KENYA: ANALYSIS OF BUDGET POLICY STATEMENT 2016

February 2016

KEY FINDINGS

- Total spending for 2016/17 is set to rise to Ksh 2.05 trillion. This reflects more modest ambitions for spending and a desire to reduce the deficit relative to recent years. The government expects to collect Ksh 1.50 trillion in revenue. This will leave a deficit of roughly Ksh 555.4 billion, 6 percent smaller than the revised 2015/16 budgeted deficit.
- Infrastructure and energy remains important, but the share of the 2016/17 budget devoted to this sector will dip slightly from 27 to 25 percent. The share of the budget devoted to governance, justice, and law and order will increase from 10 percent to 12 percent in preparation for next year's general election.
- The unconditional transfer of funds to the countries (known as the equitable share) is set to rise by 7.9 percent. This is lower than previous years and far below the 15 percent increase proposed by the Commission on Revenue Allocation. Treasury has not explained its use of a lower growth rate.
- Despite the public being invited to comment on the draft Budget Policy Statement in February, the final statement does not indicate how public input was taken into account or how it influenced the budget. This could imply that input from the public was not satisfactorily considered.

BACKGROUND

Each year the National Treasury must table a Budget Policy Statement (BPS) in Parliament by February 15. The tabling of the BPS is a critical moment in the annual budget process when a number of key decisions are made. These decisions include:

- The overall size of the national budget (revenue, spending, and deficit).
- The sector distribution of the budget (share of the budget for health, education, etc.).
- How revenue is divided between the national and county levels.
  (Technically, the decision about the division of revenue between the two levels of government is made in the Division of Revenue Bill, which is also tabled on February 15. However, the BPS describes the proposed division of revenue in greater detail than the bill and contains information on the overall size of the funding for counties and its distribution.)

We look at each of these three key items in turn.

SIZE OF THE NATIONAL BUDGET

The BPS 2016 proposes total expenditure of Ksh 2.05 trillion in 2016/17. Revenues are projected to be Ksh 1.50 trillion, leaving a deficit of roughly Ksh 555.4 billion. Compared to the 2015/16 revised budget, this represents: an 8 percent increase in expenditure; a 14 percent increase in revenue; and a 6 percent decrease in the deficit from the current year (2015/16).

Table 1 below compares these figures to those of previous years. The small increase in expenditure in 2016/17 is mainly driven by rising debt repayments (up 14 percent) and increased funding for counties (equitable share up by 8 percent).[1]

At the ministry level, we do not have a revised budget. We compare ministry allocations to the original 2015/16 budget. Allocations to ministries, departments and agencies (MDAs) in 2016/17 have decreased by just over one percent. This differs slightly with the draft BPS (released for public comment at the end of January), which had allocations to MDAs increasing slightly (by 0.2 percent) between the two years.

Table 1: Growth in Total Budget, 2013/14 to 2016/17

Year	Expenditure Growth	Revenue Growth	Deficit Growth
2013/14	15%	12%	23%
2014/15	26%	14%	63%
2015/16	16%	19%	11%
2016/17	8%	14%	-6%

Source: Author calculations based on 2016 BPS Annex Table 2; changes are based on actual figures in 2012/13, actuals from 2013/14, preliminary actual figures from 2014/15, revised figures for 2015/16 and proposed figures for 2016/17.

Table 1 indicates a significant slowdown in proposed expenditure growth in 2016/17 compared to the current and previous years and relative to proposed revenue growth. This is leading to a decline in the deficit compared to the double digit increase in recent years. As a share of GDP, the deficit (excluding grants) is declining from 9.2 percent to 7.7 percent. Even as the government expects economic growth to pick up to 6.1 percent in 2016/17, there is a modest attempt to reduce the rate of growth of public spending.

The BPS 2016 is missing key performance information that is normally included in a comprehensive table, including a comparison of revenue and expenditure performance during the first 6 months of this budget year (FY 2015/16) against target. Performance information is critical to making decisions about the future and assessing whether revenue and expenditure targets are realistic and this information should be restored. The narrative does give some basic details about revenue and expenditure performance, but lacks full information on half-year targets for comparison. In several instances, the BPS 2016 indicates that a target was missed and how much it was missed by, but fails to say the target amount, the actual amount, or the percentage gap between the targets and the actuals.

To fill in these gaps on the revenue side, we looked at actual revenue performance using gazette notices produced at the end of each half year. There were indeed challenges affecting cash flow in 2015/16, as Treasury acknowledges in the BPS 2016. But the rate of collection for the half year was quite similar to that of recent years (43 percent versus an average of 44 percent between 2011/12 and 2014/15). Over the same period, the full year collections have been 95 percent on average, suggesting that collecting just over 40 percent in the first half of the year leads to good annual performance. Given this, 2015/16 performance looks fairly average with respect to budget.

Another way to look at revenue growth is to compare actual collections in the first half of 2014/15 to that in the first half of 2015/16. The growth in actual revenue collections at the half year in 2015/16 is only 11 percent over that collected at

[1] The BPS has several figures for the size of the county transfer in different places. Annex 2 has a county allocation figure that is different from what was approved in the Division of Revenue Act 2015. Table 5.5 has the correct figure. It is not clear why there are two different county allocation figures in the tabled BPS.

the half year in 2014/15, which is lower than the average half-year growth rate for the last three years (16 percent). In this sense, performance in 2015/16 is weaker than in recent years, though 11 percent revenue growth is still robust.

SECTOR DISTRIBUTION OF THE NATIONAL BUDGET

Table 2 below shows the absolute allocations to all sectors and their percentage shares of the overall budget over a period of two years.

