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Parliamentary Budget Office

Setting the Pace for Sustainable Growth

Budget Options for 2013/14 and the Medium Term

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Preamble

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This is the fourth edition of the Budget Options prepared by the Parliamentary Budget Office (PBO). Every year, before the annual Estimates are finalized, the Parliamentary Budget Office releases the Budget Options. The primary objective of this document is to highlight the key concerns the country is facing with regard to the national budget and the economy at large. The paper takes a critical look at the underlying economic variables and proposes various options that the National Treasury could consider in framing the annual budget and medium term targets.

This Budget Options provides strategic priorities and policy options the government can consider while preparing the budget estimates for fiscal year 2013/2014 and the medium term. The proposals therein are intended to trigger discussion on public policy and induce policy makers to come up with a more effectual budget that will spur economic growth and development given the prevailing economic conditions.

The year 2013 will be a defining moment for Kenya. First, the pace at which the country shall adhere to fiscal discipline amid high expenditure incurred following the just concluded general elections remains a crucial factor in determining the pace of future growth of the country. The growth trajectory will largely depend on how fast the country returns to normalcy as well as how quickly people and industries get back to full capacity. In addition, the huge recurrent related expenses will continue to be a major challenge as the implementation of devolved system of governance sets in.

Secondly, the promise of devolution will be ultimately actualized as County governments come into operation. This is likely to present a challenge in terms of increased government recurrent expenditure in an already tight fiscal environment. Significant recurrent expenses are expected in establishment of public finance management systems and capacity building for county governments as well as the expanded legislature. In addition, the growing wage bill may continue to be a major setback as the implementation of devolved system of governance gains momentum. Devolution will also bring with it a reorientation of government expenditure into national and county budgets with revenue from property taxes as well as entertainment taxes being raised by county governments besides receiving the equitable share of revenue from the national government. These are uncharted waters and are likely to present a challenge in terms of planning and budgeting.

Thirdly, the role of the Transition Authority and other institutions in ensuring a smooth transition cannot be over-emphasized. Although there has been enormous effort, there are key challenges including the huge wage bill and debts that County Governments will inherit from the defunct local authorities. In addition, the debt take-over by County Governments will lead to limited fiscal space for other priority development needs.

Given these challenges, the government may also face increasing expenditure pressures particularly from salary demands from public servants who will be reacting to inflationary tendencies that normally occur immediately after elections. This scenario is worsened by persistent revenue shortfalls which have been witnessed over the past years.

The 2013/14 budget must therefore strike a delicate balance between prioritizing critical expenditure subject to resource constraints; promoting the functionality of the devolved system of government to spur economic growth and enhancing macroeconomic stability. These are hard times and they require hard choices. This Budget Options has three main messages. **Tighten the fiscal belt further through expenditure rationalization and prioritization; enhance revenue collection; and drive growth through devolution**.

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List of Acronyms and Abbreviations

AfDB	African Development Bank
BOP	Balance of Payment
BPS	Budget Policy Statement
BROP	Budget Review and Outlook Paper
CCTV	Closed-Circuit Television
CFS	Consolidated Fund Services
CIF	Cost Insurance and Freight
CRA	Commission on Revenue Allocation
EAC	East Africa Community
ECDE	Early Child Development Education
EFA	Education for All
ETR	Electronic Tax Register
FDSE	Free Day Secondary Education
FPE	Free Primary Education
FY	Financial Year
GDP	Gross Domestic Product
GPRS	General Packet Radio Service
GPS	Global Positioning System
GSM	Global System for Mobile Communication
HELB	Higher Education Loans Board
ICT	Information Communication Technology
IDF	Import Declaration Fees
IMF	International Monetary Fund
KARI	Kenya Agricultural Research Institute
KBC	Kenya Broadcasting Corporation
KIHBS	Kenya Integrated Household Budget Survey
KMTC	Kenya Medical Training College
KRA	Kenya Revenue Authority
LATF	Local Authority Transfer Fund
MDGs	Millennium Development Goals
MENA	Middle East and North Africa
MTEF	Medium Term Expenditure Framework
MTP	Medium Term Plan
PAYE	Pay-as-you earn
PBO	Parliamentary Budget Office
PFM	Public Finance Management
QEBR	Quarterly Economic and Budgetary Review
SAGAs	Semi Autonomous Government Agencies
SMART	Specific Measurable Achievable Realistic and Time bound

SMEs	Small and Medium Enterprises
SSA	Sub Saharan Africa
ToT	Turnover Tax
TARDA	Tana and Athi Rivers Development Authority
USA	United States of America
UN	United Nations
VAT	Value-Added Tax

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Introduction

The success of the just concluded general elections will to a large extent influence the growth trajectory of the economy in the next financial year and over the medium term. The county level of government will present additional spending pressures and competition for resources across the country with adverse macroeconomic implications. On the external front, the challenges facing the global economy especially in the Euro area and the continued unrest in the Middle East presents an uncertain near-term outlook of the global economy. For Kenya, this could lead to lower earnings from exports and tourism, lower inflows of official development assistance, foreign direct investment and remittances, as well as a possibility of a rise in oil prices. These are challenging times for the country which require fiscal prudence and sound budgetary planning in order to achieve economic growth and a smooth transition to the devolved system of government.

The 2013/14 budget is, in essence, a transition budget which should be geared towards driving economic growth and ensuring a smooth shift from a centralized system to the devolved system of governance. There is need therefore, to focus on expenditure prioritization and fiscal sustainability in the face of resource constraints while at the same time ensuring adequate resources are allocated to counties. In order to drive economic growth, there is need for the budget to be driven by an availability of resources approach as opposed to an expenditure needs approach which has been the basis of budgeting in the past. Going forward, counties will be expected to carry out their own planning and budgeting intended to promote economic development at that level.

The overriding theme of the Budget Options for 2013/14 and the medium term is ***setting the pace for sustainable economic growth rate.*** The paper is organized into five chapters. Chapter one outlines the macroeconomic outlook of the economy and is divided into four sections namely; the global economic outlook, a review of the Kenyan economy, Economic growth and risks to the national economy as well as the national debt. Chapter two focuses on revenue trends and projections including revenue enhancement alternatives. Chapter three discusses public expenditure trends and sustainable expenditure options. Chapter four focuses on driving growth through devolution. Lastly, Chapter five highlights thematic issues for consideration in the 2013/14 budget.

The annual projections and the estimates for the medium term have been informed by simulation done through the Parliamentary Budget Office Model (PBOM)[1].

[1] PBOM is a macro economic forecasting model developed for the Parliamentary Budget Office in 2011

Chapter One: Macroeconomic Outlook

In The Face of Uncertainty: Global Economic Outlook

In brief

A review of the global economy presents a mixed bag for our economy. Uncertainty lingers in the Euro zone given the forecasted contraction of the leading economies and unresolved debts. Europe is a key market for our horticulture and other exports including tourism as well as a source of Foreign Direct Investment and Official Development Assistance. The instability in the Middle East, a key market for Kenyan exports and source of oil could pose challenges to our economy. The positive outlook of SSA and the Far East however presents a window of opportunity which Kenya can seize to expand its exports and support growth of the domestic economy.

The global economic outlook is projected to improve though at a slower pace than previously anticipated. In the World Economic Outlook update for January 2013, the IMF has lowered its projections for 2012 and 2013 from 3.3 percent and 3.6 percent previously to 3.2 percent and 3.5 percent respectively. In contrast, the World Bank projects a growth of 2.3 percent and 2.4 percent in 2013 and 2014 respectively whereas the UN projects a growth of 2.2 percent and 2.4 percent respectively. The biggest threat to the global outlook is the ongoing crisis in the Euro Area. Economic activity in the Euro area is contracting, mainly due to fiscal consolidation, reduced investor confidence and reduced access to domestic credit. The Euro crisis is affecting surrounding economies with reduced economic growth in Europe.

The global economic outlook remains bleak and uncertainty lingers with the Euro crisis as the biggest threat

Constrained growth in Europe is likely to impact negatively on Kenya in terms of decreasing external demand. The European Union accounts for nearly half of Kenya's exports and has been one of the country's key trading partners. Kenya exports mainly coffee, tea and horticultural produce to the region. Europe is also a crucial source of official financing as well as remittances, tourism and investment flows. The ongoing debt turmoil and low economic growth in Europe could result in decreased demand for Kenya's exports as well as reduced foreign inflows.

The European Union is one of Kenya's major trading partners and the ongoing turmoil in Europe might decrease demand for Kenya's exports

In 2011, the export quantities of Kenya's main products to Europe - coffee, tea and horticulture - recorded declines of 12.9, 6.0 and 4.7 percent, respectively. This was partly attributed to reduced demand for these products due to the Euro

crisis. It is however worth noting that while the quantities decreased, the value of these products increased due to the weakening of the shilling. These commodities were therefore the leading foreign exchange earners in 2011. Going forward, if the demand from Europe continues to decline and given the stability of the shilling, the impact on total export value will be apparent.

Coffee, tea and horticulture are likely to be the most affected export products if the crisis persists

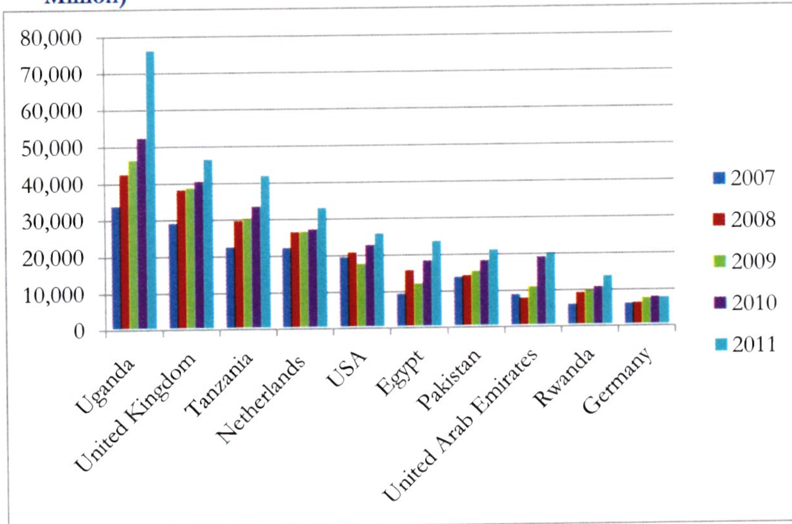
In the United States, growth remains sluggish, and is projected by the IMF to grow at about 2 percent in 2013.Kenya's volume of trade with the United States has been gradually increasing in recent times. Available statistics from the Office of the United States Trade Representative indicates that in 2011, Kenya was the United States' 103rd largest supplier of imported goods, totaling $382 million in 2011. On the other hand, U.S Foreign Direct Investment in Kenya amounted to $263 million in 2010, a 2.3 percent increase from 2009. A worsening economic outlook for the US occasioned by budget sequestration could result in a decline in total export earnings.

Kenya's trade with the US has been increasing and a worsening economic outlook could result in declining trade with the US

Economic activity is also weakening in the MENA region due to uncertainties arising from the Arab Spring, slow growth in major trading partners as well as internal conflict in some areas, have resulted in reduced economic activity. This is likely to impact negatively on Kenya's economy in terms of increasing fuel and commodity prices. **Of particular importance is Egypt whose uncertain political situation persists.** Kenya's trade with Egypt has grown considerably over the years and Egypt currently ranks third in terms of value of Kenya's exports to from African countries after Uganda and Tanzania. If the current crisis continues, the external market for tea, which is the main export to Egypt, is likely to be reduced even further. The figure below shows the top ten destinations for Kenyan exports by country for the period 2007 – 2011:

Uncertainty in the MENA region, especially Egypt, largely due to internal conflict could affect demand for tea as well as increase fuel and commodity prices in the country

Figure 1: Value of total Exports by Destination (2007-2011) (Ksh Million)



Data Source: Economic Survey 2012

The Bulk of Kenya's Exports are consumed in Africa and Europe

The import bill has been on an upward trend and this is likely to further widen the current account deficit. In 2011, the balance of payments position was under pressure due to a high import bill amounting to more than Ksh.1.3 trillion from 947.2 billion in 2010. This was largely attributed to high fuel prices and the depreciation of the Shilling. The current account balance also worsened due to a widening trade deficit as the value of imports grew faster than that of exports. The export value was approximately 409.7 billion in 2010 and 511 billion in 2011.

Reduced export earnings and a high import bill could adversely affect the Balance of Payments position

The outlook for Sub-Saharan Africa remains positive and is projected to expand by at least 5 percent in 2012/13.This economic expansion is more significant in low income countries than the middle income countries which are more integrated in the global economy. Africa continues to be the dominant destination for Kenya's exports with a substantial market within the EAC. Growth of Kenyan industries is more likely to be fueled by intra-African trade and the government should therefore facilitate trade in this vital market.

Africa consumes the bulk of Kenya's exports and is therefore likely to drive Kenya's export market

Given the different economic forecasts for each of the region of the globe, Kenya should continue diversifying its export market especially with the uncertainty of the traditional market, Europe.

The government should consider focusing on competitiveness of Kenya's produce. Strong exports have a positive multiplier to our economic growth.

Kenya should diversify its export market notably to Asia which is experiencing high economic growth

Even though growth in Asia is weaker than had earlier been anticipated, at 5.75 percent in 2013[2], it remains relatively high compared to the rest of the world's. Kenya should therefore position itself to benefit from the positive growth in this region by enhancing trade ties with Asia, diversifying its trade destinations as well as export products.

[2] IMF projections

A review of the Kenyan Economy

In brief

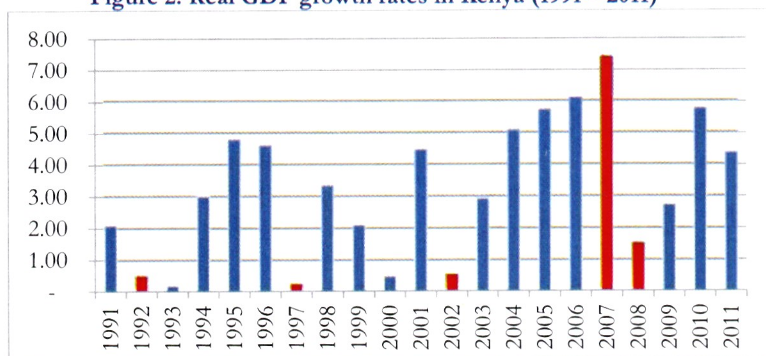
The Kenyan economy has shown uneven growth pattern and appears to follow electoral cycles. Reduced economic activity has been observed in most election years with the exception of 2007. On the other hand, investment has contributed dismally to total GDP. Over the period 1996-2011, the contribution of capital and labor to GDP growth stood at 2.64% and 0.46% respectively, while total factor productivity averaged 0.41%.Over the period 2003-2011, the saving - investment balance stood at 5.3%, implying that the current account balance has continuously widened over time.

Economic growth and the general elections

In the last two decades, economic growth has exhibited irregular patterns with periods of mild boom and recession especially in the election years as shown in figure 2. The slow growth in 1992, 1997 and 2002 was probably due to the uncertainty surrounding the general elections. Other factors which affected economic growth during these periods include adverse weather conditions such as the 1997 El-Nino rains which had a devastating effect on the agricultural sector and physical infrastructure especially the roads.

Uncertainty surrounding election periods appear to impact negatively on economic growth

Figure 2: Real GDP growth rates in Kenya (1991 – 2011)



Data Source: Economic Survey (Various Issues)
Red indicates election years except 2008, (effects of post election violence)

2007 is a unique election year whereby the economy managed 7% economic growth but the gains were wiped out with the post poll violence

In 2002, a sharp decline in economic growth was observed possibly due to the impact of the 2002 general elections. 2007 however was an exception given that the economy registered significant growth (7%) despite it being an election year. Nevertheless, the post election violence of 2007/08 wiped out the gains with economic growth dipping to 1.7% in 2008. Other factors that affected the economy negatively during this period

were the prolonged drought, rise in oil and food prices and global economic crisis. Nevertheless, the country is slowly recovering. The economy grew at a rate of 2.7 percent, 5.8 percent and 4.4 percent in 2009, 2010 and 2011, respectively.

Contribution to Real GDP

An analysis of contribution to GDP indicates that the country's economic growth is largely consumption driven. Public and private consumption as a share of real GDP remained high at an average of 78% and 16% respectively compared to overall investment which averaged 19% over the period 1996 – 2011.

