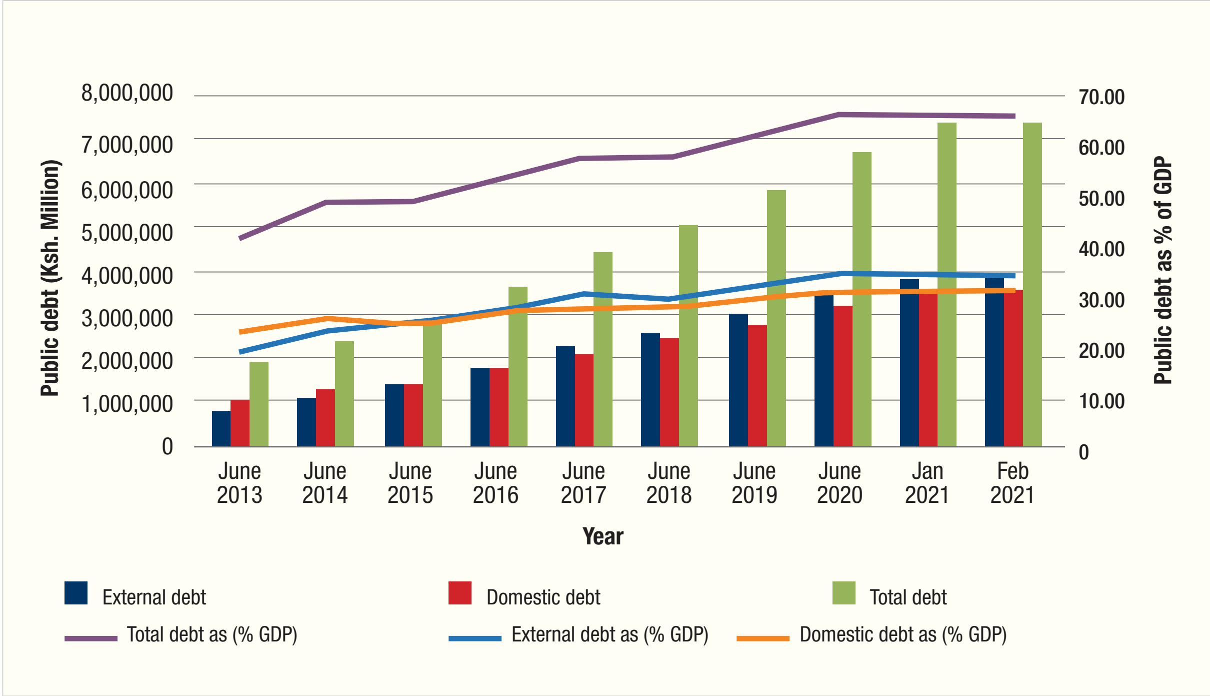
6 Ibid.

7 *Economic Survey, 2021* (Nairobi: Kenya National Bureau of Statistics, 2021), https://www.knbs.or.ke/wp-content/uploads/2021/09/Economic-Survey-2021.pdf.

8 World Economic Outlook, October 2020.

9 Graphs and computations are based on public debt and gross domestic product data accessed from various issues of *Economic Survey* for the period between 2013 and 2021 and the Central Bank of Kenya website accessed on January 2022 through Public Debt | CBK (centralbank.go.ke).

Figure 1.1: External vs. Domestic Debt Trend in Kenya (2013-2021)



Source: Author Computation Using Study Data

Figure 1.1 shows that, as the total public debt continues to swell, external debt has equally increased from Ksh. 843.562 billion in 2013 to Ksh. 4.015 trillion in June 2021. Domestic debt, on the other hand, increased from Ksh.1.050 trillion reported in 2013 to Ksh.3.697 trillion in June 2021. This reflects a 376 percent and 252 percent growth rate for external and domestic debts respectively. The implication is that the country increasingly requires foreign currency for expanding imports. The country's high dependence on foreign currency means that its exchange rate is prone to external shocks. Debt in foreign currency has major risks and its excessive leverage can lead to pressure on the exchange rate and monetary policy distress.

Multilateral and bilateral debts tend to be less expensive, are low risk as they attract low interest rates and have a longer average time to maturity and grace period relative to commercial loans. Commercial debt, including international syndicated loans and the PSF (supplier credit), is the most expensive and risky component of external public debt.

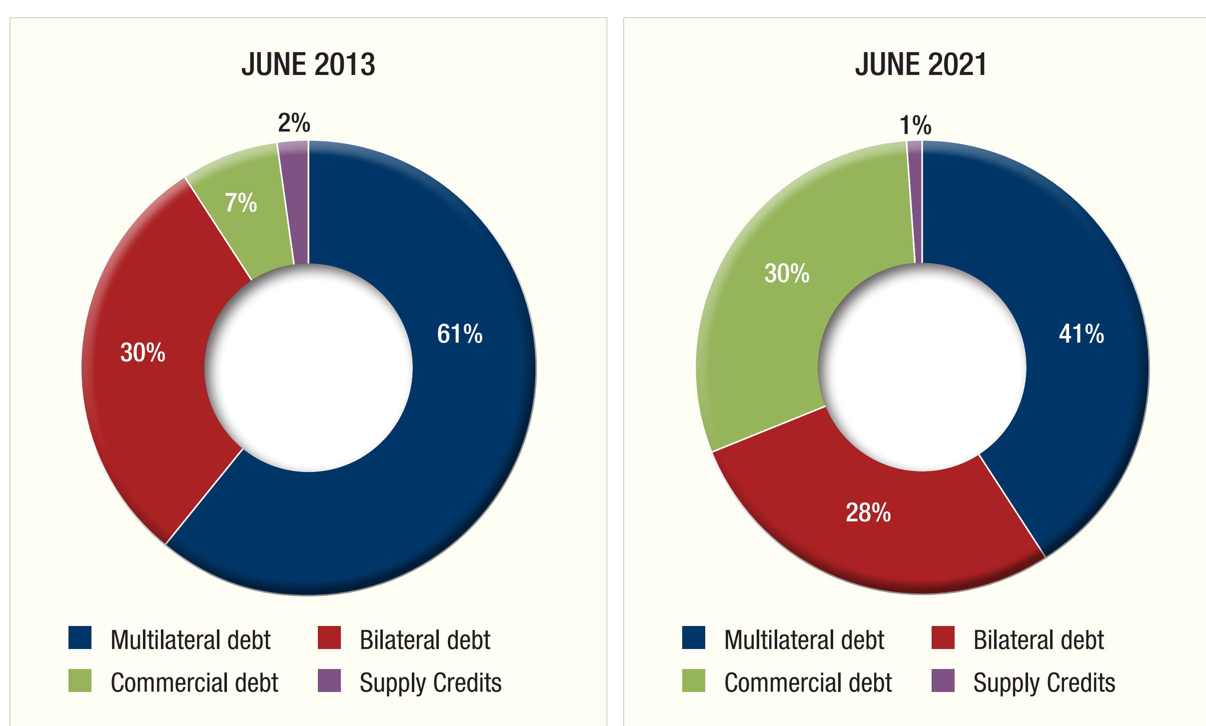
The trend and composition of external debt in Kenya from June 2013 to June 2021 are presented in Table 1.2 and Figures 1.2 and 1.3.

Table 1.2 Composition of External Debts, June 2013 - June 2021 (Ksh. Million)

Composition	2013	2014	2015	2016	2017	2018	2019	2020	2021
Multilateral	511,790	597,340	684,631	798,842	844,389	829,846	914,394	1,321,629	1659411.3
Bilateral	257,537	289,914	445,057	548,351	722,569	815,388	996,058	1,074,258	1064272.2
Commercial	58,928	234,799	276,937	432,377	711,893	906,440	1,095,754	1,102,294	1106476.3
Supplier Credits	15,207	16,452	16,628	16,628	15,303	16,725	16,932	17,631	12162.1
Foreign Debt (% of GDP)	15.88	18	20.46	23.74	27.04	27.41	29.4	32.69	35.52
Foreign Debt (% of Total Debt)	44.8	45.8	50	50	52	51	52	53	52

Source: Kenya Economic Survey (various issues)

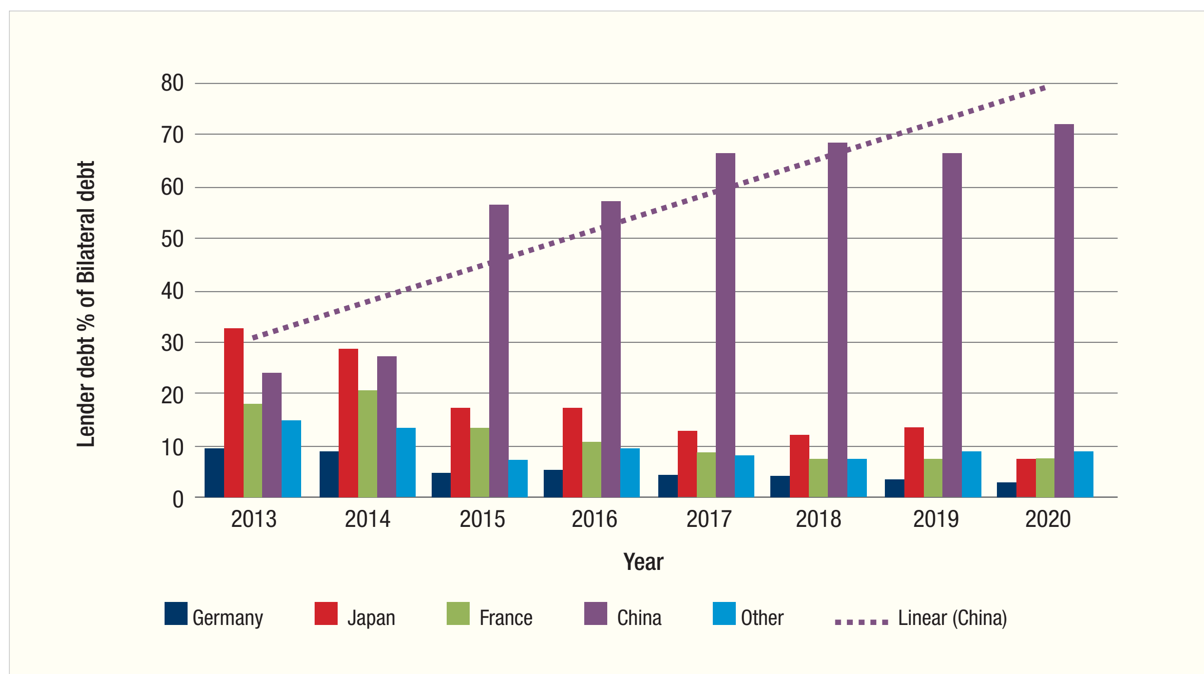
Figures 1.2 and 1.3: Comparative Composition of External Debt in Kenya



