KENYA: ANALYSIS OF THE 2015 BUDGET REVIEW AND OUTLOOK PAPER

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KEY FINDINGS

- Revenue performance was below target in 2014/15, in line with the underperformance of the last few years.
- Expenditure performance was below average in 2014/15. This was largely due to overambitious targets for development spending.
- The deficit as a share of the budget continued to rise in 2014/15. Despite expanding debt, economic growth resulted in a decline in debt as a share of the economy.
- Slow economic growth projected for this year and the next will likely lead to a higher deficit than was projected earlier in 2015, as revenues fall and expenditure expands.
- The share of the budget devoted to infrastructure and energy will fall in 2016/17 and continue to decline thereafter. Education, security, and governance will each take an increasing share of the budget.

BACKGROUND

The Budget Review and Outlook Paper (BROP) is a backward and forward looking paper. It is comprised of three key elements:

1. Review of budget performance from the most recent financial year (2014/15).
2. Updated expectations for key economic indicators and implications for budget performance in the current year (2015/16) and upcoming year (2016/17).
3. Proposed sector distribution of the budget for the coming financial year (2016/17).

REVIEW OF PERFORMANCE IN 2014/15

The 2015 BROP details the national government's revenue and expenditure performance for FY 2014/15.

REVENUE PERFORMANCE

The BROP provides performance details for the three main sources of revenue:

- Ordinary revenue – funds that are mainly generated from taxes and fees.
- Appropriations in Aid (AiA) – funds collected directly by ministries or agencies either from user fees or from international donors.
- Grants – funds from international donors that are channeled through the National Treasury.

The government projected it would raise Ksh 1.24 trillion in total revenue in 2014/15. The 2015 BROP shows that only Ksh 1.13 trillion (92 percent of this target) was raised. As Table 1 shows, this compares poorly to the government's performance in 2013/14, when it raised 97 percent of the targeted amount, but is equal to the average performance between 2011/12 and 2013/14. Underperformance has tended to be driven by a failure to collect AiA and external grants; performance in collecting ordinary revenue has consistently been better. This trend has continued into 2014/15, with below average performance on AiA collection and continuing poor performance (though slightly above average) on external grant collection.

Table 1: Revenue Performance as a Percentage of Target Amounts

	2011/12	2012/13	2013/14	Average for 2011/12 to 2013/14	2014/15
Total Revenue and Grants	*90%*	*88%*	*97%*	*92%*	*92%*
Ordinary Revenue	95%	94%	100%	97%	96%
Appropriation in Aid	72%	74%	93%	80%	75%
External Grants	36%	28%	50%	38%	41%

Sources: BROP 2012 (Table 2), BROP 2013 (Table 2), BROP 2014 (Table 1) and BROP 2015 (Table 1)

One question we might ask about targets that are not met is whether they were too ambitious in the first place. As shown in Table 2, a 17 percent increase in all revenue and grants was projected for 2014/15. As previous years have seen increases of between 13 and 19 percent, projecting a total revenue increase of 17 percent was not necessarily too ambitious. Projected increases for AiA and external grants also do not appear overly ambitious in 2014/15 relative to past experience.

The increase in actual receipts, however, was only 10 percent. The 2015 BROP provides some explanation for the failure to achieve revenue targets. As cited in all previous BROPs published since 2012, poor performance in collecting AiA is blamed on under reporting by government spending units. However, no measures are proposed for dealing with this problem and nothing seems to have been done over the past several years.

Table 2: Revenue Estimates Versus Actuals, 2011/12 to 2014/15

	Revenue Estimates			Actual Revenue Receipts		
	% Changes between 2011/12 and 2013/14	**% Changes between 2012/13 and 2013/14**	**% Changes between 2013/14 and 2014/15**	**% Changes between 2011/12 and 2012/13**	**% Changes between 2012/13 and 2013/14**	**% Changes between 2013/14 and 2014/15**
Total Revenue and Grants	*17%*	*7%*	*17%*	*13%*	*19%*	*10%*
Ordinary Revenue	14%	11%	17%	13%	18%	12%
Appropriation in Aid	15%	-3%	13%	18%	21%	-8%
External Grants	76%	-28%	24%	37%	29%	2%

Sources: BROP 201 (Table 2), BROP 2013 (Table 2), BROP 2014 (Table 1) and BROP 2015(Table 1)

EXPENDITURE PERFORMANCE

The BROP provides performance details for overall expenditure, and a breakdown for expenditure by ministries, departments and agencies (MDAs). Total expenditure includes MDAs, but also includes debt repayment, funding for counties, and constitutional obligations, such as pension payments to civil servants.

