

Special Report



**Review of the Government of Kenya
2005/06 Budget**

*Shem Ouma
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Benson Kiriga
Willis Wasala*

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**KENYA INSTITUTE FOR
PUBLIC POLICY RESEARCH
AND ANALYSIS (KIPPRA)**

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Abstract

The review of the Government of Kenya 2005/06 budget sought to ascertain how the annual budget allocations traced the broad fiscal and macroeconomic targets set out in the Economic Recovery Strategy for Wealth and Employment Creation (ERSWEC) 2003-2007. It also sought to ascertain the effectiveness, efficiency and inclusiveness of the budget process, and whether it adequately addresses poverty concerns. It further analyzed the budget for coherence between the priorities identified in the Budget Outlook Paper (BOPA) 2005/06-2006/07 and those in the printed budget estimates as presented to Parliament. The deviations between actual and budgeted expenditures were also reviewed.

*The review shows that the national sectoral prioritization does not fully reflect the priorities at the local community levels, partly due to limited participation in the budget formulation process. Prioritization at these levels should ideally inform sectoral prioritization and form the basis upon which expenditure allocations are effected. The review also found out that although government policy formulation documents envisage increased budgetary allocation to development expenditures, which was achieved to some extent during 2005/06 budget, a more than proportionate share of budgetary allocations still go to recurrent expenditures. This implies that development of capacity and crucial infrastructure of various sectors continues to suffer. Pro-poor programmes still receive less expenditure allocations than voted for. Resources allocated to Core Poverty Programmes (CPPs) were **not** well ring fenced as envisaged.*

In preparing the macroeconomic framework for the budget, the Macroeconomic Working Group (MWG) focuses mainly on major macroeconomic indicators with little consideration for social economic indicators of development. Integrating social considerations in the macroeconomic framework would make it easier to trace progress made towards meeting the MDGs, and enhance the on-going re-orientation of resource allocations to the social sectors.

The review also analyzed the strengths in the MTEF budget process, which should be capitalized upon, and include rolling out MTEF budget to the district level as well as strengthening the MTEF institutional framework; enhancing linkage between policy, planning and budgeting, which allows expenditures to be driven by policy priorities; and wider participation through sector hearings.

Abbreviations and Acronyms

AIE	Authority to Incur Expenditure
BMU	Budget Monitoring Unit
BOPA	Budget Outlook Paper
BSD	Budget Supplies Department
BSP	Budget Strategy Paper
CAG	Controller and Auditor General
CBK	Central Bank of Kenya
CBS	Central Bureau of Statistics
CDF	Constituency Development Fund
CET	Common External Tariff
CFS	Consolidated Fund Services
CPI	Consumer Price Index
CPP	Core Poverty Programmes
DDC	District Development Committee
DDP	District Development Plan
DEC	District Executive Committee
ERS	Economic Recovery Strategy (ERS) for Wealth and Employment Creation
FPE	Free Primary Education
FSP	Fiscal Strategy Paper
GDP	Gross Domestic Product
GFS	Government Financial Statistics
HIPC	Heavily Indebted Poor Countries
IFMIS	Integrated Financial Management System
IP-ERS	Investment Program for Economic Recovery Strategy (for Wealth and Employment Creation)
KIPPRA	Kenya Institute for Public Policy Research and Analysis
KRA	Kenya Revenue Authority
KTMM	KIPPRA Treasury Macro Model
MTEF	Medium Term Expenditure Framework
MDGs	Millennium Development Goals
MWG	Macroeconomic Working Group
NARC	National Rainbow Coalition
OP	Office of the President
PEM	Public Expenditure Management
PER	Public Expenditure Review
PMG	Paymaster General
PRSP	Poverty Reduction Strategy Programme
SNA	Systems of National Accounts
SWG	Sector Working Group
UNDP	United Nations Development Programme
VAT	Value Added Tax

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1. Introduction

The 2005/06 fiscal year budget is the third budget implementing the Economic Recovery Strategy for Wealth and Employment Creation (ERSWEC) 2003-2007 and the fifth under the Medium Term Expenditure Framework (MTEF) budgeting process. This budget review seeks to ascertain how the annual budgets trace the envisaged broad macroeconomic targets of the ERSWEC, the effectiveness and efficiency of the budgetary process, the consultative and inclusiveness of the process, and how it addresses poverty. Poverty reduction, as acknowledged in the budget speech, remains not only the principal goal of the government's social and economic policy, but also a major goal of the international community as envisaged in the Millennium Development Goals (MDGs). The review also analyzes the budget for coherence between the priorities identified in the Budget Outlook Paper (BOPA)¹ 2005/06-2006/07 and the priorities as evidenced in the printed estimates of the 2005/06 budget, together with the deviations between actual and budgeted expenditure.

In brief, the analysis seeks to examine the nature, extent, causes and possible remedies of the above issues with a view to improving the subsequent budget performances.

¹ BOPA is the successor to the Fiscal Strategy Paper (FSP).

2. The Budget Process

The budget process is an annual cyclical exercise. The Public Expenditure Review (PER) of 1997 identified several weaknesses² in the annual exercise and concluded that trends in expenditure allocations did not serve the goals of attaining high and sustained economic growth and poverty reduction. To improve public expenditure management (PEM), the review recommended comprehensive reforms. The reforms adopted from the review include the adoption in 2000/01 of the MTEF approach to budgeting, the establishment of a Budget Monitoring Unit (BMU), and the introduction of the Integrated Financial Management Information System (IFMIS). The adoption of the MTEF approach was intended to achieve four key goals, namely: linking policy-making to planning and budgeting; maintaining fiscal discipline by establishing hard budget constraints; facilitating prioritization of expenditures across policies, programmes and projects; and encouraging efficient use of resources to improve budget outcomes. Before its inception, the annual budget process was mainly incremental, thus, devoid of sound macroeconomic resource framework and prioritization.

