The Shuteye Economy: Unpacking the 2020/21 Budget Policy Statement

Legal Basis

- Public Finance Management (PFM) Act Section 25 (2), the National Treasury is required to submit the BPS to parliament by the 15th February each year.
- Section 25(7) states that Parliament shall not later than fourteen days after the BPS is submitted to Parliament, table and discuss a report containing its recommendations and pass a resolution to adopt it with or without amendments.
- Pursuant to Standing Order 180, the following documents were laid:
  - The 2020 Budget Policy Statement,
  - The medium term Debt Management Strategy
  - Draft Division of Revenue Bill, 2020
  - Draft County Allocation Revenue Bill, 2020

Economic Growth

Kenya's economic growth has remained stable but below the targeted growth given in the country's policy documents. Economic growth in the period 2013 – 2017 is remarkable at 5.6 percent compared to 4.7 percent (2008 – 2012) percent and 4.6 percent (2002-2007). **We estimate that the economy will grow by 5.7 percent in 2020/21** (Treasury forecast stands at 6.2 percent).

The 10 percent annual economic growth target in Kenya's VISION 2030 remains elusive and the economy needs a significant change in policy direction and budget execution to scale up the country's productive capacity that will promote a higher growth trajectory.

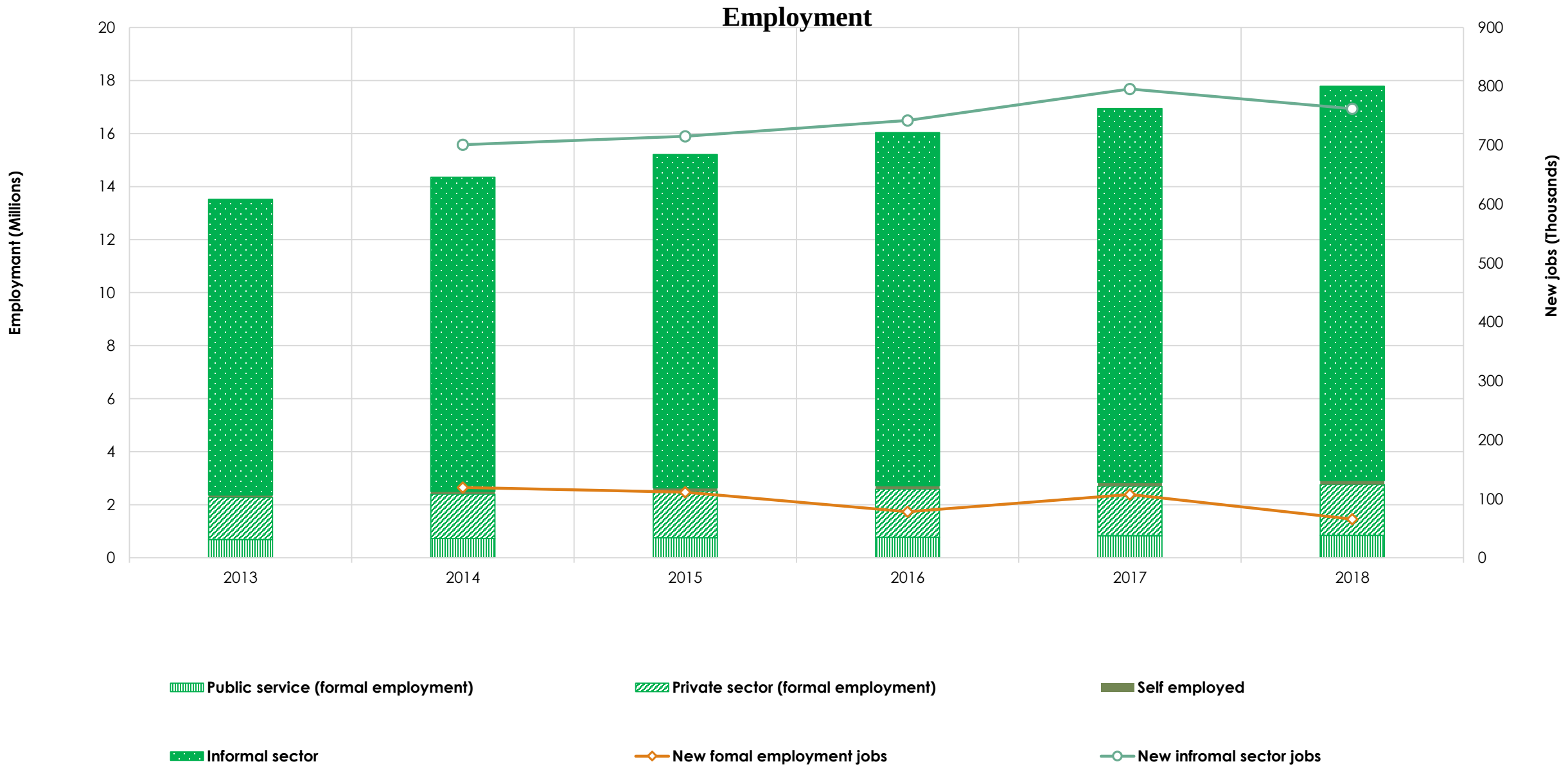
Why lower than projected?(poor performance of the agricultural sector coupled with declining export prices of the major agricultural exports).

