

**AN EVALUATION OF THE STRUCTURE AND  
SERVICING OF KENYA'S PUBLIC DEBT**

**BY**

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**A management project submitted in partial fulfillment of the  
requirements for the Degree of Master of Business and  
Administration (MBA), Faculty of Commerce, University of  
Nairobi**

**AUGUST 2002**

DEDICATION

DECLARATION

This Management Project is my own original work and has not been presented for a degree in any other university.

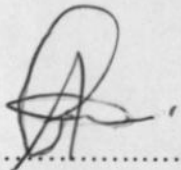
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This Management Project has been submitted for examination with my approval as the University Supervisor.

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## ACKNOWLEDGEMENTS

This study, in its present form, has been made possible by a number of people and institutions to whom I am greatly indebted and to whom I would like to express a lot of gratitude.

To my supervisor, Mrs. Angela Kibuka, I extend my very sincere thanks for her guidance, suggestions, comments, criticisms and her constant encouragement throughout the period of this research project.

I am grateful to the University of Nairobi, the entire academic staff of the Faculty of Commerce and my colleagues in the MBA Class for their contributions

to the success of this project. **To my Husband,**

In addition, I wish to thank **Daughters and Sons** African Economic Research

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I also extend my sincere gratitude to a special member of my family, my husband, for his moral, material and emotional support from the inception of the research to the final stage of this project.

Finally, I wish to thank the rest of my family, my friends and all other people who contributed in their own way or another. Thank you all!

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## ABSTRACT

The aim of this study was to determine the structure and servicing of Kenya's public debt; whether an association existed between internal and external government debt; and the ability of Kenya Government to service its debt.

The study used secondary data from documents of the Kenya Government and the Central Bank of Kenya and the data collected was analyzed using trend series and financial ratios adapted from debt and debt servicing indicators used by the World Bank and the Maastricht Treaty of the European Union . The major conclusions reached are set out below.

- (a) More than 50 percent of Kenya's public debt was on concessional terms and the fact that a larger proportion of debt servicing went to service domestic public debt is an indication that public debt in Kenya had been poorly managed.
- (b) Levels of external public debt were positively associated with levels of domestic public debt servicing.
- (c) Over the last twenty years of the study period, Kenya was severely indebted and was therefore not able to service her public debt without resorting to rollovers of domestic public debt at higher interest rates.

The study recommended that the Kenya Government should take measures to stimulate productivity, improve revenue collection, restructure its debt and, institute a sound public debt management strategy. The study also called upon the developed countries to open up their markets to Kenyan goods.

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## ABBREVIATIONS

AERC	African Economic Research Consortium
CBK	Central Bank of Kenya
GDP	Gross Domestic Product
GNP	Gross National Product
GOK	Government of Kenya
HIPCs	Highly Indebted Poor Countries
IMF	International Monetary Fund
SAP	Structural Adjustment Programme
SSA	Sub-Saharan African

## CHAPTER ONE

### 1.0 INTRODUCTION

#### 1.1 Overview

From 1963 to 1973, Kenya's economy grew at impressive rates, with the Gross Domestic Product (GDP) expanding at 6.6 percent per annum (GOK, 2002). This was mainly due to agricultural output, among other reasons. The Government was a net saver with budget surpluses of 2 to 4 percent annually (GOK, 1994). The surpluses supported investment and, as a result, public debt was very low. This situation changed between 1974 to 1979 when Kenya, like other Sub-Saharan African (SSA) countries, was affected by the economic slowdown due to the oil price shock of 1973 that made oil prices very costly to the non-producing developing countries. As a result, Kenya's economic growth rate slowed down to below 4 per cent for much of the seventies. Determined to stimulate its economy, Kenya, like other developing countries, borrowed from foreign sources. Borrowing was made easy by the fact that banks in the developed countries were awash with deposits from oil producing countries.

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Kenya was fortunate with the coffee boom of 1976 to 1978 which saw the GDP growth rate rise to 8.2 percent in 1977. The proceeds from this boom were, however, used to create public enterprises with the aim of stimulating economic growth (Wagacha et al, 1999). This expansion resulted in an over-extended public sector that in later years became unproductive and unsustainable and had to be supported by public debt.

For some years developing countries, Kenya included, rolled over their debts as they fell due. However, the collapse of oil prices in 1979 and sharp increases in interest rates led to Mexico's debt default in 1982 (EcoNews Africa, 1999) which in turn made banks in industrialized countries to become cautious in their credit dealings with developing countries. As a result, the developing countries could no longer roll over their debts. At around the same time commodity prices collapsed in the world markets due to a fall in demand, pushing developing countries to grow deeper into debt. From 1982 to the present, despite efforts to reduce their external debt, developing countries debt levels and debt service payments continue to be severe and remain impediments to the socio-economic development (EcoNews Africa, 1999).

Kenya's public debt situation has been made worse by the rising domestic debt (Wagacha et al). Decline in foreign grants and net government external borrowing, coupled with insufficient growth in exports, gave rise

to debt arrears (GOK, 1994) and Kenya turned to domestic borrowing partly to pay the arrears. These factors, and others, adversely affected Kenya's economic growth which declined to 2 percent between 1996 to 2000 (GOK, 2002).

## **1.2 Why Governments Raise Debts**

Most governments, both in the developed and the developing countries, including Kenya, raise public debt for different purposes. These include financing a deficit budget when expenditure exceeds revenue; managing a sudden spurt in government expenditure caused by calamities such as floods or famine; financing public enterprises and utilities; regulating the economy; and achieving a variety of objectives, including those of economic growth and stabilization.

Economic growth has been one of the main reasons why developing countries raise external public debt. This is due to the fact that most governments in developing countries are poor and are therefore not net savers. In addition, the technology required for economic development has to be imported and paid for in foreign currency which is generally raised from exports of mainly primary products, such as coffee and tea. Developing countries may also lack expertise to implement some projects as was prevalent immediately after independence when developing

countries obtained foreign aid in the form of technical cooperation. For example, in Kenya, a high proportion of bilateral grant and aid was devoted to technical assistance in 1970s (O'Brien, 2001).

Public debt has, however, its limits because it stimulates growth only up to a point beyond which it impacts negatively on growth. Current debt inflows stimulate growth while past debt accumulation impacts negatively on growth because it is a drain on the domestic resources through debt service payments and may result in debt overhang. Debt overhang refers to the existence of a large debt which cannot be serviced and therefore has adverse consequences for investment and growth because investors expect that current and future taxes will be increased to effect the transfer of resources to holders of government securities (Elbadawi et al, 1997). Investors are, therefore, discouraged from investing because they see their efforts as only benefiting the holders of government securities. Debt overhang is the result of high levels of debt service due to very high levels of debt accumulation, or debt maturity dates that are concentrated around a particular period. This may be a result of poor debt management because with proper debt management, both the level and the composition of debt may be controlled within limits that may be serviced with ease.

### 1.3 Statement of the Problem

In the developed as well as the developing countries, government expenditure rarely equals its revenue. Consequently, most governments are forced to raise public debt. For developing countries, the problem is compounded by the fact that most governments are not net savers, implying that public debt may be burdensome to the economic growth of those countries. The extent of the burden with respect to external debt will depend on several factors, including the terms and conditions of debt servicing, the creation of export capability and the productive capacity of the country. Internal debt may also be burdensome in that it may lead to income and wealth inequalities; may have inflationary impact; and its effect on budgetary maneuverability by the government may have adverse economic implications (Bhatia, 2001).

Up to 1972 when the economy of Kenya was agro-based, public debt was very low. However, the urge to industrialize the Kenyan economy in order to stimulate economic growth, among other reasons, led to the increase in public debt (Wagacha et al, 1999). In June 2000, the total public debt stood at K.shs.559,099 million out of which Kshs.163,405 million was domestic public debt (CBK, 2001). The decline in grants and net government borrowing, coupled with insufficient growth in exports gave rise to debt arrears (GOK, 1994). To pay these arrears Kenya was

forced to turn to domestic borrowing, thereby increasing domestic debt and causing total public debt to stand at 83 percent of GDP by June 2000 (CBK, 2001).

Kenya is among a group of low-income, highly indebted poor countries (HIPCs), most of which are in Sub-Saharan Africa (SSA), which have continued to experience serious difficulties in managing the servicing of their relatively high debt (World Bank, 1996). In fact, according to Ng'eno (1997), Kenya is among the severely indebted low-income countries and was considered by the World Bank in 1994 to have not only a high liquidity problem but also a large debt overhang. This may possibly indicate an aspect of poor management of public debt. Consequently, an in-depth evaluation of the structure and servicing of the public debt in Kenya is necessary. More so, there is need to establish whether an association exists between internal and external government debt and to assess whether the government is able to service its public debt.

#### **1.4 Objectives of the Study**

The main objective of this study is to provide a better understanding of the structure and servicing of Kenya's public debt. Its specific objectives are to analyze the structure of Kenya's public debt, to establish whether there

is an association between internal and external public debt and to assess the debt servicing capacity of the Kenya Government.

### **1.5 Importance of the Study**

This study will be important to public debt managers, government policy makers, donors and academicians.

As outlined above, public debt may promote or be burdensome to the economic growth of a country. It is therefore important that those charged with the responsibility of managing public debt are conversant with the principles and concepts of good public debt management so that they may incorporate these when they manage public debt and, as a result, public debt in Kenya may be managed efficiently and effectively to the advantage of the whole Kenyan economy.

Debt management influences and is influenced by fiscal and monetary policies and the balance of payments (Commonwealth Secretariat, 1999). Debt management should therefore be integrated into an overall strategy that is appropriate for a country. Policy makers need to be well equipped with public debt knowledge so that they are able to integrate debt management when they are formulating fiscal, monetary and balance of payment policies.

Donors are generally interested in assessing the ability of a prospective debtor country to service its public debt before the debt is actually disbursed. To this end, Kenya's prospective donors should find the study useful.

This study will add to the body of knowledge in public finance and the implications of deficit financing.

### 2.2 Structure of Public Debt

Debt raised in a country, can be categorized as public or private debt. Public debt, also known as national debt (Jirgen, 2007), is raised by a government or its agents, or by individuals but guaranteed by the government. Private debt, on the other hand, is raised by individuals, including companies.

Public debt can be classified according to its source, status of donor, maturity structure or terms of interest rate. Public debt according to its source, refers to whether the debt is raised by the residents of a country or by the residents of foreign countries. Public debt that originates from the residents of a country is known as domestic or internal public debt while that which originates from outside

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## CHAPTER TWO

### **2.0 LITERATURE REVIEW**

#### **2.1 Introduction**

The main aspects of public debt addressed by this literature review include the structure of public debt; public debt burden; causes of high levels of public debt; and public debt indicators.

#### **2.2 Structure of Public Debt**

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the country is known as external or foreign public debt. Within the domestic debt category is investment by foreigners in the domestic instruments of a government where the government becomes indebted to foreigners in its own currency.

Internal sources from which a government can borrow include the purchase of public bonds by non-banking financial institutions like insurance companies, investment trusts, mutual funds, individual corporations, commercial banks and central bank. In the case of external debt, the government borrows from persons or institutions outside the country. Such loans come from foreign governments, private foreign institutions, foreign individuals and international organizations like World Bank and the African Development Bank (Jhingan, 2001).

### 2.2.1 External Public Debt Structure

External public debt may be further classified into status of the donor and maturity structure. Classification according to the status of donors is generally divided into official and private public debt (Ajayi, 1997). Official debt may be further sub-divided into bilateral and multilateral debts. Bilateral debt is obtained from national governments while multilateral debt is obtained from multilateral institutions like the World Bank and the International Monetary Fund (IMF). Public private debt includes the debt that a government obtains from private creditors and

comprises Eurodollar loans, suppliers' of credit for exports, and loans from private commercial banks (Ajayi, 1997).

On the basis of maturity structure, external debt can be classified as either short-term or long-term debt. A short-term debt is one with original maturity of one year or less at the time of issue. On the other hand, a long-term debt has a maturity of more than one year at the time of issue. Long-term debts are generally subdivided into public or publicly guaranteed debt and private non-guaranteed debt. Publicly guaranteed external debt is defined as the external debt obligation of a private debtor that a public entity guarantees for repayment (Ajayi, 1997). In general, official debt is cheaper than commercial debt because official debt is usually given as foreign aid or as concessionary loan. One unique aspect of multilateral debt is that they cannot be rescheduled (EcoNews Africa, 1999).

### 2.2.2 Domestic Public Debt Structure

Domestic public debt may be classified on the basis of maturity structure (short-term or long-term) and on whether it is interest bearing or non-interest bearing.

Within the maturity structure, domestic debts may further be classified into short-term debt, floating debt and permanent debts. Short-term debt has a maturity of less than one year at the time of issue. An example of

such a debt is the 91-day Treasury bills. Floating debt, on the other hand, does not have specific maturity but is payable subject to various terms and conditions. Provident funds fall into this category. Permanent debt, which usually has a maturity of more than one year at the time of issue, usually has a maturity of between three and thirty years. A permanent debt may be a perpetuity and therefore be non-redeemable (Bhatia, 2001).

Another classification of domestic public debt is according to whether it is interest bearing or non-interest bearing. In this classification, domestic public debt may or may not attract interest payments. A long-term debt normally carries a fixed rate of interest known as coupon rate that is fixed at the time of issue. Alternatively, a long-term debt may have floating rates that are adjusted up or down as interest rates on traded securities to which they are pegged change. Short-term public debt, such as treasury bills, does not attract interest payments but is issued at a discount.

The debt structure of a country is, therefore, composed of various debt stock made up of different donors, maturities and interest rates (Mbanga, 2001).

