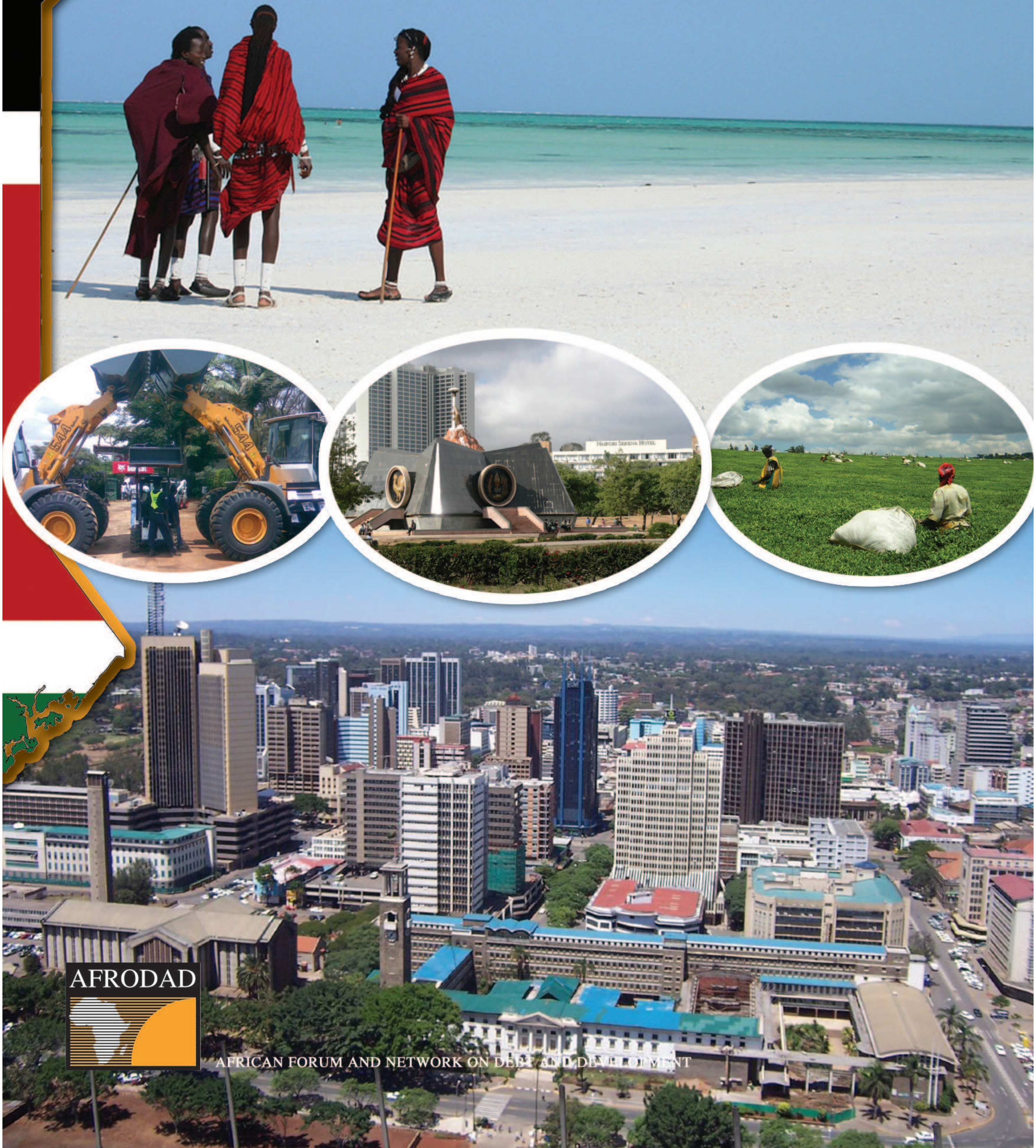
DOMESTIC DEBT MANAGEMENT IN AFRICA THE CASE OF KENYA



AFRODAD
AFRICAN FORUM AND NETWORK ON DEBT AND DEVELOPMENT

About AFRODAD

Vision

AFRODAD aspires for an equitable and sustainable development process leading to a prosperous Africa.

Mission

To secure policies that will redress the African debt crisis based on a human rights value system.

Objectives include the following:

1 To enhance efficient and effective management and use of resources by African governments;

2 To secure a paradigm shift in the international socio-economic and political world order leading to a development process that addresses the needs and aspirations of the majority of people in the world;

3 To facilitate dialogue between civil society and governments on issues related to Debt and Development in Africa and globally.

From the vision and the mission statements and from our objectives, it is clear that the Debt crisis, apart from being apolitical, economic and structural issue, has an intrinsic link to human rights. This forms the guiding philosophy for our work on Debt and the need to have African external debts cancelled for poverty eradication and attainment of social and economic justice. Furthermore, the principle of equity must of necessity apply and in this regard, responsibility of creditors and debtors in the debt crisis should be acknowledged and assumed by the parties. When this is not done, it is a reflection of failure of governance mechanisms at the global level to protect the interests of the weaker nations. The transparent arbitration mechanism on debt proposed by AFRODAD as one way of dealing with the debt crisis finds a fundamental basis in this respect.

AFRODAD aspires for an African and global society that is just (equal access to and fair distribution of resources), respects human rights and promotes popular participation as a fundamental right of citizens (Arusha Declaration of 1980). In this light, African society should have the space in the global development arena to generate its own solutions, uphold good values that ensure that its development process is owned and driven by its people and not dominated by markets/profits and international financial institutions.

AFRODAD is governed by a Board composed of seven members from the five regions of Africa, namely east, central, western, south and the North. The Board meets twice a year. The Secretariat, based in Harare, Zimbabwe, has a staff compliment of seven programme and five support staff.

Domestic Debt Management in Africa

The Case of Kenya

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Contents

Acronyms

CBK	Central Bank of Kenya
COMSEC	Commonwealth Secretariat
DMD	Debt Management Department
DMO	Debt Management Office
DGIPE	Department of Government Investment and Public Enterprise
FLSTAP	Financial and Legal Sector Technical Assistance Project
GDP	Gross Domestic Product
GDDS	General Data Dissemination System
IDA	International Development Association
IMF	International Monetary Fund
KNBS	Kenya National Bureau of Statistics
MDGs	Millennium Development Goals
MOF	Ministry of Finance
OECD	Organization of Economic Cooperation and Development
SDDS	Special Data Dissemination Standards
SIDA	Swedish International Development Assistance

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Preface

Domestic public debt is not a new phenomenon for developing countries. In the face of budget deficits, against a backdrop of drying up of concessional lending and reduction in development assistance due to the impact of the global financial crisis among others, borrowing from domestic markets becomes a viable option. Hitherto far less attention has been given to domestic debt in most development policy discussions. The efforts over the years have been centred on external debt more specifically on the Highly Indebted Poor Countries (HIPC) and Multilateral Debt Relief Initiative (MDRI). While there has been a remarkable policy shift on external debt following implementation of HIPC and MDRI in a few developing countries, AFRODAD has seen the emergence of a new threat in debt management due to domestic borrowing which is not under the same scrutiny.

Domestic debt has been used to finance primary deficits and implement monetary policies in most African governments, such that in some countries domestic debt now constitutes a large share of the total debt stock. AFRODAD believes that reforms in debt management are critical to avert a vicious cycle of recurring debt burden. If domestic debt is not kept sustainable it will erode the benefits accrued from initiatives like HIPC and MRDI which had improved the fiscal space by freeing resources on the trajectories of pro-poor development policies in most African countries. Domestic Debt can be beneficial if used for the right purposes; however, enormous levels of domestic debt may have a negative effect on financial stability. Arguments against domestic debt include the crowding out effect on private investment and its subsequent effect on economic growth especially in countries with relatively narrow domestic financial markets. Domestic Debts also affect the level of interest rates as they making borrowing expensive due to the relatively narrow investor base and the monopolistic tendencies of most investor groups in Africa.

Furthermore, Domestic debt service absorbs a significant amount of government resources which could be used for social services and other pro poor expenditures in the economy. The Kenya study reiterates the fact that the financial market should continue to be developed so that it improves its capacity to absorb new debt in order to keep the levels of interest rates low. The study found that in Kenya there are clear procedures and legislations for issuing and management of domestic debt spelt out in the Internal Loans Act (Cap420) and the Central Bank of Kenya Act (Cap491). However, there are other aspects of the overall domestic debt management practices that need attention by the various actors in the process. Parliament oversight should be included to include the institutionalization of its consistent participation in the setting up of ceiling, sources and purposes of domestic borrowing. Treasury should boost its capacity for domestic debt analysis and management.

