‘I Don’t Understand Why Kenyans Are Broke’: Mr. Kenyatta’s Debt Distress Revisited

By David Ndii

In 2018, following the Raila-Uhuru détente we call the handshake, I went against the grain and argued against the anti-corruption campaign that ensued. My reasons were simple enough; Uhuru and Ruto were jointly culpable for the administration’s corruption, hence my contention that the fight against corruption was being politically weaponised. I postulated that politicising the war on graft would blow back on the handshake (it has).

I voiced my concerns both publicly and privately. The response I got was that the anti-graft drive was strictly economic, and not political, motivated by the realisation that the government was hurtling towards a financial crunch. Different people on both sides of the handshake deal mentioned the figure of Sh300 billion, which they claimed was the amount that could be saved by stopping graft. I tried to explain the nature of the crisis that was unfolding but no one wanted to hear that fighting corruption was not the silver bullet. Heads were firmly in the sand.

The Sh300 billion figure cropped up again a few weeks ago, this time as the amount of tax payments that are in dispute. It was disclosed that the government is proposing legislation that will require the disputed figures to be paid up front. It does not take much imagination to see how such a law could be abused. A government as desperate for cash as this one can make inflated tax assessments—which tax one has to pay first and ask questions later—while also opening another avenue for tax officials to extort taxpayers. It can be used for political persecution or to cripple competitors and businesses targeted for acquisition by our rapacious crony capitalist cartels.

Why is the government clutching at straws? Let's have a look at the finances. The government plans to spend Sh2.6 trillion in the current financial year (2019-2020). It plans to finance this spending through domestic revenue to the tune of Sh1.88 trillion (Sh1.81 trillion tax and Sh70 billion non-tax, respectively), Sh701 billion of debt, and external grants of Sh19.5 billion. Of the Sh701 billion of debt, it plans to borrow Sh434 billion domestically, and Sh267 billion from foreign lenders—comprising of Sh200 billion in commercial debt and the balance of Sh67 billion in soft loans from development lenders.

Let us put some perspective to these numbers. Over a quarter (27 per cent) of the budget is debt-financed and 90 per cent of this debt will be commercial—30 per cent from foreign lenders and 60 per cent from the domestic market (we often overlook the fact that domestic debt is commercial). The Jubilee administration has been doing this for six years running. When it took office, we had a single $600 million foreign commercial loan, which was paid off using the first Eurobond issue. Today, a third of our foreign debt amounting to $10 billion is commercial. The administration justified the $2.8 billion debut Eurobond issue, the largest African issue to date, on the promise that it would replace domestic borrowing, thereby leaving domestic credit to the private sector and reducing interest rates. It did not. Instead, the administration ratcheted up domestic borrowing as well and crowded out the private sector completely. It is also worth reminding ourselves that the proceeds of that Eurobond cannot be accounted for.

The Sh701 billion deficit translates to the government spending 37 per cent more than its income. This is like a Sh30,000 earner who has just acquired a credit card deciding that she can afford to live large by spending Sh40,000 a month. Now, let us assume that the credit card charges 15 per cent per year, and requires 5 per cent repayment of the outstanding principal every month. A year down the road, the monthly debt service will be in the order of Sh7,500, which is not too bad as she will still be spending Sh2,500 more than her salary after debt charges. But four months later the debt service charge will start eating into her salary and by the end of the second year, she will be paying Sh15,000 in debt charges a month and owing Sh. 240,000. If she were to run into a credit limit at that point, she would have to live on Sh. 15,000 a month— half her salary—and her lifestyle will definitely have to change drastically.

This scenario will be familiar to people who have abused credit cards. It is the situation we are in—six years of abuse of the national credit card. For the country, it is unprecedented; we are one of the few African countries that escaped the 1980s-90s debt crisis that was resolved by the Highly Indebted Countries Initiative (HIPC). But I gather that this is not the first time that the bloke at the helm has over-swiped.

Many Kenyans have been wondering why we are told that the economy is growing at a brisk 5 to 6 per cent year after year, yet they are not feeling it. Instead, big companies are issuing profit warnings and laying off people. A related question is why government revenue is falling short when the economy is supposedly booming. Under Jubilee, the tax revenue as a percentage of GDP has declined from 18 per cent to 15 per cent, the lowest level since the 90s. The three percentage points difference is, surprise, surprise, Sh300 billion.

Jubilee has increased our public debt threefold over the last six years, from Sh1.8 trillion to Sh6 trillion and counting. Unlike our consumer, however, the government will argue that its debt has been invested. But investments are risky, or long term. Moreover, you don't borrow short-term to invest long-term as the government has been doing. If you do, the debt repayments eat into the working capital, and you will soon be defaulting on your suppliers, as the government is doing.