### **2.3 Public Debt Burden**

Public debt, unlike other government revenues such as tax, has to be serviced because interests on the principal, as well as the principal, have to

be paid by levying tax on the residents of a country. This involves hardship on the taxpayers and is therefore considered a burden to the public. The burden of debt will affect economic development of a country (Jhingan, 2001).

According to Bhatia (2001), situations where foreign loans or external debt may be burdensome and, as a result, stifle the economic development of a country depends on several factors. These include the terms and conditions of debt servicing, whether the debt is used for the creation of export capability; and whether the debt has added to the productive capacity of the country.

Bhatia (2001) observes that internal debts may also be burdensome and cites four criteria on the basis of which the internal debt may be judged to be burdensome. First is the use to which the debt is put, that is, whether it has been put into productive or unproductive use. The second criterion is the effect of the debt on income and wealth inequalities. Third is the inflationary impact the debt has on the economy, and fourth, the effect of the debt on budgetary maneuverability by the government.

In addition to the situations above, the structure of the public debt in terms of both the level and composition will generally determine the amount of debt service and, therefore, will have an impact on the burden of public debt for the following reasons. First, other things being equal, a high level

of public debt will attract a higher debt service than a lower level debt. An example is in India where the size has been identified as one of the causes of high external debt service (Bhatia, 2001). Secondly, as stated above, official debts are cheaper than commercial debts. A public debt which is highly weighted with official debt will, therefore, be cheaper than that heavily weighted with commercial debt. Third, the ability to reschedule debts will reduce the level of current debt service. Fourth and lastly, long-term debts spread debt servicing over a longer period and, therefore, reduce the actual amount payable in a fiscal year.

Thus, public debt structure has an impact on the amount of debt servicing and a high debt servicing is, in turn, generally burdensome to the residents of a county.

## **2.4 Causes of High Levels of Public Debt**

### **2.4.1 Domestic Public Debt Levels**

In the 1980s, the major problem that faced many developing countries was how to deal with high levels of external debt. Domestic debt was relatively insignificant and little discussed. The situation has changed in recent years and many countries that were previously faced with acute external debts now have very high levels of domestic debt

(Commonwealth Secretariat, 1999). Kenya is among the countries now faced with rising domestic debt (Wagacha, 1999 and GOK, 2001).

Among the reasons for high levels of domestic public debt are budget deficit and lack of external public debt for investment. According to Roe (1990), African governments have been forced to depend on domestic debt for investment due to the limits of external finance. Lebanon faced the same situation immediately after the 1975 to 1990 civil war when due to considerable political and macroeconomic uncertainties, it had very limited access to either international capital markets or foreign official financing and had to resort to domestic capital markets to finance its budget deficit (Hebling, 1999).

According to the Commonwealth Secretariat (1999) high levels of domestic public debt in developing countries are caused by several factors which include the need for governments to squeeze domestic demand in order to generate surpluses on the current account of the balance of payments so as to service large external debts; lower tax revenue caused by the squeezed domestic demand; problems of many governments in levying and collecting taxes; higher interest charges paid on existing government debt caused by the liberalization of financial markets; and a vast portfolio of loss making and heavily indebted public sector companies.

Bhatia (2001) concurs with the Commonwealth Secretariat with regard to debt servicing when he states that debt servicing in India has become a major head of government expenditure and that the government is compelled to borrow more and more just in order to service existing debt. In a way, the reason for the rising level of Kenya's domestic debt is similar to that of India because one of the reasons for the rising level of Kenya's domestic debt is the need to service external debt arrears occasioned by the decline in grants and net government borrowing as well as insufficient growth in exports (GOK, 1994). Wagacha et al (1999) agree that public debt servicing is a reason for Kenya's high domestic debt level when they observe that Kenya's fiscal crisis arises in part from the pattern of additional borrowing undertaken to finance the deficits and the resulting debt servicing associated with public debt.

#### 2.4.2 External Public Debt Levels

Unlike domestic public debt, external public debt problems have been around since 1982 when the government of Mexico announced that it could not service its debt. Causes of high levels of external debt have been widely discussed and divergent views have been expressed. Some authors blame the debtor countries while others blame the creditors. In between the two extremes, are the authors who blame both the debtor countries and the creditors for the high debt accumulation in developing

countries. Among such authors are Dornbush and Fisher (1985) who conclude that imprudent borrowing policies in the debtor countries and imprudent lending by commercial banks had a chance encounter with extraordinarily unfavorable world macroeconomic conditions that exposed the vulnerability of the debtors and the creditors (Ajayi, 1997). Gelinas (1998) expresses the same sentiments and blames the causes of over-indebtedness on different factors. He cites the lobbying by international financial institutions and developing agencies; the liquidity surplus of commercial banks in developed countries; the state-guaranteed export credit lines; the development of an overdraft culture among political leaders throughout the world; and the IMF and World Bank structural adjustment loan policies. Gelinas concludes that irresponsible lenders lend for profit to credit-addict and often-unrepresentative governments. Mbire and Atingi (1997) agree, at least in part, with Gelinas when they observe that continued government commitment to structural reforms and sound debt management are essential but are neither sustainable nor possible without further debt accumulation. They conclude that any policy that limits estimated current consumption to domestically generated revenue while devoting external finance to investment can enable a country to achieve high economic growth.



Central Bank of Nigeria (1990) concedes that the external debt problem in Nigeria is real and that the factors that contributed to the problem were both internal and external. External factors included lack of restraint and professionalism on the part of creditors and the sudden drop in oil prices. The internal factors included the failure by authorities to appraise their borrowing needs more rationally and the absence of an appropriate economic policy prior to the introduction of the Structural Adjustment Program (SAP).

Klein (1994) attributes causes of debt accumulation in developing countries to the filling of resource gap in investment. He identifies this resource gap into three categories - savings gap, the foreign exchange gap and the filling gap resulting from budget deficits.

Mbanga (2001) supports Klein's view and states that in the savings constrained situation, external finances are necessary to finance increased investments that would not be possible because of the drain resulting from payment of interest on external loans.

Yemidale (1990) also blames the African debt burden to both internal and external factors. Among the internal factors were domestic policy lapses, persistent rigidity in the structure of economies, undiversified production base and a mono-commodity export trade, which made African countries usually vulnerable to external shocks. External causes included adverse

movements in the terms of trade; rise in interest rates and decline in real net capital inflows.

M'Bet (1990) agrees with Yemidale on unfavorable price trends, high real interest rates and adverse terms of trade. To this, M'Bet (1990) adds the overvalued United States dollar and the use to which borrowed funds had been put. The author says that in some African countries borrowed funds were not invested in economically viable projects but that were instead used to finance prestigious projects with little or no economic justification nor the ability to generate foreign exchange to repay external debt.

Ajayi carried out studies in 1991 and 1997 in Nigeria to determine the internal and external causes of the country's debt accumulation. The 1991 study was carried out in two stages. The first study showed that macroeconomic policy, coupled with inadequate trade policy, led to a rate of borrowing that was not sustainable. The results of the second stage showed that worsening of both terms of trade and rise in interest rates worsen debt ratio. The 1997 results showed that the most important variables in debt accumulation were real effective rate of interest and terms of trade.

Osei (1997) studied features of Ghana's external debt, including its size and observes that Ghana's debt burden had been at critical levels since 1983. The author attributes the status directly to the country's inability to

generate sufficient foreign exchange through export earnings and to the low returns on investments to which borrowed funds were applied.

Ng'eno (1997) examines both the external and internal factors which caused debt burden in Kenya and concludes that external causes of Kenya's public debt are deterioration in terms of trade and worldwide recession while the main internal causes are sector deficits and exchange rate misalignment.

The studies above show that external debt accumulation has been caused both by internal and external factors. Internal factors included wrong policies, sector deficits, interest rate misalignment and implementing of projects for non-economic reasons. Among the external factors are adverse terms of trade, rise in interest rates, decline in real capital flows, and devaluation of the currency of the debtor countries, need to implement structural reforms, financial liberalization and the irresponsible action of the creditors.

With regard to high levels of domestic public debt accumulation, the studies by Roe (1990), Hebling (1999), the Commonwealth Secretariat (1999) and Bhatia (2001) indicate that the need to service external debt, to finance budget deficits and/or to substitute for external debt in economic development pushed the domestic debt of the countries studied to their present levels.

## 2.5 Public Debt Burden Indicators

Econometric and financial tools have, in the past, been used to analyze both private and public debt. According to Desai (2001), financial tools, including trend and ratio analysis are of immense use to the entrepreneur in carrying out his planning and controlling functions.

Among the ratios used for analysis are debt ratios, which show to what extent debt financing is used and in turn determine indebtedness and creditworthiness of an entity. A high level of debt in a firm introduces inflexibility in the firm's operations due to increasing interference and pressures from creditors. Firms with high debt ratios find difficulty in getting credit and may have to borrow on highly unfavorable terms and as a result get into a debt trap (Pandey, 2000). Pandey outlines several debt ratios that include: -

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- a) Total Debt/Total Capital Employed where total capital employed consists of net fixed assets plus net current assets. Here current liabilities are excluded;
- b) Debt/Equity Ratio, where total debt is divided by shareholders' worth;
- c) Capital Employed/Net worth, where net worth is equal to the contribution of the owners (equity shareholders); and

d) Long-term debt/Net worth, where long-term debt includes long-term leases.

Brealey et al (1991) uses similar ratios to show the extent to which a company is indebted.

Although the above ratios are specific to corporate finance, they may be slightly modified and used to indicate public debt burden for both internal and external debt as per advice by the Commonwealth Secretariat (2001) (see Section 2.5.1 below) that developing countries should make use of corporate finance models to assess conditions of national insolvency.

#### 2.5.1 Domestic Public Debt Burden Indicators

The Commonwealth Secretariat (2001), when referring to internal debt in developing countries, advises that special attention should be paid to the models in corporate finance literature for valuation and pricing of bonds in the short-run and long run. The Secretariat observes that international researchers like Ghatak and Levine (1994) use corporate finance models to explore the conditions of national insolvency and concludes that the same models can be used to get a hand on the parameters for servicing and structuring of existing public debt. In addition, the Commonwealth Secretariat (2001) provides an approach regarding the relationship between fiscal policy and a stable stock of domestic debt which uses,

among key concepts, the stock of debt in proportion to the size of the economy, that is, debt/GDP ratio.

While pointing out to the shortcomings of the certainty of mathematical models the, Commonwealth Secretariat (2001) advises developing countries to consider adopting rules of thumb embodied in the Maastricht Treaty of the European Union instead of using mathematical models. These rules state that fiscal deficits should be below 3 percent of GDP; public debt service should not exceed 15 percent of government revenue; and that domestic public debt should not consistently be higher than 200 percent of domestically generated government revenue. The Secretariat advises that the developing countries should use these rules as criteria for assessing debt sustainability. Where the ratios exceed the specified limits the debt is considered non- sustainable.

#### 2.5.2 External Public Debt Burden Indicators

The growth of external debt is linked to the need for external credits and terms on which foreign loans are available (Klein, 1994). M'Bet (1990) observes that besides import compression and its associated problems, debt stressed countries suffer from low credit rating and consequently cannot raise external loans on reasonable terms.

Klein (1994) provides two benchmark indicators for assessing the creditworthiness of countries to distinguish between severe and moderate

indebtedness. The first indicator measures the present value of debt to GNP while the second indicator measures the present value of future debt service to exports for over three years. Severely indebted countries have either the present value of debt to Gross National Product (GNP) of 80 percent or the present value of future debt service to exports of 220 percent. Moderately indebted countries, on the other hand, have either the present value of debt to GNP in the range of 18 percent to 80 percent or future debt service to exports in the range of 132 to 220 percent. These benchmarks can be used to develop a sense of relative magnitude to assess the creditworthiness of countries.

To calculate the 1999 indebtedness, The World Bank (2001) uses the ratio of the present value of total debt service in 1999 to average GNP in 1997, 1998 and 1999 and the ratio of the present value of total debt service in 1999 to average exports (including worker remittances) in 1997, 1998 and 1999. If either ratio exceeds a critical value – 80 percent for debt service to GNP and 220 percent for the debt service to exports ratio – the country is classified as severely indebted. If the critical value is not exceeded but either ratio is three-fifths or more of the critical value (48 percent for the present value of debt service to GNP and 132 percent for the present value of debt service to exports), the country is classified as moderately

indebted. If both ratios are less than three-fifths of the critical value, the country is classified as less indebted.

For countries that do not report detailed debt statistics to the World Bank, the World Bank (2001) averages four key ratios over the last three years to determine their indebtedness. Severely indebted economies have three out of the four averages of the key ratios above the critical levels which are debt to GNP of 50 percent; debt to exports of 275 percent; debt service to exports of 30 percent; and interest to exports of 20 percent.

In addition to the indicators of creditworthiness above, Klein (1994) provides the following measures of creditworthiness: -

- a) Total debt service ratio (TDS/XGS) which is a measure of principal plus interest payment to export of goods and services;
- b) Interest service ratio (INT/XGS) which is a measure of interest payment on external debt to export of goods and services;
- c) Debt export ratio (EDT/XGS) which is a measure of total external debt to export of goods and services; and
- d) Debt to GNP ratio (EDT/GNP), which is a measure of total external debt to production.

Ajayi (1997) identifies the measures of creditworthiness in terms of measures of the cost or the capacity of the government to service its debt



for debt servicing. In his analysis, Ajayi (1997) uses the following ratios:

- *debt-service ratio compared with that of the largest Latin American borrowers*  
Total debt service, interest payments, total debt outstanding and disbursed and total external debt and reserves to export of goods and services and to the GNP.

