Analysis of Quarterly Budget Implementation Reports for the National Government

Quarter 4 of FY 2020/2021 and Quarter 1 of FY2021/22

Executive Summary

The economy exhibited signs of recovery from the effects of COVID in 2021 with real GDP growth rates of 0.7% between January and March and 10.1% in the final quarter of 2020/21, this was mainly supported by improved performance in education, ICT, transport and storage, health, financial and insurance and manufacturing sectors. The period also exhibited stability in the prices of basic commodities, in September, 2021, the increase in the general price level was 6.9% from 4.2% in a similar period in 2020, a phenomenon that was mainly driven by higher fuel and food prices. However, greater performance would have been achieved had the government responded to the pandemic more effectively.

The improved economic performance correspondingly resulted in enhanced performance in revenue. Total Revenue and External Grants collected in quarter one of 2021/22 amounted to Ksh 513 Bn, representing a growth by 34.07% compared to a similar period in 2020/21 and at least 4.36% of the target revenue amount. The improvement could partly be explained by the mitigative measures that were taken by government in 2020 against the ensuing shocks experienced by the economy through the Economic Stimulus Programme (ESP). Delay in the disbursement of exchequers is particularly observed in early quarters which has affected the implementation of planned programmes by MDAs and subsequently timely delivery of services. This could be due to failure to consider the seasonality in the revenue collections in designing annual workplans and cash flow projections that are key in improving the timing of the releases of funds.

Notably, effective budget execution has been hampered by high debt servicing charges which currently is more than a third of the recurrent expenditure. Key factor driving high debt servicing charges is partly due to increase in non-concessional borrowing and has contributed to rising debt vulnerabilities.

To this end, the IEA proposes the need for the government to set realistic revenue targets to inform budgeting process in order to improve predictability of public funds, need to develop a contingency for the restructuring of state-owned enterprises and a call for enhanced public accountability and reduction on the wastage.
1.0 Introduction

The Office of the Controller Budget (OCoB) prepares quarterly in-year budget reports referred to as Budget Implementation and Review Reports (BIRRs) for both National government and County Governments in fulfilment of the requirements of Article 228(6) of the Constitution of Kenya and Section 9 of the Controller of Budget Act, 2016. The reports provide an assessment of the progress made by National and County Governments in the implementation of their budgets. It identifies critical issues hampering effective budget implementation and makes appropriate recommendations to address the issues.

This analysis has utilized the BIRR reports for the first quarter (Q1) of 2021/22 and the fourth quarter (Q4) of 2020/21 to provide a synthesis of the budget performance by the national government. Trends in the revenue mobilization; revenue disbursements and expenditure performance are analyzed to establish the extent to which they aligned to approved national budget 2021/22. This information is important in highlighting key implementation challenges, gaps and their implications especially on service delivery.

The analysis also provides insights on the extent to which ministries, departments and agencies (MDAs) have adhered to the fiscal responsibility principles based on assessment of their budget efficiencies. Implications of debt servicing owing to rise in stock of debt is also given a special mention. Text box of a case study of the Ministry of Health budget performance is also provided as a more specific sneak peek into an MDA.

The conclusion of this analysis captures key messages and recommendations for correction action by different actors.

Institute of Economic Affairs (IEA) - Kenya provides this analysis every quarter. For more reports, please visit [www.ieakenya.or.ke](http://www.ieakenya.or.ke).

1.1 Macroeconomic Outlook

Implementation of national government budget for the fourth quarter (Q4) of 2020/21 and first quarter (Q1) of 2021/22 happened when the economy was recovering from depressed economic performance occasioned by containment measures enforced to curb the spread of the COVID-19. Particularly, Q4 of 2020/21 showed remarkable improvement with rebased real GDP growth figures, up to 10.1% from 0.7% in Q3 of the same financial year.