Kenya has experienced slower economic growth relative to some of the East African Community (EAC 5) countries over the last fifteen years.

Growth……..

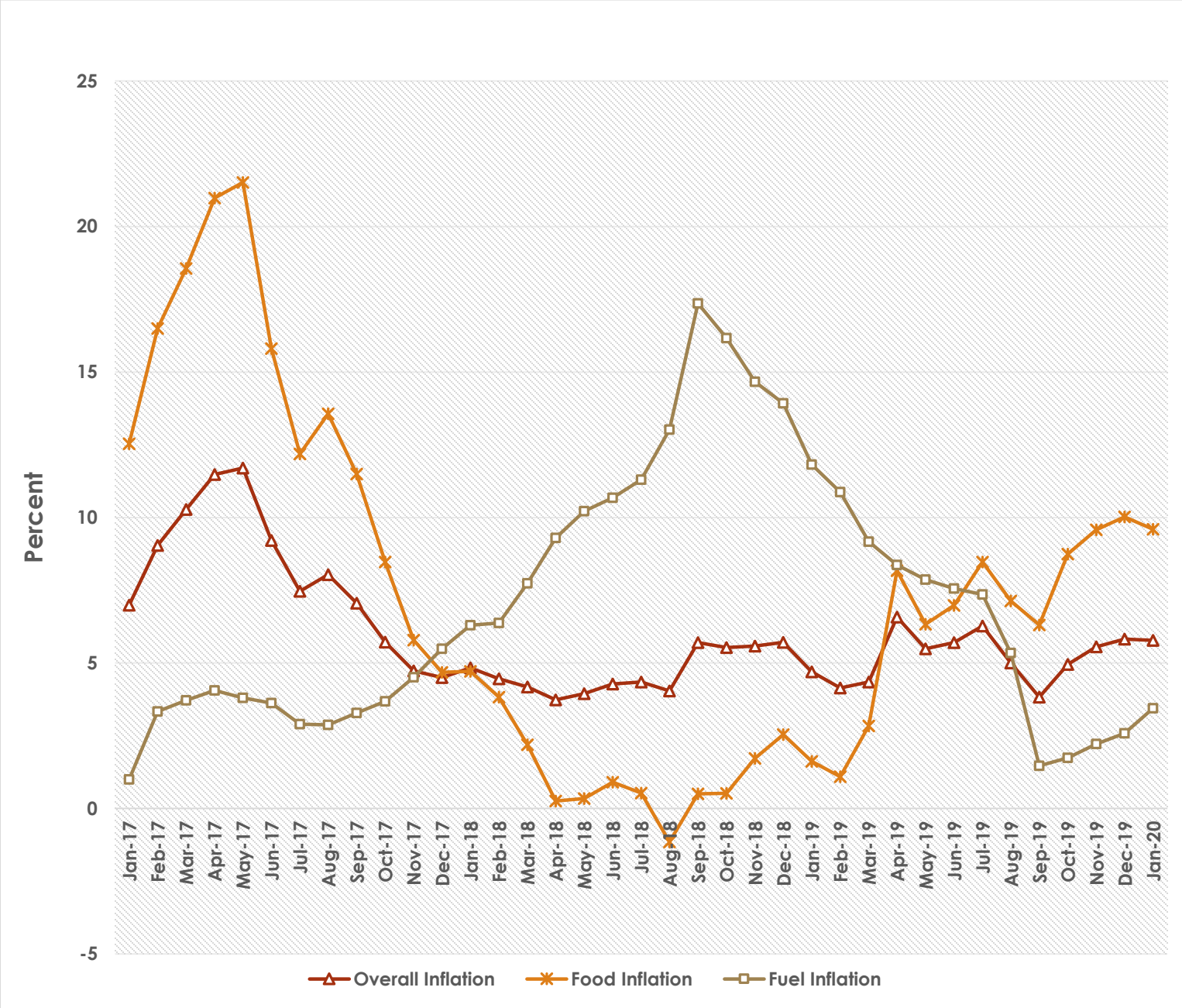
- The real per capita income has remained lower than that of other comparable African countries, despite Kenya having made some progress over the last fifteen years.
- As of 2018, Kenya's real per capita GDP (constant 2010 US$) was US$ 1,200 while that of Zambia, Ghana and Nigeria was US$ 1700, US$ 1800 and US$ 2400 respectively.

