THE ANNUAL BUDGET IMPLEMENTATION REVIEW REPORT 2016/2017

APRIL 2018

Background Information

The Office of the Controller of Budget prepares the Budget Implementation Review Report in accordance with Article 228(6) of the Constitution of Kenya, 2010 and Section 9 of the Controller of Budget Act, 2016, which require the Controller of Budget to submit to Parliament quarterly reports on budget implementation by the National and County Governments every four months. The report presents the performance of revenue and expenditure and highlights the key challenges encountered by National Government entities during budget execution.

The objective of this analysis is to identify the key issues raised by the Controller of Budget on budget implementation and propose policy recommendations.

Summary analysis of the COB Annual Budget Implementation Report

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<tr><th>No</th><th>Area</th><th>Analysis and comments from the COB Report</th><th>ICPAK Proposals/ Concerns</th></tr>
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<td>1.</td>
<td>Revenue Performance</td>
<td>Kenya's revenue portfolio is significantly driven by tax revenue. According to the COB Report, Tax income contributed 1.25 trillion shillings. Equally, data from the BROP from National treasury reveals that by the end of June 2017, total cumulative revenue including A-i-A collected amounted to Ksh 1,400.6 billion against a revised target of Ksh 1,455.4 billion. This represented a revenue shortfall of Ksh 54.8 billion (or 3.8 percent deviation from the revised target). Ordinary revenue collection amounted to Ksh 1,305.8 billion against the target of Ksh1,311.3 billion.
The table below highlights the trend of income tax performance and links it to the total overall budget.

<i>Table 1: Tax Income trend versus Total National Government Budgets</i>
<table>
<tr><th>Year</th><th>2013/14</th><th>2014/15</th><th>2015/16</th><th>2016/17</th></tr>
<tr><td>Tax Income in Kshs Trillions</td><td>0.90</td><td>1.10</td><td>1.11</td><td>1.25</td></tr>
<tr><td>Budget in Kshs Trillions</td><td>1.61</td><td>2.11</td><td>2.28</td><td>2.62</td></tr>
<tr><td>Budget Deficit in Kshs Trillions</td><td>0.71</td><td>1.01</td><td>1.17</td><td>1.37</td></tr>
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<td>▪ The National Treasury must implement policies to widen Kenya's tax base, with taxation being the largest source of revenue. This includes netting in the informal sector and other potential taxpayers left out of the tax base. The KRA estimates that tax losses from the informal sector amount to between KES 60 billion to KES 80 billion a year. As such, the government ought to encourage the formalization of informal businesses.
▪ Tax administrators need to leverage on effective use of ICT in order to improve revenue administration.
▪ For overall improved revenue performance there is need for concerted efforts towards enforcing compliance, making the tax collection exercise more efficient as well as sealing tax leakages.
▪ Austerity measures must be implemented in the public sector particularly targeting domestic and foreign travel, hospitality and entertainment among other forms of expenditure as the government seeks to bridge the revenue gap.
▪ The national budget is still geared towards recurrent spending as opposed to development expenditure. From the table the budget deficit indicates that given expanding expenditure and subpar revenue collection, borrowing from both foreign and domestic sources will continue to grow. This may not be sustainable.</td>
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<td>2.</td>
<td>Expenditure Performance</td>
<td>Development and Recurrent Expenditure
<i>Table 3: Total Expenditure in kshs billion</i>
<table>
<tr><th></th><th>FY 2015/2016</th><th>FY 2016/2017</th></tr>
<tr><td>Recurrent Expenditure in kshs billion</td><td>1,182</td><td>1,357.</td></tr>
<tr><td>Development Expenditure</td><td>452</td><td>602.3</td></tr>
<tr><td>MDA’s and CFS</td><td>1183</td><td>1357</td></tr>
<tr><td>County Government</td><td>295.3</td><td>319.1</td></tr>
<tr><td>Total</td><td>Kshs. 1.929 trillion</td><td>Kshs 2.28 trillion</td></tr>
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In FY 2016/2017, recurrent expenditure as a share of total expenditure stood at 59.6%, while development expenditure was a mere 26.4%.
The government has routinely struggled with the challenge of low absorption rates particularly with the development budget over the years despite various measures put in place to mitigate this. From the Controller of Budget report, we note that in the FY 2016/17, development expenditure had an absorption rate of 69.9%.
Failure to spend budgeted money directly affects the rate at which the economy expands.Low absorption of budget funds may be attributed to a wide range of factors, including endless court battles initiated by aggrieved parties in government tendering processes. The complex, cumbersome and sophisticated procurement procedures and processes have undermined spending and as such economic growth. Weak reporting systems in the government, coupled with poor accountability and shaky monitoring and tracking systems have also contributed largely to low absorption rates for budget funds.</td>
<td>▪ There is need for the government to enforce austerity measures that focus spending to priority areas, particularly towards development. This will improve efficiency in public spending, sector priorities and allocation and thus reduce wastages.
▪ Large allocations to infrastructure projects need to be audited and a determination made on the effectiveness of the allocations, how funds can be better spent and recommendations on how to improve efficiency.
▪ The government needs to leverage on IFMIS in procurement to combat pilferage, leakage and misuse of public funds in the procurement process in order to increase the absorption rate for budgeted funds.</td>
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<td>3.</td>
<td>Public Debt</td>
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<p>The revised allocation towards payment of public debt in FY 2016/17 amounted to Kshs.459.9 billion, a 5.4 % increase from Kshs.436.5 billion allocated in FY 2015/16.</p>
<p>It is worth noting that the share of local revenues used to service Kenya’s debt has breached the IMF upper bound for strong policy performers. Retrogressively, in both FY 2014/15 and 2015/16, the amount of money used to repay public debt is equivalent to 38% and 36% of ordinary revenue respectively. According to the IMF, a strong policy performer’s debt burden is sustainable if no more than 35% of local revenue is used for debt repayment in a given year.</p>
<p><i>Table 4: Ordinary Revenue and Debt Service</i></p>
<table>
<tr><th>Year</th><th>2014/ 15</th><th>2015/ 16</th><th>2016/ 17</th><th>2017/ 18</th><th>2018/ 19</th></tr>
<tr><td>Ord. revenue</td><td>1032</td><td>1153</td><td>1306</td><td>1486</td><td>1688</td></tr>
<tr><td>Debt service</td><td>250.9</td><td>250.4</td><td>307.2</td><td>453.4</td><td>687.6</td></tr>
<tr><td>County allocations</td><td>229.9</td><td>273.1</td><td>294.0</td><td>314.2</td><td>331.2</td></tr>
<tr><td>Bal for national allocation</td><td>218.7</td><td>249.8</td><td>277.6</td><td>259.9</td><td>164.3</td></tr>
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<p>In comparative terms, it can be demonstrated that the rate at which the economy is accumulating public debt is higher than the amount left for national government service delivery. This points to a mismatch between the fiscal policy and the broader economic policy.</p>
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There needs to be prudence in debt management. The government also should re-negotiate debt at concessionary terms covering both the cost and tenure of resulting debt.
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 keep the government in check to uphold.
By and large the government must implement deficit financing policy that tames borrowing appetite and in turn debt to ensure that as a country we do not get to unsustainable levels. This is because the borrowing narrows the window for future borrowing, and also increases the vulnerability to fiscal risks in the event of an urgent need for borrowing.
Domestic borrowing also crowds out private sector investment and thus undermines prospects for future growth.

