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Kenya Budget Policy Statement For FY 2025/26:

Key Insights

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1.0 Statement on Risks

Summary of risks Kenyan economy is exposed to that may affect the achievement of the macroeconomic targets and objectives detailed in this Budget Policy Statement (BPS).

1. **Economic Outlook**
   - **Government borrowing dominance over the private sector**
   - **Weaker economic rebound than projected**
   - **Muted Demand**

2. **The Monetary Sector**
   - **Stability in the foreign exchange rate together with a stable inflow of foreign remittances**
   - **Kenya' monetary policy stance is still tight and is contributing to the crowding out effects.**
   - **Refinancing risks are likely to persist due to the high debt servicing**
   - **The credit worthiness of the country**

3. **The Balance of Payment**
   - **Unraveling of Multilateral Trade**
   - **Deficit of productivity of the Kenyan Economy.**

4. **Fiscal Outlook**
   - **Over estimation of ordinary revenue projections**
   - **Budgetary pressures - strikes from medical personnel, teachers, etc.**
   - **The extent to which the reforms and restructuring of parastatals is successful**
   - **Public debt**
   - **National and County Government's Pending Bills.**
   - **Habitual revision of the budget attributed in part to revenue shortfall**

5. **Judiciary and independent commissions Spending Ceilings**
   - **Guaranteed financial autonomy for the Judiciary**
   - **Inadequate funding**
   - **Judiciary effectiveness**

2.0 Introduction

The Legal and Constitutional Basis for the Budget Policy Statement

Kenya's Budget Policy Statement is prepared and implemented in accordance with the Constitution of Kenya-2010 and the PFM Act, 2012. These provide the primary legal basis for the annual budget process. The constitutional and legislative framework require openness, accountability and prudence in financial management, in addition to clear fiscal reporting. Specifically, Article 201 of the Constitution articulates the principles of public finance, stating that the budget process must promote equity, accountability, and sustainable development. Article 220 of the Constitution subsequently provides the form, content and timing of both national and county budgets.

The PFM Act operationalizes the constitutional dictates by obligating the National Treasury to prepare and submit the BPS and Debt Management Strategy to Parliament by February 15, each year. As a precursor to the national budget estimates, the BPS, should reflect the constitutional principles by outlining the government's fiscal strategy, expenditure priorities, and macroeconomic assumptions for each financial year and the medium term. It plays a significant role in promoting macroeconomic stability by providing projections on GDP growth, inflation, sector performance and monetary policy, which are essential for economic planning by both the public and private sectors. The BPS details an assessment of the prevailing economic environment, the overall fiscal framework including government revenue, expenditure, borrowing projections, proposed spending ceilings, and fiscal responsibility principles to ensure sustainable debt management. It establishes the basis of the overarching fiscal policy that should guide both levels of government in preparing their respective budgets.

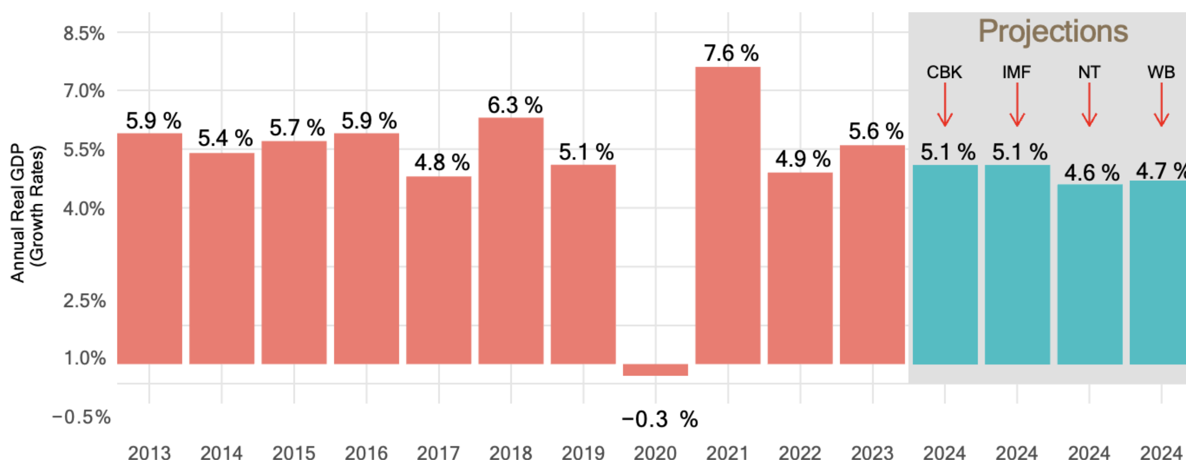
Ideally, the proposed fiscal policy should ensure that government expenditure aligns with available resources and prevents excessive deficits. The expenditure ceilings should similarly promote fiscal discipline and prudent financial management. The BPS should align fiscal policy with development goals through a sound framework for sectoral spending that ensures the efficient and effective provision of public goods and services. The budget policy should further adhere to the constitutional requirement that spending should promote equitable development in the country, including by making special provisions for marginalized groups and areas.

Given its significance, the IEA -Kenya considers the analysis of the BPS essential in evaluating the coherence and feasibility of government policy priorities. Section 36 of the PFM Act requires public participation in the budget formulation process to ensure accountability in the allocation of resources and to enhance responsiveness to public needs and priorities. Citizens should take an interest in its contents as it has direct implications for taxation, public spending, and economic policies that influence their income. This brief will assess the soundness of the rationale behind the FY 2025 BPS and the likely implications of the policy proposals on macroeconomic stability, fiscal sustainability, and social equity.

3.0 Economic Outlook

Economic growth rates measure periodical changes of a country's economic output, calculated as a percentage change in the value of the real GDP. The 2025 Budget Policy Statement presents an outlook that reflects the realities and challenges facing Kenya's economy in the current and medium term. Chart 1 illustrates Kenya's economic performance in terms of annual real GDP growth rates from 2013 to 2023, alongside projections for 2024 by different institutions.

Chart 1: Kenya's Economic Performance



Source*: Author's computation of KNBS Data*

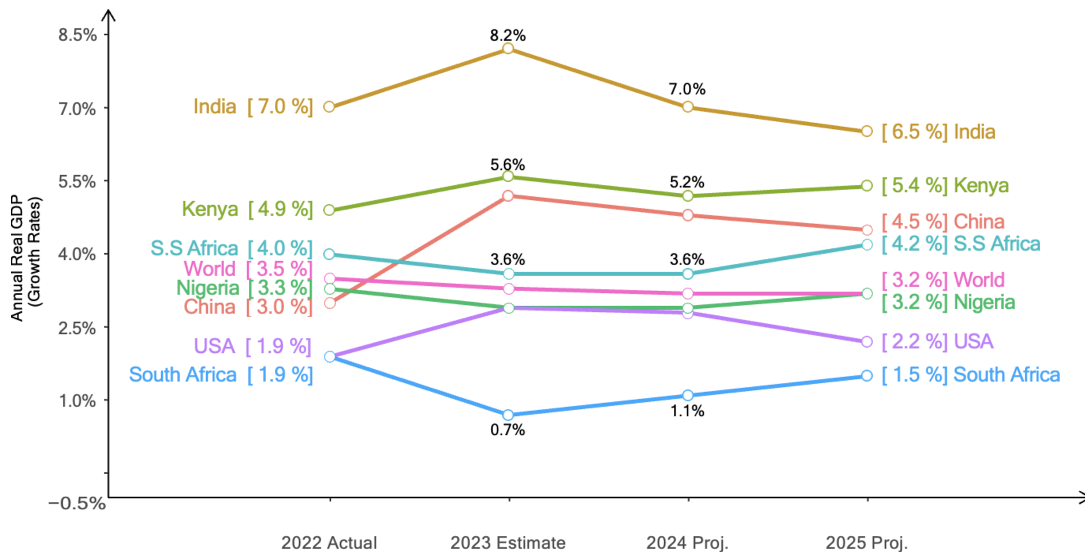
Between 2013 and 2019, Kenya maintained relatively stable growth, ranging between 4.8% and 6.3%. However, in 2020, the economy contracted by 0.3%, primarily due to the COVID-19 emergency and the associated disruptions. A recovery followed in 2021, with GDP growth peaking at 7.6%, before moderating to 4.9% in 2022 and rebounding slightly to 5.6% in 2023. Projections for 2024 vary, with the CBK and the IMF both forecasting a growth rate of 5.1%, while the National Treasury projects 4.6% as indicated in the Budget Policy Statement, and the World Bank estimates a growth rate of 4.7%.

The average of the four projections represents a decline from 5.6 percent in 2023. This deceleration is attributed to a slowdown in economic activity in the first three quarters of 2024, particularly in private sector credit growth, which has been constrained by high interest rates and liquidity challenges. However, growth is projected to rebound to 5.3 percent in 2025, driven by enhanced agricultural productivity and the services sector. Excluding the economic contraction in 2020 caused by the adverse effects of COVID-19, Kenya's GDP growth averaged 5.72% over the decade, 2013–2023 under the devolved system of government. However, with growth projections for 2024, the economy appears to be experiencing a slowdown compared to its historical performance, with the decline likely to manifest in key economic indicators such as production, employment opportunities, real income, and overall economic activity.

3.1 Global Economic Outlook

Kenya's growth curve is significantly shaped by developments in the global economic landscape. Chart 2 presents the projected annual real GDP growth rates for key economies and regions from 2022 to 2025, highlighting trends in global economic performance.

