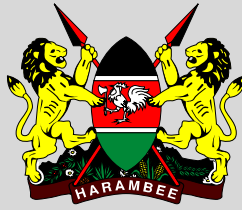


REPUBLIC OF KENYA

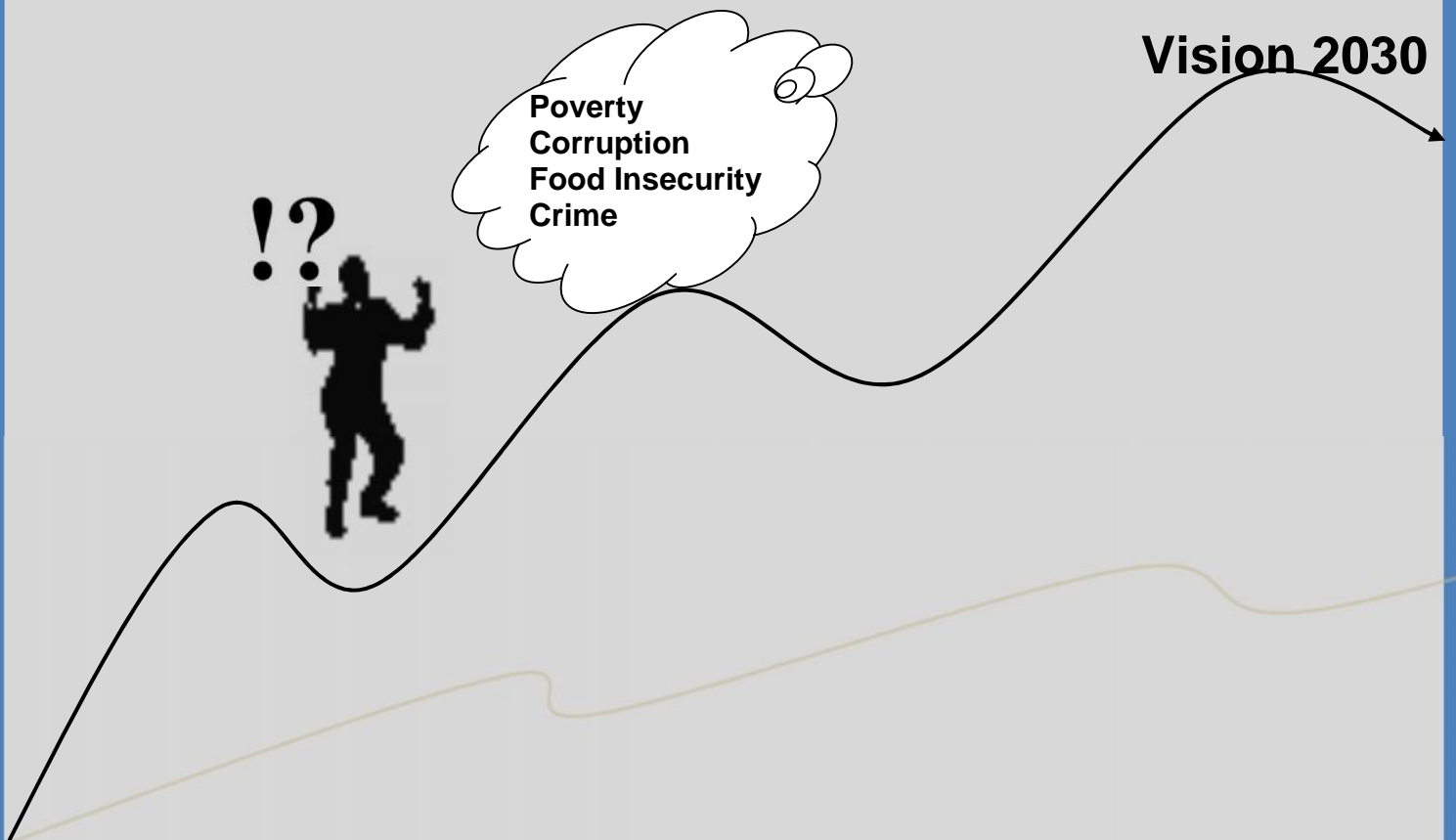


PARLIAMENTARY SERVICE COMMISSION

Parliamentary Budget Office

## *Keeping the Promise*

Budget Options for 2014/15 and the Medium Term



February 2014 (Edition No. 5)

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## Preamble

In 2008, the government of Kenya officially launched the Vision 2030 national development blueprint whose aim was to transform Kenya into a newly industrializing, middle income country providing high quality life to all its citizens by the year 2030. The vision is anchored on three pillars, namely; political, social and economic. The Political Pillar aims at realising a democratic political system founded in issue based politics and respect for the rule of law; the Social Pillar aims at building a just and cohesive society with social equity and the economic pillar seeks to improve prosperity of all Kenyans and achieve an economic growth rate of 10% per annum. However, while significant strides have been made towards achieving the various flagship projects under Vision 2030, some targets have fallen short, notably the achievement of economic prosperity for all Kenyans and in particular, achievement of the 10 percent economic growth rate by 2012, sustained to 2030.

In 2010, the country passed a new constitution which changed the country's political system from a centralized governance system to a devolved system of government. It was expected that this measure would address concerns of skewed economic development and rebalance growth by bringing services closer to the people and enabling counties to pursue diverse economic development strategies for an all-inclusive economic growth.

So far, implementation of the two “promises” has encountered various challenges. The country has not been able to achieve a 10 percent growth rate as envisioned in the national development blueprint. Furthermore, implementation to devolved system of government is also facing numerous challenges. There are concerns that key achievements under the two policy measures may take a long time before they are realized. It is therefore important for all of us<sup>1</sup> to take deliberate measures to ensure that it is possible to enhance the economic prosperity of all Kenyans. This edition of the Budget Options explores the various deliberate measures that are available and that can be considered in order to deliver on our promise to the people.

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<sup>1</sup> Kenyans must embrace hard work and an environment that does not embrace confrontation

## Acknowledgements

This Edition of the Budget Options was prepared by a core team comprising of Millicent Ojiambo, Benjamin Ng'umor and Josephat Motonu; under the supervision of the Director, Phyllis Makau together with Martin Masinde (Senior Deputy Director) and Robert Nyaga (Chief Fiscal Analyst). The team also acknowledges insightful contributions from Lucy Makara, Joseph Ndirangu, Gichohi Mwaniki, Fredrick Muthengi, Joash Kosiba and Danson Mkonu.

## List of Acronyms and Abbreviations

<b>AIA</b>	Appropriations-in-aid
<b>ASDS</b>	Agricultural Sector
<b>BPO</b>	Business Process Outsourcing
<b>BPS</b>	Budget Policy Statement
<b>CAADP</b>	Comprehensive Africa Agricultural Development Programme
<b>CBK</b>	Central Bank of Kenya
<b>CBR</b>	Central Bank Rate
<b>CCTV</b>	Closed Circuit Television
<b>EAC</b>	East Africa Community
<b>EU</b>	European Union
<b>FAO</b>	Food and Agriculture Organization
<b>FDSE</b>	Free Day Secondary Education
<b>FPE</b>	Free Primary Education
<b>GDP</b>	Gross Domestic Product
<b>GoK</b>	Government of Kenya
<b>HR</b>	Human Resource
<b>ICT</b>	Information Communication Technology
<b>IFMIS</b>	Intergrated Financial Management Information System
<b>IMF</b>	International Monetary Fund
<b>JKIA</b>	Jomo Kenyatta International Airport
<b>KIHBS</b>	Kenya Intergrated Household Budget Survey
<b>KNBS</b>	Kenya National Bureau of Statistics
<b>KRA</b>	Kenya Revenue Authority
<b>LAPSSET</b>	Lamu Port and Southern Sudan Ethiopia Transport Corridor
<b>MCA</b> s	Members of County Assemblies
<b>MDG</b>	Millennium Development Goal
<b>MTEF</b>	Medium Term Expenditure Framework
<b>MW</b>	MegaWatts
<b>NGOs</b>	Non-Governmental Organisations
<b>PAYE</b>	Pay As You Earn
<b>PBB</b>	Programme Based Budgeting
<b>PBO</b>	Parliamentary Budget Office
<b>PBOM</b>	Parliamentary Budget Office Model
<b>PER</b>	Public Expenditure Review
<b>PV</b>	Present Value
<b>QEBR</b>	Quarterly Economic Budgetary Review
<b>RLF</b>	Railway Levy Fund
<b>SMEs</b>	Small and Medium Enterprises
<b>TSC</b>	Teachers Service Commission
<b>UN</b>	United Nations
<b>UNICEF</b>	United Nations International Children's Emergency Fund
<b>US</b>	United States
<b>USD</b>	US Dollars
<b>VAT</b>	Value Added Tax
<b>WHO</b>	World Health Organization

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## Summary of Budget Options for 2014/15

### An Economy in Transition: Outlooks, Prospects and Opportunities

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	Encourage large companies and small businesses to seek finances from the stock market which is fairly strong and liquid	Page 22
	Establish the effectiveness of the Credit Bureaus reports in lending	Page 22
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	Address issue of large recurrent spending associated with inherited public workforce from the national government as well as the local authorities	Page 23
	Ensure adoption of public finance management systems such as IFMIS	Page 24
	Review county level taxes, fees and licences which are likely to increase the cost of doing business thereby hampering economic activity	Page 24
	Address resistance to transfer of some functions to county governments such as in the health sector, which has resulted in a serious crisis	Page 24
Security threats	Step up security measures and surveillances across the country especially in potential target areas	Page 24
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	Improve the livelihoods of police officers as a motivation towards enhanced service delivery and reducing cases of corruption	Page 24
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**Devolution and the Economy**

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**Chapter One: An Economy in Transition: Outlook, Prospects  
and Opportunities**

## Kenya's economy unbowed

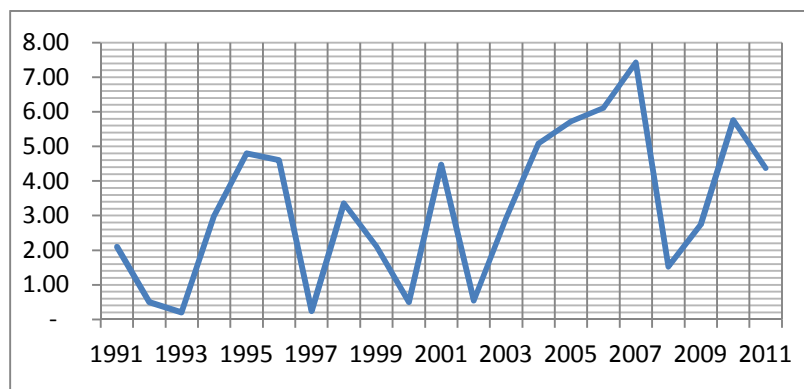
### In brief

*The Kenyan economy demonstrated great resilience in 2013, withstanding challenges such as rising cases of insecurity, public expenditure pressures, and challenges associated with transition to devolved system of government. We estimate that in 2013, the economy will grow by 4.9 percent. The macroeconomic environment remained fairly stable with single digit inflation throughout 2013 as well as stable exchange rate. However, the year closed on an uncertain note with depressed and poorly distributed short rains as well as increasing cost of living for Kenyans which is likely to subdue the growth prospects for 2014.*

### Lower than projected economic growth but...

We estimate the economy to have grown by 4.9% in 2013. This is considerably lower than the economic growth of 5.6 percent projected by the National Treasury for 2013. However, given that 2013 was an election year, the growth remains somewhat satisfactory as it is higher than the 2 percent average growth rate that is typically witnessed during election periods. Kenya's economic growth pattern for the last two decades reveals a slowdown in economic activity in the years during or immediately after an election period. This phenomenon has been attributed to decreased investor confidence during election periods and the 'wait and see' attitude among investors that has typically characterised Kenya's election periods in the past.

*Economic performance in election years is typically below 2 percent but growth in 201, despite being an election year, was much higher*

**Figure 1: Kenya's economic growth 1991 - 2011**

Data Source: Economic Survey (Various)

Year 2013 marked the first general elections since the 2007/08 post-election violence and this made the situation even more precarious, presenting serious downside risks to the economy. Furthermore, the economy faced numerous other challenges such as rising cases of insecurity, financing and budgeting problems during the transition to devolved government, expenditure pressures stemming from cost of the devolved governments as well as rising wage demands in the civil service especially from teachers and doctors; persistent unemployment and rising cost of living. However, the economy was able to navigate these challenges and post a reasonable level of growth though below target.

### **Inflation in single digits but outlook remains uncertain...**

Growth in 2013 was largely driven by a stable macroeconomic environment. Inflation, though steadily rising through the year especially between the months of May and September, remained at single digit, closing the year at 7.2 percent compared to 3.7 percent in January 2013.

