

Towards pro-poor budgeting

Analysis of Kenya's budget allocations

2016
June

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Highlights

- A budget is considered pro-poor if, on the expenditure side, there is a significant allocation of resources to basic social and economic sectors that directly reach the poorest people, and sectors that indirectly but greatly enhance access to economic and social opportunities for the poor. On the revenue side, a pro-poor budget relies more on progressive taxation to share the burden of taxation to income categories according to levels of earnings. A reasonable yardstick for measuring if a country's budget is pro-poor, is by reference to the extent to which it is aligned with the country's poverty reduction strategy, plans and commitments.
- Kenya's total fiscal revenue is estimated to have increased by 17%, in nominal terms, from fiscal year 2015/16, reaching Ksh 1.5 trillion or 20.3% of GDP.
- Overall, revenue collected has been improving over time, due to more effectiveness in collection exercises and the introduction of new sources of taxation. Kenya has a higher direct tax to GDP ratio (referred to as the tax effort) than the average for low middle income countries, with the recent increase in excise duty on kerosene and the introduction of the road maintenance levy set to increase the burden of taxation on households.
- For 2016/17, the Government of Kenya plans to spend Ksh 2.3 trillion or 30.6% of GDP, the highest budget ever for the country and the largest in the East African region. The fiscal deficit is estimated to be between 6.9% and 9.3% of GDP.
- For 2016/17, the Government of Kenya has set aside 23% of the total proposed budget for payments of interest and principals on outstanding loans, of which 53.8% will be in the form of interest repayments. The Government has had to borrow from the domestic market to sustain its investment efforts while a concurrent rising external debt has only added to mounting pressure on the economy.
- Education remains one of the priorities for the country. While most allocations have targeted teacher management (55%), there remain disparities across counties on pupil-teacher ratios.
- Despite an increase in budget allocations for national health programmes over time, the country is yet to hit the target for reductions in maternal, infant and child mortality rates set for 2017.

- Budgetary allocations to expand irrigation projects for food security in arid and semi arid land areas have been reduced for 2016/17; although more information is needed to conclude whether the country is on track against its food security targets.
- The budget for the National Safety Net Programme has increased by 537% between 2012/13 and 2016/17, even though this year's budget has declined by 1%. The programme has so far managed to reach 5% of people living below \$1.90 a day, particularly older people, orphans, vulnerable children, and people living with disabilities.
- A success story on pro-poor allocation is the rural electrification programme whose budget almost doubled between 2014/15 and 2016/17 resulting in connecting close to 95% of public schools and benefiting households around these schools.
- In conclusion, there is commendable progress in meeting the Second Medium Term Plan 2013–2017 targets in some sectors, but there is need for the country to ensure that this progress is cascaded down to the county level.

Introduction

The government of Kenya has continued to commit to poverty reduction through both its national policies (Vision 2030) and the Sustainable Development Goals (SDGs). One key means of attaining this commitment is through resource generation and allocation – by making investments in areas that continue to promote inclusive growth and ensure no one is left behind. Pro-poor budgeting allows for investigation on whether the government's commitments are reaching poor people. While analysis of pro-poor budgeting can encompass a broad array of policy commitments, resources and results, this paper focuses on the resources mobilised and spent in pro-poor ways through national budgets. Pro-poor budgeting refers, on the expenditure side, to allocation to basic social and economic sectors that directly reach the poorest people, and sectors that indirectly but greatly enhance access to economic and social opportunities. On the revenue side, pro-poor budgeting relies more on progressive taxation for revenue collection. The level to which a country's budget is pro-poor can be measured specifically by the extent to which it is aligned with the country's poverty reduction strategy, plans and commitments.

Scope of this paper

This paper summarises Kenya's national budget for 2016/17 and assesses the extent to which it is pro-poor. Revenue mobilisation and allocation for deficit financing and debt servicing are discussed, in addition to the nature of domestic revenue mobilisation, in terms of progressivity and sufficiency.

On the expenditure side, we have analysed sectors that either provide services that directly reach poor people, or that benefit people in poverty indirectly but potentially substantially, by facilitating access to economic opportunities. These sectors were identified as those aligned to programmes and/or targets set out in the Second Medium Term Plan (MTP 2) 2013–2017 social and economic pillars.¹ To this effect, the paper examines budgetary allocation to priority social sectors including education, health and social protection, while budget allocation to the agricultural sector is examined under the economic pillar. Rural electrification, as one of the foundations for national transformation, has been selected to assess budget allocation to sectors that enable poverty reduction.

