IPF
INSTITUTE OF PUBLIC FINANCE

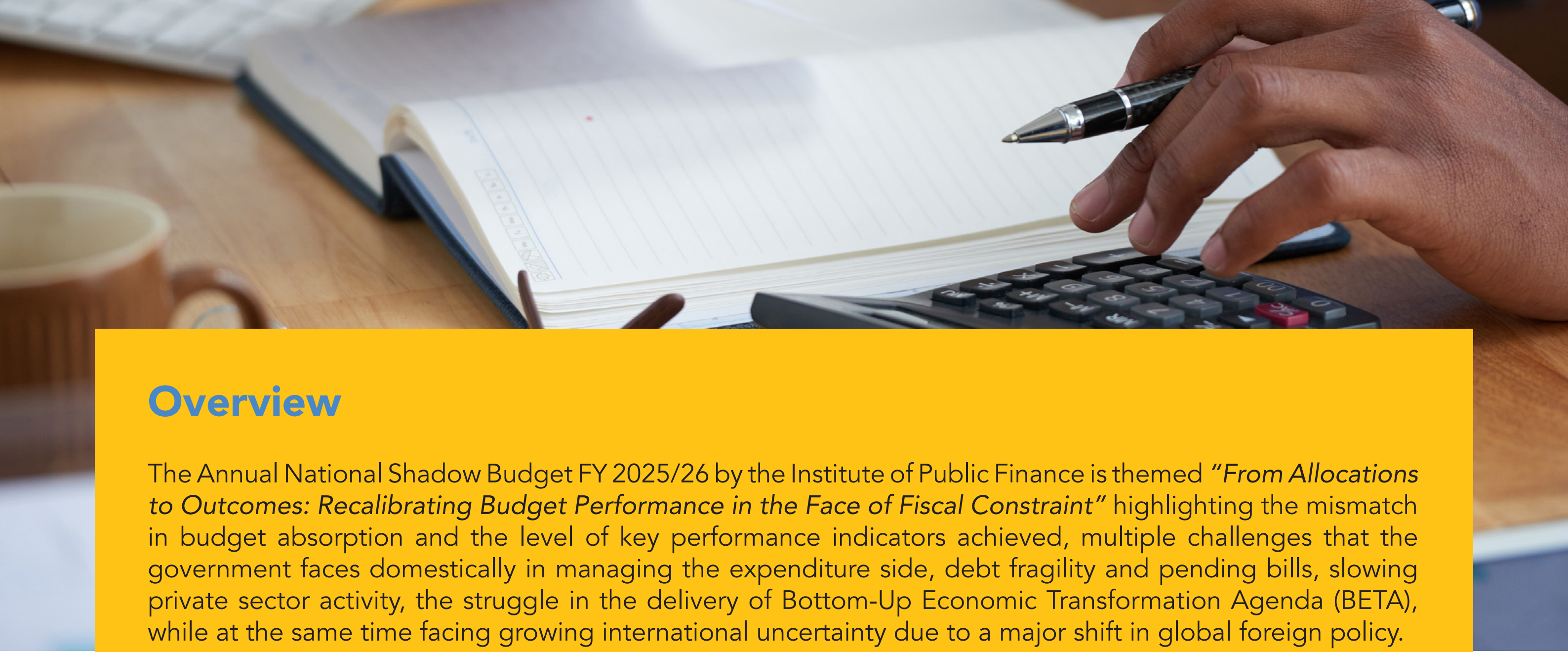
ANNUAL NATIONAL SHADOW BUDGET

FY2025/2026

Recalibrating Budget Performance in the Face of Fiscal Constraints

ABRIDGED VERSION

5th Edition



Overview

The Annual National Shadow Budget FY 2025/26 by the Institute of Public Finance is themed *"From Allocations to Outcomes: Recalibrating Budget Performance in the Face of Fiscal Constraint"* highlighting the mismatch in budget absorption and the level of key performance indicators achieved, multiple challenges that the government faces domestically in managing the expenditure side, debt fragility and pending bills, slowing private sector activity, the struggle in the delivery of Bottom-Up Economic Transformation Agenda (BETA), while at the same time facing growing international uncertainty due to a major shift in global foreign policy.