Source: Author Computation Using Study Data

Table 1.2 and Figure 1.2 show that as at June 2013, the largest component of financing was from concessional and semi-concessional sources with multilateral and bilateral debts accounting for over 91 percent of external debt. Commercial debts only accounted for 6.99 percent and supply credits for 1.80 percent. Over the years, this trend changed and by June 2021(Figure 1.2), the preference for multilateral and bilateral debt dropped to 69 percent of external debt. As a consequence, commercial debt as a share of external debt grew from 6.99 percent in the year 2013 to 30 percent in 2021. The increase resulted from the issuance of sovereign bonds and commercial syndicated loans, which has raised both the cost and risk of public debt in Kenya. During the same period, the leading bilateral lender shifted from Japan to China, as shown in Figure 1.4.

Figure 1.4: Composition of Bilateral Lending of Kenya's External Debt



Source: Data from Kenya Economic surveys (various issues)

As at June 2013, China had a share of 24 percent of bilateral lenders of external debt which has since increased to a provisional share of 72 percent of bilateral debt in 2020[10]. This growth in project support financing debt from China has raised concerns surrounding transparency and accountability, particularly regarding the cost of the debt Kenya accrued from China to finance the Mombasa-Nairobi Standard Gauge Railway (SGR). Project support financing does not get adequate scrutiny by parliament before its procurement because the projects concerned do not necessarily have to be in the budget nor in the annual plans that are subjected to parliament scrutiny and oversight.

1.2 Public Debt, Fiscal and Monetary Policy in Kenya

The Kenyan government has depended on fiscal deficits to expand popular policies, such as welfare programs and public works, without having to raise taxes or cut spending in the budget. Fiscal deficits arise whenever a government spends more money than its revenue during the fiscal year. This gap between revenue and spending is often compensated through government borrowing, thereby increasing the national debt. From FY 2005/06 to FY 2021/22, deficit financing[11] has been at more than 10 percent of the GDP growth rate per annum. Recurrent spending is the main driver of government expenditure, averaging about 17.1 percent of GDP over the period. Wages and salaries are the largest component of recurrent spending, with interest payments picking up during the latter half of the period to 55 percent of total revenue in FY 2021/22. Public expenditure has been growing faster than

10 Computation of percentages is based on data from *Economic Survey* reports for the years 2018 and 2021.

11 Deficit financing means generating funds to finance the deficit which results from excess of expenditure over revenue. The gap is covered by borrowing from the public by the sale of bonds or by printing new money.

growth in revenue collection, putting pressure on the fiscal deficit. As a result, the fiscal deficit increased from 4.7 percent (FY 2005/06) to 14 percent (FY 2019/20) of GDP.

Vulnerability to debt risks is often exacerbated and preceded by high fiscal deficits. Long-term deficits can be detrimental for economic growth and stability. Economists[12] agree that continuous budget deficits in the long run crowd out private borrowing, affect capital structures and interest rates, decrease net exports and lead to either higher taxes, higher inflation or both. However, deficit financing is favoured by economies practising Keynesian principles[13].

Before the early 20th century, economists and government advisers favoured balanced budgets or budget surpluses. The Keynesian revolution and the rise of demand-driven macroeconomics made it politically feasible for governments to spend more than they collect in revenue. Kenya is practicing these principals. Table 1.3 shows the public expenditure, revenue and deficit for the period from 2013/2014 to 2020/21 fiscal years.

Table 1.3: Government Expenditure, Ordinary Revenue and Deficit in Ksh. Millions (2013/14 - 2020/21)

		2013/2014	2014/2015	2015/2016	2016/2017	2017/2018	2018/2019	2019/2020	2020/2021
Recurrent Expenditure	Budgeted	1,043,902	1,411,159	1,583,823	1,734,403	2,107,177	1,947,932	2,398,753	2,018,222
	Actual	1,021,923	1,381,045	1,564,286	1,657,215	2,083,678	2,375,053	2,447,192	2,333,034
Development Expenditure	Budgeted	635,178	684,360	682,983	761,705	670,621	607,199	652,348	668,242
	Actual	511,070	572,465	483,066	625,780	492,387	569,745	808,889	553,900
Total Gov. Expenditure	Budgeted	1,679,080	2,095,519	2,266,806	2,496,108	2,777,799	2,555,132	3,051,100	2,886,934
	Actual	1,532,993	1,953,509	2,047,352	2,282,996	2,576,065	2,944,798	3,256,081	2,749,464
Ordinary Revenue[14]	Budgeted	1,006,862	1,170,529	1,299,912	1,514,989	1,650,989	1,794,522	2,115,902	1,578,787
	Actual	974,418	1,113,038	1,236,453	1,403,939	1,522,455	1,698,817	1,893,902	1,562,015
Recurrent Budget deficit	Budgeted	(37,040)	(240,630)	(283,911)	(219,414)	(456,188)	(153,410)	(282,851)	(439,435)
	Actual	(47,505)	(268,007)	(327,832)	(253,277)	(561,223)	(676,236)	(553,289)	(771,015)
Total Budget Deficit	Budgeted	672,218	924,990	966,894	981,119	1,126,809	760,609	935,198	1,308,147
	Actual	558,575	840,472	810,899	879,057	1,053,610	1,245,981	1,362,178	1,187,449
Nominal GDP		4,745,090	5,402,647	6,284,185	7,022,963	8,165,842	8,892,111	9,740,360	11,304,149
Actual Budget Deficit as a % of GDP		11.77%	15.56%	12.90%	12.52%	12.90%	14.01%	13.98%	10.5% (prov)

Sources: Various Economic Surveys[15].

12 Terry Ryan and Isaya Maana, *An Assessment of Kenya's Public Debt Dynamics and Sustainability* (Central Bank of Kenya, April 2014), https://www.centralbank.go.ke/uploads/working_papers/1348952198_An%20Assessment%20of%20Kenya's%20Public%20Debt%20Dynamics%20and%20Sustainability%20-%20By%20Terry%20Ryan%20and%20Isaya%20Maana.pdf.

13 Peter A. Hall, ed., *The Political Power of Economic Ideas* (Princeton University Press, 2020).

14 This includes tax revenue and appropriation in aid.

15 Expenditure, revenue and GDP data collected from various issues of Kenya *Economic Survey* for the period between 2012/2013 to 2020/2021. Budget deficit in absolute figures and as a percentage of GDP is the author's calculation.

Table 1.3 shows that the budgeted recurrent expenditure increased from Ksh. 1.04 trillion (FY 2013/14) to Ksh. 2.4 trillion (FY 2019/20) over the period. There was a 131 percent increment over the period and an average of 19 percent growth annually, in the recurrent expenditure. On the other hand, ordinary revenue increased from Ksh. 1 trillion to around Ksh. 2 trillion over the same period, a 100 percent growth in revenue, far below the growth in recurrent expenditure. The difference in expenditure/revenue growth points to the fact that part of the borrowed resources is used to finance the recurrent part of the government budget.

However, development expenditure has increased marginally from Ksh. 0.63 trillion to Ksh. 0.65 trillion between FY 2013/2014 and FY 2019/2020, an average annual growth rate of 0.5 percent. There is also a mismatch between the budgeted and actual expenditures, an indication of a lack of adherence to the planned budget. The high proportion and steep growth in expenditure remain unsustainable and are contributing to the ballooning public debt. In FY 2014/2015, recurrent expenditure accounted for over 70 percent of the budget, contrary to the Public Finance Management (PFM) Act 2015, which stipulates that, over the medium term, a minimum of 30 percent of the national and county government's budget shall be allocated to development expenditure. The Constitution of Kenya, 2010, assigned parliament the role of public budgeting and oversight in adherence to the PFM Act and prudent management of fiscal deficit.

To circumvent the stringent measures of the budget-making process, as per the law, the National Treasury has been submitting revised budgets (supplementary budgets) with higher deficits to parliament during the implementation periods each financial year. The revised mini budgets do not go through the same rigorous scrutiny as the annual budget estimates as the supplementary budgets are sometimes submitted towards the close of the financial year. For example, in FY 2019/2020, the National Treasury submitted Supplementary Estimates III to the House of Parliament, seven days before the end of the financial year. The squeezed timelines do not allow for a proper scrutiny of the revised budget estimates.

The ease of approval of supplementary budgets with larger deficits points to a weakness in adhering to the budgetary process. In addition, widening budget deficits in the annual and supplementary budgets since FY 2017/18 are equally an indicator of reduced parliamentary vigilance. Annual budget estimates go through public participation as well as parliamentary debate before approval. The National Treasury utilises the supplementary budget process, which does not go through rigorous public participation although they are routed through parliament for approval after appropriation. As a consequence, compared with the budget estimates, the actual public debt has been, on average, 12.5 percentage points above the approved budget by parliament between FY 2016/17 and FY 2020/21. The net result of the skewered process is that the debt presented for public participation and initial approval by parliament is significantly lower than what is actually borrowed at the end of a financial year.