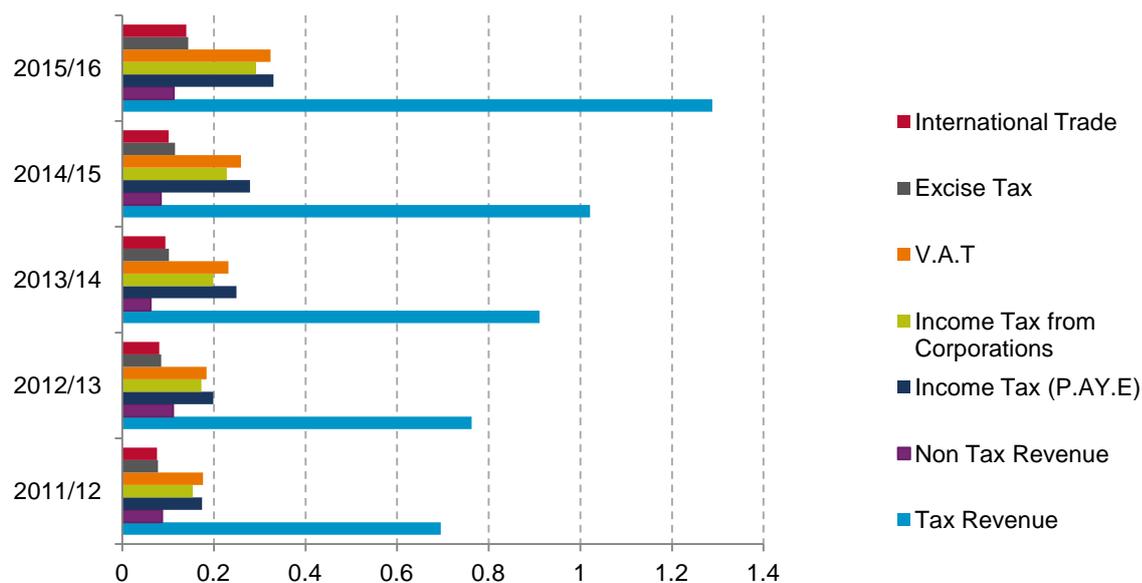
Analysis of budget allocations aligning to country plans and poverty targets

Revenue

Kenya's total revenue is estimated to increase by 16% in nominal terms from 2015/16, reaching Ksh 1.5 trillion – expected to be driven mainly by a strong push in tax revenues. Overall fiscal revenue as a percentage of GDP will hit 20.3%, not too far off from the planned medium term target of 21% by 2018/2019.

¹ Vision 2030 is structured under three main pillars: 1) social, 2) economic and 3) political, and on the foundations for national transformation. It is implemented through 5-year MTPs, which provide the building blocks for the development of Medium Term Expenditure Frameworks and are developed by sector and guide the annual budget allocations. Kenya is currently in MTP 2. The country poverty targeting names specific sectors that would contribute to the reduction of poverty – we focus on these in our analysis.

Figure 1: Kenya government revenue on recurrent account 2011/12–2015/16, Ksh trillions



Source: Economic Survey 2016

Tax revenue

Tax revenue is a primary source of finance and attaining the Vision 2030 outcomes of the Government of Kenya. In its drive to strengthen financing of development programmes, the government, in its second MTP, outlines tax reform programmes and projects to revamp turnover tax; rental income and taxes on real estate; and high net worth individuals, among other measures.² In December 2015, excise tax was increased resulting in a rise in the prices of beer and cigarettes, arguably taxing the middle class more.³ Apart from consumption tax, the country, after 30 years, reintroduced capital gains tax on its booming real estate and robust stock markets, and amended the value added tax (VAT) Act, which has resulted in higher prices of basic goods.

Kenya's tax revenue collection on income tax, both individual and corporate, and VAT revenue as a share of GDP, are all higher than average for lower middle income countries. The share of international trade tax as a share of GDP is lower than the mean for lower middle income countries due to the regional trade arrangements the country belongs to.

² www.christianaid.org.uk/images/Africa-tax-and-inequality-report-Feb2014.pdf indicates only 100 high net worth individuals are registered with KRA out of an estimated 40,000 in the country

³ www2.deloitte.com/content/dam/Deloitte/ke/Documents/tax/Excise%20Duty.pdf indicates farmers are expected to benefit from 'Remission on excise duty on beer or wine' of Excise Duty Bill 2015 as local beer manufacturers are encouraged to source inputs from local producers.

Table 1: Revenue collection in Kenya as share of GDP

Description	Kenya 2015/16	Lower middle income countries (mean)
Tax revenue,% GDP	20.7	17.7
Income tax*, % GDP	10.0	5
Value added tax revenue, % GDP	5.2	5
International trade tax, % GDP	2.3	4.9
Taxes on goods & services, % GDP	2.8	6.1

Source: Economic Survey 2016 and [IMF](#)

The share of direct tax in total revenue and GDP is higher than average (Figure 1 and Table 1), indicating revenue collection is more progressive, which should improve income distribution.

