INSTITUTE OF PUBLIC FINANCE

ANNUAL NATIONAL SHADOW BUDGET 2024/25

Budgeting in an Era of Fiscal Consolidation: Protecting Key Priorities

ABRIDGED VERSION

Overview

The 4.1 trillion budget is the second under the Kenya Kwanza administration. The 2024 Budget Policy Statement (BPS) sets a 4% increase from the previous 3.9 trillion budget, prioritizing increased allocation for debt service in FY 2024/25. With a focus on "Budgeting in an era of fiscal consolidation", the Institute of Public Finance (IPF) has analyzed spending priorities and budget ceilings as presented in the BPS as well as past budget execution and key performance indicators to produce the 2024 Annual National Shadow Budget.

This report projects gaps such as discrepancies between sector reports and budget allocations, low development budget absorption, pending bills with no allocations, overlaps, redundancies, and duplication of functions. Addressing these gaps will promote efficiency and free up resources that can be reallocated to finance key priorities at a time when the government is walking the fiscal consolidation path.

Some of the key propositions in the 2024 Annual National Shadow Budget include:

- Within the **Education sector,** the primary and secondary education programmes are likely to be most affected since they do not have a way of generating extra revenue. There is a need to fast track the merging of governance and standards programmes with the quality and assurance standards to free up resources that can be used to increase funding for primary and secondary education. Equally, TVETs and Universities, should leverage on research and innovation to generate additional resources.

- Allocation for the **Agriculture Rural and Urban Development (ARUD) sector** should retain the initial budget allocation of Ksh 60 billion of the Crop Development sub-sector in the FY 2023/24 as opposed to 12 billion reduction in the 2024 BPS. This to ringfence delivery of priority programs such as fertilizer subsidy. Equally, the subsidy program should be integrated with the national irrigation program to create synergy in outcomes.

- **The Governance Justice Law and Order (GJLO) sector** should give priority to activities that will enable fighting corruption while at the same time protecting the whistleblowers.

- In the **Health sector,** leasing medical equipment without assessing county readiness reflects a disconnect between planning and implementation, risking ineffective utilization of resources. In FY 2024/25, there is no provision for leasing of medical equipment that translates to about Ksh. 7 billion annually, through the additional allocation from the National Government's share of revenue like has been in past. Consequently, there is a review that will allow the Ministry of Health (MoH) to execute the leasing of medical equipment through Intergovernmental Participation Agreements to operationalize the project. The question that begs is who will bear the 7 billion annual payment between the MoH and the county governments, given there was no provision for this cost in the BPS 2024?

- The Curative and Reproductive Maternal Neonatal Child & Adolescent Health (RMNCAH) program under State Department for Medical Services (SDMS) significantly overlaps with the Preventive and Promotive Health Service program under State Department for Public Health and Professional Standards (SDPHPS). Both programs include subprograms like Communicable Disease Control, and many RMNCAH activities inherently fall under preventive care.

For all sectors, **setting and reporting of key performance indicators (KPIs) should improve. Sectors should provide KPIs against the resource allocation, and reporting should equally match expenditure.**

1 Macro outlook

The Shadow Budget comes amid a projected slowdown in global economic growth from 3 percent in 2023 to 2.9 percent in 2024, heightened debt servicing expenses consuming over 60% of tax revenue, external risks especially those stemming from Russia-Ukraine and the Middle East conflicts, and unemployment concerns mostly among youth and the expectation for the government to resolve financing and service delivery inadequacy in the health sector , and implement effective poverty and cost of living reducing measures.

Table 1: The total budget is rising, but debt servicing is rising faster

	Approved (Ksh Billion)	2024 BPS Ceiling (Ksh Billion)	Change
	FY2023/24	FY2024/25	
National	**2,464**	**2,511**	**2%**
Executive	2,400	2,438	2%
Parliament	40	41	2%
Judiciary	22	23	4%
CFS(including debt service)	**1,131**	**1,241**	**10%**
County transfers	**385**	**391**	**1%**
Total	**3,981**	**4,143**	**4%**

Source 2024 Budget Policy Statement

In 2024, the National Treasury projects a 5.5 percent growth in the economy. This is expected to be supported by a rebound in agriculture, government policies and priorities under the Bottom - Up Economic Transformation Agenda (BETA) and the strengthening of domestic currency which will ease external debt burden pressure.

