OKOA UCHUMI CAMPAIGN

A MEMO TO THE IMF BY CIVIL SOCIETY ORGANIZATIONS ON KENYA'S ECONOMICCHALLENGES AND PRIORITIES: 4TH REVIEW OF KENYA'S FISCAL CONSOLIDATION PROGRAM

19th January 2023

Background

This memo was prepared by members of the Okoa Uchumi Campaign, outlining issues for submissionto the International Monetary Fund (IMF) during the meeting with civil society organizations on Thursday 19th January 2023. Members of the campaign came together upon reviewing the IMF 4th Staff Review Report of the EFF and ECF arrangements of Kenya and raised issues of economic concern based on the findings of the report.

Introduction

In April 2021, the IMF officially approved the Fiscal Consolidation Program for Kenya, anchored in the Extended Fund Facility (EFF)/ Extended Credit Facility (ECF) that aims to stabilize the economy and set a basis for a resurgence of growth and shared prosperity. Upon the IMF completing the 4th review of the ECF/EFF arrangements with Kenya and releasing the staff report in mid-December 2022, the IMF Country Mission requested for a meeting with CSOs to deliberate on the progress of the IMF supported Fiscal Consolidation Program and emerging issues of concern from the findings of the review report.

According to The Annual Public Debt Management Report for Financial Year 2021/2022, the total public and publicly guaranteed debt stock in nominal terms as at June 2022 was Kshs.8,588,281 million against a debt ceiling of Kshs.10,000,000 million. This comprises external debt of Kshs.4,299,948 million and domestic debt of Kshs.4,288,333 million. The proportion of external and domestic debt accounted for 50.1 percent and 49.9 percent of the total debt portfolio respectively. The stock of public debt increased by 11.6 percent in FY

2021/22. The increase in public debt stock in nominal terms was mainly attributed to new borrowing for budget support, financing of ongoing and new development projects and exchange rate fluctuations. Against the backdrop of this fiscal position, the cost of servicing debt has ballooned. The Annual Public Debt Management Report 2022 indicates that the total public debt service has increased by 17.6 percent from Kshs.780,628 million as at June 2021 to Kshs.917,777 million as at June 2022. The treasury has recently reported that this cost is projected to cross the Kshs.1 trillion mark this financial year 2022/23 and double to 2.1 trillion in the next four years.

Kenya's Economic Situation: Emerging Issues

1. Governance and Leadership

Kenya's present national debt is the outcome of a combination of economic and governance decisions. As the new administration navigates the country through the country's difficult budgetary situation as a result of Kenya's debt concerns, governance issues must be part of the changes that will form our solution. Through evidence previously generated, the campaign maintains that Kenya's debt situation is primarily a governance problem, rather than a technical one. There is a need to strengthen oversight institutions that have a direct impact on fiscal policies, such as Parliament and the Auditor General's Office (OAG), as well as those in the criminal justice system, such as the Office of the Director of Public Prosecution (ODPP), the Ethics and Anti-corruption Commission (EACC), and the Directorate of Criminal Investigation (DCI).

Whereas the fourth review report commends the government's commitment to the fiscal consolidation program, the fight against corruption and increased fiscal accountability has not received similar commitment as the other aspects of the program. The recent dismissal of several corruption charges by the Independent Office of the Director of Public Prosecutions (ODPP) flies in the face of good governance efforts required to assuage the present economic situation in Kenya. Furthermore, the withdrawals have an impact on the efforts towards accountable governance, particularly around openness and accountability of key processes such as public finance management, and the attendant redress measures which include sanctions on corrupt actors.

2. Illicit Financial Flows and Asset Recovery

Illicit financial flows (IFFs) cause financial bleeding, which has a detrimental impact on revenue generation/mobilization. The campaign intends to ascertain the extent to which the fund is investigating the problem of IFFs and their impact on debt and income generation in Kenya. The National Risk Assessment on Money Laundering, released just before the August 2022 General elections, examines significant risk areas where proceeds of crime and corruption may be invested in order to disguise them, and in situations where the funds have been stolen, the recovery procedure should be enforced. The IMF should continually press the Kenyan government to put current anti-corruption laws into action.

3. Transparency and Accountability

We are particularly concerned as a Campaign, with the rampant withdrawal of integrity cases involving high profile individuals appointed by the new administration. This contradicts the governments' commitment towards accountable governance, especially with likelihood of there being political interference particularly with the horizontal oversight institutions. This is a huge step backwards considering the progress that has been made towards bolstering transparency and accountability frameworks in the recent past.

