Institute of Economic Affairs

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Budget Analysis 2017

CONTENTS

Key Messages

Efforts to contain expenditure and comply with fiscal responsibility principles

- Enforcement of austerity measures and reduction of spending in non priority areas is paramount given the expected size of mandatory expenditure for the financial year 2017/18 owing to increase in Consolidated Fund Services (CFS) budget share by 33% from the previous year and the size of Ministries Departments and Agencies (MDAs) budget going towards compensation of employees. This should however be done cautiously by focusing on curtailing "inflation pricing".
- Government has to deliberately implement fiscal consolidation policy[1] in line with prudent debt management as a way of addressing growing debt payment. To this end, parliament should keenly interrogate debt management strategy and plans by keeping the executive on toes to ensure we keep within debt sustainability levels.
- Parliament needs to put pressure on the executive to provide a plan of implementation of a contributory pension scheme based on the Public Service Superannuation Act 2012 for overall management and control of pension liabilities in the medium term.

Efforts to curb public wage bill:

- In rationalization of public sector, the Government needs to adopt and implement the Capacity Assessment and Rationalisation of Public Service (CARPs) and rationalization of parastatals reports.
- Other efforts should go into a deliberate plan and strategy to wean, especially commerically viable parastals off transfers and freeze creation of new ones.
- There is need to streamline allowances by instituting caps, consolidating and phasing out where possible in order to reduce risk to overall public wage sustainability through the Salaries and Remuneration Commission (SRC).

Efficiency in spending

- Parliament should cautiously cut budgets for MDAs that consistently under spend especially on new proposed projects but at the same time ensure that the executive integrates procurement into planning processes in order to improve uptake of development budget for better results and service delivery.

Revenue

- For overall improved revenue performance and also given that subdued economic activity will affect tax collection, there is need for more efforts towards increased compliance, efficiency in tax collection and sealing tax leakage.
- There is need for better transparency on deficit financing in order to allow or facilitate interpretation and dialogue by the public and the media.

[1]Reduction of government deficit and debt accumulation

1.0 Introduction

This analysis of Budget 2017/18 notes that the country has been pursuing expansionary fiscal policy driven largely by government ambitions to address gap in infrastructure development and human resource development. It also seeks to answer, though not directly the extent to which the budget is driven by elections in terms of the expected goodies that come with election years. The focus is largely on the big ticket expenditure items and their implications on the budget vis a vis the financing aspect.

In terms of organization, this analysis first presents an overview of the entire budget, then proceeds with expenditure analysis that looks at issues of mandatory spending and what this means to budget flexibility, implications of public wage bill and a brief on what is expected in terms of sectoral priorities. The final section focuses on where funds to finance this budget are expected to come from.. In addition to providing information to stir up public debate of the budget, the Institute of Economic Affairs (IEA) through this briefs points out policy concerns and issues that parliamentarians may consider in their scrutiny and interrogation of the budget.

Overview of Budget 2017/18

The table below captures an overview of government of Kenya budget for 2017/18. Overall expenditure is estimated to go up by 5.7% in relative terms, from revised expenditure estimates of Ksh 2,500.9 billion in 2016/17 to Ksh 2,643.5 billion. It is important to however due to delay in enactment of DoRB 2017 the estimated figure for County government expenditure cited in the table[2] is not final. As a result the total expenditure may be either under or overestimated.

To finance this budget, the government anticipates to collect and receive revenue and grants amounting to Ksh 1,763 billion, resulting to a deficit of Ksh 880.4 billion. It is not clear how this will be financed because the information from various budget documents including the Budget Summary only cites a deficit of Ksh 524 billion.

	Revised 2016/17	Estimates 2017/18	% change
Revenue			
Total Revenue	**1,515**	**1,705**	**12%**
Ordinary Revenue (incl. RDL)	1,372	1,549.40	13%
Grants	51	59	14%
Total Revenue & Grants	**1,567**	**1,763**	**13%**
Expenditure			
Total Discretionary Expenditure			
National Executive	1,646	1,578	-4%
Parliamentary Service Commission	15	40	177%
Judiciary	18	18.0	1%
County Governments	285	295	4%
Equalization Fund	6	8	29%
Contingency Fund	5	5	0%
Non-Discretionary Expenditure			
Consolidated Fund Service (CFS)	527	699	33%
Total GoK Budget	**2,500.91**	**2,643.49**	**5.7%**
Deficit after grants			
Commercial financing	154	150	-2%
Project Loans	265	204	-23%

[2]Figure sourced from National Treasury Budget Summary 2017

Programme support	7	0.9	-88%
Foreign Payments	-44	-149	242%
Domestic Financing other than Borrowing	3	-11	-526%
Domestic Borrowing	280	329	17%
Others		*??*	
Total Financing	**665**	**880.4**	**-32.4%**