After analyzing Nigeria's debt data, Ajayi (1997) concluded that the ratio of external debt to income and that of external debt to exports of goods and services were two of the most important indexes to assess the external debt situation of a country. He found that the most convincing evidence of a country's ability to service foreign debt was the stream of foreign exchange a country earned.

A similar study carried out by Osei (1997) arrives at the same conclusions with regard to Ghana's debt burden. The study supports Ajayi (1997) by concluding that the debt-service ratio and the debt-GNP ratio are the two most important indexes used to assess the debt burden and that the higher these ratios are, the greater the burden.

The above literature stresses the importance of GNP and exports on the debt ratios and that given a particular level of debt and debt service; GNP and exports will influence the magnitude of the ratios. M'Bet (1990) emphasizes the importance of GNP by pointing out the fact that Africa's debt is not large when compared with that of Latin America but that

Africa's status as the most impoverished continent makes its debt very burdensome compared with that of the largest Latin American borrowers. Ajayi (1997) states that there is a need for an increase in exports as one of the elements necessary to reduce the debt burden and increase debt-servicing capacity.

### 2.5.3 Limitations of Public Debt Burden Indicators

Limitations of public debt indicators are akin to those of ratio analysis. Brealey et al (1991) cautions readers that financial ratios are no substitute for a 'crystal ball' but that they are a convenient way to summarize large quantities of financial data and compare firm's performance. The authors conclude that ratios help to ask the right questions but seldom answer those questions.

With regard to domestic public debt burden, Commonwealth Secretariat (2001) supports the adoption of the rules of thumb embodied in the Maastricht Treaty because debt sustainability cannot carry the certainty of mathematics due to the estimates that have to be made on the future tax and expense patterns, inflation, interest rates, and economic growth in order to use some mathematical models.

Weaknesses of external debt burden indicators have also been discussed, and Klein (1994), for his part, discusses the limitations and concludes that:

- a) Formal models and technical analyses cannot replace good policy makers but can help by providing information on the future implications of alternative borrowing strategies;
- b) There is wide acceptance of the credit worthiness ratios but that there are no firm critical levels that if exceeded, constitute a danger for the indebted country although the World Bank has proposed a set of parameters, which it uses to demarcate "moderately" and "severely" indebted countries; and
- c) In order to make comparison between countries and for the same country over time, GNP figures must be converted into a common currency (usually United States Dollars).

GOK (1997) agrees with the view expressed by Klein (1994) and states that it is meaningless to look for a critical value of the ratio of debt to GDP beyond which the system breaks down and traumatic solutions become necessary.

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## CHAPTER THREE

### 3.0 RESEARCH DESIGN

#### 3.1 Introduction

This was a descriptive study on an evaluation of the structure and servicing of Kenya's public debt from June 1972 to June 2000. The study analyzed the levels and compositions of Kenya's public debt over the period under review and assessed whether there was any relationship between internal and external government debts. Further, the study showed the structure of public debt servicing over the same period in terms of levels and composition and assessed the debt servicing capacity of the Kenya Government.

#### 3.2 Focus of the Study

This study focuses on financial ratios and establishes changes in selected annual average macroeconomic variables, namely, domestic and external public debt and debt burden indicators between June 1972 and June 2000.

#### 3.3 Data Sources

For the sake of consistency, this study relies almost exclusively on secondary data, shown in the Appendix 1, from the Kenya Central Bureau

of Statistics' Annual Economic Surveys for the period covered by the study. In addition, data from the following documents were used where appropriate: -

- a) Central Bank of Kenya Quarterly and Annual Economic Reviews;
- b) Government of Kenya National Development Plans and Reports;
- c) Central Bureau of Statistics Annual Statistical Abstracts;
- d) Central Bureau of Statistics Quarterly Budgetary Review; and
- e) World Bank Reports.

### **3.4 Justification for Using Secondary Data**

The study on an evaluation of the structure and servicing of public debt is historical in nature and therefore requires data in the form of archival records from government documents. Secondary data is therefore the only source available to study this type of research problem.

### **3.5 Data Analysis**

Data in this study was analyzed using trend series and financial ratio analysis.

#### **3.5.1 Trend Series Analysis**

Trend series were used to show changes in levels and composition of total debt by comparing domestic and external debt as well as changes in the

levels and composition of debt service by comparing domestic public debt service with the external public debt service. Financial ratios used were in the form of debt burden indicators for total, domestic and external public debt. The results were then compared with the standard debt burden ratios provided by the World Bank and the Maastricht Treaty to assess the creditworthiness of the Kenya Government and to determine the ability of the government to service its public debt, that is to find out whether Kenya's public debt was sustainable. All the ratios were computed as at 30 June of each year, from 1972 to 2000, using Microsoft Excel. Trend series for the same period were charted by Microsoft Excel. It was possible to derive from the trend series a conclusion on whether an association exists between internal and external government debt.

### 3.5.2 Debt Burden and Debt Servicing Indicators

In order to capture the structure of debt servicing and the capacity for debt servicing, the debt burden and debt servicing indicators shown in Table 1 were used in addition to the indebtedness criteria used by the World Bank to classify countries into severely and moderately indebtedness. However, due to the difficulty of arriving at an appropriate discounting rate, which would cover both domestic and external public debt, the weighted average method, described in Section 2.5.2 above, which the World Bank uses for

countries which do not report detailed debt statistics, was used in this study to assess Kenya Government's indebtedness.

The selected measures are relevant to the study and adequately address the debt servicing for the internal and external public debt.

Ajayi (1997) and Osei (1997) used the ratios for external debts to analyze external debt for Nigeria and Ghana respectively. The ratios for domestic debt are embodied in the Maastricht Treaty of the European Union (Commonwealth Secretariat, 2001) and include the ratio of public debt service to government revenue and domestic public debt to domestically generated government revenue.

Trend series were used to show the magnitude of total debt, external debt and domestic debt over the period of study. Further, trend series were used to compare the relationship between domestic debt and external debt as well as to compare debt servicing between domestic and external public debt.

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### **3.6 Justification for Using Financial Ratios and Trend Series**

As pointed out in Sections 3.5.1 and 3.5.2, trend series and financial ratios, which were debt burden and debt servicing ratios, were used in the analysis of the data. The justifications for using these ratios and trend series are provided below.

### 3.6.1 Justification for Using Debt Burden and Debt Servicing Indicators

This study used debt or debt servicing as proportions of total exports, GDP, total government revenue, domestically generated government revenue or total debt servicing, as appropriate.

For external public debt, debt service payments to exports (debt service ratio) and total external debt to income (the debt/GNP ratio) are the most important indexes used to assess the debt burden (Osei, 1977). Kenya's income data are in GDP. GDP was therefore used instead of GNP. In the case of domestic public debt, both total revenue and domestically generated revenue were shown in the denominator to show the proportion of different categories of Kenya's revenue used in servicing domestic debt. Total debt service to total government revenue and total debt service to locally generated government ratios were used to show the proportion of the revenue used to service total debt. The World Bank, with slight adjustments, uses these ratios to assess the creditworthiness and to measure the debt burden of countries. The ratios are therefore universal, and, as indicated in section 3.5 above, Ajayi (1997) used the same ratios to study Nigeria's external debt. Debt ratios are also used in Corporate Finance to assess the extent to which a company is indebted (Desai, 2001 and Pandey, 2000).



### 3.6.2 Justification for Using Trend Series

Osei (1997) used trend series to show trends in Ghana's external public debt. In this study, trend series were used to give indication of changes in various ratios from 1972 to 2000. Like debt ratios, trend series are used in Corporate Finance to assess the performance of a company over the years and to compare the performance of different companies in the same sector or industry.

Table 1: Debt Burden and Debt Servicing Indicators

Indicators	Measures	Code
Debt Burden	Total Debt outstanding and disbursed to export of goods and services	DT/XGS
	Total external debt to export of goods and services	EDT/XGS
	Total debt to Gross Domestic Product	DT/GDP
	Total external debt to Gross Domestic Product	EDT/GDP
	Total domestic debt to total government revenue	DDT/GR
Debt Service	Total external debt servicing to export of goods and services	EDS/XGS
	Total debt servicing to export of goods and services	TDS/XGS
	Total debt servicing to total government revenue	TDS/GR
	Total debt servicing to domestically generated government revenue	TDS/DGR
	Domestic debt servicing to total government revenue	DDS/GR
	External debt servicing to total service charges	EDS/TSC

Source: Adapted from the World Bank Reports and Maastricht Treaty

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## CHAPTER FOUR

### 4.0 DATA ANALYSIS AND FINDINGS

#### 4.1 Introduction

This chapter analyzes the structure and servicing of Kenya's public debt from 1972 to 2000 under the headings of Debt Level Structure; Debt Service Structure; Debt Burden Indicators; and Debt Service Indicators/Debt Service Capacity.

#### 4.2 Debt Level Structure

##### 4.2.1 Total Public Debt

This study defines total debt as the sum of long-term and short-term borrowings of Kenya's Central Government. Debts for government corporations and for the Central Bank of Kenya are not part of the Central Government borrowing and are, therefore, excluded. Table 2 shows Kenya's total debt divided into external and domestic categories from June 1972 to June 2000. The trends in the levels of total public debt as well as of external and domestic are depicted in figure 1.

The range in the stock of public debt for Kenya, over the period under study, was Kenya shillings 4,200 million in June 1972 to Kenya shillings 564,317 million in June 1999. The total amount dropped slightly from the

June 1999 figure to Kenya shillings 559,099 million in June 2000. The growth of total public debt has been irregular. The level of total debt had a gradual upward trend up to 1992 but from June 1992 to June 1993 the level more than doubled from Kenya shillings 185,300 million in 1992 to Kenya shillings 376,700 million in 1993. The 1993 total debt was higher than the 1994 and 1995 levels which were Kenya shillings 311,300 million and Kenya shillings 357,400 million respectively. June 1996 total debt level at Kenya shillings 469,426 million was again higher than that of June 1997 at Kenya shillings 456,240 million. The June 1999 level had the highest recorded level for the period under review and was in fact higher than the June 2000 level.

#### 4.2.2 External Public Debt

The pattern of external public debt for the period under study has been more or less similar to that of total public debt. From 1972 to 1992, the level grew at a gradual pace. Between June 1992 and June 1993, however, the level more than doubled and was above June 1994 and June 1995 levels. The June 1996 level was above the June 1997 and June 1998 levels. Similar to the level of total public debt, the June 1999 had the highest level at Kenya shillings 413,819 million. The lowest level, at Kenya shillings 2,100 million, was in 1972.

#### 4.2.3 Domestic Public Debt

The range for the domestic public debt for the period under study has been between Kenya shillings 2,100 million in June 1972 to Kenya shillings 163,405 million in June 2000. Unlike levels for the total and external public debt the up and down swings started in June 1979 when the level for domestic public debt was higher by Kenya shillings 100 million than that of June 1980. Further swings were in June 1993 and June 1995. The level of domestic public debt was higher by Kenya shillings 400 million than that of June 1994 while June 1995 level was higher than that of June 1996 by Kenya shillings 900 million. From June 1996 to June 2000, the level of domestic public debt has been on an upward trend.

#### 4.2.4 Summary of the Structure of the Level of Public Debt

The above analysis shows that the build up of the total public debt has been corresponding with that of the external public debt. Although the levels of domestic debt had up and down swings, the amounts involved were small. Consequently the growth rate for domestic public debt has been smoother than those of the external and total public debt, which have had large swings, particularly in the last nine years of the study.