At the same time, domestic and external factors are likely to slow down the economy. Among them include tightening of monetary policy that raise the cost of credit for the private sector and the growing risk for financial institutions due to the rise in non-performing loans. This will likely drive commercial banks to raise credit standards for approving loans. Tightening monetary policy and growing risks to financial institutions, including rising non-performing loans, may impede economic momentum, leading to stricter credit standards by commercial banks.

If the economy undergoes a slowdown, there's a concern that revenue generation might not meet expectations, potentially impacting budget implementation *(Fig. 1and 2).* Despite the National Government's optimistic forecast of a Ksh 300 billion increase in ordinary revenue for the fiscal year 2023/24, there's uncertainty regarding the achievement of this target. At a time when the cost of borrowing has risen and highly accumulated debt shrinks the borrowing space, the government is left with domestic revenue mobilization as the best funding option for FY 2024/25 budget. Therefore, persistent revenue shortfalls against the target will compromise service delivery due to budget under-execution. *(Fig.2).*

Figure 1: Revenue Forecast vs. Outturn

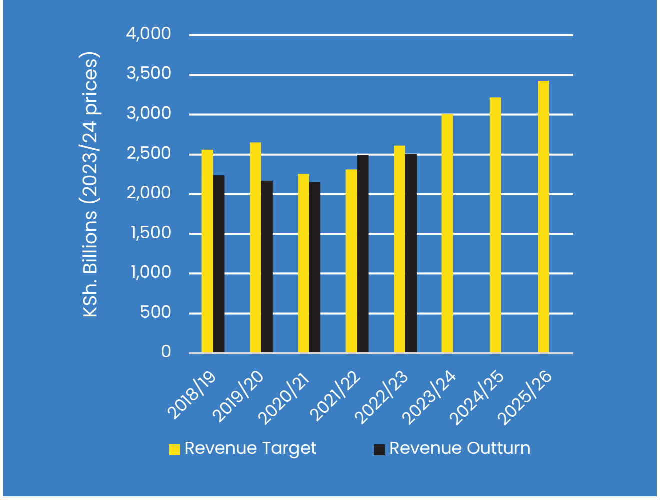
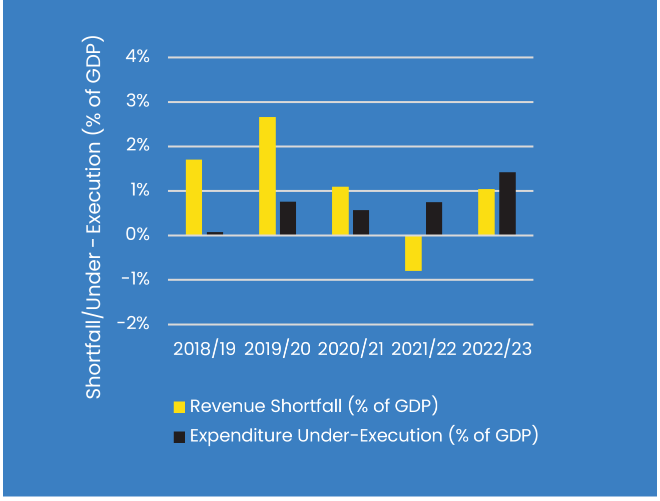


Fig 2: Revenue & Expenditure Execution



Source 2023 Budget Review and Outlook Paper

It is imperative to focus on implementing the Medium-Term Revenue Strategy (MTRS) and the National Tax Policy (NTP) to enhance revenue streams. These initiatives are crucial for maintaining projections of stable economic growth in FY2024/25 and the medium term. However, without addressing the challenges beleaguering the private sector, including tight monetary policies and delayed payments to government suppliers, the potential for economic and revenue growth could be compromised.