*The economy proved resilient in 2013, navigating numerous challenges to record a reasonable level of growth*

*Inflation in 2013, though rising, remained fairly stable and closed the year at single digit*

The key drivers of inflation in 2013 include rising food prices, high pump prices which increased transportation costs, increasing housing index and implementation of the VAT Act. Between May and September, there was a sharp increase in inflation rate largely on account of a rise in the food and non-alcoholic drinks index as well as rising costs of electricity, cooking fuels and house rents. In September, inflation sharply increased to its all year high of 8.3 percent. This was attributed to implementation of the VAT Act which caused a surge in food prices as well as increases in prices of newspapers, books and magazines among other items. This was in addition to rising fuel prices and seasonal factors which affected food supply. However, from October through December 2013, the cost of food and fuel decreased marginally, causing a decrease in the inflation rate to stand at 7.2 percent at the close of the year.

*The key contributors to inflation in 2013 include food prices, fuel prices, increase in rent and implementation of the VAT Act*

However, it is worth noting that supply side shocks remain a threat to price stability. According to the Meteorological department, the October – December short rains for 2013 were depressed and poorly distributed. Already, there are reports of drought in various counties. This is likely to adversely affect agricultural activities and food supply in the coming months. Anecdotal evidence suggests that maize production in many parts of Rift Valley and Western Kenya is likely to be below average compared to the 2012 maize production. FAO's forecast of cereal production in Kenya for 2012 and 2013 is as follows:

*Poor weather conditions are likely to increase food prices and therefore inflation levels in 2014*

**Table 1: Production In '000 of Tonnes**

	2012	2013	Deviation
Maize	3,603	3,000	-17
Wheat	442	342	-23
Sorghum	175	160	-9
Other	274	244	-11
Grand Total	4,494	3,746	-17

Source: FAO

Fuel driven inflation also remains a concern especially due to political instability in oil producing countries. Fuel is the second biggest contributor to overall inflation in Kenya and oil price volatility could easily push inflation to double digits.

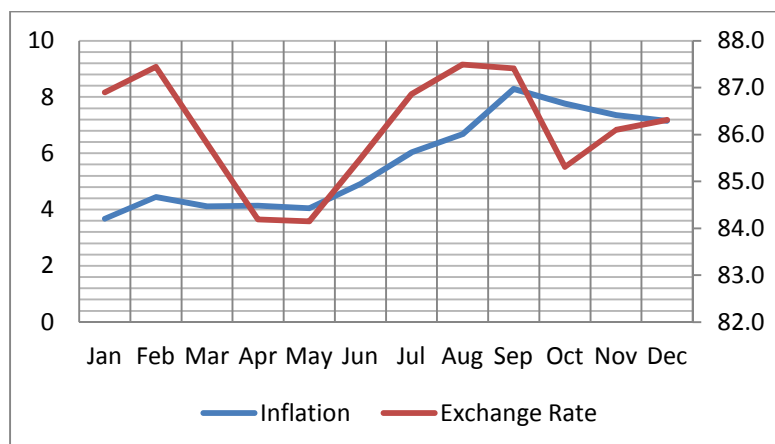
*Increase in fuel prices is also a threat to inflation levels*

### **The Exchange Rate has stabilized but downside risks persist...**

The exchange rate remained stable against major world currencies throughout 2013, fluctuating between Kshs. 84 and Kshs. 87 to the dollar. This can be attributed to loan disbursements under the IMF's Extended Credit Facility, which boosted Kenya's foreign reserves, as well as an increase in Diaspora remittances. The foreign exchange reserve position has been maintained above the statutory 4 months of import cover, albeit marginally, thereby cushioning the Kenya Shilling exchange rate. However, the risks to the exchange rate in 2014 include oil price volatility as well as increased importation of goods. Kenya's import bill remains high, driven by fuel importation as well as high import demands for capital goods. This is likely to worsen the current account deficit and exert pressure on the Kenya Shilling.

*The Kenya shilling exchange rate against major world currencies remained stable for the better part of 2013 but faces threats from oil price volatility and increased importation of goods*

Figure 2: Trends inflation and Exchange Rate in 2013



Compilation: PBO using data from CBK

### Interest rates are stable but...

The Central Bank has maintained the benchmark interest rate at 8.5 percent since May 2013, noting that the stance continues to deliver the desired objective of price stability. This signalled the commercial banks to reduce their lending rates from an average of 19.73 percent in 2012 to approximately 16.8 percent in 2013 thereby supporting credit uptake by the private sector. Indeed, the annual growth in private sector credit increased from 9.6 percent in May 2013 to 20 percent in December 2013. However, the average deposit rate for 2013 stood at 6.5 percent pointing to a high interest rate spread, which implies that banks could be making substantial profits at the expense of depositors. In order to narrow the spread and protect the welfare of depositors, there is need to continue using non market interference measures such as moral suasion in order to lower the spread.

It is worth noting that increased credit uptake has not necessarily translated to increased investment. The level of private investment in the country has remained quite low over the past decade. There is very minimal creation of new capital in various sectors in order to enhance their productivity.

*Though the Central Bank has retained its policy rate at 8.5 percent since May 2013, bank lending rates remain high and there is a high interest rate spread*

*Increased credit access by the private sector has not necessarily translated into increased investment*

Furthermore, Kenya's cost of doing business remains unacceptably high with the country being ranked position 129 out of 189 countries in the Doing Business 2014 rankings. This is a drop by 7 positions from the Doing Business 2013 Rankings. If Kenya is to achieve private sector led growth, there is need to create a proper investment climate and simplify the cost of doing business. This includes simplifying tax laws, reducing the number of licences required to start a business and the time taken to obtain the requisite documents.

*Kenya's cost of doing business remains high and is an impediment to private sector led growth*

## Fiscal Consolidation<sup>2</sup>

A review of the 2013/14 Budget Framework as contained in the Budget Policy Statement for 2013/14 indicates that the envisaged fiscal consolidation appears to be off track. The deficit including grants contained in the BPS 2013 framework has always been revised upwards. This is illustrated in the table below:

**Table 3: Balance (Cash basis including grants) projections**

	2010	2011	2012/13		2013/14		2014/15	
	/11 <i>Prov.</i>	/12 <i>Prov.</i>	BPS '13	Budget (revised)	BPS '12	BPS '13	BPS '12	BPS '13
Balance (Cash basis including grants)	-4.8	-5.7	-6.5	-6.8	-4.3	-4.7	-3.5	-4.0

**Data: BPS (Various)**

From table 3 above, there appears to be a tendency by the government to indicate a lower deficit at BPS level while an increase appears in either the budget or the subsequent Budget

*Fiscal consolidation appears to be off track as the deficit including grants is always revised upwards in the budget framework*

<sup>2</sup> Fiscal consolidation is a policy or policies aimed at reducing government deficits and accumulation of debt. It entails deliberate efforts to ensure the country is living within its means through increasing revenues and reducing non-core expenditures



Policy Statement. This implies that expenditure pressures have hampered the fiscal consolidation process. The year 2013 ended on an uncertain note on account of depressed and poorly distributed rainfall during the short rains which may affect agricultural yields and the food security situation. This may have a ripple effect on other sectors such as the manufacturing sector. Furthermore, the rising cost of living appears to have inhibited expenditure as was witnessed in subdued consumer spending during the festive season. This may adversely affect the growth trajectory in 2014.

*The economic outlook at end of 2013 appeared uncertain due to poor weather conditions and rising cost of living and this may affect growth in 2014*

## Economic Outlook – Opportunities and Risks

### In brief

*In the baseline scenario, Kenya's economy is projected to grow at an average of 5.3 percent over the medium term. Opportunities which are likely to drive economic growth include a fairly stable political environment, robust regional demand in Sub-Saharan Africa and a stable macroeconomic environment. However, there are downside risks which may adversely affect economic growth in 2014. These include taxation and budgetary challenges in the county governments, insecurity threats and a weak global outlook.*

### Economic growth projections for the Medium Term

In 2013/14, the economy is projected to grow at 4.9 percent and further rise to 5.4 percent in 2014/15 and 5.5 percent in 2015/16. This scenario is based on increased investment in infrastructure and implementation of flagship projects such as the standard gauge railway. Furthermore, vast economic opportunities lie in the petroleum and mining extractive industries and are likely to attract investors. County economic activities are also likely to drive growth including specific investment and economic exploits in each county. It is also expected that a stable political and macroeconomic environment will persist and the stable interest rates will support credit access to the private sector thereby promoting private investment. Thus there are better prospects for economic growth if the concerns of insecurity and corruption are addressed.

*The economy is poised to grow at 4.9 percent in 2013/14, rising to 5.0 percent in 2014/15 and 5.1 percent in 2015/16*

### Kenya's Opportunities for Economic Growth

#### 1. Stable political environment

Having held successful general elections in 2013, the country has maintained a somewhat stable political environment despite continuing terrorism threats.

*Kenya managed to maintain a stable political environment despite continuing terrorism threats*

However, the economy has so far proved resilient despite these threats. A stable political environment is poised to boost investor confidence and encourage investment in the country.

The country is currently implementing devolved system of government; this is expected to assist in rebalancing growth by bringing services and economic opportunities closer to the people. If properly implemented, the system can enable the various counties find home-grown solutions to their economies and the county economic activities are likely to promote growth and poverty reduction.

*Devolved government presents an opportunity for growth through diverse county economic activities*

## **2. Improving global Economic Outlook – with focus on Africa**

According to the IMF, global growth will rise to 3.6 percent in 2014 from 2.9 percent in 2013. This improvement in global growth is supported by the UN who project growth at a pace of 3.0 percent for 2013 and 3.3 percent in 2015. The Euro area appears to be pulling out of recession and growth in the US is also strengthening. A positive growth outlook of the global economy after a protracted period of low activity especially in Europe portends great benefits for the Kenyan economy through increasing demand for the country's exports, especially tea, coffee and horticulture - the country's leading foreign exchange earners.

*Global growth is somewhat improving and this may benefit the country in terms of external trade*

The economic outlook for Sub Saharan Africa is quite robust with IMF forecasts stating that the region's

economy will grow by 5 percent in 2013 and 6 percent in 2014; and the UN forecasting a growth of 4.0 percent in 2013 and 4.7 percent in 2014. This is despite weak political environment in some countries, poor weather as well as subdued global economic growth. Africa remains the dominant destination for Kenya's exports, accounting for 48.5 percent of the total Kenyan exports and a growth of 31.1 percent (KNBS, 2012). On the other hand, the EAC is projected to grow robustly, at 6.3 percent in 2013 and 6.7 percent in 2014.

A positive economic outlook for Sub Saharan Africa therefore implies more robust demand and a ready market within the continent for Kenya's export products.

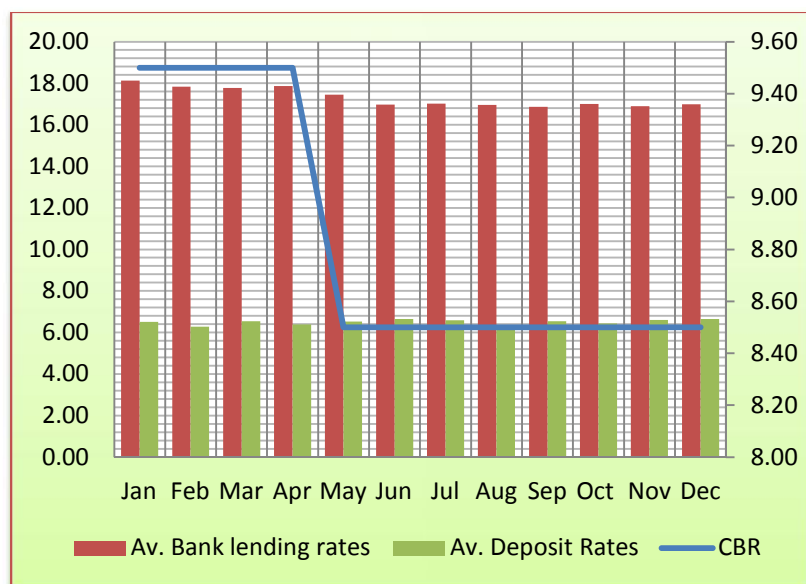
### **3. Stable Macroeconomic environment**

Inflation remained in single digits throughout 2013, and the Kenya Shilling exchange rate against all major currencies has been fairly stable. The low rates of inflation, stable interest rates and exchange rate was assured through appropriate monetary policies, especially stable CBR rates. The policy rate has remained at 8.5 percent for the better part of 2013, signalling the banks to lower credit costs. However, despite the effort by the CBK to bring down interest rates through its policy signal, bank interest rates still remain high.