In the FY2025/26, a Ksh. 4.3 trillion budget is presented by the Kenya Kwanza administration, representing a 10 percent increase from the revised Ksh. 3.9 trillion budget estimates in FY 2024/25. The 2025 Budget Policy Statement (BPS) underscores a continued commitment to fiscal consolidation, with a notable rise in debt servicing obligations, which are projected to consume over Ksh. 1.37 trillion. Fiscal consolidation should, however, not just be a statement. The revision of the ordinary revenue target from KES 3 trillion in the draft BPS to KES 2.8 trillion in the final 2025 Budget Policy Statement (BPS), without a corresponding adjustment in total expenditure estimates, not only widens the fiscal deficit but also raises credibility issues if the fiscal framework fails to align spending with realistic revenue forecasts.

While paying keen attention to Vision 2023, priorities under Medium-Term Plan IV and the BETA, the Institute of Public Finance (IPF) has reviewed historical budget execution and key performance indicators, and the sectoral ceilings set in the 2025 BPS to produce the Annual National Shadow Budget for FY2025/26.

This analysis reveals several systemic gaps, including low development budget absorption, a growing stock of pending bills, now totaling Ksh. 706 billion, and continued overlaps and duplications in government functions across multiple sectors. These inefficiencies undermine service delivery and slow progress on key national priorities. Strengthening alignment between resource allocation and sector performance, while addressing these gaps, is critical as the government navigates a tight fiscal environment and seeks to deliver on its socio-economic transformation agenda.

Key propositions

In the **Health sector**, the budget has a 72% increase from Ksh. 118 billion in FY2024/25 to Ksh. 204 billion in FY2025/26. However, despite increased allocations to the social protection in health sub-program under the GAPSS program in SDMS from KSh. 13.7 billion in FY2024/25 to KSh. 94.3 billion in FY2025/26, KShs 82.4 billion is indicated as appropriation-in-aid for the Social Health Insurance Fund, essentially to be financed from citizen's contributions, and therefore not a predictable source of financing. This will have a countereffect on the efforts to have the indigents get health insurance under the new Social Health Insurance (SHI) package. Therefore, the government needs to increase funding for Social Health Insurance Fund and establish specific budget lines for the Primary Health Care Fund and the Health Emergency and Chronic Disease Fund.

In the **Environment Protection, Water and Natural Resources (EPWNR) sector**, prioritizing the recharge of all groundwater aquifers (shallow and deep) across the country, and addressing high levels of pollution in the Thwake dam, which is reeling under heavy pollution problems from Nairobi and the upper catchment of River Athi, making the water unfit for people around it and negatively affecting large human and animal populations for nearly 300km downstream. Additionally, increasing support to mining cooperatives and committees to support artisanal miners and thus boost job creation.

Aligning budget allocations in the **Agriculture, Rural and Urban Development (ARUD) sector** to government priorities by increasing the allocation to the Land Policy and Planning programme and enhancing funding for the Land Information Management Programme to enable the full implementation of the National Land Management Information System, support the development of land value indices, and address the systemic inefficiencies that undermine infrastructure development and land governance.

Within the **Education sector**, substantially increasing resources to teacher recruitment, training and expansion of education infrastructure to support the improvement of the teacher-student ratio by employing 56,000 teachers. Further, increasing the allocation to primary education to address the decline in the gross enrollment rate, and ensuring sustained allocations to Technical and Vocational Education Training (TVET) in order to support the effectiveness of TVET initiatives.

The **Public Administration and International Relations sector** has seen minimal increases in oversight institutions including the CRA, OCOB and OAG, relative to substantial increases for executive offices under the Presidency. Additionally, there is a significant reduction in funding to the State Department for Economic Planning. These allocations raise concerns about the government's commitment to effective public finance management.

In the **Governance, Justice, Law and Order (GJLO) sector**, a comprehensive personnel audit of the National Police Service and the State Department for Internal Security and National Administration to identify areas of redundancy and optimize staff deployment, in order to support rationalization of personnel costs while ensuring adequate service delivery. Further, demanding a breakdown of the unexplained "others" category, which is allocated substantial amounts but is opaque and difficult to track.

Addressing pending bills amounting to Ksh. 17.4 billion within the **General Economic and Commercial Affairs (GECA) sector**, which have adversely affected economic activities particularly of MSMEs; and

Within the **Social Protection, Culture and Recreation (SPCR) sector**, streamlining and aggregating social protection programmes across government to ensure there is equitable allocation of resources based on need across vulnerable groups and geography, and expanding allocations to social protection in response to increased poverty.

