



PARLIAMENTARY SERVICE COMMISSION  
Parliamentary Budget Office

*Alternatives for steady economic growth during the  
transition*

*Budget Options for 2022/2023 and the Medium Term*

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## Acknowledgements

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## List of Acronyms and Abbreviations

AFCFTA	African Continental Free Trade Area
AGOA	African Growth and Opportunity Act
AU	African Union
BPS	Budget Policy Statement
BROP	Budget Review and Outlook Paper
CBK	Central Bank of Kenya
CFS	Consolidated Fund Services
COVID-19	Corona Virus Disease of 2019
CRA	Commission on Revenue Allocation
EPA	Economic Partnership Agreement
EPZ	Export Processing Zones
ETR	Electronic Tax Register
EU	European Union
FAO	Food and Agriculture Organization
FISP	Farm Input Subsidy Programme
FY	Financial Year
GDP	Gross Domestic Product
ICT	Information Communication and Technology
KIE	Kenya Industrial Estates
KNBS	Kenya National Bureau of Statistics
M3	Broad Money Supply
MDA	Ministries, Departments and Agencies
MGR	Medium Gauge railway
MRTS	Mass Rapid Transport Systems
MSME	Micro, Small and Medium Enterprises
MTP	Medium Term Plan
NDMA	National Drought Management Authority
NMS	Nairobi Metropolitan Services
NWMP	National Water Master Plan
OSR	Own Source Revenue

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PBO	Parliamentary Budget Office
PBOM	Parliamentary Budget Office Model
PFM	Public Finance Management
pH	Power of Hydrogen
Proj.	Projected
SEZ	Special Economic Zones
SGR	Standard Gauge Railway
SME	Small and Medium Enterprises
STEM	Science, Technology, Engineering and Mathematics
UAE	United Arab Emirates
UHC	Universal Health Coverage
UN	United Nations
USA	United States of America
VAT	Value Added Tax
WTO	World Trade Organization

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## Summary of policy options

Policy Option	Strategy
<b>Chapter One: Economic Performance and Outlook for the Medium Term</b>	
<b>Revitalization of Agricultural Productivity</b>	Allocate and Ring-fence resources to key programmes and projects in the Agriculture sector; notably provision of subsidized fertilizer, quality and certified seeds and mechanization
<b>Support to businesses and manufacturing</b>	Allocate resources towards a well-designed stimulus programme for MSMEs in the form of affordable medium to long term loans and grants
<b>Review VAT Administration</b>	Review list of exempt goods outside agriculture and limiting the number of zero-rated goods
<b>Debt Management</b>	Review the debt ceiling and consider debt rescheduling to ease debt service
<b>Enhance credit access for export oriented businesses</b>	Provision of a credit line through Kenya Industrial Estates or the Credit Guarantee Scheme to export oriented businesses.
<b>Enhance tea exports</b>	Bilateral agreements to increase the share of tea exports with leading tea importers in the world.
<b>Chapter Two: National Government Expenditure Framework</b>	
<b>Reorienting Agriculture for enhanced economic growth</b>	<b>Improving access to agricultural extension services</b> - Provide adequate funds possibly in form of conditional grants to counties for agricultural extension services. The National government should also prepare an agriculture extension services policy to guide the provision of these services.

	<p><b>Improving farmers access to agricultural inputs</b> - Provide funds in form of conditional grants to the 38 agriculture oriented counties for provision of relevant subsidized inputs to targeted small-scale farmers. Small-scale needy farmers will be registered through an appropriate mechanism by Counties.</p> <p><b>Increase investment in small-scale irrigation and water storage</b> – Provision of funds as well as increased efficiency and accountability in the construction of small dams for water storage and small-scale irrigation projects across various parts of the country. Priority should be given to flood prone and drought stricken regions which have high but unexploited potential for agricultural productivity.</p>
<b>Support Kenya’s foreign policy on trade and investments</b>	<b>Restructuring the foreign service</b> – review and evaluate foreign missions to ensure maximum benefits are reaped. Honorary Consuls offers an efficient diplomatic channel of increasing a country’s diplomatic network as they are more cost effective than fully fledged missions. Further, their knowledge of local conditions provides them with an invaluable ability to leverage local and regional networks.
<b>Sustainable forest management</b>	<p><b>Continued rehabilitation of Water Towers</b> – Provide funds for rehabilitation of Kenya’s five major forest Water Towers which have deteriorated over the last few decades.</p> <p>Develop a Policy on Sustainable Forest Management that will Include Neighbouring Communities</p>
<b>Streamlining land management</b>	<p><b>Funding of final survey and vesting</b> – Provide of funds for final survey and vesting programmes. This will go towards final survey and vesting programme for compulsorily acquired public land and the mapping of public land in all counties as well as development of a Public Lands information depository by June 2023.</p> <p>Ensure rollout of <i>Ardhisasa</i> digital registries to all counties.</p>
<b>Enhance access to quality healthcare</b>	Increase funding to the five National referral hospitals to support the critical areas on operations especially in the management of their health workers as well as acquisition of health commodities. ensure these facilities transform to centres of medical excellence in referral healthcare service

	The National government to consider coming up with a health support package for counties to establish level 3 health facilities especially in the counties which have low number of health facilities in the country. It is estimated a well-functioning level 3 health facility can cost around Kshs 70 Million.
<b>Chapter Three: Making Fiscal Decentralization Work</b>	
<b>Addressing legislative gaps and limitations in county public finance management</b>	Amend Section 131 of the PFM Act, 2012 and Regulation 37 (1) of the PFM (National Government) Regulations, 2015 to empower the County Assemblies to undertake the budget-making & oversight function to enhance county public expenditure & financial accountability. The limitation 1 percent power to amend the budget for any ensuing year limits the legislature considerably.
	Amend Section 9, 10, and 10A of the Urban Areas and Cities Act 2011 to entrench the role of County Assemblies in the conferment of town and the market status and provide fiscal sustainability as a criterion;
	Review of the County Government Act, 2012 and the National Government Co-ordination Act 2013 to provide for one centre of administrative power for coordination functions of both the national and county government functions to reduce red-tape associated expenditures; and
<b>Enhancing county revenue performance</b>	Counties to harmonize their Single Business Permits (Trading Licenses) regime through simplification of guidelines. Further, by enacting specific legislation establishing a clear licensing framework. The option may gradually unlock trade license revenue of up to Kshs. 23.4billion from FY 2022/2023 and the medium term.

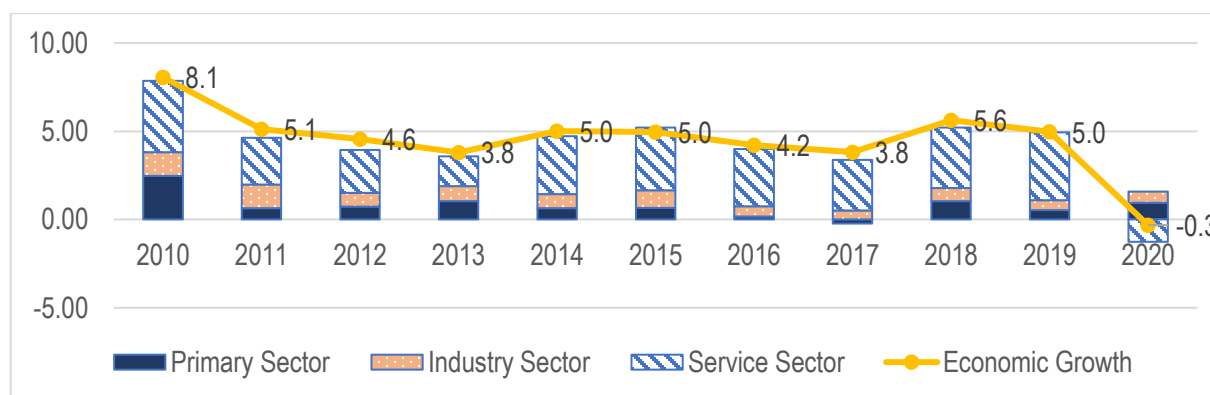
# **Chapter One:**

## **Economic Performance and Outlook for the Medium Term**

## 1.1. Economic Performance over the Past Decade

1. For the past decade, with the exception of 2020, the economy registered an average growth rate of 5 percent. During this period, the highest registered growth was 8.1 percent in 2010 and was mainly driven by growth in the Agriculture sector. Agriculture accounts for the highest share in GDP and its performance is therefore very significant for the economy. However, productive investment in the sector has not reached critical mass and it remains susceptible to weather related shocks. A review of sectoral GDP over the past decade shows that the service sector<sup>1</sup> is the highest contributor to economic growth at an average of 3.1 percent. Specifically, the Transport & Storage; Real Estate; Finance & Insurance and Wholesale & Retail Trade sub-sectors under the service sector have increasingly recorded a relatively high contribution to the economic growth. The industry sector<sup>2</sup> and the primary sector<sup>3</sup> contribute 0.9 percent and 0.8 percent respectively to economic growth.
2. The service sector was the most adversely affected by the COVID-19 pandemic, even as the contribution of the primary sector and industry sector to economic growth increased in 2020 when the effects of the pandemic were most severe. The performance of the agriculture sector in 2020 is attributed to favourable weather conditions that supported increased food and forage production. Furthermore, a notable increase in value of construction activities in 2020 enhanced the performance of the industry sector. Nevertheless, there has been a substantial increase in poverty<sup>4</sup>, unemployment and gender inequality; as well as a reduction in per capita income. It is imperative therefore, to identify and focus on priority sectors for investment by both the government and private investors, that will lead to a sustainable economic recovery and inclusive growth. On a micro level, support for MSMEs is key to facilitate job creation and poverty reduction.

Figure 1: Sector contribution to economic growth (%)



Source: KNBS, PBO

<sup>1</sup> Comprised of Transport & Storage; Real Estate; Wholesale & Retail trade; Finance & Insurance; Public Administration; Education; ICT; Hotels & Restaurants

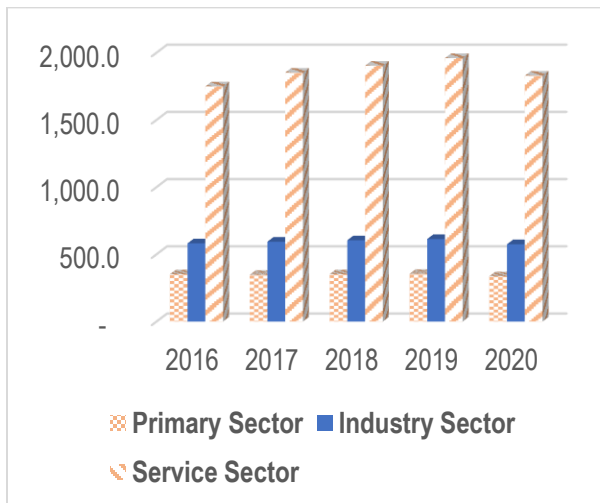
<sup>2</sup> Comprised of Manufacturing, Electricity, Water Supply and Construction

<sup>3</sup> Comprised of Agriculture, Forestry, Fishing, Mining and Quarrying

<sup>4</sup> According to World Bank there are an estimated 97 million additional people living in poverty due to COVID 19 pandemic

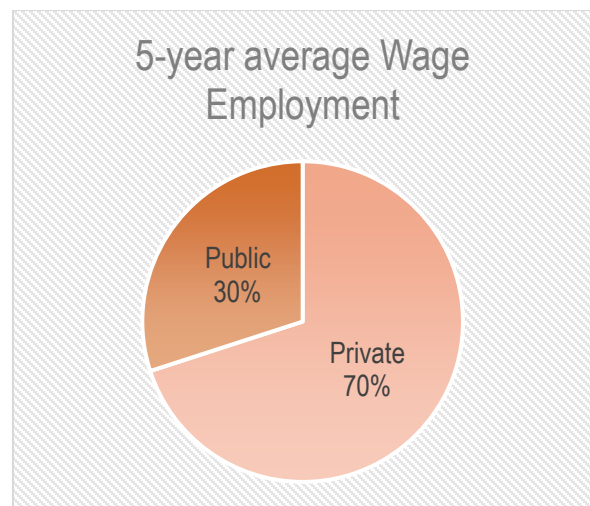
3. **Job creation is a key objective of the government, and it can only be realized by enabling a conducive environment for the private sector where most jobs are being generated.** A review of employment data over the past five years shows an increase in formal wage employment from 2.68 million people in 2016 to 2.93 million people in 2019 followed by a decline to 2.74 million people<sup>5</sup> in 2020. This outcome is attributed to loss of jobs because of the pandemic. **The 5-year average indicates that 70 percent of formal jobs are in the private sector - mainly in Manufacturing, Agriculture, Wholesale & Retail Trade, Education and Construction - whereas in the public sector, most formal jobs are in Education and Public Administration & Defence.**
  
4. **In terms of sectors, the service sector accounts for the highest formal wage employment; increasing from 65.2 percent in 2016 to 66.7 percent in 2020.** The increase is mainly in Education, Public Administration; Wholesale & Retail Trade, repair of motor vehicles and motor cycles; human health and social activities. Formal employment in the primary sector declined from 13.1 percent to 12.3 percent during the same period and this was mainly in agriculture. The industry sector share of formal wage employment also declined from 21.7 percent to 21.0 percent; attributed to a fall in formal wage employment in manufacturing and an increase in construction.

Figure 2: Formal Employment per sector ('000)



Source KNBS

Figure 3: 5-year average formal Wage Employment

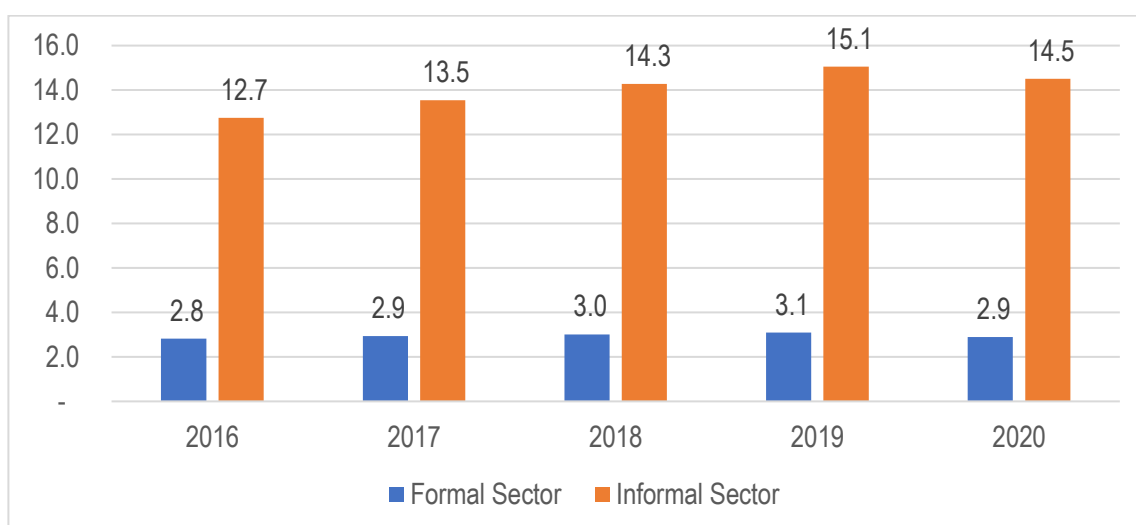


Source KNBS

<sup>5</sup> According to the KNBS, it is estimated that 83 percent of these jobs are in the informal sector

5. **Total employment increased from 15.6 million in 2016 to 17.5 million in 2020; of which majority was in the informal sector.** Informal employment accounts for approximately 83 percent of total employment; excluding small scale farming and pastoralist activities. It is estimated that 60 percent of the informal employment is mainly in wholesale, retail trade, hotel & restaurants while 20 percent is manufacturing activities. In terms of unemployment, the KNBS estimates that long-term unemployment<sup>6</sup> has been increasing from 2 percent during the first quarter of 2020 to 3.9 percent during a similar period in 2021. Many of the unemployed are youths aged 20-24 years, followed by those aged 25-29 years. As at the first quarter of 2021, long-term unemployed youths (those aged 20-34) were 555,484 out of a labour force of 8.78 million youths.

**Figure 4: Number of people employed in the formal and informal sectors (Million)**



Source: KNBS

#### a) Primary Sector<sup>7</sup>

6. **The share of the primary sector in GDP, of which agriculture is the largest component, increased from 17.6 percent in 2010 to 23 percent in 2020.** Apart from having an important role in ensuring food and nutrition security, the Agriculture sector provides critical supportive linkages to other sectors such as manufacturing through the provision of raw materials. In terms of employment, it is among the top providers of formal wage employment. However, its share of formal wage employment declined from 12.6 percent in 2016 to 11.8 percent in 2020 denoting a reduction in new jobs created in the sector or a shift to other economic activities such as construction, wholesale and retail trade. There are various constraints limiting the growth of the sector such as: adverse weather conditions; insect and crop diseases; slow implementation of flagship projects in the MTP III such as the High Grand Falls Dam and Galana Dam to support irrigation; and slow progress in promoting value addition. Going forward, increasing productivity

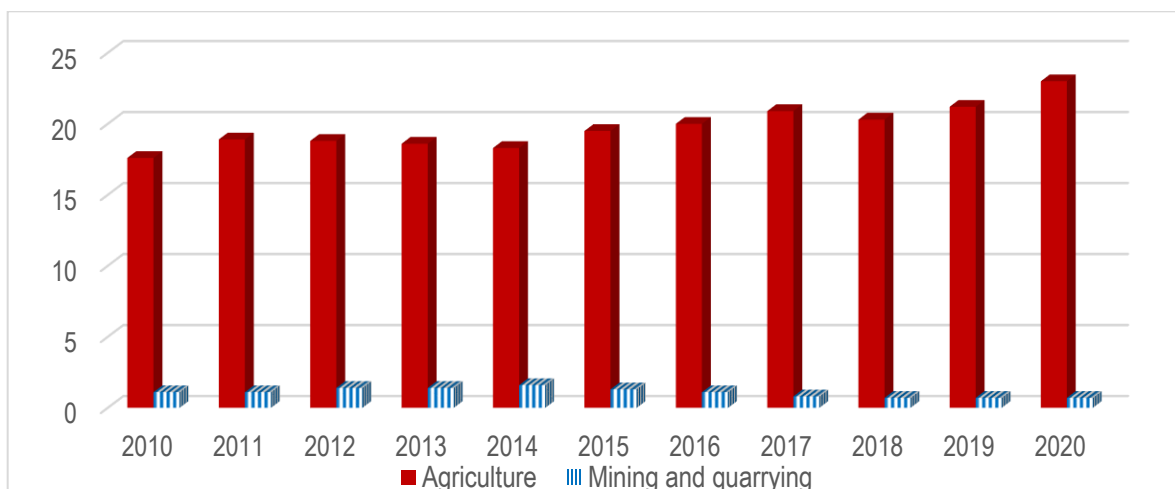
<sup>6</sup> Refers to those who have been unemployed for over one year

<sup>7</sup> Comprises of Agriculture, Forestry, Fishing, Mining and Quarrying



in the sector will require increased budgetary allocation to small-scale irrigation schemes; accessible food storage facilities for small-scale farmers and value addition to small-scale farmers including increased investment in agro-processing.