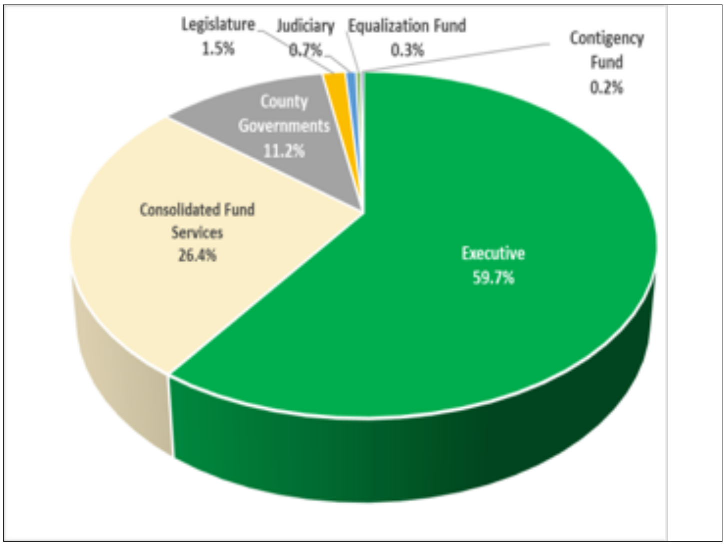
The pie chart below shows distribution of the total anticipated budget for the government of Kenya of Ksh 2.64 trillion with the largest share of 60% going to the National Executive. In fact the bulk of the estimated budget (88.5%) remains with the national government which constitutes the national executive, the Consolidated Fund Services-CFS (26.4%), the Judiciary and Parliament both of which account for 2.2%.

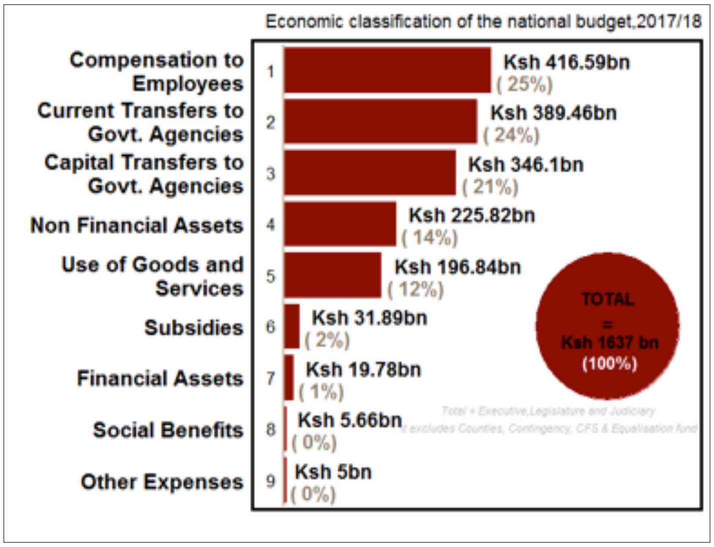
The significant size of the CFS implies that about 26.4% of the entire GoK budget is tied and compulsory, meaning that about 62.1% is left to pay salaries, infrastructure development and general public service provision.

Despite remaining largely similar to the 2016/17 distribution, notably the share to CFS is estimated to go up substantially by 33% and that of parliament by 177%. This is largely attributed to huge debt payment as a result of increased borrowing by the national government, and pension liabities for public officers.

The sectoral analysis of allocation to ministries, department and agencies (MDAs) within the national executive later in this brief will reveal changes in priority and the anticipated focus by the national government in 2017/18.

Distribution of GOK Budget 2017/18 (Ksh 2.64 Trillion)





Source: PBB 2017/18

Of the total Gok budget, the remaining share of 11.2% is anticipated to go to the county governments with an additional 0.3% Equalization Fund targeted to the 14 county governments identified as marginalized.

In addition to understanding distribution of the budget/expenditure from an administrative[3] perspective, the figure alongside the pie chart shows a breakdown of national budget by economic classification. This classification explains the type of expenditure to be incurred. For example, it shows expenditure on salaries, procurement of goods and services, transfer payment and so on which is crucial for accountability in budget management.

[3]Who is responsible for spending public resources????

Out of a total national government budget of Ksh 1,634 billion which is inclusive of the legislature and judiciary, a quarter of this amount is expected for payment of salaries and allowances to public officers. With the addition of current transfers to government agencies/state corporations, it is safe to conclude that almost 45% of the total budget will go to payment of salaries at the national government level. This already puts to questions government's effort to contain growth of the public wage bill. Operations and maintenance (use of goods and services) which is critical for service delivery accounts for 12% of the budget

The other substantial spending, 21% of national government budget is expected to go into infrastructure related state corporations for development of roads, energy, water and ICT projects as transfers from their parent ministries.

2.0 Expenditure Analysis

Expenditure for the country has been on the rise especially in the post devolution owing to growth in public wage bill at the two levels of government, debt payment, and social sector spending and infrastructure development including; the Standard Gauge Railway (SGR) project. Government budget to GDP ratio in 2015/16 was 32.9%, reduced to 31% in 2016/17 but expected to go up marginally to 31.9% in 2017/18.

