Macro-Fiscal Analytic Snapshot: Kenya[1]

Prepared by the Institute of Public Finance[2]

Foreword

This document is an analytical, yet solidly compacted flagship research product that consolidates Kenya's selected macro and fiscal indicators. The report focuses on 5 strategic areas of Kenya's economy, namely (i) the macroeconomic context and outlook, (ii) revenue and expenditure review, (iii) aid update (iv) sector deep dives and (v) institutional updates. It builds upon a review of past performance for the selected areas and presents an outlook for 2023.

In this 4th edition, the document points at the planned fiscal consolidation, the projected revenue increase, debt distress and evolution of the health budget as key issues to monitor. It emphasizes the economic damage caused by the COVID-19 pandemic, the effects of deferred fiscal consolidation, the overly ambitious revenue and fiscal deficit targets, as well as possibilities of sustained growth, poverty reduction, and a move back to medium risk of debt distress over the next few years.

The report aims to inform government institutions responsible for policy and decision making; donors and partners who support interventions in the strategic areas; peer institutions involved in evidence generation and advocacy; researchers and academia with an interest in Kenya's macro-fiscal performance.

The snapshot is developed to further IPF's purpose as an evidence-generating think tank promoting transparency, accountability, and participation in Public Finance Management.

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List of Abbreviations

BIRR	-	Budget Implementation Review Report
BROP	-	Budget Review and Outlook Paper
CAADP	-	Comprehensive African Agricultural Developed Programme
CBIRR	-	County Budgets Implementation Review Report
CPI	-	Consumer Price Index
CRA	-	Commission on Revenue Allocation
CRS	-	Creditor Reporting System
EACC	-	Ethics and Anti-Corruption Commission
GDP	-	Gross Domestic Product
GGE	-	General Government Expenditure
GHE	-	General Health Expenditure
GoK	-	Government of Kenya
IMF	-	International Monetary Fund
MTP	-	Medium Term Plan
MTRS	-	Medium-Term Revenue Strategy
NHIF	-	National Health Insurance Fund
ODA	-	Official Development Assistance
OECD	-	Organization for Economic Co-operation and Development
OOP	-	Out-Of-Pocket
PBB	-	Program Based Budget
PEFA	-	Public Expenditure and Financial Accountability
PFM	-	Public Finance Management
PIC	-	Public Investments Committee
PPP	-	Purchasing Power Parity
QEBR	-	Quarterly Economic and Budget Review
THE	-	Total Health Expenditure
UHC	-	Universal Health Coverage
UNICEF	-	United Nations Children's Fund
VAT	-	Value Added Tax
WASH	-	Water, Sanitation, and Hygiene
WHO	-	World Health Organization

Introduction

Macro-Fiscal Analytic Snapshot (MFAS) is a high-quality research output on Kenya's economy and public finances produced annually by the Institute of Public Finance (IPF) in partnership with Oxford Policy Management (OPM) and with funding from the Bill and Melinda Gates Foundation (BMGF). Its overall objective is to facilitate an active and informed public discourse on the economy and allocation and use of public finances as an effective way of policy making. The preparation of MFAS is undertaken through an in-depth analysis, scrutiny, interpretation, and dissemination of publicly available information on the Kenya's economy and public finances. The 2022/23 MFAS is the fourth edition.

Key messages:

Kenya was growing reasonably strongly, with steady poverty reduction, before COVID-19 struck in 2020. The pandemic crisis set back growth by about one year and poverty reduction by three years, as consumption was hit harder than investment by the shock. While the most recent forecasts are somewhat more positive than those in 2020 and 2021, it still appears that there has been a seemingly permanent hit to the economy, with gross domestic product (GDP) and poverty not projected to resume their previous trends.

For many years, Kenya deferred fiscal consolidation, and this continued through 2020 and 2021. Kenya was running large fiscal deficits even in 2019, with a debt-to-GDP ratio approaching 60%, which meant it had limited buffers going into what has turned out to be a series of external shocks. There was limited fiscal stimulus in response to the COVID shock and the setback to growth resulted in adverse debt dynamics, moving Kenya into a high risk of debt distress.

In the past, the government set revenue and fiscal deficit targets that were overly ambitious. Now, however, the government is running out of options, and it looks like revenue and expenditure targets might be met going forward. There are ambitious plans to cut back on spending that will result in stagnant per capita real expenditure – this forms the central projection, but there is a risk that progress towards fiscal consolidation will be slower than planned, especially if there are growth setbacks. Either way, there is essentially no room for significant real increases in expenditure for priority sectors over the medium term.

There is a lot riding on fiscal consolidation. Inflation has increased markedly in recent months but is not as high as in some other countries (such as Nigeria and Ethiopia). Deficit reduction should support efforts to dampen further price increases. Lower deficits should also result in limits to non-concessional foreign financing, thus providing insulation against global tightening of monetary policy and rising debt interest payments that would further reduce fiscal space for priority sectors. Lower borrowing should also create space for private sector credit and higher investment, which are critical if longer-term growth is to be realised.

Projections demonstrate that sustained growth, poverty reduction, and a move back to a medium risk of debt distress over the next few years is possible – but there are risks. Growth and deficit reduction will reduce the debt-to-GDP ratio over time. Exports have been recovering strongly, so Kenya should not be too affected by rising interest rates in the global economy – unless it falters on fiscal consolidation and relies on foreign financing to bridge the expanded deficit. There is therefore an opportunity for Kenya to reduce its risk of debt distress in the coming years, but this will require sticking to current plans.

Key issues to monitor:

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

- **Whether the government sticks to its fiscal consolidation plan.** In addition to current projections, the incoming government has stated that it intends to cut expenditure in the 2022/23 financial year by a further Kenya shillings (KSH) 300 billion (approximately 10% of the budget) to ease fiscal pressures. Whether this additional austerity is feasible and/or realised is currently a matter of great debate.

- **Whether projected increases to revenue come to pass.** While current medium-term revenue projections appear more realistic than in the past, they are still relatively ambitious. The publication of the Medium-Term Revenue Strategy (MTRS) – including the details of how the government intends to raise tax revenue to 25% of GDP by 2030 – should be monitored.

- **Whether the International Monetary Fund (IMF) downgrades Kenya's risk of debt distress.** The shift to a high risk of debt distress in 2020 was triggered by the deterioration in the ratio of external debt to exports. Exports have been recovering strongly and most of the public external debt is concessional, so Kenya should not be too affected by rising global interest rates. There is therefore a possibility that a reduced risk of debt distress will be signalled in the coming years.

- **The impact of fiscal consolidation on county government finances.** Government plans for fiscal consolidation are set to have a significant impact on the finances of county governments. According to National Treasury projections, county transfers (equitable share) are set to be cut in real terms for at least the next three fiscal years. This should be monitored closely, since, if it is carried through, it will have major implications for service delivery going forward.

- **The evolution of health budgets.** In particular, it will be important to see whether, after the supplementary budget for 2022/23 introduced by the incoming administration, the national government health budget will remain below the 2021/22 level until 2023/24, as legislated by the previous government. It will also be important to monitor the implementation of the National Health Insurance Fund (NHIF) reforms, particularly the increased premiums that are expected to boost the income of the social insurance body.

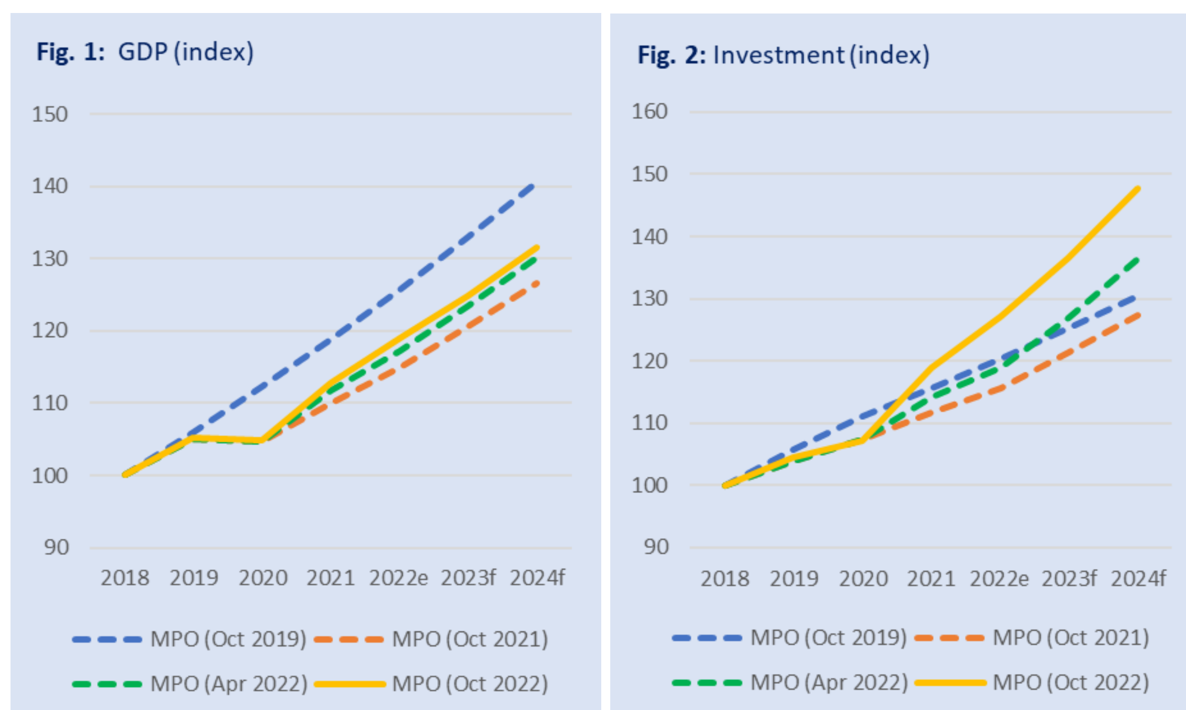
Table 1: Key indicators

(% GDP, except where indicated)	Estimate	Forecast			Extended forecast
Economy	**2021**	**2022**	**2023**	**2024**	**2025**
GDP (US$ billion, 2021 prices)	110.6	116.7	122.5	129.0	135.8
Change in GDP	7.5%	5.5%	5.0%	5.3%	5.3%
Change in agriculture	-0.2%	1.3%	3.8%	4.2%	4.2%
Change in industry	7.2%	3.5%	3.6%	4.3%	4.3%
Change in services	9.5%	7.4%	5.8%	5.9%	5.9%
Change in gross investment	10.9%	70.0%	7.5%	8.1%	8.1%
Change in gross exports	12.9%	6.2%	7.4%	7.8%	7.8%
Current account balance	-5.5%	-6.0%	-5.5%	-5.0%	-5.0%
Fiscal	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25**
Gross revenue	16.4%	17.3%	17.6%	18.1%	18.1%
Gross public expenditure	24.6%	24.6%	22.9%	22.3%	21.9%
Public investment	6.9%	6.7%	5.1%	4.7%	4.2%
Recurrent expenditure (excl. interest)	13.1%	13.1%	13.3%	13.3%	13.3%
Debt interest	4.6%	4.9%	4.5%	4.3%	4.4%
Fiscal balance	-8.2%	-7.2%	-5.2%	-4.2%	-3.8%
Public debt	67.9%	67.8%	66.2%	63.5%	64.4%
Memo items					
Headcount poverty – int'l poverty rate (US$ 2.15 in 2017 purchasing power parity (PPP))	26.7%	25.9%	25.1	24.4	n/a

