One Hundred and Twenty-Fourth Sovereign Debt News Update: Kenya Post the Finance Bill 2024: Debt, Tax and the Quest for Accountability

By:

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As previously highlighted in the One Hundred and Twenty-First Sovereign Debt News Update, June and July of 2024 proved to be a defining timeline in Kenya's economic history as the Gen-Z revolution in Kenya prompted President William Ruto to concede to the demands to do away with the 2024 austerity laden Finance Bill. This revolution also led to the complete dismissal of the cabinet of the Government of Kenya by President William Ruto on July 11, 2024. There have been reversals of the initial optimism with about half of the old cabinet returning and with leaders of Kenya's main opposition being appointed to the cabinet to form what President William Ruto has dubbed a broad based cabinet. In the meantime, the National Treasury still grapples with regressive tax and an unsustainable debt stock. The new Treasury has announced parts of the rejected 2024 Finance Bill may be brought back before Parliament.

Debt and Tax: Two Sides of the Same Coin?

The management of debt through regressive taxation systems, as an approach is not new. Countries that increase taxes to repay debt have faced significant challenges and ultimately failed to stabilize their economies. During the European debt crisis, Greece implemented severe austerity measures, including tax hikes, to manage its debt. Despite these efforts, the country faced prolonged economic hardship and required multiple bailouts from the European Union and the International Monetary Fund (IMF) to avoid default. In recent years, Argentina has struggled with high inflation and debt. The government increased taxes and implemented austerity measures in 2017, but these actions were insufficient to stabilize the economy, leading to the country defaulting on its debt multiple times (with 2020 being the most recent). Sri Lanka raised taxes to address its debt issues, but the country faced severe economic challenges, including a foreign exchange crisis. In 2022, Sri Lanka defaulted on its debt, leading to significant economic and political turmoil. Zambia increased taxes on mining companies to boost revenue and repay debt. However, the country faced economic challenges, including declining copper prices and high debt levels, with Zambia defaulting on its debt in 2020. These examples highlight the complexities and difficulties countries face, and continue to face, when trying to manage debt through tax increases alone. The burden these taxes impose resulted in the Gen-Z led protests in June and July 2024 against regressive taxation. These protests led to the withdrawal of Kenya’s Finance Bill of 2024.

Where is the Middle Ground?

During the unveiling of the 2025-26 Budget preparation process in Nairobi on the 9th of September, and in what has been dubbed as a “surprising” announcement, the government unveiled a new proposal to reduce controversial taxes, a move that could provide much-needed relief to citizens. As part of the Treasury’s medium-term revenue strategy (which aims to improve tax administration, enhance compliance, and expand the tax base), newly appointed Treasury Cabinet Secretary John Mbadi revealed plans to cut the value-added tax (VAT) from 16% to 14%, decrease corporation tax from 30% to 25%, and lower pay-as-you-earn (PAYE) rates, although specific details on the latter tax remain unspecified. Additionally, as part of his initial tasks, CS Mbadi has taken to focus on the Tax Laws (Amendment) Bill 2024. Mbadi indicated he is going after the Kes 396.0 billion annual tax expenditure, specifically targeting rationalisation of VAT zero rating and the extension of the 2023/24 tax amnesty programme. Interestingly, this was a proposal in Finance Bill 2024, with the goal of unlocking a further Kes 30.0 billion in 2024/25 through an extension to June 2025. One may argue that the Treasury has been finding “innovative” ways to resuscitate the Finance Bill 2024.

While CS Mbadi has vowed to reduce and not increase tax rates, experts have raised concerns about the government’s ability to manage public debt. The new tax strategy has been described as “an acid test” for him as he must balance immediate economic relief with the long-term sustainability of government finances. According to economic analyst Jane Mwangi, “*[w]hile tax relief is essential for stimulating the economy, especially in these challenging times, it is crucial that the government finds a balance to ensure that it does not compromise its financial obligations*.” Interestingly, on the 17th of September 2024, Kenya's Cabinet went ahead and sanctioned the review of the Value Added Tax (VAT) refund process in what it says should boost openness, transparency & accountability.

While a lower tax burden could encourage spending and investment, which might ultimately lead to higher tax revenues in the long run, the reality is that Kenya is currently navigating an International Monetary Fund (IMF) programme designed to stabilise the economy and address soaring public debt. As the government enters the budgetary process, the challenge will be to implement these tax cuts while adhering to the fiscal targets outlined in the IMF programme. Treasury will therefore need to outline a clear strategy for maintaining revenue levels despite the proposed reductions.

“New” Wine in Old Bottles?

Amidst all this, President Ruto’s government seems to not have learnt a thing from the June unrests. While Kenyan President Ruto had announced in July 2024, after the protests, that his government would avoid contracting more debt, the opposite has been true in light of his government's escapades in Beijing during the Ninth Forum on China-Africa Cooperation (FOCAC). Held from the 6th to the 8th of September 2024, this year's summit ran under the theme "*Joining Hands to Advance Modernization and Build a High-Level China-Africa Community with a Shared Future*", with 53 African Leaders in attendance. Initially, John Mbadi, then Kenya's nominee for Cabinet Secretary for National Treasury and Planning, had emphasized the need to restructure the country's debt by highlighting the importance of shifting away from expensive commercial debt and leaning on cheaper alternatives. Now that he is officially Cabinet Secretary, John Mbadi has secured a Sh40 billion agreement with the China Development Bank during the FOCAC. These funds are earmarked to fund the construction of 15 rural roads across the country which have not progressed beyond 20 percent. CS Mbadi, as part of President William Ruto's delegation at the, finalized the credit facility deal with Tan Jiong, President of the China Development Bank. During the event, China Development Bank also committed to expanding the operations of the China Africa Development Fund by opening a new office in Nairobi. This move is part of broader efforts to deepen economic ties between Kenya and China.

