"CAREFUL PLANNING, SAFE SPENDING"

An Alternative Citizens Budget
2006/07 – 2008/09

Institute of Economic Affairs (IEA)
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INTRODUCTION

Kenya’s development goals are embodied in The Economic Recovery Strategy for Wealth and Employment Creation (ERSWEC) 2003-2007. The ERSWEC as it states aims for recovery of the economy to achieve wealth and employment creation and was developed at a time when Kenya’s economic growth was declining. The strategy to create wealth and employment hinges on the existence of macroeconomic stability, strong governance institutions, rehabilitation and expansion of physical infrastructure, and investment in human capital of the poor. To this end, the government has introduced an investment programme (the IP-ERSWEC), which acts as a work plan to guide implementation of the strategy.

The role of the national budget is to facilitate implementation of our strategy to achieve our development goals. Kenyans have in various ways voiced concern over the budget and suggested ways that it can be used to address existing and imminent needs.

The Institute of Economic Affairs (IEA) is a civic forum that seeks to engage the public in the policy and budget making process. Each year, the IEA conducts pre-budget hearings to collect citizens’ proposals for the budget. This year, several presentations and submissions were made by sector representatives and the public in Nairobi, and through our partners SNV, in Moyale, Marsabit, Samburu, Isiolo and Laikipia districts. Based on the issues raised at the hearings and in consultation with sector stakeholders, we have compiled an Alternative Citizens Budget. This document captures the various concerns raised, highlights areas that need attention, and suggests ways that they can be addressed. In this regard, this is an Alternative Citizens Budget; a budget that offers alternative proposals raised by citizens, to problems faced in Kenya.

BACKGROUND, THEME AND RATIONALE

Given upcoming elections, the temptation to produce a populist budget or spend unwisely will arise. This temptation must be resisted. Donors have turned away from budgetary support and are now pursuing project or programme financing with special emphasis on a sector wide approach. In addition to this, Kenya faces numerous economic, fiscal, social and political challenges – each with their own short and long-term implications.

With or without budgetary support, Kenya must find its own way of financing development and growth. Given our economy, there is great potential to finance and spur development through revenues, private sector participation, creative banking and investment options, and trade. It is in this spirit that the chosen THEME of the Alternative Citizens Budget this year is "Careful Planning, Safe Spending" to maintain and improve growth. Naturally, this budget does not go into as much financial and technical detail as does the national budget owing to the limitation of resources.

PUBLIC FINANCE PRINCIPLES PROPOSED BY THE ALTERNATIVE BUDGET

Public finance is concerned with using and/or managing fiscal instruments of taxation, public spending and debt, to steer and build an economy.

The key to successful public finance is adherence to sound principles that embrace a system of good stewardship of public resources. To this end, we propose the following principles as underlying the alternative budget:
Long term policies and plans that consider positive and negative outcomes;
Programme based budgets that are relatively easy to disaggregate, monitor and evaluate;
Sustainable debt;
Fiscal discipline; and
Allocative and operational efficiency.

Some criteria for resource allocation
In allocating resources, the government should ensure that:
- Expenditure is based on priorities and the effectiveness of programmes;
- Expenditure aims to reduce vulnerability of the poor to income, housing and health insecurity;
- There is satisfactory performance (ministerial and sectoral) on spending and utilisation; and
- There is a good balance of development and recurrent expenditure.

Macroeconomic Framework

Macroeconomic figures act as good indicators of progress on achieving development goals. In this regard, it is important to pay attention to GDP, debt, inflation, exchange rates, interest rates, unemployment, investment and savings.

- **GDP:** Nominal GDP for year 2005 is estimated at Kshs. 1.56 trillion that is a growth of 5.8% (1.5 percentage points above year 2004). Growth was mainly underpinned by agriculture, forestry, wholesale and retail trade, transport, communication, and a rise in final domestic demand. Given that the population grew by 1.8% to 33.3 million and therefore grew faster than GDP, there is still need for GDP to grow more—GDP per capita at constant prices (provisional) in year 2005 was Kshs. 35,045, which is low to cater for food, health and housing needs.

- **Debt:** As of February 2005, the Central Bank of Kenya (CBK) reports that Kenya’s total public debt was Kshs. 747.5 billion (53.8% of GDP). This fiscal year, Kenya’s budget of Kshs. 508.5 billion allocated Kshs. 123.8 billion to finance public debt. This means that 24% of total estimated expenditure or put another way, four times the Ministry of Health budget, was allocated towards financing debt that may or may not have necessarily added a commensurate or positive return to our economy and therefore Kenyan’s welfare.