**Figure 5: Primary sector contribution to Nominal GDP (%)**



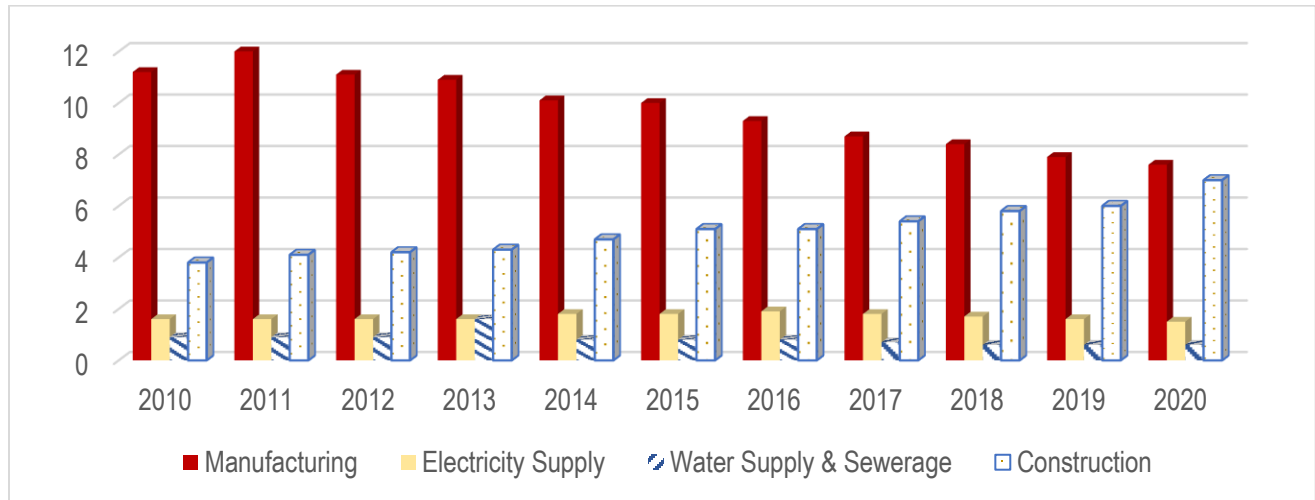
Source: KNBS

## b) Industry Sector<sup>8</sup>

7. **In the industry sector, manufacturing accounts for the largest share in GDP but trends show a progressive decline – both as a share of GDP and as a share of formal wage employment.** Manufacturing is a key pillar of the Big Four Agenda in the MTP III, with the targeted outcome being an increase the share of manufacturing to GDP from 9.2 percent in 2016 to 15 percent by 2022; one million additional jobs created annually; increase in the level of foreign direct investment to 2 billion; and improvement in ease of doing business in Kenya from 80 in 2017 to 45 by 2022. However, over the past decade, the sector's share of GDP has progressively declined from 11.2 percent in 2010 to 7.6 percent in 2020 and its share of formal wage employment declined from 12.7 percent in 2016 to 11.6 percent in 2020. This may be attributed to a substantial contraction in the manufacturing of food products as well as competition from cheaper imported manufactured products within the country. As a result, Kenya's share of manufactured exports in the regional market has also declined.
8. One of the key challenges facing the manufacturing sector has been the limited access to credit for MSMEs in the sector to enable investment in small industries and increase innovation, research and value addition. Going forward, some key interventions that may enable growth in the sector include enhanced access to affordable credit and training through interventions such as the Credit Guarantee Scheme and Kenya Industrial Estate which finances SMEs; as well as increased government support to EPZs and SEZs.

<sup>8</sup> Comprised of Manufacturing, Electricity, Water Supply and Construction

Figure 6: Industry sector contribution to Nominal GDP (%)



Source: KNBS

9. **Notably, the Construction sector share in GDP increased from 3.8 percent in 2010 to 7 percent in 2020; attributable to the continued development in road infrastructure and additional housing sub-sector.** Investment in housing and related infrastructure impacts on the national income by triggering forward and backward linkages through additional investments in building materials production, transportation, marketing and the informal sector which is involved in fabrication of construction materials. Importation of key indicators in construction such as timber and wood, steel, bitumen and cement increased, as well as completion of road and housing projects. Specifically, cement consumption grew by 23.2 percent in 2020 compared to a 0.4 percent growth in 2019. In terms of employment, the share of formal wage employment in the sector grew from 7.7 percent in 2016 to 8.1 percent in 2020.

### c) Service Sector<sup>9</sup>

10. **A review of the service sector for the past decade indicates that Transport and Storage had the highest contribution to growth with an average of 10.1 percent, followed by Real Estate at 9.3 percent and Wholesale and Retail trade at 8.7 percent.** Although the service sector was adversely affected during the onset of the pandemic, there are areas that recorded increased contribution to GDP such as Finance and Insurance and the Real Estate (see table xx).

<sup>9</sup> Comprised of Transport & Storage; Real Estate; Wholesale & Retail trade; Finance & Insurance; Public Administration; Education; ICT; Hotels & Restaurants. The Service or tertiary sector primarily delivers goods and services to customers by utilizing commodities generated by other sectors. It refers to any sectors that give services to other firms or end users.

**Table 1: Service Sector Contribution to Nominal GDP (%)**

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Average
Wholesale and retail trade	10.3	9.6	8.9	8.7	8.6	8.5	8.3	8.4	8.2	8.2	8.1	8.7
Transport and storage	7.7	8.1	9.2	10.3	11.4	10.4	10.2	10.2	11.3	11.7	10.8	10.1
Hotels and restaurants	1.5	1.2	1.2	1.2	0.9	0.9	0.9	1.0	1.1	1.2	0.7	1.1
Information and communication	3.0	2.5	2.4	2.6	2.6	2.7	2.7	2.6	2.6	2.5	2.5	2.6
Financial & insurance	6.2	6.3	6.7	6.6	6.9	7.1	7.8	7.5	6.7	6.4	6.5	6.8
Real estate	9.5	9.4	9.3	9.1	9.0	9.0	9.3	9.3	9.4	9.2	9.3	9.3
Professional, scientific and technical	2.3	2.2	2.1	2.1	2.1	2.0	1.9	1.8	1.8	1.7	1.5	2.0
Administrative and support service	1.4	1.3	1.3	1.2	1.2	1.1	1.0	1.0	1.0	1.1	0.9	1.1
Public administration and defence	5.3	5.3	5.4	5.0	5.1	5.6	5.4	5.2	5.3	5.4	5.5	5.3
Education	5.0	4.8	4.8	4.9	4.8	4.6	4.5	4.3	4.3	4.2	3.8	4.5

Source: KNBS

**11. Transport and Storage:** Kenya's transport sector is crucial in supporting other industries by providing an effective supply chain and logistics. Transportation activities include provision of passenger and freight transportation via rail, pipeline, road, water, or air. It is the largest contributor to GDP under the service sector at an average of 10.1 percent in the past decade supported by ongoing infrastructure development in road, rail, marine, air, energy, and ICT. The growth of the sector was influenced by expanded coverage of motor cycles (*boda boda*) as a means of transport, with the number of newly registered motor cycles having doubled from 123,539 in 2016 to 252,601 in 2020 while that of motor vehicles increased from 90,176 in 2016 to 94,128 in 2020. It is observed that during the covid pandemic, the sectors contribution to GDP declined from 11.7 percent in 2019 to 10.8 percent in 2020 on account of movement restrictions and other containment measures.

**12. Wholesale and Retail trade accounts for 9.1 percent of total wage employment and has contributed 8.7 percent to GDP over the past decade.** The retail industry has evolved with digital technology enabling innovation and online retail platforms which have become convenient. As the retail market becomes more digital with shifts in consumer behaviour, coupled with restrictive measures of the pandemic, businesses are investing more in technology and innovations that will enable them to make more advertisements and retail sales on digital platforms. Most MSMEs are in this sector. It is reported<sup>10</sup> that two thirds of the MSMEs have current cash flow problems while 65 percent of MSMEs experienced low demand for their products and services during the pandemic. Further, the proportion of sales generated online increased by 10 percent since the outbreak of the crisis. Going forward, increased

<sup>10</sup> IFC, *Navigating through COVID-19: Snapshots on how the pandemic affected MSMEs in Kenya*, April 2021.

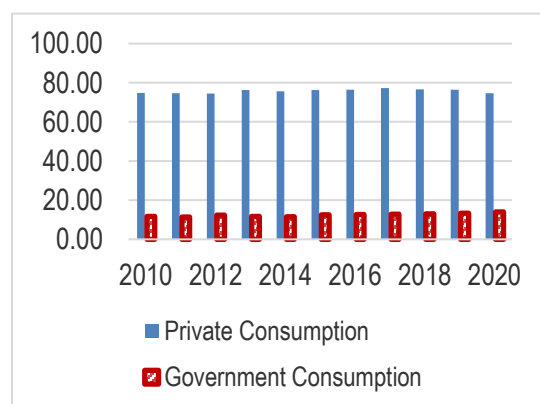
household incomes on account of higher business activity and the resultant spike in consumer demand are going to facilitate growth in the retail business.

13. The linkage of this sector to small-scale manufacturing and value-added export products cannot be overlooked. Value addition is key in ensuring that manufactured products in key areas such as food and clothing are consumed locally through the retail supply chains. This creates an increased market base locally and impedes importation of products. However, this will only materialize if local production costs are competitively lower in terms of energy, raw materials and labour.

#### d) Consumption and Investment

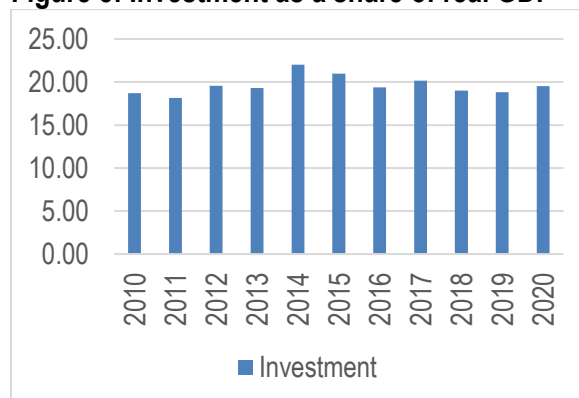
14. **Private consumption is a key driver of economic growth and its share in real GDP has remained relatively stable at an average of 75.7 percent over the past decade.** This comprises of food, beverage & tobacco (60%); housing (11%); transport (7%); clothing and footwear (3%); education (5%) and other goods and Services (14%). As such, any policy changes or foreseen and unforeseen events that affect demand and/or supply particularly for food and beverage, will have great implications on private consumption.
15. **Investment<sup>11</sup> as a share of real GDP averaged 19.6 percent over the past decade but registered an increase in 2020 during the pandemic.** Investment in this instance comprises of buildings, structures and dwellings (62%); transport, ICT, other machinery and equipment (35%) and cultivated and intangible assets (3%). The increase in investment as a share of real GDP during the pandemic is attributed to an increase in the value of buildings, structures and dwellings which ties in with the earlier observation of increased activities in the construction and real estate sectors. On the other hand, there was a decrease in the value of transport equipment; denoting a decline in demand during the pandemic period.

**Figure 7: consumption as a share of real GDP**



Source: KNBS, PBO

**Figure 8: Investment as a share of real GDP**



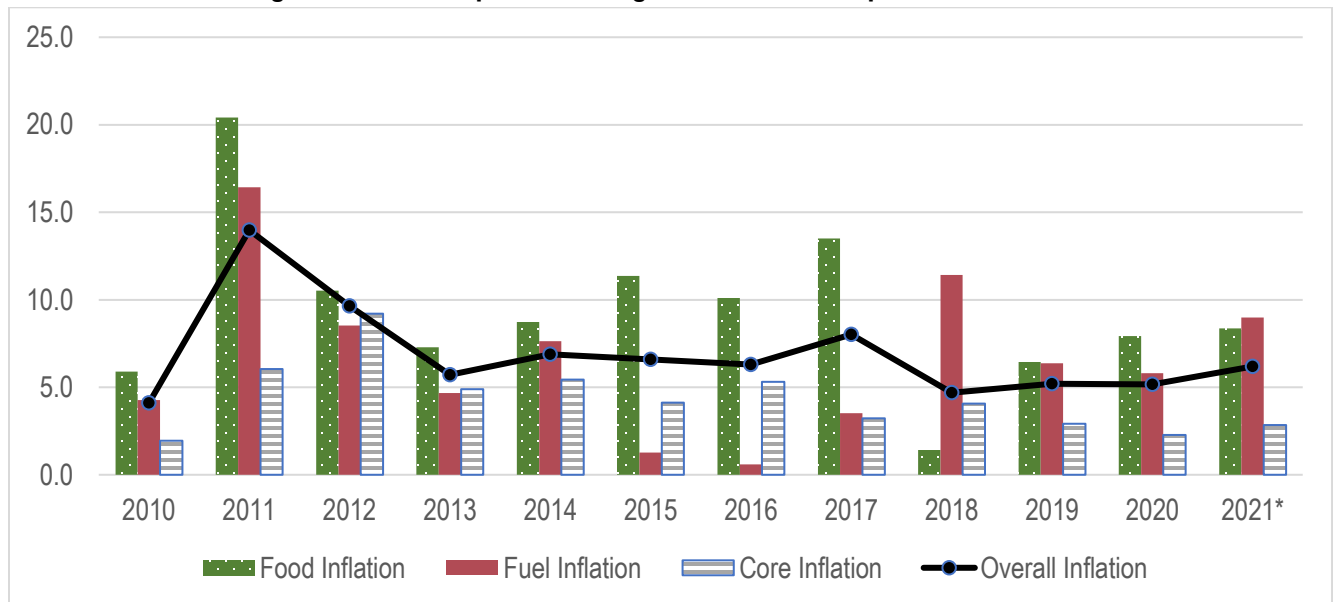
Source: KNBS, PBO

<sup>11</sup> Proxied by Gross fixed capital formation

## e) Inflation

16. Overall inflation has been relatively stable over the past decade except for 2011 when it peaked at a period average of 14 percent. This was mainly attributed to food inflation coupled with depreciation of the Kenyan Shilling. Food and fuel inflation are the main drivers of overall inflation. As such, inflation tends to worsen significantly during drought seasons as well as when the international crude oil prices rise and the exchange rate weakens. In 2021, there is an upward trend in overall inflation supported by increasing food and fuel prices. This trend is likely to continue due to the ongoing drought as well as higher fuel prices as global demand expands following the reopening of most economies.

Figure 9: Trend in period average inflation for the past decade

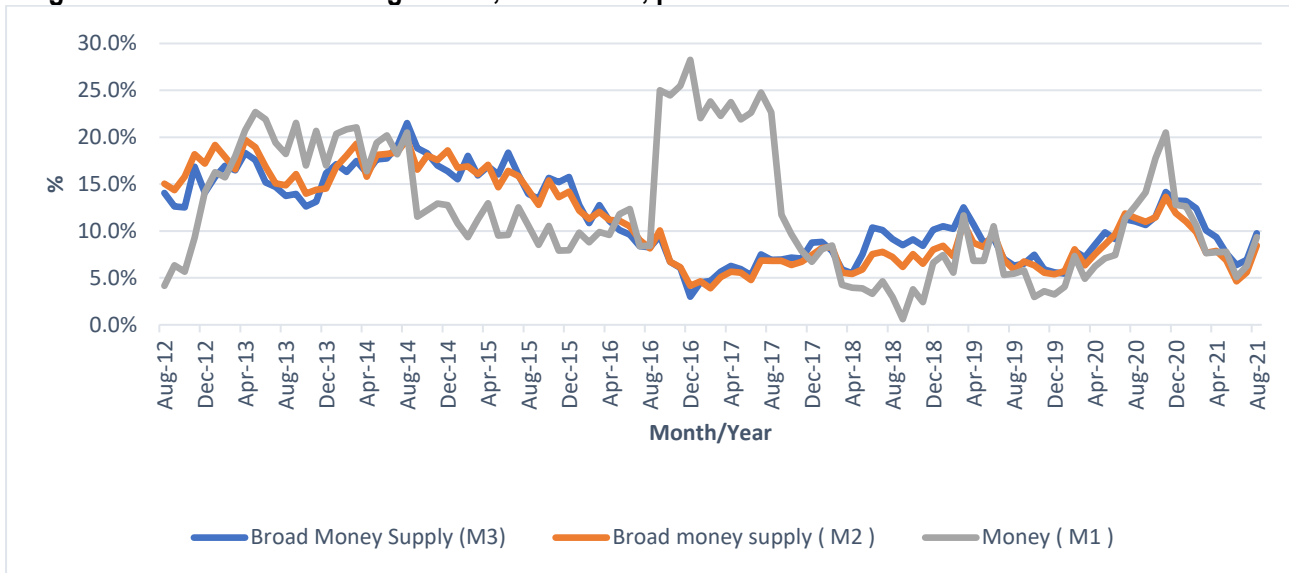


Source: KNBS, PBO

\* January to October 2021

17. The expected role of monetary policy as we head to the next year and the general elections is to maintain a stable inflation, stable interest rates and a competitive exchange rate. This will require careful monitoring of money supply especially the currency circulating outside banks during the election season. Broad money supply (M3), a key indicator for overall liquidity conditions, has been growing at a stable rate above 8 percent. The recent slowdown in M3 of 9.8 percent in August 2021 is expected to be short-lived given that CBK projects it to grow to 11 percent by end of June 2022. Indeed, there is anecdotal evidence that as we edge close to the elections there is increased money supply in the economy. The Central Bank of Kenya should therefore enhance its surveillance mechanism to ensure monetary stability with the view to containing possible inflationary pressure resulting from enhanced campaign spending.

Figure 10: Year on Year change of M1, M2 and M3, period 2012 to 2021



Source: CBK, 2021

## 1.2. Medium Term Economic Outlook and Prospects

The medium term outlook (2022/23 – 2023/24) remains uncertain and subdued for a number of reasons. Firstly, the conduct of the electoral process is a key determining factor: – high political tensions are likely to seriously dampen economic activity whereas a more contained electoral process could lead to moderate growth. Secondly, the prevailing drought conditions could spill over into 2022 with agricultural activity – notably farming and transportation of produce – likely to be further subdued due to fear of violence or actual eruption of violence. Thirdly, the lingering effects of the COVID pandemic still remain a threat and there is a risk of deadly resurgence as the campaign activities – which typically flout all social distancing directives – increase significantly in a population with low vaccination rates.

**18. Kenya’s real GDP growth is forecasted to expand by 4.5% in 2022, 5.1% in 2023 and 5.7% in 2024.** As earlier indicated, private consumption has been a significant contributor to growth and will be a key determining factor of economic performance in 2022 and 2023. Campaign related spending – resources spent on campaign materials including printing of T-shirts, banners, posters, fliers, pamphlets as well as gifts – is likely to increase money in circulation thereby increasing consumer activity. Furthermore, the stockpiling of food and essentials by *wananchi* on account of electoral uncertainty could lead to a spike in consumer demand just before the elections. Furthermore, increased travel as many return to their rural homes could also result in higher performance of the transport and storage sector. By 2023, growth in private consumption will have normalised to previous trend levels.

**19. Government consumption is expected to increase significantly in 2022 on account of election related spending and drought mitigation measures.**

Notably, increased expenditure demands for social services and a fiscal stimulus are all likely to exert significant pressure on the budget.

**20. Growth in private investment is likely to remain muted as investors adopt a wait and see attitude pending the outcome of the general elections.** A tension filled election marred with pockets of violence could lead to investor flight.

**21. Poor weather outlook will dampen agricultural performance and is likely to be a significant drag on growth.** The food security outlook has been worsening on account of two consecutive poor rainfall seasons as well as pests and diseases. On 8<sup>th</sup> of September 2021, drought in some parts of the country was officially declared a national disaster. Forecasts further indicate that the October to December short

### 2021 Economic Growth: A modest recovery

The 2021 GDP growth is estimated at **5.7%**. This is partly attributed to low base effects on account of a negative growth in 2020. More importantly however, is the rebound in economic activity particularly in the second half of 2021, following the easing of COVID containment restrictions. Indeed, significant recovery of two of the three key sectors which registered negative growth in 2020, namely: the Transport and storage sector (which contracted by -7.8%) and the education sector (which contracted by -10.8%) is expected to have boosted 2021 economic performance.

Private consumption is expected to have recovered significantly particularly in the second half of 2021 but this outlook is dampened by slow recovery in employment. As a result, the boost in purchasing power is not expected to be extremely significant, with consumer activity estimated to have recovered only moderately.

rains season is likely to be below average. This will worsen the food outlook situation for 2022. Barring any adverse weather conditions in 2022, agricultural performance may improve but this will be moderated by fear of violence (or violence) which may disrupt agricultural activity as well as the tendency of increased crime during election periods which may affect transportation of agricultural produce. Furthermore, beyond the weather outlook, there is no significant change expected in agricultural policy/ investments therefore this performance is likely to remain unremarkable for the foreseeable future.

- 22. Poor weather outlook will also adversely affect exports production but the effect of reduced quantity of produce may be cancelled out by expected high commodity prices particularly for tea and coffee.** In particular, horticulture demand has increased significantly post-COVID following the reopening of key destination markets. Coffee is also likely to benefit greatly from lower supply from Brazil as well as higher global prices. Going forward, an extended drought in 2022 may further lower production and election uncertainty could interfere with exports market.