Chart 2: Comparison of Kenya's Economic Performance with the World



Source*: IMF World Economic Outlook and National Treasury Projection*

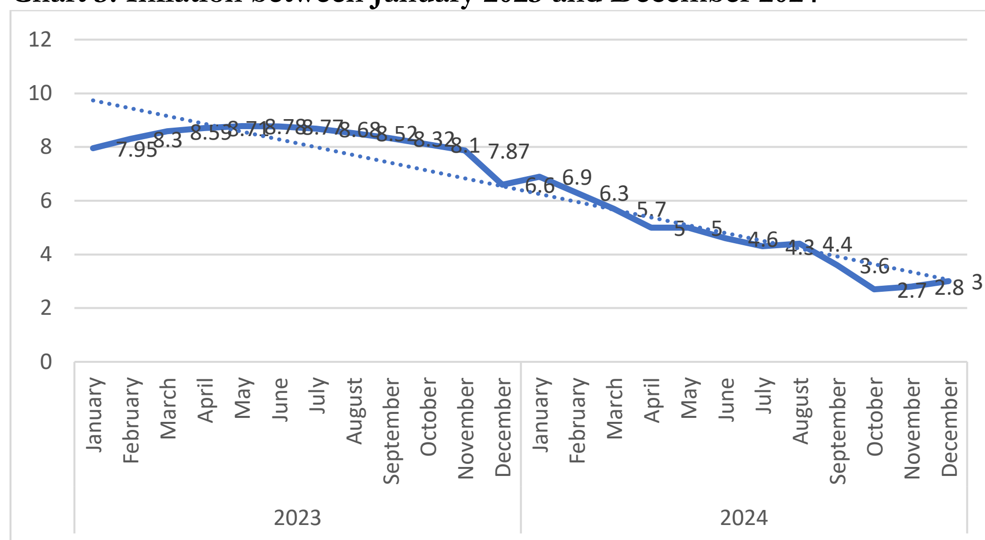
Global growth is projected to stabilize at 3.2 percent in 2024 and 2025, reflecting ongoing economic recovery in some emerging and developing economies, despite a projected slowdown in the United States and China. India maintains the highest growth trajectory, peaking at 8.2 percent in 2023 before declining to 7.0 percent in 2024 and 6.5 percent in 2025. Sub-Saharan Africa follows a similar pattern, reaching 4.2 percent growth in 2025. The global projections indicate varying recovery paths across regions, suggesting global economic uncertainties and domestic structural challenges.

3.2 Inflation

Inflation is not merely a statistic; it is an indicator of macroeconomic conditions, reflecting both internal pressures and external shocks. Kenya's overall year-on-year disinflationary path in 2024, as shown in Chart 3 below, is an outcome of interconnected macroeconomic forces, including monetary policy choices, external sector stability, and sectoral supply dynamics. As of December 2024, inflation stood at 3 percent, significantly down from 6.6 percent in December 2023. This decline represents a shift from an inflationary

cycle driven by supply-side shocks to a period of price stability, although underlying economic vulnerabilities remain.

Chart 3: Inflation between January 2023 and December 2024



Source: *Kenya National Bureau of Statistics, 2024*

The drivers of reduced year-on-year inflation were as follows: lower global oil prices and a stronger Kenya Shilling, which reduced imported inflation, significantly driving down fuel costs. The bilateral exchange rate appreciation played a key role in easing import-related cost pressures. Food price adjustment and supply response, largely due to increased food production supported by favorable weather conditions and government agricultural interventions, helped stabilize food prices. However, it is important to recognize that the decline in inflation is partly due to weak aggregate demand, as reflected in the muted core inflation numbers.

Monetary policy response by the CBK maintained a tight policy stance in early 2024 before shifting towards a measured easing to support economic activity. However, despite the 3 percent headline inflation for December 2024, the core inflation trends indicate muted demand. The reduced inflation in non-food inflation underscores constrained household purchasing power, linking inflation trends to poverty levels. Additionally, unless private investment expands at a faster rate than public investment, the economy risks continued crowding out, limiting the ability of private enterprises to drive economic growth and inflationary momentum in a sustainable manner.

Food inflation decreased to 4.8 percent in December 2024 from 7.7 percent in December 2023, underscoring the role of supply-side interventions in price stabilization. This decline was attributed to government-led fertilizer subsidy programs enhancing agricultural productivity, favorable climatic conditions boosting domestic food supply, and global food price moderation easing imported inflation pressures. While vegetable prices increased slightly, non-vegetable food items showed notable price declines, suggesting asymmetric price adjustments across food categories. However, it is notable that relative food prices remain 30 percent higher than non-food prices, despite the decrease in overall inflationary. This discrepancy highlights that food costs remain a major burden for households, particularly low-income groups, exacerbating economic hardship. With relative food prices rising significantly, households are likely shifting spending patterns within food categories, favoring items with lower relative price increases. This behavioral shift should be reflected in periodic revisions to the CPI weights to accurately capture consumer expenditure adjustments.

Chart 4: Relative Food Prices in the CPI

Fuel inflation decreased to -1.0 percent in December 2024 from 13.7 percent in December 2023. This was driven by exchange rate appreciation, which lowered imported fuel costs, global oil market adjustments that led to declining international crude oil prices, and policy changes in domestic energy markets, including reduced pump prices and electricity tariffs, reinforcing the deflationary trend. Year-on-year core inflation -non-food and non-fuel inflation- remained low and stable, reflecting the effectiveness of monetary policy in anchoring inflation expectations and limiting demand-driven inflation. However, non-food inflation has persistently remained below the target rate, staying below the target band for the last four months of 2024. The unusual one-

month increase in December suggests a temporary anomaly rather than a sustained shift in price dynamics. Generally, monetary policy remains excessively tight given the muted demand environment.

The CBK's monetary policy stance in 2024 balanced inflation control with economic growth support. The CBK progressively reduced the CBR to stimulate private sector credit growth while keeping inflation within target levels. The CBR was lowered from 13.0 percent to 12.75 percent in August 2024, signaling a shift toward pro-growth policies. This was followed by a further reduction to 12.0 percent in October and finally to 11.25 percent in December 2024, enhancing liquidity conditions. These moves align with inflation-targeting monetary frameworks, ensuring that policy shifts remain data-driven and forward-looking. However, what remains unaddressed from the explanation of the 175 bp cut and the mechanism through which underlying non-food price momentum will recover to push inflation back into the target band and stabilize at the centre of that band over the coming year.

The Risks

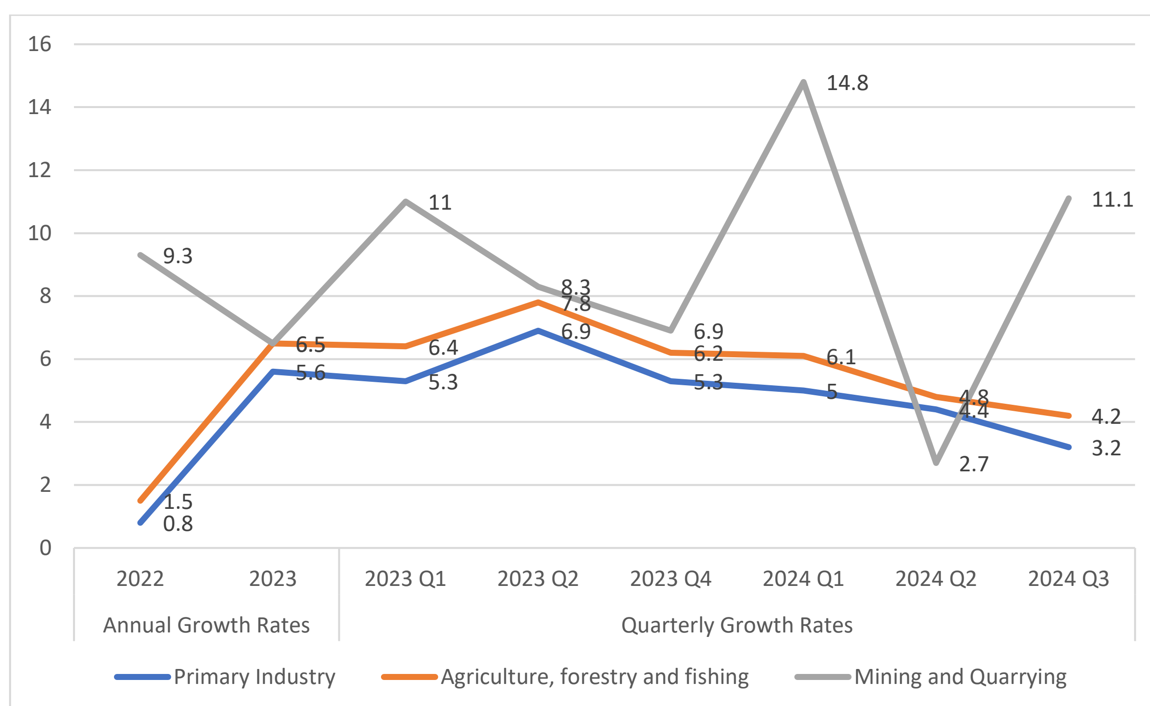
Muted demand remains a key risk to economic recovery. A significant portion of household expenditure is directed toward food, limiting discretionary spending on non-food items and further suppressing inflation in that category. This persistent weak demand points to underlying economic distress, particularly among low-income households, who face rising relative food prices while struggling to afford the non-food items. Given these conditions, expanding social protection programs targeted at the most vulnerable sections of the population is necessary. Such interventions will enhance household resilience, boost demand, and contribute to a more balanced inflation path by preventing excessive deflationary pressures on non-food items. Moving forward, the policy focus should include supporting private investment growth, ensuring a balanced monetary policy approach, and supporting social protection programs to curb economic vulnerabilities.

3.3 Agriculture Sector

Agriculture remains a critical sector of Kenya's economy, contributing 21.8 percent to the GDP in 2023 (Economic Survey, 2024), accounting for over a fifth of the country's GDP. The Agriculture, Forestry, and Fishing sector grew by 6.5 percent in 2023, marking a strong recovery from the 1.5 percent contraction recorded in 2022. This growth was primarily driven by; favorable weather conditions; expansion in the area under cultivation, as farmers anticipated higher prices for their produce; and increased government interventions, including the fertilizer subsidy program. Additionally, the sector accounts for 45.2 percent of total exports (KNBS, 2024).

Agriculture plays a vital role in ensuring food and nutrition security for Kenya's growing population. Over 80 percent of the country's 47.7 million people depend on agriculture directly or indirectly for their livelihoods either for employment, income or for food. The sector employs over 40 percent of the total population and more than 70 percent of the rural populace (CBK, 2024).

Chart 5: Sectoral Contribution to GDP growth (%)



Source: *KNBS, 2024*

Chart 5 illustrates a breakdown of sectors contribution to overall growth. The primary sector grew by an average of 4.2 percent in the Q1-Q3, 2024, with growth rates of 5.0 percent in the Q1, 4.4 percent in Q2 and 3.2 percent in Q3. This expansion was primarily driven by strong agricultural performance, despite a contraction in the mining and quarrying sub-sector.

During the same period, the agriculture sector remained robust, recording growth rates of 6.1 percent in the Q1 4.8 percent in the Q2 and 4.2 percent in the Q3. This growth was supported by favourable weather conditions and government interventions aimed at reducing production costs. However, sectoral performance was partly constrained by heavy rains and floods between March and June 2024, which resulted in livestock losses and damage to croplands, slowing down growth in Q2 and Q3.