Although there was a slight hint of government effort to contain expenditure in 2016/17 this seems to be negated in 2017/18 a common phenomenon in election year. Notably, recent supplementary budgets have ended up increasing overall spending again countering any efforts to contain expenditure growth.

The following section looks at the big ticket spending areas and their implication on Budget 2017/18, starting with CFS as mandatory expenditure, public wage bill which is implied as a non-discretionary expenditure. Furthermore, it will briefly analyze the other components of discretionary spending, that is for MDAs classified under MTEF sectors in order to understand the shift and focus of spending in 2017/18 and whether in line with the Budget Policy Statement (BPS).

3.0 Consolidated Fund Services (CFS) Implications for Budget 2017/18

Consolidated Fund Services constitutes a first charge on the Consolidated Fund meaning that it's a mandatory expenditure item that has to be dealt with before any other appropriation happens. The table shows that CFS has been growing in absolute terms from Ksh 364.4 billion in 2013/14 to Ksh 699.2 billion in 2017/18 estimates.

In fact, it is estimated to grow by 32.6% in 2017/18 from the previous financial year and to account for 26.5% of the entire budget. Public debt payments and pensions are the drivers of CFS taking up almost 100% of total estimated amount.

Trends in Consolidated Fund Services (CFS)- Ksh Bn						
Item	**2013/2014**	**2014/2015**	**2015/2016**	**2016/2017**	**2017/2018**	**% age**
Public Debt	331.17	324.92	417.20	466.51	621.76	33.3
Pensions	28.15	32.36	43.00	55.69	71.90	29.1
Salaries & Allowances	3.72	4.07	4.44	4.00	4.15	3.8
Miscellaneous Service	0.13	0.13	0.13	0.13	0.13	0.0
Subscriptions to Int'l Orgs	0.00	0.00	0.00	0.00	0.00	
Guaranteed Debt	1.18	1.01	0.94	1.02	1.29	26.5
Total	364.35	362.49	465.71	527.35	699.23	32.6
% Total Public Spending	23.20	24.64	19.81	21.09	26.45	

In order to meet budgetary requirements evident by increasing deficits from about 6% in 2013/14 to 8.1% of GDP in 2015/16 (against the desired 5% benchmarch) government borrowing has been rising. The huge increase in deficit is in part on account of the Standard Gauge Railway (SGR)project, being financed to the tune of Ksh 398.1 billion (equivalent to 6.1% of GDP)[4] currently nearing completion of the first phase.

As a result the stock of public debt has been rising, for example, reports from the Central Bank of Kenya show that debt to GDP

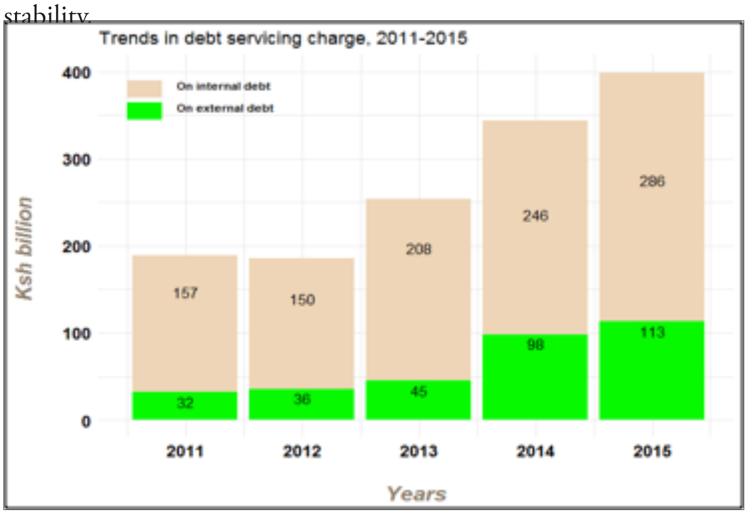
[4]Republic of Kenya, Budget Statement for the FY 2016/2017 by Henry K. Rotich, Cabinet Secretary for the National Treasury.

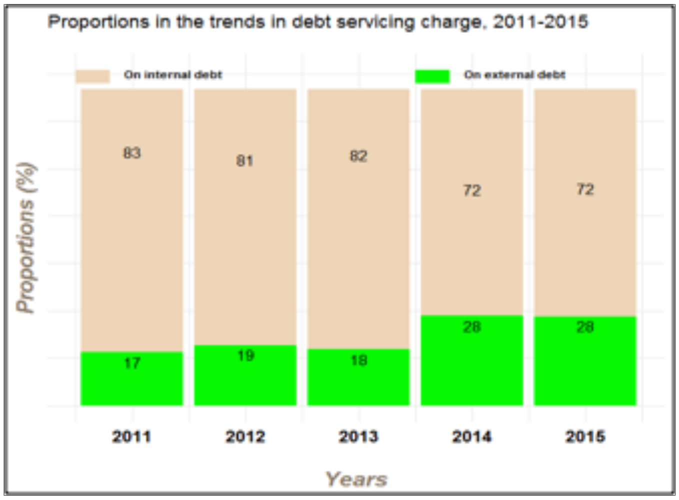
ratio increased from 36.6% in 2006/07 to 46.5% in 2015/16 with the only drop in 2011/12. This trend is increasingly dominating public and media debate on the budget due to policy concerns it raises regarding not only the intergenerational burden posed but also questions of whether this debt is sustainable.

