The Institute for Social Accountability

TRANSPARENCY AND ACCOUNTABILITY IN PUBLIC DEBT MANAGEMENT

A FOCUS ON KENYA'S PAST EUROBONDS

Popular Version

INTRODUCTION

The Rise of Eurobond Issuance by African Countries

Public is an important tool for financing growth and development. In most African countries, public debt has mostly been used to finance budget deficits and infrastructural projects, contributing towards the growth of their economies[1].

Prior to 1995, African countries relied on:

- Domestic borrowing
- External debts which included concessional and non-concessional loans from bilateral lenders such as Paris Club members and non-members
- Multilateral institutions such as African Development Bank (AfDB), World Bank (WB), and International Monetary Fund (IMF)[2].

These loans often came attached with conditionalities and complex acquisition procedures which pushed African countries to look for alternative sources of funding such as bond issuance in international financial markets.

In 1995, South Africa became the first African country to venture into international financial markets to issue Eurobonds. Thereafter, a spike of Eurobond issuance by African countries followed. At least 20 out of the 48 sub–Saharan African countries have since issued Eurobonds.

By July 2021, African countries had issued Eurobonds worth at least USD 136 billion. The advent of Covid-19 pushed African countries to issue more Eurobonds and in 2021 they issued Eurobonds worth $11.8 billion.

The table below presents a list of sampled Sub-Saharan Africa countries' issued Eurobonds focusing on the coupon rate, bond yield, and tenor between 2011 and 2018.

Table 1: Eurobonds Issued by Sampled Sub Sahara African Countries (2011 – 2018)[3]

Country	Issue Tenor yrs	Issue Date	Coupon	Beginning of 2019 Yield	End of 2019 Yield
Ghana	31	16/05/2018	8.60%	10.00%	8.60%
Senegal	30	13/03/2018	6.80%	8.30%	7.30%
Nigeria	30	28/11/2017	7.60%	9.20%	7.70%
Kenya	30	28/02/2018	8.30%	9.80%	7.90%
Zambia	12	30/07/2015	9.00%	14.70%	17.40%
Nigeria	12	23/02/2018	7.10%	8.80%	7.10%
Senegal	10	30/07/2014	6.30%	6.90%	4.70%
Kenya	10	24/06/2014	6.90%	8.30%	5.50%
Zambia	10	14/04/2014	8.50%	13.30%	19.40%
Senegal	10	13/05/2011	8.80%	6.00%	3.70%
Zambia	10	20/09/2012	5.40%	15.70%	20.70%
Kenya	10	28/02/2018	7.30%	9.00%	6.80%
Ghana	10	08/07/2013	7.90%	8.40%	5.70%

1 The African Legal Support Facility (ALSF): Understanding Sovereign Debt Options and Opportunities for Africa. https://www.alsf.int/publication/RB2ymmao.pdf)

2 https://media.africaportal.org/documents/A_Cautionary_Tale_of_Zambias_International_Sovereign_Bond_Issuances_4038QrI.pdf

3 https://cytonn.cwwom/uploads/downloads/h12019-ssa-eurobond-performance-note.pdf

Table 1 shows that African countries pay higher interest rates on borrowing than their peers from outside the continent in the same category of credit risk or macroeconomic fundamentals;[4] amounting to an unwarranted penalty on African countries estimated at USD 2.2 billion in 2015.

Sustainability of Eurobonds

Due to the nature of Eurobonds, their issuance does not give African countries a cheaper alternative source of borrowing and will need to be approached cautiously.

The volatile macroeconomic environment in Africa raises important questions about sustainability of Eurobond borrowing in the continent. A few African countries have already defaulted on Eurobond barely five years after venturing in sovereign bond issues with Seychelles (2008), Ivory Coast (2011), and Mozambique (2017) as notable examples.

Some African countries are at a high risk of default especially those that have accumulated sizeable debt stock from China such as Angola, Ethiopia, and Kenya. Chinese loans are devoid of debt relief opportunities such as those provided by Paris Club members as witnessed during the Covid -19 pandemic when Chinese lenders declined to grant Kenya an extension of debt repayment holiday.

The main advantages of Eurobond Issuance include ease of access, ability to raise large amounts of funds, relatively low interest rates (only in the short-term, and subject to favourable market conditions), and absence of attached conditionalities.

For Eurobond borrowing to be sustainable, the borrowing countries must guarantee strong sustained economic growth, political stability, prudent macroeconomic management, and low cost of borrowing—all key challenges with which African countries struggle. Hence the high risk many African countries face of plunging into debt distress or default.