Government spending on agriculture remains **below the Malabo Commitment** of **10 percent of the national budget**. In the **FY 2024/25 budget**, the allocation to agriculture stands at **Ksh 54.6 billion**, including **Ksh 10 billion for the Fertilizer Subsidy Programme**. This represents only **1.37 percent of the total budget**, highlighting a **significant shortfall** in the investment needed to meet the Malabo Declaration targets. Funding for the agriculture sector has averaged **below 5 percent**, falling **far short** of the **Malabo Commitment**. **Adequate investment** is essential for **developing rural infrastructure**, including **storage facilities** to reduce post-harvest losses, **efficient input supply and distribution**, and **market expansion with value addition** to enhance productivity and output (Kenya Economic Report, 2024)

Though the use of intermediate inputs such as fertilizer, seeds, and pesticides has been increasing, this has not translated into increased production or productivity in the sector. Timely delivery and

distribution of inputs such as fertilizer has been an issue, with reported delays in procurement and distribution of inputs occasioning late use of these inputs and, therefore, affecting output and productivity.

To mitigate the negative effects of extreme weather on agricultural production and further boost the sector, timely procurement, targeted distribution, and efficient monitoring of seeds and fertilizers are essential to enhancing productivity. Additionally, increasing budgetary allocation to agriculture both at the national and county levels will be crucial in meeting the Malabo Commitment and ensuring sustainable growth in the sector. Moreover, livestock and crop insurance schemes play a vital role in protecting farmers from climate-related risks, providing a safety net against unpredictable weather patterns.

The Mining and Quarrying sub-sector contracted by 14.8 percent in the Q1 and 2.7 percent in Q2 of 2024, compared to contractions of 11.0 percent and 8.3 percent over the same period in 2023. This decline was driven by reduced production of key minerals, including titanium, soda ash, and gemstones. A major contributing factor was the closure of Kwale-based miner Base Titanium, which formally ceased mining operations in Kenya in December 2024 following the depletion of commercially viable ore.

3.4 The Tertiary Sector

The growth rates in the first three quarters of the fiscal year 2024-2025 are the lowest in the period since 2022. Against this background, it appears that the Treasury's optimism about robust growth in the tertiary sector for 2025 is realistic or dependable. Reduction in interest rates in Kenya towards the end of the calendar year 2024 did not result in sufficiently large rise in private sector lending to create the expectation of strong business recovery. A more sensible estimate for the purposes of informing budget policy in 2025 would require an assumption of same growth rates as have been recorded in the 2024 period.

Against this background, it is unlikely that the growth of the Tertiary sector would outpace the rate achieved in the first quarter of 2024 at 6.2%. This has implications for revenue collection from labour taxes and the value added and excise taxes. While the Tertiary sector constitutes the largest share of the Gross Domestic Product (GDP), these services are in turn dependent on the wholesale and retail trade, which had sluggish growth rates in this sector.

The Risks

As stated in paragraph 155, the fact the growth rate in domestic credit extended to the private sector reduced while the pace for public sector grew by 16.6 percent. This situation indicates that government borrowing dominated private sector borrowing. The consequences for growth in the medium term shows that the vitality of the private sector is adversely affected relative to a year before and therefore the strong momentum in growth that is anticipated for the whole economy is too optimistic.

The Budget Policy Statement states the difference in growth rates between provide sector lending and public sector but fails to acknowledge its consequences for the fiscus. This divergence suggests that there is crowding out the private sector by public borrowing and this means that the muted investment conditions affect employment levels and possibly revenues that are anticipated in the financial year starting in July 2025.

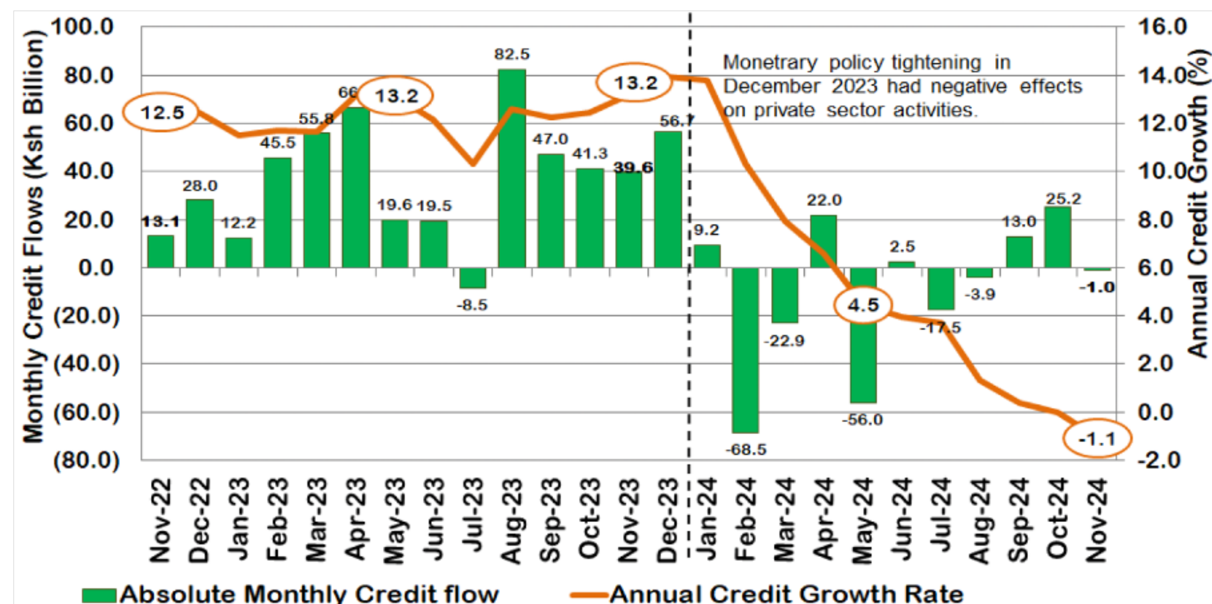
Additionally, that fall in the growth rate for credit to the private sector bears important consequences for the growth in the public debt. It implies that the expectation that economic growth rates will guarantee future revenues for debt repayments are uncertain. This means that Kenya's position as a country facing debt distress is not entirely resolved in spite of the fact that debt rating agencies record an improvement in the rating outlook of caa1 published by Moody's in late January 2025. The final risk is that with the likelihood of a weaker economic rebound than is projected, the fiscal consolidation policy should be focused on keen management of expenses and a reduction in wastage and corruption.

4.0 The Monetary Sector

4.1 Kenya' monetary policy stance is still tight and is contributing to the crowding out effects

The lagged effects of monetary policy tightening coupled with the impact of exchange rate appreciation on foreign currency denominated loans led to the decline in the credit to the private sector by 1.1 percent in the year to November 2024 compared to a growth of 13.2 percent in the year to November 2023. This is illustrated in the chart below.

Chart 6: Trend in the Credit to the Private Sector



Source: *Central Bank of Kenya*

A tight monetary stance led to a decrease in the credit to the private sector. The recent easing of monetary policy in Kenya has led to a decline in interest rates, reducing borrowing costs and

creating room for economic expansion. The Central Bank of Kenya (CBK) has progressively lowered the Central Bank Rate (CBR) from 13% in August 2024 to 12.75%, followed by further reductions to 12.0 percent in October and 11.25 percent in December 2024 with aim to stimulate credit flow to the private sector and support economic activity. In addition, the government is implementing Credit Guarantee Scheme for MSMEs to support credit uptake.

However, the current CBR rate of 11.25 percent is still high and means that concerns of the crowding out effects of the private sector remain. These concerns are compounded by the large budget deficits projected at Ksh 812 billion (4.2% of GDP) out of which Ksh 546 billion (2.8% of GDP) is to be financed through domestic borrowing.

Policy action should be directed at addressing the persistent uncertainty in the interest rate movements that has contributed to a shift towards short-term debt instruments, increasing refinancing risks. Moreover, despite easing of the monetary stance, the Kenyan government faces challenges in managing its debt portfolio which should be addressed to finance the rising debt service costs with affecting the budget.

4.2 Kenya's Poor Credit Rating persists amidst rising Refinancing Risks of the Public Debt

On 24 January 2025, Moody's revised Kenya's outlook from 'negative' to 'positive' but reaffirmed its Caa1 rating, citing a potential ease in liquidity risks and improving debt affordability over time[1]. However, it should be noted that given the overall low grade of the credit rating at **Caa1** by the Moodys'[2], Kenya's credit worthiness is still poor. This means the high external borrowing costs are likely to persist given that as per the Budget Policy Statement (BPS), the government aims to borrow from the domestic market to finance the large fiscal deficit projected at Ksh 812 billion (4.2% of GDP) out of which Ksh 546 billion (2.8% of GDP) is to be financed through domestic borrowing.

Already evidence shows that sustained budget deficits have impaired the effectiveness of the monetary policy in Kenya. For instance, while the tightening of the monetary policy managed to control inflation, it failed to stimulate economic growth. Growth in the private sector credit declined by 1.1% in the year to November 2024 compared to a growth of 13.2% over the same period in the previous year.

It has also been noted with concern that the refinancing risks continue to persist due to the high debt servicing charges projected at Ksh 2 trillion (68% of the revenue from ordinary taxes and 11.4 percent of the GDP), emphasizing the need for expenditure rationalization. This is illustrated in Table 1.