One new tax to be introduced in the coming financial year is a levy on kerosene. According to the [statement](#) read by the Cabinet Secretary of the National Treasury in parliament, some unscrupulous traders have been adulterating petroleum (taxed at Ksh 19.89 per litre), with kerosene (zero rated) to increase their profit margin; in what seems to be a move to discourage such harmful practice,⁴ the government will levy excise duty of Ksh 7,205 per 1000 litres of kerosene. Kerosene is used by millions of households in the country for cooking food and for illumination; the directive is expected to adversely affect the poor, who use it as an alternative to gas and electricity. Another directive expected to further cost the poor is the increase in the road maintenance levy, from Ksh 12 to Ksh 18 per litre. This is likely to increase the cost of transportation of both goods and people, and ultimately raise the cost of basic commodities.

In summary, the levels of overall revenue collection as well as new sources of taxation have been improving over time. The Government has outlined key ways to continue revenue growth, such as widening the tax base, reducing compliance costs and enhancing efficient revenue administration. However, the impact of certain measures to expand the tax base, such as excise duty on kerosene and increase in road maintenance levy should be carefully monitored to ascertain how they will impact people in poverty and those in vulnerable positions that could be pushed into poverty.

Budget deficit and its financing

For 2016/17, the overall expenditure and net lending of the Government of Kenya is Ksh 2.3 trillion (30.6% of GDP), the largest budget in the country's history and the region⁵ while projecting to collect Ksh 1.5 trillion, resulting in a revenue shortfall of Ksh 689 billion excluding grants. This short fall is estimated to be between 6.9%⁶ and 9.3%⁷ of GDP, which the country aims to bring down gradually to below 4% in the medium term.

The government plans to finance the deficit through net domestic borrowing of 3.3% of GDP (Ksh 241 billion) and external financing of up to 3.8% of GDP⁸ through project loans (Ksh 169 billion), commercial loans (Ksh153.7 billion), and donor specific programmes (Ksh 3.8 billion).

⁴ The CS reported that the country lost 100% of the Rwandan petroleum export market and 30% of the Ugandan market because of such adulteration.

⁵ For 2016/17, Rwanda plans to spend Ksh 260 billion; Uganda Ksh 790 billion and Tanzania Ksh 1.4 trillion

⁶ 50% absorption of committed financing and will be an improvement from 2015/16 deficit estimation of 7.9% of GDP.

⁷ Full absorption of committed financing

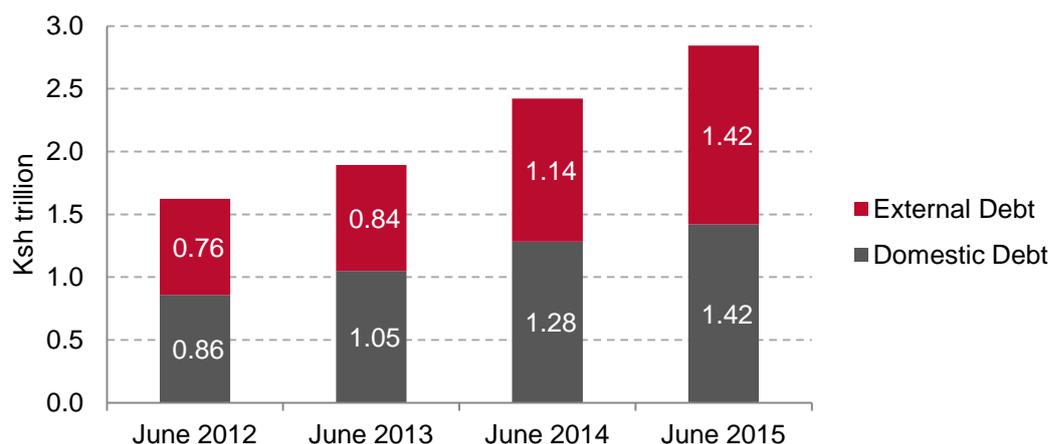
⁸ 6.2% of GDP in the case of full absorption.

This trend of increasing domestic borrowing might result in pushing interest rates higher thereby crowding out the private sector and ultimately reducing total production in the economy, which would ultimately hit the poorest people hardest, albeit in the short run.