❷ Sector Allocations for FY2024/25

Ministerial expenditures are expected to increase by 3 percent in FY2024/25 to Ksh. 2.5 trillion. However, due to factors like a steep growth in debt servicing among other competing needs, the 4 percent increase in the overall budget does not yield a positive change in resource allocations for some sectors *(Table 2)*

Table 2: Summary of sector allocations

	FY2023/24 Supp. Budget (Ksh Million)	FY2024/25 (BPS ceilings) (Ksh Million)	Change
NATIONAL SECURITY	**199,287**	**244,422**	**23%**
Recurrent	196,033	205,586	5%
Development	3,254	38,836	1093%
PUBLIC ADMINISTRATION AND INTERNATIONAL RELATIONS (PAIR)	**299,326**	**351,697**	**17%**
Recurrent	182,824	204,964	12%
Development	116,502	146,733	26%
HEALTH	**138,846**	**147,600**	**6%**
Recurrent	88,191	87,325	-1%
Development	50,655	60,275	19%
GOVERNANCE, JUSTICE, LAW & ORDER (GJLO)	**240,336**	**250,919**	**4%**
Recurrent	225,163	232,773	3%
Development	15,173	18,147	20%
ENERGY, INFRASTRUCTURE & ICT	**494,715**	**505,668**	**2%**
Recurrent	145,306	145,306	0%
Development	349,409	360,362	3%
ENVIRONMENT PROTECTION, WATER AND NATURAL RESOURCES	**125,517**	**127,965**	**2%**
Recurrent	34,725	34,549	-1%
Development	90,792	93,416	3%
SOCIAL PROTECTION, CULTURE AND RECREATION (SPCR)	**72,854**	**72,202**	**-1%**
Recurrent	47,822	46,859	-2%
Development	25,031	25,343	1%
EDUCATION	**689,612**	**666,468**	**-3%**
Recurrent	655,658	638,044	-3%
Development	33,954	28,424	-16%
AGRICULTURE, RURAL & URBAN DEVELOPMENT (ARUD)	**98,089**	**87,808**	**-10%**
Recurrent	32,507	29,820	-8%
Development	65,582	57,988	-12%
GENERAL ECONOMIC AND COMMERCIAL AFFAIRS (GECA)	**72,443**	**56,715**	**-22%**
Recurrent	39,576	32,305	-18%
Development	32,868	24,410	-26%
Total	**2,431,023**	**2,511,464**	**3%**
Recurrent	1,647,804	1,657,530	1%
Development	783,220	853,934	9%

Figure 3: National security, public administration and health are the priorities in 2024/25

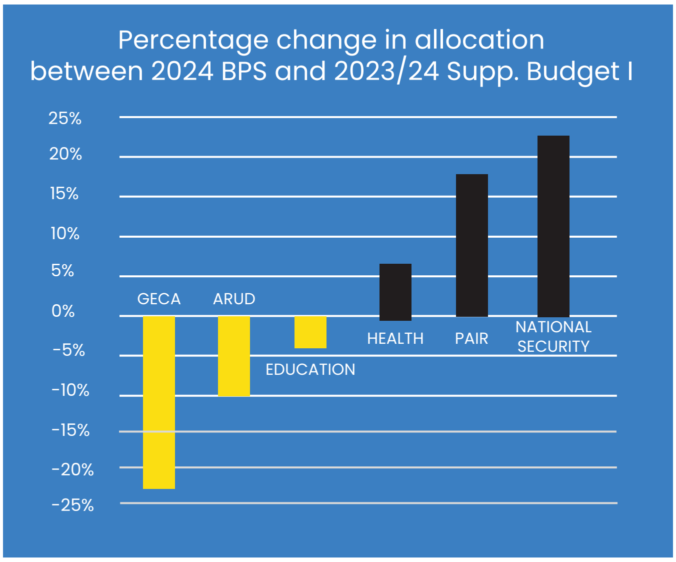
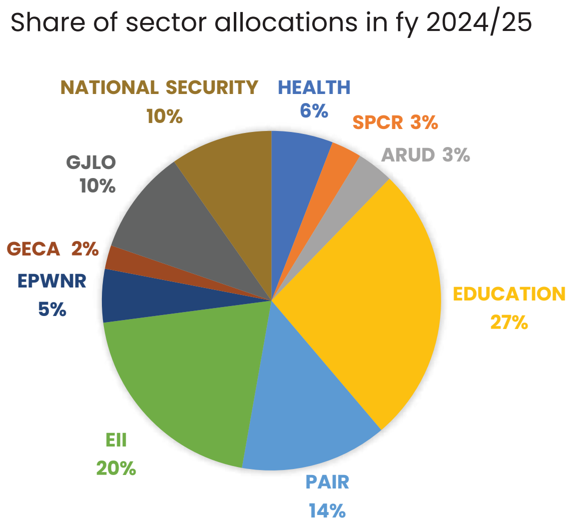


