

Scanned
28/2/2023



PAPERS LAID	
DATE	28/2/2023
TABLED BY	Chairperson
COMMITTEE	Finance & Budget
CLERK AT THE TABLE	D. Chemig

REPUBLIC OF KENYA

THIRTEENTH PARLIAMENT | SECOND SESSION

THE SENATE



STANDING COMMITTEE ON FINANCE AND BUDGET

REPORT ON THE 2023 MEDIUM TERM DEBT MANAGEMENT STRATEGY

Approved
[Signature]
28/2/23

Clerk's Chambers,
Parliament Buildings,
NAIROBI.

FEBRUARY, 2023

TABLE OF CONTENTS

Table of Contents	
TABLE OF CONTENTS	2
LIST OF ABBREVIATIONS/ACRONYMS	3
PRELIMINARIES	4
ESTABLISHMENT AND MANDATE OF THE COMMITTEE	4
MEMBERSHIP OF THE COMMITTEE	5
CHAIRPERSON’S FOREWORD	6
CHAPTER ONE	13
1.0 INTRODUCTION	13
ANALYSIS OF 2023 MEDIUM TERM DEBT MANAGEMENT STRATEGY	14
1.1 PUBLIC DEBT STOCK AND DEBT CEILING	14
1.2 REVIEW OF PREVIOUS MEDIUM TERM DEBT MANAGEMENT STRATEGIES	15
1.3 THE BORROWING STRATEGY FOR FY 2023/24	16
1.4 POTENTIAL SOURCES OF FINANCING	17
1.5 PRINCIPAL RISKS AND COSTS ASSOCIATED WITH THE CURRENT STOCK OF DEBT	18
1.6 PUBLIC DEBT SUSTAINABILITY ANALYSIS	21
CHAPTER TWO	22
2.0 OVERVIEW OF SUBMISSION FROM STAKEHOLDERS	22
2.1 The National Treasury and Economic Planning	22
2.2 The Commission on Revenue Allocation	23
2.3 The Institute for Social Accountability (TISA)	24
2.4 The Institute of Certified Public Accountants of Kenya (ICPAK)	24
CHAPTER THREE	26
3.0 COMMITTEE OBSERVATIONS	26
CHAPTER FOUR	28
4.0 RECOMMENDATIONS	28

LIST OF ABBREVIATIONS/ACRONYMS

GDP - Gross Domestic Product

MTDMS- Medium Term Debt Management Strategy

PDMO - Public Debt Management Office

PFMA- Public Finance Management Act

PPG – Public and Publicly Guaranteed Debt

PV – Present Value

USD - United States Dollar

PRELIMINARIES

ESTABLISHMENT AND MANDATE OF THE COMMITTEE

Article 124 (1) of the Constitution of Kenya provides that each house of Parliament may establish committees and shall make Standing Orders for the orderly conduct of its proceedings, including the proceedings of its committees.

Parliamentary Committees consider policy issues, scrutinise the workings and expenditures of the national and county governments, and examine proposals for legislation. The end result of any process in Committees is a report, which is tabled in the House for consideration.

The Senate Standing Committees on Finance and Budget is established pursuant section 8 (1) of the Public Finance Management Act, 2012 and standing order 228 of the Senate Standing Orders. The Fourth Schedule to the Senate Standing Orders outlines the subject matter assigned to each specific Committee. The Standing Committee on Finance and Budget is mandated to-

- a) Investigate, inquire into and report on all matters relating to coordination, control, and monitoring of the county budgets and examine -
 - i. the Budget Policy Statement presented to the Senate;
 - ii. the report on the budget allocated to constitutional Commissions and independent offices;
 - iii. the Division of Revenue Bill, the County Allocation of Revenue Bill, the County Governments Additional Allocations Bill, and the cash disbursement schedule for county governments;
 - iv. all matters related to resolutions and Bills for appropriations, the share of national revenue amongst the counties, matters concerning the national budget, including public finance and monetary policies and public debt, planning, and development policy; and

- b. Pursuant to Article 228 (6) of the Constitution, to examine the report of the Controller of Budget on the implementation of the budgets of county governments.

MEMBERSHIP OF THE COMMITTEE

Following the constitution of Standing Committees of the Senate of the Thirteenth (13th) Parliament on Thursday, 13th October, 2022, the Senate Standing Committee on Finance and Budget as currently constituted is comprised of the following Members-

- | | | |
|--|---|-------------------------|
| 1. Sen. (Capt.) Ali Ibrahim Roba, EGH, MP | - | Chairperson |
| 2. Sen. Maureen Tabitha Mutinda, MP | - | Vice-Chairperson |
| 3. Sen. (Dr.) Boni Khalwale, CBS, MP | - | Member |
| 4. Sen. Tabitha Karanja Keroche, MP | - | Member |
| 5. Sen. Joyce Chepkoech Korir, MP | - | Member |
| 6. Sen. Mohamed Faki Mwinyihaji, MP | - | Member |
| 7. Sen. Richard Momoima Onyonka, MP | - | Member |
| 8. Sen. Shakila Abdalla Mohamed, MP | - | Member |
| 9. Sen. Eddy Gicheru Oketch, MP | - | Member |

CHAIRPERSON'S FOREWORD

The 2023 Medium Term Debt Management Strategy (MTDMS) was submitted to the Senate by the National Treasury on 14th February, 2023 pursuant to section 33 of the Public Finance Management Act, 2012. The Act provides that *'On or before the 15th February in each year, the Cabinet Secretary shall submit to Parliament a statement setting out the debt management strategy of the national government over the medium term with respect to its actual liability and potential liability in respect of loans and guarantees and its plans for dealing with those liabilities'*.

The MTDMS was tabled in the Senate on 15th February, 2023. Thereafter, it was referred to the Standing Committee on Finance and Budget for consideration, facilitating public participation and consequent tabling of a report in the Senate.

Section 33(2) of the Act provides that *'the Cabinet Secretary shall include in the statement the following information—*

- a) *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;*
- c) *the principal risks associated with those loans and guarantees;*
- d) *the assumptions underlying the debt management strategy; and*
- e) *an analysis of the sustainability of the amount of debt, both actual and potential."*

The principal objective of any nation is to achieve high and equitable economic growth, and to generate enough wealth that sustains the current generation and can be transferred to subsequent generations. This will enable the country to transform from a developing country to a developed country.

This transformational path should be undertaken in a cost effective manner that safeguards the sustainability of available resources. Countries opt to borrow additional resources (finances) either to accelerate the development process or due to insufficient resources available.

Debt financing is quite critical in budgetary considerations as it enables a country to undertake development activity beyond constraints set by available resource capacity.

Article 201(c) of the Constitution stipulates that *'the burdens and benefits of the use of resources and public borrowing shall be shared equitably between present and future generations.*

Prudent fiscal and debt management practices are key since borrowing can be detrimental to a country's wellbeing. Debts may accumulate to such high levels until the country is unable to sustain or requires huge taxation measures in order to repay. Thus, regulation on borrowing, associated risk and cost should be a key consideration to safeguard incomes, available resources, and promote equitable economic growth.

The National Treasury is required under section 12(1)(b) of PFMA to *manage the level and composition of national public debt, national guarantees and other financial obligations of national government within the framework of this Act and develop a framework for sustainable debt control;*

This is buttressed by section 62(3) of the same Act which requires the Public Debt Management Office (PDMO), an office created under the National Treasury, to-

- a) *minimise the cost of public debt management and borrowing over the long-term taking account of risk;*
- b) *promote the development of the market institutions for Government debt securities; and*
- c) *ensure the sharing of the benefits and costs of public debt between the current and future generations*

The total stock of public and publicly guaranteed debt stands at Kshs.9.15 Trillion as at December, 2022 which is equivalent to 67% of Gross Domestic Product (GDP). This debt comprises external debt amounting to Kshs.4.673 Trillion and domestic debt amounting to Kshs.4.472 Trillion.

The publicly guaranteed debt amounts to Kshs.151.075 billion. These debts are owned by-

- a) Kengen- Ksh.36.568 Billion
- b) Kenya Ports Authority –Ksh.35.850 billion
- c) Kenya Airways- Ksh.78.675 billion

The stock of external debt is composed of multilateral at 47.4%, bilateral at 25.8% and commercial creditors (including sovereign bond) at 26.5%. 49% of the total public debt is in foreign currencies and is exposed to foreign exchange rate volatility risk. Among the major currencies in the external debt portfolio, USD accounts for 68.1% of the external debt, Euro accounts at 19.8%, Japanese Yen accounts at 4.2% and Great Britain Pound at 2.3%.

According to the Debt Sustainability Analysis (DSA), the Present Value (PV) of debt-to-GDP ratio has breached the threshold of 55% and was estimated at 60% as at December, 2022. The PV of debt to GDP ratio is projected to remain above the 55 percent benchmark until 2025.

The MTDMS proposes a debt ratio of 1:1 from external and domestic sources respectively. It also aims to -

- a) Maximize concessional financing;
- b) Minimize interest rate risk;
- c) Minimize refinancing risk; and
- d) Allow for flexibility in the borrowing plan

In terms of the fiscal framework, the National Treasury projects an ordinary revenue collection of Ksh.2.571 trillion against recurrent and development expenditure of Ksh.2.459 trillion and Ksh.744.2 billion respectively. Thus, there is a projected fiscal deficit of Ksh.720.1 billion in FY 2023/2024 translating to 4.4% of GDP.

To meet this deficit, the National Treasury proposes to borrow Ksh.521.5 billion from the domestic market and net foreign financing of Ksh.198.6 billion in FY 2023/24.

Observations

The Committee has considered the MTDMS and made the following observations-

- a) The projected deficit to be financed in the FY 2023/24 of Ksh.720.1 billion would breach the existing debt limit given that the available fiscal space under the Kshs.10 trillion debt ceiling is estimated at less than Ksh.600 billion.
- b) Domestic interest continues to exhibit elevated interest and refinancing risks and continues to be a driver of increased total debt service which is projected to reach Kshs.1.3 trillion in the current financial year. Accumulation of domestic debt raises concerns over further escalation of public debt risks and costs.
- c) Non-compliance with the approved borrowing mix of domestic and external debt presents a risk to the meeting of debt management objectives set out in the medium-term debt management strategy.
- d) The borrowing of external debt at 50% as proposed in the borrowing strategy, poses some risks given that the Kenya shilling has continued to depreciate against the United States Dollar (USD).
- e) There is a breach of PV of debt to GDP ratio, PV of PPG external debt to GDP ratio and PPG debt service to exports ratio which are three of the seven debt sustainability indicators. Further, there is a potential breach of PPG debt service to revenue ratio in FY 2023/24 thus indicating increasing risk of debt distress.
- f) The borrowing strategy does not provide the desired fiscal framework under the MTDS. There is no express indication, in absolute numbers, what the 50%-50% net domestic and foreign financing will amount to.

Recommendations

After consideration of the MTDMS and makes the following recommendations-

- a) The National Treasury should provide information on how the projected deficit of Kshs.720.1 billion will adhere to the Kshs.10 trillion debt ceiling given the

estimated available fiscal space of less than of Ksh.600 billion in FY 2023/24 before the end of April, 2023.

- b) The National Treasury should provide a statement on the achievability of the set targets on borrowing from both Domestic and External markets. This is in light of the past experiences where there has been under achievement in external borrowing while there has been over performance in domestic borrowing.
- c) The National Treasury should submit a statement to the Senate detailing the sources of external financing and the level of accessibility during the implementation of the FY 2023/24 budget. This is with regard to failure of international financing markets, resulting in more borrowing in the domestic market.
- d) The National Treasury should constrain domestic borrowing to a minimum while optimizing concessional and semi-concessional borrowing to prevent further increases in costs and risks associated with the domestic debt portfolio.

Financial Recommendation

- e) The Committee approves the net domestic borrowing to external borrowing of 50:50 as proposed in the borrowing strategy of FY 2023/24. This is a balanced domestic-external financing strategy which is flexible as financing is balanced between domestic and external sources.
- f) Further, in light of the Ksh.10 trillion debt ceiling, the total financing for the FY 2023/24 is capped at Ksh.600 billion, which is consistent with the estimated fiscal space. The National Treasury should device innovative strategies on how the Ksh.120.1billion fiscal gap will be funded.

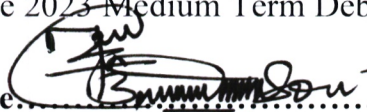
Acknowledgment

I take this opportunity to commend the Members of the Committee for their devotion and commitment to duty, which made the consideration of the 2023 Medium Term Debt Management Strategy successful.

I also wish to thank the Offices of the Speaker and the Clerk of the Senate for the support extended to the Committee in undertaking this important assignment.

Lastly, I wish to thank the stakeholders who submitted written memoranda and who appeared before the Committee to present their comments.

It is now my pleasant duty, pursuant to standing order 223 (6) of the Senate Standing Orders, to present the Report of the Standing Committee on Finance and Budget to the Senate on the 2023 Medium Term Debt Management Strategy.

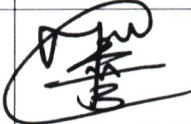
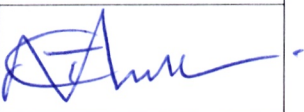


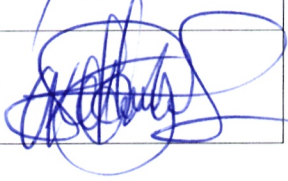
Signature..........

Date.....28/02/23.....

**SEN. CAPT. ALI IBRAHIM ROBA, MP.
CHAIRPERSON,
STANDING COMMITTEE ON FINANCE AND BUDGET)**

**ADOPTION OF THE REPORT OF THE STANDING COMMITTEE ON
FINANCE AND BUDGET ON THE 2023 MEDIUM TERM DEBT
MANAGEMENT STRATEGY**

We, the undersigned Members of the Senate Standing Committee on Finance and Budget, do hereby append our signatures to adopt this Report-

	Name	Designation	Signature
1.	Sen. Capt. Ali Ibrahim Roba, EGH, MP	Chairperson	
2.	Sen. Maureen Tabitha Mutinda, MP	Vice-Chairperson	
3.	Sen. (Dr.) Boni Khalwale, CBS, MP	Member	
4.	Sen. Tabitha Karanja Keroche, MP	Member	
5.	Sen. Joyce Chepkoech Korir, MP	Member	
6.	Sen. Mohamed Faki Mwinyihaji, MP	Member	
7.	Sen. Richard Momoima Onyonka, MP	Member	
8.	Sen. Shakila Abdalla Mohamed, MP	Member	
9.	Sen. Eddy Gicheru Oketch, MP	Member	

CHAPTER ONE

1.0 INTRODUCTION

1. The Medium Term Debt Management Strategy was submitted to parliament on 14th February 2023 in accordance with section 33 of the PFM Act, 2012. Section 62 of the Public Finance Management Act, 2012, sets out the country's debt management objectives as follows: -
 - a) Minimize the cost of public debt management and borrowing over the long-term taking account of risk.
 - b) Promote the development of domestic market institutions for government debt securities.
 - c) Ensure the sharing of the benefits and costs of public debt between the current and future generations.
2. The Medium-Term Debt Management Strategy is developed in accordance with Article 201 of the Constitution, which calls for transparency and accountability in areas of public finances. Additionally, it calls for the prudent and responsible use of public resources as well as an equitable distribution of the costs and benefits associated with use of resources and public borrowing between the present and future generations.
3. Section 15 of the PFMA (2012), stipulates that national borrowing shall be used for financing development expenditure and public debt obligations be maintained at a sustainable level approved by Parliament.
4. Section 33 (2) of the PFM Act 2012, provides that the Debt Management strategy should contain the following information:
 - a) 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;
 - c) The principal risks associated with those loans and guarantees;
 - d) The assumptions underlying the debt management strategy; and,

- e) Analysis of the sustainability of the amount of debt, both actual and potential.

ANALYSIS OF 2023 MEDIUM TERM DEBT MANAGEMENT STRATEGY.

1.1 PUBLIC DEBT STOCK AND DEBT CEILING

5. As at December 2022, the **total debt stock was Ksh.9.15 trillion** comprising Kshs.4.47 trillion domestic debt and Kshs.4.67 trillion external debt. It is estimated that the projected fiscal deficit FY 2022/23 will amount to Kshs.833 billion, raising the debt stock to about Kshs.9.42 trillion by June, 2023. Thus, the financing room for the next financial year is less than Ksh.600 billion.
6. The estimated fiscal deficit for FY 2023/24 is estimated to be Ksh.720.1 billion. This comprises of net foreign financing of Kshs.198.6 billion and net domestic financing of Ksh.521.5 billion. Given that the financing room for the next financial year is less than Ksh.600 billion, it is evident that there is not enough headroom to accommodate the financing needs of the budget as the public debt ceiling was set at Kshs.10 trillion by Parliament. It should be noted that this debt ceiling was adjusted upwards in 2022 to allow for the financing of the FY 2022/23 budget.
7. The changes in composition and structure of public debt as a result of increased debt accumulation has brought about an evolution in the costs and risks associated with the debt portfolio. The ratio of domestic to external debt is currently equal to 50% for each and costs have increased over time.
8. As at June 30, 2022, total debt service was Ksh.917.7 billion (47.9% of revenues) up from Ksh.98.5 billion, (16.2% of revenues) in June 2011. This shows that debt service is consuming more revenue, potentially reducing funds for other important financial needs.
9. The increase in debt servicing costs can be attributed to the fact that domestic debt interest has been steadily rising above external debt interest. The total stock of domestic debt was close to 50% in June 2022 with domestic debt service accounting

for 67% of all debt service costs, while external debt service accounted for 34%. This demonstrates how rising domestic debt levels continue to be a major contributor to the high debt payment costs brought on by high weighted average interest rates and refinancing pressure.

10. The government is implementing a fiscal consolidation strategy that aims to reduce the fiscal deficit to 3% of GDP by fiscal year 2026/27. This is to be accomplished by ensuring realistic revenue targets. To achieve this, the national government is targeting to undertake the following; Revenue projections will not exceed the average revenue growth in the previous three years, expenditure growth will be limited to 75% of revenue growth, and budget neutrality- new programs will be funded by releasing resources from another project that is completed.
11. It is projected that the budget deficit as a percentage of GDP will drop from 5.7% in FY 2022/23 to 4.4% in FY 2023/24 and is aimed to reach 3.6% in FY 2026/27. However, the expected reduction in deficits is contingent on the success of the fiscal consolidation program, failure to which the fiscal deficit is likely to increase as a result of revenue underperformance relative to targets and an increase in expenditure relative to revenue growth. Should this materialize, it will lead to increased borrowing.

1.2 REVIEW OF PREVIOUS MEDIUM TERM DEBT MANAGEMENT STRATEGIES

12. A review of the previous borrowing strategies indicates that there has been a shortfall in gross external financing from the MTDS target since the year 2019. The shortfall in external financing has been transferred to domestic borrowing which has consistently surpassed the target in the MTDS over the same period. Non-compliance with the approved borrowing mix of domestic and external debt presents a risk to meeting debt management objectives set out in the medium-term debt management strategy.
13. The domestic debt portfolio has consistently displayed the highest vulnerability due to its higher interest rate, shorter average time to maturity (ATM), and higher

portion of debt servicing costs. The domestic debt risk indicators have progressively worsened, making it more costly with elevated risks as a result of a deviation from the allowed borrowing mix. For instance, the Medium-Term Debt Management strategy for the FY 2022/23 envisaged a net borrowing mix of 32:68 in external and domestic loans respectively. However, as per the previous financial years borrowing trends, by the end of the FY 2022/23, the stock of domestic debt will have increased, bringing with it higher costs and risks in contradiction to the goal of debt management, which is to reduce the costs and risks of borrowing.

1.3 THE BORROWING STRATEGY FOR FY 2023/24

14. The proposed borrowing strategy after an assessment of different strategies is-
 - a) Gross domestic borrowing to gross external borrowing of 65: 35 with the larger proportion of domestic borrowing being on account of T-Bills which are short term in nature and roll over severally in the course of the year.
 - b) Net domestic borrowing to external borrowing of 50:50 which would translate to Ksh.360 billion of both domestic and external loans to meet the projected FY 2023/24.
15. The borrowing strategy for the financial year 2023/24 is founded on a number of macroeconomic assumptions that are underpinned in the Budget Policy Statement. These include; real GDP growth rate of 6.1% and inflation of 5.8% in 2023/24. Additionally, revenue growth as a percentage of GDP is projected to increase from 17.4% to 17.8% of GDP and expenditure as a percentage of GDP is projected to decline from 23.4% to 22.5% of GDP.
16. The borrowed resources will fund a fiscal deficit of Ksh.720.1 billion representing 4.4% of GDP; down from Kshs.833.9 (5.7% of GDP) in the current financial year.
 - * This amounts to net domestic financing of Ksh.21.5 billion and net external financing of Ksh.198.6 billion, representing a financing ratio of domestic to external of 72:28. This is in contrast to the proposed Medium Term Debt Management

Strategy of 50:50, raising concerns about the actual planned financing strategy in the Fiscal Year 2023/24.

17. Similarly, commercial financing is expected to increase by 145% from Kshs.110 billion in the Fiscal Year 2022/23 to Ksh.270 billion in Fiscal Year 2023/24. An increase in domestic borrowing and gross external commercial financing, both of which have elevated interest and refinancing risks, casts doubt on commitment to the medium-term debt management strategy, which is supposed to guide the appropriate mix to achieve the debt management objectives of reducing costs and risks while also achieving debt sustainability.
18. It is indicated that the chosen strategy under the MTDMS is preferred because it allows for flexibility in switching between external and domestic sources, but it isn't clear how the debt management goals will be achieved, particularly the reduction of costs and risk. There is a chance of borrowing more domestic debt, which has already demonstrated high risks which will further degrade the domestic debt portfolio and increase debt service costs beyond the budgeted amounts. Hence, domestic borrowing should be kept to a minimum while utilizing concessional and semi concessional external borrowing.

1.4 POTENTIAL SOURCES OF FINANCING

19. Financing of the fiscal deficit for the next Financial Year 2023/24 will be through domestic and external loans. On domestic debt it will be mostly treasury bills and bonds, Kenya shilling denominated syndicated debt and foreign currency denominated domestic bonds, among others. On external financing, concessional financing from multilateral and bilateral lenders will be prioritized.
20. Significantly, the Medium-Term Debt Management Strategy has not specified the precise percentage to be sourced from each category of loans both domestic and external. This is of great concern since different facilities have varying costs and risks that are inherent, which the debt management plan seeks to mitigate including ensuring intergenerational equity in the burden-sharing of debt which is tied to the loan structures.

21. The sources of domestic financing are a matter of concern because over the past years, the medium-term debt management strategy recommended domestic debt market reforms that have never materialised, leaving a limited source of finance made up of pension funds and commercial banks. The government might not only be unable to secure the necessary funds but may also be forced to take out high-interest loans due to the local debt market's limited availability.
22. Domestic interest rates have also been rising, and given the persistently high inflation, monetary policy may be used to raise the central bank rate in an effort to reduce inflation which would lead to higher interest rates. Since domestic debt service makes up the largest amount of debt service expenses due to high interest rates, taking up additional domestic market borrowing as suggested in the borrowing strategy will increase debt payment expenses.

1.5 PRINCIPAL RISKS AND COSTS ASSOCIATED WITH THE CURRENT STOCK OF DEBT

23. Interest rate risk

- a) The average time to refix (ATR) external debt has been increasing from June, 2018 to December, 2022 signaling a reduction in interest rate risk of external debt. On the contrary, the average time to refixing of domestic debt has been declining indicating an escalation of the interest rate risk.
- b) As at December, 2022, the average time to refix of the total debt was at 8.1 years having marginally declined from 8.6 years as at June, 2022 which was driven by worsening domestic debt portfolio. This portrays a higher vulnerability interest rate risk that may result in an increase in budgeted interest expenditure.
- c) Fixed-rate loans increased from 77% to 87.2% between June, 2021 and December, 2022 indicating a decrease in the contracting of new variable loans, which raises interest rate risk. A higher proportion of fixed-rate loans indicates greater repayment predictability and less vulnerability to interest rate changes that may disrupt the budget. Given the volatility of interest rates in both domestic and international

markets, loans with variable rates should be kept to a minimum over the medium term.

- d) Debt refixing in one year as a percentage of total debt was 23% as at December, 2022 having declined from 27.1 % in December 2020 indicating a marginal improvement in the debt portfolio.
- e) A larger portfolio requiring refixing in one year portrays an elevation of interest rate risk especially at a time where both domestic and interest rates have been rising and could result in higher debt service costs.
- f) External debt accounts for a higher proportion of debt refixing in one year (27%) than domestic debt (18.7%), indicating that the external debt portfolio is highly vulnerable to interest rate changes, which could result in higher debt servicing costs, disrupting the budget.