- **Inflation:** As of March 2006, the average annual overall inflation rate was 11.36% with highest inflation in food and non-alcoholic drink (approximately 29% in March), followed by fuel and power at 13% in March (Central Bank Kenya). CBK also reports that across income groups, the low-income group continued to experience the highest increase in inflation. Quite often, the average annual underlying inflation rate is quoted when it comes to inflation. Unfortunately, the limitation of using the underlying rate is that it does not factor in food, non-alcoholic drink, fuel, power, transport, communications, and medical goods and services that, is where Kenyans really feel the pinch. For this reason, the average annual overall inflation rate should also be emphasised when assessing economic performance because it measures inflation of goods and services.

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2 “Good but Opaque” MPs Budget Guide, Institute of Economic Affairs, June 2006
services mentioned above. It is this category of inflation that the government should aim at capping at a one-digit level.

- **Exchange Rates and Current Account Deficit:** According to the Economic Survey 2006, the current account deficit grew from Kshs. 28 billion in 2004 to Kshs. 37.4 billion in the year 2005. The Survey reports that the wider deficit was mainly driven by a higher import bill evidenced by a wider visible trade deficit of Kshs. 163.8 billion which offset the surplus in invisible trade accounts (i.e. Services, income and unilateral current transfers) amounting to Kshs. 126.4 billion. This is indicative of Kenya’s trade balance, which leans more towards importation of goods, rather than exportation of services, for instance. In this type of setting, it comes as no surprise that the strength of the Kenya shilling—which stood at an average of Kshs. 72.35 per US dollar as of June 2006—contributed to lower incomes made from Kenyan exports during 2005(Central Bank of Kenya). Given that growth is one of the IP-ERSWE (objectives as per the APR 2004/05), it is advisable that we keep an eye on the current account deficit.

- **Unemployment:** The Labour Force Survey 1998/99 states the unemployment rate as 14.6%. This rate was calculated as a ratio of the unemployed population of 1.8 million to an active population of 12.3 million. Given that in the year 1999, the population was 28.7 million, and by 2005 the population had grown to an estimate of 33.3 million, there is evidently need to update these figures to reflect the current situation. This will also make it easier for Kenya to know its progress on employment creation as per the ERSWEC.

- **Investment:** Gross domestic investments (at market prices) as a % of GDP rose from 17.4% in the year 2003, to 18.3% in the year 2004 (Central Bank of Kenya). To improve on economic growth, more investment should be encouraged.

- **Borrowing:** Between February 2004 and 2005, gross loans and advances from the banking sector increased from Kshs. 389.9 billion to Kshs. 424 billion. The total non-performing loans and advances as a percentage of total advances fell slightly from 20.4% to 17.3% over the same period despite the decline. There might be need to keep a close eye on the banking sector to ensure that the level of loan defaults does not increase as this can lead to insolvency which hurts creditors such as suppliers, employees and share holders.

- **Savings:** Gross domestic savings (at market prices) as a % of GDP rose from 6.2% in the year 2003 to 8.1% in the year 2004 (Central Bank of Kenya). Although the figures show an increase in savings, there is still a need to increase the level for purposes of better income and financial security.

### CHALLENGES

Having looked at Kenya’s macroeconomic framework it is also important to identify present or imminent issues that may present a challenge to the achievement of our development agenda.

1. **Economic Challenges**

   Although the year 2005 recorded a growth rate of 5.8%, a number of economic challenges remain for budget 2006/07 to consider. These are:
   - Continued poverty and inequalities across different geographical locations;
   - Unemployment;
- An expanding current account deficit;
- Food production, pricing and distribution constraints;
- The financial cost of holding the General Election in 2007; and
- An increase in number of immigrants in Northern Kenya.

2. Social and Political Challenges
Given the interrelation between economic, political and social issues, a number of factors present challenges to our development agenda. These include:
- The possibility of changing political party affiliations in the lead up to the General Election in 2007;
- Changing societal norms against a relatively traditional and conservative context;
- Continued gender inequity and inequality;
- A large part of the population, coming from the 15-34 age group who are either guardians, out of school, unemployed and/or involved in child labour or crime;
- A high dependency ratio particularly on children, young adults and women (of young, middle aged and elderly ages); and
- A rise in the reported cases of crime including sexual abuse.

3. Fiscal Challenges
Kenya also faces a number of fiscal challenges. These are:
- The possibility of non-viable and sustainable total expenditure;
- Non optimal revenue collection;
- The opportunity cost of public debt financing;
- The cost of civil service retrenchment exercise;
- High global oil prices;
- The lack of coordinated use of devolved funds; and
- The need for EAC taxation harmonisation

A LOOK AT KEY ISSUES ARISING FROM BUDGET 2005/06

1. Housing
Kenyans can hardly afford mortgages and housing supply is generally low and expensive. Majority of the Kenyan population are renters who rent at monthly prices ranging from Kshs. 1,000/- to Kshs. 150,000/- and above. It is only a paltry 120,000 Kenyans who qualify for a mortgage. While high-income earners are spoilt for choice, the middle and low-income groups have to do with substandard housing. Given this heterogeneous mix of home dwellers, Kenya should give attention to both mortgagers and renters when designing policies and plans to make homes more affordable. Priority areas and some recommendations are listed below.

