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DISCUSSION PAPER

Policy Dialogue on Managing Contingent Liabilities Processes in the Post-COVID Period

The case for Kenya and Rwanda

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Acronyms and abbreviations

AfDB	African Development Bank
CLMP	Contingent liabilities management processes
CRA	Credit Rating Agency
CSP	Country Strategy Paper
EAC	East African Community
FCCL	Fiscal commitments and contingent liabilities
FRW	Rwandan franc
GDP	Gross domestic product
IFRS	International financial reporting standards
IMF	International Monetary Fund
MINECOFIN	Ministry of Finance and Economic Planning (Rwanda)
OECD	Organisation for Economic Co-operation and Development
PFM	Public financial management
PPP	Public-private partnership
RDB	Rwanda Development Board
SALM	Sovereign asset and liability management
SOE	State-owned enterprise

Acknowledgements

Abstract

Government's role to manage contingent liabilities processes emanates from its constitutional mandate to deliver on its public responsibilities to the country's citizens. In this regard, its broad objective is to utilise contingent liabilities management processes (CLMP) in a manner which supports national priorities that are also beneficial to the citizens of a country. The effectiveness of such processes are compromised when risks emanating from contingent liabilities increase in an unsustainable manner. Many factors may lead to such an undesirable outcome, and it usually involves country-specific considerations. These may include explicit contractual arrangements as well as implicit moral obligations such as natural disasters. Effectively managing contingent liabilities processes at a country-specific level is therefore a primary responsibility of all governments.

The accepted rationale for governments to take on contingent liabilities is based on arguments of the need to correct market failure. Other arguments invoked to justify taking on risks through contingent liabilities include income redistribution and international competitiveness. In this regard, the Organisation for Economic Co-operation and Development (OECD) states that sovereign guarantees is the category of contingent liabilities with which debt management offices mostly engage (Ülgentürk, 2017). As a warning, the report states that, with the issuance of a government guarantee to a state-owned enterprise (SOE), the state undertakes to honour the debt or other obligations of such entities if they are unable to meet their contractual obligations.

1 Introduction

Contingent liabilities – such as government guarantees, debt of state-owned enterprises (SOEs) and public-private partnership (PPP) risk guarantees – are managed primarily by the debt management offices of the respective country governments. In countries where this is not the case, contingent liability management processes (CLMP), including monitoring of risk exposures in these countries, are either jointly or collectively the responsibility of the PPP unit, the National Budget Office or the Office of the Accountant-General.

Countries in the East African region generally appreciate the benefits associated with sound CLMP. These include access to funding, augmentation of SOE capital, project cost reduction, improving SOE performance, financing developmental projects, supporting developmental project start-ups, reducing SOE recapitalisation needs, improving public infrastructure investment and development, and the preference for direct loans as opposed to government funding.

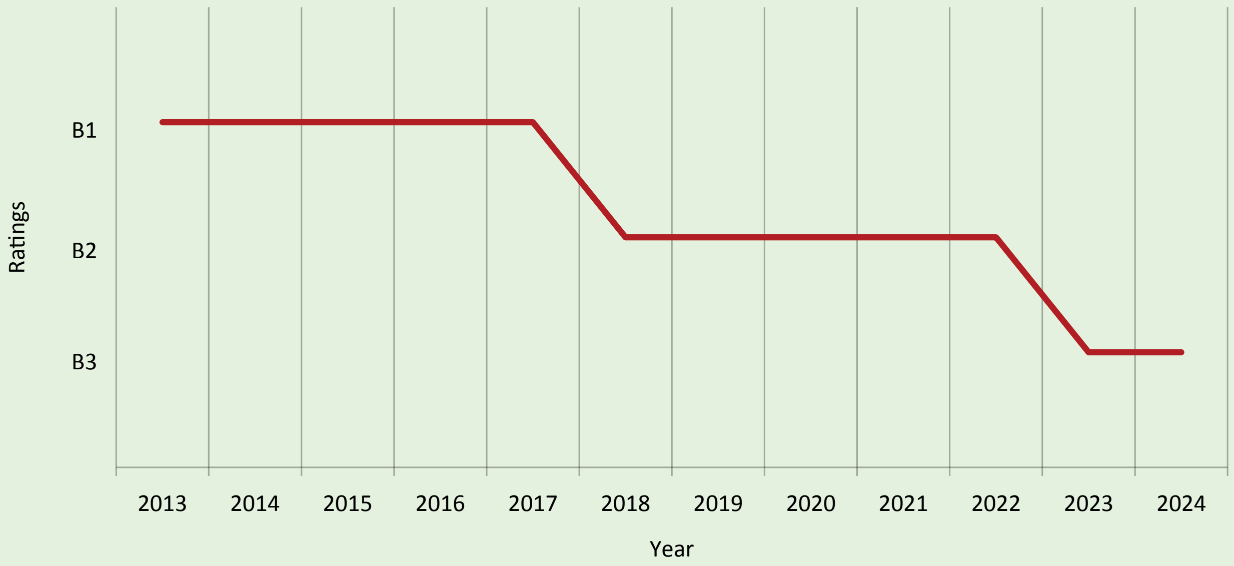
It is generally agreed that the outbreak of the COVID-19 pandemic in 2020 increased the risk exposure and probabilities of default in the African region generally, and in East Africa particularly, regarding the utilisation of government contingent liabilities. However, it is also agreed that the effectiveness of CLMP prior to the outbreak of COVID-19 was already poor.

CLMP effectiveness is characterised by non-adherence to issued guidelines, ad hoc reporting and late monitoring, inconsistencies between government and SOE expectations when issuing government guarantees, and the lack of centralisation of such processes. As a result, documented procedures were already generally lacking prior to the outbreak of the pandemic, contributing to poor monitoring and risk management.

This discussion paper considers the experiences of Kenya and Rwanda as two countries in East Africa with regards to CLMP. The sovereign credit ratings by Moody's Credit Rating Agency (CRA) show the following ratings trend for Kenya and Rwanda, respectively (see Figures 1 and 2 overleaf).

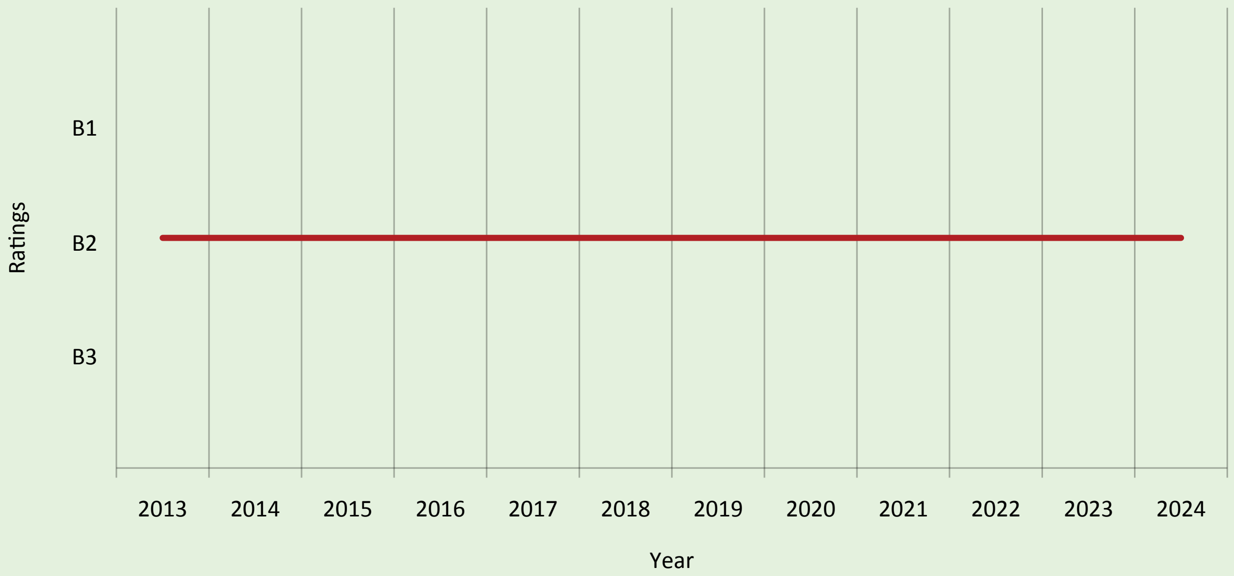
Countries in the East African region generally appreciate the benefits associated with sound CLMP.