Already the gravity of the situation is evidenced by the quantum of debt service payment. In 2016/17 interest to be paid was actually higher than principal redemption. What is proposed to be paid in 2017/18 as interest of Ksh 280.7 billion is 45% of total debt payment, lower than in the previous year on relative terms.

The figures below show an increasing trend of domestic interest payment where short term commercial debt is becoming a regular source of deficit financing but whose consequences including destabilizing interest rates may affect the country's financial stability.

There are further policy concerns that parliament should note; including danger of not complying with fiscal responsibility principle. Overall, the medium term debt strategy reports show that our debt is still within sustainability thresholds. This notwithstanding, there are further concerns that members of parliament should heed the fact that if government's appetite for borrowing is not curbed as a country we will soon run the risk of defaulting debt payment. This lack of fiscal discipline may push up interest rates and in turn affect savings and investments as private sector is starved off credit. Furthermore it may result to inflationary pressure thus affecting macro stability.





The other key driver, though at a relatively smaller proportion, but very critical is pension expenditure which is expected to grow by 29% in 2017/18 from the previous year. This calls for prudent management of pensions. In relation to this, the IEA notes that parliament needs to put pressure to the executive to provide a plan of when implementation of a contributory pension scheme based on the Public Service Superannuation Act 2012 will start as one of the ways of reducing pension liabilities. Furthermore for better control and management of pension, the executive needs to expedite the process of integrating Pension Management Information System with the Integrated Financial Management System (IFMIS) at least in the medium term.

4.0 Public wage Bill and implications on the economy

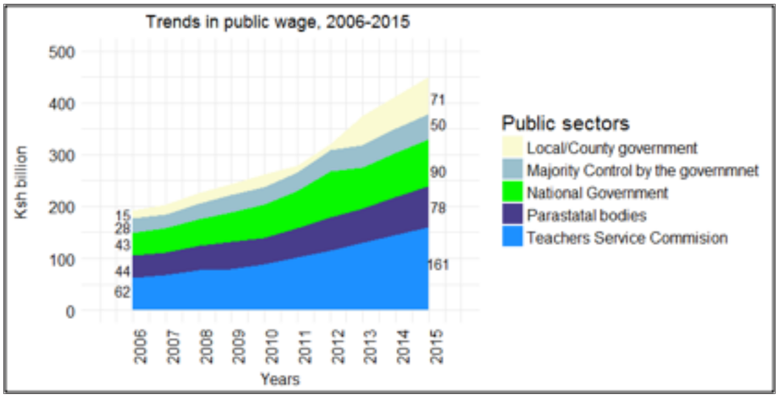
Studies show that increasing wage bill pressures often arise towards election period. For example, the country has in the recent months been hit by incessant strikes and demand for increased wages from public officers. Doctors strikes that was resolved only in the recent days lasted for three months while that of lecturers for a month. Furthermore expansion of social services is often linked to rising wage bills.

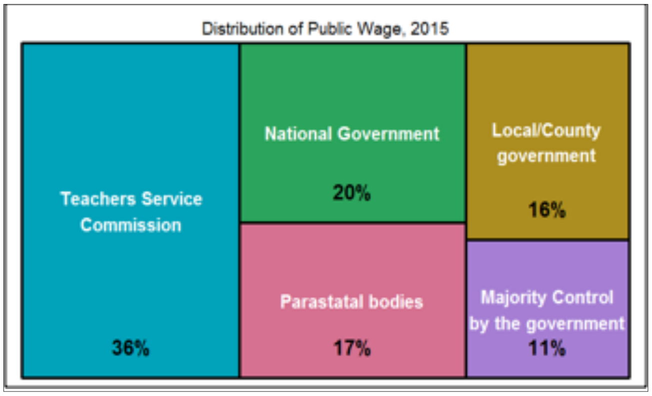
The above scenario demands better management and control of public wage which if left to grow has implications on the budget and ultimately on macroeconomic stability of the country. Already the growth of the public wage bill in Kenya is an issue that is increasingly gaining currency in public debate and a cause for concern on two fronts; affordability and sustainability.

The graph below shows that public wage bill has been on an upward trend between 2006 and 2015. Its average annual growth for example in the post devolution period (2013-2015) was 12% (from Ksh 375 billion to Ksh 450 billion) significantly higher compared to a nominal GDP growth of 5.5% and population growth of 2.7%[5] .

[5]Computed using figures from Economic Survey 2016

As the largest employer in Kenya, the right hand figure shows the composition of wage bill in the public sector with the national government and its agencies/parastatals taking the largest share of 37% followed very closely by teachers smaller only by one percentage point in 2015.