Source: World Bank Macro-Poverty Outlook (October 2022) and authors' own calculat

1. Macroeconomic Context and Outlook

1.1 The economy – growth, investment, and inflation



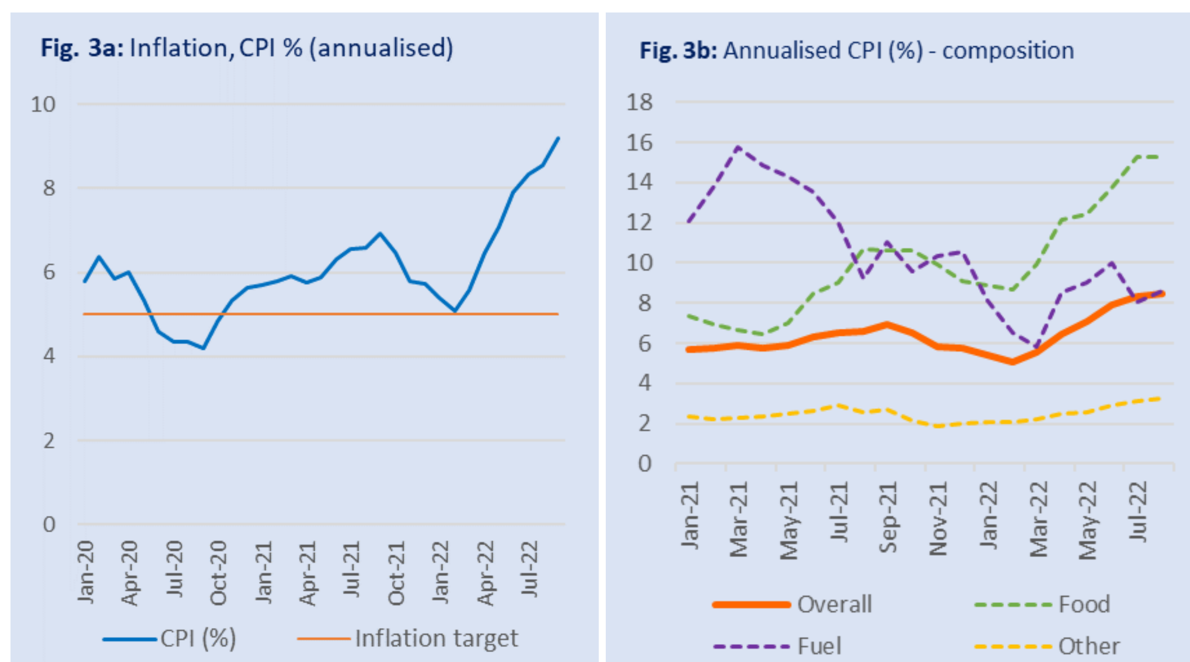
Source: World Bank, Macro-Poverty Outlook (2019–22).

While the COVID-19 pandemic halted growth in 2020, growth has since recovered, although not strongly enough to put GDP back on the pre-pandemic path. Kenya's economy staged a significant recovery in 2021, following the COVID-19 shock, aided by supportive policies, although some sectors remained severely affected.[3] A strong recovery in the services sector, as well in manufacturing and construction, contributed to an economic rebound of 7.5% in 2021, following a contraction of 0.3% in 2020.[4] Due to below-average rainfall, agricultural output, which had been the strongest sector in 2020, contracted by 0.2%.[5] The economy continued to recover in the first quarter of 2022, at a rate of 6.8% (compared to 2.7% growth in the first quarter of 2021).[6] However, real GDP growth in 2022 is projected to moderate back to 5.5% for 2022, due to high energy and food prices caused by global supply constraints, and poor agricultural performance linked to the ongoing drought.

Compared to forecasts made in 2020 and 2021, the outlook for growth and investment now looks slightly better. While GDP is still lower than projected pre-pandemic, recovery was faster than initially predicted, resulting in a better outlook than was apparent in 2020 and 2021 (Figure 1). Furthermore, the level of investment in the economy has overtaken the pre-crisis forecast (correspondingly, the forecast for consumption, Figure 4, falls back again). As a result, according to the World Bank's central projection, Kenya is set for steady growth at 5–6% per annum over the medium term, with a growing share of investment – enough to allow increases in real per capita income and poverty reduction. Nevertheless, GDP has not regained its pre-crisis path, with about a year of growth being lost – seemingly permanently.

Kenya has avoided the very high inflation seen in some African countries, but price rises have picked up rapidly in 2022, reaching almost 10% in October. The global commodity markets shock and the regional drought (affecting 29 counties) have pushed up domestic prices in 2022, particularly for food and energy. Inflation has exceeded the 7.5% upper target set by the Central Bank of Kenya since June 2022, thus resulting in a tightening of monetary policy. This comes at a time when Kenya is under pressure to cut fuel subsidies and non-priority spending. Inflation also goes hand in hand with a depreciation of the Kenyan shilling and, when combined with the tightening global monetary policy, is pushing the cost of (and limiting access to) foreign borrowing (more on this below).

The recent rise in inflation is being driven by a sharp increase in food prices. Food accounts for the largest share of the consumer price index (CPI) basket (over 30%) and therefore is the biggest driver of the overall rate of inflation. Since the beginning of 2022, food inflation has risen sharply, reaching an annualised rate of 15% by August 2022 – higher than all other categories combined (Figure 3b). Fuel inflation has also risen since the start of 2022 (having come down during 2021). Food and fuel constitute around two-thirds of household consumption on average and so largely determine the cost of living for most households. Inflation has eroded household spending power, with recent high-frequency monitoring surveys showing a rise in food insecurity, particularly in rural areas, with over half of households reducing their consumption of food in June 2022.[7] To cushion low-income households from high energy bills and pass-through of imported inflation to food commodities, policy has shifted somewhat towards targeted relief. Such measures include the supply of subsidised fertiliser in areas that expected short rains.



Source: Central Bank of Kenya, Monthly Economic Indicators (August 2022).

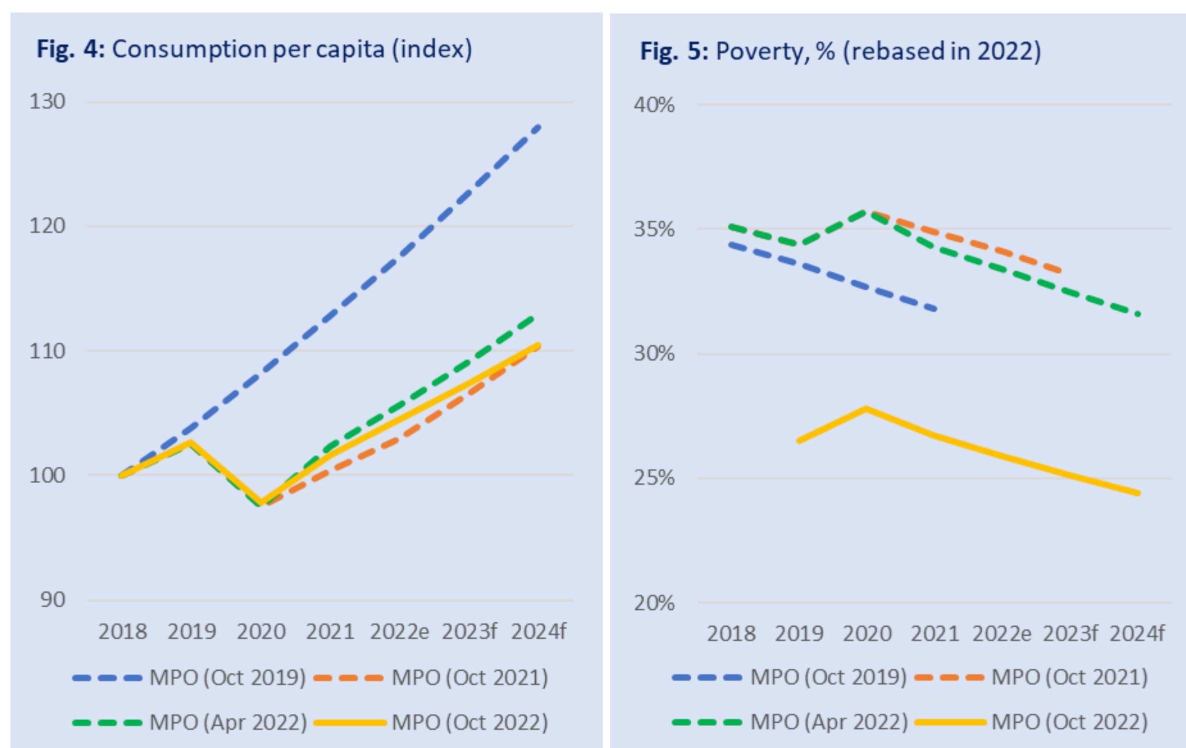
Fiscal consolidation should help to control inflation. As discussed in Section 1.4, in 2022 there has so far been no sign of backsliding on Kenya's long-awaited fiscal consolidation. To some extent this should help control inflationary pressures and strengthen the exchange rate. However, this is only achievable if revenue targets are hit while non-priority expenditures are cut.

Fiscal consolidation will also enable the increased rate of investment. Avoiding debt distress is extremely positive for investor confidence and reduced public borrowing opens up room for faster growth in credit to the private sector, including for investment.

Steady growth should make Kenya's much-needed fiscal consolidation easier – but there are still internal risks. The outlook for Kenya is better than was expected a year ago – there is economic scarring from the pandemic, but growth and poverty reduction have resumed. The main internal risk is that the fiscal consolidation unravels, as it has in previous years. This looks not to be happening so far, but if it does, Kenya will see slower investment and more inflation, and could move towards debt distress.

There are also external risks. The outlook for the global economy is deteriorating in 2022. Inflationary pressures are building, and monetary policy continues to tighten, even as some large economies trend towards recession. This undoubtedly makes strong growth more difficult for Kenya, since it will undercut exports and the tourism sector. Fiscal consolidation should help to protect Kenya somewhat from these risks but is not a fail-safe insurance policy.