[2] https://aprm.au.int/en/news/press-releases/2025-01-28/moodys-investor-services-erred-its-kenya-rating-actions

Table 1: Projected Kenya's Interest and Redemption on Domestic and External Debt

Ksh Billion	2024/25	2025/26 Estimates
Interest		
External	260	264
Domestic	750	771
Total	1,010	1,035
Redemption		
External	513	519
Domestic	331	500
Total	843	1,020
GRAND TOTAL	**1,853**	**2,055**

as a share of GDP	2024/25	2025/26 Estimates
Interest		
External	1.5%	1.5%
Domestic	4.3%	4.3%
Total	5.8%	5.7%
Redemption		
External	2.9%	2.9%
Domestic	1.9%	2.8%
Total	4.8%	5.6%
GRAND TOTAL	**10.6%**	**11.4%**

Source of Data*: The National Treasury \ Budget Estimates and Budget Policy Statement*

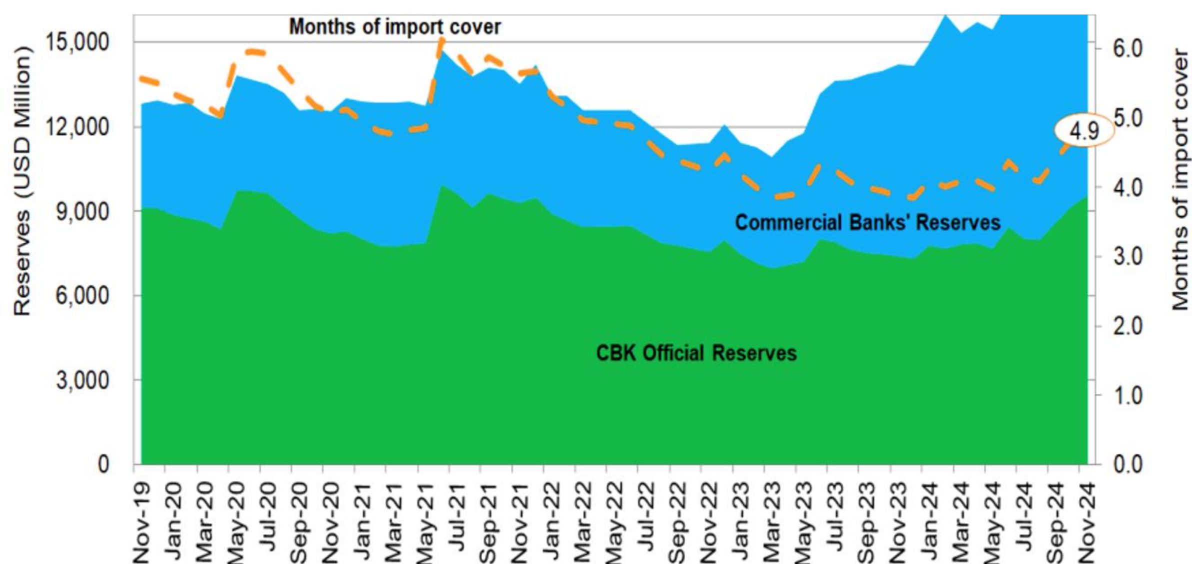
The increase in the debt servicing charges is as result of accumulation of debt and increase in the interest rate due to the lagged effect of the tight monetary policy stance by CBK over the last year aimed at containing inflation. Adverse shocks emanating from a tight monetary policy contributed to slowed growth in credit to the private sector.

Prudent fiscal management such as cutting on wastages and effort to negotiate for lower interest rates and longer grace periods on loans should be emphasized in the fiscal consolidation framework.

4.3 Stability in the Foreign Exchange Rate together with a stable inflow of foreign remittances have enhanced Foreign Exchange Reserves but the risk of the shilling depreciating against the dollar is still high due to huge Current Account Balance

According to the 2025 Budget Policy Statement, the banking system's foreign exchange holdings remained strong at US $. 16.31 billion in November 2024, up from US $.14.21 billion in November 2023. On the other hand, the official foreign exchange reserves held by the Central Bank stood at US $. 9.58 billion compared to US $. 7.39 billion over the same period, representing 14.8 percent and 29.5 percent increment for the banking system and CBK respectively. The official reserves held by the Central Bank in November 2024 represented 4.9 months of imports as compared to 3.9 months of import cover in November 2023.

Chart 7: Trends of Kenya's Foreign Reserves vis-a-vis Months of Import Cover



Source: *National Treasury*

Data from CBK further shows that between November 2023 and November 2024, usable foreign reserves fluctuated between 3.5 and 4.6 months of import cover. The reserves have remained above the minimum requirement of 4 months since September 2024. Essentially, foreign reserves are used for servicing external obligations, including external debt, and are necessary for interventions in the exchange market and cushioning against external crises.

The increase in the foreign reserves is partly due to the strengthening of the Kenyan shilling against major foreign currencies over the same period. For instance, the Kenyan shilling strengthened against the US $ by at least 19 percent between January 2024 and December 2024. Since June 2024, the shilling has stabilized against the US $ at around Ksh.129.

The continued stability of the Kenyan currency together with a stable inflow of foreign remittances remain to be important safeguards against erosion of the foreign exchange reserves. The increase also suggested that the central bank had acquired more foreign currency, which may indicate a stronger economic position, enhanced capability to intervene in the currency market, and greater resilience against economic shocks.

It is important for the government to evaluate the medium-term position of foreign reserves against the potential risks in both the global and domestic environments. For instance, the government's external debt servicing obligations remain a risk considering that external interest for FY 2025/26 are higher compared to the current financial year. Moreover, as per the Medium-Term Debt Management Strategy (MTDMS 2024), there is an upsurge in the refinancing risk reflected by the increase in the proportion of debt maturing in one year as a percentage of total debt from 10.1 percent to 12.7 percent. This indicates an increase in the issuance of short-term instruments. In addition, the Average time to Maturity (ATM) of the total debt portfolio reduced from 11.5 years to 8.5 years which further increases the debt refinancing risks.

Risks likely to effective implementation of the monetary policy

- The Kenya' monetary policy stance is still tight and is contributing to the crowding out effects. Credit to the private sector declined by 1.1 percent in the year to November 2024 compared to a growth of 13.2 percent in the year to November 2023
- The refinancing risks are likely to persist due to the high debt servicing charges projected at Ksh 2 trillion (68% of the revenue from ordinary taxes and 11.4 percent of the GDP), emphasizing the need for expenditure rationalization. The refinancing risk is also likely to be elevated due to the increase in the proportion of debt maturing in one year as a percentage of total debt from 10.1 percent to 12.7 percent.
- Despite the revision on Kenya's outlook from 'negative' to 'positive', the credit worthiness of the country is still poor given that the overall rating is still low in the junk category at Caa1 and the implication is that high external borrowing costs are likely to persist hence posing challenges in terms of financing risks.
- It can also be noted that the stability in the foreign exchange rate together with a stable inflow of foreign remittances enhanced foreign exchange reserves, the risk of the shilling depreciating against the dollar is still high due to huge Current Account Balance

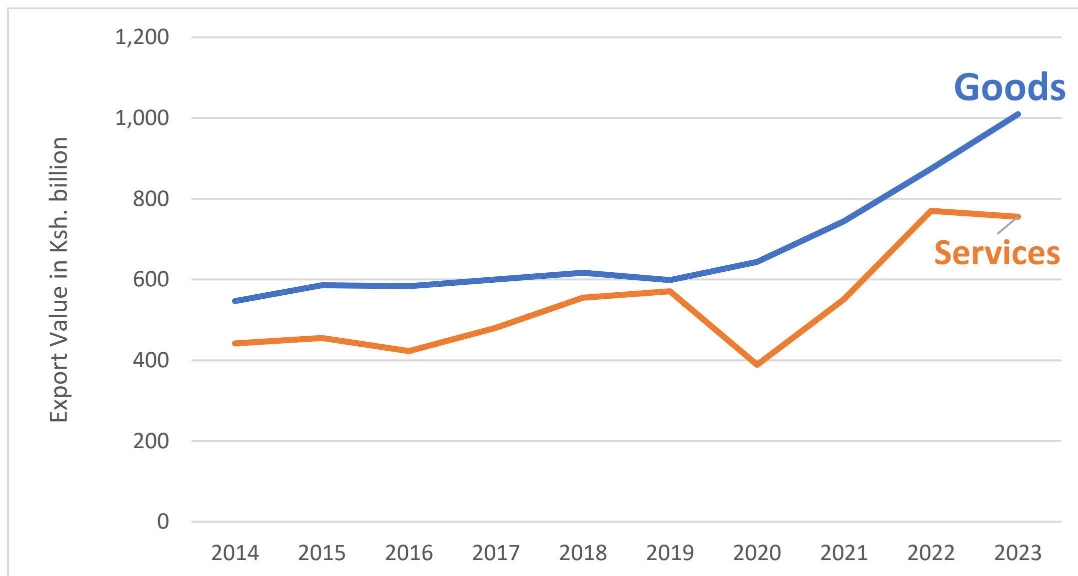
5.0 The Balance of Payments

5.1 Exports

Despite a growth in the exports as shown in figure 8, Kenya's balance of trade has been registering deficits with the latest reported deficit at Ksh.139.2 billion as of third quarter of 2024, the deficit due to more imports valued at Ksh 625.3 billion compared to Ksh 284.3 billion exports as reported by KNBS.

As shown in figure 8: Exports have been growing in value with the value accelerating in 2019 than the last 5 years before then, the growth can be traced to increase in global commodity prices and volume of trade rather than the increase in export diversity in the country. Service credit obtained from provision of services to the international markets have been fluctuating showing a higher volatility than the goods, the service sector whose main component is tourism was highly affected by terror attacks in 2016 such as the Garissa University attack and the Covid-19 pandemic hence the returns from service trade experienced a drop.

Chart 8: Kenya's Total Export Value in Ksh. Billion (2014-2023)