**Box: Poverty outlook for the medium term (Baseline scenario)\***

Under the baseline scenario, the macroeconomic outlook for the medium term has a potentially adverse effect on poverty levels. Using the baseline forecast to estimate the impact on poverty, an increase in the share of households below the poverty line (by 2.67% in 2022/23 and 2.69% in 2023/24) is observed. The increase in proportion of poor households is highest in the self-employed agriculture sector and the formal sector (by 3.6% and 3.1% respectively over the medium term). Conversely, there is a reduction in proportion of poor households in the public sector (by 2.2%).

In terms of rural and urban areas, there is a higher increase in proportion of poor households in the rural areas (by 3.0%) compared to urban areas (2.1%) over the medium term.

*\*Forecast from PBOM micro poverty module*

**Alternative Scenario: is it possible to achieve a higher economic growth?**

- 23. The key intervention areas likely to have the highest impact on growth are in Agriculture, manufacturing and exports.** In 2020, industries accounting for the highest wage employment in the private sector were manufacturing (15.8%), agriculture forestry and fishing (15.1%); and wholesale and retail (13.5%). As a result, any interventions expected to enhance economic performance should focus primarily on these key sectors. If adequately supported, the expected returns are high in terms of increased household employment and income which will boost consumer demand. If incomes are sustained at a reasonably high level over the medium to long term, then this could boost private investment and reduce poverty.



## I. Agriculture

24. One of the most significant challenges facing the agriculture sector is a steady decline in productivity. According to the Agriculture Sector Transformation and Growth Strategy for Kenya (2019 – 2029), the existing yield gaps in this sector are as a result of the following challenges which limit the productivity of both large scale and small scale farms:
- i) Limited access to high quality seeds and fertilizers*
25. Limited access to high quality, certified seeds has dampened yields, especially for small-scale farmers. Challenges in fertilizer use are linked to inadequate access, poor quality control as well as improper use of fertilizers which has led to a decline in soil pH and increased soil acidity. Indeed, it is estimated that soil acidity is a major factor adversely affecting the yield of approximately 9 million acres of crop particularly in Western, Nyanza and Rift Valley regions.
26. According to the World Bank’s enabling the business of agriculture (2017) rankings, Kenya ranks 43 out of 62 countries in terms of metrics associated with fertilizer access and use. The ministry estimates current fertilizer use at 30 kg per ha and notes that this has not improved the yield.
- ii) Post-harvest losses*
27. It is estimated that approximately 20 – 25% of agricultural production is lost through poor post-harvest handling with most of these losses taking place during drying, threshing and shelling. Eliminating post-harvest losses therefore could boost agricultural yield by up to 25%.
- iii) Low agricultural mechanization*
28. It is estimated that only 2.9% of farming households (small scale farmers) use motorized equipment. This is four times lower than Kenya’s neighbors. Mechanization technology can significantly increase the efficiency of farmers thereby boosting yields.

### The strategy:

29. Ringfence resources allocated to key programmes and projects in the Agriculture sector that will lead to higher yield. In particular, provision of subsidized fertilizer, quality and certified seeds and mechanization.
30. Additionally, ensure that the implementation is synchronized with the departments of Agriculture at the county level. Importantly, let the funds follow functions.
31. Analysis using PBOM indicates that if the resources currently allocated to these projects (estimated at Ksh. 5.5 billion in total using latest budget data) are ring-fenced and efficiently utilized, then there will be an estimated increase in agricultural productivity (proxied by increased yield) by 0.5% in 2023/2024 and an increase in GDP growth by 0.1%. More resources allocated and utilized efficiently will result in even higher GDP growth. Increased agricultural productivity will result in higher incomes in agricultural households which form bulk of employment leading to a decline of the informal sector as many venture into the now profitable farming. The analysis also indicates a slight increase in private investment as well as a rise in imports probably to expand farming activities. The impact on poverty is significant, reducing consistently over the medium term.

## II. Support to businesses and manufacturing

32. As earlier indicated, the share of manufacturing in GDP has been steadily declining over the past decade. This is despite the Big Four Agenda target of increasing the share of manufacturing to GDP to 15 percent by 2022. Thus the target to transform manufacturing into a key engine for growth and a significant avenue for job creation remains elusive. Indeed, the share of manufacturing in formal wage employment declined from 12.7 percent in 2016 to 11.6 percent in 2020.
33. In 2020, the COVID-19 pandemic and the resultant restrictions led to a significant contraction of the manufacturing sector output; by 3.9 percent in the second quarter, and 3.2% in the third quarter. The focus of businesses has therefore shifted to improving cash flow due to prevailing cash constraints; reducing costs, and retaining jobs<sup>12</sup>. Thus addressing liquidity constraints by businesses and a deliberate push to invest in manufacturing oriented MSMEs could be the shot in the arm needed to revamp the economy and create jobs.

### The Strategy:

34. Allocate resources towards a well-designed stimulus programme for MSMEs in the form of affordable medium to long term loans (and grants) to MSMEs with specified terms and rates as well as expected outputs (conditionalities). These funds can be allocated through the Kenya Industrial Estates (KIE) and/or through the Credit Guarantee Scheme as a credit line to manufacturing oriented MSMEs, particularly those that show innovation and value addition. Special focus should also be given to MSMEs engaged in agro-processing and export oriented products.
35. Analysis from PBOM indicates that a Ksh. 10 billion allocation towards MSMEs could increase private investments by approximately 0.5% in 2023/2024 and GDP growth would increase by 0.1%. The general effect will be an increase in household incomes leading to increased gross national savings, higher revenue collection an increase in exports and an even bigger increase in imports – probably for additional investment inputs.

### Projected impact of proposed policy package:

36. **Implementation of the above policy package will yield a GDP growth of 4.5% in 2022, 5.5% in 2023 and 6.3% in 2024.** There is an observed spike in private consumption in the short term but this is quickly overtaken by growth in private investments which increases by a higher margin and continues the upward trend over the medium term, growing by approximately 1% on average. Notably, in the first year of implementation, government investment grows faster than private investment with the sustained increase in private investment taking place over the medium term. There is an observed increase in imports in the short term, probably attributable to importation of raw materials as manufacturing picks up but this declines in the medium to long term even as exports increase. Thus the proposed investments if efficiently implemented, could boost export competitiveness perhaps through value addition to exported agro

<sup>12</sup> KAM impact of covid-19 on manufacturing, one year on

products and/or increase in quality of manufactured goods that can be exported to both existing and new export markets.

**Box: Poverty outlook for the medium term (Alternative scenario)\***

Under the alternative scenario, there is a marked positive impact on poverty levels over the medium term. Although the proportion of households below the poverty line is still expected to increase in the short term due to lag effects, the increase is at a reducing rate over the medium term. Using the alternative forecast to estimate the impact on poverty, an increase in the share of households below the poverty line (by 2.59% in 2022/23 and 2.43% in 2023/24 and consistently declining over the medium to long term). This is marginally lower than the baseline forecast impact on poverty.

The increase in proportion of poor households is highest in the self-employed agriculture sector and the formal sector (by 3.5% and 2.8% over the medium term; declining consistently over the medium term). Notably, when it comes to poverty reduction, some interventions in the policy package are more effective than others. Agricultural interventions are the most effective for poverty reduction even though the impact on overall GDP growth is lower in the short term. This is probably due to the income distributional effects of these interventions which then lowers inequality. This outcome tends to support the school of thought that when it comes to poverty reduction, there is a trade-off between growth and equity. However, more research is needed.

In terms of rural and urban areas, the increase in proportion of poor households in the rural areas (by 2.7%) is higher compared to urban areas (2.0%) over the medium term with a consistent decline in the medium to long term.

*\*Forecasts from PBOM – Micro Poverty Module*

### 1.3. Revenue Performance and Medium Term Outlook Introduction

- 37. Tax Revenue collection as a share of GDP has steadily declined over the past five years.** Consequently, Kenya's tax collection as a share of GDP has remained lower than some of her African peers. Estimates from the World Bank indicate that Kenya's average tax collection as a share of GDP between 2014 and 2019 was around 16 percent whereas the share in other African countries such as Botswana, Namibia and South Africa was over 20 percent.

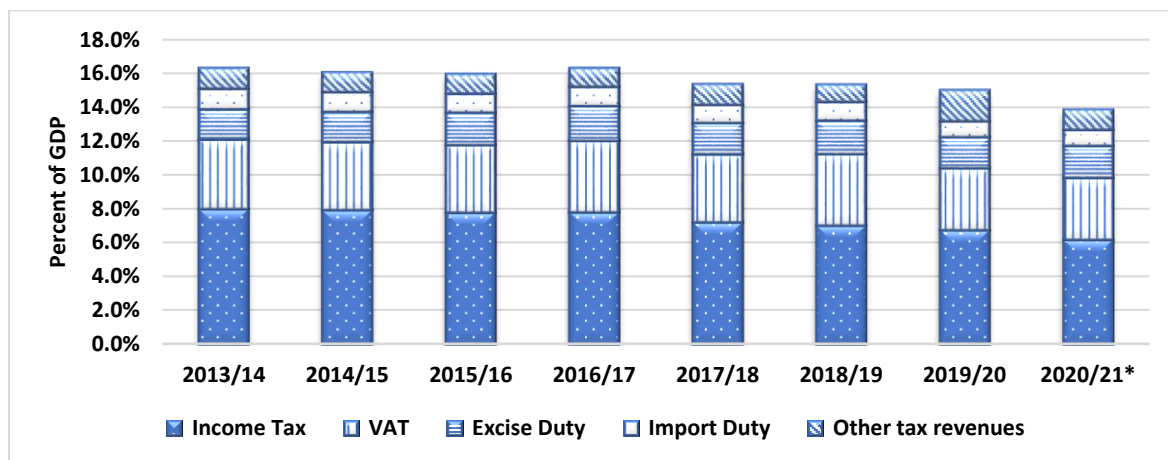
**Table 2: Tax revenue as a share of GDP for select SSA countries, 2014 - 2019**

Country Name	Tax Revenue as a share of GDP (Average: 2014-2019)
Botswana	22.7%
Ghana	13.2%
Kenya	16.0%
Namibia	31.8%
Senegal	16.1%
South Africa	26.7%
Sub-Saharan Africa (2014-2018 average)	18.6

Source of Data: World Bank -World Development Indicators updated on 15/9/2021

- 38. Income tax and value added tax have been the main contributors to the slower growth in tax revenue collection relative to economic performance in Kenya.** Income tax as a share of GDP declined from about 8 percent in 2014 to about 6 percent in 2020/21 while VAT declined from about 4 percent to 3.6 percent. Therefore, it is evident the without novel quantifiable revenue enhancement measures that are a shift from what has been proposed in past Budget Policy Statements Kenya's revenue collection as a share of GDP will continue to lag behind her peers in Africa.

**Figure 11: Tax revenue as a share of GDP**



39. The predominance of small scale/subsistence farmers in the agriculture sector has historically been touted as a possible driver of lower tax collection as a share of GDP in Kenya and other developing countries. The sheer number and geographical spread of smallholder farmers coupled with the generation of low surpluses have contributed to a large proportion of income from agriculture remaining untaxed. However, difficulties in taxing the agricultural sector may not explain the recent decline in revenue as a share of GDP which coincided with a decrease in the contribution of agriculture to GDP.
40. **Many developing countries face challenges in taxing income from the “informal sector”.** The relatively faster growth in Kenya’s informal sector employment between 2016 and 2019 has been proposed as one of the possible drivers of the declining revenue as a share of GDP. However, it should be noted that despite the number of people employed in the informal sector increasing from 15 million in 2016 to about 18 million in 2019, the structure of employment in Kenya has remained unchanged with informal sector jobs accounting for between 82 and 83 percent of total employment since 2010.
41. Changes to the tax law such as the introduction of presumptive tax, advance tax, turnover tax and a tax on rental income have unsuccessfully tried to expand the tax base and enhance revenue collection from the agriculture sector and the informal sectors. These failed attempts to tax the informal sector are an indication that without comprehensive empirical analysis aimed at understanding the dynamics of the informal sector economy, the Government may not be able to determine the ability to pay, direct and indirect costs associated with taxing the sector as well as the optimal revenue it hopes to collect from the sector.
42. A more novel proposal for the possible cause of dwindling revenue collections from the tertiary sector is the continued migration of businesses and service providers to the “digital marketplace”. Recent amendments to tax laws have attempted to improve efficiency in revenue collection from economic activities carried out electronically as a possible remedy to the declining tax revenues as a share of GDP. However, it should be noted that tax revenue from the “digital marketplace” is expected to increase gradually as the laws and procedures slowly catch up with new ways of carrying out economic activities electronically. Further, without empirical evidence, the impact of digitization on revenue as a share of GDP remains unclear.
43. The dwindling revenue as a share of GDP is an important policy issue due to its nexus with the fiscal deficit. Kenya’s fiscal deficit as a share of GDP has expanded in tandem with the slow growth in revenue collection since the 2018/19 FY. Whereas expenditure net lending as a share of GDP remained unchanged at about 25 percent between 2018/19 and 2020/21, the fiscal deficit (including grants) as a share of GDP increased from 7.4 percent (7.2 percent) to about 8.6 percent (8.3 percent). Therefore, revenue enhancement measures will be key to achieving the target of a below 5 percent fiscal deficit in the medium term.

## Medium-Term Prospects for Fiscal Policy

### a) Baseline Scenario

- 44. Tax revenue collection as a share of economic activity is expected to remain subpar over the medium term.** Total revenue as a share of GDP is expected to remain at around 16 percent in 2021/22 and 2022/23 FYs if innovative policy measures that aim to expand the tax base and minimise revenue leakages are not implemented. Consequently, in order to achieve the National Treasury's medium-term goal of raising revenue as a share of GDP to over 18 percent by 2023/24, the next BPS should include quantifiable revenue enhancement policy measures and the estimated additional revenue expected from each proposed policy.
- 45.** Ordinary revenue projection by the National Treasury for the 2021/22 and 2022/23 FYs is Ksh. 1,775.6 billion and Ksh. 2,141.6 billion respectively. However, based on the assumption of relatively slower recovery of tax revenue as a share of GDP and possible subdued private investment during an election year, PBO projects that ordinary revenue collection in 2021/22 will be between Ksh. 1,668.8 billion and Ksh. 1,749.0 billion. Further, in a no policy change scenario, the projected ordinary revenue collection for 2022/23 FY will be between Ksh1,775.4 billion and Ksh. 1,971.8 billion.

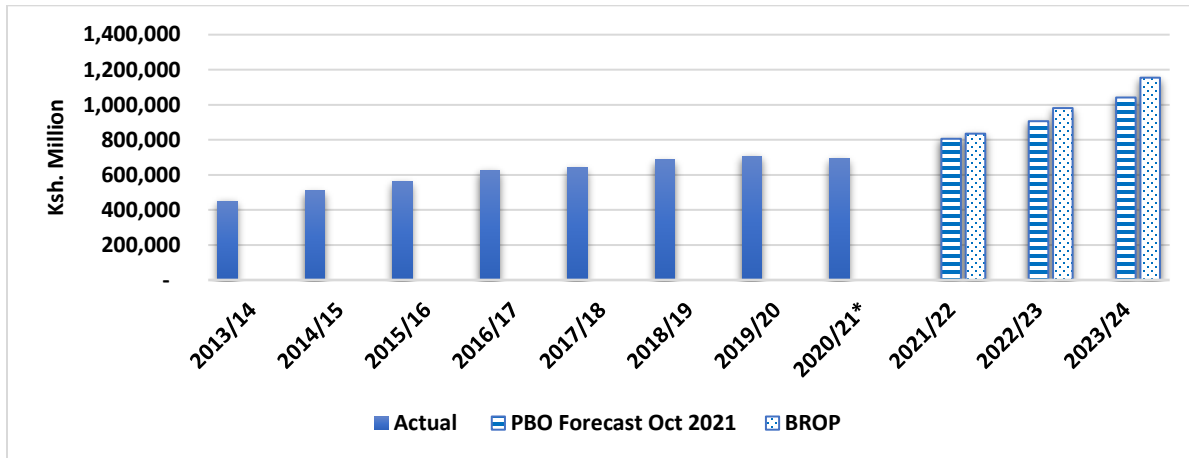
Table 3: PBO Baseline scenario Ksh. Million

Table 4: PBO Baseline scenario Ksh. Million				
	2020/21	2021/22	2022/23	2023/24
	Prel Actual	Proj	Proj	Proj
<b>Total Revenue</b>	<b>1,783,747</b>	<b>1,979,827</b>	<b>2,235,371</b>	<b>2,517,305</b>
<b>Ordinary Revenue</b>	<b>1,562,015</b>	<b>1,749,028</b>	<b>1,971,815</b>	<b>2,219,850</b>
Income tax	694,053	805,567	905,565	1,040,687
VAT	410,758	468,593	541,085	596,274
Import duty	108,375	118,400	137,224	158,151
Excise duty	216,325	239,349	263,997	294,211
Other revenue	132,504	117,119	123,945	130,528
Appropriation-in-Aid	221,732	230,799	263,556	297,455
<b>Real GDP Growth (PBO)</b>	<b>2.7%</b>	<b>5.1%</b>	<b>4.7%</b>	<b>5.2%</b>
<b>Nominal GDP Ksh. Billion (PBO)</b>	<b>11,366.6</b>	<b>12,551.7</b>	<b>13,799.8</b>	<b>15,248.5</b>

- 46. Income tax collection which accounts for close to 50 percent of ordinary revenue is expected to experience an uptick in 2021/22.** The level of unemployment has steadily declined from the peak experienced in the second quarter of 2020. KNBS reported that the estimated number of unemployed Kenyans (including potential labour force) decreased from 4.6 million in the second quarter of 2020 to 2.5

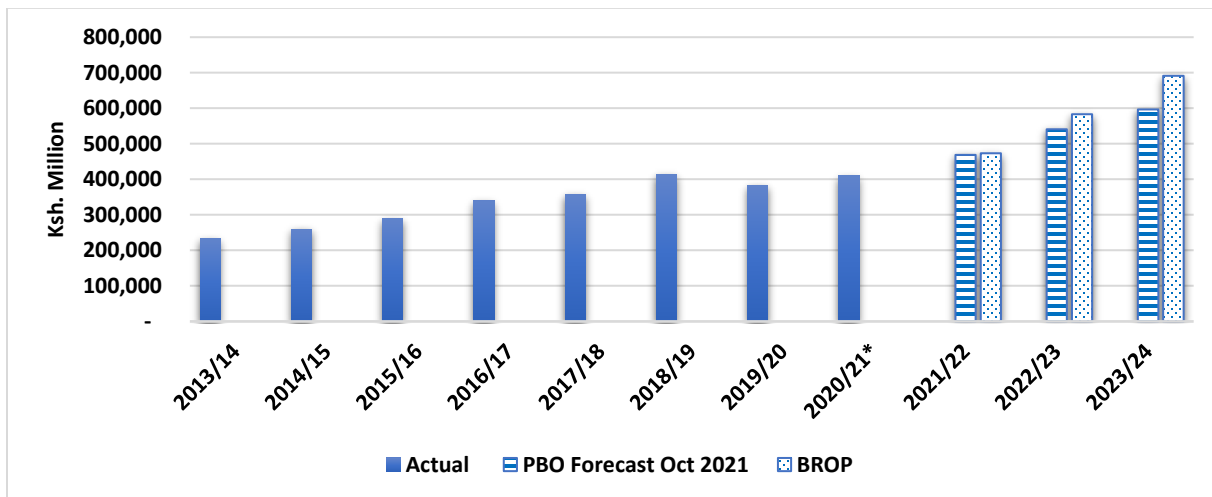
million in the first quarter of 2021. Reduced unemployment coupled with the reversal of income tax relief measures is expected to contribute to double-digit growth in income tax collection in 2021/22 FY. The projected income tax revenue collection in 2022/23 is between Ksh. 746 billion and Ksh. 906 billion.