The report analyses the linkages between domestic debt and economic development with regards to the use of domestic debt in the economy. It unpacks the legal framework and institutional structure for domestic debt contraction. It also provides an assessment of the nature of the relationships between different policy instruments for domestic debt acquisition and the role of different stakeholders in domestic debt management such as parliament, civil society and international financial institutions. Actionable policy recommendations to improving aspects of domestic debt management conclude the report. This also raises a number of concerns to be addressed if Kenya is to continue on its path of prudent public debt management. AFRODAD hopes that the Kenyan government will take the findings of this report seriously and address the concerns aptly.

Collins Magalasi
Executive Director
AFRODAD

Executive Summary

Domestic debt is increasingly playing an important role in Kenya's economic development. It has become the main financier of Kenya's budget deficit as well as the main factor in reducing the donor dependency in Kenya. Interestingly Kenya remains one of the few countries in Africa where domestic debt is used to finance infrastructural development under the Public Private Partnership approach.

At the same time this study has unearthed issues that need to be addressed if domestic debt is to continue playing an important role in the country's vision 2030. Issues ranging from legal, institutional to governance frameworks still compound the effectiveness of domestic debt in facilitating economic development. Addressing these factors will be crucial if the country is to tame the run-away magnitude of the domestic borrowing as well as the premium charged on it. Fundamentally the government must start implementing the domestic debt management policy, as well as boost its infrastructural and human resource base to facilitate an efficient and effective domestic debt management framework.

Among the key issues the study has observed, few are raised below:

Domestic debt has increased in importance in Kenyan economy. The composition of public debt has changed significantly with the share of domestic debt being 55% of the total debt stock while external debt was 45% as at end June 2010, making domestic debt an important factor in Kenya's macroeconomic policy choices. In GDP terms total public debt service has constituted

39.2% GDP of which domestic debt constituted 20%GDP while external debt constituted 19.7% GDP in 2010.

Domestic interest payments have been rising at a higher rate than growth in ordinary government revenue and GDP. Domestic debt continues to be a major challenge towards achievement of Millennium Development Goals. A significant proportion of the Government budget allocation is to service domestic debt, leaving inadequate financial resources for pro-poor development programmes.

Domestic debt borrowing is not strictly internal borrowing. There are indications that non – residents and foreign intermediary financial institutions including pension funds are increasingly becoming major players in the domestic debt market with foreign banks including Barclays, Standard Charted and foreign insurance companies owning major shares in the government's debt portfolios.

Appropriation of domestic debt has been largely based on complementing the resource gap. Most of domestic debt has been used to finance budget deficit owing to reduced access to external funding. The Government has however changed this trend by issuing project specific or infrastructure bonds to finance projects in the roads, water and energy sectors, all of which have began to impact positively on the economy. This has put the use of domestic debt at the heart of the country's economic development. Domestic borrowing should, however, be done with moderation as it can adversely affect other development financing, particularly owing to its non-concessionary character.

Kenya in 2009 started implementing the debt management strategy that covers both external and domestic debt management. Government admits that it did not include other stakeholders in formulating the strategy such as the private sector and civil society organisations. The Mid Term Debt Strategy (MTDS) will be the official debt management framework to govern both external and domestic debt operations.

There exists fragmentation and lack of harmonisation at policy level. Just like the fragmentation at the policy level, the Domestic Debt management at the ministry of finance is characterized by weak institutional arrangements with debt functions spread across departments at the Ministry of Finance (MoF) and Central Bank of Kenya (CBK). These include the Debt Management Department (DMD), the Department of Government Investments and Public Enterprises (DGIPE), and Accountant-General's Department at the MoF. In addition, debt management functions before the implementation of the policy within MoF and CBK are guided by weak debt policy framework and *ad hoc* debt management strategies. Coupled with these are the human resource issues the department is under-staffed and high staff turnover is still evident particularly within DMD, undermining operational efficiency.

No legal requirements for an inclusive procedure for domestic debt management. There are no legal requirements with regard to transparency and accountability with regard to Domestic Debt management aside from those that require the minister to report annually on the status of Domestic Debt. Domestic borrowing through Treasury bills and bonds do not seem to have a limit in law. However the government overdraft at the CBK aspect of domestic debt borrowing is limited by law.

Some corrective measures at the institutional level have been undertaken. As a step towards strengthening domestic debt back office operations at the CBK, a domestic debt data base on Debt management and recording system CS-DRMS 2000+ platform has been established as part of a joint effort to set up a comprehensive public domestic debt data base. At the same time another back office has been created at the treasury and handles not only domestic debt but also external debt.

BACKGROUND AND INTRODUCTION

Debt management, whether of domestically or externally borrowed financial resources, cannot be a veritable subject of a serious discourse today outside the historical context of the unravelling fiscal crisis in the world in general, and in Western Europe in particular. Debt has been used by the capitalist countries as a means to control the economic management of the debtor countries and it has became the pillar of the of the neo-liberal market economy. This has made calls of concerns for prudent debt management by the victims of the debt misuse which are the general tax payers.

The ideology of and fashionable infatuation with the mantra of "market knows best" is behind the international slip into an unsustainable joyride on massive debt at both domestic and external borrowing levels. Debt is an intrinsic element of modern neo-liberal capitalist economies. Speculative indebtedness continues to pervade economic activities of nearly all the significant actors in the modern market economy, it's prudent management has become a desideratum of enjoying high demand from those who are keen to spread the benefits of economic growth to all sections of society.

For quite some time undercapitalised capitalism, has been the engine of unqualified economic growth in the advanced economies of the West. The debt bubble associated with this development has caused debt-capitalist cancer which has afflicted many countries of the South. This has for many years, exacerbated an already debilitating dearth of the necessary regulative instruments required for the operations of an effective regime of legal frameworks. But more particularly and in the face of a broad systemic near-collapse of debt capitalism, and particularly where capital has become scarce, the governments in Africa which are supposed to be responsible for the financial well-being of their respective national economies seem to have been reacting tactically (and not strategically) from crisis to crisis and with a script of adamant denial of obvious facts pointing to the need for effective fiscal management tools.

The clear message that comes from this defensive adamancy is that somehow, if easy but expensive money in the form of debt is made endlessly available and a modicum regulation, in the way of different shades of fiscal management legal frameworks, put in place, the economies will stabilize and possibly outlive the credit crunch. This is notwithstanding the fact that excessive debt has been the cause of the problem. The truth of the matter, however, is that it's debt that drives the economies of most countries. Public or private spending accounts for over 50 percent of total spending in Kenya's economy. Most of this spending comes in the form of debt. Countries borrow for various purposes, mostly to provide goods and services to the people.

When the borrowing environment is not properly balanced and, for that matter, remains skewed in favour of irresponsible debt accumulation - even if financial institutions improve on their in-built risk management programmes to monitor defaulting clients – the risk of fuelling price upsurges and consequently forcing interest rates up remain a threat that cannot be gainsaid.

What is not coming out clear is the lack of mechanisms and legal framework to promote responsible borrowing, which, in essence, should address the institutional makeup; legal wirings and regulatory mandate.

Kenya's capitalist economy has bestowed some sanity on the strategic appetite for debt such that it is only logical to generate more insight into what is and what can be done to reduce the potential harm. Short of an ideological retrofitting of the structure and objectives of our political economy, the only recourse available is the regime of legal instruments that can ensure and uphold prudence in the management of debt. Under all circumstances Domestic Debt should be kept at a reasonable minimum, particularly for reasons advanced above.

Importance of Debt

In a capitalist society like Kenya, competition for public services and resources assume different forms of struggles between sections of society. The ensuing social struggles are basically over what the government spends on and who pays the taxes. In today's class-divided societies, classes and their ethnic or regional proxies differ over what governments should do and who should benefit from what is done. Governments in such societies often turn to borrowing — which produces national debts — as a way to defer and postpone the political challenges of resolving class struggles focused on the state. By borrowing, governments can immediately accommodate — at least partly — the different social demands for government spending while postponing the raising of taxes into the future.

Governments fear the political costs of going so far in placating one side that they risk losing the confidence of one section of the citizenry. Borrowing thus eases their problems at least temporarily. Moreover, politicians borrow because the eventual costs of accumulating national debts fall upon their successors who then bear the brunt of popular disillusion that come with governmental policy failures.

Economists of different shades of neo-liberal persuasion have correctly argued that the only part of the so-called national wealth that actually enters into the collective possessions of the popular masses, in a capitalist society, is their national debt. Hence, as a necessary consequence, the modern doctrine that a nation becomes the richer the more deeply it is in debt; of course with the caveat that the legal and institutional framework for managing such debt must be such as to put prudence, transparency and accountability at the centre of any remedial measure. By that very token public credit has become the credo of capital and its myriad potentials for accumulation.