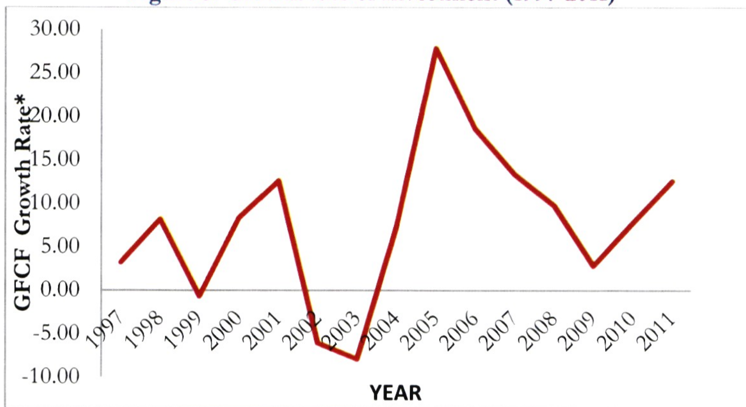
Kenya's economic growth is largely consumption driven with investment exhibiting irregular growth patterns though it has recorded an upward trend since 2009

Investment has exhibited irregular growth patterns over the years. The highest growth is recorded in 2005 at 27% whereas 2003 recorded a dismal performance at -7% of GDP. Since 2009, investment has been on an upward trend and stood at approximately 13 percent of GDP in 2011.

The declining investment growth between 2002 and 2003 can be attributed to uncertainty associated with the general elections. Decline in investments during election years is observed in the years 1997, 2002 and 2007 (Figure 3). This year, the country is likely to experience the same trend due to and the time it will take to actively convince investors that the environment is conducive. Furthermore, the pace at which the country gets back to normalcy will also influence investment growth.

Investment dips are observed mostly in election years pointing to a wait and see attitude by investors during election periods

Figure 3: Growth rate of Investment (1997-2011)



Data Source: Economic Survey, Various Issues
*GFCF refers to Gross Fixed Capital Formation

The Decomposition of GDP 1996-2011

Between 1996 and 2011, the economy grew by an average of 3.5%. Of this, the average contribution of capital and labor stood at 2.64% and 0.46% respectively. Over the same period, contribution of Total Factor Productivity was 0.41%. Table 1 and figure 4 respectively, show the average contribution to growth and the yearly contributions.

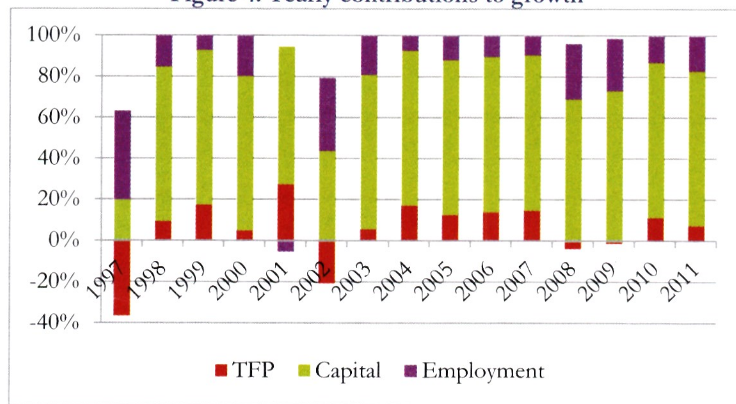
The contribution of labour and Total Factor Productivity to Economic growth has been minimal compared to contribution of capital

Table 1: Contributions to average GDP growth

Kenya: Contributions to Average GDP Growth, 1997-2011				
Item	1997-2011	1997-2001	2002-2006	2007-2011
Average Growth	3.5	2.3	4.1	4.4
Total Factor Productivity	0.4	0.4	0.5	0.4
Capital	2.6	1.6	3.1	3.3
Employment	0.5	0.2	0.5	0.7

Data Source: Parliamentary Budget Office

Figure 4: Yearly contributions to growth

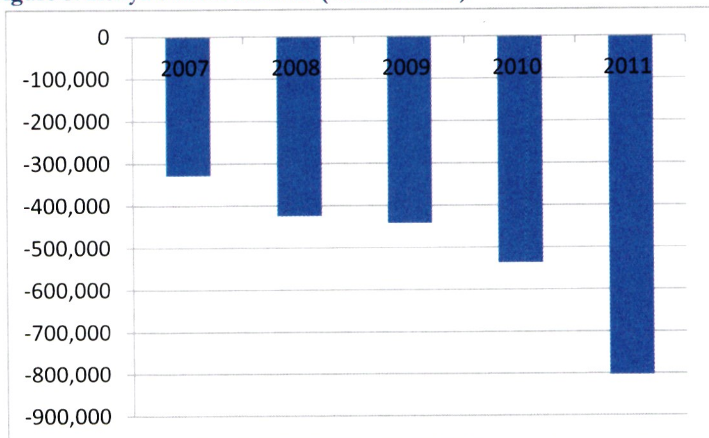


Data Source: Parliamentary Budget Office

The External Position

Kenya's trade balance has been worsening over time. The deteriorating trade balance might be explained in terms of weak growth of exports, relative to growth of imports with high demand for oil and other consumer commodities. This is illustrated in Figure 5:

Figure 5: Kenya's trade balance (Kshs Million)



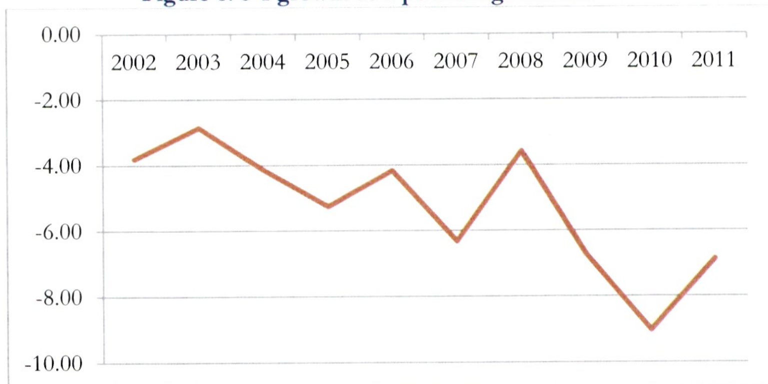
Data Source: Economic Survey (Various Issues)

Over the years, Kenya's trade balance has continuously worsened as a result of weak growth of exports as well as high import bill

Savings-Investment Balance

The Saving –Investment (S-I) balance has widened to an average of 5.30% of the GDP over the period 2003 – 2011 (Figure 6).

Figure 6: S-I growth as a percentage of GDP



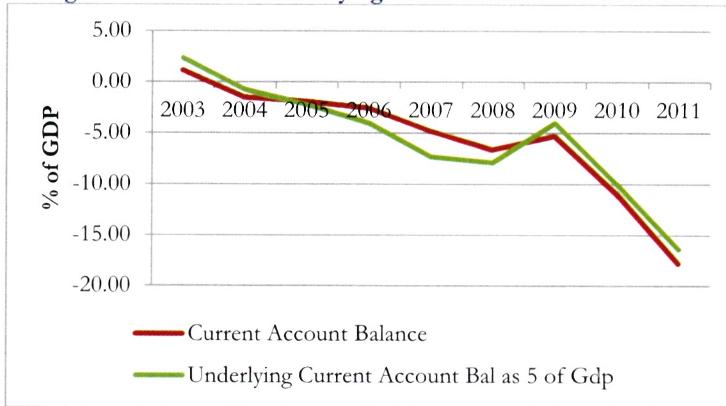
Data Source: Economic Survey (Various Issues)

The Saving – Investment balance has been widening, denoting a worsening balance of Payments position as a result of a worsening trade balance

A stable savings investment balance supports a stable current account balance. A large saving-investment indicates a deteriorating BOP position with implications on the exchange rate. The situation is made worse by a worsening trade balance. The underlying current account balance recorded an average of 5.59% of GDP for the period 2003-2011. Figure 7 summarizes

performance of the current account balance relative to the underlying current account balance since 2003.

Figure 7: Current and underlying current account Balance trend



Data Source: Economic Survey (Various Issues)

In conclusion, a wide savings investment gap implies that the country has to continuously borrow externally to finance the much needed investment.

Economic Growth for 2013/ 14 and the Medium Term

In Brief

The economy is expected to grow by 4.4 percent 5.3 percent, and 5.8 percent in 2013/ 14, 2014/ 15, and 2015/ 16 respectively. The conservative view of the country's economic growth especially in 2013/ 14 is based on wait and see scenario, especially how economic agents will behave now that elections are over. Other risks to the economic outlook include any adverse weather conditions, insecurity as well as the expected slow transition to devolved government.

Near Medium Term Economic Outlook

In 2012/13, the economy is expected to grow at 4.0 percent owing to external shocks such as the economic crisis in Europe as well as a slowdown in credit to the private sector which ultimately impacts on private consumption and private investment. In 2013/14, it is projected that economic growth will increase by 0.4 percentage points compared to the 2012/13 level to settle at 4.4 percent. In the longer horizon, the economy is expected to grow at 5.3 percent and 5.8 percent, respectively in 2014/15 and 2015/16. Telecommunication especially ICT which has been one of the key economic growth drivers is expected to continue driving growth. Agriculture is also expected to play a key role in the growth as the government shifts focus from rain-fed agriculture to irrigation. Building and construction is also expected to boost the economic prospects as structures are set in place for devolution.

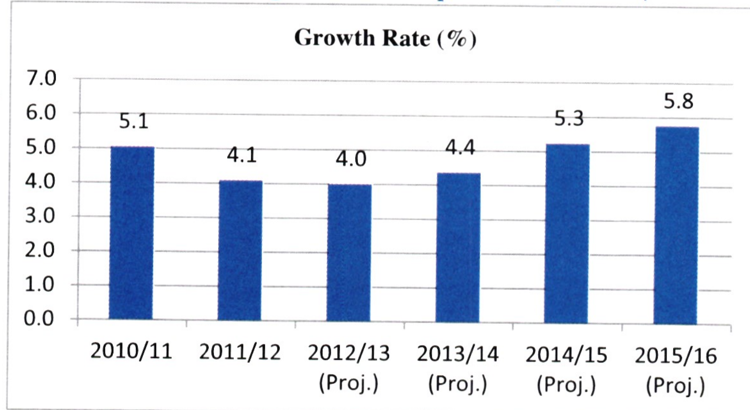
In 2013/14, economic growth is expected to average 4.0 percent. This growth will be driven by telecommunication sector, agriculture as well as building and construction

The near to medium term economic outlook is based on the assumption of no policy change (baseline scenario). The positive outlook is premised on the assumption of a smooth transition to county governments. In the further horizon, it is based on the assumption of gradual realization of gains from devolution over the same period. However, in all these scenarios, an important assumption is that efficiency in utilization of resources will improve and that the fight against corruption will continue.

The projected economic growth is based on assumption of smooth transition to county government and gradual realization of gains from devolution

The trend in real GDP growth is given in figure 8 below:

Figure 8: Trends in GDP growth over the period 2009/10-2015/16



Source: Economic Survey (Historical Data), Parliamentary Budget Office Forecast

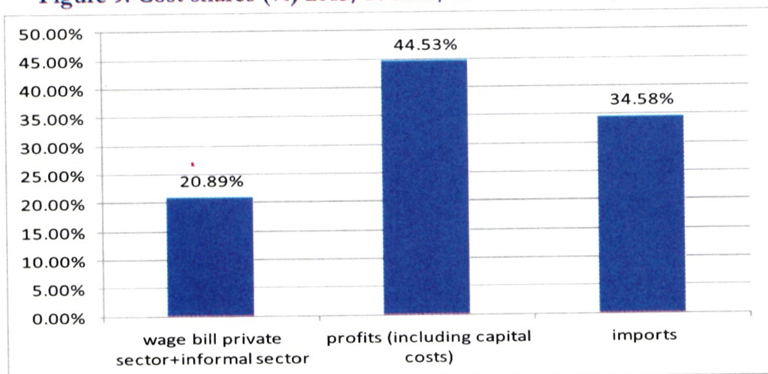
Nominal GDP is expected to grow at 17 percent in 2011/12 and stabilize at the 10 percent level over the period 2014/15 to 2015/16

Nominal GDP which grew by 17 percent in 2011/12 is expected to grow by 12 percent and 10 percent respectively in 2012/13 and 2013/14. Further the nominal GDP is expected to stabilize at the 10 percent level over the period 2014/15 and 2015/16, with average growth of 10 percent over the period 2011/12 – 2015/16. (In terms of volume growth; percentage terms), the economy is expected to average 5.1 percent over the period 2011/12 – 2015/16.

35 percent of cost shares borne by the private sector is spent on imports implying that any upward increase in the external price could adversely affect firms.

Cost shares indicate the component of costs that are incurred by the private sector in its production process. For example, the cost share of wage bill private sector is the ratio of wage bill private sector and final demand excluding indirect taxes. The same applies to profits and imports. Overall, cost shares give a picture of the share of the aggregate costs to total final demand. Figure 9 shows that a larger share of the cost goes towards profits (including capital costs), followed by imports and wages respectively. In 2012/13, 44 percent of the costs consisted of profits while import and wage bill constitute 35 percent and 21 percent, respectively. Given the fact that 35 percent of cost is spent on imports implies that any upward increase (inflationary) in the external price such as oil and other raw materials impacts adversely on the cost structure of Kenyan firms. The pass through effect ultimately affects the competitiveness of Kenyan exports.

Figure 9: Cost shares (%) 2013/14-2015/16



Source: Parliamentary Budget Office Estimates

Sectoral Economic Outlook

a) Private Consumption

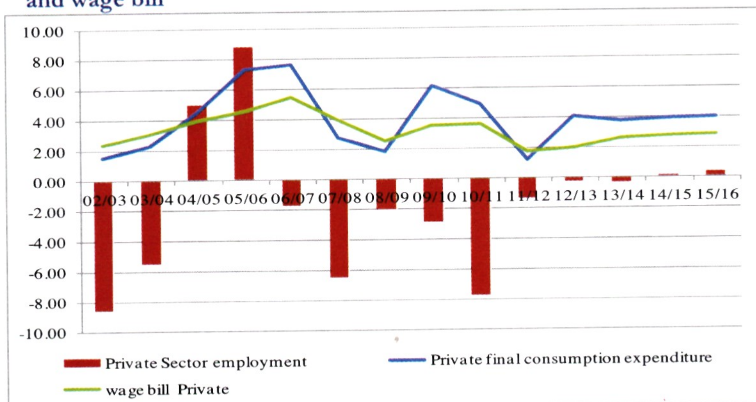
Private consumption grew at an average of 3.8 percent over the 2008/09-2011/12 period, compared to a pre-economic crisis level of 5.9 percent (2005/06-2007/08), translating to a drop of 2.1 percentage points. In the medium term, private consumption is expected to average 5.8 percent (2013/14-2015/16). Total employment (including informal sector) is envisaged to grow at an annual rate of 4.7 percent over the period 2013/14-2015/16 (about 0.6 million new jobs per year in the formal sector). This is lower than the 4.9 percent recorded over the period 2006/07-2010/11. The private sector wage bill is expected to grow at an average of 12.6 percent in 2012/13-2015/16; higher than 8.7 percent recorded over the period 2008/09-2011/12.

Private consumption is expected to average 5.8 percent in the period 2013/14 – 2015/16; lower than the 4.9 percent recorded over the period 2006/07 – 2010/11

Rising employment in the private sector is expected to bolster household consumption. In addition, the expansion in private sector credit due to downward trend in the Central Bank Rate is expected to add additional impetus to household consumption albeit in the short-term. In the event that interest rates begin to increase, it would increase household liability, thus lowering household consumption.

