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DEBT ANCHOR VS. ECONOMIC GROWTH: WALKING THE TIGHT ROPE

Budget Options for FY 2024/2025 and the Medium Term

FEBRUARY 2024 (EDITION NO. 15)

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Table of Contents

Acronyms and Abbreviations 5
Foreword 6
Acknowledgments 7
Summary of Budget Options for FY 2024/25 8
I. RECENT ECONOMIC DEVELOPMENTS 11
1.1. Sectoral Economic Growth 11
1.2. Monetary Sector Development 14
1.3. Fiscal Development 20
1.4. External Sector 24
II. MEDIUM-TERM ECONOMIC OUTLOOK AND RISKS 27
2.1. Economic Growth and Inflation 27
2.1.1. Baseline Scenario 27
2.1.2. Fiscal Consolidation Scenario 32
2.2. Fiscal Projections for FY 2024-2025 34
2.2.1. Baseline Scenario 34
2.2.2. Fiscal Consolidation Scenario 35
2.3. Sectoral Expenditure Outlook for FY 2024-2025 38
2.3.1. Baseline Scenario 38
2.3.2. Fiscal Consolidation Scenario 39
3. MANAGING THE PREVAILING ECONOMIC CHALLENGES 41
3.1. Options for fiscal consolidation at the national level 41
3.1.1. Expenditure Prioritization and Improvement of Efficiency 41
3.2. Options for fiscal consolidation at county level 52
3.2.1. Own Source Revenue – The Revenue streams 52
Addressing the overlap in mandates of National and County Governments 58

List of Figures

Figure 1: Sector contribution to overall economic growth (%) 11
Figure 2: Growth in employment growth (%) 14
Figure 3: Trend in Inflation (%) 15
Figure 4: Contribution to inflation (%) 15
Figure 5: Movement of US Fed Rate, ECB Rate, BoE Rate and CBR Rate 18
Figure 6: Movement of Key Interest Rates 19
Figure 7: Sectoral Distribution of Credit to the Private Sector 20
Figure 8: Growth in Ordinary revenue and its percentage share of GDP 21
Figure 9: Major revenue streams performance in the first half of FY 2023/24 in Ksh billions 22
Figure 10: Actual Expenditure and net lending as a percent of GDP 23
Figure 11: Annual Fiscal deficits and stock of debt as a share of GDP 23
Figure 12: Comparison of growth in the number of visitors arrival and growth in the travel account for the period 2019 – 2023 24
Figure 13: Share of total exports by broad category for the period 2021 to 2023 25
Figure 14: Share of total imports by broad category for the period 2021 to 2023 25
Figure 15: Months of import cover from July 2022 to September 2022 26
Figure 16: PMI Index trend (January - December 2023 28
Figure 17: Cumulative expenditures granted under Articles 223 2014/15–2022/23(Kshs. Billions) 45
Figure 18: Share of Cumulative Pending Bills against Ordinary Revenue 49
Figure 19: Analysis of Own Source Revenue Collection vs Target FY 2018/19 -FY 2022/23 53

List of Tables

Table 1: Sectoral Share of Real GDP (%) 12
Table 2: Contribution to Overall Inflation per category (%) 16
Table 3: Revenue outturn for FY 2018/19 to FY 2023/24 in Billions 21
Table 4:Scenario 1 - Baseline (No policy change) 27
Table 5: Scenario 2: Increase in private sector investment by 1% 34
Table 6: Fiscal Framework for Baseline and Road to the Debt Anchor Scenario for FY 2024/25 37
Table 7:Budget Summary in Kshs. Billion 38
Table 8: Sectoral Expenditure Ceilings for FY 2024/25 (Kshs. Millions) 40
Table 9: Summary of Project costs across Sectors in *Kshs.* Billions 42
Table 10: Domestic Expenditure Arrears (pending bills) and comparisons with GDP and Ordinary Revenue, Kshs. billions 47
Table 11: Breakdown and composition of Cumulative pending bills by levels of government , in Ksh millions 50
Table 12: Revenue Sources for Budget Financing in Counties (In Kshs Bn.) 53
Table 13: Top Ten revenue streams in counties in terms of amounts generated 54
Table 14: Potential vs actual receipts (FY 2022/23) 55
Table 15: OSR collections against set targets from FY 2018/19 to FY 2022/23. 56
Table 16: County government programmes being undertaken by the National Government 59
Table 17: Sampled counties and allocations to Education Bursaries and Scholarships (Kshs. Billions) 60

Acronyms and Abbreviations

AfCFTA	African Continental Free Trade Area
AR&UD	Agriculture Rural and Urban Development Sector
BETA	Bottom -up Economic Transformation Agenda
BROP	Budget Review and Outlook Paper
CBK	Central Bank of Kenya
CBR	Central Bank Rate
CFS	Consolidated Fund services
CG	County Government
COVID	Coronavirus Disease
CRA	Commission on Revenue Allocation
EAC	East African Community
ECB	European Central Bank
EI&ICT	Energy, Infrastructure and ICT sector
EPRA	Energy and Petroleum Regulatory Authority
EPW&NR	Environment Protection, Water and Natural Resources
FED	The Federal Reserve
FY	Financial Year
GDP	Gross Domestic Product
GECA	General Economic and Commercial affairs
GJLOS	Governance, Justice, Law and Order Sector
ICT	Information and Communication Technologies
IFMIS	Integrated Financial Management System
IMF	International Monetary Fund
KNBS	Kenya National Bureau of Statistics
KWh	Kilowatt hour
MDAs	Ministries, Departments and Agencies
MSMEs	Micro, Small and Medium Enterprises
MTP	Medium Term Plan
NG	National Government
OPEC	Organisation of Petroleum Exporting Countries
OSR	Own Source Revenue
PAYE	Pay As You Earn
PBO	Parliamentary Budget Office
PFM	Public Finance Management
PIM	Public Investment Management
UNWTO	United Nations World Tourism Organisation
US	United States
USD	US dollars
VAT	Value Added Tax

Foreword

A bleak global economic outlook has exposed the Kenyan economy to external shocks, from the surge in oil prices to the slowdown in debt markets and disruptions in global food chains due to escalating geopolitical tensions. The weight of financial constraints adds a layer of complexity to the risks faced by Kenya's economy.

While revenue receipts continue to increase, their performance relative to the gross domestic product (GDP) has consistently remained below the target, averaging 16.6 percent. In the first half of FY 2023/24, the revenue was underperformed by Kshs. 187.6 billion. This trend does not augur well for the country's debt position. Indeed, statistics as of June 2023 indicate that the debt-to-GDP ratio is estimated at 68.2 percent of GDP in 2023 in the present value terms. Additionally, the total debt service amounts to 58.80% of revenue. This leaves only 41.20% of tax revenue to propel government development programs. Moreover, a significant risk of debt distress persists, primarily arising from liquidity risks, while debt dynamics remain susceptible to fluctuations in exports, exchange rates, fiscal conditions, and natural disasters

In October 2023, the Parliament passed an amendment to the Public Finance Management (PFM) law, replacing the Kshs. A 10 trillion public debt numerical ceiling with a debt anchor set at 55 percent of GDP in present value terms. This goal should be achieved by 2029.

The 15th edition of the Budget Options focuses on the prevailing debt situation amidst other macroeconomic challenges, and proposes measures to actualize the debt anchor while ensuring sustainable and inclusive economic growth. As a priority for national development, it is imperative to decrease the debt service costs as a proportion of the budget. Simultaneously, Kenya should strive to enhance the value of money in its budgetary allocations. The proposed budget options outline measures from spending reviews aimed at bolstering efficiency, thus maximizing productivity for every shilling that is invested.

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Summary of Budget Options for FY 2024/25

This edition of the Budget Options addresses the pertinent issue of the country's high level of debt and proposes a road map to scale down the debt stock to the debt anchor of 55% of GDP in present-value terms by 2029. This includes measures to manage the fiscal deficit through targeted government spending and enhanced efficiency in public investment to maintain the fiscal deficit at a reasonable level. The proposed options are designed to foster fiscal responsibility, transparency, and efficiency, while supporting inclusive economic growth.

Area of Focus	Proposed Intervention
Medium-Term Economic Outlook	
Achieving private sector led Economic Growth	i. A transparent and comprehensive government plan on the depreciating shilling, as well as Eurobond repayment, will give clear signals and address uncertainty in the business environment. ii. Targeted investment across the exports value chain to improve the quality of goods and export competitiveness iii. Regulatory reforms to facilitate a favourable business environment and enhance market access iv. Targeted technical and financial support through the Financial Inclusion Fund to specific export-oriented firms Injecting liquidity into the private sector, through the payment of pending bills amounting to 5% of GDP or Kshs.794 billion, is anticipated to stimulate productivity within the private sector.
Actualizing the Debt Anchor	i. Target a 1.6 percent primary surplus. To achieve the desired primary surplus the fiscal deficit should not exceed 4 percent of GDP which is equivalent to Kshs. 721.8 billion in FY 2024-2025
	Expenditure prioritization and improvement of efficiency
Implementation of the Public Management Framework	i. Strengthen and operationalize the Public Investment Management (PIM) framework through legislative measures. ii. Regular reviews of the public investment portfolio and adjustment of priorities based on changing economic conditions and emerging needs. iii. Fostering transparency by disclosing information about public investment projects to the public. iv. Perform thorough risk assessments for each project to identify potential challenges and uncertainties.

Area of Focus	Proposed Intervention
Implementation of e- Procurement	i. Link e-Procurement with the Integrated Financial Management Information System (IFMIS). This will foster efficiency, transparency, and control across the procurement life cycle, ensuring a streamlined and accountable procurement process. ii. Public accessibility of the procurement portal for enhanced transparency. iii. Establish centralized e-procurement platforms that consolidate procurement activities across government agencies. iv. Introduce mobile-friendly solutions to enhance accessibility and responsiveness.
Review of Regulations for Article Expenditures	i. Amend the Public Finance Management Act to eliminate ambiguities on what constitutes unforeseen and unavoidable circumstances as outlined in article 223(1)(a) of the constitution; and put in place sanctions to deal with any withdrawals that do not comply with the principles of public finance as outlined in Article 201(d) of the constitution.
Managing pending bills	i. Provide for Kshs. 150 billion each Financial Year to settle pending arrears for the next five years on First in (incurred) and First Out (settled) basis using a mix of ordinary revenue and concessional based instrument to manage liquidity pressures and smoothen cash flow needs for the indicated period. Priority settlement be given to suppliers with verified pending bills and unremitted but deducted statutory obligations such as outstanding PAYE, pensions, sacco contributions and staff loans ii. Reserve a maximum of 20% of vote allocation within budgets for clearing pending bills. ii. Introduce a rule-based legal regime to identify, quantify, and report on all types of pending bills and commitments as well as provide specific sanctions curtailing accumulation of pending bills. iii. Amend the PFM Act (2012) for enhanced disclosures relating to pending bills during budget approvals. This may be in form of a template to be submitted alongside each proposed sector budget. iv. Provide disclosures on pending bills in the fiscal framework to reflect more accurately the fiscal position and operations of the national and county governments. Amend the Unclaimed Financial Assets Authority Act to provide for tracking, settlement, and reunification of unclaimed but eligible pending bills across the public sector.

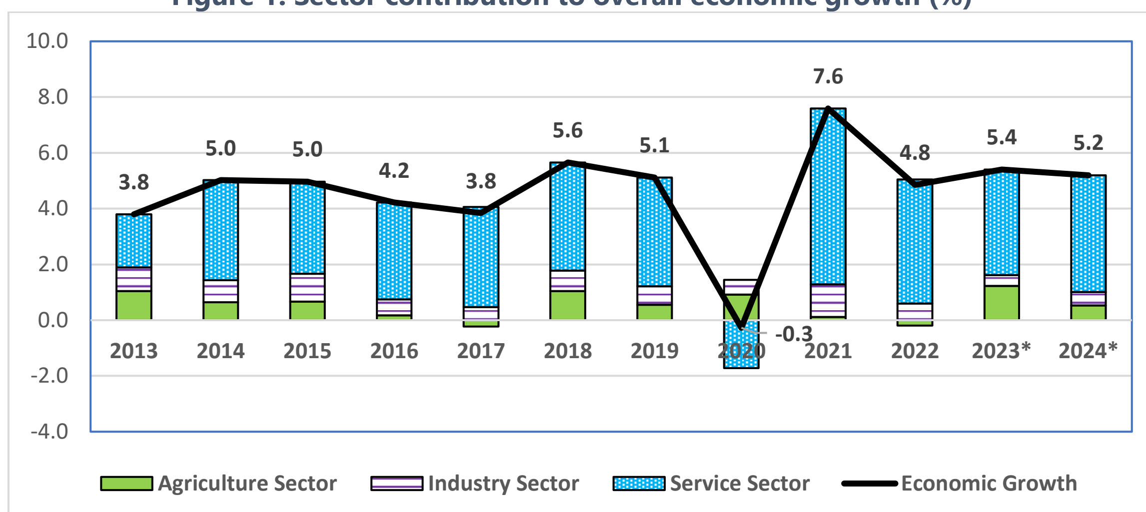
Area of Focus	Proposed Intervention
Improvement of expenditure efficiency at the County level	
Enhancing County Own Source Revenue collection	i. Adopt automated and cashless revenue systems, harmonizing Revenue Management for accountability. ii. Enhance workforce capacity and implement automatic data collection for monitoring economic indicators. iii. Strengthen collaboration and data-sharing for efficient revenue monitoring and activity evaluation. iv. County governments to develop principal revenue legislation and policies on which to anchor their taxes, fees and charges v. Counties can consider establishing revenue management collection and administration offices as an independent institution in the country.
Addressing overlap in mandates of National and County governments	v. Enhance consultation through the IGRTC to determine any overlap in mandate whenever one level is undertaking functions/programmes of the other level and ensure that requisite Memorandum of Understanding are prepared and made public in order to avoid duplication and litigation. vi. Develop a framework for gradually fully transferring health and agriculture functions to counties. vii. Review certain laws especially in the agriculture sector establishing national government state corporations which continue to perform some county government functions. viii. Counties to prioritize expenditure on essential devolved functions, notably the early childhood education programmes.

I. RECENT ECONOMIC DEVELOPMENTS

1.1. Sectoral Economic Growth

1. **Kenya's economic growth averaged 4.6 percent over the past five years, falling short of the 10 percent economic growth rate per annum target in Vision 2030**. This was attributed to shocks from erratic weather patterns that affected the Agriculture Sector and supply for raw materials for the Industry Sector. Furthermore, the Covid-19 pandemic subdued growth in the Services Sector due to restrictions in movement. MTP IV (2023-2027) projects an annual economic growth of 7.2 percent by 2027 supported by four pillars, namely, human capital development and capital accumulation, market development, protection and regulation, domestic resource mobilization, and digitization of the economy. These are poised to be achieved through the implementation of the five BETA priorities: agricultural transformation for inclusive growth, Healthcare, MSMEs, Housing and Settlement and Digital Superhighway & Creative Industry.

Figure 1: Sector contribution to overall economic growth (%)



Data Source: KNBS
*projections

2. **The Agriculture Sector, as a share of real GDP, averaged 19.5 percent in the past five years, dampened by erratic weather patterns.** The seasonal patterns of rainfall were volatile due to climate change, and this affected food production and forage for livestock during the extended adverse seasons of drought. Other challenges include locust invasion, inadequate irrigation schemes, postharvest losses, a lack of markets, and stalled projects. Investment in irrigation and the construction of various dams have been expenditure items in the budget, with the aim of enabling the availability of water during all seasons.

3. **The Agriculture Sector is a key driver of economic growth; however, the focus should be on making Kenya a food-secure nation and providing raw materials for the Industry Sector.** The focus on the value chain approach will enable the interlinkage between the agricultural sector, industry sector, and markets. Ensuring that the improvement in growth is not only on paper but also through bumper food production that will lower food prices, bolster job creation, and lead a general increase in household incomes. Key projects that are currently being implemented relate to improvement of the agriculture sector, including post-harvest loss management, fertilizer subsidy, aflatoxin management, crop and livestock insurance, Kenya climate smart agriculture project, emergency locust response and the national agriculture value chain development project, livestock value chain support project, Kenya livestock commercialization program, aquaculture business development project, and Kenya marine fisheries and socio-economic development project.

Table 1: Sectoral Share of Real GDP (%)

	2018	2019	2020	2021	2022	2023*	2024*
Primary Sector	**20.02**	**19.57**	**20.54**	**19.20**	**18.12**	**18.36**	**18.89**
1. Agriculture	19.06	18.62	19.53	18.09	16.97	17.23	17.69
2. Mining & Quarrying	0.96	0.95	1.01	1.11	1.15	1.13	1.20
Industry Sector	**16.71**	**16.52**	**17.10**	**16.98**	**16.76**	**16.28**	**16.76**
3. Manufacturing	8.86	8.65	8.65	8.63	8.46	8.19	8.38
4. Electricity & Water Supply	2.57	2.49	2.51	2.47	2.47	2.38	2.46
5. Construction	5.27	5.37	5.93	5.88	5.84	5.71	5.92
Services Sector	**63.28**	**63.91**	**62.36**	**63.82**	**65.11**	**65.36**	**64.35**
6. Wholesale and Retail Trade	8.33	8.35	8.33	8.37	8.28	8.24	8.60
7. Accommodation & Restaurant	1.07	1.16	0.61	0.86	1.04	1.18	1.45
8. Transport and Storage	10.19	10.31	9.51	9.49	9.56	9.43	9.88
9. Information and Communication	2.89	2.95	3.13	3.09	3.24	3.30	3.59
10. Financial & Insurance	7.56	7.77	8.25	8.55	9.19	9.71	10.88
11. Public Administration	5.52	5.69	6.10	6.01	5.99	5.96	6.24
12. Professional, Admin and Support	1.92	1.96	1.74	1.74	1.74	1.78	1.89
13. Real Estate	9.64	9.78	10.21	10.12	10.09	10.12	10.63
14. Education	4.71	4.74	4.31	4.92	4.92	4.84	5.05
15. Health	2.11	2.12	2.25	2.27	2.26	2.26	2.37
16. Other Services & Taxes	9.33	9.09	7.93	8.40	8.80	8.53	3.76

Data Source: KNBS

4. **The industry sector as a share of real GDP averaged 16.8 percent over the past five years, with manufacturing as the largest sub-sector.** The manufacturing share of real GDP declined mainly because of the high cost of inputs, including electricity, raw

materials, and machinery. Construction subsector indicators, such as cement consumption, were robust, implying improved performance in the real estate subsector.

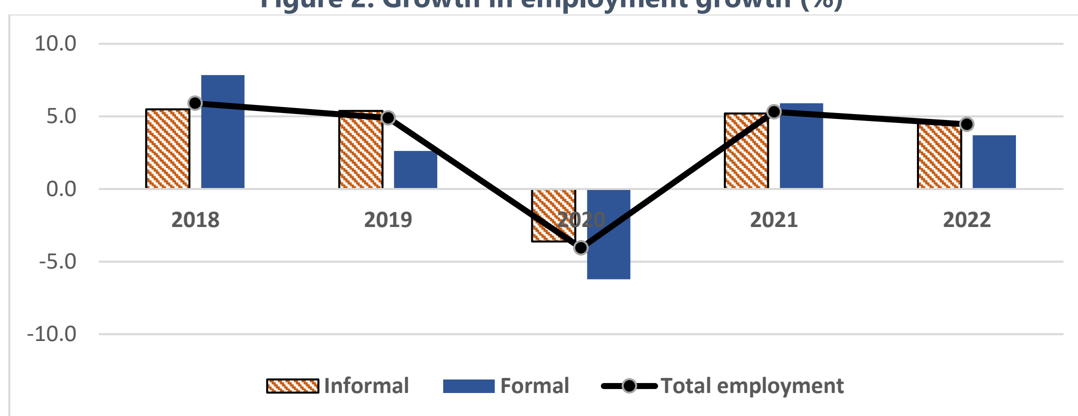
5. **Moving the economy toward a higher growth trajectory may require a deliberate shift in the Industry Sector.** This implies that the share of GDP in the industry sector should be higher than that in the agriculture sector. Efficient and effective implementation of the nine value chains[1] in the manufacturing sub-sector may support a higher Industry Sector share of GDP. The aim is to shift the economy to have higher economic growth felt by households, which is more equitable. Investment in the private sector is important, especially in human capital development, the adoption of new manufacturing technology, investment in green energy, and support for MSMEs. Government support manufacturing should be targeted at boosting "home-grown" industries through tax incentives and equally supporting foreign investment in manufacturing through lower labour costs and improvements in the cost of doing business.