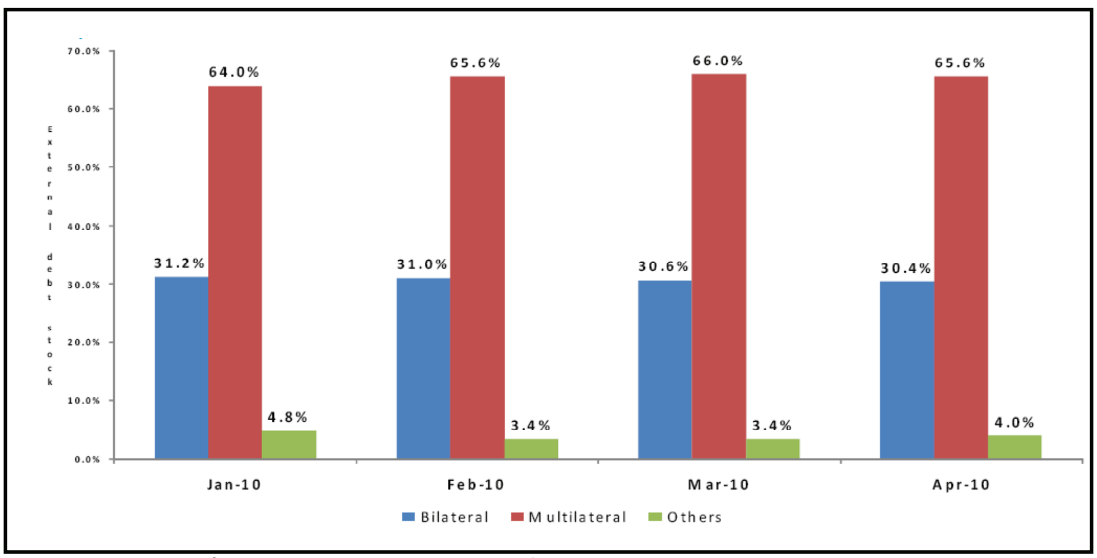
The public debt in general and domestic public debt in particular becomes one of the most powerful levers of primitive accumulation. Modern neo-liberal capitalism has spawned a myriad of alchemical permutations through which debt can be ingeniously manipulated to produce capital, flaky as its potential replicability may be. The state-creditors, in actual fact, give nothing away. In practical terms, the amounts lent are habitually transformed into public bonds, easily negotiable, which go on functioning in their hands just as hard cash would. But with the difference that the mucky interface between the public and private sectors, apart from the tax-farmers, banking syndicates, to whom a good part of every national loan renders the service of a capital fallen from heaven, the national domestic debt provides an opportunity for joint-stock companies, to dealings in negotiable effects of all kinds, and to engagement in stock-exchange gambling under the global sway of modern bankocracy.

PUBLIC DEBT IN KENYA

External debt in Kenya

Kenya's current total external debt stands at US$ 15.36 billion as at April 2010. About 65.6 percent of this debt is owed to multilateral creditors. In the multilateral category, IDA, ADB/ADF, IMF and EEC/EIB account for the largest proportion of external credit, while Japan, Germany and France are the leading creditors in the bilateral category. The amount of debt owed to other creditors remains relatively unchanged as these debts are not being serviced due to the current disputes with the creditors. As at the end of April 2010, cumulative external debt service projections stood at Kshs 21.65 billion. Principal and interest projections for the month of April were Kshs 1.68 billion and Kshs 0.41 billion, respectively. Multilateral and bilateral creditors constitute 49.97 percent and 50.03 percent, of the projected debt service.

Chart 1: External debt By Creditor Category % Share



Source Ministry of Finance: April 2010 Monthly Bulletin

Domestic Debt and Economic Development

Domestic debt remains a challenge to the achievement of key targets of the Millennium Development Goals including reduction of poverty and infant mortality by half. A significant proportion of the Government budget allocation is to service domestic debt, leaving inadequate financial resources for pro-poor development programmes. The need to strengthen domestic debt management is, therefore, extremely critical not only to lowering the cost of debt service to the Exchequer, but also to guaranteeing additional resources that could be channelled towards pro poor development programs in Kenya as well as deepening and widening the development of Kenya's capital markets to include a wider sections of the Kenyan society.

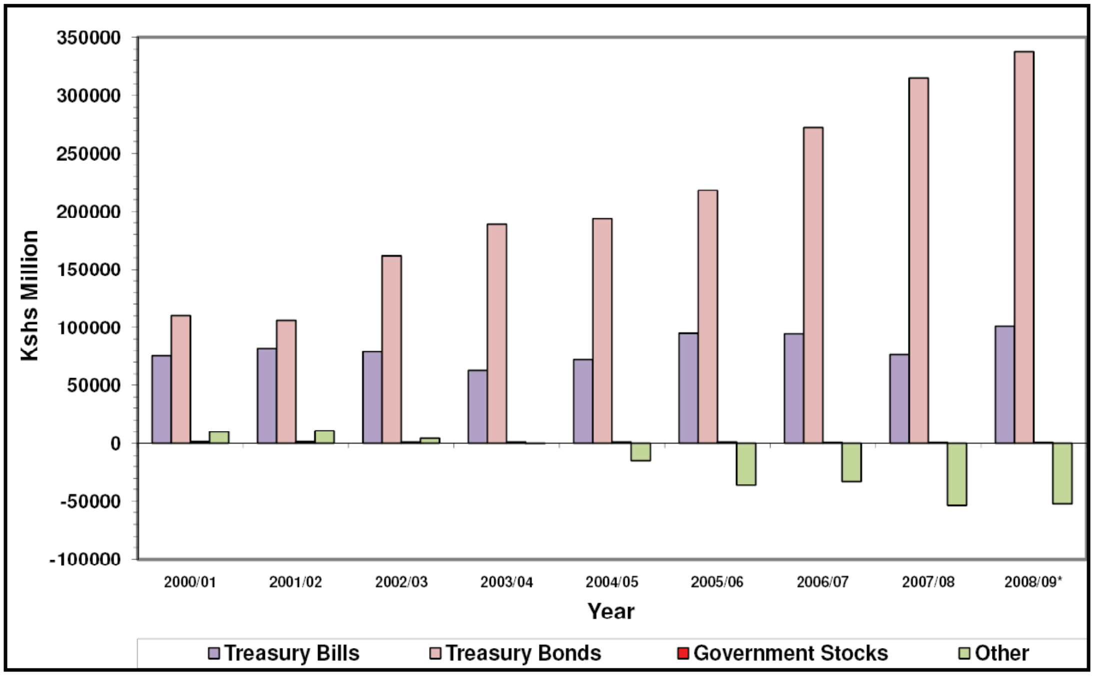
Kenya has been unable to constrain the growth of its public domestic debt to ensure that sufficient revenues remain available after debt service payments to finance other vital government recurrent and development expenditures. Buoyed by expanding real revenue receipts, and curtailed by reduced external donor support especially during the Moi era and immediately thereafter, increased contacting of domestic debt has resulted in accumulation of high stocks of domestic debt in Kenya. Kenya public expenditure review for 2010 (Ministry of State for Planning, 2010) noted that fewer allocations were extended to health and education with health receiving less than 7% GDP allocation yet the country spends above 20% GDP (Ministry of Finance 2009) annually on domestic debt service. The public expenditure review notes that to ensure that Kenya does not become overly dependent on foreign financing for its future development, it is imperative to ensure that most of the investment effort is domestically funded. This could be realised through improved revenue collection and improved domestic savings in an environment of well developed financial systems.

The Composition of Domestic Debt

Domestic borrowing from the early 90s to 2008 was mainly through Government securities, overdraft at the CBK and advances from commercial banks. Government securities comprised of Treasury Bills, Treasury bonds and long-term stocks. During the period, Treasury bills were issued in maturities of 91 days and 182 days, which were non-tradable in the secondary market. Treasury bonds, on the other hand were issued in maturities of between one and ten years, and were tradable in the secondary market. The types of bonds issued in the period were zero coupons, floating rate, fixed coupon discounted, special floating rate, special fixed rate, and fixed rate bonds.

The shift in the composition of domestic debt in favour of the longer-dated instruments followed a government initiative to restructure public domestic debt and develop the domestic debt markets in 2001. The restructuring of domestic debt from the short-dated treasury bills to the long-dated treasury bonds is meant to minimise the risks of short-term borrowing, as well as develop a secondary market for government securities for financing long term infrastructural development. It is also intended to promote financial resource mobilization for both the public and private sector through the financial market.

