IPF KENYA
INSTITUTE OF PUBLIC FINANCE

Oxford Policy Management

Fiscal Analytic Snapshot: Kenya[1]

Prepared by the Institute of Public Finance Kenya and Oxford Policy Management[2]

Key messages:

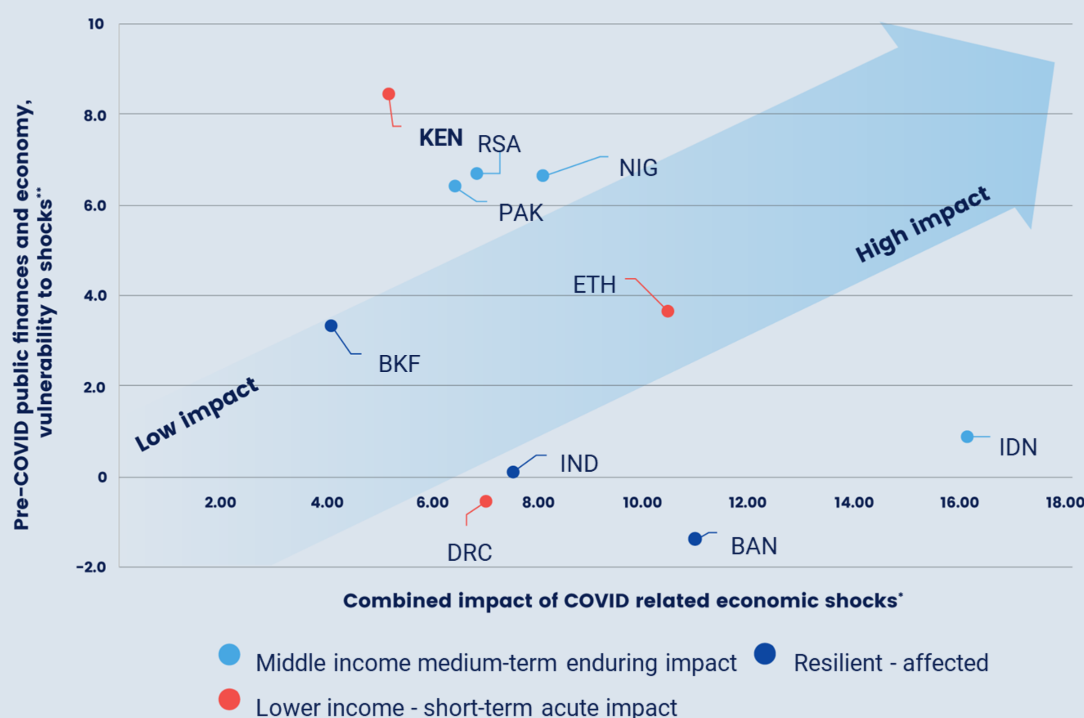
- **Kenya has been growing robustly for many years, but has not used this opportunity to reduce vulnerability to shocks – deficits have been unsustainably high, and debt service is so high that Kenya has to be cautious about expanding non-concessional debt even during a crisis.** The budget deficit approached 8% in 2019, following years of rapid expenditure growth and worsening revenue performance. The gradual decrease in revenue as a share of GDP is likely linked to the changing structure of Kenya's economy, with the informal sector growing faster than the formal sector, and tax incentives remaining commonplace and generous. Despite this, revenue remains a strength in Kenya compared to its peers, at 18.2% of GDP (compared to 12% in Ethiopia, for example). Kenya's economy is diverse and services have grown strongly in recent years.
- **According to World Bank forecasts, Kenya is set for a relatively short setback from COVID-19, with a 4-percentage-point dip in growth this year, and 5.2% growth returning in 2021. This is still a permanent loss of 5% of GDP over the two years compared to what was originally projected, and other forecasts are worse. The government plans a very modest net fiscal stimulus to combat the crisis and is taking measures to consolidate public finances starting during this year or very soon after.** Figure 1 plots 10 countries according to the expected two-year impact of COVID-19 on GDP (horizontal axis), against a proxy for vulnerability to external shocks based on the size of budget, trade deficits, and recent economic growth (vertical axis). Being at the top-right of Figure 1 suggests a maximal adverse macro-fiscal impact from COVID-19, although there are some major caveats linked to other factors. Kenya is in the 'lower-income, short-term acute impact' group – vulnerable to shocks pre-COVID and, because of financial constraints, mounting only a small fiscal response in the short term. Losing 5% of GDP still necessitates some medium-term adjustment, on top of the shift to a more sustainable footing that was necessary even before the crisis.
- **Kenya plans to reduce the deficit to a sustainable 5.6% of GDP by 2022/23 – through expenditure cuts rather than revenue increases** (see Table 1). This is the sort of medium-term trajectory Kenya was signed up to before the crisis, although implementation had been delayed for several years. The crisis adds to the difficulty of implementing the strategy. As revenue is projected at 17.2% of GDP, it is public investment and non-interest recurrent spending which will be reduced to achieve the macro-fiscal objectives.
- **Government plans to narrow the fiscal deficit during the economic slowdown translate into significant budget cuts in 2020/21, and likely beyond.** The national government budget has contracted by 10% in real terms in 2020/21. Consolidated information on county budgets is not yet available, but the budgeted transfers on which they largely depend have not increased from 2019/20. Furthermore, there has been substantial delays in the release of funds to the counties, which will have direct consequences for spending at that level.
- **Investment will bear the brunt of these cuts.** As with previous cases of public spending being reined in, investment is expected to decline most sharply, with the national government's development budget contracting by 18.5% in real terms in 2020/21. In sector terms, this is reflected in a decline in the share going to the energy and infrastructure sector. The education budget has meanwhile increased, due to increases in teacher salaries.
- **Health spending is not growing in line with increased needs, and may even see a decline in 2020/21.** Health is a devolved sector in Kenya, and while counties have been increasing their health budgets in recent years, significant delays to the conditional and equitable share (block)

transfers on which these services rely, coupled with under-performance on local revenue collection, will slow local government spending on health in 2020/21. At the national level, the Ministry of Health's budget was 7% lower in 2020/21 compared to 2019/20. Some additional provisions are made for COVID-19 (including additional health workers, refurbishing referral hospitals, and acquisition of medical equipment), implying cuts elsewhere. Emerging evidence indicates routine primary healthcare (PHC) services, such as immunisation and drug supplies, have been disrupted by the pandemic.

Given the above, the following issues warrant close monitoring in Kenya over the coming year:

1. **The impact of the economic slowdown on unemployment and poverty levels**, given the very modest net fiscal stimulus, particularly if the crisis worsens. Initial reports are already demonstrating that unemployment and underemployment is on the rise, particularly in younger cohorts with limited access to social safety nets. Although the agriculture sector has performed strongly so far in 2020 compared to 2019, downside risks to monitor include projected below-average rainfall for the October to December short rains season and the potential of a second locust invasion. *To be monitored: the quarter three (Q3) Labour Survey and the Q3 GDP report.*
2. **Whether the government is able to stick to the committed path of fiscal consolidation in 2020/21, and, if it is not, how any additional spending is financed.** Given the government's failure to bring the deficit under control in past years, there is reason to question whether it will do so amidst a significant slowdown. Conversely, additional debt on non-concessional terms will add to the already high interest payments and could lead to defaulting. *To be monitored: monthly debt bulletins.*
3. **Whether the reduction in investment is a temporary or more permanent trend.** Public investment as a share of public spending is projected to drop to close to 20% by 2022/23; staying at this depressed level over the longer term could hamper the recovery and future growth. *To be monitored: any supplementary budgets in 2020/21, and changes to capital allocations they bring, as well as the medium-term projections approved with the 2021/22 budget framework. In the interim, the quarterly Budget Implementation Review Reports (BIRRs) (with the Q1 report expected later this year) will indicate where execution of the capital budget is lagging.*
4. **The duration of disruptions to county transfers, and the implications for health spending, and other devolved services.** The delayed disbursement of the equitable share block grant and conditional grants this year will have slowed local-level spending in many counties, particularly those with limited own-source revenue (which may also have been hit by the lockdown). Monitoring the progress in disbursements of these grants, and the impact on country health department spending, will be important, particularly in light of concerns that the pandemic is also disrupting routine PHC services. Counties are also responsible for key agriculture and nutrition spending, which may similarly be affected. *To be monitored: disbursement of intergovernmental fiscal transfers, as reported in the monthly gazette, alongside county health spending, as reported in the quarterly County Budget Implementation Review Reports (with Q1 expected in later this year).*
5. **Flows of official development finance.** Official development finance has helped ease the country's immediate fiscal constraints, but further support will be required by Kenya over the medium term, to help it deal with the lasting impacts on growth and domestic revenue. Globally, 2020 has seen significant additional disbursements from international financial institutions, some of which was made possible by bringing future years' allocations forward, meaning there is a risk of a reduction in official development finance for Kenya from 2021/22. Should it fall below pre-COVID levels, this would act as an aftershock that slows recovery. *To be monitored: any further international finance institutions disbursements to Kenya this year, and any impacts on medium-term programmes, particularly from the African Development Bank, the World Bank, and the International Monetary Fund (IMF).*
6. **Whether the country enters a second lockdown.** The rising number of COVID-19 cases has led to the Cabinet Secretary for Health alluding to the possibility of reinstating restrictions such as early night curfews and travel restrictions.[3] This could act as a second shock to Kenya's much-reduced growth outlook, increasing the likelihood of scarring in the economy, and delaying the recovery. *To be monitored: the national press, for news on the public health measures.*

Figure 1: COVID-19 economic impact and pre-COVID vulnerability



***Notes:** *Where the combined impact of economic shocks is proxied by the expected two-year impact of COVID-19 on GDP. *Where pre-COVID resilience is proxied by the sum of the budget deficit and current account deficits, minus the growth rate. Sources: World Bank Macro Poverty Outlooks and World Development Indicators.*

Table 1. Key indicators (Fiscal year July–June)

(% GDP except where indicated)	2019/20 estimate	2020/21 forecast	2021/22	2022/23	2023/24 extended forecast
GDP (billion, 2019 prices)	105.5	107.1	112.6	119.1	125.8
Change in GDP*	5.4%	1.5%	5.2%	5.7%	5.7%
Change in agriculture	3.6%	3.7%	3.9%	4.2%	4.2%
Change in industry	4.6%	1.1%	3.3%	4.7%	4.7%
Change in services	6.7%	0.8%	6.4%	6.6%	6.6%
Change in gross investment	2.4%	0.3%	7.2%	7.7%	7.7%
Change in gross exports	-0.2%	0.1%	3.9%	4.8%	4.8%
Current account balance	-5.7%	-4.5%	-4.8%	-5.2%	-5.2%
Gross revenue	17.2%	17.2%	17.2%	17.2%	17.2%
Gross public expenditure	25.2%	25.0%	24.0%	22.8%	22.2%
Public investment	7.3%	7.0%	5.8%	4.7%	4.3%
Recurrent expenditure (excl. interest)	13.6%	13.9%	13.9%	13.6%	13.5%
Debt interest	4.3%	4.1%	4.3%	4.5%	4.5%
Fiscal balance	-8.0%	-7.8%	-6.8%	-5.6%	-5.0%
Public debt	62.7%	68.0%	71.9%	74.4%	75.3%
memo items					
Headcount poverty ($1.9 in 2011 PPP)	34.0%	33.8%			
Gross investment/change in GDP	3.2				
No. COVID cases (25 October 2020)	48,790				
No. Infections per million population (25 October 2020)	957				
No. COVID deaths (25 October 2020)	896				
No. deaths per million population (25 October 2020)	17.6				
Gov health expenditure % GDP (2017)	2.1				
Gov health expenditure per capita, current US$ (2017)	33				