Jobs…….


Employment
Employmant (Millions)
New jobs (Thousands)
20
18
16
14
12
10
8
6
4
2
0
900
800
700
600
500
400
300
200
100
0
2013
2014
2015
2016
2017
2018
Public service (formal employment)
Private sector (formal employment)
Self employed
Informal sector
New fomal employment jobs
New infromal sector jobs

Inflation

- The overall monthly inflation remained relatively stable (within the 5 percent target). However, supply risks still linger:
  - The impact of the desert locusts on agriculture and food production
  - Rise in fuel prices due to the tensions between the United States of America and Iran



Interest rates and Private Sector Credit

- Interest rates remained stable over the period January 2018 to September 2019 with the weighted average lending rate by commercial banks decreasing to 12.5% over the first three quarters of 2019. Between November 2018 and November 2019, net credit to the private sector expanded by 7%.
- Impact of repealing the cap is yet to be realized .

	Annual growth rate Percent			
	Nov 2016	Nov 2017	Nov 2018	Nov 2019
Net credit to private sector	**4.2**	**2.7**	**4.4**	**7.3**
Agriculture	3.5	-7.7	-5.7	-6.1
Manufacturing	-4.1	10.6	14.9	7.5
Trade	15.7	10.0	3.9	8.8
Building and construction	-5.3	3.1	7.2	-6.1
Transport and communication	16.1	-8.0	-8.0	9.8
Finance and insurance	0.1	1.5	9.1	15.8
Real Estate	8.8	9.3	1.2	1.9
Mining and quarrying	-12.3	-3.2	-12.0	-3.2
Private households	10.6	2.7	5.1	6.1
Consumer durables	10.6	-0.4	7.3	25.9
Business services	-11.7	-7.6	12.4	-0.3
Other activities	-30.6	-23.1	-14.7	30.9

Source: Central Bank of Kenya

- Crowding out of the credit to the private sector by the government through domestic borrowing remains a major challenge. Net domestic borrowing is likely to blow up by an additional Kshs.30 billion …arising from policy reversal on commercial financing in 2019/20.

4. Exchange rate & External Sector

- **Kenya's exports have been on a steady decline over the past decade.** Exports as a share of GDP declined from 14% in 2011 to 7% in 2018. The downward trend was driven by the relatively slower growth in the value of all the principal domestic exports.
- **Remittances have replaced underperforming principal domestic exports such as tea, and international tourism as Kenya's main source of foreign exchange.** The risk to the exchange rate is the over-reliance on hot money flows as the main source for foreign reserve stocks. Though diaspora remittances have grown significantly in the past, they are not reliable as a source of foreign exchange. Focus should therefore be on attracting Foreign Direct Investment (FDI) as well as diversifying and growing the country's exports.