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Government borrowing is predicated on the expectation that the projects financed will stimulate productive investment that will in turn generate tax revenues to service the debt. But very little of this debt has yielded any economic benefits that would in turn generate tax revenues. The Standard Gauge Railway (SGR)—the largest of these projects—has not stimulated any new economic activity. Much to the contrary, all it has achieved to date is to disrupt port logistics and road haulage while increasing costs and inefficiency for importers. Right now, its net economic contribution is negative. All indications are that the Galana-Kulalu irrigation scheme is a white elephant, and we know for sure that the economic contribution of the Arror and Kimwarer dams is zero.

Moreover, the government shoots itself in the foot by awarding the construction projects to foreign—predominantly Chinese—state-owned firms. This undermines revenue in two ways. First, the companies are exempted from paying tax. Second, the money they make is repatriated, denying the economy the multiplier effect it would have if the money had been earned by domestic firms. I gather that Uhuru Kenyatta was banging tables the other day demanding to know why Kenyans are broke, how come the money spent on government projects is not circulating in the economy.

Let us take his flagship project, the SGR. The man went and swiped the national credit card and the Chinese delivered the goods. The money stayed in China, debited from our loan accounts in the Chinese banks and credited to the suppliers' bank accounts. We are paying the loans from our pockets. This year, we've budgeted to pay the Chinese banks Sh94 billion, up from Sh39 billion last year. Far from circulating it in the economy, foreign debt-financed government projects are draining money from the economy.

Thus, although the data shows that the economy is growing, the tax base is not expanding and revenue is falling short as debt service charges are rising. While tax revenue has just about doubled under the Jubilee administration, from Sh900 billion in the 2012-2013 financial year to Sh1.49 trillion in the last financial year (2018-2019)—translating to 15 per cent per year—interest payments have increased three-fold from Sh93 billion to Sh390 billion, translating to 52 per cent per year. Consequently, from consuming 12 per cent of revenue, interest payments have risen to 26 per cent. It should not come as a surprise that the government is having trouble paying suppliers. It is also noteworthy that the increase in the cost of interest payments is in the order of—here we go again—Sh300 billion.

Last year the government projected that it would raise Sh1.77 trillion in tax revenues, later revised downwards to Sh1.67 trillion. It managed to raise 1.5 trillion, respectively Sh270 billion and Sh170 billion short of the approved and revised budgets. Still, it budgeted to raise Sh1.8 trillion in 2019. At the end of the first quarter of this year the government had raised Sh372 billion. If the trend remains, Sh1.49 trillion will have been raised—about the same as last year—a shortfall of, well, Sh300 billion.

If the government were to borrow the whole amount this would increase debt financing to a trillion shillings, that is, 38 per cent of the budget or 67 per cent of revenue (remember that revenue is projected at just about Sh1.5 trillion). If it were to borrow domestically, that would also suck in the little credit that is trickling to the private sector. Moreover, the interest rate caps imposed three years ago have now been removed. The caps were meant to benefit private borrowers but the only beneficiary was the government—enabling it to borrow while postponing the political price that would have been exacted had interest rates surged to the mid-20s—as they would have. But the economy has paid the price because, by making it difficult for banks to price risk, the rate caps made the government's crowding out of the private sector in the credit market more severe than it would have otherwise been.

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With the caps removed, the government's excessive appetite for debt will now put upward pressure on interest rates, including the government's own cost of domestic borrowing. The math is eye-popping; the government's domestic debt is in the order of Sh3 trillion. A one percentage point increase in the cost of borrowing translates to a Sh30 billion increase in interest expenditure. How quickly an interest rate rise is transmitted into actual cost depends on the structure of the debt—the more short-term, the faster. Jubilee has done a good job of borrowing at the short end of the market, and so transmission will be relatively quick. The exchange rate presents a similar conundrum. The annual servicing of external debt is in the order $2.5 billion, and a depreciation by one shilling translates to a Sh2.5 billion increase in the cost of servicing the debt. It should come as no surprise then that the IMF's contention that the government is propping up the shilling raised a furore.