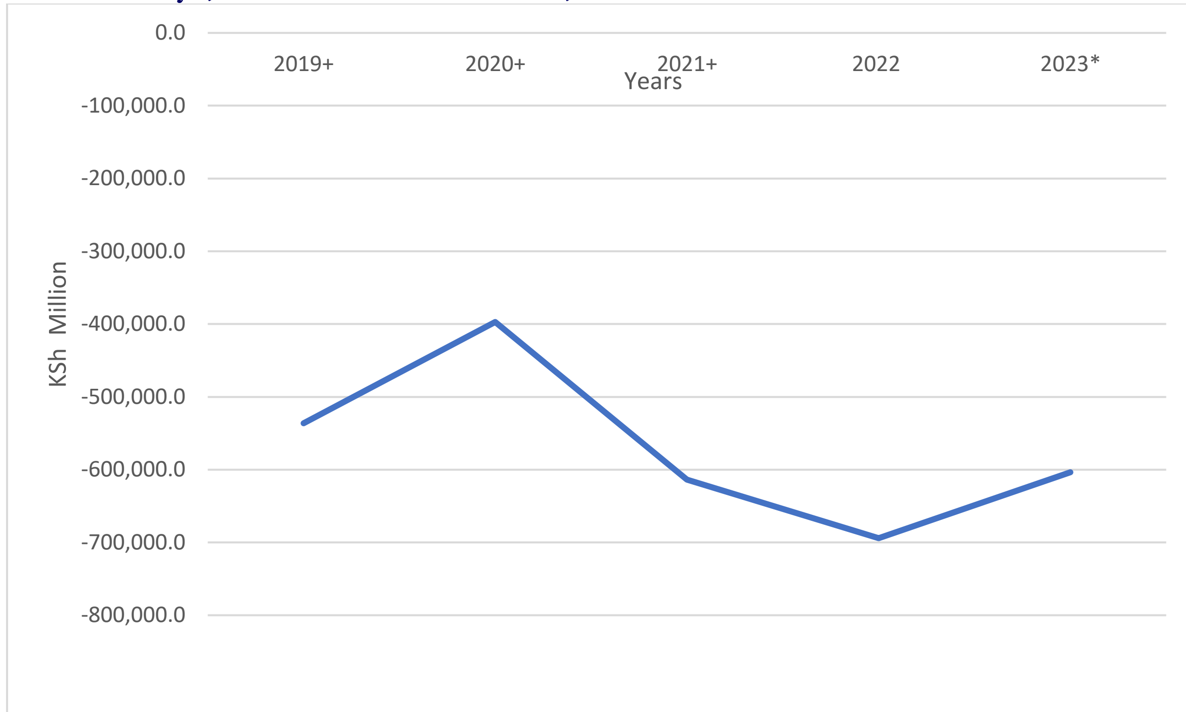


Source: *Author's compilation from KNBS Statistical Abstract Data.*

As of 2022, Kenya's Economic complexity in trade was -0.5 ranking 87 amongst 133, the negative value explains the inadequate depth in economic diversity, strength and unique production in Kenya with Tea and Titanium ore being the top two most specialized products of the Kenyan trade basket. The export basket for Kenyan has remained closely the same in the last few decades being agriculturally oriented. Tea and horticulture have been the leading exports for more than a decade accounting for about 40% of our exports over the years. The short diversity in exports and the negative economic complexity shows the likelihood of facing severe competition and therefore low commodity prices are likely to ensure. This also illustrates that the efforts to have Special Economic Zones oriented to manufacturing for exports is still below the top export drivers in the country. The developed economics with higher economic complexity for example the leading complex economy, Germany, are oriented to manufacturing, Kenya's manufacturing is yet to significantly influence the external sector globally which might in part explain why Africa is the nation largest trade region, inclusive of less tariff and non-tariff barriers to trade for Kenya as shown figure 9.

Kenya's leading export destination is Uganda which has remained a significant trading partner for the last decade consuming Ksh. 113.4 billion worth of exports in 2023. The significant increase in exports to Uganda in 2022 and 2023 was the exports of cement clinker, with Uganda consuming 99 percent of cement clinker export quantity from Kenya that is 1924 million tonnes an increase from 948.3 million tonnes in 2022. According to the latest Balance of Payment Report (Quarter three, 2024) Kenya's exports to the middle East increased due to re-exports of Kerosene type Jet Fuel to United Arab Emirates and the growing exports of Pigeon Peas to India.

Chart 9: Kenya, Current Account Balance, 2019-2023



Source: *Kenya National Bureau of Statistics*

The current account contains the countries trade balance. A current account surplus is an indication that a country is earning more than it is spending while a current account deficit is an indication that a country is spending more than it is earning on international markets.

The chart shows that for the last 5 years, Kenya has maintained a current account deficit with the world. At Ksh -694.161 billion in the year 2022, Kenya's current account deficit with the world was at its highest in the last five years. In the year 2020, Kenya's current account deficit stood at Ksh -397.116 billion. This was the lowest it had been in the last five years.

Free on board is a term borrowed from international commerce that indicates the point at which the responsibility over the costs and liability of exported goods is taken by a buyer. While the seller is responsible for the goods until they are loaded onto the ship, the buyer is responsible for the goods once they are on the ship. This means that when the cost of goods is listed as f.o.b., the cost of these goods includes the cost of transport, insurance, and unloading the goods from the ship.

In the year 2023, the value of exports was Ksh 1,009 billion while the value of imports was Ksh 2,411 billion. The balance of trade in goods remained negative throughout the period 2019 to 2023. The value of exports grew at an average rate of 12 percent and imports at an average rate of 8 percent, the value of imports remained greater than the value of exports for that period of time. In all, the balance between imports and exports improved by 22.75 percent between 2019 and 2020 only to deteriorate in the years that followed until the period 2022 to 2023 when it improved by 0.27 percent. In all, over the period 2019 to 2023, the overall balance between imports and exports deteriorated by -4 percent.

Kenya's capital account balance peaked in the year 2021 at Ksh 21.45 billion and shrank at an average rate of -10.43 percent during the period 2019 to 2023. In the year 2020, Kenya's capital account balance shrank by -50.80 percent. In the year 2021, the same account expanded by 34.63 percent only to shrink again at a rate of -29.94 percent in the year 2022. That was the worst year for Kenya's capital account.

In the period 2019 to 2021, Kenya's ownership in financial and non-financial and non-produced assets fell.

5.2 Financial Accounts

During the period 2019 to 2023, the financial account expanded at an average growth rate of 32.61percent. Between the years 2019 and 2020, this component saw an expansion of 146.75 percent, the largest expansion in that period. In the year 2021, this component shrank by -67.02 percent, the most significant negative change in that period. The financial account measures net changes in the ownership of financial assets and liabilities. A positive financial account balance means that a country is receiving more investment from overseas than it is taking abroad. Although the value of financial investments in Kenya expanded in the given period, in all, more foreign investment has been leaving Kenya than has been injected into Kenya.

Between the years 2019 and 2020, foreign direct investments into Kenya fell by -8,433 percent from Ksh 47.93 billion to Ksh -575.2 billion. On average, during the period 2019 to 2023, direct investments to Kenya fell by -2068 percent. In all, this was driven by the precipitous fall in foreign direct investment in the period 2019 to 2020. In the years 2020 to 2023, foreign direct investments to Kenya grew by 53 percent. Direct investments from Kenya to the world expanded by 28.83 percent.

Other accounts contained within the financial account measure changes in portfolio investments, changes in financial derivatives, and changes other investments. The direct investments account shrank by -10 percent in average growth rate terms. The portfolio investments account shrank by -81.06 percent on average. Other investments account grew by 1.25 percent on average terms. Portfolio investments were the most important net positive contributor to Kenya's financial accounts. The account that tracks other investments revealed that the accumulation of debt instruments made the most important negative contribution to Kenya's investment liabilities in particular and to Kenya's financial accounts in general.

Where imbalances between the country's current account and financial account emerge, the reserves and related items account acts as a balancing mechanism. Current account deficits must be financed through financial account surplus or foreign currency reserve draw downs. For the last 5 years, Kenya's current and financial accounts have been largely in deficit. Kenya has been importing more than it exports and experiencing capital outflows.

Furthermore, as its capital account shrinks, Kenya has been losing net ownership of non-produced, non-financial assets. That is, the one-time transfer of assets that do not generate future income has been falling.

In order to finance these twin deficits, Kenya has been spending it's reserves and issuing debt. Kenya's fiscal crunch and poor economic fundamentals are evident in the state of its balance of payments.

Risks Associated with Kenya's Balance of Payment Deficits

At the very core of the market, Kenya's Balance of payments deficits are a symptom of the deficit of productivity of the Kenyan economy. The perennially low economic complexity with a downward trend that suggests a premature deindustrialization and the evidence that machine imports have been falling since 2018 present risks to Kenya's Balance of payments position. The business environment is characterised by a tax regime that is unpredictable and narrow and whose rates are exceptionally high.

5.3 Kenya's Current Account and Financial Account Deficits

A current account deficit emerges when imports exceed exports. In this situation, the returns on factors of production are lower than the costs incurred by the consumption of factors of production and the consumption of goods and services. Kenya's import composition has been characterized by falling machine imports. Falling machine imports are a strong indication of falling investments in Kenya's manufacturing sector.

The risk inherent a trade deficit includes currency depreciation and a dependence on foreign capital in the form of investments and the accrual of debt required to finance the trade deficit. Firstly, demand for imports drives demand for foreign currency. When households, firms and governments buy foreign currency, the value of domestic currencies falls in response to a rise in demand for foreign currency. Kenya faces downward pressure on its currency.

A weakening currency will raise the cost of imports as the relative price of these imports rises. Kenya will also deplete its foreign reserves. Importantly, Kenya's falling productivity presents a risk to the trade balance and ultimately to the welfare of Kenyan residents. It is imperative for small poor nations like Kenya to be connected to global value chains and to contribute manufactured products to world markets in order to improve the welfare of the owners of factors of production and the trade balance.

Kenya's financial account deficit presents a risk of increasing downward pressure on the Kenyan shilling to depreciate, cause capital outflows, induce the depletion of Kenya's foreign reserves and raise the cost of debt financing. Kenya's fiscal crunch is not aided by a manufacturing base that is faltering and the cost of the debts it accrued.

Global Risks to Kenya's Balance of Payments

Another important risk to Kenya's Balance of payments is the unraveling of multilateral trade. Although a DHL study asserts that deglobalisation is not occurring, trade wars initiated by the Trump administration can have unintended consequences for the welfare of poor states. Where trade wars disrupt demand for Kenyan exports - if they include the ending of the AGOA program, for example - or reduced foreign direct investment from the United States and Europe, and overall

market uncertainties, the possible unraveling of global trade presents a risk to Kenya's Balance of payments position.

6.0 Fiscal Outlook

6.1 Fiscal Performance FY 2024/2025

The implementation of budget FY 2024/2025 was hampered by Anti-Finance bill protests and forced the government to withdraw the bill. The bill was expected to collect an additional revenue of Ksh 344.3B to ensure smooth running of the budget for the year and safeguard the government fiscal consolidation plan. The shortfall in revenue collection compelled the government to revise fiscal projections downwards thus supplementary budget I and II.

As shown in table 2.0 below, revenue performance for FY 2024/25 up to 30th November 2024 fell short of target by Ksh 77.8B driven by shortfall revenue target of VAT of Ksh 36.6B which could be attributed to disruption of slowed economic activities due to protests. The government is optimistic that this trend will reverse in the second half of the year backed by improved business environment, the on-going reforms in tax policy and revenue administration geared towards expanding the tax base and improving tax compliance as noted in the BPS 2024.

