PARLIAMENTARY SERVICE COMMISSION

PARLIAMENTARY BUDGET OFFICE

Unpacking the Estimates of Revenue and Expenditure for 2017/18 and the medium term

MARCH 2017

Disclaimer

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THE FIVE POINT MESSAGE:

Highlight of key issues in the 2017/18 Budget

To be able to determine to what extent the budget has met its intended objectives as well as highlight any fiscal and budgetary risks therein, the analysis has adopted a **five point criteria** for assessing the budget.The aim of the criteria is to measure the responsiveness of the 2017/18 medium term budget to expected performance; underscoring the prevalent strengths of the budget but also highlighting gaps and inadequacies that have in the past contributed to fiscal and budgetary risks and that need to be addressed in line with international best practices.

1. **Clarity and credibility**: *Was the budget designed within clear and credible limits of fiscal policy?*

The fiscal policy framework for the 2017/18 budget indicates a deliberate convergence path towards the East African Community Monetary Union protocol's fiscal target of 3 percent level of fiscal deficit by FY 2020/21. However, the fiscal policy direction of the country remains unclear as the government's fiscal strategy appears to be expansionary with notable increased spending amidst claims of fiscal consolidation. This probably explains why the fiscal deficit target of 6 percent that Parliament had recommended and resolved in the 2017 BPS does not seem feasible.

Brain Teaser

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- What is in the budget for 2017/18 and the medium term for a Kenyan Youth graduate who has been 'tarmacking' since 2014 after graduation and has no prospects of employment?
- What is in the budget for 2017/18 and the medium term for a Kenyan who has been trying to set up a small scale industry?
- What is in the budget for 2017/18 and the medium term for a farmer who has been affected by drought and lost his investment in the farm?

2. **Alignment with medium-term priorities**: *Was the budget closely aligned with the medium-term strategic priorities of government?*

This is a transition budget which is finalizing the second Medium Term Plan and implementing the third Medium Term plan of Vision 2030 but there is no review of the major achievements under the second medium term plan as well as the status of implementation of key projects under this plan. It is hard to link the 2017/18 budget to previous and future budgets as the targets remain the same and there is no report of past performance. Furthermore, some targets have not been achieved within the indicated timeframe. It is important to note also that the general lack of adherence to the Budget Policy Statement which was approved barely two months before the budget was brought casts doubt on whether planning is really a part of the budgeting process and whether the whole process of consultation with the legislature informs the final estimates of expenditure.

3. **Effectiveness of development budget framework**: *Does the development budget framework meet the national development needs in a cost-effective and coherent manner?*

Development expenditure is estimated to decline in nominal terms and also as a share of GDP. It should be noted that development expenditure is rarely well absorbed and that exchequer releases tend to be lower than the approved estimates. Furthermore, funds allocated for development expenditure in the printed estimates tend to differ substantially from those in the supplementary budget with significant downward revisions of the development budget. This raises concern on the amount of resources that ends up actually being utilized for development expenditure. Cost effectiveness also requires projects to be finished within the indicated time frame. However, a review of status of projects in the country indicates that quite a number are unlike to be finished within the expected time frame. In the long run, this leads to project overruns as well as delays in the envisaged returns.

4. **Justifying the allocations**: *Did the budget present a comprehensive, accurate and reliable account of public finances?*

Ideally, the budget should contain all revenue and all expenditure to be incurred by the Government in a particular financial year. However, it is noted that there are some key ongoing national projects which are funded through public private partnership and which are not included in the budget. Such projects usually carry a risk of becoming contingent liabilities and it would be prudent to include them in the Budget Estimates.

Income tax is expected to be the key driver of high revenue collection in the 2017/18 financial year. All other tax heads seem to slow down in 2017/18 and the two outer medium term years. This means that if income tax does not perform as expected, then the estimated revenues may not be attained. Considering recent performance of key revenue sources, and modest expected economic growth rates (5-6%), if revenue grew by a more conservative growth rate of 12-14%, then the 2017/18 ordinary revenue estimates (excluding AIA) would be overestimated by as much as Ksh. 46 billion. Drought, electoral challenges and expected economic slowdown could potentially affect revenue growth with implications on revenue sharing, fiscal deficit and debt sustainability. The country's continued fiscal expansion remains the greatest challenge to reducing deficit. Concern over low deficit levels being a moving target has been raised continuously in previous budgets. Given the increasing expenditure demands and no clear policy towards fiscal consolidation, the deficit level is likely to continue expanding.

5. **Quality of prospective management and monitoring plan**: *Is there a concrete plan to manage and monitor commitments made in the budget?*

It is not clear whether the commitments made in the 2016/17 budget are being monitored as the status of ongoing projects and the targets achieved in the previous financial years have not been indicated. Going forward, watch out for in year adjustments through revised/ supplementary estimates where annual approved spending plans are subjected to reallocations not in tandem with expected outputs and targets.

I. INTRODUCTION

1) This is the final budget to be prepared under the current administration, as the country prepares for the general elections that will be held in August 2017. It was tabled in the House on 15th of February; two months before the constitutional deadline of April. This was as a result of a revised budget calendar to allow for timely deliberation and approval of the budget, taking into account the preparation of the 2017 general elections. As such, the implementation as well as foreseeable impact of the 2017/18 budget on economic growth and development is fraught with significant downside risks; typical of an election year.

2) Being an election year budget, the first and most obvious risk to the implementation of this budget emanates from an uncertain business environment that may erode investor confidence due to the uncertainty that typically surrounds election years. Secondly is the likelihood of increased election related spending which will mainly drive consumption and fuel inflation thereby destabilizing the macro-framework; an outcome that will pose significant risk not just to budget implementation but also performance of the economy. Thirdly is the possibility that a new administration may want to re-align the budget to reflect their manifesto which may lead to a number of supplementary budgets being implemented. Another significant risk to the budget is the industrial unrest which is adversely impacting on the labour market contribution to the economy. As such, the budget may not be implemented as envisaged with considerable impact on the expected outcome particularly on economic growth and development hence the need to approve a conservative budget that can allow flexibility once the elections are over.

3) The National Treasury has indicated that the economic policy of the 2017/18 budget is to consolidate the economic gains of the transformation agenda that was started four years ago. This is in addition to the strategic interventions that were started in the FY 2013/14 budget. The focus of the budget is therefore on key government flagship projects in Energy and Infrastructure such as Loiyangalani Suswa transmission line, Olkaria lessos power lines construction project, Eastern Electricity Highway project (Ethiopia Kenya Interconnector), multinational Kenya Tanzania power connection project, Last Mile Connectivity, street lighting, Mombasa Port Area Roads Development Project / dongo kundu bypass, Low volume seal roads, Northern Corridor Transport Improvement Project, Southern Sudan Eastern Africa Transport Trade & Development Facilitation among other key projects such as the Standard Gauge Railway and LAPSSET. There are also ongoing irrigation projects like Galana Kulalu as well as Mwea irrigation project.

4) It has also been stated that this budget is implementing the third medium term plan of Vision 2030. There is need therefore to review the major achievements under the second medium term plan as well as the status of implementation of key projects under this plan. This has not been provided.

5) **To this end, unpacking of the 2017/18 budget attempts to address the following pertinent issues:**

i. Compliance of the budget to the legal provisions of the budget;
ii. How the overall budget links with the Policy priorities of the Government;
iii. The realism of the Macro-Fiscal Framework underpinning the budget;
iv. Debt and deficit financing; and
v. Equalization fund and the budget for SAGAs.

II. LEGAL COMPLIANCE OF 2017/18 PROPOSED BUDGET ESTIMATES

6) The budget process is underpinned by various legal instruments, namely; the Constitution of Kenya, the Public Finance Management (PFM) Act as well as the PFM Regulations. A review of the budget documents submitted to Parliament in relation to these legal documents indicates a **70.55 percent** legal compliance rate.