Debt sustainability

By June 2015, Kenya's total debt stood at Ksh 2.8 trillion – 49.75 % of GDP (the highest in the last four years). External debt for the same period was Ksh 1.423 trillion (24.9% of GDP) and domestic debt Ksh 1.420 trillion (24.8% of GDP). Figure 2: Kenya's domestic and external June 2012-June 2015

Figure 3: Domestic and external debt has increased over time



Source: various annual and monthly debt reports from the National Treasury

According to the government, its level of borrowing is within the country's debt sustainability threshold. However, the International Monetary Fund cautions that containing the fiscal deficit is needed given the rapid pace at which public debt has been accumulating.⁹

Table 2: Public debt sustainability thresholds and Kenya's share of debt (2014–2016) in %

Present Value of public sector	Threshold	2014	2015	2016
Debt–GDP ratio	74	42.9	45.8	48.3
Debt–revenue ratio	300	221.1	231.8	237.8
Debt service–revenue ratio	30	41	30.4	30

Source: Budget summary 2016/17

For 2016/17, the Government of Kenya will allocate Ksh 466.5 billion for debt servicing, or 23% of the total proposed budget, of which 53.8% will be in the form of interest repayments; this could indicate that it is increasingly borrowing on short-term concessions and/or on high interest non-concessional loans.

⁹ www.imf.org/external/pubs/ft/dsa/pdf/2015/dsacr15269.pdf

Table 3 Debt services in billions, 2014/15–2016/17

	2014/15	2015/16	2016/17	2017/18
Interest	167.4	195.2	250.8	252.1
Redemption	231.9	222.0	215.7	290.3
Total	399.3	417.2	466.5	542.4

Source: Budget estimates 2015/16 and 2016/17

Notwithstanding that various forms of financing allow greater development, creating inclusive growth and lowering debt distress are vital for ensuring the poorest people in society benefit. At present, the broadening fiscal deficit and rising debt servicing plans for 2016/17 and the coming years are expected to put extra pressure on the Kenyan economy. Increasing domestic borrowing may therefore crowd out the private sector and dampen domestic production while the rising external borrowing adds on to a level of debt that is already high – putting extra pressure on the economy

Expenditure

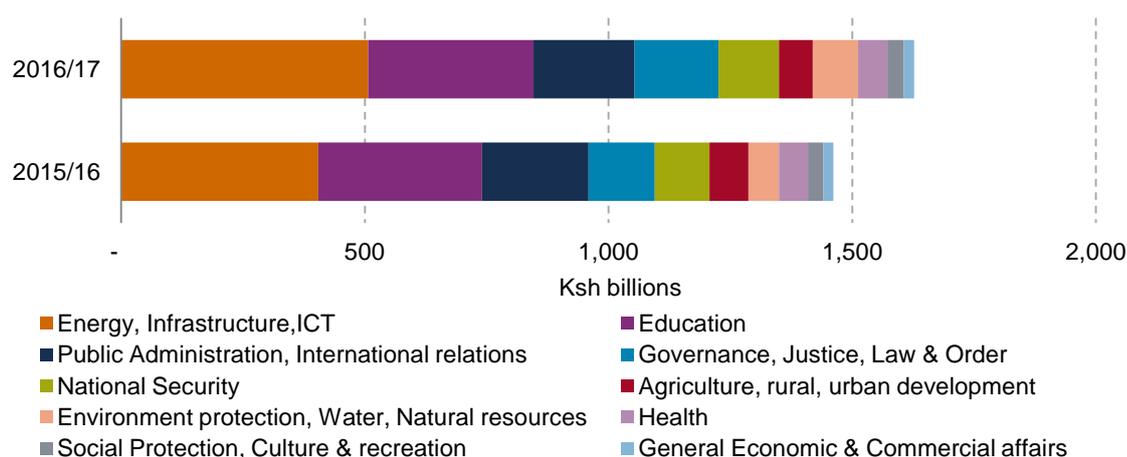
This section looks at Kenya's national budget allocations for the 2016/17 financial year, and compares with previous years. With the 2010 Constitution, some sectors are now devolved functions and therefore implemented at the county level.¹⁰ Since this analysis only looks at the national budget, we try to focus on those sectors that are national government functions; we include the health sector due to its importance in reaching poor people.

Kenya budget priorities over two years

The country's expenditure estimates stand at over Ksh 1.6 trillion in the 2016/17 budget. Two sectors receive over half of the country's budget – infrastructure and education. The health sector receives close to 4% of the total national budget; this is low because it is a devolved function, hence not all its expenditures are captured in the national budget.

¹⁰ The devolved functions include: agriculture (except for state corporations), health services, control of pollution, cultural activities, county transport, animal welfare & control, trade development & regulations, planning & development, pre-primary education & village polytechnics, county public works, disaster management, drug control and implementation of natural resources policy.