The structure of the level of total public debt has been irregular, but in general the proportion of internal debt to total debt has been downward, starting from 50 per cent at June 1972 to 29 per cent in June 2000. The highest proportion of total internal public debt to total public debt was at

Table 2. Structure of Outstanding Debt (Kenya Shillings in Millions) at Fiscal Year Data

Year	External	Domestic	Total	Interest Total
1978	3,500	3,000	6,500	31
1979	3,800	3,000	6,800	33
1980	4,200	3,800	8,000	36
1981	4,500	5,000	9,500	39
1982	4,800	5,000	9,800	40
1983	5,200	5,000	10,200	41
1984	5,500	5,000	10,500	42
1985	6,000	5,000	11,000	43
1986	6,500	5,000	11,500	44
1987	7,000	5,000	12,000	45
1988	7,500	5,000	12,500	46
1989	8,000	5,000	13,000	47
1990	8,500	5,000	13,500	48
1991	9,000	5,000	14,000	49
1992	9,500	5,000	14,500	50
1993	10,000	5,000	15,000	51
1994	10,500	5,000	15,500	52
1995	11,000	5,000	16,000	53
1996	11,500	5,000	16,500	54
1997	12,000	5,000	17,000	55
1998	12,500	5,000	17,500	56
1999	13,000	5,000	18,000	57
2000	13,500	5,000	18,500	58
2001	14,000	5,000	19,000	59
2002	14,500	5,000	19,500	60
2003	15,000	5,000	20,000	61
2004	15,500	5,000	20,500	62
2005	16,000	5,000	21,000	63
2006	16,500	5,000	21,500	64
2007	17,000	5,000	22,000	65
2008	17,500	5,000	22,500	66
2009	18,000	5,000	23,000	67
2010	18,500	5,000	23,500	68
2011	19,000	5,000	24,000	69
2012	19,500	5,000	24,500	70
2013	20,000	5,000	25,000	71
2014	20,500	5,000	25,500	72
2015	21,000	5,000	26,000	73
2016	21,500	5,000	26,500	74
2017	22,000	5,000	27,000	75
2018	22,500	5,000	27,500	76
2019	23,000	5,000	28,000	77
2020	23,500	5,000	28,500	78
2021	24,000	5,000	29,000	79
2022	24,500	5,000	29,500	80

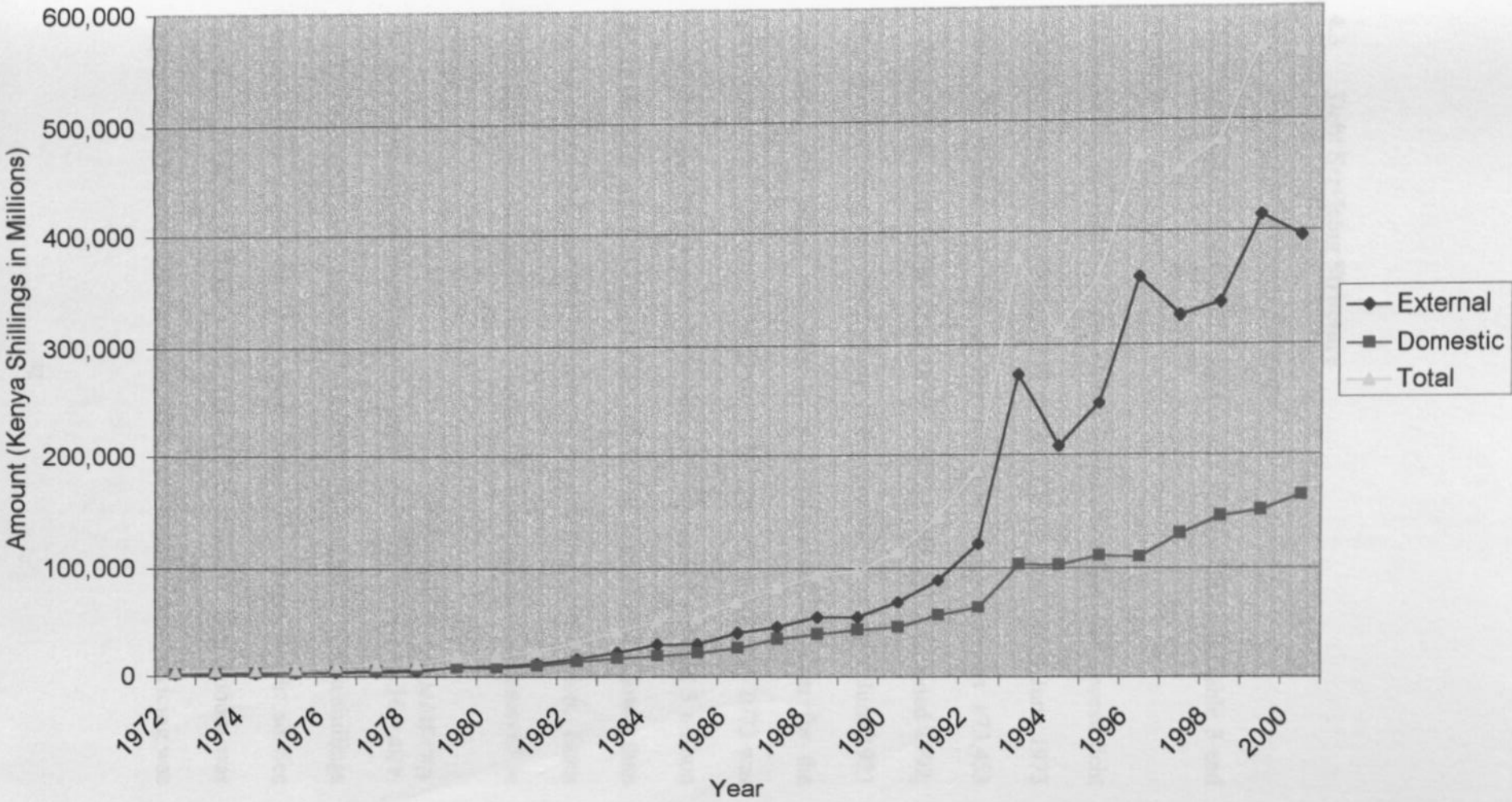
Source: Central Bureau of Statistics Economic Surveys and Quarterly Analytical Reports

Table 2: Structure of Outstanding Debt (Kenya Shillings in Millions) at Fiscal Year Data

Year	External	Domestic	Total	Internal/Total %
1972	2,100	2,100	4,200	50
1973	2,500	2,600	5,100	51
1974	2,700	3,000	5,700	53
1975	3,400	3,400	6,800	50
1976	4,200	4,800	9,000	53
1977	4,600	5,800	10,400	56
1978	4,900	6,800	11,700	58
1979	9,800	8,700	18,500	47
1980	10,000	8,600	18,600	46
1981	13,000	10,700	23,700	45
1982	17,200	14,500	31,700	46
1983	23,400	17,900	41,300	43
1984	30,600	20,000	50,600	40
1985	30,900	22,800	53,700	42
1986	40,600	27,300	67,900	40
1987	45,600	35,100	80,700	43
1988	54,300	39,200	93,500	42
1989	54,300	42,800	97,100	44
1990	68,400	45,500	113,900	40
1991	89,200	56,100	145,300	39
1992	122,300	63,000	185,300	34
1993	273,100	103,600	376,700	28
1994	208,100	103,200	311,300	33
1995	246,000	111,400	357,400	31
1996	358,926	110,500	469,426	24
1997	325,455	130,785	456,240	29
1998	336,339	145,541	481,880	30
1999	413,819	150,498	564,317	27
2000	395,694	163,405	559,099	29

Source: Central Bureau of Statistics Economic Surveys and Quarterly Budgetary Reviews

Figure 1: Structure of Outstanding Debt at Fiscal Year Data





### **4.3 Debt Servicing Structure**

#### **4.3.1 Total Debt Servicing Structure**

The Central Government's debt service structure is shown in Table 3 and Figure 2.

Examination of Table 3 and Figure 2 indicates that the lowest debt servicing was Kenya shillings 331 million for the year ended June 1973 while the highest debt service payment was Kenya shillings 173,453 million for the year ended June 1998. Up to the fiscal year ended 1992, total debt servicing increased yearly, except for the years ended June 1973 and June 1990 which had debt service payments lower than for the preceding years. The total debt servicing for the year ended June 1973 was lower than that for the year ended June 1972 by Kenya shillings 3 million while the total debt servicing for the year ended June 1990 was lower than for the year ended June 1989 by about Kenya shillings 254 million. From 1993 there were swings in debt service payments as may be observed in Figure 2.

#### **4.3.2 External Debt Servicing Structure**

Up to June 1990 yearly external debt servicing was below Kenya shillings 10,000 million. For the year ended June 1991, external debt service payments went up to Kenya shillings 12,285 million. This amount was higher than those of 1992 and 1993. The 1996 external debt servicing was

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also higher than that of 1997. From 1997 the level of external debt servicing was on an upward trend. The range for external debt servicing for the period 1972 to 2000 was from Kenya shillings 145 million to Kenya shillings 33,980 million respectively.

#### 4.3.3 Domestic Debt Servicing Structure

Unlike the structure of the level of external public debt servicing structure, domestic debt servicing structure had up and down swings in the earlier years but like total and external debt, the swings were more pronounced in the last nine years of the study. Other than in 1972 and 1974 when the levels were higher than those for the following years, the level of public domestic debt service payments grew gradually at a rate below Kenya shillings 10,000 million per year up to 1988. Between June 1988 and June 1989, debt service payments more than doubled. In fact, the 1989 amount was marginally higher than that of 1990. The year 1993 saw another hike in domestic debt service payment at Kenya shillings 51,834 million from Kenya shillings 26,521 million in 1992. The upward trend continued in 1994 at Kenya shillings 73,302 million before falling down to Kenya shillings 38,592 million in 1995. The highest domestic debt service payment was for the fiscal year ended June 1998 when it amounted to Kenya shillings 144,303 million.

#### 4.3.4 Summary of the Structure of Debt Servicing

While the individual structures are different, the general trend for all structures were similar although those of total and external debt were almost identical and all the three debt servicing structures showed greater swings from 1989 than in the earlier years.

Year	1989	1990	1991	1992	1993
1989	148	198	214	27	200
1990	175	224	221	40	240
1991	188	228	221	40	240
1992	190	228	221	40	240
1993	190	228	221	40	240
1994	190	228	221	40	240
1995	190	228	221	40	240
1996	190	228	221	40	240
1997	190	228	221	40	240
1998	190	228	221	40	240
1999	190	228	221	40	240
2000	190	228	221	40	240
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2017	190	228	221	40	240
2018	190	228	221	40	240
2019	190	228	221	40	240
2020	190	228	221	40	240
2021	190	228	221	40	240
2022	190	228	221	40	240
2023	190	228	221	40	240
2024	190	228	221	40	240
2025	190	228	221	40	240

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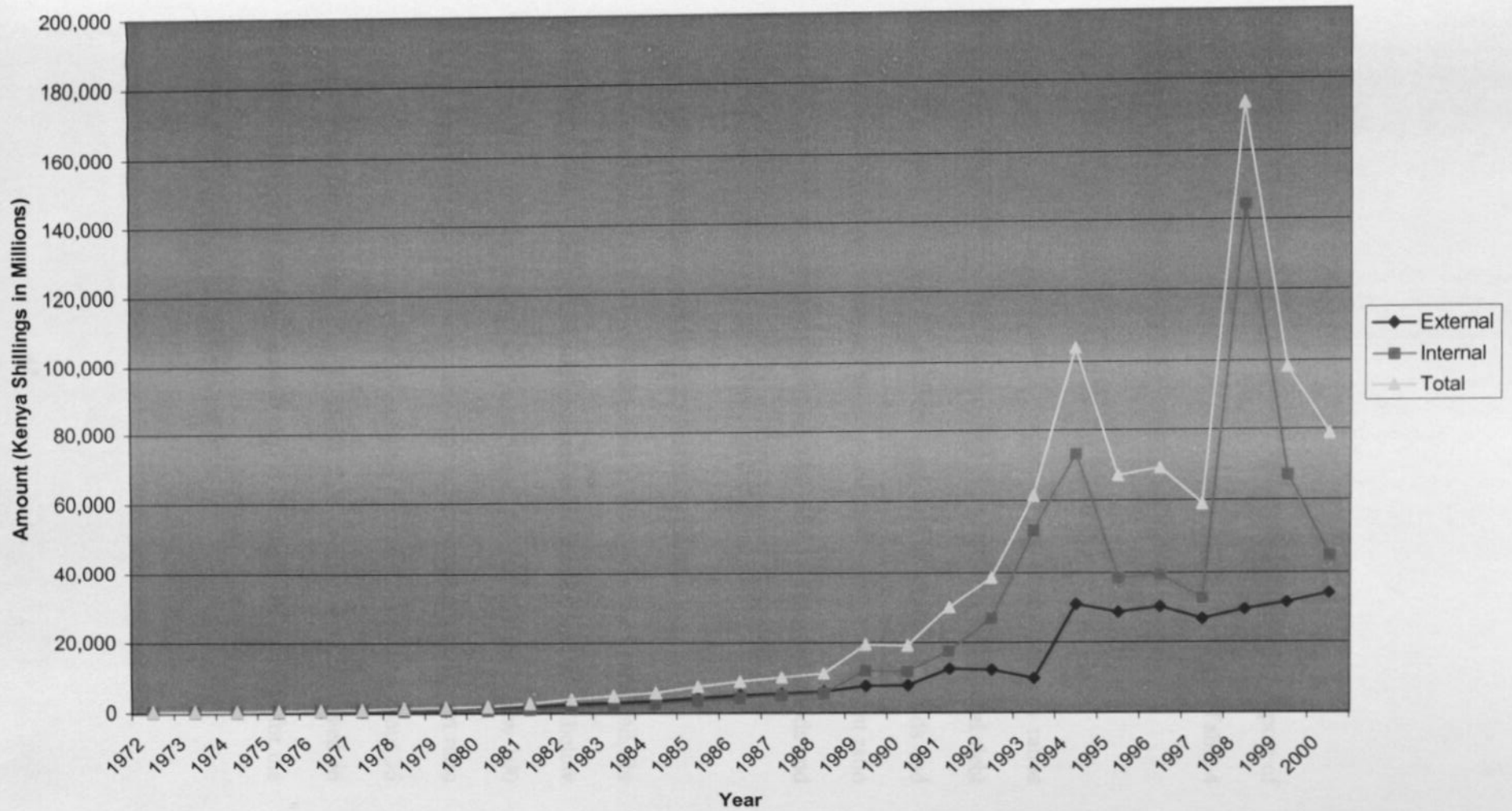
Table 3: Debt Servicing Structure in Kenya Shillings (in Millions) at Fiscal Year Data

Year	External	Internal	Total	Internal/Total %	Current Total /1972 Total %
1972	145	189	334	57	100
1973	178	153	331	46	99
1974	173	188	361	52	108
1975	202	271	473	57	142
1976	239	382	621	61	186
1977	295	430	726	59	217
1978	623	589	1,212	49	363
1979	625	684	1,309	52	392
1980	839	737	1,576	47	472
1981	1,414	1,025	2,438	42	730
1982	2,152	1,544	3,696	42	1,107
1983	2,618	1,863	4,481	42	1,342
1984	3,065	2,388	5,453	44	1,633
1985	3,896	3,223	7,118	45	2,131
1986	4,741	3,979	8,720	46	2,611
1987	5,166	4,686	9,852	48	2,950
1988	5,677	5,334	11,011	48	3,297
1989	7,376	11,949	19,325	62	5,786
1990	7,461	11,610	19,071	61	5,710
1991	12,285	17,472	29,757	59	8,909
1992	11,978	26,521	38,499	69	11,527
1993	9,469	51,834	61,302	85	18,354
1994	30,685	73,302	103,986	70	31,134
1995	28,368	38,592	66,960	58	20,048
1996	29,877	39,393	69,271	57	20,740
1997	26,460	32,501	58,961	55	17,653
1998	29,150	144,303	173,453	83	51,932
1999	31,215	66,956	98,170	68	29,392
2000	33,980	44,870	78,850	57	23,608

Source: Central Bureau of Statistics Economic Surveys and Quarterly Budgetary Reviews

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Figure 2: Debt Servicing Structure at Fiscal Year Data



#### **4.4 Debt Burden Indicators**

Debt burden indicators in this study use debt as a proportion of export of goods and services, GDP or government revenue and are shown in Table 4 and Figures 3(a) and 3(b) at the end of this section.

