Tax Justice Network Africa

cePIS Africa Centre for People Institutions and Society

The Role of Private Creditors in Kenya's Public Debt Problem

SEPTEMBER 2022

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TAX JUSTICE NETWORK AFRICA

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List of Acronyms

ASAL – Arid and Semi-Arid Lands
CSO – Civil Society Organization
GDP – Gross Domestic Product
IMF – International Monetary Fund
KES – Kenyan Shilling
PPE – Property, Plant & Equipment
USD – United States Dollar
VAT – Value Added Tax

The study pursued an exploratory approach, relying largely on desk research which entailed reviewing and assessing relevant publications such as CSO reports, budget documents and other publications by ministries, departments and agencies.

EXECUTIVE SUMMARY

TAX JUSTICE NETWORK AFRICA

In the recent past, there has been a rise in the uptake of commercial loans across African states. This has seen the composition of creditors changing from traditional concessional loans which entails loans from bilateral and multilateral creditors to commercial loans from private creditors. The shift in borrowing has been occasioned by various factors including the ineligibility of some countries to access concessional loans, less scrutiny of the use of funds borrowed from private creditors and fewer conditions attached to the loans as opposed to concessional loans. However, commercial debt which bears higher interest rates and shorter maturities has led to rising interest payments and higher refinancing risks, leading countries into debt distress. This has had significant implications on fiscal space limiting financing for development and exposing vulnerability of economies to external shocks like the Covid-19 pandemic and Ukraine war.

Purpose and Methodology of the Study

The research was commissioned to generate evidence on the role of private creditors in debt crises, and its human costs. The evidence is aimed at contributing informing advocacy by Civil Society to bring to the attention of key stakeholders, including parliamentarians, finance ministers, World Bank, IMF, Regional bodies, civil society and media on the role of private creditors in precipitating debt distress in developing economies that has received limited attention despite its implications. The study pursued an exploratory approach, relying largely on desk research which entailed reviewing and assessing relevant publications such as CSO reports, budget documents and other publications by ministries, departments and agencies. The study relied on data regarding private debt stock from external and domestic creditors, debt servicing costs for private debt and social sector expenditure for the period between 2012 – 2020.

Summary of Research Findings

Evolution of Private Sector Debt in Kenya

- Between June 2012 and June 2021, **Kenya's Debt-GDP ratio increased by 30% from 38% to 68%. The debt stock increased from KES1.6 trillion to KES7.7 trillion** over the duration. The exponential rise in the country's public debt stock has lowered the country's debt carrying capacity from high to medium, and pushed the country to be at high risk of debt distress.
- The exponential rise in the country's debt stock has been accompanied by a sharp rise in debt service obligations. **Debt service costs increased from KES113.6 billion in June 2012 to KES651.5. billion** in June 2020. It is expected that the debt service cost will rise to KES1.36 trillion in FY2022/23. This signals a shrinking fiscal space and the limited ability of government to expand investments to pro-poor sectors.
- By June 2020, **57.3% of the country's total debt stock was from private sector creditors.** Notably, the proportion of private sector debt as a share of the total debt stock has largely remained constant, averaging 58% between June 2012 and June 2020.
- Regarding composition, Kenya's private sector debt stock is largely from domestic creditors at an average of 81%. However, **the share of external private sector debt has increased over the years from 7% to 25%** between 2012 and 2020, while domestic private sector debt has declined from 93% to 75% over the same duration. This points to the increased appetite for external private debt.

Major sources of Private Sector Debt in Kenya

- External private sector debt has largely been sourced from commercial banks, which made up 98% of total external private credit in 2020. 2% comes from suppliers' credit. The main commercial lenders to Kenya include China Development Bank Citigroup Global Markets, Erste Group of Banks, First Mercantile Securities Corporation, Societe Generale, Standard Bank Limited UK and Trade and Development Bank.
- Notably, there has been an increased preference for commercial loans over concessional loans, with the **proportion of concessional loans declining from 92% to 69% between 2012 and 2020, while commercial loans increased from 7% to 31%.** This change may be attributable to a change in the country's status to a middle-income economy, which denied it access to concessional loans available to low-income economies.
- Domestic private sector debt largely includes Treasury bills, Treasury bonds and advances from commercial banks. 51.4% of the domestic debt stock comes from commercial banks, 30.7% from pension funds, and 6.7% from insurance companies. Additionally, Interest from Treasury bills, a critical component of domestic private sector debt, averaged 7.7%, 6.8%, and 6.7% in 2018, 2019, and 2020 respectively for a 91-day T-Bill.

Private Sector Debt and Fiscal Justice in Kenya

- Increase in private sector debt and the associated debt repayment obligations have had negative implications on fiscal justice in Kenya as evident from the increased tax burden. In efforts to expand the revenue base to facilitate debt servicing and other fiscal expenditures, the government has introduced new taxes and increased the tax rates on various products and services. These tax reforms have been largely regressive, translating to increased burden on people's livelihoods and businesses.
- Notably, private sector debt is costlier to finance. While the average interest rates on external loan commitments have been modest, ranging between 0.5% and 3.9%, **interest rates on instruments such as Eurobonds issued have high interest rates ranging between 6% and 8%.** Domestically, the interest rate for 91-day T-Bills ranged from 6.7% to 9.8% between 2014 and 2021.
- **Loans from private creditors have shorter maturity periods compared to those from other creditors.** For instance, the maturity periods for most issued Eurobonds between 2014 and 2014 range from 5 years to 12 years, compared to other external loans which have a maturity period ranging from 18.1 years to 26.2 years, with a grace period of between 5.6 and 7.4 years.
- Servicing debt acquired from private creditors critically diverts funds from development expenditures. As such, expenditures in pro-poor sectors such as health, education, agriculture, and social protection have thus been limited thus denying a majority of citizens' access to quality and affordable services.
- Domestic borrowing from the private sector has crowded out investment in MSMEs, thus stifling growth. The increased government's domestic borrowing has shrunk the credit available for Micro, Small, and Medium Enterprises slowing economic output. **Between 2013 and 2020, the level of access to the private sector and private investment decreased from 12.4% to 7.3%,** while the domestic debt stock increased within this period.
- **Private sector debt in Kenya is often shrouded in secrecy which limits transparency and accountability.** Additionally, there is often limited public participation in the acquisition and management of private sector debt. The limited inclusion and transparency in the

management of private sector debt have left room for corruption and mismanagement of borrowed funds at the expense of the public (citizens) who are responsible for repaying the acquired debt. Additionally, the strict conditions attached to the loans are argued to infringe on the country's sovereignty.

- Notably, **private sector credit can be seen as a barrier to efforts towards women's empowerment and gender equality.** This stems from the fact that women are often impacted the most by investment patterns by governments and instituted tax reforms. Also, private sector debt is often spent in non-pro-poor sectors, which have no immediate impact on gender equality. Additionally, the increased debt repayment obligations affect women more adversely compared to men by limiting spending on gender responsive public services.
- Increased uptake of private sector debt has also been linked to undermining of human rights in Kenya. This manifest in the form of diversion of resources from basic social services and undermining of country ownership of national development strategies and assets due to the conditions attached to the acquired credit.

Recommendations

Over the last decade, there has been an exponential increase in the portfolio of public debt, with the debt stock increasing fivefold. The increase in private sector debt has had negative implications on realization of the country's development agenda, realization of universal basic human rights, and the advancement of gender equity. Heavy repayment obligations resulting from high-interest rates have crowded out resources from critical sectors/services that are essential in reliving poverty, enhancing gender equity and promoting human rights. Sectors such as health, education, agriculture, water, and housing have borne the brunt of constrained resources.

Cognizant of these implications, the study highlights the following recommendations for the management of private sector debt.

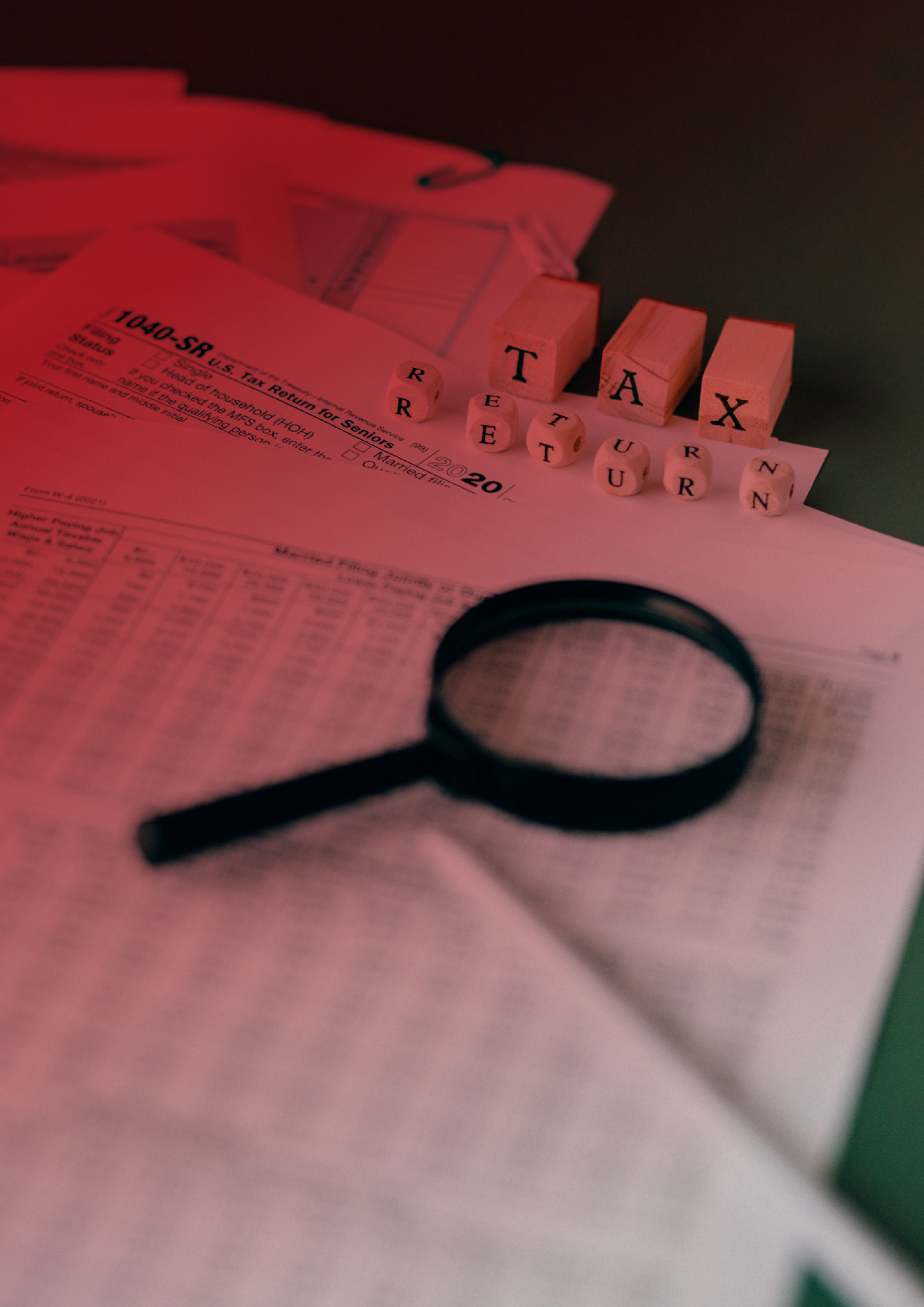
1. Challenge private sector creditors to recognise their role in debt unsustainability in Kenya.
2. Encourage the Government of Kenya to pursue more opportunities for restructuring debt from private creditors.
3. Encourage the Government of Kenya to pursue proactive debt management approaches with private creditors through, for example, debt profiling which replaces existing debts with new debt with a different currency or maturity profile.
4. State and non-state actors should push for the operationalization of laws and policies on transparency and access to information regarding public debt, including private sector debt.
5. Kenya should continue streamlining the tax policy to optimize revenue collection.
6. Support and encourage non-state actors to enhance knowledge of citizens on their role in public debt and public finance management.
7. Support the Government of Kenya to strengthen capacity to implement an effective debt management policy.
8. Advocate for G-20, IMF/ World Bank, and the UN to develop a framework that can buy time (negotiated rollover of private bank credits) for proper sustainability analyses to be done on a country-by-country basis.
9. Promote structural economic reforms and fiscal consolidation in Kenya.
10. Advocate for inclusion of contingency clauses in private debt contracts that allow for automatic extension of maturities in times of acute liquidity crisis arising from external shocks, beyond the control of debtor countries.