Figure 4: Sector allocation for 2015/16 and 2016/17



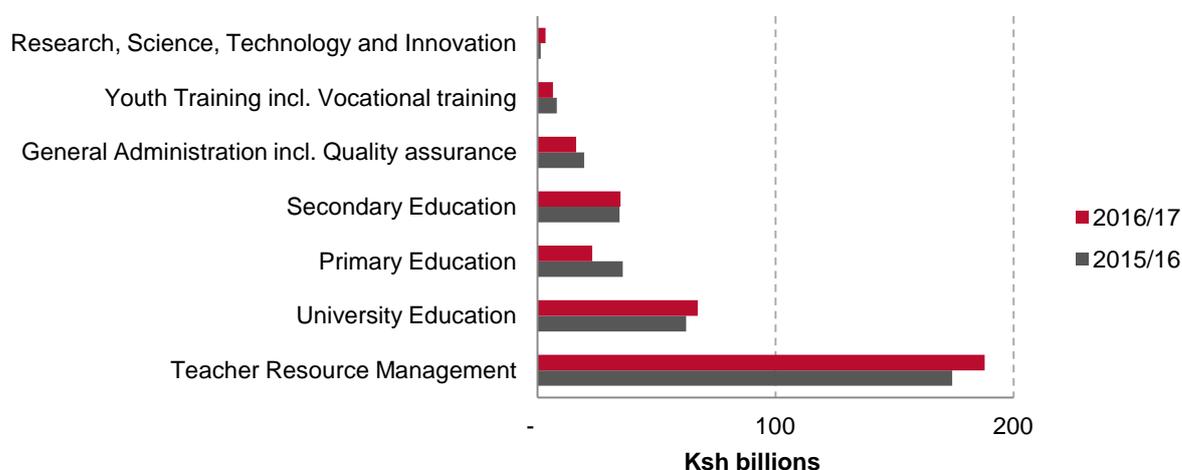
Source: 2015/16 and 2016/17 programme-based budget estimates

Education sector

Among the priorities of MTP 2 is to lower the pupil–teacher ratio through recruiting more teachers in all levels of education. To promote the health of school-going children (pre-primary and primary) from poor and marginalised communities, school feeding programmes have been introduced that provide midday meals to these children. The country has also committed to enhancing education in arid and semi arid land (ASAL) counties through special programmes.¹¹

The education budget has increased by Ksh3.1 billion, most of which is allocated to the teacher resource management programme; this receives the largest proportion of the education budget and has increased by 8% from 2015/16. The teacher management allocation is largely distributed to primary and secondary school teachers, but less to tertiary school teachers. Primary education programmes receives a 36% reduction due to the transfer of funds to the information and communications technology sector to fund and implement the [Digital Literacy Programme](#), which will distribute laptops to all first year public primary school students.

Figure 5: Education budget allocations for 2015/16 and 2016/17



Source: 2015/16 and 2016/17 programme-based budget estimates

¹¹ Other priorities include provision of more textbooks and teaching equipment as well as wider access to secondary education for all primary school leavers.

Are we in line with the MTP 2 priorities?

By 2014, the country's pupil-teacher ratio in public primary schools stood at 41.5: 1 for teachers recruited under the Teachers Service Commission. While this seems to align with the MTP 2 target of 41:1 by 2018/19, there are more disparities at the county level, with 27 counties falling below this national average.¹² The counties with the highest ratios remain among the poorest counties in Kenya.

Table 4: Five counties with the highest pupil-teacher ratios

County	Public primary school pupil-teacher ratio (2014)
Turkana	100
Mandera	80
Wajir	65
Bungoma	58
West Pokot	58

Source: Basic Education Statistical Booklet 2014

Kenya falls short of teachers at public schools in primary, secondary and tertiary institutions. The Medium Term Expenditure Frameworks (MTEF) for 2014/15–2016/17 has the target of recruiting 370,864 teachers by 2015/16. But the latest available data indicates that there are 294,060 teachers. The annual target has been to recruit 6,000 teachers in order to meet the country's needs, but this has fallen short both in 2015/16 and 2016/17.

Table 5: Teacher recruitment projections and actual

	Number of teachers 2014/15	2015/16 recruitment targets	2015/16 actual recruitment	2016/17 recruitment targets	Pupil-teacher ratio 2014/15
Primary school	294,060	10,000	2500	2,665	41.5
Secondary school		9,159	2400	2,338	29.8
Tertiary level		841	100	100	N/A

Source: Development Initiatives, based on 2015/16 and 2016/17 programme-based budget estimates and education MTEF 2016/17–2018/19

School health, nutrition and meals

The Government of Kenya has prioritised school feeding programmes in pre-primary and primary schools in the ASAL and informal settlements because the poorest households are in these locations. Allocations have increased from Ksh 1.5 billion to Ksh 2.6 billion in 2016/17. The 2016/17–2018/19 MTEF highlights that so far 1.6 million children have been reached. With close to 3.8 million children currently enrolled in pre-primary and primary schools in ASAL counties, the government has therefore been able to meet half of the need.¹³