##### **4.4.1 Total Debt to Export of Goods and Services**

A study of the trend of total debt to export of goods and services ratios shows that other than for the years ended June 1974 to 1978, total debt exceeded exports. The lowest ratio for total debt to export of goods and services was 80 percent, observed in 1974 and 1977 while the highest ratio observed was 299 percent in 1999. The total debt to export of goods and services averaged 282 in the last three years of the study.

##### **4.4.2 External Debt to Export of Goods and Services**

This ratio has been slightly lower than that of total debt to exports and, for the whole period of study, end of the years 1972 to 1981 had ratios below 100 percent. Further, among the years when the ratios were below 100 percent, only 1979 and 1981 had ratios above 80 percent. The lowest ratio was in 1977 when the proportion of external debt to exports was about 35 percent while the highest ratio, at about 219 percent, was observed in 1999. The average of external debt to export of goods and services for the last three years of the study was 201 percent.

#### 4.4.3 Total Debt to GDP

The proportion of total debt to GDP was below 100 percent except in 1993 and 1996 when it was approximately 139 and 104 percent respectively. The lowest proportion, 32 percent, was observed in 1972, 1974 and 1977. The trend shows that out of the 29 years under review, the last nine years, 1992 to 2000, each year had a total debt to GDP ratio above 80 percent while prior to 1992 the ratio ranged from about 32 percent to about 76 percent. The highest ratio was about 139 percent, observed at the end of the fiscal year 1993. The average ratio of total debt to GDP for the last three years of the study was 84 percent.

#### 4.4.4 External Debt to GDP

An analysis of the external debt to GDP ratio from 1972 to 2000 shows three distinctive categories. Seven years, 1972 to 1978, had external debt to GDP ratios of between 14 percent and 17 percent; 1993 and 1996 had ratios of 101 and 80 percent respectively while the rest of the years had ratios ranging from 22 percent to 65 percent. The ratio of external debt to GDP, therefore, ranged from 14 percent in 1977 and 1978 to 101 percent in 1993. This ratio's average for the last three years was approximately 60 percent.

#### 4.4.5 Total Domestic Debt to Total Government Revenue

The ratio of total domestic debt to government revenue had an irregular trend and had its own pattern. Starting at 74 percent in 1972, the ratio climbed up to 87 percent in 1973 and then plunged down to 4 percent in 1974. From 1974 to 1981 the ratio was stagnant at 4 percent except in 1977 when it went up to 5 percent. Between 1982 and 1984 the ratio was 5 percent but went up to 6 percent where it remained stagnant up to 1991. The ratio dropped to 5 percent the following year but went up to 7 percent in 1993 before dropping to 5 percent where it remained in 1994 and 1995. In 1996 and 1997 the ratio was 4 percent before shooting up to 84 percent in 1998. The ratio dropped to 81 percent in 1999 but went up again to 88 percent in 2000.

#### 4.4.6 Summary of Debt Burden Indicators

The trends for four of these ratios were in pairs while the trend for the fifth ratio was on its own. The ratio of total debt and external debt to exports followed more or less the same trend. Both had the highest ratios at 299 and 219 for total debt to exports and external debt to exports respectively in 1999. The lowest total debt to export of goods and services ratio was 80 percent in 1974 and 1977 and the lowest external debt to export of goods and services ratio were 35 percent in 1977. The debt to GDP ratios formed another pair of trends with the highest ratios for total debt to GDP



Table 1: Debt Ratio Indicators in Percentage

Year	DTAGDP	EDTAGDP	DTGGR	EDTGR	DTGGR	EDTGR
1972	32	14	74	87	4	7
1973	32	14	74	87	4	7
1974	32	14	74	87	4	7
1975	32	14	74	87	4	7
1976	32	14	74	87	4	7
1977	32	14	74	87	4	7
1978	32	14	74	87	4	7
1979	32	14	74	87	4	7
1980	32	14	74	87	4	7
1981	32	14	74	87	4	7
1982	32	14	74	87	4	7
1983	32	14	74	87	4	7
1984	32	14	74	87	4	7
1985	32	14	74	87	4	7
1986	32	14	74	87	4	7
1987	32	14	74	87	4	7
1988	32	14	74	87	4	7
1989	32	14	74	87	4	7
1990	32	14	74	87	4	7
1991	32	14	74	87	4	7
1992	32	14	74	87	4	7
1993	139	101	74	87	4	7
1994	139	101	74	87	4	7
1995	139	101	74	87	4	7
1996	139	101	74	87	4	7
1997	139	101	74	87	4	7
1998	84	81	84	81	84	81
1999	81	81	81	81	81	81
2000	88	88	88	88	88	88

Source: Computed from Data Obtained from the Central Office of Statistics, Ministry of Economic Services and Community Development

Table 4: Debt Burden Indicators in Percentages

Year	DT/XGS	EDT/XGS	DT/GDP	EDT/GDP	DDT/GR	TDS/XGS
1972	103	51	32	16	74	8
1973	101	49	35	17	87	7
1974	80	38	32	15	4	5
1975	95	48	33	17	4	7
1976	94	44	36	17	4	6
1977	80	35	32	14	5	6
1978	99	41	33	14	4	10
1979	154	82	47	25	4	11
1980	127	68	42	22	4	11
1981	153	84	46	25	4	16
1982	187	102	54	29	5	22
1983	211	119	62	35	5	23
1984	216	131	69	42	5	23
1985	211	121	61	35	6	28
1986	224	134	66	40	6	29
1987	288	163	72	41	6	35
1988	281	163	72	42	6	33
1989	243	136	65	36	6	48
1990	223	134	68	41	6	37
1991	240	148	76	47	6	49
1992	267	177	84	56	5	56
1993	279	202	139	101	7	45
1994	210	140	95	64	5	70
1995	234	161	91	62	5	44
1996	272	208	104	80	4	40
1997	261	186	85	61	4	34
1998	280	196	81	57	84	101
1999	299	219	89	65	81	52
2000	268	190	83	59	88	38

Source: Computed from Data Obtained from the Central Bureau of  
 Statistics Economic Surveys and Quarterly Budgetary Reviews

Figure 3(a): Debt Burden Indicators in Percentages

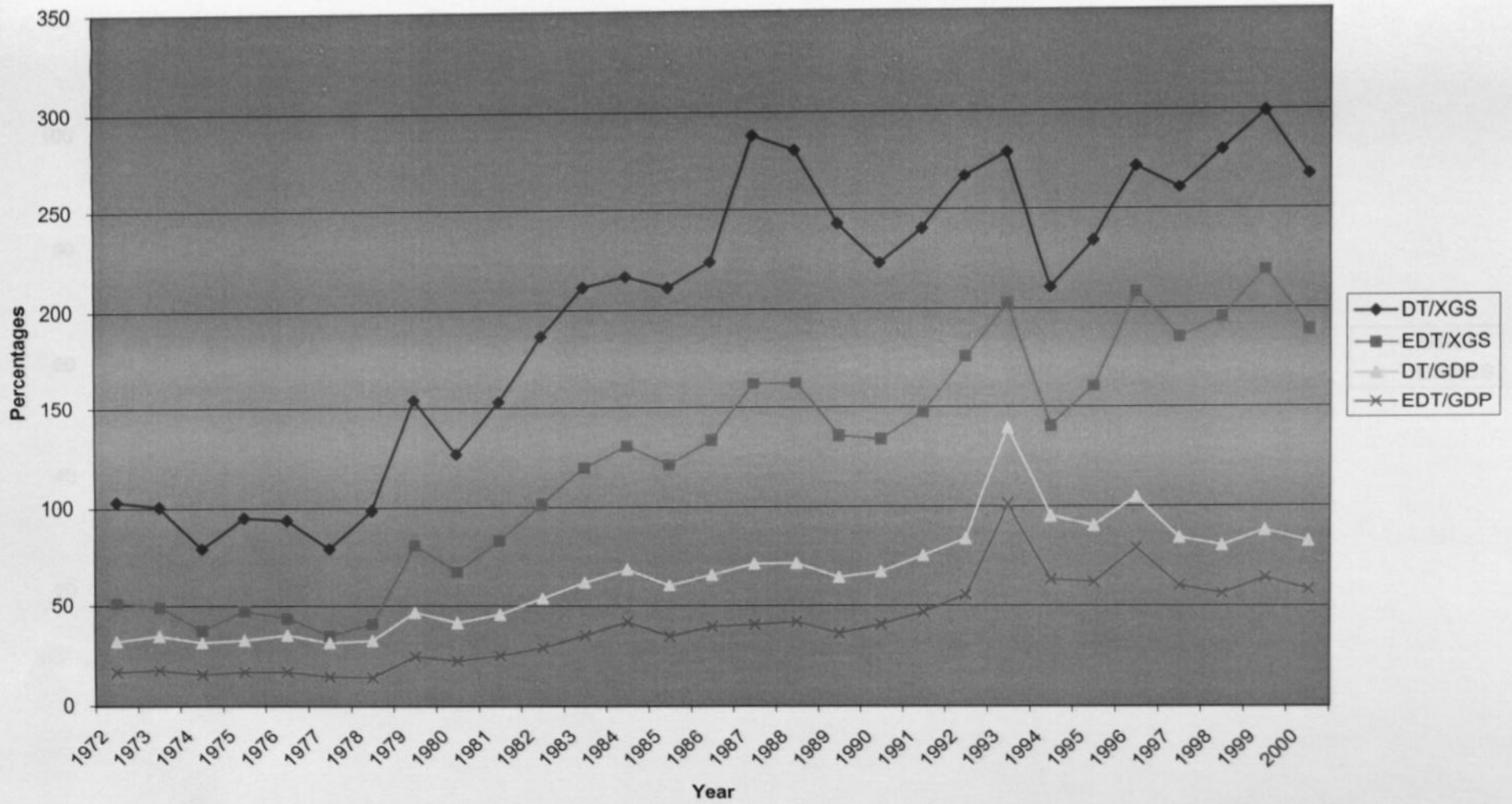
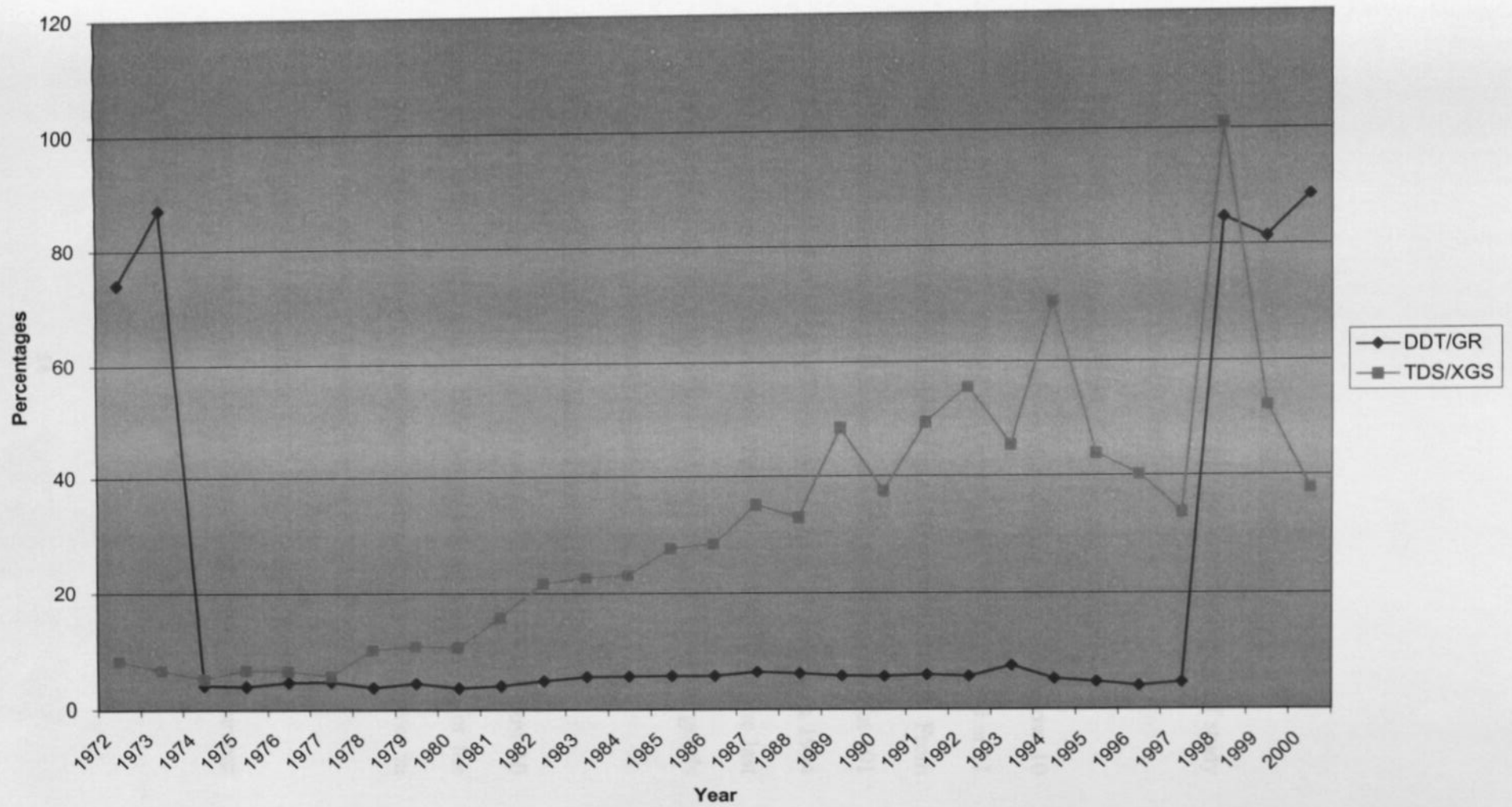


Figure 3(b): Debt Burden Indicators



#### **4.5 Debt Servicing Indicators/Debt Servicing Capacity**

The trends for debt servicing ratios in percentages over the period of study are shown in Table 5 and Figures 4(a) and 4(b).