Additionally, auditor general reports still come later than scheduled, making it difficult for agencies to have current information on the state of public expenditure. We urge the IMF to pile pressure on the Kenyan government, to provide the needed operational support to the two oversight institutions namely: the Office of the Auditor General (OAG) and the Office of the Controller of Budget (OCB), with a view to improve their constitutional mandate, and reduce the delay in their reporting.

Additionally, the OAG has in the recent past adopted the Citizen Accountability Audit framework, which aims at enhancing citizen participation in audit accountability processes by the independent office. These developments are welcome, and we hope to see a similar framework adopted for the bilateral aid engagements between the IMF and the Kenyan government, noting that citizens are the eventual beneficiaries of development support received by the Kenyan government, and therefore ought to have a stronger voice in processes that lead up to this, including the current Fiscal Consolidation program.

The IMF Fiscal Transparency Code (2019) requires that ***fiscal reports should provide a comprehensive, relevant, timely, and reliable overview of the government's financial position and performance***. However, this is not the case in Kenya. Whereas the IMF, under the fourth review, indicates that the Government of Kenya met the program quantitative and fiscal targets by large margins, a lot is left to be desired when it comes to transparency by the government. IMF has been keen on ensuring that the government adheres to certain principles, but it falls short when it comes to matters related to transparency and accountability. According to the Open Budget Survey 2021 conducted by International Budget Partnership, Kenya had a score of 50/100 when it comes to transparency. This is interpreted to mean that there is limited information available and is a clear indication that the government has a long way to go when it comes to the level of transparency.

The Okoa Uchumi campaign would seek to know which office within the IMF has the sole responsibility of pushing and following up on transparency and accountability even as the fiscal, quantitative, and structural agenda is being pursued actively. Therefore, we call upon the IMF to be clear on the specific steps that have been taken towards ensuring that the government adheres to the Fiscal Transparency Code (2019). In addition, there needs to be clear and regular updates on the progress and possibly repercussions of non-adherence to the Code.

As a campaign, we acknowledge the progress made. However, there are an array of issues that are of concern for instance:

- Lack of action regarding the Office of the Auditor General's report on Covid-19 spending.
- The commitment towards Beneficial Ownership Transparency has not been fully implemented as this is an incentive for procurement fraud.
- The need to ensure Fair taxation, in the context of overperformance of tax revenues as outlined in the 4th review of the IMF report.
- The pronouncement that Kenya's debt is sustainable at 62% of GDP in present value terms whereas on ground, the cost of servicing debt is on the rise with the National Treasury announcing that debt servicing will cross the Kshs.1 trillion mark in the financial year 2022/23 and double to Kshs.2.1 trillion in four years.

- The commitment by the new regime to anchor a number of its economic growth priorities under the PPP (Public Private Partnership) model is welcome. However, this will require stringent guardrails to prevent corruption through reduced transparency in the agreements, as seen in previous arrangements such as the SGR & the Nairobi Expressway PPP frameworks, both of which have been marred by a lack of fiscal transparency.

4. Fiscal Consolidation

Kenya is at a high risk of debt distress, and we appreciate that reducing debt vulnerabilities is a central goal of the IMF-supported program. However, in a bid to reduce debt vulnerabilities by increasing the tax revenues and reducing government spending, there are some issues that need to be considered as they have negatively impacted the lives of citizens. First, the increase in taxes on basic commodities has significantly increased the cost of living for most Kenyans who are already vulnerable. This is pushing more Kenyans into poverty. The government has stated that the cost of living is set to go higher before it eventually stabilizes. But even as the government calls upon Kenyans to brace themselves for increase in the cost of living, they should put in place measures to cushion those who are adversely affected.

Secondly, there has been talk of budget cuts by KES 300 billion from the budget. It is still not clear what this will mean. What impact it will have on social services and in particular, social protection. Kenya is currently faced by drought amid the high cost of living and therefore it will be important for the government to clearly demonstrate their commitment towards alleviating the challenges faced by Kenyans.

Thirdly, the fourth review mentions that the Government of Kenya has outperformed in some of its fiscal consolidation objectives set out in 2021. Specifically, it mentions an overperformance of tax revenues. However, it is not clear on the specific effect that this has had on Kenyans, especially the most vulnerable among us.

5. State Owned Corporations

Structural Reforms in the State-Owned Enterprises (SOE) have been underway over time. However, there remains little to no information on the progress of this process. In the FY 2020/2021, the state corporations took up about 28% of the government budget. This is a significant portion of the government budget, and we must pay attention to it. It is important to note that the number of the SOEs has also been on the increase, amidst the conversations on needed reforms.