Figure 12: Income Tax



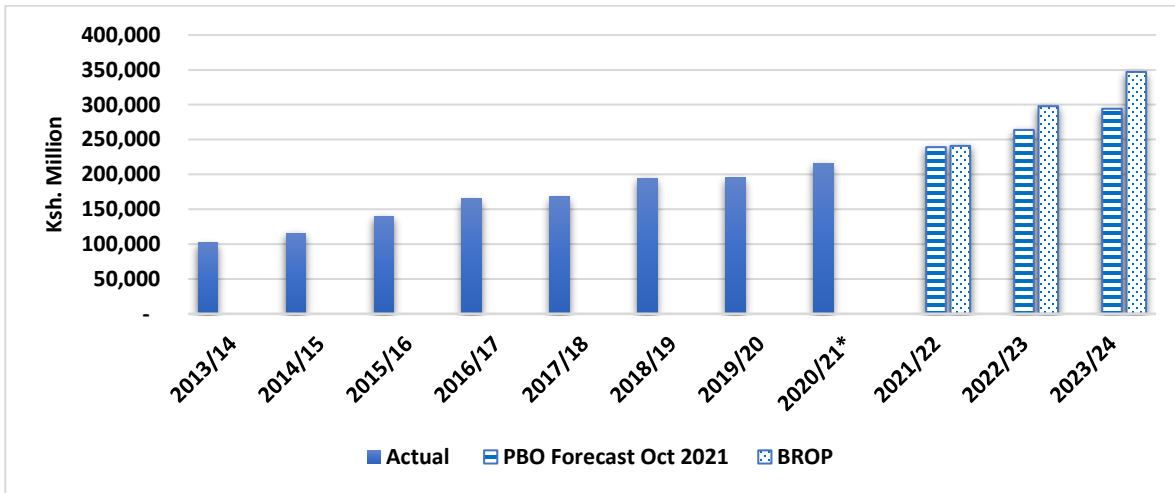
47. Over the medium-term, the National Treasury expects to increase VAT collection as a share of GDP from 3.6 percent to over 4.5 percent. However, without renewed enforcement of ETR use and a further reduction in the categories of goods that are VAT exempt or zero-rated, VAT as a share of GDP is expected to remain at around 4 percent. It should be noted, that limiting zero-rating and removal of some exemptions outside agriculture could raise VAT as a share of GDP by up to two percentage points however, such steps may prove to be unpopular especially at a time when the economy is recovering from the effects of the Covid-19 pandemic. Therefore, ceteris paribus, PBO projects that VAT collection in 2022/23 will be between Ksh. 491 billion and Ksh. 541 billion.

Figure 13: VAT



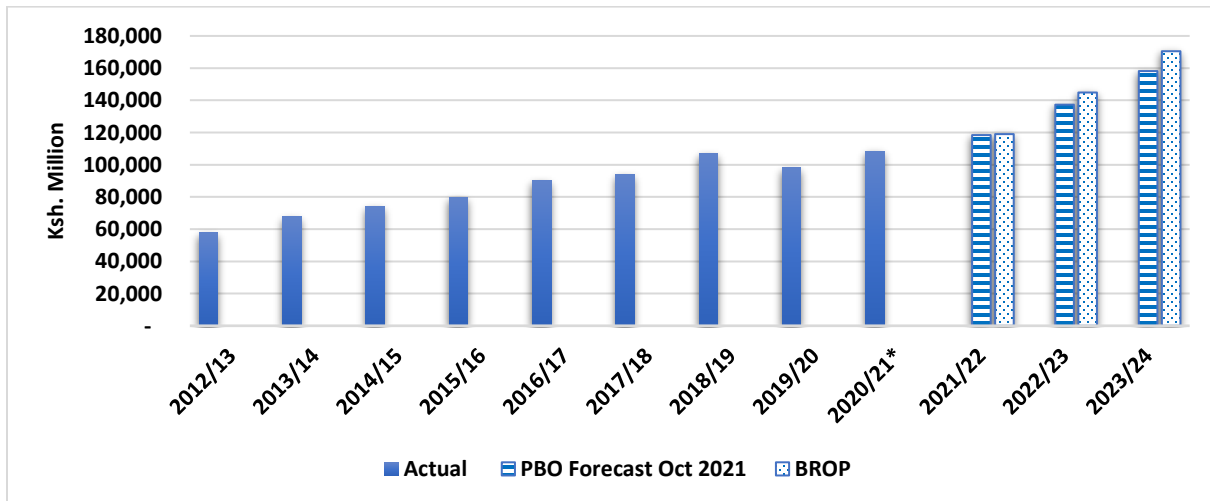
48. Excise duty revenue collection was the least affected by the measures that have been taken to curb the spread of the coronavirus. Whereas other major tax revenue categories had negative growth in 2019/20, excise duty revenue grew by about 0.5 percent. Further, excise duty as a share of GDP has remained unchanged at about 2 percent over the past five years, this trend is expected to persist in the medium-term with excise duty revenue projected to be between Ksh. 257 billion and Ksh. 264 billion in 2022/23.

Figure 14: Excise Duty



49. Global trade is gradually recovering from the bottlenecks and significant slowdown that was experienced in 2019/20. Based on the assumption that domestic growth in 2021/22 and 2022/23 will generate greater demand for imports and coupled with the projected increase in prices of crude oil and exports from developed economies, it is projected that import duty revenue in 2022/23 will be between Ksh. 128 billion and Ksh. 137 billion.

Figure 15: Import duty





50. The National Treasury is targeting to reduce the fiscal deficit (including grants) to 4.4 percent (4.1 percent) in the medium term. However, without concrete policies that are aimed at enhancing revenue collection as a share of GDP and assuming that expenditure net lending as a share of GDP will remain at around 23.5%, the fiscal deficit over the medium-term is projected to remain above 6.5 percent.

**b) Alternative Scenario/deficit-reducing options for 2022/23 FY**

- i. As at 2020 tax expenditure on VAT i.e. lost revenue due to exemptions and zero rating stood at Ksh. 234 billion. Therefore, a review of the list of exempt goods outside agriculture coupled with limiting the number of zero-rated goods could generate an additional Ksh. 68 billion and increase revenue as a share of GDP by 0.5%.
- ii. Alternative growth scenario. Through additional government investment aimed at improving agricultural productivity and creating an enabling environment for manufacturing (specific interventions are discussed in a subsequent chapter), Kenya's economy has the potential of growing by up to 5.9 percent in 2022/2023. Consequently, due to enhanced economic growth, the National Treasury has the potential to collect ordinary revenue of over Ksh. 2,008 billion in FY 2022/23. The breakdown of additional revenue resulting from enhanced growth is presented in table xx below.

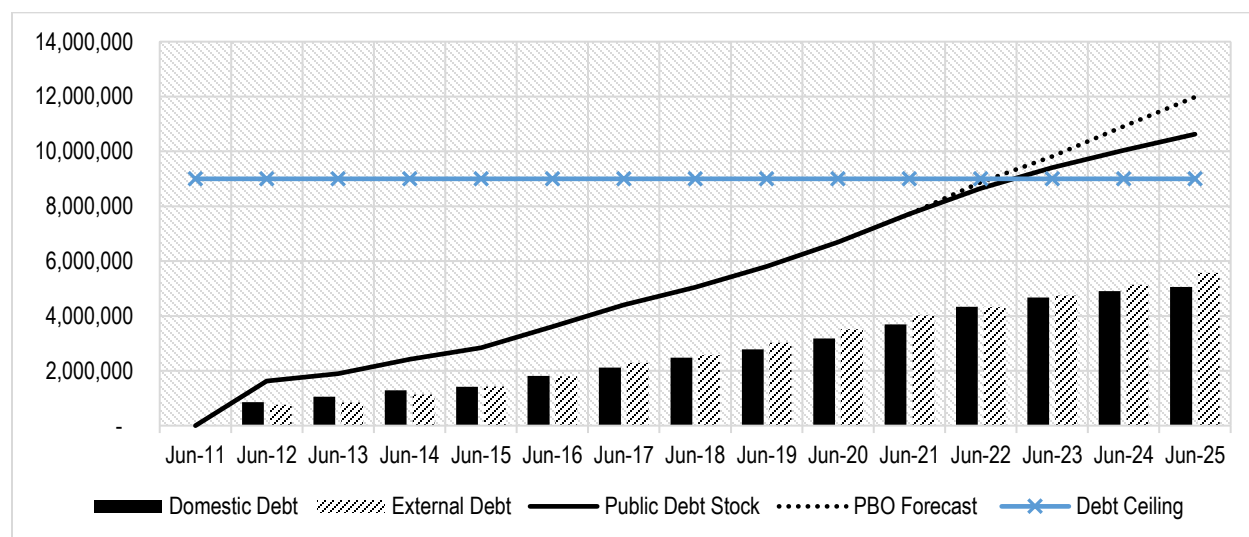
**Table 5: Alternative growth scenario Ksh. Million**

	2020/21	2021/22	2022/23	2023/24
	Prel Actual	Proj	Proj	Proj
<b>Total Revenue</b>	<b>1,783,747</b>	<b>1,979,827</b>	<b>2,276,534</b>	<b>2,573,867</b>
<b>Ordinary Revenue</b>	<b>1,562,015</b>	<b>1,749,028</b>	<b>2,008,125</b>	<b>2,269,729</b>
Income tax	694,053	805,567	922,240	1,064,071
VAT	410,758	468,593	551,049	609,672
Import duty	108,375	118,400	139,750	161,704
Excise duty	216,325	239,349	268,858	300,821
Other revenue	132,504	117,119	126,227	133,461
Appropriation-in-Aid	221,732	230,799	268,409	304,138
<b>Real GDP Growth (PBO)</b>	<b>2.7%</b>	<b>5.9%</b>	<b>5.9%</b>	<b>5.6%</b>
<b>Nominal GDP Ksh. Billion (PBO)</b>	<b>11,366.6</b>	<b>12,551.7</b>	<b>14,053.9</b>	<b>15,591.2</b>

## 1.4. Public Debt Management for the Medium Term

51. The stock of public debt continued to increase exponentially with the current debt stock accounting for 86% of the Kshs. 9 trillion PFM Debt Ceiling. As of June 2021, the public debt stock amounted to Kshs. 7.71 billion<sup>13</sup>; comprising of Domestic Debt (48 percent) and External debt (52 percent). The debt stock is established to have increased by 15% from FY 2019/20; and is forecasted to reach Kshs. 8.8 trillion and Kshs. 9.8 trillion in June 2022 and June 2023, respectively. This leaves only 4 percent or Kshs. 1.29 trillion to finance the fiscal deficit for FY 2020/21 (Kshs. 929.7 billion) and FY 2022/23 (estimated to range between Kshs. 775.8 billion and Kshs. 940 billion)<sup>14</sup>. Given the prevailing debt accumulation and debt service trends, the current debt ceiling cannot hold. Therefore, it may be subject for review in order to accommodate any further borrowing to fund expenditure requirements.

Figure 16: Debt Stock Growth Rate (June 2011 - June 2025)



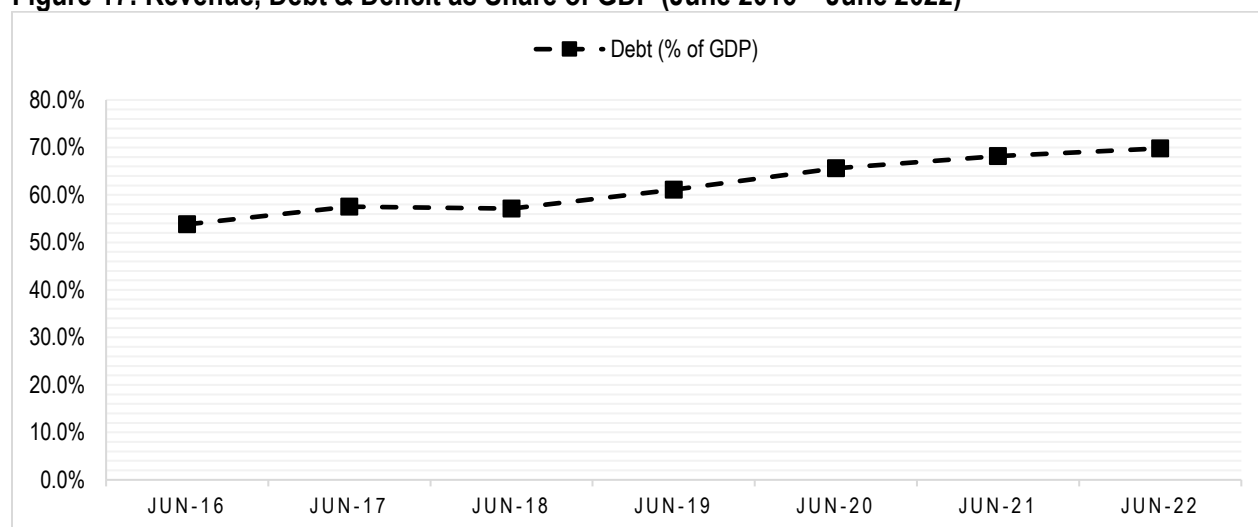
Source: Public Debt Management Report, September 2021

52. The answer to stabilisation of the Debt/GDP ratio lies with a rapid economic growth rate. Empirical evidence suggests that high debt to GDP ratio has a detrimental effect on the growth rate of an economy and that past a given critical point - between 64% and 100% depending on the nature of the economy - an increase in the ratio leads to economic losses. The Debt/GDP ratio should thus not be allowed to reach levels that would affect the economic growth rate negatively as this would lengthen the fiscal consolidation period. Kenya's Debt/GDP ratio, estimated at 68% as at June 2021, is estimated to rise to 70% by the end of FY 2022/23. While fiscal-targeted consolidation takes place, achieving rapid economic growth rate will be critical. The 10% economic growth rate envisioned within the Economic Pillar of the Vision 2030 should therefore be a key target in debt control parameters. Primary focus should be given to sectors that are critical to revenue generation such manufacturing, finance & Insurance, Information and communication, as this will accelerate the fiscal consolidation process.

<sup>13</sup> Central Bank of Kenya, October 22 2021 - Weekly Report

<sup>14</sup> BROP 2021 & PBO Estimates

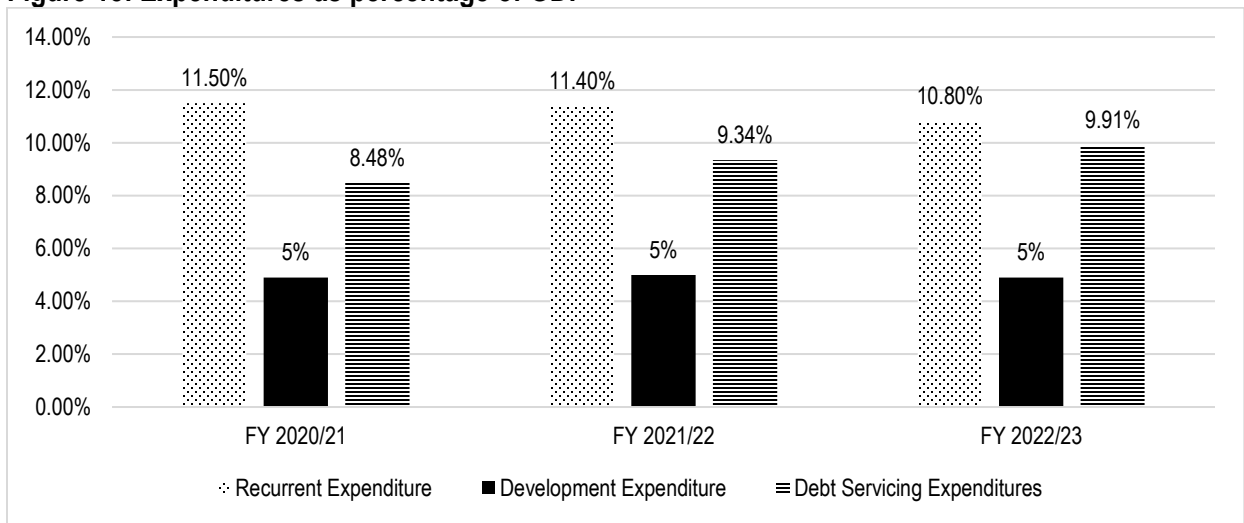
Figure 17: Revenue, Debt &amp; Deficit as Share of GDP (June 2016 – June 2022)



Source: Public Debt Management Report, September 2021

- 53. The persistent rise in fiscal deficit is a key factor contributing to rapid public debt accumulation.** Historically, the overall fiscal deficit persisted due to infrastructure-related expenditure pressures. Going forward, the increase in debt servicing expenditures alongside other critical expenditures such as the economic stimulus, election-related spending and implementation of a new manifesto by the new administration is expected to play a greater role in the stickiness of the fiscal deficit over the medium term. Thus the public debt stock is likely to increase even further in the coming years. A greater level of both fiscal discipline and commitment to efficient implementation of the budget by both national & sub-national entities could lead to higher economic growth thereby increasing revenue and reducing the need to borrow.
- 54. Controlling debt service will require restructuring of domestic debt.** Notably, debt service, which is a mandatory expense, is estimated to account for over 60% of ordinary revenue in the medium term thereby reducing resources available for other critical expenditures. Domestic debt service accounts for 74% of total public debt service even though it accounts for only 42% of total debt stock. In comparison, external debt, while accounting for 52% of total debt stock, accounts for only 26% of debt service. This implies that domestic debt restructuring will have a greater impact on alleviating the debt-service burden.
- 55. Total debt service is projected to reach Kshs. 1.36 trillion by the end of FY 2022/23 (16% increase) and will account for up to 10% of GDP by the end of the medium term. At this level, it will have outpaced the development expenditure share of GDP (5%) and will be rising faster than recurrent expenditure share of GDP (estimated to decline to 10.8% in FY 2022/23).**

**Figure 18: Expenditures as percentage of GDP**



Source: CFS Expenditures – 2021 Approved Budget, & BRP 2021

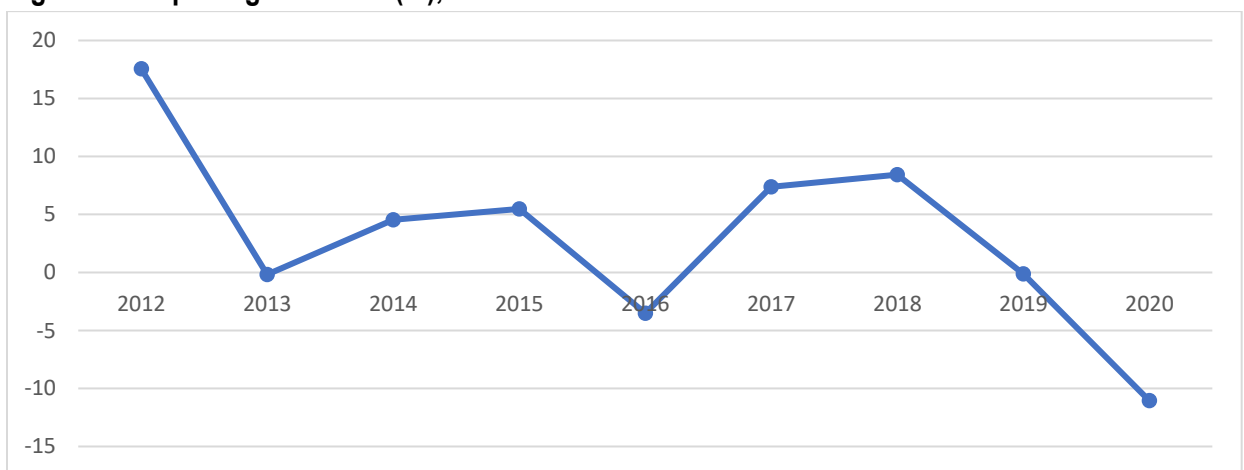
**56. Proposed policy options:**

- i. Review the debt ceiling
- ii. Consider debt rescheduling to ease debt service.

**1.5. Exports**

**57. The growth rate of exports has been declining over the past five years and this could worsen the country’s export competitiveness.** On average, between 2016 and 2020, exports grew by 1.2 percent. This was a decline compared to the period between 2011 and 2015 when exports grew by 6.9 percent.