***Sources and notes:** Macro data: World Bank (2020a).[4] Fiscal data: World Bank (2020a) and Government of Kenya (2020).[5] Debt data: authors' calculations based on IMF (2020a). Poverty data: World Bank (2020c),[6] COVID-19 related data: John Hopkins Coronavirus Resource Centre.[7] Health data: World Health Organization (WHO) Global Health Expenditure database.[8] *GDP is calculated on an annual basis, where fiscal data follow the fiscal year.*

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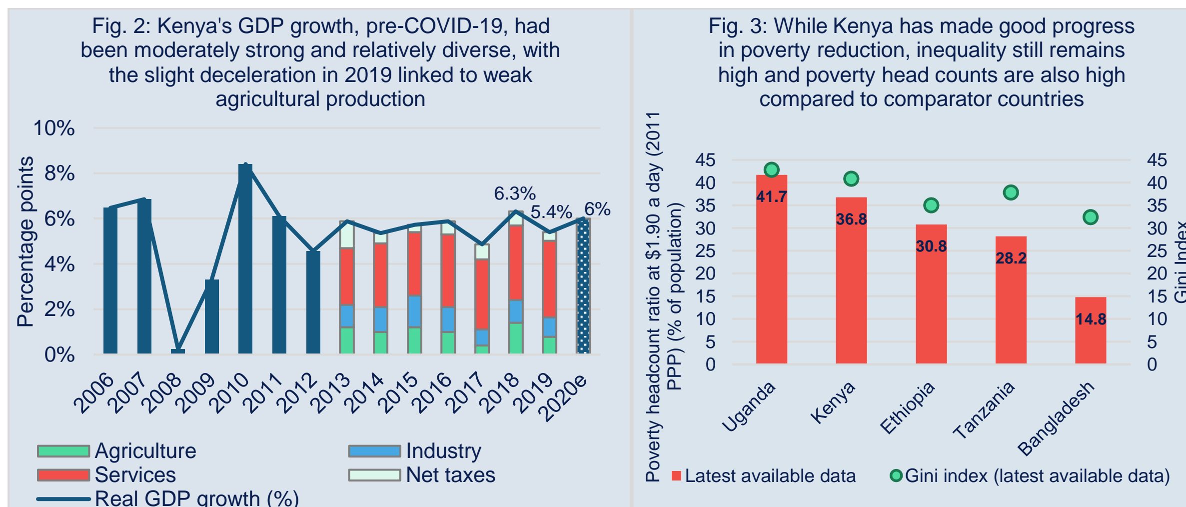
Macroeconomic context and outlook

Economic outlook pre-COVID-19 and vulnerability to shocks:

Prior to the COVID-19 pandemic, Kenya had been experiencing stable and moderately strong growth since 2008, averaging a solid 5.6%[9] per year, driven by a broad-based economy. Kenya has recorded consistent growth for the last 10 years, with the relatively diverse economy doubling in size between 2006 and 2019. Growth has consistently come from all sectors of the economy, but the services sector remains the dominant engine of growth, accounting for 56% of GDP in 2019. In 2019, GDP growth decelerated slightly from 6.3% to 5.4%, as a result of under-performance in agriculture, due to poor rains, and weaker private investment as government investment continued to crowd out the private sector.[10] Ahead of COVID-19, 2020 was set to be a good year for Kenya (with 6%[11] growth forecasted), although there were a number of downside risks for the agriculture sector emanating from locust invasions and a possible drought.[12]

Healthy growth has translated into improved livelihoods, with poverty declining by 10 percentage points between 2005 and 2015; however, given Kenya's income level, absolute poverty levels remain too high. Kenya's progress in poverty reduction over the last 10 years has been largely on a par with the sub-Saharan Africa average. However, poverty in Kenya still remains above some of its peers with similar income levels (Bangladesh, Tanzania), and even those with lower incomes (Ethiopia).[13] Kenya's latest comprehensive poverty report estimates that 53% of Kenyans remain multidimensionally poor, deprived of the realisation of at least three basic needs, services, and rights. These figures are even more stark in rural areas, where it is found that the multidimensional poverty incidence is 67%, more than double the incidence in urban areas (27%). These high poverty and vulnerability rates mean that in the event of an income shock, many households have little to no means of cushioning themselves from the impact.[14] Despite improvements in the Gini index between 2005 and 2015 (from 46.5 to 41.0),[15] inequality in Kenya too remains a concern, with levels above many of Kenya's neighbours. 0.1% of the population (8,300 people) owns more wealth than the bottom 99.9% of the population (+44 million people).[16]



Source: World Development Indictors, Kenya National Bureau of Statistics (KNBS) (2020), World Bank (2020e).[17] Note: 2020 GDP is a pre-COVID-19 forecast from January

Kenya's strategy for maintaining high growth is the President's Big Four Agenda, yet implementation is facing headwinds. Launched in 2018, the government's ambitious Big Four Agenda set out four medium-term development priorities for Kenya, including manufacturing, affordable housing, universal health coverage, and food security,[18] with the aim being to enhance job creation, improve living standards, and promote economic prosperity over the next five years. Now, almost three years in, a large chunk of public funds have been spent, yet targets remain far away from being met. The agenda aims to increase manufacturing's share of GDP to 15% by 2022, yet manufacturing's share is on the decline, falling from 10.9% of GDP in 2017 to 10.4% in 2019. On housing, of the 500,000 affordable housing units which are supposed to be constructed by 2022, only 8,888 units have been built and 200,000 are still under construction. Under the food security agenda, the government has made some strides towards increasing land use under irrigation; however, targets are being missed.[19] Implementation of the Big 4 Agenda is behind

schedule, which acts as a major hindrance to the country's development agenda and calls into doubt its reliability as a driver of future economic growth.[20]

While macroeconomic conditions over the last five years have been stable, Kenya has been running substantial twin deficits, albeit with the current account deficit narrowing. Inflation has been relatively contained in Kenya for the last few years, remaining largely within the target range of 2.5%–7.5%, reaching 4.4% in August 2020.[21] Kenya's private investment has remained weak, partly attributable to the interest rate cap that had constrained access to credit, partly due the government's expansionary fiscal stance. The scaling back of both policies in early 2019/20 did lead to some initial liquidity in markets, although non-performing loans remain a concern.[22] Kenya has been making good progress in reducing its current account deficit, from 7.2% in 2017 to 5.8%[23] in 2019, through the reduction of imports (mainly food and standard gauge railway-related imports), increased diaspora remittance inflows, and improved receipts from tourism.[24] Goods exports have declined as a share of GDP from 22% in 2012 to 12% in 2019.[25] The manufacturing sector's share of exports is declining, with Kenya's key exports (tea, cut flowers, refined petroleum, and coffee) being largely from the agricultural sector.

Meanwhile, the budget deficit has averaged an unsustainable 8% of GDP per year for the last five years. While fiscal consolidation is a stated priority of the government, plans have been consistently derailed, with the Government of Kenya forced to revise deficit targets upwards for the last four years in a row, 2019/20 being no exception. While the government has made some progress in bringing down the fiscal deficit from highs of over 9% in 2016/17 to 7.7% in 2018/19,[26] fiscal consolidation efforts have faced consistent headwinds, with budget deficits being an average of 0.9 percentage points above target each year. These levels are unsustainable, even in times of healthy growth, and have led to a substantial build-up of public debt. While pre-COVID government plans had the budget deficit falling to 6.3% of GDP in 2019/20, on past performance there was no guarantee that this ambitious reduction would actually be achieved even if the pandemic had not occurred. Revenue collections fell from 23% of GDP in 2011/12, to just 18% in 2018/19. This decline is attributed to numerous, and generous, tax incentives, including differentiated corporate income tax, which have eroded the tax base. Furthermore, declines in value-added tax (VAT) revenues in recent years have been attributed to the prevalence of exempted and zero-rated items. Tax expenditures and exemptions are estimated to cost Kenya 5–6% of GDP each year.[27] Additionally, the formal sector has been shrinking, while the large and growing informal economy now makes up 83% of employment, covering the large majority of trade, retail, and hospitality workers.[28]

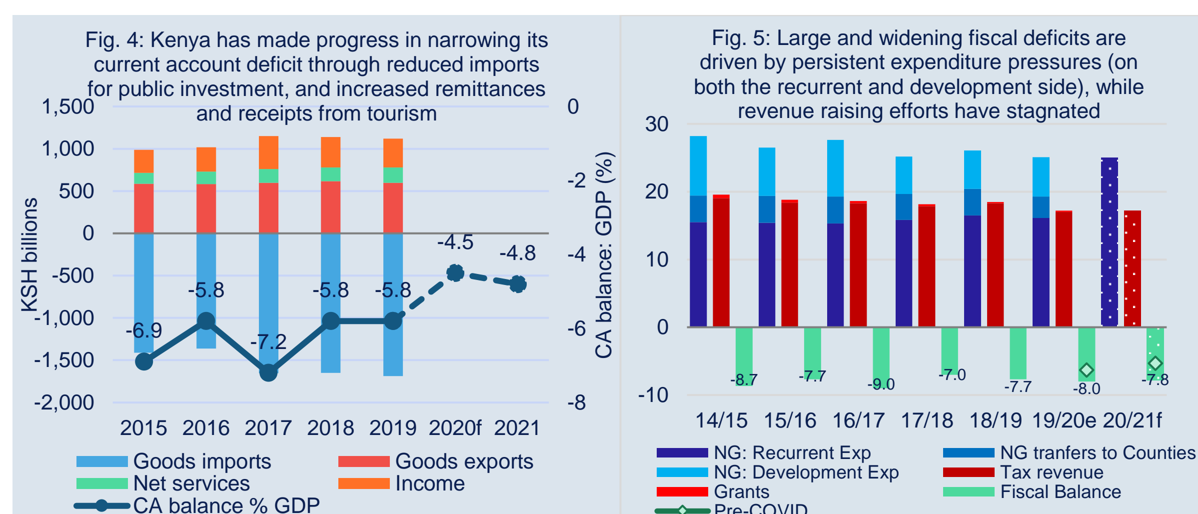


Fig. 4: Kenya has made progress in narrowing its current account deficit through reduced imports for public investment, and increased remittances and receipts from tourism

