MEMORANDUM TO THE NATIONAL TREASURY AND PLANNING ON THE NATIONAL BUDGET FOR THE FINANCIAL YEAR 2021/2022

Introduction

This memorandum has been prepared by the International Budget Partnership Kenya (IBPK) and the Institute of Public Finance Kenya (IPFK).

The International Budget Partnership Kenya (IBPK) is a Kenyan non-profit organization working to advance transparency, accountability, participation, and equity in national and county budgeting processes. The International Budget Partnership Kenya's (IBPK) work is focused on strengthening the impact of civil society advocacy and citizens on budget policies and outcomes at both levels of governance in Kenya. Through deep and sustained engagement, the IBPK provides support to build expertise and skills of civil society actors and citizens involved in budget advocacy. Citizen advocacy, generation of evidence, technical assistance, learning, and networking are integral components of IBPK's work.

The Institute of Public Finance (IPFK) is an independent non-profit think tank based in Nairobi that aspires to further ideas of open Public Finance Management systems through research, training, and capacity strengthening. IPF-Kenya areas of focus are PFM and Health, PFM and Education, PFM and Agriculture PFM and Trade, and overall transparency and accountability of the PFM sector. IPF-Kenya is keen to establish successful partnerships with PFM stakeholders both on the demand and supply side by focusing on fairness and equity at the County and National levels of Government. The institute continues to generate evidence through research to inform its advocacy work.

This submission is presented to the National Treasury and Planning. It focuses on the presentation of financial and non-final information, the public's involvement in the budget process, and considerations that need to be taken into account for the financial year 2020/21.

1. **Budget implementation remains a challenge at both levels of Government**. An analysis of the County Budget Implementation Review Report for FY 2019/20 from the Office of the Controller of Budget shows that public budgets' credibility is relatively low. For instance, during the reporting period, County Governments incurred expenditures of Kshs.104.51 billion representing an absorption rate of 55.6 percent of the County Governments' cumulative annual development expenditure budget of Kshs.187.98 billion. This performance declined from an absorption rate of 57.8 percent, reported in FY 2018/19, when development expenditure was Kshs.107.44 billion.

   In the BPS 2019, the national Government highlighted this challenge for counties. It went further to highlight challenges in procurement, though vaguely and capacity within counties as one reason. The Kenya Devolution Support Program was highlighted as one approach to helping deal with the two challenges. An analysis of the BPS 2020 gives the same challenges and the same solution as that provided in the 2019 BPS. The BPS should update the impact of efforts under KDSP to improve budget performance, but this is not the case.

However, the BPS 2020 did not provide a similar section on national government performance and why the poor budget implementation. Therefore, going into FY 2021/22, the BPS should include performance details on the national budget and mitigation measures applied so far and their impact. This is critical information for the National Assembly to carry out its oversight role and public accountability.

2. **The revenue growth factor of the county's equitable revenue should be more predictable and realistic**. Using an example, the BPS recommended that counties be allocated Ksh 317.8 billion in 2020/21, which was lower than the amount of Ksh 316.5 billion approved in 2019 when we factor inflation and only 0.4 percent higher absolute terms. The recommendation was significantly different from the 5.7 percent growth in the amount recommended by the Commission of Revenue Allocation. The table below shows that this difference is typical and indicates a transparent and predictable methodology in determining growth patterns of revenue to counties. Besides, the lack of clarity has meant that the equitable share's growth has been much lower than the increase in ordinary revenue, as shown in the last column. There is a need for a clear determinant of how revenue to counties will grow from year to year, mostly informed by ordinary revenue trends from previous years.

		Proposed Growth		Basis for Proposed Revenue Growth				Equitable Share Approved in the DoR (2019/20 is proposed)
	Year	CRA	National Treasury	CRA	National Treasury	Ordinary Revenue	*Growth in National Ordinary Revenue*	226.66
1	2015/16	10.4%	10.4%	3-Year average growth in ordinary revenue	3-Year average growth in ordinary revenue	1,152.97	*13%*	259.77
2	2016/17	15.0%	7.8%	3-Year average growth in ordinary revenue	Not provided	1,306.57	*13%*	280.30
3	2017/18	15.0%	6.7%	3-Year average growth in ordinary revenue	3-Year average month on month inflation	1,365.06	*4%*	302.00
4	2018/19	8.5%	4.0%	3-Year average inflation	Not Clear	1,496.93	*10%*	314.00
5	2019/20	6.9%	2.0%	3-Year average inflation	Not Clear	1,843.81	*23%*	316.50
6	2020/21	5.7%	0.4%	The country's 3-year (2016-2018) average economic growth	Not Clear	1,856.71	*1%*	317.80

Source: Division of Revenue Acts and Budget Policy Statements 2015-2020, National Treasury