¹² Basic Education Statistic Booklet 2014

¹³ Basic Education Statistic Booklet 2014

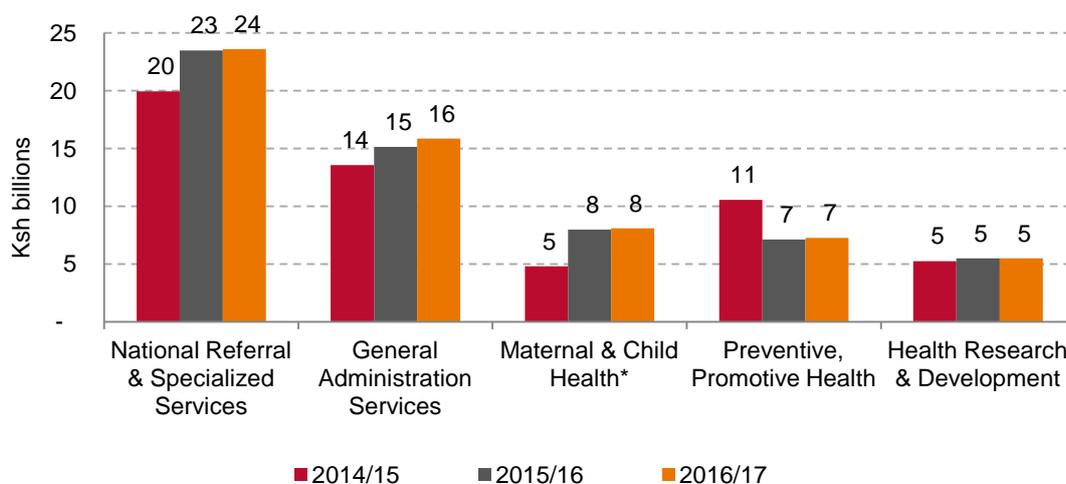
Health sector

To improve health outcomes and link to global goals in the SDGs, the MTP 2 targets to improve the reproductive, maternal, neonatal, child and adolescent health sector through increased immunisation, improved nutrition, increased access to family planning services and improved quality of health services. It also aims to improve services to promote universal health coverage including free maternity health services, Subsidies for poor and vulnerable groups and reducing out of pocket/catastrophic health expenditures are prioritised.

The health sector is largely a devolved function, particularly for service delivery; hence larger proportions of county budgets are spent on the health sector. The national government has the responsibility of policy formulation and support of the national referral hospitals. The national government also provides conditional grants that are transferred to counties to meet the costs of free maternity care – an MTP 2 priority as well as part of the ruling government manifesto.

The increase in the health budget for 2016/17 is less than the increase in previous years (increasing by Ksh 1 billion compared with Ksh 5 billion in 2015/16). The country's referral hospitals (national referral services) have continued to receive large proportions (39%) of this health budget – given that this is the responsibility of the national government. This has increased since 2014/15, and increased by 1% from 2015/16 to 2016/17.

Figure 6: Health programme allocations in the national budget



Source: 2016/17 programme-based budget estimates. *Maternal and Child Health programme is currently called the Health Policy, Standards and Regulation Programme and covers the conditional grants to fund free maternity cover

Are we in line with MTP 2 priorities?

Budget allocations for the various health programmes have increased over time, and this has translated to improved mortality rates. However, these mortality rates still fall below the targets that were set for 2017 and might not be achieved.

Table 6: MTP health indicator targets

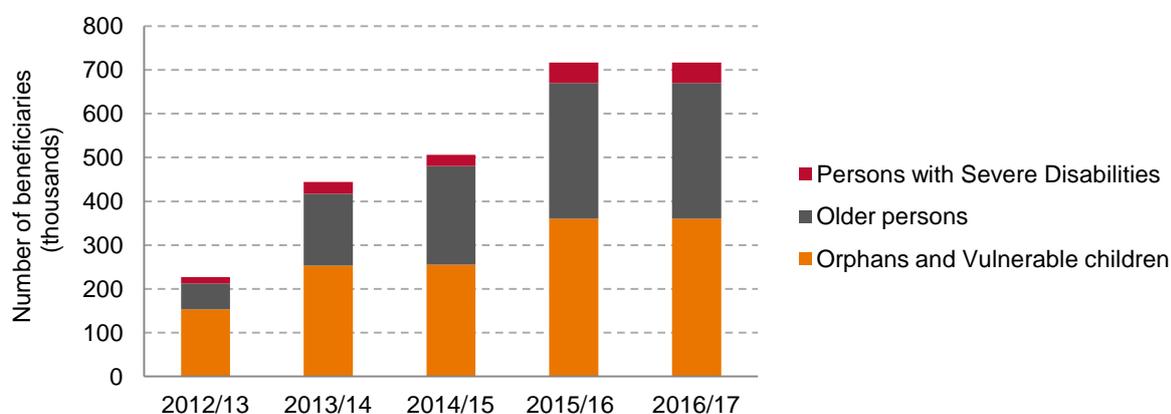
	Status in 2012	Status with most recent data (DHS, 2014)	Target for 2017
Maternal mortality rate	488/100,000	362/100,000	150/100,000
Under 5 mortality rate	74/1,000	53/1,000	35/1,000
Infant mortality rate	52/1,000	39/1,000	30/1,000