Table 2: Fiscal Performance as at 30th November, 2024

	Nov-23		**Nov-24**			
			Kshs billion			
	Prel. Act (Ksh	**% share of**	**Target**	**Prl. Act**	**Deviation**	**%**
A. Total Revenue Including	1,016.50	6.3	1,169.80	1,092.00	(77.80)	-7
Total Revenue (1+2)	1,011.60	6.3	1,165.40	1,088.10	(77.30)	-7
1. Ordinary Revenue	878.90	5.4	1,009.00	937.40	(71.60)	-7
Import Duty	56.20	0.3	64.40	57.50	(6.90)	-11
Excise Duty	116.10	0.7	127.60	115.90	(11.70)	-9
Income Duty	380.40	2.4	429.00	413.80	(15.20)	-4
VAT	266.10	1.6	284.80	248.20	(36.60)	-13
Other Revenues	60.10	0.4	103.30	102.00	(1.30)	-1
2.Ministerial Appropriation in	132.70	0.8	156.40	150.80	(5.60)	-4
3.External Grant	4.90	0	4.40	3.80	(0.60)	-14
Total Expenditure and net lending	1160.6	7.2	1509.5	1442.9	-66.6	-4
Recurrent	920.7	5.7	1149.4	1091.4	-58	-5
Development	132.4	0.8	175	193.1	18.1	10
County Transfer	107.5	0.7	184	158	-26	-14
Contingency Fund	0	0	1	0	-1	-100
Budget deficit incl. of grants	144.10	0.9	339.7	350.9	11.2	3
Deficit as a Share of GDP (%)	0.9		1.9	1.9		

Source of Data: National Treasury

Despite the government optimism of revenue performance in the second half of the year, there are risk associated with economic performance of the country given the global trend foreign policy of trade and constrained fiscal space. **The IEA Kenya notes that implementation of some programmes may be affected and it's important for the government to come up with strategies to improve revenue generation for both levels of government to ensure planned activities are funded.**

On the expenditure front, the government should also curb public debt through reduced budget deficit financing by ensuring growth in revenue through increased economic activities in the country and controlling expenditure via fiscal consolidation.

6.2 Estimation of the Ordinary Revenue

The International Monetary Fund (IMF)[3] noted in its sixth review of Kenya Extended Fund Facility/Extended Credit Facility Program (EFF/ECF) that Kenya economic outlook remain promising with projected growth of 5.5 percent in 2024 and the medium term supported by prudent fiscal and monetary policies. Nevertheless, Kenya Treasury has a history of overestimating the amount of revenue to be collected each year despite having clear tax reforms measures and a promising economic outlook. This raises concern of optimism on revenue projections when preparing annual National budgets.

Table 3.0 shows a comparison of revenue projections made a year prior to 2025 indicating there has been significant revenue forecasting errors albeit the year 2024 risk of court challenge to the finance bill which posed an additional risk for achieving the revenue targets. Revenue projection as shown in the BPS report for 2025 shows that an amount of Ksh 3,424B was the target amount against previous year 2024 BPS projection of Ksh 3,775.7B creating a difference of Ksh 275 billion. There is need for the National Treasury to continue improving accuracy in revenue forecasting as revenue shortfalls often leads budget revisions and implications on intergovernmental transfers.

Table 3: Comparison of Ordinary Revenue projections between BPS 2025 and BPS 2026

BPS 2025 report	2022/23	2023/24	2024/25	2025/26	2026/27
	2,041.1	2,288.9	2,641.4	3,018.8	3,424.7

BPS 2024 report	2022/23	2023/24	2024/25	2025/26	2025/26
	2,041.1	2,624.6	2,948.1	3,294.2	3,775.7

Differences in BPS 2024 and BPS 2025	0	(335.7)	(306.7)	(275.2)	(351.0)

Source: *BPS 2024 and BPS 2025*

[3] https://www.treasury.go.ke/wp-content/uploads/2024/02/IMF-Sixth-Review-2024.pdf

The ordinary revenue projection for FY 2025/26 is Ksh3.02 trillion, which represents a 14 percent increase relative to FY 2024/25 projected revenue collection. Despite expected enhanced revenue collection resulting from raft of proposals in the finance bill and implementation of a mix of tax administrative and tax policy measures in order to boost revenue collection efforts by the Kenya Revenue Authority (KRA),Collecting Ksh 4.0 trillion in revenue as indicated in the BPS 2025 may be unattainable. **It is therefore important for the government to endeavor on enhancing the accuracy of the revenue forecast in order to achieve realistic budget deficits.** As a result, the IEA Kenya notes that implementation of the Bottom-Up Transformation Agenda[4] of the new administration may face headwinds thus affecting economic activity in the second half of FY 2022/23. Given that revenue performance is correlated to economic performance, dampened economic activity may adversely affect realization of anticipated revenue collection.

6.3 Government Fiscal Operations

Table 4: Trends in Government revenue and expenditure FY 2022/23 – 2025/26

	2022/23	2023/24	2024/25		2025/26	
	Actual	Actual	Budget Estimates	Suppl 1 Budget	BROP 2024	BPS 2025
Total Revenue	2,355.1	2,702.7	3,343.2	3,0660.0	3,516.6	3,516.6
Ministerial Appropriation in Aid	313.9	413.7	426.0	428.6	497.8	497.8
Expenditure and Net lending	3,221.0	3,605.2	3,992.0	3,880.8	4,329.3	4,329.3
Development and Net lending	493.7	546.4	701.5	599.5	804.7	804.7
County Transfers	415.8	380.4	444.5	451.1	442.7	442.7
Contingency Fund	0	0	4	5	5	5
Fiscal balance (excluding grants)	**-865.9**	**-902.5**	**-648.8**	**-820.9**	**-812.7**	**-812.7**

Source: *National Treasury*

The fiscal deficit is projected to decline by 8.2 percent from Ksh 820.9 billion in the 2024/25 Supplementary 1 Budget to Ksh 812.7 billion. However, this projection is subject to change due to several external and domestic risks:

- Global economic risks: Recent executive orders issued by America's new administration, which include a temporary freeze and potential reduction of foreign aid could significantly impact sectors reliant on donor funding particularly the health sector.

[4] Entails 5 pillars: Agricultural transformation; micro, small and medium enterprises (MSMEs) economy; housing and settlement; healthcare and digital superhighway and creative industry

- Domestic economic slowdown: Economic growth slowed to 4.5% in the first three quarters of 2024, down from an average of 5.6 percent in the same period in 2023. If this trend continues, the government may face challenges in meeting its revenue targets, increasing the risk of fiscal slippages.

These factors underscore the need for proactive mitigation strategies to safeguard macroeconomic stability. **The IEA-Kenya proposes for combined policy action to enhance revenue mobilization and improve efficiency of spending could help rebuild fiscal space. By strictly implementing the measures outlined in the Budget Policy Statement, the government can achieve its fiscal consolidation objectives**. The policy actions include:

- Public-private partnerships (PPP) – attracting private sector investment in public projects.
- Adopting accrual-based accounting for improved financial management.
- Implementing the e-procurement to enhance value for money
- Operationalizing the assets and inventory management modules in IFMIS to track and optimize asset utilization.
- Expenditure rationalization – cutting non-essential spending
- Revenue mobilization – expanding the tax base, minimizing tax expenditures, and leveraging technology to enhance tax efficiency.
- Public-private partnerships (PPP) – attracting private sector investment in public projects.

6.4 Domestic Revenue Mobilization

Table 5: Government main sources of revenue

	Nov 23		Nov 24					% Growth
	Prel. Act (Ksh Bn)	% of GDP	KSh Billion			% of GDP		
			Target	Prl Act	Deviation	Target	Prl.Act	
Ordinary revenue	878.9	5.4	1,009	937.4	(71.6)	5.6	5.2	6.7
Import duty	56.2	0.3	64.4	57.5	(6.9)	0.4	0.3	2.4
Excise duty	116.1	0.7	127.6	115.9	(11.7)	0.7	0.6	(0.2)
Income tax	380.4	2.4	429.0	413.8	(15.2)	2.4	2.3	8.8
VAT	266.1	1.6	284.8	248.2	(36.6)	1.6	1.4	(6.7)
Other revenue	60.1	0.4	103.3	102.0	(1.3)	0.6	0.6	69.7
Ministerial A.I. A	132.7	0.8	156.4	150.8	(5.7)	0.9	0.8	13.6
Total Revenue	**1,011.5**	**6.3**	**1,165.4**	**1,088.1**	**(77.3)**	**6.5**	**6.0**	**7.6**

Source: *National Treasury*

Improving domestic revenue mobilization remains crucial for supporting fiscal consolidation. However, revenue collection continues to fall short of targets across all categories. Tax revenue as a share of GDP declined slightly from 6.3 percent in the first three quarters of 2023 to 6.0 % in the same period of 2024. This decline is largely attributed to a slower in economic growth. The major revenue shortfalls are:

- Ordinary revenue recorded the highest shortfall at Ksh 71.6 billion below target.
- VAT collection was Ksh 36.6 billion below expectations, reflecting weaker consumer demand and compliance challenges.
- Income tax and excuse duty also missed targets by Ksh 15.2 billion and Ksh 11.7 billion, respectively, pointing to lower profitability among businesses and reduced consumer spending.

Recommendations

- Improved tax revenue mobilization is dependent on a stable tax policy. The government should fast track implementation of the National Tax Policy to avoid the unpredictable environment caused by frequent tax amendments.
- Reduce tax exemptions and enhance enforcement against tax evasions.
- Improve revenue forecasting: There should be more realistic revenue projections to align budget expectations with actual collection capacity.

6.5 Devolution

The key highlights from BPS 2025 on strengthening devolution in Kenya includes County Governments' compliance with fiscal responsibility principles, actual development expenditure over the medium term, performance of County Governments own source revenue and division of revenue for FY 2025/26.

The transfer of county functions from the National Government was gazetted and unbundling of the functions from the National Government was done by the Inter-Governmental Relations Technical Committee (IGRTC), the agency mandated to establish frameworks for consultation and cooperation between the two levels of government during 11th National and County Governments Coordinating Summit in the month of December 2024.

The implication is that the necessary funds should accompany functions. The BPS 2025 projects that county government's equitable share will increase from Ksh. 380 billion in FY 2024/25 to Ksh. 405.1 billion (6.6% increase) in FY 2025/26 and Ksh. 416.9 billion in FY 2026/27. Table 2.0 shows a summary of budget allocations to both levels of government. The allocation over the medium shows that the projected increase in national government spending will be an average increase of 19.5 percent while the County Government will have an average increase of only 6.6 percent. In addition, the share of spending for the county government compared with total

spending shows declining trend from 10.4 percent in FY 2024/2025 to projected figure of 8.2 percent in FY 2027/28.

