

## FACT SHEET

### Second and Third Quarter National Government Budget Performance 2020/21

#### Key messages

- Budget implementation was negatively affected during the Q2 and Q3 of 2020/21 mainly due to disruptions of economic activities as a result of the enforcement of the containment measures against COVID 19
- Revenues underperformed; 6.5% lower in Q3 2020/21 compared to similar period last year. As a share of GDP, revenue declined to 13.5% by Q3 in 2020/21
- As a result of the declining revenues, Kenya faces a high overall risk of debt distress
- By the end of Q3 of 2020/21 recurrent spending across all the sectors was 64% compared to 46% for development—much lower than the optimal share of 75, indicating a deterioration in the overall performance especially on development.
- The period was also occasioned by a sharp rise in the debt servicing charges (above Ksh 250 billion in Q3 of 2020/21 for instance).
- The low budget execution is mainly explained by low disbursement rates, across the sectors

#### Revenue Performance

Low economic performance correlated with low revenue collection (Ksh 1.25 trillion, representing a decline by 6.5% compared to a similar period in 2019/20)

**Table 1: Government Revenue & External Grants**

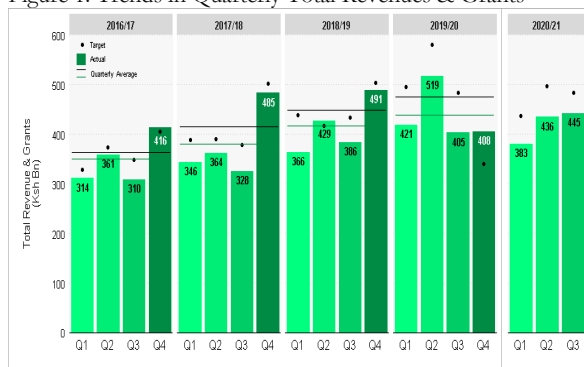
	2019/20 Actual Ksh Bn (A)	2020/21 Actual Ksh Bn (B)	Target Ksh Bn (C)	% Shortfall from Target $((B - C)/B) * 100\%$	% Growth $((B - A)/A) * 100\%$
<b>Total Revenue (a+b)</b>	<b>1332</b>	<b>1245</b>	<b>1277</b>	<b>-2.5%</b>	<b>-6.5%</b>
<b>a) Ordinary Revenue</b>	<b>1216</b>	<b>1107</b>	<b>1114</b>	<b>-0.7%</b>	<b>-9.0%</b>
Import Duty	77	80	75	7.4%	4.2%
Excise Duty	159	162	153	5.6%	1.6%
PAYE	311	252	276	-9.0%	-19.0%
Corporation Tax	209	204	219	-7.0%	-2.6%
VAT	306	292	292	0.0%	-4.4%
Other Revenue	154	117	98	19.1%	-24.1%
<b>(b) Appropriation In Aid 2 o/w Railway Development Levy</b>	<b>116</b>	<b>139</b>	<b>163</b>	<b>-14.9%</b>	<b>19.1%</b>
	18	21	20	4.9%	16.7%
<b>(c) External Grants</b>	<b>14</b>	<b>18</b>	<b>29</b>	<b>-37.6%</b>	<b>35.2%</b>
<b>Total Revenue and External Grants (a + b + c) as % of GDP</b>	<b>1346</b> 12.96%	<b>1264</b> 11.31%	<b>1306</b> 11.70%	<b>-3.3%</b>	<b>-6.1%</b>

Source: The National Treasury

- Overall revenue from ordinary taxes registered was lower compared to cumulative revenues upto Q3 of the previous period by 9%.
- With exception of import and excise duty, the rest of the revenue from tax sources declined.
- Driver for the decline was mainly PAYE with a decline of 19%.
- Non tax sources: Appropriation in aid and external grants registered a positive growth hence boosting the overall collection, however, it was below the target.