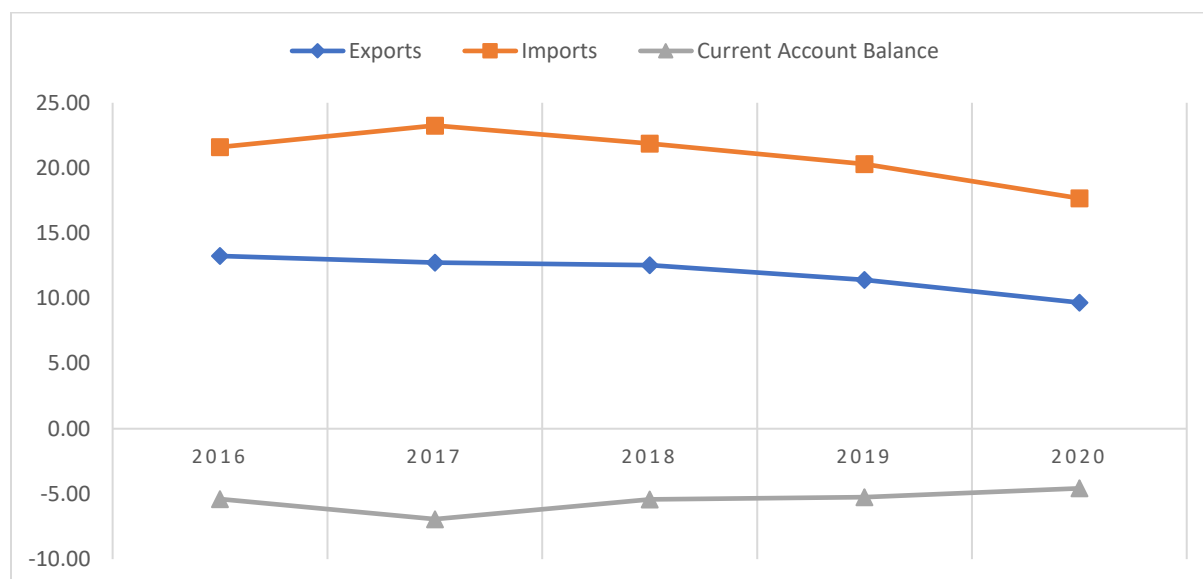
**Figure 19: Exports growth rate (%); 2012 – 2020**



Data Source: Economic Survey

**58. The share of exports to GDP has also been declining and was estimated at 11.9% over the past five year period.** The poor performance of exports is partly attributed to lack of diversification, which not only renders the country vulnerable to external shocks but also makes it challenging to penetrate new markets or increase our exports share in the already existing markets.

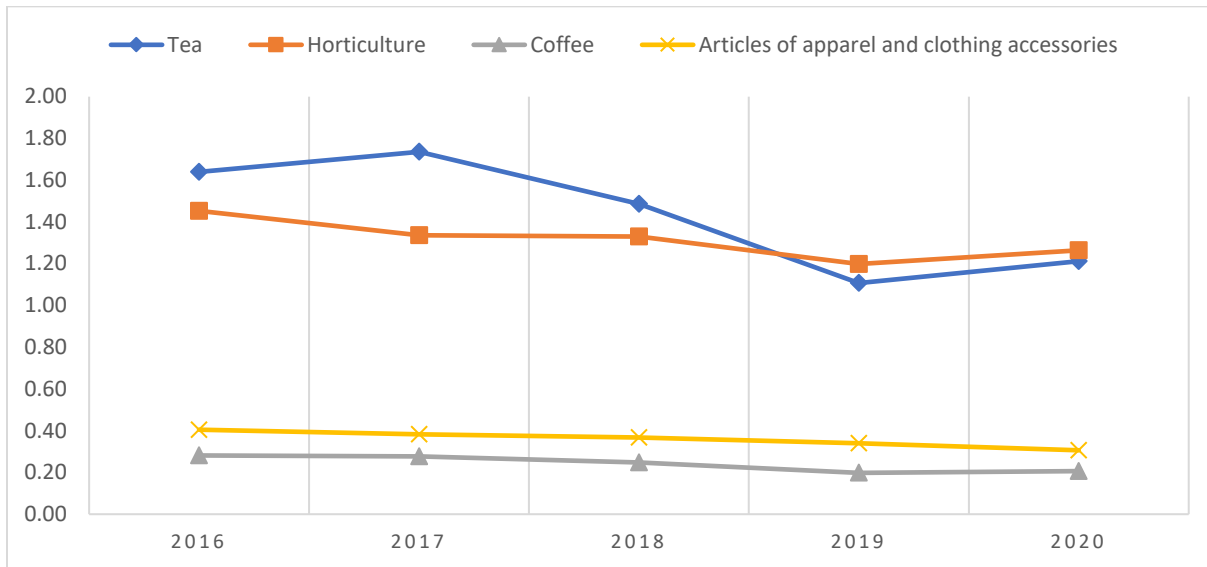
**Figure 20: Exports, imports and the current account balance as a share of GDP (% of GDP)**



Data Source: Economic Survey, 2021

**59. Kenya's exports are dominated by primary agricultural products which renders the sector vulnerable to weather related shocks as well as fluctuating global commodity prices.** Over the past five years, 32.9 percent of the country's merchandise exports has been from agriculture. The leading performing exports are horticulture and tea which account for 46.9 percent of total exports. Coffee, previously a leading export in Kenya has been underperforming and is no longer a major foreign exchange earner. Despite Kenyan coffee being ranked position ten among the world's best coffees and with high potential for very high earnings, Coffee production has been declining. Presently, the acreage under coffee production is estimated at 119,000 hectares; a more than 30 percent decline from the early 1990s where approximately 170,000 hectares were under coffee production. The decline in the performance of coffee exports is attributable to low profitability of the crop for farmers and possible mismanagement across the entire supply chain.

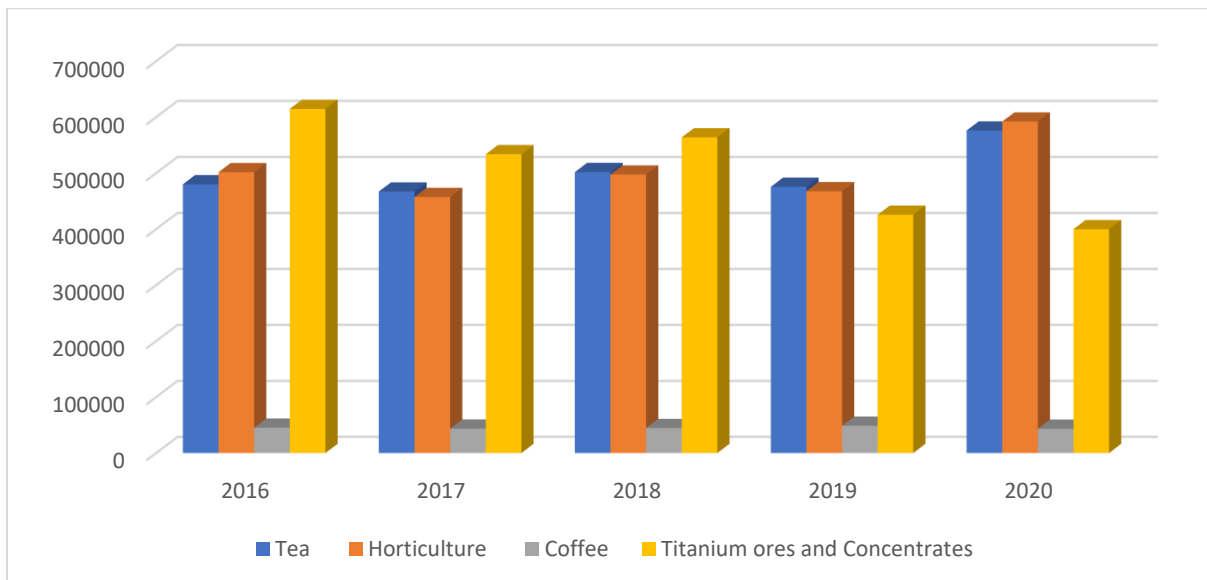
Figure 21: Leading exports as a share of GDP (% of GDP)



Data Source: Economic Survey, 2021

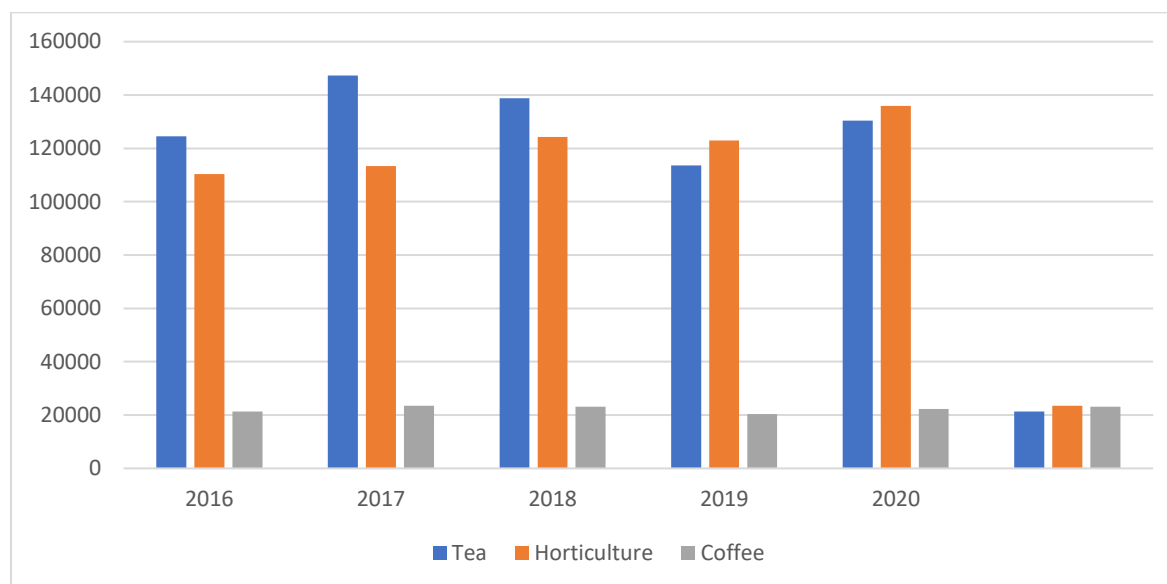
60. Despite increasing tea and horticulture production over the past five years, the value of these two products has not grown significantly. Indeed, the values of tea and horticulture exports have been declining as a share of GDP. This asymmetry is on account of fluctuating global commodity prices. In 2018 tea exports price per unit declined by 12.2% and further declined by 13.7% in 2019 and by 5.2% in 2020. On the other hand, horticulture prices improved by 7.7% in 2018 and 5.2% in 2019 but experienced a drop of 12.7% in 2020.

Figure 22: Quantities of major exports in Tonnes, 2016-2020



Data Source: Economic Survey, 2021

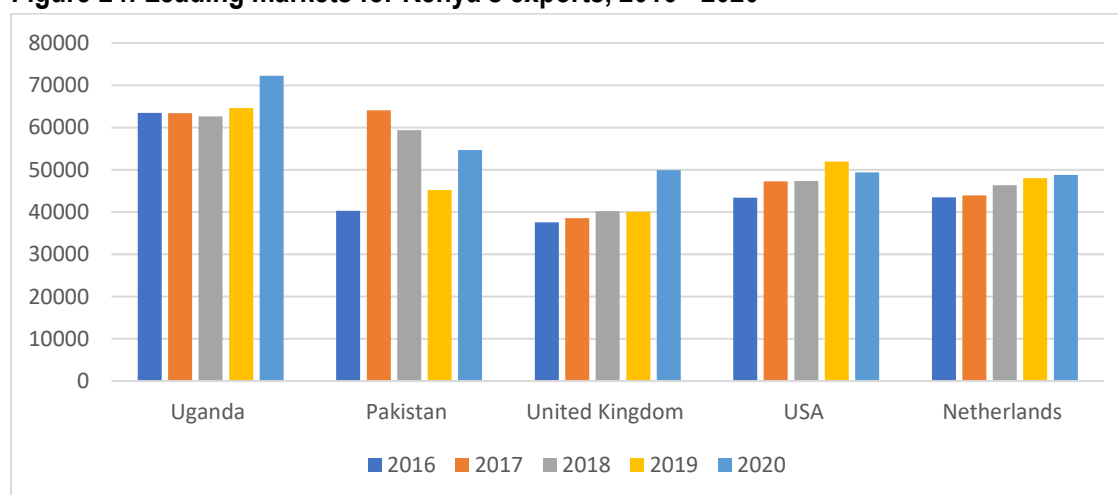
**Figure 23: Values of major exports, 2016-2020**



Data Source: Economic Survey, 2021

**61. In terms of exports market, Kenya’s export destinations have not changed much for the past five years.** Africa remains the largest market for Kenya’s exports with Uganda as the leading trade partner. In 2020, Uganda accounted for 11.2% of Kenya’s total exports. Europe is the second leading exports market with United Kingdom and Netherlands being the leading trade partners. In 2020, United Kingdom and Netherlands accounted for 7.8% and 7.6% of total exports respectively. In the Americas, the leading trade partner is the USA; accounting for 7.7% of total exports. In Asia, the leading trade partners are Pakistan and United Arab Emirates (UAE). In 2020, Pakistan and UAE accounted for 8.5% and 5.3% respectively.

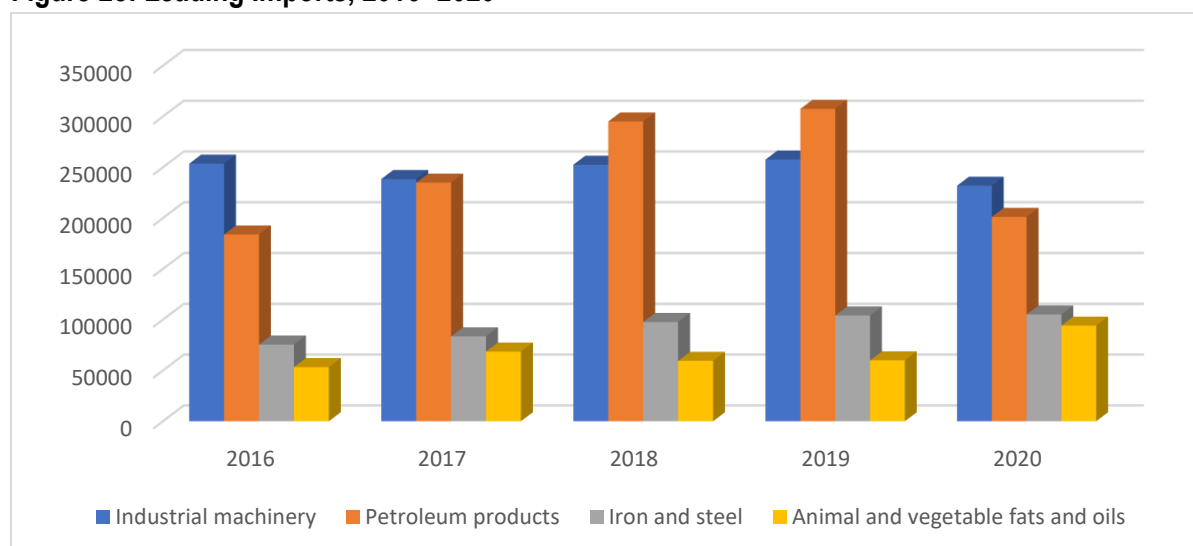
**Figure 24: Leading markets for Kenya’s exports, 2016 - 2020**



Data Source: Economic Survey, 2021

- 62. Kenya's exports cannot pay for its imports.** Over the past five years, the total imports bill has been estimated at Ksh. 1.9 billion against an average of Ksh. 1.1 billion in export earnings. The balance of trade deficit implies a depreciation in the country's foreign exchange reserves since we pay for imports in foreign currency. The low demand for exports implies low demand for the Kenya Shilling which leads to depreciation of the currency. Low foreign exchange reserves and the weakening of Kenya's currency increases our susceptibility to external shocks.
- 63.** The leading merchandise imports are petroleum products and industrial machinery accounting for 14.8% and 17% respectively. Petroleum products and industrial machinery are not locally produced on a large scale hence the need to import them. To cover such imports, there is need to increase exports which will in turn increase the foreign exchange reserves that pay for the goods we need from the global markets.

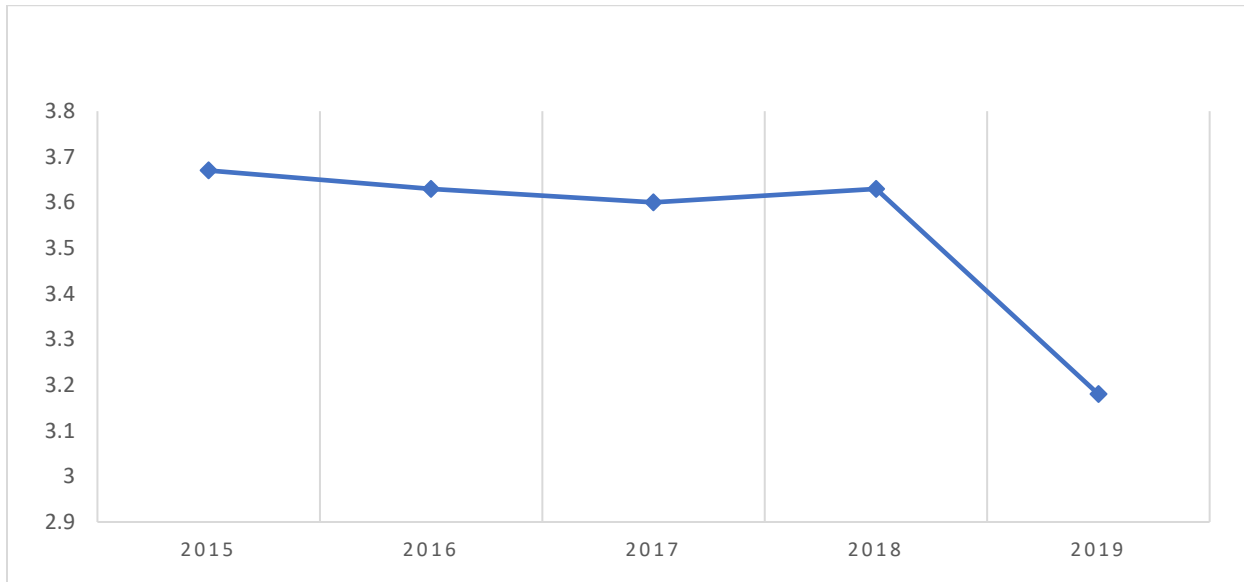
**Figure 25: Leading Imports, 2016 -2020**



**Data Source: Economic Survey, 2021**

- 64. The export market penetration index has been on a declining trend, denoting a declining reach of Kenya's exports in the global market.** Diversification of exports is the key issue. Overreliance on the same agricultural export products without investing adequately in other avenues especially in manufacturing has limited the country's inability to adequately meet the needs and demands of international markets.