Figure 1: Kenya's sovereign credit ratings, 2013–2024



Source: Moody's (2023)

Figure 2: Rwanda's sovereign credit ratings, 2013–2024



Source: Moody's (2023)

2 Relevant literature review

Objective 1

Legal framework underpinning the authority to issue government loan guarantees and other contingent liabilities.

According to a CABRI report, 'robust regulatory frameworks' are necessary to inform proper institutional arrangements and operating processes, particularly credit risk management operations (CABRI, 2018). OECD (2015) guidelines offer policy recommendations on how African states can institutionalise various policy frameworks and processes concerning corporate governance practices, including activities related to relationships, mandates, reporting structures, standardising information and disclosure policies.

Public administration reform literature (e.g. Caiden, 2017) identifies the following key objectives for consideration:

1. Reconciling the many competing and conflicting interests in modern-day societies;
2. Achieving socio-economic transformation in pursuit of a conscious purpose; and
3. Applying the law in a detailed and systematic manner in the process of identifying, collecting and analysing relevant data for effective public decision-making.

In the context of public sector CLMP, Bailey (2004, p. 283) defines public finance as:

> ***'Any revenue or expenditure that flows through government budgets reflecting a multidisciplinary constitutional relationship between the state and its citizens, dominated by the political philosophy existing in that country. Its objectives are equity, efficiency, economy, and effectiveness in its pursuit of economic growth, in the manner that national income and wealth are distributed, and society's living standards are affected.'***

With public infrastructure investment in Africa being a high priority, CLMP supported by national and international oversight and regulatory bodies can help reduce the failure rate typically associated with such projects. This can be achieved by fostering information transparency and dissemination to relevant stakeholders, including respective ministries of finance, parliaments, civil society bodies, investors, CRAs and other relevant regulatory authorities.

Objective 2

Government's broad policy (strategy) framework to issue loan guarantees, on-lending or other contingent liabilities.

A paper by Bova et al. (2016) highlights the fiscal costs of government guarantees associated with public infrastructure projects as a major source of fiscal distress. Costs to the fiscus may range between 6 to 40% of gross domestic product (GDP). A paper by Leonard and Grovogui (2017) argues that a greater understanding of industries in the energy sector is required, especially considering the poverty-reduction claims made about projects in the extractive industries sector. Infrastructure projects in the energy sector involve multiple granular processes of diverse activities (including political, social and economic) impacting societies directly. Palei (2015) concludes that a country's national competitiveness is determined by its level of institutional development. Other factors include, among others, infrastructure investment, the macroeconomic environment, market size and technological readiness.

Objective 3

Pricing the credit risk (risk-based guarantee fees) in issuing loan guarantees and credit risk assessment (tactical) frameworks of managing loan guarantee exposures in the post-COVID period.

A paper by Liu et al. (2016) supports the view that contingent liabilities and government guarantees provided to public entities often lead to significant costs incurred by the state. Liu et al. argue that while state-supported SOE borrowing costs tend to be lower than non-SOE borrowing, it raises *moral hazard* issues for the government. As such, *greater vigilance* for more effective risk mitigation strategies is required. The literature suggests that government decisions to take on contingent liabilities for purposes of correcting a market failure, as opposed to a subsidy, are better advised to shift the cost of such an obligation to the beneficiary of such instruments being issued.

According to Shi et al. (2018), government subsidy policies, like government guarantees, may improve project delivery efficiencies when governments intervene to increase and realise expected societal benefits from public infrastructure investments. Efficiencies in infrastructure projects can therefore be improved by designing an *integrated sovereign* *guarantee management policy* that combines performance guarantees and government subsidies. Basu (2014) argues that a well-calibrated guarantee structure can reduce the failure rate of infrastructure projects, supporting both fiscal prudence and economic growth.

Objective 4

Managing loan guarantee exposures with government's other direct debt (loan/bond) obligations.

According to Togo (2007), the sovereign asset and liability management (SALM) approach to budget risk management has a strong theoretical underpinning. It takes a broader view of sovereign risk management, beyond government debt and contingent liability management, and includes the management of state assets and other liabilities. As an asset of the state, the shareholder is mandated to implement measures that improve shareholder value of SOEs. This requires an approach to processing sovereign guarantees that seeks to achieve greater efficiency and effectiveness in mitigating sovereign guarantee portfolio risks. A sovereign risk analysis involves a joint assessment of both liabilities (such as sovereign guarantees) and assets (such as investments in SOEs and public infrastructure projects) on different sides of the sovereign balance sheet.

According to Curry and Velandia (2000), a SALM framework allows for a broad analysis of the nature of government assets and liabilities, with the objective of reducing the budgetary risk to the fiscus. This is achieved by efforts to match the financial risk characteristics of both government's portfolio of assets and liabilities (i.e. the SALM approach), thereby providing a framework within which various sub-portfolio cost and risk trade-offs (i.e. the portfolio approach) are analysed.

Objective 5

Institutional (organisational) framework for the approval of loan guarantee and other borrowing requests.

The literature on accounting, reporting and monitoring of contingent liabilities offers a strong case for open access to all relevant information by all relevant stakeholders at all relevant times to effectively mitigate such fiscal risks. Information symmetry in relation to contingent liability management is necessary given the conclusion by Klimczak (2017). That is, the application of a common accounting standard across countries *does not* guarantee consistently similar reporting of public entity obligations to international financial reporting standards (IFRS) compliance on 'provisioning' in financial statements of different countries. For this, an integrated sovereign guarantee management approach to public infrastructure investments by SOEs is necessary.

The first line of defence against the fiscal risks posed by most contingent liabilities (from subnational governments, SOEs or the banking system) is a strong regulatory framework. The two basic pillars of an institutional/organisational framework for managing fiscal risk from these sources include: *ex-ante* regulation, which involves ex-ante controls over the behaviour of the institutions (such as limits on borrowing, deficits, risk-taking) and monitoring of their fiscal/financial positions by a central institution; and *ex-post* insolvency mechanisms, which would help enforce hard budget constraints and would create clear expectations about ex-post risk sharing, thereby mitigating moral hazards associated with the expectation of a possible bailout of these institutions.

Objective 6

Country practices of managing contingent liabilities as part of the fiscal risks.

The improper treatment of contingent liabilities masks the true fiscal situation of governments. For this reason, contingent liabilities, and sovereign guarantees in particular, must be placed alongside other sovereign exposures arising from both fiscal assets and liabilities. Polackova (1999) suggests that effective risk management must include all types of risks that may impact the national budget. In the main, such risks arise from:

- The structure of government's revenues, assets, and contingent and direct liabilities;
- Fiscal policies and the nature of their implementation; and
- Other exogenous variables such as disasters and movements in commodity prices.

Storkey (2004), on sovereign debt management, sets out a conceptual framework of the sovereign balance sheet comprising the government financial assets and liabilities. A conceptual sovereign balance sheet approach is a more intuitive and practical approach to what should be included in a sovereign balance sheet. Such an approach is simpler than an analytical approach to SALM frameworks and is not common in many countries as it requires access to detailed sovereign balance sheet data.