Fiscal Consolidation: Do they keep their promise?

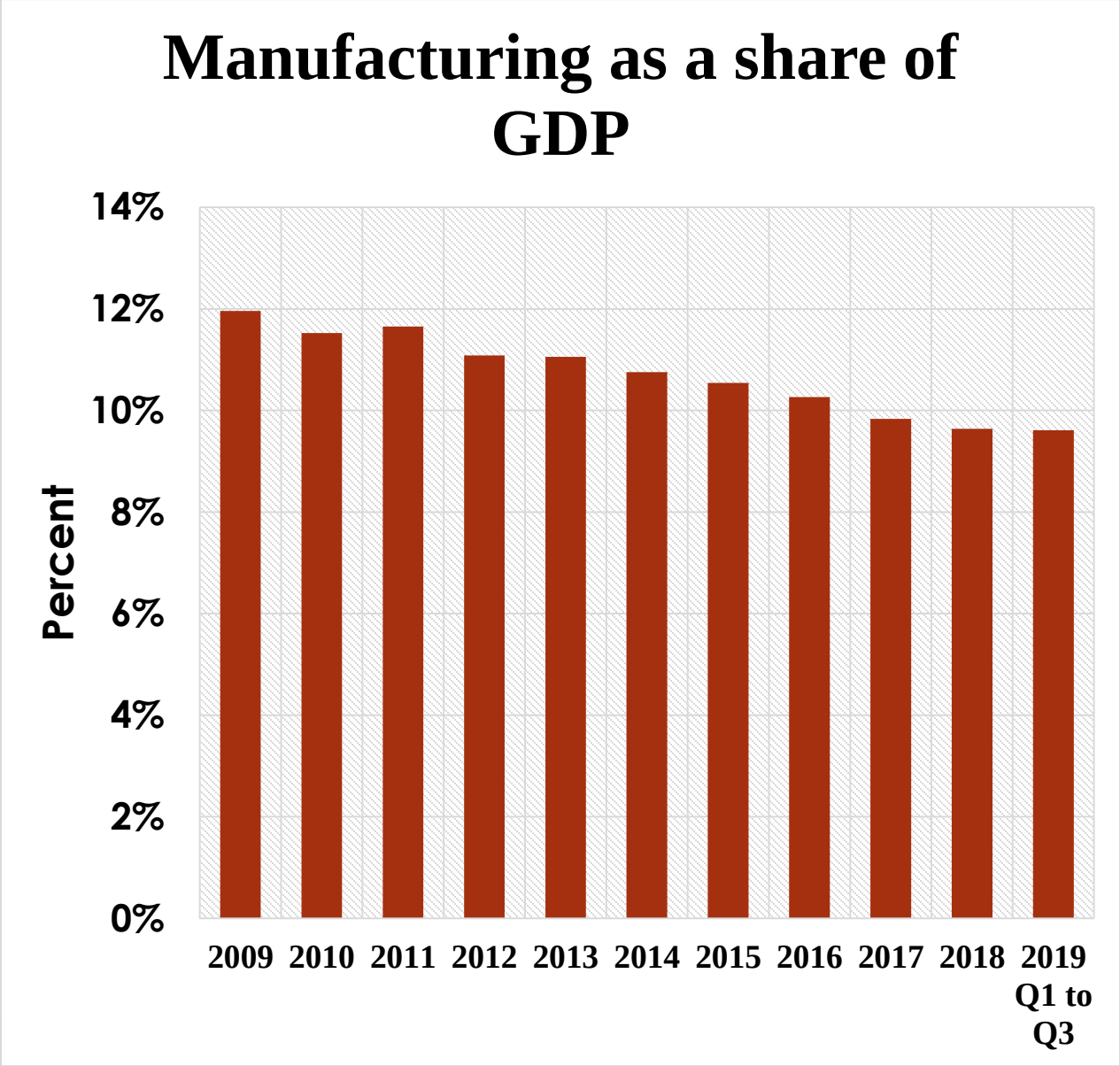
	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
BPS 2016	-8.6%	-8.0%	-6.8%	-5.4%	-4.1%					
BPS 2017	-8.4%	-7.5%	-6.9%	-6.4%	-5.0%	-4.0%				
BPS 2018		-7.4%	-9.1%	-7.2%	-6.0%	-4.3%	-3.3%	-3.0%		
BPS 2019			-8.8%	-6.8%	-6.3%	-5.1%	-3.9%	-3.3%	-3.1%	
Draft BPS 2020				-7.0%	-7.7%	-6.3%	-4.9%	-4.5%	-3.9%	-3.3%