Some recommendations to assist low and middle-income renters:
1. Reduce the cost of building materials e.g. through tax relief’s and incentives on building and construction equipment. Presently, transport and energy constitute almost 40% of the cost of housing
2. Adopt low cost techniques of building homes. The Moland technology allows completion of a building in 14 days and has been successfully experimented in Lang’ata women’s prison and South Africa
3. Make a proportion of home rental fees tax deductible

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3 Majority of banks only gives mortgages to those earning over Kshs. 120,000 per month. According to the KRA, there are only 120,000 Kenyans who earn over Kshs. 120,000 per month.
4. Encourage local authorities to partner with international housing bodies for the development of affordable rental housing
5. Establish a Housing Fund with a clear governance and institutional framework.

Some recommendations to assist mortgage seekers:
1. Waive Stamp Duty for first-time home buyers to remove barriers to investment in housing
2. Introduce multi generation mortgages i.e. mortgages that are transferable between family members
3. Increase the mortgage relief to encourage borrowing for housing
4. Set mortgage rates that are compatible with the savings rates
5. Make it possible for people to use stocks, shares and life insurance to secure mortgages

Some recommendations to make it easier to build and/or develop property:
1. Streamline the process of acquisition, construction and disposal of property
2. A one-stop licensing ‘shop’ would be useful
3. Allow developers to claim VAT so that the benefits pass on to the consumer
4. Tax land beyond a certain threshold. Government can commission a study to determine what mechanism would work best

Some recommendations on expanding options for finance for developers and builders:
1. Make it possible for established firms to access capital from statutory bodies like NSSF
2. Review Retirement Benefits Authority (RBA) rules so that developers can access long term capital for development
3. Enable firms to access funding through public bonds
4. Enable smaller organisations to enjoy access to micro finance institutions
5. Make life insurance or pension contributions acceptable as security for construction loans
6. Allow some flexibility in the RBA Act to allow a larger portfolio of funds in the Retirement Benefits Authority (RBA) to be invested in housing

Some recommendations to improve standards of construction and living
1. Set up a regulatory body to regulate construction and coordinate the various institutions
2. Earmark a percentage of property rates for infrastructure
3. Decongest areas close to the Central Business District and densely populated areas e.g. by giving rural and urban home builders incentives to build away from city and town centres

2. Water Resources, Water Supply & Sewerage
Globally, a country is categorised as ‘water stressed’ if its annual renewable freshwater supplies are 1,000 - 1,700 cubic metres per capita, and ‘water scarce’ if its renewable freshwater supplies are less than 1,000 cubic metres per capita. While 9.8% of the countries are considered as ‘water stressed,’ only 8.3% of the countries in the world are classified as ‘water scarce.’ Kenya is chronically water scarce. The combined surface and groundwater potential is estimated at 20,619 million cubic metres per year. Over the last 30 years, our water per capita decreased from 1,853 cubic metres in 1969, to 704 in the year 2000, to the current estimate of 647 cubic metres - thus going below the global benchmark of 1,000 cubic metres per person per year. This per capita water availability will continue to decline with a growing population, competing demand and reduced water capacity-supply, creating a most
dangerous national situation. By way of comparison, Kenya’s neighbours, Uganda and Tanzania have annual per capita renewable fresh water supplies of 2,940 and 2,696 cubic metres per capita per year respectively.

The availability of water is an essential factor in determining the patterns of human settlement and socio-economic development. Within the Arid and Semi Arid Lands (ASALs) that form about 80% of Kenya, there is limited endowment of water resources. This places an added financial burden on the population of Kenya compared to other countries. This burden is even greater because of the country’s vulnerability to rainfall variability. Under these circumstances, water should be treated and managed as a scarce resource with economic, social, ecological, and political value. In this regard, government should prioritise building of water capacity and;

- **Encourage private sector participation** to obtain the necessary human and financial capital required building Kenya’s water capacity. Given that approximately Kshs. 5 billion is allocated by Kenya government and another similar amount from external sources, it is estimated that Kenya has a shortfall of Kshs. 235 billion between now and 2015 to enable it meet the MGDs on access to Water Supply and Sanitation.\(^4\)

On improving water services and supply, we recommend the following;

- **Institutional strengthening and harmonisation** the personnel transfer plan must adhere to the set timetable and periodically review the need for new skills. Additionally, the overlap between institutions like the Water Resource Management Authority and NEMA needs to be ironed out

- **Expand financing options** through bonds, utility specific pricing i.e. where pricing covers maintenance, operation and capital cost recoveries and sector self-financing, targeted subsidies, the de/merits of water cess should also be examined; and user pays principle, and/or develop water pricing policies and mechanisms