6. **The contribution of the service sector to real GDP has consistently averaged 63.7% over the past five years, primarily driven by the growth of Finance and Insurance, as well as Real Estate subsectors.** The Services Sector comprises various sub-sectors, including finance and insurance, information and communication, real estate, and accommodation and restaurant services. These subsectors have experienced rapid growth due to technological advancements within the realm of AI, which have enabled a shift towards digital platforms and automation. Additionally, the growth of the real estate sector has been partially driven by factors such as the increased demand for housing, devolution, and the rising middle class. Post-COVID 19 recoveries have also positively impacted the accommodation and restaurant sub-sectors, as well as the education and health sub-sectors, due to rising demand for these services. However, the high cost of fuel has negatively impacted the transport and storage sub-sectors. Overall, the Services Sector is expected to benefit from investment in human capital development, with a focus on re-skilling and up-skilling as one of the key pillars of the MTP IV (2023-2027) of the VISION 2030 development agenda.

7. **The employment trend in Kenya has been declining in both the formal and informal sectors.** The growth in total employment has declined from 5.3 percent in 2021 to 4.5 percent in 2022. This deceleration was worse in the formal sector, declining from 5.9 percent in 2021 to 3.7 percent in 2022.

[1] minerals and natural resources; leather; rice; blue economy; tea; edible oils; dairy and cotton

Figure 2: Growth in employment growth (%)



Data Source: KNBS

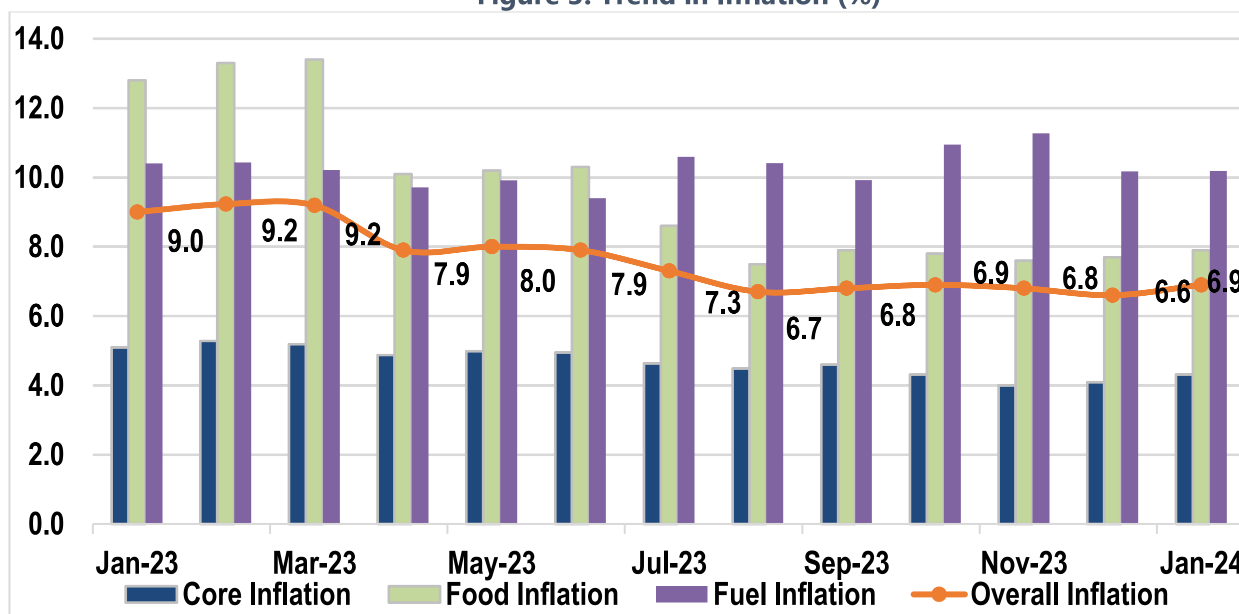
1.2. Monetary Sector Development

1.2.1. Inflation

8. **Global headline inflation has been declining, but continues to exceed the objectives of the majority of monetary authorities.** Specifically, inflation in the Eurozone decreased from 2.9% in December 2023 to 9.2% in December 2022, although it remains above the European Central Bank's target of 2.0%. In the United States, inflation slowed to 3.4% in December 2023 from 6.5% in December 2022, yet still exceeded the Federal Reserve's target of 2.0%. In South Africa, headline inflation increased from 5.9% in October to 5.4% in October, approaching the South African Reserve Bank's upper band target of 6%, largely due to the energy and food categories. This trend suggests that high interest rate regimes will persist for some time, which may have a significant impact on financing conditions in developing countries.

9. **Domestically, inflation has remained near the upper band of the CBK target, averaging 6.8%, from September to December 2023**. Nonfood and non-fuel inflation declined to 4.1 percent in January 2024 from 5.1 percent in January 2024, an indication of subdued demand, sustained impact of monetary policy tightening, and suppression of second-round effects emanating from the depreciation of shilling. Growth in food inflation has decelerated from 12.8 percent in January 2023 to 7.9 percent in January 2024. This decline has been supported by easing the prices of food commodities due to improved weather conditions, and the government backed the importation of non-vegetable food items and edible oils.

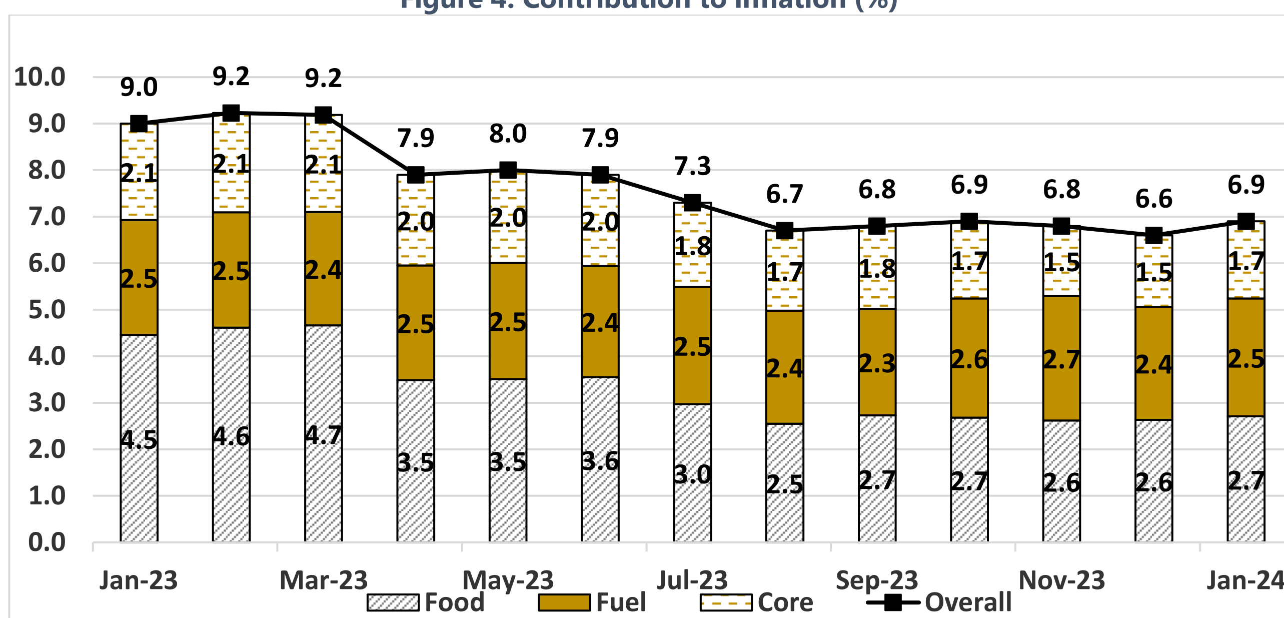
Figure 3: Trend in Inflation (%)



Data Source: KNBS

10. **Fuel inflation remains elevated mainly due to the depreciation of Kenyan Shilling and volatility in international oil prices.** Consequently, fuel inflation has persisted, declining slightly from 10.4 percent in January 2023 to 10.2% in January 2024. International oil prices have recently increased because of the drawdown of oil inventories amidst OPEC and oil exporters agreeing on voluntary oil production cuts to sustain higher global prices. The MURBAN ADNOC oil price rose from USD 85.51 per barrel in January 2023 to USD 81.6 per Barrel in November 2023.

Figure 4: Contribution to inflation (%)



Data Source: KNBS

11. **The fuel inflation share of overall inflation has risen, whereas that of food inflation has declined**. The contribution of fuel inflation to overall inflation increased from 27.8 percent in January 2023 to 36.2 percent in January 2024, whereas the contribution of food inflation declined from 50.0 percent to 39.1 percent over the same period. The key drivers of the sustained contribution of fuel inflation include rising prices of electricity, which have increased from approximately Kshs. 940.7 to Kshs 1,372.64 per 50 kWh, as well as increases in the fuel prices of kerosine, petrol, and diesel, partly due to the revision of VAT from 8 percent to 16 percent in the finance Act of 2023. The slight decline in January 2024 is attributed to the reduction in the pump prices of kerosene, petrol, and diesel by approximately Kshs 5 in the January review by the EPRA. Going forward, the contribution of fuel inflation is expected to persist as global oil prices remain elevated, and possibly continue to weaken shilling. The contribution of food to overall inflation is expected to decline further following the ongoing above-average rainfall in the country, the expected decline in global sugar prices following cane maturity in Brazil, and the expected reopening of cane factories in Kenya.

Table 2: Contribution to Overall Inflation per category (%)

Category	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24
Food & Nonalcoholic Beverages	49.5	50.0	50.7	44.1	43.9	45.0	40.7	38.0	40.2	38.8	38.5	39.9	39.2
Alcoholic Beverages, Tobacco & Narcotics	3.1	3.2	3.3	4.0	4.3	4.5	4.8	5.2	5.3	4.5	4.2	4.5	4.2
Clothing & Footwear	1.1	1.1	1.0	1.2	1.1	1.2	1.3	1.3	1.4	1.4	1.5	1.4	1.6
Housing, Water, Electricity, Gas and other Fuels	12.5	12.7	12.6	18.6	18.5	18.2	16.4	16.9	14.2	17.2	19.1	19.1	21.4
Furnishings, Household Equipment and Routine Household Maintenance	4.1	3.8	3.2	3.3	3.0	2.5	2.2	2.3	2.3	2.0	2.1	2.1	2.3
Health	0.7	0.7	0.8	0.9	0.9	1.0	1.0	1.0	1.1	1.1	1.1	1.3	1.1
Transport	14.9	14.2	14.0	12.5	12.7	12.0	18.0	19.5	19.4	19.9	20.2	17.8	15.4
Information & Communication	1.0	1.1	1.1	1.2	1.2	1.4	1.2	1.2	1.3	1.2	1.1	1.5	1.5
Recreation, Sports & Culture	1.1	1.2	1.2	1.2	1.2	1.2	1.4	1.5	1.5	1.4	1.3	1.4	1.4
Education Services	1.4	1.6	1.7	1.8	1.6	1.6	1.7	1.7	1.8	1.8	1.6	1.7	2.3
Restaurants & Accommodation Services	6.2	6.2	6.1	6.2	6.5	6.1	5.8	5.9	6.0	5.5	4.7	4.8	5.3
Personal Care, Social Protection and Miscellaneous Goods & Services	3.9	4.0	3.9	4.4	4.7	4.8	5.0	5.1	5.0	4.6	4.3	4.4	4.1
Insurance and Financial Services	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.2	0.3	0.3

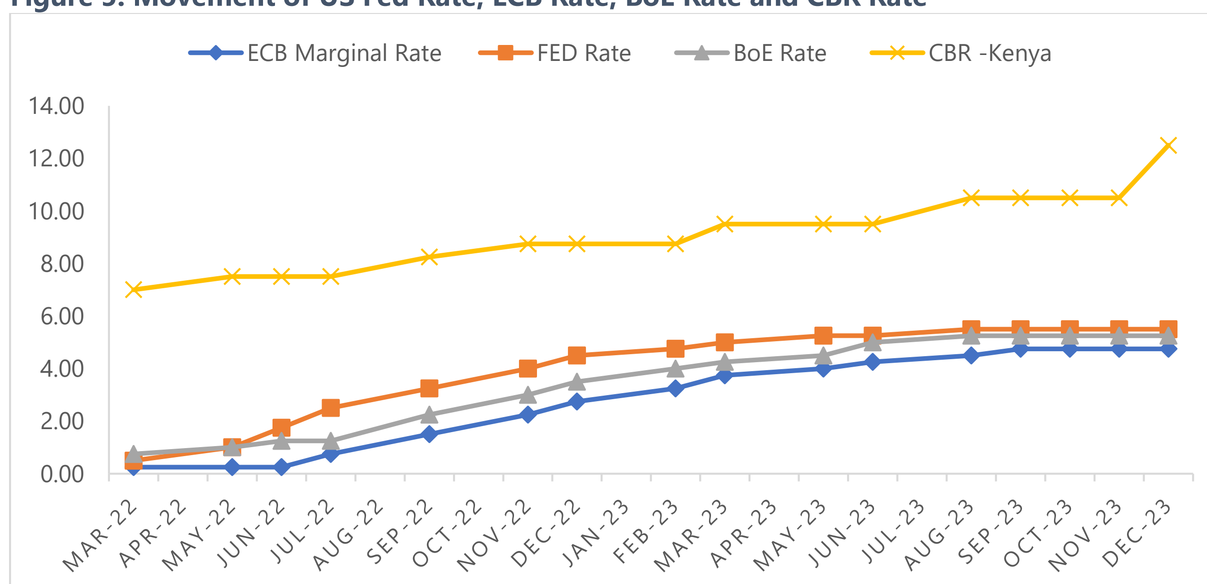
Category	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24
TOTAL	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Inflation Rate	**9.0**	**9.2**	**9.2**	**7.9**	**8.0**	**7.9**	**7.3**	**6.7**	**6.8**	**6.9**	**6.8**	**6.6**	**6.9**

Data Source: KNBS

1.2.2. Interest Rates

12. **The global tightening of financial conditions since March 2022 has seen unprecedented soaring interest rates**. The US Federal Reserve Rate upper band spiraled from 0.5 percent in March 2022 to 5.5 percent in December 2023, while the European Central Bank rate increased from 0.25 percent to 4.75 percent over the same period. Consequently, the Central Bank of Kenya revised the Central Bank Rate from 7 percent to 12.5 over the same period. The tightening monetary policy globally has had severe consequences, including an increase in interest rates and capital flights from developing countries, as investors pursue higher returns in developed economies. While global inflation has slowed and the policy rates have remained unchanged since September, the risks remain tilted downside, prompting CBK to further hike the CBR to contain the second-round effects on inflation.

Figure 5: Movement of US Fed Rate, ECB Rate, BoE Rate and CBR Rate

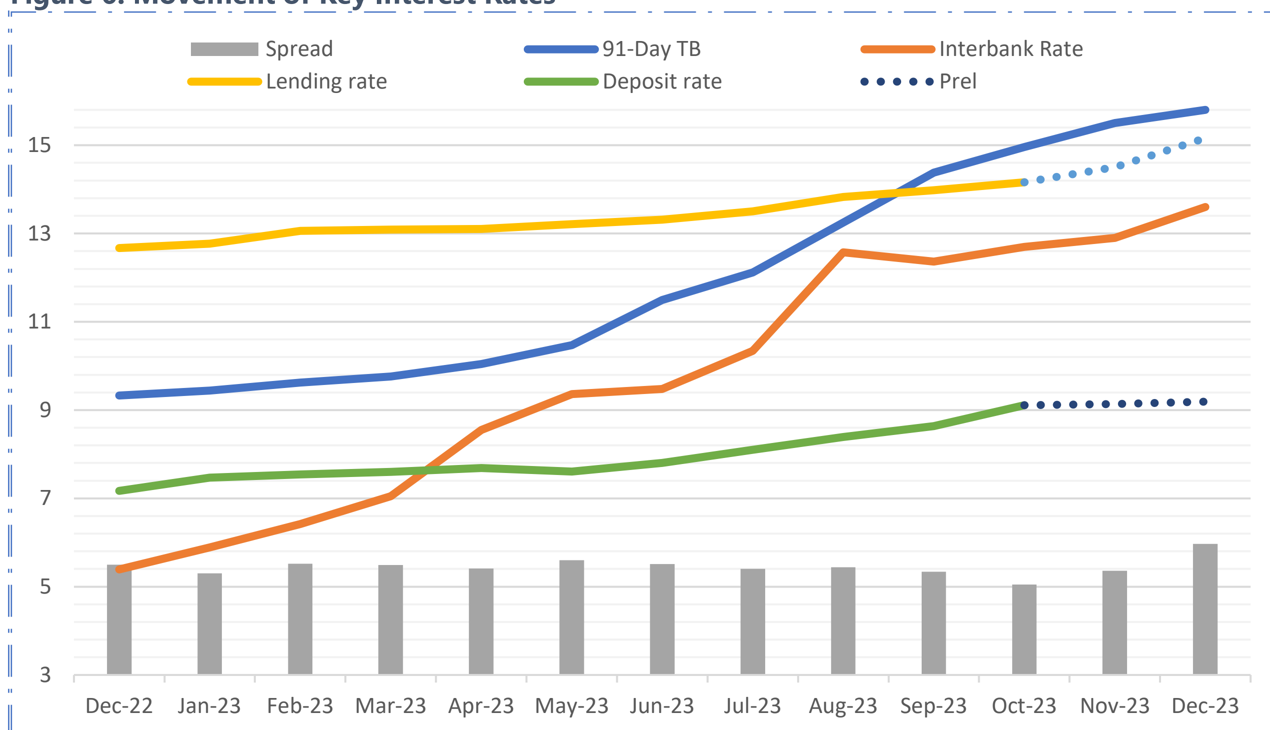


Source: CBK, ECB and FED

13. **The availability of affordable credit plays a critical role in supporting households' livelihoods and business sustainability**. However, short-term interest rates, including the lending, interbank, and treasury bill rates, have been on an upward trajectory. Soaring interbank rates signal constrained liquidity, thereby pushing borrowing costs upward. The Monetary Policy Committee has since capped the interbank rate at ± 250 basis points from the CBR to enhance the monetary policy transmission efficiency. The rates of T-bills increased from 6.3 percent in September 2020 to 15.8 percent in December 2023. This implies that economic agents, including governments, businesses, and individuals, face higher borrowing costs. Although the lending rate has remained fairly stable with an average of 12.5 percent, it remains significantly high for Micro, Small and Medium Enterprises. A high interest rate has a bearing on private

households, as they reduce disposable incomes, and on businesses, as they impact operating capital and the rate of capital accumulation to ensure business sustainability. Interest rate spread has been widening, mainly due to the rise in lending rates.