Figure 4: Energy, national security and education take more than half the budget, even amidst cuts



Despite the government's commitment to supporting SMEs, transforming the agriculture sector, and resolving the funding crisis in education, the changes in resource allocation depicted in (Table 2) suggest otherwise. Limited borrowing space to finance the budget and the drawing of huge resources by a high debt servicing burden has forced the government to resort to budget cuts for the General Economic Commercial Affairs (GECA) sector by 22 percent, the Agriculture, Rural, and Urban Development (ARUD) sector by 10 percent, and the Education sector by 3 percent.

Amidst the urgent need for fiscal consolidation and prioritization of social spending, the government is surprisingly channeling significant resources towards PAIR and National Security sectors. Whereas the 10 percent increase in the National Security budget is likely due to the improvement in housing for the police service, it is hard to hold the government to account on how this increment for "development" will be utilized since National Security is a hard audit sector. The 2024 BPS sheds no light on why National Security budget was prioritized to Social Protection Culture and Recreation (SPCR)which should be strengthening social safety nets, is expected to receive a one percent cut.

❸ Cross-cutting issues

There is a pressing need to prioritize the clearance of nearly Ksh. 570 billion nationally and Ksh. 165 billion in county pending bills. Clearing these bills may alleviate liquidity constraints for the private sector, but it could strain government finances, especially amid the necessity for fiscal consolidation.

The cumulative Ksh 570 billion, represents a substantial 23% of MDAs' allocations for FY2024/25, highlighting a critical issue. This not only jeopardizes compliance with Section 94(1)(a) of the PFM Act, 2012, but also places MDAs in a precarious position regarding their operational and financial obligations. To mitigate this, a clear medium-term plan is essential. Establishing a central sinking fund could provide a structured approach to gradually pay off the pending bills over the next five years. Alternatively, MDAs could be tasked with making targeted budget cuts to address their outstanding liabilities. This approach would allow for flexibility based on each MDA's unique circumstances, ultimately ensuring a sustainable resolution while averting potential losses from litigation and accrued interests.

It is evident that overlaps, duplications, and redundancies in functions are prevalent across various programmes, leading to a wasteful expenditure of limited resources. Additionally, national-level MDAs persist in undertaking tasks that are also within the purview of devolved units. For instance, the Teachers Service Commission (TSC) administers governance and standards programmes, duplicating efforts already undertaken by the quality assurance and standards division within the state department for Basic Education. Similarly, primary healthcare, which aligns more closely with county-level responsibilities, is redundantly managed at the national level through two separate state departments: the State Department for Medical Services and the State Department for Public Health and Professional Standards. Addressing these inefficiencies requires a concerted effort to streamline functions, eliminate redundancies, and ensure that tasks align appropriately with the mandates of national and devolved levels of government. By doing so, resources can be utilized more efficiently to achieve optimal outcomes across all sectors.