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<tr><td>4.</td><td>Wage bill</td><td>The National government wage bill in FY 2016/17 rose by 6.03% with Personnel Emoluments increasing to Ksh329.8 billion from Ksh 311.8billion in 2015/2016 and Ksh282.7billion in FY 2014/15.

Further analysis of the Personnel Emoluments (PE) shows that the Teachers Service Commission (TSC) recorded the highest expenditure at KSh189.6 billion. The amount translated to 57.5 per cent of the total PE expenditure by all MDAs. This is due to teachers' salaries, which constitutes the bulk of the recurrent expenditure under TSC.

<i>Table 5: Wage Expenditure in 2014/15,2015/16 and 2016/17 (Kshs Billions)</i>
<table>
<tr><th></th><th>2014/15</th><th>2015/16</th><th>2016/17</th></tr>
<tr><td>Actual spending on personnel emoluments (P.E)</td><td>283.0</td><td>311.8</td><td>329.8</td></tr>
<tr><td>% increase in P.E expenditure</td><td>-</td><td>10%</td><td>6.03%</td></tr>
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The country has in the recent months been hit by incessant strikes and demand for increased wages from public officers. There is therefore need for better management and control of public wages 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.
County governments must also ensure expenditure on personnel emoluments is contained within sustainable levels in compliance with the Public Finance Management Regulations 2015.
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RECOMMENDATIONS

1. The Controller of Budget year-on reports reveal challenges in Kenya’s expenditure management.There is need for the National Treasury to plan for public expenditure in light of revenue generation capabilities. An expenditure management framework must reflect prudence and accountability so as to promote tax payer compliance. This is because tax payer compliance directly depends on their perception of how and where their resources are being utilized. As such, prudent utilization of revenue generated to deliver public services will inevitably raise tax compliance rates in the country.
2. The National Treasury needs to address reasons why revenue targets are routinely not met begging the question as to whether or why unrealistic targets are set.There is need for more realistic targets in order to more effectively anticipate debt requirements for the year.
3. The low absorption of development funds denies Kenyans the benefit to be derived from development projects such as access to quality services in health, agriculture, roads, and the education sectors. It is therefore imperative that as the National Assembly discusses the allocations to different sectors and ministries, they look at implementation of past years’ budgets. MDAs that have struggled to spend the money allocated to them in previous years should be interrogated further with the aim of resolving challenges before more funds are allocated to them.
4. There is need for steady lengthening of the maturity profile of government debt securities since most of Kenya’s loans are maturing in 2019. The debt tenure must be increased in order to ease the pressure of repayment.
5. The Institute need to establish a collaborative framework with the Controller of Budget to among others capacity build MDAs in areas of identified PFM weaknesses.