Macro Outlook

The 2025/26 Annual National Shadow Budget comes at a time of tempered optimism for Kenya's economy. Kenya's economy has remained resilient in the face of domestic unrest and external shocks, including ongoing conflicts such as Russia-Ukraine and the Israeli-Hamas war. Domestically, Kenya faces challenges such as heightened debt servicing expenses consuming over 60% of tax revenue, persistent youth unemployment, and inefficiencies in financing and service delivery within critical sectors such as health and education. Additionally, the government, through the Bottom-Up Economic Transformation Agenda (BETA), is expected to prioritize poverty alleviation and measures to address the cost of living. These dynamics shape the broader economic and fiscal landscape heading into 2025.

Kenya's economy has a projected growth of 5.3 percent in 2025, slightly above sub-Saharan Africa's average of 4.2 percent. Growth will be driven by agriculture, the services sector, and the implementation of priorities under BETA and MTP IV. While growth has shifted towards agriculture and services, the contribution from industry has declined. Services, however, remain the strongest driver of growth, showing a robust recovery since mid-2021 following the COVID-19 pandemic. Despite this, real GDP growth has been on a downward trend, with quarterly year-on-year growth falling from 5% in Q1 to 4.1% in Q3 2024.

Table 1:

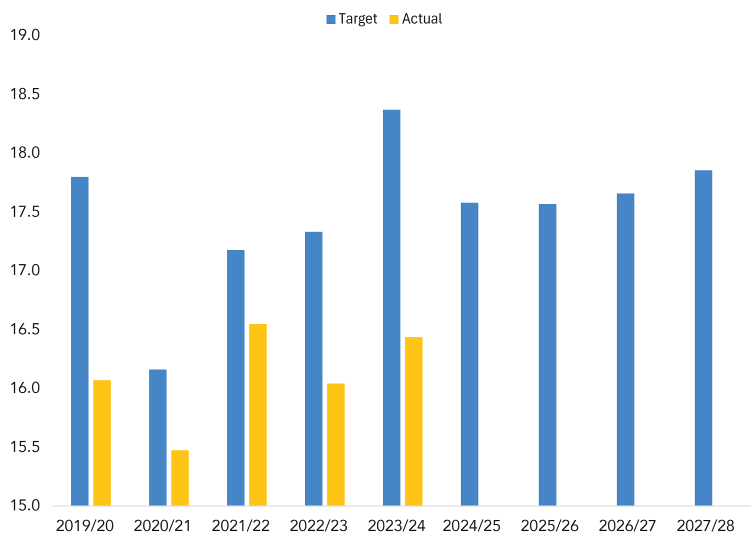
	Approved Supp I (Ksh. Billion)	2025 BPS Ceiling (Ksh. Billion)	Change
	FY2024/25	FY2025/26	
National	2,301	2,562	11%
Executive	2,237	2,494	11%
Parliament	40.9	42.5	4%
Judiciary	22.5	25.7	14%
CFS	1237.23	1368.99	11%
County transfers	380	405.1	7%
Total	**3,949**	**4,336**	**10%**

Notes*

**Consolidated Funds Services(CFS) is composed of domestic interest, foreign interest and pensions & salaries for State Officers*

However, macroeconomic risks remain. Public debt exceeds 60% of GDP, with debt servicing rising by 11% to Ksh. 1.37 trillion, thus running the risk of crowding out spending on development. Revenue collections underperformed by Ksh. 93.2 billion in 2024, driven by VAT and income tax shortfalls. Monetary tightening has eased, but credit to the private sector remains subdued. Meanwhile, the external environment is riddled with challenges like geopolitical conflicts, the surge of nationalism, especially in the West, and the impacts of climate-related disruptions.

Figure 1: Revenue targets and outturns



The fiscal deficit is expected to narrow slightly to 4.9% of GDP in FY2024/25, reflecting slow progress on consolidation. Pending bills stand at Ksh. 539.9 billion, undermining private sector liquidity and creating systemic risks. Without concrete actions to boost revenue efficiency and address overlaps and redundancies in budgeting, fiscal pressure is expected to persist.

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.

Sector Allocations for FY2025/26

Ministerial expenditures are expected to increase by 11% in FY2025/26 to Ksh. 2.56 trillion. However, due to a steep rise in debt servicing and other competing priorities, this 10% increase in the overall budget does not translate into meaningful resource gains for all sectors, with some like Public Administration and International Relations (PAIR)and Environment Protection, Water and Natural Resources experiencing cuts (Table 2).