Some of the key concerns with regards to the extent of legal adherence are as follows:

i. The ceilings provided in the 2017/18 budget estimates, do not adhere with the ceilings in the adopted BAC report on the 2017 BPS. Though a memorandum has been provided which gives an explanation of deviations from the National Assembly resolutions, these are not exhaustive enough as the ceilings given to the MDAs were issued before parliament made resolutions through its report on the Budget Policy Statement 2017.

ii. The PFM provision that ceilings for development expenditure and personnel spending of the national government budget approved by Parliament shall be binding for the next two years has not been adhered to which renders unpredictable, the fiscal framework for the medium term. For instance, whereas overall development expenditure is declining over the years and can therefore be said to broadly be 'within ceiling,' the allocation for wages and salaries is on an increasing trend with Ksh. 360.8 billion having been approved in the 2016/17 budget for wages and salaries, which has since increased to Ksh. 398.8 billion in 2017/18 BPS and 365 billion in the 2017/18 proposed budget.

iii. Some information regarding payments to be made and liabilities to be incurred for which an appropriation act is not required including those that need constitutional approval or national legislative authority has not been provided. This is particularly with regard to information on public private partnership projects which carry the risk of becoming contingent liabilities.

iv. Estimates of revenue allocated to and expenditures for the equalization fund 2017/18 were not submitted to Parliament as required even though there are indications in the budget proposals that the fund has been allocated Ksh. 7.7 billion.

v. There is no publication of citizens' budget (Mwananchi's guide) on National Treasury Website as required under PFM regulations 6(2) which hampers citizen participation in the budget process.

The detailed analysis is provided in Annex 1.

III. REALISM OF FRAMEWORK UNDERPINNING THE BUDGET

7) According to the macro-framework underpinning the 2017/18 budget, the economy is projected to expand by 5.9 percent in 2017, down from 6.0 percent in 2016. This growth momentum will be maintained over the medium term supported by output in agriculture, ongoing recovery of tourism and completion of key public projects in roads, rail and energy generation. In addition, strong consumer demand and private sector investment as well as a stable macroeconomic environment in the country will help reinforce this growth. Inflation and interest rates are expected to remain stable; whereas the exchange rate is expected to remain competitive.

8) The macroeconomic indicators as contained in the Budget Policy Statement are illustrated in the table below:

Table 1: Macroeconomic Indicators, 2014/15 – 2019/20

		2014/15 *Act.*	**2015/16** *Prel.*	**2016/17** *BPS '17*	**2017/18** *BPS '17*
National Account and Prices (annual percentage change)					
Real GDP		5.5	5.8	6	6.2
CPI Index (avg)		6.6	6.4	5.6	5
Ksh per US$ (eop)					
Investment and Saving					
Investment	%GDP	22.5	23.3	23.9	24.4
Central government	%GDP	8.7	7.2	7.8	7.6
Other	%GDP	13.8	16.1	16.1	16.9
Central government budget					
Total Revenue		19.1	18.8	20.4	20.6
Total expenditure and net lending		28.2	27.1	27.8	27.6
overall balance (commitment basis) excl. grants		-9.2	-8.3	-7.4	-7
primary budget balance		-5.4	-4.2	-3.8	-3
Net domestic borrowing		4.3	3.1	3.1	3.9
External Sector					
Exports value (goods and services)		19.6	18.9	19.2	21.7
Imports value (goods and services)		32.2	29.7	29.1	31.5
reserve coverage in months of next years imports		4.9	4.3	4.3	4.9
reserve coverage in months of this years imports		4.6	4.8	5.1	5.3

Realism of the fundamentals driving growth:

Output in agriculture

9) According to the budget summary, significant effort has been made towards improving agricultural production with resources allocated towards key irrigation projects as well as mechanization of agriculture. However, it should be noted that despite these interventions, Kenya's agriculture remains rain-fed which has rendered the country vulnerable to adverse weather shocks. Drought is a natural phenomenon, but with proper strategic planning, famine can be avoided. The dire food shortage in the reported 23 counties is therefore not a natural phenomenon but an issue that could have been addressed through key strategic interventions in the budget.

> Almost half of Kenyans, at 43 percent, went to bed hungry in the past three months while another 65 percent skipped meals due to lack of money over the same period
>
> -*Twaweza East Africa*

10) As observed in the Budget Options 2017/18, the agricultural sector has actually been experiencing resource gaps on account of lower than required funds being allocated to certain projects; with expenditure on agriculture accounting for less than 5 percent of the total budget. In some instances, the funds are allocated in the annual estimates but are reduced or removed completely in the supplementary budget. As a result some key projects have stalled.

11) Insufficient food production has increased a need for food importation thereby contributing to a worsening of the current account balance. As at 2015, statistics indicate that a total of Ksh. 8.7 billion worth of maize was imported. With the ongoing drought, increased importation of food may further increase the import bill, thereby destabilizing the macro-framework.

12) There are several inherent structural weaknesses in the agriculture sector which prevent it from attaining its full potential despite resource allocations in the budget. Improving agricultural production will require addressing these weaknesses under production, storage and distribution as well as access to credit. It will also specifically require addressing the issue of certified seeds. As noted in the Budget Options,

"Certified seeds are costly and are not readily available in the market. This has necessitated the government to provide certified seeds to farmers at a subsidized cost. However, measures to ensure the quality of these seeds are not very stringent hence some certified seeds may not be of good quality. Furthermore, the mechanisms of distribution is not straightforward and distribution is typically delayed; a factor that disadvantages the farmer because the planting season is affected. Many farmers find it difficult to access the subsidized inputs. Distribution mechanisms for seeds and fertilizers should therefore be reviewed to ensure that these are released in a timely manner and any farmer is in a position to access the inputs."

Recovery of Tourism

13) Tourism is a key factor driving economic growth in Kenya. However, in recent times, challenges in the business environment such as heightened insecurity have adversely affected performance of this sector. As such, recovery of tourism requires significant investment in the security infrastructure. It is indicated in the budget that security has been enhanced through modernized police equipment as well as improved police mobility. However, a review of the status of projects indicates that the police modernization project is possibly off-track as it is only 40 percent complete despite indications that it should be completed by 2018 (Table 5). The project on securitization of the Somali border which was supposed to be finalized this year is only 2.3 percent complete. With key security projects being off-track, security remains a challenge not only to tourism but also the business environment especially since this is an election year.

14) However, it should be noted that improving tourism is not all about putting money in security and improving the business environment. Without key strategic interventions, tourism as a driver of growth may not yield much. Focus should also be on exploring more tourism opportunities other than the traditional game park tourism or beach tourism. There is need also to explore more markets other than the traditional European markets including promotion of local tourism. The country needs to seriously re-think its strategy and to invest more in innovations in addition to trying new products and improving service delivery.

Completion of key projects in road, rail and energy

15) The key projects expected to drive growth in 2017 include the Standard Gauge Railway, roads including LAPSSET project implementation as well as power production through investment in renewable sources of energy. The key concerns here are twofold:

i. Firstly, development projects in the country typically face a risk of delayed completion due to under-absorption of development funds. Some projects are usually allocated funds but then this is revised in the supplementary budget. Completion of these projects will therefore require budget discipline. This is further illustrated in part IV of this analysis on development expenditure.

ii. Secondly, for some of these projects, the benefits are likely to be felt with a time lag. Are the timelines for the projects being adhered to? A review of the status of key projects indicates otherwise.

16) It may be necessary to ensure that performance contracting in the public sector should include a component on efficiency and effectiveness that is linked to project implementation and absorption of development funds.