Source: MTP 2 (2013–2017). DHS: Demographic and Health Surveys

Social protection

To deepen the effectiveness of social protection, the government has pledged to expand social protection coverage and bring more areas and groups through social assistance, social security and health insurance. To this effect the second MTP commits for more resource allocation to social protection including cash transfers to vulnerable people.

Figure 7: Beneficiaries of the National Safety Net Programme (and targets for 2016/17)



Data Source: 2015/16 2016/17 programme-based budget estimates

The 2016/17 budgetary allocation to the National Safety Net Programme is Ksh 18.9 billion – about 75.4% of the total budget of the Ministry of Labour, Social Security and Services. The programme has had a steady increase in budget allocation from Ksh 2.97 billion to Ksh 18.93 billion (537%) between 2012/13 and 2016/17. The government has managed to scale up the number of beneficiaries from 239,000 in 2012/13 to 717,200 in 2015/16, representing close to 5% of the population living on less than \$1.90 a day. The 2016/17 budget allocation for the National Safety Net Programme has, however, reduced by 1% since the 2015/16 budget (the reduction was largely in recurrent expenditures).

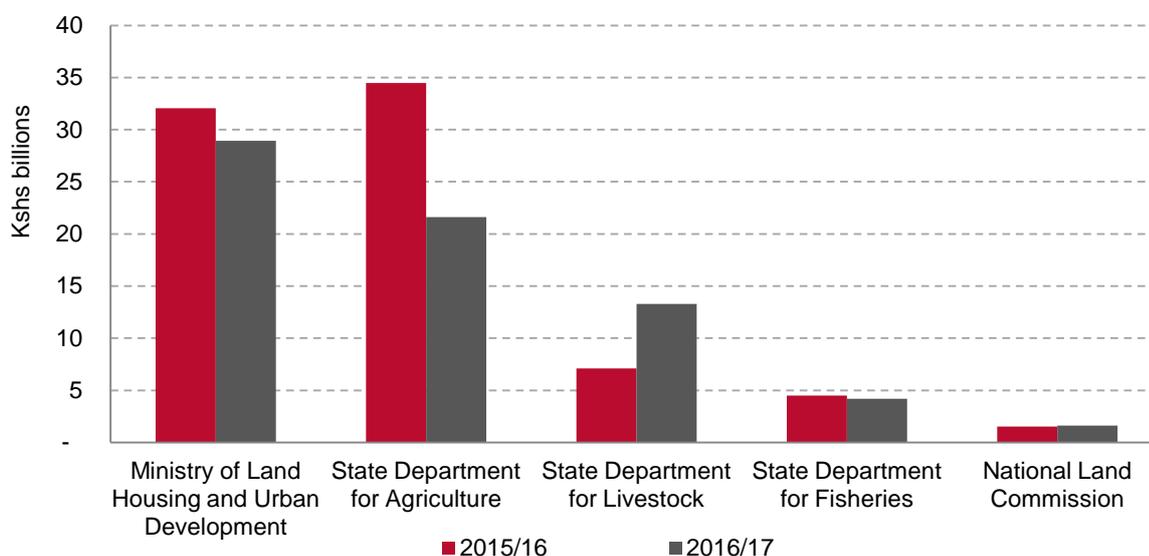
Agriculture sector

The MTP 2 prioritises the development of the ASAL areas to enhance food security and lower the cost of living. In addition, a strategy to reduce the cost of fertilisers was introduced that would enhance access to affordable fertiliser for small-scale farmers.

The county governments are tasked with implementing specific agriculture functions such as crop and animal husbandry and disease control. The national government is responsible for state corporations and research, which comprise a big proportion of the sector. Allocations to the sector have reduced by Ksh 10 billion since 2015/16, due to the elevation of the State Department of Water and Regional Authorities to the Ministry of Water and Irrigation. The

irrigation budget allocations (which is Ksh13 billion under the State Department for Agriculture) has therefore shifted from the agriculture sector.

Figure 8: Budget allocations to the agriculture sector



Source: 2015/16 and 2016/17 programme-based budget estimates

While the 2016/17 budget reports that progress has been made in the sector, it is not possible to know where this has been and if the people with most need have been reached. For example, between 2012/13 and 2014/15 the amount of subsidised fertiliser distributed to small-scale farmers increased from 66,275 to 206,955 439,396 metric tonnes. However, it is not possible to know – without making more inquiry – if farmers with the most need have been reached or if it has been on a first-come-first-served basis.