Employment in the private sector and expansion in private sector credit are likely to increase household consumption

Figure 10: Growth in private sector employment, final consumption, and wage bill



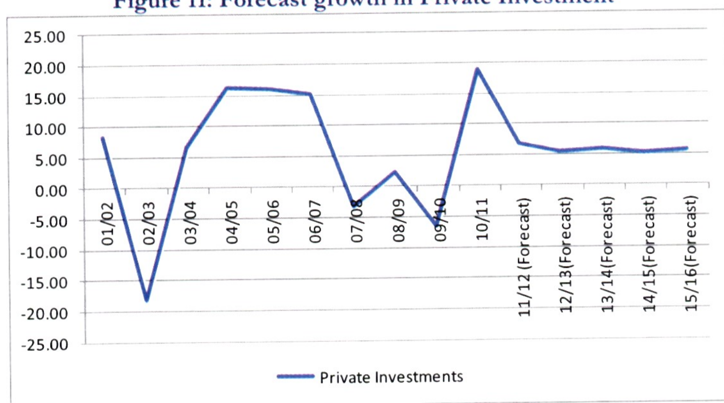
Source: Economic Survey (Historical), Parliamentary Budget Office Forecast

The easing of private sector credit will boost Private investments. This will determine growth of the construction sector

b) Private Investment

Private investment is expected to grow at a rate of 4.9 percent between 2012/13 and 2015/16[3]. As mentioned earlier on, the easing of private sector credit boosts private investment. The pace of growth of the construction sector will broadly be hinged on this account. Figure 11 shows the trend in the envisaged growth of private investment.

Figure 11: Forecast growth in Private Investment



Source: Economic Survey (Historical), Parliamentary Budget Office Forecast

High economic growth in Sub-Saharan Africa will support rise in volume of Kenyan exports

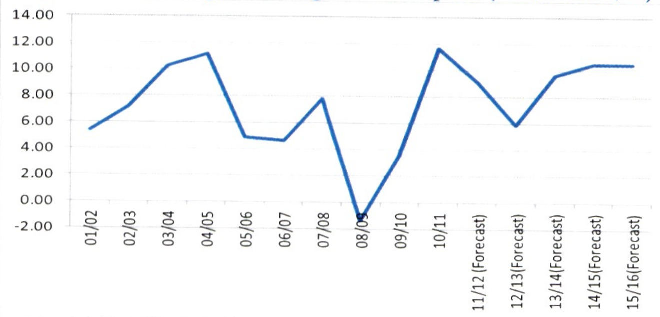
c) Exports

Though the global economy is expected to grow at a slower pace than earlier projected, faster growth in SSA is likely

[3] Assuming no major economic shocks or policy changes, growth in private investment is projected to be constant in the medium term

to support rise in the volume of exports from 1.5 percent and 4.5 percent in 2012/13 and 2013/14, respectively. It is expected that exports will grow by 6.3 percent in 2015/16.

Figure 12: Percentage Volume growth in Exports (2001/02-2015/16)



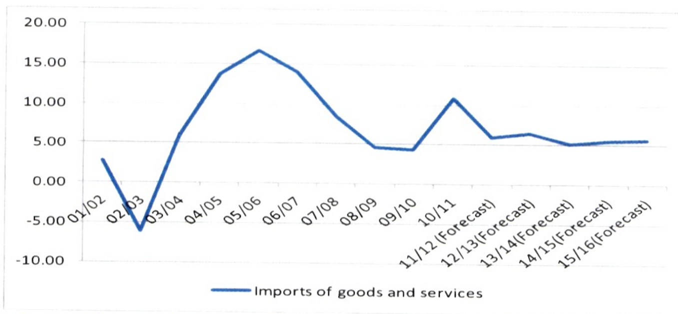
Source: Economic Survey (Historical), Parliamentary Budget Office Forecast

d) Imports

The volume of imports on a CIF basis is projected to grow by 5.5 percent over the period 2012/13 to 2015/16. This growth is premised on the steady growth in volume of domestic demand averaging 5.2 percent over the period 2012/13 to 2015/16. Import volume growth in 2012/13 is expected to stand at 5.4 percent due to a rise in domestic demand, associated with increased public sector wages (Teachers and Lecturers) and government investment in infrastructure.

The volume of imports is expected to increase in the medium term due to increasing domestic demand

Figure 13: Percentage Volume growth in Imports (2001/02-2015/16)



Source: Economic Survey (Historical), Parliamentary Budget Office Forecast

e) Current account

The deficit in the current account is forecast to stand at Ksh.304.6 billion, Kshs.341.2 billion, Kshs.382.6 billion, in 2013/14, 2014/15, and 2015/16, respectively. On the other hand, the financial account amounts to Ksh.305.9 billion over the same period. This is expected to result in an overall balance of payment surplus of Ksh. 14.1 million and a deficit of Ksh. 8.3 million in 2013/14 and 2015/16 respectively.

The current account deficit is projected to worsen over the medium term. However, the financial account will offset this resulting in Balance of Payment Surplus

f) Price level, interest rate and exchange rate

GDP deflator is expected to increase by 5.5 percent per year on average, over the period 2012/13-2015/16. Any major change in the short term interest rates below the forecast level of 6.9 percent (which is the average over the period 2012/13-2015/16) might cause some pressure on the price level. On average, the Kenyan shilling is expected to depreciate by 1.0 percent against the dollar, over the period 2012/13-2015/16. The depreciation of the shilling to the US dollar is likely to surpass the 90 mark by 2015/16. Devoid of any internal and external shocks, inflation is likely to average 5.2 percent over the period 2012/13-2015/16.

The interest rate is forecasted to average 6.9 percent over the period 2012/13 – 2015/16 whereas the Kenyan Shilling is expected to depreciate by 1.0 percent against the dollar over the same period

g) Employment and Poverty Levels

Table 2: Employment Statistics in Kenya (Millions)

	05/06	06/07	07/08	08/09	09/10	10/11	11/12	12/13	13/14	14/15	15/16
Private sector	1.18	1.24	1.29	1.33	1.37	1.42	1.45	1.48	1.51	1.56	1.61
Public sector	0.65	0.64	0.63	0.65	0.66	0.67	0.69	0.70	0.72	0.74	0.76
TOTAL WAGE EMPLOYMENT	1.83	1.88	1.93	1.97	2.03	2.09	2.14	2.19	2.24	2.30	2.37
Self-employed and unpaid family workers	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.08	0.08	0.08	0.08
INFORMAL SECTOR	6.73	7.29	7.72	8.17	8.61	9.05	9.57	10.11	10.65	11.20	11.75
TOTAL EMPLOYMENT ecl. Other	8.63	9.24	9.72	10.21	10.71	11.22	11.79	12.37	12.97	13.58	14.20
Other (traditional self-subsistence sector)	8.67	8.58	8.64	8.71	8.77	8.83	8.76	8.69	8.62	8.55	8.48
Total Employed	17.30	17.82	18.36	18.91	19.48	20.05	20.55	21.06	21.59	22.13	22.68

Data Source: Parliamentary Budget Office Model estimates

Over the period 2012/13 to 2015/16 the average formal employment is expected to stand at 26,572[4] persons per year compared to an average of 28,851 persons in the period 2008/09-2011/12. Informal sector employment is expected to cumulatively grow by 190,449 people over the period 2011/12-2015/16. Table 4 gives employment figures in the various sectors of the economy.

The average formal employment from 2012/13 to 2015/16 is expected to be lower than the average formal employment statistics for 2008/9 to 2011/12

Assuming no policy change, the share of households under the poverty line is expected to increase by approximately 0.4 percent over the medium term. This could increase further if no urgent measures are taken to address poverty.

Downside Risk factors to the National Economy

Rapid population growth rate: The current fertility rate which stands at approximately 4.6 births per woman is an issue of concern. According to Thugge (2010)[5], the number of children between the age of 5-14 years is likely to increase by 60 percent between 2005-2030. This is likely to put fiscal pressure on the recurrent budget directed to social infrastructure such as in education and health sectors. This is also an indicator that the country requires a policy shift to address the issue.

Insecurity: Unemployment among the youth in Kenya is without a doubt becoming more of a security concern as it is a social issue. The threat by the Al Shabaab is notably a looming threat on the growth of the tourism sector. Thus the related fiscal pressure from the insecurity cannot be gainsaid given that huge resources allocated to fight insecurity and institute police reforms in the current financial year.

The rapid population growth rate is exerting pressure on the recurrent budget for social expenditure and Security related fiscal pressure is increasing

Transition to devolved Government: The third risk is the manner in which this transition process is likely to be handled. Pitfalls and challenges are bound to arise in its implementation given that Kenya's devolved system of government is cited as highly ambitious and risky.

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[4] This refers to new employment per year

[5] Thugge, K, Heller, P.S and Kiringai, J, *Fiscal Policy in Kenya: Looking Towards the Medium Term to Long Term*

Some of the likely risks of devolution include: decentralization of corruption to the counties; disconnect between high expectations by the citizens and the economic realities; the budget absorption capacity of the counties; and risks associated with disruption of seamless service delivery occasioned by weak administration.

Devolution faces many pitfalls including devolved corruption, high expectations from the citizens, budget absorption capacity and disruption of service delivery

The extent to which the post election euphoria persists will also affect the gains made by the economy and the growth trajectory in the near medium term. Investors are likely to adopt the wait-and-see attitude, and hold investment flows until normalcy returns.
Other risks that our economy may face include unfavourable weather, inflationary pressure and high domestic interest rates.

Complying with Budget timelines: The timing of the General Elections 2013 has ramifications on the statutory budget timeframe. For example, the Constitution provides for the enactment of the Division of Revenue Bill and the County Allocation of Revenue Bill at least two months before the end of the financial year (by 30th April). To comply, Parliament has to dispense the Division of Revenue Bill and County Allocation of Revenue Bill as early as possible. This implies that the National Treasury, National Assembly and by extension Senate will have to take great care to ensure that the process is not held hostage within the limited timeframe.

National Debt and Sustainability

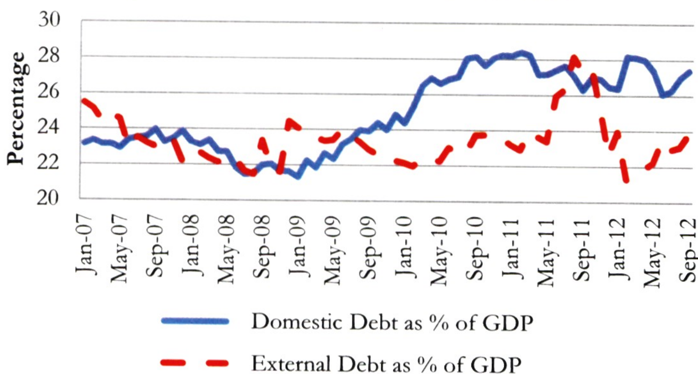
In Brief

Kenya's stock of public debt has increased substantially over time and is tipped to grow even further as the government borrows extensively to make up for the persistent revenue shortfalls. This presents the risk that the country may find it difficult to service the debt in future under modest economic growth rates, underperformance of revenue, large contingent liabilities and increasing fiscal pressures. The government therefore needs to adopt a borrowing strategy that will maintain public debt at a sustainable level. The current debt level of about 50 percent of GDP is unsustainable going forward.

The stock of public debt has more than doubled in the last decade growing from Ksh.749.5 billion in June 2005 to Ksh.1,793.2 billion as at December 2012; equivalent to 51.3% of GDP. Faced with increasing expenditure pressures and slow growth in revenues, the government has experienced a budget deficit which has been financed mainly through borrowing. A review of our current public debt indicates that the government has in the recent times financed its deficit with an increasing proportion of domestic debt. Figure 14 shows the composition of public debt and how it has evolved in the last five years, from January, 2007 to July, 2012. Domestic debt in September, 2012 was 27.4% of GDP compared to external debt level of 23.9%. This signals a higher uptake of domestic debt, which is relatively more expensive to the economy as it stifles credit flow to the private sector. The trend is also contradictory to the government stated policy of ensuring sustainable external debt to GDP ratio while reducing the domestic debt burden.

The stock of public debt has increased over the years; an expense to the economy as it stifles credit flow to the private sector

Figure 14: National Public Debt Composition



Data Source: Ministry of Finance

Kenya's debt as at November, 2011 was considered sustainable by a joint World Bank-IMF analysis. Latest estimates however indicate that if government borrows as forecasted, the country could risk debt distress and hence be categorized among the heavily indebted poor countries (HIPC).

If government borrows as forecasted the country could risk debt distress

Domestic debt

Total gross government domestic debt has grown from Ksh.379.8 billion in January, 2007 to Ksh. 969.0 billion as at December, 2012. The latest debt is composed of government securities (Ksh. 910.4 billion), overdraft (Ksh. 25.4 billion), and other domestic debt which includes clearing items on transit, advances from commercial banks, Pre-1997 government overdraft and tax reserve certificates (Ksh 33.2 billion). T-Bonds and T-Bills accounted for 78.6% and 21.4% of government securities respectively. Government's preference of longer-dated debts is sound despite the relatively higher interest rates since T-Bonds tends to push interest down thus reducing overall cost of financing.

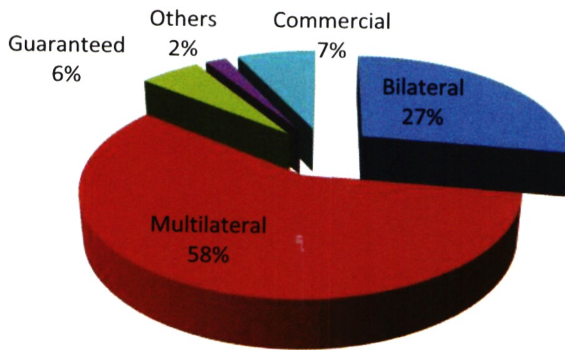
Interest payments for domestic debt instruments have been on the rise and in the first half of 2012/13 fiscal year, cumulative interest and other charges on domestic debt amounted to Ksh.47.1 billion, against a budget of Ksh 94.5 billion for the fiscal year.

The level of domestic debt has increased substantially since January 2007 and Interest payments for domestic debt instruments are quite high. External debt has also been on an increasing trend; with loans mainly from the World Bank, AfDB, IMF, Japan and China

External Borrowing

External public debt rose to Ksh.822.0 billion by the end of 2012 from Ksh.417.5 in January 2007. This is composed of multilateral (58.2%), bilateral (27.3%), commercial Banks (7.1%) guaranteed (5.5%), and others (1.9%). The World Bank through the International Development Association (IDA) is the largest multilateral creditor (Ksh 306.4 billion) followed by ADB/AFDB and IMF with loans of Ksh 75.3 billion and Ksh 67.4 billion respectively. Japan for a long time has been the main bilateral creditor but given the strengthening of the Shilling against Japanese Yen, China is now the biggest lender worth Ksh 61.3 billion followed by Japan, France and Germany with credit of Ksh 56.1 billion, Ksh 45.6 billion and Ksh 25.5 billion respectively.

Figure 15: Composition of External Debt



Data Source: Ministry of Finance

Contingent Liabilities

A scrutiny of the debt owed by other non-central government entities such as local authorities and other public enterprises indicates that the country is facing a buildup of contingent liabilities. The guaranteed external debt stood at Ksh.44.9 billion by December 2012 with Japan lending Ksh 40.4 billion. The government is currently servicing debts contracted by Nairobi City Council, TARDA and KBC. Monitoring development of these implicit debts is essential because the central government is ultimately accountable for debts contracted by these agencies. Significance of these debts is poised to increase, especially with the implementation of Public Private Partnership agreements as well as issuance of guarantees to county governments.

Contingent liabilities especially implicit debts contracted by local authorities and other public enterprises are a risk to the country's debt levels

Emerging Issues and Policy Options

It is unlikely that the government will achieve its objective of lowering the public debt to GDP ratio to below 45% at the currently projected levels of resources and expenditure. This tight fiscal position leaves government with three key options: cut expenditure, seek external concessional assistance or enhance revenues.

Given the constrained resources and high expenditure pressures, public debt is likely to remain high. Reduction of public expenditure may reduce debt burden

Option 1: Reduce public expenditure - Given the stunted growth in revenues, the government should contain expenditure. Specifically, the attempts should be focused on curbing unproductive outlays. The government should take advantage of the expected rationalization of ministries to cut administrative

costs. These measures should also be extended to SAGAs. There is need to examine the rationale for the existence of many SAGAs that carry out regulatory, regional development, and social service functions. Many of these agencies can be merged with parent ministries or wound up.

The option of reducing overall expenditure is however limited because much of the expenditure remains committed to the consolidated fund services (CFS) and the wage bill. The government has to fight the temptation to reduce development expenditure because the growth strategy hinges on a substantial increase in public investment in infrastructure and human resource development. Government thus has to scrutinize expenditure items and make the hard budget choice of curtailing unproductive spending. This will be a challenge that both national and county governments must tackle. The country therefore has to embrace a new approach of achieving higher targets with fewer resources. The focus should be on efficiency.