##### **4.5.1 Total Debt Servicing to Export of Goods and Services**

Total debt servicing to export of goods and services ratio was below 10 percent from 1972 to 1977, climbed to 10 percent in 1978 and stood at 11 percent in 1979 and 1980 before climbing up to 16 percent in 1981. From 1982 to 2000 the ratio was above 20 percent with the highest ratio at 101 percent being observed in 1998 followed by a ratio of 70 percent in 1994 while the lowest ratio at 5 percent was observed in 1974. Over the last three years of the study, the ratio of total debt servicing to export of goods and services averaged approximately 64 percent.

##### **4.5.2 External Debt Servicing to Export of Goods and Services**

External debt servicing to export of goods and services ratio was below 10 percent from 1972 to 1981 and in 1993 but swung up and down for the rest of the period under study. The highest ratio, at 21 percent, was in 1994 while the lowest ratio, at 2 percent, was in 1974 and 1977.

##### **4.5.3 Total Public Debt Servicing to Total Government Revenue**

This ratio shows the proportion of total debt servicing to total government revenue, including grants.

An analysis of the ratio of total public debt servicing to government revenue from 1972 to 2000 indicated that it fluctuated between 0 and 5 percent for most of the study period and was above 5 percent only in 1972 (12 percent), 1973 (11 percent), 1998 (101 percent), 1999 (53 percent), and in 2000 (43 percent). The highest ratio was 101 percent in 1998 while the lowest ratio, at 0 percent, was observed in 1974.

#### 4.5.4 Total Debt Servicing to Domestically Generated Government Revenue

This ratio had a range between 9 percent in 1974 to 104 percent in 1998. During the 29 years of study, the ratio was 50 percent and below in 22 years, between 13 and 9 percent in 9 years and was above 100 percent in 2 years. The highest ratio was 104 in 1998 followed by 103 percent in 1994. In general, total debt servicing to domestically generated government revenue had up and down swings throughout the period of the study, except between 1978 and 1980 when it was stagnant at 13 percent.

#### 4.5.5 Domestic Debt Servicing to Total Government Revenue

This ratio ranged from 0 per cent to 7 percent up to 1997 but shot up to 84 percent in 1998. It came down to 36 percent in 1999 and dropped further to 24 percent in 2000.

#### 4.5.6 External Debt Servicing to Total Debt Servicing

An analysis of Table 5 and Figure 4 shows that out of the 29 years of the study, the ratio of external debt servicing to total debt servicing was less than 50 percent in 18 years. This ratio was lowest, at 15 per cent, in 1993 and was highest, at 58 percent, from 1981 to 1983.

#### 4.5.7 Summary of Debt Servicing Indicators/Debt Servicing Capacity

Except for the ratio of external debt servicing to total debt servicing, all the debt servicing indicators had at least one of the lowest ratios either in 1974 or 1977 and highest ratios in either 1994 or 1998. The ratios with exports as denominators followed more or less the same trends just as those with government revenue as denominators. Other than the ratio of external debt servicing to total debt servicing and the ratio of external debt servicing to export of goods and services, all debt servicing ratios were highest in 1998.

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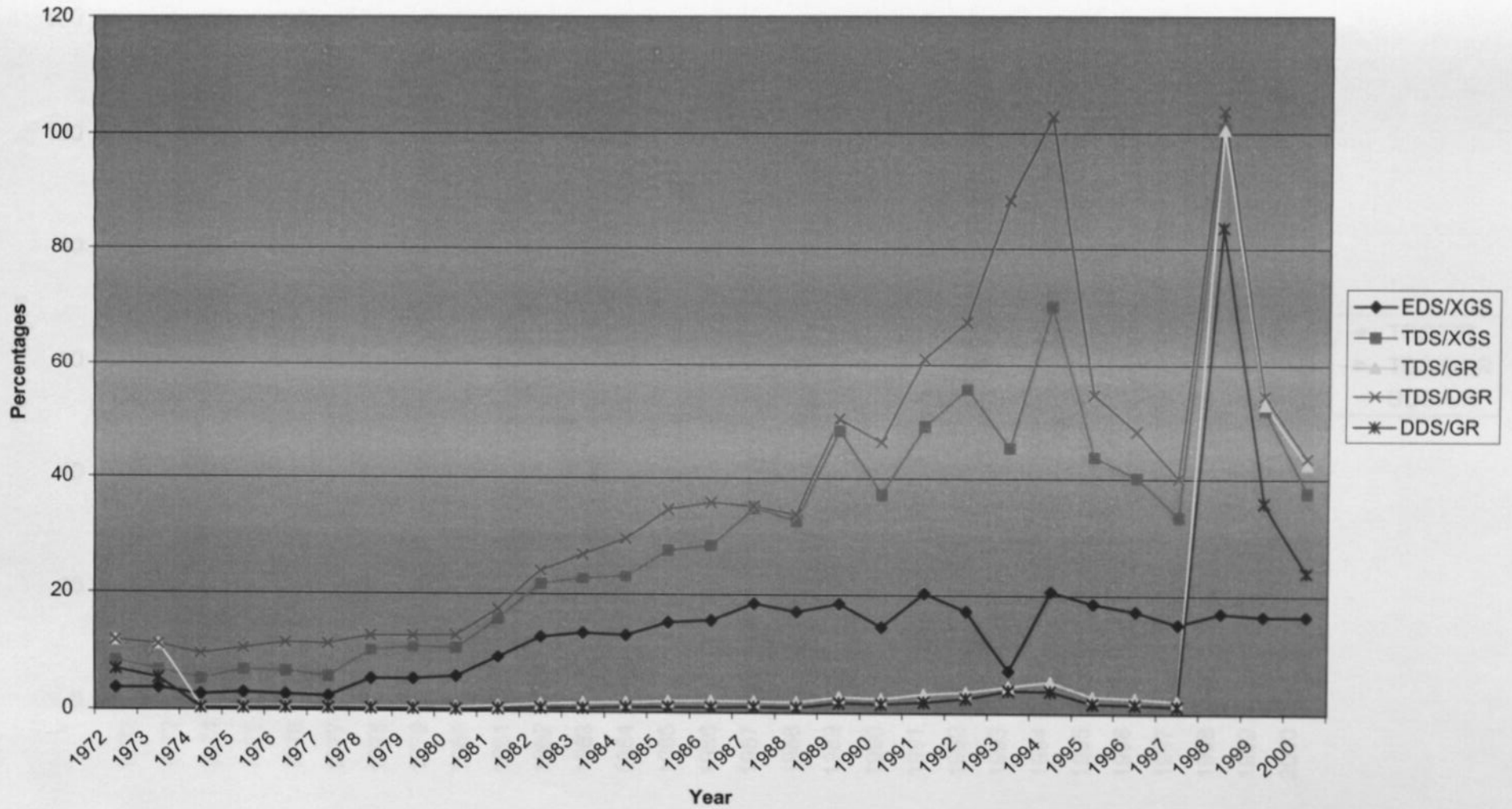
Table 5: Debt Servicing Indicators

Year	EDS/XGS	TDS/XGS	TDS/GR	TDS/DGR	DDS/GR	EDS/TSC
1972	4	8	12	12	7	43
1973	4	7	11	11	5	54
1974	2	5	0	9	0	48
1975	3	7	1	10	0	43
1976	3	6	1	12	0	39
1977	2	6	1	11	0	41
1978	5	10	1	13	0	51
1979	5	11	1	13	0	48
1980	6	11	1	13	0	53
1981	9	16	1	17	0	58
1982	13	22	1	24	1	58
1983	13	23	1	27	1	58
1984	13	23	1	30	1	56
1985	15	28	2	35	1	55
1986	16	29	2	36	1	54
1987	18	35	2	35	1	52
1988	17	33	2	34	1	52
1989	18	48	3	50	2	38
1990	15	37	2	46	1	39
1991	20	49	3	61	2	41
1992	17	56	3	67	2	31
1993	7	45	4	88	4	15
1994	21	70	5	103	4	30
1995	19	44	3	55	2	42
1996	17	40	2	48	1	43
1997	15	34	2	40	1	45
1998	17	101	101	104	84	17
1999	17	52	53	54	36	32
2000	17	38	43	44	24	43

Source: Computed from Data Obtained from the Central Bureau of Statistics Economic Surveys and Quarterly Budgetary Reviews



Figure 4 (a): Debt Servicing Ratios



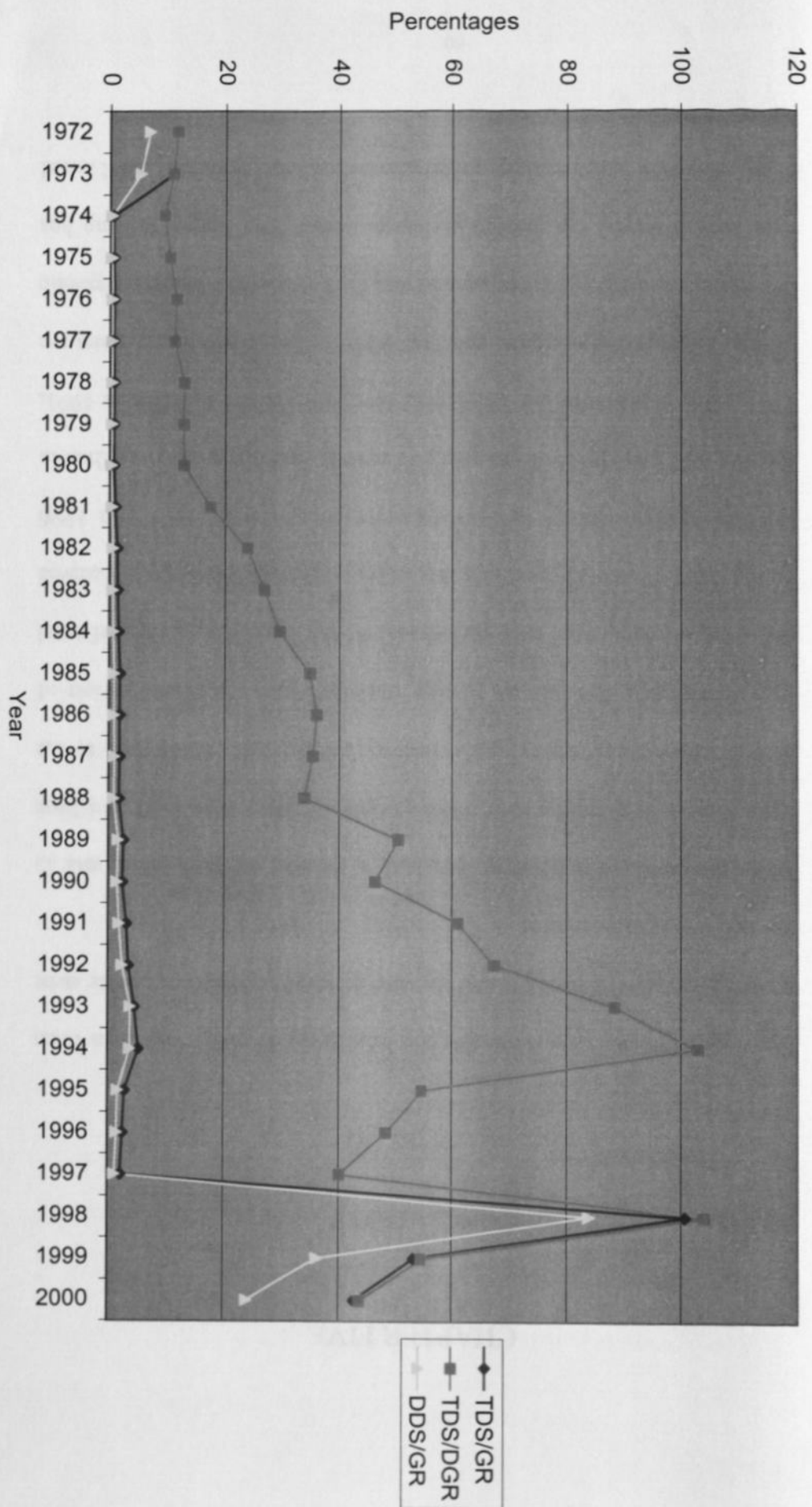


Figure 4(b): Debt Servicing Ratios

## CHAPTER FIVE

### 5.0 DISCUSSIONS AND CONCLUSIONS

#### 5.1 Discussions

##### 5.1.1 Total Debt

Results of the analyzes show that the total level of public debt has been growing from 1972 to 2000 and that the structure of Kenya's public debt has had two characteristics.