ACKNOWLEDGEMENT

Tax Justice Network Africa (TJNA) would like to thank Christian Aid for their financial and technical support towards the development of this study.

We would also like to thank the researchers from Africa Centre for People, Institutions and Society (ACEPIS) that contributed to the study, namely: Ms. Janet Muchai, Mr. Emmanuel Owuor, Mr. Michael Gor, Ms. Rachel Olpengs and Ms. Kenneth Okwaroh.

Special thanks to the team that peer reviewed the paper, namely Mr. Ishmael Zulu and Ms. Chenai Mukumba from TJNA, Ms. Nadia Saracini from Christian Aid, and Mr. Leonard Wanyama from East Africa Tax and Governance Network (EATGN).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SECTION 1

The study sought to contribute to the 'Towards a People's Recovery' project by informing advocacy efforts from various stakeholders, including parliamentarians, finance ministers, World Bank, IMF, Regional bodies, civil society and media professionals.

INTRODUCTION

1.0 Purpose of the study

Tax Justice Network Africa (TJNA) through EATGN commissioned this research to generate evidence on the role of private creditors in debt crises, and its human costs. The study sought to contribute to the 'Towards a People's Recovery' project by informing advocacy efforts from various stakeholders, including parliamentarians, finance ministers, World Bank, IMF, Regional bodies, civil society and media professionals. Specifically, the study sought to: i) Provide new material for our public campaigning and media on debt and private creditors – to popularise and humanise the issues, ii) Build popular support for campaigns on private sector debt, including by providing accessible information for wider audiences, iii) Provide a clear narrative/evidence of the human costs/opportunity costs for sustainable and equitable development, iv) Strengthen negotiating positions of countries in debt restructuring, v) Influence the UK government, including with focus on key areas of public spending such as girls' education, health, climate adaptation/ resilience.

1.1 Methodology

The study adopted an overall exploratory approach, relying largely on desk research which entailed reviewing and assessing relevant publications such as CSO reports, budget documents and other publications by ministries, departments and agencies. The study relied on data regarding private debt stock from external and domestic creditors, debt servicing costs for private debt and social sector expenditure for the period between 2012 – 2020. The data, which was largely obtained from local data-bases such as the National Treasury and Central Bank of Kenya, was used to assess the implications of increasing private credit on the fiscal space and human rights. Data on the identified indicators was analysed and the findings have been presented in the form of tables and graphs. Additionally, relevant information addressing the different research themes have been incorporated as the findings of the study. The study, however, encountered substantive challenges in terms of access to debt data disaggregated to reflect private sector debt. Nonetheless, the study was able to use the World Bank's International Debt Statistics definition of private sector debt to pick out the data needed for this study.

1.2 A Primer on Private Sector Debt

The various channels through which governments raise resources include borrowing either from external or domestic sources. As such the concept of public (sovereign) debt emerges which is described as 'all financial obligations attendant to loans raised or guaranteed and securities issued or guaranteed by the national government.'[1] Borrowing is often occasioned by various reasons such as financing large public investment projects (infrastructural projects), the need to offset budget deficits, or need for cushioning from emergencies and disasters. As local revenues continue to fall short of government expenditure, governments resort to borrowing and hence public debt is incurred.[2]

Governments can borrow externally or domestically. Domestic borrowing includes funds raised through financial assets such as Treasury bills and bonds and money borrowed from other

1 The Constitution of Kenya, 2010. **https://www.klrc.go.ke/index.php/constitution-of-kenya/149-chapter-twelve-public-finance/part-3-revenue-raising-powers-and-the-public-debt/383-214-public-debt**

2 Kibui, P. (2009). The Impact of External Debt on Public Investment and Economic Growth. University of Nairobi. http://erepository.uonbi.ac.ke/bitstream/handle/11295/5187/Kibui,%20Polly_The%20impact%20of%20external%20debt%20on%20public%20investment%20and%20economic%20growth%20in%20kenya%20(1970%20-%202007).pdf?sequence=1

locally-owned financial institutions while external borrowing entails borrowing from bilateral, multilateral or commercial sources. Bilateral credit entails borrowing from other governments while multilateral credit is borrowing through international financial institutions such as World Bank and IMF.[3] Both multilateral and bilateral loans are categorised as concessional loans as they bear favourable terms such as below-market interest rates and long repayment grace periods and as such contribute to improvement in debt sustainability. However, these loans are considered to be conditional loans as lenders attach policy measures such as IMF's Structural Adjustment programs and as such, partly because of this, governments have shifted from traditional concessional borrowing to commercial borrowing.[4] Commercial/ non-concessional borrowing is categorised as borrowing from private companies or banks based either domestically or externally. Despite the fewer conditions attached to loans from private creditors, commercial borrowing entails higher interest rates and lower maturities and as such have led to increased debt distress for many economies due to higher refinancing risks. [5]

1.3 Role of Commercial Debt in development financing in developing economies

Over the past decades, many developing countries have demonstrated an increased appetite for commercial debt which has been argued to have fewer conditions as opposed to concessional loans.[6] Additionally, the shift in borrowing has been occasioned by various factors including the ineligibility of some countries to access concessional loans, Kenya's change of status in 2014, from a low income country to a lower middle income country after revising and rebasing National accounts and less scrutiny of the use of funds borrowed from private creditors. On the other hand, commercial debt, which bears higher interest rates and shorter maturities has led to rising interest payments and higher refinancing risks, which is the risk arising from the inability to refinance existing debt. Notably, unlike concessional lenders, private creditors do not lean towards participating in debt reduction programmes such the Debt Service Suspension Initiative (DSSI). The combined result of high interest rates and prioritised debt repayment of private credit has resulted in crowding out financing for other development projects as huge a proportion of revenue is allocated to debt servicing.[7]

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3 Kinuthia, J. & Rugo, A. (2020). The State of Kenya's Public Debt: the thin line between a rock and a hard place. International Budget Partnership https://www.internationalbudget.org/wp-content/uploads/state-of-public-debt-Kenya-october-2020.pdf

4 Cytonn Investments. Kenya's Public Debt: On a path to Distress? October 10, 2021. https://cytonn.com/topicals/kenyas-public-debt-2

5 Ekeruche, M.A. (2022) Africa's Rising Debt and the Emergence of New Creditors. A Review of Trends, Challenges and Prospects (2000 -2021). Africa Debt Series Vol. 2. Friedrich Ebert Stiftung. https://library.fes.de/pdf-files/bueros/fes-ua/19365.pdf

6 FRBYN. Commercial Bank Lending to the Developing Countries. Quarterly Reviewhttps://www.newyorkfed.org/medialibrary/media/research/quarterly_review/1977v2/v2n2article1.pdf

7 Ekeruche, M.A. (2022) Africa's Rising Debt and the Emergence of New Creditors. A Review of Trends, Chal-

SECTION 2

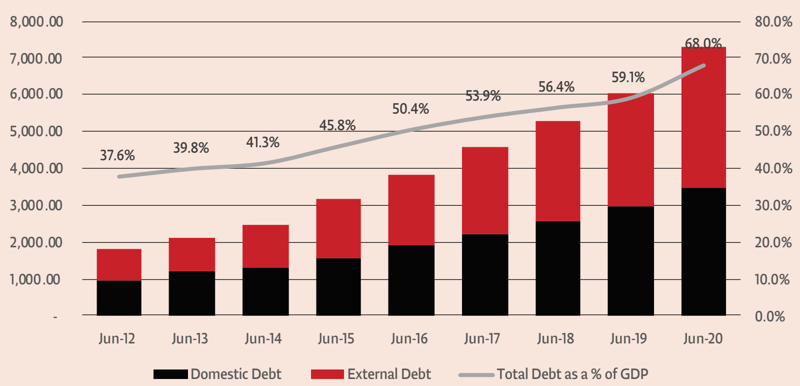
Kenya's public debt stock has increased substantively over the past decade, growing from 38% of GDP in 2012 to 68% of GDP in 2021. According to Central Bank of Kenya data, the country's public debt stock rose from KES 1.6 trillion (USD 0.2 trillion) in June 2012 to KES 7.7 trillion (USD 0.7 trillion) in June 2021.