There is need to rationalize ministries as well as Semi Autonomous Government Agencies to reduce public expenditure

Option 2: Enhance revenue collection – As indicated later in this document, there is still some potential to improve revenue yield in Kenya and reduce the fiscal deficit through various tax measures. However, the challenges the government is facing in its effort to raise revenues discussed the next chapter are significant.

Option 3: Seek external concessional borrowing and grants – The constraints cited above imply that external concessional borrowing and grants is likely to be the main instrument for achieving fiscal objectives. Provisions of the Constitution, PFM Act 2012 and other regulations on government (national or county) borrowing should be adhered to. But external concessional borrowing and grants, though appealing, remains subject to many conditionalities and low predictability. The riding principle should be that all external borrowing be geared towards infrastructure projects only.

Curtailing unproductive expenditure, enhancing the country's revenue collection and external concessional borrowing and grants are likely to assist the country meet its fiscal objectives

A combination of the three options can therefore be pursued for maximum gains.

BOX 1: DEBT SUSTAINABILITY ANALYSIS

Debt Sustainability Analysis is undertaken to assess the impact of a country's current borrowing strategy on future ability to service the debt. As a result of the analysis, a country is classified according to its risk of debt distress. Three key threshold measures are used:

- Present Value of Debt as percentage of Gross Domestic Product
- Present Value of Debt as percentage of Domestic Revenue
- Debt Service as percentage of Domestic Revenue

Kenya's public debt has increased substantially in the recent past. Provisional figures put the public debt in fiscal year 2011/12 at Ksh 1,633.4 billion. This debt is projected by Treasury to rise to Ksh 1,882.9 billion in FY 2012/13 and thereafter increase to Ksh 2,025.1 billion and Ksh 2,069.0 billion in fiscal years 2013/14 and 2014/15, respectively.

If the government borrows as forecasted, results of debt sustainability analysis indicate that in the medium term, Kenya's total public debt (sum of external and domestic debt) will be unsustainable, at the projected economic growth rate and revenue collections. The Present Value (PV) of debt as a ratio of GDP is projected to surpass the threshold in this fiscal year while debt service as a percentage of revenue is closing in towards the threshold. For instance, the present value of debt-to-GDP ratio will reach 44.7% in 2012/13, exceeding the threshold of 40%. This is summarized below

Indicator	Threshold	2011	2012/13	2013/14
Present Value of Debt as % of GDP	40	39	44.7	45.9
Present Value of Debt as % of Revenue	250	154	184	219
Debt Service as % of Revenue	30	22	28	32

Chapter Two: Revenue Trend Analysis and Outlook

Revenue Performance and Medium Term Forecasts

In Brief

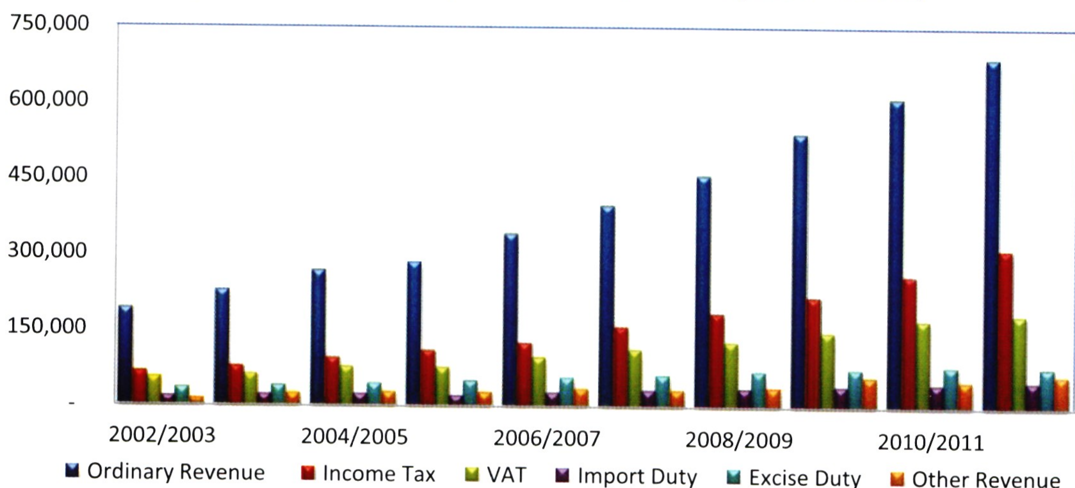
Assuming modest economic growth and relatively stable macroeconomic factors, total revenue is projected to rise from Ksh. 748.8 billion in 2011/12 to 847.2 billion in 2012/13. In 2013/14, total revenue is projected to reach Ksh. 948.2 billion in 2013/14 equivalent to 22.2% percent of GDP. In order to safeguard revenue, it is proposed that the government deepens reforms in revenue collection and administration, especially modernization of the VAT law. The government should also clampdown on tax evasion among small businesses as well as seek to introduce capital gains tax.

Revenue Performance and Composition

A review of revenue trends in the past decade shows that income tax contributes the largest proportion of revenue followed by Value Added Tax (VAT), excise duty, other revenues and import duty. In 2011/12 financial year, income tax constituted 45% of total ordinary revenue, VAT comprised of 27%, excise duty 11%, "other revenue" 9%, and import duty, 8%. Over the last decade, "other revenue" and income tax grew by 368% while VAT rose by 227%, import duty by 180% and excise duty by 121%. To support this, Figure 16 shows that import and excise duties appear to rise lethargically overtime, relative to income tax and the total ordinary revenues. Seemingly, the performance of VAT is less dramatic compared to other domestic taxes such as income tax.

The country collects revenue mostly from income tax and Value Added Tax with the other revenue items performing poorly

Figure 16: Trends and Composition Ordinary Revenue (2002/3 – 2011/12)



Data Source Source: QEBR

The government in the projected the 2012/13 total revenue collection to reach Kshs.936.5 billion from Ksh. 748.7 billion in 2011/12. Nonetheless, this target has since been revised downwards to Ksh.908.7 billion. Despite this revision, the target still appears overly optimistic due to several administrative and economic factors: one, the underperformance of VAT is expected to persist owing to the removal of VAT withholding, and delays in repealing of the current VAT law to improve administration and reduce refund problems. Secondly, the fall in inflation could affect nominal growth of various taxes such as VAT as well as excise taxes. Thirdly, tax reforms seeking to widen the tax bracket, for example through taxing the real estate sector faced various legal hitches. In this regard, the revenue projections (Table 3) shows that only about Kshs.847.2 billion is likely to be realized in fiscal year 2012/13. This could result in a revenue shortfall of about **Kshs.51.3 billion** by end-June 2013.

Revenue projection by the government appears to be overly optimistic due to expected underperformance of VAT, fall in inflation and drawbacks in tax reforms

Government revenue forecasts have often been pegged to the hypothetical revenue performance associated with the passing of the Finance Act and other tax laws. Late enactment of the Finance Act or removal of essential provisions often results in missing of the revenue targets by the tax collector. The failure to repeal the current VAT law, for example, may have contributed to the persistent underperformance of the VAT in 2012/13 financial year.

Total revenue to GDP is expected to remain fairly constant over time due to limited new areas for revenue collection, alterations to the Finance Act as well as failure to repeal the VAT law

Composition of total revenue to GDP has averaged 22.5% to 23% for last 5 years. In its projection the National Treasury expects that revenue will exceed 24% of GDP in 2012/13 and in the medium term. However, with limited new areas to collect additional revenues and compliance problems, the ratio of revenue-to-GDP may remain fairly static.

Revenue Projections for 2013/14 and the medium term

Revenue projections are based on several assumptions, primarily the assumption that Kenya's revenue response to GDP growth is inelastic but close to unity. This is the case for the main tax categories such as: import duties, VAT, PAYE, and excise taxes. This means that the responsiveness of tax collections to GDP growth is low. Further, the forecasts are based on moderate inflation in the medium term, some continued wage pressure,

but which seems to decline in the medium term. For the baseline revenue forecasts, following are some of the assumptions:

1. Slow growth in GDP and nominal GDP growth of between 12% to 14% in the medium term;
2. Revenue response to GDP growth of all tax heads is inelastic but close to unity;
3. Modest inflationary pressures in 2013.
4. Growth in oil volumes remains stable at 13%.
5. Import value growth rise marginally from 15.5% in 2013/14 to 15.7% and 15.9% in the outer years.

Assumptions for the baseline revenue forecasts include slow GDP growth, low response of revenue to GDP growth, inflationary pressures, stability of oil volumes and growth in imports

Using these assumptions, total revenue, which consists of ordinary revenue, ministerial and departmental fees (often collected by various government agencies), will rise from Ksh. 748.8 billion in 2011/12 to 847.2 billion in 2012/13. Revenue is expected to rise to Ksh. 948.2 billion in 2013/14 equivalent to 23.2% percent of GDP. Revenues will rise to Ksh. 1,065.9 billion in 2014/15 and Ksh. 1,184 billion in 2015/16.

Income tax, which consists of PAYE and "other income taxes" is the single most significant tax head. Including LATF, total income tax in 2011/12 amounted to Ksh. 329 billion. In 2012/13, income tax is expected to rise to Ksh. 367.1 billion, and rise further to Ksh. 408.8 billion in 2013/14 (Table 3). In the two fringe years, 2014/15 and 2015/16, total income tax is forecast to reach Ksh. 458 and Ksh. 520 billion respectively. Pay-as-you-earn (PAYE) will rise annually by about Ksh. 20 billion owing to positive changes in economic output and concomitant rise in employment wage rates. Wages are expected to rise by about 6.2 percent in the medium term.

Income tax is the most significant tax head and is forecasted to increase in the medium term due to changes in economic output and rise in employment wage rates

By December 2012, VAT shortfall was about Ksh. 20 billion as a result of the removal of VAT withholding provisions and this shortfall is unlikely to be resolved by the close of the financial year. Consequently, VAT will reach Ksh. 203.7 billion relative to Ksh. 183.4 billion in previous financial year. In 2013/14, VAT collections are expected to rise to Ksh. 233.6 billion assuming no major changes to the prevailing VAT legislative framework. These values could change marginally if the current VAT law is repealed through reviving the provisions of the VAT Bill which lapsed in the 10th Parliament.

VAT collections will rise further to Ksh. 267.4 billion in 2014/15, and reach Ksh. 283.1 billion in 2015/16. The VAT on imported products largely dominates VAT from domestic sources by about Ksh. 15 billion in 2011/12 and the projected performance in 2012/13. The reforms in the VAT regime and structural changes in the economy could help change this structure, that is, domestic VAT should be higher than import VAT to improve stability of revenue.

Assuming no major changes in the current VAT legislative framework, VAT collections will increase but could increase even further if current law is repealed.

In the same lines, import duties may stagnate or decline in future owing to removal or reduction of tariffs, preferential treatment, and due to commitments in regional economic integration. Import duty is expected to reach Ksh. 57.4 billion in 2012/13, and further rise to Ksh. 65.4 billion in 2013/14. In the outer years, this tax will rise at the same pace due to stable growth in import by about 15%. Thus, import duties are projected to reach Ksh. 85.4 billion in 2015/16. Excise duty consists of excise on imports (mainly oil and non-oil products) and domestic excise (excise on domestic products and airtime).

Excise on oil is the most substantial, consisting of more than 80% of excise duty on imports. Total excise duty on imports is expected to reach Ksh. 44.1 billion, but rise to Ksh. 49.7 billion in 2013/14 financial year. Excise duty on both domestic products and airtime is nearly proportionate to excise duty on imports. For example, in 2011/12, excise duty on imports was equal to Ksh. 39.3 billion while excise duty on domestic products was Ksh. 39.9 billion. the same proportions may obtain in the medium term, though excise on imports is likely to stagnate while domestic excise will receive a boost from the new provisions to tax money transfer services fees at 10% (according to Finance Act 2012).

Import duties is likely to rise in the outer years due to stable growth in imports whereas Total Total excise duty is expected to increase modestly

Total excise duty in 2012/13 is expected to reach Ksh. 89.1 billion, and rise to Ksh. 100.5 billion in 2013/14. These duties will rise marginally, in line with the changes in respective changes in the base values, by about Ksh. 14 billion each year to reach Ksh. 128.5 billion in 2015/16. However, recent reforms to improve tax collection from domestic production could

significantly change the structure of excise tax and also the tax yield. Other domestic level taxes include investment revenue and a host of revenues such as the IDF fees, aviation and airport fees, stamp duty and land rent. This component, known as "other revenue" is expected to hit Ksh. 55.8 billion by end 2012/13 and rise to Ksh. 62.9 billion in 2013/14. Reported ministerial and departmental fees constitute only about 6.7% of total revenue, but there is much more revenue mainly from regulatory state agencies whose revenue estimates is not approved by Parliament (does not appear in fiscal framework). If all revenue collected by public agencies would be included, then the total tax burden on Kenyans would be clearer.

All revenue collected by public agencies is not known hence the total tax burden is not clear

Table 3: Baseline Revenue Projections (Kshs Billion)

	2011/12	2012/13	2013/14	2014/15	2015/16
Total revenue	**748.8**	**847.2**	**948.2**	**1,065.9**	**1,184.1**
Ordinary revenue	691.3	769.4	865.9	978.4	1,089.7
Income tax (exc. LATF)	312.5	348.8	388.3	435.1	494.0
Import duty	51.9	57.4	65.4	74.7	85.4
excise duty	79.2	89.1	100.5	113.8	128.5
VAT	183.4	203.7	233.6	267.4	283.1
Investment income (BROP)	14.1	14.6	15.2	15.9	16.8
Other Revenue	50.2	55.7	62.9	71.5	81.8
LATF	16.4	18.4	20.4	22.9	26.0
Ministerial and Departmental Fees	57.4	59.5	61.8	64.6	68.4
Revenue as percent of GDP					
Total revenue	*22.7%*	*22.8%*	*23.2%*	*23.7%*	*24.0%*
Ordinary revenue	*20.9%*	*20.7%*	*21.2%*	*21.8%*	*22.1%*
Income tax (exc. LATF)	*9.5%*	*9.4%*	*9.5%*	*9.7%*	*10.0%*
Import duty	*1.6%*	*1.5%*	*1.6%*	*1.7%*	*1.7%*
excise duty	*2.4%*	*2.4%*	*2.5%*	*2.5%*	*2.6%*
VAT	*5.5%*	*5.5%*	*5.7%*	*6.0%*	*5.7%*
Investment income (BROP)	*0.4%*	*0.4%*	*0.4%*	*0.4%*	*0.3%*
Other Revenue	*1.5%*	*1.5%*	*1.5%*	*1.6%*	*1.7%*
LATF	*0.5%*	*0.5%*	*0.5%*	*0.5%*	*0.5%*
Ministerial and Departmental Fees	*1.7%*	*1.6%*	*1.5%*	*1.4%*	*1.4%*

Source: PBO Tax Forecasts

Comparing the Baseline and Alternative forecasts

The alternative revenue forecasts assumes changes in macroeconomic assumptions, differing assumptions on inflation deflators and forecasted change in various tax base

The estimates above are fairly conservative – but, changes in the macroeconomic assumptions, for example assuming reduced inflationary pressure and a slight rise in real GDP (for example 5.2% instead of 4.1% in 2013/14), could lead to a slight rise in forecasted revenue in the alternative scenario. Further, the alternative scenario incorporates differing assumptions about inflation deflators, and forecasted change in various tax bases. Relative to the baseline scenario above, the alternative forecasts are based on the assumption about the enactment of various tax laws (e.g. repealing of the VAT Act).

In the alternative scenario, there are notable increases in revenue projections on income tax and VAT but little response in the other tax heads

In this scenario, revenue projection for 2013/14 reaches Ksh. 954.9 billion, exceeding the baseline forecast by Ksh. 6.7 billion (Table 4). In 2014/15, revenue will be expected to rise to Ksh. 1,077.2 billion under the alternative scenario relative to Ksh. 1,065 billion in the baseline scenario. The most notable change in revenue projections is on income tax and VAT, which appears to rise by at least Ksh. 3 billion above the baseline. Excise duty and import duty appear inert to the assumptions under this scenario, with limited response in the forecasted revenue compared to the baseline scenario.

In summary, according to the baseline scenario it is estimated that the government will realize about Kshs.847.2 billion for the 2012/13 financial year. Revenue is further projected to rise to Ksh. 948.2 billion due to robust performance in PAYE, modest growth in VAT, import and excise duties, despite marginal contribution from investment income and "other" revenue.