Figure 1.1: Quarterly Economic Growth (Real GDP)

Source: Kenya National Bureau of Statistics (KNBS)
Figure 1.2 presents quarterly real economic growth rates across the three main sectors: agriculture, manufacturing and tertiary. The evolution of the sectoral growth rates indicates that while the tertiary sector is the largest contributor in the economic growth (2018/19 Q3 – 2019/20 Q3), it is the most volatile, especially having been worst hit in Q4 of 2019/20 but recovered the strongest in Q4 of 2020/21.

The surge in the cases of COVID-19 pandemic with over 300,000 cumulative cases and the resulting deaths of close to 6,000 by the end of 2021 slowed the economic performance with significant disruptions in many sectors of the economy such as hospitality, international travels and education.

Economic recovery was supported by relaxation of economically disruptive containment measures despite fourth COVID 19 wave between July-September 2021. This resulted to surge in the cases of COVID-19 pandemic with over 300,000 cumulative cases and the resulting deaths of close to 6,000 by the end of 2021 (figure 1.2). Besides, improved vaccination drive (2.9 million fully vaccinated adults by end of December 2021). However, the uptake of COVID vaccine is far below the target of 26 million Kenyans by end of 2022 according to the Ministry of Health reports.

2.0 Revenue Performance

Revenue under performance has been a common feature since 2013/14 according to National Treasury reports. In this analysis, fig 2.1 confirms this issue across majority of the quarters since 2016/17 including in Q4 of 2020/21.
Surprisingly, in Q1 of 2021/22, revenue collection surpassed the target in spite of the difficult economic environment clouded by COVID-19 pandemic. Table 2.1 provides more details on total revenue performance by different sources.

Table 2.1: Breakdown of Total Revenue Performance in Q1 of 2021/22 against Q1 of 2020/21

<table>
<thead>
<tr>
<th></th>
<th>2020/21</th>
<th>2021/22</th>
<th>% Deviation</th>
<th>% Growth</th>
<th>% of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Actual</td>
<td>Actual¹</td>
<td>Target</td>
<td>(B - C)/C*100</td>
<td>(B - A)/A*100</td>
</tr>
<tr>
<td>Total Revenue (a+b)</td>
<td>379</td>
<td>506</td>
<td>480</td>
<td>5.41%</td>
<td>3.70%</td>
</tr>
<tr>
<td>(a) Ordinary Revenue</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Import Duty</td>
<td>343</td>
<td>442</td>
<td>425</td>
<td>3.93%</td>
<td>20.96%</td>
</tr>
<tr>
<td>Excise Duty</td>
<td>23</td>
<td>27</td>
<td>27</td>
<td>-0.62%</td>
<td>16.84%</td>
</tr>
<tr>
<td>PAYE</td>
<td>47</td>
<td>58</td>
<td>56</td>
<td>3.52%</td>
<td>23.39%</td>
</tr>
<tr>
<td>Other Income Tax</td>
<td>72</td>
<td>106</td>
<td>100</td>
<td>6.03%</td>
<td>77.71%</td>
</tr>
<tr>
<td>VAT Local</td>
<td>80</td>
<td>90</td>
<td>99</td>
<td>-9.17%</td>
<td>12.65%</td>
</tr>
<tr>
<td>VAT Imports</td>
<td>41</td>
<td>60</td>
<td>59</td>
<td>0.89%</td>
<td>24.72%</td>
</tr>
<tr>
<td>Investment Revenue</td>
<td>21</td>
<td>19</td>
<td>12</td>
<td>52.95%</td>
<td>12.07%</td>
</tr>
<tr>
<td>Traffic Revenue</td>
<td>1.1</td>
<td>1.1</td>
<td>0.9</td>
<td>22.82%</td>
<td>17.51%</td>
</tr>
<tr>
<td>Taxes on Intl. Trade &amp; Trans. (IDF Fee)</td>
<td>8.4</td>
<td>11</td>
<td>8.0</td>
<td>34.30%</td>
<td>27.63%</td>
</tr>
<tr>
<td>(b) Appropriation in Aid²</td>
<td>36</td>
<td>65</td>
<td>55</td>
<td>16.82%</td>
<td>78.72%</td>
</tr>
<tr>
<td>o/w Railway Development Levy</td>
<td>6.3</td>
<td>8.0</td>
<td>7.7</td>
<td>4.56%</td>
<td>28.80%</td>
</tr>
<tr>
<td>(c) External Grants</td>
<td>3.9</td>
<td>6.7</td>
<td>11</td>
<td>40.81%</td>
<td>39.89%</td>
</tr>
<tr>
<td>Total Revenue and External Grants (a+b+c)</td>
<td>383</td>
<td>513</td>
<td>492</td>
<td>4.36%</td>
<td>34.67%</td>
</tr>
<tr>
<td>Total Revenue and External Grants (% of GDP)</td>
<td>3.38%</td>
<td>4.10%</td>
<td>3.93%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