First, the level of total debt has had a general upward trend and is increasing at an alarming rate. For example, between June 1992 and June 2000, the level went up by approximately 202 percent. In addition to the local borrowing, the rate of foreign exchange and the liberalization of domestic interest rates have contributed to the burgeoning level of total public debt. Note for example that despite the fact that Kenya received less net foreign inflows in loan disbursements between 1991 and 1996 (GOK, 1997), the level of external public debt was higher in 1995 than in 1991. One explanation for this higher level of debt in 1995 than in 1991, despite aid suspension, is the fact that most of Kenya's external loans are denominated in foreign currency and therefore the level of external public debt is affected by the foreign exchange rates. The Kenya shilling has been relatively weaker than other currencies, for example the United

States dollar (US\$), in recent years as demonstrated by the average exchange rates for the US\$ to Kenyan shillings between 1991 to 2000 in Appendix 3. Foreign loans therefore showed higher levels in Kenyan shilling even in the years when the net foreign inflows were negative due to the weakening of the Kenya shilling.

The liberalization of the Kenyan economy freed the interest rates paid on domestic loans and consequently the government pays market interest rates on domestic loan so as to attract new investors to buy government securities and in order to encourage existing investors to roll over their investments. The higher interest rates payable on government securities raise total debt service payments which in turn increases the government's requirements for funds, thereby increasing the level of public debt.

The second characteristic is the upward and downward swings of total public debt levels in the last nine years of the study compared to the previous years when the trend was generally upward. Such swings create uncertainty among the investors with the resultant lack of confidence in government securities. The government is therefore forced to source additional debt at higher interest rates because prospective investors view lending to the government as being riskier than if the trend in the level of public debt is predictable (Hebling, 1999).

### 5.1.2 External Debt

Other than variations in total amount, external debt may be viewed from its donor composition. External borrowing in the 1980's and early 1990s was mostly from commercial sources and were on non-concessional terms. In the later period, external borrowing has been almost entirely from official sources which are on highly concessional terms. The earlier expensive loans are being repaid off and, in line with the current Development Plan, Kenya intends to pursue prudent financial and debt management strategies so as to meet its debt service obligations (GOK, 2002). These prudent strategies cover both internal and external public debt and include borrowing internally in the form of long-term bonds instead of the high interest Treasury Bills and borrowing externally on concessional terms.

### 5.1.3 Domestic Public Debt

Viewed as a percentage of total debt, Kenya's domestic public debt forms less than 50 percent of total debt. However, since domestic debt is not affected by exchange rates, the high rate of growth of domestic debt is due to the sheer increase in the volume of borrowing. The effect of this high growth in local borrowing is destabilizing to the economy because high domestic borrowing crowds out the private sector's access to investible funds because it brings government into competition with private sector

domestic borrowers. In addition, high domestic public borrowing pushes up market interest rates as well as causing domestic debt overhang. A case in point is in 1993 when, in order to mop out extra liquidity caused by printing money for the 1992 General Elections, the interest rates on Treasury Bills went up to about 80 percent. High interest rates raise the cost of borrowing and, as a result, stifle growth in the private sector. Another reason responsible for the rise in the stock of domestic public debt is the practice of local borrowing by the government in order to service debt and to retire foreign loans (Wagacha, 1999). This is an aspect of poor public debt management and especially so because the government retires concessional loans and replaces them with high interest domestic loans.

There is an indication that the government is not happy with the level of the stock of domestic public debt and intends to put in place measures that will reduce it (GOK, 2002). These measures include the creation of a buy-back scheme through the establishment of a Domestic Debt Fund and the conversion of a proportion of current stock of short-term domestic debt into long-term stocks of 10 to 20 years attracting favourable interest rates. There are in fact indications that the proposed measures are already in place because the Central Bank of Kenya in the second half of 2000/2001 fiscal year took steps to reduce the 91-day Treasury Bills in the domestic

debt while increasing the share of longer dated Treasury Bonds (CBK 2001).

#### 5.1.4 Debt Structure

A comparison between Table 2 and Table 3 and between Figure 1 and Figure 2 brings out a contrast between the composition of the level of total debt and that of debt servicing. While the percentage of the level of domestic public debt to total public debt has been generally on a downward trend since 1991, the trend for the domestic public debt servicing to total public debt servicing during the same period has had up and down swings. The proportion taken up by domestic servicing is even more striking. For example, in 1993 and 1998 while the proportions of domestic public debt to total public debt were 28 and 30 percent respectively, the proportions of domestic debt servicing to total debt servicing were 85 and 83 per cent respectively. This comparison shows that the composition and/or the level of domestic public debt used by the Kenya Government from 1991 to 2000 was much more expensive than those of external public debt and is an indication of poor public debt management and, therefore, justifies the actions the government intends to take in order to reduce the level and alter the composition of domestic public debt.

#### 5.1.5 Debt Burden Indicators

The study established that the average ratios for the last three years in respect of total debt servicing to export of goods and services, total debt to GDP and total debt to export of goods and services were 64 percent, 84 percent and 282 percent respectively while the critical levels for severely indebted countries are 30 percent for debt service to export of goods and services; 50 percent for total debt to GDP; and 275 percent for total debt to exports (World Bank, 2001). Based on these ratios, Kenya may be classified as severely indebted country although in 1999 the World Bank (2001) classified Kenya as a moderately indebted country. This classification, however, agrees with that of Ng'eno (1977) that Kenya is among the severely indebted countries.

Looked at from the Maastricht criteria, Kenya has failed one criterion that public debt servicing should not exceed 15 per cent of government revenue. For the last three years of this study - 1998, 1999 and 2000 - the ratios of domestic debt servicing to government revenue were 84 percent, 36 percent and 24 percent respectively. Although the ratio was showing a downward trend, at 24 percent in 2000, the ratio was still well above the 15 percent recommended by the Maastricht Treaty of the European Union.



## 5.2 Summary of Conclusions

Some of the main conclusions which relate to Kenya Government's debt and have come to light from this study are that: -

- a) Kenya is a severely indebted county although the 1999 World Bank classification (World Bank, 2001) placed Kenya as a moderately indebted country. However, whether Kenya is a severely or moderately indebted country, it may not get preferred rates from the world market when looking for external finance from commercial sources and may be forced to continue relying on official sources which have not been reliable since the 1991 aid embargo to Kenya;
- b) Kenya's public debt servicing to government revenue ratio was, for the last three years of the study, consistently above the 15 percent set by the Maastricht Treaty for European Union countries to meet before they join the common currency, the Euro, and is an indication that Kenya was using more of its revenue than is advisable to service public debt. This fact is amplified by the fact that total debt servicing took up 101 percent, 53 percent and 43 percent of government revenue in 1998, 1999 and 2000 respectively. The problem seems to have come from the composition of domestic public debt because, although the level of

external public debt which was mainly concessional (GOK, 2002) in the last three years of the study accounted for at least 70 percent of total debt, domestic debt servicing was consuming more than 55 percent of total debt service payments in each of the three years. In fact there is an indication that domestic public debt was not being managed properly particularly in the last nine years of the study because, while the proportion of internal debt to total debt ranged between 34 and 24 percent, the proportion taken up by internal debt servicing was above 55 percent during the whole period. There is a need, therefore, to reduce the level of domestic public debt as well as to restructure its composition.

- c) At 83 percent in 2000 and at least 81 percent since 1992, the ratio of total debt to GDP was very high and since this ratio measures productivity of public debt, the results of the study indicated that public debt in Kenya had not been productively used. The debt was therefore burdensome because resources, other than those produced from investing public debt was being used to service it;
- d) The uneven trends in both the structures in the level and servicing of public debt showed that Kenya does not seem to have a definite public debt management strategy. The unevenness of the trends causes Kenya's public debt to be perceived as risky and the Central

Government has to pay a premium for this risk. The premium pushes up the cost of borrowing for the government in the form of higher interest rates payable on government securities and eventually these high interest rates are passed on to the Kenyan economy because interest rates in government securities are generally used as a benchmark for lending in a country.

- e) The proportion of internal debt to total debt has been going down while the shilling amount of internal debt has had a general upward trend. The shilling amount of external debt has had upward and downward swings in conformity with the level of total public debt. There does not therefore seem to have been any association between the level of external public debt and the level of internal public debt. The study, however, found that levels of external public debt were positively associated with levels of domestic public debt servicing. The study was, therefore, in line with the views expressed in the literature that local borrowing had been used to retire external debt and pay debt arrears (Wagacha, et al, 1999 and GOK, 1994);
- f) The above conclusions show that the ability of Kenya Government to service its debt is diminishing and that there is an urgent need for both the government and the international community to take

appropriate measures to rectify the situation by reducing the level and by restructuring the composition of Kenya's public debt.

### **5.3 Recommendations**

The above conclusions indicate the need to formulate and implement both economic and good public debt management policies in order to take corrective measures to raise Kenya Government's credit rating, reduce debt service burden and create predictability in the structures of the level and servicing of public debt. The Kenya Government could undertake some of the measures while other measures would need the assistance of the international community. The measures which the government could take are outlined below.

#### **5.3.1 Providing an Enabling Environment for the Private Sector**

The government should provide an enabling environment for the private sector so that the sector may be more productive and, in the process, raise GDP. An example would be to assist producers, particularly of agricultural goods, to find outlets for their products. Recent events in the country by the producers of milk, maize and sugar show that Kenyans are capable of high production but marketing of their products is a major impediment. Other areas the government could work on with regard to an enabling environment relate to the improvement of infrastructure like

roads, telephone system, electricity, water and the elimination of corruption. Improvements in these areas would increase profitability in the private sector by reducing the cost of doing business in Kenya and, as a result, new investors both foreign and local would be attracted.

### 5.3.2 Raising Government Revenue

The Central Government should raise its revenue by improving tax collection and broadening the tax base by including the informal sector in the tax base through the design of an effective strategy to incorporate the informal sector in the tax base (Wagacha, 1999). However, broadening the tax base should go hand in hand with the provision by the government of an enabling environment to the prospective taxpayers otherwise those included in the broader tax base will view their inclusion as exploitative and they may resort to tax avoidance.

### 5.3.3 Accessing More Concessional Foreign Loans and Lengthening the Maturity of Domestic Public Debt

The government should make more concerted efforts to reach agreement with the international donor community to enable the resumption of the disbursement of concessional loans. The resumption of concessional loans would, in addition to bringing in cheaper funds, provide a positive signal to foreign private investors that Kenya is viable for investment and would facilitate direct foreign investment into the country.

#### 5.3.4 Implementing Recommendations made by the 1997 Public

##### Expenditure Review

However, in view of the fact that aid from all donors to the least developed countries (LDCs), was 30 percent less in 2000 than in 1994 (United Nations Conference on Trade and Development, 2002), Kenya (which is not among the LDCs) may not in future get as much concessional loans as she has been getting in the past. The Kenya Government should therefore implement the recommendations put forward in Section 3.4.15 of the Public Expenditure Review (1997) with regard to: -

- (a) The reduction of the stock of treasury bills and lengthening the maturity of domestic debt. The government should thus relentlessly pursue the strategy it started in the second half of 2000/2001 fiscal year of reducing the 91-day treasury bills while increasing the share of longer dated treasury bonds (CBK, 2001);
- (b) Sale of assets linked to the retirement of debt;
- (c) Using external loan as far as possible to purchase capital goods so as to improve the productive capacity of the country. Any external loans should be used prudently and for the intended purposes.
- (d) Setting up a public debt management strategy that would include setting up a debt stabilization fund/ account or setting up a target of

the levels to be borrowed. The stabilization fund would delink the CBK's open market operations from fiscal requirements because retirement of government instruments would be a separate activity from that of monetary stabilization. On the other hand, setting up a target for public debt levels would remove uncertainty and create predictability and, as a result, reduce the current speculative aspects of holding the open market operations instruments of the CBK (Wagacha, 1999).

Such a strategy requires an institution and manpower to effect and coordinate. An institution could be set up composed of planners in the Ministry of Planning, the debt managers in the Treasury and officials of National Debt department at the CBK. Alternatively, the Public Debt Department in the Treasury could be strengthened so as to enable it spearhead the coordination and consultations with donors and government agencies with regard to all issues relating to Kenya's public debt.

#### 5.3.5 Increasing Access to the Markets in Developed Countries

While the Kenya Government could effect the above measures, the developed countries should show more concern for Kenya than is apparent at the moment. One way of showing concern would be for the developed countries to allow Kenya to export more goods to their countries. On the

advice from the IMF and the World Bank, Kenya liberalized its economy in the 1990s and items such as textiles and dairy products, which previously had restricted entry into Kenya, now enter Kenya freely. The imported goods have flooded the Kenyan market and made it difficult for Kenyan producers to sell their goods. Access to the world markets through international trade can give impetus to Kenya's economic development effort by reducing the debt to GDP and debt service to export of goods and services ratios through increases in GDP and revenue from exports.

#### **5.4 Limitations of the Study**

This study has been undertaken against a backdrop of the following limitations: -

##### **5.4.1 Inconsistency in Definitions of Public Debt**

Different government documents define public debt differently and in some documents, only the Central Government's debt is defined as public debt, while in other documents, public debt includes both the debt of central government and debt held by government corporations. The same problem applies to the definitions of government revenue and GDP. At times changes in definitions have been made in the same documents over



the years, thereby making it difficult to compare the same items over the whole period of study.