Kenya's MTEF budget process comprises key dual processes. The first is a "top down" fiscal process involving identification of aggregate resources and allocating them across sectors in line with national priorities. The second is a "bottom up" expenditure planning process that involves the preparation of sector strategies and the expenditure needs that would allow them achieve sector targets. This forms the resource bidding and allocations process. Of crucial importance, however, is how prioritization is done and whether expenditure allocations are conducted on that basis. Sectoral prioritization, it is feared, may not be totally reflective of the needs within the local communities at the districts, locations, sub-locations and even villages. Prioritization at these levels should ideally inform sectoral prioritization so that they reflect the people's prioritized needs and along whose preferences expenditure allocations should be effected.

² The weaknesses included the annual budgeting process and MTEF remaining two separate processes; the split of the MTEF budget process due to the split of the former Ministry of Finance and Planning into two ministries, namely, Ministry of Planning and National Development and Ministry of Finance, thus undermining the effectiveness of expenditure priorities and resource allocation; lack of a single budget document to reconcile resource allocation and priorities; and limited political engagement in budget strategy and sector ceilings determination (Republic of Kenya, 2005).

2.1 The Top-Down Approach

This approach is used to determine the overall resource envelope based on the BOPA, which is in itself, a product of the top-down process. BOPA provides forecasts of economic growth and other key macroeconomic variables, including the rate of inflation, the supply of money, the rate of exchange and interest rate, largely through the use of the KIPPRA Treasury Macro Model (KTMM). Besides providing a detailed medium-term macroeconomic framework, BOPA also provides optimal levels of aggregate revenue, expenditure and a deficit financing strategy over a three-year period. The Macroeconomic Working Group (MWG), with membership drawn from KIPPRA, Ministry of Planning and National Development, Ministry of Finance, Central Bank of Kenya, Kenya Revenue Authority, and Central Bureau of Statistics prepares the BOPA that feeds into the Budget Strategy Paper (BSP), which provides an update of available resources and proceeds to set firm ministerial ceilings. The BSP designs a strategy that restructures government spending pattern over the medium-term, intended to achieve the government's medium-term strategic goals as contained in the ERSWEC. Thus, the BSP contains specific and detailed guidelines to line ministries to help them align their expenditures to national priorities and, therefore, forms the basis of the annual budget. This approach, nonetheless, is not all-inclusive. It fails to consider the performances of all sectors, especially the social sectors. It fails to provide a framework of social fundamentals pertinent for human development and poverty eradication.

Poverty eradication has been one of the three broad enemies of the government, the others being ignorance and disease, which it has always fought since independence. Cognizance of social fundamentals such as infant mortality rate, school enrolment rates, literacy levels, and immunization level will help guide budgetary allocations. While the social conditions can be reviewed in the respective MTEF sector reports, they should be exclusively considered when determining the resource envelope. Although the Investment Programme (IP-ERS) of ERSWEC makes a good attempt at specifying the targets a priori, there is no deliberate mechanism of progression from the programmes and indicators in the IP of ERSWEC to the budget.

2.2 Bottom-Up Sector Hearings and Resource Bidding

Allocating resources derived from the top-down MTEF process are based upon discussions of the Sector Working Groups (SWGs), which come up with synthesized ministerial expenditure reports that contain expenditure requirements for the implementation of the

sectoral policy goals as per the ERSWEC. The ministerial budgets are prepared as per the budget guidelines issued by the Treasury. Currently, there are eight sectors, namely:

- (i) Agriculture and Rural Development, which comprises ministries of Agriculture; Livestock Development and Fisheries; Cooperative; Environment and Natural Resources; and Ministry of Lands and Housing;
- (ii) Public Safety Law and Order, consisting of Office of the President; State House; State Law Office; Office of the Vice President; Ministry of Home Affairs; Justice and Constitutional Affairs; and the Judiciary.
- (iii) Health, composed of the Ministry of Health and the National Aids Control Council;
- (iv) Physical Infrastructure, covering ministries of Local Government; Public Works; Transport; Water; Energy; and Information and Communication;
- (v) General Economic Services, consisting of the ministries of Trade and Industry; Tourism and Wildlife; Labour and Human Resource Development; and Gender, Sports Culture and Social Services;
- (vi) Public Administration, referring to all operations relating to fulfilment of public policy and comprises government departments such as the Directorate of Personnel Management; Public Service Commission; Ministry of Finance; Ministry of Planning and National Development; Ministry of Foreign Affairs; Ministry of Regional Development Authorities; Ministry of East African and Regional Cooperation; Electoral Commission of Kenya; and the National Assembly;
- (vii) Education, consisting of only Ministry of Education; and
- (viii) National Security, comprising of Department of Defence; and National Security Intelligence Services.

Each ministry identifies its priorities in the coming fiscal year and in the medium-term but ensures that they are not at variance with national priorities as set out in several government policy documents, especially the ERSWEC. The SWGs, however, review and rank the priorities in terms of their contribution towards realizing the overall ERSWEC goals and then sets the inter-ministerial limits. Nevertheless, the MTEF sector reports become

simply indicative limits and targets and do not obligate ministries to allocate resources. They have to be guided by the Treasury circular issued by the Ministry of Finance, which has stipulated guidelines to be followed. For the sectors that are critical in the fight against poverty, ignorance and disease, the question to ask is: "Are the social indicators that are crucial in the fight part of the Treasury Circular Guidelines?" If the answer is no, then it is hard for the SWGs to initiate measures that focus on social sectors, where a wider proportion of the fight against these three vices should be. Otherwise, when the bottom-up needs are matched with the overall expenditure ceilings determined under the macroeconomic framework, allocations for social spending definitely miss out.