Table 4: Baseline and alternative revenue forecasts (Kshs Billion)

	Baseline			Alternative Scenario		
	2013/14	**2014/15**	**2015/16**	**2013/14**	**2014/15**	**2015/16**
Total revenue	948.3	1,065.9	1,184.1	954.9	1,077.2	1,191.9
Ordinary revenue	865.9	978.4	1,089.7	871.8	987.8	1,095.7
Income tax (exc. LATF)	388.3	435.1	494.0	390.7	439.8	495.9
Import duty	65.4	74.7	85.4	65.4	74.8	85.4
excise duty	100.5	113.7	128.5	100.9	114.1	128.3
VAT	233.6	267.4	283.1	236.2	271.2	287.2
Investment income (BROP)	15.2	15.9	16.8	15.4	16.3	17.3
Other Revenue	62.9	71.5	81.7	63.1	71.7	81.7
LATF	20.4	22.9	26.0	20.6	23.1	26.1
Ministerial and Departmental Fees	61.8	64.6	68.4	62.7	66.3	70.2

Source: PBO forecasts

The drivers of revenue growth for financial year 2013/14 and the medium term will include reforms in the VAT administration and collection systems through the repeal of the VAT Act. Other reforms include increased funding of the revenue authority, and inclusion of new sources of revenues particularly from withholding taxes and other taxes from the rapidly expanding mineral exploration, mining, and oil and gas sectors.

Revenue Enhancement Alternatives

In order to enhance revenue collection, there is need to attain some macroeconomic targets, enact some administrative changes and expand the tax bracket

As noted above, attainment of revenue forecasts is dependent on attainment of macroeconomic targets together with administrative changes and widening of the tax bracket. Such reforms, would improve Kenya's revenue performance. Whereas it could be argued that persistent revenue underperformance is due to overestimation of revenue by the government, it is still possible to improve revenue collections as a proportion of GDP to about 23-24% of nominal GDP. However, this is only attainable through specific innovations in revenue collection, and widening of the tax net. Further, it is apparent that the responsiveness of tax revenue to changes in the GDP growth is quite low, and most tax heads are inelastic. This is supported by PBOs projections, which assume moderate elasticity of various tax heads to changes in GDP or respective tax bases. This information clearly shows that there is potential to improve revenue yield and reduce the fiscal deficit through various tax measures. Some of the policy options which may be considered are briefly outlined below.

Need for proper justification based on legal criterion for all tax waivers and exemptions

1. **Specify criteria for exemptions, waivers, tax remissions.** Article 210 of the Constitution provides that all tax waivers and benefits be properly accounted for including providing reasons for such waivers. While the primary objective of zero-rating, remission, exemptions and tax holidays is to help confer indirect tax relief on certain classes of people and productive sectors of the economy, the tax waivers have tended to deplete the revenue base without, in many cases, conferring the intended benefits on the beneficiaries or the economy. No criterion has been developed to implement these provisions of the Constitution. To streamline the tax

incentive regime, it is proposed that a legal criterion be developed to provide a basis for issuance of tax waivers and benefits. Alternatively, the government can assist the vulnerable groups and aid sensitive productive sectors through subsidies rather than through the tax system.

2. **Revenue Administration Reform Agenda:** The revenue administration reform agenda appears to have reached a plateau. Since 1995, KRA has undertaken key reforms culminating in commensurate increase in revenue collection. However, over the last two financial years, the revenue target set by the Treasury has been missed. There are several reasons to explain this; among them the fact that the structural and IT reform agenda was not upheld. Thus, there is need for a deliberate policy shift towards investing resources in areas that are likely to bring new sources of revenue.

Deliberate policy shift from the current revenue administration reform agenda (Structural and IT reforms) to explore other sources of revenue

3. **Rethinking the implementation of Turnover Tax:** The Kenya Revenue Authority (KRA) introduced turnover tax in order to ensure that the informal sector pays a fair share of the tax. However, despite high ToT recruitment there hasn't been a commensurate increase in revenue. For instance, ToT recruitment grew by 36.3 percent from 3,517 in 2009/10 to 4,794 in 2010/11. On the contrary, the revenue Authority was only able to collect a paltry Ksh.57 million and Kshs.130 million in 2009/10 and 2010/11, respectively. To reverse this trend, KRA should move with speed in terms of simplifying the recruitment process for TOT taxpayers as well leveraging ICT in the payment of TOT tax. Furthermore, KRA should partner with county governments in order to have a one stop shop for registration of the taxpayer for the purpose of taxation as well as licencing. Indeed, by upgrading and modernizing the city/town council databases, KRA will establish physical location of the various businesses.

Revamp the Turnover Tax system through simplifying recruitment process and leveraging on ICT to enhance revenue collection from ToT Taxpayers

4. **Revamping VAT collection:** In the 2012/13 report on the Budget Policy Statement, Parliament recommended the use of GPRS enabled Electronic Tax Register (ETR)

as a means of enhancing VAT collection. Based on the aforementioned resolution, the VAT act was amended in the Finance Bill of 2012. VAT is the tax of the future and if properly administered, it is likely to substantially enhance revenue collection. The GPRS-Integrated ETR is its single most valuable, powerful vehicle that is likely to increase VAT collection. There are concerns however with regard to the slow pace of implementation of GPRS enabled ETR. Available information indicates that the exact population of ETRs in the market is not known. This makes it difficult for the tax man to net in the non compliant taxpayers. To this end, it is recommended that KRA hastens the implementation of GPRS enabled ETRs.

The totality of ETR machines in the country should be established in order to net in the non compliant taxpayers and enhance VAT revenue collection

5. **Taxation of capital gains**: The capital gains tax was removed in mid-1980s to encourage investments in property and marketable securities. However, since then the real estate and securities market have grown tremendously. According to a real estate index by HassConsult, property values have increased by more than 300 times since 2000[6]. In peak growth times such as 2007-2008, property values rose by 3-4 percent every quarter. Similarly, most listed stocks at the Nairobi Stock Exchange have moved up several times over the past decade. Capital gains tax is present in Uganda, Tanzania, and many African countries. Uganda levies tax on capital gains at 30 percent and Tanzania at 20 percent. To broaden the tax bracket, the tax authority needs to consider levying taxes on incomes or capital gains from appreciation of properties, stocks and other marketable assets. The process of implementing this tax may include broad consultations with stakeholders such as agencies at the Nairobi Stock Exchange and real estate actors to improve compliance.

KRA should consider levying taxes on incomes or capital gains from appreciation of properties, stocks and other marketable assets

6. **Taxation of the real estate sector:** According to the fifth corporate plan of the KRA, the property developers

[6] The Hass Property Index, Quarter Three Report, 2009 and Quarter Four Report, 2012. HassConsult Limited

market in Kenya and particularly in Nairobi has grown rapidly in the last five years. Construction of apartments, estates and office blocks for sale or rent has surged. However, this growth has not been reflected in tax revenues. Despite putting measures such as using Geographical Information System (GIS) maps among other measures, there is need to rethink the issue of property tax administration. Available literature indicates that property administration in developing countries like Kenya is most problematic. Often than not, there is lack of qualified staff, outdated style of record keeping and lack of coherence and interface between the revenue collection Authority and other agencies. To increase collection in the property sector, KRA should institute a holistic approach to tax administration, namely:

i. Coverage: Put in place a comprehensive list of all eligible taxpayers. In addition, measures must be put in place for proper assessment to be done.
ii. Billing and collection: The Authority must make sure the assessed tax is actually collected. This is the only way the cycle is completed.
iii. Audit: The assessed files must be audited and the information therein be compared with other sources.

Growth in the real estate sector has not been reflected in the tax revenues. Property tax administration should be streamlined to encompass coverage of all tax payers, billing and collection of tax; and audit of all assessed tax files

Chapter Three: Public Expenditure and Proposals for 2013/14 and the Medium Term

Structure and Size of Public Expenditure

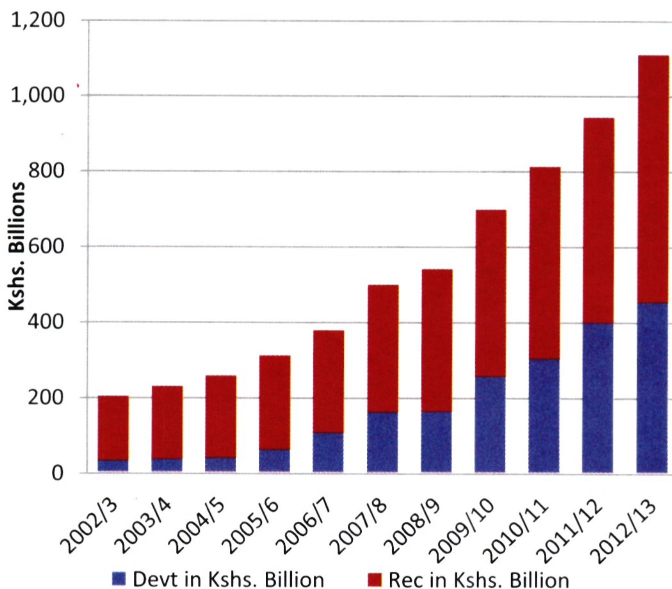
In Brief

Government expenditure has mostly been driven by recurrent expenditure with a ballooning public debt which has more than doubled over the past decade. However, the high government expenditure has not resulted in improved standards of living for the citizens in particular as relates to Health, Education and basic Infrastructure. In order to address the expenditure concerns, comprehensive and far- reaching public sector reforms will have to be undertaken including sustaining austerity measures on unproductive outlays. .

Over the last decade, government expenditure has more than quadrupled in nominal terms. Total government spending rose from a budget of Ksh 264.1 billion in FY 2002/03 to Ksh 1,195 billion in FY 2012/13 (figure 17) representing an increase by over 350%. Expansion in public spending is predominantly driven by recurrent expenditure pressures and mainly growth in employees emoluments.

Increase in public spending has been driven by recurrent expenditure

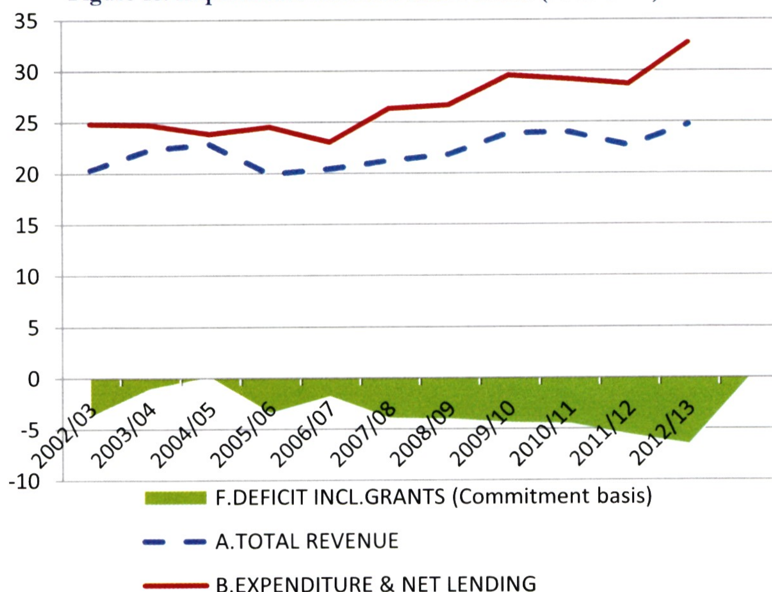
Figure 17: Trends in Public Expenditure (2002/03-2012/13)



As a ratio of GDP, expenditure has been inching upwards at a faster rate than revenues. Expenditure and net lending rose from 24.3% in 2002/03 to 28.7% in 2011/12. This is projected to rise to 32.6% and 33.1% in 2012/13 and 2013/14 respectively. However, despite the increasing government expenditure, the well being of Kenyans has not improved. Many of our citizenry are not able to access basic healthcare and the poverty levels have increased (see Annex 2 on poverty levels). This can be attributed to inefficiency in the utilization of public resources and targeting and prioritization of resources.

Expenditure has increased faster than revenue as a share of GDP but there has been no commensurate improvement in the well being of Kenyans

Figure 18: Expenditure Revenue and Deficits (% of GDP)



There appears to be a disconnect between the policies of government and expenditure priorities

Emerging Issues

A scrutiny of the approved estimates and actual expenditure show a huge divergence. There appears to be a disconnect between government's policy intent and actual priorities in spending. Whereas the recurrent component of the budget is high, the allocations to development are contrary. This means that the aspirations of the Vision 2030 may not be achieved.

Against the background of recent performance, achieving the targets of Vision 2030 requires bold decisions to be made. Some hard budget choices will have to be made to restructure the spending pattern. It is imperative to contain the recurrent expenditure pressures and address the twin problem of rising (domestic and foreign) debt and growing deficit which is forecasted at 8.0% at the end of fiscal year 2012/13. The government cannot rely only on additional resources becoming available to restructure spending. Much can be done within the existing resource envelope, but this requires hard budget choices. Specifically, attempts should be focused on sustaining austerity measures[7] on unproductive outlays. The government should take advantage of the expected rationalization of ministries to cut administrative costs. Similar measures should also be extended to SAGAs. There is also a need to review the rationale for the existence of numerous SAGAs seemingly performing similar regulatory, regional development, and social service functions.

There is need to restructure the expenditure patterns to reduce unproductive outlays

[7] The austerity measures particularly contained foreign travel as well as boards and committee expenses in the last two financial years

Spending for Growth: Sustainable Expenditure Options

In Brief

Public expenditure and investment can boost economic growth and improve the wellbeing of the citizens. However, this is only feasible if resources are properly allocated and priority given to core expenditure programmes/sectors such as Education and Health, Agriculture and Rural Development, Energy, Infrastructure and ICT.

i. Agriculture and Rural Development

Agriculture is a major sector in our country, and although its contribution to GDP has declined from about 40% at independence to about 24 - 26% currently, its contribution to development is still significant. The sector is expected to support employment especially in rural areas and provide raw materials for the manufacturing sector. Through exports such as tea, coffee, and horticulture, the sector is also a major foreign exchange earner.

The agricultural sector is expected to remain the primary engine for economic growth in the foreseeable future

Assessment of government expenditure indicates that budget allocations to agriculture accounts for about 5% of total government outlays. However, the sector has remained untapped in terms of technological advancement. The sector is still very highly dependent on rainfall and not much diversification of crops has taken place. Research and innovation has remained low and marketing of products has been left to chance. As a result, close to 10 million Kenyans are estimated to suffer from chronic food insecurity and poor nutrition. Indeed, the provision for emergency food supplies is a regular feature in the annual budget. In order to improve the sector, there is need to adopt reform measures that should target increased yield, diversification, improvement in storage, adoption of new technologies and marketing of agricultural products.

In order to address food insecurity, there is need to adopt reform measures that target increased yield, diversification, improvement in storage and adoption of new technologies and marketing of agricultural products

The following are some of the Options for 203/14 and the Medium Term:

a) **Enhance Training and Research in Agriculture:** There has been poor coordination and lack of efficient

agriculture research system that can produce effective new technologies to increase agricultural yields. Strategies to encourage private sector participation should be put in place. The planned merger of all parastatals in the sector to one umbrella body should improve efficiency and synergy in research. The research findings should adequately packaged and forums for dissemination well publicized so as to guide farmers.

In order to revamp agriculture, there is need to invest in training and research programmes, as well as adopt strategies to encourage private sector participation

b) **Availability of quality seeds and fertilizers**.

Quality seed is one of the most important inputs for farmers and influences yield potential to an estimated level of between 5% and 20%. There should be a direct investment in the production of quality seeds and measures to ensure that there is quality in the seeds produced by the private sector.

It is further estimated that with fertilizers the crop yield can increase 30 to 50%. Use of organic fertilizers should be promoted since they are generally better for the environment as less pollution is created from their manufacture; they have a longer lasting effect on the soil quality unlike many inorganic fertilizers which are easily washed by rain or water if not absorbed into the soil immediately.