The intention of examining the sovereign balance sheet is for governments to explore whether the financial characteristics associated with its assets offer any meaningful insights to the way it manages the costs and risks of its liabilities. For instance, if fiscal revenue (asset) is mainly derived in local currency, the SALM approach requires that fiscal expenditure (liability) be mainly denominated in local currency. By attempting to find synergy between the financial features of government financial assets and liabilities in this way, the budget is essentially mitigated, to some extent, against adverse economic and non-economic events or developments.

3

Proposition and methodology

Information gathered on the effectiveness of CLMP in Eastern and Southern Africa supports the following proposition that may be relevant to the governments of Kenya and Rwanda.

Proposition

> ***'The absence of an independent and dedicated unit or function, typically a middle-office function, in the Ministry of Finance, to identify, assess and mitigate and threats or uncertainties associated with contingent liabilities management processes, will result in poor socio-economic service delivery to citizens.'***

The proposition is supported by the following conclusions emanating from information gathered on CLMP in Eastern and Southern Africa.

- Contingent liabilities management processes and systems are weak and ineffective due to data inadequacies, or the range of risks not being sufficiently captured. As such, the quality of quarterly and annual reports on contingent liability risk exposures are considered as average. Stock rather than flow data is being captured by CLMP.
- Budgetary and fiscal risk mitigation mechanisms are inadequate. Information gathered suggests that existing CLMP in selected Eastern and Southern African countries do not allow for the calculation of risk management default probabilities.

- Fiscal risk mitigation processes generally only involve planning for institutional liquidations, refinancing risks, financial risks, rising debt service obligations and moral hazard.
- Poor stakeholder relationships include i) poor integration of CLMP into the annual budget process for resource allocation purposes; ii) non-existence of annual contingent liabilities management risk exposure statements as part of the annual budget; and iii) inconsistent disclosure of contingent liabilities management risk exposures to parliaments and on government departmental websites.
- Weak implementation of agreed CLMP, notwithstanding sound laws and directives. On a positive note, information gathered suggests that relevant laws and directives are adequate and that CLMP are well supported by the governments in the region. Therefore, capacity building efforts aimed at improving the effectiveness of CLMP must be prioritised. Specific focus areas include monitoring and evaluation, risk identification, risk measurement and mitigation planning, reporting and disclosure, contract management, and auditing, legal and institutional framework development.
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Contingent liabilities management processes and systems are weak and ineffective due to data inadequacies, or the range of risks not being sufficiently captured.

Methodology

The *execution capability* to assess the effectiveness of CLMP in Kenya and Rwanda, post-COVID, is discussed at three levels, namely the organisational level, the team level and the individual level.

At the organisational level, the question is asked whether CLMP are aligned to the execution of organisational goals. In this regard, institutional issues related to *clarity* and *commitment* inform the discussion paper. On clarity, the question is raised: Are the goals associated with contingent liabilities management processes known? On commitment, the question is raised: Is there buy-in into the goals linked to contingent liability exposures of the state?

At the team level*,* the question is asked about how well contingent liability management processes allow for the effective execution of the unit/function/or work group objectives. In this regard, institutional issues related to *translation into action* and *enabling* inform the discussion paper. On translation into action, the question is raised: Is it known what should be done to achieve the goals regarding CLMP of government? On enabling, the question is raised: Are the necessary barriers associated with contingent liabilities and their post-COVID challenges brought down?

At the individual level*,* the question is asked about how well public officials practise the disciplines needed for the effective execution of CLMP. In this regard, institutional issues related to *synergy* and *accountability* inform the discussion paper. On synergy, the question is raised: Do public officials work together to arrive at better ways of achieving the goals linked to CLMP? On accountability, the question is raised: Do public officials account to each other for individual commitments regarding CLMP and state responsibilities?

In addition, the discussion paper on the effectiveness of CLMP in Kenya and Rwanda is informed by eight drivers of an effective enterprise-wide risk management system, namely:

Driver 1: Risk management competency on CLMP;

Driver 2: Culture and board/committee oversight of CLMP;

Driver 3: Periodic monitoring of CLMP;

Driver 4: Ongoing monitoring of CLMP;

Driver 5: Day-to-day operations (evaluation) of CLMP;

Driver 6: Risk management strategy in relation to CLMP;

Driver 7: Risk ownership of CLMP; and

Driver 8: Decision-making ownership in CLMP.

4 Discussion

Objective 1

Legal framework underpinning the authority to issue government loan guarantees and other contingent liabilities.

This section of the discussion paper relates to the issue of *commitment* at the *organisational level* by which the question is posed whether CLMP are aligned to the execution of the organisational goals. From *a public sector enterprise-wide risk management perspective*, Objective 1 relates to Driver 2 (i.e. Culture and board/committee oversight of CLMP). Key successes and challenges are described in implementing the legal framework underpinning the issuance of government loan guarantees and other contingent liabilities.

CLMP in Kenya

The legal framework for CLMP in Kenya is comprised of the Constitution of Kenya, 2010, the Public Finance Management Act, 2012, Public Finance Management Regulations, 2015, the Public Debt and Borrowing Policy and the Public Private Partnerships (PPP) Act, 2013. Under Article 214(2) of the Constitution, public debt is defined to include all financial obligations attendant to loans or guaranteed and securities issued or guaranteed by the national government. Article 213(1) of the Constitution mandates Parliament to prescribe terms and conditions under which the national government may guarantee loans.

The experience with contingent liability management in Kenya is best appreciated when viewed within the context of the government's Vision 2030 'Big Four' agenda (Government of Kenya, n.d.) as well as infrastructure development interventions and plans of the country. The Big Four is a blueprint of government and is aligned to the country's Vision 2030, with the objective of addressing the most pressing challenges affecting the Kenyan economy, including, amongst others, unemployment, healthcare, housing and economic growth.

Institutional arrangements and the legal authority for issuing and managing the fiscal risks emanating from government contingent liabilities and PPPs in Kenya are strong. According to the PPP Act of 2013, the Cabinet Secretary may, in consultation with the Debt Management Office and the Committee, issue a guarantee, undertake or enter binding letters of comfort in relation to a project. In this regard, adequate provisions for the issuance of government guarantees are stated in the laws, policies and Acts of Parliament.

The legal framework underpinning the issuance of government loan guarantees and other contingent liabilities in Kenya is aimed at meeting three objectives, as stated earlier in the literature review section. According to Caiden (2017), public administration involves a detailed and systematic application of the law. Key elements in this analysis are data identification and collection, with the aim of informing effective decision-making within government. Further elaboration regarding this challenge is provided in subsequent sections of this discussion paper.