*Sub-Saharan economic growth, and specifically the EAC, remains robust, portending significant benefits to Kenya's economy through increased regional trade*

*The Central Bank retained the policy rate at 8.5 but the banks have respond poorly and bank interest rates remain high*

Figure 3: Average Bank lending rates, deposit rates and CBR rate



Graph: PBO, data compiled from the Central Bank of Kenya (CBK)

From the graph above, there is noted a huge difference between the bank lending rates and deposit rates. Despite a decrease in the policy rate, the bank lending rates responded only marginally. It is evident that the CBK signal alone will not bring down lending rates. It is therefore suggested that the following alternative policies can be considered to help bring down the cost of credit:

- i) Moral suasion – this entails CBK encouraging banks or lenders to reduce lending rates;
- ii) Encourage large companies and small businesses to seek finances from the stock market which is fairly strong and liquid;
- iii) Establish the effectiveness of the Credit Bureaus reports in lending. There need to investigate whether credit Reference Bureaus Reports have helped rebase loan risks and therefore lending rates.

*The banks appear not to respond to the CBK signal to lower interest rates. Other channels that will not distort market principles such as encouraging competition in the banking sector and moral sensation should be encouraged.*

#### 4. Booming Petroleum and Mining Sector

Kenya has traditionally relied on agriculture to drive its economy but now vast economic opportunities lie in the petroleum and mining sector since the discovery of oil in Turkana and gas deposits in northern Kenya, titanium at the Coast and large deposits of coal in Kitui County. This has attracted a number of investors in the regions and if properly exploited, the country is poised to be a mineral resource powerhouse.

*The discovery of mineral resources in Kenya is an opportunity for the country to reduce reliance on agriculture*

### Downside risks to the outlook

#### 1. Challenges in implementation of the new system of government

The transition to devolved government has been plagued with a number of fiscal challenges in its implementation phase. The county governments came into existence in the middle of the budget cycle resulting in poorly prepared and rushed budgets, most of which were not anchored on development strategies, and which entailed huge deficits, raising questions on sustainability. In the coming financial year, county budgets should be anchored on the county development plans and financing of the county budgets clearly to the estimated resources/ revenue available to the county.

*The challenges facing transition to devolved government are an impediment to growth*

Other pertinent issues which will need to be addressed include:

- i. Low absorption of funds occasioned by delays in county budget approvals.
- ii. Large recurrent spending associated with inherited public workforce from the national government as well as the local authorities.

*There is need to address challenges such as low absorption of funds and large recurrent spending*

- iii. Ensuring full adoption of the Integrated Financial Management Information System (IFMIS)
- iv. Proliferation of county level taxes, fees and licences which are likely to increase the cost of doing business thereby hampering economic activity.
- v. Slow pace in creating the necessary capacity especially in public finance matters.

*Other challenges which need to be addressed include challenges of public finance management systems in counties and the county taxes which appear to be hampering economic activity*

## **2. Security threats**

The country continues to face significant terror threats from terror groups in various parts of the country. Internally, the country is facing increasing cases of crime especially in northern Kenya where conflict between various communities continues to rage on. These security concerns may have an adverse impact on the country's investment climate. There is need therefore for the country to step up security measures and surveillances across the country especially in potential target areas. This includes enhancing the capacity of the security personnel to deal with the rising threat of terrorism and insecurity by providing them with proper training, latest technology and equipment to fight crime. It also entails improving the livelihoods of police officers as a motivation towards enhanced service delivery and reducing cases of corruption.

*Security concerns are an impediment to economic activity and adversely affect the investment climate. Measures should therefore be taken to address security concerns*



### 3. Expenditure Pressures and misalignment of expenditure

The country faces the twin problem of rising expenditure pressure at the national and county levels of government and misalignment of resources through duplication of roles and expenditure. At the national level, rising expenditure is driven by massive infrastructure spending and the public wage bill. At the county level, high wage bill together with additional recruitment by counties presents significant fiscal challenges. In particular, concern has been raised over the rising wage bill which stood at Kshs. 457.5 billion in 2012/13 and is likely to go higher in view of pressures emanating from both the national and county governments. Thus it appears that most of the funds are chasing consumption based expenditure as opposed to investment related expenditure. This will not only stifle growth but is also likely to drive up inflation as the increased expenditure drives up cost of goods.

*Rising expenditure pressures due to county governments, infrastructure spending and the public wage bill are an impediment to growth*

### 4. Weak global economic outlook

Despite projections of improvement in the global economic outlook, the situation is not rosy and downside risks still persist which may curtail the projected growth especially in the Euro Area. Constrained growth in Europe would impact negatively on Kenya in terms of decreasing external demand for Kenya's exports particularly horticulture and decreased Foreign Direct Investment. This may also adversely affect tourism.

*Though the global economic outlook is showing signs of improvement, downside risks remain and these may affect the country in terms of decreasing demand for Kenya's exports*



## **5. The resource curse**

While the discovery of the mineral deposits portends significant benefits to the Kenyan economy, there are risks accruing from the robust extractive industry such as negative environmental impact, higher cost of living due to increased population pressure with workers migrating to the area which if not handled properly, could lead to destruction of livelihoods and culture of some communities and escalation of conflicts among communities as well as between the communities and the government/ the mining investors. It is important therefore to ensure that there is transparency and accountability in the mining process. Furthermore, the mining companies could pursue corporate social responsibility (CSR) practices in order to address local concerns.

*The mining of resources, if not properly managed, can lead to serious challenges in resource utilization including destruction of livelihoods and escalation of conflicts*

## **Chapter Two: Fiscal Performance and Outlook**

## Trends in Fiscal Performance

### In Brief

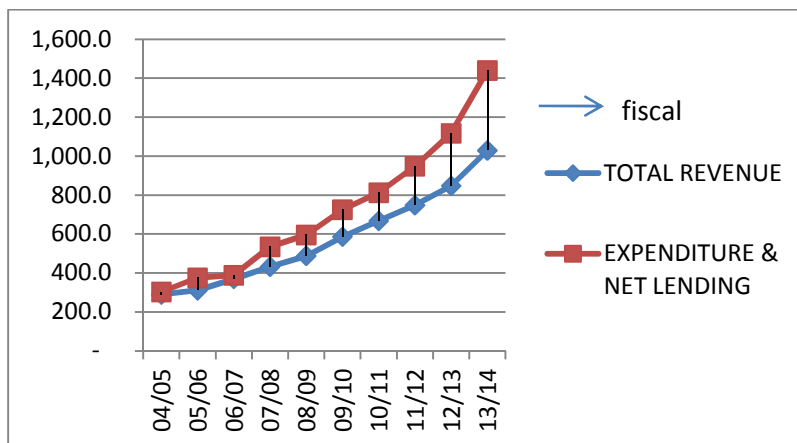
Government’s expenditure has been on an increasing trend over the last decade, with the education sector and the energy, infrastructure and ICT sectors accounting for the bulk of government spending. Revenues have also experienced modest growth over the years, with Income tax and VAT being the largest contributors to revenue. However, the growth in revenues has not matched the growth in expenditures resulting in high deficits and necessitating borrowing.

### Introduction

The government’s expenditure and net lending has substantially grown over the last ten years from Ksh. 303.4 billion in 2004/2005 to a projected Ksh. 1.4 trillion in 2013/2014. Total revenues have tripled over the period from Ksh. 289.8 billion in 2004/2005 to Ksh 847.2 billion in 2012/2013. The National Treasury projects that it will surpass the Ksh. 1 trillion mark in 2013/2014. However, the growth of the revenues falls short of the expenditures resulting in a high fiscal deficit over the period. The high deficits have led to an increased dependency on debt to finance the budget. Figure 1 indicates the trends in revenue and expenditure performance.

*Government’s expenditure increased over the last decade but growth in revenues has fallen short resulting in high deficits*

Figure 4: Trend in Revenues and Expenditure



Source: QEBR various issues

*Graph showing trends in revenues and expenditure from 2004/05 to 2013/14*

## Revenues

Collection of revenue as a proportion of the country's economic growth has modestly increased over the last decade from 21% of GDP to 23% of GDP. Over the period, Income tax and Value Added Tax (VAT) have contributed the largest proportion of revenue. In the last 10 years, all tax heads have increased with the largest growth coming from the income tax and the VAT heads. The two heads contribute about 63% of the total revenues annually. The government projects to collect Ksh 1.0 trillion in 2013/2014 with income tax accounting for 40% of it.

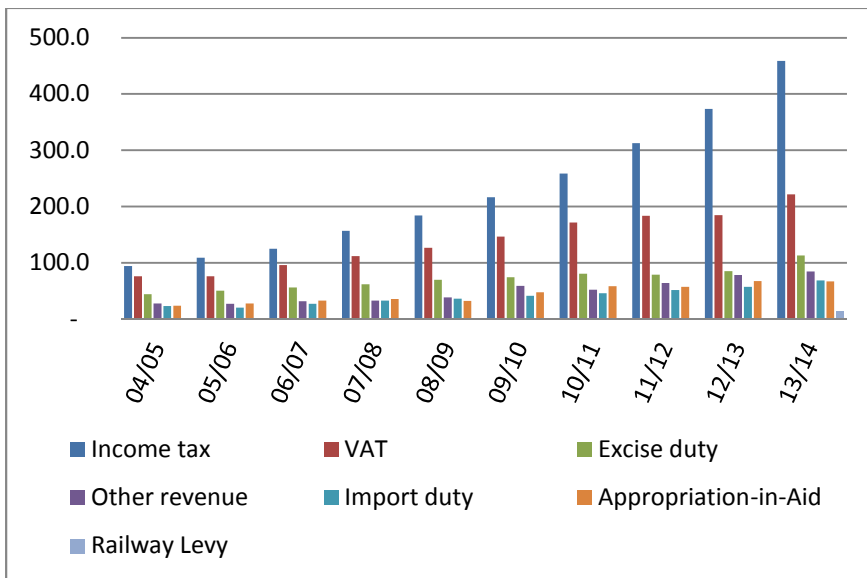
*Revenue collection has increased over the years with Income Tax and VAT as the largest contributors to revenue*

The government introduced a new tax, the railway development levy, which will support the construction of the single gauge railway line. The levy will be funded by a 1.5% tax on all home-bound imports (for Kenyan domestic market). Latest revenue figures show that KRA had collected Ksh. 10 billion of the railway development levy from July-December 2013, clearly surpassing the Ksh. 6.8 billion target. One of the reasons for performance is that the levy had little common exclusions or waivers and was applied on all imports.

*The government introduced the railway development levy and latest KRA figures indicate a collection of Kshs. 10 billion surpassing the Ksh. 6.8 billion target*

Figure 5 below indicates the average contribution to revenue from the six major revenue heads.

Figure 5: Revenue composition: 2004/05 to 2013/2014\*



Graph showing revenue composition and trends from 2004/05 to 2013/14

Source: QEBR various

\*projected figures

## Expenditures

The government expenditure has increased over the past 10 years from 23% of GDP in 2004/2005 to 30% of GDP in 2013/2014. The budget has quadrupled during the period, reaching Ksh 1.1 trillion in 2012/2013. Looking into the components of the expenditure, the recurrent expenditure has reduced from 90% to 70% of the total government expenditure in the last decade while the development expenditure has grown from 10% to 30% of the total expenditure. On the other hand, the Constitution established the county governments which fully came into operationalization in 2012/2013. The transfers to counties amounted to Kshs. 210 billion consisting of Kshs.190 for equitable share and Kshs. 20 billion as conditional grants.

Government expenditure has increased over the years, with significant growth in development expenditure while recurrent expenditure has decreased as a proportion of the budget

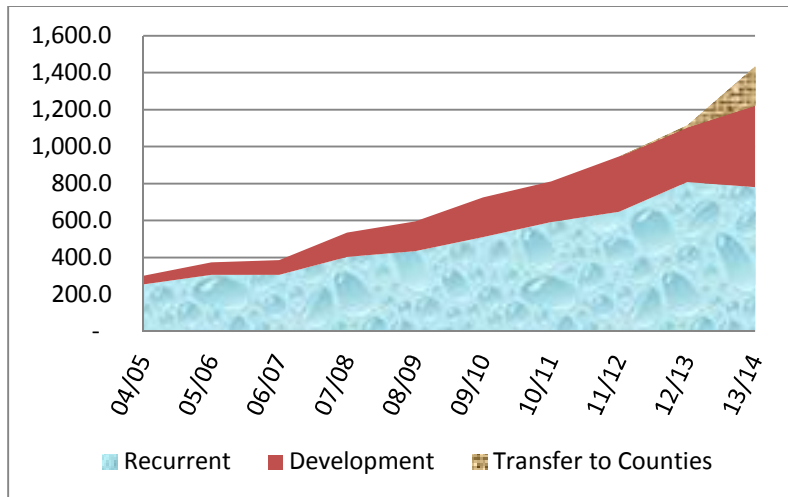
The recurrent expenditure increased from Kshs. 255.7 billion in 2004/2005 to Kshs.808.3 billion in 2012/2013 and is

projected to drop to Ksh. 780.6 billion in 2013/2014 owing to the transfer of some functions to the county governments.