1.2 Consumption and poverty



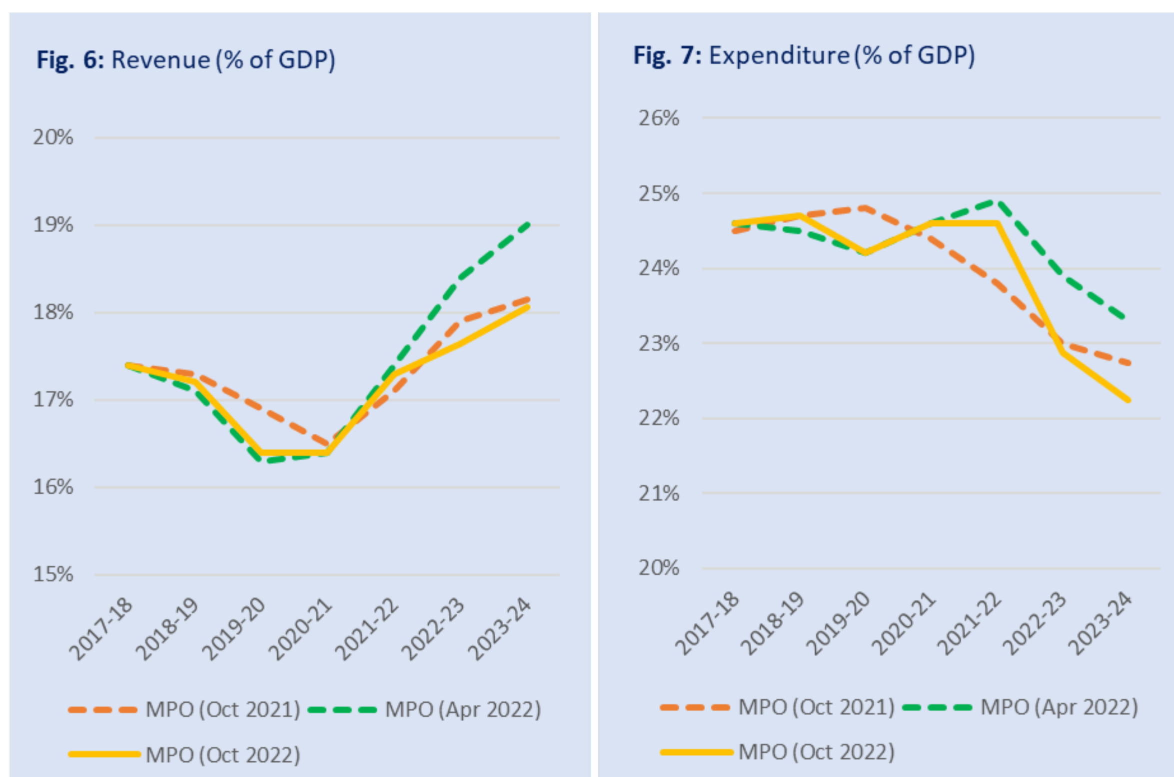
Source: World Bank, Macro-Poverty Outlook (2019–22).

Private consumption per capita fell in 2020 and has been recovering more slowly than investment during the post-pandemic period. As illustrated in Figure 4, by 2024 private consumption is projected to be 14% lower than in the pre-COVID forecast. In contrast, Figure 2 shows that investment is expected to be 13% above the pre-COVID forecast by 2024. Reduced consumption was a consequence of the direct hit to household incomes in 2020 because of pandemic restrictions on economic activity. During the recovery, investment is expected to be strong, partly because of reduced domestic financing by the government (that is, reduced crowding out).

Poverty increased in 2020 but then resumed its downward trend. This indicates that lower-income households closer to the poverty line were disproportionately impacted by the economic restrictions imposed during the pandemic. Many of Kenya's poor and near-poor are employed in the informal services sector, which was severely curtailed during the lockdown. The most recent poverty figures in Figure 5 have been re-based using a different estimate of Kenya's PPP income per capita and a poverty line of US$ 2.15. The trend remains very similar to the April 2022 forecast, suggesting there has been no fundamental change to poverty dynamics.

The data for consumption and poverty show that Kenyans have felt the impact of the COVID crisis quite strongly, but they also represent a rebalancing of the economy in the recovery towards a more sustainable path. Where GDP is set back one year (Figure 1), poverty is set back three years (Figure 5), and consumption is set back three and a half years (Figure 4). These lost years for consumers allow for an increase in the share of investment in GDP, which is good for future growth. This is achieved with a domestic rebalancing, not due to a collapse in foreign financing.

1.3 Revenue and expenditure



Source: World Bank, Macro-Poverty Outlook (2021–22).

Figure 6 shows that Kenya's revenue mobilisation fell below 17% of GDP in 2019/20, for the first time since 2008/09, and stagnated at 16.4% in 2020/21. As GDP also fell in 2020, this represented a fall in the absolute level of revenue in real terms. Part of this was caused by new exemptions and tax reductions designed to cushion businesses and households during the COVID crisis. Economic recovery in 2021/22 has enabled revenues to bounce back to 2018/19 levels, aided by improvements in tax administration, the harmonisation of exemptions, and a reduction in tax expenditures.

The medium-term outlook is for a moderate increase in revenue mobilisation, reaching over 18% of GDP by 2023/24 – a level only achieved once (in 2015/16) over the last decade. The government envisages that this will be achieved through further measures outlined in its MTRS and National Tax Policy. However, specific details of the measures to be implemented remain scant pending publication of the policy.

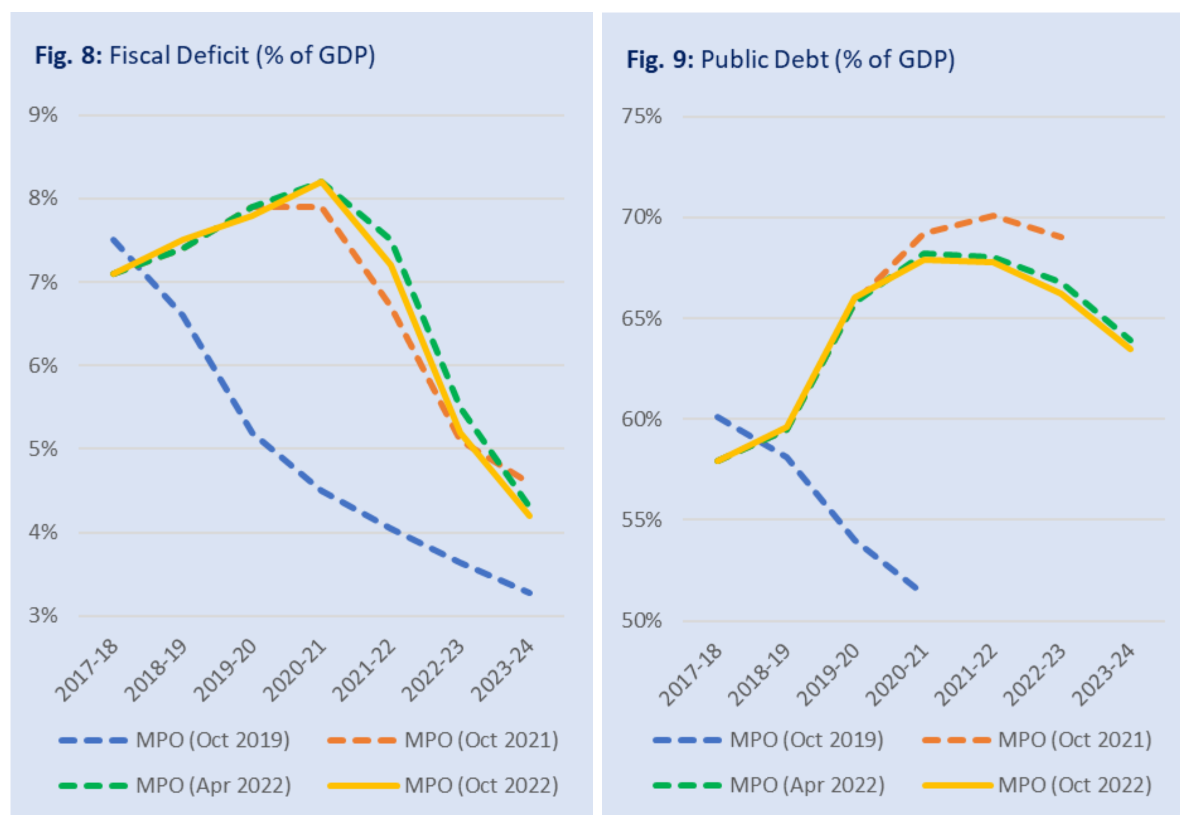
Figure 7 shows that public expenditure also fell slightly as a share of GDP in 2019/20, followed by a real gradual increase in 2020/21. While GDP contracted in calendar year 2020, in fiscal year terms growth was still positive in 2019/20 (2.3%) and 2020/21 (3.6%). This means that while expenditure as a share of GDP fell in 2019/20, real expenditure almost maintained its value. Overall, this still represents a small net fiscal stimulus (because the fiscal deficit was larger than originally planned, driven mostly on the revenue side).

The medium-term outlook involves a reduction in expenditures as a share of GDP. Despite robust projected growth, this will result in stagnant real expenditure over the period and consequently a reduction in spending per capita (see Section 2.2 below). This is even before the KSH 300 billion cut to the 2022/23 budget proposed by the incoming administration is considered. It also comes at a time when the cost of debt service may increase, thus squeezing discretionary spending more than is currently anticipated. On the positive side, the government seems to be more realistic about revenue projection than previously was the case.

These changes would represent a long-awaited fiscal consolidation – but the proposed plans are touching the limit of what is possible without an extremely painful squeeze on fiscal space, assuming there is no setback to growth. There certainly will not be much room for increased spending

in priority areas over the next two years if the plans are kept, but economic stability and progress do require a fiscal consolidation. This could possibly be staggered over an extra year.

1.4 Fiscal balance, debt sustainability, and vulnerability to future shocks



Source: World Bank, Macro-Poverty Outlook (2019–22).

Kenya has been running fiscal deficits of 6–8% of GDP since 2014, during which time public debt has risen from 43% to 67% of GDP, and the country has slipped into a high risk of debt distress. In most of these years, there was a stated intention to bring down the deficit and switch to a more sustainable path. Even prior to 2020 this proved too politically difficult. In 2019/20, there were good reasons to increase the deficit, although there was hardly any room to do so. Consolidation was postponed again in 2020/21 as the economy recovered from the COVID-19 shock.

There is now a more credible signal of commitment to fiscal consolidation. There is nothing new in the stated intention to reduce deficit, but it now seems like action is finally being taken. The fiscal deficit in 2021/22 was lower than in previous years (and lower than originally planned – see Section 2 below) and the incoming administration has pledged to bring Kenya 'back to sanity' by ordering a 10% cut to the 2022/23 budget.[8] Whether this is implemented, and whether further restraint on expenditure in 2023/24 and beyond can be delivered, remains to be seen. Current projections indicate that per capita expenditure will remain stagnant over the medium term, which may be politically difficult, but a growing economy makes it more feasible than otherwise.