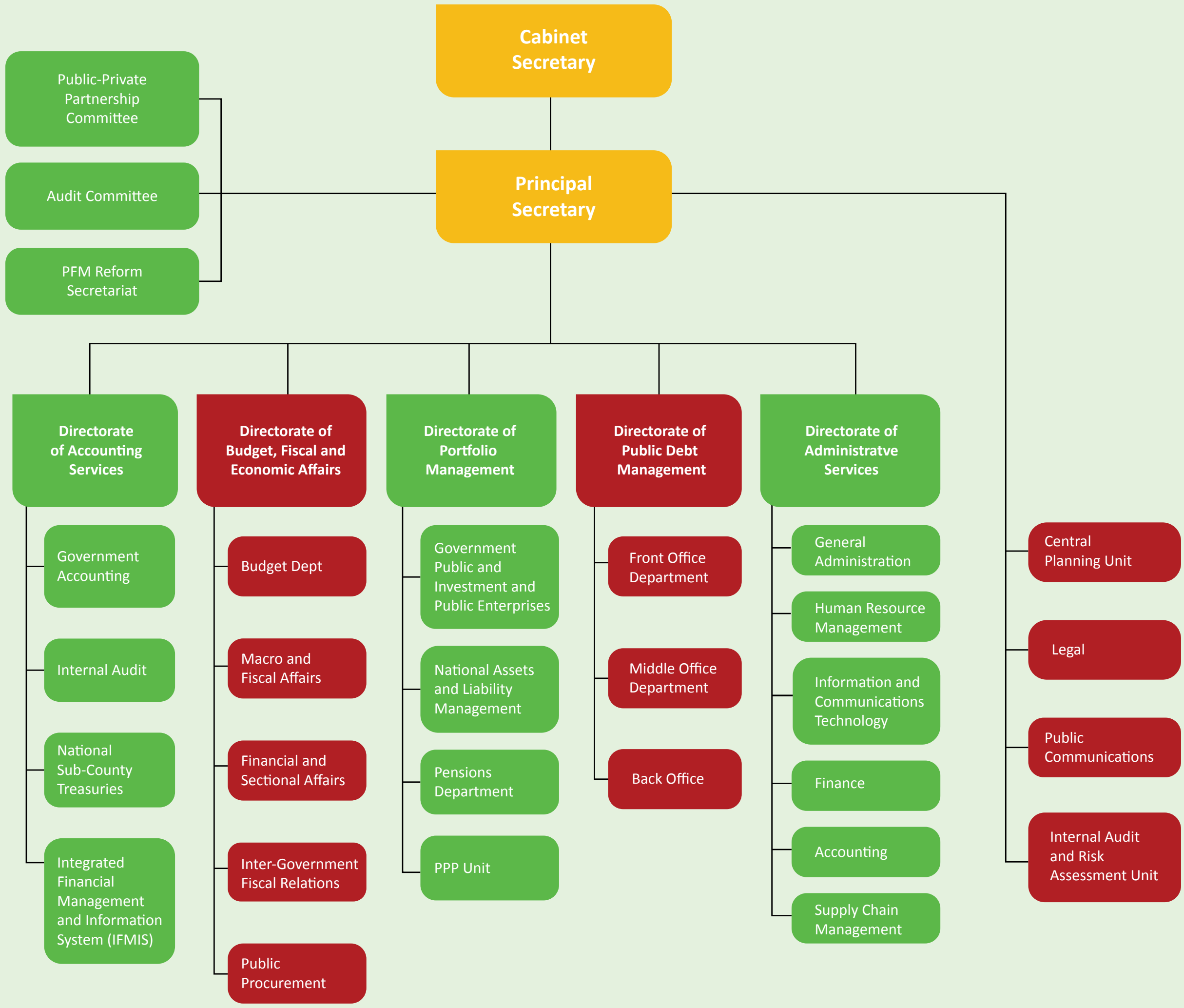
CLMP in Rwanda

According to Moody's (2023) credit ratings, Rwanda has effective institutions and credible policies that are expected to anchor the government's credit profile in response to shocks.

The 2023/24 Fiscal Risk Statement is Rwanda's fourth produced by the Ministry of Finance and Economic Planning (MINECOFIN, 2023). It demonstrates a *commitment* by the Government of Rwanda to fulfil international agreements with the International Monetary Fund (IMF) and the World Bank as well as the requirements of the East African Community Monetary Union.

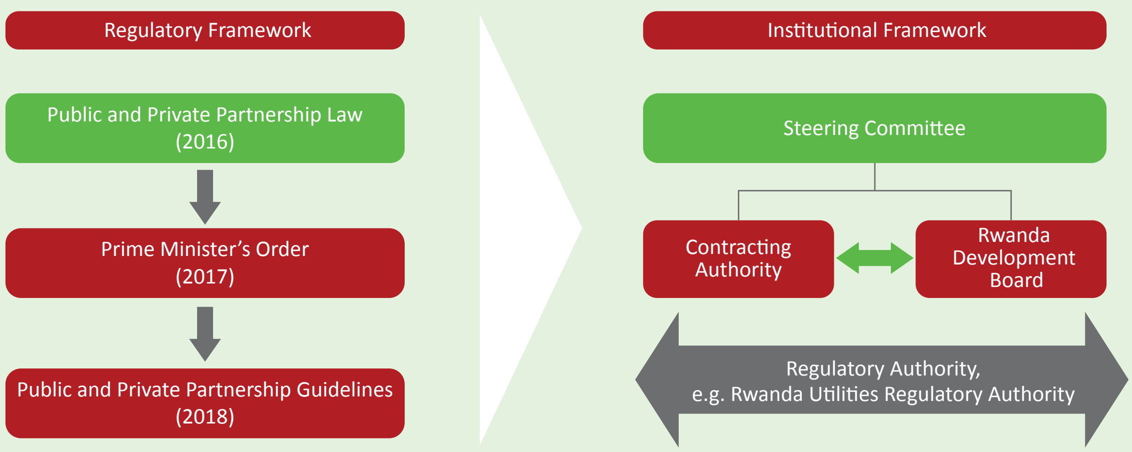
Contingent liabilities, about 6.1% of GDP, account for potential fiscal costs associated with fiscal risks of existing PPPs, as well as for the possible incidence of a financial crisis. Contingent liabilities associated with power purchase agreements (PPAs) are most common in Rwanda, which include the design, building, financing, operation and maintenance of new power plants. The legal framework in Rwanda for PPPs include Build, Operate and Transfer (BOT), Build, Operate and Own (BOO), Management, and Lease, Operate, Develop (LOD) contracts.

Figure 3: Kenya's legal and institutional context



Source*:* Wafula (2020)

Figure 4: Rwanda's PPP legal and institutional framework



Source: MINECOFIN (2023)

According to Moody's (2023) credit ratings, effective institutions and credible policies – as demonstrated by government's management of successive shocks – have preserved and will continue to support Rwanda's fiscal and debt metrics and economic growth model. This, despite downside risks stemming from climate events. The country's ratings in the Worldwide Governance Indicators remain on a gradual improving trend as well as its World Bank Country Policy and Institutional Assessment score, which is the best in Africa.

The implementation of a legal and institutional framework for managing contingent liabilities in Rwanda, and especially those associated with PPPs, is considered a key success in government's strategy to mitigate fiscal risks. It includes a high-level steering committee, co-chaired by the Minister of Finance and the CEO of the Rwanda Development Bank (RDB). Important considerations for a committee of this nature, however, are that activities of the following nature be undertaken:

- Developing objective criteria for the issuance of guarantees;
- Appreciating the unavoidable and unrealistic nature of not taking on contingent liabilities;
- Deciding whether contingent liabilities risk is better managed in the public or private sectors;
- Linking rules that restrict borrowing by subnational governments only to long-term capital investments; and
- Limiting key fiscal variables such as the overall or primary deficit, debt-service ratios and/or ceilings on guarantees.

While the creation of a high-level steering committee is a step in the right direction, it is not clear from the information gathered whether all the activities are indeed considered by such a committee tasked to manage the contingent liabilities associated with PPPs. In this regard, it may present a challenge to be overcome. According to a World Bank report (Razlog et al., 2020), country legislators are the ultimate authority on decisions to issue government guarantees. The report acknowledges that sovereign guarantee management processes are weak in many countries and argues in favour of government decisions being informed by a rigorous social cost-benefit analysis. The report states that such an analysis must involve a carefully designed process by which ministries of finance apply the experiences learnt from the utilisation and issuance of government guarantees, being ideally located to gather relevant fiscal risk exposure information. In this regard, the extent to which governments can undertake rigorous cost-benefit analysis depends on the institutional and organisational capability to manage the fiscal risk exposures associated with contingent liabilities, including the proper pricing of contingent liability credit risk.

Objective 2

Government's broad policy (strategy) framework to issue loan guarantees, on-lending or other contingent liabilities.

This section of the discussion paper relates to the issue of *clarity* at the *organisational level* and the question is posed whether buy-in exists into the goals linked to CLMP and exposures of the state. From *a public sector enterprise-wide risk management perspective*, Objective 2 relates to Driver 2 (i.e. Culture and board/committee oversight of CLMP) and Driver 6 (i.e. Risk management strategy in relation to CLMP).