Growth of private investment

17) As indicated earlier, election periods are typically marked by slowdown in private sector investment. Furthermore, there is noted increased domestic borrowing in the fiscal framework. Should this trend continue then it will be to the detriment of the private sector investment. Importantly, the deficit occasioned by public sector spending must be reviewed.

Strong consumer demand

18) Increase in (election related) spending may fuel consumption which is a key component of economic growth. However, such high spending will also fuel inflation; a situation that will be made worse by ongoing drought as well as fuel prices which have slowly been edging upwards. Strong consumer demand is therefore a double edged sword as it comes with a price of likely destabilization of the macro framework.

Macroeconomic stability

i. Inflation

19) The annual average inflation for 2016 was 6.3 percent down from 6.6 percent in 2015. The month on month inflation increased from 6.35 percent in December 2016 to 6.99 percent in January 2017 and 9 percent in February 2017. High food inflation has been on the rise since August 2016 and is a key driver of inflation. However, fuel prices have also been on the rise in the recent past. Scarcity of water is also a key factor driving inflation as residents of Nairobi and its environs have to purchase water to supplement their daily needs. As such, as seen in Table 2 below, the share of the Housing, Water, Electricity, Gas and other Fuels index in inflation has increased rapidly from 0.22 percent in January to 5.38 percent in February. According to the KNBS, inflation increase in this index is mainly driven by increase in cost of electricity, kerosene and house rents which has outweighed the decrease in price of cooking gas. Another significant jump is noted in the transport index share from 2.73 percent to 4.66 percent which can be attributed to increased fuel costs which have increased transportation costs.

20) Going forward, the key risks to inflation are high food prices and election related expenditures as well as continued water scarcity. Given ongoing trends, inflation is likely to reach double digits by mid-year, a trend that is likely to persist at least until after the elections and will likely peak towards the end of the year.

Table 2: Contribution to Inflation (Jul. 16 - Jan.17)

Category	Feb. 16	Mar. 16	Apr 16	May 16	Jun 16	Jul. 16	Aug. 16	Sep. 16	Oct. 16	Nov 16	Dec. 16	Jan. 17	Feb. 17
Food & Nonalcoholic Beverages	61.81	57.27	50.39	52.00	61.54	68.25	78.58	70.11	70.67	65.15	74.50	77.05	75.08
Alcoholic Beverages, Tobacco & Narcotics	4.54	5.11	6.00	6.51	5.56	5.15	5.93	5.26	5.17	4.67	1.04	1.01	0.91
Clothing & Footwear	5.49	5.91	7.11	6.60	5.20	4.53	5.49	4.98	5.51	5.61	6.00	5.12	4.05
Housing, Water, Electricity, Gas and other Fuels	8.13	10.66	12.61	8.59	6.47	2.96	0.92	1.56	-0.13	0.59	0.20	0.22	5.38
Furnishings, Household Equipment and Routine Household Maintenance	4.54	4.95	5.67	5.69	4.53	3.82	4.64	4.01	3.54	3.37	3.70	3.10	2.36
Health	2.69	2.73	3.37	2.62	2.18	1.97	2.18	1.92	1.86	1.61	1.78	1.21	1.41
Transport	-0.43	-0.45	-1.31	2.20	1.05	1.25	-12.18	-0.59	0.55	1.81	0.46	2.73	4.66
Communication	1.62	1.71	2.11	2.12	1.30	1.21	1.38	1.22	1.23	1.12	1.08	0.95	0.08
Recreation & Culture	1.44	1.53	1.92	2.03	1.90	1.67	1.98	1.72	1.74	1.63	1.83	0.86	0.55
Education	2.16	2.24	2.72	2.92	2.57	2.33	2.62	2.29	2.27	2.05	2.33	1.58	1.17
Restaurants & Hotels	4.28	4.43	4.99	5.12	4.78	4.05	4.93	4.30	4.46	4.20	4.11	3.44	2.44
Miscellaneous Goods & Services	3.72	3.91	4.43	3.61	2.93	2.82	3.52	3.21	3.13	8.17	2.97	2.74	1.91
TOTAL	100	100	100	100	100	100	100	100	100	100	100	100	100

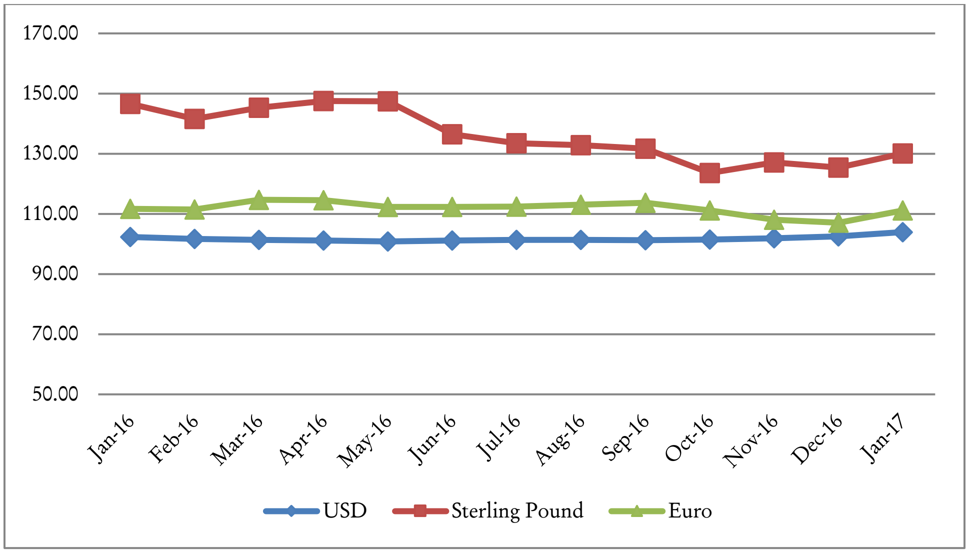
Source: KNBS, PBO

ii. Exchange Rate

21) For the period January 2016 to January 2017, there was stability in the exchange rate of the Kenyan Shilling to the US Dollar and the Euro, standing at 103.96 and 111.16 respectively by end of January 2017. However, the Kenya Shilling appreciated to the Sterling Pound from 146.57 in January 2016 to 130.09 in January 2017, a likely effect of a weak Sterling Pound in the international markets attributable to the UK's exit from the European Union (BREXIT).

22) Though a relatively stable outlook for the Kenya Shilling has been projected in 2017, rising inflation is likely to be accompanied by erosion in the value of the shilling relative to that of Kenya's trading partners. Furthermore, change in investor confidence on account of this being an election year may lead to reduction in inflow of forex as investors adopt a wait and see attitude. Some may hedge exposure to the shilling by converting their shillings to the increasingly strong US dollar. This will exert some pressure on the shilling. It should be noted also that fuel prices are slowly inching upwards; mostly on account of a strong dollar which is piling pressure on the shilling and consequently the pump prices. The global crude prices are expected to increase as OPEC and other major oil producing countries agreed to cut back on oil production but increasing US stockpiles may erode these gains. Overall, the crude prices are expected to edge upwards though this is largely dependent on whether an optimal supply-demand balance will be achieved. High fuel prices lead to a high import bill which can be worsened by food importation. This will exert pressure on the current account balance with adverse effects on the Shilling.

Figure 1: Exchange rate for the period Jan. 2016- Jan. 2017



Source: CBK

iii. Balance of Payments

23) The Balance of Payments deteriorated from a surplus of USD 458.1 Million in October 2015 to a deficit of USD 941.4 Million by October 2016. During the same period the current account deficit improved from USD 4361.7 Million to USD 3716.4 Million which may be attributed to a decline in the value of imported goods (mostly petroleum products). However, this improvement may be reverse when the oil prices start to increase in the international market. Importation of food may also increase the import bill.