## Revenue Shortfalls

Figure 1: Trends in Quarterly Total Revenues & Grants

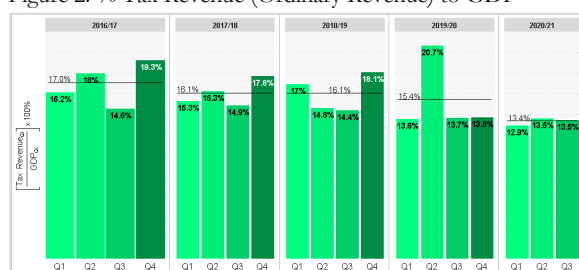


Source: The National Treasury | Quarterly Economic and Budget Review (QEBR)

- Revenue collections in all the three quarters for the year 2020/21 was below the target
- In Q3 actual collection was Ksh 445 billion, 12.5% short of target
- In Q2, Ksh 436 billion was collected which was short of the target by 14%
- Consistency in the shortfalls suggests unrealistic forecasting of revenue a policy gap that National Treasury ought to address

## Tax Revenue to GDP

Figure 2: % Tax Revenue (Ordinary Revenue) to GDP



Source: The National Treasury | Quarterly Economic and Budget Review (QEBR)

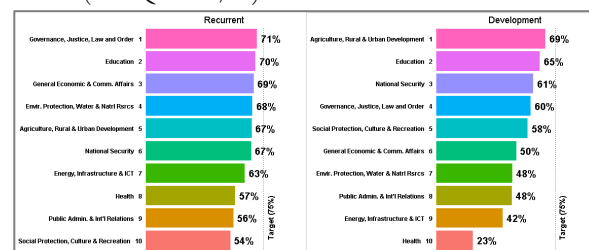
- Overall trends suggests that revenue collection has been declining relative to GDP
- As a share of GDP, tax collection in the Q2 and Q3 of 2020/21 was 13.6% and 13.5% respectively

- The general decline in the tax-to-GDP ratio is below the government's target of 18%
- This phenomenon has been witnessed even before the pandemic and suggesting a structural problem in the economy among other economic factors.

## Revenue disbursement

Across the ten sectors, none of the sectors on the recurrent and development part of the budget is above the optimal rate of 75% meaning that revenue for the recurrent spending has delayed across all the sectors

Figure 3: Ratio of Revenue Disbursements to the Total across sectors (as at Q3 2020/21)



Source: The National Treasury | Quarterly Economic and Budget Review (QEBR)

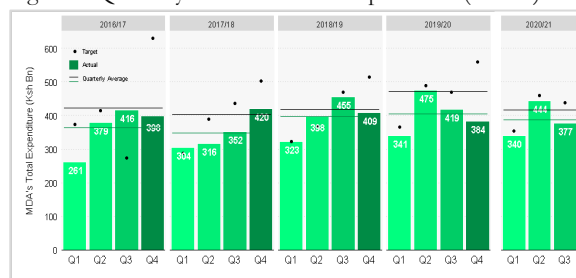
- Sectors with higher disbursement rate for recurrent spending include; Governance, Justice, Law and Order (71%), Education (70%), General Economic and Commercial Affairs (69%), Environmental Protection, Water and Natural Resources (68%), Agriculture, Rural and Urban Development (67%), Energy, Infrastructure and ICT (63%), Health (57%), Public Administration and International Relations (56%) and Social Protection, Culture and Recreation (54%)
- Sectors with higher disbursement rate for development spending include;

Agriculture, Rural and Urban Development (69%), Education (65%), National Security (61%), Governance, Justice, Law and Order (60%), Social Protection, Culture and Recreation (58%), General Economic and Commercial Affairs (50%), Environmental Protection, Water and Natural Resources (48%), Public Administration and International Relations (48%), Energy, Infrastructure and ICT (42%) and Health (23%).

## Performance on Expenditure

Overall, spending by all Ministries, Departments and Agencies (MDAs) in Q2 and Q3 were negatively impacted due to shortfalls in revenue.

Figure 4: Quarterly Trends in Total Expenditure (MDAs)



Source: The National Treasury | Quarterly Economic and Budget Review (QEBR)

- In Q3 of 2020/21 spending amounted to Ksh 377 billion out the target of Ksh 437 billion.
- In Q2 the same year, total spending was Ksh 444 billion out of the target of Ksh 460 billion.
- This implies a strong connection between shortfalls in the revenue and the spending.