Kenya also formally joined the Asian Infrastructure Investment Bank as fully paid member on the 3rd of September 2024. Making the announcement, President William Ruto said the membership will enable the country to access concessional funding for several programmes including infrastructure, climate change efforts, connectivity, regional cooperation and technology-enabled projects and programmes.

Transparency and Accountability Issues Amidst Borrowing of New Loans

The new loans contracted by President Ruto's government during the Forum on China–Africa Cooperation come at a time when the Auditor General Report on National Government covering the year 2023 shows some transparency and accountability concerns. According to the Auditor General's Report, commitment fees on undrawn amounts paid by the government during the period under review amounted to Sh1.44 billion. This means that the Government of Kenya paid Sh1.4bn interest on portions of loans or credit facilities that had been approved but it had not yet accessed or utilized.

According to Auditor General Nancy Gathungu, "*[h]ad the implementing agencies put proper mechanisms in place to enable absorption of the committed credit within the agreed timeframe, payment of commitment fees would have been minimised,*"

Further, the government cannot show projects funded with SH1.13 trillion of expensive loans it took from 2010 to 2021. In a special audit on utilisation of commercial loans in Kenya between July 2010 and December 2021, Auditor General Nancy Gathungu revealed that Treasury took 13 expensive syndicated loans and sovereign bonds, and these funds were used to settle recurrent expenditures in government- contrary to the law. It is imperative to highlight that the period under scrutiny reveals that the China Development Bank was Kenya's top lender (at Sh60.5 billion), followed by the Eastern and Southern Trade and Development Bank/PTA Bank (at Sh51.6 billion), the Standard Bank of South Africa Ltd Isle of Man Branch (at Sh142.3 billion), and CGMG (at Sh107.8 billion).

On September 16, 2024, Kenya's Treasury Cabinet Secretary asked the country's Auditor General to audit Kenya's debt that will identify the details of specific borrowers and interest rates. This was a key demand of the Gen-Z protests of June and July 2024. This audit comes after courts stopped a committee-led audit process that President William Ruto had initiated because the mandate of auditing public debt falls under the country's Auditor General under the 2010 Constitution of Kenya. In the meantime, several citizen audits of Kenya's debt and projects funded by debt are being conducted. These citizen efforts also include court cases that are keeping the government on its toes to account for how it is borrowing and for what purpose.

Kenya's Scorecard Not Impressive- Credit Rating Agencies

Credit rating agencies have been "closely monitoring" the situation in Kenya. Earlier in July 2024, Moody's had downgraded the country's credit ratings to "Caa1" from "B3" and projected Kenya's debt affordability to remain weaker for longer. According to Moody's, the government's decision to withdraw the Finance Bill and instead rely on budget cuts to reduce the fiscal deficit would cause implications for Kenya's financing needs. At the beginning of August 2024, global credit ratings agency Fitch downgraded Kenya's sovereign rating to “B-” from “B”, citing heightened risks to the country’s public finances after the government backtracked on key revenue measures following protests. The agency, however, maintained its outlook on Kenya at “stable”

While positively noting that Kenya’s diverse and dynamic economy is one of the fastest growing in Sub-Saharan Africa with a GDP growth of 5.6% in 2023, Agusto & Co. assigned Kenya a “B+” rating with a negative outlook to the Republic of Kenya. According to the credit rating agency, the rating is moderated by a high debt-to-GDP ratio (70.8%) and rising debt service to revenue ratio (58.8%), high annual inflation rate (7.7%) above regulatory threshold and depreciation of the Kenya Shilling in FY 2023. Agusto & Co. also predict that “*the suspension of the 2024 Finance Bill and inability to raise the expected additional revenue of KES 346 billion will have negative impact on Kenya’s fiscal position and finances in the short to medium term*.”

IMF Staff Concludes Visit to Kenya

From September 11-16th, an International Monetary Fund (IMF) team, led by Haimanot Teferra, held discussions with Kenyan authorities on recent developments and their policies to manage the emerging challenges. Julie Kozack, the head of communications for the IMF, described the staff visit as a “**fact finding mission**” which was *part of the IMF ongoing and constructive dialogue with Kenyan authorities to find a balanced path forward* in the wake of deadly protests that scuppered the government's planned tax hikes. In a statement, Ms. Teferra said "*[w]e remain fully committed to support the authorities on their efforts to identify a set of policies that could support the completion of the reviews under the ongoing program as soon as feasible*". Despite the IMF team’s constructive discussions, no new funding was announced following the Nairobi meeting. According to one source, *the lack of immediate financial assistance seems to indicate the IMF's stance that new policies are a prerequisite for any future funding*. The government therefore needs to navigate not only the technical aspects of tax reform but also the political ramifications of their decisions.

Conclusion

As Kenya grapples with rising debt and a struggling economy, the crafting of new tax policies is seen as crucial to restoring investor confidence and unlocking the promised IMF funds. Kenya's amended 2024/25 budget contains spending cuts and increased domestic borrowing but worries remain regarding the country's capacity to receive foreign concessional credit. Market concerns about fiscal stability and debt trajectory have grown, and with IMF talks over a $600 million disbursement postponed, questions linger about the country's ability to manage its budget deficit without inciting further. This is especially so given the additional loans that Kenya has continued to procure especially at the latest FOCAC meeting in China. Undoubtedly, the quest for politically viable fiscal solutions will be essential in defining Kenya's future direction.

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