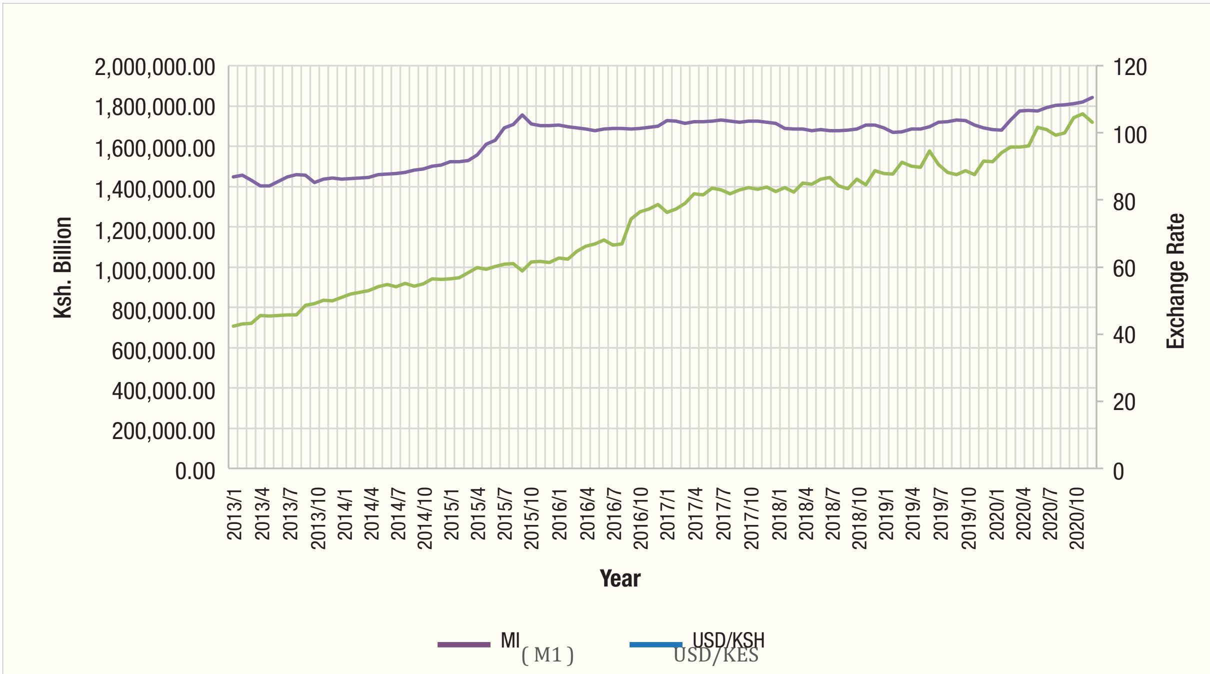
Monetary policy is equally an important tool in the management of public debt. The CBK Act provides for CBK to act as the fiscal agent and banker to the government in addition to its core functions. Section 45 of the CBK Act provides a legal framework for the bank to manage domestic debt on behalf of the government. This includes contracting domestic debt

through the sale of Treasury bills and bonds, extending overdraft facilities to the government, maintaining a domestic debt register and making payments on domestic debt. As a banker to the government, CBK effects payments to external creditors on specific instructions from the National Treasury.

CBK is responsible for formulating monetary policy and maintains exchange and interest rates that promote private investment leading to improved economic growth, higher real income and increased employment opportunities. In the management of public finance, CBK has critical roles in resource mobilization and allocation but also bears great economic risk if mismanaged. Mistakes in the central bank can cause serious instability to the economy. An example is the oversupply of currency; the undersupply also creates an economic slump. For this reason, it is important that parliament ensures proper checks and audits of the performance of the central bank by repealing Article 231(3) of the constitution.

Kenya uses its monetary policy to manage the exchange rate[16]. When the pressure is on the currency to depreciate, the Central Bank of Kenya (CBK) mops excess liquidity to curtail aggregate demand, as demonstrated in Figure 1.5.

Figure 1.5: Kenya Exchange Rate and Money Supply (2013-2020)



Source of Data: Central Bank of Kenya (various reports)

Figure 1.5 shows that an increase in money supply (M1) is usually to maintain the pegged exchange rate. The results are that the exports are not stimulated and the imports are positively induced. Consequently, the trade balance yields into a deficit. The deficit is often financed through borrowing. According to the IMF (2021), Kenya's real effective exchange

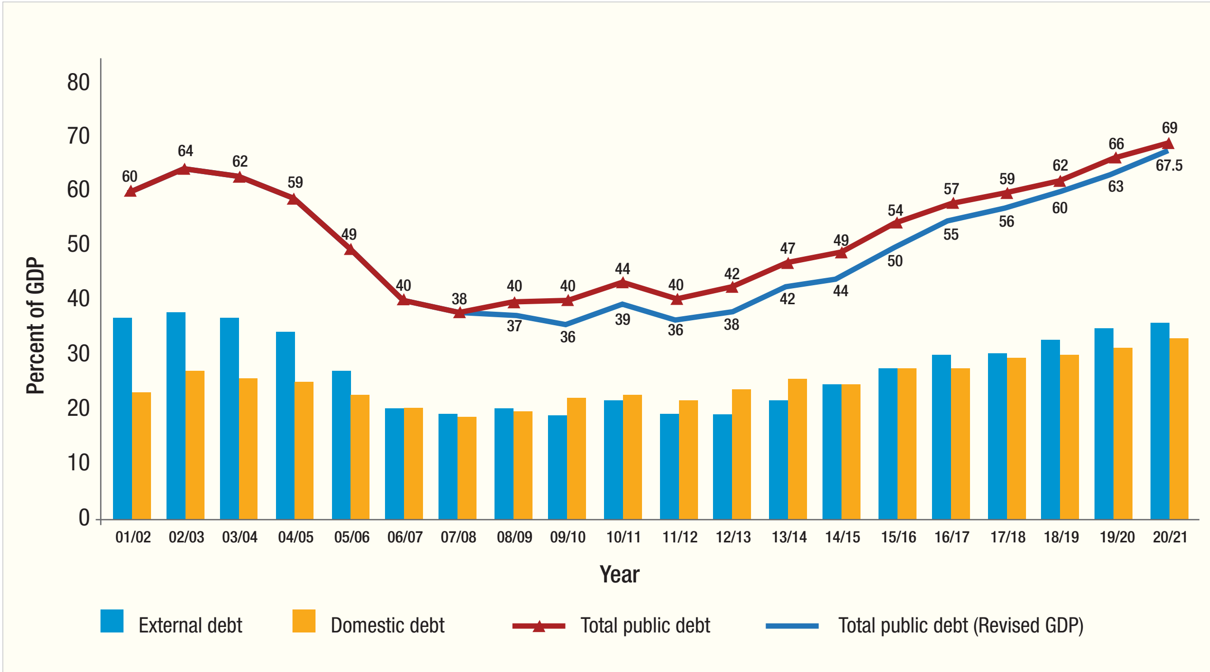
16 https://www.imf.org/-/media/Files/Publications/CR/2021/English/1KENEA2021002.ashx

rate (REER) has been on an appreciating trend in recent years. The REER has appreciated more than its nominal value and its regional peers. This has created a high demand for imports and a weak demand for exports. The ratio of exports of goods and services to GDP remained above 20 percent from 2001 to 2012, but averaged 19 percent between 1998 to 2020. However, in recent years, Kenya has suffered weak export performance. More recent data shows that Kenya has been losing market share in the international export goods market since 2015, while the other non-resource intensive sub-Saharan African countries were, on average, gaining market share. It is the role of parliament to ensure that in executing its mandate, CBK does not kill domestic productivity by maintaining an uncompetitive exchange rate and wasteful reserves financed through borrowing. This is because the loss in competitiveness for Kenyan exports has been the root cause of the high current account deficit, and is mainly connected with changes in the country's currency value.

1.2.1 Public Debt and COVID-19

Heightened accumulation of debt has been observed to have occurred since March 2020 when the first case of COVID-19 was reported in Kenya. Kenya's public debt to GDP ratio declined from 64.1 percent in June 2003 to 38.1 percent in June 2012, but increased thereafter, driven largely by spending on infrastructure and more recently by COVID-19-related spending as depicted in Figure 1.6.

Figure 1.6: Evolution of Kenya's Public Debt (Debt to GDP Ratio) – 2001/02 to 2020/21



Source: Central Bank of Kenya (2021)

Debt accumulation during the COVID-19 pandemic period can be attributed to low domestic revenue collection, while fiscal pressures grew to contain the pandemic and stimulate aggregate demand.

During the period, Kenya borrowed Ksh. 420 billion in Q4 of FY 2019/20 and approximately Ksh. 600 billion in the first half of 2020/21. Of the total amount borrowed in the first half of FY 2020/21, around Ksh. 323.41 billion was through domestic borrowing, while about Ksh. 276.58 billion was through external borrowing. Kenya also sought emergency financing from the International Monetary Fund (IMF), African Development Bank (AfDB) and the World Bank. In April 2020, Kenya sought emergency financial assistance under the IMF's Rapid Credit Facility (RCF) to address the shocks related to the COVID-19 pandemic. In May 2020, the IMF[17] approved a single disbursement of special drawing rights (SDR) of US$ 739 million to help in financing the budget and balance of payment deficit. In May 2020, the World Bank and AfDB also approved US$ 1 billion and EUR 188 million loans, respectively, to help Kenya contain the COVID-19 pandemic.