Chart 2: Government Domestic Debt (2000/01-2008/09)



Source: Statistical Annex to the Budget Speech for the Fiscal Year 2009/2010

Treasury bonds comprised the largest proportion of domestic debt between June 2000 and 2009 as chart 2 illustrates. Other forms of domestic debt which include Government overdraft at the Central Bank of Kenya (CBK), clearing items, advances from commercial banks and tax reservation certificates remained constant and in the negatives.

A weak fiscal management framework in the early 1990s led to excessive borrowing by the Government from the CBK through the overdraft facility. The larger overdraft had inflationary effects and CBK was forced to mop the resulting excess liquidity at high interest rates to contain run-away inflation. In 1996, the CBK Act was amended to limit direct borrowing by the Government from the CBK to 5 percent of the most recent audited Government revenues. This legislative measure was meant to establish a cap on

Government borrowing from CBK and to strengthen the latter's independence in the conduct of monetary policy.

Table 1: Composition of Government Gross Domestic Debt by Instrument (Shillings million)

FI SCAL YEAR	Treasury Bills*	Treasury Bonds	Government Stocks	Overdraft at Central Bank	Advances from Commercial Banks	Other Domestic Debt**
2002/2003						
June	105,744.00	161,549.06	1,057.98	4,318.91	2,685.18	14,021.83
2003/2004						
June	99,835.75	188,625.99	1,057.98	9,232.14	2,774.47	4,708.32
2004/2005						
June	107,838.30	193,357.81	1,057.98	5,225.31	2,539.04	5,554.06
2005/2006						
June	130,308.36	218,357.33	1,057.98	5,201.83	2,290.60	622.86
2006/2007						
June	129,970.26	272,199.74	754.70	41.05	1,066.11	658.26
2007/2008						
June	111,286.15	315,189.66	754.70	0.00	426.92	2,954.30
2008/2009						
June	150,122.30	360,743.95	754.70	5,124.38	6.10	1,594.72
2009/2010						
June	191,267.55	448,615.35	753.35	17,649.38	182.55	310.91

* The stock of Treasury bills includes Repos.
** Other domestic debt includes items in transit, Tax Reserve Certificates and frozen Government debt.
Source: Central Bank of Kenya.2010

The stock of Treasury bills increased by Ksh 86 billion from Ksh 105 billion in 2003 to Ksh 191 million in 2010. Similarly, outstanding Government long-term stocks fell by Ksh 304million during the period to stand at Ksh 753 million at the end of June 2010. However, the stock of Treasury bonds increased by Ksh 288 million in the period to stand at Ksh 448 billion at the end of June 2010 from Ksh 161 million at the end of June 2002. There were no overdrafts at the CBK in the 2007/8 financial year recorded unlike in other years. The 2009/10 financial year recorded the highest overdraft from the CBK of Ksh17, 649.38 million. Advances from commercial banks recorded their highest figures in 2002/3 financial year peaking Ksh2, 685.18 million. However over the period under review the advances from commercial banks have been accrued less clocking a mere Ksh6.10million in the 2009/9 financial year.

Table 2: Domestic debt instruments by holder as at end April 2010 (Kshs billion)

Instrument/ Holder	Commercial banks	Non banks	Central Bank of Kenya	Non residents
Treasury bonds	211.09	230.39	0.01	0.87
Treasury bills	153.61	20.16	0.02	2.34
Others	0.18	0.82	34.36	0.00
Total	**364.88**	**251.37**	**34.39**	**3.21**

Source: Central Bank of Kenya(2010)

By 2010 Commercial banks still constituted the largest share of Domestic debt while non banks followed. This can be attributed to the growth and strengthening of the local market. Of the total domestic debt Treasury Bonds accounted to Kshs 442.3billion while Treasury Bills accounted to Kshs176billion. Commercial banks held the largest proportion of the outstanding Government debt securities totalling Kshs 364.88 billion or 55.8 percent. Government debt securities worth 0.5 percent were held by non residents. Kshs 34.36 billion held by Central Bank of Kenya comprises of Repo Treasury Bills used for monetary policy. The non banks category comprises non bank financial institutions, National Social Security Fund (NSSF), parastatals, insurance companies, building societies, pension funds and others. The non banks held 38.4 percent of the outstanding Government paper, mostly Treasury Bonds. The structure of the holding is consistent with the debt strategy of holding more domestic debt on longer dated instruments to minimise refinancing risk.

The structure of Domestic Debt

Domestic debt has been rising rapidly since 2001 due to reduced access to external funding and the need for domestic borrowing to finance the budgetary operations. While previously domestic debt in Kenya comprised central government debt incurred internally through borrowing in the local currency from residents, currently there are indications that non – residents and intermediary financial institutions including pension funds are increasingly becoming major sources and players in the domestic debt market. Key instruments used in this regard include securities, overdrafts at the Central Bank of Kenya and advances from commercial banks.

Deficit Financing and Public Debt

Table 3: Government Deficit Financing and Public debt 2002-2010
(Shillings Millions)

	GOVERNMENT DEFICIT FINANCING				PUBLIC DEBT		
FISCAL YEAR*	Domestic	Privati-sation	Foreign	Total	Domestic Debt**	External Debt***	Total
2002/2003							
June	46,922.86	0.00	-12,143.00	34,779.86	289,376.97	407,053.00	696,429.97
2003/2004							
June	8,808.64	0.00	-8,860.00	-51.36	306,234.66	443,157.43	749,392.09
2004/2005							
June	-6,672.24	0.00	-625.00	-7,297.24	315,572.50	433,975.65	749,548.15
2005/2006							
June	28,251.29	7,000.00	1,146.00	36,397.29	357,838.95	431,236.83	789,075.78
2006/2007							
June	34,661.00	4,000.00	-2,037.00	36,624.00	404,706.35	396,564.00	801,270.35
2007/2008							
June	-13,891.00	76,303.00	6,326.00	59,938.00	430,611.73	439,967.00	870,578.73
2008/2009							
June	75,749.00	0.00	11,564.00	87,313.00	518,506.76	535,143.70	1,018,326.77
2009/2010							
June	152,531.00	0.00	11,145.00	163,676.00	659,608.93	541,058.62	1,200,667.55

* Figures are cumulative from the beginning of the fiscal year in July.
** Domestic debt is reported on gross basis
**** Provisional
Source: The Treasury and Central Bank of Kenya. June 2010

Table 3 illustrates the government continued use of domestic debt over external debt to finance budget deficits over external sources of financing which increased by only 33% between the same period. Thus Domestic debt's importance has increased in magnitude. The increase in domestic Debt was due to the global financial crisis and the post election violence. At the same time Kenya experienced a sharp increase in domestic debt interest payments. This is largely due to an increase in Government domestic borrowing to mitigate the effects of drought as well as to compensate for the shortfalls in the budget-anticipation of external financing. It should be noted that government public debt has close to doubled during the period under review (1.74% increase). In 2010 Domestic debt accounted for 55% of the total public debt in Kenya. The Government gross domestic debt has risen significantly in line with Government fiscal policy aimed at increasing domestic borrowing and supporting the Economic Stimulus Program (ESP) to kick-start Kenya's economic recovery. Gross domestic debt stock has risen by 56% between 2002 and 2010.

Domestic Debt Creditors

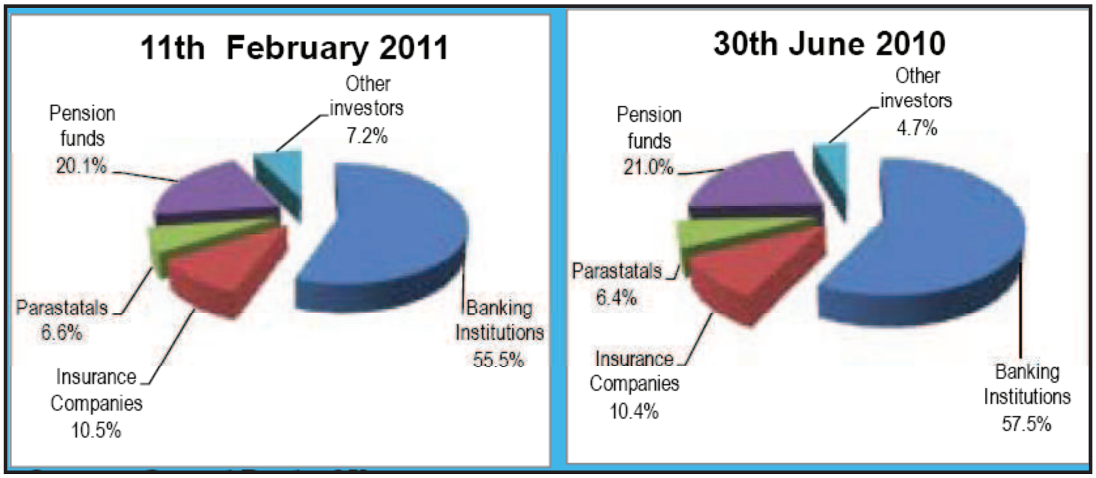
The largest proportion of domestic debt by 2007 was by commercial banks. This represented 50.7 per cent of the total domestic debt. However non-bank entities comprising non-bank financial institutions, pension funds, building societies, parastatals and individuals hold 49.3%. Closer analysis of data with regard to real investors in the commercial bank is crucial, if government is to comply with the legal definition of domestic debt and to understand the true nature of participation by the commercial bank.