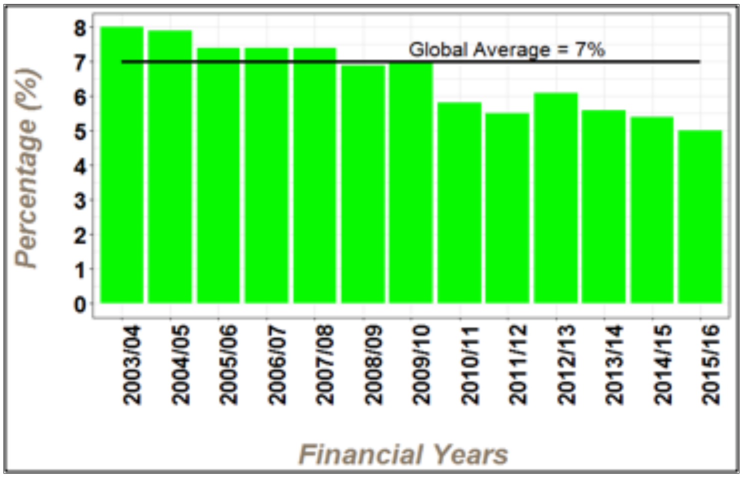
Source: Various issues of Economic Survey

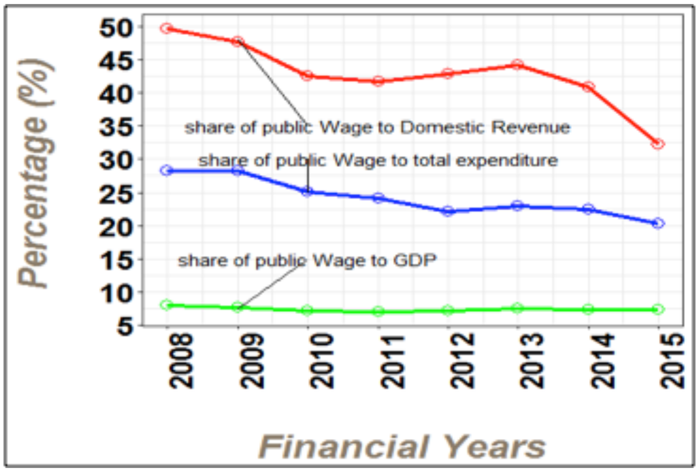
Of note is that growth in public sector wages is in part due to the increase in recruitment of public officers from 662,100 in 2012 to 718,400 in 2015 representing 8.5% growth. In addition to this, the avearage wage earnings per public sector workers has been on the rise albeit skewed concentration of higher wages in the top job groups.

Despite an upward trend, as a share of GDP, public wage bill for Kenya especially from 2012/13 to 2015/16 has been on a decline and generally below the global average of 7%. Equally public wage bill to expenditure and to domestic revenues ratios exihibit downward trends. As far as the fiscal principle rule of ensuring that governments expenditure on wages and benefits for its employees does not exceed 35% of the national revenue, this is met as shown in the graph below.

However, it is important to note that the recently agreed Collective Bargaining Agreement (CBA) between the government and doctors, as well as the new pay structure (pay rise and also harmonized salary grades across public sector) for public sector officers as recommended by the Salaries and Remuneration Commission (SRC) will put extra pressure on the wage bill. It is expected as mentioned by SRC that this structure will be effected from July 2017 and thus in part the reason for huge Budget 2017/18.

Public Wage Bill Ratios





The implication of this budgetary pressure calls for executive to among other things; adopt and implement of two reports intended to inform audit and rationalization of Capacity Assessment and Rationalisation of Public Service (CARPs) and rationalization of parastatals. Given the substantial size (24% of current transfers to national government), freezing creation of parastatals is critical and weaning commercially viable parastatals off transfers. Besides, the extent of this process succeeding is dependent on political good will.

As a non-wage benefit, allowances are often abused to avoid controls in basic pay. They should be streamlined properly with guidance from SRC through consolidation or phasing out where possible or even through caps in order to reduce risk to overall public wage sustainability. The SRC, for example has instituted that Members of Parliament will only be eligible for allowances for a four meetings per week.