Fig. 5: Large and widening fiscal deficits are driven by persistent expenditure pressures (on both the recurrent and development side), while revenue raising efforts have stagnated

Note: KSH = Kenyan shillings. Source: KNBS (2020a), World Bank (2020a), Kenya National Treasury and Planning, 2010–20.[29]

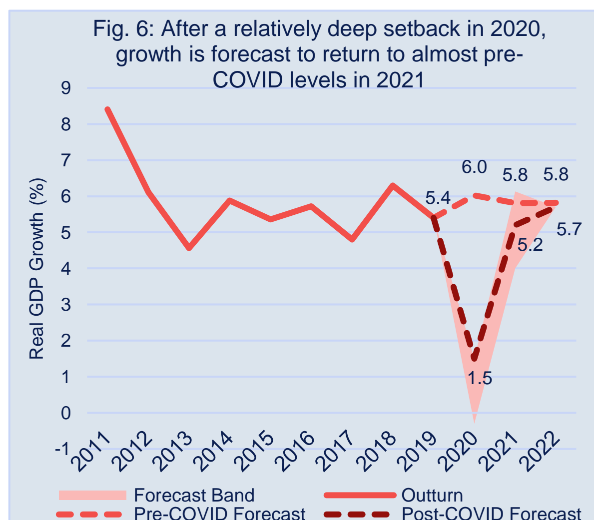
Kenya is increasingly exposed to public debt vulnerabilities, with public debt climbing to 62.4% of GDP (57% in present value (PV) terms) in June 2019. Kenya's public debt to GDP ratio has increased rapidly in recent years, by almost 30% between 2014 and 2019,[30] owing to large fiscal deficits driven by the revenue shortfalls, and large infrastructure investments, in part related to the Big 4 Agenda.[31] In November 2019, the Government of Kenya was forced to revise its non-binding debt ceiling from 50% of GDP in net present value terms (which it breached in 2016) to an absolute value of KSH 9 trillion. As at June 2020, public debt stood at 69% of this

ceiling.[32] Kenya is particularly exposed to vulnerabilities because it has accumulated relatively expensive debt. Between 2010 and 2020, the share of multilateral debt has declined by 40%, while the commercial share has grown by over 650%.[33] Interest payments have increased from about 2.7% of GDP in 2013/14 to 4.3% in 2019/20, the same size as the wages and salary bill of the national government. Falling export levels also pose a risk, leaving Kenya exposed to export shocks. In July 2020, the National Treasury introduced a Public Debt and Borrowing Policy[34] and a new Public Debt Management Office, in an effort to reduce these vulnerabilities.

The magnitude of COVID-19-related impacts on the economy:

The COVID-19 pandemic is expected to have a severe impact on the Kenyan economy and the Kenyan people, both through global and domestic channels, as the government has imposed a strict response to the virus. The first confirmed case of COVID-19 was reported on 13 March, with cases now approaching 49,000 and deaths just shy of 900 as at 25 October 2020.[35] Once COVID-19 reached East Africa, the Kenyan Government was quick to impose quarantines and restrict movement into and throughout the country. The government took measures to reduce the risk of community transmission, including a countrywide curfew effective from 7 pm to 5 am, the banning of public gatherings, the suspension of all international flights, shutting borders, the closure of schools and universities, quarantining of at-risk persons, and the implementation of social distancing measures.[36] The night-time curfew was eased slightly in early August (starting two hour later), but is still strictly enforced by the police.[37]

2020 GDP growth is expected to be 4.5 percentage points below pre-COVID forecasts, with large impacts expected on services and industry. In 2020, Kenya's GDP is expected to grow at only 1.5%, a substantial 4.5 percentage points below pre-COVID forecasts; such low growth has not been seen in Kenya in over a decade.[38] The services sector is expected to be the most severely affected sector, with the imposition of COVID-19 containment measures leading to a significant reduction in economic activity in the transport, recreation, tourism, trade, hospitality, and accommodation sectors. The worst effects of the COVID-19-related restrictions (to date) have been felt in the second quarter of 2020 (calendar year), with real GDP contracting by 5.7% (compared to an expansion of 5.3% in the same quarter in 2019). The manufacturing sector reported a contraction of 3.9% (compared to an expansion of 4% in the same period of 2019), the construction sector slowed to growth of 3.9% (compared to 7.2% growth in 2019), transport declined by 11.6% (compared to 7.6% growth in 2019), and the accommodation and goods sector contracted by 83.3% (compared to 12.1% growth in 2012). Despite the locust invasion, the agriculture sector as a whole performed well in Q2 2020, growing by 6.4%, compared to 2.9% in the previous year, when rains were poor. Strong performance was supported by increases in tea production, and fruit exports, but pulled down slightly by declines in the production of coffee and horticulture.[39] Downside risks to the agriculture sector are linked to a potential locust upsurge, as well as forecast below-average rainfall across October to December.[40]



Source: IMF (2019), World Bank (2020e), World Bank (2020a).

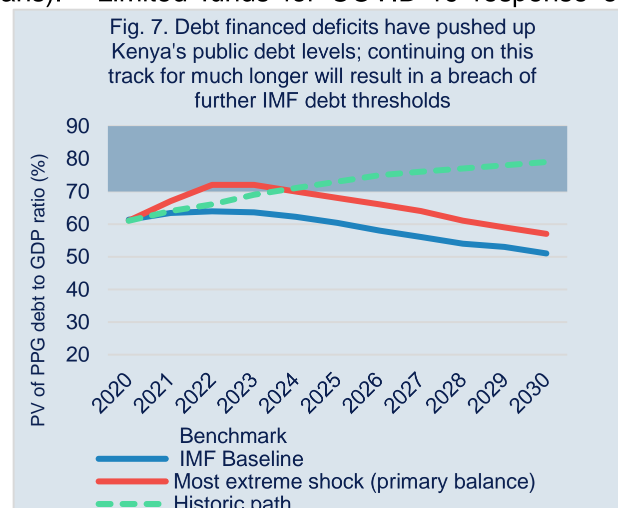
The current account deficit is expected to narrow to 4.5% of GDP in 2020 as global trade disruptions, diverted capital spending, and falling oil prices balance falling exports and a sharp decline in tourism receipts. For the manufacturing sector, which is reliant on imported raw materials and intermediate goods, global supply chain disruptions have impacted production. Business uncertainty, reduced working hours, and social distancing measures have resulted in significantly scaled down operations.[41] Domestic factors such as tight credit conditions, delays in obtaining tax refunds, and weaker demand are also constraining industry.[42] The agriculture sector is expected to be most impacted by the disrupted export of horticulture products: the horticulture industry was estimated to be losing US$ 3.5 million a day during European lockdown, thought to have declined to US$ 1 million a day now restrictions have eased.[43] Reduced exports, combined

with a sharp contraction in tourism receipts (2% of GDP in 2019)[44] and lower remittances (estimated at 2.9% of GDP in 2019),[45] are, however, expected to be outweighed by a reduction in oil imports (due to lower global energy prices) and lower imports of capital and intermediate goods. As a result, the current account deficit is forecast to narrow to 4.5% of GDP in 2020, from 5.8% in 2019 – a 10-year low.[46] Though reduced access to international capital markets will make financing this deficit considerably more challenging, the IMF approved the disbursement of US$ 739 million in May to help Kenya meet its urgent balance of payment needs.[47]

Measures imposed by the Government of Kenya to mitigate the spread of COVID-19 are resulting in job losses and reduced working hours, with worrying implications for poverty levels. While poverty has fallen in Kenya in recent years, absolute levels remain high. Combined with a large informal sector and significant unemployment among the youth population (60%),[48] Kenya has a high number of vulnerable groups who do not have the resources to cope with lockdowns and quarantine measures. Kenya's scalable social protection system, the Hunger Safety Net Programme, does not cover slum dwellers, the urban poor, and informal sector workers, who are among the most affected by initial movement restrictions.[49] Curfews and limited movement of people have made many roles redundant, resulting in job losses, unpaid leave, or reduced hours. The quarterly labour force survey indicated that the labour participation rate in the country has fallen significantly as a result of the pandemic. The unemployment rate increased from 5.2% in Q1 to 10.4% in Q2 2020, driven by high increases in unemployment among the 20–30 age group. Similarly, labour underutilisation rates have increased from 8.3% in Q1, to 17.2% in Q2 2020.[50] A COVID-19 survey by KNBS found that workers across all industries were reporting having worked fewer hours in the preceding weeks, with education and accommodation and food services the most severely impacted.[51]

To mitigate the impact of the shock on businesses and vulnerable households, the Treasury relaxed the 2019/20 and 2020/21 fiscal deficit targets, reflecting increased spending pressures and reduced revenue. As Kenya's fiscal year runs from July to June, the COVID-19 crisis has impacted both 2019/20 and 2020/21. Following the onset of the crisis, the Government of Kenya introduced a modest second Supplementary Budget in April (19/20), followed by a third, including an additional KSH 40 billion for COVID-19 interventions for health, cash transfers for the elderly, disabled and low-income households, and funds to fast-track VAT refunds. Alongside this, tax measures included full income tax relief for persons earning a gross monthly income of up to KSH 24,000 (c. US$ 225) per month, a reduction in the VAT rate from 16% to 14%, as well as a reduction of the top pay-as-you-earn rate from 30% to 25%, among others.[52] The measures were relatively contained due to Kenya's limited fiscal space, worsened by large revenue shortfalls. Overall 2019/20 expenditure was lower than budgeted, at 25.2%, with revenue collection down to just 17.2% of GDP, compared to the original plan of 19.8% of GDP and the supplementary budget plan of 18.6%, giving rise to an expanded estimated fiscal deficit of 8% of GDP in 2019/20 (from a previous target of 6.3%).[53] The 2020/21 budget, signed into law in June, estimates a slightly narrower fiscal deficit of 7.3% of GDP, up from 4.9% in the Budget Policy Statement, with both recurrent and capital expenditure set to decrease slightly to make up for some of the expected revenue shortfalls (13% reduction against plans).[54] Limited funds for COVID-19 response or recovery are built into budget plans. Both the IMF and the World Bank foresee a higher fiscal deficit, of between 7.6 and 7.8%[55] of GDP.

Fig. 7. Debt financed deficits have pushed up Kenya's public debt levels; continuing on this track for much longer will result in a breach of further IMF debt thresholds



Source: IMF (2020a).