A lot hinges on implementing this fiscal consolidation. If the authorities falter in the deficit reduction plans, Kenya may face higher inflation, high bills for foreign financing, and reduced private sector credit and investment. Kenya's debt level has already led to rating agencies elevating the country's risk level, and borrowing costs are rising with the rise in global interest rates. This leaves the government with few options but to cut expenditure and enhance revenue mobilisation.

The World Bank projection shows a way towards sustained poverty reduction and growth, and a shift back to a medium risk of debt distress, over the next few years. Growth and deficit reduction will reduce the debt-to-GDP ratio over time. Kenya's shift to a high risk of debt distress in 2020 was

triggered by the deterioration in the ratio of external debt to exports (indicating a decreasing capability to repay external debt). Exports have since been recovering strongly and most of the public external debt is concessional, so Kenya should not be too affected by rising interest rates in the global economy. Therefore, there is a good chance that a reduced risk of debt distress will be signalled in the coming years.

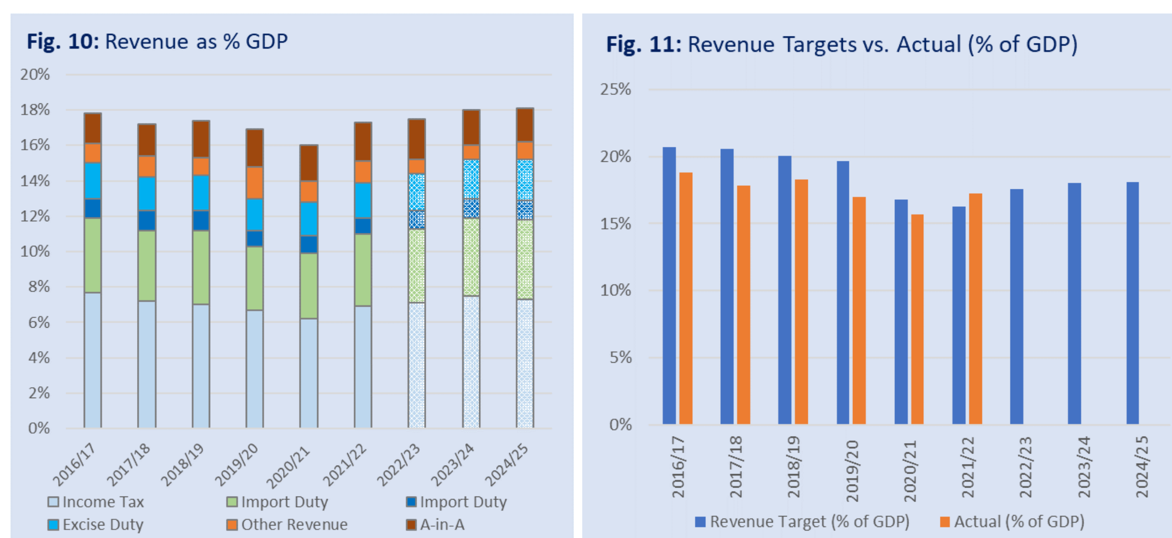
2. Revenue and Expenditure Update

2.1 Revenue

Revenue performance rebounded in 2021/22 and exceeded the target for the first time in several years – but remained slightly below pre-pandemic levels. Revenue increased from 15.7% of GDP in 2020/21 to 17.3% in 2021/22 (Figure 10). This was supported by the unwinding of temporary tax measures as the economy rebounded from the relaxation of economic restrictions imposed during the pandemic but remained below pre-crisis levels. Income tax and value-added tax account for most of the tax revenue, at 6.9% and 4.1% of GDP, respectively. However, the share of income tax has gradually declined from 8.4% in 2015/16 to 6.2% in 2020/21, which is attributable partly to an expanding informal sector. The share of informal sector employment has increased from 81.6% to 83.2%, while the share of the formal sector employment declined correspondingly from 18.4% to 16.8%, between 2015 and 2021.[9]

Government projections suggest further growth in revenues at above 18% of GDP in the medium term (Figure 11). This will be supported by development of the MTRS, which will seek to raise tax revenue to 25% of GDP by 2030, by increasing compliance and enhancing collaboration between the citizenry, civil society, county governments, and ministries, departments, and agencies. The government also envisages that the MTRS will ensure the certainty of the tax system, as indicated in the draft National Tax Policy. Nonetheless, publication of the MTRS will shed a light on the government's revenue enhancement strategies and its implications for budget execution.

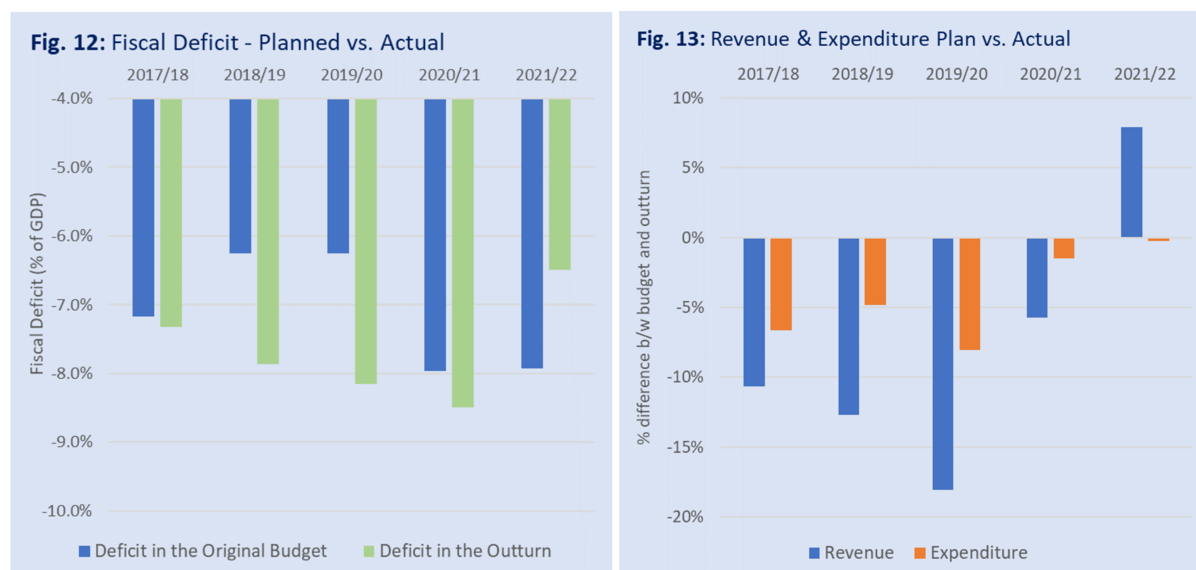
A review of revenue projections shows that Kenya has historically over-projected revenue – but this changed in 2021/22. In the past, revenue projections have been driven by the desired level of expenditure and a fiscal deficit target, rather than a realistic estimation. However, there now appears to be renewed emphasis on making revenue projections more credible: since 2020/21, projections have been much more conservative and this even resulted in outperformance in 2021/22. Over the medium term, revenue is projected to be around 18% of GDP – achievement of which will still challenging, but much more credible than in the past.



Source: Government of Kenya (GoK) Budget Review and Outlook Paper (BROP) reports (2016–22).

Fiscal deficits have been high and unsustainable, with revenue optimism contributing to above-target outcomes. The fiscal deficit declined from 8.5% of GDP in 2020/21 to 6.5% in 2021/22 – lower than the pre-pandemic levels (Figure 12). This was largely due to revenue being significantly above-target,

rather than expenditure being lower than planned. This is a reversal of previous experience, where revenue under-performance drove higher fiscal deficits in the absence of expenditure restraint. Current revenue targets for the medium term seem reasonable (Figure 11) but it will be important to monitor whether these are revised upwards during budget preparation, as has happened in the past. Recent difficulties in raising affordable financing appear to have forced the government's hand in making fiscal projections more realistic, suggesting that consolidation plans are more credible than in the past.[10]



Source: GoK BROP reports (2016–22).

Kenya's tax expenditures have progressively declined over the past five years, falling from 4.8% of GDP in 2017 to 2.2% in 2021, but they remain significant. Domestic Value Added Tax (VAT) accounts for the largest share of the tax expenditures, accounting for 82.3% of the total. This is alarming given that a significant number of exempt and zero-rated goods and services in the First and Second Schedules of the VAT Act 2013 are treated as part of the benchmark tax system. Further, there are increasing concerns about the efficiency and effectiveness of Kenya's tax expenditure. Lack of disaggregated information on tax expenditures makes it hard to evaluate their impact on investment and social welfare. As part of its reforms of tax policy, the government, in the draft National Tax Policy, indicates that it will develop a criterion for granting tax exemptions, as well a monitoring and evaluation framework for tax incentives. Such a commitment from the government is likely to address past concerns about the efficiency and effectiveness of tax expenditures, especially in regard to meeting the government's policy goals. To date, the government has not produced any report that provides evidence on the impact of its generous tax incentives on the economy.

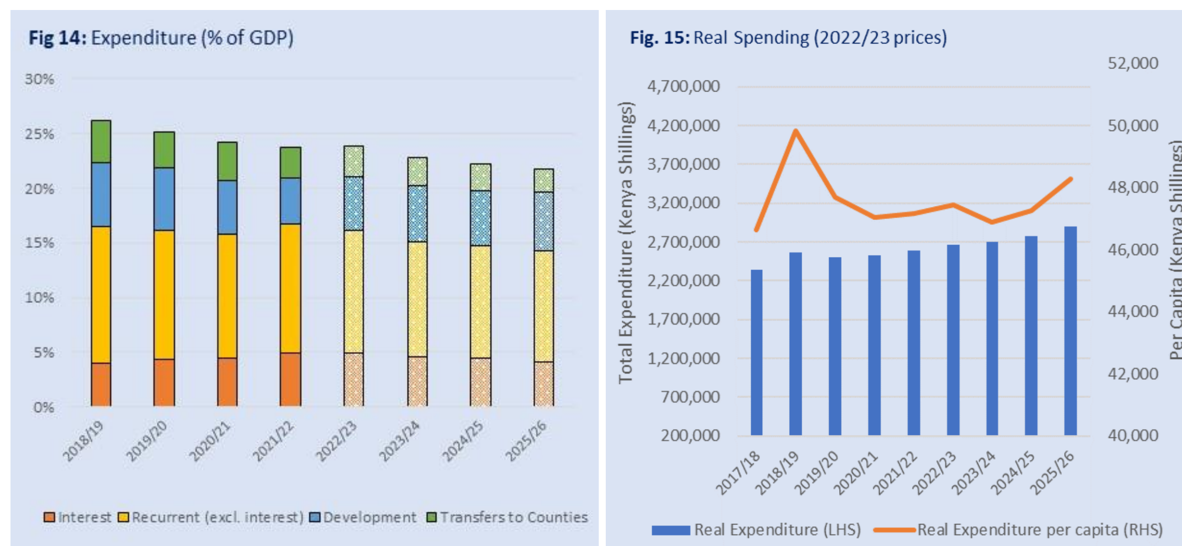
County governments continue to rely heavily on equitable share (money allocated vertically by the parliament between the national and the county governments) from the national government, with sub-optimal performance in their own-source revenue. This overreliance on equitable share has negatively affected service delivery, especially whenever there are delays in disbursing funds from the exchequer. According to a report by the Commission on Revenue Allocation (CRA), counties have the potential to collect KSH 260.6 billion, up from the KSH 35.9 billion collected in 2021/22. Key revenue streams that could support enhanced revenue mobilisation by counties include property rates, parking fees, outdoor advertising, and cess fees.[11] Even with dismal performance in own-source revenues, counties have consistently spent more than 35% of their revenue on salaries and wages, contrary to the provisions of the Public Finance Management (PFM) Act, 2022. Also problematic is the over-emphasis on public hospitals as a source of revenue, which contradicts the government's policy of attaining universal health coverage (UHC). To increase own-source revenue collection, counties need to automate their revenue administration system and set revenue targets that are commensurate with their revenue potential, as recommended by the CRA.