EVOLUTION OF PRIVATE SECTOR DEBT IN KENYA

2.0 Kenya's Public Debt Situation

Kenya's public debt stock has increased substantively over the past decade, growing from 38% of GDP in 2012 to 68% of GDP in 2021. According to Central Bank of Kenya data, the country's public debt stock rose from KES 1.6 trillion (USD 0.2 trillion) in June 2012 to KES 7.7 trillion (USD 0.7 trillion) in June 2021.[8] Public debt currently makes up 80.1% of the KES.10 trillion debt ceiling recently revised by legislators[9]. The debt stock is forecasted to range between KES. 8.6 trillion and KES. 8.8 trillion by June 2022, and is set to cross the KES. 10 trillion mark by the end of 2024. Between 2012 and 2020, the debt-to-GDP ratio increased from 37.6% to 68.1%.[10] A joint debt sustainability analysis conducted in 2020 by the IMF and World Bank categorized Kenya at a high risk of debt defaulting following the shocks occasioned by the global COVID-19. Kenya's debt carrying capacity assessment was also revised from strong to medium.[11]

Figure 1: Kenya's Public Debt Stock in KES Billions



Source: National Treasury

With the exponential growth in the country's public debt stock, there has been an equivalent sharp rise in the country's debt servicing obligations that threatens public expenditures in necessary social services and other investments crucial for investment and growth. The cost for servicing debt has increased from KES 113.6 billion to KES 651.5 billion between June 2012 and June 2020. According to the Kenya Medium Term Debt Management Strategy, debt repayment costs are expected to increase to KES 1.36 trillion, or 63% of total ordinary

lenges and Prospects (2000 -2021). Africa Debt Series Vol. 2. Friedrich Ebert Stiftung. https://library.fes.de/pdf-files/bueros/fes-ua/19365.pdf

8 Central Bank of Kenya (2022) Weekly Bulletin: Recent Monetary and Financial Developments. Central Bank of Kenya https://www.centralbank.go.ke/uploads/weekly_bulletin/1355430068_Weekly%20CBK%20Bulletin%20January%207,%202022.pdf

9 Business Daily, 2022. Senate clears last hurdle in plan to raise debt cap. https://www.businessdailyafrica.com/bd/economy/senate-clears-last-hurdle-in-plan-to-raise-debt-cap-3855634

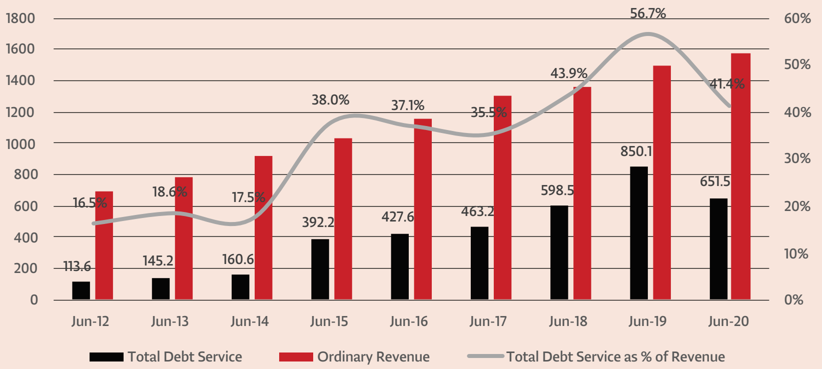
10 Kenton, W (2021) Debt to GDP ratio. Investopedia https://www.investopedia.com/terms/d/debtgdpratio.asp#citation-2

11 IMF, 2021. IMF Kenya Report: Joint Bank-Fund Debt Sustainability Analysis, https://www.imf.org/-/media/Files/DSA/external/pubs/ft/dsa/pdf/2021/dsacr2172.ashx

According to the National Treasury, debt stock from private creditors made up an average of 58% of the total debt stock between 2012 and 2020.

revenue for FY2022/23.12 Being part of Consolidated Fund Services, debt is included among the items that the government is obligated to pay in the first charge of budget payments. **The more spent on repaying debt, the smaller the amount remaining to provide basic services which includes money that goes to government ministries, department agencies (MDAs) and also the allocation going to counties.**[13] Total debt service as a proportion of revenue collected has increased from 16.5% in 2012 to 56.7% in 2019, but declined to 41.4% in 2020, which may be attributable to the debt service suspension occasioned by the pandemic. In 2019, Kenya used up KES 850.1 billion in debt repayment which is more than half of the amount of revenue collected (KES 1499.8 billion) in the financial year ending June 2019.

Figure 2: Kenya Debt Service Cost as a Proportion of Revenue (KES Billions)



Source: National Treasury

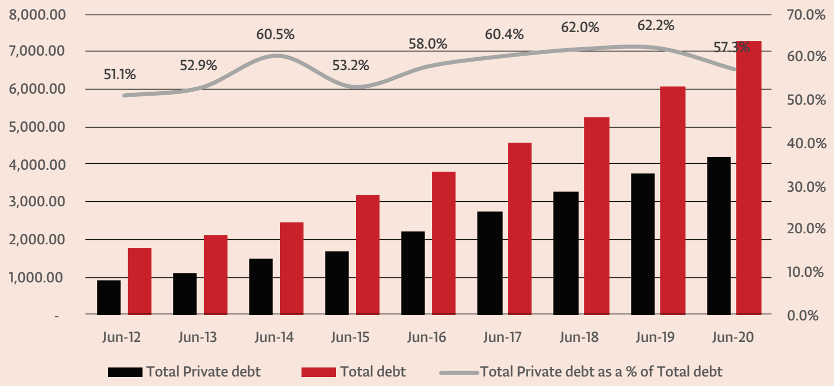
2.1 The place of Private Sector debt in Kenya's public debt situation

In the recent past, there has been a rise in the uptake of commercial loans across African states. This has seen the composition of creditors changing from traditional concessional loans which entails loans from bilateral and multilateral creditors to commercial loans from private creditors.[14] Essentially, **private sector debt is considered as credit that is acquired from non-state private sector players that includes bonds that are either publicly issued or privately placed, commercial bank loans from private banks and other private financial institutions.** It also encompasses private credits from manufacturers, exporters and other supplier of goods, bank credits covered by a guarantee of an export credit agency.[15] Private credit can be externally or domestically sourced. In Kenya, private credit from external creditors is categorised under commercial debt, which refers to syndicated loans and international sovereign bonds and suppliers credit, while private credit from domestic debt is comprised of different debt instruments such as Treasury bills, Treasury bonds and advances from Commercial banks.[16]
According to the National Treasury, debt stock from private creditors made up an average of 58% of the total debt stock between 2012 and 2020. This amount has increased substantively over the years with the highest share recorded in 2014, 2018 and 2019 at 60.5%, 62% and 62.2% respectively. Notably, these are the same time periods within which Kenya has issued Eurobonds.

In terms of composition, private debt stock is majorly composed of debt from domestic creditors accounting for an average of 81% between the period 2012 and 2020. However, domestic private

12 Parliament of Kenya, 2021. Unpacking of the 2022 Medium Term Debt Management Strategy. Parliamentary Budget office. http://www.parliament.go.ke/sites/default/files/2021-12/2022%20MTDS%20Unpacking.pdf
13 International Budget Partnership. The State of Public Debt in Kenya. (2020). https://www.internationalbudget.org/wp-content/uploads/state-of-public-debt-Kenya-october-2020.pdf
14 Ekeruche, M.A. (2022) Africa's Rising Debt and the Emergence of New Creditors. A Review of Trends, Challenges and Prospects (2000 -2021). Africa Debt Series Vol. 2. Friedrich Ebert Stiftung. https://library.fes.de/pdf-files/bueros/fes-ua/19365.pdf
15 Definition derived from World Bank International Debt Statistics Metadata Indicator definition of 'Disbursements on external debt, private guaranteed by public sector'. https://datatopics.worldbank.org/debt/ids/countryanalytical/KEN
16 The National Treasury. (2021) Annual Public Debt Report. https://www.treasury.go.ke/wp-content/uploads/2021/12/ANNUAL-PUBLIC-DEBT-REPORT-2021-final-as-at-oct-21-2021.pdf

Figure 3: Private debt as a Share of Total debt stock (Amount in KES Billions)



Source: National Treasury

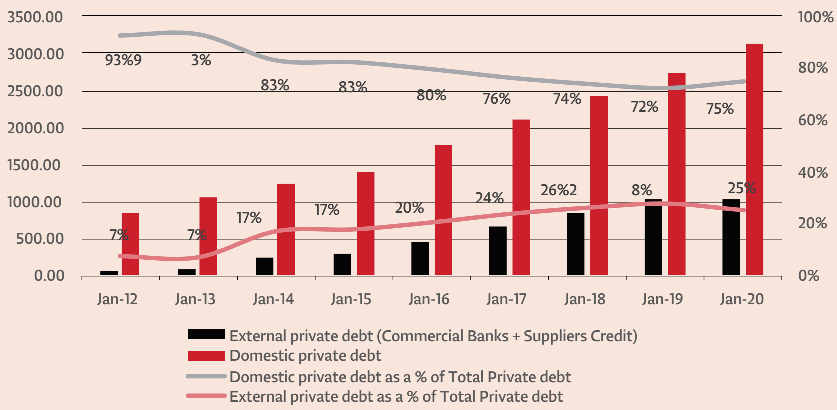
credit has been reducing with a notable increased uptake of private credit from external sources with the composition increasing from 7% in 2012 to 25% in 2020.

2.2 Major Sources of Private Sector Debt in Kenya

External Private Sector Debt

External private sector debt consists of loans sourced internationally from commercial banks, international sovereign bond issues, credit from suppliers of goods and other financial institutions such as insurance companies, pension funds. **These loan categories make up the commercial debt component of total external loans. Loans from commercial banks have increased substantively from KES 50.4 billion in 2012 to KES 1.02 trillion in 2020 rising from making up 77% of total external private credit in 2012 to 98% in 2020.** Suppliers credit has increased

Figure 4: Kenya's Private Debt Stock Composition (Amount in KES billions)



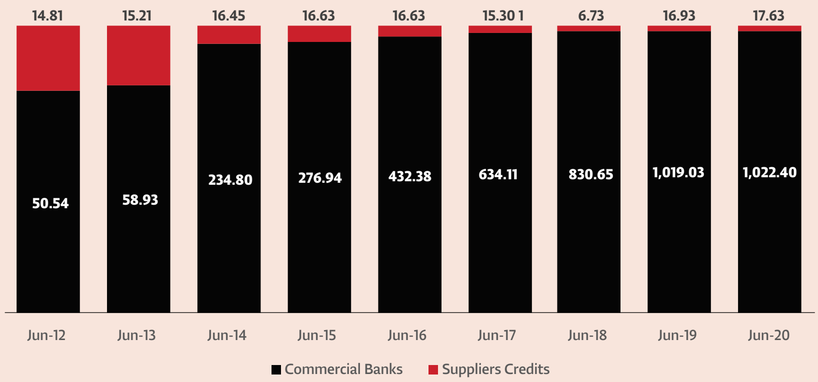
Source: National Treasury

gradually, from KES 14.8 billion in 2012 to KES 17.6 billion reducing as a proportion of total external private credit from 23% in 2012 to 2% in 2020. Some of the major commercial banks that have issued credit to Kenya include China Development Bank Citigroup Global Markets, Erste Group of Banks, First Mercantile Securities Corporation, Societe Generale, Standard Bank Limited UK and Trade and Development Bank.[17]