This fiscal deficit and reduced growth means that Kenya's debt ratios have worsened: in April 2020, the IMF raised Kenya's risk of debt distress to high as the global COVID-19 crisis exacerbated existing vulnerabilities. Kenya's high fiscal deficit demonstrates an unwillingness to contain spending during normal times; the crisis necessitates greater spending, and while some reallocations have been made in the capital budget, the Government has had to resort to debt to finance additional

expenditure needs. The IMF forecast that Kenya's already high public debt levels will climb to 69.1% of GDP in 2021 (63.4% in PV terms), while external debt will climb to 34% of GDP (27.8% in PV terms).[56] Kenya's risk of debt distress has increased to 'high', with the IMF's debt sustainability analysis showing Kenya breaching one solvency indicator (PV of external debt-to-exports ratio) and one liquidity indicator (external debt service-to-exports ratio), as a result of the export shock and increasing debt servicing costs.[57] Despite its risk of public debt distress, Kenya did not seek a suspension of debt payments under a G20 initiative aimed at helping poor countries to weather the COVID-19 pandemic. This was primarily due to concerns of the Cabinet Secretary Finance that the terms of the deal would have a negative impact on the country's credit rating and result in limits on non-concessional borrowing during the six-month relief period.[58] In the 2020/21 budget, there is a notable decrease in programme and non-concessional loans, which are instead replaced by more expensive 'semi concessional loans', with no definition included, which may result in higher debt service expenditure in the medium term.[59]

The economic impact of the pandemic in Kenya is forecast to be severe, and Kenya's fiscal stance has placed it in a vulnerable position, with limited options for how to respond. After years of high deficits and the resulting public debt build-up, Kenya has limited fiscal space to further protect vulnerable households or implement substantial stimulus measures to revive a hard-hit economy. Government plans indicate Kenya will swiftly move back onto the fiscal consolidation path in 2020/21 to try to reduce its exposure to debt vulnerabilities. However, given that Kenya has struggled to pull down deficits during times of strong growth, it remains quite optimistic to assume additional spending measures will not be required, and that the tax take will live up to expectations after years of poor performance. Continued government borrowing is also likely to crowd out the private sector, adversely impacting much-needed private sector investment. Kenya's high poverty levels, large informal sector, and high youth unemployment rates present a substantial risk factor for fiscal consolidation plans, should a fiscal response be needed due to a resurgence of the virus, a slower than anticipated recovery (domestic and international), or the triggering of other domestic risks (e.g. drought or further locust invasions).

Revenue and expenditure overview

The national government has continued to make efforts to strengthen budget transparency, but county information is limited. The 2019 Open Budget Survey shows that the national government is moving towards making publicly available most of its budget information, with Kenya's score on transparency increasing by four points, from 46 to 50, between the 2017 and 2019 Open Budget Surveys, due mainly to the new publication of in-year reports (the global average score is 45).[60] Audit reports, however, remain only for internal use. At the time of writing, half of the county governments had not made their FY 2020/21 budgets publicly available, and there continues to be no 'one-stop shop' for accessing country budgets. Some consolidated information is published in the Office of the Controller of Budget's County Budget Implementation Review Reports (CBIRRs), but these are purely financial data, and they come with a three- to five-month lag.

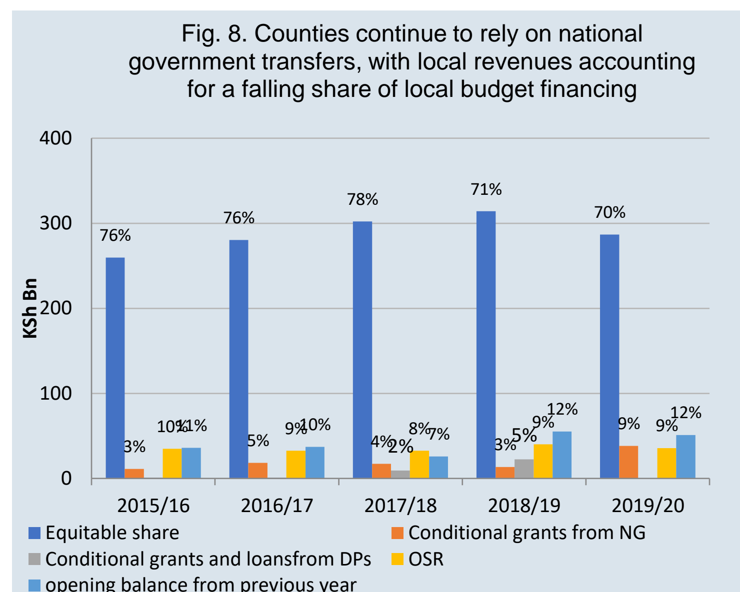
Transparency around off-budget spending is poor, including for emergencies. Kenya set up a COVID-19 Fund in March 2020, with the objective of mobilising resources to help control the spread and impacts of the pandemic in the country.[61] While the fund reports on the resources received (in cash and in kind, from government and private sources), there is no information currently available on how this is spent, or the beneficiaries. In the wake of recent emergencies (including flooding in 2019, and the current pandemic and locust infestation), the National Treasury recently issued a circular that requires ministries, departments, and agencies (MDAs) to report on disaster-related expenditures – including those related to pandemics, floods, drought, and infestation – but information from this exercise has not been reported as planned in the fourth quarter economic and budgetary review FY 2019/20.[62]

Kenya's revenue effort is higher than some of its peers, but has weakened over the past five years. As described in the section above (Figure 5) on revenue, GDP fell from 19.1% in 2014/15 to 18.2% in 2018/19,[63] but was projected to grow from 2019 onwards (before the impacts of COVID-19 were taken into account). Initial progress was encouraging: in the first nine months of FY 2019/20, total ordinary revenue grew by 14% on a similar period in the previous financial year (but remained, nonetheless, below target). Out of this, tax revenues account for the largest sources of government revenue (87% of total revenue since FY 2014/15), while non-tax revenues

and grants account for less than 15% combined. In the first nine months of FY 2019/20, the major sources of ordinary revenues were income tax (47%), VAT (29%), and excise duty (14%).[64] Although Kenya's revenue to GDP ratio is higher than that of most of its East African Community peers, such as Tanzania and Uganda, and generally that of sub-Saharan Africa states, the World Bank estimates that Kenya's tax to GDP ratio is between 4 and 7 percentage points lower than countries at similar income levels.[65]

Tax expenditures and exemptions have eroded Kenya's tax base and have contributed to revenue under-performance. Revenue foregone by the government is estimated to be between 5% and 6% of GDP.[66] Kenya has numerous, and generous, tax incentives in play, as well as differentiated corporate income tax, which have eroded the tax base. Furthermore, declines in VAT revenues in recent years have been attributed to the prevalence of exempted and zero-rated items. Revenues have also proven volatile in the face of recent shocks (including the desert locusts invasion, floods, and the effects of the COVID-19 pandemic), by virtue of the disruption to economic activity, but also because of the additional tax expenditures introduced. For instance, the reduction in corporate and personal incomes tax and VAT introduced since the pandemic hit are expected to cost the exchequer KSH 172 billion in revenue foregone in the financial year, which translates to 4.8% of total projected revenue of KSH 1.89 trillion.[67]

Fig. 8. Counties continue to rely on national government transfers, with local revenues accounting for a falling share of local budget financing



Sources: CBIRR reports FY2015-16 to FY2019/20

Revenue performance of county governments is also poor, leading to a continued reliance on national government transfers, which have been subject to extensive delays in 2020/21. County governments' major sources of revenue include a block grant equitable share of revenue raised nationally (averaging 74% of local government revenues between 2015/16 and 2019/20), own-source revenues (OSR) (9%), in addition to small amounts in loans and grants from development partners, and conditional grants from the national government. As depicted in Figure 8, counties continue to heavily rely on the national government to finance their budgets, with OSR accounting for a just 9% of spending in 2019/20. This is a cause for concern, particularly as in 2020/21 the intergovernmental transfers have been significantly delayed due to an eight-month political stalemate around the revenue sharing formula (discussed in the institutional section below). As at mid-October 2020, 3.5 months into the fiscal year, no conditional grants for the year had been disbursed, and only two months' worth of the equitable share had been disbursed.[68]

Government spending is set to fall in 2020/21, as the decline in revenues (and growing interest payments) forces the national government's hand on expenditure cuts, while delays in transfers also disrupt local spending. The approved national government budget peaked in FY 2019/20, before contracting by 10% in real terms in 2020/21 (Figure 9). This is a necessary adjustment following the shock to revenue expected this year in light of COVID-19, and the fact that a growing share (25% in 2019/20) has to go to interest payments. At the sub-national level, consolidated information on county budgets is not presently available; however, as a proxy, the allocations disbursed from the National Treasury as equitable share are set to remain constant in nominal terms (KSH 316.5 billion). Furthermore, local-level spending is expected to decline on account of the delayed disbursement of the transfers noted above. Many counties have reportedly been unable to pay salaries since June, and have built up considerable pending bills.[69]

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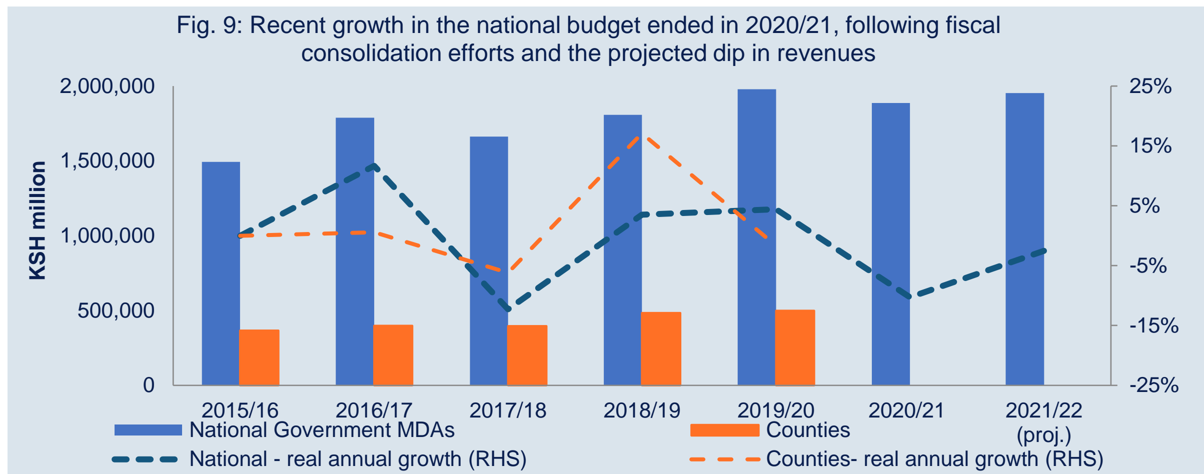
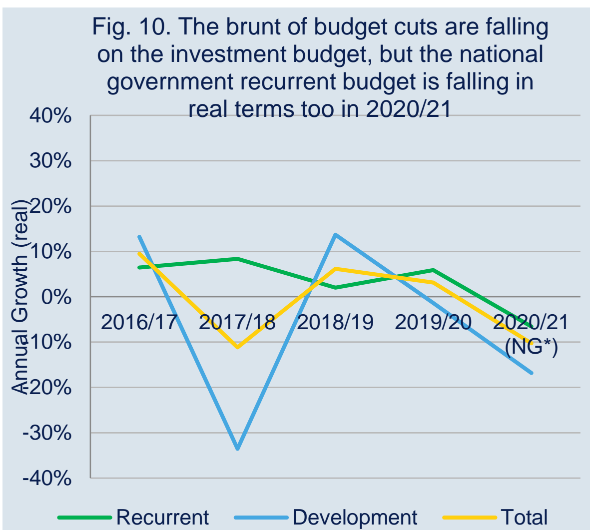