2.2 Expenditure

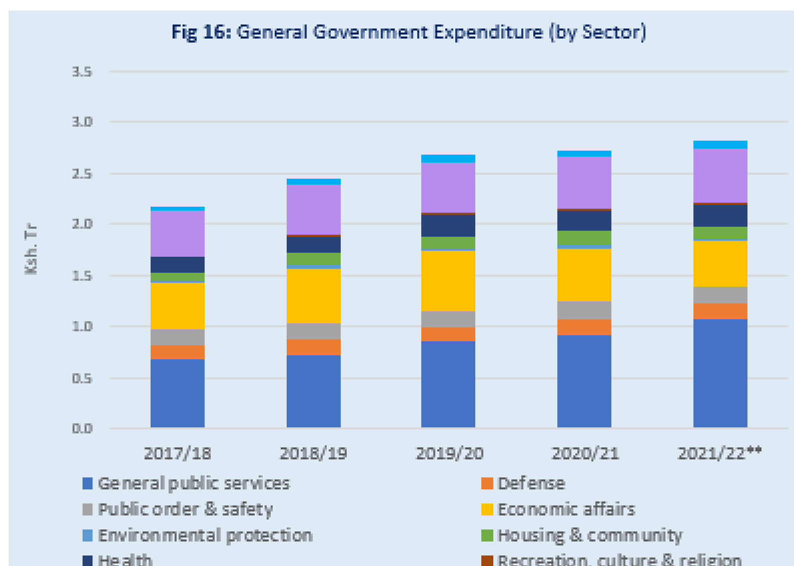
Public expenditure as a percentage of GDP has been on the decline in recent years, resulting in a decline in per capita real expenditure. While growth in the economy has meant this relative decline in spending has not translated into significant real expenditure cuts in absolute (monetary) terms – real expenditure has been stagnant since 2018/19 – it has resulted in a fall in *per capita* real expenditure (minus interest payments) that will not be reversed until at least 2024/25 (see Figure 15). As noted in Section 1, the government is operating under tight fiscal constraints, following several years of expenditure growth prior to the pandemic, and is now projecting further relative declines in spending over the medium term, to bring fiscal deficits down below 4% of GDP by 2025.

Government projections indicate relative cuts in recurrent spending and transfers to counties, but it remains unclear whether this is feasible. Over the past four fiscal years, development expenditure has been on the decline, interest payments have risen, and recurrent expenditure has been constant. The government forecast shown in Figure 14 indicates that, over the medium term, transfers to the counties as a percentage of GDP will fall (from 2.9% in 2022/23 to 2.2% in 2025/26), recurrent expenditure will fall (from 16.2% to 14.3% over the same time period), while development expenditure will remain constant at around 5% of GDP. This reversal in the trend is an issue that should be monitored, because recurrent expenditure and transfers tend to be more difficult to cut than capital expenditure, and may have significant impacts on service delivery at the sub-national level (e.g. for health).

As part of the fiscal consolidation process, a sluggish rise in real expenditure is recorded, while real per capita spending is expected to bounce back to the pre-COVID level only in the longer term. As illustrated in Figure 15, real per capita spending (excluding interest payments) peaked in 2018/19, just before the pandemic began – since then it has declined (although not too dramatically), as the fiscal squeeze has taken hold. While per capita spending should increase from 2024/25 onwards, it will take several years to reach the previous levels of 2018/19 (assuming current fiscal plans are implemented as planned).



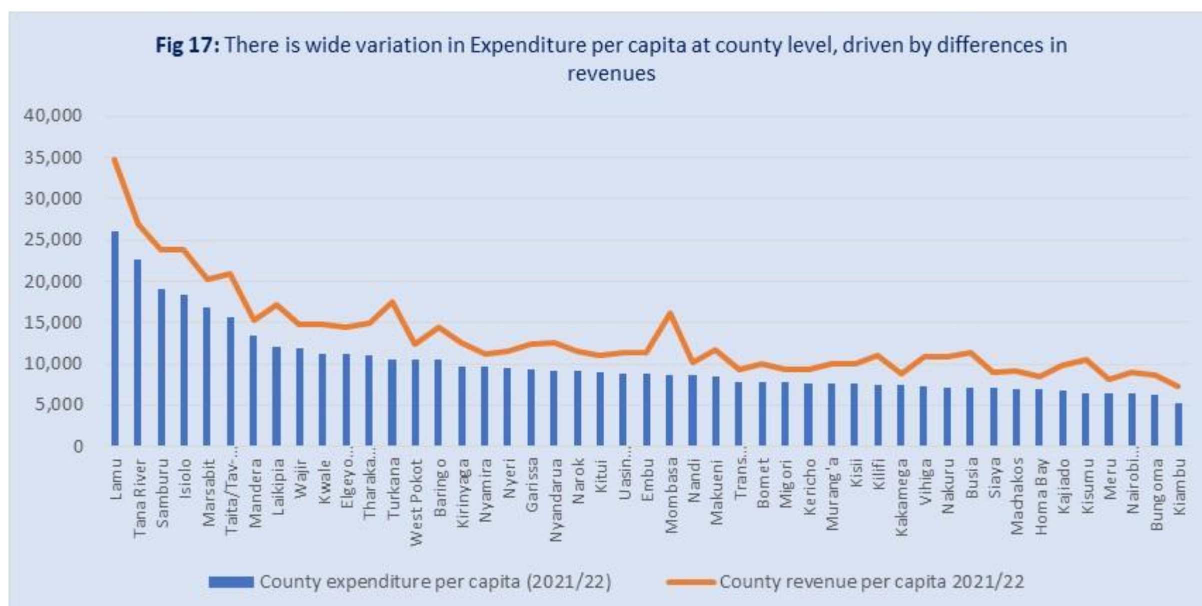
Source: GoK BROP reports (2016–22); World Bank World Development Indicators (deflators and population projections). Figure 15 presents spending figures in 2022/23 prices (excluding interest payments).



Source: Economic Survey (2022). **Provisional

Since 2017/18, the composition of public expenditure has been relatively stable – the most significant change being the expansion in 'general public services' (which includes debt interest payments). Notably, government spending on health shows a marginal increase, but it still remains far from the aspirational goals of the Abuja Declaration that envisages committing at least 15% of the national budget to health.

Analysis of the period since 2017/18 further reveals stark differences in per capita spending and revenue among the counties, while counties with huge revenue potential lag. Populous counties have lower per capita spending than marginalised counties with smaller populations. A similar trend is observed in per capita revenue, where counties such as Nairobi and Kiambu with huge revenue potential lag in revenue per capita. In the current revenue sharing formula, the population parameter has a weight of 18%, while the remainder is determined by other parameters, including health index, agriculture index, and poverty index. The noted differences in county per capita spending highlights the need to review the formula as counties enhance their own-source revenue mobilisation strategies to increase per capita revenue.



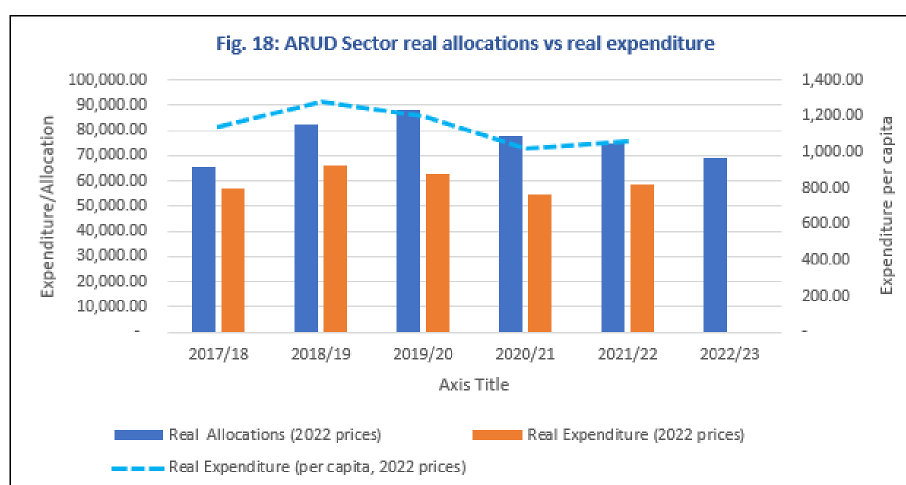
Source: County Budgets Implementation Review Report (CBIRR) (2022).

2.3 Sector zooms

Agriculture

The share of the agriculture budget within the total national budget in 2021/22 declined to 3.2%. At the same time, the budget share to the agriculture sector by both levels of government (county and national) dropped to 4.2% in FY 2021/22, from 5.4% in 2020/21. Considering the 10% minimum allocation to the agriculture sector agreed under the Comprehensive African Agricultural Developed Programme (CAADP), dubbed the Maputo Declaration, Kenya failed to hit even half of that allocation in 2021/22.

On average, a third of the budget to the agriculture sector has not been utilised between 2018/19 and 2021/22, while execution at the county level is about a half (see Table 2). This is despite the sector accounting for 22.4% of GDP in 2021.[12] Low budget execution continues to be a hinderance to the establishment and restructuring of agricultural financing institutions, passing them to the devolved governments. To date, agricultural finance institutions are still wholly owned by the national government. Other programmes negatively impacted by low budget execution include crops, livestock, and fisheries commodity insurance funds, with the Livestock Insurance Programme only covering two counties (against a target of 12 counties). Although county governments have committed to allocating at least 10% of their overall budget to crops, livestock, and fisheries investment, this will not be achieved if budget execution is not addressed.