Table 2: Summary of sector allocations

	Approved Supp I (Ksh. Billion)	2025 BPS Ceiling (Ksh. Billion)	Change
	FY2024/25	FY2025/26	
NATIONAL SECURITY	219,303	257,023	17%
Recurrent	217,769	244,507	12%
Development	1,534	12,516	716%
PUBLIC ADMINISTRATION AND INTERNATIONAL RELATIONS (PAIR)	311,795	286,759	-8%
Recurrent	186,453	189,702	2%
Development	125,342	97,057	-23%
HEALTH	118,856	204,495	72%
Recurrent	86,828	171,948	98%
Development	32,028	32,547	2%
GOVERNANCE, JUSTICE, LAW & ORDER (GJLO)	234,861	265,873	13%
Recurrent	228,980	243,505	6%
Development	5,881	22,368	280%
ENERGY, INFRASTRUCTURE & ICT	444,290	504,604	14%
Recurrent	142,034	149,704	5%
Development	302,256	354,900	17%
ENVIRONMENT PROTECTION, WATER AND NATURAL RESOURCES	101,197	33,699	-67%
Recurrent	32,152	70,065	118%
Development	69,045	103,765	50%
SOCIAL PROTECTION, CULTURE AND RECREATION (SPCR)	68,942	78,786	14%
Recurrent	45,281	52,143	15%
Development	23,662	26,643	13%
EDUCATION	681,723	723,890	6%
Recurrent	660,635	696,462	5%
Development	21,088	27,428	30%
AGRICULTURE, RURAL & URBAN DEVELOPMENT (ARUD)	73,933	77,672	5%
Recurrent	29,362	32,202	10%
Development	44,571	45,469	2%
GENERAL ECONOMIC AND COMMERCIAL AFFAIRS (GECA)	45,626	59,139	30%
Recurrent	29,866	37,813	27%
Development	15,760	21,327	35%
TOTAL	**2,300,525.7**	**2,562,005**	**11%**
Recurrent	1,659,359	1,851,684	12%
Development	641,166	710,321	11%

While the government has reiterated its focus on empowering MSMEs, revitalizing agriculture, and expanding access to health and education, the allocation trends paint a different picture. Constrained fiscal space and the growing pressure from debt servicing have resulted in only marginal gains for key sectors. GECA receives a 30 percent increase and ARUD a modest 5 percent, both of which fall short of the financial support needed to drive meaningful transformation. This reflects a disconnect between policy ambitions and actual funding decisions.

Meanwhile, PAIR faces an 8 percent budget cut, while National Security gets a substantial rise, primarily due to a 716% increase in development spending, although this lacks clarity on audit and utilization mechanisms.

The FY2025/26 Shadow Budget reveals that while the government commits to fiscal consolidation, entrenched structural inefficiencies, pending bills, and unbalanced sector allocations continue to pose risks. In the face of limited borrowing space, realigning spending with performance, clearing arrears, and enhancing revenue collection remain critical to achieving Kenya's economic goals.

Cross-cutting issues

The urgent and critical clearance of national government pending bills amounting to Ksh. 524 billion and Ksh. 182 billion for county governments to ease cash flow pressures on the private sector, while ensuring that the government's procurement process is not hindered. Of the Ksh. 524 billion, Ksh. 426.3 billion is owed by state corporations and Ksh. 97.8 billion owed by ministries, state departments and other government entities. This accumulation negatively impacts the liquidity of the private sector and the government's procurement process. Notably, the accumulation will attract penalties and interest and create additional public costs in litigation fees. It is imperative that the payment of outstanding pending bills be prioritized before the commencement of new projects.

There is notable poor implementation of projects evidenced by stalling and delays in meeting implementation timelines. This translates to significant losses in taxpayer funds while creating risks for embezzlement of funds. A recurring concern has been the significantly poor implementation of projects, which has exerted rising costs and lowered value for money in publicly funded projects. Failed projects, including those that have exceeded their implementation timelines by many years but still continue to receive budget allocations, are causing major losses to the public and creating avenues for the misappropriation of funds.

Timely and predictable disbursement of funds from the exchequer to Ministries, Departments, and Agencies (MDAs) is vital to enhance service delivery and maintain fiscal discipline. There is an imperative need to prioritize timely disbursements of funds from the exchequer to MDAs. Erratic disbursement of funds from the exchequer to MDAs poses a significant issue for implementing agencies, which are forced to divert existing funds to meet urgent liabilities, or to borrow money from the financial sector in order to make payments.Addressing this challenge significantly improves fiscal discipline and operational stability while ensuring the credibility and responsiveness of government programs.