- **Sector wide legislative reform** harmonise older Acts of Parliament e.g. Lands and Agriculture, with the Water Act 2002 to minimise the current conflict. Additionally, modify the Water Act 2002 to address the legal instruments associated with sewerage and sewage disposal

3. Health

Over the past few years, Kenya’s health budget has increased and this is commendable. Unfortunately, it still falls short of what is needed to enable the sector to meet it objectives. To help improve the health of Kenyans, government should:

- **Strengthen Primary Health Care** The disease burden from preventable illnesses remains quite high. It is therefore critical that more funds be spent on preventive and promotive health than is currently the case. The need to increase coverage to reduce mortality and morbidity from immunization preventable illnesses such as measles is important. This will in the long term contribute to improving the health and general well being of Kenyans and result in savings that could be invested in improvement of the health infrastructure and strengthening of health systems. This will also contribute towards meeting related MDGs

- **Invest in community education and demand creation to increase the utilization of health care services** Targets should include increasing the immunisation coverage, skilled care at delivery and enhance access to AIDS related services such as ART and PMCT. A comprehensive prevention campaign would reduce the incidence and

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prevalence of common diseases for which most people visit health facilities. It is estimated that in some areas, outpatient loads could be reduced by between 40%-60%.

- **Increase budget to meet Abuja target of 15%** The 30% increase in the health care budget this year is a very welcome move. However, the government must increase the health budget for FY 2006/07 to meet the Abuja target of 15% of GDP from the current levels (At present, the health budget is 15% of GDP).

- **Increase the share of the budget for reproductive health and family planning services** The FY 2005/06 health budget included Kshs. 200 million for family planning and reproductive health. This is relatively insignificant given the contribution to overall morbidity and mortality from related complications. This should be increased to facilitate the expansion of certain services such as those dealing with sexual violence given the increase in the incidence of the same and the clear link between violence and HIV/AIDS. Currently only 7 out of the 73 district hospitals and 1 provincial hospital can provide these services.

- **Increase the development budget** Currently most health facilities need renovation and refurbishment. An increase in the development budget would enable the Ministry of Health (MOH) to renovate and refurbish more health facilities and in some areas construct new ones.

- **Policy review, implementation and dissemination** While the MOH has developed several policies and protocols during the last financial year, it has been the practice of government to develop policies without a corresponding budget for implementation.

- **Invest in improving logistics to improve quality of care and structures that support activities geared towards meeting health related MDG.**

4. **Sanitation**

Kenya’s population is increasing at an average rate of 1.8% and faces enormous challenge of providing water and sewerage services to the increasing population. Most of the population lives in rural areas (24 million), while 9 million live in urban areas out of which more than half live in informal settlements. It is widely recognised that without safe sanitation and hygienic practices, health benefits of improving water supply are minimal. In Kenya, over half of the disease burden is linked to poor personal and domestic hygiene and inadequate sanitation. The 1999 population and housing census showed access to sanitation facilities to be 82%. If you omit pit latrines in urban areas from these statistics as per the Ministry of Health, classification national coverage falls to less than 50%. In light of this alarming situation, government should:

- **Profile Sanitation and Sewerage** The Ministry of Water and Irrigation, Ministry of Local Government, NEMA and other relevant institutions need to ensure that appropriate and comprehensive policy; organisational and legal instruments on sewerage and sewage disposal are developed and enforced. The Environmental Sanitation and Hygiene Policy should also be adopted.

- **Finance sanitation** Prioritise and increase commitment of public money and encourage private households to finance their own sanitation facilities e.g. through micro finance schemes and merry go round arrangements.

- **Adopt low cost technologies** such as improved pit-latrines in the short term if conventional sewerage is too expensive.

- **Expand and upgrade existing treatment plants** with advanced treatment technologies such as chemical coagulation and sedimentation, wetlands, filtration and/or chlorinating systems in order for effluent to meet discharge standards.

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5 Sanitation in Kenya falls into two broad categories: (i). Onsite, which comprises mainly of pit latrines, and (ii) offsite or waterborne.
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- **Enforce standards compliance** on discharge from sewage treatment plants into the aquatic environment and the sewers. Reduce the use of harmful technology that is harmful to health and the environment
- **Penalise pollution** e.g. through the polluter pays policy (which is yet to be effectively enforced)
- **Price wastewater treatment** Currently the national pricing or costing policy for domestic sewage or industrial effluent discharged into the public sewers only takes into account the volume discharge. It is necessary for quality or the load of the effluent to be incorporated into the formula
- **Promote public awareness or education** on sewer usage and on disposal of wastewater
- **Require environmental health assessment impacts** to be carried out as a pre requisite to licensing

5. **Livestock**

Livestock is the major source of livelihood for pastoralists. However, a number of factors such as insecurity, animal diseases, and environmental degradation, inadequate and non-optimal markets for livestock and livestock products and poor livestock breeds have compromised the returns from this source of livelihood. There is need to give livestock more prominence in thought and planning than it currently receives. In this regard, government should:

- Intensify security in conflict prone areas to address the problem of cattle rustling
- Put in place clear administrative boundaries for pastoral communities since most of the conflicts are due to use of natural resources such as water and pasture
- Develop an off-take and restocking strategy to cushion pastoralist communities against adverse effects of drought
- Improve early warning systems and communicate findings to decision makers and resident communities
- Institute disease control zones and consider disease surveillance, including introduction of animal vaccination cycles
- Construct market sites in the region and establish a national livestock market information system
- Carry out a livestock census to assess the market potential of livestock
- Undertake sensitisation campaigns for local communities to upgrade their livestock breeds

6. **Infrastructure Financing**

While there is still some argument about the exact level of economic growth, there is little doubt that the economy has been placed on a recovery path. However, in order to maintain and surpass a growth level of 5.8% over the mid-term, the quality of infrastructure in Kenya will require massive improvements through investments. Estimates of the sums that are required to upgrade and expand the road, rail and national electricity grid are massive. Taking into account of the limited flexibility within the budget, it is highly unlikely that meaningful infrastructure expansion can be made from public resources dedicated from the annual budget. Therefore, in order to retain the momentum in economic growth, government should:

- Set up a national infrastructure plan that includes urban, rural and ASAL areas
- Take advantage of the savings that Kenyans have built up by fast tracking the issuance of an infrastructure bond to raise immediate funds for the required upgrading and setting up of new roads and other infrastructure.
- Put in place a proper framework for Private Public Partnerships (PPPs) in infrastructure development and service delivery. This would also ensure that critical services such as port services and required developments and improvements at the
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airsports are completed promptly. This will require well-coordinated public institutions and good corporate governance.

7. Energy
With growing industrialisation, household and industry consumption levels of energy are far outstripping our domestic generation capacity. Additionally, global supply of some forms of energy such as petroleum is limited and costly. Kenyans are concerned that with these issues as well as the present wood fuel supply deficit, the harmful effect of coal on the ozone layer, the non-reliability of HEP, and the limited availability of LPG, immediate and long-term intervention measures are required. There is great potential for alternative sources of energy such as solar, wind and biomass (waste), not just for domestic use but for exportation as well.

The Energy sub-sector proposes to harness geothermal, solar, wind and biomass power as alternative sources of energy and this is commendable. However, to deal with the above concerns, government should:

- Provide tax exemptions to micro-power production and mini hydro electric plants for the first 5 years of starting up to boost supply and industrialisation without burdening the public purse
- Not increase the tax on petroleum products. A tax increase on petroleum products will be passed on to businesses and consumers and therefore increase their expenses
- Offset tax dues from petroleum marketing companies on imported products against verified tax refunds. This is administratively efficient and will reduce the likelihood of companies and inevitably consumers paying the costs of tax refunds that are otherwise lying idle
- Develop a mechanism to protect Kenyans from fuel inflation. The immediate remedy is to reform the tax on fuel from a fixed tax to an advalorem tax and in the medium to long term embark on fuel price hedging in the international market

CROSS CUTTING ISSUES

1. Procuring and Financing Of Security Contracts
The trend in Kenya of procuring and financing security contracts gives rise to considerable cause for concern. For starters, the value of Anglo Leasing type contracts increased eight fold between fiscal years 2001/02 and 2005/06 and planned debt repayment to Anglo Leasing type of companies accounted for 28% of total external debt service requirements in 2005/06, up from a low of 4% in 2001/02. The government has borrowed funds at approximately 28% per annum to finance some of the irregular security contracts, a rate that was almost 4 times the market rate then.

Evidence suggests that some of the security contracts were highly inflated. Some of the companies awarded the security tenders had no demonstrable competence and there is no evidence to suggest that the said companies were credible financiers. Yet, the exchequer paid approximately Kshs. 8.9 billion before the commencement of work. The scheduled payments in respect of the Anglo Leasing type of contracts in 2005/06 would have funded the secondary school bursary scheme for the next 10 years or a 3-year programme of rural electrification at current funding levels.

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Anglo Leasing type contracts refer to contracts where the contractor secures a contract then approaches their bankers to secure a loan guarantee. With the commitment fee paid to them and a loan guarantee, they then enter into a contract with manufacturers of the equipment for delivery of the merchandise. The merchandise is then supplied to government and payments made to contractor as agreed. Over time, government pays the contract amounts in full to the contractor. On receipt of the money, the contractor's bankers in turn pay the manufacturers. Their bankers earn commissions for the loan guarantee and the contractor then makes windfall profits without spending on the transaction.
Unlike other multilateral and bilateral financing arrangements, the mode of financing used to finance the contracts (i.e. use of promissory notes) does not allow any grace period. Also, it is worth noting that all the questionable security contracts entered into recently were housed in two powerful offices. That is, the Office of the President, and the Office of the Vice President and Ministry of Home Affairs. The budgeted outflows (repayments) to Anglo Leasing type companies were almost half of total project and programme loan inflows in 2004/05.