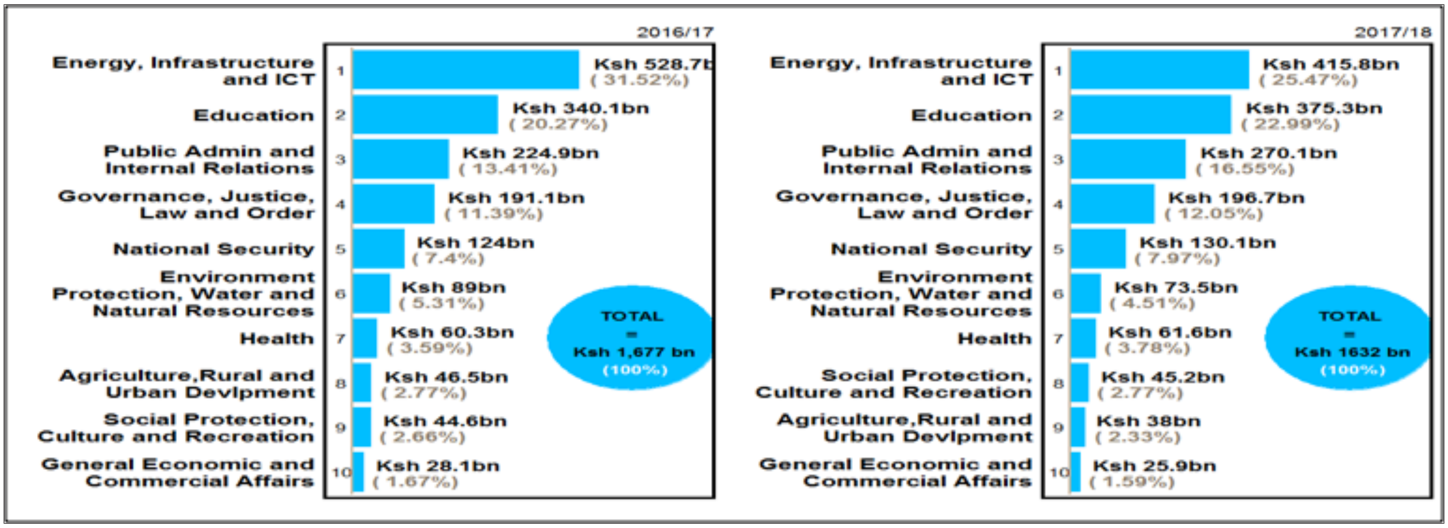
Sector priorities

The total MDAs budget including the judiciary and the legislature reduced from Ksh 1,667 billion in 2016/17 to Ksh 1,632 billion in 2017/18. Comparatively, the top seven sectors in terms of budget share starting with the energy, infrasture and ICT, education all the way to health sector has not changed for the two financial years.

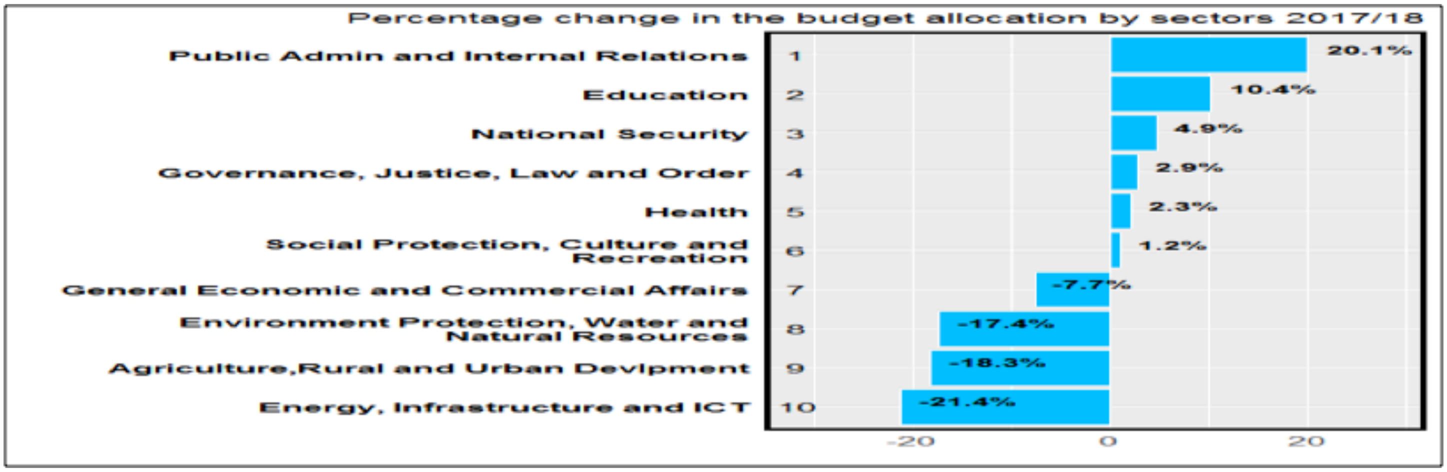
Equally, the top three sectors take up 65% of the total Ministries, Departments and Agencies (MDAs) budget in the two financial years. Overall, the sectoral budget shares are in line with the Second medium term plan 2013-2017.

The figure below shows change and shift is sector priorities, giving an indication what the government will focus on in 2017/18 as captured in the budget. It is evident that although the lion share of the budget is going to the energy, infrasture and ICT sector, a more significant shift in focus will be on public administration and internal relations, education and national security.

Total budget share allocation by Sectors



One of the reasons why the Public Administration and Internal Relations (PAIR) sector tops in shift in expenditure focus for 2017 is because a significant amount has been set aside for compensation of employees including those new recruited staff to fill vacancies in the National Treasury. These recruitments are in the departments like Debt Management Office, Financial Services Department, Macro department and so on. In addition, the new pay structure as recommended by SRC to take effect from July 2017 is also factored in the budget 2017/18. Thus, this is the reason why National Treasury whose budget is expected to increase by 50% (Ksh 82.3 billion to Ksh 122.8 billion).