The mechanism for reconciling the overall consistency between the needs assessment from the bottom-up with the resource availability from the top-down approaches provides the budget negotiation framework conducted through the sector bidding process. When the ministries and agencies have prepared detailed itemized budget estimates and submitted to the Budget Supplies Department (BSD), the drafting process starts. The final draft is presented to the Cabinet for review and approval. Its execution begins with the tabling of the budget as a motion in Parliament by the Minister of Finance. With the approval of ministerial expenditures by Parliament, the implementation, supervision and audit follow. Release of funds to the ministries and agencies follow the Exchequer procedures of issuing Authority to Incur Expenditure (AIE) to the authorized officers.

2.3 The Budget Cycle

The ideal budget cycle differs significantly from the practical budget calendar followed annually. The MTEF process begins in **September to December** the previous year, and climaxes with a budget speech read in Parliament in mid June the following year by the Minister of Finance. It starts with the PER activities flagged off by the issuance of Treasury guidelines to the Ministries/Departments and district departments to guide preparation of ministerial budgets. District budgets are assumed to have benefited from inputs from the community through location and divisional prioritization processes. The ideal process of prioritizing community needs by local-based committees starts by calling *barazas* where community development issues and agenda are discussed. The constituent committees, such as the Constituency Development Fund (CDF), act as facilitators and conveners. People from a sub-location or a location enumerate their developmental needs. Once the needs have been identified and enumerated, the facilitators take the people through a ranking

process. The needs are ranked according to a scale of preference. During ranking, decisions are made either by acclamation or consensus or voting by those present. This exercise is repeated in other sub-locations or locations within the constituency (or district) depending on the smallest development unit chosen and then submitted to the District Executive Committee (DEC). The DEC prepares the technical report to the District Development Committee (DDC), which comes up with the overall district prioritization projects and programmes. The DDC draws an action plan upon which resources are distributed.

This approach, though clearly documented, is never followed in reality. It is always assumed that the PRSP consultation process had helped to identify people's needs that were reflected in the district PRSPs. This has remained inadequate and there is, therefore, need to make the proposed consultation framework an integral part of the budget cycle. There are no clear indications that the District PRSPs were integrated into the budgeting process. Besides, District priorities identified at the time PRSPs were conducted could have materially changed.

In **January to March**, the Ministries/Departments submit initial drafts of the Ministerial Public Expenditure Reports (MPERs). Over the same period, the Macroeconomic Working Group develops the macroeconomic and fiscal framework in accordance with government priorities. Sector Working Group meetings also go on to finalize the sector reports. Thereafter, sector hearings on policies, expenditure proposals and targets for the next financial year are conducted followed by a review of sector ceilings, approval and communication of the same to Ministries/Departments. It is noted, however, that whereas the process provides for a MWG, a counterpart on the social sector is conspicuously missing. Even though the District MTEF is meant to be a bottom-up process for identifying people's needs, including social ones, it has remained theoretical. District management organs are less involved in budget prioritization and activity identification.

Between **April and June**, sector resource bidding is done followed by the consolidation and compilation of ministerial allocations. Thereafter, the draft estimates are presented to the Minister of Finance for approval. The Minister then presents the draft estimates to the Cabinet for approval and thereafter tables the budget in Parliament in the form of a budget speech in June. This process is captured in Annex 1, and the immediate fiscal year's budget process captured in Annex 2. The budget estimates are revised in March the following year and tabled in Parliament as approved estimates. The

revisions take into account unforeseen circumstances, such as revenue shortages, and unforeseen expenditure needs, for ratification by Parliament. However, the district budgets are never revised.

2.4 Releasing Money to Spending Units

Releasing budgeted funds to spending units takes a process too. After the budget is tabled in Parliament, Parliament authorizes spending agents to spend up to 50 percent of the allocations through the "Vote on Account" while the estimates are being debated during the months of July/August. Through parliamentary approval, the government obtains the mandate to raise and spend the money as per the budget. Before funds reach the spending units, they are moved from the Consolidated Fund to the Exchequer Account, Paymaster General (PMG), and the Accounting Officers Account from where Authority to Incur Expenditure (AIE) to those with delegated authority from the Accounting Officer are issued. Those issued with AIE at the spending units, sometimes based at the headquarters, provinces but mostly in the districts and government departments, are authorized to expend the budgeted monies. The following is usually the procedure used to release the funds:

- (i) Parliament approves the budget (statement of sources of revenue and proposals of expenditure by the Government in the subsequent fiscal year). After the budget approval by Parliament, the government is given power to raise and spend the money as stipulated in the budget.
- (ii) Voted funds moved from the Consolidated Fund to the Exchequer Account.
- (iii) Funds moved from the Exchequer Account to the Paymaster General Account.
- (iv) Funds moved to the Accounting Officers' Account at the PMG.
- (v) Authority to Incur Expenditure (AIE) issued to those with delegated authority from the Accounting Officer, both at headquarters, provinces and at the districts.
- (vi) Expenditure incurred, at headquarters and at the district.
- (vii) Returns made to the Accounting officers who prepare final accounts for the ministry or department and hand over to the Treasury for onward passing to Parliament.
- (viii) Audit of the expenditures by the National Audit Office. The Controller and Auditor General (CAG) has powers to request

for further explanations from the accounting officers as to how funds were spent.

- (ix) Audited reports handed to Parliament for deliberations and for any other actions as Parliament may find necessary.