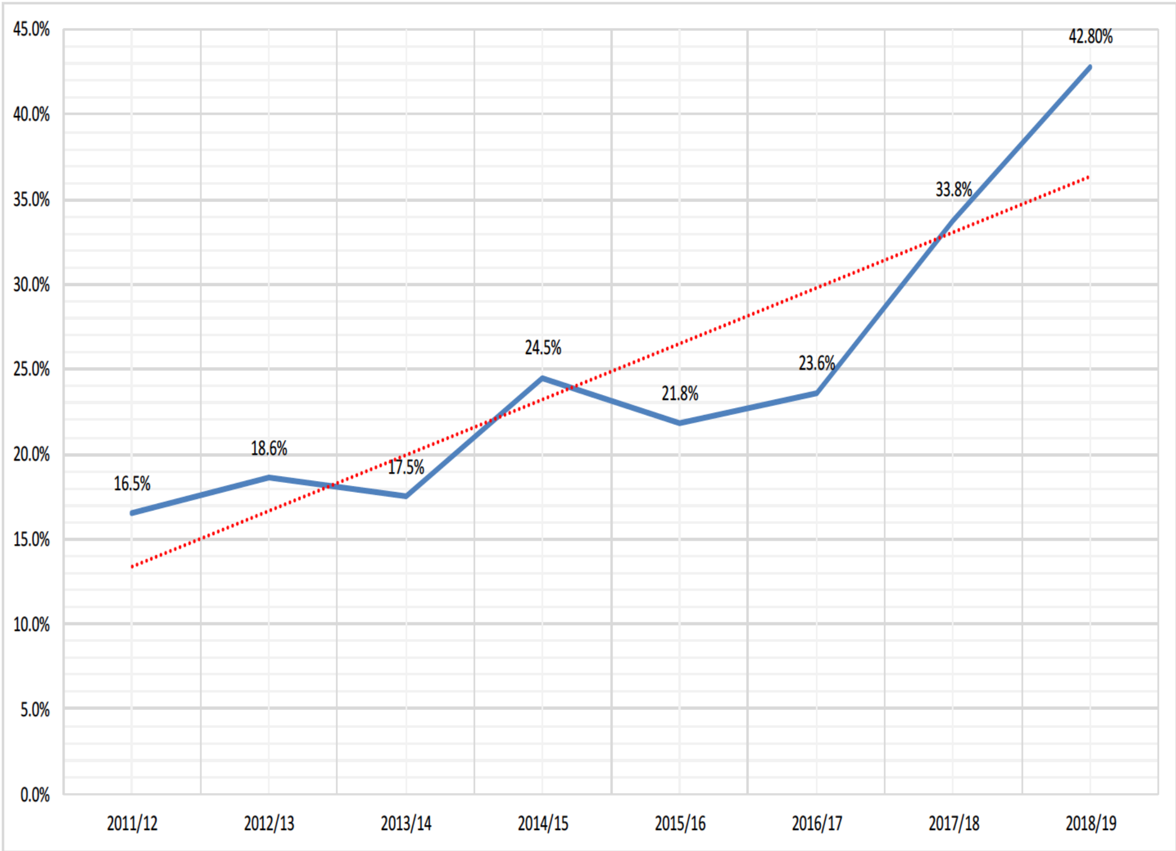
3. **The criteria of how conditional grants are set up and conditions for their use remains unclear.** There are several concerns with conditional grants from the national Government that require addressing. First is that there seem to be no clear criteria as to how they are set up. A closer look at them indicates that they facilitate functions assigned to the counties by the constitution. As such, the resources should be part of the unconditional share for the county governments. Secondly, there is no clarity of how the resources are to be utilized once they are at the county level or a clear monitoring framework that citizens can follow. As a result, it is impossible to establish if the objectives they are supposed to actualize have been accomplished. Thirdly, how they grow from one year to another is unclear, and the process of their disbursement to counties is uncertain. For example, compensation for user fees foregone has remained the same for the last six years, which does not reflect primary health care demand. Generally, the growth and decline in allocations to conditional grants seem as arbitrary as the equitable share. This makes medium-term budgeting quite tricky at the county level due to

unpredictability in the allocations when counties are working through their County Fiscal Strategy Papers. The table below shows the allocations over the last six years (includes 2020/21 projections)

