Ninety Fourth Sovereign Debt News Update: Kenya breaches its Debt Ceiling, anchors its Debt to GDP

By:

The African Sovereign Debt Justice Network

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Kenya's public debt hit KES10.027 trillion in the last week of June, 2023, effectively breaching the statutory debt ceiling of KES10 trillion which was set in June 2022 for the 2022/2023 financial year. At the same time, the country's Parliament approved the conversion of the current KES10 trillion debt ceiling with a debt anchor as a percentage of GDP, fulfilling some of the IMF conditions to the country. This move, however, compromises the government's bid to comply with the East African Community's debt target of 50 percent of GDP.

Kenya's National Assembly's Public Debt and Privatisation Committee set the public debt threshold at 55% of the GDP in present value terms. The Committee, however, provided a window not exceeding 5% to accommodate the current public debt to GDP threshold of 60%. This, effectively, means that the country's debt limit will be a moving target from an absolute figure with the present value of debt as a percentage of GDP to represent the current debt value in contrast to the current value of future cash flows.

The public debt ceiling is anchored in the Public Finance Management Act, 2012, with section 50(2) of the said Act empowering the Parliament to limit the national government's borrowing. However, this clause was recently amended to allow the government to exceed the limit under certain circumstances. These circumstances include depreciation of the shilling, material balance of payments imbalances, or fiscal disruptions caused by wars, health pandemics, or national disasters. The section was also amended to give the Public Debt Management Office the responsibility to advise the National Assembly on an annual borrowing limit. Thus, the government now has the flexibility to adjust the borrowing limit every year. However, this flexibility introduced by these new amendments can be abused by an irresponsible government.

Why is a public debt ceiling important?

A public debt ceiling is a legally imposed upper limit on the stock of public debt of a country. For emerging and developing economies, a debt limit of no more than 64% of the country's production (gross domestic product or GDP) is recommended. A ceiling is imposed to ensure that countries employ public debt sustainably. Therefore, a breach of the debt ceiling signals the possibility that the country's debt could be excessive and unsustainable. For African countries, the debt ceiling is particularly significant because many of them are heavily indebted. Therefore, maintaining the public debt levels within the ceiling encourages governments to manage their finances responsibly, control expenditure, and avoid excessive debt accumulation. In this way, African countries can mitigate the risk of over-indebtedness, protect their creditworthiness and promote long-term fiscal sustainability.

Second, a public debt ceiling can reduce the costs of sovereign debt borrowing by enhancing confidence in financial management. This, therefore, means that African countries can lower borrowing costs, reduce the risk premium demanded by investors, and attract more sustainable and affordable financing options.

Third, a public debt ceiling can reduce vulnerability to external shocks. By limiting excessive borrowing, sudden increases in debt servicing costs, which can strain public finances and impact economic stability, can be avoided. It provides a mechanism to control debt growth, ensuring countries maintain a sustainable debt burden and have sufficient fiscal space to respond to economic downturns or emergencies. Besides, a debt ceiling necessitates improved governance and transparency in public financial management. It encourages long-term development planning and prioritises investments that yield sustainable economic growth. By aligning borrowing decisions with development goals, countries can utilise debt financing more effectively, reducing the likelihood of debt distress and ensuring that borrowed funds contribute to long-term economic advancement.

Moreover, failure to manage the debt within the limit would cause worries about the government's creditworthiness. Investors would likely demand a higher return on debt issued by the national government. In turn, the government would have to pay more interest on its debt, which would create a further strain on future budgets.

Finally, government borrowing essentially transfers wealth from the poor, who must pay increased taxes for debt repayment to the rich who lend money to the government and earn interest from it. Excessive public debt therefore widens the welfare divide between the rich and the poor.

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