Over the years, the composition of external debt has been changing, with preference for concessional loans declining in favour of commercial loans. The proportion of concessional loans has declined

17 The National Treasury. (2021) External Public Debt Register as at the end of June 2021. https://www.treasury.go.ke/wp-content/uploads/2022/06/External-Public-Debt-Register-as-at-End-June-2021.pdf

Figure 5: Composition of Kenya's External Private Credit in KES billions

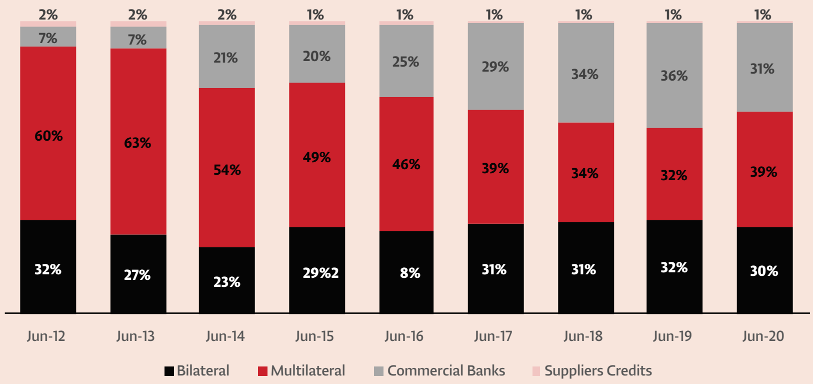


Source: National Treasury

from 92% in 2012 to 69% in 2020 while commercial loans have increased from 7% in 2012 to 31% in 2020. The drastic increase in commercial loans is attributed to Kenya's change of status from a low income country to a lower middle income country resulting from Kenya National Bureau of Statistics rebasing its national accounts, changing the base year from 2001 to 2009.[18] Additionally, the shift in political regime contributed to increased accumulation of commercial loans as the incumbent government sought resources without conditions attached to fund various projects under the 'Big 4 Agenda.'[19]

The change in status barred Kenya from accessing concessional loans for low income countries, pushing it into commercial borrowing.[20] This, in turn, saw the country issue the first Eurobond in June 2014 which raised KES 280 billion, with subsequent Eurobond issues issued in 2018, 2019 and 2021 resulting to increased accumulation of commercial loans as shown in the figure below.[21] **Some of the biggest financial corporations in the world make up the various holders of Kenya's outstanding portfolio of Eurobonds worth USD 7.1 billion.** These include BlackRock, which has the highest holdings estimated at USD 198.8 million, JP Morgan (USD 112.1 million), Aberdeen Standard Investments (USD 65.7 million), UBS (USD 61.1 million), HSBC (USD 49.1 million), Legal and General (USD 28.1 million) and Goldman Sachs (USD 2.5 million).

Figure 6: Composition of Kenya's External debt



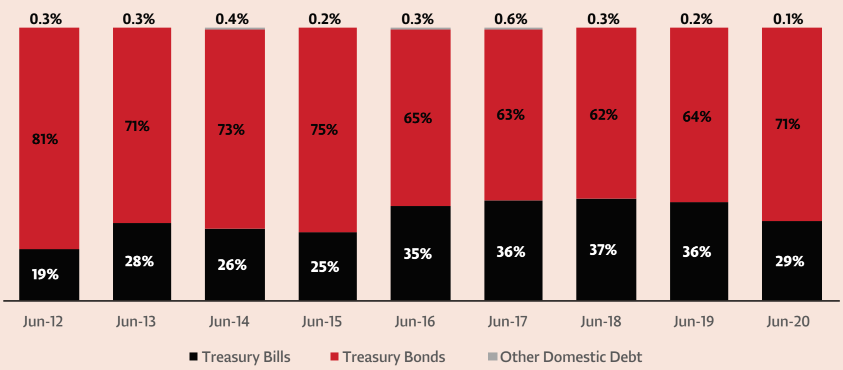
Source: National Treasury

18 The National Treasury. (2018). Eurobond II Prospectus. https://s3-eu-west-1.amazonaws.com/s3.sourceafrica.net/documents/119736/Eurobond-II-Prospectus-The-National-Treasury-Kenya.pdf
19 The East African. Grand promises: The high cost of financing Cord, Jubilee manifestos. February 9, 2013. https://www.theeastafrican.co.ke/tea/news/east-africa/grand-promises-the-high-cost-of-financing-cord-jubilee-manifestos--1314760
20 Cytonn Investments. Kenya's Public Debt: On a path to Distress? October 10, 2021. https://cytonn.com/topicals/kenyas-public-debt-2
21 Wafula, P. Eurobond dossier reveals Kenya's deep economic ties to China, IMF. Nation Media Group. June 17, 2021. https://nation.africa/kenya/business/eurobond-kenya-s-deep-ties-to-china-imf-now-revealed-3440074

Domestic private Sector Debt

Private credit from domestic sources includes debt instruments such as Treasury bills, Treasury bonds, and advances from commercial banks among other sources. Treasury bills are short-term domestic debt securities with maturities of either 91, 182 or 364 days while treasury bonds are medium to long term domestic debt instruments with maturities ranging 1 to 30 years.[22] Issuing more treasury bills helps in reducing vulnerability to interest rate risk which occurs when the rise in market interest rate causes the price of fixed bonds to fall. On the other hand, issuing more treasury bonds helps in reducing vulnerability to rollover risk which is high when there is an increase in proportion of debt maturing in one year.[23] As such, the composition of domestic debt, which in the past decade has been composed of more treasury bonds in the ratio of 70:30, has shown to be a good debt strategy in reducing rollover risks.[24] Over the years, domestic borrowing has increased significantly from 0.8 trillion in 2012 to 3.1 trillion in 2020 with treasury bonds accounting for 71% and treasury bills 29% as at June 2020.[25]

Figure 8: Composition of Kenya's Domestic debt



Source: National Treasury

More than half of domestic debt, 51.4%, is held by commercial banks, followed by pension funds, 30.7%, and insurance companies, 6.7% as shown in the table below.26 The increased holding of domestic debt by government is a source of susceptibility to crowding out of the private sector resulting in investment declines and consequently leading to financial market instability.[27]

Table 1: Domestic credit by holder in %

Holder	2012	2013	2014	2015	2016	2017	2018	2019	2020
Commercial banks	48.0	49.9	48.1	51.4	51.1	54.1	51.1	50.8	54.0
CBK	5.5	3.7	5.1	4.5	5.5	2.6	4.5	3.9	4.0
Non-banks	46.5	46.3	46.8	44.1	43.4	43.3	44.4	45.3	42.0

22 Musili, W. & Opiyo, S. (2021). Dynamics of Domestic Debt in Kenya: Composition, Risks and Financial Market Stability. Kenya Institute for Public Policy Research and Analysis. https://kippra.or.ke/dynamics-of-domestic-debt-in-kenya-composition-risks-and-financial-market-stability/
23 Musili, W. & Opiyo, S. (2021). Dynamics of Domestic Debt in Kenya: Composition, Risks and Financial Market Stability. Kenya Institute for Public Policy Research and Analysis. https://kippra.or.ke/dynamics-of-domestic-debt-in-kenya-composition-risks-and-financial-market-stability/
24 Musili, W. & Opiyo, S. (2021). Dynamics of Domestic Debt in Kenya: Composition, Risks and Financial Market Stability. Kenya Institute for Public Policy Research and Analysis. https://kippra.or.ke/dynamics-of-domestic-debt-in-kenya-composition-risks-and-financial-market-stability/
25 The National Treasury and Planning, (2021) Annual Public Debt Report. https://www.treasury.go.ke/wp-content/uploads/2021/12/ANNUAL-PUBLIC-DEBT-REPORT-2021-final-as-at-oct-21-2021.pdf
26 The National Treasury and Planning, (2021) Annual Public Debt Report. https://www.treasury.go.ke/wp-content/uploads/2021/12/ANNUAL-PUBLIC-DEBT-REPORT-2021-final-as-at-oct-21-2021.pdf
27 KIPPRA, (2021) Dynamics of Domestic Debt in Kenya: Composition, Risks, and Financial Market Stability. https://kippra.or.ke/dynamics-of-domestic-debt-in-kenya-composition-risks-and-financial-market-stability/

SECTION 3

Between 2006 and 2020, there was a shift in the portfolio of creditors with most African countries turning from concessional loans offered by the multilateral and Paris Club Creditors to private creditors and non-Paris Club creditors, largely China

PRIVATE SECTOR DEBT AND FISCAL JUSTICE IN KENYA

3.0 Background to Africa obtaining Debt from Private Creditors

The Kenyan experience reflects that of other sub-Saharan African Countries. The level of public debt stock of Sub-Saharan African countries has increased over the last decade as a result of increased borrowing[28]. Initially, African countries borrowed largely from Bilateral Creditors – Paris Club Official Creditor and multilateral sources. Between 2006 and 2020, there was a shift in the portfolio of creditors with most African countries turning from concessional loans offered by the multilateral and Paris Club Creditors to private creditors and non-Paris Club creditors, largely China[29]. Among countries eligible for DSSI- largely African states, the proportion of debt owed to bilateral creditors decreased from 28% in 2006 to 10% of GDP in 2020 while that owed to multilateral creditors decreased from 55% to 48% of GDP within the same duration. African States increased borrowing from private creditors, especially through Eurobonds. Consequently, the share of Eurobonds to private creditors increased from 3% in 2006 to 11% in 2020.[30] **The shift in borrowing was occasioned by various factors including the ineligibility some countries to access concessional loans, less scrutiny of the use of funds borrowed from private creditors and fewer conditions attached to such loans as opposed to loans from multilateral and Paris Club creditors.** Bond issuances by African countries increased from US$67 billion in 2012 to US$179 billion in 2020[31]. Kenya issued Eurobonds of US$ 2 billion in 2014, US$2 billion in 2018, US$ 2.1 billion in 2019 and US$ 1 billion in 2021[32]. The IMF notes that in 2020, Eurobonds and syndicated loans accounted for 70% and 27% of Kenya's commercial debt respectively[33].