24. Refinancing risk

- a) This refers to the probability that a matured debt will not be paid off or refinanced/ replaced with a new debt. The risk indicators are (Average Time to Maturity), Debt maturing in one year and as a percentage of total. The average time to maturity of the total portfolio deteriorated from 9.1 years in 2020 to 8.8 years as at December 2022. This was due to a deterioration in the average time to maturity in the external debt portfolio from 11.2 years to 9.8 years over the same period due to maturing commercial debt.
- b) Conversely, the domestic debt portfolio Average Time to Maturity increased from 6.3 years to 7.8 years. The improvement in the indicator for the domestic debt portfolio is as a result of the strategy to replace short term domestic debt (T-Bills) with medium term to long term debt (T- bonds). To reduce this risk therefore, contracting of treasury bills and short term external commercial loans should be scaled down to improve the maturity profile of existing debt. Spikes in maturity of debt are likely to cause huge budgetary requirements for servicing that might disrupt the budget since debt service is a first charge on the Consolidated Fund.
- c) Additionally, debt maturing in one year has declined from 15.5% to 11.5% between December 2020 and December 2022. This shows an overall improvement in the debt

profile and reduced refinancing risk with less debt due in one year, which is critical for cash flow management. This however implies that both short term commercial debt and short-term domestic debt should be reduced over the medium term to sustain this low proportion otherwise a converse of this would lead to escalation of the refinancing risk.

- d) A review of new external loans contracted shows an improvement in average maturity period from 23.3 years to 25.9 years which is an improvement in the debt profile with regard to refinancing risk. However, the average grace period has declined from 10.3 years in 2018 to 4.2 years in 2022 showing deterioration in terms of external debt and elevation of refinancing risk. Long time to maturity and grace periods are important in improving the debt profile refinancing risk and therefore contracting of new external debt should seek to improve these indicators in order to further improve the external debt profile and lower refinancing risk.

25. Exchange rate risk

- e) Exchange rate risk refers to the exposure of the public debt portfolio to fluctuations in the foreign currencies in which the external debt is denominated. As of December 2022, external debt as a proportion of total debt was 49% having reduced from 51.2 % in December, 2020. This indicates a decline in the external debt proportion resulting in a decline in the exchange rate risk on the overall portfolio. In terms of composition, as of December 2022, 68% of the debt was denominated in United States Dollars (USD) followed by the Euro and Yen at 19.8% and 4.2% respectively.
- f) The performance of the local currency against the United States dollar exposes nearly 68% of the external debt portfolio to exchange rate shock. As at December 2022, the USD was trading at Ksh.122.93 having appreciated from Ksh.102.29 from December, 2018. The sustained appreciation of the USD against the local currency signals an elevation of the exchange rate risk to the external debt stock which is predominantly denominated in the United States dollar. Further contracting of new debt in the United States Dollar would therefore result in further escalation unless mitigation measures like hedging or rate fixing at the time of contracting are put in place.

- g) The Controller of Budget reports indicate that Ksh.5.4 billion was paid as a result of exchange fluctuation in FY 2021/22 and other Ksh.3.4 billion was incurred in the first half of FY 2022/23. This indicates that by the end of the current FY 2022/23, this sum will exceed Ksh.6 billion reflecting the impact of the exchange rate risk on the external debt portfolio. The strain on foreign exchange reserves, particularly for the payment of external debt, will remain a worry in the medium term due to the underperformance of exports and the rise in import costs.

1.6 PUBLIC DEBT SUSTAINABILITY ANALYSIS.

26. Public debt sustainability framework assesses a country's debt portfolio and examines the inherent vulnerabilities against set thresholds to determine the country's debt carrying capacity. Kenya's debt carrying capacity was downgraded in 2019 from strong to medium with a high risk of debt distress.
27. The recent debt sustainability analysis shows that the Country has breached three ratios out of the seven debt sustainability indicators. These are, PV of debt to GDP Ratio, PV of Public & Publicly guaranteed external debt to exports and Public and publicly guaranteed external debt service to exports. Further it is projected that the country will breach the Public & Publicly guaranteed debt service to revenue ratio in 2024.
28. Generally, this indicates the country is at high risk of debt distress. Debt sustainability will only be achieved if fiscal consolidation efforts are sustained through expenditure rationalization and revenue enhancement. Growth in GDP as well as increase in exports will remain critical in ensuring that the risk of debt distress is ameliorated.

CHAPTER TWO

2.0 OVERVIEW OF SUBMISSION FROM STAKEHOLDERS

29. The Committee pursuant to the provisions of Article 118 of the Constitution and the Senate Standing Order, the Committee sent invitations to key Stakeholders inviting them to a meeting and submit their comments on the Medium Term Debt Management Strategy.

30. The committee received submissions from the following Stakeholders-

- a) the National Treasury and Economic Planning;
- b) the Commission on Revenue Allocation
- c) The Institute for Social Accountability
- d) the Institute of Certified Public Accountants-Kenya (ICPAK)

The submission by each stakeholder is as summarised below-

2.1 The National Treasury and Economic Planning

The National Treasury appeared before the Committee and made the following submission-

31. Kenya's domestic debt is at 48.9% while external debt is at 51.1 %.

32. The MTDMS 2023 considers four alternative funding strategies-

- a) Biased financing towards more domestic borrowing- it assumes a net borrowing of 81% from domestic and 19% from external sources
- b) External biased borrowing- This strategy assumes net financing majorly from external commercial, semi- concessional and concessional debt of 60% and 40% domestic via treasury bonds.
- c) More domestic bias with gradual lengthening of maturity profile- Financing fiscal deficit majorly from domestic market with 71% net domestic financing and 29% from external financing sources.
- d) Balanced domestic-external financing strategy- This is by financing allocations to domestic and external sources for deficit strategy for 2023/24.

33. Policy implications from analysing the different fiscal deficit scenarios.

- a) Reduction in annual borrowing limits (fiscal deficits is imperative to public debt sustainability).

- b) For the Kenya public debt stock to revert to sustainable levels in the medium term (by 2026), annual borrowing limits should be maintained below 4 percent of GDP. Projected GDP growth for 2023/24 is 6.1 percent and therefore the fiscal consolidation allows for debt to revert to a sustainable path. Growth of public debt should be less than growth of GDP for public debt to remain within a sustainable level.
- c) Funding fiscal deficits and refinancing external debt through concessional borrowing and less commercial debt, while implementing policies geared towards improving Kenya's export sector.
- d) Operationalization of the Sinking Fund in conformity with Regulation 206 (1) of the PFM (National Government) Regulations, 2015, is key to provide liquidity for timely funding for redemption of government securities

2.2 The Commission on Revenue Allocation

34. The Commission appeared before the Committee and made the following submission-

- a) The Commission noted that the Medium Term Debt Strategy does not provide the value of debt projections for FY 2023/24. They recommended that the document should provide for the outlook and the accompanying costs and risks on the debt portfolio as per Article 212 of the Constitution.
- b) The domestic debt stock comprises of Treasury bills amounting to Ksh.671.5 billion, Treasury bonds of Ksh.3.710 trillion and an outstanding pre-1997 government debt of Ksh.18.3 billion. The Commission recommended that the MTDS explain the outstanding pre-1997 government debt, its components, why it has not been paid and what the government is doing to repay.
- c) The MTDS proposes amendments to the PFM (National Government) Regulations 2015, to increase the public debt limit which is currently Kshs.10 trillion and to provide for public debt as a ratio of GDP. The Commission recommended that the National Treasury should provide a timeline on when to anchor the debt limit to the GDP and explain the transition.

2.3 The Institute for Social Accountability (TISA)

35. The Institute of Social Accountability submitted the following on the Medium Term Debt Strategy-

- a) That the National Treasury should consider pursuing aggressive debt restructuring efforts both in the short and medium term so as to reduce the interest rate hike given that about 49% of Kenya's public debt is held in foreign currencies.
- b) Being that the debt carrying capacity was downgraded from strong in 2019 to medium in 2022, efforts to enhance Kenya's exports need to be seen. The BPS suggests that the debt is sustainable which is not accurate.
- c) That the National Treasury commit to minimise non-priority expenditure. The MTDS makes no mention of debt restructuring efforts focused on current expensive loans.

36. TISA indicated that they support the National Treasury on development of guidelines for operationalizing the Sinking Fund as per Regulation 206 of the PFM 2015. The fund will assist the government in times of economic distress.

2.4 The Institute of Certified Public Accountants of Kenya (ICPAK)

37. ICPAK appeared before the committee and submitted as follows-

- a) Public debt service expenditure is required to finance the repayment of Ksh.8.2 trillion and in this respect public stock of debt will constitute the largest share of CFS expenditures at 89%.
- b) Public debt is projected to reach Ksh.11.5 trillion by June of 2025 on account of expanding fiscal deficit.
- c) ICPAK proposed a cost benefit analysis to be conducted on new loans to determine the best alternative that would bring about maximum yield and minimum cost for both current and future generations.

CHAPTER THREE

3.0 COMMITTEE OBSERVATIONS

38. This section presents Committee's observations after consideration of the MTDMS
- a) The projected deficit to be financed in the FY 2023/24 of Ksh.720.1 billion would breach the existing debt limit given that the available fiscal space under the Ksh.10 trillion debt ceiling is estimated at less than Ksh.600 billion.
 - b) Domestic interest continues to exhibit elevated interest and refinancing risks and continues to be a driver of increased total debt service which is projected to reach Ksh.1.3 trillion in the current financial year. Accumulation of domestic debt raises concerns over further escalation of public debt risks and costs.
 - c) Previous MTDS targets against actual performance in borrowing has demonstrated that over the last few years, there has been under achievement in the external borrowing while there has been over performance in domestic borrowing.
 - d) Domestic debt market reforms on which previous proposals to borrow were premised, have not been reviewed to diversify the investor base from the usual Pension Firms and Commercial Banks.
 - e) Non-compliance with the approved borrowing mix of domestic and external debt presents a risk to the meeting of debt management objectives set out in the medium-term debt management strategy.
 - f) The borrowing of external debt at 50% as proposed in the borrowing strategy, poses some risks given that the Kenya shilling has continued to depreciate against the United States Dollar (USD).
 - g) There is a breach of PV of debt to GDP ratio, PV of PPG external debt to GDP ratio and PPG debt service to exports ratio which are three of the seven debt sustainability indicators. Further, there is a potential breach of PPG debt service to revenue ratio in FY 2023/24 thus indicating increasing risk of debt distress.

- h) The borrowing strategy does not provide the desired fiscal framework under the MTDS. There is no express indication, in absolute numbers, what the 50%-50% net domestic and foreign financing will amount to.

CHAPTER FOUR

4.0 RECOMMENDATIONS

39. The Committee makes the following recommendations-

Policy recommendations

- a) The National Treasury should provide information on how the projected deficit of Kshs.720.1 billion will adhere to the Kshs.10 trillion debt ceiling given the estimated available fiscal space of less than of Ksh.600 billion in FY 2023/24 before the end of April, 2023.
- b) The National Treasury should provide a statement on the achievability of the set targets on borrowing from both Domestic and External markets. This is in light of the past experiences where there has been under achievement in external borrowing while there has been over performance in domestic borrowing.
- c) The National Treasury should submit a statement to the Senate detailing the sources of external financing and the level of accessibility during the implementation of the FY 2023/24 budget. This is with regard to failure of international financing markets, resulting in more borrowing in the domestic market.
- d) The National Treasury should constrain domestic borrowing to a minimum while optimising concessional and semi-concessional borrowing to prevent further increases in costs and risks associated with the domestic debt portfolio.

Financial Recommendation

- a) The committee approves the net domestic borrowing to external borrowing of 50:50 as proposed in the borrowing strategy of FY 2023/24. This is a balanced domestic-external financing strategy which is flexible as financing is balanced between domestic and external sources.
- b) Further, in light of the Ksh.10 trillion debt ceiling, the total financing for the FY 2023/24 is capped at Ksh.600 billion, which is consistent with the estimated fiscal space. The National Treasury should device innovative strategies on how the Ksh.120.1billion fiscal gap will be funded.

LIST OF APPENDICES

Appendix 1: Minutes of the sittings of the Committee

Appendix 2: Copies of submissions



MINUTES OF THE NINETEENTH MEETING OF THE SENATE STANDING COMMITTEE ON FINANCE AND BUDGET HELD ON MONDAY, 27TH FEBRUARY, 2023 AT FOUR POINTS BY SHERATON, AIRPORT IN RWENZORI CONFERENCE HALL FROM 5.40 P.M.

PRESENT

1. Sen. (Capt.) Ali Ibrahim Roba, EGH, MP-	Chairperson
2. Sen. Maureen Tabitha Mutinda, MP	Vice-Chairperson
3. Sen. Joyce Chepkoech Korir, MP	Member
4. Sen. Shakila Abdalla Mohamed, MP	Member
5. Sen. Eddy Gicheru Oketch, MP	Member
6. Sen. Richard Momoima Onyonka, MP	Member
7. Sen. Tabitha Karanja Keroche, MP	Member

ABSENT WITH APOLOGY

1. Sen. (Dr.) Boni Khalwale, CBS, MP	Member
2. Sen. Mohamed Faki Mwinyihaji, MP	Member

SECRETARIAT

1. Mr. Boniface Lenairoshi	Deputy Director, DSEC
2. Mr. Christopher Gitonga	Clerk Assistant
3. Ms. Beverlyne Chivadika	Clerk Assistant
4. Ms. Lucy Makara	Deputy Director, PBO
5. Ms. Amran Mursal	Fiscal Analyst
6. Ms. Millicent Makina	Fiscal Analyst
7. Mr. Kioko Kiminza	Fiscal Analyst
8. Ms. Joan Mahinda	Researcher
9. Mr. Sekento Tonkei	Researcher
10. Mr. Abdallah Mbore	Serjeant-at-Arms
11. Ms. Elijah Ichwara	Audio Officer

MIN/SEN/SCF&B/93/2023

PRELIMINARIES

The Chairperson called the meeting to order at 5.50 p.m. This was followed by a word of prayer.

MIN/SEN/SCF&B/94/2023**ADOPTION OF THE AGENDA**

The agenda was adopted after it was proposed by Sen. Tabitha Karanja Keroche, MP and seconded by Sen. Maureen Tabitha Mutinda, MP as listed below-

1. Prayer;
2. Adoption of the Agenda;
3. Consideration and adoption of the report on the 2023 Medium-Term Debt Management Strategy;
4. Any Other Business; and
5. Next Meeting and Adjournment.

MIN/SEN/SCF&B/95/2023**CONFIRMATION OF MINUTES OF THE PREVIOUS SITTING**

The Minutes of the Tenth sitting held on Thursday, 9th February, 2023 at 10.00 a.m. were confirmed as a true record of the proceedings of the committee having been proposed by Sen. Richard Momoima Onyonka, MP, and seconded by Sen. Shakila Abdalla Mohamed, MP.

MIN/SEN/SCF&B/96/2023**CONSIDERATION OF THE DRAFT REPORT ON THE 2023 MEDIUM-TERM DEBT MANAGEMENT STRATEGY**

The Committee was taken through the draft report on the 2023 Medium-Term Debt Management Strategy (MTDMS) summarized into-

- a) Public Debt Stock and Debt Ceiling;
- b) Review of Previous Medium-Term Debt Management Strategies;
- c) The borrowing Strategy for FY 2023/24;
- d) Principal risks and costs associated with the Current Stock of Debt: Interest Rate Risk, Refinancing Risk, and Exchange Rate Risk;
- e) Public Debt Sustainability Analysis;
- f) Overview of Submissions from stakeholders from the National Treasury, and Economic Planning, the Commission on Revenue Allocation, the Institute for Social Accountability, and the Institute of Certified Public Accountants-Kenya;
- g) Committee Observations; and
- h) Committee recommendation.

The Committee unanimously adopted the report having been proposed by Sen. Richard Momoima Onyonka, MP, and seconded by Sen. Tabitha Karanja Keroche, MP with the following policy and financial recommendations-

Policy recommendations

- a) The National Treasury should provide information on how the projected deficit of Kshs.720.1 billion will adhere to the Kshs.10 trillion debt ceiling given the

estimated available fiscal space of less than kshs.600 billion in FY 2023/24 before the end of April 2023.

- b) The National Treasury should provide a statement on the achievability of the set targets on borrowing from both Domestic and External markets. This is in light of past experiences where there has been underachievement in external borrowing while there has been overperformance in domestic borrowing.
- c) The National Treasury should submit a statement to the Senate detailing the sources of external financing and the level of accessibility during the implementation of the FY 2023/24 budget. This is with regard to failure of international financing, resulting in more borrowing in the domestic market.
- d) The National Treasury should constrain domestic borrowing to a minimum while optimising concessional and semi-concessional borrowing to prevent further increases in costs and risks associated with the domestic debt portfolio.

Financial Recommendation

- a) The committee approves the net domestic borrowing to external borrowing of 50:50 as proposed in the borrowing strategy of FY 2023/24 be adopted. This is a balanced domestic-external financing strategy which is flexible as financing is balanced between domestic and external sources.
- b) Further, in light of the Kshs.10 trillion debt ceiling, the total financing for the FY 2023/24 is capped at Ksh.600 billion, which is consistent with the estimated fiscal space. The National Treasury should device innovative strategies on how the Kshs.120.1 billion fiscal gap will be funded.

MIN/SEN/SCF&B/97/2023

ANY OTHER BUSINESS

The meeting was informed that the Committee will hold a joint pre-vetting hearing meeting on vetting of Dr. Susan Jemtai Koech for the position of Deputy Governor of the Central Bank of Kenya with the National Assembly Departmental Committee on Finance and Economic Planning on Tuesday, 28th February, 2023 at 9.00 a.m. Thereafter, the Committee will proceed to a report writing retreat.

MIN/SEN/SCF&B/98/2023

ANY OTHER BUSINESS

The meeting was adjourned at 7:06 p.m. The Next meeting to be held on Monday, 27th February, 2023 at 5:40 p.m.

SIGNATURE..........DATE...28/02/2023....

SEN. (CAPT.) ALI IBRAHIM ROBA, EGH, MP.

(CHAIRPERSON)



REPUBLIC OF KENYA
THE NATIONAL TREASURY AND ECONOMIC PLANNING

**SUBMISSION BY THE CABINET SECRETARY, NATIONAL
TREASURY AND ECONOMIC PLANNING TO THE SENATE
STANDING COMMITTEE ON FINANCE AND BUDGET ON
THE 2023 BUDGET POLICY STATEMENT AND THE 2023
MEDIUM-TERM DEBT MANAGEMENT STRATEGY**

I. Introduction

1. **Hon. Chairperson and Hon. Members**, allow me to thank you for inviting us to this first meeting to consider and deliberate on the 2023 Budget Policy Statement and the Medium-Term Debt Management Strategy, 2023. It is a great Honour to the National Treasury and Economic Planning.

THE 2023 BUDGET POLICY STATEMENT

2. **Hon. Members**, the focus that makes the difference in the 2023 Budget Policy Statement is the **Value Chain Approach** to the budget process. This process will ensure **we don't break the cycle** by not **allocating requisite resources** to any entity **along the value chain** and also ensure we eliminate **duplication of allocations and roles**. This will ensure we **deliver as one** while implementing the Government Priorities.

3. **Ministries** will be expected to prepare their budgets consistent with the **sector ceilings** and adopt the **value chain approach** as agreed during the recent Cabinet Retreat under the five clusters that include: (i) **Finance & Production Economy**, (ii) **Infrastructure**, (iii) **Land & Natural Resource**, (iv) **Social Sectors**, and (v) **Governance & Public Administration**.

4. The 2023 Budget Policy Statement (BPS), which is the first to be prepared under the new Administration, the Kenya Kwanza Government, is based on the framework of **Bottom-up Economic Transformation Agenda (BETA)**. It sets

out the Administration's priority programs, policies and reforms to be implemented in the Medium-Term Expenditure Framework (MTEF).

5. **Hon. Members**, as the effects of COVID-19 pandemic started to fade away, the Kenyan economy bounced back recording a GDP growth rate of **7.5 percent in 2021** from a contraction of **0.3 percent in 2020**. However, the growth momentum is estimated to have slowed down to **5.5 percent in 2022** due to multiple shocks that include among others:

- the Russia-Ukraine conflict leading to increased prices of fuel, fertiliser and food prices;
- lingering effects of COVID-19 pandemic; and
- climate change that has affected agricultural productivity.

6. The need to address these constraints and bolster resilience forms the basis of the Kenya Kwanza Government's **Bottom-Up Economic Transformation Agenda (BETA)** that is geared towards economic turnaround and inclusive growth. Focus is on interventions that: reduce the cost of living; increase employment; achieve more equitable distribution of income; enhance social security, expand tax base for more revenue; and increase foreign exchange earnings.

7. The Agenda aims to increase investments in at least **five sectors** envisaged to have the largest impact and linkages to the economy as well as on household welfare. These include:

i. **Agricultural Transformation and inclusive growth;**

- This intervention will ensure food security in the Country thereby reducing the cost of living and creating jobs as agriculture has the highest employment multiplier effect owing to its strong forward and backward linkages to other sectors of the economy.

ii. **Transforming the Micro, Small and Medium Enterprise (MSME) Economy:**

- This entails correcting market and institution failure problems through schemes, like the Hustlers Fund, that will ensure that benefits of growth are fairly distributed. This will promote accessibility to affordable credit to most Kenyans at the bottom of the pyramid.

iii. Housing and Settlement:

- This intervention aims at reducing proliferation of slums and hence preserve human dignity. This will be done through among other measures facilitating delivery of 250,000 houses per annum and enabling low cost housing mortgages;

iv. Healthcare:

- This entails promoting access to quality and affordable healthcare through ensuring Universal Health Coverage

v. Digital Superhighway and Creative Industry:

- Digitization and automation will increase productivity and competitiveness through eliminating information asymmetry in market access and risk management.
- Promotion of music, theatre, graphic design, digital animation, fashion and craft, among others will increase employment for the youth.

8. The implementation of these interventions is expected to stimulate economic recovery to **6.1 percent growth in 2023** and maintain that momentum over the medium term supported by a broad-based private sector growth, including recoveries in agriculture while the public sector consolidates. But more importantly improve the quality of growth from public sector investment led growth to a dynamic private sector led growth.

II. FY 2022/23 Budget Execution

9. **Hon. Members**, budget execution in the first half of FY 2022/23 progressed well. **Revenues** continued to record positive growth of **11.2 percent to December 2022** with all tax revenue categories recording positive growths, an indication of continued recovery in revenue collection. However, this was below target by **Ksh 11.2 billion** on account of **shortfalls in ordinary revenue of Ksh 43.2 billion**. **Ministerial A-i-A** was above target by **Ksh 32.0 billion**.

10. Revenue performance is expected to pick up in the second half of FY 2022/23 to reflect improvement in business environment, tax policy measures and enhanced revenue administration by the Kenya Revenue Authority.

11. **Total expenditure** to December 2022 was above target by **Ksh 19.9 billion** largely on account of above target absorption towards **recurrent**

expenditure by **Ksh 106.8 billion**. Disbursements to **development** expenditure was below target by **Ksh 28.4 billion while County Governments** disbursement was also below target by **Ksh 56.6 billion**.

12. Fiscal deficit incl. grants by end December 2022 was **Ksh 233.0 billion** funded through Net Domestic Financing of **Ksh 124.1 billion** and Net Foreign Financing of **Ksh 95.2 billion**

III. Fiscal Policy for FY 2023/24 Budget

13. The fiscal policy stance over the medium term aims at supporting the Bottom - Up Economic Transformation Agenda of the Government through a **growth friendly fiscal consolidation plan** designed to slow down the annual growth in public debt and implement an effective liability management strategy without compromising service delivery to citizens. This is expected to boost the country's debt sustainability position and ensure that Kenya's development agenda honours the principle of inter-generational equity.

14. As part of the economic turnaround plan, the Government will scale up revenue collection efforts to **Ksh 3.0 trillion** in the **FY 2023/24 and Ksh 4.0 trillion** over the medium term through a combination of both tax administration and tax policy reforms.

15. On tax administration, the Kenya revenue Authority targets to:

- Improve tax compliance through reduction of VAT gap from 38.9% to 19.8% and reduction of Corporate Income Tax (CIT) gap from 32.2% to 30.0% Integrate their tax system with the Telecommunication companies;
- Expand tax base;
- Map all Rental properties;
- Roll out of measures at the Customs and Border Control by leveraging on technology and enhanced data analytics to enhance revenue per unit; and
- Upscale technical capacity of KRA through skills, technology and additional staffing.

16. On the tax policy, the Government will strengthen revenue mobilization efforts through **National Tax Policy and the Medium-Term Revenue Strategy**.

17. The National Tax Policy Framework will enhance the administrative efficiency of the tax system, provide consistency and entrench predictability in tax legislations and management of tax expenditure. **The Medium-Term**

Revenue Strategy will provide a comprehensive approach of undertaking effective tax system reforms for boosting tax revenues and improving the tax system over the medium term.

18. Additionally, the Government will continue to improve **efficiency in public spending to ensure value for money** by:

- eliminating non-priority expenditures;
- retiring expensive and unsustainable consumption subsidies;
- reducing tax exemptions;
- scaling up the use of Public Private Partnerships financing for commercially viable projects;
- rolling out an end-to-end e-procurement system; and
- streamlining the initiation, execution, delivery and sustainability of public investment projects.

19. Therefore, during the **FY 2023/24**, revenues are projected at **Ksh 2,894.9 billion (17.8 percent of GDP)** while total expenditures are projected at **Ksh 3,663.1 (22.5 percent of GDP)**. The fiscal deficit (incl. grants) is projected at **Ksh 720.1 billion (4.4 percent of GDP)**.