In March 2021, as a result of the lingering impact of COVID-19, Kenya requested additional funding for budget support under the IMF's Extended Credit Facility (ECF) and Extended Fund Facility (EFF) arrangements. The IMF's ECF is meant to address balance of payment (BoP) problems. In April 2021, the IMF approved SDR 1.655 billion (US$ 2.34 billion) disbursement under a three-year programme (2021-2024) of which US$ 577.26 million is through ECF and US$ 1,770.09 million through the EFF. The amount is to be disbursed in different instalments, with the first instalment being US$ 307.5 million in April 2021, US$ 404 million in June 2021 after the first EFF-ECF review and the balance released after subsequent reviews undertaken after every six months.

Two reviews have been undertaken and have exposed the misappropriation of funds allocated to fight the COVID-19 pandemic. The IMF has since made several demands. First, it requested the publication of a comprehensive audit of the spending of COVID-19 funds in FY 2019/2020. The audit report was submitted to parliament in May 2021. Second, the IMF required parliament to enact laws on public procurement portal implementation, access to information and asset declaration by public officials. Notably, the budget for FY 2021/22 is consistent with the IMF-supported fiscal consolidation program. Regrettably, while parliament has a constitutional mandate to oversight public funds, it was kept in the dark when IMF supported the fiscal consolidation program. Parliament was only involved when ratifications of the law were required to conform to the IMF programme[18].

17 The National Treasury, "Kenya-IMF Program," Republic of Kenya, n.d., https://www.Treasury.go.ke/kenya-imf-program/.

18 International Monetary Fund, "IMF Executive Board Completes the 2021 Article IV Consultation and Second Reviews of the Extended Arrangement under the EFF and ECF Arrangements for Kenya," news release no. 21/387, December 17, 2021, https://www.imf.org/en/News/Articles/2021/12/17/pr21387-kenya-imf-exec-board-completes-2021-art-iv-consultation-2nd-rev-extended-arrangement-eff-ecf.

2.0 Review of Legal Framework Governing Public Debt Management in Kenya

Borrowing by the government of Kenya is governed by the Constitution, the PFM Act (2012), its subsequent amendments[19] and the guidelines outlined in the debt and borrowing policy 2020[20]. The Constitution of Kenya and the PFM Act provide the legal framework for debt and borrowing. Due to the significant growth and complexity of public debt in Kenya, the National Treasury formulated a comprehensive public debt and borrowing policy in the year 2020[21]. The policy should play a role in guiding the process of procuring and managing debt that maximizes benefits while minimizing costs and related risks. Subject to the provisions of the constitution and other relevant laws, the government, through the cabinet secretary for the National Treasury and planning, may borrow or raise funds from any reputable source for purposes of economic management and development of the country. The cabinet secretary is also mandated to guarantee or raise a loan on behalf of the government or any other public institution, authority or person as authorised by an act of parliament.

2.1 Public Debt and the Constitution (2010)

Chapter 12 of the constitution[22] outlines the principles for public finance. Article 214 of the constitution defines public debt as all financial obligations attendant to loans raised or guaranteed and securities issued or guaranteed by the national government. Article 214(2), read together with Section 50(6) of the PFM Act, provides that public debt is a charge on the consolidated fund.[23] Public debt through loan agreements incurred by the national government is a charge on the consolidated fund, unless otherwise determined by the cabinet secretary through a regulation approved by parliament.

According to Article 206 of the constitution, read together with Section 50 (7) of the PFM Act, the cabinet secretary is mandated to ensure that the proceeds of any loan are paid into the consolidated fund or into any other public fund established by the national government or any of its entities, as the cabinet secretary may determine in accordance with regulations approved by parliament. In addition, Article 211(2) of the constitution provides that when parliament

19 Republic of Kenya, *Public Finance Management (Amendment) Bill* (Nairobi: The Kenya Gazette, March 2015), http://www.parliament.go.ke/sites/default/files/2017-05/Gazette_Notice_Vol._No._CXVII___No._26.pdf.

20 Republic of Kenya, *Public Debt and Borrowing Policy* (Nairobi: Republic of Kenya, June 2020), https://www.treasury.go.ke/wp-content/uploads/2021/02/Debt-and-Borrowing-Policy-2020-Final-June-2020.pdf.

21 https://www.treasury.go.ke/wp-content/uploads/2021/02/Debt-and-Borrowing-Policy-2020-Final-June-2020.pdf

22 *The Constitution of Kenya* (Republic of Kenya, 2010), Kenya Law, http://kenyalaw.org/kl/index.php?id=398.

23 This is the government account into which all money raised or received by or on behalf of the national government should be paid, except money that excluded under Article 206(1). Money can only be withdrawn from the Consolidated Fund with the approval of controller of budget and in accordance with an appropriation by an Act of Parliament (Appropriation Act); in accordance with Article 222 or 223 of the constitution; or as a charge against the Fund as authorized by the constitution or an Act of Parliament. The account is administered by the National Treasury in accordance with Article 206 of the constitution.

passes a resolution for borrowing, the cabinet secretary for the National Treasury shall present information concerning any particular loan or guarantee, including information to show: the extent of the total indebtedness by way of principal and accumulated interest; the use made or to be made of the proceeds of the loan; the provision made for servicing or repayment of the loan; and the progress made in the repayment of the loan.

Borrowing by a county government must also be guaranteed by the national government, but with the approval of the county assembly as stipulated by Article 212 of the constitution, as read together with Section 52 of the PFM Act.

The Constitution of Kenya provides the following principles to guide all aspects of public finance management. These principles apply to public borrowing as well as in debt management and include: There will be openness and accountability in borrowing and management of public debt; public debt management will promote an equitable society; the burdens and benefits of the use of resources and public borrowing will be shared equitably between present and future generations; public money will be used in a prudent and responsible way; and borrowing and management of public debt will be responsible and fiscal reporting will be clear.

Article 225 of the constitution equally directs parliament to enact legislation; to prescribe the terms on which the national government may borrow and impose reporting requirements; and for the establishment, functions and responsibilities of the National Treasury.

The Constitution of Kenya and the laws governing public finance are comprehensive. The laws provide a framework for adherence by the National Treasury as the technical office responsible for matters of public finance and the attorney general as the principal legal advisor to the national government, as well as for parliament any oversight on behalf of the public.

2.2 Public Debt and the Public Finance Management Act

The authority to borrow is given to the National Treasury under Section 50 of the PFM Act, within Kenya or otherwise. The law provides that the terms and conditions of the loan be in writing and in line with the fiscal responsibility principles and the financial objectives set out in the most recent budget policy statement (BPS) and the medium-term debt management strategy (MTDS). The guiding principle of borrowing is espoused in Section 50(1) of the PFM Act. The Act also provides that in guaranteeing and borrowing money, the national government shall ensure that its financing needs and payment obligations are met at the lowest possible cost in the market, consistent with a prudent degree of risk, while ensuring that the overall level of public debt is sustainable.

Section 11(1)(b) of the PFM Act mandates the National Treasury to manage the level and composition of public debt, guarantees and other financial obligations of the national government and to develop a framework for sustainable debt control. These are the thresholds that the National Treasury should use to certify that any given credit facility does not exceed the margins for national indebtedness. Parliament, through a resolution duly moved and

passed by the house as provided for in Section 15(2)(d) of the PFM Act, sets the limit for the national debt. The National Treasury ensures that the limits are maintained at sustainable levels and within the approved margins at any given time.

The government of Kenya should borrow subject to the limits set by parliament. The borrowing should also be in accordance with the fiscal policy and financial objectives set out in the most recent BPS and allocations for loans as approved by parliament. Such funds or the purchase of goods or services should be expended in accordance with the given agreements.

According to Section 15 (2)(c) of the PFM Act, a key fiscal principle is that borrowing for the midterm should be used only for purposes of financing development expenditure and not for recurrent expenditure. Moreover, borrowing for a county government must be guaranteed by the national government with the approval of the county assembly as provided in Article 212 of the constitution, read together with Section 52 of the PFM Act. Section 32 of the PFM Act also provides that an annual report is prepared and submitted to parliament on the total number of loans guaranteed with details on the parties, the interest rates and terms of repayment.

The cabinet secretary (CS) for the National Treasury is also required to submit the MTDS to parliament on or before February 15 of each year pursuant to Section 33 of the PFM Act. The MTDS should include the stock of all debt, the sources of loans and nature of guarantees, risks associated with the debt and the potential sustainability of the amount of debt. Every loan or grant advanced to the government comes with its set of terms, largely determined by the lender, depending on the intended use of the facility. However, it is important to safeguard the interests of the country and citizens by ensuring that the acquired facility is not at variance with the laws on public finance and is in tandem with the national fiscal policy. Such assurance is the mandate of the National Treasury as the technical office responsible for matters of public finance and the attorney general as the principal legal advisor to the national government.

The PFM Act mandates the National Treasury to manage public debt and prepare an MTDS and outline fiscal responsibility principles. The Act defines the role of the CS-National Treasury as borrowing from domestic and external sources, issuing guarantees with the approval of parliament and reporting to parliament and citizens on public debt matters. The CS-National Treasury is required to delegate the mandate of debt management to the public debt management office (PDMO)[24] on the operational decisions on debt management and the day-to-day management of the office. The CS is required to ensure that the PDMO has the required resources and skills to manage debt and borrowing according to international best practices for liability management. The PDMO is then required to generate reports for the CS and to parliament. The CS remains accountable to parliament for the work of the PDMO.[25]

24 Section 62 of the Public Finance Management Act establishes the PDMO in Kenya. It is housed within the National Treasury.
25 This office became operational in May 2020.