Inherent in the process, nevertheless, are frequent delays. It is common to find allocations going to the districts in the last quarter of the financial year, implying that expenditure planning is not adhered to. This means that the AIE holders have to come up with ways and means of spending the money, some of which are economically irrational. Some allocations, however, go back to the respective ministry headquarters and it is common to find the allocations used in unplanned expenditure items. Besides, the returns worsen the absorption capacity problem in the economy.

2.5 A SWOT Analysis of the Current Budgetary Process

A critical examination of the current MTEF budgetary process reveals its strengths and opportunities that can be exploited to improve budget outcomes. However, it also shows weaknesses and threats, which jeopardize its performance to realize the social and economic objectives as set out in various government policy documents.

The strengths the process enjoys include:

- The linkage between policy, planning and budgeting, which allows expenditures to be driven by policy priorities and be guided by budget realities.
- Its implementation of the Investment Programme for ERSWEC, which translates the nationwide PRSP consultative process priorities and the mandate of the NARC government as expressed in its Manifesto.
- District level establishment of institutions that implement the MTEF budgetary process.
- Political goodwill. The government has committed itself to the MTEF process initiating, whenever necessary, reforms to improve upon its performance.
- The process has wider participation through sector hearings.

The weaknesses the process suffers include:

- In operation, the MTEF process and annual budgeting used to be somewhat two separate processes. Efforts are now in place to

reconcile the two processes. The 2003/04 review of the MTEF process, for instance, found out that the process started too late in the fiscal year, implying that its indicative sector ceilings came after the MPERs had been concluded. Thus, expenditure plans from line ministries could not be firmly anchored in the financial framework and be guided by hard budgetary constraints.

- Lack of a strong legal framework. The existing legal framework for budgeting does not cover the MTEF budgeting process. For instance, though the MTEF process provides for a sectoral approach to resource allocation and prioritization, ultimately the budget is voted by ministry since the sector has no legal foundation. Indeed, doubts have been raised as to whether there is sufficient value added in issuing sectoral ceilings then reverting back to the ministry level. There is also no provision in the budget institutions for the MTEF Secretariat, which limits its institutionalization.
- Although the current MTEF framework is a participatory budget process by design, some participating institutions suffer inertia in performing their roles, thus delaying the entire budget process. In fact, some of the institutions such as the district MTEF are not even functional.
- Inadequate information on output and costings at the districts undermines the process of inter- and intra-sectoral resource allocations based on a careful evaluation of their priorities. The data is necessary in improving this process, despite the process adhering to the overall resource envelope.
- Lack of medium-term focus, whereby ministries fail to regularly refer to their forward estimates in developing new budgets at the beginning of each new budget cycle. This, in effect, renders the two outer years of the MTEF budgetary process irrelevant.
- A fairly weak linkage between national and community priorities given that current national and district development plans and the district PRSPs do not fully inform the budgetary process. Departmental heads liaise more with their parent ministries or sectors directly, with their proposals being totally at variance with the contents of the District Development Plan (DDP).
- Lack of adherence to the MTEF timelines. Some actions, such as the issuance of budget circular guidelines from the Ministry of

Finance can delay by as late as four months, with the implication that the guidelines are not utilized at the lower levels, thus weakening the MTEF process.

- Lack of community awareness and sensitization. For communities to play their rightful roles, there is need for awareness creation and sensitization for communities to demand delivery of services and accountability on the part of service deliverers.

The opportunities the process can exploit include:

- The current budgetary process provides great opportunities of strengthening the Public-Private Sector Partnerships in the budget formulation and implementation process. This will improve the focus on the needs of all the stakeholders, including the community, by enhancing their participation. For along time, Kenyan people have been willing to participate in their own development with proper facilitation.
- In addition, the PER and Public Expenditure Tracking Systems provide an opportunity to link changing social indicator trends to the allocation and utilization of resources. This has huge potential not only in shaping the future identification and prioritization of the community's needs, but also service delivery to the community.
- The performance-oriented and results focused MTEF process can be a major boost to good governance. Its potential to shift attention from what the government does to what the people want the government to do based on the people's needs identification process from below implies better utilization of resources. Proper checks and balances on how the resources are invested in community-sanctioned projects are effected by the community, which inspires good governance practices.
- The SWGs also provide an opportunity for the process to focus on the social sectors.

The threats the process should avoid include:

- The weak institutional framework that is manifested in poor governance, lack of capacity at the district level, and conflicting interest between sustaining of the old and new systems. To effectively operationalize the MTEF, there is need to strengthen the existing institutional framework and allow for partnership between the public, private, civil and community in the

prioritization of needs and allocation of resources; strengthen the capacity at the districts and provide adequate resources; improve on the systems of accountability and transparency; provide the necessary political commitment for the decentralized process that goes on with the process; and ensure the MTEF process is grounded on a firm legal framework.

2.6 The Budget and Government Financial Statistics (GFS) 2001

The government adopted the Government Financial Statistics (GFS) in 2001 and prepared the 2005/06 budget using the same. It recognizes budget more as a policy document used to convey government strategies. The GFS structure ensures that the budget communicates the objectives and as much as possible ensures linkage with the budget planning cycle, namely: planning/allocation, execution, accounting, auditing and monitoring and evaluation.

The budget before adoption of GFS 2001 had three main areas, namely:

- **Organizational:** This is a description of the institutions and are the votes and vote heads. Basically, by the vote head, one would establish the specific institution and where it may be geographically located.
- **Operational:** This is the functional or programme level. It describes what the money is for, and is commonly referred to as sub-vote.
- **Economic classification:** This is the third segment and describes the various inputs commonly referred to as items of expenditure. Although on another platform, the other two segments may have to be revised under IFMIS, it is this third segment that is changing completely to reflect the international standards of classification.