¹ includes rent on land/buildings, fines and forfeitures, other taxes, loan interest receipts, reimbursements and other fund contributions, fees, and miscellaneous revenue
² includes receipts from Road Maintenance Levy Fund and A-A-A from Universities

Source of Data: National Treasury

Total revenue and external grants collected in quarter one of 2021/22 amounted to Ksh 513 billion, representing a growth by 34.1% compared to a similar period in 2020/21 and 4.4% above the target revenue amount.

Enhanced performance in ordinary revenue collection was driven by the two main tax heads (PAYE and VAT) as well as by significant growth of Appropriation in Aid (78.7%). Improved collection of PAYE and VAT is on the back of relaxation of mitigation measures that had previously been enforced by the government against the spread of COVID-19. What
is also noticeable from table 2.1 is the significant receipt of investment revenue (example, dividends from state owned enterprises) of Ksh 19 billion, which is 52.4% over the target by end of Q1 of 2021/22.

From a quarterly perspective, nominal revenue receipts are highest in the second and the fourth quarters for the period 2016/17 to 2019/20. These quarters coincide with increased economic activities during the end of the calendar year (Q2) and the increase in filing of returns towards the end of the fiscal year (Q4).

Further, the breakdown of the revenue from ordinary taxes as illustrated in Figure 2.2 reveals seasonal nature of revenue collection by various tax revenue sources and by their contribution (size).

Figure 2.2: Breakdown of Ordinary Revenue by Sources and by Quarters, 2018/19-2021/22

Beyond increased economic activity (growth services sector, energy, and constructions sectors) owing to relaxation of COVID 19 containment measures as the primary driver of enhanced revenue performance by end of Q1 of 2021/22, other factors are notable. According to the Kenya Revenue Authority, tax reforms towards broadening tax base (digital services tax, minimum tax), enhanced compliance enforcement and increase in the number of active taxpayers from 3.94 million in 2018 to 6.1 million by end of 2021.

3.0 Expenditure performance

The government has over the years continued to underperform in spending. This is shown in figure 3.1, where quarterly spending by ministries, department and agencies (MDAs) from 2016/17 to 2020/21 (bars) has been below quarterly target (black dot), save for Q3 of 2016/17, Q1 of 2017/18 and Q2 of 2018/19.

This was not any different in Q1 of 2021/22, however, the unspent portion, Ksh 4 billion was comparatively lower than in previous years. The reduced expenditure gap in Q1 of 2021/22 (actual spending against the target) is attributed to enhanced revenue collection and improved revenue forecast and represents significant improvement from the previous quarter.
The Budget Focus

Figure 3.1: Total Expenditure Trends for MDAs by Quarter from 2016/17 - 2021/22

Source: The National Treasury | Quarterly Economic and Budget Review (QEBR)

Further breakdown of government spending is more revealing as shown figure 3.2, in terms of explaining expenditure performance.