## Absorption Rates

Absorption rate ascertains the extend of the implementation of the budget. It tells the actual expenditure of the budget out of the planned expenditure

The summary of during Q2 and Q3 of 2020/21, there is observed relatively low budget execution for development.

Figure 5: Trends in Absorption Rates



Source: Controller of Budget | Budget Implementation and Review Reports (BIRR)

- In Q2 and Q3 of 2020/21, absorption rate for development was 9% and 12% respectively.
- In the same period, absorption rate for recurrent was 23% and 20% respectively.
- This suggests that the revenue shortfalls disproportionately affects the development budget

## Sectoral Absorption Rates

At the sectoral level, a similar observation is made: execution for the development side of budget is much more severe for the development relative to the recurrent.

Table 2: Sectoral distribution of Cumulative Absorption Rates

	Recurrent (%)				Development (%)			
	2018/20		2020/21		2018/20		2020/21	
Agriculture, Rural & Urban Dev	18	43	69	59	11	21	49	80
Education	23	51	69	86	8	28	64	79
Energy, Infrastructure & ICT	12	45	66	86	21	44	68	91
Envmt, Water & Natural Rsrcs	14	33	59	80	22	37	58	87
General Economic & Commercial Affairs	10	26	41	54	14	22	76	88
Governance, Justice, Law & Order	16	39	65	94	22	47	70	102
Health	11	28	42	88	2	18	60	89
National Security	24	51	69	93	2	45	47	83
Public Admin & Int'l Relations	17	38	54	93	4	21	46	75
Social Protection, Culture & Recreation	9	42	51	80	3	30	43	70
Total	19	44	63	88	21	44	64	86

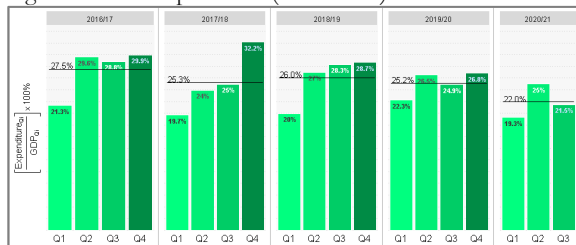
Source: Controller of Budget | Budget Implementation and Review Reports (BIRR)

- In Q3 of 2020/21 the average spending across all the sectors was 64% and 46% out of the budget for recurrent and development respectively.
- In a similar period in 2019/20 the average spending across all the sectors was 63% and 61% which indicates a deterioration in the overall performance.
- None of the sector had an absorption rate that was above 75% in the third quarter of 2020/21 for the recurrent spending suggesting suboptimal performance
- It is only Governance, Justice, Law and Order (GJLOs) and National Security whose actual spending on development surpassed the budget, at 98% and 86% absorption rates respectively.
- Noteworthy, despite the COVID the Health sector registered only 43% of its recurrent budget having been spent in by the end of Q3 out of the optimal ratio of 75%.
- On the other hand, Environment, Water and Natural Resources had the lowest performance with only 26% of the budget being spend.

## Total Expenditure in relation to GDP

The overall trend in Total Expenditure in relation to GDP is declining, between 2016/17 and first three quarters of 2020/21, it reduced from 27.5% to 22.0%.

Figure 6: Total Expenditure (% of GDP)



Source: The National Treasury | Quarterly Economic and Budget Review (QEBR)

This shows that government spending is rising at a slower rate compared to the size of the economy which suggests increase in the contribution of the private sector in the overall GDP

- In Q3 of 2020/21, the ratio of expenditure to GDP was 21.5%, lower compared to Q2: 25%.

## Budget Revisions

Evidence shows that there have been adjustments both the revenue and expenditure side of the budget

Figure 7: Trends in the Budget Revisions



Source: The National Treasury | Quarterly Economic and Budget Review (QEBR)

However, the magnitude of the revisions has grown prominently in Revenue than Expenditure suggesting more pronounced poor planning on the revenue part of the budget.