24) Based on these fundamentals, an economic growth target of 5.9 percent may not be achieved. Indeed, the economy is projected to grow at 5.8 percent in real terms. Lower growth implies lower revenue collection which may hamper implementation of the budget as has been envisaged.

IV. KEY HIGHLIGHTS OF THE 2017/18 BUDGET

How much is in the proposed 2017/18 Budget?

Table 3: Key Highlights of the 2017/18 proposed Budget

		2016-17	2017-18	2018-19	2019-20	2016-17	2017-18	2018-19	2019-20
		Kshs. Billions				% of GDP			
National Government	*Recurrent*	*878.41*	*942.31*	*1,010.83*	*1,088.67*	11.81	11.37	10.92	10.86
	Development	*752.09*	*636.03*	*677.15*	*745.28*	10.12	7.68	7.31	7.44
	Total	***1,630.50***	***1,578.34***	***1,687.97***	***1,833.94***	**21.93**	**19.05**	**18.23**	**18.30**
Judiciary*	*Recurrent*	*13.46*	*13.80*	*14.19*	*14.60*	0.18	0.17	0.15	0.15
	Development	*4.15*	*4.20*	*5.18*	*5.83*	0.06	0.05	0.06	0.06
	Total	***17.61***	***18.00***	***19.37***	***20.43***	**0.24**	**0.22**	**0.21**	**0.20**
Parliament**	*Recurrent*	*27.40*	*36.06*	*30.01*	*31.80*	0.37	0.44	0.32	0.32
	Development	*3.15*	*4.15*	*3.50*	*3.50*	0.04	0.05	0.04	0.03
	Total	***30.55***	***40.21***	***33.51***	***35.30***	**0.41**	**0.49**	**0.36**	**0.35**
CFS	*Interest Payments*	*250.79*	*280.72*	*291.40*	*319.80*	3.37	3.39	3.15	3.19
	Debt Redemptions	*215.73*	*341.04*	*412.16*	*279.18*	2.90	4.12	4.45	2.79
	Pensions etc	*60.79*	*77.46*	*91.97*	*109.44*	0.82	0.94	0.99	1.09
	Total	***527.31***	***699.22***	***795.53***	***708.42***	**7.09**	**8.44**	**8.59**	**7.07**
County Allocation***		***295.34***	***295.34***	***328.51***	***354.88***	**3.97**	**3.57**	**3.55**	**3.54**
Overall Budget		***2,501.30***	***2,631.11***	***2,864.90***	***2,952.98***	**33.64**	**31.76**	**30.94**	**29.47**
GDP		*7,435.21*	*8,284.28*	*9,258.79*	*10,021.79*	100.00	100.00	100.00	100.00

**Judiciary and Judicial Service Commission*

*** Parliamentary Service Commission and National Assembly*

**** As provided in the Budget Summary for Fiscal Year 2017/18*

25) The overall Budget for the three arms of government, including Consolidated Fund Services (CFS) and County Allocation, has increased in FY 2017-18 by 5.2 percent to 2.631Trillion from 2.501 Trillion in FY 2016-17. However, the overall budget has declined as a share of GDP from 33.6 percent to 31.8 percent.

26) The CFS has the highest increase of 32.6 percent, mainly for redemption of debt in FY 2017-18 (Ksh. 79 billion external debt redemption owed to Standard Chartered) and an increase in pensions etc. The National Government Ministerial expenditure has reduced by 3.2 percent owing to a decrease in development expenditure.

Fiscal Policy

27) The fiscal policy framework for the 2017/18 financial year aims at supporting rapid and inclusive economic growth, ensuring a sustainable debt position while supporting the devolved system of governance for effective service delivery. Fiscal policy also indicates a deliberate convergence path towards the East African Community Monetary Union protocol's fiscal targets.

28) As a share of GDP, the fiscal framework for FY 2017-18 and the medium term indicates that expenditures will decline to 27.6 percent from 30 percent in FY 2016-17.

29) It is worth noting that the fiscal policy direction of the country is not clear. As noted in the budget options 2017/18, despite allusions towards pursuing fiscal consolidation through rationalization, realignment and reprioritization of programs and resources, the government's fiscal strategy appears to be expansionary with most of the expenditure geared towards infrastructure investment. The 2017/18 budget seems to support expansionary policy as there are funds allocated towards economic stimulus projects. This may explain why a fiscal deficit target of 6 percent that this House committed to in the 2017 BPS does not seem feasible. The key concern here is that though expansionary fiscal policy is a useful tool in addressing economic growth in times of economic contraction and creating employment, it should not be done in perpetuity as eventually, the budget deficit will become too large, leading to unsustainable debt. As such, expansionary fiscal policy should be a short term, not a long term tool.

30) This is probably why though the national treasury acknowledges the need to reduce the deficit and the indications are that it will decline from 9.6 percent in FY 2016-17, 6.3 percent in FY 2017-18 and 4.3 percent in FY 2019-2, the roadmap towards achieving it remains unclear. Kenya is required, under the East Africa Monetary Union, to attain 3 percent level of fiscal deficit by FY 2020/21. There is need for specific measures to be put in place to achieve this otherwise it remains a moving target. The persistent widening of the deficit over the medium term actually renders unpredictable the entire process of budgeting.

Development expenditure

31) The development expenditure is estimated to decline in nominal terms from Kshs. 727.7 Billion in 2016-17 to Kshs. 644.4 Billion in 2017-18; and also as a share of GDP from 9.8 percent to 7.7 percent. The decline in development expenditure to 39.4 percent of total ministerial expenditure in FY 2017-18 from 48.9 percent in FY 2016-17 is on account of a reduction in Capital transfers, other expenses and Non-financial Assets. It is worth noting that there are new categories in the 2017-18 budget estimates, namely Compensation to employees(mainly for the Youth empowerment programme);use of goods and services (National social safety net, Road Transport, Livestock Resources Management, Population management services, others) and Financial Assets (Gender empowerment).

32) It should be noted however, that development expenditure is rarely well absorbed. Also, funds allocated for development expenditure in the printed estimates tend to differ substantially from those in the supplementary budget with significant downward revisions of the development budget. This raises concern on the amount of resources that ends up actually being utilized for development expenditure.

Table 4: Trends in Development Expenditure from 2013/14-2015/16 per sector

	sectors	Net Estims	Exchequer Releases	Variation	% Var	Net Estimates	Exchequer Releases	Variation	% Var	Net Estimates	Exchequer Releases	Variation on Net estimates vs. Exchequer	% Variation
1	Agriculture, Rural & Urban Development	42.4	33	**9.4**	**78%**	50.5	38.7	**11.8**	**77%**	43	37.2	**5.8**	**87%**
2	Education	16	6.6	**9.4**	**41%**	18	16	**2**	**89%**	16	12	**4.2**	**74%**
3	Energy, Infrastructure and Information Communications Technology	94	73.1	**20.9**	**78%**	112.1	88.3	**23.8**	**79%**	111.9	106	**5.9**	**95%**
4	Environment Protection, Water and Natural Resources	22	20.9	**1.1**	**95%**	27.6	22.1	**5.5**	**80%**	22	18.2	**3.8**	**83%**
5	General Economic and Commercial Affairs (GECA)	4.6	4.5	**0.1**	**98%**	8.3	5.3	**3**	**64%**	9.5	8.7	**0.8**	**92%**
6	The Governance, Justice, Law and Order (GJLOS)	9.5	8.1	**1.4**	**85%**	12.7	6.7	**6**	**53%**	19.4	16.9	**2.5**	**87%**
7	Health	14.4	13.9	**0.5**	**97%**	17.5	10.5	**7**	**60%**	21.5	17	**4.5**	**79%**
8	Public Administration and International Relations	64	57.7	**6.3**	**90%**	97.3	70.8	**26.5**	**73%**	108.5	103.4	**5.1**	**95%**
9	Social Protection, Culture and Recreation	8.1	6	**2.1**	**74%**	13.2	11.9	**1.3**	**90%**	17.4	13.3	**4.1**	**76%**
	Total	275	223.8	**51.2**	**81%**	357.2	270.3	**86.9**	**76%**	369.5	332.8	**36.7**	**90%**