The discussion examines government's broad policy objectives of issuing loan guarantees in terms of meeting development objectives. It explores the practices in Kenya and Rwanda regarding on-lending by government to sub-national entities (i.e. government agencies) and whether these instruments are used as an alternative or alongside the issuance of guarantees, including the rationale for doing so. With contingent liabilities generally associated with public infrastructure investments, particularly in the post-COVID period, Yang et al. (2010) argue that such projects serve as a useful counter-cyclical fiscal instrument capable of promoting economic growth, provided that such projects are productive.

CLMP in Kenya

Important considerations when developing and examining broad policy objectives by governments in relation to managing contingent liability processes, particularly in the post-COVID period, include, amongst others, the strong relationship between contingent liability management and public infrastructure projects, the social impact of public infrastructure investments, particularly in the energy sector, and the important positive relationship between public infrastructure investment and economic growth.

In this regard, to mitigate the negative perceptions generally associated with public infrastructure projects being wasteful, corrupt and mismanaged, formal legal mechanisms and administrative institutional frameworks must be established and operationalised to attract much-needed private capital into public infrastructure project financing. According to the 2019–2023 African Development Bank Group's Country Strategy Paper (CSP) for Kenya (AfDB, 2019), the government's broad policy framework on public infrastructure investments include targets on universal electricity access through power generation from geothermal, hydro, wind and solar sources, and the construction of national and regional transmission lines with distribution network construction and customer connections.

In the transport sector, government infrastructure plans focus on connecting urban, rural and regional markets to improve overall productivity by encouraging the manufacturing of 'high value' addition and improving households' welfare situation. In the water and sanitation sector, projects are aimed at increasing water supply and sanitation for industrial use, household consumption and for irrigation purposes. In this regard, government plans to increase access to safely managed pipe water and access to sanitation services. This involves the construction of multi-purpose dams, the rehabilitation and restoration of rivers, as well as urban and sanitation programmes.

As a result of COVID-19, government financing requirements increased substantially due to rising debt to GDP outcomes. The stimulus package announced in May 2020, targeting ongoing huge payouts, as social safety measures to the old and vulnerable, contributed meaningfully to this rise. The main source of contingent liability risk emanates from SOEs, requiring bailouts to, amongst others, meet interest payments associated with loan guarantees to SOEs.

The information gathered for this discussion paper suggests that the Government of Kenya has clear public infrastructure development plans, both of a social and economic nature. Social infrastructure projects are financed on the government budget while economic public infrastructure projects are financed by SOEs, with government guarantees provided when required. The practice of the Government of Kenya issuing securities for on-lending to government agencies (e.g. SOEs) to obtain loans at more favourable rates is not common. Rather, government guarantees are issued to SOEs to support their public infrastructure investments.

With this approach, the Government of Kenya utilises the issuance of sovereign guarantees to meet the countries socio-economic developmental objectives. This being a positive feature of CLMP in Kenya, various Global Competitiveness Reports show Kenya ranking low in areas of an *enabling environment* and *human capital*. According to the 2019 Global Competitiveness Report (Schwab, 2019), competitiveness in the infrastructure sector ranks 110 out of 141 countries. This suggests that effective CLMP in the post-COVID period must target efforts to improve human resource capacity in fiscal risk management.

Figure 5: East African Community sensitivity analysis for key indicators of public debt in Kenya, 2021

	Burundi	Kenya	Rwanda	Tanzania
PV of Debt-to-GDP ratio				
Baseline	**17**	**36**	**18**	**33**
A. Alternative scenarios				
A1. Real GDP growth by 2.0% each year	29	56	33	48
A2. Interest rates on domestic debt are 350 basis points higher	19	41	19	35
A3. Interest rates on foreign debt are 200 basis points higher	18	38	21	37
A4. Exchange rate depreciates by 4% more each year	20	38	23	38
A5. Combined A1–A4	39	71	44	65
Debt-to-GDP ratio				
Baseline	**19**	**41**	**28**	**44**
A. Alternative scenarios				
A1. Real GDP growth by 2.0% each year	32	62	44	61
A2. Interest rates on domestic debt are 350 basis points higher	22	46	29	47
A3. Interest rates on foreign debt are 200 basis points higher	21	43	31	48
A4. Exchange rate depreciates by 4% more each year	23	46	38	54
A5. Combined A1–A4	44	79	60	83
Baseline assumptions: averages for 2015–21				
Real growth	5.3	6.9	7.4	7.0
Interest rate on domestic debt	7.3	9.1	0.5	7.0
Interest rate on external debt	1.1	2.4	2.0	2.2
Annual nominal depreciation (+)	2.5	0.3	3.0	2.7

Source: Country authorities and IMF staff calculations

CLMP in Rwanda

The Government of Rwanda is committed to its main policy objectives of promoting economic development. *Clarity* in its economic strategy manifests in its Economic Recovery Plan, with the objectives of returning to the pre-COVID-19 growth path, improving the resilience of the economy and maintaining sustainable public finances.

The Government of Rwanda manages the impact of exposure to 'discrete fiscal risks'[1] on the budget linked to natural disasters and climate change risks. These risks may or may not occur. However, their occurrence will have significant consequences for the value of government assets and liabilities, including government revenue and spending. Two types of discrete fiscal risks are *direct physical risks* (including landslides that may cause damage to key public infrastructure) and *transition risks* (when transitioning to a carbon neutral economy – the so-called 'just-transition').

Public corporations in Rwanda serve to implement government's socio-economic policies and strategies. As an example, RwandAir plans to enhance its fleet by adding new aircraft to cater for the growing demand for popular destinations (Dubai, Doha, Europe). Furthermore, RwandAir also plans to provide cargo services to contribute to the region's economic growth. According to Moody's (2023) credit ratings, effective debt management in Rwanda is evidenced by the early refinancing of its Eurobonds in August 2021, well ahead of the maturity date and with a lower coupon rate. Also, the World Bank's country policy and institutional assessment score, which measures public sector accountability, is stronger than its peers.

The Government of Rwanda issues loan guarantees largely for PPP economic infrastructure projects, in which the MINECOFIN and the Rwanda Development Bank are key stakeholders. As such, its broad policy objective is aimed at meeting the socio-economic needs of its citizens. The more extensive the utilisation of PPPs become, the more mindful government needs to be of specific fiscal risks emanating from this well-researched and relevant fiscal instrument of public finance management. Fiscal risks, may, amongst others, have their source in non-financial public corporations, government guarantees, pension liabilities, natural disasters, the financial sector and in local government.

As a small land-locked economy, the Rwandan authorities therefore face the challenge of effectively managing a diverse range of inter-relationships and linkages, both in the financial and real sectors. The application of a SALM framework, as an instrument of public finance management, may be a useful instrument to detect fiscal risks that ordinarily may not be detected when analysing individual SOE balance sheets.

Objective 3

Pricing the credit risk (risk-based guarantee fees in issuing loan guarantees and credit risk assessment (tactical frameworks of managing loan guarantee exposures in the post-COVID period.

This section of the discussion paper relates to the issue of *enabling* at the *team level* by which the question is posed whether barriers associated with contingent liabilities and their post-COVID challenges/exposures are taken down. From *a public sector enterprise-wide risk management perspective*, Objective 3 relates to Driver 1 (i.e. Risk management competency on CLMP) and Driver 5 (i.e. Day-to-day operations/evaluation of CLMP). The discussion establishes whether the pricing of loan guarantees by governments acts as a deterrent for entities to seek government guarantees, and instead rely on the strength of their balance sheets when raising funds in the market. Alternatively, an enquiry is made whether the pricing of loan guarantees is more reflective of the differentiated and perhaps more complex sector-specific risks.