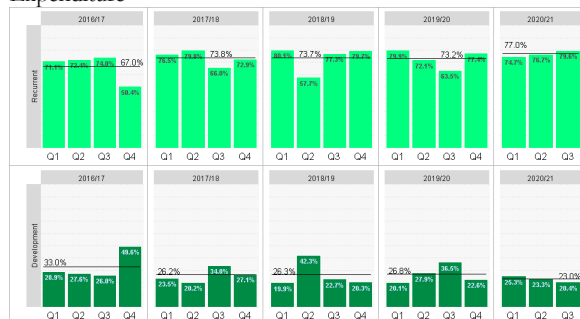
- In 2020/21, respective adjustments on revenue and expenditure are: -5.2% and -3.5% respectively which suggests a tendency to maintain expenditure in the event of revenue shortfalls in which case the government resorts to borrowing.

## Adherence to fiscal responsibility principles

### Spending on development

Spending pattern in the first three quarters of 2020/21 indicate that development expenditure averaged atleast 23.0% of the total spending, representing sub-optimal performance by 7 percentage points.

Figure 8: Proportions of Development versus Recurrent Expenditure



Source: The National Treasury | Quarterly Economic and Budget Review (QEBR)

This is in breach of Section 15 of the PFM Act (2012) provides for a minimum threshold of 30% expenditure on development

## Maximum spending on Wages and Salaries

Overall spending Wages and Salaries has largely been within the fiscal threshold of 35% maximum however, a surge in debt financing is significantly reducing expenditure on Operations and Maintenance (O&M)

Figure 9: % Distribution of the Recurrent Expenditure



Source: The National Treasury | Quarterly Economic and Budget Review (QEBR)

- Strikingly, the debt serving charges constitute the main component that is on the rise. Quarter-over-Quarter average shows that the proportion of debt servicing charges in relation to the total recurrent expenditure and is the main driver to the decline in the O&M
- Continued increase in the debt services may potentially crowd out spending especially on Operations and Maintenance.

## Exchequer Issues

Timely disbursements of revenue to the Ministries, Departments and Agencies (MDAs) is key in supporting effective budget execution. According to the cash disbursement schedule, the quarterly disbursements are evenly distributed around 25%. Evidently, most disbursements are received in Q3 and Q4 while delays happen in Q1 and Q2.

Figure 10: Proportions in Quarterly Exchequer Issues to the MDAs



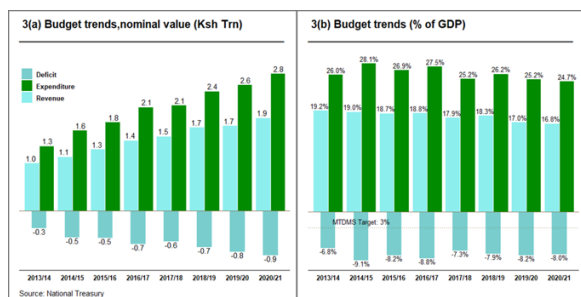
Source: Controller of Budget | Budget Implementation and Review Reports (BIRR)

- For the recurrent budget, it is observed that on average between 2016/17 and 2020/21, about 22.2% and 31% for Q1 and Q4 respectively
- For the development budget, it is observed that on average between 2016/17 and 2020/21, about 12.9% and 37% for Q1 and Q4 respectively
- Delays are more pronounced on the development

## Budget Deficits

The government has been running budget deficits, and this has been worsened by the revenue shortfalls as seen in Figures 3 and 4.

Figure 11: Proportions in Quarterly Exchequer Issues



The budget deficit has increased from Ksh 0.3 trillion to Ksh 0.9 trillion between 2013/14 to 2020/21. As a ratio of GDP, in 2020/21 the budget deficit is 8% which is above the Medium-Term Debt Management Strategy (MTDMS) of 3%.

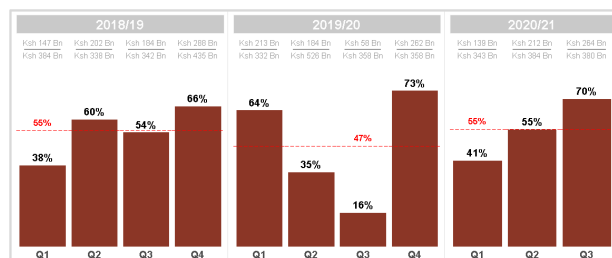
It is anticipated that the deficit will be financed from domestic sources and external markets.

Continued accumulation of budget deficits has led to a surge in the debt stock which is currently above Ksh 8 trillion (more than 70% of GDP).