Figure 3.2: Trends in absorption rates

Source: Controller of Budget | Budget Implementation and Review Reports (BIRR)

First, disaggregation by recurrent and development shows that on average, the lowest spending relative to budget is in Q1 (15%) followed by Q3 (18%). Spending however picks up in Q2 and Q4, which apparently matches peaks in revenue collection. Ability of MDAs to spend relative to their budget is a more pronounced challenges for development expenditure than recurrent expenditure. This is evident in table 3.2 which shows that by the end of Q1 of 2021/22, absorption rate for development budget was 17% compared to 22% for recurrent against ideal quarterly target of 25%. Comparatively for development budget, this is a reduction from 27% in Q1 of 2020/21.
Remarkably, delays in the disbursement of funds is disproportionately affecting development budget whereas disbursements for recurrent budget are relatively more evenly distributed across the years. The low absorption rate for development not only underscores inadequate budget planning but also inefficiencies in the implementation development programmes and projects.

Second, figure 3.3 shows mixed performance in spending by sectors and explains reasons behind overall budget performance of MDAs and also by recurrent and development budget. Budget performance is measured by absorption rates (ratio of actual expenditure/spending relative to the budget).

Figure 3.3 reiterates the fact that low uptake of public resources is a challenge for the development budget. The struggling sectors (low spending by end of Q1 of 2021/22) include: Agriculture, Rural and Urban Development; Environment, Water and Natural resources; Health, Education; Social protection, Culture and Recreation and Public Administration and International Relations (PAIR).

Noticeably development spending in Energy, Infrastructure and ICT; National Security and Social Protection, Culture and Recreation sectors exceeded funds disbursed to them by end of Q1 of 2021/22, measured by utilization rate. For the former two sectors, their absorption rates was equally above the expected target implying they used unreported funds and donor funds. However, for the Social Protection, Culture and Recreation, its less than optimum absorption rate means that quantum of funds released to this sector was well below its ability to spend.

Conversely, development spending was significantly above 25%, for both Governance, Justice, Law and Order-GJLO (30%); and GECA (27%) but their utilization rates was below 25% for Q1 of 2021/22. This could perhaps be explained by the fact that they utilized unreported finances, in particular Appropriation in Aid (funds generated from services offered by MDAs). The other explanation could be use of funds that were carried forward from the previous financial year.
3.1 Low Budget Execution and Other Implications?

Overall low development spending if not addressed at least in the subsequent three quarter of 2021/22 by the national government may end up undermining service delivery on development projects for the following sectors: Agriculture, Rural and Urban Development, Environment, Water and Natural resources; Health, Education; Social protection, Culture and Recreation and Public Administration and International Relations (PAIR).

In particular, low spending leads to delays in completion of projects such as road construction, health facilities, provision of cash transfers funds and general lack of service delivery. Therefore, increasing budgetary allocations without quality spending translates to poor results and thus why citizen, the media, civil society and parliament should pay closer attention to budget implement.

There are other budgetary implications that arise owing to delays in disbursement of funds to MDAs and consequently their effect on budget execution.

3.1.1 Budget Revisions

Often MDA have to result to making adjustments on the original approved budget during the financial year by introduction of supplementary budgets, which has become a common feature in the budgeting process in Kenya. While this is within the legal provisions of the Public Finance and Management Act, 2012 the frequency and the magnitude of the adjustments may divulge challenges and weaknesses as far as budget planning is concerned.

Figure 3.4 above summarises budget changes by MDA\textsuperscript{1} by noting deviations in the original budgets as approved at the beginning of the fiscal year (Q1) and the final budget at the end of the fiscal year (Q4). It is observed that budget revisions have occurred both on estimates of revenue and expenditure. In both cases, the direction of the revisions has been downwards, as illustrated by negative deviations. With exception of 2016/17 and 2021/22, the magnitude of the revisions has grown prominently on Revenue side than Expenditure side suggesting more pronounced poor planning on the revenue part of the budget.

Source: The National Treasury | Quarterly Economic and Budget Review (QEBR)

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\textsuperscript{1}Ministries, Departments and Agencies (MDAs)
Frequent and significant changes in the budget undermines its credibility especially when supplementary funds are used by the MDAs to fund projects which have not been subjected to public participation as required by Section 35(2) of the PFM Act, 2012.