Numbers don't lie: Some Fiscal Aggregates

	Share of GDP (%)						
	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
	Actual	*Actual*	*Pre. Actual*	*Estimate*	*Proj.*	*Proj.*	*Proj.*
1. Total Revenue	**18.8**	**17.9**	**17.9**	**20.2**	**18.5**	**18.3**	**20.6**
1.1 Ordinary Revenue	17.1	16.0	16.1	17.9	16.3	16.3	18.4
1.2 Appropriation –in –Aid	1.7	1.8	1.9	2.3	2.2	2.1	2.2
2. Expenditure & Net lending	**28.1**	**25.2**	**25.9**	**27.5**	**23.9**	**23.3**	**25.5**
2.1 Recurrent	**15.7**	**15.8**	**16.1**	**16.9**	**15.8**	**15.3**	**16.8**
Wages and Salaries	*4.4*	*4.6*	*4.5*	*4.7*	*4.4*	*4.2*	*4.4*
Interest Payments	*3.5*	*3.8*	*4.0*	*4.3*	*4.1*	*4.1*	*4.6*
Domestic Interest	*2.8*	*2.8*	*2.9*	*2.8*	*2.7*	*2.8*	*3.1*
Foreign Interest Due	*0.8*	*1.0*	*1.1*	*1.5*	*1.4*	*1.3*	*1.5*
Pensions, etc	*0.8*	*0.8*	*0.8*	*1.0*	*1.1*	*1.1*	*1.2*
O & M/ Others	*5.2*	*5.2*	*5.3*	*5.5*	*4.8*	*4.7*	*5.3*
2.2 Development & Net Lending	**8.4**	**5.5**	**5.9**	**6.9**	**4.8**	**4.8**	**5.5**
2.3 Contingencies	0.00	0.00	0.00	0.05	0.04	0.04	0.04
2.4 Transfers to county govt.	4.0	3.8	3.9	3.7	3.2	3.0	3.1

The Big 4 Agenda Supporting the manufacturing sector for job creation

- The main goals are to support job creation through increased value addition and to raise manufacturing to 15% of GDP.
- We are in the third year of implementing the big four agenda however, minimal progress was made in the first two years (2017/2018 and 2018/2019).
- Very ambitious targets were set in 2019/2020 and the medium-term. The targets are unlikely to be met due to the slow absorption over the first half of the financial year.
- The programmes implemented so far have not spurred the manufacturing sector. Its share of GDP has been steadily declining.



Big 4: Providing universal health care hence guaranteeing quality and affordable healthcare to Kenyans by 2022.

- **MTEF Allocation** - The proposed allocation to the sector is Kshs 114.4 Billion (6.2 % of the total sectoral allocations). The allocation is expected to increase to Kshs 130.5 Billion in 2022/23. Thus, over the next medium term, the proposed sector resource is Kshs. 365 Billion.
- **Reforms at NHIF-** To support the UHC goal, the government intends to modernize NHIF systems and improve governance structure through legal and institutional reforms. However, since 2018 when the UHC agenda was introduced, no tangible reforms have been undertaken in this critical institution as envisaged
- Role of county governments
- Governance issues…

Big 4: Housing

- The State Department for Housing and Urban development is mandated with the delivery of 500,000 housing units by 2022 under the affordable Housing programme theme in the Big four agenda.
- Only 228 units have been achieved since inception of the programme. The programme seems to be off track hence the need for a comprehensive status report on the implementation and viability of pursuing the programme.
- Framework to involve county governments??