33) According to the Public Finance Management Act 2012, a minimum of 30 percent of the national government's budget should be allocated to development expenditure over the medium term. Though the 2017/18 development budget is estimated at 32.3 percent of the total budget with projections at 32.4 percent and 32.6 percent in FY 2018/19 and 2019/20 respectively, given the low absorption rate of development expenditure and the revisions received during the supplementary budget. Thus, unless concrete measures are put in place to address this anomaly, it is possible that the amount of funds actually spent on development expenditure is significantly less than 30 percent.

34) There is need to review the manner in which projects are implemented, especially since key projects seem to take extremely long to complete; a factor that erodes the expected gains from the project. The state of development expenditure is such that this will likely result in slowdown in completion of projects. Table 4 below shows the status of some key projects in the budget which are expected to drive growth, particularly in the agriculture and industry sector. It is apparent that not only do the projects receive significantly less amounts than is required with respect to the total cost of the projects as well as the expected date of completion, but also that the total amount that has actually been expended or used, is actually less than what has been allocated in the budgets. This typically leads to delays in projects which has an impact on economic performance.

Table 5: Status of key projects in Agriculture, Security and Industry Sectors as at 2017/18 (Ksh. Mln)

Name of the Project	Start Date	Completion Date	2016/2017	2017/2018	Amount Expended	Total Cost	% level of completion
Construction of Forensic Laboratory	1-Mar-14	19-Mar	940	936	747	3,949	18.9
Police Modernization	14-Jul	18-Jul	10,299	10,354	20,000	50,000	40
Securitization of the Somalia Border	14-Jul	17-Jun	2,000		908.7	40,000	2.3
Bulk procurement of fertilizer and assorted seeds	Jun-08	Continuous	4,948	5,030	28,000	42,500	
Development of agriculture technology innovation centre	Jul-15	Jun-22	35	24		1,665	
Strengthening mechanization	Jul-16	Jun-21	113	119		1,500	new project
Small scale irrigation and value addition project	Feb-16	Dec-21	886	1,045		6,544	new project
Ease of Doing Business Project	2014	2018	505	250	120	420	40.00%
Athi River Textile Hub – EPZA	2014	2018	2,051	800	1,325	6,500	33.00%

Name of the Project	Start Date	Completion Date	2016/2017	2017/2018	Amount Expended	Total Cost	% level of completion
Kenanie Leather Industrial Park	2014	2018	1,235	800	600	4,000	15.00%
Modernization of Rivatex	2014	2019	500	450	375	1,000	
Acquisition of equipment and machinery New KCC.	2015	2019	500	-	100	1,700	

Recurrent expenditure

35) The recurrent expenditure is estimated to increase in nominal terms through to the medium term, though the impact on GDP is negligible. However, it should be noted that the measure of GDP used may not be achieved on account of dynamics that will be discussed in part III of this analysis. As such, the minimal impact of recurrent expenditure as a percentage of GDP may simply be a denominator effect.

36) In terms of total ministerial expenditure, the recurrent expenditure is set rise from 51.1 percent of the total ministerial expenditure in FY 2016-17 to 60.6 percent in FY 2017-18. According to the economic classification of expenditures, the increase in recurrent is mainly attributable to an increase in Compensation to employees and current transfers. According to the economic classification of expenditures, the increase in recurrent is mainly attributable to an increase in Compensation to employees and current transfers. However, a review of the medium term fiscal framework indicates different estimates for the component of wages and salaries at Ksh. 365 billion compared to Ksh. 384.9 billion from the classification of government expenditure. Worth noting also, is the indicated reduction in compensation to employees from the Ksh. 398.8 billion in the BPS to Ksh. 365 billion despite the ongoing labour market unrest in the Health and Education sectors. It is not clear whether or how this issue will be addressed in the current budget. If changes are implemented then they are likely to alter the fiscal framework.

37) It should be noted also that the national government level of compensation to employees does not capture compensation to employees in the state corporations. According to the State Corporation budget for 2017/18, Ksh. 214.6 billion (35 percent of total recurrent expenditure in the state corporations budget) goes towards personnel emoluments. As such, it is possible that the national government's expenditure on wages and benefits for its public officers actually exceeds 35 percentage of the national government revenue contrary to the regulations.

38) In addition, there are new categories in the 2017/18 budget estimates such as subsidies (Secondary Education and Tourism Development and promotion Programmes); Social benefits (mainly General Administration Programme in National Treasury); Non- Financial Assets (Policing Services

Programme in State Department for Interior and Crop Development Programme in the State Department for Agriculture); Financial Assets (University Education and General Administration Programme in National Treasury).

39) It is worth noting that the ceiling for ministerial recurrent expenditure as approved in the 2017 Budget Policy Statement has been exceeded by Ksh. 11 billion.

Table 6: Fiscal Framework for 2017/2018 and the Medium Term

		2015-16	2016-17	2017-18	2018-19	2019-20
Total Revenues & Grants	**Kshs. Millions**	**1,267,480.0**	**1,566,935.0**	**1,763,324.0**	**1,974,099.0**	**2,248,244.0**
	% of GDP	**19.48%**	**21.07%**	**21.29%**	**21.32%**	**22.43%**
o/w Revenues	*Kshs. Millions*	*1,237,883.0*	*1,515,464.0*	*1,704,503.0*	*1,914,103.0*	*2,166,878.0*
	% of GDP	*19.02%*	*20.38%*	*20.58%*	*20.67%*	*21.62%*
o/w Grants	*Kshs. Millions*	*29,597.0*	*51,471.0*	*58,821.0*	*59,996.0*	*81,366.0*
	% of GDP	*0.45%*	*0.69%*	*0.71%*	*0.65%*	*0.81%*
Total Expenditures	**Kshs. Millions**	**1,692,146.5**	**2,285,573.5**	**2,290,067.0**	**2,452,734.4**	**2,673,795.6**
	% of GDP	**26.00%**	**30.74%**	**27.64%**	**26.49%**	**26.68%**
o/w Ministerial Recurrent	*Kshs. Millions*	*706,496.6*	*919,260.9*	*992,171.3*	*1,055,024.0*	*1,135,072.0*
	% of GDP	*10.86%*	*12.36%*	*11.98%*	*11.39%*	*11.33%*
o/w Ministerial Development	*Kshs. Millions*	*451,831.1*	*759,397.6*	*644,379.3*	*685,826.0*	*754,603.0*
	% of GDP	*6.94%*	*10.21%*	*7.78%*	*7.41%*	*7.53%*
o/w Interest, Pensions, etc.	*Kshs. Millions*	*269,779.8*	*311,580.0*	*358,180.3*	*383,372.4*	*429,244.6*
	% of GDP	*4.15%*	*4.19%*	*4.32%*	*4.14%*	*4.28%*
o/w County Allocations	*Kshs. Millions*	*264,039.0*	*295,335.0*	*295,336.0*	*328,512.0*	*354,876.0*
	% of GDP	*4.06%*	*3.97%*	*3.57%*	*3.55%*	*3.54%*
Fiscal Deficit (incl. grants)	**Kshs. Millions**	**(424,666.5)**	**(718,638.5)**	**(526,743.0)**	**(478,635.4)**	**(425,551.6)**
	% of GDP	**-6.53%**	**-9.67%**	**-6.36%**	**-5.17%**	**-4.25%**
GDP	**Kshs. Millions**	**6,508,084.0**	**7,435,211.0**	**8,284,284.0**	**9,258,788.0**	**10,021,791.0**

Source: National Treasury

Expenditure by Classification of Functions of Government

40) The Classification of Functions of Government (COFOG) is used to link the Government budget to ten general functions. This ensures efficient allocation of funds to the intended key broad objectives of the Government. A key advantage of COFOG is that it enables tracking of government spending, as highlighted in the budget that is aimed at eradication of poverty and job creation such as in health, education, social protection, economic affairs among others.