Figure 6: Movement of Key Interest Rates

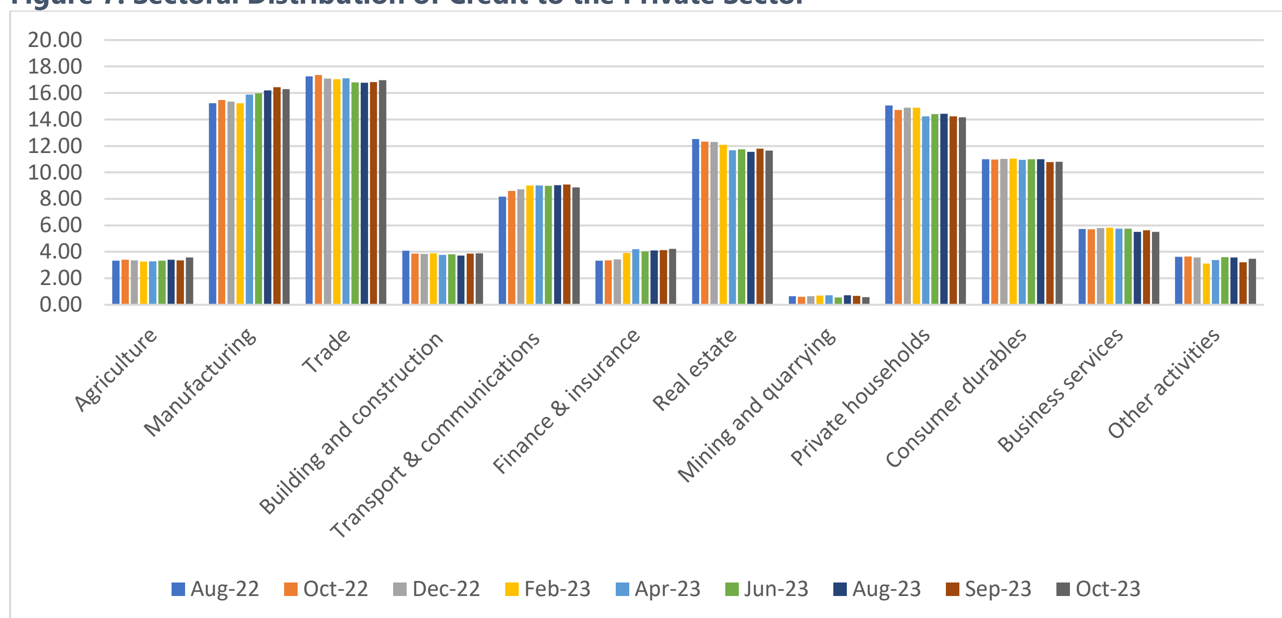


Source: CBK

1.2.3. Credit to Private Sector

14. **The structure and composition of credit to the private sector has remained unchanged despite the government's policy focus**. The Bottom-UP Economic Transformation Agenda (BETA) is premised on private sector led growth and anchored on five pillars: agriculture, MSMEs, healthcare, housing, and digital Superhighway. The major sectors that drive credit to the private sector are trade, manufacturing, private households, real estate, and consumer durables. The share of credit to these sectors has been declining, except for the manufacturing sector, which has exhibited a slight but sustained increase from 15.4% in August 2022 to 16.2% in August 2023. The uptick has been attributed to the post covid recovery of the sector and the rising cost of inputs, thereby necessitating additional funding to remain afloat. Similar trends were demonstrated in the transport and communications sectors. The primary sector had the lowest credit uptake with mining and quarrying, and the agriculture sector accounted for 0.65 percent and 3.3%, respectively, over the period.

Figure 7: Sectoral Distribution of Credit to the Private Sector



Source: CBK

15. **Although the growth in credit to the private sector has remained steady at an average of 12 percent, the rate of Non-Performing Assets has also been rising, registering 15.3 percent in November 2023 from 13.8 percent in November 2022.** The increased NPLs may put pressure on the banking sector's ability to recycle lending funds and additional provisions for the non-performing loans reducing the capacity of banks for lending, thus resulting in higher interest rates. The uptick in NPLs has been attributed to the high cost of borrowing due to tightening of monetary stance and weak business environment occasioned by depreciation of the shilling, high cost of fuel and other inputs, pending bills, and new tax measures that have reduced household disposable income and purchasing power. Further, the non-performing loans are spread across all sectors of the economy, and banks have indicated their intent to intensify their credit recovery efforts, which may result in borrowers losing their collaterals in the process.

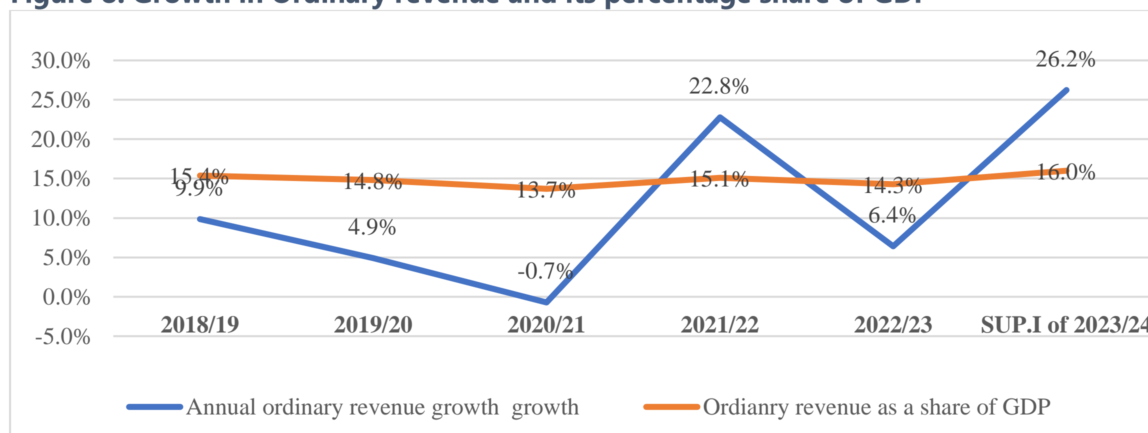
1.3. Fiscal Development

1.3.1. Revenue Performance

16. **The total revenue as a share of GDP averaged 16.8 percent from FY 2018/19 to FY 2022/23.** Actual total revenue received by the end of June 2023 was Kshs.2,360.5 billion (16.3% of GDP) recording an increase of Kshs.656.2 billion since FY 2018/19. Ordinary revenues have been recorded on average at a growth rate of less than 10 percent; however, there was an extraordinary growth of 22.8 percent (355.8 billion)

realized in FY 2021/22 attributable to the base effects of low collection in FY 2020/21 due to Covid-19.

Figure 8: Growth in Ordinary revenue and its percentage share of GDP



Source: National Treasury.

17. **The majority of tax revenues have registered year-to-year growth in absolute terms but have shown a marginal decrease when compared to the share of GDP.** Income tax as a percentage has largely remained at 6.5%, whereas VAT has oscillated between 3.6 and 4.0 percent. All other tax revenues, including Appropriation in Aid, have a share of GDP below 2.5 percent. Actual receipts for income tax were Kshs.941.5 billion (6.5 percent of GDP), VAT Kshs.550.4 billion (3.8 percent of GDP), and Excise duty Kshs.264.5(1.8 percent of GDP) by the end of June 2023. The tax revenue projections for FY 2023/24 indicate a similar trend, as shown in Table 3.

Table 3: Revenue outturn for FY 2018/19 to FY 2023/24 in Billions

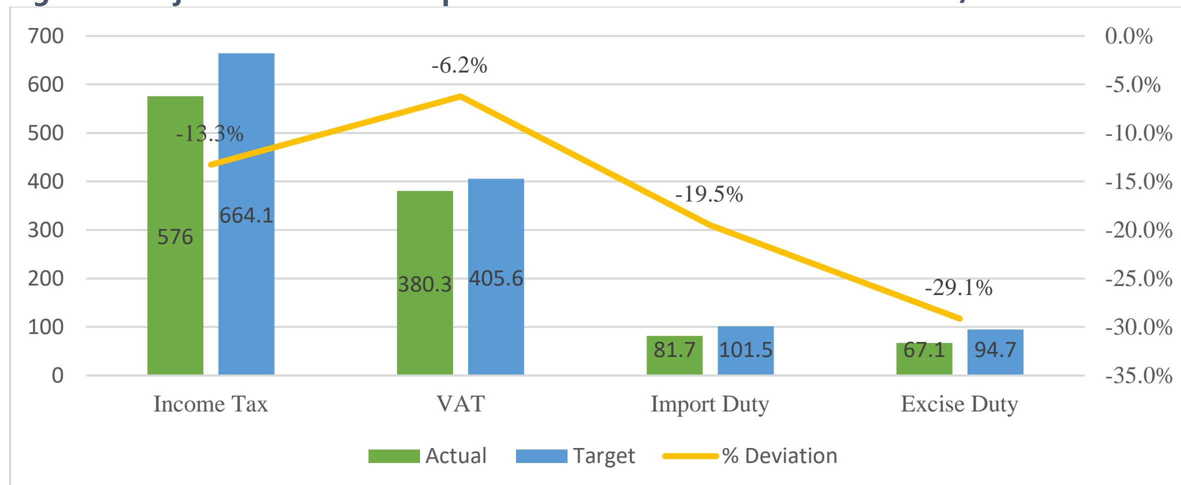
	2018/19	2019/20	2020/21	2021/22	2022/23	Proj. 2023/24
Total Revenue	1,704.3	1,795.6	1,783.8	2,199.8	2,360.5	3,042.8
Ordinary Revenue	1,499.7	1,573.4	1,562.1	1,917.9	2,041.1	2,596.8
Income Tax	685.3	706.9	694.1	876.7	941.6	1,198.5
VAT	414.1	383.7	410.8	523.1	550.4	703.3
Import Duty	106.9	98.0	108.4	118.3	130.1	173.3
Excise Duty	194.3	195.3	216.3	252.1	264.5	352.7
Other Revenue	99.1	189.5	132.5	147.7	154.5	169.0
Appropriation in Aid	204.6	222.2	221.7	281.9	319.4	446.0
As a percent of GDP						
Total Revenue	17.5	16.9	15.7	17.3	16.3	18.9
Ordinary Revenue	15.4	14.8	13.7	15.1	14.1	16.1
Income Tax	7.0	6.7	6.1	6.9	6.5	7.4
VAT	4.2	3.6	3.6	4.1	3.8	4.4
Import Duty	1.1	0.9	1.0	0.9	0.9	1.1

	2018/19	2019/20	2020/21	2021/22	2022/23	Proj. 2023/24
Excise Duty	2.0	1.8	1.9	2.0	1.8	2.2
Other Revenue	1.0	1.8	1.2	1.2	1.1	1.0
Appropriation in Aid	2.1	2.1	2.0	2.2	2.2	2.8

Source: National Treasury

18. **In the first half of the FY 2023/24, total exchequer revenue fell short of target by Ksh187.6 billion from a projection of Kshs.1,455.1 billion to actual receipts of Kshs.1,267.8 billion.** The underperformance is attributable to deficits in income tax of Kshs.88.1 billion, VAT of Kshs.25.3 billion, and other losses in import duty of Kshs.19.5 billion and excise duty of Kshs.29.1 billion. This trend points to an overall deviation of 13 percent from the target, implying that by the end of June 2024, government revenues are likely to underperform by Kshs.330 billion.

Figure 9: Major revenue streams performance in the first half of FY 2023/24 in Ksh billions

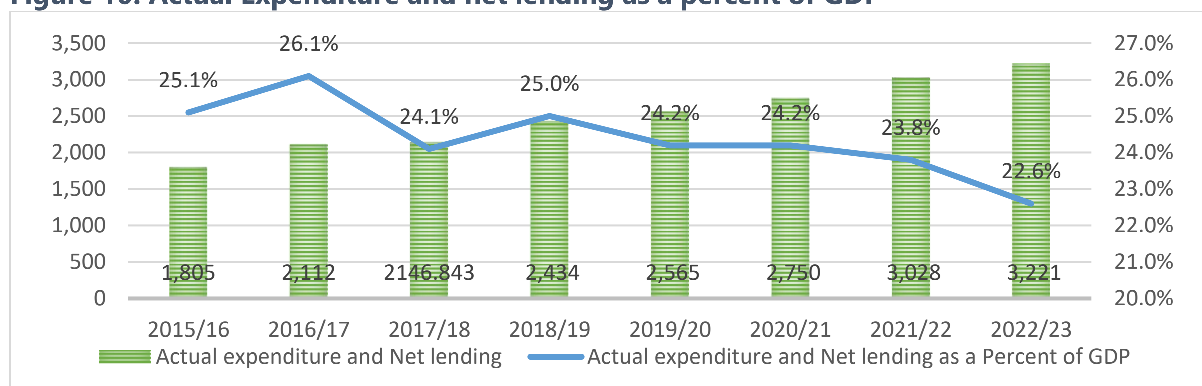


Source: Kenya Revenue Authority (KRA).

1.3.2. Expenditure Performance

19. **Government expenditure as a share of GDP has been 3.5 percent points lower in the last seven years since FY 2016/17.** However, total expenditure has been stable as a percentage of GDP, with an average of 24 percent. In FY 2022/23 total expenditure and net lending increased by Ksh193.2 billion from Kshs.3,027billion (23.8 percent of GDP) in FY2021/22 to Kshs.3,221 billion (22.6 Percent of GDP) in FY 2022/23.

Figure 10: Actual Expenditure and net lending as a percent of GDP



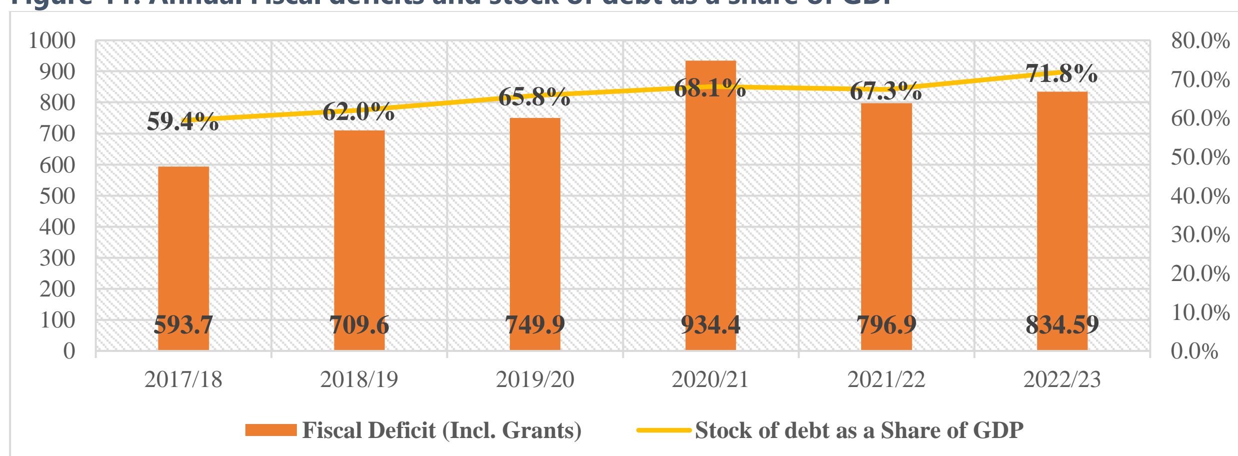
Source: National treasury.

20. **A significant shift in total expenditure over the years is attributable to recurrent expenditures**, mainly toward payments of public debt and expenditures on operations and maintenance, as well as pensions. However, development has risen significantly relative to overall expenditure with the share of development to GDP decreasing to 3.4 percent by June 2023 from 5.3 percent in FY 2017/18. The drop in capital expenditure significantly affects targeted economic growth.

Fiscal Deficit and Public Debt

21. **The fiscal deficit over the last five years (From FY2018/19 to June 2023) has remained above Kshs.700 billion (on average).** The highest was experienced in FY 2020/21, when the shortfall was Kshs.934.4 billion. As a share of GDP, the deficit decreased from approximately 7.3% in FY 2018/19 to 5.7% by the end of FY 2022/23. As a result of the growing fiscal deficits the gross debt stock has risen from Kshs.6.7 trillion in FY 2019/20 to Kshs.10.24 trillion by the end of June 2023. This has led debt as a share of GDP, in nominal terms, to rise from 65.8 percent to 71.8 percent in the same period.

Figure 11: Annual Fiscal deficits and stock of debt as a share of GDP

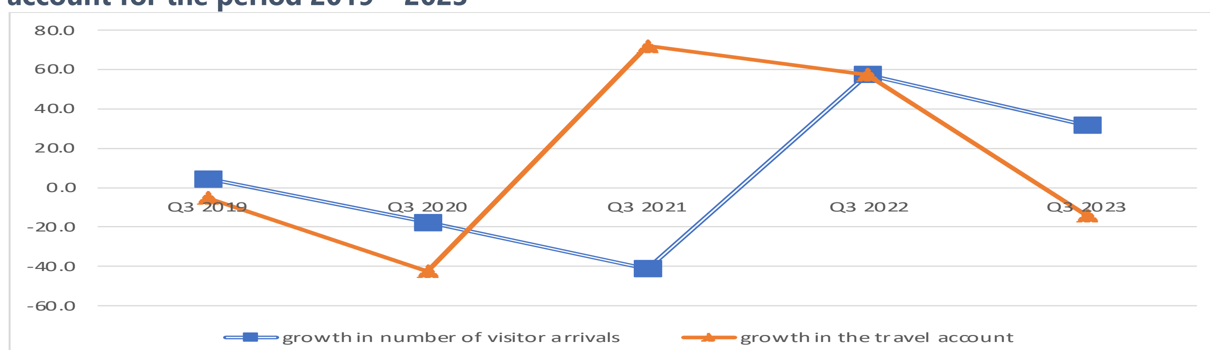


Source: National Treasury

1.4. External Sector

22. **The current account deficit recorded an improvement of 42.1 percent from the deficit in Kshs. 211.5 billion in the third quarter of 2022 to a deficit of Kshs. 122.5 billion in the third quarter of 2023.** The improvement is mainly due to 19.7% growth in exports, while imports remained steady, increasing slightly by only 0.4 percent. Notably, services declined by 5.8%, with travel receipts declining by 14.1 percent in the third quarter of 2023. Receipts from the travel account have been on an upward trend since the second quarter of 2022. However, the number of visitors arriving increased by 31.7 percent in the third quarter of 2023. This is likely an indication of foreign exchange losses resulting from the goods and services consumed by tourists during their visits to Kenya. Notably, there is likely a positive correlation between the growth in the number of visitor arrivals and the growth in travel account receipts from the third quarter of 2019 to the third quarter of 2023, as indicated in figure 12.

Figure 12: Comparison of growth in the number of visitors arrival and growth in the travel account for the period 2019 – 2023

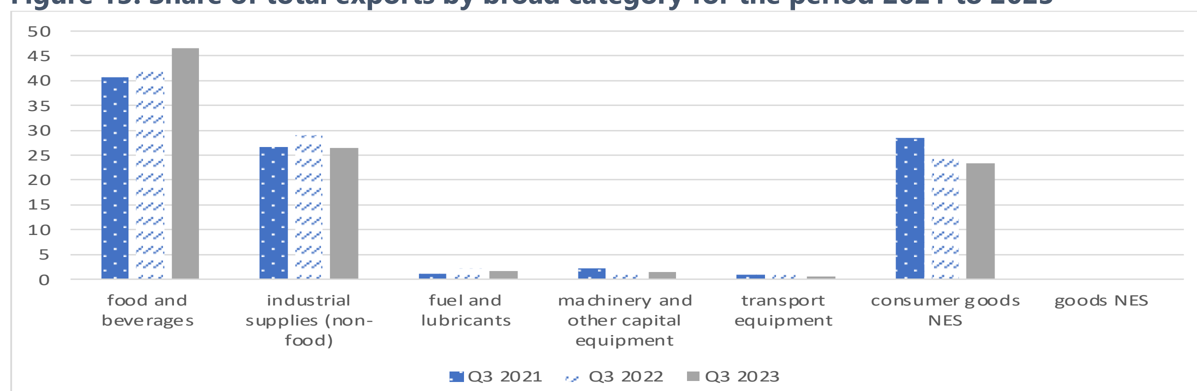


Data Source: Kenya National Bureau of Statistics

23. **In the merchandise trade account, food and beverages constituted the largest share of total exports, while industrial supplies constituted the largest share of total imports, followed by fuel and lubricants. Notably, the trends in the share of exports as well as in the share of imports have been similar since 2021, with the same commodity categories dominating the goods account.** Of the exported foods and beverages, 77.5% were primary commodities, while processed foods and beverages constituted only 22.5%, indicating a lack of value addition to the exported commodities. Notably, the share of food and beverage exports grew from 42.2 percent in the third quarter of 2022 to 46.6 percent in the third quarter of 2023, an indication of potential in the category. The share of industrial exports declined from 29.1 percent to 26.4 percent during the same period. In AfCFTA, Kenya is likely to be disadvantaged in regional markets as it seeks to leverage the agreement to narrow its balance of trade deficit. Compared to some of its trade partners, such as South Africa, who export

finished goods, such as motor vehicles, to other African countries, Kenya's major exports are primary raw goods that may not be competitive compared to value-added goods.