### 3.1.2 Adherence to Fiscal Responsibility Principles

The budget constraints experienced in the course of the year have often led to prioritization of the expenditure items in the fiscal year. Section 15 of the PFM Act (2012) provides for a minimum threshold of 30% expenditure on development over the medium term. Figure 3.5, looks at expenditure performance of Ministries, Departments and Agencies (MDAs) by comparing first quarter of 2021/22 with past trends.

**Figure 3.5: Proportions of Development Versus Recurrent Expenditure**

<table>
<thead>
<tr>
<th>Year</th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016/17</td>
<td>28.9%</td>
<td>28.2%</td>
<td>28.2%</td>
<td>28.8%</td>
</tr>
<tr>
<td>2017/18</td>
<td>28.3%</td>
<td>28.3%</td>
<td>27.1%</td>
<td>28.3%</td>
</tr>
<tr>
<td>2018/19</td>
<td>28.3%</td>
<td>27.7%</td>
<td>22.7%</td>
<td>26.3%</td>
</tr>
<tr>
<td>2019/20</td>
<td>28.8%</td>
<td>27.9%</td>
<td>18.5%</td>
<td>22.5%</td>
</tr>
<tr>
<td>2020/21</td>
<td>28.3%</td>
<td>23.3%</td>
<td>20.6%</td>
<td>26.6%</td>
</tr>
</tbody>
</table>

Source: The National Treasury | Quarterly Economic and Budget Review (QEBR)

The proportion of the recurrent to development spending is below the required threshold by the PFM Act:

- In the first quarter of 2021/22, the ratio of development expenditure composed of at least 20.5% of the total spending, representing sub-optimal performance by about 10 percentage points. Past trends show that, with the exception of 2016/17 where the average, development expenditure has been under 30%, thus violating the fiscal responsibility minimum provision of 30%.
- On average, spending on development has largely been skewed towards the last quarters of the year with the data showing high tendencies for the significant expenditure in the last two quarters. In not a single quarter, has the proportion of expenditure on development exceeded 30% in Q1.
- The over the period, the share of the spending on development in Q1 has been on a downward trend (from 2016/17: 28.8% to 2021/22: 20.5%).

### 3.1.3 Breakdown of Recurrent Expenditure

The other fiscal responsibility rules provided for in the PFM Act to promote prudence in the financial management is the 35% maximum spending on Wages and Salaries out of the total recurrent expenditure. This rule is important in ensuring availability of funds other recurrent activities such as Operations and Maintenance. Figure 3.6, is a breakdown of spending across Ministries, Departments and Agencies (MDAs) across the quarters.
The breakdown of the expenditure on recurrent activities shows the following key observations:

- **Debt servicing charges has continued to increase**, this has increased from 29% in 2016/17 to 35% in 2021/22. The rise is driven mainly, first, by large accumulated overall public debt and secondly, the high refinancing costs due to an increase the commercial borrowing (see details of public debt trends in the Annexe.

- **Spending on operations and maintenance has continued to fall** which may potentially lead to: increased capital repairs, increased unscheduled shutdowns and repairs, reduce facility life among other deficiencies that may result in increased inefficiencies that may ultimately lead to poor public service delivery.

**Box 1: Case Study of Budget Performance under the Ministry of Health**

The health sector is largely a devolved function under the Fourth Schedule of the Constitution of Kenya. Nationally, the Ministry if Health is responsible for providing and coordinating health policy formulation, ensuring quality service delivery, and regulating health care at the national level.

Thus, this Ministry is not among the high spenders, with the budgetary allocation of Ksh 121 billion in 2021/22 representing 3% of the gross national budget. This budget comprised Ksh 56 billion (46%) for development activities and Ksh 65 billion (54%) for recurrent expenditure.