These observations indicate that Treasury needs to tighten controls over procurement and financing of security contracts. In this regard, government should:

- Amend the law to allow greater scrutiny of security contracts by parliament and the National Audit Office
- Compel minimum reporting standards on security contracts
- Enact the proposed Fiscal Management Bill 2006
- Blacklist/ban all companies and individuals that abet, participate or collude to defraud the government from ever transacting with the government
- Review government contract law to define clearly, the roles of various public offices that are involved in the formulation and solemnisation of government contracts e.g. the State Law Office, Treasury, Line Ministries, and Government Departments.

2. Revenues
Revenues can be sourced in many ways including proceeds from privatisation of entities, profits from State Owned Enterprises, taxes, rent, interest and dividend income, user fees, fines and licensing fees. Revenues can be used to finance public expenditure, redistribute wealth, manage the economy and, in the case of taxes, alter social behaviour, household, and individual decision-making.

In 2004/05, Kenya raised an estimated Kshs. 326 billion in total revenues. Of this amount, 90% came from ordinary revenues, that is, taxes that include income tax, customs, excise and VAT. It is therefore evident that Kenya relies heavily on tax type revenues. In light of this, the government should:

- **Up tax compliance** - Carry out random tax audits on companies and individuals to enhance compliance
- **Policy design** - Develop coherent (not piecemeal) tax policies that will enable revenue generation and management of the economy towards intended growth. This will entail having data on consumption behaviour and impacts of various tax measures on sectors
- **Policy considerations** - Refrain from tax policy development that purely results from lobbyist demands, but instead results from careful assessment of policies that will promote growth - Examine the suitability of EAC tax harmonisation for our economy type and vision
- **Recognise the relationship between pronounced tax measures, and gender, welfare and development.** This has been done in other countries such as Mexico, UK, Canada, USA and South Africa and is necessary if government wishes to achieve and maintain a ratio of revenue to GDP of 21%

**Government should also look into optimising potential to raise revenues from non-taxation.**

**Recommendations to this end include:**

- **Reduce and prevent leakages** - Monitor public institutions such as the Registrars Office, law courts and hospitals for revenue leakages and institute disciplinary procedures against personnel who are guilty, and institutions which fail to take systematic measures to curb leakage
- **Develop innovative ways to raise monies through user fees** e.g. by creating (or
enabling the creation of recreational facilities in parks where minimal fees can be charged for use, or, opening cyber or service centres at public service centres like law courts

3. Devolved Financing
Over the last decade, lower levels of administration have been receiving an increasing number of decentralised funds from central government and donor agencies. As evidenced in the table below, most of the allocations to the funds have been increasing. These Funds are earmarked to address poverty reduction and regional inequalities. Though there are no current figures to indicate the extent of success in achieving the above objectives, information documented in various studies indicate that although there have been efforts to address area specific priorities, there exist overlaps in the use of the various funds that have resulted in conflict of interest, duplication of efforts and misuse of resources. The table below illustrates this.

<table>
<thead>
<tr>
<th>Year of Inception</th>
<th>Fund</th>
<th>Source of Fund</th>
<th>Administration level</th>
<th>Thematic Area of Funding</th>
<th>Fund Allocation/Collection</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>Roads Maintenance Levy Fund (RMLF)</td>
<td>Roads Maintenance Levy</td>
<td>☑ Local Authorities ☑ District ☑ Constituency</td>
<td>☑ Roads</td>
<td>2002/03 – 2003/04 16.9% increase in allocation</td>
</tr>
<tr>
<td>1993/94</td>
<td>Secondary School Education Bursary Fund (SEBF)</td>
<td>Central government and donor support</td>
<td>☑ Constituency (it was initially disbursed through school heads and education officers)</td>
<td>☑ Education</td>
<td>2004/05 – 2005/06 85% Increase in Allocation</td>
</tr>
<tr>
<td>1998/99</td>
<td>Local Authority Transfer Fund (LATF)</td>
<td>It is calculated at 5% of national personal income tax and distributed equitably to all LAs</td>
<td>☑ Local Authorities ☑ Education ☑ Roads ☑ Water &amp; Sanitation</td>
<td></td>
<td>2004 - 2005 25% Increase in Allocation</td>
</tr>
<tr>
<td>1999</td>
<td>Rural Electrification Levy Fund</td>
<td>Electrification Levy</td>
<td>☑ Constituency ☑ District</td>
<td>☑ Electricity</td>
<td>2003 – 2004 19.7% increase in allocation</td>
</tr>
<tr>
<td>1999</td>
<td>Constituency HIV/AIDS Fund</td>
<td>Global Aids Fund disbursed through the National Aids Council Central government</td>
<td>☑ Constituency ☑ Health ☑ HIV/AIDS</td>
<td></td>
<td>2002/03 – 2003/04 15.4% increase in allocation</td>
</tr>
<tr>
<td>2003</td>
<td>Free Primary Education (FPE) Fund</td>
<td>Central government and donor support</td>
<td>☑ Constituency ☑ District</td>
<td>☑ Education</td>
<td>2004/05 – 2005/06 30% increase in allocation</td>
</tr>
<tr>
<td>2003/04</td>
<td>Constituency Development Fund (CDF)</td>
<td>2.5% of ordinary revenue collected and any monies accruing to or received by the National committee from any other source</td>
<td>☑ Constituency ☑ Education ☑ Health ☑ Electricity ☑ Roads ☑ Water &amp; Sanitation</td>
<td></td>
<td>2004/05 – 2005/06 29.5% increase in allocation</td>
</tr>
</tbody>
</table>
The laid down mechanisms in the use and administration of the Funds have been disregarded due to weak accountability and transparency structure. In this regard, government should:

- Establish a clear policy on which administrative level it will officially engage decentralisation i.e. whether the planning unit will be the Local Authority, Constituency, or the District
- Enforce decentralised fund policies to ensure citizen participation in planning, project identification and management as well as in monitoring and evaluation for more transparency and accountability of funds and ownership
- Ensure that fund use is linked to the macroeconomic policy framework and local and national priorities
- Ensure clear separation of powers and responsibilities i.e. on policymaking roles, oversight and technical/implementation roles. In addition, there is need to amend the legal provisions to make the fund managers accountable to the citizens
- Since the funds seem to go towards similar thematic areas, there is need for harmonisation to achieve optimum results
- Fund disbursement criterion should not only include poverty level considerations but also the geographical size, population density, and current economic status/level of development
- Deploy technical capacity to improve planning and execution of projects
- Strengthen institutional arrangements that provide for strong intra and inter sectoral linkages
- Ensure an institutional frame work that facilitates an adequate translation of planned policy objectives to achievable outputs and outcomes
- Have adequate provisions within budgeted amounts for operations and maintenance

4. Public Sector Performance
Kenya is endowed with factors that can cause change and growth. However, despite these endowments, Kenya is not where it could be. A considerable factor missing is the unwritten attitude and approach of public servants to tasks with exception of a few good women or men. There is need for Kenyan public servants to take ownership of the development agenda. Performance contracts although good in outlining tasks and responsibilities required, only work where they are followed. Other countries have drawn up Social Charters, which bind the service provider to certain standards of service provision, and the Public Service Commission has recently adopted this. What could be done in addition to these measures to stir better performance is a reduction of the wage variance between the various levels of public offices, rewarding of good performance through promotions and better pay benefits.

5. Wages Policy
Being the largest employer in the country, the government has expressed the desire to maintain reasonable growth in the public sector wage bill while ensuring that all workers receive adequate compensation. (The consequence of a large wage bill has primarily been the reduced expenditure on operations and maintenance.) Having recently published a pay policy for the public sector, the major policy changes involve undertaking to maintain an affordable and sustainable wage bill together with increased transparency in the compensation structure. The achievement of this will require staff rationalisation and a direct linking of pay to economic performance. Because similar undertakings have been made in earlier budgets, a staff rationalisation plan and the new compensation policy must be actualised through a published plan. The expected costs and duration of this plan ought to form a prominent part of the budget for financial year 2006/7. 

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6. Pensions
Liabilities related to the payment of pensions for retired employees in the public sector are not only substantial but are growing in line with wages. The gross estimates for pensions and gratuities for the financial year ending in June 2006 was Kshs. 17.9 billion and thereby constituted 4.7% of the gross estimates of the recurrent expenditure. The figure will be higher following the presidential announcement made on June 1 2006, of a Kshs. 1,500 increase in the pension amount, bringing the total pension amount to Kshs. 2,000 per month per person.

This growing liability reflects the absence of planning in terms of meeting the payments of pensions and gratuities for retired public sector workers. It is therefore a policy imperative for the Minister for Finance to immediately establish a contributory pension scheme for all civil servants. While the intention has been expressed before, the rising financial burden must be controlled promptly through the establishment of a funded pension scheme. The establishment of a contributory civil servants pension scheme would be advantageous to the economy in three ways. First, it would isolate the financial liability arising from the payment of pensions and gratuities away from the general budget and put it on a sound actuarial footing. Secondly, it would allow all public sector workers to benefit from the interest generated by their savings over their working lives. Thirdly, the pensions industry would be massively boosted as the savings from the large pool of the public sector workers would be available for investment in the economy. Over time, the government’s liabilities in respect of pensions and gratuities for retirees would become financially viable.