Commercial banks have been known to invest in government securities on behalf of individuals or institutions such as pension funds. Since these funds are part of what commercial banks declare as their own investments, statistics on holdings of government securities by banks could be overstated, while those on holdings by individuals could be understated. Therefore, making it statutory for the banks to declare these holdings to the CBK would increase the accuracy of statistics on holders of the debt.

Currently, non-resident holdings comprise only direct investment in securities through the Central Bank of Kenya. It is thought that most non-resident investors in government securities invest through commercial banks through nominee accounts. Since the banks do not disclose these holdings, a large proportion is not reported. The practice is harmful to the economy and should be discontinued.

While participation of foreign investors in the domestic debt market could promote competition, thereby lowering the cost of domestic borrowing, and increasing efficiency in the domestic debt market through financial technology and innovation, government must guard against crowding out of domestic investors by promoting non-resident investors. The fact is that non-domestic investors benefit more than they are able to get from not only their own countries but even from anywhere else. Deliberate efforts must be put in place to facilitate their participation in the purchase of government securities.

Chart 3: Composition of Government Securities by Investor



Source: CBK weekly Bulletin: February 18, 2011

The share of Government securities held by parastatals and other investors rose from 6.4 percent and 4.6 percent, respectively in June 2010 to 6.6 percent and 7.2 percent, respectively as at February 11, 2011. While commercial banks and pension funds dominated the Government securities market, their respective shares declined from 57.6 percent and 21.0 percent, to percent and 20.1 percent, respectively during the same period.

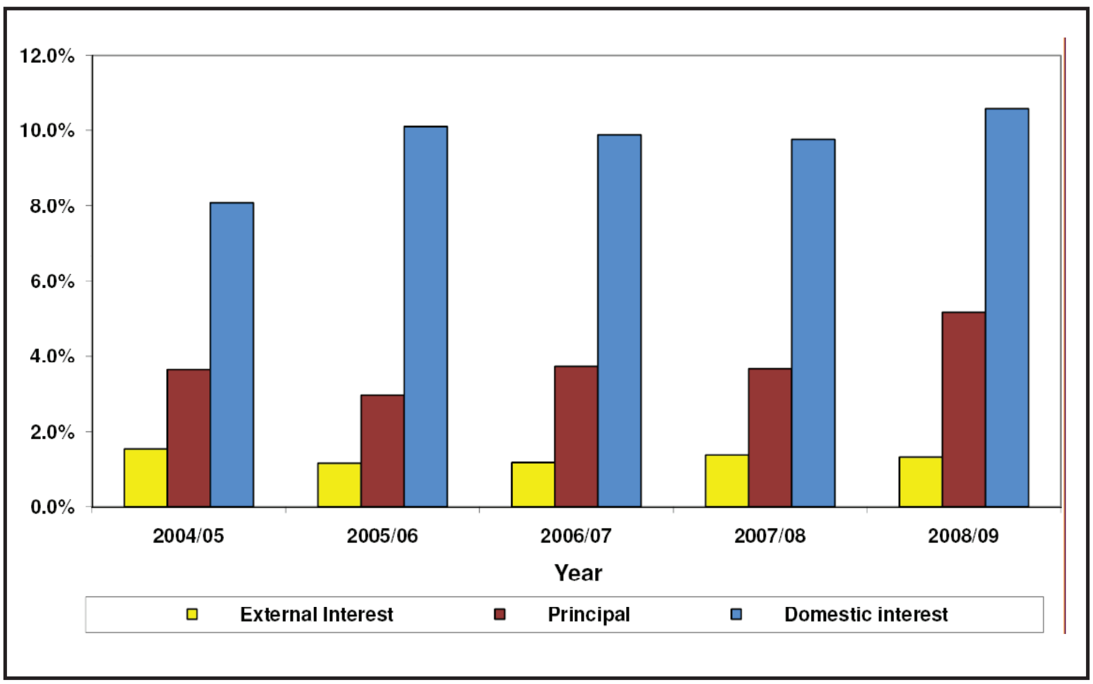
Table 4: Debt Service ratios (2007-2011) Ksh millions

	2007/08	2008/09	2009/10	2010/11
External	439,967	526,460	532,620	667,439
% of GDP	21.1	21.4	19.2	21.7
Domestic	430,612	502,530	554,140	604,586
% of GDP	20.8	20.5	20.0	19.7
Total Public Debt	870,579	1,028,990	1,086,760	1,209,025
% of GDP	41.9	41.9	39.2	41.4
Nominal GDP	2,077,795	2,456,300	2,770,100	3,076,600

Source: Treasury/BOPA 2009

Debt service is a crucial part of managing the economy and keeping good will among creditors ensure smooth running of government operations. Domestic debt per se is not bad as long as the debt does not crowd out the private sector and is sustainable. Debt service as a percentage of GDP should be kept at a minimum level. However, domestic debt service, as a percentage of GDP, decreased from 27.9% in June 2003 to 20.8% in June 2008 following improved performance of the economy Table 4 illustrates that domestic debt service has on average consumed 20% of GDP since the 2007/2008 financial year. This amounts to one fifth of the countries resources diverted from other social spending provisions like health care and education.

Chart 4: Debt service as % of Revenue (2004/05-2008/09)



Source: Statistical Annex to the Budget Speech for fiscal year 2009/10. Republic of Kenya

The increase in domestic interest payment was attributed to a higher domestic debt stock while the rise in external debt service was as a result of the expiry of the Paris Club rescheduling Consolidation Period. Kenya's interest payment on domestic debt as a percentage of revenue has been on the 8% to 10% range from 2005 to 2008. External interests have remained constant over the period. The structure of debt service remained the same with external debt service increasing slightly from 21.1 percent of GDP in 2007/08 to 21.7 percent GDP in 2010/11.

Table 5: Interests on Debt (2000 – 2007)

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2008/2009
External interest (KES billion)	3.9	5.9	9.8	5.8	4.4	3.6	4.4	
Domestic interest (KES billion)	**23.2**	**23.7**	**27.6**	**23.3**	**23.4**	**31.4**	**36.9**	
External interest (% revenue)	2	3	4.6	2.3	1.5	1.2	1.2	
Domestic interest (% revenue)	**12.1**	**12.1**	**13.1**	**9.1**	**8.1**	**10.1**	**9.9**	**9.8**
External interest (% revenue)	14.3	19.8	26.2	20	15.9	10.4	10.7	
Domestic interest (% total interest)	**85.7**	**80.2**	**73.8**	**80**	**84.1**	**89.6**	**89.3**	**87.6**
External interest (% of GDP)	0.4	0.6	0.9	0.5	0.3	0.2	0.2	
Domestic interest (% GDP)	**2.3**	**2.3**	**2.5**	**1.9**	**1.7**	**2**	**2**	**2.1**
Implicit interest rate on domestic debt %	**11**	**10.1**	**9.5**	**7.6**	**7.4**	**8.8**	**9.1**	
Implicit interest rate on external debt %	1	1.6	2.4	1.3	1	0.8	1.1	

Source: Central Bank of Kenya 2009

With a rising domestic debt stock, an important issue for debt management is the cost implications for the government budget. Interest payments on domestic debt have been rising at a lower rate than growth in ordinary government revenue and GDP. Domestic interest payments, as a percentage of revenues, decreased from 12.1% in the fiscal year 2000/01 to 9.9% in the fiscal year 2006/07. The decline is attributed to strong revenue performance in the period. Due to higher interest rates and rising domestic debt, the interest cost on domestic debt accounted for the largest proportion of total government interest expenditure during the period in question.

Domestic Debt Expenditure

Domestic debt in Kenya is contracted for various reasons. First, it is used to finance the budget deficit when the government is not able to meet its expenditure commitments using domestically raised revenue and externally sourced grants and borrowing. Second, domestic debt is contracted during implementation of monetary policy through open market operations. Third, debt instruments are important in financial markets development. Domestic debt therefore for a long time have been treated as complementary resources meant to address resource gaps that arise from revenue, and external financing.