2.3 Public Debt and Borrowing Policy

The debt policy formulated in accordance with Section 12(1) (b) of the PFM Act came to effect in March 2020. The primary objective of the policy is to ensure that the government's financing needs and payment obligations are met at the lowest possible cost and prudent degree of risk over the medium to long run. The secondary objective of the policy is to promote the development of the domestic debt market for government securities. The policy is meant to provide guidance on public debt management and contracting to ensure value for money from debt-funded programs and safeguard debt sustainability. The enforcement of the policy is done through relevant laws and regulations and, where necessary, parliament enacts legislation to enable the policy alignments. Overall, the objective of the debt and policy is to ensure that government financing needs and its payment obligations are contracted at the lowest possible cost over the medium to long term, and that they are consistent with a prudent degree of risks. This means that the structure of public debt will balance the costs and risks that will include refinancing risk, foreign exchange risks, size of the economy, public revenues and debt liabilities currency vis-a-vis revenue currency. This then will ensure that public debt remains sustainable and that it does not place an unbearable burden on current and future generations. In this regard, management of public debt will seek to safeguard the national government's ability to service debt without compromising the fiscal capability to fund the provision of public services and development projects, and ensure regional equity in the distribution of benefits and costs arising from debt-funded projects. The policy equally points to the promotion and development of the domestic debt market for government debt securities. This is to ensure more domestic borrowing and project support rather than relying on foreign financial markets.

Despite the elaborate legal structure, Kenya seems to be drowning in debt risks and debt distress that has largely resulted from an enlarging public deficit, unproductive expenditure and large, costly and risky loans and investments. In addition, the government appears to engage in unhealthy debt practices including borrowing to finance recurrent expenditure (borrowing to finance other loan repayments), accumulating commitment fees (the National Treasury has paid Ksh. 1.65 billion as of June 30, 2021, in commitment fees)[26] and poor use of monetary policy. There is a need for more rigorous scrutiny of debt procurement and management by parliament to secure public interest and oversee the executive overreach.

26 Commitment fees are an expense which are lost if the borrower does not draw down the loans.

3.0 Parliament and Public Debt Management

Kenya's public debt continues to be pushed upwards by consistent fiscal deficits. As at June 2021, the stock of public debt stood at 68 percent of the nominal GDP. External debt accounts for 52 percent of the total public debt and must be repaid in the currency in which it is borrowed. Foreign currencies are majorly earned through exports, remittances and foreign direct investment. However, despite the dire need for Kenya to boost her foreign earnings to cover up for the perpetual rising debt, data shows that Kenya has been losing international market share since 2013. In addition, foreign direct investment (FDI) net inflows have been on a decline since 2013[27]. Kenya's overvalued currency seems to have lowered its competitive ranking in the foreign market. The CBK engages in periodic foreign exchange interventions purportedly to smooth volatility in the Kenyan shilling. CBK has maintained a heavily managed exchange rate that is not flexible enough to absorb external price shocks.

Therefore, the real effective exchange rate has been on an appreciating trend in recent years despite economic fundamentals[28] showing otherwise. In addition, Kenya's public expenditure has been rising at a higher rate than its revenues, further exacerbating the debt problem. Between 2013 and 2020, public expenditure has grown by over 118 percent while ordinary revenue increased by 94.4 percent. The expenditures were purportedly aimed at stimulating economic growth and hence triggering employment which seems to have failed. Under the constitution and in exercise of the parliamentary powers, parliament can take corrective action against any abuse or inept application of the law in public debt management.

Constitutionally, parliament is delegated the legislative and oversight functions of public finance. Parliament has the political mandate to monitor and oversight the executive in the economic management of the country. As the representative body, parliament also plays the role of setting and modernizing legal frameworks for prudent public debt management. Parliament therefore has a legal role to review public debt during budget formulation through Budget Policy Statement (BPS) and the Medium Term Debt Management Strategy (MTDS). However, the current practice is that once parliament passes the Finance Bill, the only time it ever gets involved again in debt management is when reports from the Office of the Auditor General (OAG), the audit reports, are filed which are often delayed for as long as three years. This denies the parliament the opportunity to scrutinize the process that includes public debts procurements.

Kenya inherited the United Kingdom's parliamentary practices at independence until 1991. After 1991, and in a bid to improve governance and public resources management, several reforms have been undertaken with varying degrees of success. The reforms have facilitated

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27 International Monetary Fund, *IMF Country Report No. 21/72* (IMF, March 2021), https://www.imf.org/-/media/Files/Publications/CR/2021/English/1KENEA2021002.ashx.

28 Interest rates, imports, exports, FDI and remittances.

openness and inclusivity in the budget process through the implementation of the medium-term expenditure framework (MTEF) in 2003/4, the launch of the public finance management reform strategy (PFMRS), and the National Integrated Monitoring and Evaluation System (NIMES) in 2007, the formation of financial audit and money-related parliamentary committees including the Public Accounts Committee (PAC), Public Investment Committee (PIC), Special Funds Account Committee (SFAC), Budget and Appropriations Committee (BAC); and the review of parliamentary standing orders to reflect the functioning of the committees. The legislature now has a mandate on budget preparation, approval, implementation and monitoring.

The constitution requires a distinction between recurrent and development expenditure in the budget estimates.[29] Further, the constitution requires proposals on borrowing and other forms of public liability with the potential for increasing public debt in the following fiscal year to be included in the budget estimates. Article 211 of the constitution gives parliament the mandate and powers to oversee public debt management which is again emphasised in Section 50 of the PFM Act requiring that all public loans be subjected to parliamentary approval, based on audits and reports by the Controller of Budget (COB) and OAG. The role of parliament seems to have been relegated to the approval to release the of funds and does not relate to the quality of expenditure or realization of results which goes against the constitution and the PFM Act.

Further, the PFM Act gives parliament the role of setting up a public debt ceiling which can be reviewed from time to time. The executive is required to provide information about their decisions and actions and to justify them to parliament. On the other hand, parliament is then required to scrutinize the decisions and actions of the executive and/or other public bodies and provide constructive and appropriate recommendations in their oversight role.

3.1 Parliament's Legislation Role and Public Debt in Kenya

A sound legal framework is required to ensure sound management of public debt. For prudent management of public debt, a robust legal framework is necessary. This is because, although public debt policies are a factor of political and economic variables, a good legal framework ensures sustainable debt by promoting fiscal discipline, transparency and accountability. A good public financial management law should address the following: the authorizations status of debt, servicing of debts, debt ceilings, the purpose for which the debt is acquired, the relationship of institutions, and the requirements for control, audit and reporting.

Article 220 of the constitution provides for the budget's form, content and timing. This law states that national government budgets shall be tabled in parliament and shall contain the following: estimates of revenue and expenditure, differentiating between recurrent and development expenditure; proposals for financing any anticipated deficit for the period to which they apply; and proposals regarding borrowing and other forms of public liability that will increase public debt during the following year.

29 "Article 220(a)," in The Constitution of Kenya (Republic of Kenya, 2010), Kenya Law, http://kenyalaw.org/kl/index.php?id=398.

Article 221 of the constitution provides that the CS-finance submits estimates of the revenue and expenditure of the national government to the national assembly for the next financial year, at least two months before the end of each financial year. Given that public debt is explicitly an item in the budget, it ought to follow all the laws that the national budget also goes through.

Section 49 of the PFM Act gives authority to the CS-finance to raise a loan as long as the loan and the terms and conditions for the loan are set out in writing and in accordance with the fiscal responsibility principles and the financial objectives set out in the BPS, and the debt management strategy of the national government over the medium term. The BPS must also include the limits on the annual total budget (upper ceiling). The BPS and debt management strategy are presented to parliament no later than February 15 of every year. The BPS forms the basis of the budget formulation for that specific financial year. This seems to be happening for budget support borrowing, but project support borrowing fails to meet the legal and regulatory processes. The Act is also not explicit on who should ratify the loan once it is raised by the CS-finance.

In the PFM Act, the legislature has three critical functions regarding public finance. These include revenue mobilization – the imposition of taxes and borrowing, allocation of resources, and a monitoring and supervisory role. These functions exist to enable parliament to assess the effectiveness of fiscal policies and to hold budget implementers accountable for what they do, and how they do it and to ensure that they conduct public affairs transparently.

On borrowing, Section 31 of the PFM Act requires that every four months, parliament should receive a report from the Treasury stating the loan balances brought forward or carried down, drawings and amortisations on new loans obtained from outside Kenya or denominated in foreign currency, and such other information as may be prescribed by regulations, specifying the names of the parties to the loan, the amount of the loan and the currency in which it is expressed and in which it is repayable, the terms and conditions of the loan, including interest and other charges payable and the terms of repayment, the amount of the loan advanced at the time the report is submitted, and the purpose for which the loan was used and the perceived benefits of the loan. This section leaves parliament at a loss since they are faced with a report of an already procured loan and cannot remedy any action or decision made by the National Treasury. In addition, some external loans are said to contain secrecy clauses like the SGR loan and therefore are normally exempted from this legal requirement. Parliament should therefore amend the legislation that is able to cure the lacuna.

Section 50(5) of the PFM Act allows parliament to provide borrowing thresholds for the country. In 2019, parliament set the debt ceiling at Ksh. 9 trillion. In June 2022, parliament set the debt ceiling for FY 2022/2023 to Ksh. 10 trillion. Legal Notice No. 34 of 2015 indicated that the debt ceiling should be reviewed annually. However, the law does not give details on what should guide the determination of the threshold. As the law is currently, the CS-finance can borrow and spend before seeking parliamentary approval, as long as she or he submits supplementary estimates later. Under Articles 100, 101, 102, 103 and 104 of the constitution,

parliament is empowered to authorize the spending of public funds to deliver public goods and services. However, under Article 100, the CS-finance is authorized to make alterations after parliamentary approval. This authority has significant implications on how and where public borrowing will come from.