#### 5.4.2 Alteration of Figures

In the majority of cases, figures for specific items are provisional in the first years of publication and are altered in the subsequent publications of the same document. In some publications of the same document, some items may be provisional figures while other items are not provisional. For example, in a particular publication of Annual Statistical Abstract, public debt may be provisional while government revenue may not be provisional. In other cases even non-provisional figures are altered in subsequent years of the same publications. The figures used in this study therefore depend on the particular publication used.

#### 5.4.3 Omissions and Errors

This particularly relates to the earlier documents when the use of computers was not widespread. Items included in later publications are at times omitted in the earlier versions thus making comparisons difficult. Due to the omission of figures in some earlier publications, it was not possible to carry out an analysis to show the structure between short-term and long-term debts for the whole study period.

#### 5.4.4 Use of Debt Burden Indicators

Other than the source data above, burden indicators used in the study were designed specifically for either external debt or internal debt. For example, creditworthiness indicators used by the World Bank were designed specifically for external debt while the Maastricht Treaty rule of thumb ratios were designed specifically for domestic debt. However, this study focused on the total public debt which, in Kenya, happens to be a combination of internal and external debt. Ratios for total debt and total debt servicing in this study, therefore, incorporated more elements than those originally designed in the World Bank creditworthiness indicators or the Maastricht Treaty.

#### 5.4.5 The Omission of Pending Bills from the Figure of Total Debt

Public Expenditure Review (1997) states that the recorded stock of pending bills owed by government as at 30 June 1996 was Kshs.4,900 million. This, they estimated, was about 4.5 per cent of the total stock of debt as at that date. The Review pointed out that the figure for pending bills could be much higher than the estimated amount because data on pending bills were not readily available.

## 5.5 Suggestions for Further Research

Limited studies have been carried out on Kenya's public debt. Studies in this area would help Kenya manage its public debt more efficiently and effectively. Such studies should be narrow and focus on various aspects of the public debt. Such studies could include: -

- (a) A study focussing either on domestic public debt or external public debt which would allow for finer detail that has not been possible in this broad study, to be paid to the structure and servicing of Kenya's public debt. Such a study would also allow for the use of appropriate debt and debt service indicators designed by the World Bank and the Maastricht Treaty for external and domestic debt respectively; and
- (b) A study to find out the amount of pending bills so that their level could be ascertained and factored in the level of domestic public debt.

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APPENDIX 1: KENYA'S FINANCIAL DATA AT FISCAL YEAR IN KENYA SHILLINGS (IN MILLIONS) AND PERCENTAGES

Year	Outstanding Debt			Debt Service				External Debt Service as a % of Exports	Domestically Generated Revenue	Total Revenue	Export of Goods and Services	GDP		
	External	Domestic	Total	External	Internal	Total	Principal						Interest	Total
1972	2,100	2,100	4,200	145	189	334	160	174	334	4	2,841	2,841	4,090	12,970
1973	2,500	2,600	5,100	178	153	331	118	213	331	4	2,992	2,992	5,072	14,497
1974	2,700	3,000	5,700	173	188	361	121	240	361	2	3,820	3,820	7,144	17,906
1975	3,400	3,400	6,800	202	271	473	183	291	473	3	4,533	4,533	9,560	20,560
1976	4,200	4,800	9,000	239	382	621	230	391	621	3	5,383	5,383	107,809	25,257
1977	4,600	5,800	10,400	295	430	726	247	479	726	2	6,411	6,411	13,004	32,813
1978	4,900	6,800	11,700	623	589	1,212	556	656	1,212	5	9,443	9,443	11,862	35,768
1979	9,800	8,700	18,500	625	684	1,309	459	850	1,309	5	10,213	10,213	12,002	39,592
1980	10,000	8,600	18,600	839	737	1,576	615	961	1,576	6	12,220	12,220	14,696	44,570
1981	13,000	10,700	23,700	1,414	1,025	2,438	1,065	1,374	2,438	9	14,030	14,030	15,474	51,641
1982	17,200	14,500	31,700	2,152	1,544	3,696	1,325	2,371	3,696	13	15,262	15,262	16,940	58,892
1983	23,400	17,900	41,300	2,618	1,863	4,481	1,562	2,919	4,481	13	16,510	16,510	19,592	66,333
1984	30,600	20,000	50,600	3,065	2,388	5,453	1,982	3,472	5,453	13	18,242	18,242	23,410	73,091
1985	30,900	22,800	53,700	3,896	3,223	7,118	3,212	3,906	7,118	15	20,392	20,392	25,497	88,373
1986	40,600	27,300	67,900	4,741	3,979	8,720	3,399	5,321	8,720	16	24,186	24,186	30,334	102,299
1987	45,600	35,100	80,700	5,166	4,686	9,852	3,848	6,004	9,852	18	27,792	27,792	27,992	112,250
1988	54,300	39,200	93,500	5,677	5,334	11,011	3,604	7,407	11,011	17	32,369	32,369	33,297	129,612
1989	54,300	42,800	97,100	7,376	11,949	19,325	10,057	9,268	19,325	18	38,371	38,371	39,954	149,027
1990	68,400	45,500	113,900	7,461	11,610	19,071	4,777	14,294	19,071	15	41,122	41,122	51,065	167,556
1991	89,200	56,100	145,300	12,285	17,472	29,757	14,835	14,922	29,757	20	48,736	48,736	60,453	190,807
1992	122,300	63,000	185,300	11,978	26,521	38,499	22,802	15,697	38,499	17	57,081	57,081	69,287	219,720
1993	273,100	103,600	376,700	9,469	51,834	61,302	33,449	27,853	61,302	7	69,522	69,522	134,900	270,246
1994	208,100	103,200	311,300	30,685	73,302	103,986	49,227	54,759	103,986	21	101,034	101,034	148,225	326,080
1995	246,000	111,400	357,400	28,368	38,592	66,960	31,592	35,368	66,960	19	122,729	122,729	152,596	393,767
1996	358,926	110,500	469,426	29,877	39,393	69,271	33,903	35,368	69,271	17	143,424	143,424	172,459	449,621
1997	325,455	130,785	456,240	26,460	32,501	58,961	25,316	33,645	58,961	15	147,084	147,084	174,846	536,383
1998	336,339	145,541	481,880	29,150	144,303	173,453	133,640	39,813	173,453	17	167,146	167,146	171,895	594,019
1999	413,819	150,498	564,317	31,215	66,956	98,170	62,081	36,090	98,170	17	180,327	180,327	188,693	637,362
2000	395,694	163,405	559,099	33,980	44,870	78,850	49,932	28,918	78,850	17	180,541	180,541	208,800	672,219

Source: Central Bureau of Statistics Economic Surveys and Quarterly Budgetary Reviews

## APPENDIX 2: GLOSSARY OF TERMS

Arrears	The total of scheduled debt service payments that have fallen due but remain unpaid.
Base rate	A recognized and published interest rate, for example LIBOR, used to determine the rate to be used for variable interest rate loans. The rate for the loan is determined by adding the spread to the base rate.
Borrower (or debtor)	The organization which is responsible for servicing the debt.
Central Bank	The financial institution that holds reserve deposits of commercial banks, serves as a lender of last resort to commercial banks, and holds deposits of the central government and may lend to it. It is the agency for managing a country's monetary and banking system through regulations and through intervention as a buyer or seller in the market for government securities. It normally has the authority to issue bank notes which comprise part of the country's stock of legal tender. It also holds foreign

exchange assets and has the responsibility for intervening in foreign exchange assets to influence foreign exchange rates.

- Creditor The one who provides money or resources and to whom payment is owed, under a specific loan agreement.
- Currency of denomination The currency in which a loan amount is expressed.
- Currency of repayment The unit of account in which a loan is to be repaid.
- Debt service All payments made against the loan, that is, principal repayments plus service payments. One must distinguish actual from scheduled debt service payments; the latter are the principal and interest payments that are contractually required to be made through the life of the debt. The "actual payments" are those that, in fact, were executed.
- Disbursed and Outstanding debt The amount that has been disbursed from a loan commitment but has not yet been repaid or forgiven.
- Direct investment Transactions that provide a foreigner (the direct investor) with an equity position in a company, done with the objective of obtaining, or enhancing,

	a lasting interest. The recipient enterprise is considered to be a direct investment enterprise if a foreign direct investor owns 10 percent of the ordinary shares or voting power. The components of direct investment are equity capital, reinvested earnings or the taking on of inter-company debt
Disbursement	Resources, such as goods, services, or funds, taken by the borrower against a loan agreement.
Export of goods and Services	The total value of goods and all services sold to the rest of the world.
Fixed interest rate	A rate of interest that is defined in absolute terms at the time of the loan agreement, for example, 8.5 percent.
Grant	An exchange of goods, services or financial instruments with nothing being received in return - also known as a transfer. A capital grant (or transfer) involves (a) the exchange of a fixed asset or (b) the forgiveness of a liability. A current grant (or transfer) involves the exchange of goods or services designed for consumption or the exchange

	of financial instruments not earmarked for the purchase of a fixed asset.
Grant element	The measure of concessionality of a loan, calculated as the difference between the face value of the loan and the sum of the discounted future debt service payments to be made by the borrower (i.e., the grant equivalent) expressed as a percentage of the face value of the loan. By convention, a 10 percent discount rate is used.
Gross national product	The measure of the total domestic and foreign output claimed by residents of an economy, less the domestic output claimed by nonresidents. GNP does not include deductions for depreciation.
Indebtedness	The financial obligation to make payment in cash, goods or services to a creditor in accordance with contractual or other arrangements.
Interest payments	Payments made in accordance with the contractual terms of a loan that specify the rate of interest that are to be applied, and the way in which the interest is to be computed. The loan may have fixed or variable interest rates.

Liability	An amount owed (i.e. payable) by an individual or entity for goods or services received, expenses incurred, assets acquired, construction performed, and amounts received but not yet earned.
Loan	An agreement in which a lender undertakes to make specified resources available to a borrower. The amount of funds disbursed is to be repaid (with or without interest and late fees) in accordance with the terms of a promissory note or repayment schedule.
Loan agreement	The legal evidence of an agreement to lend once certain preconditions have been met.
Long-term external debt	Debt that has an original or extended maturity of more than one year.
Lump sum payment	Repayment of the total amount of a loan commitment in a single amount at maturity. However, interest is normally payable at regular intervals (quarterly, semiannually, etc) during the life of the loan.
Maturity	The debt service amounts to be paid on a particular date. Final maturity date is the date of the last

	<p>payment due on the loan. Maturity period is sometimes used to denote the entire period over which principal repayments are being made for the loan.</p>
Net transfers	<p>Loan disbursements minus repayments of principal minus service payments during some period.</p>
Net flows	<p>Loan disbursements minus principal repayments during some period.</p>
Official creditors	<p>Public sector lenders. Some are multilateral, consisting of international institutions such as the World Bank and regional development banks. Others are bilateral, being agencies of individual governments (including central banks).</p>
Official development Assistance (ODA)	<p>Flows to developing countries and to multilateral institutions provided by official agencies, including state and local governments, or by their executive agencies, each transaction of which meets the following test: (a) it is administered with the promotion of the economic development and welfare of the developing countries as its main</p>



Banks	objective, and, (b) it is concessional in character and contains a grant element of at least 25 percent.
Official development	The sum of official development assistance and less
Finance	concessional official flows (other official development flows).
Principal outstanding	The amount of principal disbursed and not repaid.
Principal repayments	The payments which are made against the drawn and outstanding amount of the loan.
Private creditors	Lenders not part of the public sector, comprising bondholders (of bonds that are either publicly issued or privately placed), private banks and other private financial institutions, manufacturers, exporters and other suppliers of goods on credit.
Public debt	The internal or external obligation of a public debtor, including the national government, a political subdivision (or an agency of either) and autonomous public bodies.
Publicly guaranteed debt	The external obligation of a private debtor that is guaranteed for repayment by a public entity.
Regional development	Multilateral organizations that are set up to provide

Banks	and administer loans, normally at concessional terms, to member countries. Membership is limited to a geographic region.
Roll over	Extension of credit is essentially routine and, upon repayment funds are relent to the same borrower for similar purposes.
Service charges	All charges that must be paid as a price for the loan, such as: interest, commitment fees, and management fees.
Service payments	Amounts actually remitted by the borrower to repay a debt.
Short-term debt	Debt that has an original maturity of one year or less.
Spread (or margin)	A percentage to be added to some defined base interest rate, such as LIBOR, to determine the rate of interest to be used for a loan.
Stock of debt	The amount outstanding as at moment of time. Examples are disbursed and outstanding debt (the amount drawn and not yet repaid); undisbursed balance (the amount of a loan commitment that is still available to be drawn); arrears (amounts which

were due but have not yet been paid). The concept of debt stock contrasts with that of financial flows, which measures transactions during a given period of time.

Supplier's credit

A loan extended by an exporter to finance the purchase of that exporter's goods or contractual services.

Undisbursed balance

The amount of a loan commitment that is still available to be drawn.

Variable interest rate

A rate of interest that is computed by adding a spread to a predetermined base rate. For example, 1.25% over Treasury Bills rate.

**APPENDIX 3: AVERAGE EXCHANGE RATES FOR THE UNITED STATES DOLLAR TO KENYA SHILLINGS**

<u>Dollar</u>	<u>Shilling</u>
1991	27.51;
1992	32.22;
1993	58.00;
1994	56.05;
1995	51.43;
1996	57.12;
1997	58.82;
1998	60.38;
1999	70.33;
2000	76.54.

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