**Figure 26: Kenya Exports Market Penetration Index, 2015 - 2019**

Data Source: World Bank

### Policy options

- i. **Enhance credit access for export-oriented businesses:** This can be achieved through provision of a credit line through Kenya Industrial Estates or the Credit Guarantee Scheme.
- ii. **Bilateral agreements to increase the share of tea exports with leading tea importers in the world.**

## Chapter Two:

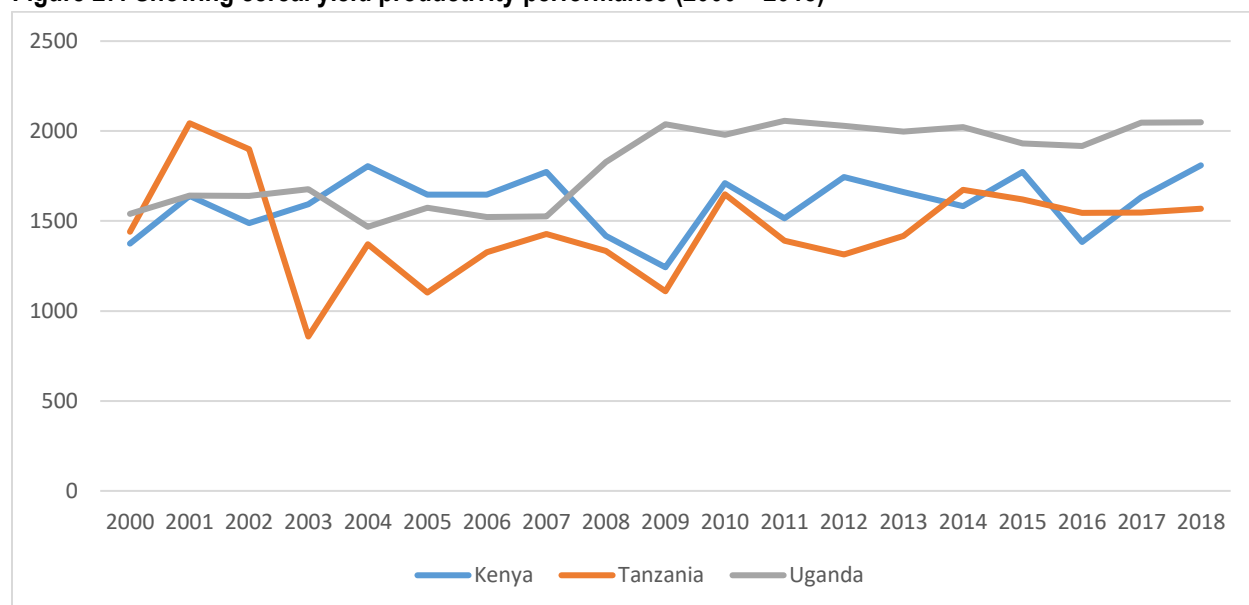
# National Government Expenditure Framework

## 2.1. Budget and policy options for achieving a higher growth target

### 2.1.1. Reorienting Agriculture for Enhanced Economic Growth

65. **The role of agriculture in the Kenyan economy cannot be gainsaid with the sector directly and indirectly supporting about 75 percent of the country's labour force and accounting for about a fifth of GDP.** Its significant place in the country's economy was felt in 2020 where it became the fall back sector for many Kenyans after the adverse impact of the covid-19 pandemic on the economy. Since it is also a major source of raw materials for the manufacturing industry, its reorientation towards better productivity is critical for economic growth.
66. **Despite the government increasingly making efforts to ensure the country achieves food and nutrition security through substantial allocation to agriculture related activities, the country is still a food deficit nation.** One of the key challenges facing the achievement of food and nutritional security is the decline in agricultural productivity. Compared to the performance in the 80's and 90's, the average cereal yield has reduced over the years from 1,681 kgs per hectare to the current 1,562 kgs per hectare. When compared to the performance of its neighbouring countries, Kenya's 10 year average cereal productivity trails that of Uganda which stands at 2,003 kgs per hectare but is above that of Tanzania which stands at 1,525 kgs per hectare. The figure below compares the cereal yield per hectare for the three countries over the last two decades.

Figure 27: Showing cereal yield productivity performance (2000 – 2018)



67. **The decline in Kenya's agricultural productivity has mainly been as a result of lack of information on good agricultural practices, limited access to high quality inputs and effects of climate change.** The agriculture sector is dominated by small-scale farmers who account for 70 percent of total agricultural produce. There are more than 600,000 small-scale farmers each owning farms that are on average below 3 hectares in size and mainly practice rain-fed farming. Therefore, unreliable and sometimes non-existence of agricultural extension services are key contributors to the poor agricultural practices. Similarly, due to lack of economies of scale, these farmers are also unlikely to access quality and affordable farm inputs including seeds, fertilizers, agro-chemicals and equipment

without adequate government intervention. On the other hand, the dependency on rain-fed farming makes agriculture yields vulnerable to the current climate crisis especially the changes in temperature regimes, precipitation patterns, and extreme weather events.

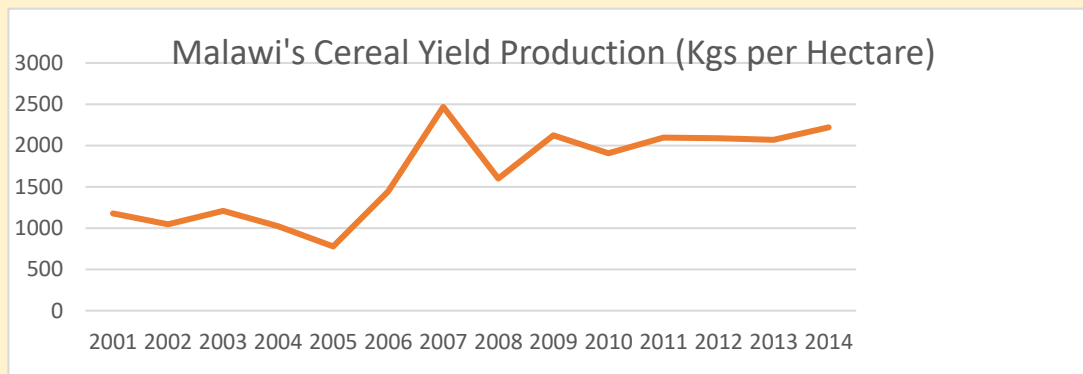
- 68. Agricultural extension services are critical for the sector since they are the means through which modern practises and technologies based on recent agricultural researches are communicated and demonstrated to farmers.** However, these services, which the government used to offer free of charge in the past, has broken down over the years while the alternatives currently being provided by the private sector are limited and sometimes too expensive for the smallholder farmers. Food Agricultural Organizations (FAO) estimates the current ratio of extension officers to farmers in Kenya to be 1:5,000 against the proposed ratio of 1:500. Despite it being a county function according to Schedule 4 of the Constitution, the national government also has a responsibility of ensuring the quality and availability of these services through development of relevant policies and provision of necessary support through conditional grants to county governments.
- 69. Despite the government implementing a programme to improve farmers' access to agricultural inputs, Inefficiencies in the supply chain systems has hampered their availability, quality, quantity and timeliness.** The transition from the seed and fertilizer subsidy program to the E-voucher system was anticipated to improve the supply chain ineffectiveness but the much anticipated results are yet to be achieved 3 years of its launch. It is noted that the operationalization of the e-voucher system has been hampered by low budget allocation. with funding for the FY2019/2020 and FY2020/2021 being reduced through supplementary budgets. In FY 2019/2020, no outputs were achieved while in the FY 2020/2021, the programme was only able to cover 18,000 beneficiaries in 12 counties against a target of 300,000 beneficiaries in 38 counties. The current annual allocation for the FY 2021/2022 and the medium term amounts to Kshs. 1.5 billion with a target of 200,000 small scale farmers in 37 counties. With an estimate of 600,000 small scale farmers in Kenya, this allocation can only meet a third of the total number of farmers in the countries thus the funding should be enhanced. A good example of the success of the provision of subsidy inputs is the Malawian Farm Input Subsidy Program (FISP) which led to a three-fold increase in maize production within the first two years of inception (see the box below).
- 70. The country has experienced an increase in extreme weather events, with severe flooding and droughts being witnessed annually over the past two decades leading to frequent crop failure, livestock death and loss of fish stocks.** The National Climate Change Response Strategy recommends a number of climate smart interventions to help farmers adapt to climate change. One of the adaptation measures is the investment in irrigation and water storage. The National Water Master Plan (NWMP) recognizes that Kenya has not fully developed its irrigation potential estimated at 1.34 million hectares, with less than 20 percent of the potential currently having been equipped with irrigation and water storage infrastructure. To achieve its full potential, the government investment in irrigation and water storage infrastructure should be reoriented from focusing on large-scale to small-scale farming.

The deterioration in the food security situation in the country is attributable to dismal performance of the long rains season and poor performance of the previous short rains season. The NDMA<sup>15</sup> projects the situation to worsen further and affect 2.4 million people during the October-December 2021 short rains season forecasted to be below normal in 23 counties including Baringo, Wajir, Marsabit, Mandera, Makueni among others.

### The Case of Malawi Farm Input Subsidy Program (FISP)

In 2005/06, the Malawian government introduced the Farm Input Subsidy Program (FISP) and since then there has been a notable stability and improvement in agricultural productivity and policy direction. The main objective of the programme is to achieve food security through increasing agricultural production and yields. FISP's key focus has been the provision of subsidized fertilizer and higher-yielding modern maize seed varieties, which are often prohibitively expensive to smallholders. Other program components have included the provision or subsidization of "tobacco" fertilizer, legume seed, and other chemicals.

The program has since been lauded particularly for its success in raising maize yields and bringing about food security in Malawi, with official crop statistics claiming a three-fold increase in maize production within the first two years of inception. The impact was much improved economic growth, with agricultural and national GDP purportedly expanding by more than seven percent per annum in real terms during 2004–2010. The impact on cereal productivity can be seen in the following chart. As a result of the introduction of the FISP in 2005/06, there was an increase in cereal productivity from 777.8 Kgs in 2005 to 2,467 Kgs per hectare in 2007<sup>16</sup>.



### Policy Options

71. Policy options to reorient the agriculture sector:

- (i) **Improving access to agricultural extension services** - Provision of adequate funds maybe in form of conditional grants to counties for agricultural extension services. This will ensure employment and training of extension officers with an aim of improving the ratio to 1 extension

<sup>15</sup> National Monthly Drought Bulletin, September 2021

<sup>16</sup> Impacts of Malawi's farm input subsidy programme- FAO

officer for every 500 farmers across the country. The National government should also prepare an agriculture extension services policy to guide the provision of these services.

- (ii) **Improving farmers access to agricultural inputs** - Provision of funds in form of conditional grants to the 38 Counties for provision of relevant subsidized inputs to targeted small-scale farmers. Small-scale needy farmers will be registered through an appropriate mechanism by Counties.
- (iii) **Increase investment in small-scale irrigation and water storage** – Provision of funds as well as increased efficiency and accountability in the construction of small dams for water storage and small-scale irrigation projects across various parts of the country. Priority should be given to flood prone and drought stricken region which have high but unexploited potential for agricultural productivity.
- (iv) **Operationalize the National Drought Management Fund and ensure the county drought management committees are working.**

### 2.1.2. Supporting Kenya's foreign policy on trade and investments

**72. The main pillar of Kenya's Foreign Policy in the recent past has been the economic and diaspora pillars which are also linked to the peace, environment and culture pillar.** The economic diplomacy pillar aims to achieve robust economic engagement in order to secure Kenya's socio-economic development and prosperity in line with vision 2030. The pillar is also closely linked to the diaspora pillar which aims to harness the diverse skills, expertise and the potential of Kenya's diaspora by facilitating their integration into the national development agenda.

**73. To achieve the foreign policy objectives, Kenya missions abroad have mainly been driven by political and economic considerations.** To this end, missions abroad are either bilateral missions which handle relations between Kenya and its partners or multilateral missions which handle issues of intergovernmental bodies such UN, WTO, AU among others. An overview of Kenya's missions abroad shows that the country has a total of 61 missions including consulates and liaison offices which are spread across the five continents.

**74. Despite the expansion of Kenya's footprint across the globe, the destination of Kenya's exports has remained narrow with only twelve countries<sup>17</sup> accounting for 70 percent of total exports in 2020.** The African continent accounts for 38 percent of these exports, which are further mainly domiciled within the East African Community (accounts for 65 percent of the total exports to the continent). The

<sup>17</sup> The twelve countries constituting 70% of Kenya's global exports include in 2020 include Uganda, Pakistan, United Kingdom, USA, Netherlands, UAE, Tanzania, Rwanda, South Sudan, Egypt, China and Germany

problem has also been exacerbated by narrow product base with only ten categories of products accounting for 67 percent of the total exports<sup>18</sup>.

**75. For Kenya to improve on its exports volumes, opportunities lie in untapped markets where preferential market access already exists.** They include Africa region where AFCFTA started trading in January 2021, the United States of America under the AGOA scheme, and the United Kingdom under the Kenya-UK EPA. Further they will be a need for Kenya to diversify its product base through value addition in Agriculture, manufacturing and the blue economy. There is also unexplored potential in trade in services including Health, Professional services and tourism among others.

**Table 6: Destination of Kenya Exports (Million Dollars)**

	2017	2018	2019	2020
World	5,747	6,050	5,836	6,027
Africa	2,164	2,132	2,186	2,287
<i>o/w East Africa</i>	1,111	1,145	1,249	1,261
<i>o/w South Africa</i>	599	617	643	582
<i>o/w West Africa</i>	37	42	48	63
<i>o/w North Africa</i>	190	199	186	178
Asia	1,630	1,842	1,579	1,544
EU(28)	1,218	1,297	1,308	1,403
America	529	551	549	491

Source: International Trade Centre

### **Policy Options**

**76.** Policy options to support Kenya's foreign policy on trade and investments:

- (i) **Restructuring the foreign service** – In view of limited resources for expansion of missions abroad and to harness trade and investment based on current Kenya's foreign policy, there will need to do a review and evaluation of these missions to ensure maximum benefits are reaped. Honorary Consuls offers an efficient diplomatic channel of increasing a country's diplomatic network as they are cost effective than fully fledged missions because of the lower costs attached to maintain a Honorary Consuls as they serve for free and only require reimbursed of expenses incurred in offering their services. Further, their knowledge of local conditions and personalities provide them with an invaluable ability to leverage local and regional networks.

<sup>18</sup> The top products are (i)Tea, Coffee, mate and spices(ii) Live trees and other plants, bulbs, roots and cut flowers (iii)Mineral fuels and mineral oils (iv)Edible vegetables and nuts, peel of citrus fruits (v)ores, slag and ash (vi) articles of apparel and clothing accessories (vii) animal or vegetable fats and oils (viii)Tobacco and manufactured tobacco substitutes (ix) Preparations of vegetable fruits, nuts (x) Pharmaceutical products

The data are all obtained from ITC, [https://www.trademap.org/Country\\_SelProductCountry\\_TS.aspx?nvpm](https://www.trademap.org/Country_SelProductCountry_TS.aspx?nvpm)

### 2.1.3. Addressing Challenges in Land Transfers to encourage investment

- 77. One of the most significant milestones of land reforms in the country has been the operationalization of the National Land Information Management System (Ardhisasa), which is an advanced records management system that will guarantee efficient service delivery in the lands sub-sector.** Ardhisasa is a one stop shop for all Government services and information on land matters, currently covering land and properties registered under the Nairobi Land Registry. It is expected that it will speed up land transactions as well as enable online transactions. The platform has reduced the time taken to do a single land transaction from an average of six months to two days. It has also led to an increase in revenue collection through the capture of more properties in the system; expansion of the tax base through integration of the digital records with data relating to registration of businesses; and addressing tax evasion. To ensure accountability and credibility, the system integrates professional players in the land sector such as advocates and registered valuers thereby ensuring integrity of Information in the platform.
- 78. Despite its successful rollout in Nairobi County, the project is unlikely to meet its target of digitizing all land records in the country by the end of 2022.** The slow pace in implementation of the project has been occasioned by the challenges related to identification and illegal occupation of both private and public land parcels registered in the Nairobi Land registries where the project has so far been undertaken. Another factor impacting the rollout of the project has been the delay in the construction of Land registries aimed at decentralizing land administration services and processes. The project that began in July 2014 had an expected completion date of June 2022 but it is way behind schedule. As of June 2021, the project had only achieved 18% completion rate. Land registries are a significant part of the land transfer transaction process especially for areas where registries have not been digitized since one can only conduct a search of title and pay for Land rent in the Land registry where it was registered.
- 79. With respect to public land, there is need to conduct a final survey and vesting in readiness for digitization.** Final survey is a last stage in the acquisition process and is done within six months, before payment of compensation. This occurs when only a portion of land belonging to either an individual or entity is earmarked for compulsory acquisition. Vesting in relation to compulsorily acquired land occurs when the rights and interests arising from legal ownership of a property is acquired by the requisite Ministry or state department that intends to utilize the Land, therefore creating immediate secured right of present and future deployment. This will ensure protection of public land from illegal occupation and reallocation to private individuals.

#### **Policy Option**

- i) **Funding of final survey and vesting** – Provision of funds for final survey and vesting programmes. This will go towards final survey and vesting programme for compulsorily acquired



public land and the mapping of public land in all counties as well as development of a Public Lands information depository by June 2023.

- ii) **Ensure rollout of *Arghisasa* digital registries to all counties.**

#### 2.1.4. Supporting Suitable Forest Management

- 80. Sustainable forest management involves achieving significant reduction in deforestation rates, while enhancing agricultural productivity, biodiversity conservation, and sustainable management of natural resources and income of small-scale food and forest producers.** It also incorporates improved cross sectoral collaboration in the fields of forestry, wildlife, agriculture, livestock, water, energy, tourism, and also addresses issues related to the human-wildlife-livestock-ecosystem interface and sustainable value chain development.
- 81. Deforestation and forest degradation remain a challenge since independence, causing large amounts of greenhouse gas emissions.** Currently, Kenya is among countries of the world with a forest cover of less than 10 percent of total land mass. Factors which have contributed to massive deforestation in Kenya include: changes in land tenure; breakdown of traditional governance; decentralization and rapid privatization of rangelands resulting in overstocking; forest encroachment; poaching; conflicts and loss of wildlife habitat; extensive agricultural expansion; and Kenya's rural population being concentrated in what are termed 'high' and 'medium-potential' agro-ecological zones in which rainfall levels are adequate to support agriculture. These are also the places in which closed canopy forests, and the five water towers are located.
- 82.** The application of good forest policies often leads to the protection of ecosystem functions, thereby maintaining a sustainable forest ecosystem. Neighboring communities can be incorporated in sustainable forest management e.g. the Ogiek who live in different parts within Mount Elgon and the Mau forest ecosystem.

#### ***Budget and Policy Options***

- (i) **Continued rehabilitation of Water Towers** – Provide funds for rehabilitation of Kenya's five major forest Water Towers which have deteriorated over the last few decades.
- (ii) **Develop a Policy on Sustainable Forest Management that will Include Neighbouring Communities** - The country can revise and modify forests laws, codes and institutions to enhance progress towards sustainable forest management. Measures can be put in place to protect forests, halve deforestation, and expand the forest area legally protected with a view to preserving biodiversity, native forests, and forest ecosystem functions. Further, establish an

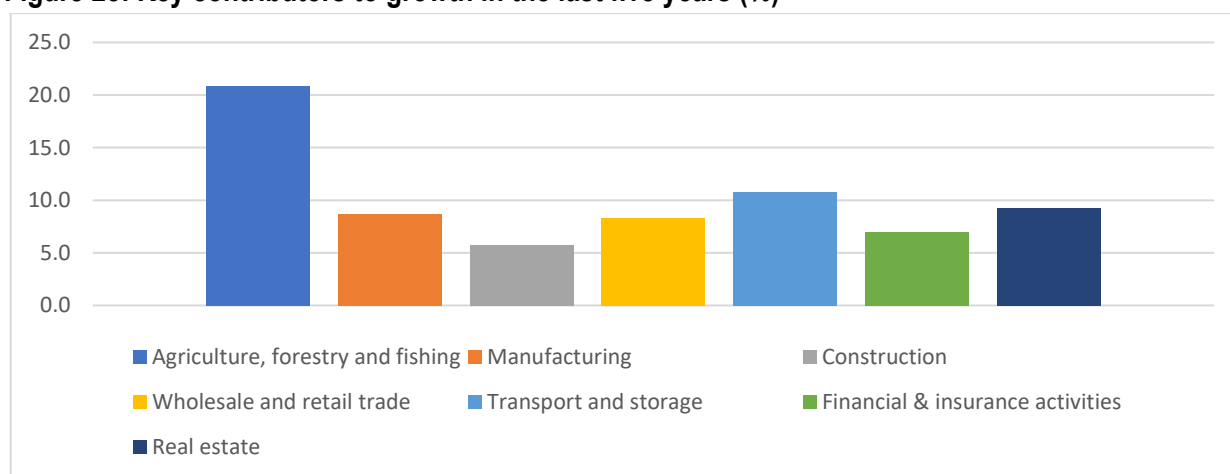
enabling legislative and institutional framework for development of the forest sector; and, support forestry research, education, training, information.

### 2.1.5. Linking Education to the Labour Market needs

**83. High quality education is a pre-requisite for accelerated economic development as it enables full participation in productive activities in the economy.** Quality education ensures that the skills which are released in the economy are well targeted and resonate well with the labour market demands. It is expected that through provision of quality education especially at the technical and higher level - where most graduates are released into the market, the key sectors that drive economic growth will continue to benefit through supply of requisite skills.

**84. Learning should be aligned with labour market needs and should especially be geared towards access to the key industries which have consistently supported economic growth.** This includes emerging growth areas as well as industries which have been absorbing a significant number of job seekers. The key industries that have consistently contributed to economic growth in the last five years as well as the key industries that have absorbed the highest number of workers (has a huge number of wage employment) are key parameters which may give an indication on the areas which require to be given attention and priority in higher education to ensure the right skills are released in the economy. The contribution to GDP has largely been supported by seven key industries spread across the three sectors of the economy in the last five years. These industries account for 70% of the Nominal Domestic Gross Product (NGDP). Among the top industries which contribute to growth in the last five years is Agriculture and allied industries (20.8%), Transport (10.8%) and Real Estate (9.3%). The figure below indicates the key contributors to economic growth in the last five years per industry.