Sources: Controller of Budget (COB) BIRR and CBIRR reports. The national government allocations for FY 2020/21 and FY 2021/22 are sourced from FY 2020/21. The county government allocations for FY 2020/21 will be available once Q1 CBIRR 2020/21 has been prepared. Notes: budgeted amounts are as per the last supplementary budget in the years in which they were

As with previous cases of public spending being reined in, investment is bearing the brunt of budget cuts, although recurrent spending is also projected to fall in real terms this year. The recurrent budget grew consistently from FY 2015/16 to FY 2019/20, including in 2017/18, when the consolidated budget as a whole got smaller following a severe drought. With the reduction in planned national government spending in 2020/21, the burden of cuts is again falling on the development budget, which is contracting by 17% in real terms compared to the third supplementary budget in 2019/20. The recurrent budget is set to be marginally lower than 2019/20 in nominal terms, but when taking into account projected inflation of 5.7%, this amounts to a real reduction of 6.5%, the first time the recurrent budget has seen a year-on-year decrease in recent times. However, this assumes the government withstands pressures to increase recurrent spending beyond the levels set out in the original budget – which it has previously failed to do (in 2019/20 there were three supplementary budgets, and the final recurrent budget for MDAs was 3% above original budget).



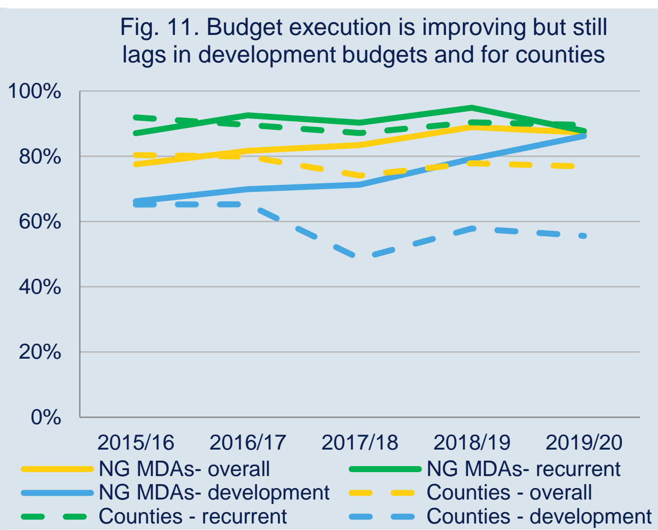


Fig 10: Sources: COB BIRR and CBIRR reports, approved national government 2020/21 budget. Notes: FY 2016/17 – FY 2019/20 are national and county government budgets, FY 2020/21 is national government only. Fig 11: Sources: COB BIRR and CBIRR reports FY 2015/16 – FY 2019/20. Note: The high execution rate for development in 2019/20 is largely due to a late supplementary budget, where the capital budget was significantly reduced. NG = National Government

The government is meeting its commitment to allocate at least 30% of the budget to capital, but under-performance in capital expenditure means the outturn often falls below this level in counties. The Public Finance Management (PFM) Act requires national and county governments to assign at least 30% of their approved budgets for development expenditures. This threshold has been comfortably exceeded every year between 2015/16 and 2019/20, with the national government allocating an average of 41% over that period, and counties an average of 39%.[70] Even with the reduction in spending expected in 2020/21, the 34% of the national government's MDAs budget is going to capital. However, when considering actual expenditures, the share going to development is considerably lower at both levels of government, and in the

counties has accounted for less than 30% of total spending in 2017/18, 2018/19, and 2020/21. This reflects budget execution challenges (termed absorption in Kenya), which affect development budgets and counties more profoundly (see Figure 11), as well as unrealised local revenue targets, and delays in the disbursement of the equitable share from the National Treasury.

County expenditure is unequal between counties, driven by variations in revenue. The cumulative expenditure at the sub-national level accounted for an average of 19% of overall spending between 2015/16 and 2019/20. At county level, expenditure per capita is very unequal – with spending per person in Isiolo nearly seven times that of Nairobi city (see Figure 12). Counties with the highest per capita spending are those with the lowest population density: for example, Isiolo has 11 people per km^2, compared to 6247 in Nairobi city.[71]

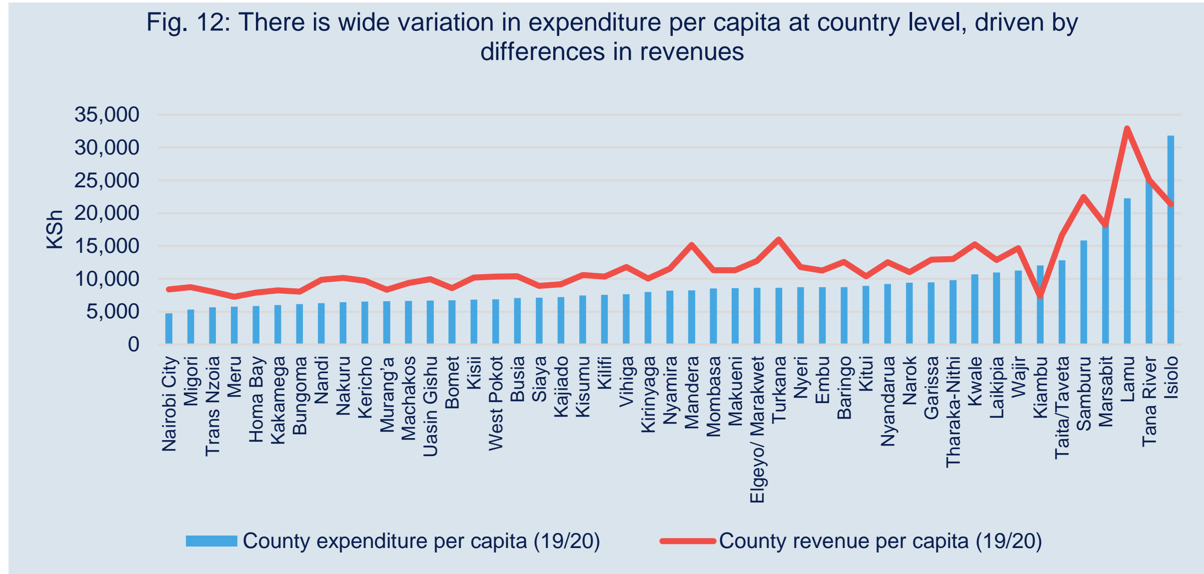


Fig. 12: There is wide variation in expenditure per capita at country level, driven by differences in revenues

Sources: COB CBIRR reports FY 2018/19 and KNBS Census report, 2019

The consolidation set out in the 2020/21 national government budget is mainly delivered by cuts to the energy and infrastructure sector, while allocations to education and public administration have grown. Figure 13 reveals that the national government spending priorities include education, energy and infrastructure, and public administration, together accounting for over 60% of spending. However the share allocated to energy, infrastructure, and ICT fell by nearly 4 percentage points, which, considering the overall budget is of a smaller magnitude, amounts to a nominal cut to the sector's budget of over 20% (compared to the revised budget of 2019/20), driving the fall in capital spending shown above in Figure 10. Conversely, the share for the public administration and international relations (PAIR) sector, which includes the Presidency, the National Treasury, and the National Assembly among other non-service delivery institutions, has grown, as has spending on education, driven mainly by increased spending on teacher salaries.

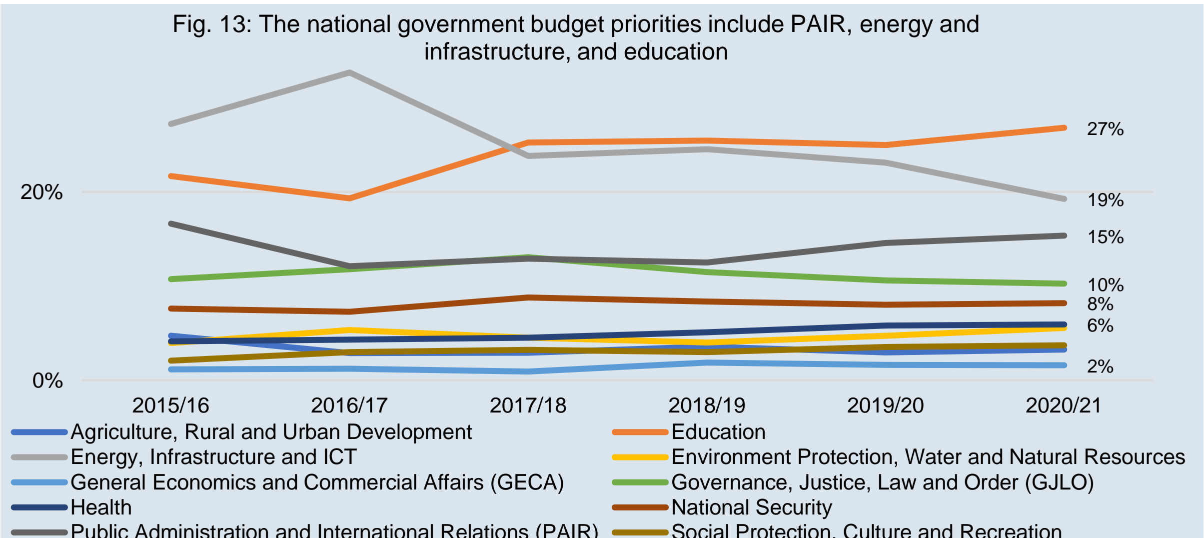
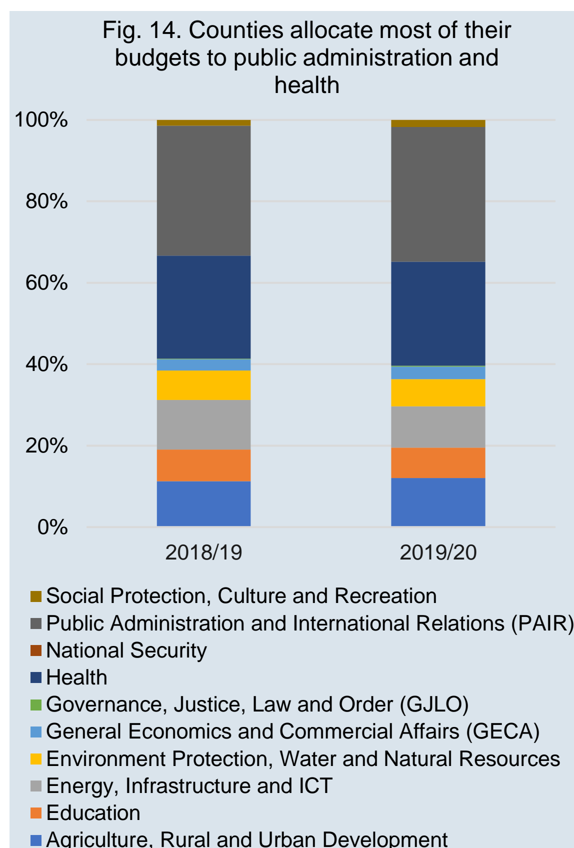


Fig. 13: The national government budget priorities include PAIR, energy and infrastructure, and education

Sources: COB BIRR reports FY 2015/16 – FY 2019/20 and approved PBB Budget FY2020/21

The allocation towards health has remained the same (6% of the national government budget), despite the additional COVID measures introduced; with the reduction in the overall envelope, this amounts to a cut of 7% in the health budget (discussed in the health chapter below).