Tax expenditures must be well targeted and progressive to avoid regressivity and unjustified revenue loss. As of 2023, tax expenditure was Ksh. 510.6 billion, (3.4 percent of GDP). The largest tax expenditures were on value-added tax, which amounted to Ksh. 333 billion, with the largest contributions from finance and insurance, manufacturing and agriculture, forestry and fishing.[1] The implementation of tax expenditures that target a class of taxpayers must ensure that the exemptions are progressive. Exemptions that have the highest benefits for higher-income individuals are best implemented using other instruments.

The persistent duplication of functions across national and devolved governments, and within national government entities, leads to wasteful spending and inefficiency. The budget still continues to include allocations for functions that ought to be implemented by counties thus leading to inefficient use of public resources. These expenditures should either be justified or implemented at their appropriate level in order to avoid the duplication of functions and require rationalization.

[1] The National Treasury and Economic Planning, 2024 Tax Expenditure Report, September 2024, Table 16, p. 22.

Conclusion

The Annual National Shadow Budget for FY2025/26 comes at a time when GDP growth has experienced a slow down although the government is over ambitiously targeting an improvement to 5.3% in 2025 – to be supported by strengthening macroeconomic indicators such as declining inflation and appreciation of the Kenya Shilling against the US dollar. Another critical development is the government's decision to adopt zero-based budgeting and implement Public Investment Management (PIM) regulations, which is a significant policy shift that, if fully implemented can improve efficiency, reduce wastage, and ensure that allocations align with outcomes. Also worth noting is significant budget increase to the health sector to KSh. 204 billion in FY2025/26—up from KSh. 118 billion in FY2024/25 — underscoring government's commitment to rolling out Universal Health Coverage under the Bottom-Up Economic Transformation Agenda (BETA). Furthermore, under the social protection sector, the National Safety Net Programme has a 19% increase in budget allocation up to KSh. 35 billion in FY2025/26 from KSh. 30 billion in FY2024/25.

However, glaring concerns remain with respect to the accumulation of pending bills, that according to the Office of the Controller of Budget stood at KSh. 706 billion as at the end of first half of FY2024/25. These arrears are not only growing, but they reflect serious weaknesses in procurement planning, commitment control, and cash flow forecasting. A big concern is with SAGAs that saw pending bills grow by 12% from KES 379 billion in FY2023/24 to KES 476 billion. Deliberate action is required to address pending bills challenge. Otherwise, government statement that pending bills need to be prioritized remain just mere rhetorics if that lack of provision is persistently cited by the sector reports as a contributor to pending bills.

In the health sector, despite increased allocations to the Social protection in health sub-program under the GAPSS program in SDMS from KSh. 13.7 billion in FY2024/25 to KSh. 94.3 billion in FY2025/26, KShs 82.4 billion is indicated as appropriation-in-aid for the Social Health Insurance Fund, essentially to be financed from citizen's contributions, and therefore not a predictable source of financing. Another worrying trend is low absorption for the health sector development budget—only 59% of allocated development funds were utilized in FY 2023/24 thus undermining infrastructure expansion and service delivery.

Analysis of KPIs within the education sector reveals that spending is not translating into value or equity because basic education is one of the largest recipients of public funds yet there is slow execution of the Competency-Based Curriculum reforms, poor learning outcomes, and stagnating infrastructure expansion. In the State Department for Higher Education and Research, the development budget absorption rate was at a low of 49% in FY2023/24.

In the GECA sector, inefficiencies persist not only in the State Department for Investment Promotion but also in tourism, where recurrent spending on administration remains high while performance indicators tied to job creation and visitor numbers have plateaued. These trends point to a broader failure to enforce performance-based budgeting, with many programmes continuing to receive funding despite weak results and poor monitoring frameworks.

To restore fiscal credibility and ensure public resources deliver desired outcomes efficiently and effectively, the government must urgently strengthen the linkage between budget planning and execution. This requires enforcing programme rationalization across all sectors, especially where poorly performing initiatives continue to absorb resources with disproportionately low returns. Enhancing absorption capacity must go hand-in-hand with strengthening the operational autonomy and accountability of frontline spending units, particularly at the programme and sub-programme level. In social protection, harmonizing national and initiatives and anchoring them in a coherent policy framework will be critical to ensuring coverage expansion aligns with real vulnerability. Furthermore, the full implementation of PIM guidelines must be accompanied by transparent publication of project appraisals, while zero-based budgeting should not become a technical label without political commitment to reallocate resources based on performance and need.

Disclaimer

The findings and conclusions contained within are those of the authors and do not necessarily reflect the positions or policies of the Gates Foundation

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