Total actual spending (including MDAs, debt, etc.) grew by nearly 26 percent between 2013/14 and 2014/15, but fell short of a target expansion of 39 percent (comparing the 2014/15 target to actuals in 2013/14). The actual total expenditure for the year was 91 percent of the total expenditure approved, a slight increase from an absorption rate of 89 percent in 2013/14.[1]

The total expenditure for MDAs was 76 percent of the approved expenditure of Ksh 1.41 trillion. This is lower than the average of 85 percent absorption rate in the three previous years. This was mainly due to a sharp decline in absorption of development allocations (see Table 3).

Table 3: Ministries, Departments and Agencies Absorption Rates, 2012/13 to 2014/15 [2]

	2011/12	2012/13	2013/14	2014/15
MDAs Expenditure	**% Budget Absorption**	**% Budget Absorption**	**% Budget Absorption**	**% Budget Absorption**
Recurrent Expenditure	92%	92%	91%	93%
Development Expenditure	78%	71%	77%	59%
Total MDAs Expenditure	*86%*	*84%*	*86%*	*76%*

Sources: BROP 2012 (Table 3); BROP 2013 (Table 3); BROP 2014 (Table 3); and BROP 2015 (Table 3).
Notes: In 2013/14 and 2014/15 we were able to draw these figures from a detailed breakdown of MDA spending only. This was not available in 2011/12 and 2012/13, so we were forced to use total development figures, which may include other items not funded through MDAs.

Some MDAs, such as the Teachers Service Commission and the Ministry of Defence, spent all the funds allocated to them. However, some of the infrastructure votes and independent agencies struggled to absorb their budget allocations (Table 4).

Table 4: Best and Worst Performing of Ministries, Departments and Agencies by Absorption Rates

	Ministry/Department/Commissions	Actual*	Target	Variance	% Total Expenditure to Total Target
1	National Land Commission	1,678	1,536	142	109%
2	Ministry of Mining	1,972	1,958	14	101%
3	Teachers Service Commission	169,758	169,636	122	100%
4	National Intelligence Service	19,137	19,142	-4	100%
5	Ministry of Defence	78,695	78,781	-86	100%
5	Ministry of Foreign Affairs	9,745	15,041	-5,296	65%
4	Ministry of Energy and Petroleum	52,751	90,776	-38,026	58%
3	State Department for Transport	39,723	187,741	-148,017	21%
2	Commission for the Implementation of the Constitution	38	306	-268	12%
1	Witness Protection Agency	10	295	-285	3%
	Total (All MDAs)	***1,072,317***	***1,409,425***	***-337,109***	***76%***

Source: BROP 2015 (Table 3)

Overall, expenditure was projected to grow by 28 percent beyond the previous year's target. This is far above actual expenditure growth in recent years (Table 5). Projected growth of recurrent expenditure seems to have been modest compared with years prior, but the development projection of 68 percent growth in a single year seems extremely ambitious. Some targets at sector level were also unrealistic – the total amount allocated to energy/infrastructure increased by 95 percent between 2013/14 and 2014/15.

[1] BROP 2015 (Table 7), BROP 2014 (Table 7)

Table 5: Absorption Rates for Ministries, Departments and Agencies (2012/13 to 2014/15)

	Expenditure Estimates			Actual Expenditure		
MDAs Expenditure	**% Changes between 2011/12 and 2012/13**	**% Changes between 2012/13 and 2013/14**	**% Changes between 2013/14 and 2014/15**	**% Changes between 2011/12 and 2012/13**	**% Changes between 2012/13 and 2013/14**	**% Changes between 2013/14 and 2014/15**
Recurrent Expenditure	25%	-5%	4%	25%	-6%	7%
Development Expenditure	9%	-1%	68%	-1%	7%	28%
Total MDAs Expenditure	*18%*	*-4%*	*28%*	*15%*	*-2%*	*14%*

Sources: BROP 2013 (Table 3); BROP 2014 (Table 2); and BROP 2015 (Table 2).

The BROP does not explain variations in performance at the MDA level. In BROPs from the last few years, the Treasury has identified poor reporting on development spending from subnational units as a major reason for under performance in development absorption. However, there are no further details about the magnitude of this problem or how it can be solved.

DEFICIT

The overall fiscal deficit for 2014/15 was 33 percent of the total expenditure, and has been trending upward since 2012/13 (see Table 6). The 2015 BROP projects that the deficit will remain at a similar level in 2015/16, but drop to about 26 percent of total expenditure in 2016/17. Table 6 shows the relationship between the deficit and public debt; as the deficit has increased, public debt has also been on the rise. However, the projected decline in the deficit in 2016/17 corresponds to a projected decline in the rate of growth of the public debt.