Therefore, we call for transparency and publication of the information surrounding the reforms taking place. In addition, in 2021, the Auditor General reported that there was no information of the details of government guarantees to key state corporations such as Kenya Airways, KENGEN, KPA and KPLC. Transparency related to the management and reforms in SOEs cannot be overstated.

6. Medium Term Revenue Strategy

The government is set to develop a Medium Tern Revenue Strategy to guide its revenue mobilization efforts. Some of the identified areas for reform include enhancing tax compliance, broadening the tax base and improving tax administration. A key source of revenue leakage has been generous tax exemptions that in some cases have not been guided by clear policy goals. According to the Tax Expenditure Report 2021, Kenya forgoes about 318.3 billion worth of revenues. This amounts to 2.96% of GDP. The main beneficiaries of such exemptions are Multinational corporations, who are among the wealth holders in the country. Further, tax evasion by unscrupulous business owners result to significant revenue loss. Therefore, a comprehensive evaluation of Kenya's tax exemptions and incentives should be conducted to eliminate redundant tax expenditures for enhanced domestic mobilization. In addition, the tax expenditures report as currently produced lack critical information such as who are the ultimate beneficiaries of tax exemptions. This then may mask the real cost of tax exemptions, which have contributed greatly to revenue lost each year.

7. Domestic Debt

The government is currently shifting its borrowing policy in favor of domestic borrowing. The government proposes a 68:32 ratio of domestic to external debt. This comes at a time when the Kenyan economy is faced with global economic shocks. Increased domestic borrowing can potentially crowd out the private sector and is associated with high cost of debt servicing. Lengthening the maturity period of domestic debt from the current average maturity period of 7.9 years reported in the 2022 Annual Public Debt Management Report could ease pressure from the high cost of debt service.

On point 12. page 12 of the fourth economic review report, states that Kenya's debt is sustainable but overall and external ratings for risk of debt distress remain high (DSA).

As a campaign, we raise the following concerns:

i. Civil society and national treasuries have always contested IMF debt sustainability classifications mainly because of methodology and different debt indicators used. National governments through their ministries of finance and central banks have always carried their own debt sustainability analysis independent of IMF using their own economic data sets and political economy analysis etc. CSOs have always argued for the use of social indicators such as debt service ratio to the national budgets, spending on interest payments, education, health etc. to anchor debt sustainability analysis (DSA). The IMF will always defend their classification. It's unfortunate that investors use IMF economic analysis to make their investment decisions and rarely national or CSO economic analysis. Issues around liquidity challenges and broader global crises needs to be taken into account when doing DSA). In addition, looking closely at the political economy lens, the bottom line is that the IMF DSA ratings – as widely acceptable and referenced as they are - must not be accepted uncritically and with alternatives.

ii. The report says Kenya's debt is sustainable albeit with elevated risks of distress – but only at a granular level of analysis. The present value of Kenya's debt is expected to reach about 67 percent of GDP, but this is 17 points above the regional convergence criteria which is about 50 percent of the East African Community. This itself is not acceptable. A further point of controversy in the DSA is that it works with indicators and granular analysis which do not immediately capture what is the actual effects of the current debt burden on citizens faced with rising inflation, and an increased cost of living vis-à-vis slow growth in household incomes. This is to say that DSA is not a true reflection of the current experience of citizens which should be the central issue in government policy on debt.

iii. This also brings us to another question on how well and how fast the current ratings considered sustainable, can provide the government of Kenya with adequate fiscal space to not only turn around the fruits of growth but to also continue to service its debts while meeting its commitments to Kenyan citizens all of down the road without actually running into debt distress. Somewhere in pages 8 and 9 of the report, it is indicated that the country runs on a negative fiscal and current account balance which is projected to continue beyond 2023 and indicates some of the stress factors that are likely to push the country down the path of debt default. In this case, the DSA analysis is only to be accepted cautiously – especially with more alternative scenarios beyond just DSA.

iv. We note that ddeveloping countries have a right to restructure their debts whenever they encounter challenges. For decades Civil society have called for establishment of global debt mechanism to protect indebted countries. The Common framework is work in progress and Kenya have a right to apply for it when need arise. Slowly the powers behind the current flowed global financial debt architecture are warming up for its reform.

v. budget statements should always be accompanied by debt data. The budget deficit in most African countries is always funded through debt both domestic and external. Citizen budget consultations in our view sanitize lack of proper and structured participation by citizens directly, although parliaments indirectly represent citizens. What's important is for the budget to reflect citizens priorities and fund sectors that have impact on their lives – health, education, agriculture).