Worse still, bondholders are largely private companies and financial institutions which, in case of mass debt default or distress, are unlikely to offer debt relief services such as the *Highly Indebted Poor Country (HIPC)* initiative and *Multilateral Debt Relief Initiative (MDRI)* in the 1990s that restored Africa's[5] debt sustainability.

Eurobond Issuance in Kenya

Due to increased budgetary constraints and the need to protect the domestic economy against the crowding out effects of domestic borrowing, Kenya, since 2014, has increasingly embraced Eurobonds issuance.

Kenya has so far issued 4 Eurobonds between 2014 and 2021. The country's appetite for these foreign currency-based syndicate loans seems to be growing unabated.

The topic of proceeds from the first Eurobond in 2014 to the latest one in 2021 is one shrouded in mystery. The Office of the Auditor General (OAG) in its analysis reported that the proceeds from Kenya's first

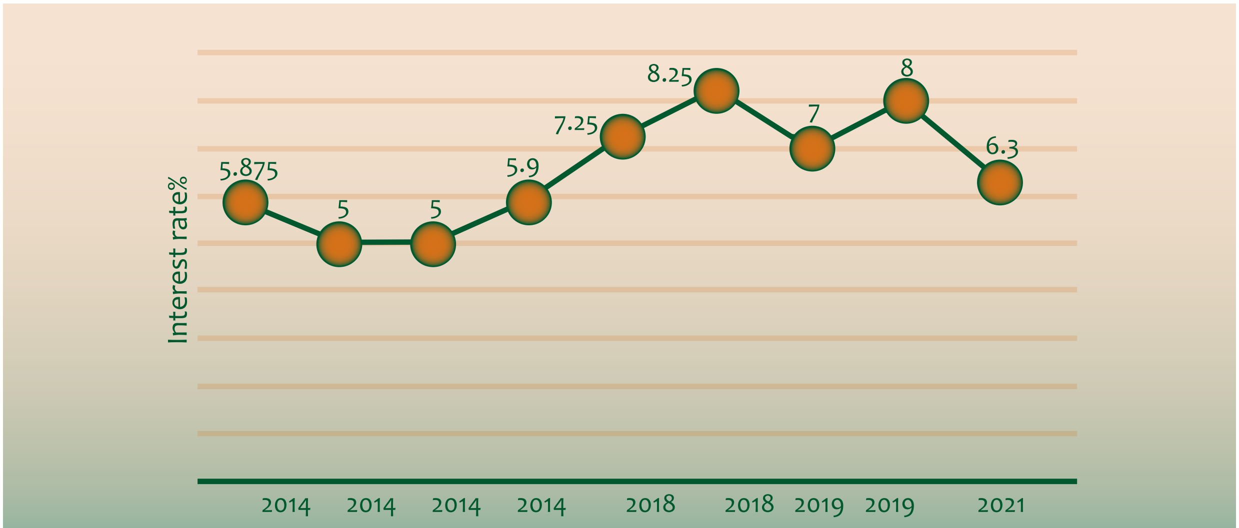
4 Michael Olabisi, Howard Stein,Sovereign bond issues: Do African countries pay more to borrow?,Journal of African Trade,Volume 2, Issues 1–2,2015,Pages 87-109: https://www.sciencedirect.com/science/article/pii/S2214851515000079

5 The African Legal Support Facility (ALSF): Understanding Sovereign Debt Options and Opportunities for Africa. https://www.alsf.int/publication/RB2ymma0.pdf)

Eurobond issue could not be traced within the domestic economy.[6] Two further Eurobonds were issued in 2018 and 2019. The public, however, is not aware of how their proceeds were spent within the economy.

Table 2: Kenya's Eurobond Issuance (2014 -2021)

Year	Month	Amount (USD)	Tranche Amount (USD)	Repayment Period (Years)	Interest rate (%)
2014	June	2.0 Billion	500 Million	5	5.875
			1.5 Billion	10	5.0
	December	750 million	250 Million	5	5.0
			500 Million	10	5.9
Year	**Month**	**Amount (USD)**	**Tranche Amount (USD)**	**Repayment Period (Years)**	**Interest rate (%)**
2018	February	2.0 Billion	1.0 Billion	10	7.25
			1.0 Billion	30	8.25
2019	May	2.1 Billion	900 million	7	7.0
			1.2 Billion	10	8.0
2021	June	1.0 Billion	1.0 Billion	12	6.3



