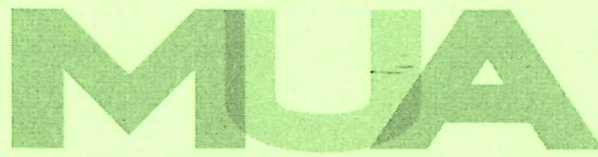


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**UNDERGRADUATE UNIVERSITY EXAMINATIONS**

**SCHOOL OF MANAGEMENT AND LEADERSHIP**

**DEGREE OF BACHELOR OF COMMERCE**

**FIN 321 : PUBLIC FINANCE**

**DATE: 29<sup>TH</sup> JULY 2024**

**DURATION: 2 HOURS**

**MAXIMUM MARKS: 70**

**INSTRUCTIONS:**

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **SIX (6)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **THREE** questions.
6. Question **ONE** carries **25 MARKS** and the rest carry **15 MARKS** each.
7. Write all your answers in the Examination answer booklet provided.

**QUESTION ONE**

Read the Case Study below carefully and answer the questions that follow:

**KENYA'S PUBLIC DEBT REVIEW 2023:*****IS KENYA'S PUBLIC DEBT SUSTAINABLE?***

Kenya is one of the fastest growing economies in Sub-Saharan Africa, having registered a growth rate of 5.4% in the second quarter of 2023. However, the country also faces significant challenges in managing its public debt, which has increased rapidly in recent years. According to the latest data from the Central Bank of Kenya (CBK), the total public debt stood at Kshs 10.2 tn as of June 2023, compared to Kshs 8.6 tn recorded in June 2022. This has in turn increased the debt to GDP ratio to 70.2% as of June 2023, 20.1% points higher than the International Monetary Fund (IMF) threshold of 50.0% for developing countries, up from the 66.7% recorded in June 2022.

The public debt comprises both external and domestic debt, where the ratio of the external debt to domestic debt remains high at 54.3% to 45.7% as of September 2023. The government has been working on trimming the domestic borrowing so as to ease the pressure on interest rates, with the short-day papers all crossing the 15.0% mark in the current auction results. The reduction in local borrowing is also meant to address the private sector crowding out.

The main sources of external debt are multilateral and bilateral creditors, while the main instruments of domestic debt are Treasury bonds and Treasury bills. Likewise, the debt service to revenue ratio has increased over the period to 64.3% as of September 2023, 34.3% points higher than the IMF threshold of 30.0%. Notably, the debt service to revenue ratio hit an all-time high of 101.4% as of July 2023, indicating how debt servicing continues to weigh on the government's expenditure.

The rising public debt has raised concerns about its sustainability and implications for fiscal and macroeconomic stability. With the upcoming maturity of the USD 2.0 bn Eurobond in June 2024, there are concerns whether the government will meet the debt repayment.

This is as the public debt situation continues to deteriorate on the back of high fiscal deficits, and the depreciation of the Kenyan Shilling, which has depreciated by 21.4% on a year to date basis, given that 67.1% of Kenya's external debt is USD denominated, thus putting more pressure on debt servicing. This has been worsened by the conflict in Eastern Europe, which has raised the expenditure on imports; and the adverse effects of climate change have worsened the fiscal position and debt vulnerability of Kenya.

According to the Revenue and Net Expenditures Report for the FY'2022/23 by the National Treasury, the cumulative public debt servicing cost amounted to Kshs 1,161.6 bn which was 83.9% of the revised estimates of Kshs 1,385.1 bn, and 83.4% of the original estimates of Kshs 1,393.1 bn. Notably, the Kshs 1,161.6 bn debt servicing cost was equivalent to 56.8% of the actual revenues collected as at the end of FY'2022/23, which was 26.8% points above IMF's recommended threshold of 30.0%. Similarly, according to the National Treasury's Annual Public Debt Management Report 2022, the debt service to revenue ratio was estimated at 47.9% for the FY'2022/23 which was 2.1% points lower than 50.0% debt service to revenue ratio recorded in FY'2020/21.

The sustained high debt service to revenue ratio above the recommended threshold is a worrying sign. A ratio approaching 50.0% means that nearly half of the government's revenue is being allocated to servicing debt which may leave limited fiscal space for public investments, social programs, and other critical government functions, which are essential for the long-term well-being of country. Notably, the debt servicing cost has continued to rise with the

latest revenue and net expenditures for the three months of FY'2023/2024 ending 30<sup>th</sup> September 2023, highlighting that debt servicing to total revenue stood at 64.3%. Below is a chart showing the debt service to revenue ratio for the last ten fiscal years:

**Source: Cytonn, October, 2023 (Extracts from Cytonn Report)**

**Required:**

Based on the above report coupled with your insight on Public Debt Management, you are required to:

- a) Analyse four main factors that have accelerated the growth in Kenya's Public debt, citing examples. **(6 Marks)**
- b) Assess six negative economic consequences of high debt levels in developing countries. **(9 Marks)**
- c) Describe five approaches that Kenya can employ to get out of external debt trap. **(10 Marks)**

**QUESTION TWO**

- a) Identify three bases of public sector accounting and demonstrate the mode of operation of each. **(6 Marks)**
- b) Describe six categories of activities carried out by the Kenyan government which form the basis for raising revenue. **(9 Marks)**

**QUESTION THREE**

- a) Analyse three classifications of government expenditures from an economics perspective. **(6 Marks)**
- b) Examine six objectives of revenue control system in the public sector. **(9 Marks)**

**QUESTION FOUR**

- a) Assess the rationales for the importance of sound Public Finance Management (PFM) in your country. **(6 Marks)**
- b) Examine six tenets of effective management of domestic debt. **(9 Marks)**

**QUESTION FIVE**

- a) Evaluate four factors that are the principal causes of Revenue Allocation Problems in your country, recommending a possible solution for each. **(8 Marks)**
- b) Explain seven Objectives of Public Sector Accounting. **(7 Marks)**

**QUESTION SIX**

- a) Appraise four major purposes of Government budget. **(6 Marks)**
- b) The Kenyan Government expenditure has been skyrocketing over the years. Discuss reasons for this trend. **(9 Marks)**