	Current Conditional Grants (Billions)	2015/16 DORA	2016/17 DORA	2017/18 DORA	2018/19 DORA	2019/20 DORA	2020/21 DORA	% Increase of National Treasury Grants to DORA
1	Level 5 hospitals	3.60	4.00	4.20	4.33	4.24	4.30	2%
2	Free maternal health care	4.30	4.12	-	-			-
3	Compensation for user fees forgone	0.90	0.90	0.90	0.90	0.90	0.90	0%
4	Leasing of medical equipment	4.50	4.50	4.50	9.40	6.20	6.21	0%
5	Road Fuel Levy Fund	3.30	4.31	11.09	8.27	8.98	9.40	5%
7	Development of Youth Polytechnics			2.00	2.00	2.00	2.00	0%
8	Supplement for construction of county headquarters			0.61	0.61	0.49	0.30	-38%
	Total	***16.60***	***17.83***	***23.3***	***25.5***	***22.8***	***23.1***	1%

4. **The annual budget deficit and the attendant public borrowing remains the Achilles heel in Kenya's fiscal framework.** There is a need to reduce the budget deficit in 2021/2022 significantly. Kenya's budget continues to experience deficits that have forced the country to continue borrowing heavily. Consequently, the debt repayment bill has snowballed, and the increasing proportion of ordinary revenue absorbed by debt has become a serious threat to other critical service provision areas as highlighted in the Budget Policy Statement 2020, where the National Treasury indicated that all additional resources in 2020/21 would be taken up by debt servicing and pensions.

   A close analysis of debt service to revenue indicates that debt service has breached the ceiling and continues to snowball. The International Monetary Fund sets a debt repayment to the ordinary revenue ratio threshold of 30 percent for countries like Kenya. The figure below indicates the ratio of Kenya's debt repayment to ordinary revenue growing steadily and stands at 42.8 percent as of 2018/19 – up from 16.5 percent in 2011/12.



Source: Annual Public Debt Reports 2017/18 and 2018/19

The more spent on repaying debt, the smaller the amount remaining to provide essential services, including money that goes to government ministries, department agencies (MDAs), and the allocation that is going to counties. For these reasons, the ratio of debt repayment to ordinary revenue must be maintained at a level that does not constrain revenue from the two key service provision avenues. Therefore, the Government has to find ways to reduce Kenya's debt repayment burden by restructuring some of its debt. The country also has to minimize commercial borrowing that has been more expensive and with shorter maturity periods.

5. **In addition to the budget deficit and public borrowing, there is a need for a comprehensive picture and plan on the constitutional offices' pension and expenses.** We take note that this non-discretionary line of spending has more than doubled in the last five years. The table below illustrates the increasing trajectory over time of the government expenditure on pensions between 2016-2020.

Year	2016	2017	2018	2019	2020
Pension and other CFS	43,429 Million	60,169 Million	91.1 Billions	109.5 Billions	118.7 Billions

Source: Budget Policy Statements 2016-2020

We further note that a bulk of public officers recruited around or just before the structural adjustment programs of the early 1990s will be due for retirement in this medium-term (2021-2023. That notwithstanding, different cadres of state officers (MPs, Governors, and MCAs) seek to be on the public pension scheme, which is projected to increase the pension claims and the budget of the first charges CFS.

Public debt, pensions, and other charges of the consolidated fund services are crowding out the amount available for revenue division and hurting allocation to counties. As the table below shows, servicing of non-discretionary CFS has been snowballing, limiting how much is available for allocation to devolved services. More importantly, while public borrowing directly impacts the shareable revenue's size, the National Treasury is the only body deciding on this vital national instrument. We recommend that counties and the Senate be involved in the discussion on national borrowing, impacting the revenue shared between the two government levels.

Year	Public Debt Service	Ordinary Revenue	Counties' allocation	Growth in Public Debt Service	Growth in Sharable Revenue	Growth in County Allocation
2014/15	250.97	1,031.82	226.66			
2015/16	250.39	1,152.97	259.77	0%	12%	14.6%
2016/17	307.16	1,305.79	280.30	23%	13%	7.9%
2017/18	453.36	1,486.29	302.00	48%	14%	7.7%
2018/19	687.57	1,688.49	314.00	52%	14%	4.0%
Average				**30%**	**13%**	**9%**

Source: Budget Review and Outlook Papers and Division of Revenue Acts (2014-2019)

6. **Input given by the public should be stated, and clear feedback on how it was considered or not with justifications must be provided**. The BPS 2020 has a section that lists conversations and input from the public. Annex Table 6 has what is indicated as "Public participation highlights." This section should be framed as the feedback part of the BPS on the actions taken based on public input and not just a listing of what the public said. Further, it would be helpful if the specific input sought is stated to tell what the intended direction for such input was. Justifications for why certain decisions were taken and not others are critical for accountability. Currently, it is hard to tell if the decisions have influenced budget allocations in any way. Besides, paragraph 216 indicates that stakeholders' inputs will only be taken up once additional resources are available, as shown below.