Section 59 of the PFM Act requires that a statement from the CS-finance after the accrual of a guarantee be issued to parliament within 14 days. The act does not provide for a threshold to guaranteed loans and the judgement criteria on the loans guaranteed. The result is that over-guaranteeing non-credible government institutions is taking place.

Section 62 of the PFM Act establishes the PDMO within the National Treasury. The functions of the PDMO are provided as:

a. Carrying out the government's debt management policy of minimising its financing cost in the long term and accounting for risk;
b. Maintaining a reliable debt database;
c. Preparing and updating the annual MTDMS, including debt sustainability analysis;
d. Preparing and implementing the government's borrowing plan;
e. Acting as the principal in the issuance of government debt securities;
f. Monitoring and evaluating all borrowing debt-related transactions to ensure they are within the debt management strategy;
g. Processing the issuance of loan guarantees; and
h. Transacting in derivative financial instruments according to best practice.

The PDMO prepares and publicizes the MTDMS in line with the budget policy statement and the government's borrowing plan for the approved annual budget. The PDMO should also analyse reports of debt and borrowing.

The Parliamentary Budget Office (PBO) was created through an Act of Parliament in 2007, further incorporated in the PFM Act as an office in the Parliamentary Service Commission (PSC). PBO was intended to enhance the oversight role of parliament by providing the requisite capacity for scrutiny of the national budget and economic policies such as the budget policy paper and the MTDS. The primary role of the PBO is to provide timely and objective information and conduct an analysis of the national budget and economic policies and make recommendations to parliament. The PBO, therefore, is mandated to provide technical assistance on PFM to parliament. Further, the PBO is the secretariat to the budget and finance committee of parliament and thus should help in bridging the information gap in budgetary and economic policies to the legislature.

Under Parliamentary Standing Order (PSO) Number 207, the BAC of parliament is responsible for investigating, inquiring into and reporting on all matters related to coordination, control and monitoring of the national budget; discussing and reviewing the estimates and making recommendations to the full house of parliament. BAC should receive the BPS and the debt management strategy at the onset of the budget cycle and ensure public participation at the budget formulation stage. The committee should also incorporate the

views from various economic sectors and the public into programmes and projects in the budget proposal. Once the budget proposals are presented to the PBO, BAC is required to ensure that public budget hearings are held[30].

While the transition of the budget from PBO to parliament through BAC seems to be effective, the departmental committees operate under the same rules and procedure applicable to the committee of the house. The BAC then reviews the budget proposal and forwards its recommendations to parliament where budgets are approved. The standing order also requires that within seven days after parliament requests by a resolution, the CS-finance must present to the BAC, information concerning any particular loan or guarantee, including all information necessary to show the extent of the total indebtedness by way of principal and accumulated interest; the use made or to be made of the proceeds of the loan; the provision made for repayment; and the progress made in the repayment of the loan. In addition, when parliament is debating a matter on national debt, the CS-finance shall submit to parliament a report of all loans made to the national government within seven days of receiving the request.

Despite Article 211 of the Constitution providing that parliament may, by legislation, prescribe the terms on which the national government may borrow and impose reporting requirements, enabling legislation on matters of public debt remain less cogent, offering very little room for effective parliamentary supervision. Parliament is therefore not fully empowered by the laws to authorize the spending of public funds and debt procurement approval to meet various public purposes. In addition, under the PFM Act, the CS-Treasury is authorized to make alterations after parliamentary approval. This makes parliamentary authority on resource allocation mainly proactive[31]. Unless these weak institutional arrangements and legislative gaps are corrected through legislation, parliament will hardly be effective in its oversight role.

3.2 Parliament's Oversight Role and Public Debt in Kenya

As highlighted in the previous section, one of the primary roles of parliament is to establish a broad legal framework for public debt management. The other mandate is to oversight and ensure that debt management is conducted in accordance with the established legal framework[32]. These roles of parliament should promote sustainability of public debt by ensuring that the authorities procuring and managing public debt abide by the set financial objectives and purpose of borrowing within the allowable thresholds. Public debt sustainability is highly dependent on the ability of parliament to enforce accountability and demand transparency from the National Treasury.

30 The National Assembly of Kenya, *Standing Orders* (Republic of Kenya, January 2013), http://www.parliament.go.ke/sites/default/files/2018-09/The%20National%20Assembly-4th%20Edition.pdf.

31 Parliament doesn't have the authority to ratify loan agreements before procurements.

32 Global Parliamentary Report 2017: *Parliamentary Oversight: Parliament's Power to Hold Government to Account* (IPU & UNDP, 2017), https://www.ipu.org/resources/publications/reports/2017-10/global-parliamentary-report-2017-parliamentary-oversight-parliaments-power-hold-government-account.

To enhance parliamentary oversight and scrutiny of public debt, parliament should ensure that it has all the information on the public debt situation. Parliament is authorized by law to request detailed information from the National Treasury about the structure, sources, the long-term estimated effects of debt and the conditions attached to credits and loans. As a legal requirement of the PFM Act, the CS-finance or Treasury should avail a report of all loans made to the national government, national government entities, and county governments not later than seven days after receiving a request from parliament. It is envisaged that with full disclosure from the National Treasury, parliament can ascertain that funds approved to be borrowed by the national government are fiscally sustainable. However, over the years, parliament seems to have delegated its responsibility for public debt to other government agencies like the debt management office and PBO. Furthermore, the delegation has no commensurate reporting and monitoring requirements. The result is that any abuse of delegated powers has no ready mechanism for identification and correction.

The participation and involvement of parliament in public debt management fall short of statutory requirements. Procurement of public debt has remained an executive-driven process resulting in a debt crisis. The Kenyan parliament does not approve loans before procurement as envisaged in law and practice. The CS-Treasury borrows and spends before seeking parliamentary approval as long as she or he submits supplementary estimates later to parliament. The PFM Act and Article 100 of the constitution authorize the CS-Treasury or finance to make alterations only after parliamentary approval.

According to the statutes, parliament should retain the authority to ratify loan agreements, particularly loans contracted internationally to strengthen accountability for all public liabilities. Parliamentary oversight should deter imprudent borrowing. Section 49 of the PFM Act gives authority to the CS-Treasury to raise a loan only if its terms and conditions are in writing and in accordance with the BPS and the MTDMS. Section 59 of the PFM Act then requires the CS-Treasury to issue a statement to parliament after the accrual of a guarantee within 14 days. At present, the supervisory function only seems possible through audits and reports by the OAG. Discussions with the PAC and PIC paint the picture that despite them having a legal mandate to summon the CS-Treasury or ask questions regarding external debts, in practice, their supervisory role seem limited to linking parliamentary approval to the release of funds and does not relate to the quality of expenditure or realization of results.

Parliament has not been able to provide sufficient oversight for supplementary budgets. A member of parliament observed that while the deficit presented to parliament through the BPS appears low, the figures change significantly during the revision of the approved estimates in supplementary budgets despite allowable variations to the budget through supplementary mechanisms being capped at 10 percent. The supplementary budgets have become routine and an avenue for expansive deficits every financial year. Since FY 2012/13, the approved estimates have been revised at least twice each financial year with that of FY 2019/2020 being revised three times. While the revisions are approved by parliament, regular revisions of estimates often demonstrate poor budgeting. Revisions in the development estimates also shift citizens' development priorities contained in the original budget developed through public participation. In addition, some supplementary budgets are tabled in parliament too

close to the end of the financial year to allow for meaningful scrutiny and public participation. The supplementary budget process, therefore, has failed to comply with the requirements of the constitution and PFM Act. Due to these shortcomings, parliament has been approving supplementary budgets with high deficits that are not properly scrutinized for fiscal sustainability leading to the exploding public debt.

To enhance transparency, accountability and oversight of public debt management, Section 31(3) of the PFM Act requires that parliament receives reports from the National Treasury on loan balances, drawings and amortizations on new loans, interest and terms of repayment every four months. Section 31(2) also gives powers to parliament to request and receive reports on loans made to the national government when debating matters relating to public debt. However, the "request" provision has been weakened as the balance of power leans towards the executive; parliament seldom receives the requests in full and the information on public debt is never fully disclosed by the executive. Since 2017, the lack of a visibly active opposition in parliament propagated the problem. The minority or opposition parties in parliament tend to strengthen parliamentary oversight.

The experience has been that the National Treasury does not willingly provide debt-related information to parliament. Whenever parliament makes a request, the National Treasury provides incomplete information leaving parliament to rely on quarterly national government budget implementation review reports from the COB. The COB reports are highlights of what has already happened and therefore are merely accounts of the past, which gives parliament very little opportunity to be fully involved in the management of public debt[33].

The external Debt Register is another source of data on public debt which is hardly updated by the National Treasury, leaving parliament almost inept in their function of oversight. However, parliament can decide to suspend further budget approval until all of their requests are honoured by the National Treasury, a legal wiggle room parliament has never invoked.

Parliament has been setting debt ceilings to ensure debt sustainability. The debt limits approved through legislation are to enable budget support and debt sustainability. In October 2019, the parliament approved a request by the National Treasury to move the debt ceiling to Ksh. 9 trillion. In June 2022, parliament approved a debt ceiling of Ksh. 10 trillion, which is from Ksh. 6 trillion, set in 2018. The move came after Kenya breached the World Bank recommended threshold of 50 percent of GDP in FY 2017/2018. Further, with an increased accumulation of public debt and a narrowing headroom for more borrowing, the debt ceiling was raised to Ksh. 10 trillion for FY 2022/2023 to accommodate gaps in the budget. The debt limit is unrealistic given the economic situation and lacks political commitment to prudent fiscal responsibility. Kenya is seemingly in debt distress as a result of increased accumulation of public debt and an arbitrarily shifting debt ceiling. Parliament has failed in managing the debt ceiling and its overall role in debt management is weak. The debt ceiling has become a legal limit, an absolute numerical limit without debt sustainability consideration, arbitrarily

33 International Budget Partnership Open budget survey (2021) https://internationalbudget.org/open-budget-survey/open-budget-survey-2021

set and delinked from macroeconomic factors that determine the public debt capacity of a country, alongside other factors.