20. The budget ceilings for the FY 2023/24 amounts **Ksh 2,252.1 billion** comprising of **Ksh 1,485.1 billion** in recurrent expenditures and **Ksh 766.9 billion** in development expenditure.

21. In the FY 2023/24, **Ksh 385.4 billion** has been allocated to the **47 County Governments** as equitable revenue share.

22. In addition to their proposed equitable share of revenue, County Governments will receive the following additional conditional allocations:

- amounting to **Ksh 454 million** for construction of county headquarters, **Ksh. 5.9 billion** for leasing of medical equipment and **Ksh 4.7 billion** for the aggregated Industrial Parks programme;
- Equalization Fund to the marginalized areas amounting to **Ksh 7.9 billion**; and
- **Ksh 33.2 billion** from proceeds of external loans and grants.

23. The County Governments will therefore receive a total of **Ksh 429.6 billion in the FY 2023/24** both as equitable share allocation and conditional grants.

THE 2023 MEDIUM-TERM DEBT MANAGEMENT STRATEGY (MTDS)

24. **Hon Members**, it is my pleasure and honour to present the 2023 Medium -Term Debt Management Strategy which informs the financing of the FY 2023/2024 budget to this Committee.

25. **Hon Members**, the stock of public and publicly guaranteed debt grew from Kshs. 8.03 trillion (61.6% of GDP in PV terms) by end December 2021 to Ksh 9.14 trillion (61.7% of GDP in PV terms) as at end December 2022.

The Public debt is comprised of:

- a) **Ksh 4.67 trillion** External debt
- b) **Ksh. 4.47 trillion** Domestic debt

26. The growth in external debt is mainly attributed to the foreign exchange depreciation & deficit financing disbursements from external borrowing and domestic debt during the period.

Total external debt is composed of:

- **Kshs. 2.21 trillion** multilateral debts (47%)
- **Kshs. 1.21 trillion** bilateral debts (26%) out of which China accounts for 17% and
- **Kshs. 1.25 trillion** commercial debts (27%) with the Eurobond accounting for Kshs 0.87 trillion (19%).

Total Domestic debt is composed of:

- **Kshs. 3.71 trillion** T-bonds (84%)
- **Kshs. 0.67 trillion** T-bills (14%); and
- **Kshs 0.09 trillion** (2%) as others (pre-1997 overdraft, overdraft and advances)

Domestic debt is categorized as short (91, 182 and 364), medium (2-7 years) and long term (8-30 years) instruments accounting for 14%, 11% and 73% respectively.

27. **Hon Members**, the proposed FY 2023/2024 budget has a fiscal deficit of Kshs 720.1 billion (4.4% of GDP) to be financed as follows;

a) Net Foreign financing	-	Kshs 198.6 bn
o/w -		
Commercial Borrowing		-Kshs 270 bn
Programme loans		-Kshs 65 bn
Project Loans & A-I-A		-Kshs 239 bn
External Repayment		-Kshs (476) bn
b) Net Domestic financing	-	Kshs 521.5 bn
Total		<u>Kshs 720.1 bn</u>

28. **Hon Members**, the total Present Value of debt as a Percentage of GDP is currently at 61.7 percent and is projected to decline to 53.1 percent in FY 2025-2026 under the proposed fiscal consolidation programme currently supported by the IMF.

29. From a combination of debt stock of Kshs 9.14 trillion as at end December 2022 and projected net borrowing for the remaining part of the current year and a fiscal deficit of Kshs 720 billion in the next fiscal year, public debt stock is expected to surpass the Kshs. 10 trillion debt limit in the FY 2023-2024.

30. The ratio of the total debt maturing in one year as a share of GDP has been gradually declining over time, thus reducing the refinancing risk. The reduction is due to ongoing shift from Treasury bills (short-term instruments) to Treasury bonds (long-term instruments).

31. The redemption profile is characterized by large maturities of external public debt in 2024 and 2028 which increases the refinancing risks. This includes the USD 2 billion Eurobond maturity in June 2024.

32. The redemption profile of Kenya's Eurobonds indicates increased rollover and refinancing risks in the FY 2023-2024 when the International Sovereign Bonds of USD 2,000 million issued in 2014 will be maturing, and in FY 2027-2028 when a bond of USD 1,000 million will be maturing.

33. The National Treasury will pursue Liability Management Operation targeting the 2024 Euro bond maturity and redeeming expensive domestic debt maturities.

34. Hon Members, in addition to the continued implementation of fiscal consolidation, the 2023 Medium-Term Debt Strategy identifies key actions to guide borrowings during FY2023-24 to 2025-2026. These include:

- Funding cost and risks optimization through a balanced allocation (50:50) of fiscal deficit financing between domestic and external sources. The optimal strategy allows for flexibility to adjust depending on evolving domestic and international market interest rates;
- Use of long tenor Treasury bonds for refinancing of maturing domestic debt and raising of new deficit funding resources along with reduction in the proportion of short-term domestic debt (Treasury bills). This will minimize refinancing risks and lengthen the Average Time Maturity for domestic and total debt.
- Maximize use of concessional borrowing as opposed to commercial debt. Eurobonds will be rolled over as new commercial debt borrowing will be considered only as a residual.
- Diverse ways of managing maturities including a Sinking Fund to manage debt maturities.

35. The deficit financing mix of 50 percent each from the external and domestic sources aims to achieve the following:

- i. Interest payments as a ratio to GDP and the implied percentage interest cost are projected to be minimized in the medium term under this strategy on account of maximizing the use of concessional sources and reduction in use of commercial borrowing from external sources.
- ii. minimize refinancing risk by lengthening the total portfolio Average Time to Maturity through issuance of longer tenor debt instruments and use of concessional debt whose terms include longer maturities;
- iii. The use of fixed interest rate debt minimizes interest rate risk in terms of average time to refixing.
- iv. The strategy contributes to deepening of the domestic debt by allocating 50 percent of net new borrowing to domestic debt market and through issuance of more medium to long tenor instruments as the main source of domestic financing.
- v. The strategy may be adjusted towards either external or domestic borrowing targets depending on prevailing market conditions.

36. **Hon Members**, sustainable debt is where the government is able to meet its current and future debt payment obligations when due without compromising on its other budget programs or defaulting on its obligation. Kenya's Debt Sustainability Analysis (DSA) indicates that;

- Debt stock remains sustainable with a high risk of distress
- Risk of debt distress is high since the year 2020 as compared to moderate in 2019.
- Kenya's debt carrying capacity is medium.
- Subdued growth in exports has increased external debt vulnerability.
- Redeeming the commercial debts borrowed under the Eurobond by application of diverse optimal sources.

37. **Hon Members**, in 2016, the National Treasury pronounced itself on several reforms aimed at removing constrains to Kenya's domestic debt market development and to deepen the market. The debt market reforms included:

- Facilitation of an electronic bond and bills auction;
- Implement a new Central Securities Depository (CSD) to enhance market infrastructure;
- Separation of the retail and wholesale markets;
- Annual publishing of the Issuance calendar;
- Re-energizing and enhancing the effectiveness of a horizontal repo market and the securities lending and short-selling for key market participants
- Strengthening monthly stakeholders meeting and feedback

38. Public debt sustainability is projected to improve as a result of reforms under the ongoing Extended Fund Facility/ Extended Credit Facility (EEF/ECF) supported by the IMF which embeds implementation of the proposed fiscal consolidation strategies for macroeconomic stability over the medium-term.

39. To pursue debt sustainability, the Government has to optimize use of concessional external funding sources, lengthen the maturity profile of public debt through issuance of medium to long dated bonds and deepening the domestic debt market to be able financing more of the budget deficits and reduce reliance on external sources.

IV. Risks to the Outlook

40. **Hon. Members**, the current administration started with a perfect storm emanating from effects of COVID-19, the ongoing Russia-Ukraine war and drought.

41. Domestic negative structural effects underpinning economic recovery emanate from:

- Effects of climate change resulting in unfavorable weather conditions has affected agricultural production and led to domestic inflationary pressures and
- the fiscal space has diminishing as we continue to experience the multiple shocks that has produced a very protractive recession to the economy.

42. On the external front, the risk arises from uncertainties in the global economic outlook. These include:

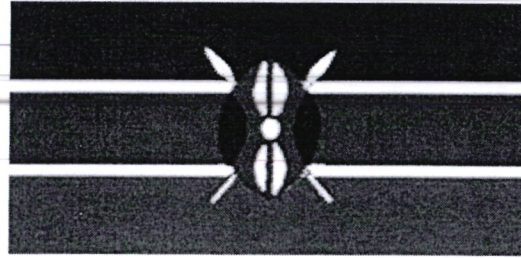
- the lingering adverse effects of COVID-19 that could disrupt the global supply chains
- the Russia - Ukraine conflict which heightens the risk of oil and commodity price volatility and elevated inflationary pressures;
- further dollar tightening in frontier & emerging markets has brought about capital flight in the USA thus increasing volatility in the financial markets; and
- Global Payments System's Pressure could worsen the forex exchange markets for African economies.

V. CONCLUSION

43. I thank you once again, **Hon. Chairperson and Hon. Members** for giving us this opportunity to engage with you on the 2023 Budget Policy Statement and the Medium-Term Debt Management Strategy. We remain available to support the Committee when called upon during this approval process.

NJUGUNA NDUNG'U, CBS
CABINET SECRETARY

24th February 2023



2023 BUDGET POLICY STATEMENT

**Presentation to the Standing Committee on
Finance and Budget Committee**

**PROF. NJUGUNA NDUNG’U, CBS
CABINET SECRETARY**

THE NATIONAL TREASURY AND ECONOMIC PLANNING

February 24, 2023

PRESENTATION OUTLINE

1. Bottom–Up Economic Transformation Agenda
2. Implementation Framework of the Government Agenda
3. FY 2022/23 Budget Execution
4. Fiscal Policy for FY 2023/24 Budget
5. County Resource Allocation Proposals
6. Risks to the Outlook
7. Ask/Request to the Committee

1a. *Bottom-up Economic Transformation Agenda*

- 2023 Budget Policy Statement:
 - First under the Kenya Kwanza Government,
 - Based on **The Bottom-up Economic Transformation Agenda (BETA)** Framework.
 - It sets out the Administration's priority programs, policies and reforms for implementation
 - Theme is: ***The Bottom-up Economic Transformation Agenda for inclusive Growth.***
- Domestic Economy:
 - Remains resilient in the face of severe shocks
 - Real GDP grew by **7.5% in 2021** from a lower base **-0.3% in 2020**
 - Estimated to grow by **5.5% in 2022** and projected at above **6.0% in 2023.**
 - **Allows us to focus on quality and structure of growth for an inclusive strategy**

1b. *Bottom-up Economic Transformation Agenda cont..*

- Domestic Economy: Growth momentum in 2022 was slowed by multiple shocks:-It is what we describe as a perfect storm:
 - i. lingering effects of COVID-19 pandemic;
 - ii. the Russia-Ukraine conflict leading to increased prices of fuel, fertiliser and food prices;
 - iii. climate change that has affected agricultural productivity; and
 - iv. The rising US interest rate and capital flight – shortage of dollars in Frontier and Emerging Markets
- a) The characteristics is that they are all persistent shocks
- b) The economy is in a recession and tax revenues have been affected severely: Financing constrains and limited headroom and deficit financing
- c) Affects the quality and structure of growth

1b. *Bottom-up Economic Transformation Agenda cont..*

- New Administration addressing constraints to growth and bolster resilience through The Bottom-Up Economic Transformation Agenda (BETA) to achieve economic turnaround and inclusive growth
- Focus is on interventions that: reduce the cost of living; increase employment; incentivize investment and production; achieve more equitable distribution of income; enhance social security, expand tax base for more revenue; and increase foreign exchange earnings.
- The Agenda will increase investments in at least **five sectors** – with largest impact and linkages to the economy and household welfare. These include:
 - a) **Agricultural Transformation and Inclusive Growth:**
 - To ensure food security in the Country thereby reducing the cost of living;

1c. *Bottom-up Economic Transformation Agenda cont.*

- Create jobs as agriculture has the highest employment multiplier effect owing to its strong forward and backward linkages to other sectors of the economy; and
- Agro-industrial structure at the County levels

b) Transforming the Micro, Small and Medium Enterprise (MSME) Economy:

- To correct market and institution failure problems through schemes that will ensure that benefits of growth are fairly distributed;
- Promote accessibility to affordable credit to most Kenyans at the bottom of the pyramid through the Hustlers Fund – An intervention that will work and remain at that level.

1d. *Bottom-up Economic Transformation Agenda cont.*

c) Housing and Settlement

- Reduce proliferation of slums and preserve human dignity through:
 - Facilitating delivery of 250,000 houses per annum and enabling low cost housing mortgages;

d) Healthcare

- Promote access to quality and affordable healthcare through ensuring Universal Health Coverage

e) Digital Superhighway and Creative Economy

- Digitization and automation to increase productivity and competitiveness - eliminates information asymmetry in market access and risk management.
- Create employment for the youth - promotion of music, theatre, graphic design, digital animation, fashion and craft, among others.

2a. Implementation Framework of the Bottom–Up Economic Transformation Agenda

- Implementation of policy priorities under The Bottom–Up Economic Transformation Agenda through a Framework anchored on three pillars:

i. Prioritization

- The priorities have been chosen based on the largest impact on six objectives namely:
 - ❖ Lower the cost of living;
 - ❖ eradicating hunger:- Food Security and Climate Change Agenda
 - ❖ creating jobs;
 - ❖ expanding the tax base:- A Tax Policy that reflects the growth objectives of the country
 - ❖ Foreign exchange generation to support the economy needs; and
 - ❖ achieving inclusive growth.

2b. Implementation Framework of the Bottom–Up Economic Transformation Agenda cont..

ii. Sequencing

- The Agenda will be implemented within **Four Timeframes**:
 - i. **Quick wins.** These are interventions that will have economic impact within six months.
 - ii. **High Priority.** These are interventions that will deliver impact within 6 - 18 months.
 - iii. **Medium term.** These are interventions that will deliver impact between 18 – 36 months.
 - iv. **Long term.** These are interventions whose impact is expected to be felt between 3 and 5 years and beyond, but need to be started in good time.

2c. Implementation Framework of the Bottom–Up Economic Transformation Agenda cont..

iii. Financing Principles and Framework

- **Fiscal consolidation is a priority.** The priorities must be financed within a budget deficit target of **3.6 percent of GDP** over the medium term. Appropriate and effective Liability Management Strategy to signal debt sustainability
- **Use Public Private Partnership (PPP):** Enhance the use of PPPs, with a view to progressively reducing the financing of commercially viable infrastructure projects from the budget.
- **Grants and concessional loans:** to finance priorities in: water, health, education and environment/climate change.

2d. Implementation Framework of the Bottom–Up Economic Transformation Agenda cont..

Criteria for Resource Allocation

- Use of a **Value Chain Budgeting Approach** under Five Clusters:
 - i) Finance and Production Economy;
 - (ii) Infrastructure;
 - iii) Land and Natural Resource;
 - (iv) Social Sectors; and
 - v) Governance and Public Administration.
- This **Value Chain Budgeting Approach** ensures:
 - there is no break in the cycle due to failure to allocate requisite resources to any entity along the value chain; and
 - duplication of allocations and roles is eliminated.

3. FY 2022/23 Budget Execution

- ❑ Budget Execution for the FY 2022/23 progressed smoothly to end **December 2022**.
- ❑ **Total revenues** to December 2022 grew by **11.2 percent to December 2022** with all tax revenue categories recording positive growths, an indication of continued recovery in revenue collection. However, this was below target by **Ksh 11.2 billion** on account of **shortfalls** in **ordinary revenue** of **Ksh 43.2 billion** as **Ministerial A-i-A** was above target by **Ksh 32.0 billion**.
- ❑ **Total expenditure** to December 2022 was above target by **Ksh 19.9 billion** largely on account of:
 - above target absorption towards **recurrent** expenditure by **Ksh 106.8 billion** while disbursements to **development** expenditure was below target by **Ksh 28.4 billion** and **County Governments** disbursements was also below target by **Ksh 56.6 billion**
- ❑ **Fiscal deficit incl. grants** by end **December 2022** was **Ksh 233.0 billion** funded through:
 - ❖ Net Domestic Financing of **Ksh 124.1 billion** and
 - ❖ Net Foreign Financing of **Ksh 95.2 billion**

4a. Fiscal Policy for FY 2023/24 Budget

- The fiscal policy stance: Supports the Bottom-Up Economic Transformation Agenda through a growth **friendly fiscal consolidation plan** designed to:
 - slow down the annual growth in public debt; and
 - implement an effective liability management strategy, without compromising service delivery to citizens.
 - Boost the country's debt sustainability position and ensure that Kenya's development agenda honours the principle of inter-generational equity.
- KRA to collect **Ksh 3.0 trillion in the FY 2023/24 and Ksh 4.0 trillion over the medium term.**
- A combination of both tax administrative and tax policy reforms to be implemented.

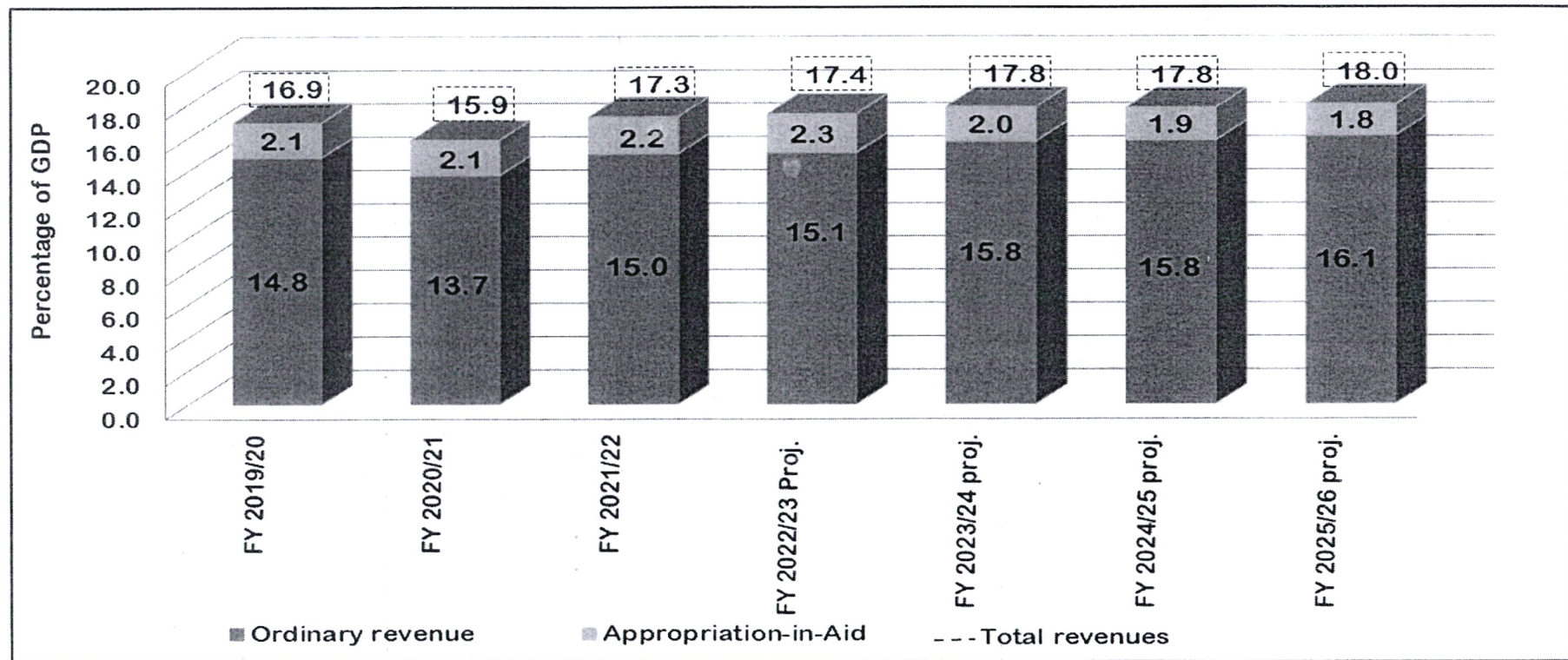
4b. Fiscal Policy for FY 2023/24 Budget

□ Tax Administration: KRA to:

- ❖ Improve tax compliance through reduction of VAT gap from 38.9% to 19.8% and reduction of Corporate Income Tax (CIT) gap from 32.2% to 30.0% Integrate their tax system with the Telecommunication companies;
- ❖ Expand tax base;
- ❖ Map all Rental properties;
- ❖ Roll out of measures at the Customs and Border Control by leveraging on technology and enhanced data analytics to enhance revenue per unit; and
- ❖ Upscale technical capacity of KRA through skills, technology and additional staffing.

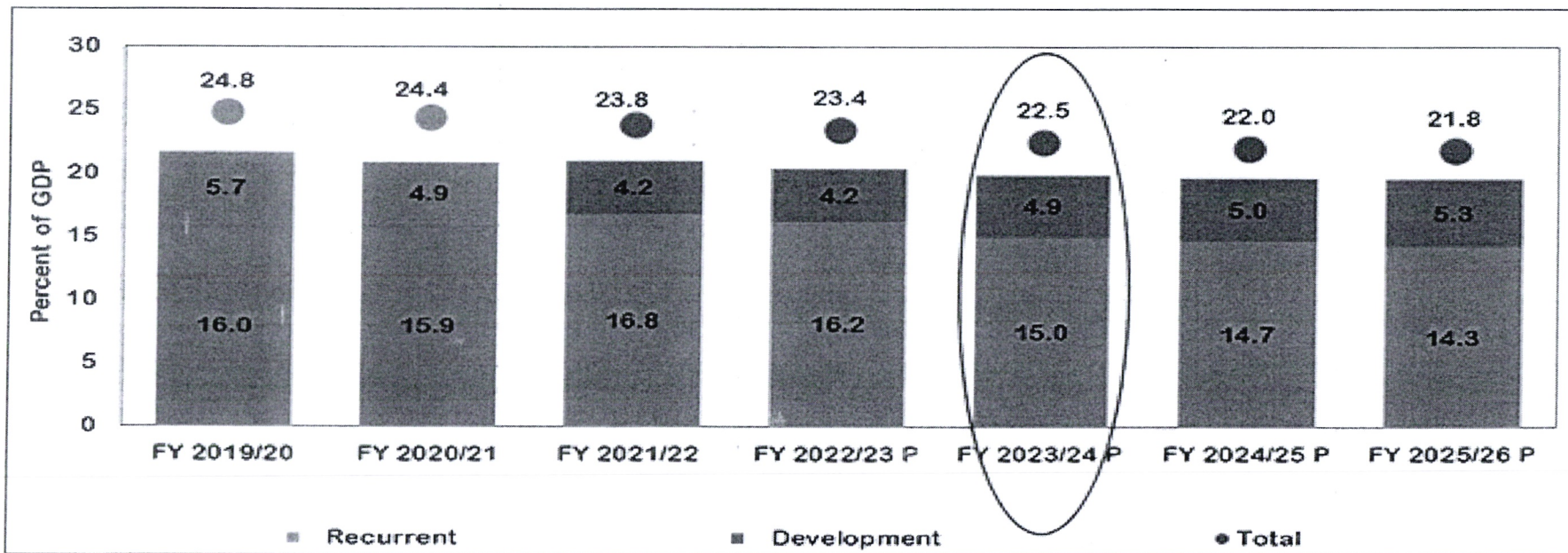
4c. Efforts to grow revenues to 17.8% of GDP in FY 2023/24 from 17.4% of GDP in FY 2022/23 and 18.0 % of GDP over the Medium term have been put in place

- ❑ **Tax policy:** Strengthen revenue mobilization efforts through the **National Tax Policy** (to be completed in Q1 of 2023) and the **Medium-Term Revenue Strategy** (draft to be ready for stakeholder comments by end February, 2023).