Development expenditure rose tremendously over the period from Ksh. 45.6 billion in 2003/2004 to Ksh 298.9 billion in 2012/2013 and its projected to further increase to Ksh. 444.1 billion in 2013/2014. This increased spending has been attributed mainly to the investment in physical infrastructure. Figure 6 below shows the systematic growth of government expenditure from 2004/2005 to 2013/2014.

*Development expenditure has increased mainly due to investment in physical infrastructure*

**Figure 6: Growth of government expenditure 2004/05 to 2013/14\***



*Graph showing government recurrent and development expenditure from 2004/05 to 2013/14*

Source: QEBR various

\*projected figures

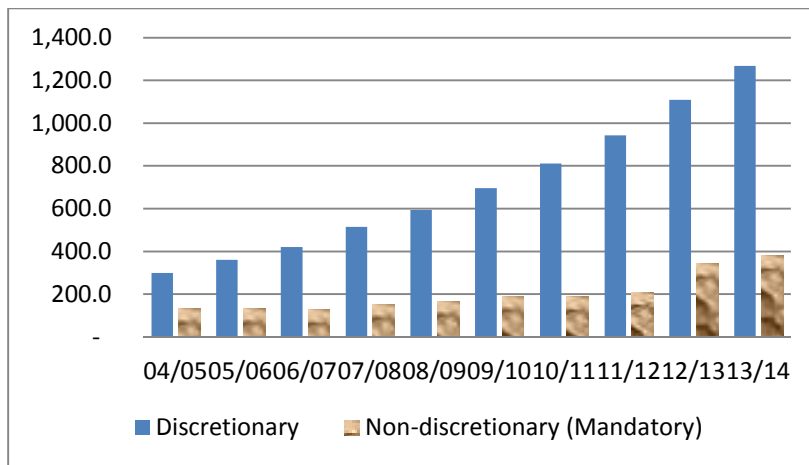
The government’s discretionary spending has increased fourfold over the last ten years from Ksh 299.1 billion in 2004/2005 to Ksh 1.1 trillion in 2012/2013 and it is projected to further increase to Ksh 1.3 trillion in 2013/2014. The mandatory expenditures have doubled over the same period from Ksh 132 billion in 2004/2005 to Ksh 346 billion in 2012/2013 with a proposed increase to Ksh 380 billion in 2013/2014. The allocations for mandatory expenditure mainly consists of

*Government’s discretionary spending has increased fourfold whereas the mandatory expenditures have doubled over the last ten years*

repayments of public debt, payment of pensions and payment of salaries and allowances of constitutional officer holders. Repayment of public debt constitutes 86% of all mandatory expenditure while payment of pensions accounts for 13% of it. For the last decade, the government has used a total of Ksh 1.9 billion for debt repayment. The figure 4 below shows the allocations for discretionary and non-discretionary over the last ten years.

*Repayment of public debt constitutes the majority of government mandatory spending*

**Figure 7: Discretionary and Non-discretionary Expenditure 2004/2005 to 2013/2014\***



*Graph showing discretionary and non-discretionary spending*

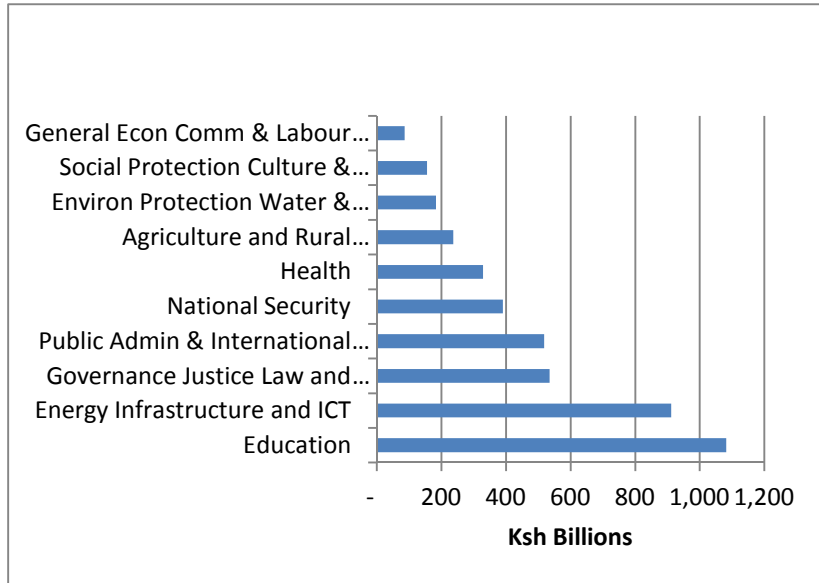
Source: Estimates of Expenditure various

\*projected figures

Spending across sectors has increased over the period with the increase in the budget. The government has used a total of Ksh 4.4 trillion from 2005/2006 to 2012/2013 to fund sectoral programmes. The highest spending was on education and infrastructure which accounted for 24% and 21% respectively of the total government spending over the period. Figure 5 below details the total spending on the ten MTEF sectors between 2005/2006 and 2012/2013.

*The highest government expenditure has been on education and infrastructure*

**Figure 8: Cumulative spending on MTEF sectors: 2005/2006 to 2012/2013**



*Graph showing cumulative sectoral spending 2005/06 – 2012/13*

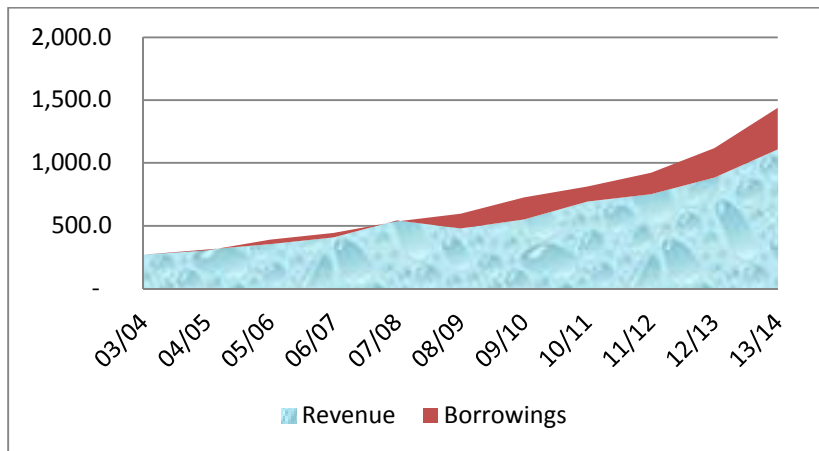
Source: BPS various

### Financing of the Expenditures

The government expenditures are financed by both revenues and borrowings. The proportion of the budget financed through borrowing has risen since 2008/2009 as seen in figure 6 below. This trend can be attributed to either a large fiscal deficit or insufficient revenue mobilization.

*Proportion of government spending financed through borrowing has been increasing since 2008/09*

**Figure 9: Financing of the budget**



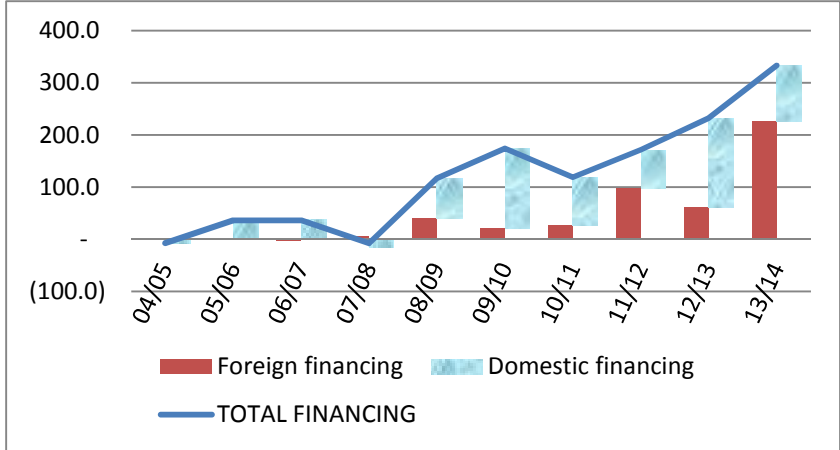
Source: QEBR various



A comparison of foreign and domestic debt indicates that the government has over the years increased borrowing domestically. The figure 7 below indicates the trend in financing for the past ten years. Between 2008/2009 and 2012/2013 the government’s domestic borrowing has been substantially higher than the foreign borrowing. For 2013/2014, the government projects the ratio of domestic borrowing to foreign borrowing to be 7:3.

*Government domestic borrowing has been higher than foreign borrowing*

Figure 10: Trends in deficit financing 2004/05 to 2013/14\*



Source: QEBR various  
 \*projected figures

## Public Debt

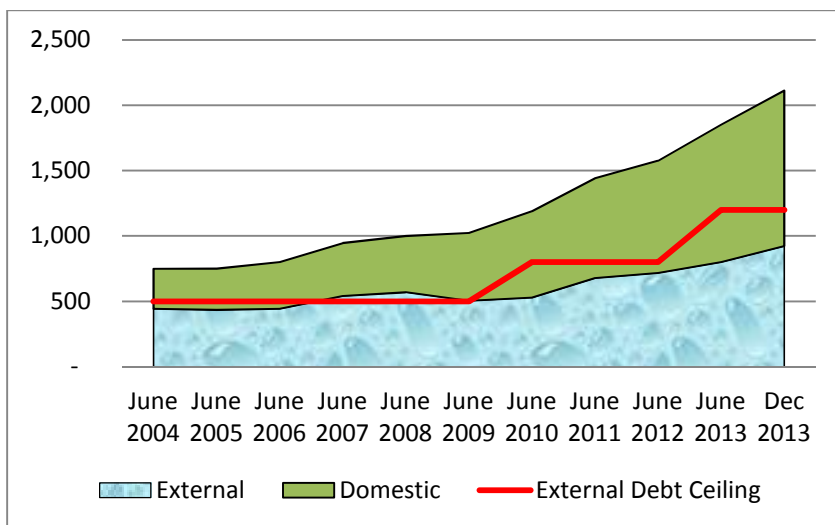
### In Brief

*The stock of public debt has increased in the last decade with domestic debt at 55% of total debt and external debt at 45% of total debt. External debt is largely on concessional terms but the commercial component has been increasing. Domestically, the government has focused on long term borrowing.*

Increased borrowing overtime has led to an increase in the stock of public debt. As at December 2013, the stock of debt stood at Ksh 2.1 trillion compared to Ksh 749 billion in June 2004. The debt has a near equal split comprising of 45% external debt and 55% domestic debt. The trend in public debt over the last decade is as indicated in figure 8 below.

*The stock of public debt has increased over the last ten years and has a nearly equal split with external debt comprising 45% and domestic debt comprising 55% of total debt*

**Figure 11: Stock of public debt 2004 - 2013**



Source: Monthly debt bulletin various

The external debt as at December 2013 amounts to Ksh 922 billion. Bulk of the external debt was from multilateral creditors which accounted for 61 percent while bilateral creditors and commercial creditors accounted for 31 percent and 8 percent respectively. The government has most of its external debt in

*The bulk of external debt is from multilateral creditors*

concessional terms but since 2012, the commercial component has been gradually increasing. This is attributed to the country's ability to access cheaper commercial loans after its international credit ratings improved<sup>3</sup> thanks to the country's stable macroeconomic environment and investment climate. The commercial debt as at December 2013 amounted to Ksh 74.9 billion due to a syndicate loan of about Ksh 52 billion acquired in 2012/2013. The government proposes to issue another sovereign bond of Ksh 87 billion in 2013/2014. However, Parliament having set the external debt limit at Ksh 1.2 trillion, the current external debt is progressively approaching the limit and government should ensure the debt can be maintained below it.

*External debt is largely on concessional terms though the commercial component has been increasing due to easy access to cheaper commercial loans*

The domestic debt has increased fourfold over the last decade to stand at Ksh 1.2 trillion in December 2013. The government has shifted its focus on long-term borrowing overtime with increased borrowing from treasury bonds compared to treasury bills. As at December 2013, the domestic debt comprised of 69 percent treasury bonds, 28 percent treasury bills and 3 percent other domestic debt (government stock, overdrafts at central bank, etc).

*Domestic debt has increased with focus on long term borrowing in terms of Treasury bonds*

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<sup>3</sup> For the first time, Kenya was given a credit ration of B+ by S&P, B1 by Moody and B+ by Fitch; and all the three indicated that Kenya has a stable outlook. This will enable Kenya negotiate a favourable rate for its sovereign bonds.