Eurobond issues (Tranches): 4 tranches in 2014, 2 in 2018 & 2019, 1 in 2021

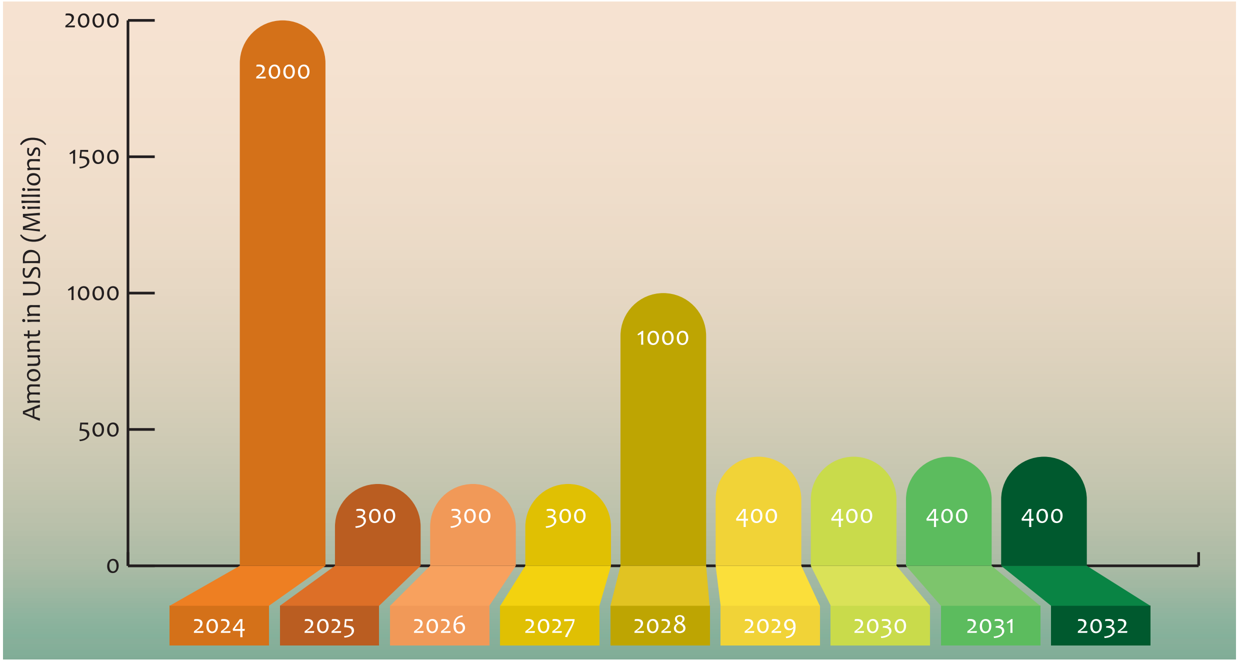
Graph 1 presents the trend of the cost of servicing Eurobond debt issued by Kenya from 2014 to 2021. The graph shows that the interest rate charged on the country's Eurobond has been fluctuating on an upward trend, an indication of increasing cost of debt servicing over time.

Kenya's use of Eurobond Proceeds and Repayment Concerns

The limited information available indicates that the funds have been used mainly to finance budget deficits, repay maturing Eurobonds, and invest in infrastructure projects that do not give immediate returns. Considering the short maturity profile of Eurobonds, the manner in which the Eurobond proceeds are used in Kenya means that the debt cannot repay itself and is, therefore, unsustainable in the long term.

6 Special Audit Report on the Proceeds and Utilization of Euroboand 2019.pdf (parliament.go.ke).

Due to the short maturity profile of Eurobonds, Kenya will be faced with a concentration of maturing Eurobond obligations between 2024 and 2028 as shown in graph 1.



Major risks of Eurobond borrowing

The major risks in Eurobond borrowing include exchange risks, debt servicing burden, and misuse of Eurobond proceeds.

Allocation of Kenya's First Eurobond proceeds to Ministries, Departments and Agencies (MDAs)

Inconsistencies have plagued the government's accounting of its Eurobond proceeds' expenditure. The cost of nine projects in the energy sector were inflated-- showing overruns of nearly Kshs. 50 billion. One example is the rural electrification of public schools which reportedly cost Kshs. 34 billion rather than the budgeted Kshs. 9.9 billion.