Appropriation of domestic debt has been largely based on complementing the resource gap, the Government has however changed this trend by issuing project specific or infrastructure bonds to finance projects in the roads, water and energy sectors, all of which impact positively on the economy. This has put the use of domestic debt at the heart of the country's economic development. It will also contribute to the deepening of the domestic financial markets. The cumulative Government expenditure on interest and other charges on domestic debt amounted to Ksh 37.7 billion. Actual interest payments on Treasury Bonds and Treasury Bills were Kshs 38.33 billion and Kshs 9.56 billion, respectively. The variance of Kshs 2.94 billion is due to higher actual payments than was initially projected .In the 2009/10 financial year the projected net borrowing was 5.1%GDP (MoF 2010).

The objective of the domestic debt management strategy has been to reduce the refinancing risk while taking account of due costs. The Mid Term Debt Management strategy for the 2009/10 financial year to 2011/12 financial year states the following:

Domestic borrowing will be undertaken through issuance of Treasury Bills and Treasury Bonds at the ratio of 30:70 and ensuring that the maturity structure of the existing portfolio is lengthened to minimize refinancing risk. Domestic borrowing is about 70 percent of total net borrowing in financial years 2009/10, 2010/11 and 2011/12 and drops to 60 percent in financial year 2012/13. Net domestic borrowing for financial year 2009/10 is 4.3 percent of GDP and expected to fall to 2.2 percent of GDP in 2011/12.

Table 6: Domestic Debt as a percentage of GDP

Year	2002	2003	2004	2005	2006	2007	2008	2009
Domestic Debt % GDP	28	27	25	25	25	21	25	31

Source: Authors compilation using data from table 3 and IMF: World Economic Outlook Database

From the above data set domestic debt has been on a marginal decrease since 2002 and has increased in importance in Kenya.

Its importance is amplified by its use to finance infrastructural development, a trajectory rarely used by other African countries.

There was no overall change in domestic debt trend in real terms. However, the fluctuations indicate that the percentages were decreasing between 2002 to 2007, what is worrying is that now they have taken a different direction with the domestic debt increasing by "6 percentage points" in one year between 2008 and 2009. This is in contrast to the reduction of only "4 percentage points" between 2006 and 2007. This may be attributed to the negative effects of the global financial crisis, the drying up of concessional lending and the political turmoil that ravaged the country. Central Bank Governor notes that the trend to dig deeper into the domestic markets has been sustained as the government embarked on an ambitious spending in projects such as *Kazi kwa Vijana* and the 'absorption capacity' hit economic stimulus package that was to target development at constituency level. Hence the government has been using domestic debt not for recurrent expenditures of government day to day needs but for capital expenditures for the productive sectors of the economy. This has necessitated the growth of the economy.

LEGAL FRAMEWORK AND INSTITUTIONAL FRAMEWORK

Slightly more than a decade ago, an important actor in the multilateral financial environment, the International Monetary Fund (IMF) was under pressure to spearhead the clamour for the establishment of a *Code of Good Practices on Fiscal Transparency*. The ensuing draft code of good practice was crafted and adopted in 1998 and revised in 2001. It contained the following general principles, the underlying objectives of which were expected to bring positive changes in the way debt is managed from the point of view of the lending agencies and borrowing authorities:

- clarity of roles and responsibilities
- public availability of information
- open budget preparation, execution and reporting, and
- Independent assurances of integrity.

Subsequent to the adoption of the code of good practices on fiscal transparency, the IMF relied on the code to measure country performance. The results were published in order to exert diplomatic pressure on the poorly performing countries to fall in line. This was followed by the OECD's *Best Practices for Budget Transparency* that was designed as a reference tool for member and non-member countries to use in order to increase the degree of budget transparency in their respective countries. Together with other fiscal management reform initiatives the above helped inspire many Third World countries to seek compliance with what was increasingly gaining traction worldwide as an international practice.

It is in anticipation of the above that the Swedish International Development Agency (SIDA), in 1985 in conjunction with the Commonwealth Secretariat (COMSEC) supported Kenya's initial debt, management support effort. The support was aimed at and designed to facilitate capacity building in sovereign debt management within the aegis of the Ministry of Finance. Consequently, a Debt Management Division (DMD) was established in 1987 as part of the Fiscal and Monetary Affairs Department. Widespread corruption within the bureaucracy stood on the way of these cosmetic efforts to translate into serious commitment to good fiscal governance; such that by 2001, the Division's core mandate had been reduced to a mere recording of external debt inflows and haphazard determination of consessionality of external loan proposals. Up to this point in time public debt management in general and domestic debt management in particular was characterized by weak institutional instruments that left nearly all debt management activities and functions spread across poorly coordinated departments, mainly at Ministry of Finance and Central bank of Kenya .With a patrimonial and corruption-ridden state bestriding all other governmental departments with the dead weight of a colossus, the stage had been set for all manner of mismanagement of nearly all debt portfolio.

The spiralling debt burden and the drying up of external borrowing opportunities as a result of Kenya government's poor performance in the execution of its fiduciary responsibilities in regard to the management of public resources, occasioning the intensification of the search for an alternative, preferably, domestic sources of borrowing, coincided with and provided an opportunity for internally driven public debt management reforms. Under the Financial and Legal Sector Technical Assistance Programme (FLSTAP) several efforts were made in order to strengthen the management of public debt. At the core of these reform initiatives was the drive for the re-organization of the Debt Management Office. This included the establishment of a Back, Middle and Front Offices and eventual operationalization of the same. More particularly, the Back Office was strengthened with a view to a more coordinated and transparent sets of operations and functions. The Fiscal Management Act of 2008 provided the legal and regulatory platform on which the legal and strategic framework for the management of Domestic Debt has been constructed.

Debt management Strategy

Kenya has ad hoc policy guidelines to assist in the debt management. A debt management strategy is in place which seeks to among other things minimize the cost and risk of domestic borrowing in the long run. It ensures consistency with both fiscal and monetary policy objectives while on external borrowing emphases on concessional terms as a strategy for minimising borrowing costs, external loans must have a minimum grant element of 35 percent to be considered for borrowing. It should be noted that the government notes that it has a debt management policy in place which informs the strategy.

Box 1 Main Principles of Government Debt Management

1. The overall objective of Government debt management policy is to meet the Central Government's financing requirements at most optimal borrowing costs with a prudent degree of risk. It also aims at facilitating the Government's access to the financial markets as well as supporting development of a well functioning domestic financial market.

2. Consistent with the stated policy objectives, Government borrows externally on concessional terms. As a strategy for minimising borrowing costs, external loans must have a minimum grant element of 35 percent to be considered for borrowing.

3. The strategy of domestic debt issuance is reviewed on a continuous basis and agreed upon between the Treasury and CBK. To ensure transparency and credibility of Government debt policy, the annual net domestic borrowing target is announced in the Budget Speech each year in June.

4. The CBK issues Treasury bonds and Bills as determined by the Government's current revenue and expenditures. To meet temporary shortfalls in cash-flows, the Government may access the overdraft facility at the CBK up to the statutory set limit of 5 percent of the latest audited Government annual ordinary revenue.

5. The Government plans to issue project specific or infrastructure bonds to finance projects in the roads, water and energy sectors, all of which impact positively on the economy. It will also contribute to the deepening of the domestic financial markets.

6. In its continued efforts in restructuring domestic debt, the Government plans to address bond market fragmentation by implementing a well structured benchmark bond programme. This will be done through reopening benchmark bonds as well as consolidating small illiquid bonds or issues.

7. The Government may consider issuing a sovereign bond when global markets stabilize The rationale for the bond issuance include supplementing domestic savings with external resources, diversify funding sources and provide a benchmark for corporate borrowing.

8. The Government undertakes borrowing within limits set by Parliament. Under the External Loans and Credits Act (Cap 422), the limit set in January 2009 for external debt is Ksh 800 billion. Under the Guarantee Loans Act (Cap 461), the limit for all guaranteed loans set in 1993 is Ksh 80 billion. The domestic borrowing is contracted under the Internal Loans Act (Cap 420). The Central Bank of Kenya Act (Cap 491) provides for the Government overdraft at the CBK.

9. The Minister for Finance is empowered by law to mobilise resources on behalf of the Government. However, the Permanent Secretary, Treasury has the overall responsibility over the national debt management functions which are operationalized through the Debt Management Department. The Central Bank of Kenya borrows on behalf of the Government in the domestic market under an agency agreement.

10. An important element of Government debt management is to promote transparency in its operations. To this end, the Government publishes various reports in its efforts to disseminate information to the public on debt management operations. A wide range of information is currently published in the CBK's *Monthly Economic Review* and *Weekly Bulletin, MoFs Annual Public Debt Management Report, Monthly Debt Bulletin, Quarterly Budget Review, Budget Outlook Paper* and *Budget Strategy Paper* and in the *Annual Economic Survey* published by the Kenya National Bureau of Statistics. This information may also be downloaded from the respective websites.