Overall absorption rates for both development and recurrent shows that the ministry is underperforming, 10% of the development budget was executed in the first three months of the 2021/22 compared to 15% amounted for recurrent budget. This is partly explained by low disbursement rate of the transfers to the sector; total exchequer issues to the sector represented 17% of the sector’s net estimates, comprising of development (10.7%) and recurrent (22.9%). Analysis of the Health sector programmes shows that National Referral & Specialized Services programme received the highest budgetary allocation of Ksh 47.7 billion translating to 39.4% of the gross estimates for the sector, while the General Administration, Planning & Support Services had the lowest share at Ksh 7 billion (5.8%). As would be expected, absorption rates show that the General Administration, Planning & Support Services recorded
3.2 Causes of Low Budget Execution

3.2.1 Predictability of funds

Revenue performance is critical to cash flow management and timely disbursement of funds to spending units. Although for the period 2016/17-2020/21, revenue receipts have invariably fallen short of targets, it is commendable that the government in Q1 of 2021/22 surpassed revenue targets by 4.4%. This suggests improved forecasting of revenue. In fact, as shown in figure 3.4, actual tax revenue as a share of GDP, in Q1 of 2021/22 went up to 14.1% compared to 12.9% in a similar period in 2020/21 but below government target of 18%. This nevertheless signals enhanced economic performance.

![Figure 3.7: % Tax Revenue (Ordinary revenue) Ratio to GDP](source)

It is important to note that despite improved overall revenue performance, only a meagre 2% of external loans and grants target of Ksh 379 billion was received by end of Q1 of 2021/22. Although external loans and grants contribute a small portion, 1% of total receipts, dismal performance in Q1 of 2021/22, implies that donor finance development projects are likely to face delays and stall if this is not addressed in the course of financial year 2021/22.
3.2.2 Delays in Exchequer Issues

Overall delays in release of funds to MDAs, which emanates from unpredictability of funds remains the main challenge and cause of low budget execution.

Figure 3.8: Proportions in The Quarterly Exchequer Issues to The MDAs

Figure 3.8 shows quarterly distribution of cash disbursements by to the MDAs for each quarter by examining the share and amount issued at every quarter out of the annual disbursements. Ideally, about 25% of the total funds ought to be disbursed on quarterly basis.

Evidently, most disbursements are received in Q3 and Q4 signalling delays, on average over the period, about 22% of the total disbursements were issued in both Q1 and Q2 respectively for recurrent spending compared to 25% and 31% issued in Q3 and Q4, implying delays in favour of the later quarters. On the other hand, over the same period, about 14% and 22% of the disbursements are issued in Q1 and Q2 respectively for development spending compared to 26% and 39% issued in Q3 and Q4, again implying delays in favour of the later quarters. In comparison, delays in release of funds are more pronounced for development spending than recurrent spending.

Delay in the disbursement of exchequer issues affects the implementation of planned programmes by MDAs and subsequently affects the timely delivery of services. It is recommended that the National Treasury should consider the seasonality in the revenue collections in designing annual workplans and cash flow projections in order to improve on the timing of the releases in order to enhance effective service delivery.

3.2.3 Under Release of Funds

Utilization of available funds by MDAs is not a challenge. This fact is backed by data which shows that overall spending on recurrent budget exceeded available funds released (exchequer issues) by 8 percentage points and 36 percentage points for development budget end of Q1 of 2021/22. Overall budget performance by MDAs in Q1 of 2021/22 dropped marginally relative to past years of the same period going back to 2016/17. The reasons for non-optimal performance is in part due to under release of funds, from domestic and external sources. This is demonstrated by table 3.2 below.
### Table 3.2: Summary of Exchequer Issues as a Share of Recurrent and Development Budgets

<table>
<thead>
<tr>
<th></th>
<th>First Quarter of 2021/22</th>
<th>First Quarter of 2020/21</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recurrent</td>
<td>2,600.85</td>
<td>2,433.78</td>
</tr>
<tr>
<td>Development</td>
<td>668.34</td>
<td>389.23</td>
</tr>
<tr>
<td>Total</td>
<td>3,269.19</td>
<td>2,823.01</td>
</tr>
</tbody>
</table>

Source: OCOB 1st Quarter BIRR 2020/21

Exchequer issues as a share of quarterly gross recurrent budget is 21%, about 4 percentage points below the ideal target. Recurrent spending above available (released) funds denotes under reporting by MDAs of Appropriation in Aids (AiA) generated from services offered by these MDAs. In other words, MDAs spent some funds that should have been remitted to the Consolidated Fund without express approval by the National Treasury. On the part of development budget, funds released only amounted to 12% of their quarterly budget. The balance of 13%, to the meet ideal target, accounts for portion of domestic resources and donor funds not released to MDAs for execution of their development budget based on their work plans.