Investment in high quality seeds and use of fertilizers will facilitate production of healthier crops. There is need to also invest in post harvest handling technology and interventions to reduce post harvest losses

c) **Post-harvest handling**

The post-harvest losses in Kenya accounted for about 30% of all produced crops before the advent of the Lager Grain Borer and Aflatoxin. Post-harvest losses occur at various levels that include drying, shelling/threshing, storage and transportation. Post-harvest losses are also influenced by pre-harvest decisions such as time of planting, harvest periods and choices of varieties. Increased extension services to farmers as well as development of facilities for storage and preservation would reduce the losses incurred.

ii. Health Sector

Article 43 of the Constitution of Kenya entrenches healthcare as a right to every Kenyan. The health sector in Kenya has been receiving slightly below 10% of the total government outlays over the last decade. Although there has been growth of allocations in nominal terms, a huge proportion has been to cater for wages. Also, there is a mismatch between policy and resource allocation in the sector. Though the policy has been to align resources on preventive healthcare, curative programs still get lion's share of resources during budget implementation.

There is a mismatch between policy and resource allocation in the health sector with more focus on curative rather than preventive healthcare, poor distribution of personnel, wastage of medical supplies and poor administration of healthcare facilities

There are significant non-financial constraints that affect delivery of healthcare in Kenya such as shortage and bias in distribution of personnel, leakage and wastage of drugs and medical supplies, and poor administration of healthcare facilities.

The health services have largely been devolved under the new constitution. The national government is responsible for health policy and national health referral hospitals only. This means that the bulk of resources shall be devolved to county governments. Indeed, in the 2012/13 budget, an estimated 67.9% of total allocations for the sector was allocated for devolved functions. The allocation to the sector in the medium terms is given in table 5. The table shows that a larger proportion of resources are allocated to county governments.

Policy options for 2013/14 and the Medium Term

Whereas the challenges in the sector are pertinent and have been inhibiting government delivery of services, it is important to note that available resources are finite and the health sector competes with other sectors for resources. Solving these challenges therefore calls for creative solutions.

Health services are largely devolved to the county governments with the national government being responsible for policies as well as national referral hospitals

Social Health Protection – care for indigents

User fees are charged at almost every public health facility, though the rates vary. The public facilities are however expected to issue waivers for citizens who are not able to meet the cost of treatment. This has resulted in most public facilities especially in

rural areas and referral hospitals being overwhelmed by claims of waivers yet the government does not compensate for revenues foregone. This has affected the resources for these facilities leading to compromised service delivery.

Reforming National Health Insurance Scheme is vital. The scheme should be managed in a more transparent and accountable manner. Better strategies to reach a larger proportion of the population especially those in informal sector and the unemployed are necessary.

Public facilities forego revenue in terms of waivers for citizens and this has compromised service delivery. To address this, the National Health Insurance Scheme should be reformed

Automation of health facilities

This should be fast-tracked to improve efficiency and accountability of health facilities, due to competing needs in the sector. A pilot automation process should begin in the FY 2013/14 by automating at least two facilities per county and until all facilities in the country are automated.

Promotion of Preventive Healthcare

The public health officers should intensify community training and sensitization on public health issues to prevent diseases that are spread due to inadequate cleanliness, poor waste disposal methods and stagnant water and bushes around the homesteads. There should be promotion of construction and use of ventilated pit latrines and hygiene. Spraying of homes and stagnant water by Health officers to prevent insects breeding is also crucial. Water source protection, proper disposal of solid waste, waste water drainage and market hygiene that involve water and sanitation facilities should be promoted.

Promotion of preventive healthcare can be done through community training and sensitization on waste handling and hygiene; as well as water source protection

iii. Education Sector

Articles 43 and 53 of the constitution provide for the right to education. The constitution gives the national government responsibility of providing primary, secondary and university education as well as overall education policy and standards. The county governments on the other hand are responsible for provision of pre-primary education and youth polytechnics.

Public outlays on education sector have continued to rise over the past, though of late, the sector has been overtaken by infrastructure as the largest recipient of government resources. With the introduction of Free Primary Education (FPE) in 2003, expenditure outlays have steadily risen, with a further jump in 2008 when Free Day Secondary Education (FDSE) was introduced. One should note that there is substantial expenditure by households and private sector[8] on education.

There is a mismatch between education spending and policy priorities with low levels of development expenditure

Past trends and Key Challenges

Education sector expenditure trends have not reflected policy priorities. Low levels of development expenditure despite the rise in enrolment have resulted in overstretched and deteriorating infrastructure. More resources should therefore be budgeted towards the expanding infrastructure in public institutions of learning.

Policy Options for 2013/14 and Medium Term

In the 2013/14 budget, the government should prioritize its allocations in the sector key programs as follows:

- Increase the FPE allocations from Ksh 9 billion to at least Ksh 10.5 billion in order to cover all expenditure outlays including increased enrolments and bridging regional disparities demand for additional resources

The government should increase allocations to Free Primary Education to at least Kshs 10.5 billion and FDSE allocations to over Kshs 22 billion

- Increase the FDSE funds to over Ksh 22 billion from Ksh 19 billion to cater for expected increased enrolments as well as bridging regional disparities. Special attention should focus on ASAL regions where transition and retention in secondary schools is low.

- Increase HELB allocations by Ksh 2 billion to Ksh 5 billion. The Higher Education Loans Board should complement these efforts by intensifying recovery efforts and reducing the coverage by giving priority to bright students from disadvantaged backgrounds

[8] For instance, in 2008, 10.8% of total primary education enrolment was in private schools while 12.31% of secondary school children were in private secondary schools.

iv. Energy, Infrastructure and ICT Sector

In the past three years, the infrastructure sector has been highly prioritized by the government, receiving the highest funding. The sector's allocation increased from Kshs. 165.73 billion in 2010/11 to Kshs. 267.91 billion in 2012/13. Much of the funds for the sector are used in capital projects under the ministries of roads and energy.

Infrastructure has been a major priority of the government with huge funding for roads and energy but transportation remains a problem

Owing to substantial spending on infrastructure, improved road network is now seen as a success story of the outgoing government. However, various bottlenecks still remain in the transport and energy sectors. Consequently, the government has embarked on addressing the bottlenecks in the transportation system within the country and commissioned major power production plants especially for renewable energy sources like geothermal and wind power.

Policy Options for 2013/14 and the Medium Term:

a) Amalgamation of the public service transport to enhance efficiency and give rise to Rapid bus transportation services within the major towns and cities.

There is need to fast-track development of commuter railway as well as rapid bus transportation within Nairobi and Improvement of the Mombasa/ Kisumu/Malaba railway to ease transportation problems

b) Fast-track the development of the commuter railway transportation within Nairobi city to ease congestion on the roads and connect major suburbs to the city center.

c) Fast-track upgrade of the Mombasa/Kisumu/Malaba railway line. This can be achieved through Public Private Partnership (PPP) and there exists a legal framework to facilitate that.

d) Allocate adequate resources for the development of the Konza ICT Park to enhance the information sub-sector.

Expenditure allocation across sectors

In Brief

The allocation of resources for 2013/14 and the medium term will take a different approach from previous years. Notably, with the coming to existence of the county governments, expected functional allocations to county governments will be taken into account and deducted. County governments will receive a minimum of 15% of the total sharable revenue collected by the national government. Nonetheless, the county governments will be independent of the national government with respect to budgeting therefore the setting of ceilings for the different sectors in the national government budget will not include the budget for the county governments.

The 2013/14 budget is in essence a transition budget and therefore a critical stage of setting the pace for devolution in this country. It therefore means that the allocation of resources for 2013/14 and the medium term presents a shift from centralization to decentralization. More importantly, the first step is to adhere to the principles of public finance as outlined in the constitution of Kenya.

The proposed expenditure allocation have been made taking into account the responsibilities of the national and county governments

The second issue to consider in resource allocation is the anticipated targets for 2013/14 and the medium term. These targets should be in line with the provisions of the constitution with regard to the rights of Kenyans, the distribution of functions between the national and county level of governments and the Vision 2030.

Thirdly, starting with 2013/14 budget, the principles of devolution have to be adhered to and thus the ceilings have to be made taking into consideration the responsibilities of either levels of government under the new dispensation. The central government is expected to retain a lean establishment in sectors such as agriculture and health where the national government is majorly responsible for policy and research services. Table 5 provides proposed expenditure allocations across the MTEF sectors for national government

The budgetary allocations should be in line with the expenditure priorities of the country as per the constitution, distribution of functions between the two levels of government and Vision 2030

BOX 2: PRINCIPLES OF PUBLIC FINANCE AS PER ARTICLE 201 OF THE CONSTITUTION

The following principles shall guide all aspects of public finance in the republic –

a) there shall be openness and accountability, including public participation in financial matters;

b) the public finance system shall promote an equitable society and in particular –
   (i) the burden of taxation shall be shared fairly;
   (ii) revenue raised nationally shall be shared equitably among national and county governments; and
   (iii) expenditure shall promote the equitable development of the country, including by making special provision for marginalized groups and areas;

c) the burdens and benefits of the use of resources and public borrowing shall be shared equitably between present and future generations;

d) public money shall be used in a prudent and responsible way; and

e) Financial management shall be responsible and fiscal reporting shall be clear.

Table 5: Proposed Expenditure allocation across sectors

	MTEF Sector	2012/13 Baseline Year^			Alternative Scenarios - National Government		
		Gross Est	GoK	% Share of GoK	2013/14*	2014/15*	2015/16*
1	Agriculture and Rural Development	51.1	42.8	4.7%			
	o/w National Government		33.0	3.6%	2.5%	2.6%	2.6%
	o/w Devolved Function	9.8	9.8	1.1%			
2	Energy Infrastructure and ICT Sector	268.7	145.0	16.0%			
	o/w National Government		77.4	8.5%	7.4%	7.5%	7.5%
	o/w Devolved Function	67.6	67.6	7.5%			
3	General Economic Commercial and Labor Affairs	16.1	13.9	1.5%			
	o/w National Government		9.0	1.0%	0.7%	0.8%	0.7%
	o/w Devolved Function	4.9	4.9	0.5%			
4	Health	87.0	65.4	7.2%			
	o/w National Government		11.5	1.3%	1.0%	1.1%	1.1%
	o/w Devolved Function	53.9	53.9	6.0%			
5	Education	236.0	223.6	24.7%			
	o/w National Government		222.0	24.5%	24.1%	24.3%	24.5%
	o/w Devolved Function	1.6	1.6	0.2%			
6	Governance Justice Law and Order	108.6	107.4	11.9%			
	o/w National Government		106.9	11.8%	10.6%	10.5%	10.5%
	o/w Devolved Function	0.5	0.5	0.1%			
	o/w Judiciary	15.0	15.0	1.7%	1.8%	2.0%	2.0%
7	Public Administration and International Relations	131.1	113.4	12.5%			
	o/w National Government		91.1	10.1%	7.7%	7.5%	7.3%
	o/w Devolved Function	22.3	22.3	2.5%			
	o/w Parliament	16.4	16.4	1.8%	2.0%	2.0%	2.0%
8	National Security	83.7	83.7	9.2%	7.6%	7.4%	7.4%
9	Social Protection Culture and Recreation	37.8	27.4	3.0%			
	o/w National Government		19.7	2.2%	1.6%	1.5%	1.5%
	o/w Devolved Function	7.7	7.7	0.9%			
10	Environmental Protection Water and Housing	55.0	26.5	2.9%			
	o/w National Government		20.7	2.3%	1.8%	1.8%	1.9%
	o/w Devolved Function	5.8	5.8	0.6%			
11	Others**	29.0	29.0	3.2%			
12	Devolved Functions (Others)***	13.6	13.6	1.5%			
	National Government		675.0	74.6%	65.0%	65.0%	65.0%
	Devolved Functions		187.7	20.7%	35.0%	35.0%	35.0%

^ Units in Ksh billions unless otherwise stated

**These are one-off expenditures such as elections, CCF, etc

***Includes funds under Transition Authority and funds appropriated in January 2013 for counties

Notes:

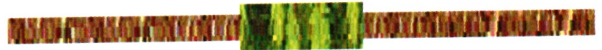
1 The Constitution guarantees at least 15% of the most recent audited accounts of revenue collected by national government to be transferred to County Governments. Beginning 2013/14, resources shall be devoted to functions assigned to each of the two levels of government. It is therefore estimated that in 2013/14, about 35% of forecasted sharable revenue should be transferred to Counties.

2 Foreign funding to specific projects in MDAs are not part of the ceilings proposed for 2013/14 and Medium Term

3 It is assumed that any deficit projected in 2013/14 finance either domestically or externally should be devoted to physical infrastructure

4 *Sectoral expenditures at devolved levels are to be decided by the county governments

Chapter Four: The Economics of Devolution



Driving Growth through Devolution

In Brief

For years, the country has experienced skewed development with some regions advancing more than others in development. Kenyans are optimistic that through devolution, the perceived historical injustices will be addressed and equity will be achieved. However, rebalancing growth will be a challenge as economic performance differs from county to county with some more prepared for takeoff than others. There is need to address regional inequalities across the counties and exploit competitive advantage. However, it is worth noting that devolution alone cannot drive economic growth. There is need for a concerted effort to ensure varied prescription to remedy the various challenges experienced by the respective counties while exploiting competitive advantage.

The country is gearing itself for a major shift in its political, economic and administrative structure as it shifts from a centralized governance system to a devolved system of government. The county system of government took effect immediately following the 2013 general elections. The county governments will enjoy a distinct and inter-dependent relation with the national government, enjoy guaranteed share of national revenue, revenue raising powers (albeit limited) and control over service delivery within their various jurisdictions. It is largely envisaged that through devolution, the 47 new counties will be able to find homegrown solutions to their problems and freely determine their expenditure priorities thereby facilitating overall economic development.

The transition to devolved government is expected to enable counties to find home grown solutions to their problems thereby facilitating overall economic development

Since independence, Kenya has experienced skewed growth. According to the Kenya Economic Update (World Bank, 2011), economic activity in the country has been concentrated in only 23 out of the 47 counties. According to the World Bank analysis, the biggest share of Kenya's total production is from Nairobi and Mombasa while contributions to the national economy from counties like Isiolo and Samburu are very minimal. This presents a challenge in terms of rebalancing growth and redistribution of productive capacity across the counties.

Kenya's economic activity has been concentrated only in 23 out of the 47 counties

For counties to achieve sustainable and all inclusive economic growth, they will have to address the following:

i. Create employment,

ii. Reduce Poverty levels, and
iii. Enhance Revenue Collection.

i. Creating Employment

One of the biggest challenges for the county governments will be generation of employment opportunities. Latest employment statistics indicates a high prevalence of unemployment in almost all counties. From available data, unemployment is highest in Garissa (46.9), Wajir (36.0), Mandera (31.0), Kiambu (25.8) and Mombasa (17.7). Only ten counties have an unemployment rate of less than 5 percent. A high unemployment rate also implies less revenue collection for the county governments (For details on unemployment rate per county, refer to Annex 1).

Generation of employment opportunities is one of the biggest challenges facing county governments. A high unemployment rate implies less revenue collection and high dependency on county governments

Counties will therefore need to device policies that generate productive employment opportunities. This may include policies that promote entrepreneurship to increase employment opportunities outside the public sector as well as skills development for the unemployed to increase their chances of being employed or setting up businesses.

ii. Reducing Poverty Levels

with available data showing that more than half of the population in 22 out of the 47 counties is poor, counties will have to put in place practical poverty reduction strategies (For details on poverty levels per county, refer to Annex 2).

Employment creation will result in poverty reduction but only if the employment opportunities are productive enough to enable escape poverty

Increased employment levels can only reduce poverty if there is an increase in productivity levels. To this end, Counties should focus on ensuring that job creation policies offer stable and productive opportunities as opposed to a temporary fix to the problem such as temporary odd jobs for the youth.

iii. Contribution to Revenue

Available data indicates that Nairobi is the largest contributor of revenue national basket with Mombasa County coming a distant second (See Annex 3). The contribution is very minimal for the other counties. This in essence means that most counties have limited internal revenue generation potential. In the medium term, most counties are likely to over-rely on the revenue transfers from the national government. The County Executive Committees may therefore need to put in place efficient revenue collection systems and seal all revenue leakage loopholes to enable enhanced revenue collections.

The contribution to revenue is high in Nairobi County but quite minimal in all the other counties

Economic Growth through Counties

Driving economic growth at the national level through devolution will require a two pronged approach:

i. Address regional inequalities
ii. Capitalize on competitive advantage

Addressing regional inequalities

Historical patterns of unequal development across the country has resulted in areas perceived to have more economic opportunities being economically advanced by attracting even greater investment through rural to urban migration as well as businesses setting up base in those areas where they are more likely to maximize profits. The consequent is that, the 'rich' counties continued to be richer while the 'poor' counties became poorer.