7. Savings and Investment
The response to the KenGen IPO indicates that Kenyans are interested in investing in capital markets. Additionally, the Economic Survey 2006 records a growth of 27.4% in gross fixed capital formation. This indicates that there are a number of Kenyans who are willing and able to invest their income but opportunities to invest are slim. In other words, there is need not only for Nairobi Stock Exchange to expand, but also for investment companies to come up with more innovative investment products. There are a few companies with relatively innovative products but these products are not known to the public and for some, restricted to income earners in high-end groups. Perhaps companies can design products that can be applicable to low and non-wage income earners. In addition, given that a number of Kenyans borrowed money to purchase KenGen shares, there is need to educate the public on the fundamentals of investment.

8. Governance, Justice, Law and Order Sector (GJLOS)
Since its inception in 2003, GJLOS has been implementing two work plans, That is, Short-Term Priorities Programme (STPP) and Medium-Term Strategy 1 for 2005/06 financial year (MTS 1) with a combined estimated cost of Kshs. 7.9 billion. Under STPP, the basket fund from donors is to finance 51% of the budget. Under MTS 1, the government is to contribute the highest amount estimated at 55% of the total MTS 1 budget. Under the MTEF budgeting framework, the Public Safety Law and Order sector (PSLO) is considered the legitimate sector and not GJLOS. However, unlike the GJLOS which has embraced a sector wide approach to planning, PSLO is still ministerial and department driven. The biggest challenge that should be addressed urgently if GJLOS reform agenda are to succeed is to collapse GJLOS and PSLO into one sector to smooth reform efforts and capitalise on strengths of both sector groups. In this regard, the following should be done:

- Review the current variance in institutional mix and performance indicators and recommend appropriate alignment where necessary. The starting point is to develop criteria for exit and entry into the sector and then prepare a plan to phase out non-GJLOS sector departments. Further, governance indicators of monitoring performance...
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must be harmonised in all government documents and especially the IP-ERSWEC and the MTS

- **Merge GJLOS, PSLO, and legitimise the merger** e.g. by way of cabinet approval. This should be preceded by policy providing guidelines on role and operation of the sector, including linkage with other public sector institutions and processes
- **Build capacity within the sector implementers.** The Financial Management Agency (FMA) should prepare a plan for building capacity among the participating ministries and departments. In addition, job placements should be based on skill requirements
- **Fit the sector into other government processes and reforms** by fitting GJLOS reforms in the MTEF cycle
- **Increase engagement with Treasury** in activities, and if possible with Thematic Working Groups. This will lead to increased appreciation of the role of the sectors’ reform agenda in promoting economic growth
- **Insulate funding for the reform programme from regular cuts** through Cabinet recognition and formal contracts

9. Monitoring and Evaluation of National Plans and Strategy

The role of the Medium Term Expenditure Framework (MTEF) is to link budgets with planning and policies. Towards this end, a monitoring and evaluation framework has been set up which is good, but has a few areas that could be improved upon to optimise on the value of M & E. These are;

- Develop appropriate indicators, targets and timeframes
- The PER should be released before end January to allow sector working groups to develop their reports on challenges for the sector in the past year and priorities for the upcoming three year in a timely fashion.
- Some sector working groups (SWGs) need to have more non government participation
- SWGs should continually reflect on own progress rather than wait till November or thereabouts plan for the next budget cycle
- Sector Working Groups should plan for three years in line with MTEF
- Basic data, such as unemployment and poverty levels, are needed to allow proper assessment of the ERSWEC
- Adopt GJLOS style of activity level budgeting across all MTEF sectors

**CONCLUSION**

The majority of Kenyans work hard but find that productivity is not as good as it could be and that incomes, do not go far as they could. Productivity is a function of land, labour-skill, capital and endowments, and prices of basic goods and services, and individual levels of health, income and housing security affect income.

There is need to increase Kenyans’ incomes and simultaneously reduce the cost of expenditure. Expenditure in this case is not restricted to nominal expenses borne by an individual for say medication or bus fare, but extends to the time, health and opportunity cost incurred by individuals, families and thereby the state where public resources are not used efficiently or effectively. Such expenditure can arise for instance, from having to wait a long time in line to clear goods at an airport, inhaling exhaust fumes from vehicles, as a pedestrian, having to replace shock absorbers on cars more frequently than the manufacturer intended, parting with money to receive a service, having to walk several steps outside ones dwelling to excrete, losing a life to malaria, under financing development to allow repayment of unjustified contracts having to wait to the next general election to hope for change or even having to travel to Nairobi to receive medical treatment.
Kenya’s economy is improving, and this should not be dismissed. To avoid the risk of reneging on progress we have made so far, careful planning and safe spending are necessary. To our advantage, we have a number of opportunities that we can use. These include revenues, private sector participation, trade and innovative banking and investment. As we endeavour to assess our past, evaluate our progress, and look ahead, let us seize the day and take advantage of these opportunities.