3. An Assessment of the Macroeconomic Framework

The first part of this section analyses economic performance (macroeconomic, fiscal, monetary and external developments) over the fiscal year 2004/05, against the key targets set for the country's macroeconomic framework defined in the ERS/IP-ERS, the 2004/05 budget and the Fiscal Strategy Paper (FSP 2004/05). This allows us to examine whether the targets set in the macroeconomic framework were met or not and the reasons for the observed performance. The second part attempts to look at the key economic targets set in the macroeconomic framework defined in the Budget Strategy Paper (BSP 2005/06-2007/08), how these targets relate to the wider ERS/IP-ERS targets and the extent to which the 2005/06 budget traces the set macroeconomic framework. This, in essence, allows us to understand the extent to which the budget is informed by the planning process, in line with the MTEF's stated objective of ensuring a proper link between policy, the budget and planning processes. As a policy, the government budget is to be guided by the ERS and the investment programme as the main planning documents. The third part presents key challenges that are likely to influence the attainment of the 2005/06 budget targets. The last part provides the conclusions drawn from the analysis and the key recommendations that would ensure the macroeconomic framework being implemented in the budget remains in line with the overall macroeconomic objectives contained in the ERS.

3.1 An Assessment of the 2004/05 targets Against Outcomes

The key macroeconomic targets defining the government macroeconomic framework covering the period 2004/05 were contained in the ERS, the IP-ERS and the Fiscal Strategy Paper (FSP 2004/05). Accordingly, the ERS and the IP-ERS's broad macroeconomic framework had articulated the following as key objectives and targets³ over 2003 to 2007.

³ We depend on the targets set in the IP-ERS where targets in the ERS are unclear.

Box 1: ERS/IP-ERS objectives and targets: 2003-2007

- A rise in average real GDP growth rate to 4.3 percent over 2003-2007.
- Achieving a sustainable fiscal framework, with a reduction in stock of domestic debt from 25.1 percent of GDP in 2002/03 to 17.7 percent of GDP by 2006/07; a reduction in the fiscal deficit to 3.3 percent of GDP; and an increase in revenue to GDP to 23.4 percent over the same period.
- Restructuring expenditures to be more pro-poor and pro-growth by increasing spending on Core Poverty Programmes from 3.4 percent of GDP in 2002/03 to 4.0 percent of GDP in 2003/04 and lowering the wage bill to below 8.5 percent of GDP by 2006.
- Enhancing policy, planning and budgeting and expenditure control by minimizing the deviations between actual expenditure and printed estimates by 30 percent by 2006/07, and similarly reducing deviations between MTEF projected estimates and printed estimates over the same period. Other targets aim at clearing pending bills and lowering supplementary budgets.
- Relying more on external concessional borrowing and reducing public domestic borrowing to achieve the following targets: annual net domestic financing to decline to -0.4 percent in 2004/05; maturity profile of government debt lengthened from 45 percent long term Treasury bonds in 2002/03 to 70 percent in 2003/04; and concessional international borrowing and grants to rise from 0.8 percent of GDP to 5.9 percent in 2005/06.
- Higher private savings and investments to reach 15 percent and 24.6 percent of GDP by 2005/06, respectively.
- Low and stable interest and inflation rates, with an inflation target of below 5 percent annually.
- Money supply growth in line with nominal GDP (about 10% annually).
- Reduced government participation in the banking sector. The share of government equity/capital not to exceed 25 percent by 2006/07; increased availability of credit to private sector and reduction in stock of non-performing loans by 30 percent over 2003-2006.

To ensure the implementation of the proposed macroeconomic framework, the 2004/05 Fiscal Strategy Paper (FSP) traces closely the broad ERS macroeconomic targets. Thus, the objectives of the FSP sought to establish and maintain a stable macroeconomic and fiscal framework and re-align expenditures to enhance pro-the-poor growth.

Detailed below are some of the key targets of the 2004/2005 Fiscal Strategy Paper.⁴

Box 2: Key macroeconomic targets of the 2004/05 Fiscal Strategy Paper

- A real GDP growth of 2.5 and 3.7 percent in 2004 and 2005, respectively;
- A real investment growth of 26.2 percent and 18 percent in 2004 and 2005, respectively;
- A real export growth of 2.0 percent and 4.8 percent in 2004 and 2005, respectively;
- A real import growth of 18.2 percent and 10.5 percent in 2004 and 2005, respectively;
- An underlying inflation that remains below 3.5 percent over the medium term;
- Revenues expected to decline from 21.6 percent of GDP in 2003/04 to 20 percent in 2006/07 (and not 21% as originally envisaged in the ERS) following the implementation of the Common External Tariff (CET) of the East African Community;
- Overall expenditures expected to decline from 27.4 percent of GDP in 2003/04 to 25.9 percent in 2006/07 as a result of the declining levels of interest payments and reduction in the wage bill. Development expenditures were to rise from 4.3 percent of GDP in 2003/04 to 5.9 percent in 2006/07 (from Ksh 47 billion to Ksh 80 billion), with the bulk of these resources going to infrastructure development;
- Deficit expected to rise to 4.27 percent of GDP in 2004/05 and 4.29 percent in 2006/07 (up from ERSWEC target of 3% following anticipated lower revenues and lower absorption of donor funds). The deficit was to be financed mainly from external resources, hence, allowing for lower levels of domestic borrowing and subsequent reduction in domestic debt stock; and
- Non-inclusion of adjustments of civil servants wages in the wage expenditure, free primary education expenditures were to be maintained at Ksh 9 billion while non-wage health expenditures are expected to rise in line with the objective of implementing the National Social Health Insurance Scheme.

In an attempt to implement the proposed fiscal framework, the 2004/05 budget had stipulated the following as the broad macroeconomic targets over 2004/05.