At the sub-national level, budgets have predominantly been allocated to public administration and health. County budgets in 2019/20 saw a continuation of the distributional patterns in the 2018/19 budget, i.e. with the greatest share of funds (around one-third) going to public administration, followed by a quarter going to health, which is a county function. Consolidated budgets for counties for 2020/21 are not yet available, so it is not yet clear whether more of their budgets will be going to health following the current epidemic. However, with the delays in disbursing the local government transfers, execution of planned spending will be inhibited this year, with worrying implications for primary healthcare services (discussed further in the health chapter, below).



Sources: COB CBIRR reports FY 2018/19 and FY 2019/20

Agriculture:

Funding for agriculture is set to fall, in line with the overall reduction in spending, from already inadequate levels. Agriculture is primarily a county responsibility, with the national government being responsible for agricultural policy and for assisting the county governments on agricultural development sustainability for food security. The share of county budgets going to the sector stood at 12% in 2019/20 (2020/21 budgets are not yet available), while the national government allocated just 3% of its 2020/21 budget, a similar share to that in 2019/20. Given the overall reduction in the budget envelope and the noted challenges around county transfers, this indicates agriculture spending will fall in 2020/21. Even before this, spending did not meet internationally defined benchmarks: looking at the budgets of both levels of government as a whole, allocations to the agriculture sector amounted to 5% of consolidated budgets in 2019/20, considerably below the benchmark of 10% set out in the Maputo Declaration.

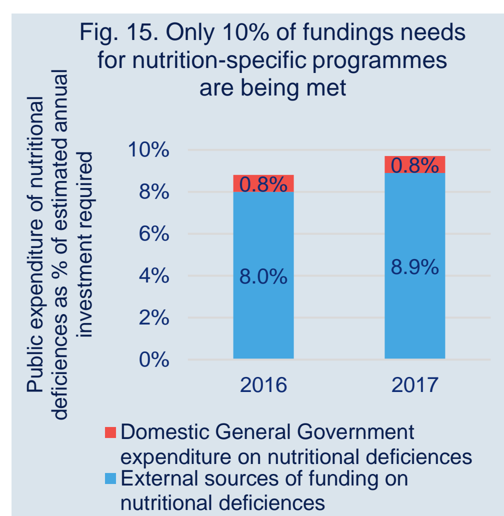
The sector has been faced with a number of food security challenges in recent times, which have not been matched with commensurate additional funding. A drought in the first half of 2019, followed by extremely high rainfall and floods in the second half of the year, in addition to locust invasions, culminated in reduced production of crops and pasture for livestock.[72] In 2020, the desert locust invasion has coincided with the COVID-19 pandemic, placing a double burden on the sector. The pandemic has also disrupted global supply chains for the pesticides and other tools required to control the invasion. Reduced global demand for agricultural products, such as horticulture and other cash crops, has further hit the sector, as has the slowdown in cargo, which reduces access to international markets. However, despite these additional threats to food security, the sector did not receive additional resources in the post-COVID supplementary budget of 2019/20, and while the 2020/21 budget did include a stimulus programme with KSH 3 billion to subsidise the supply of farm inputs and KSH 1.5 billion to assist flower and horticultural farmers to access international markets, the sector's allocation as a whole did not increase in volume, or as a share of the budget.

Nutrition:

Undernutrition is a significant impediment to growth, and is expected to increase following the pandemic. Kenya is on course to meet several of its World Health Assembly targets for 2025;[73] however, undernutrition among children is still a concern, with almost one in four children under five being stunted. Estimates indicate that child undernutrition costs the economy 6.9% of its GDP through its effects on health, education, and productivity.[74] Furthermore, the economic crisis triggered by COVID-19 could slow down the improvements made in reducing undernutrition, as

more children are at risk of experiencing malnutrition. This has lifetime implications for these children's health and economic outcomes, and will have implications for future economic growth for Kenya.[75]

Costed plans of action for nutrition are in place, but funding needs are not being met. Costed plans of action for nutrition are in place at the federal level and in 2019 some counties, such as Busia, Vihiga, Nandi, and Makueni, also published costed plans.[76] However, Kenya only meets about 10%[77] of its estimated required financing (US$ 76 million) for scaling up high-impact nutrition-specific interventions (Figure 15).[78] In its budget for 2020/21, the national government tried to reaffirm its commitment to enhancing food and nutrition security, with an allocation of KSH 52.8 billion for various nutrition-sensitive programmes, including national agricultural and rural inclusivity, cereal enhancement, and drought resilience, but it is silent on nutrition-specific programmes, which, as a health sector intervention, are county responsibilities.[79] There is, and will likely remain, a high dependency on external sources of financing for nutrition, in particular for nutrition-specific programmes (in 2017, only 10% of public spending on nutrition in health accounts was from the government).



Source: Adapted from the Global Nutrition Report 2020.

Water, sanitation, and hygiene (WASH):

Despite some progress, there remain significant gaps in water access and sanitation. Rural water supply coverage improved from 47.1% in 2013 to 50.2% in 2017 countrywide.[80] However, further progress is marred by a lack of funding: a study by the United States Agency for International Development (USAID) estimates that Kenya requires US$ 12.9 billion for universal water access, and there are only US$ 5.6 billion available funds, leaving a US$ 7 billion gap.[81] According to a WASH joint monitoring programme report (2019) by the WHO and the United Nations Children's Fund (UNICEF), only 29% of Kenyans have access to sanitary services.[82]

Tracking WASH funding is challenging, due to changing administrative structures and the lack of a WASH budget programme. The Constitution of Kenya assigns responsibility for water resources management to the national government, while devolving the provision of water and sanitation, including hygiene services, to county governments. In Kenyan budget documents, responsibility for providing water services is sometimes merged with irrigation, natural resources, or both, while in other instances health and sanitation are amalgamated. It is therefore not possible to track WASH spending at the national and county level through routine budget documents, or to measure progress against funding commitments.

The COVID-19 pandemic is increasing the need for WASH services, but the limited additional spending measures which have been announced do not extend to WASH. The COVID-19 pandemic calls for WASH-related interventions like safe water and hygiene services supply, adequate preparedness, and communication to promote handwashing, safe water, and hygiene. It also calls for rapid low-cost water service provision, coupled with emergency response to communities, to allow them to fulfil their basic needs. To mitigate these challenges requires financial support to the relevant water institutions, and ensuring the availability of hygiene products. However, in Kenya the COVID-19 funds that were included as part of the 2020/21 budget have very little for WASH, apart from KSH 0.9 billion for the rehabilitation of water sources in arid and semi-arid regions.[83]

Gender:

Kenya's policy framework for gender has been recently revitalised. Kenya upgraded its National Policy on Gender and Development through a Sessional Paper in 2019. The policy is anchored in international and national laws, with the aim of achieving gender equality and women's empowerment in national development. Further, it seeks to enhance the participation of women and men, boys and girls, and vulnerable and marginalised groups, in order to be able to attain sustainable development.

Despite this, the State Department for Gender has not been spared from government budget cuts. There is no gender budgeting exercise to provide a holistic view of what share of public resources are promoting the policy's gender equality goals. However, the State Department of Gender has had its budget cut by 23% in 2021/22 (the much smaller National Gender and Equality Commission did receive an 8% increase). The responsibility for overseeing gender at the county level is subsumed under a broader set of departmental responsibilities and so spending cannot be determined through routine budget data. The 2020 Economic Survey reported that tenders under the Access to Government Procurement Opportunities set aside for women and people with disabilities grew from KSH 30.1 billion in 2018/19 to KSH 32.7 billion in 2019/20.[84]

COVID-19 measures are likely to lead to an increase in gender-based violence. The National Council on the Administration of Justice reported an increase in sexual offences in the country in the month of April 2020, when it went into lockdown. The offences constituted 35.8% of all criminal matters reported in that period, and most cases involved close relatives, guardians, and people living with victims. More broadly, the COVID-19 pandemic has brought an increase in gender-based violence and teenage pregnancies, and also a decrease in health-seeking behaviour. Pregnant women and girls are at high risk – especially those who have to forgo antenatal services due to the fear of contracting COVID-19.[85]

PFM performance:

The PFM system in Kenya still faces some critical weaknesses, as highlighted by the latest Public Expenditure and Financial Accountability (PEFA) report. The recently published PEFA report identified numerous weaknesses in the PFM system. Amongst these are substantial deviations between budgets and outturns, primarily because of the priority given to aggregate fiscal stability over service delivery (i.e. the Treasury will introduce delays in releases of resources during the year in response to revenue shortfalls and/or unexpected extra expenditure demands, which has a negative impact on service delivery). It also noted that revenue administration continues to underperform, as does public investment management, and that medium-term budget allocations are unreliable, and audit reports are often late and recommendations not followed up. The assessments also identify a few key strengths, such as the orderly budget preparation process (discussed below), and some areas of notable improvement, including the existence of costed strategies in all sectors, as well as wider use of competitive procurement methods.[86]

The PFM reform agenda is addressing these but capacity constraints and insufficient prioritisation have hindered progress in the past. The current pressures arising from the pandemic might focus efforts. The National Treasury's Strategic Plan proposes some corrective measures to address the shortcomings flagged in the PEFA. For example, the plan aims to streamline the initiation, execution, and delivery of public investment projects, and to boost revenue collection through more technology and reforms to enhance own-source revenue at the local level.[87] However, as noted in the PEFA, past progress in implementing PFM reforms has been slower than planned, partly because of capacity constraints, and insufficient prioritising and sequencing of reforms, taking into account these constraints.[88] It is possible that the heightened fiscal constraints imposed by COVID-19 may bring the necessity of these reforms into sharp relief.