Another example is the National Treasury report which showed that Eurobond money was received and spent in the 2013/14 financial year. But given that the Eurobond money was received in the last week of 2013/2014 financial year, it is impossible that it was spent by close of the same financial year.

Ministries, Department and Agencies (MDAs)	Amount (Kshs. Billion)
State department of Infrastructure	64.37
Ministry of Energy and petroleum	21.07
State department of water and irrigation	15.06
State department of agriculture	14.21
State department of livestock	2.50
State department of fisheries	1.24
Ministry of sports, culture and arts	1.28

Ministry of ICT	2.93
State department of education	6.21
Ministry of land, housing and urban development	9.17
State department of planning	44.57
State department of EAC, commerce and tourism	2.61
State department of science and technology	8.97
Ministry of industrialization and enterprise development	2.72

The detailed accounting of the use of the first Eurobond proceeds shown in Table 1 has been the subject of dispute by key oversight stakeholders such as CSOs, Members of the National Assembly, and non-elected leaders such the clergy and others.

The Auditor General's report also showed that two years after the allocation of Eurobond proceeds, the government could still not account for the funds; there were no records of such expenditure as first claimed by the government— displaying a lack of transparency and accountability.

OBJECTIVES OF THE STUDY

The main objective of the assignment was to formulate advocacy strategies for transparency and accountability in commercial debt borrowing and management in Kenya with a focus on the Eurobond. More specifically, the assignment involved:

i). To establish transparency and accountability standards and requirements set out in the Constitution 2010, Public Finance Management Act 2012, and Public Finance Management Regulations 2015, and any other relevant laws.

ii). Highlight the risks and identify best practice accountability and transparency standards and practices on Eurobond borrowing and management.

iii). Identify the actors and processes in the Eurobond issuance, planning, implementation, and reporting process. Assess their performance in ensuring compliance with requirements identified under (1 and 2). Identify best practices, gaps, and risks.

iv). Based on (3) make recommendations for advocacy intervention.

v). Generate a policy brief and accompanying petition.

FINDINGS

This section looks at the instances where Kenya's previous Eurobond issuances have violated Kenya's public finance and debt management legal framework as stipulated in the following areas:

i). The Constitution of Kenya 2010—Chapter 12 on Public Finance

ii). Public Finance Management Act (PFM Act)

iii). The Public Finance Management Regulations 2015 (PFMR)

iv). The United Nations Conference on Trade and Development (UNCTAD) Principles on Promoting responsible Sovereign Lending and Borrowing.

v). The actors and the process of Eurobond Issuance such as the World Bank's Guidance Note in Issuing International Bonds.

VIOLATIONS IN KENYA'S ISSUANCE OF EUROBONDS
Eurobond proceeds have been used to service loans, and finance budget deficits which include recurrent expenditure such as salaries and wages, pensions, interest payments as well as expenses for general maintenance and operations. National borrowing on Eurobond is not sustainable as evidenced by the governments' tendency to issue new Eurobonds to repay the one due. There is lack of prudent management of fiscal risks by venturing in issuing Eurobonds which are expensive commercial loans and associated with so many risks including and not limited to exchange rate risks, debt accumulation risks, high interest risks, among others.
The debt ceiling was to be exceeded in 2019 by issuing the second Eurobond, hence the government pushed the national assembly to review the debt ceiling in 2019 to an absolute figure of Ksh 9 trillion.
The first Eurobond was to issue a USD 500 million benchmarking bond which was escalated to US$ 1.5 billion, then to US$ 2 billion without any evidence of proper authorization by the national Assembly[7].
The Auditor General's report indicated that Sovereign Bond of USD 1,999,052,872.97 proceeds of Kenya's first Eurobond issue was deposited in an offshore account[8], going against the PFM Act which requires that money raised or received by or on behalf of the National Government be paid into the Consolidated Fund.
The national government expenditure reports show that information on the receipt of Eurobond proceeds has been neither clearly and comprehensively reported on nor reconciled — the numbers disclosed in different budget reports are confusing and contradictory[9]. According to the Auditor General, the government did not provide a satisfactory accounting for the use of the first Eurobond issue. To date, the Kshs.215,469,626,035.75 is yet to be satisfactorily accounted for.[10]

7 https://www.kara.or.ke/Eurobond%20Facts%20Figures%20Questions.pdf
8 https://www.oagkenya.go.ke/2014-2015-national-government-audit-reports/
9 https://www.oagkenya.go.ke/2017-2018-national-government-audit-reports/
10 https://www.oagkenya.go.ke/2014-2015-national-government-audit-reports/

Kenya went for the fourth Eurobond to settle her debt obligation estimated at Kshs. 925 Billion[11], an indication that the country had earlier borrowed to an unsustainable level; hence could not meet her debt obligations without borrowing to repay.