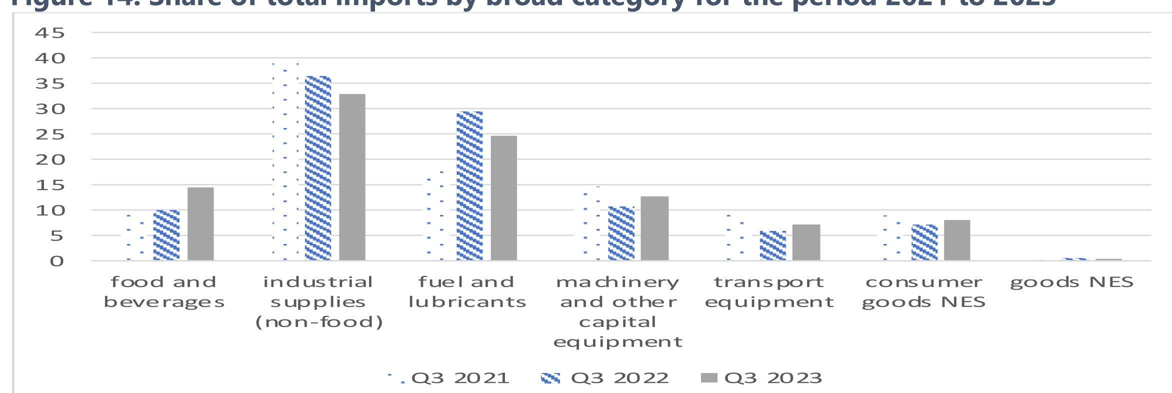
Figure 13: Share of total exports by broad category for the period 2021 to 2023



Data Source: Kenya National Bureau of Statistics

24. **The share of imported industrial supplies declined from 36.4 percent in the third quarter of 2022 to 32.9 percent in the third quarter of 2023 due to a decline in imports of processed industrial supplies, while primary industrial supplies in raw form slightly increased**. Notably, imported quantities of fertilizer recorded a significant decline, as well as the importation of cement clinker. Cement clinker is one of the listed commodities in the third schedule of the Finance Act, 2023, whose importation is subject to the Exports Promotion and Investments Levy at 17.5 percent of customs value. The share of fuel and lubricant imports also declined, from 29.4 percent to 24.6 percent. The share of machinery and other capital supply imports increased, as did imports of food and beverages. The increase in food and beverages is mainly due to increased demand for animal and vegetable oils, sugar, and wheat, while the quantities of maize and rice imports declined.

Figure 14: Share of total imports by broad category for the period 2021 to 2023



Data Source: Kenya National Bureau of Statistics

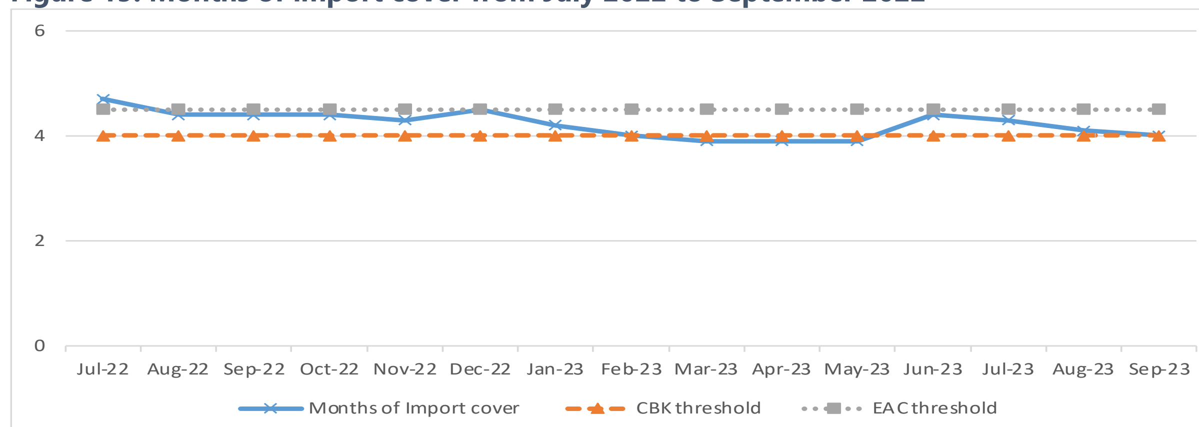
25. **The deficit in primary income deteriorated by 33.5 percent from the deficit in Kshs. 63.6 billion in the third quarter of 2022 to a deficit in Kshs. 84.5 billion in**

the third quarter of 2023. The surplus in secondary income improved by 35.2% due to the steady growth in diaspora remittances. Diaspora remittances which continue to support the current account improved from Kshs. 114.2 billion to Kshs. 155.8 billion. Notably, diaspora remittances have been a major foreign exchange earner for Kenya and recorded steady upward growth.

26. **The capital account balance improved from the surplus of Kshs. 623 million to a surplus of kshs. 3.4 billion while the financial account surplus worsened from a surplus of Kshs. 175.1 billion to a deficit of Kshs. 20.6 billion in the third quarter of 2023 compared to the third quarter of 2022.** Consequently, the overall balance of payments worsened from a deficit of Kshs. 112.6 billion to a deficit of Kshs. 131.4 billion financed by gross official reserves as well as credits and loans from the IMF. Notably, there was external debt repayment during this period that contributed to the deterioration of the overall balance of payments.

27. **Gross reserves grew from USD 11.3 billion to USD 13.8 billion in the 12 months leading to September 2023.** The growth in gross reserves is due to a significant increase in reserves held by commercial banks from USD 3.6 billion to USD 6.3 billion. Official reserves held by the Central Bank declined slightly from USD 7.8 billion to USD 7.5 billion. Notably, the months of import cover declined from 4.4 months to four months, which is in line with the CBK threshold but below the EAC threshold.

Figure 15: Months of import cover from July 2022 to September 2022



Data source: Central Bank of Kenya

II. MEDIUM-TERM ECONOMIC OUTLOOK AND RISKS

2.1. Economic Growth and Inflation

28. As Kenya charts its course through the opportunities and challenges of 2024, the interplay between strategic policy decisions and international collaborations takes center stage in shaping the nation's economic growth trajectory. Within this evolving landscape, securing government funding, exercising judicious fiscal management, and revitalizing investor confidence are imperative for fostering sustained and inclusive economic development.

2.1.1. Baseline Scenario

Table 4:Scenario 1 - Baseline (No policy change)

Scenario 1 - Baseline (No policy change) GDP growth and Inflation 2023/24-2026/27				
	2023/24	**2024/25**	**2025/26**	**2026/27**
Output				
Real GDP growth (%)	5.2	5.1	5.3	5.0
Prices				
Inflation (average)	6.7	7.2	7.4	6.9

Assumptions

i. The shilling will shed approximately 21% of its value by end of 2024
ii. Business enterprises will continue their cautionary stance, leading to reduced private-sector activity
iii. Subdued household consumption will persist in 2024
iv. Revenue shortfall and increased cost of funding will undermine the implementation of key development projects
v. Agriculture and services sector will be the key drivers of growth

29. Against prevailing economic headwinds, the PBO's economic growth projection for 2024 is estimated to be 4.9% (+ or – 1%). This is a measured adjustment from the previous year's estimated growth rate of 5.5% and is primarily attributed to less-than-optimistic expectations of currency depreciation, business conditions, and household consumption.

Exchange rate depreciation will heighten inflationary pressures and weaken consumption in 2024…

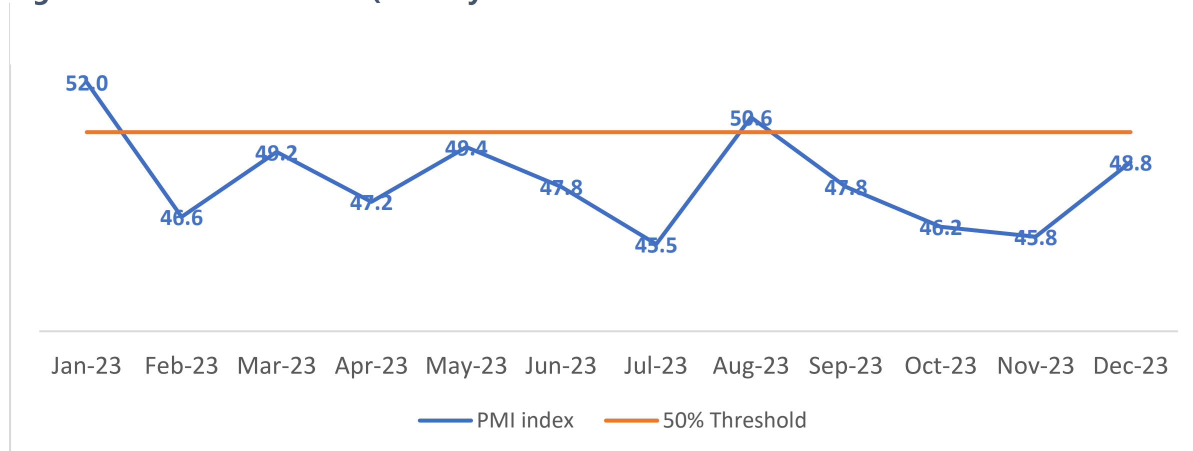
30. Continued loss in the value of shilling is expected to adversely affect consumption and investment. Experts have posited that shilling is likely to continue losing value for the

better part of the year and may shed as much as 21% of its value by the close of the year due to the ripple effect of high US interest rates coupled with geopolitical tensions that have triggered capital flights in pursuit of higher yields and safer investments, and the rising cost of imports, which will increase demand for dollars. Kenya is a net importer of goods, the key to which is fuel, food (including edible oils), and raw materials. A weak shilling implies that these goods will be substantially costlier, and this cost will be passed on to the consumer, thereby increasing the cost of living and perpetuating the decline in household consumption.

31. On the investment side, foreign investors' flight due to the likelihood of reduced profits from the bourse is a significant risk. In 2023, the Nairobi Securities Exchange (NSE) experienced a decline of 27.5%, resulting in a decrease of Sh547 billion in paper wealth, as the prolonged bear run continued to impact investors' equity portfolios. Market data reveal that the NSE concluded the final trading day of the year with a valuation of Sh1.439 trillion, down from Sh1.986 trillion at the end of 2022. During the same period, the Nairobi All Share Index (NASI), which reflects overall stock performance, also experienced a comparable decline. Additionally, NSE 20 and 25, tracking the top 20 and 25 listed firms, registered contractions of 10.4% and 24%, respectively. The erosion of investor confidence and reduced capital formation stemming from the struggling stock market collectively contribute to a challenging economic landscape for businesses across sectors.

Business activity will remain weak in 2024...

Figure 16: PMI Index trend (January - December 2023



Source: Stanbic Bank PMI (Various)

32. The headline Purchasing Managers Index (PMI) for 2023 has been below 50 percent for the better part of 2023, denoting a deterioration in business conditions. It is observed that in 2023, a notable succession of profit warnings unfolded among diverse listed companies in Kenya, underscoring the resilience demanded in an increasingly

challenging business landscape. These enterprises attributed their cautionary stance to an array of challenges, including decelerated economic activities, onerous business operating costs, subdued demand, rising financing costs, depreciation of Kenyan shilling, escalating prices of basic commodities, and heightened tax burdens.

33. Notably, there was an improvement in the PMI from 45.8 percent in November to 48.8 percent in December 2023, which was attributed to the cooling of inflationary pressures. However, private sector firms have expressed pessimism in business expectations for 2024, with the Future Output Index recording some of the lowest readings. Indeed, the output forecasts for 2024 for all five PMI-monitored sectors, particularly the construction industry, were subdued.

34. This scenario reflects a concerning trend in Kenya's private business landscape that is worsened by an unpredictable tax environment. The challenges faced by local companies are expected to trigger cost-cutting measures, potentially leading to layoffs and freezes. This, in turn, has a direct impact on employment levels and, consequently, overall consumption and productivity.

35. Furthermore, the compounding effect of the delayed payment of pending bills has cast a shadow over the financial health of business enterprises, hindering their ability to invest in innovation and expansion. Therefore, the unresolved issue of pending bills is a critical factor that demands urgent attention for a more robust economic recovery in the upcoming years.

Subdued household consumption will persist in 2024…

36. The expectation of subdued consumer activity can be attributed to declining incomes due to prevailing challenges in the private business landscape, as elucidated above, as well as household pessimism due to the expectation of a higher tax burden and increased cost of goods. Indeed, despite the cooling of inflationary pressures due to stabilized food and fuel costs, the knock-on effects from exchange rate depreciation could substantially increase input costs and fuel costs, leading to higher production costs.

Revenue shortfall and increased cost of funding could undermine the implementation of key government projects…

37. The divergence between anticipated and actual revenue presents a considerable hurdle, hindering the government's ability to fully execute key economic growth

enablers. The shortfall in budget revenue collections is accentuated by the influence of revised tax measures on consumer behavior amid global economic uncertainties, compound concerns about the prevailing subdued business environment, and its implications for long-term economic stability. These factors inevitably influence business decisions and contribute to a downward revision of growth projections. The collective impact of these factors underscores the need for strategic measures to rejuvenate investor confidence and stimulate economic recovery in the coming years.

38. Further, the upward adjustment in the pricing of government debt, driven by factors such as heightened country risk, volatile international financial markets, elevated global interest rates, and depreciating Kenyan Shilling, has significantly increased the cost of borrowing for the government. In the current global macroeconomic environment, the decline in international appetite for Kenyan government bonds is pronounced, with investors now demanding a premium to offset the perceived risks. This surge in borrowing costs is evident across the yield curve, which makes long-term bonds more expensive.

39. Moreover, the escalating cost of debt poses a substantial challenge for the repayment of both external and domestic obligations. As the repayment burden increases, the country faces potential funding constraints, emphasizing the need for strategic measures to mitigate these challenges and ensure sustainable financial stability.

Economic growth in 2024 will mainly be driven by a strong agricultural recovery…

40. Anticipated ample rainfall and lower global commodity prices reduce the production costs. Government measures, including subsidies for fertilizer and seeds, along with affordable working capital for farmers, are expected to support sector growth.

41. A nationwide farmer registration (farmers were enrolled in a digital register)and fertilizer subsidy program made 5.5 million bags of fertilizer available to Kenyan farmers. The government has significantly reduced fertilizer costs from Ksh 6,500 to Ksh 2,500. The government has also expanded maize acreage by 200,000 acres and increased maize production by 18 million bags.

42. Additionally, the government has invested in a post-harvest management system, with 17 certified warehouses with a combined capacity of 365,000 metric tons prepared in maize-growing areas.

43. Predicated by favorable weather conditions, the agricultural sector is poised to spearhead economic growth. Recognizing the need for resilience, it is imperative to supplement weather-dependent strategies with proactive expansion of irrigation infrastructure, fortifying the country's capacity to predict and plan for sustained agricultural development.

44. Expanding agriculture, agribusiness, and value addition increases exports, reduces imports, and lowers food prices, thereby contributing to economic stability.

The service sector, including key enablers, such as tourism, presents opportunities for growth and development, contributing to overall economic expansion…

45. The sector is set to receive substantial support from resilient activities in various domains, including accommodation and restaurant services, financial and insurance services, information and communication services, wholesale and retail trade, and transport and storage, among others.

46. According to UNWTO scenarios released in May 2022, international tourism will rebound to 63% of the pre-pandemic levels. As expected, international tourism has been consolidating its recovery in 2023, supported by pent-up demand, particularly from Asia and the Pacific, as destinations and markets opened up after the Covid-19 pandemic. The recovery trend is expected to continue in 2024; with the number of international arrivals to Kenya projected at 2,476,733 in 2024, with total inbound receipts at 447,501,084.

47. The accommodation and restaurant subsector will benefit from a sustained increase in tourist arrivals, driven by the recovery of international travel after the global economic slowdown. The government's initiatives to revitalize the sector through the promotion of international conferences, cultural festivals, and wildlife safaris will further contribute to its growth.

Support from various multilateral sources could potentially address the funding gap…

48. As Kenya navigates the challenge of funding gaps, the government has successfully harnessed substantial support from various multilateral sources, ushering in a new era of economic stability. Anticipated inflows from the International Monetary Fund (IMF) and the World Bank, with projections reaching approximately USD 1.6 billion and potentially exceeding USD 1.5 billion by March 2024, showcase a strategic approach to meeting financial needs. Additionally, the expected disbursements from the World

Bank, particularly through the PFORR arrangement, are poised to provide gradual support for essential budgetary requirements. This surge in multilateral funding not only addresses immediate financial challenges but also catalyzes the building of international investor confidence, potentially attracting increased Foreign Direct Investments (FDIs).

2.1.2. Fiscal Consolidation Scenario

49. The primary concern in 2024 is how to achieve progressively higher economic growth that is sustainable and inclusive, while maintaining debt at a reasonable level. The impending substantial debt repayments that will fall in 2024 are poised to exert even more pressure on government expenditures, thereby limiting the fiscal space available for the government to implement its development projects. To stabilize debt accumulation, overall government spending should be cautious and focused on programs with high social impact and high returns on investment.

50. Notably, the national government recently adopted a debt anchor target of 55 percent of GDP in present value terms, to be achieved by 2029. Achieving this debt anchor requires the national government to run a fiscal deficit of approximately 3 percent or lower. Current government statistics (BPS) indicate that the fiscal deficit for FY 2023/24 is estimated at 5.5 percent of GDP, with a target of achieving a deficit of at least 3.1 percent by FY 2027/28. In this regard, the national government's strategy over the next four years should be to strategically implement fiscal consolidation to slow down debt accumulation while restructuring government spending to focus on policies and programs with high social impact, high returns on investment, and the ability to **crowd in** private sector investment.

51. Key interventions to support resilient economic growth

i. **Streamlining government expenditure to enhance efficiency and eliminate duplications can enhance domestic resource mobilization without undue pressure on taxation.** A review of government expenditure indicates that duplication in mandates among MDAs amounts to an estimated Kshs. 8.8 billion. A savings of this amount can be directed towards payment of pending bills and the balance on high-impact social programs. Fiscal consolidation measures are critically discussed in chapter three.

ii. **The payment of pending bills will inject liquidity in the private sector, thereby stimulating private sector productivity.** It is estimated that pending bills presently amounts to 5 percent of GDP or Kshs. 794.2 billion. These delayed

payments have affected private sector liquidity and profitability, thereby dampening continued investment in businesses that have contracts with the government. This can also partially explain the increase in non-performing loans for these businesses. This scenario, which is prevalent at both the national and county levels, does not augur the country's economic growth prospects. The settlement of these pending bills will undoubtedly lead to increased business activities, which will enhance economic growth and revenue collection.

iii. **Addressing uncertainty in the business environment will enhance the productivity of the private sector,** which primarily stems from existing macroeconomic challenges, such as depreciating shilling, debt repayment pressure, and an ever-changing taxation regime. Among various other solutions, the government may aim to address challenges in the tax regime, including more business-friendly tax administration, improving the balance of payments through measures to address exports, and incentivizing Foreign Direct Investment (FDI).

iv. **Structural reforms through continued investment in enablers will drive private sector-led growth,** which entails a multifaceted approach targeting specific sectors, including infrastructure (transportation and energy), a value chain approach to improve the quality of goods and export competitiveness, and regulatory reforms to facilitate a favorable business environment and enhance market access.