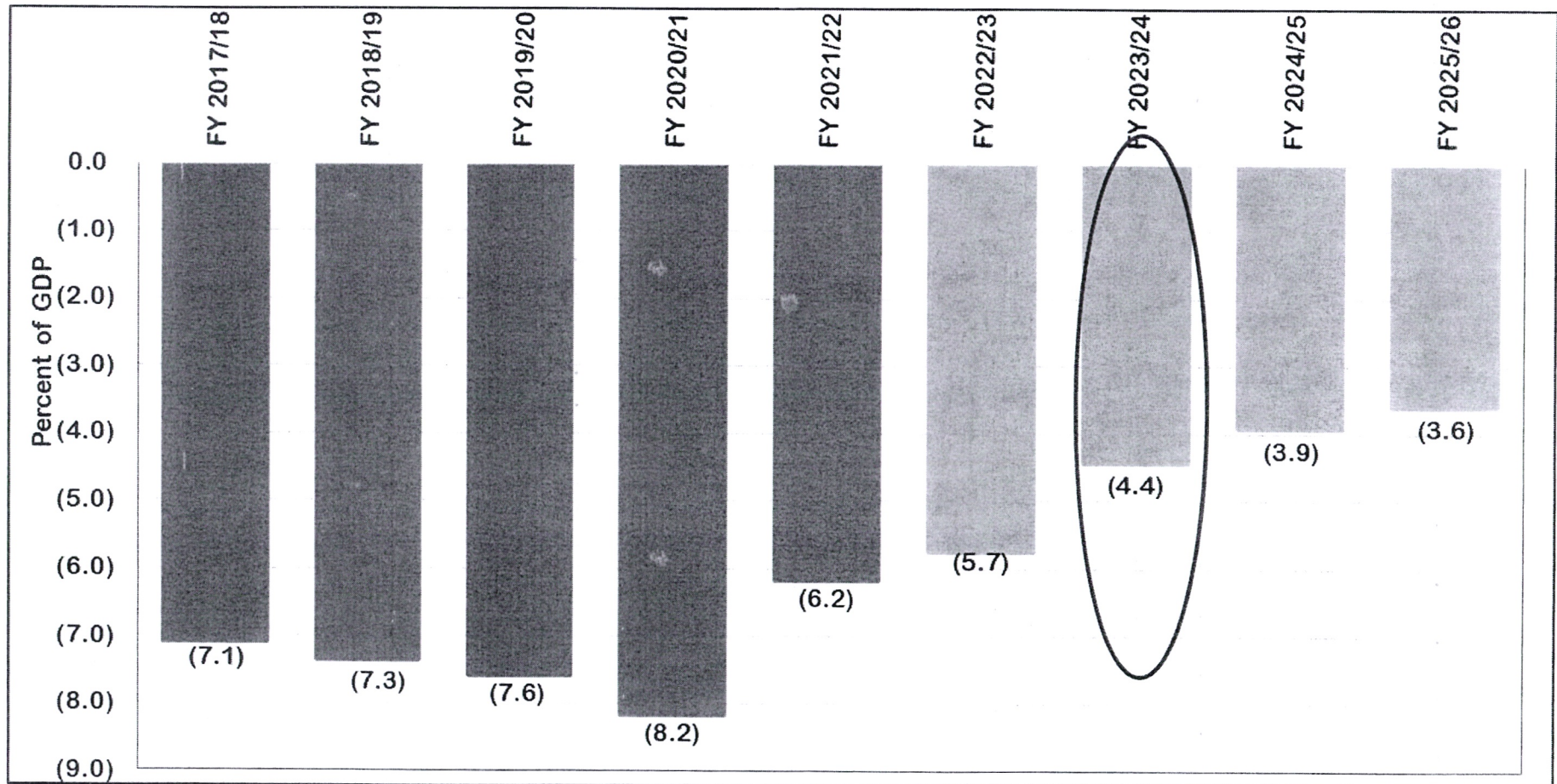
4d. Fiscal Policy for FY 2023/24 Budget : Expenditures

- Improvement of expenditures:
 - Eliminate non priority expenditures;
 - reduce Tax Exemptions and Waivers;
 - scale up the use of Public Private Partnerships;
 - roll out an end-to-end e-procurement system; and streamline the initiation, execution, delivery and sustainability of public investment projects.
- Total expenditures as a share of GDP to decline as a share to GDP from **23.4% (Ksh 3.4 trillion)** in the FY 2022/23 to **22.5% (Ksh 3.7 trillion)** in the FY 2023/24 and further to **21.8% (Ksh 4.5 trillion)** in the FY 2025/26.



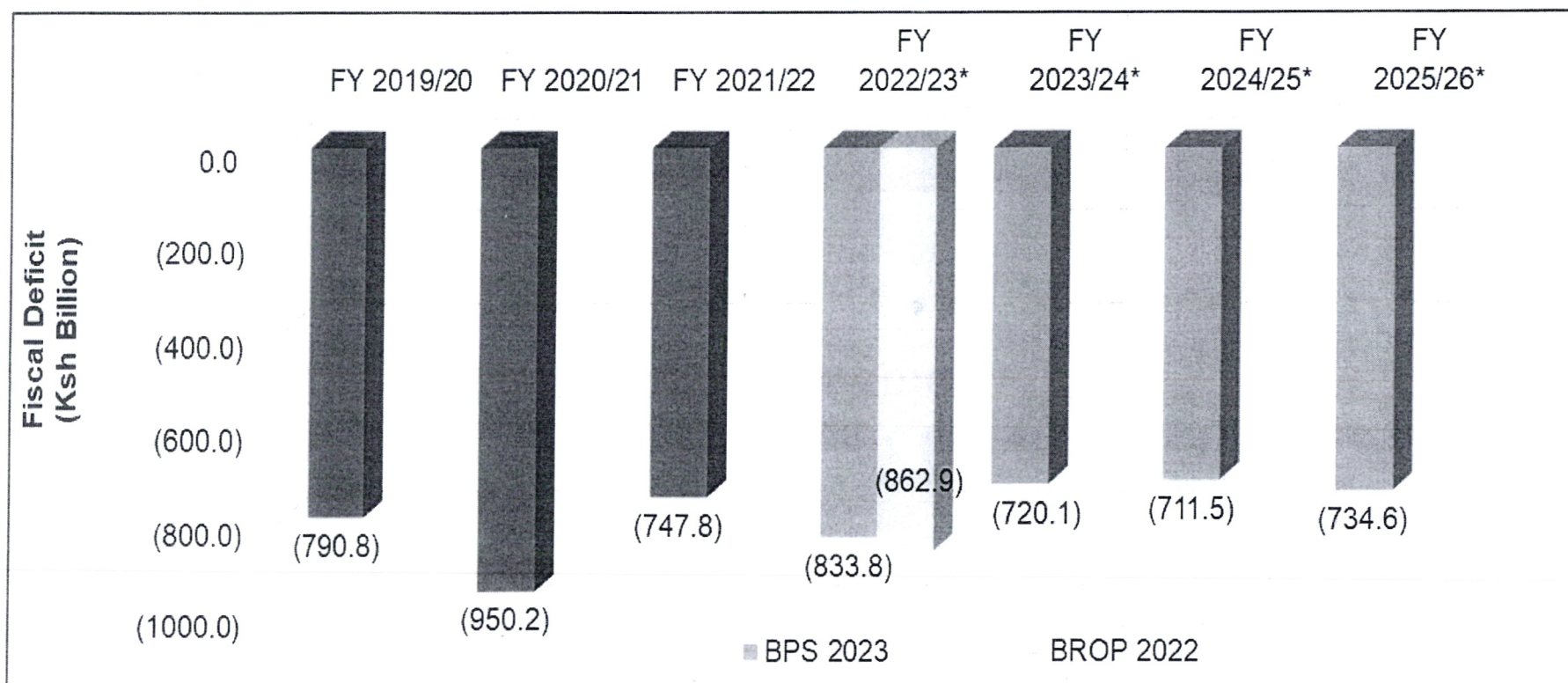
4e: Reduction fiscal deficit. Incl. grants, as a percentage of GDP, from 8.2% in the FY 2020/21 to 6.2% in the FY 2021/22 and down further to 5.7% in the FY 2022/23 and 4.4% in the FY 2023/24.

- a remarkable 3.8% reduction from FY 2020/21 to FY 2023/24
- a strong signal on commitment to reduce growth of public debt and boost debt sustainability position.



4f: In nominal terms, the fiscal deficit (including grants), is projected at Ksh 720.1 billion (4.4% of GDP) in FY 2023/24 against the estimated revised fiscal balance of Ksh 833.8 billion (5.7% of GDP) in FY 2022/23.

The approved budget for FY 2022/23 projected fiscal deficit at Ksh 862.9 billion (6.2% of GDP). Reduction in deficit is due to the New Administration efforts to cut expenditure and enhance revenue mobilization



4g. Fiscal Policy for FY 2023/24 Budget cont..

FY 2023/24 Budget

- Total revenue collection is projected at **Ksh 2,902.9 billion (17.8% of GDP)**;
- Total expenditures is projected at **Ksh 3,671.0 billion (22.5% of GDP)**.
- The fiscal deficit (including grants), is projected at **Ksh 720.1 billion (4.4% of GDP)** which will be financed by:
 - net external financing of Ksh 198.6 billion (1.2% of GDP), and
 - net domestic borrowing of Ksh 521.4 billion (3.2% of GDP).
- The budget ceilings for the FY 2023/24 amounts **Ksh 2,251.5 billion** comprising of **Ksh 1,488.2 billion** in recurrent expenditures and **Ksh 763.3 billion** in development expenditure.

4h. Fiscal Policy for FY 2023/24 Budget cont..

Revenue composition for the FY 2023/24

The total revenue of Ksh 2,902.9 billion (17.8% of GDP) constitutes Ordinary revenues of Ksh 2,571.2 billion (15.8% of GDP) and Appropriation in Aid of Ksh 331.7 billion (2.0% of GDP).

	FY 2022/23	FY 2023/24	FY 2022/23	FY 2023/24
	Suppl.I	Budget	Suppl.I	Budget
	Absolute (Ksh Billion)		% of GDP	
A. Total Revenue (1+2)	2,528.8	2,902.9	17.4	17.8
1. Ordinary Revenue (a+b+c+d+e)	2,191.9	2,571.2	15.1	15.8
a) Import Duty	145.9	173.3	1.0	1.1
b) Excise Duty	297.2	352.7	2.0	2.2
c) Income Tax	1,004.3	1,198.5	6.9	7.4
PAYE	512.7	619.0	3.5	3.8
Other Income Tax	491.6	579.5	3.4	3.6
d) VAT	587.7	703.3	4.0	4.3
VAT Local	304.2	356.3	2.1	2.2
VAT Imports	283.4	347.0	2.0	2.1
e) Other Revenue	156.8	143.3	1.1	0.9
2. Appropriation In Aid	336.9	331.7	2.3	2.0
Nominal GDP	14,521.6	16,290.3	100	100

4i. Budget for FY 2023/24 and the Medium Term cont..

Budgetary Allocations for the FY 2023/24 and the Medium-Term

- The total Budget ceiling for FY 2023/24 is **Ksh 3,628.8 billion** of which: **Ksh 2,252.1 billion** for National Government; **Ksh 991.3 billion** for Consolidated Fund Services (CFS) and **Ksh 385.4 billion** for County Governments.

S/NO.	Details	Approved Original Budget	Budget Ceilings
		(Amount in Ksh Million)	
		FY 2022/23	FY 2023/24
1.0	National Government	2,119,258.8	2,252,077.2
	Executive	2,050,154.4	2,189,681.4
	Parliament	50,220.0	40,401.8
	Judiciary	18,884.4	21,994.0
2.0	Consolidated Fund Services	869,342.7	991,340.5
3.0	County Government	370,000.0	385,425.0
	Total.....Kshs.	3,358,601.5	3,628,842.8
% Share in the Total Allocation			
1.0	National Government	63.1	62.1
	Executive	61.0	60.3
	Parliament	1.5	1.1
	Judiciary	0.6	0.6
		-	-
2.0	Consolidated Fund Services	25.9	27.3
3.0	County Government	11.0	10.6

5: Transfer to County Governments will amount to Ksh 424.9 billion in FY 2023/24 of which Ksh 385.4 billion is County equitable share of revenue raised Nationally

Type/Level of Allocation	2019/20	2020/21	2021/22	2022/23	2023/24
County Equitable Share	316,500	316,500	370,000	370,000	385,425
Additional conditional allocations, of which					
Leasing of medical equipment	6,205	6,205	7,205	5,200	5,862
Supplement of construction of county headquarters	300	300	332	454	454
Allocations from loans and grants	39,090	30,204	32,334	31,382	33,192
Total County Allocations	362,095	353,209	409,871	407,036	424,933

- ❑ Conditional allocations amounting to **Ksh 454 million** for construction of County Headquarters and **Ksh. 5.9 billion** for leasing of Medical Equipment:
 - **Ksh 33.2 billion** from proceeds of external loans and grants, and
 - Equalization Fund of **Ksh 7.9 billion**
- ❑ H.E The President announced a conditional grant for County Governments Industrial Parks of **Ksh 100 million** for each County.

6. Risks to this outlook have remained elevated

- ❑ **Domestic side:** Risks emanate from climate change resulting in unfavorable weather conditions – Food Security is a real challenge:
 - Affects agricultural production
- ❑ **Tight Fiscal space:** impact of the multiple shocks that have affected the global and the domestic economy as well as inflationary pressures and dollar shortages in the markets for frontier and emerging economies.
- ❑ **On the external front:**
 - Possible worsening of the Russia - Ukraine conflict which could heighten the risk of oil and commodity price volatility and elevated inflationary pressures;
 - the lingering adverse effects of COVID-19 that could disrupt the global supply chains; and
 - Further monetary policy tightening, especially in the United States, could increase volatility in the financial markets ; and
 - Global Payments System's Pressure could worsen the forex exchange markets for African economies.

7. Our Asks/Requests to the Committee

1. A briefing for the lay out of the 2023 Budget Policy Statement and the Medium Term Debt Management Strategy, 2023;
2. The Bottom–Up Economic Transformation Agenda (BETA) Approach to the economic management;
3. The challenges with us and in the Medium Term;
4. From the above adopt a position to support National Treasury and Economic Planning and Government's resolve to push the economy to a recovery path.

THANK



YOU



2023 MEDIUM TERM DEBT MANAGEMENT STRATEGY

NATIONAL TREASURY & ECONOMIC PLANNING

FEBRUARY 2023



Outline of the Presentation

1. Background
2. Potential Sources of financing
3. Actual cost and risk characteristics of December 2022 MTDS
4. Macroeconomic assumptions and key risks to the MTDS
5. Cost-risk analysis of alternative debt management strategies
6. Optimal (selected) debt management strategy
7. Developments in Debt Management & Reforms
8. Implementation



Background

Section 33(2) of (PFM) 2012 Act guides preparation of MTDS

- Scope of MTDS covers:-
 - i. National Government external and domestic debt
 - ii. Macroeconomic assumptions in the 2023 BPS
- 2023-MTDS prepared amidst;
 - COVID-2019 pandemic recovery environment
 - Constrained world and local economic growth
 - Kenya's elevated risk to public debt sustainability(debt distress)
 - Public Debt ceiling of Ksh 10.0 trillion
- Kenya's public debt remain sustainable but with elevated risks,(Debt sustainability Analysis-as at December 2022) therefore government must reduce fiscal deficits to reduce debt accumulation rate.



Potential Sources of financing

External sources-

- Focus on concessional financing from multilateral financial institutions, bilateral lenders, and other credible institutions to finance development expenditure.
- Need for monitoring the market conditions in international capital market to refinance the maturities in 2024.



Potential Sources of financing

Domestic sources-

- Domestic debt market contributes more than half of total financing requirements of the Government and is expected to remain a key source- T. bonds.
- Other alternative sources may include issuance of a Kenya Shilling syndicated loan, foreign currency denominated local bonds and private placement among others.



Existing debt –Dec 2022

- External debt at 51.1% of total
- Domestic debt at 48.9% of total

	Kshs bn	% of GDP	% of Total
External debt	4,673.1	34.4	51.1
Domestic debt	4,472.8	32.6	48.9
Total debt	9,145.9	67.0	100



Costs and Risks Indicators of Existing Debt

Risk Indicators		2	3	6	5	
		Baseline Dec 2020	2021 MTDS	Actual End December 2022	Deviation (4-3)	Remark on deviation
Nominal debt as % of GDP		63.3	67.8	67.0	-0.8	Debt to GDP remains high
Present value debt as % of GDP		56.8	61.6	60.0	-1.6	
Interest costs as % of GDP		4.4	4.6	5.3	0.7	Increased debt service cost in domestic and international debt market
Refinancing risk	Debt maturing in 1yr (% of total debt)	15.5	14.8	11.7	-3.1	Reduced refinancing risk-issuance of longer dated domestic debt and contracting concessional loans ATM external reduced due to short-term commercial debt, 2024 maturities – \$2 Bn, domestic improved
	Debt maturing in 1yr (% of GDP)	11	10.2	8.4	-1.8	
	ATM External Portfolio (years)	11.2	10.8	9.8	-1.0	
	ATM Domestic Portfolio (years)	6.3	6.9	7.8	0.9	
	ATM Total Portfolio (years)	9.1	9.0	8.8	-0.2	
Interest rate risk	ATR (years)	8.4	8.3	8.1	-0.2	Partial improvement due to more fixed rate risk indicators
	Debt refixing in 1yr (% of total)	27.1	25.4	23.0	-2.4	
	Fixed rate debt (% of total)	86.9	87.7	87.2	-0.5	
Foreign exchange (FX) risk	FX debt as % of total debt	51.2	51.3	49.0	-2.3	Reduced foreign exchange exposure



Actual Costs and Risks Indicators of Public Debt –Dec 2022

Risk Indicators		External debt	Domestic debt	Total debt
Amount (in billions of KSH)		4,673.1	4,472.8	9,145.9
Amount (in billions of USD)		38.3	36.7	75.0
Nominal debt as percent of GDP		34.4	32.6	67.0
PV as percent of GDP		26.8	33.2	60.0
Cost of debt²	Interest payment as percent of GDP ³	1.4	3.9	5.3
	Weighted Av. IR (percent)	3.9	11.4	7.6
Refinancing risk	ATM (years)	9.8	7.8	8.8
	Debt maturing in 1yr (percent of total)	5.1	18.7	11.7
	Debt maturing in 1yr (percent of GDP)	1.9	6.5	8.4
Interest rate risk²	ATR (years)	8.4	7.8	8.1
	Debt refixing in 1yr (percent of total)	27.0	18.7	23.0
	Fixed rate debt incl T-bills (percent of total)	75.3	100.0	87.2
	T-bills (percent of total)	0.0	15.3	7.4
FX risk	FX debt (percent of total debt)			49.0
	ST FX debt (percent of	8		23.9

Key messages:-

- ❖ High interest cost for Domestic debt compared to external debt
- ❖ High domestic Weighted average IR compared to external debt
- ❖ Low ATM of domestic debt due to huge stock of T-bills
- ❖ High debt maturing in 1 year for domestic debt due to huge stock of T-bills
- ❖ Most debt in fixed interest rate
- ❖ Stock of short term debt to be reduced through switch to bonds



Kenya's Debt Sustainability Status (2022)

Total Public Debt Sustainability Analysis

Indicators	Thresho lds	2022	2023	2024	2025	2026	2027
PV of debt-to-GDP ratio	55	61.7	60.0	57.8	55.9	54.0	52.5
PV of public debt-to-revenue and grants ratio	n/a	353.1	340.4	332.5	310.9	301.0	289.6
Debt service-to-revenue and grants ratio	n/a	52.0	57.0	62.7	54.5	49.9	43.9

Key Messages

- The PV of debt to GDP ratio is projected to remain above the 55 percent benchmark until 2025
- Public debt sustainability indicators are projected to begin improving in 2026 after settlement of major maturities in 2024, 2025, and 2026 couple with anticipated recovery in exports sector as global economy recover from 2020 COVID-19 pandemic effects and shocks to global supply chain, as well as implementation of the ongoing fiscal reforms under the EFF/ECF program



Kenya's Debt Sustainability Status (2022)

External Debt Sustainability Analysis

Indicators	Thresholds	2022	2023	2024	2025	2026	2027
PV of PPG external debt to GDP ratio	40	26.6	26.8	26.1	25.6	25.1	25.0
PV of PPG external debt to export ratio	180	221.5	208.6	195.9	186.5	179.8	175.4
PPG debt service to export ratio	15	22.6	20.5	29.6	21.1	19.2	15.8
PPG debt service to revenue ratio	18	15.7	15.2	22.3	16.5	15.2	12.6

Key Messages

- PV of external debt to GDP is below the 40 percent sustainability threshold even in medium term
- The debt service to revenue ratio breaches the threshold in 2024 due to the upcoming international sovereign bond repayment and the rollover of external commercial loans coming due in 2025
- the PV of external debt-to-exports ratio breaches the threshold until 2025 and the rollover of external commercial loans coming due in 2025



Macroeconomic Assumptions for MTDS 2023

Over the medium term;

Recovering economy leading to more revenues

Fiscal consolidation leading to declining overall fiscal balance declining to 3.6% of GDP in 2026/27

	Unit	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
		Actual	Pre-Act.	Projection				
Real GDP	Percent	3.6	6.5	5.8	6.1	6.2	6.1	6.2
GDP Deflator	Percent	5.0	6.2	6.9	5.8	4.8	5.9	6.0
Inflation	Percent	5.7	6.8	7.0	5.8	5.0	5.0	5.0
Revenue	Percent of GDP	15.9	17.3	17.4	17.8	17.8	18.0	18.3
Expenditure	Percent of GDP	24.4	23.8	23.4	22.5	22.0	21.8	22.3
Overall Fiscal Balance	Percent of GDP	(8.4)	(6.2)	(5.7)	(4.4)	(3.9)	(3.6)	(3.6)
Primary Budget Balance	Percent of GDP	(4.0)	(1.3)	(1.1)	0.3	0.7	0.7	0.7



MTDS 2023 considered four alternative funding strategies

- i. **Option 1 (S1) – Biased financing towards more domestic borrowing:** This strategy assumes a **net** borrowing of 81 percent from domestic and 19 percent from external sources (baseline). Domestic borrowing -Treasury bonds & External through concessional debt with no commercial borrowing.
- ii. **Option 2 (S2) – External biased borrowing:** The strategy assumes **net** financing majorly from external commercial, semi-concessional and concessional debt of 60 percent external and 40 percent from domestic mainly through Treasury bonds .



Cont` Alternatives

iii. **Option 3 (S3) – More domestic bias with gradual lengthening of maturity profile:** Financing the fiscal deficit majorly from the domestic market with 71 percent net domestic financing and 29 percent from external financing sources - issuing long tenor Treasury bonds and gradually reducing the stock of Treasury bills to reduce refinancing risk; with external financing from concessional debt.

iv. **Option 4 (S4) – Balanced domestic-external financing strategy:** Balanced financing allocations to domestic and external sources for deficit financing for 2023/24

- i.e 50 percent net domestic borrowing and 50 per cent external borrowing
- maximizing external concessional borrowing and commercial debt rolled over; and
- long tenor Treasury bonds being the main source of financing from the domestic market.
- Gross borrowing being 35 percent external and 65 per cent domestic borrowing.

The strategy is positioned for flexibility in financing the deficit from both sources should one source fail;

Medium Term Strategy selection criteria

The optimal strategy is the one that offers the most favourable medium term debt costs and risks indicators combination.



Medium-Term Costs-Risks of Alternative Strategies

Risk Indicators		2022	As at end 2026			
		Current	S1	S2	S3	S4
Nominal debt as percent of GDP		67.0	60.4	59.9	60.1	59.8
Present value debt as percent of GDP		60.0	54.9	54.4	54.5	53.1
Interest payment as percent of GDP		5.3	4.8	4.5	4.6	4.4
Implied interest rate (percent)		7.6	8.5	8	8.3	7.9
Refinancing risk	Debt maturing in 1yr (percent of total)	11.7	10.7	10.5	10.1	10.5
	Debt maturing in 1yr (% of GDP)	8.4	6.4	6.3	6.1	6.3
	ATM External Portfolio (years)	9.8	10.8	10.4	10.8	11.4
	ATM Domestic Portfolio (years)	7.8	9.3	8.4	9	8.5
	ATM Total Portfolio (years)	8.8	10	9.5	9.9	10
Interest rate risk	ATR (years)	8.1	9.6	8.8	9.4	9.6
	Debt refixing in 1yr (percent of total)	23	19.3	23.7	19.4	20.1
	Fixed rate debt incl T-bills (percent of total)	87.2	89.7	85.2	89.4	88.9
	T-bills (percent of total)	7.4	5.5	5.6	5.2	5.5
FX risk	FX debt as % of total	49	45.3	53.3	47.3	51.4
	ST FX debt as % of reserves	23.9	30.9	31.4	28.1	29.5

Strategy 4 (S4) has greater benefits to debt management objectives

- Minimizes refinancing risk of total portfolio as a result of lengthening the ATM of external debt portfolio. This is attributed to concessional terms that have longer maturities
- Has least PV of debt to GDP – improves debt sustainability
- Least cost of debt (low interest payments and implied interest rate)
- Deepens domestic market through issuance of medium to long term instruments
- Flexible as financing is balanced between domestic and external sources of financing the fiscal deficit (Net new borrowing)



Optimal (selected) Debt Management Strategy

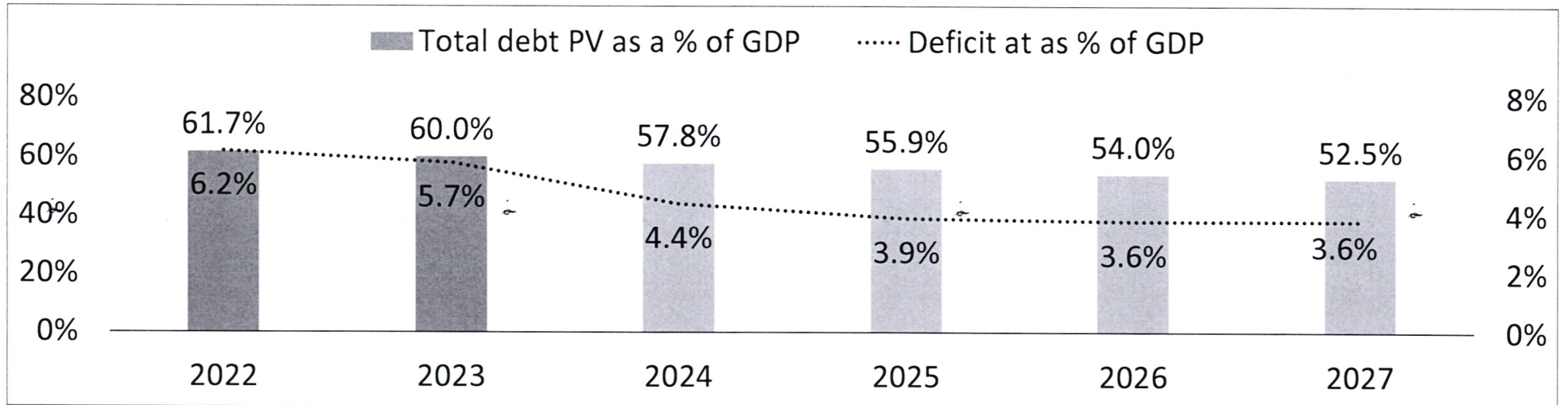
- S4 provides flexibility to the Government to adjust the borrowing sources under ensuing prevailing domestic and global debt markets condition.
- However the gross borrowing needs for Government in FY2023/24 is elevated* due to Ksh 252 bn maturity of 2024 Eurobond and may pose a challenge to the success of the Strategy if market conditions do not improve.
- This underscores the need to initiate early liability management operations on the 2024 Eurobond.