3.1 Implications of Private Sector Debt on Fiscal Justice

The increasing trend of African States borrowing from private creditors has had various implications on these jurisdictions, including fuelling tax injustice[34]. In a bid to finance repayment of debt governments have resorted to reforming tax policies for more revenue collection[35]. For example, Kenya initiated various tax reforms – introduction of Digital Service Tax, expansion of the residential income tax bracket, introduction of new VAT rates for certain commodities and restructure of income tax brackets[36]. These reforms were not necessarily progressive. The reforms have furthered inequalities by increasing burden on the taxpayers and reducing the

28 World Bank, 2022, International Debt Statistics 2022, https://openknowledge.worldbank.org/handle/10986/36289
29 Ekeruche, M., 2022, Africa's Rising Debt and the Emergence of New Creditors, https://library.fes.de/pdf-files/bueros/fes-ua/19365.pdf
30 Chabert, G., Cerisola, M. and Hakura, D., 2022. Restructuring Debt of Poorer Nations Requires More Efficient Coordination, https://blogs.imf.org/2022/04/07/restructuring-debt-of-poorer-nations-requires-more-efficient-coordination/
31 Ekeruche, M., 2022, Africa's Rising Debt and the Emergence of New Creditors, https://library.fes.de/pdf-files/bueros/fes-ua/19365.pdf
32 Julians Amboko, Terms of Kenya's Sh108bn fresh Eurobond revealed, Business Daily, June 18th 2021. https://www.businessdailyafrica.com/bd/economy/terms-of-kenya-sh108bn-fresh-eurobond-revealed-3441560
33 IMF, Kenya Debt Sustainability Assessment, https://www.imf.org/-/media/Files/DSA/external/pubs/ft/dsa/pdf/2021/dsacr2172.ashx
34 EATGN, 2021, Economic Sustainability In East Africa- Framing the Linkages Between Public Debt and Tax Justice https://www.eataxgovernance.net/wp-content/uploads/2021/08/F-Economic-Sustainability-In-East-Africa-1.pdf
35 Rasnah Warah, 2022, Blog: Kenyans head into an election amid skyrocketing debt and food insecurity, https://www.one.org/africa/blog/kenya-election-debt-food-insecurity/
36 Ernst & Young, 2021. Tax Alert- Kenya enacts significant tax measures for 2021 https://www.ey.com/en_gl/tax-alerts/kenya-enacts-significant-tax-measures-for-2021

level of disposable income, especially for the poor. Moreover, the proceeds from taxation have increasingly been used to service debt instead of funding vital public service as required. This has the effect of slowing economic output and reducing tax revenues in the long run as little is being investment in the country to spur economic growth.

A research by the African Development Bank, which utilized synthetic control experiments to conduct comparative case study analysis to assess the implications of Eurobonds notes that Eurobond issuances potentially led to 13% points acceleration in the debt-to-GDP ratios ten years after issuance, compared to the no-issuance counterfactual scenario[37]. In Kenya, implications of debt acquired from private sector creditors on debt sustainability and economic development have been varied. Some of them are discussed hereunder.

Costlier terms of borrowing offered by Private Creditors

Private creditors generally offer loans at higher rates of interest compared to other creditors. Debt from multilateral and some bilateral creditors are normally at concessional terms, that is, below the market interest rates. According to the National Treasury, there is no period where the average interest for new external loans exceeded 4%. The Ministry also indicates that the terms of borrowing for new external loans are highly concessional[38]. This is depicted in the table below:

Table 2: Average Interest Rates for New External Loan Commitments

Year	2014	2015	2016	2017	2018	2019	2020	2021
Average Interest Rate (%)	2.6	2.5	2.6	2.6	3.9	3.9	0.5	2.1

Source: National Treasury

However, interest rates for Eurobonds (a major source of private sector debt) issued by Kenya are higher compared to other external loan as the bonds are affected by market conditions, including currency fluctuations. The higher interest rates are show in the table below. **Poor credit ratings of African States and the perception of high risk renders also contributes to the bonds higher interest ratings.[39]**

Table 3: Interest rates for Eurobonds Issued by Kenya

Year	Bond	Interest Rate (%)
2014	Eurobond A (US$ 0.5 Billion)	5.875
	Eurobond B(US$ 1.5 Billion)	6.875
2018	Eurobond A (US$ 1 Billion)	7.25
	Eurobond A (US$ 1 Billion)	8.25
2019	Eurobond A (US$ 900 Million)	7
	Eurobond A (US$ 1.2 Billion)	8
2021	Eurobond (US$ 1 Billion)	6.3

Source: Institute of Economic Affairs40, Business Daily[41]

With regards to domestic private sector creditors, the interest rates for treasury bills are also high and attractive to local financial and non-financial institutions. This implies that the government has to make higher repayments, beyond the market rates, when the treasury bills mature.

37 AFDB, 2021. Working Paper: Eurobonds, debt sustainability and macroeconomic performance in Africa: Synthetic controlled experiments, https://www.afdb.org/en/documents/working-paper-356-euro-bonds-debt-sustainability-and-macroeconomic-performance-africa-synthetic-controlled-experiments

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

39 Muti Mutize M., 2021, African governments have developed a taste for Eurobonds: why it's dangerous, The Conversation Article, https://theconversation.com/african-governments-have-developed-a-taste-for-eu-robonds-why-its-dangerous-165469

40 Institute of Economic Affairs, 2019, Eurobond: Facts and Figures: Kenya's Experience from 2014-2019, https://ieakenya.or.ke/download/eurobond-facts-and-figures-kenyas-experience-from-2014-2019/

41 Julians Amboko, 2021, Terms of Kenya's Sh108bn fresh Eurobond revealed, Business Daily, https://www.businessdailyafrica.com/bd/economy/terms-of-kenya-sh108bn-fresh-eurobond-revealed-3441560

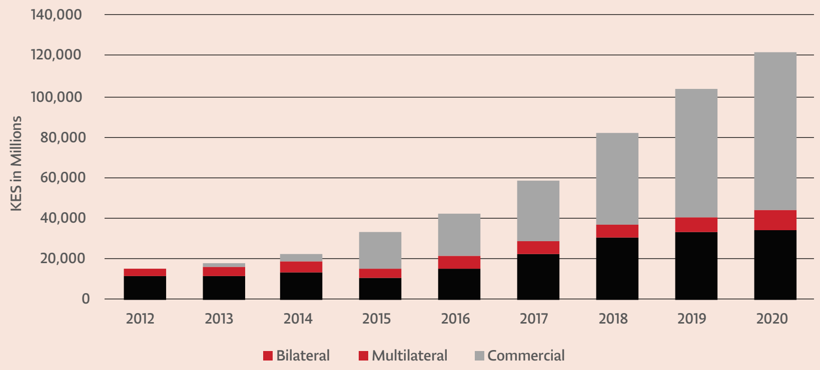
Table 4: Average Interest Rates for Treasury Bills

Year	2014	2015	2016	2017	2018	2019	2020	2021
Av. Interest for 91-day T Bill	9.8	8.2	7.1	8.3	7.7	6.8	6.7	6.7
Av. Interest for 182-day T Bill	10.5	11.3	9.2	10.3	9.6	7.6	7.4	7.3
Av. Interest for 364-day T Bill	10.6	11.0	10.7	10.9	10.5	9.0	8.2	8.4

Source: National Treasury Annual Public Debt Reports

Higher interest rates result in higher debt servicing costs. In Kenya, since 2015, interest payments for commercial loans (which are mostly from private creditors) have constituted a larger share of the overall interest payments to external creditors. This is illustrated in figure 5 below. Moreover, interest payments to private creditors have been increasing since 2012. In 2020, whilst there was a general increase in interest payments on loans from external creditors, the increase (20%) in interest payments towards commercial creditors was more compared to payments to other creditors. This was amidst the country facing the negative economic impacts occasioned by Covid-19 Pandemic. Overall, **costlier interest rates translate to high debt servicing costs. As such, more tax revenues are diverted into servicing debt while little is left to finance public service.**

Figure 5: Kenya Interest Payment on loans from External Creditors



Source: National Treasury Reports

Short maturity periods of Commercial Debt

Loans from private creditors have short maturities compared to advances from other creditors. As such, the governments have a shorter period to use the costly funds before starting to make interest payments for the loans. This period is not normally enough to see the loan investments spur economic growth. Data from the National Treasury (shown in table 5) indicates that external loans from all creditors have longer maturity period compared to some of the private sector debt (largely Eurobond).

Table 5: Average terms of new External Loans to Kenya

Terms	2014	2015	2016	2017	2018	2019	2020	2021
Average Maturity (years)	18.1	21.0	20.3	17.6	20.8	15.3	26.2	23.3
Grace Period (years)	6.2	6.4	6.2	4.5	10.3	5.6	7.4	7.4

Source: National Treasury Annual Public Debt Report

As shown in the table below, most of the Eurobonds (a major source of private sector debt) issued by Kenya have shorter maturity periods of up to 5 years. This is unlike the terms offered

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some lenders, for example the IMF, which provide loans with a grace period of five years and a 30-year repayment period[42]. The short maturity periods are perilous for African countries, including for Kenya, which has been borrowing short to medium term loans to finance long term mega infrastructure projects[43]. It can be argued that the government borrows to spur economic growth and development, which would ultimately translate in increased tax revenues. However, most of the government's commercial loans acquired since 2012 were largely invested in big infrastructure projects (road and railways) and energy production, projects which take longer to produce direct social and economic returns[44]. Thus increasingly, loans from such creditors tend to mature long before the benefits are seen and the government has had to start repaying the loans. This has largely burdened fiscal space, as the loan investments have contributed only a marginal increase in the tax base and hence potential for revenue collection.

However, most of the government's commercial loans acquired since 2012 were largely invested in big infrastructure projects (road and railways) and energy production, projects which take longer to produce direct social and economic returns

Table 6: Maturity period of Eurobonds issued by Kenya

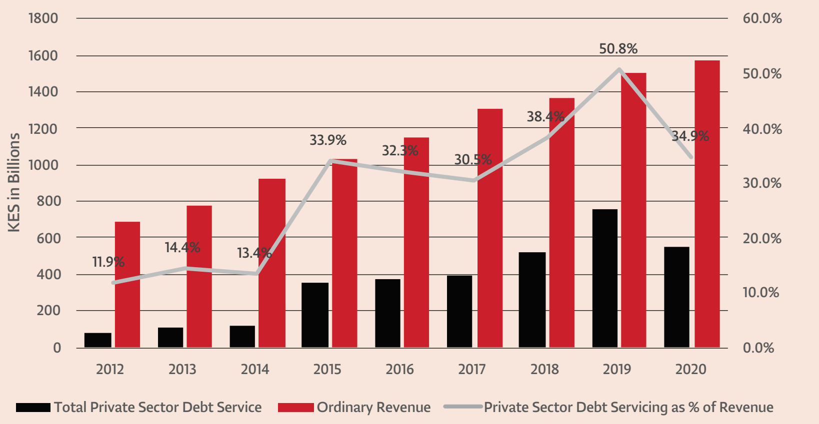
Year	Bond	Maturity (Years)
2014	Eurobond A (US$ 0.5 Billion)	5
	Eurobond B(US$ 1.5 Billion)	10
2018	Eurobond A (US$ 1 Billion)	10
	Eurobond A (US$ 1 Billion)	30
2019	Eurobond A (US$ 900 Million)	7
	Eurobond A (US$ 1.2 Billion)	12
2021	Eurobond (US$ 1 Billion)	12