## Fiscal Framework for the Medium Term (PBO projections)

### In Brief

Revenue is projected to amount to Kshs. 966.8 billion in 2013/14 and rise to Kshs. 1.1 trillion in 2014/15 with income tax and VAT as the more significant tax heads. On the other hand, government expenditure for the both the national government and county governments is estimated at Kshs 1.3 trillion in 2013/14 and 1.5 trillion in 2014/15.

### Baseline Revenue Projections

The revenue forecasts are pegged on the attainment of the macroeconomic targets and improved tax administration. Tax is influenced by the GDP and other macroeconomic indicators like inflation and stability of the exchange rate. Baseline revenue forecast are based on the following assumptions:

- i. Modest growth of GDP over the medium term of between 5% and 7%.
- ii. Stable inflationary pressures in 2014 of about 7%.
- iii. Slow growth of ordinary import duty with the introduction of the railway levy fund to finance the construction of the single gauge railway line reflecting some substitution effect.
- iv. Improved VAT performance by 14% with the implementation of the VAT Act 2013.

Based on above assumptions, the total revenue is projected to rise from Ksh 966.8 billion in 2013/2014 to Ksh 1.1 trillion in 2014/2015 which is 23.5% of GDP. In the medium term, total revenue will grow to Ksh 1.2 trillion and Ksh 1.4 trillion in 2015/2016 and 2016/2017 respectively.

*Revenue forecasts is based on assumption of GDP growth between 5 – 7%, stable inflationary pressures, slow growth of import duty and improved VAT performance*

*Revenue is projected to amount to Kshs. 966.8 billion in 2013/14 and Kshs. 1.1 trillion in 2014/15*

Income tax is the most significant tax head in 2014/2015 whose contribution is projected to be Ksh 458 billion which is about 10.1% of GDP. The second largest revenue contributor is expected to be VAT whose 15% estimated increase in 2013/2014 is due to the implementation of the VAT Act, 2013. The VAT collection is projected to be Ksh 267.4 billion in 2014/2015 and steadily increase in the medium term. The government also introduced the railway levy fund in 2013/2014 as 1.5% on all home-bound imports (for Kenyan domestic market). The RLF is estimated using import values. It is projected to grow by 11% from Ksh 18.5 billion in 2013/2014 to Ksh 20.6 billion in 2014/2015. Table 1 below presents revenue projections for 2014/2015 and the medium term.

*Income tax is the most significant tax head, followed by VAT collections*

**Table 4: Revenue projections for 2014/2015 and the medium term (Ksh Billions)**

	Projections*					
	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
<b>Total revenue</b>	<b>765.2</b>	<b>847.2</b>	<b>966.8</b>	<b>1,086.5</b>	<b>1,219.2</b>	<b>1,373.1</b>
<b>Ordinary revenue</b>	<b>707.8</b>	<b>787.7</b>	<b>905.0</b>	<b>1,021.8</b>	<b>1,151.3</b>	<b>1,301.6</b>
Income tax	329.0	367.1	408.8	458	515.5	582.7
Import duty	51.9	57.4	65.4	74.7	85.4	97.7
excise duty	79.2	89.1	100.5	113.8	129	146.4
VAT	183.4	203.7	233.6	267.4	300.6	338.9
Investment income	14.1	14.6	15.2	15.9	16.7	17.6
Other Revenue	50.2	55.7	62.9	71.5	81.6	93.3
Railway Development Levy	-	-	18.5	20.6	22.6	24.8
<b>Ministerial &amp; Departmental Fees</b>	<b>57.4</b>	<b>59.5</b>	<b>61.8</b>	<b>64.6</b>	<b>67.9</b>	<b>71.6</b>
As percent of GDP						
<b>Total revenue</b>	23.6%	23.3%	23.6%	23.5%	23.3%	23.4%
<b>Ordinary revenue</b>	21.8%	21.6%	21.6%	21.7%	21.6%	21.8%
Income tax	10.1%	10.1%	10.0%	9.9%	9.9%	9.9%
Import duty	1.6%	1.6%	1.6%	1.6%	1.6%	1.7%
excise duty	2.4%	2.4%	2.5%	2.5%	2.5%	2.5%

VAT	5.7%	5.6%	5.7%	5.8%	5.8%	5.8%
Investment income	0.4%	0.4%	0.4%	0.3%	0.3%	0.3%
Other Revenue	1.5%	1.5%	1.5%	1.5%	1.6%	1.6%
Railway Development Levy	0.0%	0.0%	0.5%	0.4%	0.4%	0.4%
<b>Ministerial &amp; Departmental Fees</b>	1.8%	1.6%	1.5%	1.4%	1.3%	1.2%

Source: PBO

\*PBO Estimates

### Baseline Expenditure Projections

The 2014/2015 budget forecast is pegged on the proposed revenue performance and the continued implementation of devolution. The budget should aim at ensuring inclusive economic growth that is targeted on poverty reduction and improvement of the well-being of Kenyans. The baseline forecast is based on the following assumptions:

- i. Targeting to fund the entire budget with minimal domestic borrowings.
- ii. High absorption capacities of spending agencies especially for development funds.
- iii. Continued implementation of the government’s development agenda by investment in proposed infrastructure projects like the standard gauge railway.
- iv. Successful acquisition of the Ksh 87 billion sovereign bond in 2013/2014.

*Expenditure projections are based on targeted minimal domestic borrowing, absorption capacities of spending agencies, continued government investment and successful acquisition of the sovereign bond*

Based on the above assumption the total expenditure and net lending (comprising National Government and County Governments) is projected to rise from Ksh 1.1 trillion in 2012/2013 to Ksh 1.3 trillion in 2013/2014. The 2014/2015 expenditures are projected to be Ksh 1.5 trillion which is about

*Expenditure for both national and county governments is estimated at Kshs. 1.3 trillion in 2013/14 and Kshs. 1.5 trillion in 2014/15*

33.1% of GDP. In the medium term, the expenditure will substantially increase over 2015/2016 and 2016/2017 to Ksh 1.7 trillion and Ksh 1.8 trillion respectively.

Recurrent expenditure is projected to rise from Ksh 761.6 billion in 2013/2014 to Ksh 849.7 billion in 2014/2015 which is about 19% of GDP. The development expenditure is projected to rise from Ksh 375.3 billion in 2013/2014 to Ksh 414 billion in 2014/2015 which is about 9.3% of GDP.

*Recurrent expenditure is estimated at Kshs. 849.7 billion in 2014/15 (19% of GDP) and development expenditure is estimated at Kshs. 414 billion in 2014/15*

**Table 5: Expenditure projections for 2014/2015 and the medium term**

	Projections*				
	2012/13	2013/14	2014/15	2015/16	2016/17
As percent of GDP					
<b>EXPENDITURE &amp; NET LENDING</b>	30.7%	33.6%	33.1%	33.1%	32.4%
<b>1. Recurrent</b>	22.2%	19.2%	19.0%	19.2%	18.7%
Wages and salaries	7.5%	6.9%	6.6%	6.3%	6.1%
Interest payments	3.3%	3.1%	3.5%	4.3%	4.3%
Pensions	0.7%	1.0%	0.9%	0.9%	0.9%
Operation and maintenance	10.6%	8.1%	7.9%	7.7%	7.5%
<b>2. Development &amp; Net Lending</b>	8.2%	9.5%	9.3%	9.1%	8.9%
Development projects (GoK+A-I-A)	8.1%	9.4%	9.2%	9.0%	8.9%
Payment of guaranteed loans	0.1%	0.1%	0.1%	0.0%	0.0%

Source: PBO

\*PBO Estimates

## Efficiency in Expenditure and Increasing Opportunities

### In Brief

*Resource mobilization and absorption capacities of spending agencies will determine performance of government expenditure policies. Options which may enable the country to position itself for efficient budgetary performance include creating a budget surplus in the medium term through leveraging ICT, restructuring parastatals, eradicating ghost workers, improving programme based budgeting, review of the Public Procurement and Disposal Act and linking National and County Development Strategies.*

The performance of government expenditure policies will depend on the resource mobilization and absorption capacities of spending agencies. The country's budget is funded by taxpayers' monies and borrowings. Prudent spending of these minimal resources will ensure the country catapults to the envisaged middle income country as per the Vision 2030. The following policy options may be considered to assist in positioning the country for significant economic growth:

*Efficient expenditure of minimal resources that the country collects will promote growth*

#### **i. Creating a budget surplus in the Medium Term**

The country has maintained perennial fiscal deficits for the last 10 years due to increased expenditure. It is noted that even though the revenue collection has been improving over the period, government's appetite for spending has been increasing with the rise in collection. The recurring fiscal deficit has forced the government to resort to borrowing from external and domestic sources. Domestic borrowing tends to crowd out private investment, bids up interest rates and presents a significant burden to the taxpayers through debt repayment. The government should strive to reduce dependency on borrowing in the next financial year and strive to achieve a budget surplus in the medium term.

*The government should target to reduce dependency on borrowing and achieve a budget surplus in the medium term*



To achieve a surplus in the medium term, the government has to set clear guidelines on how to minimize expenditure. The following are some of the proposed measures the government can undertake:

**ii. Embracing ICT**

The country has been recognized as an ICT hub in the region<sup>4</sup>. The government's support to the ICT industry has been overwhelming. Most parts of the country now have access to the internet and other telecommunication facilities. However, the government's uptake of the ICT infrastructure is still low with some critical sections still having bureaucratic processes that are cumbersome and costly and would have otherwise saved the country massive resources. Both the national government and county governments should embrace ICT in their daily operations. Instances where the government can fully utilize ICT include:

- All government (National and County Governments) advertisements could be done on their respective websites instead of purchasing multiple pages on print media.
- Adoption of electronic pay slips for all government officers.
- Adoption of electronic payment for all government transactions.

Embracing of ICT will substantially reduce the government's spending on printing and advertisement, curb corruption by ensuring minimal handling of cash by government officers and

*Government's uptake of ICT infrastructure has been slow paced.*

*Both the national and county governments can leverage ICT in all areas of operation. This include advertisements, and adoption of electronic modes of payment*

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<sup>4</sup> Kenya is ranked 3<sup>rd</sup> in Africa by the Global ICT Development Index behind Egypt and South Africa

improve the turnaround time in service delivery by government entities.

**iii. Restructuring of Parastatals**

To ensure there is value for money, the National Assembly should also closely scrutinize all legislations that propose formation of new parastatals with the aim of either embedding the proposed functions to an existing government ministry or entity.

*Embed proposed parastatals to existing government ministries/entities to reduce duplication of functions*

**iv. Eradicating ghost workers**

The need for a comprehensive audit of personnel in government is critical to ascertain the optimum number of staff required by the government. This will help in eradicating ghost workers thus saving the government colossal amounts of taxpayers' money. A number of counties have already undertaken headcounts of the staff they inherited from the government and defunct local authorities, revealing that a large number of people on their payroll are not physically working. With an ongoing audit of the National Government human resource by the Ministry of Planning and Devolution indicates that upto Ksh 70 million is lost monthly in eight ministries. The government should undertake a comprehensive human resource audit on all government ministries and state agencies.

*There is need to carry out a comprehensive audit of personnel to ascertain the optimal number of staff required by the government*

**v. Improving the Programme Based Budgeting**

The programme based budget (PBB) is a format of budgeting that links budget allocations and performance indicators. The push to have the budget prepared on programme level has been very useful in making reporting clear on whether resources are aligned to strategic priorities. However, it is worth noting that most of the budget documents are focused on presenting

*Programme Based Budgeting is useful in highlighting whether expenditures are aligned to strategic priorities as well as evaluating performance*

financial information but not reporting on performance. At the end of each financial year accounting officers prepare their financial statements only by votes yet they prepared their budgets both in programme format and per vote. This makes it difficult to evaluate the output of a programme and whether they are achieving results. Besides preparing final accounts based on the accounting framework, there need to put in the PFM law a rule requiring mandatory reporting of outputs and outcomes for every agency.

**vi. Review of Public Procurement and Disposal Act**

The cumbersome procurement process has been cited as a cause of delays in the implementation of many projects, leading to upward revision of costs. The government has already indicated for the need to review the Public Procurement and Disposal Act, 2005 which regulates the government’s procurement process. Its fast-tracking will ensure prompt government implementation of projects by addressing the bottlenecks that are as a result of the procurement process. The government should present to Parliament the proposed amendments to the Act to ensure Parliament discusses and approves it before the beginning of the 2014/2015 fiscal year.