Table 7: Overall Ministerial Expenditure by Economic Classification (FY 2016-17 and 2017-18)

	2016/17	2017/18	2016/17	2017/18
	Ksh. Million		% of Total	
Recurrent	**857,526**	**992,171**	**51.11%**	**60.63%**
Compensation to employees	*341,769*	*412,518*	*20.37%*	*25.21%*
Use of Goods and services	*132,928*	*133,084*	*7.92%*	*8.13%*
Current Transfers	*327,395*	*389,605*	*19.51%*	*23.81%*
Other Recurrent	*55,434*	*57,027*	*3.30%*	*3.48%*
o/w Subsidies		*31,019*		*1.90%*
o/w Social Benefits		*5,644*		*0.34%*
o/wNFAs		*7,294*		*0.45%*
o/w Financial Assets		*12,411*		*0.76%*
Development	**820,161**	**644,379**	**48.89%**	**39.37%**
NFAs	*359,449*	*217,039*	*21.43%*	*13.26%*
Capital Transfers	*376,944*	*345,505*	*22.47%*	*21.11%*
Other Development	*83,768*	*81,835*	*4.99%*	*5.00%*
o/w Compensation to employees		*3,992*		*0.24%*
o/w Use of Goods and services		*64,582*		*3.95%*
o/w Subsidies		*896*		*0.05%*
o/w Financial Assets		*7,365*		*0.45%*
Total Ministerial	**1,677,687**	**1,636,551**		

41) According to the Classification of Functions of Government (COFOG) Framework, the expenditure as a share of GDP is set to decline in FY 2017-18 for all of the functions, with the highest decline being in the Economic Affairs function from 7.8 percent of GDP in FY 2016-17 to 5.5 percent of GDP in FY 2017-18. The decline in the Economic affairs function can be attributed to a reduction in allocation for capital spending in the allocation in transport and infrastructure.

Table 8: Expenditure according to COFOG

	Kshs. Millions		% of GDP	
	2016-17	2017-18	2016-17	2017-18
General Public Service	**815,645**	**911,249**	11.0%	11.0%
o/w Interest Payments	*250,787*	*280,720*	3.4%	3.4%
Defense	**124,045**	**130,223**	**1.7%**	**1.6%**
Public Order and Safety	**146,456**	**148,162**	**2.0%**	**1.8%**
Economic Affairs	**576,345**	**452,252**	**7.8%**	**5.5%**
o/w Transport and Infrastructure	*358,338*	*290,406*	4.8%	3.5%
Environmental Protection	**84,412**	**70,816**	**1.1%**	**0.9%**
Housing and Community Amenities	**27,616**	**23,984**	**0.4%**	**0.3%**
Health	**60,270**	**61,640**	**0.8%**	**0.7%**
Recreation, Culture and Religion	**8,799**	**6,604**	**0.1%**	**0.1%**
Education	**339,924**	**375,337**	**4.6%**	**4.5%**
Social Protection	**29,748**	**32,340**	**0.4%**	**0.4%**

Source: KNBS, National Treasury

Consolidated Fund Services

42) The expenditure estimates for the Consolidated Fund Services (CFS) has recorded a significant increase of 32.60 percent from Ksh. 527.306 billion in the FY 2016/2017 to Ksh. 699.224 billion in the FY 2017/2018. The major driver of the increase in the CFS expenditures is public debt interest and redemptions which is increasing from Ksh. 466.514 billion in the FY 2016/2017 to Ksh. 621.764 billion in the FY 2017/2018. The internal debt interests is increasing from Ksh. 171.3 billion in the revised estimates to Ksh. 210.147 billion while external debt interest is increasing from Ksh. 62.4 billion in the revised estimates to Ksh. 70.572 billion in 2017/18. Internal debt redemption is increasing from Ksh. 172.104 billion in the FY 2016/2017 to Ksh. 191.99 billion in the FY 2017/18. External debt redemption is increasing from Ksh. 43.622 billion to Ksh. 149.046 billion.

43) For the FY 2017/18 the CFS expenditure will account for upto 41% of the projected Total Revenue of KSh. 1.704 trillion (FY 2017/18) projections (indicating that it only 60% of total revenue will be available for other government budgetary activities) and 8% of the total GDP (KSh. 8.3 trillion) indicating that upto 8% of total national output is dedicated to addressing debt related cost and other necessary expenditures such as pensions and allowances.

V. FINANCING OF THE 2017/18 BUDGET AND THE MEDIUM TERM

Revenue Projections

44) Overall expenditure estimates for 2017/18 financial year amount including net lending amount rises by 2% from Ksh. 2,232.3 billion in 2016/17 to KSh. 2,287.0 billion (27% of GDP). The budget will be financed through KSh. 1,704.5 billion total revenue, including AIA, grants amounting to KSh. 58.8 billion and Ksh. 523.7 billion of external and domestic borrowing (see fiscal framework in Table 9). Ordinary revenues, which excludes appropriations-in-aid (AIA) is estimated to reachKSh. 1.549 trillion in 2017/18. The estimates show that total revenue will expand by 12% while ordinary revenue, which excludes AIA, rises by 13% in 2017/18. Thus, revenue appears to revert to near normal growth after the unusual 23% rally in the revised 2016/17 revenue figures , quite some deceleration for excise duty, import duty and value added tax (VAT)

45) Income tax, however, rises by 16% in 2017/18 becoming the primary driver of revenue growth in 2017/18. About Ksh. 769.1 billion will be collected as income tax,Ksh. 106.2 billion more in 2017/18 relative to the current financial year, comprising of pay-as-you-earn estimated at Ksh. 400.6 billion, Corporate income tax at KSh. 365.2 billion and capital gains tax KSh. 3.5 billion.Excise duty collections, which were the best performing category in 2015/16, will grow less rapidly by a mere 11% as the positive effects of the Excise duty Act, 2015 review dissipate. Nevertheless, regular review of price indexes for specific duty goods category will ensure strong year-on-year yield of this tax.