### 4.0 Recommendations

The following recommendations are critical towards improving budget execution by MDAs and enhanced service delivery.

1. **Unpredictability and insufficiency of funds**
   - The National Treasury should set realistic revenue targets to inform budgeting process in order to improve predictability of public funds and thus to enhance execution and reduce on frequent budget revisions that often compromise credibility.
   - The National Treasury should consider the seasonality in the revenue collections in designing annual workplans and cash flow projections in order to improve on the timing of the releases in order to enhance effective service delivery.
   - Civil Society Organizations (CSOs) and other non-state actors including the media should interrogate revenue projections towards influencing realistic budget ceilings for MDAs.
   - The National Assembly should oversight and rein on optimistic revenue projections and large budget deficits to enhance delivery on fiscal consolidation, this is key in controlling public debt.

2. **High debt vulnerabilities and the need to support economic recovery**
   - National government debt management policy should seek to explore refinancing of expensive debt with those on more favourable terms as well as overall renegotiation of debt terms and conditions including seeking to lengthen maturities of large debts in order to limit refinancing risks.
   - The National Treasury should develop a contingency plan to address a potential economic shock due to high debt distress levels and high level of uncertainty with regards to increased probability of debt defaults by businesses and parastatals.
   - National Assembly should ensure MDAs have rigorous criteria used to determine the advancement of additional loans to State Owned Enterprises (SOEs) to minimize issuance of loans to non-performing entities.
   - Determine and maintain an optimal liquidity in terms of foreign reserves as buffer against volatility in the forex.
3. Restructuring and reduction on wastage and increased efficiency in spending.
   - There is need for the restructuring of state-owned enterprises (SOEs) performing similar functions to eliminate duplication. There is need to consider privatizing of non-performing and non-strategic SOEs.

4. Under release of funds including donor funds
   - The National government should scale down donor funds projections to avoid huge gaps whenever donor commitments do not materialize. As a result, the national government should agree with donor on a simple, harmonized and synchronized donor disbursement plan.

5. Enhanced public accountability and reduction on the wastage
   - The National Assembly and other oversight institutions should enhance enforcement of sound financial management to promote prudence in the use of public funds. There is need to set up effective mechanisms (both at the oversight institutions such as National Assembly but also within the respective MDAs) to enhance further follow up on the audit recommendations to address the audit queries.
   - The National Assembly should utilise the findings of the audit reports to identify areas of wastage, invoke sanctions on public entities that have perennially failed to adequately account for the management, address cases of fiscal indiscipline including misallocations, wastage of resources and lack of value for money in implementation of projects.
Annexe

Annexe 1: Public Debt Trends

Annexe 1.1 Rising of Kenya’s debt and its implication on debt distress

Since 2016/17 to 2021/22, Kenya has been borrowing a net amount of Ksh 224 billion quarterly. This has increased the debt stock to Ksh 8 Trillion by the first quarter of 2021/22 and projections indicate that by 2023 the net accumulated debt will be Ksh 9.31 Trillion, surpassing the current ceiling by Ksh 310 Billion.

Figure A1: Trends in Kenya’s debt

The high level of debt stock has resulted in the surge in debt servicing charges (as shown in Table A1) and the situation may be worsened by the continued heavy borrowing (as shown by trends in Figure A1) amidst the continued shortfall in revenue (Figure 2.1 and 2.2). Key factor driving high debt servicing charges is partly due to increase in non-concessional borrowing and has contributed to rising debt vulnerabilities.