Kenya's public finance systems are generally ill equipped to respond to emergencies. Kenya is prone to emergencies, including drought, floods, landslides, epidemics, terrorist attacks, and major accidents. Poor coordination between state departments leads to coordination challenges, and agencies mandated to handle emergencies in Kenya are confronted with limited budgetary allocations. This often leads to funds being diverted from development expenditure in the case of emergencies, as happened following the 2016 drought, and as is expected in 2020/21 with the current pandemic. At the county level, the PFM Act 2012 allows the County Executive Committee Member for Finance to establish an emergency fund. However, since this is not a requirement, and due to fiscal space constraints, few counties have done this, being unable to countenance the opportunity cost of setting funding aside. As such, counties often resort to supplementary budgets, reallocating monies meant for development projects, which further worsens budget credibility.[89]

Aid update

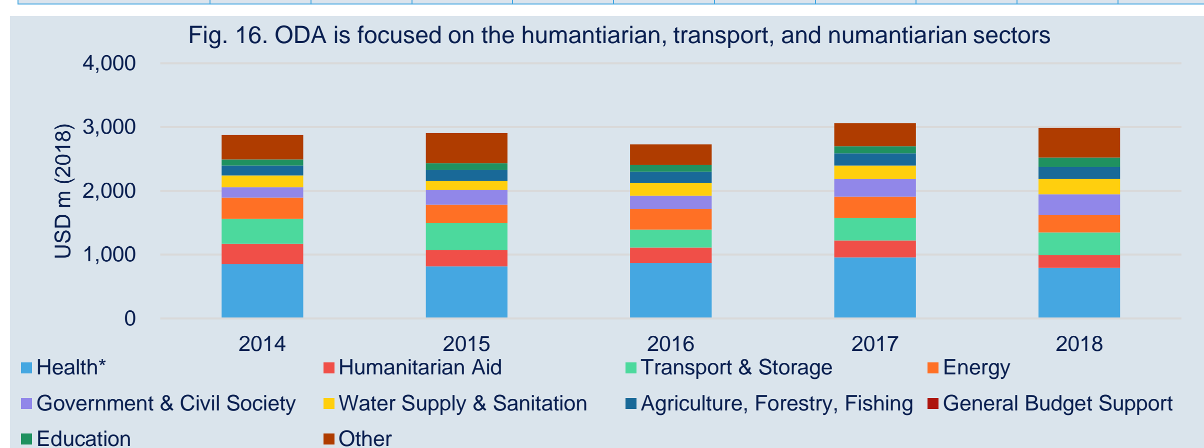
Official development assistance (ODA) was on a declining course, but remains an important source of inflows in the country. ODA for 2018 was 4.8% of total GDP, compared to 5.3% in 2018.[90] This decline is associated with Kenya's transition to being a lower middle-income country

in 2014, and its robust growth. However, aid is still significant. Foreign direct investment, by contrast, amounted to 1.85% of GDP in 2018.[91] The largest donor is the United States, accounting for 29% of total ODA between 2010 and 2018, followed by the World Bank, the African Development Bank, and the UK (see Table 2).[92] The sectors that receive the greatest share of ODA are health, governance, humanitarian, and transport (see Figure 16).

Table 2. ODA disbursements by Donor

Donor(s)	2010	2011	2012	2013	2014	2015	2016	2017	2018	%
United States	648	804	907	971	864	753	846	882	833	29.8
World Bank	220	251	288	466	550	497	476	601	762	14.7
AfDB	101	157	194	242	224	274	210	207	190	7.1
UK	118	134	168	237	200	221	186	210	157	6.4
Japan	94	121	169	310	110	245	162	165	224	6.2
Germany	90	159	360	108	115	78	95	133	97	4.9
France	135	102	111	177	117	111	95	82	115	4.0
Global Fund	65	25	78	112	113	121	113	176	87	3.5
IMF	0	297	211	208	0	0	0	0	0	3.1
Sweden	45	67	70	67	63	66	55	64	55	2.3
Other	391	525	551	600	517	538	494	540	464	18.1
Total	1,906	2,642	3,105	3,499	2,872	2,904	2,731	3,061	2984	100

Fig. 16. ODA is focused on the humantiarian, transport, and numantiarian sectors



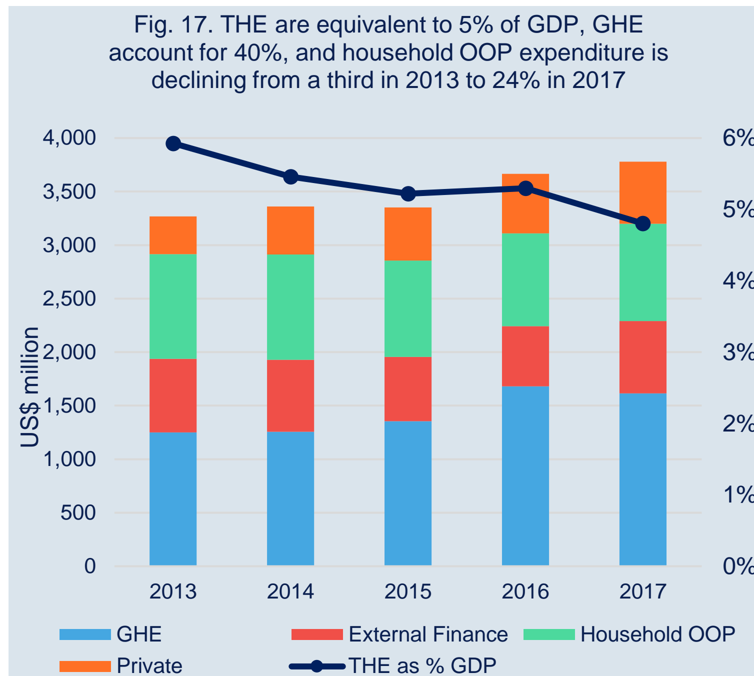
Sources: Organisation for Economic Co-operation and Development (OECD) creditor reporting system (CRS), US$ million

Kenya is receiving significant COVID-related official development finance in 2020, with projected disbursements in 2020/21 equivalent to 1.7% of GDP. This includes US$ 739 million from the IMF and over US$ 1 billion from the World Bank.[93] While this fast-disbursing and predominantly fungible support has helped ease the country's immediate fiscal constraints, it is not sufficient to offset the net fall in foreign development financing, or to prevent the need for cuts to public expenditure.[94]

Further support from development finance institutions will be required by Kenya over the medium term, to help it deal with the lasting impacts on growth and domestic revenue. Kenya has historically received significant levels of ODA, particularly off-budget and non-fungible grants. 2020 has seen significant additional disbursements from international finance institutions, some of which was made possible by bringing future years' allocations forward, meaning there is a risk of a reduction in official development finance for Kenya from 2021/22. Should this fall below pre-COVID levels, this would act as an aftershock that slows recovery. Therefore, ensuring sufficient flows of development finance to Kenya over the medium term would be an appropriate issue for the Bill and Melinda Gates Foundation (BMGF) to engage on, including through fora such as the OECD's Development Assistance Committee.

Health drill-down

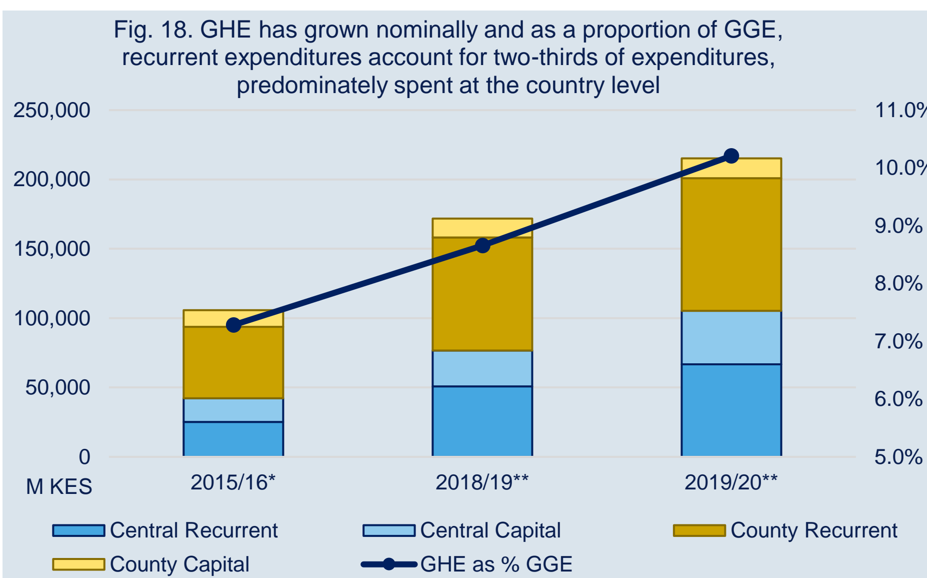
According to National Health Accounts (NHA) data, the health sector in Kenya is primarily funded by the government and households' out of pocket (OOP) expenditures – averaging 41% and 27% of total health spending from 2013 to 2017, respectively. Total health expenditure (THE) – the sum of these sources, external funds, and the private sector – accounted for 5% of GDP on average and reached US$ 81 per capita in 2017, with the government contributing US$ 35 per capita of this.



Sources: WHO Global Health Expenditure Database (GHED) – based on NHA data

Even pre-COVID, spending on health was below international estimates of the US$ 86 per capita (2012 prices) required to achieve universal health coverage (UHC)[95] – a Kenyan goal and one part of the President's the Big 4 Agenda. The US$ 86 per capita benchmark is for public funding – which in Kenya stood at US$ 49 per capita in 2017 (US$ 35 from the Government of Kenya, and US$14 from donors). This situation is not conducive to citizens accessing healthcare services without financial risk. Indeed, the amount spent per household in OOP expenditures was US$ 20 per capita in 2017. With the declining path of aid (discussed above), it is difficult to see how UHC can be achieved without a substantial uptick in government spending.

Government budget data show similar levels of health spending, reaching US$ 43 per capita in 2019/20, up from US$ 24 in 2015/16. This increase in spending on health – rising to 10% of general government expenditures (GGE) in 2019/20, from 7% in 2015/16, comes as the government seeks to roll out UHC across the country, following a pilot in 2018 and 2019. The ambition is constrained by inadequate budget allocations, but also by low execution rates in the sector (averaging 84% at the national level and 78% at the county level over the last five years). Indeed, planned 2019/20 spending for health should have led to a per capita expenditure of US$ 49 rather than the US$ 43.



*Source: National data from BIRR reports. *2015/16 county data from UNICEF (2017) PER Health, Water and Sanitation** 2018/19 and 2019/20 county data are an estimate based on administrative breakdown of county budgets in CBIRR. However, in some cases relevant departments have responsibilities beyond health, e.g. the Department for Health and Sanitation, so this may be an overestimate.*

The PHC Strategy 2019–2024 was developed to close the gap between the current reality in health and attainment of UHC.[96] The strategy states that there is a lack of financing for PHC and only 11% of the population has health insurance cover. The solution proposed to reduce OOP spending is to raise health insurance coverage and make insurance more focused on PHC and UHC needs. No information as to how this is progressing could be identified.