The government has committed to expand irrigation to promote food security. A target of 404,800 hectares put under irrigation, especially in Turkana and Tana River counties, was set for 2017. MTEF reports that so far 54,258 to 21,703 hectares have been irrigated. This could mean two things: the targets set will not be achieved by 2017, or that information on actual land that has been irrigated needs more inquiry. Regardless, the 2016/17 budget for irrigation has reduced by close to Ksh 3 billion.

Table 7: Irrigation and drainage infrastructure budget allocations

	2014/15	2015/16	2016/17
Annual budget allocation (Ksh millions)	15,897	16,546	13,178

Source: 2015/16 and 2016/17 programme-based budget estimates

Infrastructure sector: rural electrification

Through the MTP 2, the government has planned to connect two million new customers to electricity by 2017. This is implemented through the Rural Electrification Authority, under the Ministry of Energy and Petroleum. This will connect 6,304 public facilities that include electrification of the remaining 2,600 main public facilities (including trading centres, secondary schools, health centres and dispensaries) and other public facilities including primary schools, tea buying centres, water supply systems and places of worship).

It is indicated that by July 2015, the government has managed to connect **95% of all public primary schools in the country** in readiness for the Government Digital Learning programme, through grid extension and provision of solar photovoltaic systems to areas far from the national grid network. Connecting the public schools will have a multiplier effect as households around these schools will therefore be able to get an electricity connection.

This progress is illustrated in the budget allocation that has increased over time – in 2016/17 it was 83% higher than in 2014/15. The success may also be attributed to the government's need to fast-track its commitments ahead of the 2018 elections as the Digital Learning Programme, which is pegged on electricity connection, is a key project in the manifesto.

Table 8: Expenditure on rural electrification

Programme	2014/15 estimates	2015/16 estimates	2016/17 estimates
Rural electrification (Ksh millions)	14,189	16,906	26,021

Source: 2015/16 and 2016/17 programme-based budget estimates

Conclusions

Kenya's levels of overall revenue collection have been improving over time. The share of tax revenue in GDP, particularly taxes on income, profit, goods and services and VAT is above the average for lower middle income countries. The government has outlined key ways to continue revenue growth, of which some appear progressive and can be regarded as pro-poor. The impact of other forms of revenue generation, however, should be carefully monitored; these include taxing of basic goods, which would affect poor people.

Our analysis on fiscal deficit and public debt indicates that increasing fiscal deficit and debt servicing plans for 2016/17 and the coming years are expected to put extra pressure on the Kenyan economy. Increasing internal borrowing could likely crowd out the private sector. Furthermore, about 23% of the total budget for 2016/17 has been locked for debt servicing. Already, the International Monetary Fund has advised the Government of Kenya to contain the broadening fiscal deficit given the rapid pace of public debt accumulation.

Allocations to the education sector have increased over time, with the sector remaining one of the two priorities for the country. While most of this has targeted teacher management (55%), there remain disparities between counties on pupil–teacher ratios. Counties with high poverty rates still have high pupil–teacher ratios: as high as 100:1. More equitable resource allocation to teacher recruitment is needed for the country to attain the MTP targets across the counties and for the populations with the greatest need to benefit.

Budget allocations for health programmes at the national level have increased over time but these have not been sufficient to fast-track the reduction in maternal, infant and child mortality rates that were set for 2017.

The government has made commitments to food security by expanding irrigation projects. The allocations to irrigation have reduced in the 2016/17 budget. More importantly, it is not clear if the country is in line to meet the MTP targets, as there remains limited information on the progress of achieving this.

Pro-poor budgeting over the years by the Government of Kenya is evident from the allocation to social protection. The budget for the National Safety Net Programme increased by 537%

between 2012/13 and 2016/17, even though this year's budget for the programme has declined by 1%. The programme has so far reached 5% of people living below \$1.90 a day, particularly older persons, orphan and vulnerable children, and people living with disabilities.

Budget allocations to rural electrification have almost doubled between 2014/15 and 2016/17. This has resulted in impressive progress with close to 95% of public schools having electricity connections – households around these schools are therefore also benefitting. From a pro-poor budgeting element, this has been a success for the country.

Importantly, information on progress as indicated in the budgets and MTEFs is not enough to demonstrate if the poorest populations have been reached. Analysing only national budgets presents opportunities to understand the extent to which the country is targeting poor people. But this is not the full picture; without information on how counties are allocating their resources and whether they target poor people, we can only see part of the picture.

Lastly, the national budget indicates commendable progress in meeting the MTP 2 targets in some sectors, but there is need for the country to ensure that this progress is cascaded down to the county level – something we find is not happening in the education sector, and may not be in other sectors too.