The government can also undertake targeted technical and financial support through the Financial Inclusion Fund for specific export-oriented firms, including value addition, value chain coordination, and ensuring compliance with specific standards appropriate to the export market.

Box 1: A case for private sector led growth

A case for private sector led growth: Holding all other factors constant, an increase in private sector investment by 1 percent increases the GDP growth forecast to 5.1 percent in 2024. Private sector-led growth is key to achieving higher growth without a significant increase in government expenditure. This will require targeted expenditure in enabler sectors such as infrastructure, especially in roads and energy, as well as regulatory reforms that will boost business confidence and will crowd in private investment.

Table 5: Scenario 2: Increase in private sector investment by 1%

Scenario 2: Increase in private sector investment by 1%
GDP growth and Inflation 2023/24-2026/27

	2023/24	**2024/25**	**2025/26**	**2026/27**
Output				
Real GDP growth (%)	6.4	5.3	5.4	5.7
Prices				
Inflation (average)	6.6	6.2	6.0	5.2

Assumptions

i. Enhanced efficiency in use of public resources
ii. Payment of pending bills to enhance private sector liquidity and profitability
iii. Targeted investment and reforms in export-oriented industries/ firms
iv. Targeted Investment and reforms to promote private sector-led growth

2.2. Fiscal Projections for FY 2024-2025

52. To determine the fiscal projections for FY 2023-2024 two distinct scenarios were developed: the baseline scenario and a scenario that reduces the debt-to-GDP ratio in the medium-term.

2.2.1. Baseline Scenario

53. The baseline scenario is predicated on no policy change with regard to economic performance, revenue performance, and expenditure outlook. The assumption is that performance follows a historic trend without any major deviation from the usual routine. In this scenario, revenues are projected to grow modestly by 12 percent in FY 2023-2024 and 13 percent in FY 2024-2025. This is in line with the average revenue growth rate over the past decade.

54. **Based on the assumptions of the baseline scenario, revenue is projected to grow from 16.7 percent of GDP in FY 2023-2024 to 17.3 percent in FY 2024-2025.** This implies that the total revenue including grants is projected at Kshs 3,107.6 billion against a projection of Kshs 3,457.1 billion by the National Treasury in the Budget Review and Outlook Paper. This is partly explained by the fact that, despite the raft of revenue mobilization measures pronounced in the Finance Act of 2023, the actual revenue collection is still off-target.
55. **The expenditure outlook in this scenario is maintained at around 22.5 percent of GDP, and therefore closely mirrors the proposals under the Budget Review and Outlook Paper**. Recurrent expenditure is projected to remain within its proposed levels, while development expenditure is expected to slightly decline to reflect the actual levels of development expenditure over the previous period, taking into consideration the necessary investments in BETA priority pillars. Consequently, this translates into a fiscal deficit in Kshs. 937 billion (5.2% of GDP) and a primary surplus of 0.4 percent of GDP.

2.2.2. Fiscal Consolidation Scenario

56. **This Scenario is informed by the amendment to the Public Finance Management Act, which mandates the National Treasury to scale down the debt stock to the legal threshold of 55% of Gross Domestic Product (GDP) in present-value terms over a period of five years.** The PFM Act was amended by the Parliament to change the debt limit from a numerical value to a debt anchor, which is a percentage of GDP. This scenario evaluates the best pathway for achieving the required debt-to-GDP threshold by 2028. Public Debt Stock amounted to Kshs.10.248 trillion as of December 2023.

57. **Revenues are assumed to perform relatively well as a result of modest gains from measures in the Finance Act of 2023 over the medium-term**. The scenario adopts an optimistic outlook in which domestic revenue mobilization efforts are scaled up in line with the Finance Act, and as such, revenue, including grants as a share of GDP, is projected to increase to 17.9% in FY 2024-2025. These measures are expected to be reinforced by the government's concerted efforts to reduce and eliminate revenue leakages.

58. **The assumptions on the expenditure outlook in this scenario are grounded in a growth-friendly fiscal consolidation effort.** The scenario presumes that the government will undertake deliberate decisions to reduce wasteful expenditure while

simultaneously upscaling investment in BETA initiatives that will enhance growth and reduce poverty and inequality. As such, total expenditure is expected to decline to 22 percent of the GDP from the 23.6 percent projected in the Budget Review and Outlook Paper. To achieve growth-friendly fiscal consolidation, the government must enhance the quality of public investments while promoting efficiency and effectiveness in public investment management.

59. **According to the latest Debt Sustainability Analysis (DSA), the ratio of public debt stock to GDP in Present Value terms at the time of the enactment of the law was 61%.** To achieve the legal threshold of 55 percent of the GDP, the National Treasury requires a progressive primary surplus that eventually leads to the debt anchor. Based on macroeconomic modelling, the scenario assumes a target of 1.6 percent primary surplus as the first step in the journey to achieve the debt anchor by 2028. To achieve the desired primary surplus, the fiscal deficit should not exceed 4 percent of GDP, which is equivalent to Kshs 721.8 billion in FY 2024-2025.

Table 6: Fiscal Framework for Baseline and Road to the Debt Anchor Scenario for FY 2024/25

Fiscal Framework in Kshs. Billion							
	2021/22	2022/23	2023/24		2024/25		
	Prel Actual	Prel Actual	Budget Est	BROP	BROP Proj	PBO Baseline[1]	PBO Alt[2]
Revenue and grants	**2,230.8**	**2,383.6**	**3,027.7**	**3,049.8**	**3,457.1**	**3,107.6**	**3,222.8**
Total Revenue	**2,199.8**	**2,360.5**	**2,985.6**	**3,007.6**	**3,407.8**	**3,063.1**	**3,178.3**
Ordinary Revenue	**1,917.9**	**2,041.1**	**2,571.2**	**2,576.4**	**2,918.9**	**2,573.9**	**2,689.1**
Income tax	876.7	941.6	1,198.5	1,198.5	1,325.7	1,194.5	1,239.4
VAT	523.1	550.4	703.3	703.3	804.7	690.8	710.7
Import duty	118.3	130.1	173.3	173.3	199.4	179.2	173.6
Excise duty	252.1	264.5	352.7	352.7	401.1	331.4	343.3
Other tax revenue	147.7	154.5	143.3	148.6	188.0	178.0	222.1
Appropriation-in-Aid	281.9	319.4	414.4	431.2	488.9	489.2	489.2
Grants	31.0	23.1	42.2	42.2	49.3	44.5	44.5
Total expenditures & net lending	**3,027.8**	**3,221.0**	**3,746.7**	**3,913.5**	**4,257.3**	**4,044.4**	**3,944.7**
Recurrent expenditure	2,135.3	2,311.6	2,536.3	2,687.2	2,851.0	2,841.8	2,812.0
Wages & salaries National gvt	520.0	547.2	584.6	584.6	645.3	574.8	574.8
Pensions & Other CFS	122.4	120.4	165.4	165.4	181.4	181.4	181.4
Interest	578.0	687.3	775.1	918.9	966.1	1,008.7	1,008.7
On domestic debt	456.8	533.1	628.3	646.4	716.1	747.7	747.7
On foreign debt	121.1	154.2	146.9	272.5	250.0	261.0	261.0
O&M and other recurrent	866.1	866.1	982.6	989.8*	1,026.9*	1,045.6*	1,015.8*
Contribution to civil ser pension fund		29.6	28.5	28.5	31.3	31.3	31.3
Development & net lending	**540.1**	**493.7**	**777.8**	**793.8**	**957.3**	**753.6**	**683.7**
Development expenditure	540.1	481.3	752.8	764.1	926.2	722.5	652.6
Net lending	-	12.3	17.2	18.8	19.7	19.7	19.7
Contingency Fund			2.8	2.8	5.0	5.0	5.0
Transfer to Counties	352.4	415.8	429.7	429.7	444.0	444.0	444.0
Parliamentary service	32.7	41.2					
Judicial Service	16.2	19.8					
Equalization Fund			7.9	10.9	11.4	11.4	11.4
Overall balance including Grants	**(797.0)**	**(837.4)**	**(718.9)**	**(863.7)**	**(800.2)**	**(936.9)**	**(721.9)**
Overall balance excluding grants	**(828.0)**	**(860.5)**	**(761.1)**	**(905.9)**	**(849.5)**	**(981.4)**	**(766.4)**
Adjustment to cash basis	11.9	37.0	-				
Deficit incl grants cash basis	**(785.1)**	**(800.4)**	**(718.9)**	**(863.7)**	**(800.2)**	**(936.9)**	**(721.9)**
As a Share of GDP							
Revenue and grants	**17.5%**	**16.7%**	**18.6%**	**19.2%**	**18.2%**	**17.3%**	**17.9%**
Total Revenue	**17.3%**	**16.5%**	**18.3%**	**18.9%**	**18.0%**	**17.1%**	**17.7%**
Ordinary Revenue	15.1%	14.3%	15.8%	16.2%	16.1%	14.3%	15.0%
Total expenditures and net lending	**23.8%**	**22.6%**	**23.0%**	**24.3%**	**23.6%**	**22.5%**	**22.0%**
Overall balance excluding grants	-6.5%	-5.9%	-4.4%	-5.4%	-4.4%	-5.2%	-4.0%
Overall balance including Grants	-6.3%	-6.0%	-4.7%	-5.6%	-4.7%	-5.5%	-4.3%
Primary Balance						**0.4%**	**1.6%**
Nominal GDP	**12,698**	**14,274**	**16,290**	**16,132**	**18,015**	**17,964**	**17,964**

[1] Baseline refers to "Business as usual"/No Policy Change.

[2] Alt -Alternative scenario that includes enhanced revenue collection coupled with expenditure rationalization aimed at reducing the nominal debt to GDP ratio to below 55% By 2028.

*Includes an allocation for Parliament and The Judiciary.

Source: PBO

Table 7:Budget Summary in Kshs. Billion							
	2021/22	2022/23	2023/24		2024/25		
	Prel Actual		Budget Est	BROP	BROP Proj	PBO Baseline1	PBO Alt2
Recurrent	1,434.9	1,474.2	1,567.4	1,574.5	1,672.2	1,620.4	1,590.6
Development	552.1	497.5	807.6	822.1	979.9	776.2	706.3
Ministerial National Gvt	1,987.0	1,971.8	2,375.1	2,396.6	2,652.1	2,396.6	2,296.9
Pensions & Other CFS	122.4	120.4	165.4	165.4	181.4	181.4	181.4
Interest	578.0	687.3	775.1	918.9	966.1	1,008.7	1,008.7
Contribution to civil service pension fund	-	29.6	28.5	28.5	31.3	31.3	31.3
Net lending/ (Payment of guaranteed loans)	-	12.3	17.2	18.8	19.7	19.7	19.7
CFS	700.4	849.6	986.2	1,131.5	1,198.5	1,241.1	1,241.1
County Equitable Share	340.4	399.6	385.4	385.4	406.7	406.7	406.7
Total	3,027.8	3,221.0	3,746.7	3,913.5	4,257.3	4,044.4	3,944.7

1 Baseline refers to "Business as usual"/No Policy Change.
2 Alt -Alternative scenario that includes enhanced revenue collection coupled with expenditure rationalization aimed at reducing the nominal debt to GDP ratio to below 55% By 2029

2.3. Sectoral Expenditure Outlook for FY 2024-2025

2.3.1. Baseline Scenario

60. The baseline expenditure outlook is premised on the contractionary policy of the government, which contains expenditure pressures due to the lower projections of revenue collection. Mandatory expenditures including interest payments on domestic and foreign debt as well as pension and other CFS related expenditures were assumed to remain as per the National Treasury projections in the Budget Review and Outlook Paper (BROP).

61. For recurrent expenditure, the scenario proposes that wages and salaries will be higher than the projections in the BROP to capture the actual expectations of wage drift in civil service, while Operation and Maintenance expenditures are expected to be lower than projected in the BROP, in line with government efforts to rationalize expenditures. However, it is expected that the salaries for the health, education, and Governance Justice Law and Order sectors will be higher than those proposed in the BROP due to expected recruitments in these sectors to address current shortfalls. The reduction in expenditure will be largely due to lower projections in Exchequer funding, while Appropriations-in-Aid are expected to be at the same level as in the BROP.

62. On the development side, expenditures will be lower when compared to the BROP due to government efforts to rationalize expenditure. Expenditures across all sectors are expected to be lower than projections in BROP, with the largest declines witnessed in the Energy, Infrastructure and ICT sector, Public Administration and International Relations Sector, and the National Security Sector. The reduction in expenditure is largely due to lower projections in Exchequer funding and

Development Loans while the Local Appropriations-in-Aid and Grants are expected to be at the same level as in the BROP.

63. Therefore, the sectoral ceilings have been aligned to the attendant fiscal framework to ensure that they are in line with revenue projections and the resultant fiscal deficit. The total ministerial expenditure, including that of the Judiciary and Parliament, is projected at Kshs. 2,397 billion, consisting of Kshs. 1,620 billion recurrent expenditure and Kshs.776 billion in development expenditure translating to 67.6% and 32.4% in recurrent and development expenditure, respectively, in adherence to fiscal responsibility principles.

2.3.2. Fiscal Consolidation Scenario

64. The debt-stabilizing scenario is based on the assumption that there are deliberate efforts towards expenditure rationalization with all sectors witnessing either a significant reduction or being maintained at FY 2023/24 overall expenditure ceilings. Mandatory expenditures including interest payments on domestic and foreign debt as well as pension and other CFS related expenditures were assumed to remain as projected in the Budget Review and Outlook Paper (BROP).

65. The recurrent expenditure proposals for wages and salaries will be enhanced when compared to the BROP, but at a similar rate to that of the baseline scenario. However, expenditures for Operation and Maintenance are expected to be much lower than those proposed in the baseline scenario, as the government will enhance expenditure rationalization efforts to reduce debt accumulation. The reduction in expenditure will be largely due to lower projections in Exchequer funding, while Appropriations-in-Aid are expected to be at the same level as in the BROP.

66. On the development side, the decline in expenditures will correlate with that of the baseline scenario but will be significantly lower due to the government's enhanced efforts to rationalize expenditure to reduce debt accumulation. The reduction in expenditure is largely due to lower projections in Exchequer funding and Development Loans while the Local Appropriations-in-Aid and Grants are expected to be at the same level as in the BROP.

67. The total ministerial expenditure, including that of the Judiciary and Parliament, is projected at Kshs. 2,297 billion consisting of Kshs. 1,591 billion in recurrent expenditures and Kshs.706 billion in development expenditures, translating to 69.2% and 30.8% in recurrent and development expenditures, respectively. It is important to emphasize that, for this scenario to crystallize, all sectors will be required to reprioritize their allocations without adversely affecting service provisions.

Table 8: Sectoral Expenditure Ceilings for FY 2024/25 (Kshs. Millions)

Sector		FY 2023/24	FY 2024/25		
		Approved Budget	BROP	PBO Baseline	PBO Alternative
Agriculture, Rural & Urban Development	**Sub-Total**	**87,941.50**	**85,794.10**	**82,445.10**	**73,445.10**
	Rec. Gross	32,970.20	28,156.00	28,156.00	28,156.00
	Dev. Gross	54,971.30	57,638.10	54,289.10	45,289.10
Energy, Infrastructure & ICT	**Sub-Total**	**532,363.70**	**541,120.00**	**505,668.00**	**485,822.00**
	Rec. Gross	148,004.60	148,380.90	145,306.00	145,306.00
	Dev. Gross	384,359.10	392,739.10	360,362.00	340,516.00
General Economic & Commercial Affairs	**Sub-Total**	**61,419.80**	**57,339.80**	**54,710.00**	**54,455.00**
	Rec. Gross	30,044.50	30,299.80	30,300.00	30,045.00
	Dev. Gross	31,375.30	27,040.00	24,410.00	24,410.00
Health	**Sub-Total**	**141,186.50**	**143,120.80**	**142,618.10**	**131,104.40**
	Rec. Gross	80,627.10	82,343.40	82,343.40	80,627.00
	Dev. Gross	60,559.40	60,777.40	60,274.70	50,477.40
Education	**Sub-Total**	**628,580.10**	**669,953.00**	**666,865.00**	**653,953.00**
	Rec. Gross	595,480.70	640,408.70	638,440.00	630,408.70
	Dev. Gross	33,099.40	29,544.30	28,425.00	23,544.30
Governance, Justice, Law & Order	**Sub-Total**	**230,401.10**	**250,175.50**	**242,391.70**	**229,399.00**
	Rec. Gross	220,529.50	232,657.70	232,422.70	220,530.00
	Dev. Gross	9,871.60	17,517.80	9,969.00	8,869.00
Public Admin. & International Relations	**Sub-Total**	**310,191.10**	**332,890.90**	**313,204.20**	**299,256.00**
	Rec. Gross	194,209.80	197,958.20	197,158.20	194,210.00
	Dev. Gross	115,981.30	134,932.70	116,046.00	105,046.00
National Security	**Sub-Total**	**189,244.20**	**253,635.60**	**191,280.60**	**187,671.00**
	Rec. Gross	184,990.20	204,026.60	187,026.60	183,417.00
	Dev. Gross	4,254.00	49,609.00	4,254.00	4,254.00
Social Protection, Culture and Recreation	**Sub-Total**	**70,642.90**	**72,619.30**	**71,601.70**	**69,473.10**
	Rec. Gross	45,681.90	47,828.20	46,810.60	45,682.00
	Dev. Gross	24,961.00	24,791.10	24,791.10	23,791.10
Environment Protection, Water & Nat. Resources	**Sub-Total**	**120,559.70**	**141,126.40**	**125,827.20**	**112,323.40**
	Rec. Gross	32,348.70	32,211.40	32,411.40	32,211.40
	Dev. Gross	88,211.00	108,915.00	93,415.80	80,112.00
Total	**Sub-Total**	**2,372,530.60**	**2,547,775.40**	**2,396,611.60**	**2,296,902.00**
	Rec. Gross	**1,564,887.20**	**1,644,270.90**	**1,620,374.90**	**1,590,593.10**
	Dev. Gross	**807,643.40**	**903,504.50**	**776,236.70**	**706,308.90**

Source: PBO

3. MANAGING THE PREVAILING ECONOMIC CHALLENGES

3.1. Options for fiscal consolidation at the national level

3.1.1. Expenditure Prioritization and Improvement of Efficiency

a) Overview

68. Over the years, the government of Kenya has attempted a series of budgetary reforms, but the results, as Kenya's fiscal story shows, have been futile given the penchant for incrementalism and wastage of expenditures. Policymakers have always recognized the significance of budgeting in influencing economic growth, as evidenced by various policy guidelines.

69. Three main initiatives were rolled out prior to the introduction of the Medium-Term Expenditure Framework in 2002 to deal with the proclivity of expenditure incrementalism. The Programme Review and Forward Budget, which was introduced to link resource allocation to planning, did not live up to its expectations; therefore, other reforms such as Budget Rationalization were introduced to deal with financial management and accounting and the Public Investment Programme to impose a clearer criterion for selecting and appraising development projects with the objective of reducing the number of projects and prioritizing scarce development resources.

70. The Medium-Term Expenditure Framework (MTEF) was regarded as a panacea to fiscal discipline, where resources were to be allocated in accordance with strategic priorities, and efficient and effective use of resources in the implementation of strategic priorities has not lived up to these objectives. This is evidenced by in-year budgetary reviews (Supplementary Budgets), mainly occasioned by the misapplication of Article 223 of the Constitution.