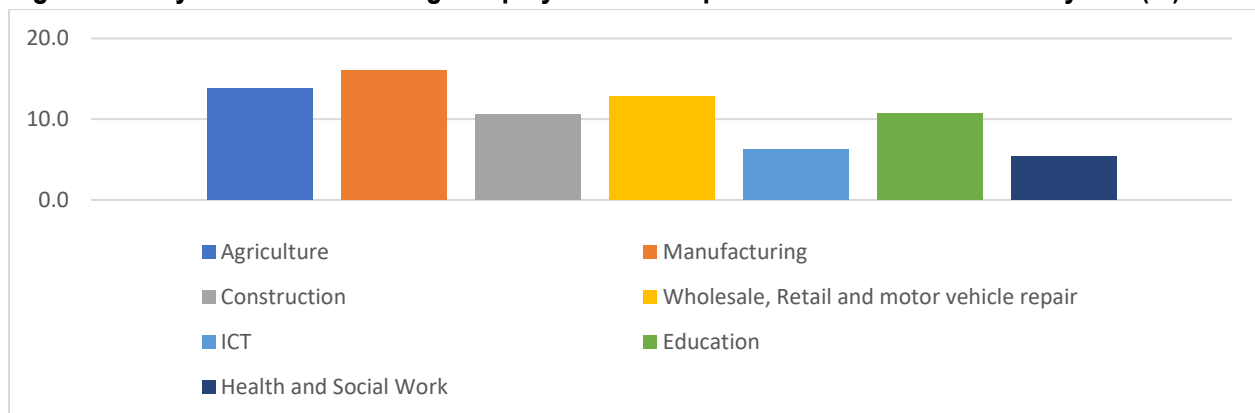
**Figure 28: Key contributors to growth in the last five years (%)**



Source: Kenya National Bureau of Statistics (KNBS), 2020

- 85. As indicated in chapter one, the service sector industries account for the largest component of economic growth, followed by the primary sector (mainly agriculture) and secondary sector (largely manufacturing).** The service sector is supported by a mix of skills - technical, science and arts. It is also a sector where the set skills support both informal and formal sectors. As such, in terms of contribution to wage employment in the country, the industries which are service oriented have a significant share (see fig 30) of wage employment.
- 86. In terms of wage employment in the economy, the private sector accounted for 70% of the total wage employment in the country whereas the public sector accounted for 30% in the last five years.** As such, the private sector is the main driver of wage employment in the country and absorbs a majority of persons in the labour market. Figure 30 indicates the key industries that account for 76% of the total wage employment in the private sector.

**Figure 29: Key contributors to wage employment in the private sector in the last five years (%)**

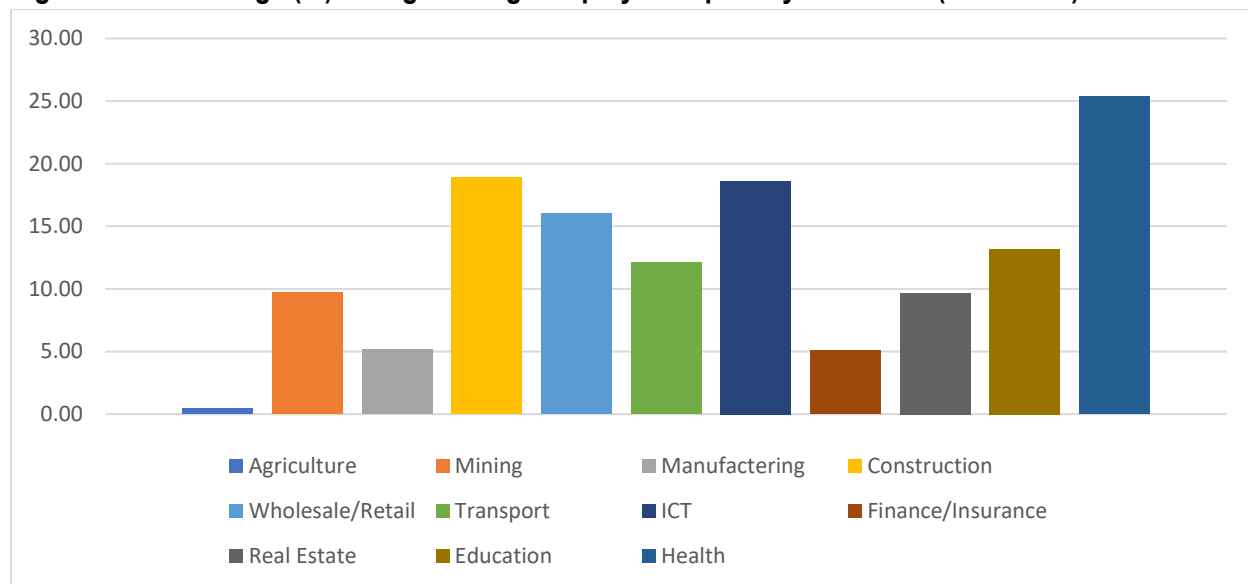


Source: Kenya National Bureau of Statistics (KNBS), 2020

- 87. The contribution to wage employment in the last five years cuts across the three sectors with the service sector having comparatively a larger share.** The observed distribution of the share of wage employment per industry is an indication that the existing labour market requires a blended set of skills in areas such as agriculture, manufacturing, ICT, construction, retail, health and education amongst others for economic growth.
- 88. A look at the change in contribution to wage employment, agriculture and manufacturing absorbed the least number of workers between 2015 and 2020 at 0.5% and 5.2% respectively.** This is despite the contribution of these two industries to growth during the same period. This is an indication that despite agriculture being a key pillar of the economy, most of the labour is largely in the informal sector. Thus, there is the need to re-orient agriculture productivity through modernization and this can be done through supporting agricultural related technical courses. There is also need to invest in training related to manufacturing to upscale the contribution of manufacturing in the country. On the other hand, the construction, Transport and ICT industries have shown potential in terms of contribution to growth as well as creation of employment. Between 2015 and 2020, the percentage change in terms of contribution to

wage employment by construction, Transport and ICT was way above the average at 19%, 12% and 18% respectively. These are areas which require focus since they have the affinity to create employment; both formal and informal.

**Figure 30: Percentage (%) change in wage employment per key industries (2015-2020)**



Source: Kenya National Bureau of Statistics (KNBS), 2020

**89. Despite the potential for further growth and employment creation from Agriculture, Manufacturing, Construction, ICT and Transport sectors; the participation of learners in the Science, Technology, Engineering and Mathematics (STEM) has been comparatively low to those in the arts disciplines.** Additionally, more often than not, the STEM trainees lack the right skills to join the labour market due to quality concerns. Thus, the support to STEM is two pronged - expansion of access to STEM to learners as well as ensuring quality of learning. One way of offering relevant training that responds to the market demands is a focus by the government on improving STEM training infrastructure in technical institutions as well as institutions of higher learning in the STEM domain. This may require re-programming of financing in education and learning to ensure that the institutions in STEM are supported through expansion of infrastructure such as laboratories as well as modern equipment to enable acquisition of right technical skills.

**2.1.6. Access to Quality Healthcare for Socio-economic Development: Leave No One Behind**

90. Provision of quality healthcare is important in order to sustainably drive the development agenda. The third (3<sup>rd</sup>) Sustainable Development Goal envisages a healthy life for all where the goal is the attainment of universal health coverage by the year 2030. At the national level, various health policy documents speak to the importance of a quality healthcare system.
91. In 2018, the national government identified health as one of the key priority areas to focus on in the next five years under the big four agenda. The goal is to ensure that all persons are able to access quality healthcare without incurring high out of pocket health expenditure. The adverse effects of the COVID 19 pandemic have further reinforced the need for a robust healthcare system and affordable healthcare.
92. In order to achieve the goal of leaving no one behind in access to quality health care, the government unveiled the UHC flagship programme where the government settled on the output financing through provision of social insurance. Under the social insurance, the government targets to cater for the health needs of an estimated 5 Million indigent households as well as ensure the other segment of the population access health care at a cost. It is estimated that Kshs 30 Billion is required annually to ensure that all indigents in the country are placed under the insurance cover.
93. However, as much as the output financing under the social insurance is important, there is need to also support the input financing aspect to ensure all the aspects of UHC are adequately addressed. Input financing entails ensuring that there are enough health facilities and health commodities to ensure that patients are able to access affordable and quality health care. There is evidence to indicate that the public health facilities may not be able to support UHC due to lack of investment in input financing.
94. First, it is estimated that 75% of the health facilities accredited by National Hospital Insurance Fund (NHIF) are public health facilities whereas 21% are private health facilities. However, rebates pay outs to private health facilities are comparatively high. This is attributed to consistency in healthcare service offered by private health facilities as well as investments made on health commodities which attracts health service seekers unlike public facilities.
95. Second, a patient's average distance to a health facility is about 9.5km against a recommended 5km radius. Furthermore, when it comes to access to specialized healthcare, the distribution of national referral hospitals is skewed. Health facilities are thinly spread across the country hence affecting healthcare delivery. Table 8 below shows counties with the lowest number of health facilities per 10,000 population.

**Table 7: Counties with the lowest number of health facilities per 10,000 population**

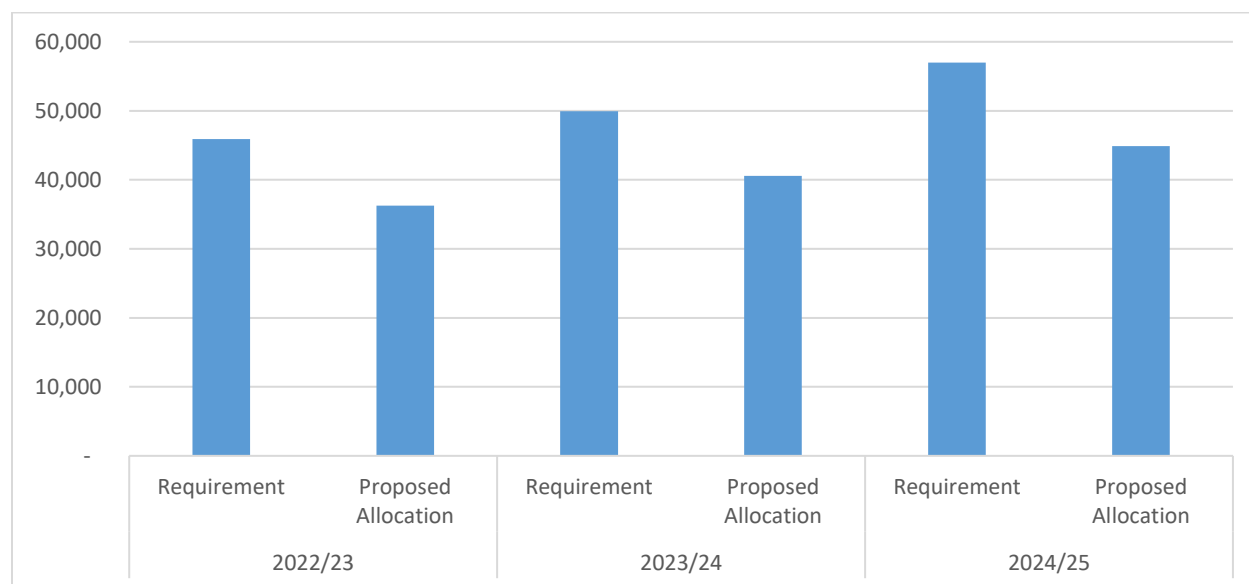
Counties	Total number of facilities/ 10,000 population	Number of inpatient beds/ 10,000 population
Bomet	1.5	8.8
Bungoma	1.3	10.9
Busia	1.6	14.3
Kakamega	1.5	11.2
Kisii	1.3	16.3
Kwale	1.7	5.3
Mandera	1	7.2
Nairobi	1.6	15.4
Nandi	1.9	7.8
Narok	1.5	9.6
Trans nzoia	1.5	7
Uasin gishu	1.7	15.9
Vihiga	1.5	12.5
Wajir	1.5	5.3

**Source: Kenya Harmonized Health Facility Assessment (KHFA 2019), Economic Survey 2020**

96. Third the average national core health workforce stands at 15.6/10,000 population. In county perspective, only 6 counties (12%) have surpassed the global target of 23/10,000 population. This means the human health resource is also a critical element to be considered in input financing. Annex 2 gives the number of core health workers per 10,000 population per county.
97. There is need to invest in public health facilities in the country to make them functional and effective in order to be attractive to health service seekers. This can only be done by ensuring that public health facilities are near the users and also ensure that HPT's including human health resource are available. As the country moves towards making the universal health coverage a reality, each level of government should focus on expanding access to health through investing in public health facilities in terms of expansion to cover more people as well as ensuring that health commodities are made available.
98. At the National level, strengthening the referral system is a critical aspect to focus on in terms of expanding access to specialized healthcare. The referral system in the country is faced with systemic problems such as inadequate health and hospitality facilities, shortage of health workers as well as erratic industrial disputes which deny these facilities to be centres of excellence in healthcare.
99. Some of the challenges faced by these higher level health facilities are related to inadequate funding. It is the responsibility of the National government to ensure that the challenges are addressed since the

tertiary health facilities are under the National Government. Over the last five years, funding towards referral hospitals has remained stagnant despite the cost of specialized health care changing rapidly. Further, the medium term prospects in terms of funding to national referral hospitals remains bleak given the foreseen funding gaps as indicated below.

**Figure 31: Funding gap in National referral facilities**



**Source: Ministry of Health**

**100.** In 2022/23 and over the medium term, the national referral facilities have an estimated resource gap of Kshs 32 Billion which means that over the next three years, the national government will support the national health facilities at 75% level. This sends a business as usual signal in terms of the support to our referral system and implies that the systemic problems facing the national health facilities will take no longer to be addressed. The goal of ensuring that the referral hospitals remain centres of excellence in provision of quality health care will therefore remain a mirage.

**101.** The following are the budget options to support public health facilities in order to expand access to quality healthcare and support the UHC:

- i. The funding to the five National referral hospitals be increased to support the critical areas of operations especially in the management of health workers as well as support acquisition of health commodities.;
- ii. The National government to consider coming up with a health support package for counties to establish level 3 health facilities especially in the counties with a low number of health facilities in the country. It is estimated that a well-functioning level 3 health facility can cost around Kshs 70 Million.

- iii. Enhance the NHIF cover to the vulnerable including older persons, persons with disability, orphans and poor households.

### **2.1.7. Supporting Micro, Small and Medium Enterprises: From Incubation to Market Access**

102. Kenya is primarily an agriculture based economy. Most of the agriculture products are traded in the domestic and external market as either raw materials to be used for manufacturing purposes or for direct consumption. The Micro, Small and Medium Enterprises (MSMEs) contribute approximately 40% of the GDP with the majority being categorized as informal. According to the KNBS there are about 7.41 Million MSMEs in Kenya of which only 1.46 Million are licensed whereas 5.85 Million are unlicensed. This has been accessioned by a number of bottlenecks in licensing and supporting MSMEs. There is need therefore to undertake practical steps towards formalization of the informally operating MSMEs, to build their capacity and promote them into sustainable business enterprises.
103. Over the years the National Government has invested heavily on supporting the growth of MSMEs to enable them sell their products both locally and in the external markets. However, MSMEs continue to face challenges from the production stage to availing their final products to the consumer markets. The challenges that MSMEs face in Kenya are caused by a lack of synchrony in the channels put in place to help them access the market.
104. There is need to create a multiagency task force to synchronize government efforts that promote the MSMEs through the various stages of the business cycle. The multi-agency team will monitor and report the progress made by each institution towards progressing beneficiaries to the next stage of incubation.
105. Through the proposed multi agency coordination team, the relevant institutions will be tasked to undertake specific interventions based on the nature of the business and requisite needs assessment to support eligible beneficiaries to the last stage.



## Chapter Three:

# Making Fiscal Decentralization Work ~Options for the FY 2022/2023 and the Medium Term

## 1.1. Fiscal Decentralization Legislations, Gaps and Options

### (a) Legislation Gaps & Limitations

106. The anchor for fiscal decentralization in Kenya is the Constitution. To this end, Article 190 (1) requires Parliament to ensure, via legislation, that county governments have adequate support to enable them to perform their functions. **Some of the enacted laws on fiscal decentralization include Urban Areas and Cities Act 2011, County Governments Act, 2012, Intergovernmental Relations Act, 2012, Public Finance Management (PFM) Act, 2012, Transition to Devolved Government Act, 2013, Basic Education Act, 2013, National Government Co-ordination Act 2013, County Assemblies Service Act, 2017, County Assemblies Powers and Privileges Act, No. 6 of 2017, and Public Appointments (County Assemblies Approval) Act, No. 5 of 2017.**
107. Table 9 provides a summary matrix of legislative gaps & inadequacies with possible implications for counties.

Table 8: summary of gaps and limitations in the devolution laws		
Laws	Gaps & Limitations	Possible Implications
a) Public Finance Management Act, 2012	Section 131 of the PFM Act, 2012 and Regulation 37 (1) of the PFM (National Government) Regulations, 2015 limits the County Assembly changes to not more than one (1) percent a Vote ceiling in the County Annual budget estimates.	<ul style="list-style-type: none"> <li>These provisions essentially make the County Assemblies "rubber-stamping" rather than budget approvals and appropriating bodies as contemplated in the Constitution.</li> </ul>
b) Urban Areas and Cities Act 2011	The Act provides for two-step approvals for conferment of municipality status while conferment of towns and markets status is at the discretion of the Governor.	<ul style="list-style-type: none"> <li>The discretion of the Governor to confer a town status to a market or create new markets undermines the role of the County Assemblies as the oversight organ.</li> </ul>
c) County Government Act, 2012	Section 104 (2) of the Act provides that county planning framework shall integrate economic, physical, social, environmental, and spatial planning. The Act fails to provide an in-depth framework for the different plans.	<ul style="list-style-type: none"> <li>Lack of a clear coordinated approach &amp; institutional framework for planning at the County. Further, the laws create conflict and inconsistencies between economic and physical planning</li> </ul>
d) Basic Education Act, 2013	The representation of the Counties at the Board is limited to one person. Further, the technical and vocational education and training system in the Act claws back the role of provision of vocational training.	<ul style="list-style-type: none"> <li>Limits the role of the county in promoting vocational training. Further, the national government either took over existing village polytechnics or offer similar vocational training</li> </ul>
e) Transition to Devolved Government Act, 2013	The object of the Act is to implement the transitional provisions and to facilitate the transfer of functions to the Counties. However, there still exists no comprehensive framework for the analysis and clarification of national and county government functions.	<ul style="list-style-type: none"> <li>Ministries, Departments, &amp; Agencies (MDAs) including some State Corporations still plan, budget, and implement for the devolved functions</li> </ul>

Source: The PBO, 2021

### Policy options

108. The following are possible policy options:

- i. *Amend Section 131 of the PFM Act, 2012 and Regulation 37 (1) of the PFM (National Government) Regulations, 2015 to empower the County Assemblies to undertake the budget-making & oversight function to enhance county public expenditure & financial accountability. The 1 percent power to amend the budget for any ensuing year limits the legislature considerably.*

- ii. *Amend Section 9, 10, and 10A of the Urban Areas and Cities Act 2011 to entrench the role of County Assemblies in the conferment of town and the market status and provide fiscal sustainability as a criterion;*
- iii. *Review of the County Government Act, 2012 and the National Government Co-ordination Act 2013 to provide for one centre of administrative power for coordination functions of both the national and county government functions to reduce red-tape associated expenditures; and*
- iv. *Formulation of policies that should be reviewed regularly to realign them to emerging situations including governance and accountability.*