Source: Institute of Economic Affairs, Business Daily

Servicing Private Sector Debt crowding out pro-poor Government Expenditure

Studies have shown that increasing debt stock and servicing/repayment obligations have the effect of crowding out development expenditure as government revenues are diverted

Figure 6: **Kenya Private Sector Debt Servicing as Proportion of Revenue**



Source: National Treasury Reports

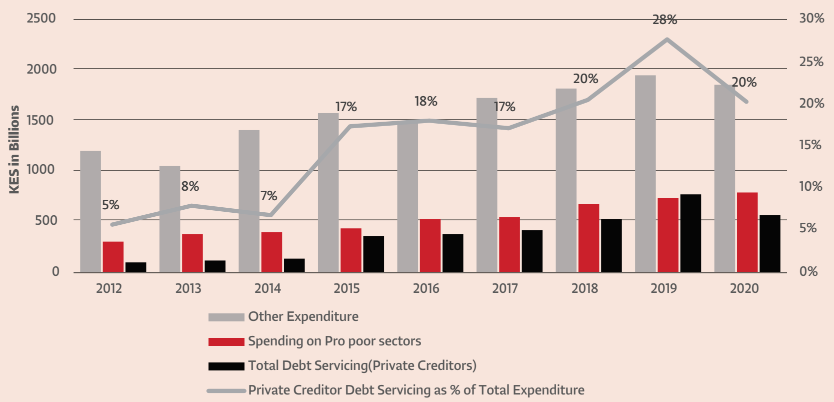
42 Otiato Guguyu, 2019, IMF: Kenya risks Eurobond access over debt pile up, Business Daily, https://www.businessdailyafrica.com/bd/economy/imf-kenya-risks-eurobond-debt-pile-up-3248298
43 Mutize M., 2021, African governments have developed a taste for Eurobonds: why it's dangerous, The Conversation Article, https://theconversation.com/african-governments-have-developed-a-taste-for-eurobonds-why-its-dangerous-165469
44 David Ndii, 2019. Op Ed: I Don't Understand Why Kenyans Are Broke': Mr. Kenyatta's Debt Distress Revisited, The Elephant, https://www.theelephant.info/op-eds/2019/11/15/i-dont-understand-why-kenyans-are-broke-mr-kenyattas-debt-distress-revisited/

to repaying debt[45]**.** The negative effect is greater for servicing debt acquired from commercial creditors (largely private sector creditors) as they are costlier as explained (in the section above). As illustrated on Figure 6, there has been an increase in the proportion of tax revenues being used up in debt servicing. This implies that **tax revenues are increasingly being diverted from financing government expenditure on its citizens to repaying loans acquired from creditors.** In 2019, half (KES 761.4 Billion) of the government's tax revenues were used up in servicing debt from both local and external private creditors.

Private sector debt servicing continues to burden Kenya, which is already grappling with the challenge of domestic revenue mobilization.[46] As shown in figure 7 below, the high costs for servicing private sector debt has increasingly limited expenditure on Kenya's pro-poor sectors - health, education, agriculture and social protection. Notably, private sector debt servicing surpassed Kenya's pro-poor spending in 2019 (see Figure 7). The government has also been unable to provide additional budgetary support/financing to meet the increasing sectoral needs that arise from changes such as population grown and climate change. As such, underfunding of continues to cripple the level of access to and quality of key public services such as health and education and generally undermines/slows general growth in the economy.

In 2020, the government used 548.41 billion to service private sector debt, which was twice the allocation to the health sector (KES 247 billion) during the same period.[47] These debt servicing amounts could have been used to improve Covid-19 response interventions in the country such as isolation centres, respiratory equipment, PPEs and the hire of additional health workers. According to Jubilee Debt Campaign UK, the money used up by developing countries in servicing private sector debt during the pandemic would have been sufficient to buy Covid-19 vaccines for 6.3 billion people with more than US$ 133 billion remaining to finance health care and debt cancellation[48].

Figure 7: Private Creditors Debt Servicing Vs Other Expenditure



Source: National Treasury Reports

Secrecy of Private Sector Debt limiting transparency and accountability

Transparency in public debt data is important for ensuring prudent public debt management. It promotes accountability and higher credit ratings, lowers the cost of external borrowing and attracts investors (as investors prefer countries where they know the stock and composition of debt[49]). Nevertheless, there is notable opacity furthered by private creditors in Kenya's public debt

45 Ocheing, J. Gisore, N. & Kibet, L (2014) Does Public Debt Crowd-Out Public Investment in East Africa Community? Journal of Economics. Vol. 2 No.4 https://www.researchgate.net/publication/334451486_Does_Public_Debt_Crowd-Out_Public_Investment_In_East_Africa_Community

46 Calderón, C. and Zeufack, A., 2020, Borrow with Sorrow? The Changing Risk Profile of Sub-Saharan Africa's Debt, https://documents1.worldbank.org/curated/en/370721580415352349/pdf/Borrow-with-Sorrow-The-Changing-Risk-Profile-of-Sub-Saharan-Africas-Debt.pdf

47 Ministry of Health, 2022. National and County Health Budget Analysis FY 2020/21, https://www.health.go.ke/wp-content/uploads/2022/06/National-and-County-Budget-Analysis-FY-2021-22.pdf

48 Eurodad, Infogram: Is the IMF doing Enough?, https://infogram.com/1pqm5pjj5vl030iq6ejxx2v551b0gx0p-jx5?live

49 Larraín, G., H. Reisen and J. von Maltzan (1997), "Emerging Market Risk and Sovereign Credit Ratings", OECD Development Centre Working Papers, No. 124, OECD Publishing, Paris, https://doi.org/10.1787/004352173554.

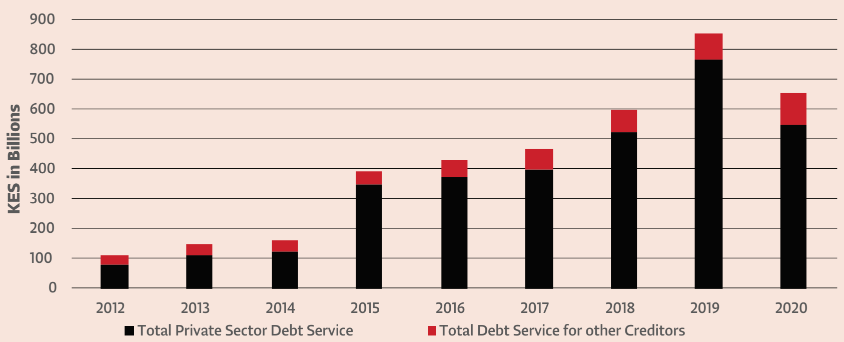
situation. **Loans acquired from private creditors are shrouded in secrecy and complexity.** Such private sector driven debt instruments, especially Eurobonds, are characterized by broad discretion and limited scrutiny in their use[50]. This presents a loophole for corruption and mismanagement of the borrowed funds at the expense of the public (citizens) who are responsible for repaying the acquired debt. For instance, there have been several allegations of corruption involving Eurobond issued by Kenya[51]. Also, the use of the loans obtained through Kenya's Eurobond issuance in 2014 still remains questionable.[52] The secrecy involved in obtaining such loans further grants private creditors enormous power over developing countries. Additionally, the opaque nature of private sector debt may delay and complicate debt restructuring.

Sovereignty surrounding Private Sector Debt

Like other creditors, **private sector players that contribute to the country's public debt portfolio have considerable leverage over the government, as a result of agreements and conditionalities that come with the financing they provide.** This can be deduced from Kenya's legal and institutional framework on Public Finance which prioritizes public debt over other budget commitments[53]. That is, Kenya is obligated to first pay its debt (through Consolidated Funds Service) before spending money on other government functions including service delivery. This leaves little revenue for service-related expenditures. As shown in the figure below, private sector debt servicing constitutes the largest share of total debt servicing. Moreover, private creditors have more control over the decisions Kenya makes regarding its debt.

This control was evident during the Covid-19 pandemic as indebted countries, including Kenya, had to continue repaying private sector debt amidst worsening economic conditions. Countries which were indebted to private creditors were discouraged from applying for debt service suspension or relief in case this would downgrade their credit ratings.[54] The countries thus had to forego the initiatives that would have benefitted them during the pandemic and opted to continue servicing debt - further straining their available resources. Kenya, for example, was reluctant in applying for debt relief from its private creditors[55]. Even as the IMF offered loans to the countries to help ease the effects of Covid-19, US$ 194 billion (47.3% of the loans) were diverted to repay debt owed to private creditors[56]. This illustrates the level of control that private creditors have over countries that are indebted to them.

Figure 8: Total Domestic and External Debt Servicing by Creditor Type (KES Billions)



Source: National Treasury

50 Oxfam et al., 2020. Passing the Buck on Debt Relief: How the failure of the private sector to cancel debts is fuelling a crisis across the developing world, https://policy-practice.oxfam.org/resources/passing-the-buck-on-debt-relief-how-the-failure-of-the-private-sector-to-cancel-621026/

51 Edwin Mutai, Ouko says Eurobond billions still a mystery, Business Daily, 23rd January 2018, https://www.businessdailyafrica.com/bd/economy/ouko-says-eurobond-billions-still-a-mystery--2186608

52 David Ndii, Eurobond Accountability: Facts, Figures, Questions, https://www.kara.or.ke/Eurobond%20Facts%20Figures%20Questions.pdf

53 Kinuthia, J., and Rugo, A., 2020. The State of Kenya's Public Debt: the thin line between a rock and a hard place. International Budget Partnership https://www.internationalbudget.org/wp-content/uploads/state-of-public-debt-Kenya-october-2020.pdf

54 Sokpoh, A., Chirikure, N. & Braganza, J., 2022, Policy Brief: Africa's Debt Landscape: Scope for Sustainability. https://afripoli.org/africas-debt-landscape-scope-for-sustainability

55 The Conversation, 2020. Why African countries are reluctant to take up COVID-19 debt relief, https://the-conversation.com/why-african-countries-are-reluctant-to-take-up-covid-19-debt-relief-140643

56 Eurodad, Infogram: Is the IMF doing Enough?, https://infogram.com/1pqm5pjj5vl030iq6ejxx2v551b0gx0p-jx5?live

Limited Public Participation in Private Sector Debt

Prudent debt management requires the involvement and participation of various stakeholders in debt decisions. However, there is no inclusive and elaborate framework that guides participation of citizens and other non–state actors in decisions on acquiring debt private sector creditors (including decisions on debt acquisition and utility of the borrowed funds). As such, private sector debt continues to further secrecy and disempowerment of citizens in public debt management. Moreover, unlike debt from multilateral and Paris Club bilateral creditors, there is no elaborate framework that guides relief/restructure. There are complexities in restructuring debt from private creditors due to gaps in contractual agreements such as lack of enhanced collective action clauses, lack of restructuring provisions for interest payments and the use of certain collateral instruments [57]. For instance, during the Covid-19 Pandemic, private creditors were indifferent towards offering debt service relief to developing economies even after the G20 agreed to the Debt Service Suspension Initiative in 2020[58]. Developing countries thus had to continue servicing debt for private creditors amidst the adverse economic conditions experienced around the globe owing to the Covid-19 pandemic. This further strained the limited resources of the developing economies that were supposed to be used in cushioning citizens from the effects of Covid-19.