Big 4: Food Security

- The realization of the agenda on food and nutrition security appears to be a bleak unless concerted effort is met on diminishing agricultural productivity, declining land sizes, underfunding, and prevalence of pest and diseases among others….. **Do this issues relate to counties??**
- Need to revive or strengthen the support services including agricultural extension services for improved and sustainable productivity of agriculture.
- The sector's resource requirement stands at **Kshs.105.4 billion** against an allocation of **Kshs. 51.2 billion** in the FY 2020/21.

Funding at the Sub-national level (Counties)

- The counties have received a total of Ksh.1.906 trillion. The total annual disbursements to counties grew from Kshs. 195.66 billion in the FY 2013/2014 to Kshs. 364.38 billion in the FY 2018/19.

- The nominal growth was driven mainly by: an increase of equitable share; nominal growth of GoK funded conditional grants; and increase in additional conditional allocations from the Road Maintenance Levy Fund and other conditional allocations.

Lessons learnt (issues)….

- GOK funded Conditional grants increased from Kshs. 5.67 billion in the FY 2013/14 to Kshs. 19.32 billion in the FY 2018/19. While the number of the grants have increased over the years there is no clear basis/criteria that determines how much conditional grants is allocated and the basis of distribution.
- Loans and grants from development partners have increased from Kshs. 1.11 billion in the FY 2014/15 to Kshs. 23.64 billion in the FY 2018/2019. It is necessary to take stock of utilization of conditional allocations in addressing specific issues of national importance under the purview of devolved governments.
- Equitable share to the counties grew from Kshs.190 billion in the FY 2013/14 to Kshs. 316.5 billion in the FY 2019/20. To spur economic growth and enhance service delivery in line with the scheduled county functions, there should be clear criteria used in sharing of resources across sectors once the funds reach the counties.

Vertical Sharing of Resources in a Fiscal Consolidation Regime

- In a regime of fiscal consolidation, the driving policy that underpins the fiscal goal is the reduction in government expenditures to achieve a budget deficit that can be financed without triggering adverse macroeconomic effects.

a) Reduction in overall expenditure

- The current government having embraced fiscal consolidation in the last three years have consequently led to a reduction in the overall government expenditure.

Summary of proposed Budgetary Allocations in KSh. Millions				
	FY 2019/20	**FY 2020/21**	**FY 2021/22**	**FY 2022/23**
Total	**2,873,527**	**2,723,556**	**2,955,132**	**3,191,701**
Of which:				
(i). The Executive	1,947,873	1,778,133	1,897,105	2,067,139
(ii).The Judiciary	19,202	18,051	18,572	19,308
(iii).The Parliament	39,889	36,222	38,468	40,529
2.Consolidated Fund Services*	550,063	574,650	675,293	729,889
3.County Governments**	316,500	316,500	325,694	334,836

(b)The Principle of Subsidiarity

- The principle demands that decisions on resources, priorities, service delivery and performance targets are made at the lowest possible unit of operation…
  - The principle requires that issues pertaining to the largely devolved functions such as Agriculture and Health are undertaken by the devolved units
  - An assessment of the 2020/21 Key Performance Indicators (KPIs) envisaged to be undertaken in various programmes reveal that the National Government set out to undertake functions beyond its constitutional mandate (rice and combine harvesters procured, pans and dams etc .

(c)Unlocking County Own-Source Revenue (OSR)

- OSR collection in counties has shown a shrinking trend in the past years with county OSR performing below target for the past five (5) financial years
  - On average, counties revenues under performed by **Kshs.85.0 billion** equivalents of **32 per cent** of the total targeted revenue collection.
  - Counties with high revenue collection …..have highest expenditure on wages with low expenditure on the development expenditure front.

Quality of Investments

- The achievement of the targets under the various programmes as envisaged in the 2020 BPS are hinged on the budgetary allocative efficiency and effectiveness at both levels of government. It takes both reduction in wastages of public resources and strategic prioritization of public expenditure.
- The various reports of Auditor General and the Controller of Budget have raised concerns related to the fiduciary risks that public expenditure are exposed to.