Table 2: Major Changes in Sector Shares, 2015/16 and 2016/17

Sector	Printed Estimates 2015/16	BPS Ceilings 2016/17	Sector % Share of Total Expenditure 2015/16	Sector % Share of Total Expenditure 2016/17	% Point Change between 2015/16 and 2016/17
Agriculture, Rural & Urban Development	80	64	5.3%	4.3%	-1.0%
Energy, Infrastructure & ICT	405	368	26.9%	24.7%	-2.2%
General, Economic & Commercial Affairs	21	15	1.4%	1.0%	-0.4%
Health	59	60	3.9%	4.0%	0.1%
Education	336	342	22.3%	23.0%	0.7%
Governance, Justice, Law & Order	154	183	10.2%	12.3%	2.0%
Public Administration & International Relations	243	233	16.2%	15.6%	-0.5%
National Security	113	121	7.5%	8.1%	0.6%
Social Protection, Culture & Recreation	31	30	2.1%	2.0%	-0.1%
Environment Protection, Water & Natural Resources	63	75	4.2%	5.0%	0.8%
Total	**1,505**	**1,490**	**100.0%**	**100.0%**	
Total Rec. Gross	***784***	***833***	***52.1%***	***55.9%***	***3.8%***
Total Dev. Gross	***721***	***657***	***47.9%***	***44.1%***	***-3.8%***

Source: BPS 2016, Table 4.2

This table shows two key changes in the proposed ceilings compared to the trends in 2015/16. First the share of the budget allocated for the energy/infrastructure sector will decrease by 2 percentage points, from 27 to 25 percent of the total budget in 2016/17. This sector is large and capital-intensive, so a small reduction in its share of the budget is one reason why development expenditure as a share of the total budget is decreasing. Despite the reduction, the BPS 2016 still demonstrates that expenditure on infrastructure continues to receive substantial resources over the medium term.

The second key priority shift is in the governance, justice, and law and order sectors, which have increased their share of the total budget from 10 to 12 percent. This is mainly driven by a significant increase (352 percent) in the allocation to the Independent Electoral and Boundaries Commission (IEBC) to prepare for the general elections in 2017. This is even higher than the 239 percent increase that was proposed in the draft BPS.

The other changes in the distribution of the budget are smaller. For example, there are small but important increases for the national security, environment, water and natural resources, and education sectors.

The government has not provided a clear justification for these changes. The narrative identifies education, health, and social protection as priority areas. It is true that, taken together, the social sector has a larger share of the budget (29 percent) than infrastructure this year, which is a shift from last year. However, this masks the fact that the share of the budget for social protection is actually declining from 2.1 to 2.0 percent. Moreover, the changing relative shares of these and other sectors are not explained in the BPS 2016.

FUNDING FOR COUNTIES

The BPS 2016 proposes increasing the unconditional transfer to counties, known as the equitable share, from Ksh 259.8 billion to 280.3 billion in 2016/17. This primarily reflects an "agreed revenue growth factor" of roughly 7.9 percent, which is slightly lower than the growth factor of 9.85 percent in the draft BPS (and lower than last year's 10.41 percent). This adjustment is also significantly lower than that used by the Commission on Revenue Allocation (CRA), which proposes a revenue growth factor of 15 percent in 2016/17 based on a three year average.[2] Treasury does not explain the source of its revenue growth factor or why it differs with CRA.

The total proposed funding for counties for 2016/17, combining the equitable share with conditional grants and in-kind support from national programs, is Ksh 302.2 billion. This is up from Ksh 287 billion this year. Normally, we would not include the so-called conditional allocations in this figure because these are funds that consist mainly of donor funds that are spent in counties by the national government and are not actually passed to county governments. If we remove these, then the comparison is 276.3 billion last year, and 298.3 this year, an increase of Ksh 22 billion.

This increase is mainly due to the increase in the equitable share. The National Treasury proposes maintaining all the conditional grants transferred to counties in 2015/16, with small increases for Level 5 hospitals and the road maintenance grant and a small decrease for maternal health. The reduction in the free maternity grant is surprising, given that this is a flagship program. Treasury also proposes a small additional grant (Ksh 200 million) to improve emergency services in Tana River and Lamu Counties due to their proximity to Somalia and terror attacks in the region. It is not clear why other areas affected by insecurity are not included in this grant.

CRA recommended an allocation for counties of Ksh 378 billion, Ksh 76 billion higher than Treasury's recommendation in the BPS 2016. There is also a significant difference in the number of conditional grants and their allocation. CRA proposes five new grants, while Treasury has only added one (the new emergency services grant). This brings CRA's allocation for conditional grants to Ksh 46 billion, Ksh 24 billion higher than Treasury's allocation. Although Treasury would have seen the CRA recommendations before preparing the BPS 2016, there is no attempt to explain divergences between the two in the BPS.

The BPS 2015 did not give the criteria for distributing conditional grants and this oversight persists in 2016. The distribution of funds across counties should respond to equity concerns and different needs across the country, and the BPS should contain an explanation of distributional criteria and a justification for the same.

PUBLIC PARTICIPATION

The Treasury invited the general public to comment on the draft BPS in early February 2016. The final BPS 2016 should show how public input led to revisions between the draft and final documents. While some information on the public's comments is contained in an annex in the final BPS 2016, this annex does not provide much guidance on how key

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[2] See http://www.crakenya.org/wp-content/uploads/2016/01/RECOMMENDATION-ON-THE-SHARING-OF-REVENUE-FY-2016-2017.pdf

decisions were made or what role, if any, public input played in influencing these decisions. Instead, it provides responses to public concerns at sector level that appear not to have led to any changes in the BPS. The impression created is that public concerns have already been addressed elsewhere and that public input does not have an impact on budget decisions.