Health spending will likely fall in 2020/21, further stalling progress on UHC. At the national level, the Ministry of Health's budget was 7% lower in 2020/21 compared to 2019/20. Consolidated information on country health department budgets is not yet available; however, the substantial delays to intergovernmental transfers this year, including conditional grants for health (none of which had been disbursed as at mid-October), and the equitable share block grant (which was only partially disbursed), will have knock-on consequences for health expenditure in 2020/21. This will slow progress on UHC, and is additionally concerning in the context of the pandemic.

The COVID-19 pandemic has added further pressure on the health sector and PHC services, such as immunisation and drug supplies. Immunisation against infectious diseases is one of the eight elements of the PHC Strategy. However, a recent survey has found that 50% of vaccination outreach services have been disrupted by COVID-19, and the other 50% at national level were limited.[97] Additionally, fixed-post vaccination activities were suspended or limited throughout the country. Another key element in the PHC Strategy is HIV/Aids; a survey shows that Kenya may experience antiretroviral drug stock-outs due to COVID-19.[98]

Moreover, the provisions in the 2020/21 health budget for COVID-19 have been described as not prioritising needs.[99] The immediate health needs due to COVID were defined as the recruitment of health workers, refurbishing health facilities (particularly referral hospitals), and the acquisition of medical equipment. The Parliamentary Budget office report finds that '*except for a Kshs.2.6 billion allocation towards mass testing of COVID patients under the Kenya COVID-19 Emergency Response Project, the health budget remains more or less the same with only slight upward adjustments probably to cater for inflationary trends*'.[100] More generally, the Parliamentary report also finds that the 2020/21 health budget has 'not adequately addressed the challenges that threaten to hinder the attainment of Universal Health Coverage'.[101] The report states that, in particular, this refers to the human resources inadequacies and poor health infrastructure. It does note that '*some counties have made significant effort towards revamping their hospitals and equipping them particularly to deal with the COVID-19 pandemic. However, a lot more still needs to be done to improve the status of healthcare*'.[102]

Institutional update

In Kenya, there are several key laws that guide the workings of the public financial system; however, these are not always adhered to. The overarching PFM framework appears in Kenya's new Constitution, 2010, which establishes a set of principles that spell out the role of public finances in promoting an equitable society, public participation in the budget process, and transparent financial reporting. The PFM Act 2012 itself provides for the effective management of public finances, which is operationalised in the 2015 PFM Regulations, for both national and county governments. In response to the COVID-19 pandemic, the PFM (COVID-19 Emergency Response Fund) Regulations, 2020, have established the COVID-19 Emergency Response Fund under Section 24 of the PFM Act. The purpose of the fund is to mobilise resources for emergency response towards containing the spread, effect, and impact of the COVID-19 pandemic. The fund supports the purchase of essential supplies for public hospitals, the provision of emergency relief to the most vulnerable, and any other emerging issues arising from the COVID-19 pandemic. Sources of monies for this fund include appropriations by the National Assembly, voluntary contributions from public officers and private persons, grants, and donations.[103] Unsurprisingly, given Kenya's poor transparency record, there have already been accusations of the embezzlement of COVID-19 funds and equipment. In one such case, the Kenya Medical Supplies Authority is being investigated over alleged irregularities during the procurement of personal protective equipment.[104]

In pursuit of reducing vulnerabilities to risks of public debt, the National Treasury has formulated a Public Debt and Borrowing Policy, which was approved by cabinet on 23 March

2020. The policy is meant to guide the public debt management and borrowing practices of the national and county governments. It assigns responsibility for deciding to borrow on behalf of the government to the Cabinet Secretary, while the Controller of Budget has the authority to authorise the withdrawal of funds for debt management operations and to prepare reports on public debt and borrowing. It also establishes the operational independence of the Public Debt Management Office in the Treasury.[105]

The budget process in Kenya has four major stages, reflected in Figure 19 below, which also illustrates the lead actors and key decision makers at each stage. The budget process is dominated by the powerful National Treasury. Parliament, mainly through the National Assembly, also plays a key role, as provided for in the PFM Act 2012.

Fig. 19. The four stages of the budget cycle

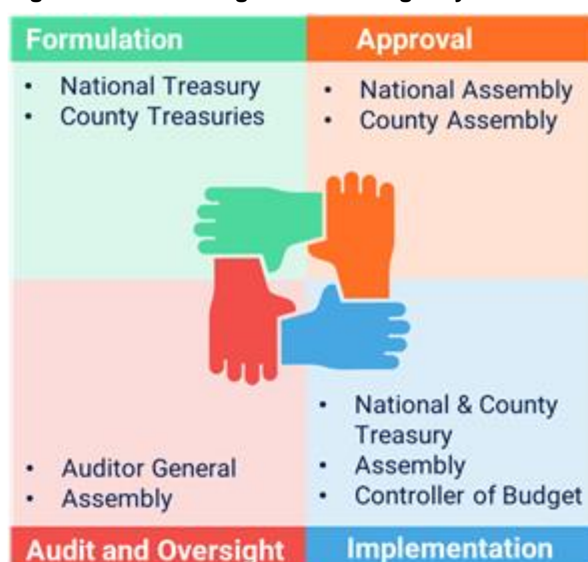


Table 3. Key dates in budget cycle (fiscal year runs 1 July to June 30)

Date	Event
30 Aug	Budget circular issued
Sept–Feb	County annual development plan prepared; public consultations held
21 Oct	Budget Review and Outlook Paper submitted to respective assembly by National Treasury/County Treasury
15 Feb	Budget Policy Statement (BPS) tabled in Parliament (national government)
28 Feb	BPS approved by Parliament (national government), County Fiscal Strategy Paper tabled in County Assembly
14 Mar	County Fiscal Strategy Paper approved
30 Apr	Budget estimates proposed to respective assembly (national government and counties)
May	Budget appropriations committees hold hearings and table reports to assembles
30 Jun	End of FY; National/county appropriation act enacted

As a result of fiscal devolution, allocations and equitable sharing of revenues between the different levels of government are now determined annually through a highly political process. The County Allocation of Revenue Act provides for the equitable allocation of national revenue amongst county governments and each January the Commission on Revenue allocation makes a proposal to the senate on how the revenue allocation should be determined. Kenya's proposed third-generation basis for revenue sharing has led to a stalemate in the senate in 2020, with senators failing to agree on the basis for sharing KSH 316.5 billion among the 47 counties until 8 October, over three months into the fiscal year. The stalemate has occurred since some counties were to receive less money than under the second-generation revenue sharing basis. The third basis for revenue sharing varies the parameters upon which the revenue is shared (as shown in Table 4 below). Specifically, there is less of an emphasis on population, or on fiscal effort (revenue collection), but there is more weight given to service delivery access considerations.

Table 4. Revenue-sharing formula

Third generation			Second generation	
Parameter	**Indicator of exp need**	**Weight**	**Parameter**	**Weight**
Health	Facility gaps Total inpatient days Total outpatient visits	17%	Population Basic equal share Poverty	45% 26% 18%
Agriculture	Rural households	10%	Land area	8%
Urban services	Urban households	5%	Fiscal effort	2%
Other county services	County population	18%	Development factor	1%
Minimum share	Shared equally Inverse of population	20%		
Balanced development	Land area Rural access index Number of poor people	8% 8% 14%		

Conclusion

Kenya has enjoyed over a decade of robust growth, which has enabled a considerable reduction in poverty. However, underlying this growth, economic vulnerabilities have been emerging, including a substantial fiscal deficit and deteriorating revenue performance, leading to the steady build-up of public debt, to levels that could only be sustainable for as long as strong growth is maintained.

2020 has heralded a series of shocks that have brought these vulnerabilities to the surface. The COVID-19 pandemic, alongside the continued threat of further locust invasions, is having a severe impact on the Kenyan economy, both through global and domestic channels. 2020 GDP growth is expected to be 4.5 percentage points below pre-COVID forecasts, with the services sector facing the greatest hit. The government imposed a strict response to the virus, which is resulting in job losses and reduced working hours, with worrying implications for poverty levels, while international measures weigh on demand for tourism and trade. Revenues to GDP ratios have also continued to fall, meaning the government has once again had to scale down its plans for fiscal consolidation. Fiscal deficits of 8% of GDP in 2019/20 and 7.8 (estimated) in 2020/21 are expected to push debt to 68% of GDP this year, with Kenya now assessed as being at high risk of debt distress by the IMF. If further fiscal measures are required to respond to continuing or worsening COVID-19 impacts, Kenya will face challenges in identifying the necessary additional fiscal space.

Government plans to narrow the deficit imply significant cuts to public spending in 2020/21, at both levels of government. As in previous years when public spending was reined in, public investment is bearing the brunt of the cuts, with consequences for future growth. In sector terms, this is reflected in a significant decline in the share going to the energy and infrastructure sector. An additional risk to health spending is the ongoing political deadlock around the basis for sharing revenues between counties. This has meant that, four months into the fiscal year, counties have still not received any conditional transfers, and have only received July and August's allocations of the equitable share block grant, their most significant revenue stream, in October. This will have implications for the services they deliver (including PHC). As with all countries, these risks are heightened by the prospect of a second wave of COVID-19, and/or a second lockdown, and in the case of Kenya other climate-related shocks, such as drought or pest infestations.

Issues to monitor in light of this outlook include whether the government is able to stick to the committed path of fiscal consolidation in 2020/21, or whether, as is expected by international forecasters, an additional year of high deficits is likely. If consolidation does not occur, and high revenue targets do not materialise, careful attention should be paid to the nature of the additional debt sought. Interest payments are already substantial in Kenya, consuming 25% of revenues in 2019/20. Additionally, the disbursement performance of transfers should be closely monitored now that the political deadlock on the basis of revenue sharing has been resolved, and rapid disbursement of funds for local service delivery should be prioritised. Over the medium term, it will be necessary to monitor whether the depression to public investment is reversed, which will be important for returning to pre-COVID levels of growth. Official development finance could be an important source of funding to help bridge this gap, alongside much-needed augmentation of revenue collection.

In terms of opportunities, some of the readjustments necessitated in 2020 should set Kenya on a more sustainable fiscal path, once the crisis abates. For example, the elimination of some of Kenya's many tax exemptions, introduced primarily to make the COVID-19 tax package largely revenue neutral, should make Kenya's revenue collection efforts more sustainable in the longer term. Additionally, a newly passed debt management policy provides the institutional basis for Kenya to embark on a path towards debt sustainability. The National Treasury's PFM Strategy has also been recently completed and provides a roadmap for reforms around fiscal discipline and improving the efficiency in public finance, which will be all the more necessary in the COVID-19 recovery process.

Endnotes

[1] This brief provides an analytical snapshot of the economy and public finances in Kenya. It is based on publicly available data produced by the Government of Kenya, and a range of secondary analyses. It is part of a package of 10 country briefs commissioned by BMGF, and is intended to provide a common analytical backdrop to BMGF programming in Kenya.
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