In line with ensuring that borrowed funds are productively used and not embezzled, Article 229 of the constitution, requires that parliament receives an audit report on public debt within six months after the end of each financial year. The report presented to parliament should list the names and/or institutions that have misappropriated public funds and resources or where money has been used unlawfully. The OAG reports are generally produced with a year or more time lag delaying expedited action by the parliamentary committees. Even though the PAC has the mandate to summon any officer concerning public finances, CS-finance and Treasury rarely appears in person or fails to attend summons of the house committees. The law also outlines the punishment for the misuse of funds and failure to honour summons outlined by the PAC. Parliament should strengthen the role of the Committee of Implementation to make it more effective in following up on resolutions and in enforcing PAC recommendations. There is also a lack of penalties to mitigate similar malpractices in the future. Parliament has also not been effective in the exercise of its power to ensure compliance by publicly exposing government shortcomings, passing corrective legislation, influencing budget allocations or issuing formal sanctions that could range from official censure to impeachment or a vote of no confidence.

Parliamentary supervisory functions are performed based on audits and reports from the COB and OAG. It is therefore limiting for parliament to scrutinize procurement of public debt on an ongoing basis to prevent unproductive public debt acquisitions.

3.3 Parliament's Representation Role and Public Debt in Kenya

Parliamentary representation is demonstrated by ensuring that the executive and the judiciary remain accountable to the public. Primarily, the executive has an obligation to provide information about their decisions and actions and to justify them to parliament as a representative of the public. Parliament then has an obligation to scrutinize the decisions and actions of the executive or other public authorities and provide constructive and appropriate recommendations on behalf of the public. These obligations form the basis of assessing the effectiveness of parliamentary representation on public debt matters.

The constitution mandates parliament to oversee public debt management through the budgetary process. To ensure the sustainability of public debt, parliament is required to ensure that borrowing by the national and county governments is within thresholds of its public debt purpose. Parliament also approves the annual budget estimates through discussion and adoption of BPS and the budget review and outlook paper (BROP). Parliament should also approve draft loan guarantees and deviations from financial objectives where such deviations are necessitated by a major natural disaster or other significant unforeseen events without deviations from the fiscal responsibility principles.

To enhance transparency and accountability in the management of public finances, parliament should facilitate public participation during the budgetary process before budget approval.

Section 36(5) of the PFM Act requires the CS-finance/treasury to issue regulations, prescribing procedures that specify how, when and where members of the public can participate in the budget process at the national level. Parliament, as a representative of the people, should ensure that the regulations spell out in detail how public participation should be conducted during the budget process. The current regulations fall short of providing a detailed procedure for public participation and how citizens' views are incorporated into the budget-making process.

Parliament through PBO should ensure that the house, particularly those of BAC, is empowered with the requisite capacity to investigate, inquire into and report on matters related to coordination, control and monitoring of the national budget and to discuss and review budget estimates and make recommendations to the house. The reports should then be made available on publicly accessible sites and portals. Before approval of the budget, parliament should ascertain that the National Treasury has considered financing the needs and payment obligations at the lowest cost in the market consistent with a prudent degree of risk and sustainable public debt management policy.

Parliament, as a representative of the people, has a responsibility to ensure that there is transparency in public debt management through a demand for full disclosure in debt reporting. This is achievable by ensuring in-depth scrutiny of government financial reports. The National Treasury reports should reveal materially important aspects of debt management operations and information on the government's financial position assets and liabilities and highlights the need to ensure that public debt is audited to foster accountability. Section 31 of the PFM Act requires that parliament receives a report from the National Treasury showing the loan balances brought forward or carried down, drawings and amortizations on new loans obtained from outside Kenya or denominated in foreign currency. It is the role of parliament to ensure that they receive factual reports, and that the information is available and accessible to the public[34].

Section 50(5) of the PFM Act requires parliament to set a debt ceiling. Legal Notice No. 34 of 2015,[35] indicates that this ceiling should be reviewed annually. For countries with high public debt and experiencing fiscal sustainability challenges, the adoption of fiscal rules with debt limits endorsed by legislation, either formally through a law or informally through a review requirement by parliament, can aid in meeting objectives for medium-term fiscal consolidation and debt sustainability. However, it is imperative that such quantitative fiscal rules, including debt limits, are expressed in legislation only if the targets are realistic, there is adequate political commitment to it and compliance mechanisms are put in place to enforce them[36].

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34 The disclosures on Kenya's sovereign debt indebtedness so far indicate that there could very well be examples of hidden debt, particularly sovereign debt that may not be publicly or dully disclosed particularly to parliament.

35 Republic of Kenya, *Legal Notice No. 34: The Public Finance Management Act* (Republic of Kenya, March 2015), http://kenyalaw.org/kl/fileadmin/pdfdownloads/LegalNotices/2015/LN34_2015.pdf.

36 Fiscal Affairs Department, *Fiscal Rules: Anchoring Expectations for Sustainable Public Finances* (International Monetary Fund, December 2009), https://www.researchgate.net/publication/237776138_Fiscal_Rules-Anchoring_Expectations_for_Sustainable_Public_Finances_Staff_Board_Paper.

To strengthen debt management in Kenya, parliament is mandated by law to approve new loans and require reporting on public debt to strengthen debt transparency. Parliament also retains the authority to ratify loan agreements, particularly loans contracted abroad to ensure government accountability for all public liabilities. If enforced, the requirements should deter the occurrence of imprudent borrowing and improve executive accountability. Parliament should enhance transparency and accountability by providing strategic direction to borrowing decisions and specifying the debt management roles and responsibilities for the institutions involved as anticipated by the law. Parliament should also strengthen accountability and transparency by providing specifications and purposes for which government can borrow and that safeguards against borrowing for risky investments or financing expenditures that have neither been included in the annual budget nor approved by parliament. Parliament should equally ratify all borrowings to ensure that the government has undertaken rigorous economic appraisal, selection and costing of any public investment project and has a monitoring strategy on behalf of the public.

Parliament needs to actively engage in the public debt management process. Kenya's fiscal consolidation strategy aims to reduce the budget deficit to 3.6% by FY 2024/25. The BAC, which receives the BPS and the debt management strategy at the onset of the budget cycle, should demand meaningful participation of the public during the budget formulation stages. Guided by the parliamentary Standing Order Number 207, BAC should investigate, inquire into and report on coordination, control and monitoring of the national budget, discuss and review the estimates and make recommendations to the house for approval. A critical question to the objectivity of parliamentary scrutiny of the budget proposals is to what extent has Kenya's budget process adhered to the principles of public expenditure, the national plans and prudent use of funds? Over the past eight years, there have been consistent fiscal deficits precipitously increasing public debt. As demonstrated in section one of this report, the actual budget deficit increased from 558.6 billion (FY 2013/2014) to 1.36 trillion (FY 2019/2020). This represents a 143.9 percent increase in a span of seven years representing an average annual increase of 17 percent. The consistent budget deficits are due to the growth in recurrent expenditure above the 70 percent limit necessitating debt financing, contrary to the PFM Act, 2015. Budgetary approvals by parliament have gone against the principles of fiscal responsibility which the institution, as a representative of its citizens, should uphold.

4.0 Summary, Conclusion and Recommendations

This section summarises and concludes the study's findings and also gives recommendations on the parliamentary oversight role in debt management in Kenya.

4.1 Summary of the Study Findings

Parliament should be the custodian of public interest with the authority to protect and preserve public property. All other persons and institutions with the power to collect taxes or spend public resources, do so on the basis of delegated authority. In the exercise of such powers, if there is abuse or inept application of the law, parliament reserves the right to take corrective action. With emerging debt distress as a result of enlarging public deficit, unproductive expenditure, and large, costly and risky investments, parliament's action is long overdue. Parliament ought to ensure that there is a comprehensive debt management legal framework and offer effective oversight on the same.

Public borrowing is governed by the constitution, the PFM Act and the national fiscal policy. Despite the rigorous legal framework, this study finds that there is limited transparency and accountability for public debt sustainability in debt management. In addition, laws and regulations on the debt ceiling law are weak as they only provide for legal limits without consideration for public debt sustainability. Moreover, setting the debt ceiling to an exact figure goes against the convergence criteria of a 50 percent gross public debt to GDP ratio in the East Africa Community (EAC)[37].

While a debt ceiling is simple for the public to understand, its absolute nature makes it difficult to make comparisons between countries and between different periods of time and political regimes. Furthermore, it limits the regulatory role of the public debt management office given that there is a single regulatory parameter, which is already fixed. There is anticipation that the debt ceiling will be raised further to accommodate an expanding budget deficit caused by increasing expenditure and low tax revenue. The country's budget is expenditure driven and therefore, reviewing the debt ceiling has become routine. The public debt limit serves as a restraint on government debt and therefore adjusting it too often or too easily, signals a casual or little commitment by the government to managing public debt.

Section 49 of the PFM Act gives authority to the CS-finance/treasury to raise a loan only if the loan, and its terms and conditions, are in writing and in accordance with the BPS and the MTDS. This law gives the CS the latitude to procure debts that are not ratified by parliament. This presents a gap that allows the treasury to act unilaterally in the procurement

37 https://core.ac.uk/download/pdf/19917439.pdf

of public debt. Consequently, the treasury does not willingly provide debt-related information to parliament even when requested. When the treasury complies, they tend to provide incomplete information. Consequently, parliament is unable to oversee the executive on public debt management. This has been evidenced by the ever-increasing expenditure on commitment fees that parliament is unable to restrain. The signed agreements between the national government and foreign financial institutions provide for commitment fees whether resources are utilized or not, particularly on commitments for resources yet to be drawn. The loan drawing may be delayed owing to disputes like land ownership, procurement procedures, among the delays, cost the nation as a result of poor planning and budgeting[38].