*The Public Procurement and Disposal Act should be reviewed in order to enhance absorption of development budget*

**Revenue Enhancing Measures**

In the previous Budget Options<sup>5</sup>, the Parliamentary Budget Office (PBO) recommended consideration of the following measures to enhance revenue:

- a) Development of a criteria for exemptions, waivers and tax remissions;
- b) Revenue administration reform agenda;

*PBO has previously recommended determination of criteria for exemptions, revamping VAT, rethinking Turnover Tax implementation among other revenue administration reforms to enhance revenue collection*

<sup>5</sup> ‘Setting the Pace for Sustainable Growth’, Budget Options for 2013/14 and the Medium Term, March 2013

- c) Rethinking the implementation of turnover tax;
- d) Revamping the Value Added Tax (VAT) collections through enactment of the VAT Bill;
- e) Reintroduction of taxation of capital gains; and
- f) Taxation of the real estate sector

Most of the proposals are at various stages of consideration. With regard to the capital gains tax, the Cabinet Secretary for the National Treasury promised in his Budget Statement for 2013/14 that the government would review the capital gain tax under the Income Tax Act with a view of formulating modalities for its effective enforcement. This tax can help incorporate new taxpayers and improve the equity or fairness of tax system. However, it is critical to assess its revenue potential, its impact on the real estate growth, and effect on the stock market activity. International best practices show that initial tax rates for capital gains should be modest and simple, with greater emphasis on voluntary compliance to minimize administrative costs.

*Government committed to review the Capital Gains Tax in 2013/14. It is critical to assess its revenue potential, impact on real estate growth and effect on stock market activity*

The recently enacted VAT Act reduces the number of exempt and zero-rated items. For example, only a limited class of public institutions will benefit from tax waivers and exclusions. Further review of remaining tax legislations is required to reduce and streamline tax waivers and exclusions in line with the Constitution. Reduction of tax waivers and exclusions could help improve equitable sharing of tax burden including possible reduction of tax rates on account of expansion of the tax base.

*After enacting the VAT act, review of other tax legislations is important to streamline tax waivers and exclusions in line with the Constitution*

For 2014/2015 and the medium term, tax authorities and policy makers may wish to further reform the tax system by among others:

**i. Expanding the tax net/tax base**

The tax net should be expanded with a view to improving tax yields and possible reduction of final tax rates. For example, workers in the formal sectors disproportionately account for most income tax collections, whereas workers in some robust SMEs have not complied to the Turnover Tax (TOT) Regime. Bringing in more of this people into the tax net could ultimately help reduce the overall tax rate on income earners.

*Measures should be taken to bring in more people to Tax net such as robust SMEs that have not complied to ToT*

**ii. Improving the progressiveness of the income tax brackets over the medium term**

The robust growth of income tax over the last decade denotes certain structural changes in the wage and corporate incomes. Investment in infrastructure has attracted substantial foreign capital, investors which are partly driving growth in corporate incomes and personal wage incomes. Despite these shifts, anecdotal information on wage changes relative to the price level since 2009 shows that prevailing tax brackets place greater burden on low wage earners. To improve equity and progressiveness of(PAYE), the income tax brackets should be reviewed by shifting the brackets or creating additional tax brackets for higher income earners.

*There is need to review progressiveness of the income tax brackets as anecdotal information on wage changes shows that prevailing tax brackets place greater burden on low wage earners*

However, adequate analysis is required to determine the impact of the changes in the price level on the incomes of low wage earners relative to their tax burden, revenue cost of any measures to changes in the rates or shifting the tax brackets, and possible effects of increased progressiveness of income tax on investment and wealth creation among the higher income earners.

*There is need for adequate analysis to determine possible effects of increased progressiveness of income tax brackets*

**i. Harnessing revenues outside exchequer revenues**

There are multiple levies, charges and fees collected by state corporations which are inadequately scrutinized by Parliament. The levies include the Universal Service Fund (Communication Commission of Kenya), Rural Electrification Levy (Rural Electrification Authority). All the revenues collected by public agencies should be included in the revenue estimates so as to clearly understand the total tax burden on Kenyans. Indeed, compartmentalization of these taxes, levies, fees and charges tends to underestimate the true tax burden on tax payers and cost to businesses. This should be corrected through consolidation of some of the charges, fees and licenses and improved reporting throughout the budget process.

*All revenues harnessed by public agencies in form of taxes, levies, fees and charges should be included in the revenue estimates*

**ii. Stepping-up oversight of revenue accounts**

The ‘Finance Planning & Trade’ and ‘Budget’ Committees’ investigation on the discrepancy in the revenue accounts for 2007/08, brought out concerns on the validity and reliability of revenue accounts and reports. Whereas KRA collects revenue on behalf of government, the National Treasury is the designated receiver of most of ordinary revenue. The National Treasury is further responsible for reporting of revenue collections and performance to oversight authorities. But, the fact that differences occasionally occur over the actual revenue collected per accounting period points to weaknesses in revenue collection, reconciliation and reporting framework. To redress this problem, especially to improve the process of receipts, reconciliation, reporting, and accounting of revenue, it is suggested that the following systems be put in place:

*Measures should be taken to improve the revenue collection, reconciliation and reporting framework*

- Allow KRA to report periodically revenue collections concurrently to Treasury and relevant oversight authorities including Parliament; and

- Provide through legislation for regular reporting of substantive revenue collections from all revenue receivers and agents, clearly explaining any discrepancies, pending reconciliations, and differences between the realized revenue versus target.

*All revenue receivers and agents should report on revenue for clarity*

# **Chapter Three: Keeping the Promise**



## Strategic Interventions for long term, pro-poor growth (Simulations from PBOM)

### In Brief

*The economic Pillar of Vision 2030 targets a 10 percent growth rate per annum that was to be achieved in 2012 and sustained to 2030. However, this target is unlikely to be achieved and poverty reduced unless deliberate measures are taken. Simulations from the Parliamentary Budget Office Model (PBOM) indicate that achieve a 10 percent economic growth in 2014/15, the government should invest at least Kshs 90 billion in infrastructure, promote growth private sector investments by at least 5 percent, enhance agricultural productivity by 7 percent and increase value of exports by at least 0.5 percent*

### There was a Vision

The country's national development blueprint, Vision 2030, is aimed at transforming Kenya into a newly industrializing, middle income country providing high quality of life to all its citizens by 2030. One of the pillars which the Vision is anchored on is the Economic Pillar which aims at improving the prosperity of Kenyans through an economic development programme and targets a 10 percent economic growth rate per annum which was to be achieved by 2012 and thereafter sustained to 2030.

However, some of the Vision 2030 economic milestones have not been achieved, particularly the targeted economic growth rate. Indeed, the highest growth ever recorded by the Kenyan economy in the last decade is the 7 percent growth recorded in 2007. In 2012, the target year, the economy grew by 4.7 percent and not the envisaged 10 percent growth rate. Given the current challenges facing the economy, the country may not achieve the target growth rate unless concrete measures are taken to achieve this growth.

*The Economic Pillar of Vision 2030 targets a 10 percent economic growth rate per annum which was to be achieved by 2012 and thereafter sustained to 2030*

*The 10 percent growth target has not been achieved and is unlikely to be achieved unless deliberate measures are taken*

The Parliamentary Budget Office Macro Model (PBOM) has been used to run simulations using “what if” scenarios, in order to determine, hypothetically, the mix of policy measures that the government may need to put more emphasis on in order to achieve the targeted 10 percent growth rate in the next financial year and the medium term; as well as reduce poverty and increase employment levels.

### **Policy Option 1: Investment in infrastructure**

The Vision 2030 aspires for the country to have highly modernized infrastructure through a vast network of roads, railways, ports, airports, water and sanitation facilities and telecommunications; such that it will be impossible to refer to any region of the country as remote.

Assuming that additional Ksh. 90 billion is invested in revamping the country’s infrastructure in 2014, Simulations indicate that this investment will result in an additional 2.9 percent growth, pushing the 2014/15 growth from about 5 percent in the baseline scenario to approximately 7.9 percent. This growth is also likely to be driven in part by an increase in private investments which from the simulations, is seen to increase by approximately 2 percent in 2014/15. This can be attributed to improvements in the investment climate with the modernization of infrastructure, thereby attracting private investments and boosting private businesses. There is observed an increase in private sector employment, attributable to booming business in the private sector, as well as increase in total productivity and real GDP per capita. Consequently, poverty is likely to decrease by 0.3 percent in 2013/14 and 0.6 percent in 2014/15.

*Simulations were carried out using PBOM to determine the mix of policy measures that could drive the country to achieve a 10 percent growth rate and decrease poverty levels*

*An investment of Kshs. 90 billion in the country’s infrastructure in 2014/15 will result in a 7.9 percent economic growth and reduction in poverty levels by 0.3 percent*

## Policy Option 2: Promoting Private Sector Development

The private sector is a crucial engine for economic growth. The government recognizes this and has encouraged private sector led growth in previous budget and policy documents as part of the strategy to promote all inclusive economic growth. This has the capacity to create more jobs and economic opportunities for the unemployed, higher returns on investments, reduction in poverty and improvements in the standard of living.

Simulations indicate that a 1 percent increase in real growth of private investments is likely to result in a 0.5 percent increase in economic growth, pushing the projected growth for 2014/15 from 5 percent to 5.5 percent and rising to 5.6 percent in 2015/16. This growth is driven by an increase in incomes in the private sector resulting in increased private sector consumption and investment. There is noted an increase in ordinary revenues especially the income tax component. The impact of this measure on poverty is decreasing levels of poverty though not significantly. This implies that for higher levels of growth and reduction of poverty to be realized, there must be a higher growth of private sector investments.

To achieve a 1 percent increase in real growth private investments, it is estimated that the government should invest approximately Kshs. 177 billion<sup>6</sup> in the economy, targeted at various sectors of the budget likely to promote private sector growth. Of the Kshs. 177 billion, 90 billion can be targeted at transport infrastructure as indicated in policy option 1. The remaining Kshs 87 billion could be invested in agricultural interventions such as investment in agro processing industries, quality seed and fertilizers as will be further discussed in policy

*A 1 percent growth in private investments in 2014/15 will result in a 5.5 percent economic growth and negligible reduction of poverty therefore there is need to ensure higher growth of private investments*

*There is need to address constraints facing the private sector such as challenges in infrastructure, insecurity, limited access to credit in order to promote all inclusive economic growth*

<sup>6</sup> See Annex 3

Option 3. Alternatively, the money can be channeled towards combating insecurity through specialized training of security personnel and investment in latest technology.

### **Policy Option 3: Agricultural productivity**

Agriculture accounts for approximately 25% of the country's total GDP and a majority of Kenyans - statistics puts it at 75% of those in the rural areas - depend on agriculture for their livelihoods. Given that the majority of Kenyans earn a living from agriculture, then in order to achieve the twin goals of long term economic growth and poverty reduction, any strategic budgetary interventions aimed at addressing poverty and improving the standard of living for most Kenyans should primarily be targeted at enhancing agricultural productivity.

In 2010, the government launched the Agricultural Sector Development Strategy (ASDS) covering the period 2010 – 2020. One of the targets of the strategy is for the agricultural sector to achieve a growth rate of 7 percent per year over the next five years.

Simulations indicate that an increase in agricultural productivity by 7 percent in 2014/15 will result in an increase in GDP to 5.4 percent in 2014/15 and 5.5 percent in 2015/16. This growth will largely be driven by an increase in investment levels, especially private investments, as well as an increase in private consumption. There is a notable increase in the level of income of households in the agriculture sector, as well as an increase in ordinary revenues especially income tax. On the other hand, poverty is observed to decrease by 0.9 percent in 2014/15 and 1.8 percent in 2015/16, especially for households in the rural sector.

*Majority of Kenyans depend on agriculture for their livelihoods and strategic interventions to reduce poverty should primarily be targeted at agriculture*

*An increase in agricultural productivity by 7 percent in 2014/15 will increase GDP by 5.4 percent and reduce poverty by 0.9 percent*

To achieve a 1 percent growth in agricultural productivity, there is need to invest approximately Kshs. 87.12 billion <sup>7</sup> in agricultural interventions. These include provision of fertilizers and quality seeds, improved farming technology, enhanced irrigation, and value addition such as agro-processing.

A 7 percent growth in agricultural productivity as indicated in the ASDS would require Kshs. 609.84 billion.

**When the above policies are combined, simulations indicate that the country will achieve a 10 percent economic growth in 2014/15 as envisaged in Vision 2030.**

Specifically, investment of Kshs 90 billion in infrastructure, promotion of private sector investments by at least 5 percent, enhancement of agricultural productivity by 7 percent as outlined in the ASDS strategy and enhanced value of exports by 0.5 percent in 2014/15 will yield the following:

The economy will achieve a 10.1 percent growth in 2014/15, averaging 10 percent in 2015/16. This growth will be driven by increased investment levels with a greater increase in government investment levels than private investment levels. Exports will also increase by 3.8 percent in 2014/15 and the medium. There is also observed an increase in imports by approximately 5 percent over the medium term probably due to increased importation of investment goods.