Table 6: Summary Budget Allocations for the FY2025/26 – 2027/28 (Ksh Million)

S/NO.	Details	Financial Years			
		Supplementary Estimates No.1	BPS Projections		
		FY 2024/25	FY 2025/26	FY 2026/27	FY 2027/28
1.0	National Government	2,300,525.7	2,749,514.0	2,886,887.2	3,194,632.9
	Executive	2,237,155.0	2,681,396.1	2,814,008.4	3,116,725.6
	Parliament	40,865.5	42,488.2	44,612.7	46,087.8
	Judiciary	22,505.1	25,629.8	28,266.0	31,819.5
2.0	Consolidated Fund Services	1,237,233.8	1,331,132.6	1,465,935.8	1,616,667.9
3.0	County Government- Sharable Revenue	410,834.0	405,069.4	416,992.2	429,377.2
	Sharable Revenue	380,000.0	405,069.4	416,992.2	429,377.2
	Arrears	30,834.0			
	Total	**3,948,593.4**	**4,485,716.0**	**4,769,815.2**	**5,240,678.1**
% Share in the Total Allocation					
1.0	**National Government**	58.3	61.3	60.5	61.0
	Executive	56.7	59.8	59.0	59.5
	Parliament	1.0	0.9	0.9	0.9
	Judiciary	0.6	0.6	0.6	0.6
		-	-	-	-
2.0	Consolidated Fund Services	31.3	29.7	30.7	30.8
3.0	County Government	10.4	9.0	8.7	8.2

Notes**

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

***County Government allocation is composed of sharable allocation*

**** FY 2024/25 Supplementary Estimates includes Ksh.67.8billion proposed under Supplementary Estimates No.2*

Source of Data: The National Treasury

BPS 2025 also reveals a gradual decline in percentage share of county allocation to the total national government spending declining from 10.4 percent to 8.4 percent from 2024/25 to 2027/28 whereas national government has somewhat maintained. This is despite the fact the national government has been adherence to the constitutional mandate of transferring 15 percent of resources to the counties based on the most recent audited government accounts. Given the forgoing on the transfer of further functions to the counties, it's imperative for the national government to ensure levelness in spending for the both the National and County Government. This will **address the decline in share of spending relative transfers to the counties.**

Risks on fiscal outlook

- Revenue underperformance and the pile up of pending bills will undermine fiscal consolidation efforts in FY25/26. Relate this/link to prevailing global and domestic economic conditions/performance/shocks.
- A lack of fiscal space could hamper the government's ability to absorb any economic shocks that may rise. Shocks like adverse weather conditions (e.g., drought) would adversely affect the agricultural sector considering that the sector is one of the strongest performing sectors of the economy thus negatively affecting livelihoods of many people and consequently leading to slower economic growth and loss of revenue by government.
- Frequent industrial actions by unions (e.g., teachers, doctors, lecturers) add fiscal pressures and raise the wage bill. These shocks raise probability for fiscal slippages from planned fiscal consolidation, potentially adding risks to macroeconomic stability.

- Habitual revision of the budget attributed in part to revenue shortfall (missed revenue target) undermines fiscal consolidation agenda
- Budgetary pressures - strikes from medical personnel, teachers, etc.
- The extent to which the reforms and restructuring of parastatals is successful and indeed overall expenditure rationalization (including austerity measures) may counter/reduce these risks
- Slower economic growth: A continued slowdown of economic growth will adversely affect tax collection.
- Unstable tax policies: Frequent tax amendments create an unpredictable environment for businesses, reducing compliance and discouraging investments.

7.0 Judiciary and Independent Commissions Spending Ceilings

The Judiciary projected spending ceiling in the Financial Year 2025/2026 would be Ksh 24.94 billion, which, if allocated by Parliament, would be 14% higher than Ksh 21.85 billion in the financial year 2024/2025. On the other hand, the Judicial Service Commission spending ceiling was pegged at Ksh 692 million in the financial year 2025/2026, which is 5% higher than the 661 million allocated in the financial year 2024/2025.

Table 7: Judiciary 2025/2026 Ceilings

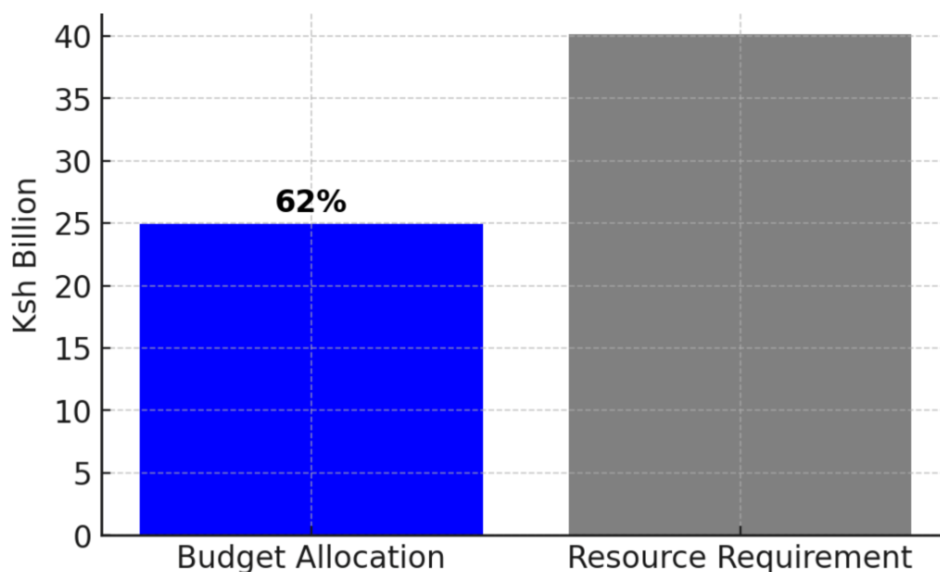
	FY 2024/25 (Ksh Bn)	FY 2025/26 (Ksh Bn)	% Change
Judiciary	21.85	24.94	14%
Judicial Service Commission	0.66	0.69	5%

Source: *2025 Draft Budget Policy Statement, 2024/25 based on Supplementary Budget Estimates*

The majority of the Judicial Service Commission budget is in current expenditure. Judiciary's development will double from 3% to 6% from Ksh 826 million in the financial year 2024/2025 to Ksh 1.5 billion in the financial year 2025/2026, which is a good policy signal on meeting core development financial needs of the Judiciary which means to expand Judicial access in areas they have been no courts and, in the bid, to bring services closer to the people.

However, examining the Judiciary MTEF Budget Report Financial 2025/26 – 2027/28 gives a different picture where the Judiciary requested a resource requirement of Ksh 40.1 billion in resources in total for FY 2025–2026, of which recurrent requirement is Ksh 31.6 billion and the development vote requirement is Ksh 8.5 billion yet the he total allocated ceiling for the FY 2025-2026 is Ksh. 24.937 billion, of which Ksh 23.437 is recurrent vote and Ksh. 1.500 billion is for development vote, as shown above. This means the ceiling only met 62 percent of the resource requirement.

Chart 10: Judiciary Resource Requirement versus Spending Ceiling



Source: *Judiciary MTEF Budget Report Financial 2025/26 – 2027/28*

The biggest political economy problem is that the Judiciary's problem is that allocations to the Judiciary have never gone close to the requested resource requirements. At any time that the Chief Registrar of the Judiciary has transmitted the resource requirement to Parliament, Parliament has always allocated fewer resources at any time. The resource gaps between the Judiciary's resource requirement requests and parliamentary allocation have ranged from 19 percent in some years to 53 percent in other years. The implication is that the Judiciary's delivery of Justice might not be met in a financial year due to the failure of Parliament to allocate sufficient resources. The resource question is an important policy question because it can hamper the independence of the Judiciary. The resource questions also hamper the efficiency in discharging the efficient delivery of Justice as required by Article 159 of the Constitution of Kenya. Maraga (2020) advanced that financial autonomy is a critical aspect of judicial independence, and for it to effectively discharge its mandate, the Judiciary requires not just adequate financial allocation but also real financial autonomy"[5].

One of the key issues of concern in the run-up to the budget process for the financial year 2025/2026 is that the Judiciary received a spending ceiling that is smaller compared to its resource requirements, and the IEA examined this issue. The IEA noted the recurring problem of inadequate funding for the Judiciary after comparing the resource requirements requested by the

[5] Owino, Winfrey. "Koome on a Low Start Treasury Slashes Judiciary Budget Again." The Standard, June 10, 2021. https://www.standardmedia.co.ke/national/article/2001415336/koome-on-a-low-start-as-treasury-slashes-judiciary-budget-again.

Judiciary with those allocated by Parliament after the appropriations bill had been passed[6]. This could imply two things: i) either the Judiciary budget request is off target and not a priority, or ii) the Judiciary's resource requests are ignored.

Table 8: Historical Problem of Judiciary's Resource Requirement vis-à-vis Allocation

Fiscal Year	Resource Requirement (Ksh Bn)	Allocation (Ksh Bn)	The gap between Judiciary requests and parliamentary allocation
2017/18	35.95	17.56	51%
2018/19	31.17	17.30	44%
2019/20	23.29	18.86	19%
2020/21	37.42	17.42	53%

Source: *"The Judiciary Budget Public Hearing for The FY 2021/22-2023/24 Medium Term Budget*[7] [8]

The Judiciary MTEF Budget Report Financial 2025/26 – 2027/28 recognizes the budget deficit, and they are saying they are keen on engaging other Development partners to mobilize additional funding to reduce the gap because of this budget deficit, it will lead the identified key priority areas not being fully funded. The IEA proposes that Judicial access, being a Public Good, should be fully funded from the budget because any under-provision will not be met by any player, which harms Constitutional protections of economic freedoms, which harms economic growth and development of democratic space in Kenya. A public good in economics is both non-excludable and non-rivalrous, meaning one person's use doesn't prevent others' access or reduce availability, allowing simultaneous use by multiple people.[9]

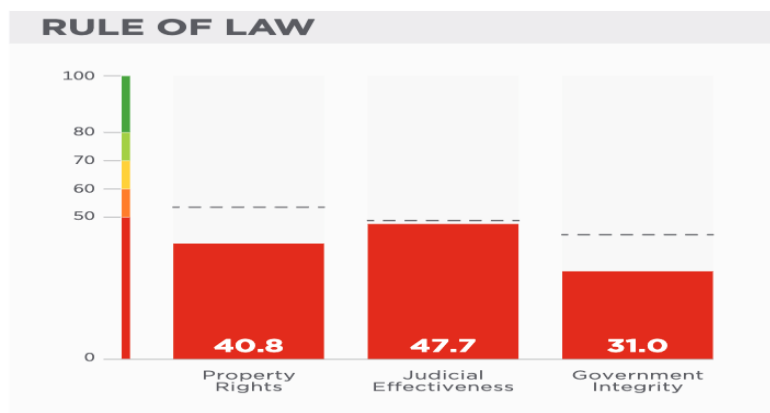
The Judicial ineffectiveness and its historical problems are seen in the various reports, including the State of Judiciary Annual Report (SOJAR) and Index of Economic Freedom. The SOJAR Report for the 2023/2024 financial year shows that the pending cases rose by 1.2 percent from 625,643 to 649,310, proving the case backlog problem.[10] The index of economic freedom shows the overall rule of law is weak in Kenya; also, Kenya's property rights score is below the world average; its judicial effectiveness score is below the world average; and its overall government integrity score is below the world average. Kenya's score on the Index of Economic Freedom is considered repressed.