Given this significant shift that will go up by 9 percentage points in sector budget share one expects that it will translate to promotion of better fiscal management.

The other agency within PAIR sector that is driving the considerable expected increase in the sector's budget for 2017/18 is Parliamentary Service Commission (PSC). A closer look shows significant expenditure is anticipated in salaries and wages as well as domestic travel for Members of Parliament. In particular, this budget for PSC seems to have incorporated compensation to cover remuneration loses due to the shortened term for MPs with elections slated for 8th August 2017.

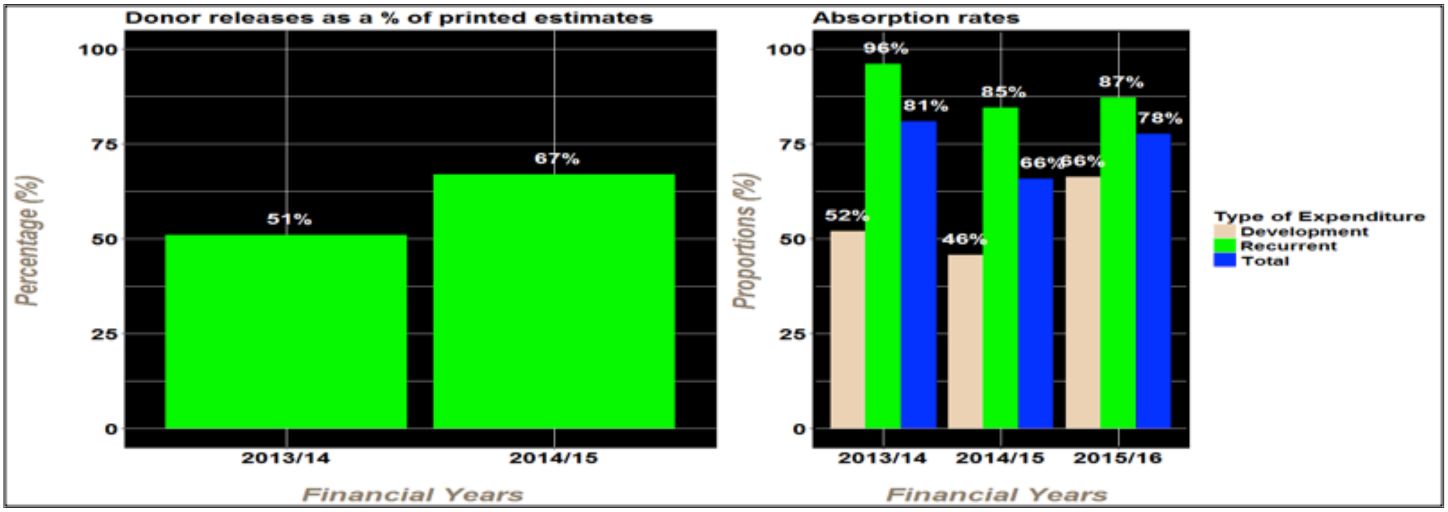
From the foregoing, it is clear that the overall growing public wage bill is bumped up by the fact that the respectively budgets for the National Treasury and PSC are considerably buoyed by funds set aside for compensation of employees.

IEA is of the opinion that Parliament should consider reducing the portion of budget for compensation MPs for their shortened term as a way of reducing the burden this will have not only on the overall public wage budget but the GOK budget.

5.0 Efficiency in Spending

Related to sector priorities and allocation, the question of public expenditure management, that is, how to improve efficiency of public spending and reduce wastages is pertinent to the government. The government has routinely struggled with the challenge of low uptake/absorption particularly the development budget over the years despite various measures put in place to mitigate this (see below).

Against a performance benchmark of at least 80%, absorption of development budget for the period 2013/14 to 2015/16, has consistently been below 66%.



As a result of this, the IEA note the importance of government enforcing austerity measures so as to focus spending to priority areas. Besides this, we point out the following policy specific issues that need to be considered by parliament towards enhancing better results and value for money in spending:

- The national government should address ambitious or overoptimistic estimation of donor component of development budget
- Budget cuts for culprit MDAs, in particular infrastructure related ministries that have consistently been under spending (average absorption rate of 60%) The IEA proposes that these cuts are focused on any new proposed projects so that effort is put on completion of on-going projects instead.
- There is need to strengthen spending units' capacity and incentive to integrate procurement into planning processes.
- Improve institutional frameworks and streamline use of financial performance information for regular and timely reporting in order to address delays in release of funds