- ❖ Ordinary revenues are likely to increase significantly, with the key revenue components being income tax as well as VAT. Income Tax is likely to go up due to increased employment levels, especially in the private sector where employment is observed to go up.

*In order to achieve a 10 percent economic growth rate and significant poverty reduction, there is need for investment in agriculture which will also enhance value of agricultural exports, investment in infrastructure and promotion of private sector investments*

*Revenues are likely to increase significantly and poverty will reduce by approximately 1.4 percent*

<sup>7</sup> See Annex 3

- ❖ Poverty will reduce by approximately 1.4 percent in 2014/15 and 2.8 percent in 2015/16. There is also observed a significant reduction of households in the agricultural and informal sectors and an increase in the number of households in the formal sector. This can be attributed to increased attractiveness of the formal private sector which is seen to thrive from the simulation with increased productivity of employees in the private sector by approximately 1.7 percent.

#### Policy Option 4: Investment in Human Capital

In order to achieve the envisaged growth, it is important to also invest in the human resource base in order to ensure that human capital is competitive enough to drive growth to double digits and sustain it through 2030 and beyond. This will be achieved through provision of quality education as well as investment in health.

*Government expenditure on education has increased significantly over the past decade*

##### i. Education

The percentage allocation to the sector has been growing in real terms over the years, from 19.8% of total government spending in 2003/04 to 22.1% of total government spending in 2011/12. Education expenditure as a percentage of GDP has also increased from 6.2% in 2003/04 to 7.2% in 2010/11, decreasing slightly to 6.6% in 2011/12. The table below shows total education expenditure as a percentage of government spending:

**Table 6: % of education expenditure to GDP and total government spending 2003/04 to 2011/13 budget**

Year	03/04	04/05	05/06	06/07	07/08	08/09	09/10	10/11	11/12
Total education Expenditure of GDP (%)	6.2	6.2	6.3	6.3	6.4	6.3	6.8	7.2	6.6
% of total education expenditure to govt. spending	19.8	22.0	22.2	21.3	19.0	20.4	20.6	20.0	22.1

Source: Comprehensive Public Expenditure Review 2013, Ministry of Devolution and Planning.



The allocation of resources in 2012/13 and 2013/14 has also shown increased allocation to the education sector which was allocated 21.3% in 2012/13 and 26.1% in 2013/14 (budget estimates 2012/13 and 2013/14). However, while significant amount of resources have been spent on ensuring increased access to education opportunities, the quality appears to have deteriorated due to high enrolment numbers and inadequacy of facilities.

*Despite increasing investment in education, quality appears to have deteriorated. Quality assurance, investment in research and innovation will promote education standards*

**Funding should therefore be channeled towards Quality assurance** through provision of adequate facilities to ensure standards and quality delivery, assessment and evaluation to provide reports for timely interventions.

**The National technology and innovation Act, 2013 should be implemented** especially to fund research and innovation to develop and operationalise innovation system.

**i. Health**

Resource allocation to the Health sector by the government has been on an increasing trend apart from 2013/14 when the allocation declined from Ksh. 86.97 billion in 2012/13 to Ksh 37.5 billion in 2013/14 due to devolution of health services to the counties. The sector also gets finances from various development partners that include; EU, WHO and UNICEF that do not pass through government systems. However, the per capita allocation on health services over the years has been below 34 USD recommended by WHO to provide a minimum health package.

*The Health Sector received significant budget allocation from government but per capita allocation on health services is below the WHO recommended level*

There has been an increase in recruitment of health personnel - less than 2.3 health workers per 1,000 population as recommended by WHO. The devolution of health functions may require the counties to use some resources to hire and retain more health workers for efficient service delivery.

The number of health facilities has increased from 7,100 in 2010 to 8,375 in 2012. However, the facilities are not evenly distributed and some lack the necessary commodities such as drugs, medical supplies and beds. Patients living far from the facilities have to walk for long distances to access the facility. Furthermore, the out of pocket spending on health is still high and this affects access to health care.

**Funding should be channeled towards Promotion of disease prevention measures** Preventive health services are not adequately addressed by allocating sufficient capital and human resources yet majority of the diseases causing mortality and morbidity in Kenya are preventable.

**Reduction of out of pocket spending on health will reduce individual carrying health burden.** The cost of health care discourages many people who are sick from seeking medical care. This is demonstrated by the high number of people who turn up during free medical campaigns by various institutions.

**Improved access to health care** can be achieved by establishing health facilities within 5 km radius, ensuring they are properly equipped and having requisite personnel and commodities.

*There is need to recruit additional health personnel especially at county level in order and to increase accessibility of health facilities*

*Funding in the health sector should be channeled towards preventive health as well as reduction of out of pocket spending on health*



**Limitation to Policy**

It is apparent that to achieve 10 percent growth, colossal amounts of resources will be required to be invested in different sectors of the economy as discussed in the policy options. However, given the limited resources and expenditure pressures on the government, it may be difficult for the government to achieve the desired growth within the next financial year.

We propose that it will be more realistic to stagger the resources for investment over the years, carrying out key flagship projects in designated financial years. The impact of these investments will be felt in the medium term and beyond as the economy experiences spillover effects from previous budgetary allocations.

*The policy package requires colossal amounts of money and this may not be achievable given the limited resources and expenditure pressures. Investment should therefore be done gradually over the years but targeted to achieve benefits within a specific timeframe*

## Can Kenya break the cycle of Poverty?

### Assessment of Poverty in the Country

At independence, poverty, illiteracy and disease were identified as impediments to prosperity. The country therefore embarked on instituting policies and programmes aimed at alleviating poverty.

The first assessment of poverty in Kenya was done in 1992, when the government in collaboration with the World Bank conducted the Welfare Monitoring Survey. This was designed to help in tracking the implementation of the Structural Adjustment Programmes that had been introduced earlier on. Two similar surveys were carried out in 1994 and 1997 and in 2004/05; the Kenya Integrated Household Budget Survey (KIHBS) was conducted. The estimates of poverty rates from the four studies were 46.33%, 46.75%, 52.9% and 46% respectively.

**Table: Key Economic Indicators since independence (10 year averages)**

Key Economic Indicators	1963-1972	1973-1982	1983-1992	1993-2002	2003-2013
GDP Const Prices (2005)	244,943,463,856	474,690,338,257	716,977,801,497	935,953,770,155	1,330,241,100,000
GDP Annual Growth (%)	8.0	5.0	4.0	2.0	5.0
GDP Per Capita	23,305	31,723	33,161	31,895	34,847
GDP Per Capita Annual Growth (%)	5.4	0.3	(2.0)	(0.4)	2.3
Population (total)	10,502,250	14,900,879	21,563,864	29,361,451	38,899,373
Population Growth Rate (%)	3.0	4.0	4.0	3.0	3.0

From the table above, it is evident that the Gross Domestic Product exhibited quite irregular growth with sharp declines in late 1980s and early 1990s. Similarly, the GDP per capita demonstrated a fairly inconsistent growth. Also, from the second to third decade after independence, the country experienced a tough economic period before a gradual upward trajectory in 2003. The GDP Per Capita annual growth dropped from 5.4% in 1963-1972 to -2.0% in 1983-1992 before rising again to 2.3% in 2003-2013.

On the other hand, the population has been constantly increasing, from an average of 10.5 million people in 1963-1972 to about 39 million in 2013. However, the growth rate increased from 3% in the first decade to 4% in the third decade before stabilizing at 3% till 2003-2013. It is worth noting that over time, population growth rate has persistently been higher than the GDP Per Capita growth rate and this could threaten long term poverty reduction efforts.

### Economic Growth and Poverty Linkage

Poverty levels in the country have remained high despite numerous interventions coupled with modest economic growth. For instance, between 2003 and 2007, the economic grew from 1.7 percent to about 7.1 percent without significant reduction in poverty levels. This indicates that even during periods of economic growth, the anticipated trickle-down effects have not been experienced. It therefore raises pertinent concerns as to whether economic growth alone is a cure for poverty reduction, or still if poverty reduction objectives were well articulated at the policy formulation stage. Various policy reviews commissioned by government have shown that there is nothing wrong with policy formulation. Perhaps, perennial institutional weaknesses in the implementation of such policy strategies could explain the failure.

## Devolution and the Economy In Brief

*The past 10 months of the devolved system of government provides ample lessons for the future, especially vital lessons on how to correct the weak budgeting and financial management capacity at the county level. This includes insights on how to temper disagreements over revenue sharing and functional transfers, and ideas on gradually resolving apparent mismatch between citizen's expectations and actual pace of delivery of services by individual counties. Improvements are expected in various areas of devolution, but greater effort is suggested in enhancing fiscal prudence and absorptive capacity within existing laws.*

### Transition to Devolved Governments: Revenue Allocation and Budgeting

Devolved system of government took form after the 4<sup>th</sup> March 2013 general election. The ensuing transition to devolved governments was tricky and jagged in subsequent months particularly from the budgetary and financing perspective. For the first three months of 2012/13 leading up to 2013/14 budget counties were allocated Ksh. 9.78 billion to finance initial operating costs and setting up county offices for governments prior to the approval of budgets for 2013/14. The initial revenue allocations were shared among 47 counties using the formula approved by the National Assembly (Transition County Allocation of Revenue Act and Transition County Appropriations Act).

*Transition to devolved government has faced challenges in budgeting and financing*

The 2013/14 budget process started in earnest after the elections amidst intense disagreements over revenue sharing and functional transfer. Initial resources allocated to the counties were said to be inadequate and county governments demanded

*County budgets encountered difficulties over revenue sharing and functional transfer*

full transfer of functions and resources in the coming budget. The enactment of the Division of Revenue Bill, 2013 was particularly taxing owing to disagreements over revenue allocations to county governments. The Division of Revenue Bill was introduced in the National Assembly soon after the official opening of Parliament. Since at the time of consideration of the Division of Revenue Bill the Budget and Appropriations Committee had not been formed, the bill was considered in the National Assembly plenary.

*Disagreements ensued over revenue allocations to county governments*

The Schedule to the Division of Revenue Bill provided revenue allocations as follows: out of total shareable revenue equal to Ksh. 920.4 billion; the national government would receive Ksh. 721.7 billion, while County governments would receive Ksh. 198.7 billion, divided into Ksh. 154.8 billion “unconditional” allocations and Ksh. 43.9 billion for “conditional” allocations. Conditional allocations would be used for “the financing and continuation of on-going services in accordance with Articles 187(2) and 203(1)(d) of the constitution.” The Division of Revenue Act eventually allocated Ksh. 210 billion: Ksh. 190 billion would be shared using the approved revenue sharing formula among counties, and Ksh. 20 billion would cater for referral health facilities and donor commitments. The Ksh. 210 billion exceeded the threshold for allocations to county governments set in Article 203(2) of the Constitution. The National government received 730.4 billion out of the shareable revenue.

*Counties received unconditional and conditional revenue allocations from the national government to finance ongoing services*

Disagreements over “inadequate” revenue allocation to county governments and transfer of functions persisted through the first quarter of 2013/14 financial year. Latent weaknesses in the county level budgeting process through the first quarter of 2013/14 led to financing gaps in the first budgets, and delays in

*Weaknesses in county budgeting process in first quarter of 2013/14 led to financing gaps in the first budgets*

approval of the budgets and essential county appropriations bills. Though the problem in budgeting was eventually settled, slow adoption of public financial management systems such as the IFMIS hampered absorption of budgetary funds (see Budget Implementation Review Report, First Quarter 2013/14 by the Office of Controller of Budget) particularly: hence the underlying mismatch between citizen’s expectations and actual pace of delivery of services by individual counties.

*Slow adoption of public finance management systems hampered absorption of budgetary funds*

The last 10 months of devolution and revenue sharing provides a host of lessons and insights for improvements in future. On the revenue sharing following could serve as a guide to reduce acrimony in future:

1. **Ensure stable revenue allocations between the levels of government:** Revenue sharing in the first year of county governments was acrimonious and largely masked critical issues of proper budgeting and fiscal prudence. To remedy, this revenue sharing should be stable and predictable, hopefully based on a reliable baseline. This will help to ease undue political contest for resources between the levels of government.
2. **Gradual development of “needs-based” budgeting frameworks:** whereas budgets and resource allocation may not escape political competition, reliable and stable forecasting of financing needs by each level of government could help tone down disagreements. Ideally, this may require improvements in a “needs-based” budgeting framework for funding requests through the Division of Revenue Act. This calls for adherence to the MTEF budgeting framework and alignment of spending policies to overall national goals such as those envisioned in the Vision 2030. A needs

*Revenue sharing should be stable and predictable based on a reliable baseline*

*There is need to adhere to the MTEF budgeting framework and align spending policies to overall national goals*

based “resource requirement” approach could form best grounds for negotiation of resources through a supranational organ such as the Intergovernmental Budget and Economic Council prior to the introduction of the Division of Revenue Bill.