71. Further reforms have been introduced, including the adoption of programme-based budgeting, where emphasis has been placed on outputs rather than inputs as the basis of resource allocation; however, little success has been achieved. Instead, MDAs have continued to receive budgetary allocations, but with little achievement of planned outputs and targets.

b) Broad Proposals for Expenditure Reforms

i. Implementation of the Public Investment Management Framework

72. However, the role of public investment in influencing growth cannot be gainsaid. Although the literature is divided, public investments encourage new private investment, which increases economic growth (Gupta et al., 2014). Public investment plays a crucial role in Kenya by contributing to the provision of essential public services,

fostering connections between citizens and businesses, and by acting as a significant driver of economic growth.

73. However, the quality of such investment remains a central policy challenge. Anecdotal evidence points to cost overruns, time delays, and inadequate maintenance as some of the factors affecting the quality of public investments in sub-Saharan African countries, including Kenya. Indeed, a large project portfolio characterized by a slow pace of project implementation is an indication of poor quality investments. The large project portfolio may suggest that not all of these projects have undergone a technical appraisal as required by the Public Investment Management guidelines.

74. Despite their significance in realizing Vision 2030, the execution of many of these projects has resulted in financial constraints, capacity limitations, and inadequate institutional structure. These challenges have resulted in significant outstanding bills, and in some cases, projects stalling and subsequently delaying returns on such investments. Presently, the government is overseeing more than 4,500 projects at various stages of development, with some of the earliest initiatives dating back to pre-2010. To successfully complete these ongoing projects, the government estimates a financial requirement that exceeds Kshs. 4.2 trillion[2]. (See Table 9).

Table 9: Summary of Project costs across Sectors in *Kshs.* Billions

S/No.	Sector	Estimated Requirement	Total Expenditure 30-6-23	Outstanding Cost
1	Governance, Justice Law and Order	262	94	168
2	Education	48	24	24
3	Public Administration and International Relations	1,952	1,229	723
4	Health	583	206	377
5	Social Protection, Culture and Recreation	163	81	82
6	General Economic and Commercial Affairs	31	14	18
7	Agriculture and Rural Development	517	313	203
8	Energy ICT and Infrastructure	3,323	1,643	1,680
9	Environmental Protection Water and Natural Resources	1,248	347	901
10	National Security			-
	TOTAL	**8,127**	**3,951**	**4,176**

75. Given the conundrum facing the implementation of these projects, the development of Public Investment Management (PIM) regulations in Kenya has come at a time, and

[2] PBO Project Compendium

there is a need for effective and transparent management of public resources. These regulations should enhance the efficiency and accountability of public investment processes by establishing a structured framework for the planning, appraisal, approval, and implementation of projects. This initiative aligns Kenya with international standards, bolstering its credibility and facilitating collaboration on development projects but significantly the Public Investment Management Information Systems (PIMIS) should help control costs, eliminate redundancy, prioritize projects, and maximize socio-economic returns

76. Despite these advancements, progress in making the PIMIS operational has been slow, and its implementation is a crucial quantitative performance criterion necessary for the approval of disbursements under the IMF Extended Credit Facility (ECF)[3]/ Extended Fund Facility (EFF)[4]. The following options can be considered to ensure efficiency in public investment.

i. Strengthen and operationalize the PIM framework by empowering it through legislative measures.
ii. Periodically review the public investment portfolio and adjust priorities based on changing economic conditions and emerging needs. This ensures that the government remains adaptable to evolving circumstances.
iii. Foster transparency by disclosing information about public investment projects to the public. Encourage public participation to gather feedback, which can contribute to better decision-making and accountability.
iv. Perform thorough risk assessments for each project to identify potential challenges and uncertainties. This would allow better risk management and ensure that public investments are less likely to result in unexpected costs or delays.

ii) Implementation of e-Procurement

77. The Public Procurement and Disposal Act of 2015 is pivotal in Kenya as it dictates how the government procures goods and services. However, the procurement process encounters challenges, such as operational issues and corruption, hindering its effectiveness, efficiency, and transparency. Corruption significantly undermines this process, leading to subpar outcomes. Ineffective procurement processes, marked by complex procedures and bureaucratic obstacles, result in project delays, disruption of goals, and impact the timely delivery of goods and services.

[3] https://www.imf.org/en/About/Factsheets/Sheets/2023/Extended-Credit-Facility-ECF
[4] https://www.imf.org/en/About/Factsheets/Sheets/2023/Extended-Fund-Facility-EFF

78. In the past year, the government initiated the implementation and integration of the Electronic Government Procurement (e-GP) system, aiming to modernize government procurement processes and enhance overall governance. Despite these efforts, there has been sluggish progress in making the system fully operational, and this lack of advancement serves as a critical quantitative performance criterion necessary for the approval of disbursements under the IMF Extended Credit Facility (ECF)[5]/ Extended Fund Facility (EFF)[6].

79. By combining expenditure prioritization with improvements in e-procurement efficiency, Kenya can achieve fiscal consolidation while maintaining essential public services and promoting economic growth through the following options:

i. Link e-procurement using IFMIS. This would foster greater efficiency, transparency, and control across the procurement lifecycle, ultimately contributing to better financial management and organizational performance.

ii. Make the procurement portal publicly available to enhance the transparency of procurement for citizens.

iii. Establish centralized e-procurement platforms that consolidate procurement activities across government agencies. This promotes economies of scale, standardization, and better negotiation power with suppliers.

iv. Introduce mobile-friendly procurement solutions to enhance accessibility and responsiveness. Mobile apps can facilitate approval, provide notifications, and allow stakeholders to engage in the procurement process on-the-go.

iii) Review of Regulations for Article 223 Expenditures

80. There have been significant reforms in public finance management in Kenya with the promulgation of the new constitution in 2010 and the subsequent enactment of the Public Finance Management Act in 2012, with the aim of increasing transparency and accountability in the management of public resources. However, as mentioned earlier, incremental budgeting, mainly occasioned through in-year changes (supplementary budgets), often reversed the initial focus of these reforms.

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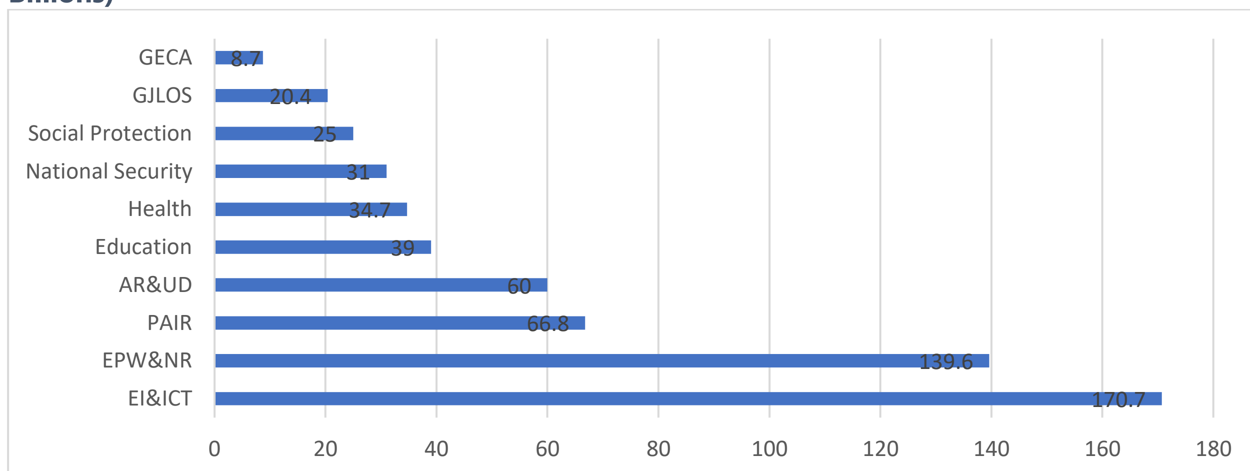
[5] https://www.imf.org/en/About/Factsheets/Sheets/2023/Extended-Credit-Facility-ECF
[6] https://www.imf.org/en/About/Factsheets/Sheets/2023/Extended-Fund-Facility-EFF

81. The supplementary budgets, mainly through Article 223 of the Constitution, have often been implemented despite not being consistent with the medium-term expenditure framework amidst underperformance of the revenues and further exposing the MDAs to other vulnerabilities such as pending bills, thus casting doubt on the efficiency and effectiveness of such budgets.

82. Article 223 of the Constitution allows the national government to spend money that has not been appropriated in case of insufficiency, or when a need has arisen for which there was no appropriation. Despite this provision, the Public Finance Management Act and its attendant regulations provide safeguards to deter any misuse of spending. The safeguards in PFM Regulations 40(3) include unforeseen expenditures that are often overlooked by Ministries, Departments and Agencies.

83. Available data from the Auditor General reveals that MDAs majorly domiciled within sectors such as Energy, Infrastructure, environment, and water have seen the highest withdrawal (See Figure 17); however, these are sectors whose activities may wait for approval to be granted by the National Assembly without invoking the provisions of Article 223.

Figure 17: Cumulative expenditures granted under Articles 223 2014/15–2022/23(Kshs. Billions)



Source: OAG report and PBO computations

84. The misuse of the provisions of Article 223 expenditures, as aforementioned, weakens the trustworthiness of annual planning and budgeting since MDAs appear to avoid rigorous examination in the regular budget process in favor of supplementary budgeting, which permits the approval of additional expenses post facto by the Parliament. Most of these expenses are directly linked to predictable requirements that should be foreseen and incorporated into the original budget. Such expenditures, which were previously questioned by the National Assembly, include the withdrawal

of Kshs. 1.5 billion towards the purchase of land in Ruaraka by the Ministry of Education and the payment of Kshs.6.7 billion by the National Treasury towards the purchase of Telkom Kenya.

85. Supplementary budgets disrupt well-crafted budget policies, which are vital for promoting a country's economic agenda. Given the current state of the country's economy, amid growing public debt, it is crucial for the government to adopt a practical and efficient approach to fiscal consolidation, limiting supplementary expenditures that require additional spending, except in cases of unforeseen emergencies. This will ensure that government efforts to achieve fiscal austerity are not undermined by supplementary budgets that call for more money or additional borrowing.

86. To ensure movement towards the fiscal consolidation path, the following options can be considered:

(i) Supplementary spending under Article 223 should be limited to unforeseen and unavoidable emergencies and funded via contingency funds and expenditure savings.

(ii) The Public Finance Management Act was amended to ensure that sanctions are put in place to deal with any withdrawal not in line with the principles of public finance as outlined in Article 201(d) of the Constitution and to further tighten the existing legislation to eliminate any ambiguities in the law.

iv) Risks and options for managing Pending Bills

87. Domestic expenditure arrears (pending bills), being non-remittances of statutory deductions and payment delays for goods and services rendered to the government mainly by citizen contractors/suppliers and special groups, continue to be both fiscal and expenditure risk. Longstanding pending bills are considered a form of forced financing because they are overdue and evidently not safeguarded against inflation (loss of value) or compensated for opportunity loss. The absence of timely settlement with no benchmark or market-linked interest rate consideration for unexpected delays is a key feature of pending bills in public-sector financial management. Similarly, court awards arising from litigation are not settled promptly due to the non-provision of allocation and also suffer from further delays. Moreover, the diversion of earmarked allocations towards payment of approved-to-be-paid pending bills tends to exacerbate the accumulation or persistence of pending bills.

88. Consequently, long-standing arrears have negative outcomes on firms' balance sheets and working capital, which disproportionally affect micro and small enterprises, in

addition to stifling competition in the marketplace. According to the Micro and Small Enterprise Authority, these enterprises account for 24% of the country's GDP and approximately 90% and 93% of private sector enterprises and the total labor force, respectively. The World Bank Enterprise Survey for Kenya indicated that 19 per cent of the firms surveyed in the private sector had government contracts for the provision of goods and services, which further indicated that small firms accounted for the largest share (40%) followed by medium-sized firms (35%), followed by large firms (25%), while the remaining shares (approximately 9%) were those issued with government contracts under affirmative considerations.

89. Moreover, outstanding arrears increase the risk of loan defaults and remains a source of major risk to banking systems and other lending avenues such as SACCOs in the form of non-performing loans (NPLs). These practices expose government procurement to higher pricing (risks) as suppliers cover or mitigate the impact of delayed payments or increasingly avoid participating in government procurement, which is indicative of material breach of the constitutional principles of public procurement.

90. Cumulative pending bills increased from 1% of GDP in 2018/19 to nearly 5% of GDP in FY 2023/24, pointing to elevated levels of arrears accumulation, with State Corporations (SCs) and other Semi-Autonomous Government Agencies (SAGAs) accounting for the largest share. On the downside, growing arrears, including ad hoc disclosures, negatively reflect past measures by government entities to settle (while proactively managing) arrears as well as poor revenue forecasts coupled with weak financial commitment/controls during budget implementation requiring a rethink in terms of both legal and policy shift.

Table 10: Domestic Expenditure Arrears (pending bills) and comparisons with GDP and Ordinary Revenue, Kshs. billions

Domestic Expenditure Arrears (Pending bills) and comparisons with GDP and Ordinary Revenue , Ksh billions						
Description/Details	**2018/2019**	**2019/2020**	**2020/2021**	**2021/2022**	**2022/2023**	**2023/24**
GDP - Market Prices	9,789.02	10,483.78	11,374.41	12,693.67	15,202.95	17,073.35
Ordinary revenue	1,704.36	1,795.66	1,783.75	2,199.81	2,360.51	2,576.80
Domestic Expenditure Arrears	129.04	448.05	455.51	685.61	732.26	794.18
of which						
National Government (MDAs, SCs)	94.5	334.2	359.50	532.59	567.50	630.56
of which State Corporations (SCs)				*448.62*	*443.60*	*509.37*
County Government (Sub - National)	34.54	113.85	96.01	153.02	164.76	163.62

Domestic Expenditure Arrears (Pending bills) and comparisons with GDP and Ordinary Revenue , Ksh billions						
Description/Details	**2018/2019**	**2019/2020**	**2020/2021**	**2021/2022**	**2022/2023**	**2023/24**
% of GDP						
Domestic Expenditure Arrears against GDP	1%	4%	4%	5%	5%	5%
of which						
National Government (MDAs, SCs)	1%	3%	3%	4%	4%	4%
of which State Corporations (SCs)	*0*	*0*	*0*	*4%*	*3%*	*3%*
County Government (Sub - National)	0%	1%	1%	1%	1%	1%
% of Ordinary Revenue						
Domestic Expenditure Arrears against Ordinary Revenue	8%	25%	26%	31%	31%	31%
of which						
National Government (MDAs, SCs)	6%	19%	20%	24%	24%	24%
of which State Corporations (SCs)	*0%*	*0%*	*0%*	*20%*	*19%*	*20%*
County Government (Sub - National)	2%	6%	5%	7%	7%	6%

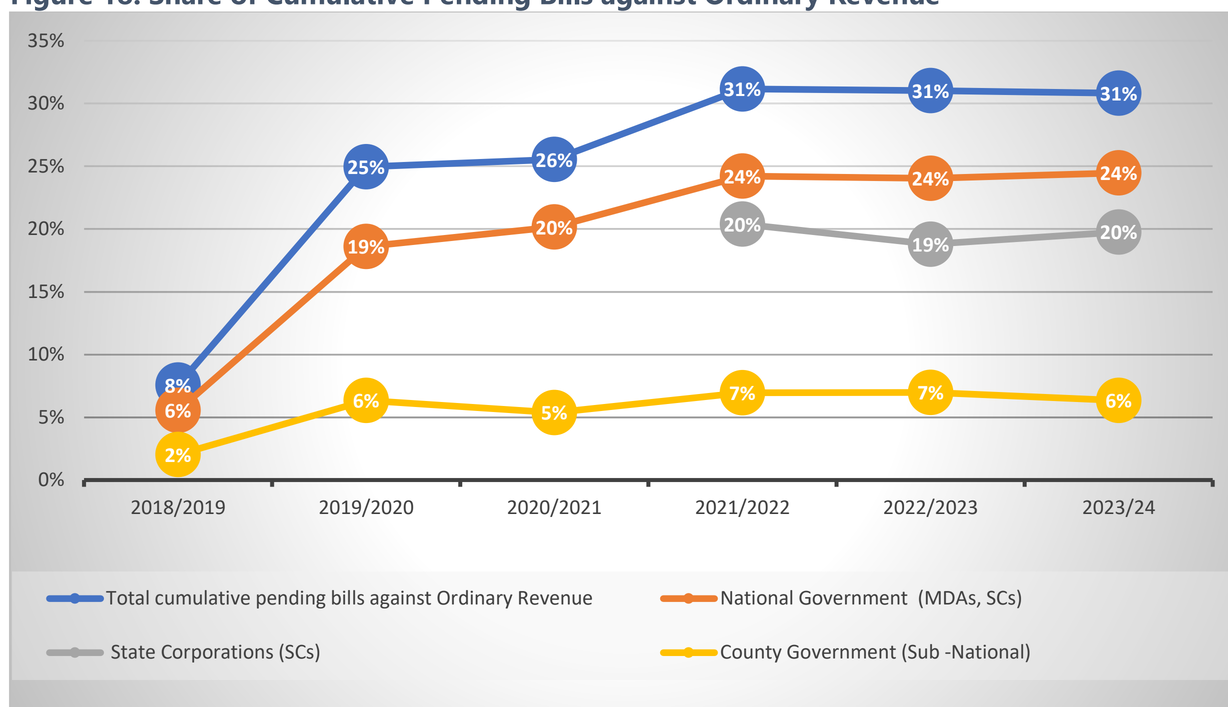
Source: Various Controller of Budget Implementation reports and Various QEBR

Trend of Pending bills against ordinary revenue

91. The share of cumulative pending bills against ordinary revenue remained at approximately 31% of ordinary revenue by the end of FY 2022/23, with the national government share of arrears at approximately 24%, mainly contributed by state corporations, by up to 19 percentage points. A similar trend is obtained by the end of 1st Quarter for the current FY 2023/24, although the share under state corporations increases by 1 percentage point to 20%. On the other hand, arrears under county government remained at nearly 7% in the same period, posing constrained fiscal maneuvers for the affected counties, if not curtailed or addressed conclusively in the medium-term.

92. Taken together, the government would have to forgo nearly 31% of ordinary revenue if pending bills were to be settled ceteris paribus. On the downside, this points to elevated fiscal vulnerabilities that the reported growing stock of arrears - also considered (or emerging) as a form of hidden debt and the carryover profile it assumes during annual sector budget implementation – pose material risks to government fiscal stance, and can further potentially compound debt vulnerabilities given the constraining fiscal environment, including pressures from sizeable growth in other mandatory expenditure items.

Figure 18: Share of Cumulative Pending Bills against Ordinary Revenue



Source: Various Controller of budget Reports and National Treasury's QEBR

Breakdown and composition of Pending Bills by levels of Government

93. As indicated earlier, SCs and other SAGAs account for the lion's share of the total government's pending bills at 64%, out of which statutory obligations such as Pay as You Earn, pensions, staff loans, and tobacco deductions account for some of the outstanding arrears under SCs. Moreover, penalties and interests form part of the arrears under SCs and SAGAS for FY 2022/23, which amounted to approximately KSh 10.76 billion, with KENHA, NOCK, and Chemelil Sugar Company accounting for 43%, 21%, and 11% of the total penalties and interest, respectively.[7]. While some state corporations receive budget support in the form of current and capital transfers, SCs operating on commercial principle terms generate revenues and are consequently expected to manage commitments and resulting arrears. However, obtaining a scenario points to general liquidity challenges in settling expenditure commitments as well as poor corporate governance, including weak or non-existent oversight between the respective SC/SAGAs Board and parent ministry/National Treasury.