The prevalence of overlaps, duplications, and redundancies in functions across various programmes leads to wasteful expenditure of limited resources. National-level Ministries, Departments, and Agencies (MDAs) often undertake tasks also within the purview of devolved units. For example, the Teachers Service Commission (TSC) duplicates efforts already undertaken by the quality assurance and standards division within the state department for Basic Education. Similarly, primary healthcare, aligning more closely with county-level responsibilities, is redundantly managed at the national level through separate state departments. Addressing these inefficiencies requires streamlining functions, eliminating redundancies, and ensuring tasks align appropriately with the mandates of national and devolved levels of government. This optimization allows for more efficient resource utilization and better outcomes across sectors.

A comparative analysis reveals significant discrepancies between sector reports and budget allocations, indicating a weak linkage between planning and budgeting. These discrepancies hinder accountability and make it challenging to determine the efficient utilization of resources.

- **In the health sector, leasing medical equipment without assessing county readiness reflects a disconnect between planning and implementation, risking ineffective utilization of resources.** In FY 2024/25, there is no provision for leasing of medical equipment that translates to about Ksh. 7 billion annually, through the additional allocation from the National government's share of revenue like has been in past. Consequently, there is a review that will allow the Ministry of Health (MoH) to execute the leasing of medical equipment through Intergovernmental Participation Agreements to operationalize the project. The question that begs is who will bear the 7 billion annual payment between the MoH and the county governments, given there was no provision for this cost in the BPS 2024?

- While there are pledges to uphold Universal Health Coverage (UHC) via Social Health Insurance (SHI), Primary Health Care (PHC), and support for Community Health Promoters (CHPs), as well as funding for emergency, chronic, and critical conditions, the absence of budget votes for these areas in the budget policy statement indicates a misalignment with policy priorities.

- In FY 2022/23, both the State Department for Public Health and Professional Standards (SDPHPS) and State Department of Medical Services (SDMS) had the same programs except for the National Referral and Specialized Services that was only under SDMS. An attempt was made in FY2023/24 to address the duplicity. However, the move has created redundancy between the SDPHPS and SDMS programs. Specifically, the Curative and Reproductive Maternal Neonatal Child & Adolescent Health (RMNCAH) program under SDMS significantly overlaps with the Preventive and Promotive Health Service program under SDPHPS. Both programs include subprograms like Communicable Disease Control, and many RMNCAH activities inherently fall under preventive care.

- Highlighting the fight against corruption is aimed at safeguarding public resources, but, is likely to be affected by the decrease in allocation for crucial agencies like the Office of the Director of Public Prosecutions (ODPP) and Witness Protection that are faced with 9 percent and 4 percent budget cuts respectively. For EACC to effectively work it needs to employ a multi-agency approach. Instead, the resources added to the State Department for Immigration and Citizen Services could be re-allocated, since the Appropriation In Aid (AIA) for this department is expected to increase after the introduction of service charges on issuance of identity cards, and increased fees for passports and marriage certificates among others.

- **Education sector priorities lack clear KPIs, leading to uncertainty about performance tracking and accountability.** For instance, the Sector Working Report for 2023/24 targets to employ 3,000 TVET tutors while the 2024 BPS states 2,000 tutors.

- **Despite Library Services within the State Department for Culture and Heritage consuming 91 percent of the budget in FY2022/23, the absence of clear and measurable Key Performance Indicators (KPIs) impedes performance tracking and accountability.** This issue is particularly concerning given the substantial budget allocation of Ksh. 553 million for Libraries in FY2024/25.

- **While the Galana Kulalu Irrigation development project has made significant strides, utilizing 90% of the estimated project cost and achieving a reported 97% completion rate of civil works, but fails to give targets of actual yields.** Despite handing over a portion of the project to a private investor for trials, detailed information on yields and crops cultivated remains elusive. This discrepancy between reported completion rates and actual achievements raises questions about project transparency and effective resource allocation. A thorough review and clarification are necessary to ensure accountability and optimize resource utilization moving forward.