3. **Each level of government to live within its means:**

increasing competition of resources by both levels of governments could lead to inadvertent fiscal expansion. In a real world revenue allocations need not exactly meet all government spending needs or costs. However, soaring demand for resources to fund various services by the national government and counties continue to pile pressure on the national and county treasuries. To enhance fiscal prudence, all levels of government should be mindful of wastage. Ideally, each level of government should face a real budget constraint given that tax resources are limited. Fiscal policies at each level of government should be consistent with the need to maintain sustainable public debt, low inflation, stable interest rates, and a external competitiveness.

*To enhance fiscal prudence, each level of government should face a real budget constraint and be mindful of wastage*

4. **Fostering the symbiotic relationship envisaged in**

**Article 187:** sharing of functions in accordance with Article 187 could help in moving away from the present antagonistic competition over resources. Often intense competition for resources could mask underlying adverse incentives expressed in wasteful spending and corruption at either level of government.

*Sharing of functions in accordance with Article 187 could assist in moving from antagonistic competition over resources*

5. **Addressing emerging issues raised in the Controller**

**of Budget Reports:** recent Controller of Budget reports highlight low absorptive capacity in various governments. For instance, the Controller of Budget reported that the counties had an average absorption

capacity of 4.78% (the highest being 12.3% and lowest 1.2%) in the first quarter of the FY 2013/14 against a target of about 25%. To address this problem, then the national and county treasuries should make improvements in budgeting, procurement, and **public finance management systems.**

*Emerging issues raised in  
Controller of Budget Reports  
should be addressed*



### Box: Devolution Experiences in Other Jurisdictions.

#### Box: devolution experiences in other jurisdictions.

##### Indonesia

Devolution in Indonesia began in 2001 and it was occasioned by the clamour to reduce the power from Jakarta and also increase local participation in politics and the economic. It is a 3 tier system comprising of the central, the provincial and the local governments. During the implementation of devolution, there was suspicion, just like has been seen in Kenya, that the central government was not keen on decentralization and it wanted to revert back to centralized system. Further, there were some local governments that depended only on the general purpose grant (devolved funds) since their own local revenue was too thin. Nonetheless, the local governments imposed some fees and charges that were somehow considered illegal or disruptive, just like what some of our counties have been doing recently, and it impacted negatively on the local investment climate. In the case of foreign financing, the central government could sign agreements with international agencies on behalf of the local governments to get the funds and lend such that in case of default, the charge is done through intergovernmental transfers on the share of that local government. If this is emulated, it may lift the burden of contingent liabilities off the national government due to loan guarantees to county governments. Nonetheless, despite all the initial challenges, Indonesia is said to have come out strong by broadening and spreading its growth due to local competition for investment.

##### South Africa

South Africa's system is composed of the national, provincial and local governments. In the course of implementing devolution, there have been calls from some political quarters for the disbandment of the provincial governments due to a feeling that their role was unnecessary but it was realized that it is not easy to disband a system embedded in the constitution. There have been similar calls in Kenya to disband one of the Houses of Parliament and this presents a learning experience. Now, the Provinces are clustered according to economic and regional development areas but still 7 of the 9 provinces have similar linguistic majority like the case in most of the Kenyan Counties. Because of this, there were suggestions to change the ethnic boundaries to create functional, effective, economically viable and integrated communities but it has not been successful because of boundary intricacies involved. It is also noted that whereas in Kenya politics is ethnic, the South African political system is based on ideology and economic policy and to what they have done to guard against constituting a single party electoral result in the devolved units is to use proportional representation where elections are coupled with party list so as to produce proportional results. This is a system that might be considered in Kenya since there are counties, for instance Mombasa, where all Members of its Assembly are from one party.

**Note:** Drawing experiences from other countries which have implemented devolution, it is evident that challenges have been faced in a good measure but their devolution dreams realized. Therefore, it is a call for Kenya to learn from the successes as it endeavours to deliver on devolution promise.



## APPENDIX 1: Proposed Sector Ceilings for 2014/15

Discretionary Sector	Total Expenditure (KshBlns)		% of Total Expenditure	
	Allocation 2013/2014	Ceiling 2014/2015	Allocation 2013/2015	Ceiling 2014/2016
<b>Public Admin. &amp; Foreign Relations</b>	112.8	125.2	11%	12%
<b>Social Services</b>	334.5	344.7	32%	32%
<b>Judiciary</b>	18.3	18.3	2%	2%
<b>Parliament</b>	19.0	20.2	2%	2%
<b>Environment and Natural Resources</b>	57.1	59.1	5%	5%
<b>Agriculture</b>	37.4	37.6	4%	3%
<b>Physical Infrastructure &amp; ICT</b>	232.5	253.7	22%	23%
<b>National Security</b>	84.7	77.3	8%	7%
<b>Commercial and Economic Affairs</b>	150.6	131.3	14%	12%
<b>Justice and Legal Affairs</b>	10.3	12.3	1%	1%
<b>Total</b>	<b>1,057.3</b>	<b>1,079.6</b>	<b>100%</b>	<b>100%</b>

Non-Discretionary Item	Total Expenditure (KshBlns)		% of Total Expenditure	
	Allocation 2013/2014	Ceiling 2014/2015	Allocation 2013/2015	Ceiling 2014/2016
<b>Public Debt</b>	341.6	374.1	89%	89%
<b>Pensions</b>	39.1	42.0	10%	10%
<b>Salaries, Allowances &amp; miscellaneous expenditures</b>	3.5	3.5	1%	1%
<b>Total</b>	<b>384.2</b>	<b>419.6</b>	<b>100%</b>	<b>100%</b>

**Appendix 2: Selected Macroeconomic Indicators**

<b>Contributions to real GDP</b>	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Government final consumption expenditure						
of which wage bill government	0.2	0	0.2	0.2	0.2	0.2
of which material consumption government	0.7	1.2	0.9	0.3	0.2	0.2
Private final consumption expenditure	4	3.3	7.4	4.5	5.4	5.6
Gross fixed capital formation						
of which private investments	2.9	0	0.9	0.9	0.8	0.8
of which govt investments	-0.1	3.9	-0.5	0.3	0.4	0.4
Changes in inventories	0	0	0	0	0	0
Exports of goods and services	3.2	1.6	0.3	1.5	1	0.9
Imports of goods and services	4.7	6.6	4.1	2.8	2.6	2.6
Discrepancy 1	-1	1.1	-0.3	0	0	0
Gross domestic product at market prices	5.1	4.5	4.9	4.9	5.4	5.5
<b>Contributions to GDP Deflator</b>						
Government final consumption expenditure	1.1	1.2	1.4	0.9	0.8	0.8
of which wage bill government	0.6	0.8	0.4	0.4	0.4	0.3
of which material consumption government	0.5	0.4	0.3	0.6	0.6	0.5
Private final consumption expenditure	6.1	8.6	3.7	6.4	6.4	6.5
Gross fixed capital formation	1	1	1.2	2	2	2
Changes in inventories	0.3	-0.4	0	0	0	0
Exports of goods and services	2.9	2.3	0.7	1.9	2.1	2.1
Imports of goods and services	5.7	3	0.1	3.9	4	4
Discrepancy 1	2.7	1.1	0.1	-0.3	-0.3	-0.3
Gross domestic product at market prices (with weights 2001 at market prices)	8.4	10.9	7	6.9	7	7.1
<b>Poverty</b>						
Share Households below poverty line (Percent)	44.4	45.9	44.1	43.4	42.6	42
Individuals:						
WAGE EMPLOYMENT (individuals)						
Private sector (Million)	1.4	1.5	1.5	1.5	1.6	1.6
Public sector (Million)	0.7	0.7	0.7	0.7	0.7	0.7
of which Central Government	0.2	0.2	0.7	0.7	0.7	0.7
TOTAL WAGE EMPLOYMENT (in million)	2.1	2.1	2.2	2.3	2.3	2.4
Self-employed and unpaid family workers (in million)	0.1	0.4	0.4	0.4	0.5	0.5
INFORMAL SECTOR (in million)	9	9.9	10.4	10.9	11.4	11.9
TOTAL EMPLOYMENT excl. Other (in million)	11.2	12.5	13	13.6	14.2	14.8
Other (traditional self-subsistence sector) in million	8.4	7.7	7.7	7.6	7.5	7.5
Total Employed	19.6	20.2	20.7	21.2	21.7	22.3
Seeking Work / No Work Available						
Total population (Million)	39	40.1	41.1	42.1	43.2	44.3
informal sector ratio	80.7	79.4	79.8	80.2	80.5	80.8
real GDP per capita	2.6	1.6	2.4	2.3	2.8	2.9

**APPENDIX 3: DETERMINATION OF RESOURCE REQUIREMENTS**

To enhance Productivity in a given sector of the economy, we determine the nominal value of 1 percent GDP in that sector. This is multiplied by the Incremental Capital Output Ratio (ICOR) which measures marginal amount of investment capital necessary for an entity to generate the next unit of production. The result will determine total amount of investment required to drive growth in that sector. This is demonstrated as follows:

- 1) To achieve 1 percent growth in the private sector, the following resources are required:

$$\text{GDP Private Sector (2011)} = 2,954.4 \text{ billion}$$

$$1\% = 29.5$$

$$\text{Kenya's Incremental Capital Output Ratio (ICOR)} = 6$$

Therefore, total amount required to generate additional amount of GDP private sector:

$$29.5 \times 6 = \text{Kshs } 177 \text{ billion}$$

- 2) To achieve a 1 percent growth in agricultural productivity, the following is the estimated additional budgetary allocation required:

$$\text{Nominal agricultural GDP (2011)} = 726.16 \text{ billion}$$

$$1\% = 7.26$$

$$\text{Kenya's Incremental Capital Output Ratio (ICOR)} = 6$$

Therefore, total amount required to generate additional amount of

$$\text{Agricultural GDP} = 7.26 \times 6 = \text{43.56 billion}$$

APPENDIX 4: ANALYSIS OF COUNTY BUDGETS

County	% Personnel Emoluments to Total Expenditure	% Operation and Maintenance to Total Expenditure	% Development to Total Expenditure	Total Expenditure (Ksh Billions)
BARINGO	16%	54%	31%	4.4
BOMET	13%	53%	34%	5.6
BUNGOMA	14%	53%	33%	8.0
BUSIA	16%	53%	32%	4.1
ELGEYO-MARAKWET	8%	51%	42%	8.7
EMBU	20%	50%	31%	4.0
GARISSA	21%	48%	30%	3.3
HOMA-BAY	26%	45%	30%	8.3
ISIOLO	20%	44%	37%	3.2
KAJIADO	28%	42%	29%	3.3
KAKAMEGA	24%	41%	35%	5.1
KERICHO	30%	40%	30%	8.1
KIAMBU	19%	38%	44%	3.5
KILIFI	33%	36%	30%	10.0
KIRINYAGA	23%	35%	42%	4.6
KISII	35%	35%	30%	5.5
KISUMU	23%	34%	43%	3.5
KITUI	13%	34%	53%	3.2
KWALE	18%	33%	49%	4.0
LAIKIPIA	33%	33%	35%	3.4
LAMU	28%	32%	40%	5.1
MACHAKOS	19%	29%	52%	8.0
MAKUENI	21%	29%	50%	5.4
MANDERA	16%	29%	55%	2.4
MARSABIT	16%	28%	56%	3.8
MERU	30%	28%	41%	4.5
MIGORI	41%	28%	32%	25.7
MOMBASA	21%	27%	51%	21.8
MURANG'A	34%	27%	38%	4.4
NAIROBI CITY	35%	27%	38%	5.8
NAKURU	13%	27%	61%	4.2
NANDI	13%	27%	60%	8.5
NAROK	23%	26%	51%	5.7
NYAMIRA	31%	25%	43%	12.6
NYANDARUA	27%	25%	48%	3.1
NYERI	13%	24%	62%	7.0
SAMBURU	14%	24%	62%	2.2
SIAYA	33%	24%	43%	6.5
TAITA-TAVETA	25%	23%	52%	3.8
TANA-RIVER	29%	21%	50%	3.6
THARAKA-NITHI	38%	20%	42%	7.1
TRANS-NZOIA	36%	19%	45%	3.6
TURKANA	27%	18%	55%	13.3
UASIN-GISHU	22%	17%	61%	4.3
VIHIGA	44%	16%	40%	5.3
WAJIR	36%	15%	49%	4.1
WEST POKOT	48%	11%	41%	2.9
<b>Total</b>	<b>26%</b>	<b>31%</b>	<b>43%</b>	<b>288.6</b>

Source: Controller of Budget