94. As regards counties, Nairobi City County accounts for 66% of counties total arrears translating into outstanding amount of KSh 107.33 billion, out of which KSh 103.29 billion are outstanding arrears under the recurrent expenditure category. Realism reviews of past county budgets reflect weak forecasts with optimistic bias underpinning key assumptions for estimation of own source revenue, resulting in unmitigated build-up of arrears. The rate of accumulation of arrears in some counties

[7] National Government Budget Implementation Review Report FY 2022/23 by The Controller of Budget

outpaced the corresponding increase in the respective county equitable share, indicative of near material risk to affected counties' fiscal ability to settle outstanding obligations that can result in a breakdown (or compromise) in the provision of key services in the medium term.

95. Overall, exposure resulting from pending bills suggests growing contingent obligations for the national government, further increasing the complexity and impact of fiscal risks on government resources.

Table 11: Breakdown and composition of Cumulative pending bills by levels of government , in Ksh millions

No	Levels/Details	FY 2022/23	FY 2023/24*	% Share of total pending bills, FY 2023/24*
A1	**National Government (MDAs)**	**123,905.43**	**121,199.75**	15.26%
	Recurrent	87,835.18	86,632.93	10.91%
	Development	36,070.25	34,566.82	4.35%
A2	**National Government (SC/SOEs)**	**443,595.99**	**509,368.41**	**64.14%**
	Recurrent	**188,135.27**	**220,170.99**	27.72%
1	Pay As You Earn	20,158.41	25,309.79	3.19%
2	National Social Security Fund	182.52	407.36	0.05%
3	National Hospital Insurance Fund	33.89	80.92	0.01%
4	Unremitted Sacco Deductions	2,504.10	2,681.37	0.34%
5	Unremitted Staff Loan Deductions	1,781.22	2,475.20	0.31%
6	Pension Arrears	46,806.80	47,646.27	6.00%
7	Consumables & General Supplies	31,072.55	30,488.28	3.84%
8	Others (unclassified)	85,595.78	111,081.80	13.99%
	Development	**255,460.72**	**289,197.42**	36.41%
1	Contractors/Projects (Development)	255,460.72	289,197.42	36.41%
C	**Total National Government (C= A1+A2)**	**567,501.42**	**630,568.16**	**79.40%**
D	**County Governments (Sub- National)**	**164,764.67**	**163,616.71**	**20.60%**
	Recurrent	132,220.33	129,145.10	16.26%
	Development	32,544.34	34,471.61	4.34%
E	**Total (E= C+D)**	**732,266.09**	**794,184.87**	**100.00%**

Source: Various issues – Office of the Controller of Budget

*1st Quarter Cumulative amounts for FY 2023/24

** Nairobi County Accounts for 66% of total counties pending bills

96. Legal measures contained in public financial management are either inadequate, or the application of the law is not sufficiently applied. The PFM Act (2012) considers failure to make any payments as and when due by a State Organ or a Public Entity as an indicator of a serious material breach (Section 94) and provides a basis for the process of stoppage of funds as stipulated in the Constitution (Article 225).

Administratively, the government appointed a Committee in the FY 2022/23 to formally ascertain and manage the exposure posed by arrears across the public sector.

97. In FY 2019/20, the government undertook various measures to address the challenges of pending bills at both levels, such as auditing their veracity and extent of pending bills. However, discretionary management of allocations/releases meant that paying eligible pending bills continues to be the main cause of persisting pending bills, especially in the last three years. This has greatly compromised the requisition and approval process during budget execution, meaning a preference for new commitments at the expense of old and eligible pending bills. Additionally, starting new project(s) while pending bills for existing or ongoing projects continues to persist, often leading to the stalling of such projects and wastage. To commit and follow through the validation and clearance of pending bills in the public sector accumulated between 2005 and June 2022, the government has created an inter-ministerial committee (Pending Bills Verification Committee) with mandate until September 2024[8]

98. Additionally, there are no specific sanctions and deterrence to curtail accumulation and non-disclosure of pending bills as well as expenditure based legal rules to identify, track, classify and report on the extent and risks posed by such arrears (see trends under SCs/SAGAs). Moreover, some arrears remain outstanding with no formal rules to guide or trigger either the final settlement or re-unification of such arrears to their rightful owners, as is the case with financial assets through the Unclaimed Financial Assets Authority.

Options in managing pending bills in the public sector

99. Given the obtaining liquidity challenges which in the past has been the major contributing factor to the growth of expenditure arrears, the settlement of outstanding obligations may require a mix of legal, policy and budgetary/fiscal measures that if implemented may curtail unmitigated accumulation of arrears:

(1) Provide for Kshs. 150 billion each FY to settle and clear expenditure arrears (pending bills) for the next five years on First in (incurred) and First Out (settled) basis using a mix of ordinary revenue and concessional based instrument to manage liquidity pressures and smoothen cash flow needs for the indicated period. Priority settlement be given to suppliers with verified pending bills and unremitted-but-deducted statutory obligations such as outstanding PAYE, pensions, SACCO contributions and staff loans

(2) Respective allocation to clear or settle pending is provided within the vote or sector budget and is set at not more than 25% of vote allocation for the fiscal

[8] https://www.imf.org/en/Publications/CR/Issues/2024/01/17/Kenya-2023-Article-IV-Consultation-Sixth-Reviews-Under-the-Extended-Fund-Facility-and-543889

year. Details of the pending bills to be settled be submitted as a schedule annexed alongside the annual appropriation measures to be approved by the National Assembly or respective County Assembly

(3) Introduce and codify rule-based legal regimes to identify, quantify, classify, limit, and report all types of pending bills and commitments and provide specific sanctions curtailing the accumulation of pending bills. This should be complimented by a system based approach for recording and reporting on pending bills

(4) Amend the PFM, Act (2012) to introduce further disclosure measures relating to pending bills and other government arrears during budget approvals. This may be the in-form of a template to be submitted alongside (or annexed) to each proposed sector/vote budget for approval and provide on first charge a basis or authority for payment of eligible pending arrears in the next financial year

(5) Provide disclosures on pending bills in the fiscal framework to accurately reflect the fiscal position and operations of the government, including counties.

(6) Amend the Unclaimed Financial Assets Authority Act to provide for tracking, settlement, and reunification of unclaimed but eligible pending bills across the public sector.

(7) Follow appropriate legal measures on the creation and falsification of liabilities, including pending bills, as this will, in the first instance, minimize costly validation of the stock of pending bills and offer some level of deterrence on fraudulent activities by duty bearers.

3.2. Options for fiscal consolidation at county level

3.2.1. Own Source Revenue – The Revenue streams

100. **Article 175(b) of the Constitution stipulates that County Governments should have reliable sources of revenue to enable them to effectively govern and deliver services**. These funding sources include equitable shares from the National Government, Conditional and unconditional grants; loans and grants; and local revenues, which include local taxes, charges, and fees. The Constitution allows counties to impose property rates, entertainment taxes, and charges for the services provided, as well as any other taxes arising from the Act of Parliament. County Governments impose their own source of revenue through county Finance Acts.

101. County budgets were approved by the respective County Assembly. ***Table 12*** indicates the sources of revenue for the counties from FY 2018/19 to FY 2022/23.

Table 12: Revenue Sources for Budget Financing in Counties (In Kshs Bn.)

Revenue source	FY 2018/19	FY 2019/20	FY 2020/21	FY 2021/22	FY 2022/23	FY 2023/24 Projection*
Equitable Share	314	316.5	316.5	370	370	385.42
OSR	**53.86**	**54.9**	**53.66**	**60.42**	**57.37**	**78.61**
Add. Allocations (Nat Govt)	25.50	22.9	23.16	7.54	5.36	42.64**
Add. Allocations (Dev Partners)	36.98	39.09	30.20	32.34	17.16	
Cash Balance	55.08	51.23	51.99	58.88	42.03	27.96
Total	483.47	499.62	501.74	535.74	515.18	534.63
(OSR/Total) %	**11.1%**	**11.3%**	**11.0%**	**11.27%**	**11.13%**	**14.70**

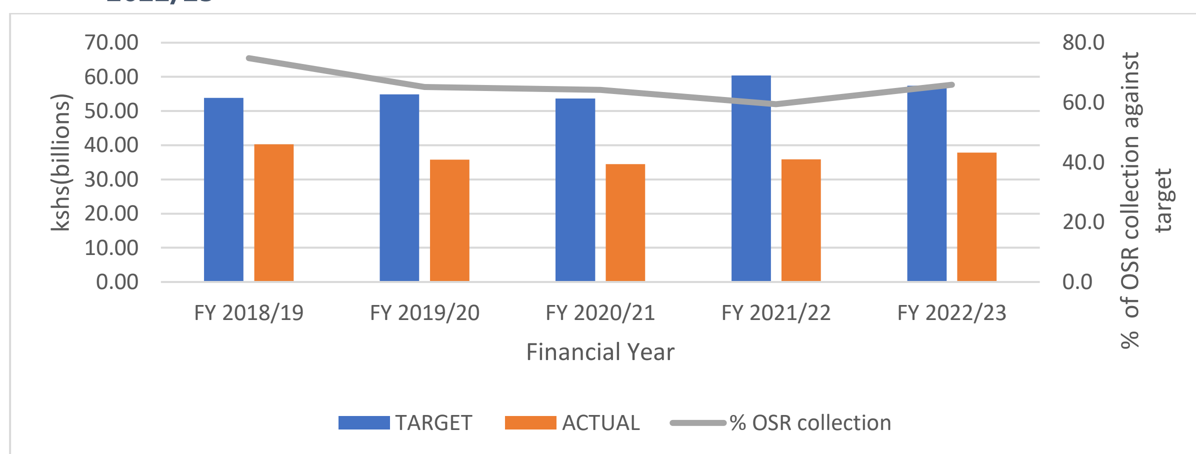
Source: Controller of Budget (COB) Reports

**This is the projection as at 30th September 2023.*

*** The County Governments Additional Allocation Bill is yet to be approved by Parliament as at January,2023.*

102. **While the revenues above represent the budgeted financing sources, counties have, over the years, had a revenue out-run that differed from projections**. This has led to fiscal deficits, pending bills, supplementary budgets, and unfinanced programs in the respective financial years. The gap between OSR targets and actual revenue generated continues to occur over the years, in which counties managed to collect 59.43% of their target OSR collections in FY 2021/22 and 69.7% in FY 2022/23 (Figure 19***).*** shows the performance of the OSR collection against set targets from FY 2018/19 to FY 2022/23.

Figure 19: Analysis of Own Source Revenue Collection vs Target FY 2018/19 -FY 2022/23



Source: COB Reports

103. In FY2022/23, only three counties–Lamu County-120%, Kirinyaga-112%, and Kitui -110%–achieved their target OSR collection, while seven counties achieved less

than 50% of their projected revenues in the same year. Nairobi City County is the county with the highest absolute OSR collection at kshs.10.2 billion in FY 2022/23. ***Annex 1*** shows the OSR performance of all counties from FY 2018/19 to FY 2022/23.

104. The major sources of revenue in the counties are business permits, signboards, advertising fees, and revenue from public facilities operations. The top ten revenue streams shown below accounted for 71% of the absolute total own-source revenue collected by the County Governments in FY 2022/23. Most revenue streams registered growth from the collection in FY 2021/22, except for the revenue from public facilities operations, which reduced by 12.3%. Insurance claims recovery registered 180.7% growth, as shown in ***Table 13***.

Table 13: Top Ten revenue streams in counties in terms of amounts generated

	Revenue Stream	FY 2022/23(Kshs.)	FY 2021/22(Kshs.)	% growth
1	Business permits	4,468,146,082	3,672,333,867	1.7%
2	Sign boards and advertising fees	3,846,193,614	3,631,956,916	5.9%
3	Public facilities operations	3,389,768,451	3,863,963,420	-12.3%
4	Insurance claims recovery	2,691,893,958	958,944,571	180.7%
5	Vehicle parking fees	2,618,366,129	2,559,309,352	2.3%
6	Cess	2,291,740,246	2,076,108,738	10.4%
7	Market/trade Centre fees	2,239,765,583	2,197,658,626	1.9%
8	Receipts from sale of agricultural Goods	2,097,057,255	1,627,585,454	28.8%
9	Land/ plot rents	1,649,649,849	1,405,146,743	17.4%
10	Poll rates	1,488,047,958	1,299,796,476	14.5%
	Other receipts	10,094,376,387	9,497,018,219	6.3%
	Total	**36,875,005,512**	**32,789,822,381**	**12.5%**

Source: National Treasury, County Consolidated Statements June 2023

105. Counties have not met their potential collection of OSR since their inception. As per the Commission on Revenue Allocation's report on OSR potential and tax gaps 2021, counties have not exploited their potential collections in all revenue streams. Therefore, it is important for counties to focus on their individual revenue streams to ensure optimal collection. Hospital and public health service fees, trade

licensing, natural resource exploitation fees, and property rates have the highest revenue gaps, exceeding Kshs 10 billion per revenue stream. ***Table 14.*** shows potential OSR collections from sampled revenue streams and their actual collections in FY 2022/23.

Table 14: Potential vs actual receipts (FY 2022/23)

Revenue Stream	Total Potential (Kshs. Millions)	FY 2022/23 (Kshs. Millions)	Revenue gap (Kshs. Millions)	% Revenue Gap
Hospital and Public Health Services fees	32,000	3,389	28,611	89.41
Trading Licensing	23,000	4,468	18,532	80.57
Natural Resource exploitation fees	16,000	84	15,916	99.48
Property Rates	14,000	1,649	12,351	88.22
Parking fees	8,500	2,618	5,882	69.20
Environment and Conservancy Administration fees	5,000	1,093	3,907	78.14
Market Trade Center	4,600	2,240	2,360	51.30
Liquor Licensing fees	4,400	676	3,724	84.63
Fines and Penalties	800	180	620	78

Source: CRA & National Treasury

106. **The realism and accuracy of OSR targets remain uncertain because of their low achievement rate of the set targets.** Counties have exhibited consistent non-achievement of OSR collections as a percentage of targets of approximately 60 to75 percent from FY 2018/19 to FY2022/23. The average collections pose questions on how realistic the OSR targets are, the accuracy in making revenue forecasts, and the existence of effective and efficient structures and procedures to ensure optimum collection. This highlights the importance of having a Revenue Management System with the view of assisting the county in meeting its potential revenue collections for service delivery to the residents of all counties. ***Table 15*** shows the percentage achieved in OSR collections for all counties against the set targets from FY 2018/19 to FY 2022/23.

Table 15: OSR collections against set targets from FY 2018/19 to FY 2022/23.

Financial Year	Target OSR (Bn Kshs)	Actual OSR Collected (Bn Kshs)	% Achieved
2018/19	53.86	40.3	74.82
2019/20	54.9	35.77	65.15
2020/21	53.66	34.44	64.18
2021/22	60.42	35.91	59.43
2022/23	57.37	37.81	65.90

Source: COB Reports

107. **The new legislation enacted in 2023 will affect OSR collections going forward.** The Facilities Improvement Financing Act (2023) was passed towards the end of the 2023 calendar year. The law will have an impact on OSR collections by counties and how they are utilized because it aims to ensure that funds are spent in the facilities in which they are raised only. This will ensure that the funds collected, mostly in health facilities, are not re-directed to other programmes apart from those of the relevant facility.

4. Revenue Management Systems

108. The Public Finance Management (PFM) Act (2012) Section 104(d) authorizes County Executive Committee member for Finance to mobilize resources for funding the County's budgetary requirements and put in place mechanisms to raise revenue and resources. Section 157 of The PFM Act (2012) authorizes the County Executive Committee member for Finance to designate persons to be responsible for collecting, receiving, and accounting for county government revenue in the respective county.

109. **County Governments have four administrative arrangements for revenue collection and management.** According to the PFM Act (2012), the four options are as follows:

- i) internal revenue administration, which is currently in use by most Counties
- ii) establishment of an autonomous revenue authority (or County corporation)
- iii) contracting the Kenya Revenue Authority
- iv) Contracting private firms or other agents.

110. Counties have the choice to identify the administrative arrangement through which revenue can be collected. However, there is no set guideline on how county governments determine the most appropriate administrative arrangements for revenue collection and management.

111. **Automated revenue management system for revenue streams**. Article 216 of the Constitution gives the Commission on Revenue Allocation (CRA) the mandate to make recommendations on matters concerning the financing of, and financial management by, county governments as required by the Constitution and national

legislation. In formulating recommendations, the commission shall seek to promote and give effect to the criteria set out for equitable shares and other financial laws, when appropriate, to define and enhance the revenue sources of the national and county governments and to encourage fiscal responsibility. Over the years, the CRA has provided recommendations on the need for an efficient Revenue Management System to ensure that counties collect revenues that match their potential, have prudent use of collected revenues, and ensure fiscal responsibility. Some factors that have hampered the efficiency of Revenue Management Systems are:

i. The cost of the acquisition and maintenance of revenue management systems remains relatively high in some counties.
ii. Unstable power supply and internet connectivity, especially in rural areas, prevent Internet-dependent systems from functioning as planned.
iii. Slow progress in enacting effective legal and policy frameworks to underpin revenue administration. Some counties have inadequate policies and key legislation, such as rating and valuation laws, which are needed to collect taxes. Most counties use only their annual Finance Acts for revenue collection. They should be encouraged to enact legislation for revenue collection and management.
iv. Political interference in the system may arise when a new administration wishes to adopt a different system.
v. The existence of multiple revenue management systems for different revenue streams.
vi. Changes in county functions placed in different ministries occasionally cause conflicts in an automated system over time.
vii. Seamless operations within county functions should be encouraged to ensure transparency in the collection and remittance of county revenue. A study by Saum Anyango Tsuma in 2020 on the determinants of revenue collection in county governments in Kenya recommended that the County Government consider automating all revenue collection systems to enhance revenue collection by minimizing fraud, enhancing efficiency and accountability in revenue collection, as well as minimizing waste and increasing revenue.

112. ***Policy Options:***

i. Automation of all revenue streams and harmonization of Revenue Management systems: Revenues are still being collected manually for some revenue streams in the counties. An automatic and cashless system would improve collection accountability.
ii. Capacity building: Training the County Government workforce that deals with fiscal matters and creating an automatic system for collecting data, not only on

revenues but also on economic indicators that are relevant to the economic base for each stream. The database will help determine compliance levels and enhance the setting of realistic targets.

iii. Strengthening collaboration and data-sharing mechanisms between different organizations and departments in County Governments: This will help counties monitor their revenue base, evaluate their revenue-raising activities, and adopt efficiency-improving practices.

iv. Establishing an effective policy and legal framework through clear guidelines and strategies for tax and fee administration and management. County Governments should be encouraged to develop principal revenue legislation and policies on which to anchor their taxes, fees and charges should be supported to do so.

v. Counties can consider making revenue management collection and administration offices independent institutions in the county. This may help provide functional autonomy and improve efficiency.

3.2.2. Addressing the overlap in mandates of National and County Governments

113. The fourth Schedule of the Constitution demarcates functions between the two levels and assigns functions such as Agriculture, Health and Water and partly Education to devolved units of government. However, there still exists overlap in the functions being undertaken by each level of government in these sectors. These overlaps bring about duplication of tasks which leads to challenges such as reduced efficiency in service delivery, increased level of bureaucracy, under-utilization of the workforce, and disagreements between the two levels over funding for County functions, as well as contributing to budget constraints on paying extra salaries[9].

114. Under the Energy sector, it is observed that street lighting is a function of the county governments as per the Fourth Schedule. This role is further amplified by the Energy Act 2019 which outlines the County Government's role in promoting energy efficiency and sustainability within their jurisdictions, including the provision and maintenance of street lighting. The street lighting project has a budget allocation of Kshs.544 million in the FY 2023-24 (current financial year). However, the success of this transfer hinges on several factors, including adequate resource allocation, technical expertise within County Governments, and effective collaboration between

[9] https://www.ijsrp.org/research-paper-0520/ijsrp-p10165.pdf

national and county governments to enable them to harness the intended benefits of improved lighting and enhanced safety.