Some counties are more developed than others due to historical patterns of neglect. Devolution is expected to redistribute national income and address regional inequalities

Redistribution of national income is a highly desired outcome of devolution. Through allocating specific shares of the national revenue to each county including equalization fund transfers and conditional grants, it is hoped that those counties which are lagging behind in terms of development will be able to reach the level of the other counties. Indeed, Kenyans are very hopeful that the implementation of county governments will translate to

close proximity of services to the people and bring about the much need economic development thereby reducing inequalities. However, it is worth noting that equitable development is not a guarantee. Redistributing national resources will not necessarily bring about equitable development across the forty seven counties (47). In actual fact, devolution is likely to perpetuate inequality as not all counties will be able to immediately absorb fully, the resources that will be allocated to them. Also, some counties lack the capacity to effectively take up the constitutionally devolved functions. This is attributed to the different levels of development of the Counties. Furthermore, proper utilization of resources at county level will largely depend on the levels of transparency and accountability in the management of public resources by the county leaders. Otherwise, there is a risk that devolution may achieve nothing more than devolved corruption.

Devolution will not necessarily bring about equitable development and it may take some time for some counties to reach the level of the more developed counties

In order for county governments to be successfully implemented, the following need to be done:

i. **Infrastructural Development and Budget Absorption Capacity:** Not all the 47 counties are endowed with infrastructure necessary for immediate takeoff. Some counties lack proper roads, social amenities including health and education facilities, adequate supply of electricity and other public works. This coupled with low budget absorption capacity poses risk of disruption of seamless service delivery by the county governments. Transition Authority is in the process of undertaking county assets audit to determine the infrastructure levels of various counties. In order to ensure continuity of services, there is need to undertake phased transfer of functions to the county governments based on the ability of each county.

Counties are endowed differently in terms of infrastructural development and not all counties are prepared to take up all functions of county governments

ii. **Capacity Building for County Staff:-**The counties are likely to face strong headwinds in implementation of its functions if there is rushed transition without the requisite capacity. There is need to ensure that

as resources are devolved to the counties, the county staff can properly manage these resources by carrying out proper planning, budget execution, monitoring and evaluation. The County Public Service Boards working closely with Transition Authority should as a matter of priority undertake capacity building programme to develop the requisite skills needed to take the county to the path of development. The staff must also commit themselves to sign performance contracts with SMART targets to improve service delivery to the people.

Capacity building for county staff is imperative to ensure prudent management of resources at county level

iii. **County Development Plans: -** for Counties to remain on a development trajectory, each county should develop a five year county development plan in line with Kenya Vision 2030. The Plan should clearly outline the development priorities and the criteria for allocation of resources. Functional departments within the county government should also develop a strategic plan outlining vision, mission and commitment to service delivery in its area of jurisdiction. Counties risk spending their resources on remuneration and non-priority expenditure areas at the expense of development if not guided by such plans.

County governments should prepare development plans outlining their development priorities and the roadmap to development in order to prioritize spending

Exploiting competitive advantage

For devolution to drive economic growth, the country will have to capitalize on the economic strengths unique to each county. Since counties can freely determine their expenditure priorities, local development strategies should be tailor made to address local needs. This will enable counties to be their own drivers of economic change. Though some of these economic activities are cross cutting across regions, some counties appear to have a competitive advantage over others.

Some counties have an edge in terms of agriculture. This includes tea and coffee farming, horticulture, livestock farming, fishing among others. However despite many counties being agriculturally endowed, the threat of food insecurity remains very real to the economy. These counties can choose to concentrate on value addition to their products which can then be 'exported' to other counties as well as beyond borders. This includes the setting up of agro-processing industries.

Each county has different economic capabilities and should exploit its competitive advantage to drive economic growth

However it is worth noting that a county does not have to be naturally endowed with fertile land in order to earn a livelihood from agriculture. Counties which are located in arid and semi arid areas can become food secure through investment in irrigation, appropriate seeds and fertilizers as well as green house technology.

Other competitive advantages which can be exploited include tourism, provision of services, and energy generation among others. Overall, county specific economic activity will certainly induce potentially positive spillovers in adjacent counties. For example, an economic boom in one county could provide a market for goods in another county. The primary goal is therefore for counties and the national government to promote free flow of factors of production and goods and services. No doubt, localized economic booms at the county government level could aggregate to an unprecedented economic boom in Kenya.

County specific economic activity will induce potentially positive spillovers in adjacent counties and the entire country

Lastly, it is essential for the National government to continuously monitor key macroeconomic indicators such as inflation and interest rates which undoubtedly will be affected by economic activity at county level.

Devolution is not a panacea for economic growth and equitable development. While devolution has enormous potential to change livelihoods through bringing services closer to the people, poor management of the process, unprecedented challenges and lack of innovation can easily obliterate the expected gains. Public participation will be critical in deepening the engagement of the citizenry to develop strategies to tackle development challenges at the grassroots level.

Proper planning and implementation along with a heightened sense of responsibility cannot be ignored in embracing the new devolved system of government. This will require great effort from the local leaders as well as the citizens. As much as possible, counties should be very innovative in enhancing their growth and development. This will require increased tax effort across each county in order to enhance revenue collection as well as coordinated development efforts between the county leaders, local businesses and the people. In the long run, the objective of devolution is to promote economic development and address inequality by bringing services closer to the people.

Devolution will only bring about growth and development if there is proper planning and coordinated development efforts among leaders

Chapter Five: Planning for Growth – the 2013/14 Budget

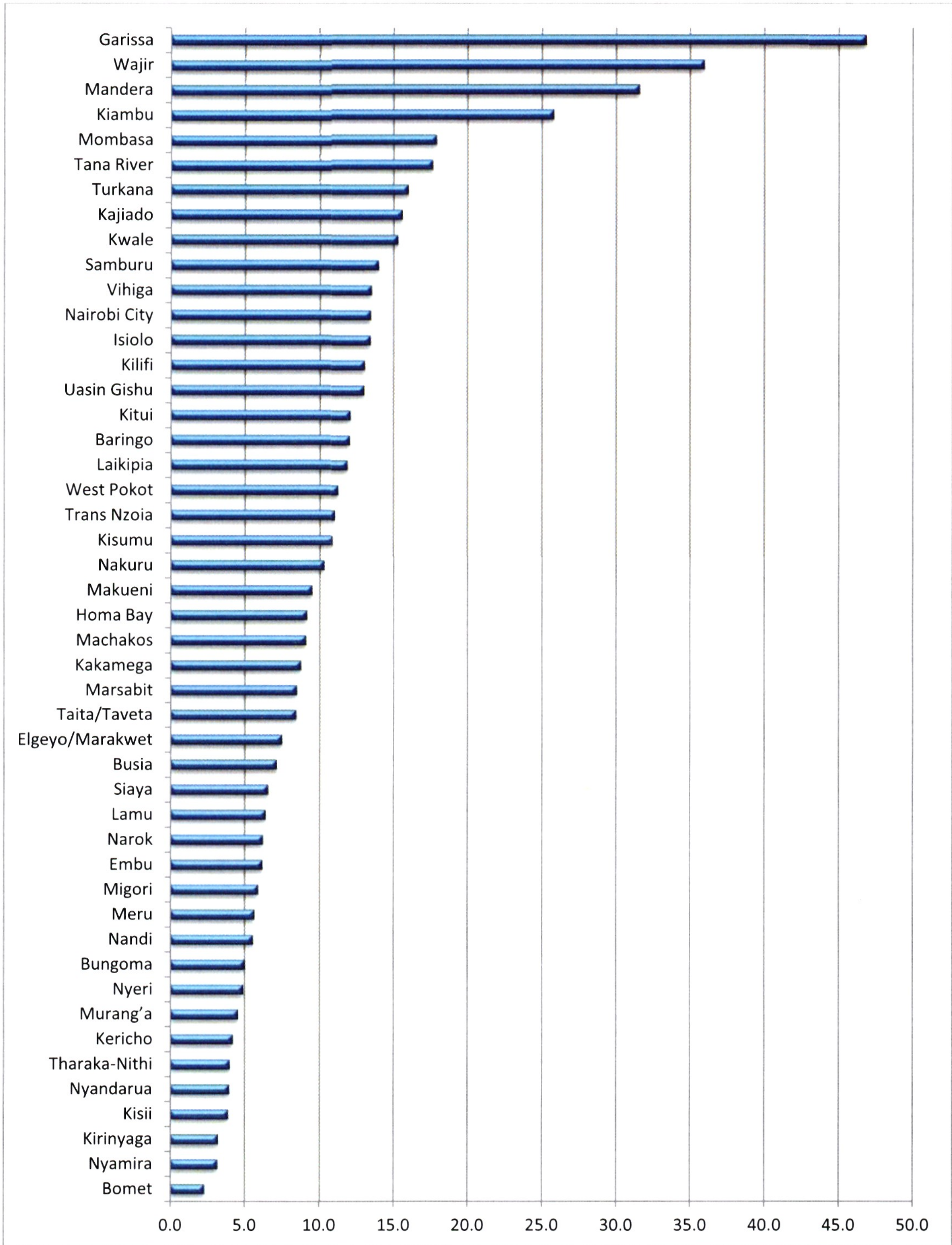
Thematic Issues for Consideration in 2013/14 budget

Options	Justification
	Macroeconomic stability
1. Reduce recurrent expenditure especially on the public sector wage bill and other allowances	The downward salary adjustments for state officers by SRC may not achieve much if not supported by sealing of loopholes for pilferage of public funds through public sector staff audit and reducing of unnecessary foreign travels. For the 2013/14 budget allowances in form of foreign travel as well domestic should be reduced. Any additional windfall arising from other expenditure cuts or increased revenue collection due tax administrative measures should go towards increasing development expenditure to at least Kshs.400 billion in 2013/14.
2. Manage Fiduciary Risks	The country's budget formulation and execution is prone to various fiduciary risks that make service delivery unnecessarily expensive to the tax payer. The government should develop fiduciary risk management programme to ensure that the budget allocations to various programmes achieve value for money.
3. Manage Public Debt levels	The stock of public debt has grown to 50 percent of the GDP which is unsustainable going forward. There is need to adopt a borrowing strategy that will maintain a public debt at a sustainable level. With the coming of county governments, it's imperative that the Government adopts a robust debt management strategy. More importantly, the National Government should not guarantee any county government for the first 3 years. This moratorium will allow county government to develop the requisite capacity in terms of public finance management.
4. Reduce current account deficit	To reduce this high level of current account deficit which stands at 13.1 percent of GDP, the country needs to re-orients its trade to intra-Africa trade with a focus on deepening its trade with EAC partners as well diversifying exports to far East so as to cushion it from global uncertainties.
5. Public Sector Staff Rationalization Programme	There is need to undertake public service staff rationalization to determine the human capital needs for the national and the county governments. The County Government should also give priority to establishment of County Public Service Boards to take charge of managing staff entry and exit into the county public service.
Revenue Enhancement Measures	
Options	**Justification**
7. Specify criteria for tax exemptions, waivers, remissions.	To streamline the tax incentive regime, it is proposed that a legal criterion be developed to provide a basis for issuance of tax waivers and benefits in line with article 210 (1-2). The government can assist the vulnerable groups and aid sensitive productive sectors through subsidies rather than through the tax system.

Options	Justification
6. Rethink implementation of Turnover Tax	Despite the high recruitment of eligible ToT Taxpayers, there hasn't been a commensurate increase in revenue. To reverse this trend, KRA should simplify recruitment process for ToT Taxpayers as well as leverage ICT in payment of ToT tax. KRA should also partner with county governments to have a one stop shop for taxpayer registration and licencing. Upgrading and modernizing the database at the city council will enable KA to get the physical location of various businesses
7. Reintroduce Capital Gains Tax	The capital gains tax was removed in mid-1980s to encourage investments in property and marketable securities. However, since then the real estate and securities market have grown tremendously. All countries in the East Africa region except Kenya are levying taxes on Capital Gains with Uganda at 30 percent and Tanzania at 20 percent. Consequently, the government should reintroduce capital gains tax at a modest rate, after adequate consultations with stakeholders so as to improve compliance.
8. Hasten implementation of GPRS enabled ETRs	The GPRS enabled ETR will enable the KRA to establish the totality of ETRs and to track them thereby reducing leakage of resources and enhancing VAT revenue collection
9. Rethink property tax administration	The property developers market in Kenya has grown rapidly in the last five years but there has been no commensurate increase in revenue collection. there is need to enhance coverage by establishing list of all eligible taxpayers, ensure assessed tax is actually collected and carry out audits
Sustainable Expenditure Options	
Options	**Justification**
10. Enhance allocation to FPE and county government to take over management of ECDE.	The annual enrolment into pre-primary and primary schools is expected to continue to expand with the growth in population. Despite the government efforts in FPE, the resource allocation to pre-primary school is still way below the minimum threshold for building a strong education foundation. The national government should enhance allocation to FPE to at least Ksh. 10.5 billion in 2013/14 budget from Ksh. 9 billion while the county government should as a matter of priority budget for and take over the management of pre-primary schools including employment of teachers with effect from 2013/14 budget.
11. Enhance FDSE Budgetary Allocation.	The government should increase FDSE to at least Ksh. 22 million in 2013/14 budget from Ksh. 19 billion to cater for increased students' enrollment to about 2 million. The government should also bridge regional disparities especially in ASAL regions through enhanced allocation for school infrastructure by channeling the equalization funds and other conditional grants to marginalized areas.
12. Enhance budgetary allocation to HELB.	The government has recently awarded charter to several public universities across the country to cater for enhanced enrollment anticipated from FPE and FDSE graduates who are expected to join universities. To effectively cater for

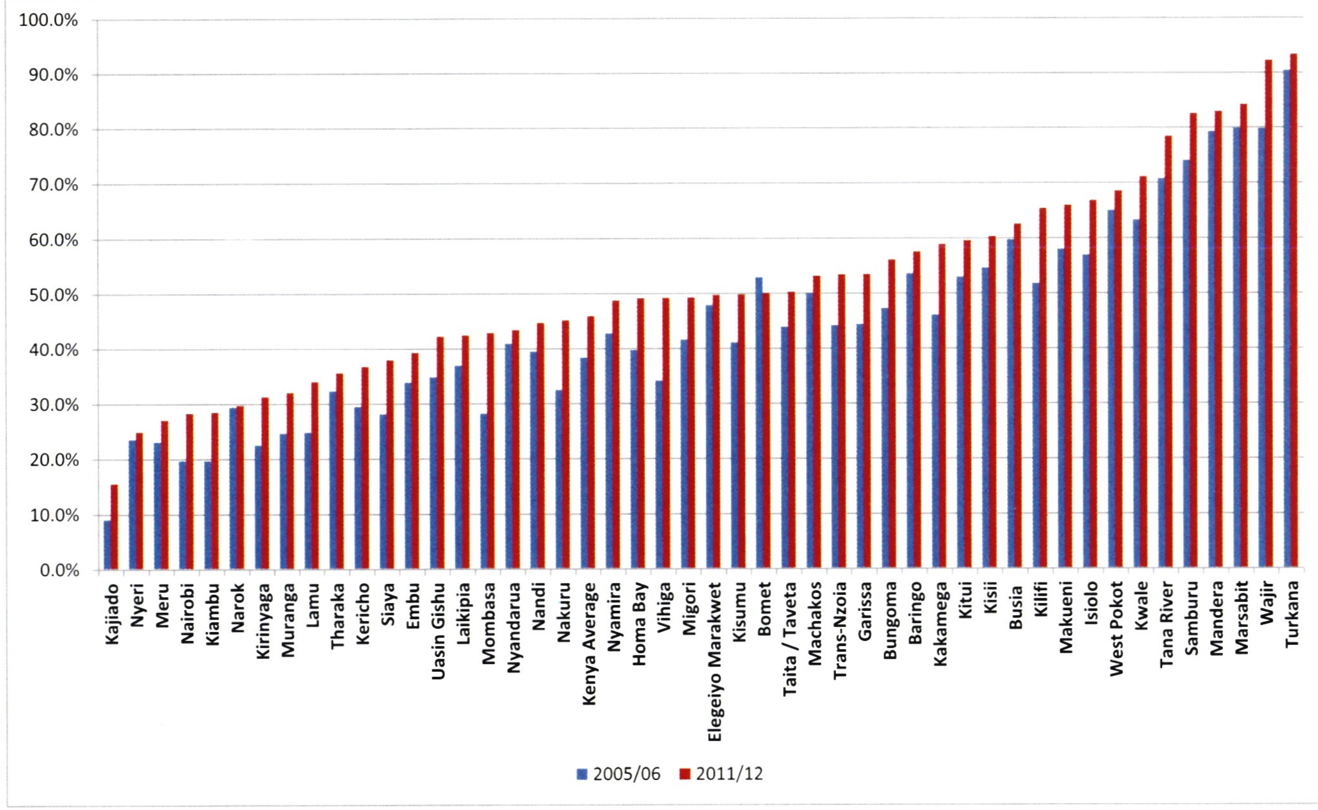
Options	Justification
	the double intake and growing student population in the universities, the government should double HELB allocation from Ksh. 2 billion to at least Ksh. 5 billion in 2013/14 budget so as to meet the huge demand from needy students who rely on government support to complete their education.
13. Develop Mass Transport System	To reduce traffic jams in major cities of Kisumu, Mombasa and Nairobi, the government through public private partnerships should embark on introduction of mass transport buses that can meet demand of commuters and decongest the road. Mass transport should also include enhancement of the light railway network coverage as a substitute to easing pressure on the road transport network
14. Revamping of the Cargo Railway Network	This is imperative in making the cost of production cheaper by reducing transport costs for both raw materials and finished products across the country, and also importantly, for the exports market
15. Enhance allocation for Research and Development in Agriculture	Investment in research and development in agriculture facilitate the use of new farming technologies in order to enhance agricultural productivity and address food insecurity as well as job creation in the agricultural sector