Parliament has also failed to legislate on the identified gaps that allow the National Treasury to wield enormous powers and to indulge in unhealthy debt management practices. Parliament has not censured and invoked the law to demand transparency and accountability in debt management. Parliament needs to develop a comprehensive public participation policy and require that every loan is ratified by parliament before procurement. Parliament's supervisory function relies on audits and reports of the COB and OAG which are then delayed, leaving parliament with a bill that fails to connect with the quality of expenditure or the realization of citizens' preferences.

4.2 Conclusion and Recommendations

The following conclusions are derived from the study:

i. Persistent increase in budget deficits has resulted in debt rising more rapidly than the GDP growth rate. The rate of growth in public debt is way above the capacity of the economy to generate commensurate income for settling its debt obligations. Worse still, external borrowing has surpassed domestic borrowing leading to the cost of borrowing spiking due to the government's increased preference for commercial loans. With the immobility to generate adequate foreign reserves to facilitate the settlement of external debt, the National Treasury is being forced to borrow more in order to pay the maturing foreign obligations.
ii. Kenya's real effective exchange rate (REER) has been on an appreciating trend in recent years and the country has suffered weak export performance as the treasury continues to use monetary policy to manage its exchange rate, arguably to safeguard against the risk of the exchange volatility. This seems to be denying the country market access as the prices domestically become expensive and foreign prices are deemed as low. The net result is that exports are not stimulated and imports keep on rising. This has put the country in a constant current account deficit and a growing public debt in order to pay for its import of goods and services.
iii. Public participation as a mechanism for good governance, democracy, transparency and accountability remains a mirage due to the complexity of the budget, and access to budget information and materials during the budgeting process. A draft policy on public participation, whose development began in 2018, is yet to be finalized. Public

38 The National Treasury and Planning of Kenya, Annual Public Debt Report 2020/2021 (Republic of Kenya, September 2021), https://www.treasury.go.ke/wp-content/uploads/2021/12/ANNUAL-PUBLIC-DEBT-REPORT-2021-final-as-at-oct-21-2021.pdf.

participation has been amorphous with the views not being given adequate weight in the budget proposals and the management of public debt. Parliament seems to have failed in its role to legislate.

iv. Despite a public debt ceiling existing, the contribution of public debt management remains weak and merely a legal limit but not a sustainability indicator. The public debt ceiling is a numerical limit arbitrarily set and delinked from macroeconomic factors that determine the debt capacity of the country's economy.

v. Section 49 of the PFM Act gives authority to the CS-finance/treasury to raise a loan only if the loan and its terms and conditions are in writing and in accordance with the BPS and the MTDMS. The Act is, however, silent on who should ratify the loan once it is raised by the CS. The gap in the law allows the National Treasury to act unilaterally in the procurement of public loans against the public interest.

vi. The practice in Kenya over the years has been that the CS-finance/treasury does not willingly provide debt-related information to parliament and when the parliament makes a request, the treasury provides inadequate pieces of information leaving parliament to rely on quarterly national government budget implementation review reports by the COB. These reports are highlights of what is in the past and therefore merely for information purposes leaving parliament with very little room for monitoring and oversight. Consequently, sources, costs and conditions attached to public debt, particularly external debt, remain scanty. The accountability principle, as underlined in the PFM Act, is therefore undermined.

vii. MPs are confronted with a lot of paperwork on public debt and budget, yet they have inadequate personal capacity to interpret the outputs and the information therein for any meaningful debate. This is also compounded by the fact that every election cycle (five years), about 70 percent of MPs do not get re-elected. The capacity of MPs to legislate, oversight and represent its citizens is therefore undermined every electoral cycle.

viii. Although the PAC and PIC have the mandate to summon any officer concerning public finances, more often than not, cabinet secretaries do not appear in person or fail to attend to the sermons of the house committees. In the end, the OAG reports just serve as mere reports rather than corrective audits. This is a major failure of the parliament in its oversight role. Most of the recommendations are never implemented, notwithstanding the law giving timelines[39].

ix. The opposition parties in parliament are important for the rigorous oversight of the executive as members of the governing party use their majority to ensure that the executive is not exposed, and the improper public debt management is not exposed to the public. The co-optation of opposition parties in parliament has strangled effective oversight of the government budget and public debt.

39 The auditor general may audit and report on the accounts of any entity that is funded from public funds. An audit report shall confirm whether or not public money has been applied lawfully and in an effective way. Audit reports shall be submitted to parliament or the relevant county assembly. Within three months after receiving an audit report, parliament or the county assembly shall debate and consider the report and take appropriate action.

In view of the above conclusions, the study makes the following recommendations:

A. Legal Reforms

i. Parliament should move and pass a resolution in line with Section 15(2)(d) of the PFM Act to set the public debt limits to be pegged to real economic performance. This will ensure that public debts are maintained at sustainable levels.

ii. Parliament should finalize the draft policy on public participation and the development of a public participation regulation as stipulated by the PFM Act. This should provide a framework for the public in deciding on borrowing decisions.

iii. Parliament should amend the PFM Act to provide that all new loans are ratified by the legislature before they are procured in order to improve debt reporting and strengthen debt transparency.

iv. Parliament should amend the PFM Act to require that all new loans must provide details on the names of the parties to the loan, the amount of the loan and the currency in which the loan is expected and in which it is repayable, the terms and conditions of the loan including interest and other charges payable and the terms of repayment, and the purpose for which the loan will be used and the perceived benefits.

v. Parliament should consider developing a policy requiring that loans with non-disclosure clauses are rejected to stop the executive from taking advantage of the lacuna.

vi. Parliament should amend the PFM Act to provide for a timeline for the audit of public debt.

vii. Parliament needs to regulate the number and justification for supplementary budgets. This will reverse the regular overshooting of actual expenditure and deficits above the initial budget figures. The non-adherence to prudent management of financial resources results from regular reviews of the budget.

viii. A policy requires to be in place that commitments to loans should only happen once the programs and projects are ready for implementation and financing. This will reduce wastages incurred through commitment fees and thus, eliminate the gap between budgeted and actual public debt.

B. Law Enforcement and Oversight

i. Borrowing should be used only for the purpose of financing development expenditure and not for recurrent expenditure as provided for in Section 15(2)(c)), of the PFM Act. This law needs to be enforced by parliament during the budget-making process.

ii. Borrowing should only be allowed for fully planned prospects that have been approved by parliament. The loans should be directed to the purchase of goods or services for the projects and should be expended on time in accordance with the laws to avoid the incurrence of commitment fees as per the public debt management strategy (PMS)[40]. Commitment fees are payments on undisbursed external loans and often increase the real cost of external debt.

40 Payments on commitment fees were Ksh. 1.9 billion in FY 2019/2021. This figure has increased over the years.

iii. Where foreign debt is necessary, the government should reduce its appetite for commercial loans to avoid exposing the country to higher risk. The guiding principle of borrowing as espoused in Section 50(1) of the PFM Act stipulates that in guaranteeing and borrowing money, the national government shall ensure that its financing needs and payment obligations are met at the lowest possible cost in the market, which is consistent with a prudent degree of risk, while ensuring that level of public debt is sustainable ought to be observed.
iv. Parliament should ensure that the threshold for guaranteed loans and judgement criteria on the loans are clear. Over-guaranteeing to non-credible government institutions should be disallowed. Additionally, government institutions with a guaranteed loan should not under normal circumstances be allowed until the old loan is paid up.
v. Parliament should provide enhanced oversight over the CBK exchange rate management and enforce a move of the country's REER closer to its equilibrium. In addition, Kenya can reduce taxes on imported inputs and upgrade productive capacity to match domestic and foreign demand. This will reduce project-financed borrowing by the government.

C. Institutional Capacity

i. The PBO should carry out more research, analysis and modelling to enable the office to produce useful reports based on universal models that can be used by parliament to adequately make critical oversight decisions. In addition, the technical capacity of PBO and the number of staffs should be enhanced to enable them to effectively and efficiently unpack the budget documents with and for the members of parliament.
ii. Parliament should enhance the allocation of funding to develop the auditing capacity of the OAG, and increase laws that strengthen the implementation of the recommendations by the PAC, PIC and OAG should also be considered.
iii. Strengthening the capacity of political parties in parliament and the public on the role of parliament in oversight, legislation and representation on budget, public debt processes will enhance engagements and participation and improve the financial health of the nation.

D. Public Participation

i. Citizens should be empowered to ensure their elected representatives play an effective oversight role and to demand reformative action from the executive.
ii. Parliament should enforce the need for disclosure of public debt data to enhance public participation.
iii. Parliament should encourage members of the public to participate in the budget-making process to enhance transparency and accountability. This can be achieved by educating the public on the importance of public participation and opening public participation avenues in the constituencies.

SUPPORT TO PARLIAMENTS IN THE MANAGEMENT OF PUBLIC DEBT

The National Democratic Institute (NDI), in partnership with the **Westminster Foundation for Democracy** (WFD), have published four briefs highlighting the fundamental components that foster successful debt management.

The purpose of the briefs is to serve as a practical resource for parliamentarians as they work to manage debt burdens and address public spending needs. They are the result of our ongoing effort to globally support parliaments in addressing public debt burdens compounded by the pandemic.

BRIEF I

Debt Management for Parliaments

BRIEF II

Debt Management Legal Frameworks: A Primer for Parliamentarians

BRIEF III

Role of Parliaments in Oversight of Public Debt Management

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