- **Budgeting should be guided by policy documents and blueprints.** Vision 2030 targeted to address the issue of access and affordability of fertilizer through identification of a private investor for blending. There seems to be a departure from this approach as the 2024 BPS targets to lower the cost of inputs using fertilizer subsidies.

- **Low development budget absorption:** a concerning trend emerges with an average of 40% of development budgets remaining unabsorbed across various programs. This low absorption rate, coupled with the accumulation of pending bills and stalled projects, underscores the need for improved efficiency and effectiveness in budget implementation.

4 Fiscal Decentralization

This section illuminates fiscal performance of county governments and gives recommendations on transfer of functions with a goal to inform how devolution can be strengthened. We emphasize the need to expedite costing of functions, clear stipulation and full devolvement of contentious functions, mostly in agriculture and water and sanitation. According to the IGRTC, MDAs are still performing county functions with an estimated cost of Ksh 272 billion.

Revenue performance

The 2024 BPS proposes a modest increase of 1.4 percent in equitable share which is much lower than the 4 percent increase in the total budget, In the past, counties have relied heavily on equitable share form the national government. In FY 2022/2023, counties collected total revenue of 37.8 billion against a target of 57.4 billion, funding only 8 percent of their total budget from own sources. On the other hand, The Commission on Revenue Allocation observed that counties collected only 15 percent of potential revenue based on their economic capacities. Although some counties have in the past exceeded their revenue targets, the targets are often set below actual potential, due to limited capacity to set realistic targets, and lack of comprehensive datasets to inform projections, thus resulting in widespread underperformance.

Delays in disbursing funds from the national government adversely affect county operations, pressing more on need to boost county revenue generation efforts.

Expenditure performance

Just like the national government, counties are still facing challenges in effectively utilizing their development budgets, with a 61 percent absorption rate noted for FY 2022/2023. Delays in national government disbursements, a longstanding issue, have contributed to this difficulty. Such delays impede counties' ability to address development needs, especially since they heavily rely on exchequer releases.

Moreover, counties encounter hurdles in adhering to fiscal responsibility principles, notably allocating a minimum of 30% of their budgets to development and limiting wages and salaries expenditure to 35% of total revenues. Exceeding the 35% threshold on salaries and wages leaves insufficient funds for development needs. General public service takes up the greatest share of counties' expenditure. The health sector, which is heavily devolved, also takes up a great share of the budget. For the less devolved functions such as education, the expenditure is minimal as most of the functions are under the national government. As counties implement their budgets, they need to be keen not to spend on the national government functions.

Transfer of functions

Counties continue to grapple with challenges concerning the transfer of constitutional functions and corresponding funds from the national government. The Intergovernmental Relations Technical Committee (IGRTC) identifies issues such as overlapping functions and disparities in funding allocation. Various efforts, including delineating functions and establishing Multi-Agent Technical Task Teams (MATTs) to facilitate transfers, have been initiated to tackle these issues. However, progress has been sluggish, particularly in sectors such as agriculture, transport, education, tourism, wildlife, and water.

Despite delineation efforts, ambiguity persists regarding the roles of the national government and counties in functions like water. Concerns have been raised about the operations of the Regional Development Authorities possibly violating the constitution This calls for more effort to ensure all functions are fully delineated, enhancing the service delivery.

Acknowledgement:

Gratitude to the IPF team, the sector experts who shared their valuable insights to build the report, and Jason Lakin, PHD for the collaboration in developing this document. Special appreciation to the Bill and Melinda Gates Foundation for the resources to undertake this research, which went a long way in making this publication possible.

Disclaimer:

Institute of Public Finance
Suite 8, 4th Floor, Rosami Court,
Muringa Road, Nairobi, Kenya

ipf_global
Institute of Public Finance
Institute of Public Finance
www.ipfglobal.or.ke

To access the full report and other IPF publications

SCAN ME