115. The Regional Development Authorities which were established by different Acts of Parliament continue to implement functions which are in agriculture and water sub-sectors with a combined budgetary allocation of KSh. 3,909 million under the programme integrated basin-based development. It is however recognized that there is already a Regional Authorities Development Bill before Parliament that will align the six RDAs to the Constitution of Kenya 2010. It is recommended that once the bill is enacted into law, the components which relates to small holder agriculture and water be transferred to the counties.

116. In the Agriculture sector, some of the overlapping functions include the crop and livestock insurance and pests/disease control programmes. One of the reasons for such programmes still remaining at the national government level is the continued existence of state corporations that had been established prior to devolution[10]. Table 16 summarises some of the areas/sectors where overlap in mandate exists. The same may be replicated across other sectors including water, the arts and trade.

Table 16: County government programmes being undertaken by the National Government

S/No.	Sector	Programme (s)	FY 2023/24 Allocation (Ksh. Blns)
1.	Agriculture	Crop and Livestock insurance, pests/disease control programmes, food security & crop diversification, among others.	9.92
2.	Education	Bursaries & Scholarships programmes– Most counties have established Bursary and Scholarship Funds out of which Bursaries are paid and scholarship support given to students in secondary schools and institutions of higher learning	7.07
3.	Energy	Power Transmission and Distribution-Street Lighting	0.542
4.	Youth Affairs and the Arts	Library Services	0.424
5.	Regional Development Authorities	Integrated Basin Based Development	3.9
6.	**Total**		**21.856**

Source: Budget Books & CoB Budget implementation reports

[10] IGRTC report on 'Finalisation of outstanding issues in the transfer of functions in the agriculture sector'

117. County Governments on the other hand, are also undertaking national government functions which includes; Provision of bursaries to students in secondary schools and institutions of higher learning which are also being provided at the National level. This limits the amount of resources that counties can devote to the devolved sectors of health and agriculture. The allocations to Bursaries & Scholarships by a number of sampled counties for the past three financial years is shown in table 17. Notably, counties allocated a total of Kshs. 7.07 billion towards bursaries and scholarships in the financial year 2023/24 budgets.

Table 17: Sampled counties and allocations to Education Bursaries and Scholarships (Kshs. Billions)

S/No.	County	Education (Bursaries & Scholarships)		
		2021/22	2022/23	2023/24
1	Bungoma	0.410	0.524	0.275
2	Homa Bay	0.052	0.152	0.430
3	Kakamega	-	0.120	0.240
4	Kilifi	0.350	0.350	0.350
5	Kirinyaga	0.126	0.108	0.108
6	Makueni	0.113	0.030	0.130
7	Mandera	0.120	0.350	0.460
8	Marsabit	0.099	0.143	0.150
9	Migori	0.057	0.170	0.140
10	Mombasa	0.162	0.212	0.580
11	Murang'a	0.244	0.308	0.245
12	Nairobi	-	-	-
13	Narok	0.260	0.372	0.380
14	Uasin Gishu	0.128	0.122	0.194
15	West Pokot	0.538	0.441	0.210
Total		**2.659**	**3.402**	**3.892**

Source: Controller of Budget Reports

118. The following policy options may be considered to address the overlap in mandates between the two levels:

i) Both levels of government through Inter-governmental Relations Technical Committee (IGRTC) to enhance consultation whenever one level is undertaking functions/programmes of the other level and ensure that requisite agreements are prepared and made public in order to avoid duplication and litigation.

ii) Develop a framework for progressively transferring county functions and the attendant resources which largely remain at the national level.

iii) Addressing policy and legislative barriers that hamper implementation of devolved functions by counties. i.e. reviewing certain laws especially in the

agriculture sector establishing national government state corporations/institutions which continue to perform some county government functions.

iv) Prioritization of expenditure by counties – Counties should prioritize their spending and allocate more funds to essential devolved functions. In the education sector, counties should limit their spending to only early childhood education programmes which is devolved and devote more resources to other devolved sectors.

ANNEXTURES

Annex 1: Recurrent Expenditure Ceilings for FY 2024/25 (Kshs. Millions)

Sector		**2023/24**	**2024/25**		
		Approved Budget	**BROP**	**PBO Baseline**	**PBO Alternative**
Agriculture, Rural & Urban Development	**Gross**	**32,970**	**28,156**	**28,156**	**28,156**
	A-i-A	14,332	9,589	9,589	9,589
	Net	18,638	18,567	18,567	18,567
	Salaries	6,636	6,725	6,936	6,936
	O&M	26,334	21,431	21,220	21,220
Energy, Infrastructure and ICT	**Gross**	**148,005**	**148,381**	**145,306**	**145,306**
	A-i-A	130,597	130,597	130,597	130,597
	Net	17,408	17,784	14,709	14,709
	Salaries	4,696	4,824	4,938	4,938
	O&M	143,308	143,557	140,369	140,369
General Economic and Commercial Affairs	**Gross**	**30,045**	**30,300**	**30,300**	**30,045**
	A-i-A	11,115	11,115	11,115	11,115
	Net	18,930	19,185	19,186	18,931
	Salaries	2,486	2,562	2,662	2,662
	O&M	27,558	27,737	27,638	27,383
Health	**Gross**	**80,627**	**82,343**	**82,343**	**80,627**
	A-i-A	25,185	25,185	25,185	25,185
	Net	55,442	57,158	57,158	55,442
	Salaries	14,126	15,458	20,458	20,458
	O&M	66,501	66,886	61,886	60,169
Education	**Gross**	**595,481**	**640,409**	**638,440**	**630,409**
	A-i-A	52,645	52,645	52,645	52,645
	Net	542,836	587,764	585,795	577,764
	Salaries	315,328	321,625	329,825	329,825
	O&M	280,153	318,784	308,615	300,584
Governance, Justice, Law and Order	**Gross**	**220,530**	**232,658**	**232,423**	**220,530**
	A-i-A	1,222	1,222	1,222	1,222
	Net	219,307	231,436	231,201	219,308
	Salaries	136,900	141,054	146,054	146,054
	O&M	83,630	91,604	86,369	74,476
Public Administration and International Relations	**Gross**	**194,210**	**197,958**	**197,158**	**194,210**
	A-i-A	10,609	10,609	10,609	10,609
	Net	183,601	187,350	186,550	183,602
	Salaries	48,146	49,590	54,591	54,591
	O&M	146,064	148,368	142,567	139,619
	Gross	**184,990**	**204,027**	**187,027**	**183,417**

Sector		2023/24	2024/25		
		Approved Budget	**BROP**	**PBO Baseline**	**PBO Alternative**
National Security	A-i-A	-	4,743	4,743	4,743
	Net	184,990	199,283	182,283	178,674
	Salaries	2,059	2,121	2,121	2,121
	O&M	182,931	201,906	184,906	181,296
Social Protection, Culture and Recreation	**Gross**	**45,682**	**47,828**	**46,811**	**45,682**
	A-i-A	3,679	3,679	3,679	3,679
	Net	42,003	44,150	43,132	42,003
	Salaries	4,222	4,348	4,448	4,448
	O&M	41,460	43,480	42,363	41,234
Environment Protection, Water and Natural Resources	**Gross**	**32,349**	**32,211**	**32,411**	**32,211**
	A-i-A	12,701	12,701	12,701	12,701
	Net	19,647	19,510	19,710	19,510
	Salaries	2,588	2,666	2,728	2,728
	O&M	29,761	29,546	29,684	29,484
Total	**Gross**	**1,564,887**	**1,644,271**	**1,620,375**	**1,590,593**
	A-i-A	**262,084**	**262,084**	**262,084**	**262,084**
	Net	**1,302,804**	**1,382,187**	**1,358,291**	**1,328,509**
	Salaries	**537,186**	**550,972**	**574,760**	**574,760**
	O&M	**1,027,701**	**1,093,299**	**1,045,615**	**1,015,833**

Annex 2: Development Expenditure Ceilings for FY 2024/25 (Kshs. Millions)

Sector		2023/24	2024/25		
		Approved Budget	BROP	PBO Baseline	PBO Alternative
Agriculture, Rural & Urban Development	**Gross**	**54,971**	**57,638**	**54,289**	**45,289**
	GoK	19,949	23,298	19,949	16,949
	Loans	32,206	31,132	31,132	25,132
	Grants	2,182	2,413	2,413	2,413
	Local AiA	635	795	795	795
Energy, Infrastructure and ICT	**Gross**	**384,359**	**392,739**	**360,362**	**340,516**
	GoK	113,457	101,161	82,007	92,161
	Loans	131,163	144,386	131,163	101,163
	Grants	7,882	7,321	7,321	7,321
	Local AiA	131,857	139,871	139,871	139,871
General Economic and Commercial Affairs	**Gross**	**31,375**	**27,040**	**24,410**	**24,410**
	GoK	27,378	23,229	20,599	20,599
	Loans	2,476	2,289	2,289	2,289
	Grants	1,522	1,522	1,522	1,522
	Local AiA	-	-	-	-
Health	**Gross**	**60,559**	**60,777**	**60,275**	**50,477**
	GoK	39,100	39,318	38,816	32,018
	Loans	13,292	13,292	13,292	10,292
	Grants	8,168	8,168	8,168	8,168
	Local AiA	-	-	-	-
Education	**Gross**	**33,099**	**29,544**	**28,425**	**23,544**
	GoK	13,236	13,039	11,920	10,039
	Loans	18,940	15,497	15,497	12,497
	Grants	880	965	965	965
	Local AiA	43	43	43	43
Governance, Justice, Law and Order	**Gross**	**9,872**	**17,518**	**9,969**	**8,869**
	GoK	8,987	16,536	8,987	7,887
	Loans	-	-	-	-
	Grants	135	232	232	232
	Local AiA	750	750	750	750
Public Administration and International Relations	**Gross**	**115,981**	**134,933**	**116,046**	**105,046**
	GoK	82,613	98,831	82,613	73,613
	Loans	17,053	19,721	17,053	15,053
	Grants	16,315	16,380	16,380	16,380
	Local AiA	-	-	-	-
National Security	**Gross**	**4,254**	**49,609**	**4,254**	**4,254**
	GoK	3,720	5,320	3,720	3,720
	Loans	-	43,755	-	-
	Grants	-	-	-	-
	Local AiA	534	534	534	534
Social Protection, Culture and Recreation	**Gross**	**24,961**	**24,791**	**24,791**	**23,791**
	GoK	5,951	5,194	5,194	4,194
	Loans	2,415	2,174	2,174	2,174

Sector		2023/24	2024/25		
		Approved Budget	**BROP**	**PBO Baseline**	**PBO Alternative**
	Grants	595	623	623	623
	Local AiA	16,000	16,800	16,800	16,800
Environment Protection, Water and Natural Resources	**Gross**	**88,211**	**108,915**	**93,416**	**80,112**
	GoK	29,627	30,067	33,071	28,767
	Loans	54,091	72,594	54,091	45,091
	Grants	4,493	6,254	6,254	6,254
	Local AiA	-	-	-	-
Total	**Gross**	**807,643**	**903,505**	**776,237**	**706,309**
	GoK	**344,018**	**355,994**	**306,876**	**289,948**
	Loans	**271,635**	**344,840**	**266,690**	**213,690**
	Grants	**42,172**	**43,878**	**43,878**	**43,878**
	Local AiA	**149,819**	**158,793**	**158,793**	**158,793**

Annex 3: OSR ACTUAL VS TARGET

SN	COUNTY	2018/19	2019/20	2020/21	2021/22	2022/23
1	Baringo	96.80%	76.70%	59.30%	91.80%	80.90%
2	Bomet	83.90%	100.30%	82.70%	77.90%	80.80%
3	Bungoma	104.70%	84.60%	79.00%	49.30%	75.90%
4	Busia	64.70%	44.80%	28.80%	30.00%	64.90%
5	Elgeyo Marakwet	108.80%	88.00%	99.00%	61.00%	88.30%
6	Embu	66.30%	55.40%	40.00%	43.80%	74.50%
7	Garissa	43.30%	73.30%	69.00%	43.70%	81.40%
8	Homa Bay	58.90%	154.60%	70.50%	88.90%	60.10%
9	Isiolo	107.20%	71.50%	50.30%	94.90%	85.20%
10	Kajiado	68.00%	39.10%	51.10%	33.10%	50.20%
11	Kakamega	71.50%	70.90%	67.50%	76.60%	67.40%
12	Kericho	68.20%	66.60%	91.10%	67.30%	49.20%
13	Kiambu	100.20%	69.70%	63.90%	73.40%	71.50%
14	Kilifi	58.90%	71.70%	69.40%	74.00%	62.90%
15	Kirinyaga	100.60%	78.10%	85.60%	75.20%	112.30%
16	Kisii	36.10%	38.30%	62.00%	57.80%	63.70%
17	Kisumu	61.00%	55.90%	52.10%	49.50%	48.20%
18	Kitui	55.20%	68.00%	54.40%	45.20%	110.60%
19	Kwale	103.90%	78.30%	68.40%	69.10%	86.50%
20	Laikipia	102.00%	72.30%	83.50%	68.10%	61.40%
21	Lamu	116.90%	108.90%	108.40%	105.80%	119.80%
22	Machakos	90.50%	118.60%	99.70%	66.50%	83.30%
23	Makueni	64.20%	98.40%	51.70%	82.70%	62.50%
24	Mandera	52.60%	68.10%	71.60%	66.40%	42.20%
25	Marsabit	88.60%	74.50%	73.60%	58.60%	34.50%
26	Meru	44.80%	46.50%	72.70%	55.90%	69.80%
27	Migori	25.90%	67.90%	101.20%	110.50%	67.70%
28	Mombasa	78.10%	68.90%	51.30%	72.80%	79.90%
29	Muranga	70.40%	60.40%	69.70%	32.90%	42.20%

SN	COUNTY	2018/19	2019/20	2020/21	2021/22	2022/23
30	Nairobi	66.10%	50.20%	61.40%	47.10%	58.50%
31	Nakuru	104.80%	82.30%	90.50%	86.20%	70.70%
32	Nandi	45.40%	45.00%	64.40%	71.20%	53.80%
33	Narok	109.10%	97.80%	44.00%	56.70%	72.80%
34	Nyamira	64.70%	74.20%	65.10%	56.40%	26.30%
35	Nyandarua	98.40%	60.20%	42.80%	47.80%	76.70%
36	Nyeri	82.00%	66.50%	88.70%	94.80%	76.30%
37	Samburu	96.00%	80.80%	87.60%	76.30%	94.30%
38	Siaya	58.40%	42.70%	79.30%	97.50%	68.10%
39	Taita Taveta	110.90%	128.70%	83.20%	70.10%	68.10%
40	Tana River	104.40%	97.70%	114.40%	82.30%	67.40%
41	Tharaka Nithi	81.80%	77.20%	72.80%	66.90%	63.20%
42	Trans Nzoia	74.20%	71.20%	68.90%	71.80%	81.50%
43	Turkana	70.00%	97.90%	119.90%	113.50%	89.80%
44	Uasin-Gishu	76.60%	86.60%	111.60%	60.70%	66.90%
45	Vihiga	115.30%	77.20%	78.30%	101.60%	59.70%
46	Wajir	30.10%	40.30%	49.30%	52.40%	46.70%
47	West Pokot	97.10%	71.30%	88.20%	66.70%	75.40%
	Total	**74.80%**	**65.20%**	**64.20%**	**59.40%**	**65.90%**

Annex 4: Details of devolved functions in the Agriculture Sector budgeted under National Government

Vote Head/Delivery Unit	Key Performance Indicators	FY 2023/24 Allocation in Kshs.
1. State Department for Crop Development		
Crop Insurance	No. of counties covered and No. of farmers covered	150,000,000
Aflatoxin Management	Quantity of Aflasafe (KE01) (MT)	20,000,000
Fall Army Worm Mitigation	No. of pest surveillance conducted & Litres of pesticides procured	80,000,000
Coconut Industry Revitalization Project-BETA	Amount in Kshs. Millions of loans disbursed to coconut enterprises & No. of loan beneficiaries	92,000,000
Cashew Nut Revitalization Project	Amount in Ksh Millions of loans disbursed to cashew nut enterprises & No. of loan beneficiaries	65,000,000
Banana Enterprise Financing Project	Amount of loans disbursed to banana enterprises (Kshs. Millions) & No. of loan beneficiaries	40,000,000
Youth and Women Empowerment in Modern Agriculture Project	No. of youth trained on Agriculture and Agribusiness skills, No. of ToTs trained on rebranded 4-K Clubs and No. of clubs trained on Modern Agricultural technologies	70,000,000
Cotton Industry Revitalization Project-BETA	Area under cotton (acres), MT. of seed cotton produced	120,000,000
National Edible Oil Crops Promotion Project-BETA	MT. of assorted seed availed to farmers & No. of beneficiaries	134,000,000
Kenya Cereal Enhancement Programme (KCEP)	No. of Smallholder farmers accessing production inputs, Agro-dealers trained and accredited as agents and No. of farmers linked to bulk buyers	2,075,500,000
Capacity Building for Enhancement of Rice Production (CADREP)-BETA	No. of farmers groups trained & No. of farmers that have adopted the technologies	35,000,000
Quelea Quelea Management-BETA	No. of colony surveyed and controlled Quantities of avicide procured (lts)	50,000,000
Sugar reforms support project	No. of cane testing units maintained & No. of farmer sensitization fora on cane testing units	270,000,000
Enable Youth Kenya Programme	Youth capacity on agribusiness & No. of youth Agripreneurs funded	601,000,000
Development of Aggregation Centres	% of completion of the centres in Meru, Busia, Bomet & Uasin Gishu counties	300,000,000
Crop Post-Harvest Management	Quantity of Aflasafe (MT), No. of grain dryers availed to cooperatives and NCPB depos and No. of technicians trained on operations and maintenance	2,344,000,000
Small Scale Irrigation and Value Addition Project	Area of existing irrigation schemes developed (Ha), No. of livestock marketing facilities constructed & No. of post-harvest handling facilities constructed	1,145,000,000

Food Security and Crop Diversification Project- BETA	MT. of rice seed availed, MT. of sunflower seed availed, MT. of purple tea seedlings, availed (Million), MT. of canola seeds availed, & MT. of Cotton seed availed	1,122,000,000
2. State Department for Livestock Development		
Sheep and Goats breeding Farms	No. of sheep and goats availed to farmers	95,467,982
Breeding and Livestock Research Farms	No. of cattle stock availed to farmers	32,878,127
Apicultural and emerging livestock services	No. of bee colonies established	13,126,141
Bee Bulking Project- Apiculture and emerging Livestock Service	No. of bee bulking sites established	2,000,000
Rangeland Ecosystems Development Services	No. of counties capacity built on pasture & fodder development	31,968,329
Towards Ending Drought Emergencies in Kenya (TWENDE)-BETA	No. of participants trained, No. of Counties supported to domesticate rangeland legal frameworks, Acreage of reseeded rangeland and No. of structures established	318,000,000
Livestock Market and Agribusiness Development Services	No. of breeding programmes developed for counties and livestock farms	25,030,559
Livestock Production Interventions	Chemongoch model feedlot completion level (%), No. of livestock processed at Chemongoch feedlot No. of pasture bales harvested	5,000,000
Vector Regulatory and Zoological Services	No. of apiary sites maintained, & No. of county maps on bee diseases, vectors and vector borne diseases developed	81,439,322
National Animal Disease Strategies and Programmes	Number of trans-boundary animal diseases surveyed and mapped	457,207,545
Disease Free Zoning Programme	No. of surveillance missions conducted	8,161,547
Ports of Entry and Border Posts Veterinary Inspection Services	Number of border/entry points operational	35,630,569
Sustainable Tsetse and Trypanosomiasis free areas in Kenya KENTTEC	No. of tsetse and trypanosomiasis 6 belts controlled and sustained	97,000,000
Total		**9,922,805,157**

***Figures are as per FY 2023/24 revised estimates**