Table 9: Financing the 2017/18 budget

	2015/16	2016/17	2017/18	2018/19	2019/20
Total Revenue	**1231.4**	**1515.5**	**1704.5**	**1914.1**	**2166.4**

	2015/16	2016/17	2017/18	2018/19	2019/20
Ordinary Revenue	**1151.8**	**1371.5**	**1549.4**	**1749.4**	**1993.2**
Import Duty	**79.2**	**90.4**	**102.4**	**115.0**	**129.2**
Excise Duty	**139.5**	**178.4**	**197.4**	**223.9**	**252.8**
Value Added Tax	**289.2**	**338.7**	**383.5**	**435.1**	**494.4**
Income Tax	**566.0**	**662.9**	**769.1**	**867.2**	**998.0**
Other taxes (Stamp duty)	**10.3**	**12.0**	**13.5**	**15.2**	**17.1**
Other revenue (income, fees, penalties)	**67.6**	**89.2**	**83.4**	**93.0**	**101.7**
AIA (local)	**79.7**	**143.9**	**155.1**	**164.7**	**173.2**
RDL	**17.3**	**18.9**	**21.3**	**23.9**	**26.8**
RML	**24.5**	**47.4**	**49.3**	**53.8**	**58.2**
Other (AIA)	**37.8**	**77.6**	**84.6**	**86.9**	**88.2**
Foreign Grants (AIA and Revenue)	**29.6**	**51.5**	**58.8**	**60.0**	**81.4**
Total Expenditure	**1781.9**	**2232.3**	**2287.0**	**2458.7**	**2676.6**
Deficit (incl grants)	**-520.9**	**-665.4**	**-523.7**	**-484.6**	**-428.9**
Loan financing	**520.9**	**665.4**	**523.7**	**484.6**	**428.9**
Domestic borrowing		**280.1**	**328.9**	**365.5**	**236.2**
Commercial borrowing		**153.8**	**150.0**	**125.0**	**53.0**
Other Financing		**231.5**	**44.8**	**-5.8**	**139.7**

46) Value Added Tax, the second largest tax category similarly slows down in 2017/18 despite a strong estimated growth of 17% in 2016/17. Growth of VAT does not necessarily correlate strongly with the growth of GDP in recent years. The share of VAT in GDP only rose marginally in 2013/14 following the repeal of the legal regime, but has since declined to about 4%. Import duties continue to perform poorly, with the share to GDP at about 1%. Income tax, VAT and excise duties therefore form the mainstay of Kenya's taxes, due to their relative sizes, and growth potential. Continued reforms to strengthen these revenue sources, particularly the lethargic VAT could help government finance rising expenditure and debt requirements.

47) Other forms of taxes such as stamp duty increase from Ksh. 12 billion in the revised estimates for 2016/17 to Ksh. 13.5 billion in 2017/18. Other types of revenue accruing to the government amount to Ksh. 83.4 billion which includes property income, mainly dividends, interest, rent and withdrawals from income of quasi-corporations at KSh. 23 billion; sale of goods and services which is estimated at KSh. 18.5 billion; fines, penalties and forfeiture at KSh. 1.8 billion, and other miscellaneous revenue at KSh. 3.4 billion. Dividend income from state corporations is estimated to fall fromKSh. 26.0 billion in the current financial year to KSh. 15.1 billion.

Debt and deficit financing

48) The deficit including grants will fall from revised estimate of Ksh. 665.4 billion in 2016/17 to Ksh. 523.7 billion, financed through Ksh. 328.9 net domestic borrowing, KSh. 150.0 billion of commercial loans, and net external borrowing of Ksh. 44.8 billion from concessional lenders (Table 9). Though the deficit appears to be decreasing over the medium term, the country's continued fiscal expansion remains the greatest challenge to this target being actualized. Indeed, concerns over low deficit levels being a moving target has been raised continuously in previous budgets. Given the increasing expenditure demands and no clear policy towards fiscal consolidation, the deficit level is likely to continue expanding.

49) It should be noted that level of net domestic borrowing has been revised upwards from the BPS level of Ksh. 320.9 billion to Ksh. 328.8 billion. This is indicative of pre-existing pressures that are already pushing borrowing upwards and away from the agreed framework in the medium term debt management strategy.Given that revenue performance in the next financial year is largely tied to reforms in the income tax law, depending on how the reforms are carried out, the revenue target may or may not be achieved which will only increase further, the level of borrowing. even so, it is interesting to note that a further evaluation of the internal debt as contained in the **budget summary assumes the net domestic borrowing at Ksh. 320.9 billion leaving close to Ksh. 8 billion unaccounted for**.

50) Contingent liabilities also continue to pose a risk to the macro-fiscal framework. The statement of national government loans to state corporations, government agencies and other organizations that has been provided indicates that of Ksh. 558 billion lent, Ksh. 572.2 billion remains outstanding/ unpaid. Out of these amounts, the non-performing loans amount to Ksh. 15.4 billion.

Debt Sustainability Analysis

Comparison of Public Debt DSA framework 2016/17 with figures quoted in budget summary 2017

	Threshold	**2014**	**2015**	**2016**	**2016** *(bgt. Summary 2017)*	**2017**	**2017** *(bgt.Summary 2017)*	**2018**	**2019**	**2020**
PV of Public Sector Debt to GDP Ratio	***74***	42.9	45.8	48.3	48.7	48.5	49.0	48.5	47.9	47
PV of Public Sector Debt To Revenue Ratio	***300***	221.1	231.8	237.8	247.2	232	235.7	228.1	224.5	218
Debt Service - to - Revenue Ratio	***30***	41	30.4	30		34.7		28.8	32.2	26.4

Source: National Treasury

51) In the Budget for 2016/17, data on public debt sustainability thresholds and performance was provided as indicated in the table above. Among the key concerns was that the ratio of debt service to revenue was projected to go beyond the threshold of 30 percent over the period 2016/17 on account of debt redemptions and interest rate costs which were expected to rise substantially in the

FY 2017/18. It is interesting to note that this information has been omitted in the Budget for 2017/18 and it is therefore not clear, what the debt service to revenue ratio will amount to especially since public debt interest and redemptions have increased substantially from Ksh. 466.514 billion in the FY 2016/2017 to Ksh. 621.764 billion in the FY 2017/2018.

52) It is also interesting to note that the estimates of the present value of debt to GDP ratio as well as the present value of public sector debt to revenue ratio are notably higher than what was projected in the 2016/17 budget. This concern is compounded by the fact that the country's public investments which we have been borrowing for, are largely off-track and are experiencing delays in implementation which translates to delays in expected returns from these projects. The delay also increases the cost of the projects.

53) It is noted that 2017/18 revenue estimates are based on a very optimistic 2016/17 estimated revenue base following the mid-year revision of budget estimates. For instance, income tax, excise duty, other revenues and AIA grow very strongly; in the revised 2016/17 figures fueling the 23% forecasted growth of total revenues by end of June 2017. Apart from income tax, all other tax heads seem to slow down in 2017/18 and the two outer medium term years. This presents the risk that if income tax does not do well, then the estimated revenues may not be attained. A healthy rise in excise tax even with price indexing may be inadequate to reverse overall revenue slowdown. Drought, electoral challenges and expected economic slowdown could potentially affect revenue growth. Considering recent performance of key revenue sources, and modest expected economic growth rates (5-6%), that is if revenue grew by a more conservative growth rates of 12-14%, then the 2017/18ordinary revenue estimates (excluding AIA) would be overestimated by as much as KSh. 46 billion. This presents a likelihood that the framework is not fully financed, posing a significant risk to the debt sustainability framework.