Government Reforms in Domestic Debt Management

Automated Trading systems were adopted in 2009 to improve efficiency and safety of secondary trading for bonds since transactions were on delivery. Horizontal Repos Transactions (HRT) platforms were adopted in 2008 to enhance liquidity distribution across the financial system. Action based offers through issuance method and pricing has promoted price discovery which is crucial for market development. The development of an Issuance calendar has enhanced investor planning and offer take-up. The government made reviews of the Securities Law which has allowed the dematerialisation of the register to facilitate secondary trading. Pension and Insurance reforms created demand for long term bonds.

Government as carry over work in domestic debt management reforms has planned to continue issuance of benchmark bonds. To develop secondary markets further plans are at hand to rollout market makers windows to achieve two way price quotes. The government needs to introduce online bidding for institutional investors and introduce agency for retail investors. The government will continuously encourage public and corporate entities to issue bonds. It will work towards the development of a bond index.

Legal Framework

Currently, there exist four different but related Acts of Parliament governing public debt management in Kenya, namely: the Guarantee Loans Act (Cap 461), Internal Loans Act (Cap 420), External Loans and Credits Act (Cap 422), and the Central Bank of Kenya Act (Cap 491).

The Guarantee Loan Act (Cap 461) is an act of Parliament to provide for the guarantee by the Government of loans and for matters incidental thereto and connected therewith. The government will under the provision of this act guarantee the repayment of the principal money of and the payment of the interest and other charges in respect of any loan raised either within or outside Kenya by a local authority or a body corporate.

The Internal Loans Act (Cap 420) provides the legal framework for the Minister for Finance to borrow on behalf of the government from the domestic market through issuance of Treasury bills and Treasury bonds. According to this Act "the government sets a target for domestic borrowing annually through the budget and has the option of revising the figure through the revised budget in the second half of the fiscal year. The Act also allows the Government access to an overdraft at the CBK when there is a mismatch between revenue receipts and expenditures. As a measure of checking inflationary pressures resulting from use of the overdraft facility, the Act sets a limit to the use of the overdraft to a 5 percent level of the latest audited Government revenue.

The external Loan and Credit act (Cap 422) is an Act of Parliament to authorize the Government to raise loans outside Kenya, to provide for the negotiation by the Government of credit facilities outside Kenya. Domestic borrowing through Treasury bills and bonds do not have a limit in law. This is different from external borrowing where the External Loans and Credit Act, CAP. 422 of the laws of Kenya limits the total indebtedness in respect of principal amount to Ksh 500 billion or such higher sum as the National Assembly may by resolution approve. The minister of Finance, according to the Act, is required by provisions of the Internal Loans Act to "report to the National Assembly in writing, the amount of indebtedness outstanding at the end of each financial year in respect of each manner of borrowing specified in section 3" of the Internal Loans Act. This, however, is hardly done promptly and with the necessary regularity.

The government overdraft at the Central Bank of Kenya is the only aspect of domestic debt borrowing that seems to be limited by law. The Central Bank of Kenya Act (Cap 491) establish the Central Bank of Kenya and provide for its operation thereof; to establish the currency of Kenya and for matters connected therewith and related.

Institutional framework

Section 45 of the Central Bank of Kenya (CBK) Act provides the legal framework for the Bank to manage public domestic debt on behalf of the government. This includes contracting domestic debt through sale of Treasury Bills and Bonds, extending overdraft facilities to the Government, maintaining domestic debt register and making payments of domestic debt. As a Banker to the Government, CBK effects payments to external creditors on specific instructions from the Treasury. A clear separation of duties and responsibilities is required in order to benefit from a highly rationalised and articulated policy framework.

Compilation of data on domestic debt is guided by international standards specified in the IMF manuals. Kenya subscribed to the IMF GDDS and SDDS in 2002 with the aim of improving the quality, coverage, periodicity and timeliness of its macroeconomic data, and a commitment to improving the integrity and ensuring timely dissemination of data to the public.

Other institutions relevant to the management of domestic debts include:

- **The Attorney General's Office:** Principal legal adviser to Government and is responsible for reviewing draft loan agreements to ensure conformity with the relevant legislation.
- **Accountant General's Department:** Responsible for cash management and in particular the use of the Government overdraft facility at CBK. The institution could benefit from increased institutionalization in order to put paid to the image of a one-man-show syndrome.
- **Controller and Auditor General:** Responsible for issuance of authority to debit the Consolidated Fund Service account to settle Government debts. It undertakes periodic audits of public debt.

Co-ordination of Domestic Debt: Treasury and Central Bank of Kenya (CBK)

Just like the fragmentation at the policy level, the Domestic debt management at the Ministry of Finance was characterized by weak institutional arrangements with debt functions spread across departments at the MoF and CBK. These include the Debt Management Department (DMD), the Department of Government Investments and Public Enterprises (DGIPE), and Accountant-General's Department at the MoF. In addition, debt management functions within MoF and CBK are guided by weak debt policy framework and ad hoc debt management strategies. Coupled with these are the human resource issues. The department is under-staffed and high staff turnover is still evident particularly within DMD, undermining operational efficiency.

The government has however taken some steps to address some of the gaps; CBK in consultation with the Treasury has implemented reforms to strengthen the management of domestic debt. In efforts to streamlining public debt management a formal organization structure detailing the functions of the Debt Management Office, i.e. Front, Middle and Back office was prepared and forwarded together with job descriptions for the staff under each office, to Directorate of Personnel Management for consideration and approval. This is set to replace the DMD.

As a step towards strengthening domestic debt back office operations at the CBK, a domestic debt data base on CS-DRMS 2000+ platform has been established as part of joint effort to set up a comprehensive public domestic debt data base. At the same time another back office has been created at the treasury and handles not only domestic debt but also external debt. The office has also been fully installed with CS-DRMS 2000+ system. Approximately 50 members of staff drawn from departments responsible for debt management functions at MoF and CBK have received training on the external and domestic debt modules of CS-DRMS 2000+.The government has since set up a fibre optic connection between Treasury and CBK to facilitate sharing of information, including debt data, by the two institutions through establishment of a centralised debt database.

Nevertheless key challenges still remain. The Back Office is understaffed and generally has low level of technical skills to handle debt management. Lack of an effective ICT system within back office exacerbates the loans administration capacity in the department. CS-DRMS is designed for external and domestic debt management and not on-lending; it has only been adopted to handle this function within back office. The system therefore has limitations in the management of on-lent loans, including inability to generate various reports necessary for proper loan management. The system is also not yet integrated with the other systems within Treasury.

Information and Communication of Domestic debt

The debt is compiled from the accounts of the National Debt Office at CBK for all government securities. The CBK balance sheet is the source of advances to government and holdings of government securities by the CBK. Commercial banks' reports are the sources for data on their advances to government and their holdings of government securities. Securitised public domestic debt statistics comprise: outstanding amount; borrowed amount (net issues); interest payments amounts; maturity profile; and weighted interest rates.

The Central Bank of Kenya, Ministry of Finance and Kenya National Bureau of Statistics publish outstanding domestic debt securities statistics with varying time lags. The CBK publishes the statistics weekly in the *Weekly Bulletin of Economic Indicators,* monthly in the *Monthly Economic Review,* in June and December in the *Bi-Annual Statistical Bulletin* (longer time series), and annually in the Bank's Annual Report. The Ministry of Finance and Kenya National Bureau of Statistics obtain data on domestic debt from the Central Bank of Kenya for dissemination through their respective publications. The Ministry of Finance disseminates the data quarterly in the Quarterly Budget and Economic Review, and in the Annual Public Debt Management Report. The Kenya National Bureau of Statistics publishes annual data in the Annual Economic Survey. It is not possible to tell how the information reaches the public as the language that the means of dissemination is in itself exclusive to those who have technical expertise to understand domestic debt.

There are however no legal requirements with regard to transparency and accountability with regard to domestic debt management aside from those that require the minister to report, in writing, annually to the National Assembly on the status of domestic debt and the amount of indebtedness outstanding at the end of each financial year in respect of each manner of borrowing specified in section 3" of the Internal Loans Act'.

Roles and Responsibilities

On and around the debt management platform stand a retinue of actors and players, the cumulative activities and functions of which are intended to conflate into an efficient debt management machinery as a basis for effective coordination of roles, functions and responsibilities. Together and within the context of a comprehensive debt management strategy, the platform provides for a more structured regulatory presence in the fiscal environment. This is one sure way of forestalling the trend towards ponsification of government paper and bank leverages. The effectiveness of such machinery is measured by the extent to which it promotes transparency of the interactions, accountability of the bona fide actors and integrity of the entailed processes. The result should be: sustainable and equitable social development.