Annex 1: Unemployment rates per county



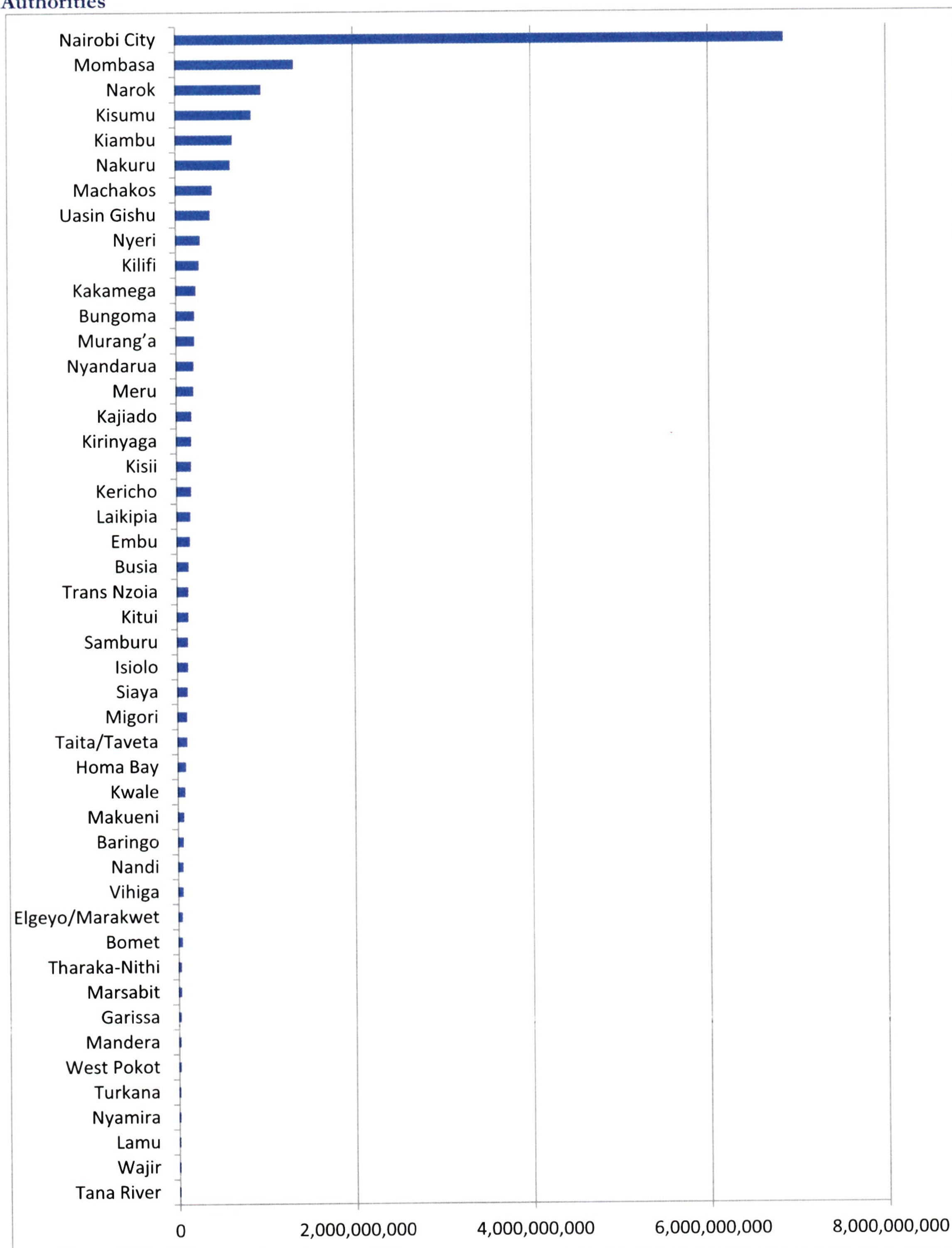
Data Source: KNBS 2009 Census

Annex 2: Proportion of poor households per County as at 2005/6 and 2011/12



Data Source: KIHBS and PBO estimates

Annex 3: Revenue collection per county as per 2010/11 data from the Audited accounts of Local Authorities



Annex 4: Documentation as per PFM Act

A Summary of the Documentations Under the Public Finance Management Act and the Required Timelines

PFM Act	Document	Date / Timeline	Action / By Whom	Content
	National Budget Process			
S.36	Treasury Circular	By 30th August	Cabinet Secretary to to all national government entities	▪ Guidelines on the budget process
S 25	Budget Policy Statement	By 15th February	National Treasury	▪ Setting broad strategic priorities and goals
S.26	Budget Review and Outlook Paper	30th September	National treasury	▪ Actual fiscal performance in the previous financial year, ▪ Updated macro-economic and financial forecasts ▪ Information on how actual financial performance for the previous financial year may have affected compliance with the fiscal responsibility principles ▪ The reasons for any deviation from the financial objectives together with proposals to address the deviation and the time estimated to do so.
		By 14th October (within 14 days)	Consideration and approval by Cabinet	
		By 21st October (within 7 days)	Submit to Budget Committee for laying before each House	
		5th November (within 14 days)	Publish and Publicise	
S.27.	Pre Election Economic and Fiscal Update	Within 4 months before General Election. (From 4th November)	National Treasury	Details of all election related spending including- ▪ Direct election expenses such as those for the IEBC for costs of elections and election materials; ▪ Indirect election expenses such as allocations to police and security forces for the election year; and ▪ Any other expenses related to the election specified in regulations or instructions;
	Post Election Economic and Fiscal Update	Within 4 months after General Election. (By 4th July)		
S. 31	Report on All Loans	Quarterly(every 4 months)	Cabinet Secretary to Submit to parliament	▪ Report of all loans made to thenational government, national government entities and county governments,
	Report On Outstanding Loan Balances	Every 4 months	Cabinet Secretary to Submit to parliament	▪ A report to Parliament stating the loan balances brought forward, carried down, drawings and amortizations on new loans obtained from outside Kenya or denominated in foreign currency,
	Record Of All Guarantees Given By The National Government	Up request by parliament		Information specifying— ▪ the names of the parties to the loan; ▪ the amount of the loan and the currency in which it is

PFM Act	Document	Date / Timeline	Action / By Whom	Content
				expressed and in which it is repayable; ▪ the terms and conditions of the loan, including interest and other charges payable and the terms of repayment; ▪ the amount of the loan advanced at the time the report is submitted; ▪ (e) the purpose for which the loan was used and the perceived benefits of the loan;
S. 33	National Government Debt Management Strategy	By 15th February	Cabinet Secretary to Submit to parliament	Information on - ▪ the total stock of debt as at the date of the statement; (b) the sources of loans made to the national government and the nature of guarantees given by the national government; ▪ the principal risks associated with those loans and guarantees; ▪ the assumptions underlying the debt management strategy; and ▪ (e) an analysis of the sustainability of the amount of debt, both actual and potential.
		Within 14 days	Cabinet Secretary to Submit to CRA, and IBEC	
s. 37	The Budget Estimates	30th April	Cabinet Secretary to submit to national Assembly	▪ the budget estimates excluding those for Parliament and the Judiciary; and other documents supporting the budget; ▪ Any other Bills required implementing the national government budget.
	The Budget Estimates For Parliament,	30th April	Accounting Officer to submit to national Assembly	▪ the budget estimates for Parliament, including proposed appropriations;
	He Budget Estimates For The Judiciary,	30th April	The Chief Registrar of the Judiciary	▪ submit to the National Assembly the budget estimates for the Judiciary, including proposed appropriations;
	NB. In preparing the documents, the accounting officers for the Parliamentary Service Commission and the Chief Registrar of the Judiciary— to ensure that members of the public are given an opportunity to participate in the preparation process			
	National Treasury	15th May	Cabinet Secretary submit to the National Assembly	▪ National Treasury comments on the budgets proposed by

PFM Act	Document	Date / Timeline	Action / By Whom	Content
	Comments			the Parliamentary Service Commission and the Chief Registrar for the Judiciary.
	Appropriation Bill		Cabinet Secretary to prepare and submit to the National Assembly.	▪ Upon approval of the budget estimates by the National Assembly,
S. 39	Consideration of The Budget Estimates.	30th June	National Assembly	▪ Consideration of the budget estimates of the national government, Parliament and the Judiciary,
		Within 21 days	National Treasury to consolidate, publish and publicise the budget estimates after approval by National Assembly.	
S.40	Budget Policy Highlights And Revenue Raising Measures	Date as prescribed in regional and international agreements ratified by Kenya	Cabinet Secretary to make a public pronouncement of the budget policy highlights	
	Finance Bill,	Date as prescribed in regional and international agreements ratified by Kenya	Cabinet Secretary to submit to Parliament	▪ Setting out the revenue raising measures for the national government,
		By 30th September	National Assembly to consider and approve the Finance Bill	▪ After passing the Appropriation Bill
	Division of Revenue and County Allocation of Revenue Bill		Parliament to consider and approve	
S. 46	statement of actual revenues and net exchequer issues	Within 21 days after the end of each month,	Cabinet Secretary to publish in the Gazette	▪ A statement of actual revenues collected by category and net exchequer issues by the National Treasury.
S.59	Statement of guarantees	Within 14 days (after it has been is entered into)	Cabinet Secretary to submit to Parliament	Details of- ▪ the guarantee, including the name and other particulars of the borrower whose loan is guaranteed; ▪ the duration and nature of the guarantee; ▪ a risk assessment in respect of the guarantee; and ▪ any other information
S.68	Annual Financial Statements	within three months after the end of the financial year (30th September)	accounting officers for national government entities, Parliamentary Service Commission and the Judiciary	▪ Submit them to the Controller of Budget and the Auditor-General for audit, and in the case of a national government entity,
S. 80	Annual Financial Statements For National	Within 4 months (by 30th November)	National Treasury to submit to the Auditor-General, the Controller of	▪ The financial statements and summaries of annual financial statements for national

PFM Act	Document	Date / Timeline	Action / By Whom	Content
	Government Entities,		Budget and the Commission on Revenue Allocation	government entities,
S.83	Quarterly Reports For National Government Entity.	15 days after the end of each quarter of the financial year	Accounting officer to submit the quarterly report to the Cabinet Secretary responsible for the entity and the National Treasury.	▪ information on the financial and nonfinancial performance of the entity;
		Within 45 days after the end of each quarter	National Treasury to consolidate the quarterly reports and submit them to the National Assembly with copies of the reports to the Controller of Budget, Auditor-General and the Commission on Revenue Allocation;	▪ Information on the financial and nonfinancial performance of the entity;
	Quarterly Reports For state corporation.		accounting officer for the corporation shall submit the quarterly report to the Cabinet Secretary responsible for the corporation	▪ Information on the financial and nonfinancial performance of the entity;
S. 89	Consolidated report on the extent of national government investment	Within four months after the end of each financial year	The cabinet secretary responsible for matters to relating to public investments to prepare and submit to national assembly,	▪ Information on the date of incorporation and objects of the corporation; ▪ The amount of national government shareholding, directly or indirectly, in the state corporation; ▪ Any changes in the shareholding of the state corporation during the financial year; ▪ The amount of any funding in the form of grants or subsidies provided by the national government to the state corporation or government-linked state corporations,
	Report on the assessment of the National Government's continued investment in the state corporation	Once every three years,	Cabinet Secretary responsible for matters relating to public investments to prepare and submit to the Cabinet Secretary, the Controller of Budget, the Commission on Revenue Allocation and to the Auditor-General.	

Annex 6: Main Macroeconomic Indicators

	Unit	2011/12	2012/13	2013/14	2014/15	2015/16
Nationalaccount and prices						
Real GDP	%Δ	4.1	4.0	4.4	5.3	5.8
GDP deflator	%Δ	15.3	7.5	5.5	4.7	4.2
CPI Index(eop)	%Δ					
CPI Index(avg)	%Δ	16.0	6.6	5.3	4.6	4.2
Terms of trade (-deterioration)	%Δ	-0.8	2.6	0.4	0.1	-0.1
Exchange Rate(Ksh/US$, average)		88.7	89.6	90.5	91.4	92.3
Money and credit (end of period)						
Net domestic assets	%Δ	5.0	7.2	8.5	11.7	14.2
Net domestic credit to the Government	%Δ	5.0	7.2	8.5	11.7	14.2
Credit to the rest of the economy	%Δ	5.0	7.2	8.5	11.7	14.2
Broad Money, M3 (percent change)		10.4	9.2	8.6	9.5	10.0
Reserve money(percent change)						
Investment and saving						
Investment	%GDP	21.7	21.5	21.4	21.1	20.9
Central Government	%GDP	9.0	8.8	8.6	8.5	8.3
Other	%GDP	12.7	12.7	12.7	12.7	12.6
Gross National Saving	%GDP	13.9	13.2	13.0	12.6	12.3
Central Government	%GDP	0.1	0.7	1.4	2.0	2.5
Other	%GDP	13.8	12.5	11.6	10.7	9.8
Central government budget						
Total revenue	%GDP	25.6	22.8	23.2	23.7	24.0
Tota lexpenditure and netlending	%GDP	28.7	28.4	27.7	27.0	26.4
Overall balance (commitment basis) excl. grants	%GDP	-6.0	-5.3	-4.6	-3.9	-3.4
Overall balance (commitment basis) incl. grants	%GDP	-5.2	-4.5	-3.9	-3.2	-2.7
Primary budget balance	%GDP	-2.4	-1.8	-1.3	-0.7	-0.1
Net domestic borrowing	%GDP	2.2	1.7	1.3	0.7	0.4
Total external support (grant & loans)	%GDP	3.4	3.2	3.1	2.9	2.8
External sector						
Exports value, goods and services	%GDP	28.8	28.0	27.9	28.0	28.2
Imports value, goods and services	%GDP	43.5	42.9	42.9	43.0	43.2
Current external balance, including official transfers	%GDP	-6.9	-7.3	-7.5	-7.6	-7.7
Current external balance, excluding official transfers	%GDP	-7.4	-7.8	-8.0	-8.1	-8.2
Gross international reserve coverage in months of next year imports (end ofperiod)						
Gross international reserve coverage in months of this year's imports (end ofperiod)		3.4	3.5	3.5	3.3	2.9
Public debt						
Nominal central government debt (eop), gross	%GDP	46.3	45.7	45.5	44.6	43.3
Nominal central government debt (eop), net of deposits	%GDP					
Domestic (gross)	%GDP	24.2	23.3	22.4	21.1	19.6
Domestic (net)	%GDP					
External	%GDP	22.0	22.4	23.0	23.5	23.7
Memorandum items:						
Nominal GDP (in Ksh billions)		3,305	3,713	4,082	4,489	4,941
Nominal GDP (inUS$ millions)		37,277	41,458	45,129	49,143	53,547

Source: Ministry of Finance (Historical), PBO (Forecasts)