Skewed investments of Private Sector credit away from pro-poor sectors

Whilst there exists limited information on the utility of the funds borrowed from private creditors, available data points to some of the funds being utilised more on economic sectors like infrastructure and energy development compared to sectors such as health, education and social protection[59]. This skewed funding limits the adherence and attainment of global commitments. For example, Kenya has not met the Abuja declaration of allocating 15% of its budget to the health sector[60], and is also yet to spend 6% of its GDP in Education in line with the Global Partnership for Education commitment[61]. Eurobond proceeds have been used to finance development expenditure and repay other debt obligations. For example, money from Eurobonds issued by Kenya in 2014 and 2018 were used to repay KES 53.2 billion syndicated loans and KES 75 billion loans respectively[62]. It is also reported that the Eurobonds were utilised for other budgetary expenditure although the exact details have not been disclosed. Notably, there exist information gaps related to private sector debt that limit rigorous analysis of the use of resources raised through private loans.

Private Sector debt limiting gender responsiveness of public finance

Public expenditure decisions and the underpinning public financial management systems can have materially different impacts on economic and social outcomes for different genders. Men and women typically have different work and livelihood patterns, unequal education and skills levels, large divergences in levels of asset ownership and access to resources, different levels of voice and participation in public life, and different assumptions of household responsibilities.63 Thus, it is necessary to have targeted public spending that reduces structural inequalities, including to improve the position of women in society. More gender-responsive public expenditure is needed, including deliberate spending on specific gender-related measures for equal opportunities and public services that reduce gendered burdens of unpaid work and strengthen services mostly used by women.

Governments are committed to delivering Sustainable Development Goals (SDG) services such as health, education, and justice, and ending gender inequality. **Funding essential services becomes**

57 Alberto Isgut, 2022. Addressing sovereign debt challenges in the era of covid-19 and beyond: The role of the United Nations. Asia-Pacific Sustainable Development Journal, Vol. 28, No. 2, pp. 149-192. https://www.unescap.org/sites/default/d8files/event-documents/Background%20Paper%20-%20Debt%20Restructuring_25%20March%202022_0.pdf

58 Muchabaiwa, B., 2021, The Looming Debt Crisis in Eastern and Southern Africa: What it Means for Social Sector Investments and Children, https://www.unicef.org/esa/media/9636/file/UNICEF-ESARO-Looming-Debt-Crisis-2021.pdf

59 Kinuthia, J., and Rugo, A., 2020. The State of Kenya's Public Debt: the thin line between a rock and a hard place. International Budget Partnership https://www.internationalbudget.org/wp-content/uploads/state-of-public-debt-Kenya-october-2020.pdf

60 Ministry of Health, 2020. Health Sector Report: Medium Term Expenditure Framework (MTEF) for the Period 2021/22-2023/24. https://www.treasury.go.ke/wp-content/uploads/2021/05/REVISED-HEALTH-SECTOR-REPORT.pdf

61 UNESCO, 2021, UNESCO Member States unite to increase investment in education, https://en.unesco.org/news/unesco-member-states-unite-increase-investment-education

62 Institute of Economic Affairs, 2019, Eurobond: Facts and Figures: Kenya's Experience from 2014-2019, https://ieakenya.or.ke/download/eurobond-facts-and-figures-kenyas-experience-from-2014-2019/

63 ADB – Asian Development Bank (2012) Gender Toolkit: Public Sector Management. Philippines: Asian Development Bank (https://www.adb.org/sites/default/files/institutional-document/33643/files/gender-tool-kit.pdf)

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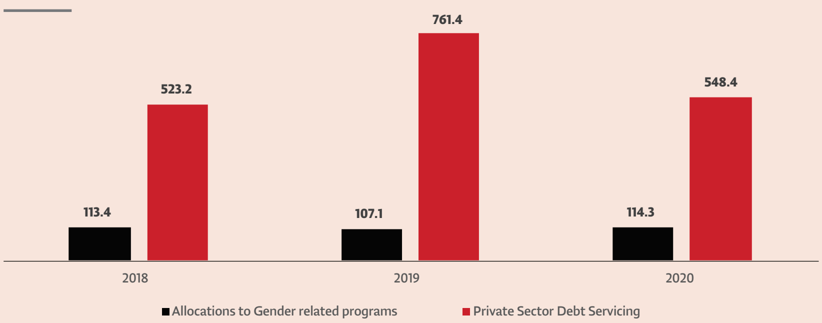
difficult in a situation where the government has to repay expensive commercial loans of which private sector debt contributes a significant proportion. For instance, servicing commercial debts diverts resources from critical programs like the provision of sanitary pads to keep girls in school, universal healthcare for pregnant and breastfeeding mothers, free water supplies in informal settlements/ASAL (dryland) areas, grants and loans for women's businesses, and building more boarding schools to promote the education of girls. Figure 12 shows a comparison between what the government spends on gender-responsive and equal opportunities programmes and private debt servicing across three years. The gender specific programs include Allocations to the National Gender and Equality Commission, Women Economic Empowerment and Health and Education programs enhancing equity. Evidently, substantive resources go to debt servicing hence reducing what is available for spending on programmes that enhance gender equity.

Figure 12: Allocations to Gender-related Programs vs Private Debt Servicing



*Source: National Treasury and Auditor's General Report. *The national budgets provide an incomplete funding picture of Kenya's national gender financing.*

Further, **women are more affected by public debt and related repayment obligations than men.**[64] Women are the primary caregivers and therefore a shortage of basic health care and other social services often results in them assuming the extra burden of caring for the young, sick, and elderly. For younger women, this comes at the expense of their education since they are forced to drop out of school to be caregivers. Moreover, women bear the brunt of the reduction in healthcare budgets as governments put in place austerity measures and fiscal adjustment policies because they together with children are frequent users of healthcare facilities.[65] Since women are often marginalized, excluded from decision-making at all levels, and lack independent control over resources and livelihoods[66], they tend to suffer most from measures put in place by the government to raise revenues to finance debt repayment such as increased Value Added Tax (resulting in high commodity prices). In a nutshell, private sector debts exacerbate gender inequality by denying women the resources and opportunities to learn, earn, and lead to match males.

Essentially, the ever increasing debt repayment obligations occasioned by costly private sector debt acquired by the government limits spending on gender responsive development programmes. This limits development of women's livelihoods, frustrating efforts towards reduction of poverty and inequality, and retarding gains made in advancing human rights and achieving sustainable development for all.

- **Private Sector Debt and human rights:** The implications of public debt acquired by government for realization of citizens' human rights under the International Covenant on Economic, Social, and Cultural Rights and other human rights treaties cannot be overemphasized. Lumina & Tamale (2021) note that excessive foreign debt burden limits the realization of human rights and development in the indebted countries by diverting resources that are meant for provision of public services[67]. Heavy external debt burdens orchestrated by the preference for expensive

Moreover, women bear the brunt of the reduction in healthcare budgets as governments put in place austerity measures and fiscal adjustment policies because they together with children are frequent users of healthcare facilities.

64 Concluding comments of the Committee on the Elimination of Discrimination against Women on Uganda (A/57/38, para. 149) and Guyana (A/56/38, para. 161) https://www.ohchr.org/sites/default/files/Documents/Issues/Development/RTDBook/PartIIIChapter21.pdf

65 Bertakis, K, Azari R, Helms, L, Callahan, E, Robbins J. (2000), Gender Differences in the utilization of health-care services, National Library of Medicine https://pubmed.ncbi.nlm.nih.gov/10718692/

66 United Nations Department of Economic and Social Affairs (2009), World Survey on the Role of Women in Development https://www.un.org/womenwatch/daw/public/WorldSurvey2009.pdf

67 Lumina, C. and Tamale, N. 2021.Sovereign Debt and Human Rights-A Focus on Sub Saharan Africa. https://

commercial loans negatively impact the realization of human rights and development in debtor countries in two main interrelated ways: (i) through the diversion of resources from basic social services; and (ii) through conditions given by commercial creditors which undermine country ownership of national development strategies and assets.

- **Diversion of resources from basic social services:** Commercially acquired debts are substantively expensive since they attract high-interest rates and shorter repayment periods. As a result, servicing them significantly diverts scarce national resources from government programmes that deliver crucial public goods and services like education, health, and social protection. This in turn constrains the capacity of developing countries to create the conditions for the realization of human rights and undermines their development.[68] As such, several human rights, including the right to education, health, adequate housing, work, and development are threatened/violated, and in many developing countries such as Kenya, millions face poorer living conditions. Moreover, the conditions that borrowing countries have to fulfil before qualifying for debt relief often compel governments to further reduce spending on social services that are critical in guaranteeing human rights.[69]
- **Undermining country ownership of national development strategies and assets: Achieving a country's ownership of national development strategies is difficult in a situation of severe aid dependence, and even more so where the country is heavily indebted**. Chronic indebtedness necessitated by the preference for short-term expensive commercial loans renders borrowing countries subject to the control of creditors. This erodes the ability of the indebted country to freely determine and pursue policies favourable to their development in line with the Declaration on the Right to Development.[70] This limits the developmental impact of loans, for example, by preventing potential technology transfers that could improve the country's productive capabilities and limiting the resources available to realize human rights. Also, external commercial loans, especially private sector driven, come with limited transparency of agreements on terms and collateral with important implications for accountable governance. There have been concerns about loan terms with China that fuelled unconfirmed rumours about government having staked Mombasa port as collateral. These fears were compounded by a leaked Auditor's General report in 2018 suggesting that Kenya had staked the port of Mombasa as collateral for a $3.6 billion loan from China for the construction of the Mombasa-Nairobi Standard Gauge Railway (SGR).[71] Additionally, by excluding participation of citizens and other non-state actors in debt decisions, private sector debt continues to limit citizens from exercising their sovereignty.[72]
- **Domestic Private sector debt crowding out MSMEs; stifling growth:** The government's increased borrowing from local banks, insurance companies, pension funds and through issuance of treasury bills and bonds has the effect of crowding out private investment. Research has shown that increasing levels of government borrowing from local banks can contribute to the shrinking of credit available for Micro, Small and Medium Enterprises (MSMEs).[73][74] As a result of the higher interest rates associated with Kenya's public debt stock[75], local financial and non-financial institutions offer more credit to the government compared to the amounts they lend to MSMEs. As shown in Table 7, there has been a declining trend in access to credit for MSMEs.[76] Overall, domestic private sector debt has been seen to stifle lending towards

www.afronomicslaw.org/category/african-sovereign-debt-justice-network-afsdjn/sovereign-debt-and-human-rights-focus-sub