Earlier on in this paper, we have expressed the view that public debt management in Kenya has been characterised by weak institutional arrangements with the operations of debt managements functions spread across departments falling mainly within Ministry of Finance (External Resource Department) and Central Bank of Kenya; with the weight of the powerful office of the president precariously leaning on them with the hidden power of an *eminence griese*. Besides the Debt Management Office (DMO) and its critical role, the other departmental actors/institutions involved in public debt management activities include the following:

Central Bank of Kenya

As in many countries, it manages public domestic debt on behalf of the treasury. This mandate includes the role of contracting domestic debt through the sale of treasury bills and bonds, offering and extending overdraft facilities to the government, preparing and maintaining an up-to-date domestic debt register and making due payments in respect domestic debt. Given the enormous tasks at hand, the institution could greatly benefit from an additional body, exercising oversight authority.

Civil Society

Civil society which is supposed to be a major actor in ensuring accountability and integrity of the debt management exercise and process has had its potentially critical role smothered by the fact that the debt register is yet to be open to the public for scrutiny. Given the Kenya government's reluctance to embrace the imperative of freedom of information it may still be a long way before the Kenyan civil society can count itself a desirable part of the domestic debt management outfit.

Parliament

With the recent introduction of the Fiscal Management Act of 2008, the oversight role of parliament has been raised a notch higher than had been the case before. The Act introduces key changes in the way budget is prepared and transacted in the House. For the first time in Kenya's Budget making history, budget estimates will be enriched by inputs from parliament's relevant departmental committees. Further, the act requires that the annual estimates laid before the National Assembly shall be accompanied by a treasury report specifying all the measures taken by the government to implement the audit recommendations made by the House in the previous year. This, no doubt, constitutes a major improvement on Parliament's oversight role in ensuring that contracting debt by those authorized to do so does not become a gravy train for rent-seekers in government. Yet more needs to be done in the way of giving parliament the necessary teeth to perform its oversight functions with the required efficiency.

Medium Term Debt Strategy

This, along with the Budget Outlook and Budget strategy papers, do provide short and long-term macro outlook in regard to the debt situation in the economy. Mechanisms for their mutual reinforcement and internal strength should be put in place. The Midterm Debt Strategy is prepared by the Debt Management department at the treasury. It is meant to strengthen relation with external creditors, donors, investors and promotes development of a domestic market.

CONCLUSIONS AND RECOMMENDATIONS

- Given the challenges that Kenya has faced regarding Debt management in general and domestic debt in particular, it is imperative that the need for a more comprehensive debt management policy that seeks to rationalize the complementary relationship between domestic and external borrowing is formulated.
- In order for the envisaged comprehensive debt management policy to be effective, Kenya government will find it necessary to institute legal reform measures that should regulate external and domestic debt contracting. This needs to go beyond addressing the challenges associated with overdraft procedures and mechanisms.
- Treasury should boost its capacity for domestic debt analysis and management. This should include attracting the required expertise and the retention of the same. At the moment no special interest is directed at hiring of the necessary competence that can help improve the ministry's performance in this particular area.
- The oversight mandate of parliament should be expanded to include the institutionalization of its consistent participation in the setting of the ceiling, sources, and purpose of domestic borrowing.
- A comprehensive debt register should be developed made accessible to the Kenyan public. Such a register should contain information touching on: the creditor, when the debt was contracted, the amount involved, how much has been paid and how much is still outstanding.
- Monitoring and evaluation of the domestic debt situation should be carried out so as to allow for continuous tracking of debt.

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Ministry of State for Planning, National Development and Vision 2030. Public Expenditure Review Policy for Prosperity 2010

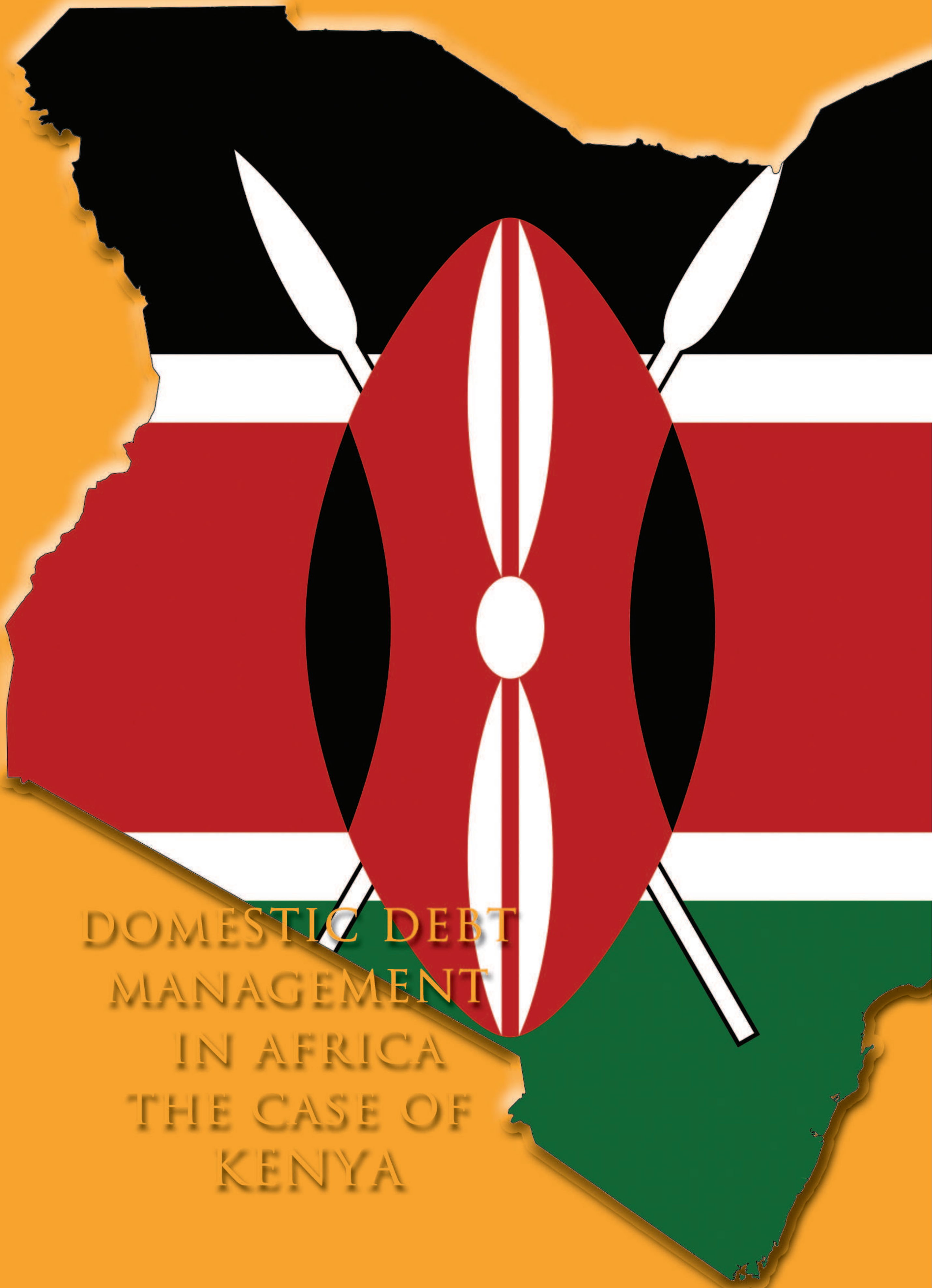
Annex 1

OFFICE OF THE DEPUTY PRIME MINISTER AND MINISTRY OF FINANCE DEBT MANAGEMENT DEPARTMENT

OUTSTANDING DOMESTIC DEBT: DETAILS

Security type	Amount (Ksh million)	
	June 2008	June 2009
Treasury Bills (Days)		
91	17,980	23,523
182	58,313	93,271
Sub total	76,293	116,794
Treasury Bonds (Years)		
1	13,191	14,789
2	31,747	45,206
3	26,663	12,798
4	16,539	12,914
5	43,511	52,787
6	47,589	38,769
7	24,154	24,153
8	17,944	17,944
9	12,615	12,615
10	34,415	44,415
11	4,031	4,031
12	8,766	28,494
15	32,114	42,303
20	1,912	9,526
Sub total	315,190	360,744

Long term Stock	755	755
Pre 1997 Government Debt	34,993	33,328
Others:	3,381	6,886
Of which:		
Government overdraft		
from CBK	0	5,124
Items on transit	3,381	1,762
Total Domestic Debt	430,612	518,507



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