CLMP in Kenya

SOEs operate largely within the infrastructure sector and benefit from government guarantees. According to the CSP for Kenya (AfDB, 2019) with regards to staffing challenges, the Public Debt Management Office is under-staffed, with inadequate requisite staffing levels to effectively discharge its functions. Further, the CSP states that the provision of government guarantees contributed to moral hazard and a rise in payments to the private sector.

This undesirable situation, according to the AfDB (2019), is exacerbated by the lack of adequate financial risk management models to quantify the potential risks associated with PPP projects. Consequently, weak monitoring systems to effectively mitigate the fiscal risks associated with contingent liabilities expose the budget to potential loss if the risks materialise.

Information gathered for this discussion paper suggests that CLMP in Kenya are not adequately modelled to quantify the fiscal risks associated with government guarantees to SOEs. Reports suggest that inadequate information exists to perform rigorous debt sustainability analysis, resulting in the size of contingent liabilities often being under-estimated.

1 Discreet fiscal risks arise from the exposure of the government budget to natural hazards and climate change risks (MINECOFIN, 2023).

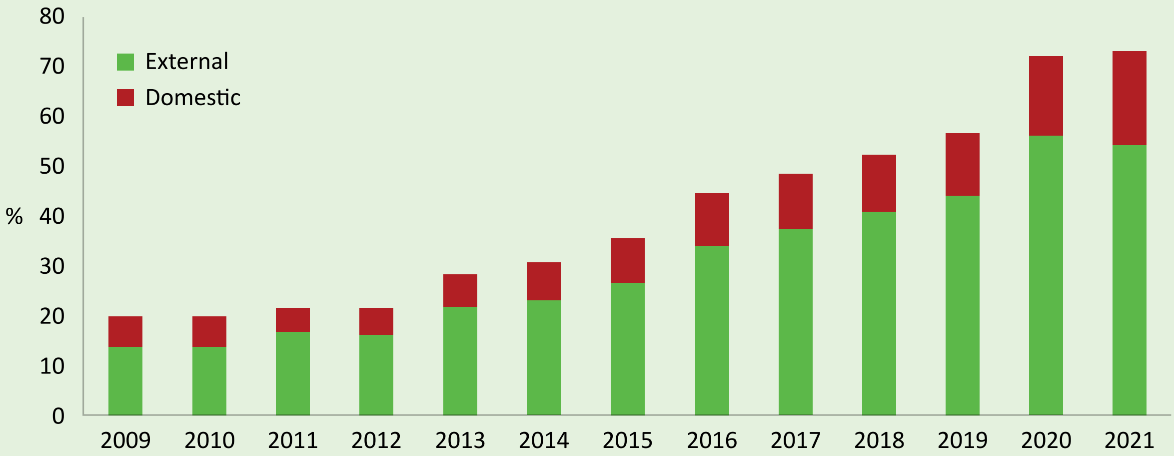
CLMP in Rwanda

In Rwanda, public corporations have a significant role in delivering public infrastructure, particularly in the water and energy sectors. By managing discreet fiscal risks from natural hazards and climate change, government is likely to absorb such exposures from financially weak public corporations. The Government of Rwanda keeps a close watch on foreign currency exposures given its dependence on foreign grant assistance. Any unplanned foreign assistance shortfalls impact budget implementation negatively. Delays in disbursements create short-term funding gaps causing development activity in Rwanda to slow down.

A sectoral credit risk analysis in Rwanda focuses on the transport and infrastructure sectors, performing risk analyses of losses and the accumulation of debt and liquidity challenges.

From the information gathered on Rwanda, the internal institutional structures to price loan guarantees and appropriately leverage the balance sheets of SOEs, in PPP operations, seem well developed and improving. However, the Government of Rwanda must keep a watchful eye on 'specific risks' as they emerge in relation to a growing portfolio of PPP projects, given their causal relation to macroeconomic risks within the overall fiscal risk framework.

Figure 6: Rwanda's public debt as a percentage of GDP, 2009–2021



Source: World Bank (2022)

Figure 7: Rwanda's fiscal risk framework, 2020

Macroeconomic risks

External risks
Forecast performance
Nominal GDP
Budget balance
Revenue
Expenditure

Specific risks

Non-financial public corporations
Government guarantees
Pension liabilities
Local government
Financial sector
Natural disasters

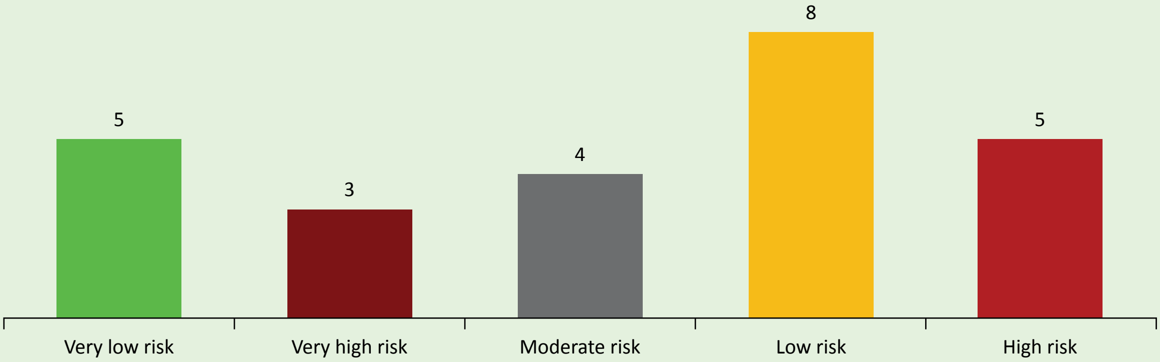
Source: MINECOFIN (2020)

Figure 8: Sectoral analysis of Rwanda's state-owned enterprises

		Profitability		Liquidity		Solvency	
Sector	**SOE**	**Return on assets**	**Return on equity**	**Current ratio**	**Quick ratio**	**Debt to assets**	**Debt to equity**
Transportation	RwandAir	13.5%	-31%	23.3%	23.1%	144%	-327%
Infrastructure/Utility	REG	-0.02%	-101%	112%	87%	104%	-5520%
	WASAC	0.01%	0.03%	214%	250%	83%	480%

Source: MINECOFIN (2023)

Figure 9: Overall risk rating of Rwanda's public corporations



Source: MINECOFIN (2023)

Objective 4

Managing loan guarantee exposures with government's other direct debt (loan/bond) obligations.

This section of the discussion paper relates to the issue of *translation into action* at the *team level*, posing the question as to whether it is known what to do to achieve the goals set out regarding the CLMP of government. From *a public sector enterprise-wide risk management perspective*, Objective 4 relates to Driver 1 (i.e. Risk management competency on CLMP), Driver 3 (i.e. Periodic monitoring of CLMP) and Driver 4 (i.e. Ongoing monitoring of CLMP).

The discussion centres on how loan guarantees and other contingent liabilities are managed alongside government's more direct liabilities such as loans or bond portfolios.

CLMP in Kenya

Reporting on contingent liabilities in Kenya has improved in recent years. This is particularly true for implicit contingent liabilities that were previously not reported. The recent improvement in reporting of contingent liabilities is attributable to the enactment of the Public Debt and Borrowing Policy in 2020. The Public Debt Management Office[2] in Kenya is made up of three departments each with its distinct roles, namely the:

- Resource Mobilisation Department (RMD);
- Debt Policy, Strategy and Risk Management Department (DPSRMD); and
- Debt Recording and Settlement Department (DRSD).

The specific role under the Public Private Partnership Act, 2013, to analyse fiscal commitments and contingent liabilities (FCCL) is undertaken by the Middle Office (the DPSRMD), which

2 The Public Debt Management Office is established under Section 62 of the Public Financial Management Act, 2012.

is a designated FCCL Unit. The CSP for Kenya (AfDB, 2019) acknowledges a need to critically assess the effectiveness of government guarantee management processes, requiring adequate human resources in requisite FCCL-specific disciplines. In this regard, the CSP argues for a co-ordinated approach in developing an effective enterprise-wide risk management framework to assess the fiscal risks emanating from the lack of adequate financial risk modelling expertise.