Source: OCOB Reports

Table 2: Agriculture sector budget execution

	2018/19	2019/20	2020/21	2021/22	Average
National government	80%	71%	71%	78%	75%
Recurrent	95%	59%	91%	83%	82%
Capital	69%	80%	52%	75%	69%
County governments	63%	61%	35%	58%	54%
Recurrent	84%	84%	57%	85%	77%
Capital	52%	52%	26%	48%	44%
Total execution	72%	67%	55%	71%	66%
Recurrent	90%	68%	79%	72%	77%
Capital	61%	66%	38%	64%	57%

Nutrition

Kenya frequently experiences natural calamities, such as droughts and floods, which disrupt the health and nutrition of vulnerable groups, such as children, lactating mothers, and older persons. This has prompted the government to put in place contingency measures for specific hazards, but the country continues to face severe food insecurity and malnutrition. According to the UNICEF report, the number of people facing food insecurity has increased from 3.1 to 3.5 million people over the period February-July 2022.[13] Under the Big Four Agenda plan, the government targeted a reduction in malnutrition of children under five by 27% by the year 2022.[14] However, this has not been achieved, due to the ravaging effects of drought caused by the cumulative impacts of consecutive failed seasonal rains affecting almost half of counties. Achievement of this ambition has also been affected by the COVID-19 pandemic, higher food prices, and the army worm invasion, which caused below-average crop production in 2022.

Undernutrition (including micronutrient deficiencies), obesity, and diet-related non-communicable diseases remain a burden in Kenya. Nutrition International has been working with counties, providing technical assistance in formulating action plans and policy documents. The organisation has provided donor funding to 20% of the counties in Kenya, towards strengthening the county nutrition plans, contributing 0.3% of the total county budgets for nutrition.[15]

Water, sanitation, and hygiene (WASH)

In 2021/22 the Ministry of Water, Sanitation and Irrigation made significant strides in development spending, accounting for 11% of total national development expenditure, as compared to FY 2020/21, where it had the lowest ministerial spending on development.[16] As in the previous financial year, the ministry accounted for the bulk of the Environmental Protection, Water and Natural Resources Sector budget in 2021/22, at 76.3%.[17] Significantly more Kenyans have access to safe drinking water (59%) than to basic sanitation (29%). Since 2000, access to safe drinking water has increased by 12%, while access to basic sanitation has fallen by 5%. Further, 9.9 million people in Kenya drink directly from contaminated surface water sources, and an estimated 5 million people practise open defecation, while 15% of Kenyans rely on unimproved water sources, such as ponds, shallow wells, and rivers, and 41% of Kenyans lack access to basic sanitation solutions. Only 25% have hand-washing facilities with soap and water at home. The summary statement of appropriation reflects the fact that the ministry still experiences under-funding, and this may impact negatively on the delivery of services to the public. Both state and non-state actors can collaborate to establish water points, including having central large water tanks and water boozers to supply clean water to the target populace.[18]

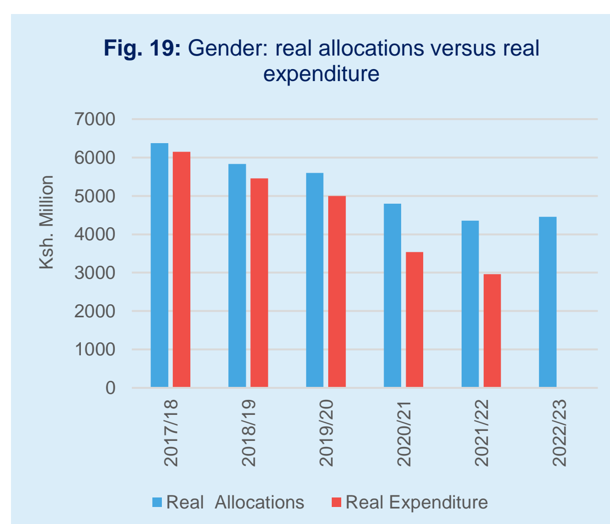
Recent healthcare facility assessments in Kenya have highlighted very low access to soap and water and functional toilets, especially for people with limited mobility. Three of the assessed needs (soap and water at toilets, functional toilets for handicapped laboratory patients, and grab bars on walls) were available in just 7% of healthcare facilities. However, in Kenya 40% of healthcare facilities had at least one area where services could be provided to a person in a wheelchair.[19]

According to the WHO/UNICEF Joint Monitoring Programme, the availability of data on WASH has significantly risen. This improvement is based on availability of all five basic WASH services (water, sanitation, hygiene, waste management, and environmental cleaning) that are measurable in Kenya. Even though, this can be improved further by enhancing data collection, analysis and reporting, in line with the devolved mandate for WASH services. Key sector data available for Sustainable Development Goal 6 reporting emanate from counties and are aggregated at the national level.[20]

Gender

Real expenditure by the State Department for Gender declined by 41% between 2019/20 and 2021/22, which corresponded to a 23% decline in the budgetary allocation over the same period. As observed, real allocation to, and expenditure on, gender have decreased over the years, with expenditure declining to as low as KSH 3 billion in FY 2021/22. In the same fiscal year, community development and gender empowerment programmes accounted for KSH 2.19 billion and KSH 1 billion, respectively, of the department's total expenditure. Even with the reduced budgetary allocation, effectiveness in budget execution has been declining. The department's absorption rate gradually declined from 89% to 68% between 2019/20 and 2021/22. Nonetheless the State Department for Gender reports that it realised most of its the planned outputs for the 2018/19–2021/22 period, including distribution of funds to youth, women, and people with disability groups through the Uwezo and Women Enterprise funds.[21] Additionally, 4,853 important actors have received training on female genital mutilation concerns, while 74,359 persons have received training on gender-based violence prevention and response. Budgetary allocation to the State Department for Gender was retained at the same level in 2022/23 as in 2021/22, which is inadequate to meet the financing needs of the department. In addition, little progress has been made on the implementation of gender-responsive budgeting, which limits the possibility of assessing the impact of fiscal policy on gender equity and equality.[22] Kenya receives a significant amount of gender aid from international donors. Data from the Organisation for Economic Co-operation and Development (OECD) Creditor Reporting System (CRS) show that there has been increasing official development assistance (ODA) disbursement towards gender-related programmes. The gross disbursement to women's rights organisations, movements, and government institutions, and to ending violence against women and girls, significantly increased from US$ 4.6 million in 2019 to US$ 5.1 million in 2020 (a 12% increase), and from US$ 3.8 million in 2019 to US$ 4.7 million (a 22% increase), respectively.

Fig. 19: Gender: real allocations versus real expenditure



Kenya improved in its ranking, from 95 to 57, out of 146 countries globally, in the 2022 Global Gender Gap Index, with an overall score of 0.729. Economic participation and opportunity, educational attainment, health, and survival scores remained consistent from the previous year, while the political empowerment score declined by 0.001%.[23] The COVID-19 pandemic resulted in significantly more women (20%) than men (12%) losing their salaries due to loss of jobs and other sources of income. Women's mental health declined at a 60% rate, compared to 56% for men. In addition, although 76% of women and 24% of men encouraged their children to continue learning from home during the pandemic, more girls than boys (34% of rural and 28% of urban) did not. Moreover, the closure of schools due to the pandemic led to a rise in early teenage pregnancies and marriages, increased gender-based violence cases, and an aggravated school dropout rate, especially among girls. The most prevalent forms of violence were physical violence (23% and 21% in urban and rural areas, respectively), sexual harassment (19% and 16% in urban and rural areas, respectively), child marriages (15% and 20% in urban and rural areas, respectively), and female genital mutilation, especially in rural areas.[24]

PFM performance

Kenya's PFM system still faces critical weaknesses, according to the latest Public Expenditure and Financial Accountability (PEFA) report of 2019. In this report, Kenya scored an A for its macroeconomic and fiscal forecasting and a B for its fiscal strategy. The former score was a result of Budget Policy Statement (BPS) containing forecasts of key macroeconomic parameters and the National Treasury conducting fiscal sensitivity analyses that are updated at least once a year. In terms of efficiency in approval

of the draft budget, legislative scrutiny of budgets scored a B+. However, the Open Budget Survey (2021) delivered a low budget transparency score of 50% because of delayed audit reports. It therefore calls for the need to enhance budget transparency from its low score of 50% to at least 70%, which can be achieved through expediting audit reports.

Capacity constraints have continued to hinder the PFM reform agenda, including the Medium-Term Plan 2018–2022 and institutional framework harmonisation. There has been an increase in the cost of domestic debt service and in the debt-to-GDP ratio, while fiscal space for delivering MTP priorities is limited. Even though the National Treasury's Strategic Plan for 2018–2022 proposed corrective measures to address the problem of service prioritisation, there is a need to adopt recommendation by PEFA that champions transparency, accountability, equity, fiscal discipline, and efficiency in the management and use of public resources for improved service delivery and economic development.

Kenya's public finance systems are generally inelastic with regard to responding to emergencies, as experienced during the COVID-19 pandemic. The PFM Act 2012 (sections 110 to 114) states that counties must establish county emergency funds that contain resources carried forward from previous years, as well as allocations from their current year's budget. However, there is increasingly weak coordination between the executive government and the county governments, which makes it easy to divert funds from development expenditure, as experienced during COVID-19 pandemic budget re-allocations. The Presidential Address on Enhanced Measures in Response to the COVID-19 Pandemic on 6 April 2020 confirmed that approximately KSH 216 billion allocated for development expenditure were re-allocated to the emergency kitty as the government shifted resources to the fight against COVID-19. This shows that, with no clarity on allocations to the emergency kitty, both the national government and county governments often resort to supplementary budgets and reallocating of monies meant for development projects, thus resulting in upward pressure on fiscal budgetary allocations.

3. Aid Update

ODA has been on a fluctuating trend between 2016 and 2020. Declines were experienced in the years 2016 and 2018, while there was an increase in total ODA disbursement in the years 2017, 2019, and 2020, of 12%, 21%, and 24%, respectively (Table 3). The increase was because of expanded assistance to the education sector, health sector, WASH, production, and the humanitarian sector. Notably, programme assistance had the highest increase in allocations from 2019 to 2020, with the bulk of this growth sector being attributed to the budget support. The most significant declines were experienced in the economic infrastructure and services sector, and the multi-sector (general environment protection and other cross-cutting aid), which saw declines of 29% and 31%, respectively. This raises concerns about whether the government has opted for alternative means of financing development-related endeavours, or whether these declines point to a wavering commitment towards these sectors.