[6] Kagume, Jackline, and Leo Kemboi. "Comments on the Judiciary Medium-Term Expenditure Framework (MTEF) Financial Year 2022/2023-2024/2025." Institute of Economic Affairs Kenya, November 2021.
[7] The Judiciary. "The Judiciary Budget Public Hearing for The FY 2021/22 2023/24 Medium Term Budget," 2020.
[8] Kemboi, Leo Kipkogei, and Jackline Kagume. "Problem-Driven Political Economy Analysis of Judiciary's Resource Allocations." (2023).

[9] Fernando, Jason. "What Are Public Goods? Definition, How They Work, and Example." Investopedia, March 20, 2022. https://www.investopedia.com/terms/p/public-good.asp.

[10] Page 6, State of the Judiciary & the Administration of Justice Annual Report for the 2023-24 Financial Year. https://judiciary.go.ke/downloads-reports/#flipbook-df_35405/1/

Chart 11: Rule of Law Pillar



Source: *Index of Economic Freedom 2024*[11]

Conclusion and Key Policy Recommendations

The persistent underfunding of the Judiciary remains a significant challenge, affecting its ability to deliver Justice effectively. The discrepancy between the Judiciary's resource requirements and its allocated budget highlights the financial constraints that have historically hindered its operations. While the slight increase in the development budget signals an attempt to improve judicial access, the overall allocation falls short of critical funding needs. This funding gap raises concerns about judicial independence, efficiency, and the ability to clear case backlogs. Given the Judiciary's crucial role in upholding the rule of law and protecting constitutional freedoms, Parliament must prioritize adequate funding to strengthen Kenya's judicial system.

The Judiciary must direct its limited resources toward high-impact spending, particularly in areas that reduce case backlogs and improve the efficiency of justice delivery. Prioritizing investments in automation, alternative dispute resolution mechanisms, and hiring additional judicial officers could enhance case clearance rates. Ensuring financial autonomy and sufficient funding for the Judiciary is crucial for improving access to Justice, promoting economic freedoms, and strengthening democratic governance in Kenya.

The following recommendations are IEA's recommendations regarding ceilings as set out in the budget policy statement.

(i) National Treasury shouldn't provide indicative ceilings in the draft Budget Policy Statement but that should be the function of Parliament which would call for discussions and public hearings on what should be the spending ceilings for the Judiciary. The arguments for this reason are itemized as follows

[11] https://static.heritage.org/index/pdf/2024/2024_indexofeconomicfreedom_kenya.pdf

a. Article 173 of the Constitution of Kenya 2010 establishes the Judiciary Fund, administered by the Chief Registrar, to cover the Judiciary's administrative expenses and other necessary functions.
b. The Chief Registrar is required to submit annual expenditure estimates to the National Assembly for approval. Upon approval, these expenses become a charge on the Consolidated Fund, paid directly into the Judiciary Fund. Parliament is mandated to regulate the Fund through legislation.
c. Therefore, the National Treasury providing indicative ceilings in the draft Budget Policy Statement undermines the constitutional authority of Parliament to determine and approve the Judiciary's budget, thereby encroaching upon its independence.
d. **Parliament, through public hearings and discussions, is the appropriate body to set spending ceilings for the Judiciary, ensuring transparency and accountability in the budgetary process.**

(ii) The IEA provides that Kenya's Judiciary should be able to run optimally on a budget of Ksh 40 billion as shown in the chart below out of which the majority of it would go to hiring more judges and meeting the access cost (expanding court facilities) in areas where there was none. In the study titled, "Costing the Consumer Mandate of the Judiciary" , we note that for the Judiciary, to optimize its functionality and address case backlog, the Kenyan judiciary aims to increase its judicial officers and staff. A proposed budget of Ksh 40 billion is estimated to increase human capacity by at least 66 percent. This budget allocates Ksh 16.4 billion for employee compensation, Ksh 12 billion for goods and services, Ksh 7.9 billion (spread over six years) for court construction and facilities, and Ksh 3.6 billion for increased operational and maintenance costs. Recurrent expenses comprise 80% of the budget, while infrastructure development accounts for 20 percent.[12] Also, this provision can be met in the medium term which would require the Judiciary's request to be at Ksh 29 billion, but we advise against this as there are huge opportunity costs of doing so.

Table 9: Indicative Cost for the Judiciary

	Amount (Ksh Bn)	Share of the total Budget
Fixed Costs		
Compensation of employees	**16.4**	**41%**
Use of goods and services	**12.0**	**30%**
One-time infrastructure costs		
Courts and other facilities	**7.9**	**20%**
O & M Costs		
O & M Costs	**3.6**	**9%**
	40.0	

Source: *IEA*

[12] Detailed reasoning on the cost indicative is available in this study available at IEA Kenya. Kemboi, Leo Kipkogei, and Jackline Kagume. "Costing the Consumer Mandate of the Judiciary in Kenya." (2023). https://ieakenya.or.ke/?wpdmdl=2925

Parliament and Constitutional Commissions

The combined budget ceiling for Parliament and the listed constitutional commissions is set to rise from Ksh 69.064 billion in FY 2024/2025 to Ksh 72.864 billion in FY 2025/2026, representing an overall increase of Ksh 3,799.70 million. The Parliament has the highest ceiling set at Ksh 42.488 billion, which is equivalent to 58 percent of the ceiling, while the rest, 42 percent, went to independent offices and Constitutional Commissions.

All of the oversight agencies received a spending ceiling totalling Ksh 3.8 billion, out of which Ksh 1.62 billion of the spending ceiling went to Parliament, which shows the power of Parliament in resource bidding, and this has to do with its Constitutional function of determining the form, type, and contents of the budget.

Table 10: Parliament and Constitutional Commissions

	FY 2024/2025 Ksh Bn	FY 2025/2026 Ksh Bn	Changes (Ksh Mn)	Changes as a share of the total budget increases
Parliament	40.866	42.488	1622.70	43%
Commission on Revenue Allocation	0.364	0.409	44.70	1%
Public Service Commission	3.477	3.601	124.00	3%
Salaries Remuneration Commission (SRC)	0.453	0.482	29.10	1%
Auditor General	8.104	8.652	548.30	14%
Controller of Budget	0.704	0.778	73.20	2%
Commission on Administrative Justice	0.637	0.676	39.70	1%
Independent Electoral and Boundaries Commission	3.818	3.996	177.90	5%
National Police Service Commission	1.008	1.333	325.00	9%
National Gender and Equality Commission	0.418	0.477	59.00	2%
Independent Policing and Oversight Authority	1.089	1.314	225.50	6%
EACC	4.144	4.414	270.20	7%
Office of the Director of Public Prosecutions	3.985	4.245	260.40	7%
Total	69.064	72.864	3799.70	

Source: *Draft Budget Policy Statement 2025*

The Office of the Auditor General receives a notable boost, with its spending ceiling growing from Ksh 8.104 billion to Ksh 8.652 billion—a Ksh 548.30 million increases representing 14 percent of the total budget growth for Parliament and Constitutional Commissions. The National Police Service Commission's spending ceiling sees a considerable jump from Ksh 1.008 billion to Ksh

1.333 billion, an increase of Ksh 325 million, constituting 9 percent of the overall budget increment.

Several other commissions experience more moderate increases in their spending ceilings. The Commission on Revenue Allocation's spending ceiling rises by Ksh 44.70 million, the Public Service Commission's by Ksh 124 million, and the Salaries and Remuneration Commission's by Ksh 29.10 million. The Controller of Budget receives an additional Ksh 73.20 million, the Commission on Administrative Justice Ksh 39.70 million, and the Independent Electoral and Boundaries Commission Ksh 177.90 million. Further increases in spending ceilings are allocated to the National Gender and Equality Commission of Ksh 59 million, the Independent Policing and Oversight Authority of Ksh 225.50 million, the Ethics and Anti-Corruption Commission of Ksh 270.20 million, and the Office of the Director of Public Prosecutions of Ksh 260.40 million.

Focus on Resource Issues Facing the Auditor General

The Office of the Auditor General in Kenya faces a critical funding gap, hindering its ability to ensure financial transparency and accountability. For the 2024/2025 fiscal year, the OAG requires Ksh 11.20 billion but is only allocated Ksh 8.67 billion, leaving a Ksh 2.53 billion shortfall. This gap severely restricted the OAG's capacity to conduct specialized audits, particularly those targeting procurement fraud, which are crucial for addressing fiscal slippage. While the OAG maintains a high budget absorption rate (around 95%), chronic underfunding, as exemplified by the Ksh 2.53 billion shortfall in the 2024/2025 fiscal year, prevents the office from operating at full capacity and effectively fulfilling its mandate to provide the independent overview on lawfulness and effectiveness (value for money) on all Kenya's resources. Increased budgetary allocations and capacity building are essential to empower the OAG to combat procurement fraud and promote accountability. The National Treasury should review its indicative ceiling for the office of the Auditor General to match their resource requirements.

Risks of Failing to Meet the Judiciary's Funding

The Failure to meet the recommended funding framework for Kenya's Judiciary poses significant risks that could undermine the justice system's effectiveness, weaken judicial independence, and negatively impact economic and democratic governance. Below are the key risks:

- Inadequate funding will worsen the severe case backlog by limiting the Judiciary's ability to hire more judicial officers, expand court infrastructure, and implement automation. This will delay case resolution, deny justice to litigants, and violate the constitutional right to a fair and timely trial.
- A Judiciary that relies on insufficient and politically influenced funding risks undermining its independence. If the National Treasury continues to set budget ceilings, judicial autonomy (including financial independence) may be compromised,
- The Judiciary will struggle to expand court facilities without sufficient resources, particularly in underserved areas. This will widen regional inequalities in access to justice, leaving marginalized communities with limited legal recourse.

- A slow and underfunded judicial system discourages both domestic and foreign investment. Investors seek legal environments where contracts are enforced efficiently, and disputes are resolved in a predictable timeframe. Persistent judicial inefficiencies can increase business costs, deter investments, and ultimately slow economic growth.
- Article 173 of the Constitution of Kenya (2010) guarantees financial autonomy for the Judiciary if Parliament does not take full charge of determining spending ceilings.