Table 6: Budget Deficit and Public Debt between 2012/13 and 2016/17

	2012/13 (Actual)	2013/14 (Actual)	2014/15 (Actual)	2015/16 (Projections)	2016/17 (Projections)
Fiscal Deficit excluding grants (billions)	260	326	534	651	542
Total Expenditure (billions)	1,107	1,301	1,640	2,015	2,102
Deficit as a % of the total Expenditure Estimates	*23%*	*25%*	*33%*	*32%*	*26%*
Public Debt	1,894	2,360	2,844	3,319	3,517
Public Debt to GDP	48%	48%	46%	51%	48%
		% Growth between 2012/13 and 2013/14	**% Growth between 2013/14 and 2014/15**	**% Growth between 2014/15 and 2015/16**	**% Growth between 2015/16 and 2016/17**
	Fiscal Deficit Growth	25%	64%	22%	-17%
	Public Debt Growth	25%	20%	17%	6%

Sources: BROP 2015 (Table 7); Controller of Budget (CoB) 4th Qtr 2012/13 Report Page 11; CoB 4th Qtr Report 2013/14 Figure 3.1; CoB 4th Qtr Report 2014/15 Figure 3.1; and BROP 2015 Table 7

UPDATES TO THE FISCAL EXPECTATIONS FOR 2015/16

The 2015 BROP identifies a number of economic challenges in 2015. These include the depreciation of the Kenyan shilling and higher interest rates, which might affect revenue and expenditure. In the last six months, additional challenges such as lack of liquidity (inadequate cash at the beginning of the year to pay expenses) have also affected the government budget. Despite these issues, the 2015 BROP does not propose major adjustments to revenue or expenditure projections in 2015/16 or 2016/17.

Expected economic growth for the current financial year (2015/16) has been revised down from 7 percent in the approved budget to 6.1 percent in the 2015 BROP.[3] However, revenue and expenditure estimates for 2015/16 are slightly revised upwards. Expenditure is projected to rise by Ksh 16.3 billion while the revenue is projected to increase by Ksh 5.7 billion, thereby increasing the deficit by Ksh 10.6 billion.[4]

GDP growth for 2016/17 has been revised downwards from 7.1 percent in the 2015 Budget Policy Statement (BPS) to 6.5 percent in the 2015 BROP.[5] There is a modest 2 percent decrease in the revenue projection for 2016/17 between the BPS and the BROP (from 1.59 trillion to Ksh 1.56 trillion) and an increase in the expenditure projection by 2 percent for the year 2016/17. These changes are projected to increase the deficit by Ksh 84 billion beyond the BPS projection.

PROVISIONAL CEILINGS AND JUSTIFICATIONS

The total expenditure projection in the 2015 BROP for 2016/17 will be Ksh 2.10 trillion, a 4 percent increase over the 2015/16 budget. For 2016/17, the 2015 BROP projects that health, education, and infrastructure development will continue to receive the largest shares of the MDA budget. Education and health will get 27.5 percent of the total MDAs allocation in 2016/17, up from 26.2 percent this year, while infrastructure and energy sector allocations will make up 23.5 percent of the total MDAs expenditure, a decline from 26.9 percent this year.[6]

Another key priority area for the government is improving the business environment in Kenya through more investment in the security sector and the governance, justice, law and order (GJLO) sector. The ceiling for the security sector is projected to rise from 7.5 percent in 2015/16 to 7.7 percent next year. This reverses a trend of declining sector shares for security. The GJLO sector is rising from 10.2 percent of the total MDA budget this year to 11.5 percent of the budget in 2016/17.

Over the medium term, the social sector will continue to get more funding, a shift from last year's proposal to reduce social sector spending over the next several years. Social spending increases are mainly driven by the education sector (rising from 23.5 percent for 2016/17 to 24.8 percent in 2018/19); the health sector will be maintained at roughly 4 percent of the total budget.

The GJLO and security sectors will see their share of the budget increase over the medium term. GJLO will rise from 11.5 percent in 2016/17 to 12.1 percent in 2018/19, while the share of the budget allocated to security will increase from 7.7 percent to 9 percent over the same period.

The 2015 BROP narrative suggests that funding to the energy and infrastructure sector will either remain steady or be increased over the next 3 years. However, Table 10 on page 31 of the 2015 BROP contradicts this, with the share of the budget allocated for infrastructure development projected to fall from 23.5 percent in 2016/17 to 18.4 percent in 2018/19.

The completion of some key infrastructure projects in the country is given as the reason for the decreasing infrastructure budget over the medium term. For example, construction of the Standard Gauge Railway, which may

[3] BROP 2015 (Table 9)

[4] BROP 2015 (Annex 2)

[5] BROP 2015 (Annex 1)

[6] BROP 2015 (Table 10)

have accounted for the huge increase in the development budget between 2013/14 and 2014/15, is expected to be completed in 2017.

The Security and GJLO sectors will get more funding to improve security agencies, judicial services, and promotion of good governance. Insecurity has been major a concern in Kenya for the last few years, so this is a plausible reason for it to command an increasing share of the budget. However, there are no reasons given for any specific expenditures. Similarly, the increase in social spending and why education is favoured relative to health are not explained.