According to the CSP for Kenya debt sustainability analysis (AfDB, 2019), assumptions on the amount of contingent liabilities are based on limited parameter estimates which often under-estimate the size of contingent liabilities. While such analysis is undertaken to inform debt management decisions, it does not feature in the national budget allocations (expenditures) when preparing the annual budget. Indicatively, however, the annual budget notes, without quantification, the existence of contingent liabilities and the proposed measures being addressed to mitigate the associated fiscal risks.

Furthermore, the Medium-Term Debt Management Strategy provides no estimate for a guarantee exposure target for the level of expected guarantees, which, if decided, would require a policy prescription. Notwithstanding the reporting improvements in 2020, the instruments used in the reporting of contingent liabilities are narrow and the technical language used in the preparation of debt reports may not be easily understood by the public.

CLMP in Rwanda

The 2023/24 Rwanda Fiscal Risk Report (MINECOFIN, 2023) expands the analysis of contingent liabilities using the Public Fiscal Risk Assessment Model to better assess the fiscal impact of public infrastructure projects.

Quasi-fiscal activities undertaken by the Government of Rwanda are activities that are usually conducted with a social mandate in mind and therefore at a loss or below the usual rate of profit. As such, these activities can be replaced by specific taxes, subsidies or other direct expenditures that would have the same net effect on the price at which these services are offered. Should this be the case, it would bring these activities onto the government budget.

Figure 10: Rwanda's public corporations with quasi-fiscal activities (FRW billion), 2018–2022

Quasi-fiscal activity	2018	2019	2020	2021	2022
Rwanda Energy Group					
Total revenue	130.8	148.9	155.4	177.7	2006.6
Government grants received	34.1	39.9	36.0	42.7	56.5
Government of Rwanda contribution (%)	**26%**	**27%**	**23%**	**24%**	**28%**
Water and Sanitation Corporation					
Total revenue	41.8	30.7	35.8	37.7	39.64
Government grants received	25.7	10.4	13.9	13.6	9.74
Government of Rwanda contribution (%)	**62%**	**34%**	**39%**	**36%**	**25%**
RwandAir					
Total revenue	159	334	300	271	341
Government grants received	97	131	132	146	144
Government of Rwanda contribution (%)	**61%**	**39%**	**44%**	**44%**	**42%**
Aggregate					
Total revenue	3320.0	513.7	490.9	486.4	581.7
Government grants received	156.8	181.5	182.2	201.9	210.4
Government of Rwanda contribution (%)	**47%**	**35%**	**37%**	**42%**	**36%**

Source: MINECOFIN (2023)

Rwanda's energy and transport infrastructure sectors (Rwanda Energy Group, RwandAir, and the Water and Sanitation Corporation) are the major beneficiaries of government subsidies, being central to the Rwandan government's economic development strategy. The MINECOFIN's Debt Management Directorate analyses the major risks associated with Rwanda's public debt portfolio. It covers debt sustainability risk, refinancing risk, interest rate risk and foreign currency risk.

When the fiscal position improves, the government's debt strategy enables the proactive measures to take advantage of opportunities for early payment of foreign currency debt (i.e. such as the remainder of the 2013 Eurobond). In this manner, the debt and risk management strategy mitigates higher interest rates in the developed markets (United States Treasury Bonds and Eurobonds). Also, to mitigate rising domestic interest rates, the preference is for longer-dated domestic bonds. Further, opportunities are sought to convert short-term external debt into long-term domestic debt.

Rwanda's total SOE debt amounts to FRW 465 billion or 3.4% of GDP as at the end of 2022. This is an increase from FRW 372 billion as at the end of 2021, mainly due to the expansion of debt data coverage to include both guaranteed and non-guaranteed SOE debt (i.e. explicit and implicit contingent liabilities).

From the information observed, debt management operations in Rwanda are sophisticated at the government debt portfolio level. Greater efforts, however, are needed to develop capacity within the MINECOFIN to undertake rigorous social-cost benefit analysis at the sovereign balance-sheet level. This will promote greater synergy between the national budget and fiscal risks emanating from contingent liabilities.

Figure 11: Rwandan government guarantees as of December 2022

State-owned enterprises external debt stock (USD million)		
Entity	**Guaranteed amount at end of December 2022 (USD million)**	**FRW billion**
RwandAir	Guaranteed	44.7
Bugesera Airport Company (BAC)	Guaranteed	1.4
Sub-total		**46.1**
State-owned enterprises domestic debt stock (FRW billion)		
Entity	**Guaranteed amount at end of December 2022 (FRW billion)**	**FRW billion**
Ultimate Concept Ltd (UCL)	Guaranteed	152.4
EWASA		48.5
SONARWA	Guaranteed	4.0
Bugesera Airport Company (BAC)	Guaranteed	153.4
Horizon Group	Non-guaranteed	13.2
WASAC	Non-guaranteed	13.7
Bella Flowers	Non-guaranteed	1.1
RwandAir Domestic	Non-guaranteed	31.1
EAX	Non-guaranteed	1.9
Sub-total		**419.4**
Total		**465.5**
Nominal GDP		13 716.0
Exchange On Line (EOP) exchange rate		1 070.7
Guarantees % of GDP		**3.4**

Source: MINECOFIN (2023)

Objective 5

Institutional (organisational) framework for the approval of loan guarantee and other borrowing requests.

This section of the discussion paper relates to the issue of *synergy* at the *individual level*, posing the question as to whether individual officials work together to arrive at better ways of achieving the goals linked to CLMP. From *a public sector enterprise-wide risk management perspective*, Objective 5 relates to Driver 8 (i.e. Decision-making ownership in CLMP).

The discussion looks at the possible existence of a high-level advisory committee that advises and recommends loan guarantees or other borrowing requests brought by other entities of government to the Minister of Finance. It attempts to investigate its structure and approval processes.

CLMP in Kenya

The architecture for public financial management (PFM) in Kenya at the central and sub-national levels of government is supported by 'best-practice' PFM legislation. Various reforms are underway in Kenya to improve the quality of budgetary and financial management. These include, amongst others, the introduction of the Treasury Single Account (TSA), reforms in strategic planning and budget formulation, and the introduction of medium-term expenditure frameworks.

Debt sustainability analysis in Kenya covers the debt of the central government, the social security fund, central bank debt taken on behalf of the government and government guaranteed debt. Debt statistics that include public and publicly guaranteed data and medium-term debt management strategies are published regularly. While no evidence suggests that a high-level advisory committee exists to advise and recommend loan guarantees or other borrowing requests, the authorities are working on expanding the reporting of SOEs to cover all 260 entities and to automate data collection by establishing linkages to the existing electronic reporting system.

CLMP in Rwanda

Specific risks and contingent liabilities in Rwanda are managed as part of a Fiscal Risk Statement produced by the MINECOFIN. According to the 2023/24 statement (MINECOFIN, 2023), some public corporations are making good efforts to reduce their fiscal exposures on the government budget. RwandAir, as an example, has been able to reduce fuel expenses and improve lease rates for its aircraft. In addition, the repayment of costly loans are likely to improve the airlines' cashflow position and improve its growth potential.

A PPP Steering Committee oversees the functioning of PPPs, from which most contingent liabilities (fiscal risks) emanate and is chaired by the Minister of Finance and the chief executive officer (CEO) of the Rwanda Development Board (RDB), respectively. While not a 'high-level advisory committee' within the MINECOFIN, a PPP Steering Committee exists to oversee significant fiscal risks. Key stakeholders in this structure include the Minister of Finance and the CEO of the RDB.