⁴ Cabinet Memorandum on the FSP and sectoral ceilings for the 2004/05-2005/07.

Box 3: Macroeconomic targets for 2004/05 budget

- Attaining real GDP growth of 3 percent in 2004;
- Allowing money supply to grow by 8 percent, predicated on underlying inflation being no more than 3.5 percent per annum;
- Expending private sector credit by around 13.5 percent per annum;
- Attaining official foreign exchange reserves equivalent to 4.1 months import cover;
- Undertaking bank restructuring measures aimed at improving the banking sector;
- Total revenue target of Ksh 271.03 billion for fiscal year 2004/05, composed of Ksh 233 billion of ordinary revenue (20.1% of GDP) and Ksh 38 billion in A-I-A;
- Gross recurrent expenditure for 2004/05 estimated at Ksh 353.9 billion, comprising Ksh 23.8 billion as A-I-A, Ksh 132.8 for Consolidated Fund Services (CFS) and Ksh 197.2 billion for discretionary expenditures;
- Development expenditure estimated at Ksh 86.7 billion. Comprising Ksh 32 billion as A-I-A, Ksh 12.2 billion for direct project financing, Ksh 17.8 billion as grants and Ksh 2 billion as local A-I-A. Consequently, a net development expenditure of Ksh 54.8 billion was expected to be financed from the Exchequer; and
- Overall deficit of Ksh 57.9 billion for the current fiscal year of which Ksh 22 billion to be financed through domestic borrowing and the remaining Ksh 35.9 billion to be financed through external support by the development partners and the privatization proceeds in the course of the financial year.

Whereas earlier analysis by KIPPRA had indicated marked variations between the macroeconomic targets set in the 2004/05 Fiscal Strategy Paper and those that were contained in the 2004/05 budget, it was clear that the budget had attempted to implement the macroeconomic framework contained in the 2004/05 Fiscal Strategy Paper. An important question that, therefore, comes to mind is the extent to which the defined targets relate to the actual outcomes over 2004/05.

The table below provides a summary of the outcomes of key macroeconomic targets against the target set in 2004/05. It can be argued from the outset that there were high variations between the set targets and the actual outcomes.

Table 1: Targets and outcomes of key economic indicators over 2004/05

Indicator	ERS/IP-ERS Targets	2004/05 FSP Targets	2004/05 Budget Targets	2004/05 Outcomes
2004				
Real GDP growth %	3.7	2.5	3.0	4.7
Gross investments/GDP %	16.6	20.4	21.0	18.4
Savings/GDP %	9.6	9.7	11.5	13.9
CPI (Excl. food and energy) %	3.5	3.5	3.5	5.6
2004/05				
Total revenue/GDP %	22.0	21.7	22.3	21.2
Total expenditure and net lending/GDP %	25.7	25.9	28	22.2
Overall balance including grants (Cash)/GDP (%)	-3.7	-3.3	-6.1	-0.1
Net domestic borrowing/GDP %	3.1	2.5	1.39	-0.5
Domestic debt, Net (period end)/GDP %	22.2	21.2	23.3	18.6

Source: ERS/IP-ERS 2003-2007; 2004/05 FSP; and Budget and the Economic Survey 2005

A comparison of the set targets against the actual outcomes tests the effectiveness of Kenya's macroeconomic projections. Of particular attention to this analysis are the reasons behind the observed variances between the set targets and the outcomes. The actual outcome of the overall economic performance in 2004 was higher than the targets laid out in the ERS, the FSP (2004/05) and the 2004/05 budget.

The budget forecasted an average real economic growth rate of 3 percent for 2004, which was lower than the ERS projection of 3.7 percent but higher than the FSP forecast of 2.5 percent. However, following data revision based on System of National Accounts (SNA) 93, real economic growth in 2004 was estimated at 4.3 percent, above all the forecasts contained in the Budget, FSP and the ERS. The variations between the actual outcome and targets set in the ERS/IP-ERS, the 2004/05 FSP and the 2004/05 budget are not comparable because of the differences in the methodologies used in arriving at these numbers. Any future target setting should use data generated within the new SNA 93 framework. It may even require that a mid-term revision of the ERS be put in place to ensure that new targets are set within the revised framework. Besides, the revisions would be

called for based on the fact that economic circumstances over the last two years have changed. Again, gross investment averaged 18.3 percent over 2004, obviously higher than the 16.6 percent target in the ERS and below the 20.4 percent 2004/05 FSP target.

The inflation outcome was well within the targets set in the ERSWEC, FSP (2004/05) and the 2004/05 budget. The average annual underlying inflation stood at 3.46 percent by December 2004. Although the government had put in place policy measures that were to ensure that a low interest rate regime is maintained, this was not realized. Interest rates on the 91-day Treasury bill averaged 8.3 percent in 2004 up from 3.6 percent recorded in 2003. In line with the stated 2004/05-budget target, the government had targeted low levels of domestic borrowing so as to protect the increases in Treasury bill rates and hence cushion lending rates at low levels; a target that was never met. The government allowed a major policy shift that saw an expansion in actual domestic borrowing, and thus averaging Ksh 30 billion in 2004/05.

There were also variations between the government's targeted fiscal stance and the actual outcome. The revenue generated by the KRA was much higher than the targets that had earlier been set in the ERS, FSP (2004/05) and the 2004/05 budget. The proportion of the revenue generated to GDP averaged 22.8 percent, which is higher than the 22.2 percent and 21.7 percent targets set in the 2004/05 budget and the FSP (2004/05), respectively. The government was also able to consolidate its expenditures, hence achieving an actual outcome of 25.9 percent to the GDP lower than the 38 percent and 27.6 percent targets set in the 2004/05 budget and the FSP (2004/05). This resulted in a less than anticipated outcome of the overall deficit. The actual deficit (including grants) averaged 1.2 percent of GDP compared to the 6.1 percent and 3.67 percent targets set in the 2004/05 budget and the FSP (2004/05). The lower achievements in expenditure executions were, however, blamed on the lower than expected donor disbursement and the government's low absorptive capacity of donor funds.