**(b) Pending Legislations**

- 109.** Article 204 of the Constitution provides for the establishment of an Equalization Fund with the object of providing basic services such as water, roads, health facilities, and electricity to marginalized areas. The total allocation to the Fund as of FY 2019/20 stood at Kshs.12.4 billion against the Constitutional entitlement to the Fund of Kshs.34.6 billion; resulting in a shortfall in the allocation of Kshs.22.2 billion. As of 31<sup>st</sup> May 2021, the National Treasury disbursed a total of Ksh.10.35 billion to the MDAs implementing identified projects in the 14 marginalized counties.
- 110.** The operationalization of the Fund has faced numerous pitfalls due to legislative & administrative gaps. On the 5<sup>th</sup> of November 2019, the High court ruled on the petition no. 272 of 2016 filed by the Council of Governors that invalidated the National Treasury guidelines on the administration of the Equalization Fund. Following the court ruling, the Cabinet Secretary for the National Treasury drafted and submitted to Parliament the PFM (Equalization Fund Administration) Regulations, 2021 which were approved by Parliament. The various bodies including the National Assembly and the Senate are in the process of nominating their representatives to the Equalization Fund Advisory Board.
- 111.** There still exists legal & administrative gaps in the approved PFM (Equalization Fund Administration) Regulations, 2021. The Regulation provides for the County Technical Committee with representation from the national and county government (both County Executive & County Assembly). There is no specification of the number and selection of representatives of the implementing sectors that are presumably relevant national government MDAs.
- 112.** The following are some other legislative gaps and possible options to address budgeting and oversight for transferred functions & funds and boost OSR collection:
- i. *Lack of legislative framework on the transfer of functions and powers between the two levels of government as contemplated in Article 187 of the Constitution. There is need for Parliament to enact a law to guide transfers of functions, budgeting, and financial accountability oversight of funds for transferred the functions. This is to provide clarity and avoid legal pitfalls facing such transfers as the present case of the Nairobi Metropolitan Services (NMS).*

- ii. *To unlock counties revenue potential estimated at Kshs.173 billion (by a world bank study in 2018,, each County to enact a County (Taxes, Fees, and Charges) Act that provides for all the revenue streams charged by the county and specify the relevant tax rates, fees or charges in line with Article 209 (3) (c) of the Constitution.*

## 1.2. Linking Resource Allocation to Service Delivery

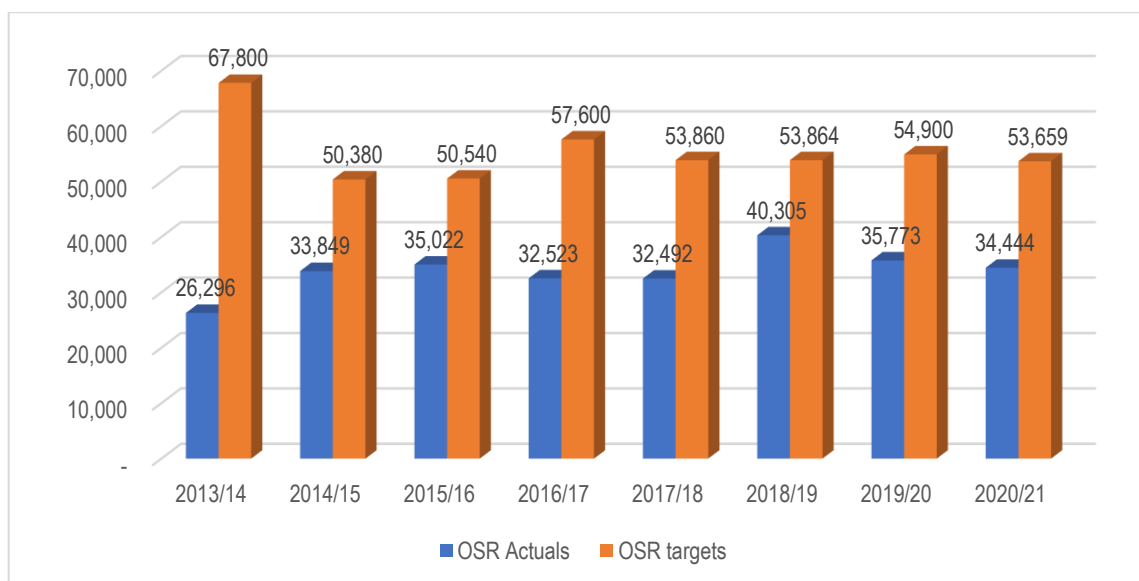
113. Improving the delivery of public services is a key objective in a decentralized regime. For Counties to improve on service delivery they would require more resources as well as improved management and accountability measures in line with Public Finance Management requirements. This includes ensuring timely equitable share disbursement as well as putting more emphasis on national government interventions in some devolved functions, notably in Agriculture and Health.

## 1.3. Enhancing county fiscal performance

### (a) Own Source Revenue (OSR) Collections by Counties

114. The total aggregate OSR collection by counties from FY 2013/14 to FY 2020/21 amounts to Kshs.270.7billion against a target of Kshs.442.6billion. It has risen sluggishly from Kshs.26.3billion in the FY 2013/2014 to Kshs.40.3billion in the FY 2018/19 (CRA, May 2021). There was a noticeable dip in the collection of OSR by counties in FY 2016/2017 where counties collected 32.52billion from Kshs.35.02billion in FY 2015/16. It dipped further to Kshs. 32.49billion in FY 2017/18 before rising to Kshs.40.3billion in the FY 2018/19.
115. In FY 2019/20 the OSR target was Kshs.54.9billion while the actual collection was Kshs.35.77billion representing 65.2 percent of the target. This was a decrease compared to Kshs.40.30billion generated in FY 2018/19. Further, in FY 2020/21 counties collected a total of Kshs.34.44billion representing 64.2 percent of the annual target of Kshs.53.66billion. This was a further decrease compared to Kshs.35.77billion generated in FY 2019/20. Figure 33 presents a comparison of OSR annual target against actual collection from FY 2013/14 to FY 2020/21.

Figure 32: Comparison of OSR annual targets and actual Collections from FY 2013/14 to FY 2020/21 in Kenya Shilings Millions



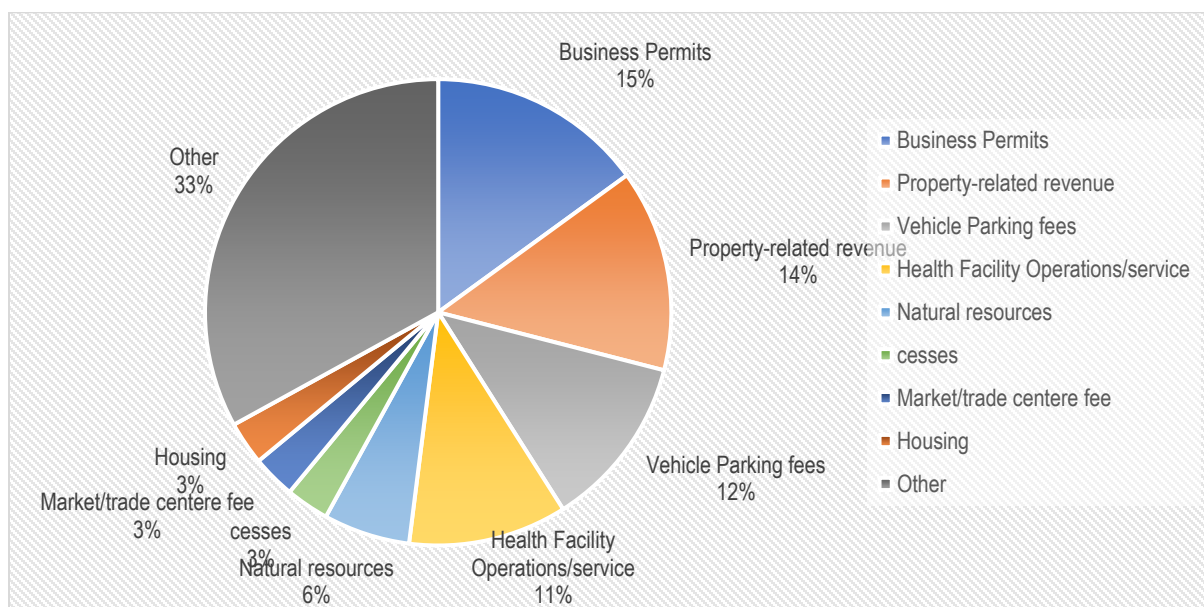
Data Source: Controller of Budget

116. Analysis of the actual collection OSR for the period FY 2013/14 to 2018/19 shows that **Embu, Bungoma, and Garissa tripled their OSR collection in the six years. However, Homa-Bay, Busia, Wajir, and Mandera OSR collection in the six years was worse than their revenue collection in the first year of fiscal decentralization (CRA, May 2021).**
117. The OSR annual collection is stagnant and declining in some counties. **The dwindling OSR annual collection by counties is attributable to policy & legal gaps, lack of information & poor reporting, low institutional capacity, and weak political commitment**

#### b) OSR Revenue Streams for Counties

118. Article 175 (b) of the Constitution requires Counties to have reliable sources of revenue to enable them to have consistent revenue for effective administration and services delivery. Counties have three primary revenue streams namely property-related revenues, business permits, and vehicle parking fees. Figure 34 provides a snapshot of OSR collection by categories in FY 2016/17. A significant share of OSR collection by counties is from business permits, property taxes, and Parking Fees.

Figure 33: County governments OSR collection by categories 2016/17



Source: PBO, 2021

119. The primary sources of OSR collection are business permits, property-related rates, vehicle parking fees, cess, and market fees. There exists inconsistencies in the classification of OSR streams in the annual actual collection data by counties. Counties frequently report their OSR collection using summary categories such as miscellaneous or other charges. **This aggregate reporting of OSR collection is attributable to the revenue-reporting template, with the revenue classification not reflecting all of the common main revenue sources across counties. Several counties lump OSR collected under others as shown in the sampled FY 2016/17 in figure 34.**

### c) Enhancing county fiscal performance

120. According to a study by World Bank in 2018 on Own Source Revenue potential and tax gap in Kenya County Government, the county revenue potential ranges between Kshs 55 billion and Kshs 173 billion compared to an average of Kshs 35 billion which is currently collected each year. Majority of the counties show gaps between 35% and 94% between actual and potential revenue collection. This means that counties can actually fund a higher share of local service delivery from OSR if the potential is realised.

### Policy options

#### 121. The following are possible options:

- i. Counties to harmonize their Single Business Permits (Trading Licenses) regime through simplification of guidelines. Further, by enacting specific legislation establishing a clear licensing framework. The option may gradually unlock trade license revenue of up to Kshs. 23.4billion from FY 2022/2023 and the medium term.

#### d) County Public Expenditure and Financial Accountability

122. Counties continue to face fiscal challenges including prudence in their management of public finances. Notably, high expenditure on salaries continues to be a challenge. Section 107(2) of the PFM Act, 2012 requires counties not to exceed 35 percent of their total revenues on compensation to employees. A review of compensation to employees in counties shows 27 counties not adhering to the fiscal principle in FY 2018/2019 as shown in table 10. The increasing wage bill in counties mainly contributed to high employment levels as county government employments increased from 146,300 in 2015 to 190,000 in 2019 (Economic Survey 2020).

**Table 9: County Expenditures On Compensation to Employees As A Share Of Total Revenue Revenues In FY 2018/2019 (Ksh. Millions)**

No.	Counties	Personnel Emolument	Total Revenue	Ratio
1	Kisii	4,608	9,489	48.6
2	Homa Bay	3,136	6,273	50.0
3	Embu	2,793	5,994	46.6
4	Tharaka-Nithi	2,116	4,781	44.3
5	Elgeyo Marakwet	2,093	4,253	49.2
6	Bungoma	4,421	10,766	41.0
7	Kirinyaga	2,508	4,937	50.8
8	Taita Taveta	2,085	4,848	43.0
9	Meru	4,235	9,934	42.6
10	Kitui	3,757	8,729	43.0
11	Nyamira	2,885	5,707	50.5
12	Murang'a	3,498	7,379	47.4
13	Makueni	3,240	7,826	41.4
14	Laikipia	2,616	5,380	48.6
15	Kisumu	3,439	8,920	38.5
16	Kiambu	7,423	16,223	46.0
17	Mombasa	5,186	12,920	40.0
18	Baringo	2,765	7,657	36.0
19	Garissa	3,869	8,038	48.1
20	Nyeri	3,362	8,540	39.4
21	West Pokot	2,049	5,523	37.0
22	Nakuru	5,631	14,456	38.9
23	Vihiga	1,965	5,267	37.3
24	Machakos	5,229	13,329	39.2
25	Uasin Gishu	3,027	7,992	37.9
26	Nandi	2,853	7,310	39.0
27	Bungoma	4,421	10,766	41.1
	<b>Total</b>	<b>95,210</b>	<b>223,237</b>	<b>42.6</b>

**Data Source: Auditor-General**

## ANNEX 1: COMPARATIVE ANALYSIS OF ACTUAL DEVELOPMENT SPENDING AGAINST TOTAL BUDGET PER COUNTY FOR THE FY 2018/19 TO 2020/21 IN KENYA SHILLINGS MILLIONS

County	FY 2018/19			FY 2019/20			FY 2020/21			3 Year Average Ratio Actual Dev Spend
	Actual Dev Spend	Total Budget	Actual Dev Spend % of Total Budget	Actual Dev Spend	Total Budget	Actual Dev Spend % of Total Budget	Actual Dev Spend	Total Budget	Actual Dev Spend % of Total Budget	
Marsabit	3,605	8,719	41.35	3,161	8,349	37.87	3,438	8,715	39.45	39.56
Mandera	5,750	13,710	41.94	5,015	13,118	38.23	4,432	13,211	33.55	37.91
Kakamega	4,984	14,489	34.40	4,924	15,407	31.96	4,612	16,074	28.70	31.68
Wajir	4,520	13,176	34.31	3,488	11,468	30.41	3,105	10,944	28.37	31.03
Trans Nzoia	2,395	8,043	29.78	2,195	7,974	27.52	2,748	8,396	32.73	30.01
Murang'a	2,503	8,851	28.28	2,804	8,823	31.78	2,541	8,885	28.60	29.55
Kitui	3,305	11,689	28.27	2,919	11,795	24.75	3,452	11,840	29.16	27.39
Kwale	2,610	11,518	22.66	3,505	13,246	26.46	3,670	12,261	29.93	26.35
Kilifi	3,567	14,482	24.63	3,671	15,035	24.42	4,103	14,661	27.99	25.68
Makueni	2,656	10,652	24.93	2,649	11,186	23.68	3,310	11,705	28.28	25.63
Mombasa	3,107	14,457	21.49	3,150	13,670	23.04	4,750	15,635	30.38	24.97
Vihiga	1,569	7,003	22.41	1,310	6,955	18.84	2,002	6,585	30.41	23.89
Kajiado	2,391	9,605	24.89	1,859	10,252	18.13	2,852	10,051	28.38	23.80
West Pokot	1,620	6,370	25.43	1,103	6,422	17.18	2,007	6,990	28.72	23.78
Nyandarua	1,582	7,670	20.63	1,894	7,984	23.72	2,045	7,816	26.16	23.50
Kiambu	4,495	16,914	26.58	4,411	17,862	24.70	3,297	17,878	18.44	23.24
Isiolo	998	5,484	18.20	1,923	5,733	33.55	1,029	5,762	17.87	23.20
T h a r a k a – Nithi	1,396	5,721	24.40	1,116	5,119	21.81	1,260	5,858	21.50	22.57
Bomet	2,062	8,134	25.35	1,707	7,513	22.73	1,494	7,620	19.60	22.56
E/Marakwet	1,333	5,601	23.80	1,107	5,774	19.17	1,449	5,952	24.35	22.44
Siaya	1,176	8,444	13.92	2,123	8,882	23.90	2,246	8,221	27.32	21.71
Taita/Taveta	1,302	5,987	21.74	806	5,665	14.22	1,777	6,115	29.06	21.67
Narok	3,008	10,195	29.51	2,924	11,998	24.37	1,163	11,666	9.97	21.28
Nyeri	1,884	8,837	21.32	1,646	8,975	18.34	2,176	9,098	23.92	21.19
Meru	2,641	12,556	21.04	2,171	11,244	19.30	2,626	11,784	22.28	20.88
Migori	1,815	8,801	20.62	1,663	9,727	17.09	2,190	9,157	23.92	20.54
Bungoma	2,345	12,765	18.37	2,654	13,836	19.18	3,361	14,003	24.00	20.52
Kericho	1,417	8,418	16.83	1,771	8,746	20.25	1,861	7,623	24.42	20.50
Busia	1,941	8,826	21.99	1,690	9,276	18.22	2,175	10,419	20.88	20.36
Uasin Gishu	1,635	9,958	16.42	2,675	11,568	23.13	2,564	12,012	21.35	20.30
Homa Bay	1,011	8,467	11.94	2,194	8,970	24.46	2,194	8,985	24.42	20.27
Nandi	1,733	8,427	20.56	1,305	8,720	14.97	1,923	7,612	25.26	20.26
Kirinyaga	1,139	5,911	19.26	1,149	6,132	18.74	1,458	6,796	21.45	19.82
Laikipia	1,786	6,928	25.78	1,025	7,173	14.28	1,450	7,499	19.34	19.80
Kisii	2,285	12,011	19.03	2,544	12,926	19.68	2,595	12,671	20.48	19.73
Garissa	2,375	10,722	22.15	2,015	10,868	18.54	1,821	10,177	17.90	19.53
Kisumu	2,676	11,876	22.53	2,380	12,216	19.48	1,931	12,780	15.11	19.04
Tana River	1,589	7,573	20.98	1,497	8,035	18.64	1,290	8,145	15.84	18.48
Machakos	3,098	14,965	20.70	1,958	13,330	14.69	2,589	13,489	19.20	18.20
Embu	1,361	6,827	19.94	1,086	6,780	16.01	1,282	7,107	18.04	18.00
Nyamira	1,121	6,959	16.10	1,203	7,002	17.18	1,398	6,800	20.56	17.95
Lamu	694	4,847	14.31	844	4,736	17.81	854	4,707	18.15	16.76



County	FY 2018/19			FY 2019/20			FY 2020/21			3 Year Average Ratio Actual Dev Spend
	Actual Dev Spend	Total Budget	Actual Dev Spend % of Total Budget	Actual Dev Spend	Total Budget	Actual Dev Spend % of Total Budget	Actual Dev Spend	Total Budget	Actual Dev Spend % of Total Budget	
<b>Nakuru</b>	1,478	18,479	<b>8.00</b>	4,110	21,951	<b>18.72</b>	4,883	20,971	<b>23.28</b>	16.67
<b>Turkana</b>	1,675	15,352	<b>10.91</b>	2,511	14,843	<b>16.92</b>	2,770	14,479	<b>19.13</b>	15.65
<b>Samburu</b>	745	5,861	<b>12.71</b>	947	6,969	<b>13.60</b>	1,374	6,791	<b>20.23</b>	15.51
<b>Baringo</b>	1,158	8,125	<b>14.26</b>	1,730	8,385	<b>20.63</b>	888	7,913	<b>11.22</b>	15.37
<b>Nairobi City</b>	5,900	33,068	<b>17.84</b>	1,980	36,981	<b>5.35</b>	5,629	37,882	<b>14.86</b>	12.69
<b>Total</b>	<b>107,436</b>	<b>483,473</b>	<b>22.22</b>	<b>104,515</b>	<b>499,619</b>	<b>20.92</b>	<b>116,068</b>	<b>501,736</b>	<b>23.13</b>	<b>22.09</b>

Source: PBO 2021

**Annex 2: County distribution of health care workers per 10,000 of population**

County	Core health workforce per 10,000 population
Baringo	10.6
Bomet	8.9
Bungoma	8.5
Busia	11.9
Elgeyo-marakwet	9.9
Embu	21.2
Garissa	10
Homa bay	14.2
Isiolo	22
Kajiado	24.6
Kakamega	9.9
Kericho	16.2
Kiambu	22.8
Kilifi	10
Kirinyaga	22.3
Kisii	13.6
Kisumu	22.6
Kitui	14.9
Kwale	8
Laikipia	16.5
Lamu	24.6
Machakos	18.2
Makueni	13.2
Mandera	5.2
Marsabit	13.5
Meru	18.6
Migori	11.3
Mombasa	19.2
Murang'a	9.3
Nairobi	26.3
Nakuru	19.3
Nandi	8.8
Narok	6.1
Nyamira	14.1
Nyandarua	11.6
Nyeri	31

County	Core health workforce per 10,000 population
Samburu	11.3
Siaya	13.7
Taita taveta	19.1
Tana river	7.2
Tharaka-nithi	33.8
Trans nzoia	7.5
Turkana	7.4
Uasin gishu	28.2
Vihiga	12.2
Wajir	6.1
West pokot	9.3
Total	15.6

Source: KHFA 2019, Economic Survey