ODA flows are expected to decline over the medium term to offset the significant amount of ODA received to fund the COVID-19 response. This is explained by the fact that some of the disbursements of the pandemic response funds were made possible by bringing forward allocations for future years.[25] The World Bank was the largest donor in 2020 and over the entirety of the period between 2016 and 2020. As shown in Table 3, ODA from France increased the highest, by 79.4%, while ODA from the UK declined by 35.6%, from 2019 to 2020. The health sector accounted for the highest proportion of ODA, at 25% between 2016 and 2020, followed by economic infrastructure and services, at 21% (Figure 20). There is a need for the government to shift from donor reliance and to develop a domestic resource mobilisation strategy for health financing. This is critical for the successful implementation of the UHC programme that was recently rolled out nationally, as well for bridging the gaps that exist in the health sector that were exposed by the COVID-19 pandemic.

Table 3: ODA disbursements by donor

Donor	2016	2017	2018	2019	2020	% change from 2019	% of total ODA 2020	2016–2020 total	% of total 2016–2020
United States	871	909	860	697	684	-1.86%	15.02%	4,020	23.46%
World Bank	480	607	768	1,536	1,717	11.78%	37.70%	5,108	29.81%
IMF	..	..	..	..	756		16.60%	756	4.41%
Japan	170	174	235	299	222	-25.79%	4.87%	1,100	6.42%
Agence Française de Développement	212	209	191	92	63	-31.90%	1.37%	767	4.48%
United Kingdom	193	219	163	183	118	-35.57%	2.59%	876	5.11%
Germany	96	134	97	95	105	10.52%	2.30%	526	3.07%
France	96	82	115	135	242	79.38%	5.31%	670	3.91%
Sweden	54	63	54	51	53	3.43%	1.16%	275	1.61%
Global Fund	114	177	87	117	124	5.63%	2.72%	620	3.62%
Other	492	539	459	455	471	3.58%	10.35%	2,416	14.10%
Official donors, total	**2,778**	**3,112**	**3,031**	**3,659**	**4,554**	24.43%	**100.00%**	**17,135**	**100.00%**
% change in total ODA disbursement	**-5.96**	**12.01**	**-2.6**	**20.73**	**24.43**				

Source: OECD CRS.

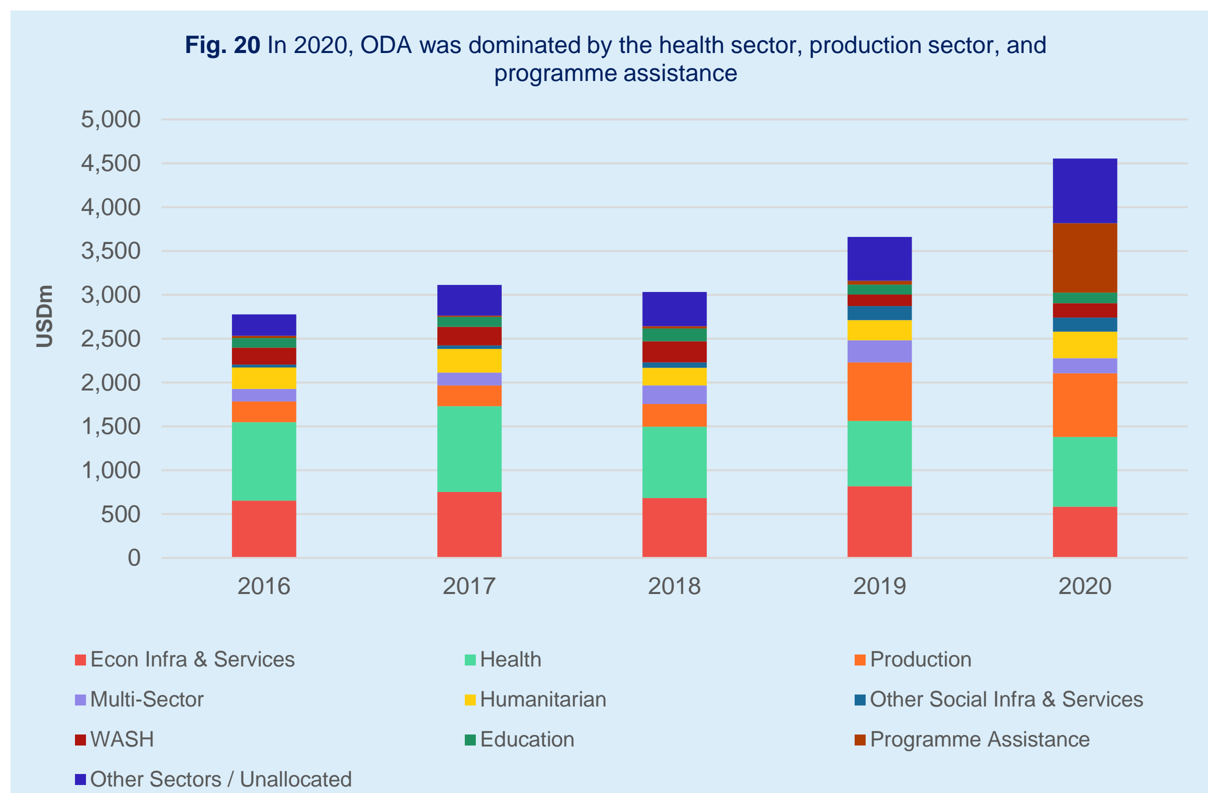


Fig. 20 In 2020, ODA was dominated by the health sector, production sector, and programme assistance

Source: OECD CRS.

4. Health Drill-Down

According to the National Health Accounts data, government expenditure and households' out-of-pocket (OOP) expenditure are the main sources of finance for the health sector, providing about two-thirds (66%) of the health sector funding in Kenya.[26] Government and OOP expenditure on health averaged 44% and 24%, respectively, for the period 2015 to 2019. External and private finance accounted for 19% and 13%, respectively. Total government health expenditure averaged 2% of GDP and 7.6% of general government expenditure.

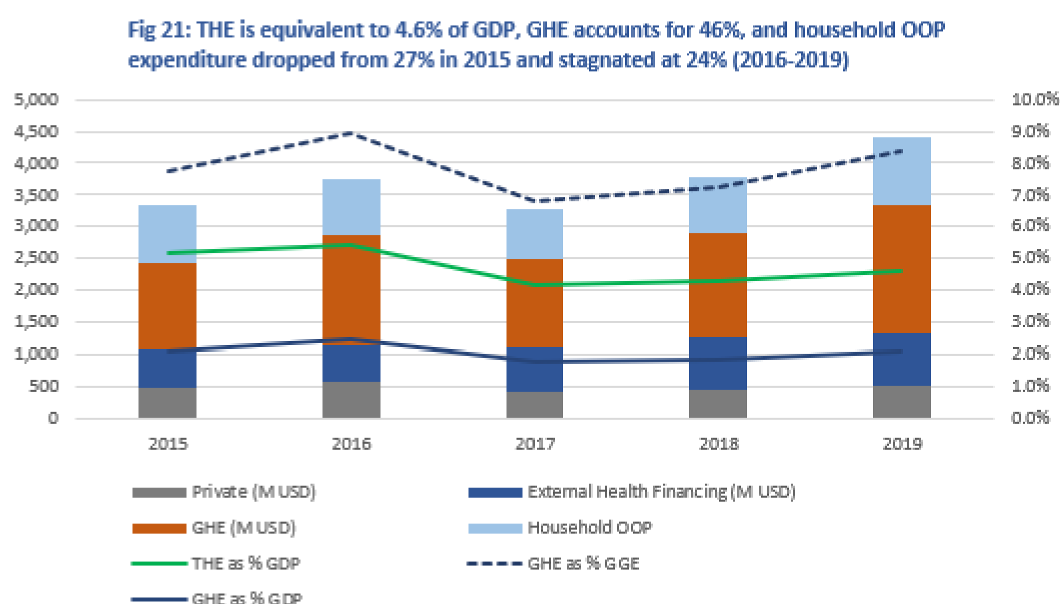


Fig 21: THE is equivalent to 4.6% of GDP, GHE accounts for 46%, and household OOP expenditure dropped from 27% in 2015 and stagnated at 24% (2016-2019)

Source: WHO Global Health Expenditure Database (GHED)

Households' OOP has been on a downward trend, declining from a high of 32% of total health expenditure in 2012, and has since stagnated at 23% and 24% for the four-year period from 2016 to 2019. The initial reduction in households' OOP implied the protection of citizens from catastrophic and impoverishing effects of OOP healthcare payments; however, this positive sign is diminishing. The nominal increase in OOP per capita spending from US$ 18 in 2018 to US$ 22 in 2019 increases the risk of people being pushed into poverty because of unexpected illness that requires them to use up their life savings, sell assets, or borrow.[27]

Official health funding (government and external funds) has increased in recent years but still did not meet international norms for achieving UHC in 2018 and 2019. Per capita official health funding for Kenya stood at US$ 57 in 2019 (US$ 41 from GoK plus US$ 16 from donors), having increased from US$ 55 in 2018 (US$ 40 from GoK plus US$ 15 from donors). This is still below the international official health funding benchmark of US$ 86 per capita that is required to achieve UHC, as recommended by McIntyre and Meheus (2014).[28]

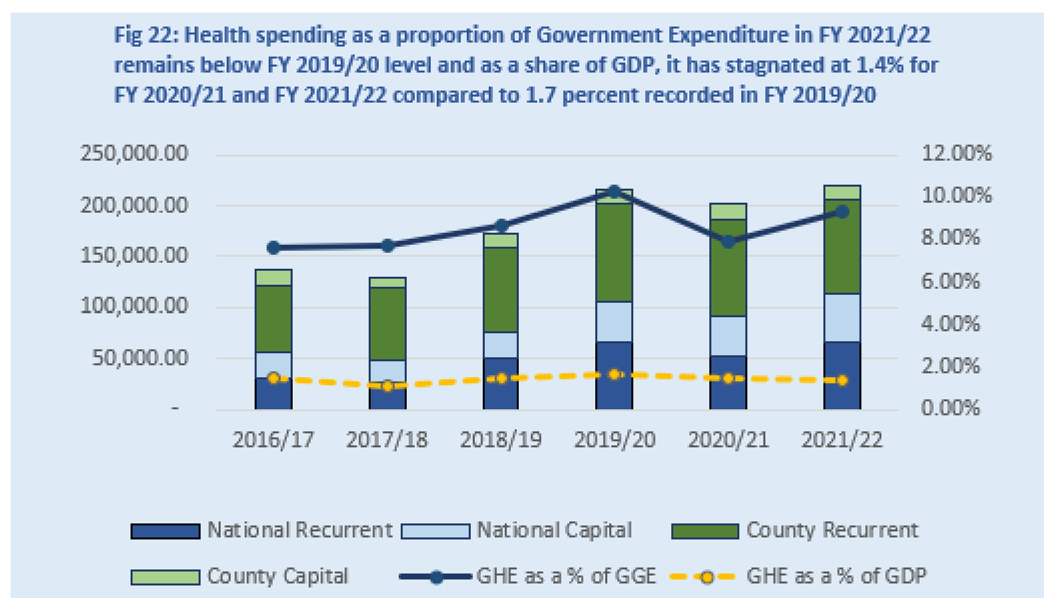
Analysis of health expenditure at national and sub-national levels[29] shows low execution of county capital budgets, averaging 56% for the period 2017/18 to 2021/22, and national capital at 74% for the same period. On average, only 81% of total health expenditure is spent, as compared to the budget. This is a relatively low execution rate and is partially explained by constraints on revenue performance and cashflows at both levels of government, delays in fiscal transfers from the national government to counties, and huge pending bills, among others.