It is important to note at this point that analyzing the outcomes against the targets is quite complicated, since the ERS/IP-ERS, FSP (2004/05) and 2004/05 budget sets targets on different macroeconomic indicators. The failure to adopt similar macroeconomic indicators for targeting complicates the tracking of the overall economic policy implementations. This can, therefore, complicate the effective monitoring and evaluation of the country's overall macroeconomic framework.

3.2 Assessment of the 2005/06 Macroeconomic Framework

This section compares the macroeconomic framework contained in the ERS/IP-ERS 2003-2007, the 2005/06 Budget Strategy Paper and the 2005/06 budget. The objective of such a comparison is to assess the extent to which the budget adheres to the ERS and the agreed fiscal strategies. It is important to note that variations in the targets could occur over time, reflecting the changing economic situations, but such variations ought to remain within the wider macroeconomic objectives. While both the 2005/06 Budget Strategy Paper and the Budget adopted macroeconomic frameworks that were largely in line with that of the ERS, certain variations are observable. Before we embark on an in-depth assessment of the variations, it is important that we highlight the key macroeconomic targets of the 2005/06 Budget Strategy Paper (BSP) and the Budget. The overall targets for the ERS/IP-ERS have been provided under section 3.1 of this report.

Accordingly, the key targets of the 2005/2006-2007/08 BSP (the predecessor to the FSP) include:

Box 4: Key macroeconomic targets of the BSP 2005/06

- Raising the rate of real GDP growth from 2.1 percent in 2003/04 to 3.5 percent in 2005/06;
- Achieving low and stable inflation rates of below 5 percent;
- Increasing broad money supply by 8.8 percent over 2005/06;
- Revenues as a percent of GDP to rise from 21.8 percent in 2003/04 to 22 percent in 2005/06;
- Total expenditures to rise slightly from 25.9 percent of GDP in 2004/05 to 26.8 percent, with development expenditure also rising from 4.7 percent of GDP in 2004/05 to 5.9 percent, reflecting the wider objective of restructuring expenditures to key priority areas as identified in the ERS;
- The overall deficit (on cash basis and including grants) is expected to widen from 1.2 percent of GDP in 2004/05 to 3.4 percent in 2005/06;
- Domestic borrowing is targeted to rise from 1.4 percent of GDP in 2004/05 to 1.8 percent in 2005/06;
- Net external financing is projected to average 3.2 percent of GDP over 2005/06; and
- The stock of domestic debt to stabilize around 21.5 percent of GDP over 2004/05-2007/08.

The 2005/06 budget also attempted to implement these wider targets of the BSP. Some of the targets set in this budget include:

Box 5: Key macroeconomic targets in the 2005/06 budget

- Continue to pursue and sustain macroeconomic stability;
- Attain at least 5 percent real GDP growth in 2005 and 2006;
- The 2005/2006 budget targets revenue collection of about 22.8 percent of GDP underpinned by successful implementation of tax administration reforms buoyed by the rollout of electronic tax registers and expansion of tax base resulting from tax amnesty;
- The government's expenditure policy for the 2005/06 and the medium term is to contain both the wage bill and domestic borrowing to sustainable levels;
- Monetary policy, on the other hand, targets to: (i) achieve a core inflation rate below 5 percent, (ii) restrict growth of money supply at about 8 percent, (iii) increase credit to the private sector by about 12 percent, and (iv) maintain gross international reserves of the Central Bank of Kenya at about 3 months of import cover;
- Allow the exchange rate to be market-determined as always and permit the Central Bank of Kenya to intervene only in a limited way to achieve the international reserve target and smoothen the short-term fluctuations in the market; and
- Strengthen anti-corruption institutions to reduce rent-seeking behaviour; strengthen Public Expenditure Management (PEM) and financial management; strengthen the police force and justice system; and improve procurement procedures by enacting the Public Procurement and Disposal of Assets bill.

The summary of the above targets and the calculated variances are represented in the table below. Accordingly, there are wide variations between the targets contained in the 2005/06 BSP, which is the budget policy document and the prepared budget. The question that, therefore, comes to mind is whether the key budget proposals are guided by firm commitments made in line with the medium term policy. Whereas the picture created points to the effect that the agreed medium term macroeconomic framework was not adhered to in preparing the budget, we acknowledge the fact that the macroeconomic condition could change, warranting adjustments in the adopted macroeconomic framework. The budget should, as much as possible, reflect the positions adopted in the policy arena.

Table 2: Targets of key economic variables as set in the 2005/06 BSP and Budget

Indicator	2005/06 BSP Targets	2005/06 Budget Targets	Deviations (Budget and BSP)
Real GDP growth %	3.5	5	+1.5
Gross investments/GDP %	17.2		
Savings/GDP %	10.2		
CPI (Excl. food and energy) %	3.5	3.5	0
Total revenue/GDP %	22	22.8	+0.8
Total expenditure and net lending/GDP %	26.8	35.6	+8.8
Overall balance including grants /GDP (%)	-3.4	-4.7	-1.3

Source: 2005/06 BSP and the Budget

The government in its 2005/06 budget projects real GDP to grow at 5 percent in 2005, which is above the 2.5 percent average actual real economic growth between 2000 and 2004, the 3.5 percent targeted in the BSP and the estimated average growth rate of 4 percent over 2003-2007 targeted in the ERS. The high growth rates are to be supported by broad-based improvements in economic performance in sectors such as horticulture exports, tourism, manufacturing, and the increased domestic demand.⁵ While it is widely believed that the high economic growth is to be driven by improved investments and exports, the 2005/06 budget fails to set specific targets for these key economic indicators. The underlying inflation is expected to remain at below 3.5 percent as contained in the 2005/06 Budget Strategy Paper and the wider targets of the Central Bank of Kenya.