### Public Debt Servicing

A sustained increase in the public debt has impacted heavily on the debt servicing charges

Figure 12: % Public Debt Servicing to Tax Revenue (Ordinary Revenue)



Source: The Office of the Controller of Budget

- In 2020/21 Q3, for every Ksh 100 raised as Ordinary Revenue atleast Ksh 70 was paid for the debt
- In 2020/21 Q2, for every Ksh 100 raised as Ordinary Revenue atleast Ksh 55 was paid for the debt
- In 2020/21 Q1, for every Ksh 100 raised as Ordinary Revenue atleast Ksh 41 was paid for the debt
- The flexibility of the overall budget is limited by the sharp rise in the debt charges

## Debt Sustainability

A country's public debt is considered sustainable if the government is able to meet all its current and future payment obligations without exceptional financial assistance or going into default. The measures for the debt sustainability include, for instance, liquidity ratios such as Present Value (PV) of public debt to revenue and grants ratio and Debt service to revenue and grants ratio.

Table 3: Debt Sustainability Analysis, April 2020

Indicator	Threshold (%)	Actual			Projection	
		2017	2018	2019	2020	2022
PV of public debt to GDP ratio	74	49	48.6	57.6	61.3	63.9
PV of public debt to revenue & grants ratio	300	235.7	226.6	313.9	338.1	356.6
Debt service-to-revenue & grants ratio	30	38.2	42.3	33.4	53.8	68.0

IMF Country Report No. 20/156

Kenya's debt sustainability has deteriorated rapidly mainly due to falling domestic revenues.

Liquidity indicators such as *debt-to-revenue ratio* and *debt service-to-revenue ratio* have been breached. This has raised overall risk of debt distress to high.

## Recommendations

### 1. Unpredictability and insufficiency of funds

- The National Treasury should strengthen revenue forecasting capacity in order to improve predictability of public funds for improved budgeting and execution. This will reduce need and frequency of budget revisions.
- Civil Society Organisations (CSOs) and other non-state actors including the media should interrogate and analysis how realistic revenue projections towards influencing realistic budget ceilings for MDAs.
- The Legislature should oversight and rein on optimistic revenue projections that are used to “understate” the magnitude of budget deficit and as a way of curbing borrowing appetite by the government

### 2. Debt Distress

- There is need for national government through the National Treasury to develop a contingency plan to address a potential deepening of the economic shock due to higher level of uncertainty with regards to increased debt obligations and other contingency liabilities on due to high Publicly Guaranteed Debt and a surge in Non-Performing Loans. Other sources of economic shocks could arise from missed tax revenue targets and deterioration of the shilling leading to a shock on the external debt position.
- Seek to lengthen maturities of large debts such as the Euro bonds in order to limit refinancing risks
- Determine and maintain an optimal liquidity in terms of foreign reserves as buffer against volatility in the forex

### 3. Budget revisions(supplementary budgets)

- In any particular financial year, the budget adjustments should be accompanied by an explanation on the sources of financing in

order to reinforce against increase in the overall budget deficit through introduction of supplementary budgets.

- The budget adjustments by Parliament should not increase the overall budget deficit by more than ten percent for that financial year unless, in special circumstances, Parliament has approved a higher percentage.

### 4. Overall delays in releases of funds to MDAs

- There is need for harmonization and synchronization of MDAs work plans and cash request working with the National Treasury to releases

### 5. Transparency in declaration of AiAs by MDAs

- The Legislature and civil society should rein on the National Treasury to strengthen and enforce reporting of appropriations in aid (A.i.A) as provided in the Public Finance Management Act (PFMA), 2012.

### 6. Under release of donor funds, direct donor funding to project (off-budget) and lack of transparency

- The National Government should scale donor funds projections to avoid huge gaps when commitments by donors do not materialize NG should agree with donors on a simple, harmonized and synchronized donor disbursement procedure.
- Civil society should demand for accountability and reporting of direct donor funding in line with PFMA, 2012 and External Resources Policy to improve overall transparency of flow of donor funds.

### 4. Budget deficits

The government through National Treasury should deliver on the fiscal consolidation policy of ensuring that the budget deficit is below 3% of GDP in order to curb on excessive borrowing.