Post-COVID consolidation is observed in the current budget (2022/23), where there is an 11% decline in the approved budget in real terms from KHS 138,427 million approved in 2021/22 to KHS 122,519 million approved for 2022/23. The budget cut only affects the recurrent budget, which declined by 24%, while the capital budget increased by 1%. Given the trend of a low execution rate for the capital budget, the 2022/23 budget execution does not seem to be better than in previous years.

Table 4: Budget Allocations and Expenditure in Real Terms- 2022 prices

KES Million	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23 (Budget)	Average Execution rate (%) 2017/18-2021/22	2021/22 Per capita Allocation	2022/23 Per capita Allocation	Change in allocations (2021/22-2022/23)	Change in per capita allocations (2021/22-2022/23)
TOTAL Health Budget	232,103.51	268,604.78	293,702.82	271,549.88	273,140.59			4,966.19			
National	96,775.61	115,107.09	141,272.42	125,390.49	138,427.73	122,519.25		2,516.87	2,179.02	-11%	-13%
Recurrent	49,529.25	66,215.21	89,692.86	72,348.35	70,726.83	54,016.25		1,285.94	960.69	-24%	-25%
Capital	47,246.37	48,891.89	51,579.55	53,042.14	67,700.89	68,503.00		1,230.93	1,218.33	1%	-1%
County	135,327.90	153,497.69	152,430.40	146,159.39	134,712.87			2,449.32			
Recurrent	109,517.58	121,296.96	123,202.54	116,022.67	108,926.88			1,980.49			
Capital	25,810.32	32,200.72	29,227.86	30,136.72	25,785.99			468.84			
Total Health Expenditure	166,735.35	213,782.74	254,014.28	226,679.90	233,116.10		81%				
National	61,146.48	95,381.56	124,236.66	103,198.12	120,866.96		81%				
Recurrent	35,760.64	63,220.53	78,561.82	58,512.37	69,474.10		87%				
Capital	25,385.85	32,161.03	45,674.84	44,685.75	51,392.86		74%				
County	105,588.87	118,401.18	129,777.62	123,481.78	112,249.14		82%				
Recurrent	91,402.50	101,576.89	113,000.70	104,902.73	98,293.45		88%				
Capital	14,186.37	16,824.28	16,776.92	18,579.06	13,955.69		56%				
Execution Rate (%)	71.84%	79.59%	86.49%	83.48%	85.35%						

Source: BROPs (2017–22), Economic Survey 2022, BIRR reports, QEBR FY 2021/2022, approved 2022/23 PBB. Note: County budgets for 2022/23 are not yet available. Note: BROP denotes Budget Review and Outlook Paper, BIRR denotes Budget Implementation Review Report, QEBR denotes Quarterly Economic and Budget Review and PBB denotes Program Based Budget.



Source: Office of the Controller of Budget reports and BROP.

The budget for 2021/22 allocated KSH 45 billion (0.4% of GDP) for COVID-related spending. This included KSH 14.3 billion for vaccines roll-out, KSH 7.6 billion to enhance access to affordable medical care, and KSH 23.1 billion for the economic stimulus programme to cushion vulnerable groups. In addition, tax relief was offered on various pharmaceutical products and items of medical equipment.[30]

The Primary Healthcare Strategy 2019 identifies a lack of financing for primary healthcare as a critical gap that requires urgent intervention, noting that only 11% of the population has health insurance cover. The solution proposed to reduce OOP spending is to increase health insurance coverage and make insurance more focused on primary healthcare and UHC needs.

Forward projections indicate that, in real terms, the national government health budget will remain below the 2021/22 level until at least 2024/25, according to current medium-term budget forecasts. This therefore implies that per capita General Health Expenditure (GHE) will decline and coincides with the acceleration phase of transition out of Gavi funding as the country expects to enter the full financing phase in 2027. It is also worth noting that with Kenya joining the lower middle-income economies, donor funding will shrink going forwards.

5. Institutional Update

There is confusion due to overlapping functions between the National Treasury and the Economic Unit under the Office of the President. Through Executive Order No. 1 of 2022, the President established the Office of the Council of Economic Advisors, the Office of Fiscal Affairs and Budget Policy, and the Office of the Economic Transformation, among key offices under the Office of the President. Although the specific roles of the three offices are not listed, it is highly probable that an overlap of the functions of the National Treasury and the newly created offices under the Office of the President will arise. The Executive Order duplicates the functions 'overall economic policy management', 'management of public finance and debt', and 'formulation of national budget'.

The creation of an additional 10 committees in the 13th Parliament through the division of Public Investments Committee (PIC) into three committees is another change that will raise expenditure, in addition to it not being clear how it will improve efficiency and service delivery. Although the role of each of the new committees is not explicitly stated, the public is left to assume that the newly created committees will undertake the work done by the National Assembly such as carrying out investigations, hearing evidence from witnesses, seeking advice from experts, and deliberating on matters of inquiry related to each committee before reporting to the National Assembly.

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Moreover, the new government, under the 'Kenya Kwanza' Administration, has created Office of the Prime Cabinet Secretary, despite this position not being anchored in the Constitution. The holder of this office will assist the President and the Deputy President in coordinating and supervising government ministries and State Departments. The current administration has promised to cut the government budget by approximately KSH 300 billion to ease pressure on taxpayers, but the move to expand executive positions and house committees contradicts this expenditure-cutting agenda. This will also hinder the current administration's ability to deliver on its manifesto, which was built on five pillars, including revival of the country's economy, lowering the cost of living, and improving the welfare of the youth.

Article 223 of the Constitution, on supplementary appropriation, remains an issue of concern as it can render stringent measures taken to cut wastage and overall expenditure as counterproductive, as the article is highly prone to abuse. If a need for expenditure arises and the amount appropriated for any purpose under the Appropriation Act is insufficient, Article 223 allows the national government to spend beyond the appropriated amount, but not more than 10% of the sum appropriated by parliament for that financial year, except in special circumstances in which parliament has approved a higher percentage. An amendment to this article is therefore recommended to seal loopholes that those in power can use to misallocate and misappropriate public resources.

Kenya has witnessed an increasing number of corruption cases concerning the misuse of public money, with minimal prosecution or consequences. Even though Kenya has an independent Ethics and Anti-Corruption Commission (EACC), established under Section 3 of the EACC Act, pursuant to Article 79 of the Constitution of Kenya, the government has not exercised such laws, which may have eased fiscal pressure in the country. In 2021, the executive, through then President Uhuru Kenyatta, informed the citizenry that the country was losing approximately KSH 2 billion daily to corruption, which is approximately KSH 730 billion annually. Even though the law permits the EACC to investigate and recommend to the Director of Public Prosecution the prosecution of corruption and economic crimes, there has been increased interference with the investigations of such cases by the political classes, with those perceived to be supporting the government of the day finding a soft hand in prosecutions, thus making the EACC's function ineffective in prosecuting corruption cases. This calls for the new administration to guarantee the independence of the EACC and Director of Public Prosecution in investigating and prosecuting corruption cases without executive interference.

The introduction of the National Tax Policy draft recommended a review of tax laws every five years to create a predictable tax policy environment. With a regular review of the tax incentives to align them with the government's development agenda, the policy specified excise duty rates that must be subjected to periodic adjustment to account for inflation. Unpredictability of the tax system was seen as a hindrance to the country's attractiveness to investors, thus the policy permits a standard rate of corporate tax, and where a preferential rate is granted the policy specifies that this cannot be lower than 50% of the standard rate. Given that the main objective of the National Tax Policy is to provide a legal framework that guarantees tax incentives and concessions to various sectors in the economy, it therefore needs to be fully implemented to stabilise the tax regime structure in such a way as to promote a conducive business environment.

Parliament should expedite the approval of reports by the Office of the Auditor General, to build public confidence in the oversight role. There is an increasing lag in the approval of audit reports: in 2022 the last accounts audited and approved by the parliament were those from FY 2017/18.

6. Conclusion

The medium-term impact of the COVID-19 shock was not quite as bad as originally feared, although it still resulted in very significant permanent damage to the economy and livelihoods. Growth, consumption, and poverty were all negatively impacted to a large degree, and while the economy has covered, Kenya will not resume its pre-pandemic path. Over the medium term, fiscal consolidation should pave the way for more sustainable and balanced growth, allowing for an increase in private sector credit and investment, lower risk of debt distress, and reduced pressure on domestic prices and the exchange rate.

In addition to the rise in global interest rates, Kenya has not been spared the impact of global events and prolonged drought that have led to high commodity prices. Food inflation and high energy bills have made life very difficult for many low-income households. This comes at a time when Kenya is under pressure to cut fuel subsidies and non-priority spending. Keen interest is now focused on the government's use of the fiscal and monetary mix to address inflation, measures to cushion vulnerable segments of the society, and efforts to ensure food security.

The incoming government has committed to fiscal consolidation, with both expenditure and the fiscal deficit as a percentage of GDP projected to remain on a downward trend. Unwinding some of the tax breaks offered in 2020 and enhanced revenue mobilisation have moved revenue closer to the target. Public debt to GDP is expected to fall if the government delivers on consolidation over the medium term. It will be of keen interest to monitor if the government remains on this path – a lot rides on this.

In addition to monitoring whether the incoming government sticks to its committed fiscal path, it will be important to see how this plays out for county budgets and service delivery expenditure (especially health). According to National Treasury projections, county transfers (equitable share) are set to be cut in real terms for at least the next three fiscal years. This should be monitored closely, since, if carried through, it will have major implications for service delivery going forward.

Notwithstanding these challenges, projections demonstrate that sustained poverty reduction and growth over the next few years is possible. Growth and deficit reduction will reduce the debt-to-GDP ratio over time. Exports have been recovering strongly, so Kenya should not be too affected by rising interest rates in the global economy – unless it falters on fiscal consolidation and relies on foreign financing to bridge the expanded deficit. There is therefore an opportunity for Kenya to reduce its risk of debt distress in the coming years, but this will require sticking to current plans. However, improved sustainability and macro-fiscal stability does mean that in the shorter term there is likely to be some pain, in the form of expenditure restraint.

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End notes

[1] This brief provides an analytical snapshot of the economy of, and public finances in, Kenya. It is based on publicly available data produced by GoK, and a range of secondary analyses. It is part of a package of five country briefs commissioned by the Bill & Melinda Gates Foundation, and is intended to provide a common analytical backdrop to foundation programming in the country.
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