The architecture for PFM in Kenya at the central and sub-national levels of government is supported by 'best-practice' PFM legislation.

Objective 6

Country practices of managing contingent liabilities as part of the fiscal risks.

This section of the discussion paper relates to the issue of *accountability* at the *individual level* and responds to the question as to whether officials account to each other for the individual commitments regarding CLMP and responsibilities of the state. From *a public sector enterprise-wide risk management perspective*, Objective 6 relates to Driver 7 (i.e. Risk ownership of CLMP). The discussion examines how the budgetary process have improved in a manner that incorporates contingent liabilities as part of government's fiscal risks.

CLMP in Kenya

According to the Kenya Country Fiduciary Risk Assessment (AfDB, 2019), fiscal transparency of extra-budgetary operations remains weak, including the timeliness to provide information on the amount of fiscal transfers in subsequent years. While the preparation and disclosure of contingent liability management reports is done alongside the annual reporting on debt management, the growth in contingent liabilities necessitates a separate report exclusively for analysing the fiscal risks emanating from extra-budgetary operations (i.e. contingent liabilities and PPPs).

CLMP in Rwanda

The MINECOFIN publishes annual debt data, covering domestic and external debt of the central government, broken down by multilateral, bilateral and commercial debt, as well as information on both domestic and external guarantees and domestic and external debt held by all SOEs. All local government debt is subject to contractual approvals by the MINECOFIN.

One measure of mitigating the fiscal risks associated with loan guarantee exposures is ensuring tax compliance and other administrative measures to expand and diversify the revenue base in the medium term. This is supported by revenue mobilisation efforts as part of the Medium-Term Revenue Strategy (2021/22–20923/24). Public corporations in Rwanda are responsible for 10% of annual public investment, with 90% of public corporation capital stock funded through the budget. The MINECOFIN undertakes a 'health check' analysis of public corporations to assess the fiscal risk exposure of government business enterprises. The Ministry judges the financial performance and financial position of public corporations to establish their financial health. It provides a holistic scenario of government investment risk exposure, with each corporation analysed individually using financial ratios and economic indicators.

Rwanda has 27 public corporations of which 23 are non-financial and 4 are financial corporations.

Figure 12: Public corporations classification in Rwanda

Non-financial public enterprises	**23**
Non-commercial public institutions	7
Commercial state-owned companies	16
Financial public corporations	**4**
Non-commercial public institutions	1
Commercial state-owned companies	0
Special organs	3
Total public corporations	**27**

Source: MINECOFIN (2023)

5

Findings, key results and proposition conclusion

Findings and key results

Objective 1: Legal framework underpinning the authority to issue government loan guarantees and other contingent liabilities.

Kenya has a good legal framework that underpins the issuance of government loan guarantees and other contingent liabilities. Its aim is to advance socio-economic transformation in the country, consistent with the literature on public administration reforms. The effectiveness of CLMP in Kenya, however, requires improvement, particularly regarding identifying, collecting and analysing fiscal risks.

The legal framework in Rwanda for PPPs is well developed. Most contingent liabilities fiscal risk exposures emanate from PPPs. A high-level steering committee that oversees the implementation of PPPs in Rwanda may not have adequate insights into more granular detail required to adequately assess the fiscal risks associated with PPP projects through rigorous cost-benefit analysis.

Objective 2: Government's broad policy (strategy) framework to issue loan guarantees, on-lending or other contingent liabilities.

The Government of Kenya has clear public infrastructure development plans, both of a social and economic nature. It is not a common practice in Kenya for the government to be issuing securities for on-lending to government agencies (SOEs) for purposes of obtaining loans at more favourable rates. Government guarantees are instead issued to SOEs to support their public infrastructure investments and socio-economic developmental objectives. The analysis however shows that efforts to improve the effectiveness of CLMP in Kenya must target initiatives to improve human resource capacity in fiscal risk management.

PPP economic infrastructure projects are the mainstay of public infrastructure investments in Rwanda, advancing socio-economic transformation in the country. With PPPs being a prime instrument of fiscal policy to deliver public infrastructure, the government must be alert to potential fiscal risks embedded in the operations of non-financial public corporations, government guarantees, pension liabilities, natural disasters, the financial sector and in local government.

Objective 3: Pricing the credit risk (risk-based guarantee fees) in issuing loan guarantees and credit risk assessment (tactical) frameworks of managing loan guarantee exposures in the post-COVID period.

CLMP in Kenya lacks adequate financial risk management human resource capability to develop effective fiscal risk models. Possessing this human resource capability will permit the quantification of potential risks associated with PPP projects. A priority, therefore, is to gather adequate fiscal risk data to perform rigorous debt sustainability analysis.

Internal institutional structures in Rwanda, to price loan guarantees and appropriately leverage the balance sheets of SOEs in PPP operations, seem well developed and improving. Notwithstanding, the Government of Rwanda must keep a watchful eye on 'specific risks' emerging in relation to a growing portfolio of PPP projects, given its causal relation to macroeconomic risks within the overall fiscal risk framework. Consideration may be given to 'replicate' the PPP institutional arrangement to effectively address the contingent liabilities associated with government support to SOEs.

Objective 4: Managing loan guarantee exposures with government's other direct debt (loan/bond) obligations.

Recent advancements in the reporting on contingent liabilities in Kenya, particularly on implicit contingent liabilities, must be welcomed. This reform, coupled with an existing designated (and dedicated) FCCL Unit, as a Middle-Office function (the Debt Policy, Strategy and Risk Management Department), are steps in the right direction. It lays the basis to develop the necessary human resource capability for more reliable reporting on contingent liability fiscal exposures in the official annual budget documents.

CLMP in Rwanda can benefit meaningfully from existing institutional processes involving PPP projects. Already, fiscal risk analysis associated with the government debt portfolio is well advanced. Incorporating contingent liability management fiscal risk processes in current debt management operations within the MINECOFIN will allow for a more integrated and holistic approach to national budget formulation.

Objective 5: Institutional (organisational) framework for the approval of loan guarantee and other borrowing requests.

Several PFM reforms are underway in Kenya that include debt sustainability analysis. These involve initiatives aimed at expanding the reporting of SOEs to cover all 260 entities and to automate data collection systems. These ongoing reform efforts are likely to benefit from the creation of a high-level advisory committee mandated to advise and recommend on loan guarantees and other borrowing requests from sub-national entities.

A Fiscal Risk Statement in Rwanda includes specific risks and contingent liabilities and is proving to deliver positive (reduced) fiscal exposures on the national budget. The direct participation of the Minister of Finance and the CEO of the Rwanda Development Bank in PPP operations is having desirable outcomes on the fiscal position and socio-economic conditions in the country.

Objective 6: Country practices of managing contingent liabilities as part of the fiscal risks.

Fiscal transparency on contingent liability exposures in Kenya remains weak. While the preparation and disclosure of contingent liability management reports is done alongside the annual reporting on debt management, the growth in contingent liabilities necessitates a separate report exclusively for analysing the fiscal risks emanating from extra-budgetary operations (i.e. contingent liabilities and PPPs).

In Rwanda, the MINECOFIN publishes annual debt data and ensures tax compliance with other innovative administrative measures to expand and diversify the revenue base. Also, all local debt is subjected to contractual approvals by the MINECOFIN. Further, the Ministry undertakes a 'health check' analysis of public corporations to assess the fiscal risk exposure of government business enterprises. It provides a holistic scenario of government investment risk exposure, with each corporation analysed individually using financial ratios and economic indicators.

Proposition conclusion

Information gathered for this discussion paper suggests that there is a need for an independent and dedicated unit or function, typically a middle-office function in the Ministry of Finance, to identify, assess and mitigate any threats or uncertainties associated with CLMP to improve public finances and to advance socio-economic service delivery in the countries concerned.

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