Finalization of Spending Plans

216. The finalization of the detailed budgets will entail thorough scrutiny to curtail spending on non-productive areas and ensure resources are directed to priority programmes. Since detailed budgets are scrutinized and the resource envelope firmed up, in the event that additional resources become available, Government will utilize them to accommodate key national strategic priorities. Specifically, the following will receive priority:

- Interventions identified during the stakeholders consultation for the FY 2019/20 budget and over the medium term

Public participation should be part and parcel of all budget decisions rather than what seems to be a focus on additional priorities. The BPS indicated that the national treasury's ceilings in the BROP before SWGs/public hearings remain intact. This raises the question of why take the MDAs and the public through a futile process. It is clear from the BPS that the National Treasury intended to do nothing with the public input they sought. This amounts to an abuse of a constitutional and legal provision for a participatory and accountable public finance process

7. **There is a need for clarity on what is the planning policy informing government budgeting**. The budget documents should indicate if the big four agenda items are now part

of the Medium-Term Plan III or separate and which of the two is guiding budgeting. For example, as framed, the BPS 2020 did not give a clear picture of the planning policy in use.

Also, since the first confirmed case of COVID-19 in Kenya, the Government put a raft of measures to curb the virus's spread. These measures negatively impacted the already struggling economy. Therefore, with the anticipated/developed economic recovery strategy, it will be necessary to clearly show how it is linked to the two frameworks mentioned above. It doesn't become yet another basis of planning away from what already exists.

8. **There should be details of significant capital projects across sectors**. Using the example in the 2020 BPS, Annex Table 5 contained details of public-private partnership projects in the energy sector, but the same was not provided from other sectors. The BPS did not explain whether these were the only PPP projects in the 2020/21 budget or explain why the other sectors were not included in other projects were beyond energy. Besides, this should explain how capital projects are prioritized, especially with the BPS's revenue challenges.

9. **The budget presentation needs to be more detailed.** The Programme Based Budgets are essential to provide budget information at programme and sub-programme. However, in some instances, the level of the information supplied does not go to the point of sub-programmes, making it difficult to follow the specific issues that the budgets seek to address. This lack of information makes it difficult to hold the Government accountable.

   Further, the level of non-financial information in the PBB is carried forward from previous years with the same challenges and solutions, making it difficult to understand if there is an improvement in the implementation of budgets. Additionally, the level of non-financial information should help citizens understand what informed the budget decisions.

10. **Public Sector Hearings remain centered in Nairobi and should be decentralized and held in different parts of the country**. By way of example, the 2019 BPS had a section that listed conversations and public input. This was an essential step in providing feedback to the public on its' input, and we applaud the National Treasury for this step. However, the process by which the public is consulted remains quite limiting to the public, with the forums only being held in Nairobi and with minimal space for deliberation. Treasury addressed this concern in its feedback to the public but not in a satisfactory way, as shown in the snippet below.

General comments/ Clarifications/ Corrections.	• Correction of grammatical and editorial errors in the document. • Consistency check on the use of the words 'financing' and 'borrowing'. • Repetition of Paragraphs 55 and 56 on the PIM Unit	• All highlighted errors in the BPS were noted and appropriately corrected. • The repeated text has been deleted.
	• Consider holding Public Sector Hearings across Counties for adequate representation and participation rather than holding the forums at Nairobi where majority of Kenyans are unable to participate.	• The suggestion is well noted.

Unfortunately, the Public Sector Hearings in January 2020 were still only held in Nairobi. This remains a significant gap in public engagement with this very critical budget stage at the national level. This will see a wider part of society is given a chance to participate in decisions that affect them through the budget.

In addition, justifications for why certain decisions were taken and not others are critical for accountability. Currently, it is hard to tell if the decisions have influenced budget allocations in any way. Besides, paragraph 179 of the 2020 BPS indicates that stakeholders' inputs will only be taken up once additional resources are available, as shown below. The consideration of public input should not just be on what new things can be done but also on proposals from that the Government has in the BPS. Unfortunately, this is the same language used in the BPS 2019, as seen in the snippet below.

179. Detailed budgets will be scrutinized and should additional resources become available in the process of firming up the resource envelope, the Government will redirect them to inadequately funded strategic priorities. Specifically, the following will receive priority:

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- Interventions identified by the stakeholders consultation forums for the FY2020/21 Medium-Term Budget;

Finalization of Spending Plans

223. The finalization of the detailed budgets will entail thorough scrutiny to curtail spending on non-productive areas and ensure resources are directed to priority programmes. Since detailed budgets are scrutinized and the resource envelope firmed up, in the event that additional resources become available, Government will utilize them to accommodate key national strategic priorities. Specifically, the following will receive priority:

- Interventions identified during the stakeholders consultation for the FY 2019/20 budget and over the medium term

Source: 2019 Budget Policy Statement

Signed on Friday, 13 November 2020
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