68 Lumina, C. Sovereign debt, and human rights, Docplayer https://docplayer.net/12525128-Sovereign-debt-and-human-rights.html

69 Lumina, C. Sovereign debt, and human rights, Docplayer https://docplayer.net/12525128-Sovereign-debt-and-human-rights.html

70 United Nations Human Rights Office of the High Commissioner (1986), Declaration on the Right to Development https://www.ohchr.org/sites/default/files/rtd.pdf

71 Omondi, G. 2018, Mombasa Port at risk as audit finds it was used to secure SGR loan, The East African https://www.theeastafrican.co.ke/tea/business/mombasa-port-at-risk-as-audit-finds-it-was-used-to-secure-sgr-loan-1408886

72 KLRC, Article 1: Constitution of Kenya, https://www.klrc.go.ke/index.php/constitution-of-kenya/106-chapter-one-sovereignty-of-the-people-and-supremacy-of-this-constitution/166-article-1-sovereignty-of-the-people#:~:text=Sovereignty%20of%20the%20people,-The%20Constitution%20of&text=(1)%20All%20sovereign%20power%20belongs,through%20their%20democratically%20elected%20representatives.

73 Akomolafe et al, Public Debt and Private Investment in Nigeria, American Journal of Economics 2015, 5(5): 501-507 https://www.researchgate.net/publication/320718899_Public_Debt_and_Private_Investment_in_Nigeria

74 Hashibul Hassan (2015), Impact of Public Debt Burden on Economic Growth Evidence from Bangladesh, https://www.researchgate.net/publication/255725380_Impact_of_Public_Debt_Burden_on_Economic_Growth_Evidence_from_Bangladesh

75 Kemboi, L. & Kwamboka V.,2021, Blog: Kenya's Public Debt Distress: Issues and Scenarios, Institute of Economic Affairs https://ieakenya.or.ke/blog/kenyas-public-debt-distress-issues-and-scenarios/

76 Central Bank of Kenya. 2020 MSME FinAccess Business Survey Report, https://www.centralbank.

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MSMEs although the decline in loan amounts could also be partly attributed to the rise of mobile lending platforms and Covid-19 pandemic which affected many businesses.

Table 7: Average MSME Loan Sizes in KES Millions 2017 - 2020

Category	Commercial Banks		Microfinance Banks	
	2017	2020	2017	2020
Micro	0.5	0.086	0.13	0.02
Small	3.2	2.9	1.25	0.4
Medium	14.4	7.7	4.27	4.5

Source: MSME Survey Data, 2020

Local banks also prefer to lend to the government since it is considered a low risk creditor[77.] This has the effect of slowing economic output as entrepreneurs lack adequate private investments to start or boost their businesses. **Between 2013 and 2020, the level of access of credit to the private sector and private investment decreased from 12.4% to 7.3%[78].** Within this period, there was an increase in the country's domestic debt stock. This illustrates the crowding out effect of government's domestic borrowing.

3.2 Addressing the Problem of Private Sector Debt

Following the Debt Service Suspension Initiative established by G20 countries[79], civil society have taken the initiative of rallying various actors (International Financial Institutions, Multilateral creditors) to have private creditors offer debt relief programs to developing economies.[80] This comes at a time when countries are still grappling with the effects of COVID-19 which pushed many developing countries into ballooning debt stocks largely comprised of private sector debt. Private sector debt is characterised by high interest rates and short repayment periods and as such attracts high debt servicing costs. **The reluctant nature of private sector creditors to offer debt relief programmes (noting that only one private creditor participated in the DSSI[81)] has resulted in countries allocating more resources to debt servicing rather than to their development budgets.[82]** The trend of increasing private debt stock of many developing economies calls for conversations on involving private creditors in the prevention of debt crises. Some of the suggested approaches that could be used to involve private creditors in the prevention of a debt crises including i) a Code of Conduct and ii) Contingent credit lines. The code of conduct should constitute an element of a roadmap setting out how debtors and creditors ought to coordinate the restructuring of debt in such a way as to restore a given country's debt sustainability while the purpose of contingent credit lines is ward off speculative attacks and close the gap between short term liabilities abroad and actual currency reserves.[83]

go.ke/2021/07/15/2020-survey-report-on-msme-access-to-bank-credit/

77 Institute of Public Finance Kenya. What Does It Mean when the Government Borrows from the Local Commercial Banks? (2020). http://ipfkenya.or.ke/wp-content/uploads/2020/08/WHAT-DOES-IT-MEAN-WHEN-THE-GOVERNMENT-BORROWS-FROM-THE-LOCAL-COMMERCIAL-BANKS.pdf

78 Oxfam, 2021, Impact of Debt Servicing on Social Spending and Wellbeing of Low-income Households in Kenya-A Case Study of Nairobi City and Mombasa County, https://kenya.oxfam.org/latest/policy-paper/impact-debt-servicing-social-spending-and-wellbeing-low-income-households-kenya

79 World Bank. (2022) Debt Service Suspension Initiative. https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative

80 Oxfam et al., (2020) Under the Radar: Private sector debt and coronavirus in developing countries. https://oxfamilibrary.openrepository.com/bitstream/handle/10546/621063/mb-under-radar-private-sector-debt-121020-en.pdf

81 World Bank. (2022) Debt Service Suspension Initiative. https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative#:~:text=The%20G20%20has%20also%20called%20on%20private%20creditors%20to%20participate%20in%20the%20initiative%20on%20comparable%20terms.%20Regrettably%2C%20only%20one%20private%20creditor%20participated.

82 Ekeruche, M.A. (2022) Africa's Rising Debt and the Emergence of New Creditors. A Review of Trends, Challenges and Prospects (2000 -2021). Africa Debt Series Vol. 2. Friedrich Ebert Stiftung. https://library.fes.de/pdf-files/bueros/fes-ua/19365.pdf

83 Berensmann, K. (2003) Involving Private Creditors and Resolution of International Debt Crises. German Development Institute. Bonn https://www.files.ethz.ch/isn/27907/2003-08.pdf

SECTION 4

> *Moreover, repayment obligations associated with private sector debt have prompted the government to initiate reforms in tax regimes such as the introduction of the digital service tax and the raising of VAT on basic commodities thus increasing the cost of living and furthering inequalities.*

CONCLUSION AND RECOMMENDATIONS

4.0 Conclusion

Over the last decade, there has been an exponential increase in the portfolio of public debt, with the debt stock increasing fivefold. The increased debt acquisition is attributable to continued increase in budget deficits occasioned by increased spending on infrastructure development. The increased expenditure need, coupled with limited access to concessional loans forced the government to turn to private sector lenders. However, whilst commercial debt comes with limited conditions, it also comes with higher interest rates and shorter repayment periods. This has resulted in increased debt service costs and a downgrade of the country's credit ratings, while increasing its risk of debt distress.

The increase in private sector debt has had negative implications on realization of the country's development agenda, realization of universal basic human rights, and the advancement of gender equity. Heavy repayment obligations resulting from high-interest rates have crowded out resources from critical sectors/services that are essential in reliving poverty, enhancing gender equity and promoting human rights. Sectors such as health, education, agriculture, water, and housing have borne the brunt of constrained resources. Moreover, repayment obligations associated with private sector debt have prompted the government to initiate reforms in tax regimes such as the introduction of the digital service tax and the raising of VAT on basic commodities thus increasing the cost of living and furthering inequalities. Also, domestic private debt has reduced private sector investment and stifled economic growth since the private sector has to compete with the government for locally available loans.

4.1 Recommendations

Cognizant of these implications, the study highlights the following recommendations for the management of private sector debt.

1. Challenge private sector creditors to recognise their role in debt unsustainability in Kenya. Advocate for and encourage private sector players to pursue more open and accountable debt agreements with government. Challenge private sector to recognise their contribution to the country's public debt problem and consider offering debt relief programmes for post-Covid-19 recovery and to expand fiscal space for government spending on essential public goods and services.
2. Encourage the Government of Kenya to pursue more opportunities for restructuring debt from private creditors. An early restructuring will help in minimizing fiscal pressures and provide a breathing space, while also lifting the uncertainties around repayment obligations.
3. Encourage the Government of Kenya to pursue proactive debt management approaches with private creditors through, for example, debt profiling which replaces existing debts with new debt with a different currency or maturity profile.
4. State and non-state actors should push for the operationalization of laws and policies on transparency and access to information regarding public debt, including private sector debt. This entails advocating for provisions that require comprehensive disclosure terms attached to debt contracts, to enable creditors and rating agencies to understand borrowers' debt sustainability challenges, accurately price debt instruments and estimate comparability of treatment in the event of debt restructuring. It is essential to have accurate information on the debts incurred, including short-term private debt.
5. Kenya should continue streamlining the tax policy to optimize revenue collection. An

expanded revenue base will help narrow budget deficits, complement efforts to restructure debt and enhance the country's debt sustainability outlook. To ensure equity while pursuing an increased tax base, Kenya should adopt a more progressive tax policy such as increasing wealth/property tax & Capital Gains Tax, while eliminating tax evasion.

6. Support and encourage non-state actors to enhance knowledge of citizens on their role in public debt and public finance management. When citizens play an active role in demanding transparency and accountability, including participating in decision-making processes, the quality of governance is improved. Principles of participatory governance should be applied to the acquisition of private sector credit.
7. Support the Government of Kenya to strengthen capacity to implement an effective debt management policy. This debt management strategy should include aspects such as elaboration of strategies, institutional issues, legal matters, coordinating, registering, and channelling of information flows for operations and decision-making.
8. Advocate for G-20, IMF/ World Bank, and the UN to develop a framework that can buy time (negotiated rollover of private bank credits) for proper sustainability analyses to be done on a country-by-country basis. There should also be exploration to assess the extent to borrowing contributes to sustainable development.
9. Promote structural economic reforms and fiscal consolidation in Kenya: Structural reforms will be essential to avoid sovereign default by countries that have higher debt ratios.
10. Advocate for inclusion of contingency clauses in private debt contracts that allow for automatic extension of maturities in times of acute liquidity crisis arising from external shocks, beyond the control of debtor countries, such as a sharp fall in the terms of trade or sudden withdrawal of foreign capital because of contagion.

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INSIDE BACK COVER

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