The fourth Eurobond was issued when global rating agencies namely S&P, Fitch, and Moody's Investor Service had downgraded Kenya's credit status due to her debt accumulation against falling revenue collection[12]. Therefore, the fourth Eurobond attracted higher premium, against the PFMA provision that borrowing be made at the lowest cost possible while ensuring that the overall of public debt is sustainable.

The sinking fund is to be used solely for debt servicing including the Eurobond. However, the National Assembly is yet to approve the fund[13]. The absence of a Sinking puts the country at a high risk of debt default especially in times of distress such as economic shocks..

Assessing Kenya's Eurobond issuance processes against international best practices.

INTERNATIONAL BEST PRACTICES IN MANAGEMENT OF EXTERNAL DEBT	VIOLATIONS IN KENYA
For middle-income countries, the recommended debt to GDP ratio has always been 50 per cent.	By end of 2021, Kenya was at about 69%, placing it at par with developed nations which borrow in their currencies.[14]
Transparency and public participation in public borrowing.	Transparency in public borrowing in Kenya is still inadequate. Public participation in public borrowing only takes place at the budget making process. This is hardly sufficient. Eurobond issuance in Kenya has not been conducted in a transparent[15] manner and there has not been any form of public participation.
Prudent use of public debt in a transparent and accountable manner.	The Auditor General announced that the Ksh. 215 billion sourced from the sovereign bond could not be accounted for two years after the borrowing[16]. The Auditor's report revealed that although the Treasury claimed that the Ministry of Water received Ksh. 11.6 billion, receipts and documentations could not be provided. The government did not provide a list of public projects funded by the Eurobond funds[17] Investigations demonstrated that the government did not deposit the funds in the consolidated Government Fund as required by the constitution but rather deposited these funds in offshore accounts. The lack of transparency in external borrowing has placed the Kenya's sovereign debt on an unsustainable path[18].

11 https://www.theeastafrican.co.ke/tea/business/kenya-goes-for-costly-eurobond-3323384
12 https://www.theeastafrican.co.ke/tea/business/kenya-goes-for-costly-eurobond-3323384
13 https://www.businessdailyafrica.com/bd/markets/capital-markets/parliament-delays-creation-kitty-for-debt-payment-3558008
14 https://allafrica.com/stories/202104120150.html
15 https://www.oagkenya.go.ke/document/summary-report-2016-2017/
16 Wafula, P. (2018). Audit: Sh215b Eurobond cash unaccounted for. [online] The Standard. Available at: https://www.standardmedia.co.ke/article/2000215138/audit-sh215b-eurobond-cash-unaccounted-for
17 Kegoro, G. (2018). Eurobond scandal puts Jubilee in a difficult situation. [online] Daily Nation. Available at: https://www.nation.co.ke/oped/opinion/Eurobond-scandal-puts-Jubilee-in-a-difficult-situation/440808-3046654-lwkpisz/index.html
18 Ibid

RECOMMENDATIONS

- **Review of the current legal framework on public debt management**
- **Strengthening the role of oversight bodies on Eurobond borrowing**
- **Establishment of a 'sinking fund' for debt repayment**
- **Extensive export promotion**
- **Legislations to promote alternative sources of funding development projects**
- **Effective and efficient national budgeting**
- **Sound macroeconomic policy with robust debt management**
- **Establish clearer and transparent government accounting procedure for Eurobond proceeds**
- **The underwriters should ensure the bonds issued follow Kenya's debt management policy**
- **There is need for the country to maintain good diplomatic relations with other countries**

CONCLUSIONS

There are clear provisions for transparency and accountability with regards to public debt management in Kenya based on conventional borrowing from multilateral and bilateral lenders.

The government has not strictly adhered to these provisions when borrowing and managing loan proceeds.

With the advent of the Eurobond, which has a unique process of issuance, current legislations need to be amended, new laws enacted that factor the uniqueness of Eurobond borrowing to enhance accountability and transparency in the process of issuance.

The Institute for Social Accountability (TISA)
P. O. Box 48353-00100, Nairobi, Kenya
+ 254 20 444 3676 / +254 757 129 700
www.tisa.or.ke info@tisa.or.ke
TISA Kenya @tisakenya

The Institute for Social Accountability

OXFAM