*Includes 671B – T. bills, 240B - T. Bond, 720B- Total Net Borrowing; O/W 533B – New Domestic Borrowing and 197B New External Borrowing; 475B – External Repayment (of which 252B –Eurobond 223B –Other External repayments)



SCENARIOS: Public Debt Stock Management Strategy

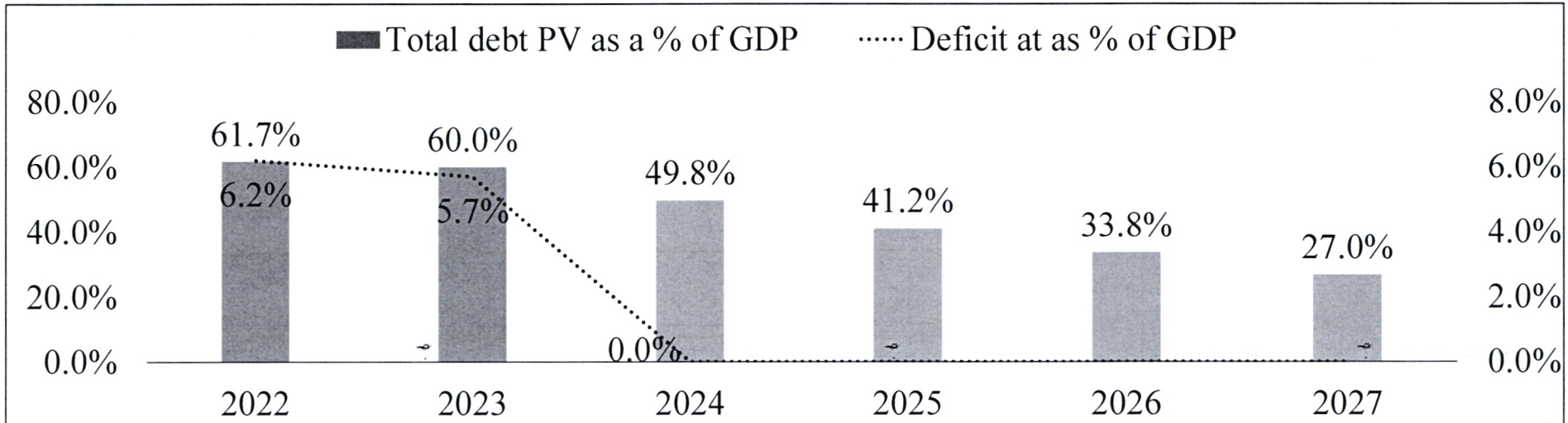
Scenario I: Total Public Debt growth projection under the proposed fiscal consolidation trends



Optimization of public debt to a sustainable path	2023	2024	2025	2026	2027
PV of total public debt	9,301,925	9,985,145	10,686,646	11,428,3244	12,288,736
Reducing the Fiscal Deficit/increase	(772,633)	(482,628)	(171,783)	211,371	584,671
PV of total public debt to GDP (%)	60.0	57.8	55.9	54.0	52.5

Cont.: SCENARIOS: Public Debt Stock Management Strategy

Scenario 2: Balanced Budget

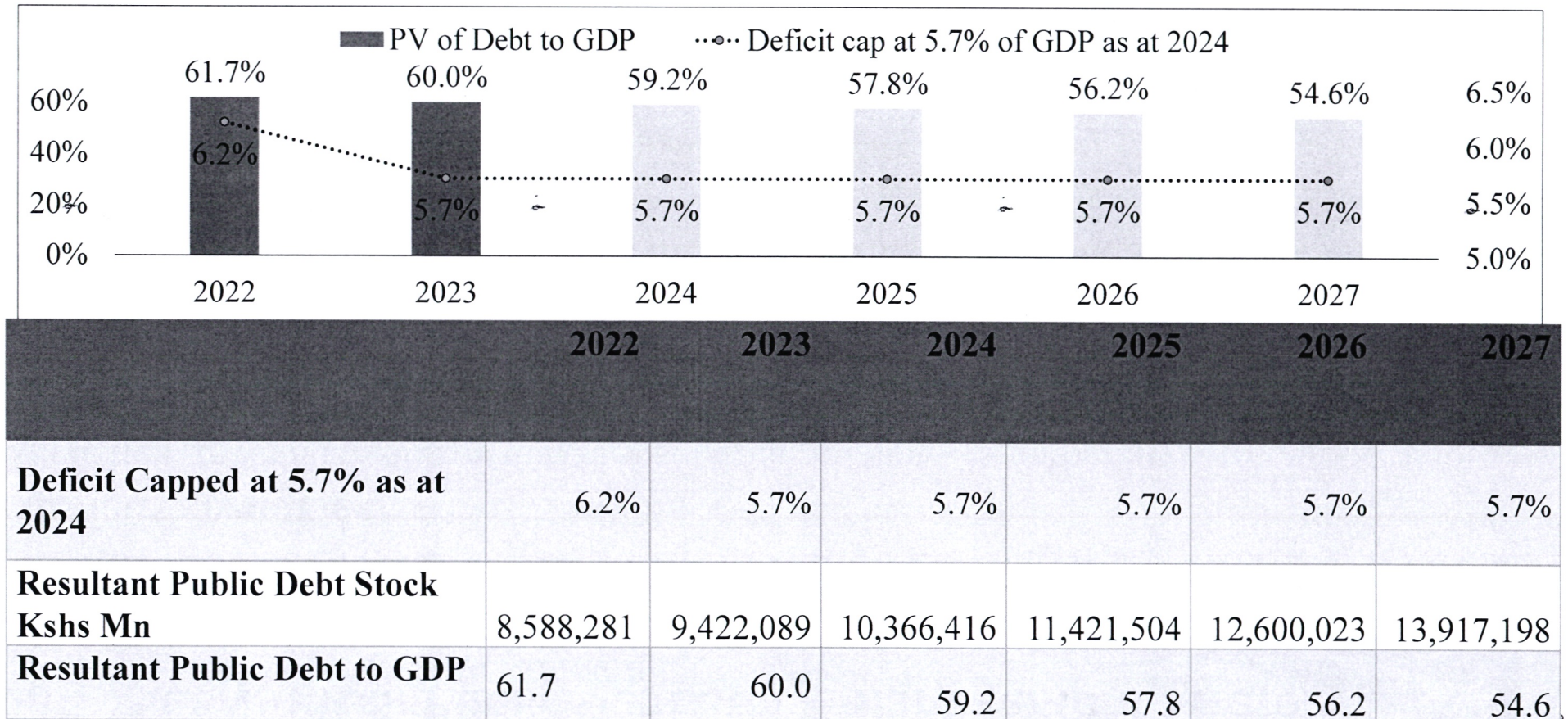


	2022	2023	2024	2025	2026	2027
Current Deficit Projection as a % of GDP	6.2%	5.7%	4.4%	3.9%	3.6%	3.6%
Deficit Capped at 0% from 2024	6.2%	5.7%	0%	0%	0%	0%
Fiscal Deficit	(747,825)	(833,809)	(720,123)	(711,522)	(734,640)	(826,051)
Resultant Public Debt Stock	8,588,281	9,422,089	8,701,839	7,990,317	7,255,677	6,429,626
Resultant Public Debt to GDP	61.7	60.0	49.8	41.2	33.8	27.0



Cont.: SCENARIOS: Public Debt Stock Management Strategy

Scenario 3: Capping the overall deficits at 5.7 percent of GDP in the medium term



Policy implications emanating from the foregoing analysing under different fiscal deficits scenarios

- a. Reduction in annual borrowing limits (fiscal deficits is imperative to public debt sustainability).
- b. For Kenya public debt stock to revert to sustainable path in the medium (by 2026) annual borrowing limits should be maintained below 4 percent of GDP. Projected GDP growth for 2023/24 is 6.1 percent and therefore the fiscal consolidation allows for debt to revert to sustainable path. Growth of public debt should be less than growth of GDP for public debt to remain within sustainable thresholds.
- c. funding fiscal deficits and refinancing external debt through concessional borrowing and less commercial debt, while implementing policies geared towards improving Kenya's export sector
- d. operationalization of the Sinking Fund in conformity with Regulation 206 (1) of the PFM (National Government) Regulations, 2015, key to provide liquidity for timely funding for redemption of government securities



Domestic Market Development As Part of DMS

- Domestic debt is half of the public debt stock, thus mitigates against foreign exchange risk exposure and cushions the public debt against the downside risks of the global market volatilities. Development of the domestic debt market is a necessary catalyst for public debt sustainability. A deeper domestic debt market would guarantee a cheaper and more funding in local currency which is less exposed to internal capital markets volatilities. Strategic initiatives to increase market efficiency (liquidity, pricing) include:
 - Market infrastructure -automation of issuance, trading and settlement operations, and transparency (establish an OTC trading platform for Government securities).
 - Market liquidity –Issue fewer but large size long tenor bonds to reduce refinancing risks
 - Sustain market/Investor engagement, communication (e.g issuance calendar publication).



MTDS 2023-Implementation Plan

- 2023 MTDS guides funding of the fiscal deficits and refinancing maturing debt, including 2024 Euro Bonds.
- Annual borrowing calendar will be prepared by the PDMO (middle & front office)
- In domestic market, Treasury bonds of medium to long tenor will be the major financing instruments while stock of short term debt (treasury bills) will be reduced to minimize refinancing costs.
- The cost and risk indicators indicated/projected in the optimal plan will be evaluated against their respective outturns during strategy review
- Review of the Strategy implementation will be through regular debt management status reports
- Despite the optimal strategy leading to reduced overall debt to GDP, cost of debt, refinancing risk and interest rate risk exposure, its implementation will depend on prevailing market condition that will trail the current global economic uncertainties.



NATIONAL TREASURY REQUEST

- To approve the 2023 Medium Term Debt Management Strategy and adopt the optimal strategy to fund the FY 2023/24 fiscal deficit.



End





COUNCIL OF GOVERNORS

Westlands Delta House 2 Floor, Waiyaki
Way, PO. BOX 40401-00100,
Nairobi.

Tel: (020) 2403314, 2403313
E-mail: info@cog.go.ke

Our Ref: COG/8/5A Vol.9 (51)

22nd February 2023

Mr. Jeremiah Nyegenye
Clerk of the Senate
The Senate
Main Parliament Buildings
NAIROBI

Dear Mr. Nyegenye

COMMENTS ON THE 2023 BUDGET POLICY STATEMENT

We acknowledge receipt of your letter Ref. **SEN/DSEC/F&B/CORR/2023/014** dated **16th February 2023** requesting comments on the 2023 Budget Policy Statement (BPS).

The Council of Governors (the Council) appreciates the need for consultation and cooperation in realizing the objects of Devolution as stipulated under Article 6(2) and Article 189 of the Constitution. Further, the Council takes note of strengthened cooperation between the two levels of Government in the performance of each level's functions and responsibilities.

The Council has reviewed the 2023 BPS and notes that County Governments will face major challenges in the performance of the functions assigned to them and delivery of services to citizens in the Financial Year (FY) 2023/24 and the Medium-term.

The Council hereby notes as follows on the 2023 BPS:

I.1. General Comments

1. The Council does not agree with the National Treasury's projected allocation to County Governments of **Ksh.385 billion** for FY 2023/24 as equitable share of revenue for the following reasons:
 - ✓ The allocation falls short of the criteria for determining equitable share allocation as set out in **Article 203 (1)** of the Constitution of Kenya, 2010 in the sense that:
 - (a) The sharing of resources is pegged on financing constraints as opposed to budget **(paragraph 259 (d))**. This negates the desirability of a stable and predictable allocations of revenue as stipulated under **Article 203 (1)(j)** of the Constitution of Kenya, 2010.

The National Treasury should therefore make their allocation to respond to the budgetary needs of the Counties and also the fiscal capacity and efficiency of county governments (Article 203 (1)(e)).

- (b) The National Treasury has allocated resources to National Government Ministries, Departments and Agencies (MDAs) for programmes that fall under the devolved functions specified under the Fourth Schedule of the Constitution. This does not conform to the provisions of Article 203 (1)(d) on the need to ensure that County governments are able to perform the functions allocated to them.
- (c) The allocation does not respond to the provisions of Article 203 (1)(k) on the need for flexibility in responding to emergencies and other temporary needs given the ravaging drought situation in the Country. The allocation to County Governments for FY 2023/24 should be such that it enables Counties to adequately respond to the adverse effects of the drought especially in the Agriculture and Water sectors.

- ✓ The adjustment for revenue growth of **Ksh.15 billion** is not commensurate with the projected revenue growth of **Ksh.379.2 billion** for FY 2023/24. We therefore propose an adjustment of revenue growth of at least **Ksh.55 billion** to bring County governments allocation to a minimum of **Ksh.425 billion** for FY 2023/24.
- ✓ The projected allocation in the BPS has not taken into account the cost of inflation in the Country that has been on the rise in the recent years. As you are aware, County governments' equitable share allocation for FY 2022/23 was maintained at Ksh.370 billion despite the high inflation. Failure to make an adjustment for the cost of inflation renders County governments unable to efficiently deliver services due to increased prices of goods and services. We therefore call for the National Treasury to consider the cost of inflation in their projected revenue allocation to Counties.
- ✓ Analysis of the projected expenditure by programmes under various MDAs reveals allocation to perform functions that are devolved. The National Treasury should therefore review the allocations to various MDAs performing devolved functions and have those funds allocated to County governments for FY 2023/24 and the Medium-term.
- ✓ There is need for economic stimulation to spur recovery, growth and stability following the slump attributed to COVID-19 and the high cost of inflation due to the Russia vs Ukraine war. This requires restructuring of expenditure priorities by both levels of government hence the Council's proposal for a considerable increment.

1.2. Specific Comments

Below are the detailed specific comments on the Draft 2023 BPS;

Chapter/Paragraph	Provision	CoG's proposal	Rationale/Justification
Chapter 4: 4.4.2 Division of Revenue for FY 2023/24 Paragraph 259.	259. Based on ordinary revenue projection of Ksh 2,571.2 billion in FY 2023/24, Ksh.2,177.9 billion has been allocated to National Government, Ksh.385.4 billion to County Governments as equitable revenue share to the two levels of Government and Ksh.7.9 billion to the Equalization Fund. The allocation to County Governments' equitable revenue share of Ksh.385.4 billion in FY 2023/24 is informed by the following prevailing circumstances:	1. The projected allocation to County Governments in FY 2023/24 as equitable share is not commensurate with the projected revenue growth. In order for the allocation to be equitable as it is in the letter and spirit of the Constitution, there is need to allocate a minimum of Ksh.425 billion to County Governments in FY 2023/24. This is an increment of Ksh.55 billion , being an adjustment for revenue growth of at least 15% of the baseline allocation of Ksh.370 billion.	
	c) Increased Government expenditure need relating to drought intervention, fertilizer subsidy and the Hustlers Fund;	Amend to provide for County Governments expenditure relating to drought intervention. Further, the fertilizer subsidy programme should be implemented by the County Governments given	As you are aware, the drought situation has affected County Governments especially in the performance of the devolved functions of Agriculture, Water and Sanitation among others. The drought has affected livestock production, crop production and the general welfare of the farmers and the

		<p>that Agriculture is a citizens. Therefore, devolved function.</p>	<p>there is need for Counties too, as a matter of priority, to address the adverse impact of the ongoing drought in the Country. Allocations to County Governments should take into account this reality.</p>
	<p>d) In the medium term, sharing of resources will be pegged on the financing constraints and not on the budget. Availability of resources is key and it should be remembered that National Treasury did not disburse Kshs 29.6 billion to county governments in the FY 2021/22 due to financial constraints;</p>	<p>Delet (d)</p>	<p>Pegging sharing of resources on financing constraints as opposed to budget is not founded in law and will deny County Governments an equitable share of the resources and in a timely and predictable manner as envisaged in the Constitution under the criteria for allocation on revenue.</p> <p>Article 203 (1)(j) desires stable and predictable allocations of revenue. The element of availability of resources in allocation of revenue is therefore tantamount to unpredictability hence Unconstitutional.</p>
<p>Annex Table 4a:</p>	<p>Summary of Expenditure by Programmes (Ksh Million)</p>	<p>The allocation to various MDAs be reviewed to exclude allocations to perform functions that are devolved. This projected allocation for programmes that relate to devolved functions should be</p>	<p>Allocations for expenditures by programmes that relate to devolved functions include:</p> <ol style="list-style-type: none"> 1. Crop Development and Management, Livestock Resources

made to County Governments in FY 2023/24 and the Medium-term

Management &

Development and Fisheries Development & Management which relate to the devolved function of Agriculture as per the Fourth Schedule of the Constitution.

2. Water Resource Management, Water & Sewerage Infrastructure Development and Water Harvesting & Storage for Irrigation which relate to the function of County public works and services under the Fourth Schedule of the Constitution.

3. Preventive, Promotive & RMNCAH under the function of Health.

4. Library Services

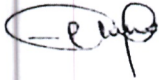
5. Domestic Trade and Enterprise Development and Fair Trade Practices and compliance of Standards under the devolved function of

			<p>Trade development and regulation.</p> <p>The Fourth Schedule assigns functions between the two levels of government. Whereas some of the assigned functions are distinct to either level of government, other functions are performed concurrently by both levels of government. Since the advent of devolution in 2013, the National government has continued to perform functions that are devolved to the County level of government. Duplication of county functions by the National government are in the functional areas of: Health; Agriculture (crop, livestock and fisheries development); Water, Irrigation, Sanitation and regional development.</p> <p>Further, Article 187 (2) provides that, if a function or power is transferred from a government at one level to a government at the other level, arrangements shall be put in place to ensure that the resources necessary for the performance of the function or exercise of</p>
--	--	--	--

			<p>the power are transferred.</p> <p>The allocations to Counties should therefore be in line with the provisions of the Fourth Schedule, Article 187 (2) and Article 203 (1)(d) on the need to ensure that County governments are able to perform the functions allocated to them.</p>
--	--	--	--

Please accept assurance of our highest esteem and consideration.

Yours sincerely



Mary Mwiti
Chief Executive Officer



COMMENTS ON THE 2023 BUDGET POLICY STATEMENT

Promoting an Equitable Society

Para	Issue	Recommendation
Para 65, p 18	<p>The 2023 BPS strategy regarding the women agenda proposes to provide financial and capacity building support for women through the Hustler Fund for women-led co-operative societies, <i>chamas</i>, merry-go rounds and table banking initiatives to protect them from predatory interest rates charged by unscrupulous money lenders.</p>	<ol style="list-style-type: none"> 1. Predatory Interest rates affect both men and women. A strategy should be put in place to ensure for both men and women access the funding from the Hustler Fund equitably. 2. The Biashara Fund still exists. Parliament to align the Hustler Fund and <i>Biashara</i> Kenya Fund to avoid duplication, noting that <i>Biashara</i> Kenya Fund already has an existing framework
Para 171 (Table 3.1) p 47	<p>The BPS adjusts upwards the equitable share allocation to national government by Ksh.133,818 million from Ksh.2,119,258.8 million to Ksh. 2,252,077.2 and that to county by 15,425 million Ksh.370,000 million to Ksh.385,425 million</p> <p>Table 4.3 on page 71 uses a base of Ksh.2141.6 billion for FY 2022/23 as the total shareable revenue while Annex Table 2 on Page 100 uses a different base of Ksh. 2192 billion</p>	<ol style="list-style-type: none"> 1. The projected absolute ordinary revenue growth between FYs 2022/23 and 2023/24 is Ksh. 379.2 billion. Adjusting the county allocation by only Ksh. 15.4 billion amounts to inequitable sharing of revenues between the two levels of government. The five priorities of governments, namely; agricultural Transformation, Micro, Small and Medium Enterprise; Housing and Settlement; Healthcare and Digital Superhighway and Creative Industry are either county government functions and/ or concurrent functions. 2. Parliament to consider adopting the Commission's recommendation to increase the county governments' allocation by Ksh. 37.4 billion from Ksh 380 billion to Ksh. 407 billion in the financial year 2023/24.

Para	Issue	Recommendation
Table 3.2, p 49	The BPS proposes to increase the allocation to the health sector from Ksh. 122.5 billion in FY 2022/23 to Ksh. 154.2 billion in FY 2023/24. Indeed, the allocation to the health sector at the national level has consistently increased from Ksh. 30 billion at the beginning of devolution in FY 2013/14.	1. Healthcare provision is largely a devolved function. Preventive and promotive healthcare is the mandate of county governments. The national government seeks to ensure Universal Health Coverage through recruitment of community health workers who will form part of primary health care system. Resources should therefore be reallocated from the national health sector to county governments to perform the function
Para 251, p 66	Prior to devolution, the defunct local authorities received Contribution in Lieu of Rates (CILOR) from the Central Government for public land within their jurisdictions. Since devolution, only one county (Laikipia) has received CILOR from the National Government. This is mainly due to inadequate legal framework for claiming CILOR, widespread lack of up-to-date valuation rolls to support imposition of property rates and counties being unfamiliar with payment of CILOR procedures.	1. The nonpayment of CILOR by the National Treasury over the years has compromised county governments ability to raise OSR. Parliament should fast-track the development of a legal framework to enable county governments to benefit from the CILOR payments
Table 4.1, p 68	Pending bills: A summary of the outstanding pending bills by the county governments is presented as at 21 st December 2022.	1. The BPS did not present a similar table of outstanding pending bills for the national government which makes it difficult to assess the national government's adherence to prudent financial management
259, p 69	The BPS allocates Ksh. 7.9 billion to Equalisation Fund in the financial year 2023/24	<p>1. Art. 204 (1) provides for an allocation of one half of all the revenue collected by the national government each year calculated on the basis of the most recent audited accounts of revenue received, as approved by the national Assembly</p> <p>2. The BPS, however, allocates Ksh. 7.9 billion to Equalisation Fund based on the last audited accounts for FY 2019/20 of Ksh. 1,573.4 billion</p>

Para	Issue	Recommendation
		3. The Commission notes that the last audited accounts for FY 2019/20 amounts to Ksh. 1,730.9 billion
Annex1, Table 1 on p 79	<p>The BPS has over time misreported the proportion of development expenditure to the total national government budget.</p> <ul style="list-style-type: none"> • Section 15(2) (a) and Section 15(5) of the Public Finance Management (PFM) Act, 2012, and the PFM (National Government) Regulations, 2015 provides that the over the medium term a minimum of thirty percent of the national governments budget shall be allocated to the development expenditure. • The BPS has, however, rendered the interpretation of Section 15(2) (a) and Section 15(5) of the PFMA, 2012 to mean total national government development expenditure (ministries, Parliament, Judiciary) as a proportion of the ministerial national government expenditures. 	<ol style="list-style-type: none"> 1. The use of a lower denominator in deriving the proportion of the development expenditure to the national government budget has continued to over report the proportion of development expenditures of the national government. 2. Parliament to ensure the adherence by the National Treasury on Section 15(2) (a) and Section 15(5) of the PFMA, 2012
Annex Table 4a	<ul style="list-style-type: none"> • The BPS presents Annex Table 4a with missing data on the printed budget estimates for the FY 2022/23 and BPS ceilings for some MDAs. 	1. The BPS should present complete data on printed budget estimates and for the FY 2022/23 and BPS ceilings for some MDAs



Promoting an Equitable Society

COMMENTS ON THE 2023 MEDIUM-TERM DEBT STRATEGY

Para	Issue	Comments	Recommendations
Para 26, p 8	<p>The stock of public and publicly guaranteed debt was Ksh. 9,145.9 billion as at December 2022.</p> <p>The Medium-Term Debt Strategy (MTDS), however, does not provide the absolute values of debt projections for the financial year 2023/24 and the medium term.</p>	<p>The 2023 Budget Policy Statement projects the total stock of public debt to be Ksh. 10,133.1 billion in the financial year 2023/24. If this projection is reached within the year, it means a breach of the Ksh. 10,000 billion threshold.</p>	<p>The MTDS should further provide for the outlook and the accompanying costs and risks on the debt portfolio should county governments borrow in accordance with Article 212.</p>
Para 29, p 8	<p>The stock of domestic debt comprised of Treasury bills amounting to Ksh. 671.5 billion, Treasury bonds of Ksh. 3,710.6 billion, and outstanding pre-1997 government debt of Ksh. 18.3 billion as at end December 2022.</p>		<p>The MTDS should explain the outstanding pre-1997 government debt of Ksh. 18.3 billion, its components, why the it has not been paid and what the government is doing to repay.</p>
Para 113, p 39	<p>The MTDS has proposed to Parliament amendments to the PFM (National Government) Regulations, 2015 to replace the current public debt limit of Ksh. 10 trillion with a debt anchor hinged on Gross Domestic Product as a desired level of public debt as a ratio of GDP.</p>	<p>The MTDS did not give a timeline within which this change will be made</p> <p>Further, there is no explanation on how to transition from the absolute value to the ratio to GDP without breaching the threshold of 55% for Kenya</p>	<p>The MTDS to provide a timeline on when to anchor the debt limit to the Gross Domestic Product and explain the transition</p>



**SUBMISSIONS BY THE INSTITUTE FOR SOCIAL ACCOUNTABILITY (TISA) ON
THE BUDGET POLICY STATEMENT AND THE MEDIUM TERM DEBT
STRATEGY PAPER 2023/24**

22ND FEBRUARY 2023

INTRODUCTION

Pursuant to the call for public participation and submissions by the National Treasury on 18th January 2023, the following are submissions by **The Institute for Social Accountability (TISA)** towards the draft 2023 Budget Policy Statement (BPS) for the MTEF 2023/2024 to 2025/26 budget. The submissions have been updated to respond to the call for public participation for the budget policy paper 2023 submitted to the parliament made on 15th February 2023. Budget preparation kicks off as the government rolls out the fourth medium terms plan for the country. The submission is based on the need for prudence, transparency, accountability, protection of a devolved system of governance and public participation in managing Kenya's public finance and fiscal priorities and policy goals.