VI. OVERALL KEY CONCERNS IN THE SECTORAL BUDGET ESTIMATES FY 2017/18

54) The overall concerns with regard to the sectoral budget for 2017/18 are highlighted below:

i. **Strengthening the Programme Based Budget framework:** In order to strengthen the link between the Programme Based Budget framework and Itemized Budget, there is need for a review of the set of indicators, key outputs and targets in order to make them realistic and achievable. This will facilitate monitoring and evaluation of the government programmes.

ii. **Efficiency in utilization:** In order to ensure efficiency in utilization of resources, the National Treasury should minimize in- year substantial revisions from approved allocations in terms of supplementary budgeting. There is need to ensure that the ministries improve the utilization of approved allocations especially of external funds already mobilized and committed with a view to minimizing the associated opportunity costs in form of delayed benefits to Kenyans, fiscal risks as well as contingent liabilities.

iii. **Predictability of the budget planning process:** Over the last years, the government has been implementing the Medium Term Expenditure Framework (MTEF) approach to budgeting. Under this, it means that there has to exist a link between the projected estimates and the annual estimates. It therefore aims at increasing the predictability of the budget planning process by providing more reliable estimates of revenue and expenditures over a three year period. A comparative analysis of actual approved expenditure estimates and MTEF baseline expenditures estimates proposal in all the MDAs reveals that the MTEF baseline do not inform the approved expenditure estimates raising doubts on effectiveness of applicability of MTEF budgeting process in Kenya.

iv. There is need to invest in better and modern weather forecasting and early warning systems to provide the Kenya Meteorological Department the capability to give accurate information on future erratic weather patterns to ensure effective mitigation measures. This together with quality and affordable agricultural inputs will enhance productivity hence attaining food security.

v. Inadequate counterpart funding to development projects by GoK affects implementation of ongoing projects to which money has already been committed. for instance, modernization of KMC allocation of Kshs.550 million in 2016/17 had to be reallocated to counter fund livestock value chain support project funded by Polish Government for supply Milk coolers.

vi. **Duplication of functions at National and County levels:** The Agricultural sector is largely devolved, however resources are still held at the National level to fund activities that are also funded by the devolved units. Apart from the donor funded projects which require commitments from the National Government, there is need to direct resources from the devolved and duplicated activities to other initiatives which are National functions e.g Value Addition and Youth in modern agriculture.

vii. **Rationalizing State agencies:** Under the state department of water services further analysis shows that out of the Kshs. 3.15 billion allocated to State agencies, Kshs. 2.41 billion (77%) is for personnel emoluments. To reduce the increasing level of the wage bill there is need to rationalize the state agencies and implement the recommendations by the presidential taskforce and in cases where there is overstaffing there is need to consider voluntary retirements to reduce the wage bill in the long run.

viii. **Agricultural research:** The fertilizer subsidy initiative has been financed since 2008 however the funding does not translate to improved production due to the quality of seeds and its (seed) adaptability to varying climatic conditions. There is need to invest in seed subsidy alongside the fertilizer subsidy for efficiency and better results.

ix. **Completion of key ongoing projects:** It is necessary for the MDAs to focus on fast-tracking completion of key ongoing projects and ensure that new projects are considered against the context of constrained exchequer support.

x. **Energy:** While modest progress has been registered in terms of power generation and transmission, there is notable under performance in terms of achieving the target of generating extra 5000 MW as the additional capacity so far amounts to 615 MW or 13 percent as at June 2016, indicating no change or addition to the reported levels in the 2016 BPS (which is also the same level by 2017 BPS). This may mean that it is practically not feasible to attain the 5000 MW mark as indicated which may urgently require the ministry to review its generation forecast position and give a more realistic framework of power generation and demand, which partly is critical guide in resource allocation. In addition, there may be need for policy shift towards demand creation especially by enhancing the manufacturing base and further scale up on going street and rural electrification projects.

VII. HARD BUDGET CONSTRAINTS

55) Based on the foregoing analysis, it is apparent that there is need to rationalize the budget in order to reduce the overall deficit while giving priority to the funding of key projects. The committee should therefore consider looking into the following key areas:

- Given the recent government policy directive on advertising, the advertising budgets of the various MDAs can be scaled down which will result in savings that can be re-allocated to key projects or go towards reducing the deficit level.
- Implementation and operationalization of the Presidential Taskforce on Parastatal reforms report will also rationalize the state agencies and reduce duplication of functions which can result in some savings.
- Foreign travel budget still remains a major expenditure item in budgets. This should also be rationalized with a view to generating savings for the budget.
- No new projects should be started except externally funded projects and/or key flagship projects under vision 2030.

Annex 1: Legal Compliance of Budget Estimates of 2017/18

Item	Constitution	PFM Act	PFM Regulations	Score (out of 10)	Comments
1. Submission of estimates of revenue and expenditure of the national government, Parliament and Judiciary for the next financial year by 30th April	221(1), (3)	37(2)		10 out of 10	Submitted to Parliament on 15th February, 2017
2. The ceilings approved in the report on 2017 Budget Policy Statement, shall serve as the basis of the expenditure ceilings for 2017/18 and medium term		25(8)	27(4)	0 out of 10	The ceilings provided in the 2017/18 budget estimates, do not adhere with the ceilings in the adopted BAC report on 2017 BPS
3. The Ceilings for development expenditure and personnel spending of the national government budget shall be approved by Parliament and be binding for the next two years			27(5)	0 out of 10	Not adhered.
DOCUMENTS SUPPORTING THE BUDGET ESTIMATES (BUDGET SUMMARY)					
4. The preparation and submission of estimates shall be done exclusively through prescribed automated integrated financial management systems (Itemized Budget).			32(6)	10 out of 10	Information provided
5. Submission of Budget Summary that includes a summary of budget policies on revenue, expenditure, debt and deficit financing		38(a)(i)		10 out of 10	Information provided

Item	Constitution	PFM Act	PFM Regulations	Score (out of 10)	Comments
6. Submission of Budget Summary that includes an explanation of how the budget relates to the fiscal responsibility principles and financial objectives		15,38(a)(ii)	26(1)	7 out of 10	No information has been provided on how the budget relates to financial objectives of the 2017 BPS
7. Submission of Budget Summary that includes a memorandum by the cabinet secretary explaining resolutions adopted by National Assembly on the BPS under section 25(7) have been taken account		25 (8), 38(a)(iii)		5 out of 10	Although the information was provided, some resolutions adopted by National Assembly were not taken into account without a convincing explanation
8. A list of all entities that receive funds appropriated from the budget of the national government		38(b)(i)		10 out of 10	Information provided.
9. Estimates of revenue allocated to and expenditures projected from equalization fund guided by the CRA policy on marginalized areas	216(4)	38(b)(ii)		0 out of 10	Estimates of revenue allocated to and expenditures for 2017/18 not submitted to Parliament as required even though there are indications that the fund has been allocated Ksh. 7.7 billion.
10. Revenue allocations to county governments including conditional and unconditional grants	202(2)	38(b)(iii)		10 out of 10	Information provided, however Parliament has not passed the DORB, 2017
11. Estimated revenue by broad economic classification and format		38(b)(iv)	59(1)	10 out of 10	information provided
12. Estimated expenditure by vote &programme identifying both recurrent and development expenditures		38(b)(v)	32(4)	10 out of 10	Information provided
13. An estimate of budget deficit or Surplus and the medium term		38(b)(vi)		10 out of 10	Information provided. However, the budget deficit provided is not in tandem with the 2017 BPS and adopted report of Budget Policy Statement 2017 by the House
14. Information regarding loans made by the national government including principal interest and other charges to be received by the national government in respect to those		38(c)		10 out of 10	Information provided

Item	Constitution	PFM Act	PFM Regulations	Score (out of 10)	Comments
loans					
15. Loans and guarantees to be paid by national government in the financial year respect to those loans		38(d)		10 out of 10	Information provided
16. Information regarding payments to be made and liabilities for which an appropriation act is not required including those that need constitutional approval or legislative authority for such payments		38(e)		5 out of 10	Information provided but not in full. The budget does not provide information on ongoing public private partnership projects in the country
17. A statement showing measures taken by the national government to implement any recommendations made by the national assembly with respect to budget for the previous years		38 (f)		5out of 10	Information provided is limited. Some of the recommendations made by the national assembly seem to be moving targets for National Treasury e.g. fiscal consolidation and efficiency in revenue allocation
18. Public participation on all public matters including the publication of the Citizen's budget	201(a)		6(2)	5 out of 10	No citizen's budget uploaded on National Treasury's Website
Total				**127/180**	**70.55 percent**