Appetite for the Borrowing by the National Government

- The higher the share of ordinary revenue that is taken up by public debt and other national obligations the lower the sharable revenue and allocations to counties.

Distribution of Ordinary Revenue to Key Expenditure Categories, FY 2014/15 to 2019/20							
Details		**Distribution (%)**					
		2014/15	**2015/16**	**2016/17**	**2017/18**	**2018/19**	**2019/20**
Total Ordinary Revenue		100%	100%	100%	100%	100%	100%
o/w	Interest payments	17%	19%	21%	24%	23%	23%
o/w	Pensions	4%	5%	5%	5%	5%	6%
Total Net Recurrent		63%	65%	58%	63%	56%	54%
County Allocation		22%	22%	21%	22%	18%	17%
Available Resources for Development		-6%	-11%	-5%	-14%	-2%	0%

Equitable share and Debt Service as % of GDP FY 2013-2023

FY	13/14	14/15	15/16	16/17	17/18	18/19	19/20	20/21	21/22	22/23
Equitable share % of GDP	**4.40**	**3.90**	**3.87**	**3.66**	**3.54**	**3.30**	**2.94**	**2.61**	**2.40**	**2.20**
Stock of debt % of GDP	56.07	48.94	53.82	57.55	59.11	61.08	59.87	57.75	55.48	52.44
Interest Payments % of GDP	2.66	2.95	3.21	3.54	3.80	3.95	4.10	3.90	3.80	3.80

Division of Revenue Between the two Levels of Government

	2020/21	
	BPS 2020	CRA
Equitable Share	316,500.00	321,744.00
Conditional Grants	13,731.00	27,500.00
Free Maternal Health Care	-	-
Leasing of Medical Equipment	6,205.00	-
Compensation for user fees foregone	900	-
Level 5 Hospitals	4,326.00	-
Special Purpose Grant (Emergency Medical Service)	-	-
Rehabilitation of Village Polytechnics	2,000.00	-
Supplement for Construction of County HQs	300	-
Allocation from the Fuel Levy (15%)	9,433.00	-
Financing of Cities	-	5,000.00
Allocation from Loans and Grants	30,204.30	30,204.30
Establishment of 2 Regional Cancer Referral Centres	-	-
National Cancer Drugs Access Programme	-	-
Total Allocation to Counties	**369,868.30**	**379,448.30**

Basis for Treasury figures

- Continued underperformance in ordinary revenue;
- The fact that the National Government solely bears the shortfalls in revenue in any given FY;
- The Kshs. 161 billion funding gap in the FY 2019/20 budget;
- The 10.3% projected contraction in National Government's net spending in FY 2020/21 vis-a-vis FY 2019/20
- The proposal by National Treasury that the entire incremental revenue in FY 2020/21 be earmarked for CFS, specifically debt repayment and pensions

Basis for CRAs figures

- Adjustment to both the National and County governments' development expenditures on the basis of the average rate of the country's economic growth by 5.7 per cent (based on the Country's three year 2016-2018 average economic growth) on the actual three-year average development expenditure for each level of government.
- The adjustment translates to additional allocation of Kshs. 5.24 billion to the counties thus translating to a proposed equitable county allocation of Kshs. 321.74 billion in the FY 2020/21; and
- Additional Kshs. 31.35 billion to the National Government to finance development activities.

Basis ….

- The equitable revenue share allocation of **Ksh. 316.5 billion for the FY 2020/21 is less by Ksh. 5.24 billion** compared to the CRA recommendation of Ksh. 321.74 billion. The CRA projections are based on the **audited reports for the FY 2014/2015** with approved revenue of Kshs. 1,038.04 billion while the National Treasury proposal is equivalent to **26.5 percent of FY 2015/2016 audited accounts** (Kshs. 1,194 billion).
- The latest audited accounts approved by National Assembly is for FY 2016/2017 with revenue of **Kshs.1,357.698 billion**. Using the latest audited report for FY 2016/17, the counties equitable share revenue for the FY 2020/21 stands at **Kshs.359.79 billion** (using 26.5 percent used by the National Treasury).

Policy Options for Vertical Share??

- Work in progress……