TISA commends the tax measures and policy positions proposed in the BPS to shore up revenue collection efforts by the Kenya Revenue Authority (KRA) to Kshs.3 trillion in the financial year 2023/2024 and Kshs.4 trillion in the medium term. The improved revenue performance will lower the budget deficit, reducing the public debt required to meet the budget deficit. Acknowledging the government's need for friendly fiscal consolidation measures is also welcome. Still, it should be accompanied by demonstrating how it intends to improve transparency and accountability and the measures it will take to cushion the public against the harmful effects of fiscal consolidation. Additionally lauds the BPS for adhering to the rule of law, including the commitment to support independence and resourcing of independent institutions and offices and continued adherence to the constitutional budget procedure in dividing revenue between the national and county governments.

TISA seeks to provide general recommendations for improvement of the BPS around the following areas:

- A. Adherence to the public participation guidelines to enable effective stakeholder engagement as the budget-making process is a matter of national importance and create a mechanism for feedback to all actors who submit proposals.
- B. Respect for the rule of law and a commitment to the devolved system of government .
- C. Adoption of alternative revenue-raising measures like the wealth tax alluded to by the president as a way of raising more revenue and reducing inequality.

- D. Provision of robust frameworks around the accountability of the proposed public-private partnerships and feasibility assessment for the proposed irrigation projects to provide a value-for-money assessment before investing taxpayer's money.
- E. Increased social spending investment towards pro-poor sectors such as health, agriculture, and education, which have the most effect on the poor and vulnerable and address inequalities.
- F. Enhanced budget allocation to the Governance, Justice, and Law Organizations (GJLOs) discussed under the governance proviso in the BPS to enhance adherence to the rule of law and protection of the values and resources of the Kenyan people in line with the constitution of Kenya (2010)
- G. Striking an equitable balance between domestic resource mobilisation and addressing the high cost of living for all, especially those below the poverty line.
- H. Prudent debt acquisition, utilization, and analysis of the Medium Term Debt Strategy Paper.

PROPOSED AREAS OF IMPROVEMENT TO THE BPS

1. Public Participation

Public participation allows citizens to get involved in government issues that concern them, including the budget-making process, and it ensures that citizens are heard and can actively participate in decisions that impact their needs. It is one of the national principles and values of governance that allows citizens to get involved in government issues that concern them, per article 10 of the constitution. Additionally, it allows citizens to get involved in government issues that concern allows citizens to get involved in government issues that concern allows citizens to get involved in government issues that concern one of the key objectives of devolution to ensure that powers of self-governance are given to the people to enhance their participation in the exercise of the powers of the state and in making decisions affecting them as stated in Article 174c, Constitution of Kenya.

Although the government, through the treasury, issued a notice inviting members of the public to submit comments to the Budget Policy Statement, the notice only provided for a meagre period of four working days seeing as the notice was issued on 18th January 2023 with the submissions expected by 24th January 2023. The same trend appears to have recurred with a short notice issued by Senate on 18th February, with submission deadline capped at 22nd February 2023. The principles of public participation state that there should be provision of timely and relevant information and that the information should be accessible to all members of the public so that they are aware and can engage in decisions that affect them. The BPS is a critical yet complex document whose participation would require adequate time to engage most people in the language they understand. The principles also state that it should be a two-way process with feedback given to citizens on decisions, actions taken, and results achieved by the county government. Currently, the notice provided may lock out some citizens from sharing submissions given that the budget policy statement is technical and may require more time for members of the public to internalize and provide comments and proposals to inform the final budget 2023/24. In addition, citizens rarely get feedback on the number of adopted proposals

who - who to be done proposal.

and justification for not adopting other proposals, as there is no feedback mechanism between the National Treasury and citizens.

Proposals

The short notice violates the meaningful public participation requirement by the constitution and a means of achieving a tokenistic approach to public participation. We propose that Parliament demands from national treasury issuance of proper notice for memoranda towards issues of high public interest, like the budget-making process, which determines priorities for budgetary allocations. The short notice given for proposal consolidation and submission from the public needs to be longer, given the sensitivity and severity of the issue and the social contract considered. National Treasury should issue enough notice of at least two weeks to allow for consultation among stakeholders to give meaningful submissions.

2. Pending Bills

Pending bills and delayed payments are now a critical problem in all government tenders. Research indicates that procurement entities should be more careful with the guidelines of the Public Procurement and Asset Disposal regulations on the need to pay for the supply of goods and services after thirty days. Currently, most counties do not prioritize the payment of debt, unlike the case of the national government, which performs better. This is largely a political issue that requires political accountability to resolve. The exchequer releases most of the time are irregular and make it difficult for county governments to meet their obligations. Comparatively, the National Government entities are prioritized in exchequer releases and would prioritize their payments. The county governments are adversely affected because of late disbursements of financing. At times the National Treasury is not able to raise enough money to pay for work done because the payments are only budgeted for after the completion of work

The budget policy statement notes the pending bills as one of the bottlenecks confronting the Kenyan economy and even proposes measures to address pending bills. These include a Circular No.2/2022 dated 24th March 2022, issued by the National Treasury informing all Governors and County Executive Committee Members (CECMs) for Finance to urgently ensure outstanding pending bills are paid as soon as possible to comply with the PFM act and, most importantly, avoid disrupting the operations and other financial obligations of the county government due to stoppage of monthly disbursements. Despite these measures, county governments continue to report many pending bills that still need to be paid, negatively impacting the business community and the economy. They also affect people who engage in business with the government. In particular, they have dealt a blow to the effectiveness of Access to Government Procurement Opportunities (AGPO) which seeks to foster the inclusion of marginalized groups like women, youth and persons with disability by delaying payment hence keeping most of them in debt and not able to raise money to continue engaging in business. This has pushed these marginalized deeper into poverty and debt.

Pending bills are a liability to counties and weaken general county economic activities since suppliers need to be paid to manage day-to-day operations. A report by the Controller of Budget (CoB) indicates that by 21st December 2022, Counties had settled Ksh. 22.9 billion (47.6% of the eligible pending bills), leaving an outstanding balance of Kshs. 25.1 billion and a total of

28 days
which in
of people?
aware?

which
areas?

Ksh. 1.8 billion of the ineligible pending bills had been paid by the County Governments simultaneously, leaving a balance of Ksh. 106.2 billion. To this end, the President in June 2019 directed that county governments clear existing pending bills that had been approved for payment, reiterated by the National Treasury. Still, the level of compliance could be higher in most counties. The recent directive is that Counties should treat pending bill as a first charge on the County Revenue Fund and fast-track its clearance.

Although there are commitments to ensuring pending bills are prioritized in the budget policy statement 2023/24, implementation of the previous commitments to settle pending bills as a priority often has yet to be seen given the year in year out pending bills accumulation. As explained by counties, the problem is often linked to delayed disbursements by the treasury. This inevitably increases the cost of business with the government, where suppliers quote a high price to cover the inordinate delay.

Proposal

In ensuring pending bills are cleared, the National Government should increase allocations for County Governments to clear pending bills and peg future disbursement to counties based on evidence of paid-up pending bills as outlined in the County Government Payment Plans, which counties are to submit to the National Treasury and the Controller of Budget.

According to Section 94 (1) (a) of the PFM Act, 2012, failure to make any payments as and when due by a State organ or a public entity may indicate a serious material breach or a persistent material breach of measures established under the Act. In this context, Article 225 of the Constitution, together with Section 96 of the PFM Act, gives the Cabinet Secretary responsible for Finance powers to stop the transfer of funds to the concerned State organ. However, the same may not be viable to the cyclical nature of the problem. We propose that the public finance actors commit to implementing the reforms made by the public finance management reform secretariat and ensure efficiency in all stages of public finance from planning to implementing and discharging liability. We also recommend that a mechanism for holding all actors who breach their liabilities when it comes to pending bills is developed for national government and county governments bills to deter the accumulation of pending bills.

3. Own Source of Revenue

Under Devolution, the BPS outlines the need to increase County Governments' own source revenue. A report of the County Governments by the Commission on Revenue Allocation on Comprehensive Own Source Revenue Potential and Tax Gap published in June 2022 estimates the revenue potential of all 47 County Governments at Ksh. 215.6 billion against the current own source revenue collections of Kshs 35.9 billion in FY 2021/22. To improve their OSR (Own Source Revenue) collections, the report recommends adopting automatic and cashless payment systems and streamlining taxation and fees structure by the County Governments. In addition, the report recommends strengthening collaboration and data sharing between different organizations and departments within and outside the County Governments to enable the Counties to monitor their revenue base, evaluate their revenue-raising activities, and adopt an evidence-based approach to OSR policy decision-making.

3.2 Taxation Measures

Report of
Pending
bills?

In the wake of the current fiscal landscape, there is a need for effective and efficient domestic revenue mobilization. With tax being the main source of government revenue, it is laudable that the government has put in an array of tax measures and policy positions in a bid to shore up revenue collection efforts by the Kenya Revenue Authority to Kshs.3 trillion in the financial year 2023/2024 and Kshs.4 trillion in the medium term.

In the recent past, the measures put in place have been regressive and punitive, especially to ordinary citizens, as they have mostly targeted consumption taxes such as VAT that apply uniformly across the board. Consumers continue to decry the high cost of living as a result of the high cost of basic commodities which is directly linked to the high cost of production due to the high LPG and energy costs.

We take note of that the proposals made in the draft BPS are progressive as they involve bolstering efficiency in revenue collection by reducing taxation gaps as well as growing the tax base, targeting the informal sector. Most of the proposals align with the recommendations of the [fair tax monitor report](#) released in 2022 by Oxfam and Tax Justice Network Africa (TJNA).

Proposal

There is a need for the government to review and reduce VAT of LPG and Energy products that have a direct effect on the cost of production in order to bring down the overall cost of living.

Under own source revenue, there is the need to clarify the assignment of revenue-raising powers between the two levels of Government and among Counties: County Governments are entrusted with fiscal powers to raise revenue to finance their functions, but there are overlaps and duplications between the two levels of Government. Disputes have arisen between the two levels of Government and among the Counties regarding who should collect certain types of revenue (e.g., for outdoor advertising and cess) and how revenue should be shared, where a revenue base sits between two or more Counties.

Also, there is a need for a proper legal framework, policies, and guidelines on own-source revenue and the operationalization of the County Revenue Bills to guide this process. Finally, county governments should prioritize identifying opportunities for optimizing Counties' own source revenue and examining possibilities of increasing efficiency through a resource audit that will inform the expansion of the base for the imposition of assigned taxes, fees, and charges.

5. Protection of Devolution

Division of Revenue, which ensures division revenue raised by the national government among the national and county levels of government in accordance with the Constitution has been well captured in the BPS. Despite devolution being a key aspect of service delivery in Kenya, the allocations to county government have been declining. The provisions stand at 24.5 percent of the last audited accounts (1573.42 billion for FY2019/20) which is on the lower side.

The County governments have also in the recent past complained about disbursement delays and called on the national government to put in place mechanisms that will ensure swift

disbursement of funds to the devolved units. We join these calls in urging that Parliament supports counties in timely disbursement, which has previously affected county operations.

On the audited accounts to be used as the basis for the FY 2023/24 division of revenue allocation the BPS uses the accounts of FY 2019/20 as the basis. The question of whether audited accounts older than two financial years could be used to determine the revenue allocation still stands. The Court held that considering the 9-month audit timeline in Articles 229(4) and (8), “the most recent audited accounts of revenue received as approved by the National Assembly’ must be the audited accounts for the preceding year”.

The BPS commits to operationalizing the Equalization Fund, which was first operationalized using guidelines on its administration published in gazette notice No. 1711 of 13th March 2015. However, the High Court ruling on petition No. 272/2016 on 5th November 2019 quashed the guidelines. This, in effect, disbanded the Equalization Fund Advisory Board (EFAB) and stopped any further expenditures from the Equalization Fund.

The BPS proposes to focus on the agricultural, MSMES and health sectors as areas of focus for the current government and the same is evidenced in the BPS. We take note that health and agriculture are primarily devolved functions which would be implemented best by county governments.

Proposal

On the division of revenue, there is need to progressively increase the percentage of the allocation made to the counties. The allocation to the counties should be at least 30 percent of the audited accounts set aside for revenue allocation to counties. This will reflect the increased growth in demand for services at that level of governance. Allocation of more resources to the counties should be addressed so as to maintain the gains already made through devolution of public services. Revenue projections should be realistic since the ambitious nature of National Treasury’s revenue projections negatively affect revenue sharing between the national and county governments. The Commission on Revenue Allocation (CRA) for instance recommended that based on a revenue projection of Ksh. 2,142 billion for the financial year 2022/23, the national government be allocated Ksh. 1,765.2 billion, county government Ksh. 370 billion and Equalisation Fund Ksh. 6.8 billion. The Commission further recommends that the projected revenue increase of Ksh.366.4 billion above the financial year 2021/22 estimate of Ksh.1, 775.6 billion if realised, be used to reduce the national government’s fiscal deficit as a matter of national interest.

The audited accounts for FY2020/21 approved by the Parliament should be used as a basis for the 2023/24 FY revenue division. These are yet to be approved by parliament and it is imperative that parliament works to improve this and ensure that we comply in adhering to this legal requirement.

There is also need for legislative clarity on explicit timelines for the approval of the Division of Revenue Bill and County Allocation of Revenue Bill as they have been tabled in Parliament to address delays in release of funds to counties.

On the Equalization Fund, there is the need to expedite the operationalisation of the fund as the Board has been properly constituted to enable the marginalised counties to reap the benefits enshrined in the constitution. The implementation must, however ensure that roles by the board for devolved functions are defined and do not encroach on the role of the county governments.

We also call on the Senate to create a mechanism to ensure the intended inclusion of the marginalised groups is attained. In addition, the National Government needs to create awareness of the administration of the fund and ensure the participation of the marginalised communities in the identification, implementation, monitoring and evaluation of the projects to be implemented through the fund. We hope that the implementation can help with lessons of how best to ensure the participation of the people, including the most vulnerable and marginalised in government processes even after the equalisation fund is wound up by the sunset clause of 20 years.

On devolved functions, we note the steps proposed to cancel the contract to lease medical equipment, which was conducted against the principles of public finance and devolution of power. We urge that the senate takes measures to guard against the agriculture and health sectors which are largely devolved. The distribution of agricultural inputs like fertilizer seem to be residing with the

6. Debt Strategy

TISA takes note of the proposals made by the National Treasury to improve Kenya's debt status. We note that the strategy makes proposals for: reducing the overall fiscal deficit; increasing the national export capacity; strengthening the capacity for domestic and concessional borrowing; and establishing the sinking fund, among others. These proposals are in line with a TISA report released in 2022 titled, "*Transparency and Accountability in Public Debt Management: A focus on Kenya's Past Eurobonds*". The report is available [here](#).

Transparency & Accountability in Sovereign Bonds

The MTDSP (Medium Term Debt Strategy Paper) needs to include important commitments by the National Treasury on Transparency and accountability in sovereign bonds that will be floated in the medium term. We take note that Eurobond issuance has been a significant component of Kenya's national debt, with about four (4) Eurobonds so far issued between 2014 and 2021. However, there have been concerns with the manner in which the Kenyan government has handled these sovereign bonds, including limited information available that indicates that the funds were used to finance budget deficit, repay maturing loans, and finance infrastructure projects that don't have any immediate returns. Considering the maturity profile of Eurobonds, which is relatively short, it is clear that the manner in which the Eurobond proceeds have been used in Kenya means that the debt cannot repay itself hence may be unsustainable in the long term.

Due to the short maturity profile of Eurobonds, Kenya will be faced with a concentration of maturing Eurobond obligations between 2024 and 2028¹, which the MTDSP notes, but fails to provide detailed commitments on the mitigation risks that this will have on public service delivery. Coupled with this, is the observation (section 36), that the average time to maturity of debt reduced to 8.8 years compared to 9 years in 2021.

Given the current high debt levels, enhancement of debt transparency and accountability initiatives in line with the constitution in Article 201 is paramount. In line with this, the National Treasury ought to ensure that the public debt register is availed to Parliament with full quantification of Kenya's Public debt stock as defined under Article 214, which includes debt disbursed and debt commitments already entered.

¹ [Eurobond-Study-Report.pdf \(tisa.co.ke\)](#)

Analysis on Key Sections within the MTDSP

1. Section 40 - About 49% of Kenya's public debt is held in foreign currencies, which exposes the economy to high foreign exchange rate volatility risks. Major currencies include the US dollar at 68.1%, Euro at 19.8%, Chinese Yuan at 5.4%. The National Treasury could consider pursuing aggressive debt restructuring efforts both in the short and medium term to alleviate the ongoing interest rate hike on the dollar especially.
2. Section 43 - Kenya's Debt Carrying Capacity (DCC) was downgraded from Strong in 2019 to Medium in 2022, and Kenya is ranked as being in risk of debt distress. Linked to the BPS, concrete efforts to enhance Kenya's exports need to be seen, which are lacking in the BPS. Instead, the policy alludes in Section 51 that Kenya's public debt is at sustainable levels, which is not accurate.
3. Section 48 - The National Treasury commits to maintain debt at sustainable levels through minimizing non-priority expenditures, yet the Budget Policy Statement has had a marginal reduction in the fiscal deficit to 5.7% of GDP down from 6.2% in 2022. Additionally, the MTDS makes no mention of debt restructuring efforts focused on current expensive loans, whose fiscal risk is high.
4. Section 71 - The National Treasury has listed plans to float a syndicated loan domestically. We urge that this process follows the transparency and accountability mechanisms spelt out in the constitution, as well the PFM Act, which have previously been disregarded.
5. Section 77 - The National Treasury does not appear to give a deliberate commitment to have green and blue bonds as part of development financing going forward, yet commitments have previously been made on the needed reforestation, as part of climate change mitigation. The green bond market offers market offers opportunities for national and subnational government to invest in climate change related projects, while contributing towards climate resilience and sustainable development.
6. Section 113 - TISA welcomes the move by the National Treasury to replace the current debt ceiling with a debt anchor hinged on Gross Domestic Product as a desired level of public debt as a ratio of GDP, as this allows for more flexibility on the periodic impact of unforeseen shocks on debt and GDP.
7. Section 114 - We equally welcome the move by the National Treasury to develop guidelines for the operationalization of a sinking fund in conformity with Regulation 206(1) of PFM (National Government) Regulations of 2015. The sinking fund will help stem default in times of economic distress, such as the ongoing global financial crisis, as well as the current drought facing most Kenyan counties. The distress tends to affect most of the devolved functions and services. As this is developed, it must entrench the principles of devolved government.

↓ the economy
need transparency
finance

Diana Gichengo
National Coordinator
The Institute for Social Accountability
Email: diana.gichengo@tisa.or.ke or info@tisa.or.ke

CC

- 1. Chair National Assembly Committee on Finance and National Planning**
- 2. Chair National Assembly Committee on Budget and Appropriations Committee**
- 3. Chair Senate Committee on Finance and Budget**



ON

THE DRAFT BUDGET POLICY STATEMENT 2023

JANUARY 2023

1.0 INTRODUCTION

Institute of Certified Public Accountants of Kenya (ICPAK) is a statutory body of accountants with the mandate to develop and regulate accountancy profession in Kenya. The Institute is further mandated under Sec 8 of the Accountants' Act of 2008 to advise the Cabinet Secretary for Finance on matters relating to governance and accountability in all sectors of the economy. The Institute is dedicated to enhancing its contribution and that of its members to the national economic growth and development agenda. It has been instrumental in making contributions that shape the public financial management in Kenya. This submission is therefore in tandem with the Institute's overarching advisory mandate in the realms of financial management.

The FY 2023/24 budget will be implemented in a new regime and against the backdrop of sustained economic recovery from Covid 19 and other existent shocks within the micro and macroeconomic environment. Indeed, the current state of affairs has been occasioned by the ongoing Russia-Ukraine conflict- disruption on global supply chain likely to affect incomes from exporters, higher-than expected inflation worldwide triggered by higher global oil and food prices; climate change that has produced a severe crisis- food insecurity, poverty, inequality and socio-conflicts; limited access to foreign finance; global tightening of monetary policy and uncertainty on dissipation of COVID-19 if the recent upsurge in China is anything to go by.

These projections are attributed to elevated commodity prices as activity continues to rebound in the region's main trading partners (China, the Euro area, and the United States), albeit at a slower pace than last year. The outlook is also predicated on a gradual recovery in tourism. However, these projections could be hindered by higher food prices, supply disruptions and extreme weather conditions as well as constraints on financing and pressures to improve debt sustainability,

The main goal of the government is to revitalize performance in all economic sectors in order to foster growth, employment creation, poverty reduction and ultimately improve livelihood of the economically disadvantaged group. Although Kenya's economy has in the past remained resilient, could lead to loss of the gains that have been accumulated over the past years.

The Institute has reviewed the Draft Budget Policy Statement 2023 and has developed the following set of submissions for National Treasury's consideration.