8. Revenue Targets and Progressive Taxation

We commend efforts by the government to increase the fiscal space and improve tax revenues. However, we note with great concern the progressivity of the revenue raising strategy by the Kenyan government driven by the fiscal consolidation obligations. For instance, there has been an increase in consumption taxes such as excise duty which have targeted vulnerable groups. This negates the repricing role of excise duty taxes that were meant to limit consumption of harmful and luxury goods. Majority of Kenyans are still yet to recover from the compounding global crises that has had a major impact on the cost of living and therefore it is important that the government distributes the burden of taxation equitably. We propose the introduction of wealth taxes to meet the government revenue targets and to shift the yoke of taxation to those with the ability to pay. A study conducted by Oxfam shows that the introduction of annual wealth taxes could serve as a key solution to addressing extreme wealth and resource mobilization. According to the report, if a net wealth tax was introduced in Kenya at rate of 2% on the millionaires worth above \$5 million (Ksh615 million) and 3% on those with wealth above $50 million (Ksh6.15 billion) the revenue potential could be $731 million (Ksh89.9 billion) a year. This would be enough to hire 100,000 teachers in public primary and secondary schools and more than 38,000 nurses to close the teachers and nurses' gap in the education and health sectors.

9. Quality of IMF Engagement with Civil Society Organizations

IMF has engaged with Kenya CSOs over time on the facility extended to the Government of Kenya. Specific issues have been raised over time but there doesn't seem to be commitment from the government to address the issues raised. Whereas the IMF seems to be the middle ground on this engagement, there needs to be a progress report that documents the status of the issues raised by CSOs, and the steps taken by government to address those specific issues. Otherwise, there runs a risk of consistent engagement with CSOs just as a routine as opposed to more meaningful engagement that bears fruit.

10. Feasibility of IMF Conditionalities

As a campaign we have concerns over the viability of the IMF conditionalities. Being a developing country, we are of the view that focus on economic growth is the way to go as opposed to austerity route which from our analysis of the fiscal consolidation program, has had dire impacts on the economy. Cuts in social sector spending at a time when there is a multiplicity of crisis has had adverse impacts on the standards of living. Cuts in public sector employment and financing of social safety nets have resulted in the denial and infringement of economic, social and cultural rights particularly for marginalized groups or those at the risk of marginalization. We therefore call on the IMF to suspend austerity on existing loans and increase access to emergency financing.

About the Okoa Uchumi Campaign

The Okoa Uchumi Campaign [1]is a civil society platform that seeks to push for the accountable redress of Kenya's public debt crisis through engagement in the policy and political arena pushing for political accountability and bolstering constitutional safeguards in public debt management[1]. It is a platform for coordination of civil society engagements in the public debt management processes that articulate the shared concerns, demands and proposes solutions around Kenya's Public debt management as well as influencing public discourse on public debt through media and other engagements.

Okoa Uchumi traces its inception to the concerns raised by Kenyans of all walks of life, on the lack of accountability in the management of public debt in Kenya which has triggered an economic crisis, marked by the unbearable cost of living, high unemployment, and rising poverty, all which impact Kenya's poorest the most vulnerable including women. The campaign is spurred by a deep concern about the state of the Kenyan economy on account of imprudent management of public debt and the individual corrupt interests that have fueled the acquisition of costly and imprudent debt, driving Kenya into a debt crisis and deepening poverty and inequality.

This memo was prepared by The Institute for Social Accountability (TISA), Institute of Public Finance (IPF), Oxfam in Kenya, African Forum and Network on Debt and Development (AFRODAD), International Budget Partnership-Kenya (IBP) and Transparency International- Kenya.

[1] **Coalition Members:** Oxfam in Kenya, The Institute for Social Accountability, Institute for Public Finance Kenya, International Budget Partnership Kenya, Interreligious Council Kenya, Kenya Human Rights Commission, National Taxpayers Association Kenya, Okoa Mombasa, Transparency International Kenya, National Democratic Institute, Mzalendo, Crawn Trust Kenya, Diakonia Sweden, Diocese of Lodwar, PAWA 254, Fight Inequality Kenya, Social Justice Centres, Kenya Tuitakayo Movement, ICJ – Kenya, Christian Aid Kenya, Katiba Institute, Tax Justice Network Africa, Access Coalition, Inuka Kenya, Kenya Civil Society for Oil and Gas.