Belt tightening is the sensible thing to do when a person or a business is over-indebted. For governments it is a little more complicated. The government is the single largest entity in the economy, and what it does has feedback loops that can amplify the problems it is trying to solve. The problem we have now is that the economy has become addicted to expansionary budgets. Five years ago, government expenditure accounted for a fifth of annual GDP growth, meaning that when growth was reported at 5 per cent, it meant that the private sector accounted for 4 per cent and the government for 1 per cent. Today, the share of the private sector is down to 3 per cent and the government's share has doubled to 2 per cent. In effect, belt tightening has to contend with the economy suffering withdrawal symptoms—a weakening economy feeding into an even bigger revenue shortfall, requiring even more belt tightening.

This whole conundrum is how countries end up in a Greek-style downward spiral of a contracting economy and ballooning indebtedness. The case of Mozambique is instructive. Before the "tuna bond" scandal unfolded**,** Mozambique's economy was roaring at 7 per cent per year, riding on post-conflict reconstruction and the discovery of huge offshore natural gas reserves. The loan sharks moved in. In 2013 Mozambique borrowed $2 billion—equivalent to a third of the budget—in privately placed bonds known as "loan participation notes" to finance a tuna fishing fleet and maritime security, of which only $850 million was made public. It has recently emerged from a fraud and money laundering court case in New York that at least $200 million was stolen and shared out between the investment bankers and Mozambique's who's who, including the finance minister and the president's son.

In early 2016, Mozambique defaulted on interest due on the $850 million. Shortly thereafter, the secret loans were exposed. Money dried up. By the end of the year, the currency had fallen 40 per cent, causing the debt-to-GDP ratio to increase from 55 per cent to 120 per cent. Everything unravelled. Serial defaults and debt restructuring became the order of the day. Growth tumbled to 3.3 per cent last year and is now down to just over 2 per cent. It is going to be a long and painful climb out of the mess.

Which brings me to the question that many people are asking: what is the solution? I have opined that our debt distress will be resolved by one of two scenarios: the Ethiopia or the Sudan scenario.

This is why:

To dig ourselves out of the debt quagmire requires four things. First, you need a dollop of cheap money to cushion the economy and vulnerable groups as the government withdraws from domestic borrowing so as to release credit to the private sector, restructure government finances, and rebalance the economy more generally. My guesstimate is a minimum of $3 billion (yes, Sh300 billion!) to $4.5 billion. The only source of such money is an international bailout. Second, to get financiers to buy in, you need a bankable plan. Third, you need a credible turn-around team to implement it. It is not a job for yes-men and yes-women—you need people who can stare down Kenyatta and his crony capitalist cartels. Fourth, economic turnarounds entail making tough unpopular decisions and pushing through painful reforms, and that requires political goodwill. It is not the sort of thing you can do with the 2022 political warfare raging—as we witnessed it in the Kibra by-election.

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This is the situation that Ethiopia found itself in two years ago when the Ethiopian Peoples' Revolutionary Democratic Front (EPRDF) coalition realised that only a leadership change could save it. Fortunately for Prime Minister Abiy Ahmed, there was a lot of low-hanging political fruit—releasing political prisoners, making peace with Eritrea, appointing women— that he could use to build goodwill, bring in some money and buy time. Still, that's all he's been able to do— he is still circling the big economic reform questions, and he now runs the risk of his political honeymoon ending before he gets started.

Sudan's Omar al-Bashir sought to do the same thing but it was too little too late. Just over a year before he was toppled, amid mounting protests and a deepening economic crisis, he dissolved the government, intending to constitute an economic turn-around team. But the ship of state was already too leaky and his key appointees turned down his overtures (his choice of finance minister is now Prime Minister).

Can the Jubilee administration pull a political rabbit out of the hat like the EPDRF did in Ethiopia? Doubtful. For one, the EPRDF had the advantage of a parliamentary system which enables change of leadership without going through elections. But it is also the case that for a President at the tail end of his tenure, an economic reform programme would be all pain and no gain. Moreover, a lot of what needs to be done means reversing his policies, and he would have to cede a fair amount of power, making him even more of a lame duck than he already is. And having left it until the ship was leaking, there is also the question of who loves him enough to jump in when its owners—the Moses Kurias of this world —are jumping out. So his best strategy is the path of least resistance—kick the can and hope and pray that the bottom does not fall out this side of the election, be that by way of a financial meltdown or people taking to the streets.

Five years ago, I cautioned Jubilee that it had embarked on a reckless fiscal path, to wit, "We cannot afford to continue on the fiscal path that we are on. It is reckless. This mega-infrastructure madness has to stop. If we don't do it ourselves, the iron laws of economics will do it for us—and that, take it from me, does not come cheap."

We say in Gikuyu *mũrega akĩĩrwo ndaregaga akĩhetwo*: a person who rejects counsel will listen when the consequences arrive. That moment is upon us.

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