2.0 SUMMARY OF ICPAK SUBMISSION ON BPS 2023

S/NO	KEY BUDGET IMPERATIVES	DISCUSSION & ISSUE OF CONCERN	ICPAK RECOMMENDATIONS
1.	Budget for FY 2023/24 and the Medium-Term	<p>In the FY 2023/24, the Government projects that the total Government expenditure will amount to about Ksh. 3.64 trillion while total revenue will be approximately Ksh. 2.89 trillion leaving a fiscal gap of about Ksh. 695 billion. The Institute is concerned that:</p> <ul style="list-style-type: none"> This fiscal gap is likely to increase the current public debt because it would require debt financing to actualize the budget. The Government has in the past prepared supplementary budgets which have increased expenditures and reduced revenues. The implication is compromised services being delivered or increased borrowing, or both. 	<ol style="list-style-type: none"> Ensure adherence to fiscal responsibility principles on planning and budgeting. Supplementary budgets should only be prepared and approved within the precincts of the Public Finance Management Act and Regulations which are: in case of; <ol style="list-style-type: none"> Unforeseen and unavoidable, in circumstances where no budget provision was made; or Unavoidable, in circumstances where there is an existing budgetary provision which, however, is inadequate. <p>This will ensure quality delivery of services, maintain public debt within sustainable level and align with Constitutional and PFM Act requirement of ensuring public participation is observed in public finance management</p>
2.	Paragraph 9 and 10: Agricultural Transformation and Inclusive Growth	<p>Over the medium term, the Government will develop policy, legal and institutional reforms to provide an enabling environment for agricultural productivity. However, this section is not all inclusive to deal with the perennial challenge of food insecurity.</p>	<p>In addition to the proposed policy interventions, the Government should prioritize and implement the following in the Agricultural sector:</p> <ol style="list-style-type: none"> To incentivize the sector and make the practice of agriculture more lucrative, there is need to explore the option of commodity exchange which will ensure symmetric access of price information to all agriculture value-chain players and reduce the costly market intervention. Increase funding levels especially to the

S/NO	KEY BUDGET IMPERATIVES	DISCUSSION & ISSUE OF CONCERN	ICPAK RECOMMENDATIONS
			<p>sectors that contribute to food security such as Agriculture and manufacturing. Exchequer releases should be within the prescribed timeline to facilitate implementation of development programs. Agriculture should be at least 10% of the total National Budget as per Maputo Declaration.</p> <ol style="list-style-type: none"> 3. Build and improve rural infrastructure to open space for movement of goods and services. Also, revisiting policies on Trade Agreements to boost export of some agricultural products will boost direct foreign investment. 4. Improve access to financial services and credit in agriculture and rural development and reduce taxes on agriculture that might impede the growth of the agriculture sector. 5. Encourage growth of agribusiness and improve regulatory services to ensure quality inputs and products and conducive environment for small business holders. 6. Invest in locally More Agricultural research institutions. 7. Enhance Practice of large-scale Water Harvesting. 8. Tax highly Imported Agricultural products, which can be available locally. Such as maize, beans, eggs, fish, potatoes, tea, coffee and sugar. 9. Government should establish Agricultural insurance through collaboration with willing

S/NO	KEY BUDGET IMPERATIVES	DISCUSSION & ISSUE OF CONCERN	ICPAK RECOMMENDATIONS
			Stakeholders to mitigate and protect farmers from Natural and Economical Risks. i.e. Droughts, floods, fire, inflation etc
3.	Banking Sector	Consider the following reforms in the Banking industry	<ol style="list-style-type: none"> 1. <i>New Technologies Adoption</i> : Enable Kenya to retain and accelerate its status as a financial and tech hub. It is an important policy direction and tax/non-tax incentives is essential to encourage rapid adoption of the 4th INDUSTRIAL REVOLUTION (4IR) TECHNOLOGIES to diversify beyond mobile money computing Kenya is renowned for globally. 2. <i>New Business Model Adoption</i>: Regulatory reforms and budgetary policy alignments are critical to enable banking and financial services institutions adoption of advanced DIGITAL PLATFORM BUSINESS MODELS key to positioning Kenya's financial sector globally. 3. <i>Key Anchor Institutions Reforms For Digital Financial Services</i> (Kenya's Silicon Savannah Innovation Hub & International Financial Centre). Acceleration of full roll out of the Konza Technopolis, Nairobi International Financial Centre Authority (NIFCTA) core mandates and competencies 4. <i>Export Of Banking and Financial Service</i>: Deliberate efforts for promotion/facilitation of exports of banking and financial services to Sub-Sahara Africa e.g., Ethiopia via government-to-government (G2G)

S/NO	KEY BUDGET IMPERATIVES	DISCUSSION & ISSUE OF CONCERN	ICPAK RECOMMENDATIONS
			<p>engagements for entry of Kenyan banks and insurance companies into ETHIOPIA and vice versa.</p> <p>5. <i>Credit Reference Bureau</i>: Reforms to deepen private sector credit % of GDP by deepening the level of CRB (Credit Reference Bureau) coverage to the level of South Africa, Malaysia etc. is key to enhance access to finance for households and MSMEs. Widening the net to include more sectors of the economy (Saccos; Telco's, Water Utilities, Electricity utilities, Real Estate rentals etc) provision of CRBs data will reduce information asymmetries (adverse selection and moral hazard) to spur growth of credit to MSMEs and households.</p>

S/NO	KEY BUDGET IMPERATIVES	DISCUSSION & ISSUE OF CONCERN	ICPAK RECOMMENDATIONS
6.	<p>Paragraph 10-13: Transforming the Micro, Small and Medium Enterprise (MSME) Economy</p>	<ul style="list-style-type: none"> • Micro, Small and Medium Enterprises popularly known as MSMEs are engines of growth, vital to most economies and have been recognized by multilateral organizations, development agencies and governments across the world as a key enabler of economic growth and development. • A Survey by KNBS on MSME indicates that approximately 400,000 micro, small and medium enterprises do not celebrate their second birthday. In addition, the pilot training by ICPAK for Laikipia County Government gave a glimpse of the challenges MSMEs face including but not limited to: <ul style="list-style-type: none"> a) Capacity gaps in managerial training: small and medium enterprises establish managerial strategies through trial-and-error mechanism. b) Low financial literacy levels among MSMEs on areas such as basic record-keeping, cash management, managing customer and supplier payments, tax, insurance and other regulatory requirements impedes their success. c) Rapid technology changes: Technology change poses a big challenge to the growth of small and medium enterprises. Most of these enterprises are not able to adopt new technology due to its high initial and installation costs. d) New laws and regulations: Every day, the government and other stakeholders continue to introduce new regulations for industries and enterprises in Kenya. <p>It is therefore important that MSMEs are supported for sustainability and growth</p>	<p>Consider the following proposals:</p> <ol style="list-style-type: none"> 1. Need Predictable Tax Regime for MSMEs through an overarching tax policy: Reform the tax policy to help in the formalization of the informal sector for sustained revenue collection. This can be achieved through: <ul style="list-style-type: none"> - harmonization of taxes- reduce multiplicity of taxes both at National and subnational levels - Tax education for taxpayers to understand why they pay - simplification of taxes- for instance, uptake of turnover tax still low - Link taxation to elector's cards- integrate the registration systems – taxation, identification and election. 2. Continuous Taxpayer engagement: There's need to engage SMEs and create a dedicated channel of communication to support tax compliance. KRA should consider establishing a dedicated desk for purposes of handling SME-related concerns, challenges and queries. 3. Make it easier to pay taxes. Enhance iTax system to optimize tax collections while minimizing the burden on taxpayers to comply with tax laws. 4. Efforts to improve formality should be based on corresponding investments in value creation for MSEs such as the provision of basic services, improved market

S/NO	KEY BUDGET IMPERATIVES	DISCUSSION & ISSUE OF CONCERN	ICPAK RECOMMENDATIONS
			<p>areas, provision of funding.</p> <p>5. Alternative forms of collateral. Need for collaborative efforts between financial market participants and Government agencies towards the identification, deployment and maintenance of appropriate technologies that will promote the eligibility of a wider range of assets as loan collateral e.g social security contributions.</p> <p>6. Digital portal. Create a simplified and responsive digital portal that enables MSME owners to access market information that will enhance their growth. This will be especially useful in light of the AfCFTA agreement.</p> <p>7. Reorganizing not criminalizing Hawkers through introduction of Hawkers identification cards and tax compliance certificate to enhance smooth operations. This will help to deal away with criminal activities in the hawking sector and enhance government to collect tax easily</p> <p>8. Partner with Professional Bodies such as ICPAK to capacity build and support in financial literacy initiatives.</p>

S/NO	KEY BUDGET IMPERATIVES	DISCUSSION & ISSUE OF CONCERN	ICPAK RECOMMENDATIONS
9.	<p data-bbox="315 252 472 277">Healthcare</p> <p data-bbox="315 312 539 373">Paragraph 16-19</p>	<p data-bbox="562 252 757 277">Key concerns</p> <ul data-bbox="562 312 1529 884" style="list-style-type: none"> <li data-bbox="562 312 1529 549">▪ According to the Ministry of Health (MoH Kenya) (2019), only 11% of Kenyans are covered by the NHIF insurance program leaving most of the population (89%) without the government-subsidized health plan. With over 70% of the Kenyan workforce working in the informal sector, most of them are either not eligible or cannot be able to afford the premiums set by the government to maintain health insurance provision. <li data-bbox="562 580 1529 884">▪ Financing management of communicable and non-communicable diseases such as Malaria, TB, and HIV/AIDS in Kenya is largely dependent on donor funds from international organizations, non-governmental entities, and contributions from other countries. This has led to under-investment of the health sector, weakening health systems and structures, and raising concern as to whether the public health infrastructure can withstand a potential overburden in the wake of the COVID-19 pandemic with the majority of Kenyans facing uncertainty due to lack of health coverage. <p data-bbox="607 916 1529 1075">Kenya's budgetary allocation to health has averagely stood at 9% despite signing the Abuja declaration, which requires signatories to allocate 15% budgetary allocation for health. Most of this is absorbed as recurrent expenditure leaving little room for the development of health facilities and the acquisition of medicine and equipment</p>	<ol data-bbox="1599 252 2208 1335" style="list-style-type: none"> <li data-bbox="1599 252 2208 820">1. Ensuring that at least 70% of NHIF disbursements go to public health institutions and service providers; with 30% going to the private sector. This will help build capacity of public health institutions as opposed to utilizing public funds to support private entities. According to the Health Financing Reforms Expert Panel (HEFREP) Report, private hospitals received KES 22 billion from NHIF while government and mission hospitals received KES 7 Billion and KES 8 Billion respectively out of the KES 37.7 billion expenditure in FY 2018/19. This implies that government health facilities received only 18.6% allocation of NHIF disbursement in that year. <li data-bbox="1599 836 2208 1299">2. There is need to increase the health budgetary allocation to the recommended 15% of the total annual budget as recommended by the AU under the auspices of Abuja declaration. This will go a long way in increasing recruitment and welfare of health personnel to enable efficiency in the health sector. It will also solve the problem of periodic strikes and brain drain that has become a new normal in the health sector by ensuring health workers are well paid, offered proper protective gear that they need to work in a safe environment. <li data-bbox="1599 1315 2208 1335">3. Strengthen accountability in the utilization

S/NO	KEY BUDGET IMPERATIVES	DISCUSSION & ISSUE OF CONCERN	ICPAK RECOMMENDATIONS
			<p>of funds and resources that are allocated in the health sector. The perpetrators of mismanagement of healthcare provision funds should be brought to book and such funds recovered.</p> <ol style="list-style-type: none"> 4. Invest in Medical Research: Counties should support medical research such as Cancer research and studies in NCDs. 5. The Government should invest in established KEMRI county units in all counties to help in combating any tropical Disease Outbreaks. This will enable to control/contain any outbreak that may spread easily to other counties hence affects the economy stability. 6. Offer tax relief on Medical facilities and inputs- To allow medical health facilities to be available to avoid people traveling overseas for treatment. For instance, collaborating with India to establish Cancer Centre/Hospital in Kenya, given that over 10,000 Kenyans travel annually to India for specialized treatment.
10.	Electricity Paragraph 28	Electricity is a vital economic and social good critical for production of consumer goods and provision of essential services such as health and security. The increasing cost of energy may hamper realization of some of the government's growth priorities including manufacturing.	<p>By end of 2021, the government had embarked on a pathway for reduction of the cost of electricity by 30%.</p> <ol style="list-style-type: none"> 1. Therefore, the government should consider reducing the cost of electricity to spur the manufacturing sector and other important sectors of the economy.

S/NO	KEY BUDGET IMPERATIVES	DISCUSSION & ISSUE OF CONCERN	ICPAK RECOMMENDATIONS								
11.	Governance Paragraph 57	<p>The Judiciary notes as one of its achievements that 34 judges of the COA, ELRC and ELC were appointed in the FY 2021/22. This increased the numbers to 173 judges against an approved establishment of 347 judges.</p> <p>According to the European Judicial systems The European Commission for the Efficiency of Justice (CEPEJ) Evaluation Report - 2020, Europe had an average of 21.4 professional judges per 100,000 inhabitants implying one judge serving a population of about 5,000 inhabitants. With a population of 48M Kenyans, In Kenya, if one judge would serve 100,000 inhabitants, we will require an establishment of 480 Judges for enhanced access to justice.</p> <p>The USA and India have an average of 21 judges per 1,000,000 people indicating service of 48,000 citizens per judge; in Germany, one judge serves about 4,000 citizens. Case clearance rate of 72% in Kenya and the attendant backlogs indicate a strained judiciary.</p> <p>In the period between FY 2019/20 – 2022/23, the Judiciary has been receiving less than 1% of the total budget, with the other two arms (Executive and Parliament) receiving the larger share. In addition, this proportion has been declining.</p> <p>This has resulted in resource constraints in the Judiciary operations.</p> <table border="1"> <thead> <tr> <th>FY</th> <th>Total National Budget (Ksh in trillion)</th> <th>Judiciary Budget (Ksh in trillion)</th> <th>(Judiciary/Total)%</th> </tr> </thead> <tbody> <tr> <td>2022/23</td> <td>3.3</td> <td>0.0189</td> <td>0.57%</td> </tr> </tbody> </table>	FY	Total National Budget (Ksh in trillion)	Judiciary Budget (Ksh in trillion)	(Judiciary/Total)%	2022/23	3.3	0.0189	0.57%	<p>To ensure financial autonomy for the Judiciary as envisaged in the Constitution and sufficient Judicial officers to administer justice, consider:</p> <ol style="list-style-type: none"> revising the establishment to 480 Judges to enhance access to justice and prompt delivery of cases. Upscale budget allocation to the Judiciary to support the operationalization of the Judiciary Fund. The government should allocate at least 1.5% to 2.5% of the total budget to the Judiciary.
FY	Total National Budget (Ksh in trillion)	Judiciary Budget (Ksh in trillion)	(Judiciary/Total)%								
2022/23	3.3	0.0189	0.57%								

S/NO	KEY BUDGET IMPERATIVES	DISCUSSION & ISSUE OF CONCERN				ICPAK RECOMMENDATIONS															
		2021/22	3.1	0.0185	0.60%																
		2020/21	2.8	0.0171	0.61%																
		2019/20	2.6	0.0169	0.65%																
		<p>Source: BPS</p> <p>Allocation to Judiciary:</p> <p>The Institute notes that the Allocation for Parliament has increased by Kshs 12,337 million from Kshs 37,883 in FY2021/22 to Kshs50,220 in 2022/23 while the Allocation for Judiciary has only increased by Kshs 380 Million from Kshs 17,918 Million in FY2021/22 to Kshs 18,297 Million in 2022/23</p> <table border="1"> <thead> <tr> <th>Body</th> <th>FY2018/19</th> <th>FY2019/20</th> <th>FY2020/21</th> <th>FY2021/22</th> </tr> </thead> <tbody> <tr> <td>Parliament</td> <td>34,490</td> <td>36,240</td> <td>36,222</td> <td>37,883</td> </tr> <tr> <td>Judiciary</td> <td>13,458</td> <td>14,437</td> <td>14,150</td> <td>17,918</td> </tr> </tbody> </table> <p>Source: Division of Revenue Bill,2022</p> <p>According to the State of the Judiciary and PMMU reports, the Judiciary is operating at about 60% of its optimal staffing levels. In addition to this, it faces crippling financial challenges that seriously curtail its ability to invest in the infrastructure and activities that will enhance its efficiency and expedite the delivery of justice.</p>				Body	FY2018/19	FY2019/20	FY2020/21	FY2021/22	Parliament	34,490	36,240	36,222	37,883	Judiciary	13,458	14,437	14,150	17,918	
Body	FY2018/19	FY2019/20	FY2020/21	FY2021/22																	
Parliament	34,490	36,240	36,222	37,883																	
Judiciary	13,458	14,437	14,150	17,918																	
12.	Pending bills Paragraph 146-149	<p>A report by the Controller of Budget (CoB) indicates that by 21st December 2022, Counties had settled Ksh. 22.9 billion (47.6% of the eligible pending bills)</p>				<p>1. The National Treasury should consider accrual accounting as opposed to cash</p>															

S/NO	KEY BUDGET IMPERATIVES	DISCUSSION & ISSUE OF CONCERN	ICPAK RECOMMENDATIONS
		<p>leaving an outstanding balance of Kshs. 25.1 billion. During this period, the National Government released to the Counties significant resources to enable them to clear their pending bills.</p> <p>The total outstanding MDAs' pending bills as of 30th September 2022, amounted to Kshs.82.35 billion, comprising Kshs.61.15 billion (74.3 per cent) for recurrent expenditure and Kshs.21.2 billion (25.7 per cent) for development expenditure.</p> <p>Continued delays in payment of pending bills to entities that provide goods and services to both National and County Governments have affected liquidity and operations of these entities. In a number of cases, this has led to closure of businesses, affecting many livelihoods.</p> <p>Though some progress was noted in settlement of these bills by the National and County Governments, there are still challenges where a number of suppliers are owed large amounts of money. The outstanding issue of pending Bills has negative effects on the economy:</p> <ul style="list-style-type: none"> ▪ <i>Effect on Investment-</i> investor confidence is eroded. ▪ Entities risk losing reliable suppliers. ▪ <i>Private Sector Credit:</i> Credit to SME's is stifled since banks cut lending to government suppliers due to high defaults attributed to late payments by national and county governments. ▪ Non-payment of suppliers and contractors adversely affects other sectors of the economy like the financial sector by increasing non-performing loans. ▪ <i>Cashflow problems:</i> Businesses face huge cashflow problems and are unable to pay their workers, suppliers, pay rent, and other expenses. 	<p>accounting which presents challenges in terms of monthly and annual financial reporting on pending bills and other liabilities.</p> <ol style="list-style-type: none"> 2. There is need to develop a database of all owed dues to counties and MDAs and assess the multiplier effect/impact to the economy. 3. Closure on payments of existing pending bills and fast-tracked implementation of the Prompt Payment Bill, 2021 is necessary to avert death of MSMEs engaged in public sector supplies. 4. The National Treasury should follow up and ensure strict compliance to Circular AG.3/83/1/Vol.VII (22) dated 11th May 2022 to all CECMs for Finance on Year End Closing Procedures for Financial Year 2021/2022.
13.	Paragraph 87 Private Sector Credit	Adequate credit to the private sector plays an important role in economic growth by ensuring that there is efficient allocation of resources for investment.	In order to improve private sector credit, the Institute recommends as follows; 1. Implementation of the Credit Guarantee

S/NO	KEY BUDGET IMPERATIVES	DISCUSSION & ISSUE OF CONCERN	ICPAK RECOMMENDATIONS
		<p>In Kenya, the major constituents of the private sector lending include commercial banks, capital markets, Saccos, microfinance institutions, finance and leasing companies, pension funds, as well as insurance corporations.</p> <p>Accessibility of credit has been a challenge especially to the SMEs, largely attributable to high-risk perception by banks, and the high cost of credit charged on the current available credit options.</p> <p>Private sector credit improved to a growth of 12.5 percent in the 12 months to December 2022 compared to a growth of 8.6 percent in the year to December 2021. The Institute commends the government for these efforts. However, more measures need to be put in place to continue in the same growth path.</p>	<p>Scheme (CGS) Regulation 2020 to enhance credit access to MSMEs.</p> <ol style="list-style-type: none"> 2. Alternative sources of borrowing - The Kenyan Government should focus more on the concessional borrowing such as soft loans that are cheaper as compared to commercial loans such as the Eurobonds. By implementing alternative borrowing, the government domestic credit from commercial banks will reduce, and as a result, increase the ease of credit access to the private sector. 3. Implementing Public-Private Partnerships (PPP) initiatives in different sectors such as infrastructure and housing projects to reduce its borrowing costs and promote fiscal consolidation efforts. The move helps in minimizing the crowding out of the private sector, 4. Lowering the cash reserve requirement ratio – The CBK reviewed the cash reserve ratio in March 2022 to 4.25% from the preceding 5.25% releasing Kshs 35.2 bn additional liquidity to commercial banks. The increased liquidity improved credit access within the economy, and consequently to the private sector, 5. Deepening financial inclusion through digital integration – Banks are increasing their presence and accessibility to the private sector through digital avenues such as apps and USSD in promoting credit uptake. Banks

S/NO	KEY BUDGET IMPERATIVES	DISCUSSION & ISSUE OF CONCERN	ICPAK RECOMMENDATIONS
			<p>such as KCB and NCBA partnered with Safaricom to offer the overdraft credit facility of Fuliza in increasing credit lending to SMEs.</p> <p>6. Adoption of risk-based pricing - 22 out of the 38 commercial banks have adopted risk-based pricing as a measure of tailoring loans to a customer's financial profile while helping banks and other lenders to manage their risk exposure. The initiative will increase credit accessibility to the private sector based on an individual financial profile in terms of borrowing and repayment history.</p>
14.	Paragraph 88 Hustler Fund	<p>The Hustler Fund was also launched as an intervention to correct market failure problems that led to predatory lending. It aims to lift those at the bottom of the pyramid through structured products in personnel finance that includes savings, credit, insurance and investment.</p> <p>It targets those who are seen as having entrepreneurial potential but remain poor and excluded in the face of mushrooming unemployment, marginalization, high poverty rates and the high cost of living.</p>	<p>Hustler Fund is a good intervention but needs training and coaching of entrepreneurs as well as conscious government effort to address emerging regulatory/policy bottlenecks.</p> <ol style="list-style-type: none"> 1. The government should also ensure that the Regulations governing the Fund are strictly adhered to in tandem with the requirements of the Public Finance Management Act to serve the intended purpose. 2. There is need to ensure that the Hustler Fund does not join the long list of financial digital platforms that instead of pulling people out of poverty, disenfranchises and mortgages their future into more debt thereby worsening their lives. 3. The Institute recommends that the government focuses more on providing universal and guaranteed public services such as affordable healthcare, education, basics of life and housing.

S/NO	KEY BUDGET IMPERATIVES	DISCUSSION & ISSUE OF CONCERN	ICPAK RECOMMENDATIONS
			4. Enhance oversight on the fund initiatives to promote transparency - The government needs to come up with measures that will oversee the running of the Hustler Fund and other Funds in terms of timely publication of updates on amounts disbursed, disclosure of beneficiaries already covered and requirement regulations. This will enhance public confidence since the Fund draws from the Exchequer.
15.	Paragraph 97 Fiscal Performance	<p>Revenue Performance</p> <ul style="list-style-type: none"> • Revenue collection to November 2022 grew by 10.6 percent compared to a growth of 29.5 percent in November 2021. This decline in rate of growth is attributed to the fact that the previous FY's growth was anchored on a lower base— a contraction recorded in the FY 2019/20 which had the effects of COVID-19 pandemic. • As at end November 2022, the cumulative total revenue inclusive of Ministerial Appropriation in Aid (A-i-A) was Ksh 893.8 billion against a target of Ksh 912.9 billion. This performance was Ksh 19.1 billion below the set target. • Ordinary revenue to November 2022 recorded a growth of 9.5 percent compared to a growth of 27.2 percent in November 2021. • In nominal terms, ordinary revenue collection to November 2022 was Ksh 786.5 billion against a target of Ksh 818.7 billion. This performance was Ksh 32.2 billion below the target. • According to the 2023 BPS, the Government will scale up revenue collection efforts by the Kenya Revenue Authority (KRA) to Ksh 3.0 trillion in the FY 2023/24 and Ksh 4.0 trillion over the medium term. In order to achieve this, the Government will undertake a combination of both tax administrative and tax policy reforms. • KRA will reduce the Value Added Tax (VAT) gap from 38.9 percent to 	<p>For enhanced revenue performance, the following measures could be adopted;</p> <ol style="list-style-type: none"> 1. How Government will balance revenue mobilization; expenditure rationalization; public debt management and other externalities will be key in achieving the economic growth projected. 2. The government should also seek new ways of increasing revenue –predictability in tax system, tax base expansion, simplification of the tax process among others. 3. The Government should find ways to reduce recurrent expenditure as it could become unsustainable in the long term. 4. Leadership and accountability is called for. Effective public debt management measures should be adopted. 5. Concessionary loans and grants should be preferred to commercial loans. <p>Benchmarked with Ghana's revenue mobilization policies, Kenya could adopt the following.</p>

S/NO	KEY BUDGET IMPERATIVES	DISCUSSION & ISSUE OF CONCERN	ICPAK RECOMMENDATIONS
		<p>19.8 percent of the potential by fully rolling out electronic Tax Invoice Management System (eTIMS); reduction of Corporate Income Tax (CIT) gap from 32.2 percent to 30.0 percent of the potential as envisaged in the KRA Corporate Plan.</p>	<ol style="list-style-type: none"> Aggressively mobilize domestic revenue. Streamline and rationalize expenditures. Boost local productive capacity. Promote and diversify exports. Protect the poor and vulnerable. Expand digital and climate-responsive physical infrastructure; and Implement structural and public sector reforms.
16.		<p>Expenditure performance</p> <ul style="list-style-type: none"> Total expenditure and net lending for the period ending November 2022 was Ksh 1,096.6 billion which was below the projected amount of Ksh 1,183.7 billion by Ksh 87.1 billion. Recurrent spending amounted to Ksh 825.6 billion; Development expenditure was Ksh 149.0 billion while Transfer to County Governments was Ksh 122.1 billion The fiscal policy will target to grow tax revenues above 17.8 percent of GDP in the FY 2023/24 and above 18.0 percent of GDP over the medium term. Further statistics show that public expenditure also fell slightly as a share of GDP in 2019/20, followed by a real gradual increase in 2020/21. While GDP contracted in calendar year 2020, in fiscal year terms growth was still positive in 2019/20 (2.3%) and 2020/21 (3.6%). This means that while expenditure as a share of GDP fell in 2019/20, real expenditure almost maintained its value. Overall, this still represents a small net fiscal stimulus (because the fiscal deficit was larger than originally planned, driven mostly on the revenue side). In addition to the government's intended Kshs 300 billion expenditures cut, the austerity measures also come at a time when the cost of debt service may increase, thus squeezing discretionary spending more than is currently anticipated. In the PS National Treasury Speech 	<ol style="list-style-type: none"> Consider scaling down rather than absolute suspension of some of these "non-priority" expenditures such as training since there is need for the Government to continuously capacity strengthen its new and existing officials. There's need for a robust debate and policy direction on implementation of subsidies. For instance, the new administration has given a policy direction to substitute consumption subsidies with production subsidies, for instance, subsidies that touch on fuel have been removed. This has led to increase in the cost of production among other negative consequences.