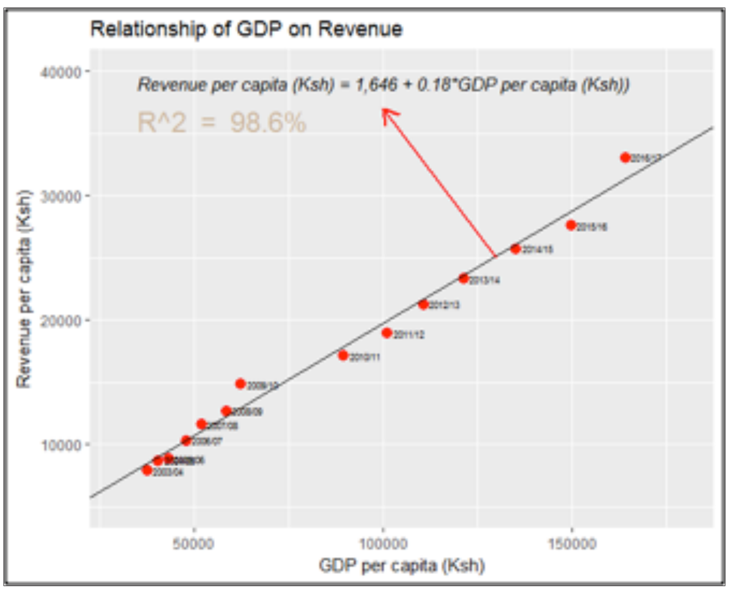
6.0 Revenue Analysis

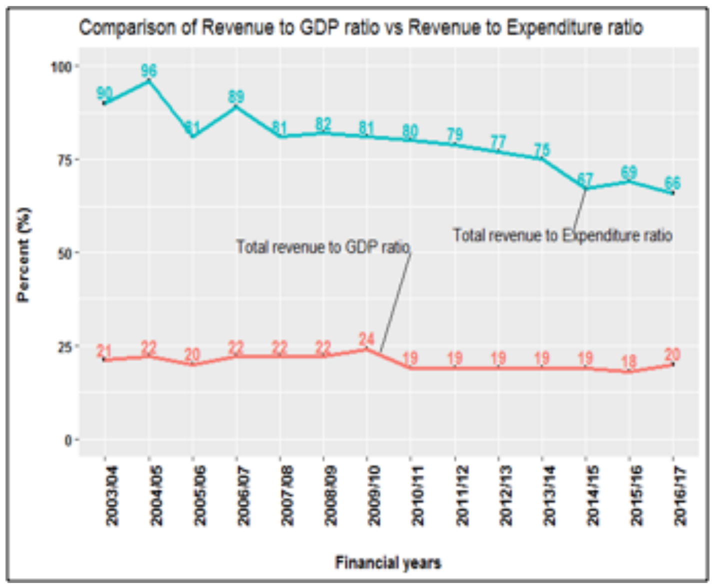
According to the BPS 2017 medium term fiscal policy aims at supporting rapid and inclusive economic growth, ensuring sustainable debt position and at the same time supporting the devolved system of government for effective delivery of services.

Total revenue (including AiA) collected by the end of December 2016 was Ksh 674.2 billion missing the target of Ksh 701.7 billion by Ksh 27.5 billion. This translates to a performance of 96% better than 88.5% for the same period in 2015. Underperformance in revenue in half year of 2016/17 was occasioned notably by shortfalls in both PAYE and VAT imports which account for almost 40% of total revenue collected. By the end of December 2015, PAYE and VAT imports missed the target by 11% and 13% respectively compared to 10% and 11.2% underperformance in the same period of 2016. Performance of AiA , which is often under reported has continued to be dismal over the years

Although revenue performance is predicated on economic growth and on-going tax reforms, it is clear that over the years, expenditure growth has outpaced that of revenue. This trend has continually being creating fears among citizens of imminent higher taxes probably not for 2017/18 but in the near future. Given revenue performance and projection for 2017/18 we draw the following issues for consideration by parliament.

- First, with an average economic growth rate of about 5.5% in the last three years, it is evident that the country's economic growth rate during election period has tended to be subdued. It therefore means that revenue projections pegged on economic activity during an election year may be affected. As shown below there is a strong relationship between revenue collection and economic growth. This implies that a dip in economic growth rate often results to drop in revenue performance.





- Furthermore, domestic resource mobilization efforts through taxation may be reaching it limits, with ordinary revenue to GDP ratio of about 20%. This implies a comparatively high tax effort but low collection capacity. Besides, the option of raising tax, especially in an election year may be a no go zone area for government. As a result the government should pursue other citizen friendly alternatives, including improving tax collection system, sealing leakages and increasing compliance.
- Deficit financing: Our calculation shows that the financing gap in 2017/18 is about Ksh 880 billion but what is captured in the Budget Summary is Ksh 524 billion leaving an unexplained difference of Ksh 356 billion. Of course without clear information on for instance county government expenditure and others may have over or underestimated the deficit and in turn how it will be plugged.

Our appetite as a country to borrow is a growing concern, yet information provided on our loans is not open for citizen scrutiny and analysis, something that parliament should pressurize the government to uphold. By and large the government has to be seen to implement deficit financing policy by taming borrowing appetite and in turn debt to ensure that as a country we do not teeter on the brink of unsustainability levels.

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