Annexe 1.2: Debt Servicing Charges

Table A1: Breakdown of Consolidated Fund Services (CFS), 2021/22

<table>
<thead>
<tr>
<th></th>
<th>Annual Gross Estimates (Ksh Bn)</th>
<th>Quarterly Expenditure (Ksh Bn)</th>
<th>% Expenditure to Budget [B/A] * 100</th>
<th>% Expenditure to Ordinary Revenue [B/Ksh 442 Bn]*100</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt servicing charges</td>
<td>1,169</td>
<td>204</td>
<td>17.40%</td>
<td>46%</td>
</tr>
<tr>
<td>Pensions &amp; Gratuities</td>
<td>154</td>
<td>36</td>
<td>23.70%</td>
<td>8%</td>
</tr>
<tr>
<td>Others</td>
<td>4.4</td>
<td>0.7</td>
<td>16.60%</td>
<td>0%</td>
</tr>
<tr>
<td>Total</td>
<td>1,327</td>
<td>241</td>
<td>18.20%</td>
<td>55%</td>
</tr>
</tbody>
</table>

Source: Office of the Controller of Budget | Budget Implementation and Review Reports (BIRR)

In 2021/22, Ksh 1.3 trillion (36% of the budget) was allocated for the purposes of payments of the Consolidated Fund Services (CFS) which heavily reduced the flexibility of the budget. The main driver has been public debt whose first quarter payment (Ksh 204 billion) is half of all the spending by MDAs (Ksh 403 billion).
Annexe 1.3: Debt Sustainability Analysis

A sustainable debt is that whose current and future payment obligations can be serviced without exceptional financial assistance or going into default. Policy makers are interested in debt sustainability to understand risks associated with refinancing the debt.

Table A2: Assessment of Kenya’s public debt sustainability

<table>
<thead>
<tr>
<th>Description</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk of external debt distress</td>
<td>High</td>
</tr>
<tr>
<td>Overall risk of debt distress</td>
<td>High</td>
</tr>
</tbody>
</table>

Source: IMF²

In 2021, International Monetary Fund (IMF) indicated that both the risk of Kenya’s total as well as external debt distress are high, raising the likelihood of the country being unable to fulfill its financial obligations and debt restructuring to high.

Table A3: Debt Sustainability Analysis, December 2021

<table>
<thead>
<tr>
<th>Description</th>
<th>Threshold</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
<th>2025</th>
<th>2026</th>
</tr>
</thead>
<tbody>
<tr>
<td>PV of public debt-to-GDP ratio</td>
<td>55</td>
<td>60.3</td>
<td>61.7</td>
<td>62.2</td>
<td>61.2</td>
<td>59.2</td>
<td>56.3</td>
<td>53.2</td>
</tr>
<tr>
<td>PV of public debt-to-revenue &amp; grants ratio</td>
<td>300</td>
<td>362.8</td>
<td>375.5</td>
<td>364.5</td>
<td>343.7</td>
<td>323.9</td>
<td>300.8</td>
<td>277.9</td>
</tr>
<tr>
<td>Debt service-to-revenue and grants ratio</td>
<td>30</td>
<td>53.7</td>
<td>51.8</td>
<td>58.2</td>
<td>56</td>
<td>58.1</td>
<td>46.8</td>
<td>39.8</td>
</tr>
</tbody>
</table>

Source: IMF³

PV: present value

As presented in Table 6, Kenya has experienced a deterioration in the debt level and debt services at least breaching indicators on PV of public debt-to-GDP ratio and PV of public debt-to-revenue & grants ratio and debt service-to-revenue ratio and Debt service-to-revenue and grants ratio. Rapid rise in the debt stock relative to GDP has sharply led to increase in the debt servicing relative to the revenues.

² https://www.imf.org/-/media/Files/Publications/CR/2021/English/1KENEA2021004.ashx
³ https://www.imf.org/-/media/Files/Publications/CR/2021/English/1KENEA2021004.ashx
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