S/NO	KEY BUDGET IMPERATIVES	DISCUSSION & ISSUE OF CONCERN	ICPAK RECOMMENDATIONS
		<p>while officially launching the pre-budget hearing, it was indicated that the Government will suspend expenditures in some recurrent areas such as domestic and foreign travels, communication, printing, training, hospitality, fuel, purchase of furniture, purchase of motor vehicles, refurbishments and routine maintenance.</p> <ul style="list-style-type: none"> • Suspending these activities, may ground government and private sector, local tourism and auxiliary sectors dependant on government leading to unemployment. 	
17.	<p>Paragraph 111</p> <p>National Tax Policy Framework</p>	<p>The Government will implement various tax policy measures to further boost revenue collection. In addition, to further strengthen revenue mobilization efforts, the Government will finalize the development of the National Tax Policy and the Medium-Term Revenue Strategy (MTRS) for the period FY 2023/24 - 2026/27.</p> <p>The Government also intends to raise ordinary revenue to GDP from 15.0 percent in the FY 2021/22 to 25 percent by 2030 and increase tax compliance rate from 70 percent in the FY 2021/22 to 90 percent by 2030. These tax reforms are timely and intended to enhance tax revenues.</p>	<p>1. The National Treasury and Parliament should expedite the finalization and enactment of the National Tax Policy that will help catalyze tax revenues in this country.</p>
18.	<p>Public Debt</p>	<ul style="list-style-type: none"> • Kenya's debt remains sustainable but categorized as facing high risk of debt distress (IMF Country Report No. 22/383). • The Present Value (PV) of external debt-to-export and Public and Publicly Guaranteed (PPG) of debt-service-to-exports indicators remain above the thresholds over the medium-term projection period. • As the economy recover from global shocks and fiscal consolidation continues, Kenya's debt indicators are expected to improve. • The gross public debt as at 30th June, 2022 increased by KSh. 882.5 billion to KSh. 8,579.1 billion compared to KSh. 7,696.6 billion as at end of June 2021. The gross public debt comprised of 50 percent external debt and 50 percent domestic debt. • Public Debt Servicing expenditures (interest payments and 	<ol style="list-style-type: none"> 1. Given that the CFS expenditures are a first charge to the consolidated fund, their management is critical for cash management and creation of fiscal space to successfully implement other budgetary activities 2. The National Treasury should consider renegotiating the terms of current external loans, especially those acquired from commercial creditors. 3. Going forward, the National treasury should conduct a thorough cost-benefit analysis of new loans to determine the best alternative to contract that would yield maximum benefit

S/NO	KEY BUDGET IMPERATIVES	DISCUSSION & ISSUE OF CONCERN	ICPAK RECOMMENDATIONS
		<p>redemptions), required to finance the repayment of Kshs. 8.2 trillion¹³ public stock of debt, will constitute the largest share of CFS expenditures - at 89%. The total public debt is projected to reach Kshs. 11.5 trillion¹⁴ by June 2025 on account of expanding fiscal deficit.</p> <ul style="list-style-type: none"> The stock of gross domestic debt increased by KSh. 591.2 billion from KSh. 3,697.1 billion in June 2021 to KSh. 4,288.3 billion in June 2022. The net domestic debt was KSh. 3,870.2 billion by end of the period under review. <p>In dollar terms, external public debt stock declined by US\$. 670.41 million from US\$. 37,084.3 million by end of June 2021 to US\$. 36,413.89 million by the end of June, 2022.</p>	<p>and minimum cost for both current and future generations.</p> <p>4. The National treasury should provide training and capacity strengthening sessions to personnel in the public debt Management Directorate and continuously appraise them on emerging trends in the global markets. The National Treasury should consider the option of public-private-partnership (PPP) in financing future development projects to reduce over-reliance on loans.</p>
19.	<p>Paragraph 120</p> <p>Risks to the Economic Outlook</p>	<p>Potential risks and uncertainties arising from both domestic and external sources such as;</p> <ul style="list-style-type: none"> Possible resurgence of new COVID-19 variants that may require broader policies on trade and exports between Kenya and other trading partners like China could lead to renewed disruptions to trade and tourism. Lower agricultural output due to potential adverse weather conditions and continued desert locust infestation in the northern region of the country, which could potentially reduce production of food crops and animal feeds. Increased public expenditure pressures, particularly wage and other recurrent expenditures, would put a strain to the fiscal space. The Russia- Ukraine War could result to potential higher oil prices in the international market would result in worsened terms of trade. This could impact on domestic growth as well. On positive note, faster than projected rebound in economic activities that would result in higher Government revenues providing fiscal space that would support faster reduction in fiscal deficit and debt accumulation. 	<ol style="list-style-type: none"> Reprioritize spending to support the vulnerable Maintain exchange rate flexibilities to deal with the capital outflows from the private sector that could hamper capital market access of the sovereign. This will in turn help the economy absorb potential shocks. Liability management – reduce expensive debt and substitute with concessional debt that reduce deficit and expand fiscal space

S/NO	KEY BUDGET IMPERATIVES	DISCUSSION & ISSUE OF CONCERN	ICPAK RECOMMENDATIONS
		<ul style="list-style-type: none"> • Rising inflation could impact the purchasing power of the population and impact domestic growth negatively. • Global monetary policy tightening, especially in the United States, could increase volatility in the financial markets. 	
20.		<p>Consider Other Macroeconomic Stabilization Measures as follows:</p> <ol style="list-style-type: none"> 1. EXCHANGE RATE - Halting Kenya shilling forex depreciation against a resurgent strong dollar and other global currencies. Whereas Exporters have benefited, Kenya is a net importer and importers have generally passed on the imported inflation to Mwananchi. Policy interventions to deepen and diversify Kenya's exports base remains paramount to enhance Kenya's Forex earning capability. 2. INFLATION - Inflation is high/persistent and increasingly entrenching – it is important to slow it within the CBK range of 5%+-2.5% to control the current damaging and painful erosion of Wananchi purchasing power and ensure investments have positive inflation adjusted returns. Control of inflation is key to reducing cost of borrowing for all economic actors (Government, Households, MSMEs & Corporates). 3. This can be pursued by instituting policy to embrace Electric Cars to reduce on fuel inflation and capital flight (Maximizing on the country's capability to generate power – Geo, Wind, Solar & Hydro) 4. SOVERIGN RATING - Urgent policy interventions to quickly restore Kenya government (and by association global credit ratings of all Kenyan MSMES/ Corporates) Credit Rating by Moodys/Fitch/ Standard and Poors is paramount as the cost of borrowing in international financial markets for Government, Banks and MSMEs remains high as does domestic FCY borrowing by MSMEs. 	



Institute of
Economic Affairs

**COMMENTS ON THE BUDGET POLICY STATEMENT FOR THE MTEF 2023/24 –
2025/26 BUDGET**

1. Is anticipated revenue collection and performance for FY 2022/23 realistic and tenable?

With the exception of FY 2021/22 where actual revenue collection surpassed the target, past revenue trends have been characterized by persistent underperformance. Therefore, the question is whether what is projected for FY 2022/23 is realistic and tenable. So far, in the first half year of FY 2022/23 total revenue collection has fallen short of target by Ksh 11.1 billion as shown in table 1. This was surprisingly driven by over performance in AiA collection by Ksh 32 billion, however countered by underperformance in ordinary revenue collection of Ksh 43.1 billion. Often revenue collection picks¹ in quarter three and four of every financial year and this confirms BPS 2023 assertion of anticipated improved revenue performance. This performance is expected on the back of improved business environment, tax policy measures and enhance revenue administration by the Kenya Revenue Authority as noted in the BPS 2023.

Table 1: Fiscal Framework and Outturn (Ksh billion)

	Budget Est.	Suppl. 1	Fiscal Performance – Q2 of FY 2022/23		
			Target	Prel. Actual	Gap
Total Revenue	2,462.4	2,528.8	1,158.2	1,147.1	-11.1
Ordinary Revenue	2,141.6	2,192	1,028.1	985	-43.1
Ministerial Appropriation in Aid (AiA)	320.8	336.8	130.1	162.1	32
Grants	33.3	31.4	5.6	4.3	-1.3
Total Revenue incl. of Grants	2,495.7	2,560.2	1,163.8	1,151.4	-12.4
Recurrent	2,271	2,349.9	1,014.6	1,121.4	106.8
Development	676.6	605.8	234.7	206.3	-28.4
County Transfer	407	436.3	197.7	141.1	-56.6
Contingency Fund	4	2	2	0	-2
<i>Deficit as a Share of GDP (%)</i>	-6.2	-5.7	-2.0	-2.2	

Source: National Treasury BPS 2023

¹ National Treasury Quarterly Budgetary and Economic Reviews and Office of Controller of Budget Implementation Review Reports

Nevertheless, there are risks to revenue performance in second half of FY 2022/23 owing to both domestic (rising cost of living and constrained fiscal space) and external (global commodity prices and interest rates) factors. For example, persistent drought will continue to dampen agricultural production and turning around the manufacturing sector is still proving to be a challenge. **As a result, the IEA Kenya notes that implementation of the Bottom-Up Transformation Agenda² of the new administration may face headwinds thus affecting economic activity in the second half of FY 2022/23. Given that revenue performance is correlated to economic performance, dampened economic activity may adversely affect realization of anticipated revenue collection. This in turn will lead to delays in disbursement to county governments and thus undermine service delivery.**

2. The National Treasury should enhance its accuracy in the estimation of the ordinary revenue which is key in addressing sub-sequent delays in intergovernmental fiscal transfers

As noted earlier, Kenya has experienced persistent underperformance of revenue in the last decade despite on-going tax reforms measures. In FY 2021/22 there was some respite, National Treasury reports show that actual revenue collection surpassed the target (See annexe 1). So far, in the first half of FY 2022/23, reports show that this gap has narrowed relative to the past financial years. Nevertheless, there are lingering concerns of patterns of optimistic revenue forecasts during the formulation of the annual budgets. It has also been noted by other institutions such as the International Monetary Fund (IMF)³, that Kenya’s forecasts of tax revenue used in preparing its annual National budgets have been unduly optimistic, particularly in more recent financial years leading to revenue shortfalls.

Table 2: Comparison of Ordinary Revenue projections between BPS 2023 and BPS 2022

BPS 2023 report	2020/21 (Actual) Ksh Billion	2021/22 (prel.) Ksh Billion	2022/23 (BPS proj.) Ksh Billion	2023/24 (BPS proj.) Ksh Billion
	1,562.0	1,917.9	2192.0	2,571.2
BPS 2021 report	2020/21 (Prel) Ksh Billion	2021/22 (BPS proj.) Ksh Billion	2022/23 (BPS proj.) Ksh Billion	2023/24 (BPS proj.) Ksh Billion
	1,562.0	1,800.0	2,141.6	2,516.3

² Entails 5 pillars: Agricultural transformation; micro, small and medium enterprises (MSMEs) economy; housing and settlement; healthcare and digital superhighway and creative industry

³ IMF (2018) 2018 Article IV Consultation and Establishment Of Performance Criteria For The Second Review Under The Stand-By Arrangement—Press Release; Staff Report; And Statement By The Executive Director For Kenya IMF Country Report No. 18/295

Differences in BPS 2020 and BPS 2021	0	117.9	50.4	54.9
--------------------------------------	---	-------	------	------

Source: BPS 2023 and BPS 2022

As demonstrated in table 2 that shows comparison of the revenue projections made a year prior, that is, projections in BPS 2022, forecasting errors have commendably reduced by a half from Ksh 117.9 billion in FY 2021/22 to the range of Ksh 50 billion. That said, there is need for the National Treasury to continue to improve accuracy in revenue forecasting and insulate the process from political interference given that it often leads to revenue shortfalls, budget revisions with implications on intergovernmental transfers.

Quarterly Budget Implementation and Review Reports (BIRR) by the Office of the Controller of Budget (OCOB) have shown that revenue shortfalls have contributed to delays in the disbursement of funds to both the national Ministries Departments and Agencies (MDAs) and counties. For instance, actual disbursement of funds indicate that counties do not receive funds in accordance with the annual Senate monthly disbursement schedule. Further analysis shows that the delays have affected the budget implementation especially on the development budget as evidenced by low absorption rates. This is compounded by the fact that counties have limited capacity in own-source revenue generation despite latent potential. **It is therefore incumbent upon the national government to enhance national revenue collection for both national and county public purposes and these revenues must be distributed to the counties in sufficient quantity and on time. The National Treasury should hence endeavor on enhancing the accuracy of the revenue forecast in order to achieve realistic budget deficits.**

Furthermore, as much as the IEA-Kenya concurs that a National Tax Policy framework and Medium-Term Revenue Strategy as critical in fostering predictability in the tax system. **There is however need to provide clear timelines and implementation framework to facilitate any interested person(s) to estimate the viability of these intended reforms but also enable oversight institutions and civil society to monitor and track their implementation.**

3. The Revenue Disbursement Schedule is largely misaligned when compared with the timing of revenues collected at the national level which has been one of the driving factors for the delay in the disbursement of funds to the county governments.

There is need for the Senate to question for the accuracy of the revenue forecasting by the National Treasury and ensure realistic ratios in the revenue disbursement schedule. IEA Kenya study report finds a wide gap between the proposed monthly revenue disbursement ratios to the counties vis-à-vis the actual revenue collection. The first quarter is the worst affected. As a result, and given the importance of revenue disbursement schedule in guiding release of funds, there is need to enhance the accuracy of the revenue forecast in order to inform the predictability of funds. Besides it is an important accountability tool that the Senate can use to track whether the National Treasury is

adhering to approved disbursement schedule. The consequence of the misalignment has been that budgeting at the county level, especially in the first quarter, has been based on overoptimistic projections which has adversely affected budget execution. For instance, the findings indicate that for the six years since 2014/15, on average, out of the total equitable funds that were disbursed, approximately 13% was made in the first quarter, most of the funds (37%) were disbursed late in the year (in quarter four).

4. Efficiency in Spending and importance in delivery of growth friendly fiscal consolidation

As one of the key public expenditure management issues, the Government should improve efficiency of public spending and reduce wastages is pertinent. The BPS indicates that the Government through the bottom-Up Economic Transformation agenda will improve efficiency in public spending and ensure that there is value for money by eliminating non priority expenditures and scaling up use of public private partnership. The reforms on either the expenditure and revenue side are aimed at reducing the fiscal deficit and reduction in the growth of the public debt thus boosting the country debt sustainability position.

IEA -Kenya notes that whereas these are great policy measures, we point out the following policy issues to be considered by the senate toward enhancing results and value for money in spending. **Rise in fiscal deficit will mostly be associated with infrastructure related project pressures and elections related spending on manifesto implementation promises by the new administration in the medium term. This may lead to increase in debt stock and the Senate has a critical role of ensuring Counties and the National Government play a greater role of fiscal discipline and commitment for efficient implementation of the budgets**

5. Strengthening Devolution

The 2023 BPS highlights initiatives towards strengthening devolution. Among them is the plan to complete transfer of all functions constitutionally earmarked to counties within six months and ensure that shareable revenue is transferred to counties in a timely and predictable manner and in accordance with the law.

IEA –Kenya commends the move to transfer all functions but cautions that this could negatively affect service delivery if revenue allocations do not match the increased functions. The BPS 2023 projects that county government’s equitable share will increase from Ksh. 370 billion in FY 2022/23 to Ksh. 385.4 billion (4% increase) in FY 2023/24 and Ksh. 405.6 billion in FY 2025/26. The table below from the BPS shows a summary of budget allocations to both levels of government. **Over the medium term, National Government allocation is projected to increase on average by 7.2% while that of County Government increases by slightly less than a half of that of the national government (3.2%).**

Table 3.1: Summary Budget Allocations for the FY 2023/24 – 2025/26 (Ksh Million)

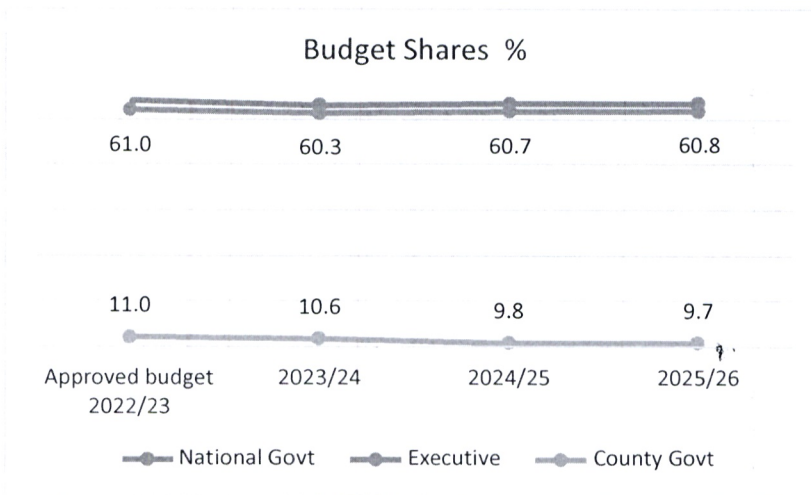
S/NO.	Details	Financial Years			
		Approved Original Budget	BPS Projection		
			2022/23	2023/24	2024/25
1.0	National Government	2,119,258.8	2,252,077.2	2,433,399.8	2,611,442.5
	Executive	2,050,154.4	2,189,681.4	2,365,634.3	2,538,201.5
	Parliament	50,220.0	40,401.8	41,911.0	43,483.7
	Judiciary	18,884.4	21,994.0	25,854.5	29,757.4
2.0	Consolidated Fund Services	869,342.7	991,340.5	1,079,992.6	1,156,863.6
3.0	County Government	370,000.0	385,425.0	380,645.1	405,646.1
	Total.....Kshs.	3,358,601.5	3,628,842.8	3,894,037.5	4,173,952.2
% Share in the Total Allocation					
1.0	National Government	63.1	62.1	62.5	62.6
	Executive	61.0	60.3	60.8	60.8
	Parliament	1.5	1.1	1.1	1.0
	Judiciary	0.6	0.6	0.7	0.7
		-	-	-	-
2.0	Consolidated Fund Services	25.9	27.3	27.7	27.7
3.0	County Government	11.0	10.6	9.8	9.7
Notes**					
* Consolidated Fund Services (CFS) is composed of domestic interest, foreign interest and pension					
**County Government allocation is composed of sharable allocation					

Source of Data: National Treasury

Despite the fact that the National Government has continually observed the legal requirement of providing an equitable share of at least 15 percent of the most recently audited measure of its revenue, County Governments have seen an ongoing decline in the resources available to them as a share of both available funds and GDP⁴.

Besides, the current county allocation ratios as per BPS 2023 also reveals a gradual decline, from 11% to 9.7% from 2022/23 to 2025/26 whereas that for the national executive and indeed the national government is somewhat maintained.

⁴ IEA Kenya 2022, Intergovernmental Fiscal Relations in Kenya (2014-2020): Implications for County Budget Execution



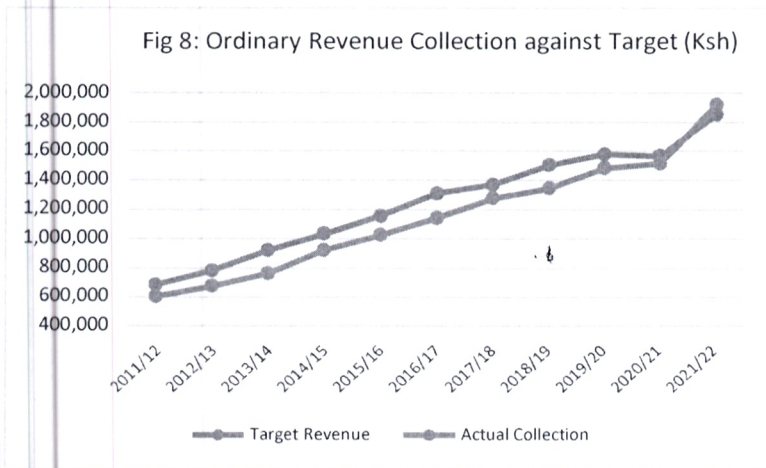
Source: National Treasury BPS 2023

Despite the declining share of the transfers to counties in the national budget, the national government is still adhering to the constitutional requirement that the equitable share must be at least 15 percent of national ordinary revenues. However, the declining trend is evidence that national spending is prioritized over county spending and hence the **IEA Kenya recommends that the Senate should push the National Treasury to enforce the “parity principle” to ensure that national spending is not prioritized over counties in order to address the decline relative transfers to the counties**

Further, the 2023 BPS also notes that the “National Government will improve County Governments’ capacity to generate their own income and reduce over-reliance on transfers from the National Government”. Indeed, missed OSR targets has been a contributing factor to the growing pending bills and underfunding portions of the budget, and recommendations by institutions such as CRA and National Treasury on the same should be implemented to reduce the gaps. **However, this language insinuates and points to the claim that OSR⁵ can fund county functions. Since the counties have limited own-source revenue and varying capacity to raise such revenue, it is incumbent upon the national government to collect sufficient revenues for both national and county public purposes and these revenues must be distributed to the counties in sufficient quantity and on time.**

⁵ Reports show that on average 80% of county government budgets are financed through equitable share

Annexe 1



Source: Various issues of National Treasury QEBR



MEMORANDUM TO THE SENATE ON THE COUNTY GOVERNMENTS ADDITIONAL ALLOCATIONS (No. 2) BILL, 2022

This memorandum has been prepared by the International Budget Partnership Kenya (IBP Kenya). IBP Kenya is a non-profit organization working to advance transparency, accountability, participation, and equity in national and county budgeting processes. IBP Kenya's work is focused on strengthening the impact of citizen and civil society organizations (CSOs) advocacy on budget policies and outcomes at national and sub-national levels of governance. Citizen advocacy, evidence generation, technical assistance to both levels of governments and CSOs, learning, and networking are integral components of IBP Kenya's work.

In response to the public notice requesting memoranda on the County Governments Additional Allocations (No. 2) Bill, Senate Bills No. 4 of 2022, this memorandum raises the following four issues:

- 1. Whereas the Bill specifies that it shall be prepared and agreed upon by the National Assembly and the Senate during the consideration of the Budget Policy Statement, this is the second one being prepared for the FY 2022/23.** In May 2022, the Senate, through a letter **REF: SEN/DCS/SCF&B/2022/016 (F)**, requested IBP Kenya to share their views on the County Governments Additional Allocations Bill, 2022. We note that this is the second Bill drafted for FY 2022/23 that has been developed. It will be essential to clarify at which point of the budget cycle it should be produced. Will this be an annual bill accompanying the Budget Policy Statement (BPS), Division of Revenue Bill, and the County Allocation of Revenue Bill?

The Senate needs to state how the implementation in the FY 2021/22 fared on and highlight any adjustments made in this Bill to address any gaps that have been identified. In particular, it will be good for the Senate to highlight to the public the progress made in its implementation, the challenges faced, and the lesson learned that would be carried forward to ensure that the consequent Bills are implemented better.

- 2. There is no clear criteria for allocating conditional grants from the national government revenue.** As highlighted in Column C of the First Schedule of the County Governments Additional Allocations Bill, 2022, all the counties are receiving an equal amount of KShs 110,638,298 for medical equipment leasing. However, it is apparent that not all the counties are at the same level, and their requirements are very diverse. In addition, there are specific issues raised over time regarding the structure and implementation of medical equipment leasing. What lessons have informed consequent decisions that the Senate has taken on the subject?

Similarly, Column G of the Second Schedule allocates an equal amount of KShs 11 million to each county to finance the Locally-led Climate Action Program. It is worth noting that in the Bill published in May 2022, the amount allocated towards this was KShs 125 million per county. What is the rationale for reducing the allocations from KShs 125 million to 11 million? Does it mean that all the counties with their diversities will implement a similar program given the equal



**International
Budget
Partnership**

Kenya

allocations? There needs to be a clear criterion highlighting the allocations and how they are adjusted yearly. Therefore, we call upon the Senate Standing Committee on Finance and Budget to ensure that an explicit criterion for determining equitable allocations to the counties is implemented to ensure resources are distributed equitably. In addition, the Senate should ensure that all conditional grants follow the same Medium Term Expenditure Framework (MTEF), which means the conditional grants allocations should include projections for two outer years. This will help counties be prepared when donor funds are discontinued in any given financial year.

3. **Whereas it has been ten years since the onset of devolution, counties are still receiving funds to supplement the construction of county headquarters.** The County Governments Additional Allocations (No. 2) Bill has identified five counties in FY 2022/23 to receive an additional allocation of various amounts ranging from KShs 24 million to KShs 121 million to supplement the construction of county headquarters. Does it mean the counties still do not have headquarters to operate from? Have there been assessment reports toward all the previous allocations directed towards the county to construct their headquarters? How far are they, and when are they likely to be completed? It will also be good for the Senate to highlight the criteria used to arrive at the five counties listed in Column B of the Bill.
4. **What is the impact of the collapse of conditional grants into equitable share?** From the FY 2020/21, the conditional grants were collapsed to be part of the equitable share. This action was largely anticipated to impact some services, especially those provided by the level 5 hospitals. Is there any study done to understand the impact of this action? We recommend that the Senate institute a study to understand the implications of this action and how the effect has been mitigated.

Signed on November 14, 2022, in Nairobi

Dr. Abraham Rugo Muriu

Country Manager

International Budget Partnership Kenya (IBP Kenya)

Email: arugo@internationalbudget.org

Phone: +254721431083