The 2005/06 budget projects ordinary revenues as a share of GDP to reach 22.8 percent in 2005/06 compared to an average of 20.7 percent realized in the last five fiscal years (between 2000/01 to 2004/05). This target is higher than the 22 percent target in the BSP (2005/06). The improvement in revenue collection is underpinned by: the successful implementation of wide-ranging tax administration reforms, which include the roll out of electronic tax registers; the expansion of the tax base resulting from tax amnesty; the integration of the Income Tax and VAT departments into an integrated function-based Domestic Tax Department; deployment of information technology to facilitate integration and modernization of the tax

⁵ Government of Kenya, The Medium Term Budget Strategy Paper 2005/06-2007/08.

system; enhanced capacity of the Large Taxpayers Office; the introduction of computerized audits for large Taxpayers Office and Domestic Tax Department; and the implementation of Customs Modernization Reforms to reduce corruption and facilitate trade, and; introduction of simplified customs processing procedures for imports and exports, supported by verifiable performance indicators.

The 2005/06 budget also sets expenditure to GDP target at 30 percent, which is above the 26.8 percent target set in the BSP (2005/06). This, therefore, implies a wider deficit target than that contained in the BSP (2005/06). The 2005/06 budget targets the deficit, excluding grants, at an average of 3.4 percent in 2005/06, obviously higher than the targets set in the 2005/06 BSP and the ERS/IP-ERS.

3.3 Emerging Challenges in the Macroeconomic Framework

Several challenges pertain to the set macroeconomic framework and include:

- Attaining and sustaining higher levels of economic growth that is adequate for sustained poverty reduction. The high levels of growth, however, will only be possible if the government succeeds in implementing the key reform initiatives that are already in the pipeline. The key reforms include the finalization of the concessioning plans for the Kenya Railways, Modernization of port facilities, the liberalization of Telkoms, Government divesture in KenGen and the modernization of Kenya's airports. The wider fiscal reforms, especially the orientation of government budget towards development expenditure, will also anchor the growth of private investments.
- Maintaining macroeconomic stability supportive of the economic recovery process requires that inflation rate be maintained at lower levels. However, the extent to which this can be achieved remains a key challenge, especially with the rising international oil prices and the need to design monetary policy that is supportive to the recovery process. The shillings' exchange rate would have to be maintained at levels that Kenya's exports remain competitive.
- There is limited scope for public expenditure restructuring. For instance, while the government has outlined its commitment to reorienting expenditures towards the development overheads, the already high levels of non-discretionary expenditures on wages and salaries, and the Consolidated Fund Services, may undermine this objective. To tackle the challenge, the

government is implementing civil service reforms with the aim of reducing and maintaining the wage bill below 8.4 percent of GDP, reducing resource allocations to the parastatals, and implementing a broad spectrum of parastatal reforms aimed at making them profitable and self sustaining (including privatizing the non-strategic parastatals).

Weak budget implementation and low donor disbursement undermine the macroeconomic framework. All donor inflows are not included in the macroeconomic framework due to weak accounting, reporting and other institutional constraints. Low donor disbursements compromise the Exchequer allocations, requiring that the government resort to unplanned domestic borrowing with deleterious effects on monetary policy. Uncertainties in donor inflows also undermine the credibility of the macroeconomic framework. Poor budgeting planning and implementation has resulted in payment arrears. These challenges are being addressed through reforms under the Enhanced Financial Management Action Plan, the development of a national aid policy, and strengthening of the legislative framework for public expenditure management through the enactment of Government Financial Management Act and Public Audit Act. The legal framework for public procurement is to be strengthened with the enactment of the Public Procurement and Disposal of Assets Bill 2005. The government has also formulated a monitoring and evaluation framework to facilitate the tracking of project and programme implementation.

4. Comparative Review of the 2004/05 and 2005/06 Budgetary Allocations

This comparison is based especially on the budget as an instrument for fighting poverty. As mentioned below, although the government has always fought poverty since independence, poverty has instead been increasing, as measured by the rising numbers of those living on a dollar and less by the day. Efforts to reverse this trend have been embedded in the budget system and a comparison of successive budgets gives an indication of whether the efforts are intensifying or waning and whether the affront on poverty through the instrument is significant.

4.1 Pro-poor Expenditures

Poverty, ignorance and disease are the three enemies Kenya's successive governments have always fought since independence. Unlike the other two, where spots of success can be traced, the war on poverty has not had much success. Kenyans were better off in the earlier years immediately after independence than they are today. More than half of them, measured by those living below a dollar a day, are poor – a situation that did not pertain at independence. The massive poverty has in the past one and a half decades spurred successive governments into anti-poverty actions, which intensified by the introduction of Poverty Reduction Strategy Programmes (PRSPs) at the onset of the millennium. Despite original PRSPs world over-emphasizing debt relief under the Heavily Indebted Poor Countries (HIPC) initiative, for Kenya, the first PRSP of 2001-04 published in the year 2000 also helped identify pro-poor expenditure areas. In any case, PRSPs were intended to guide the investment of resources freed by debt relief initiatives into poverty reduction programmes.

The international initiative under the MDGs has put the war against poverty at the centre of all development initiatives with the aim of halving poverty by the year 2015. In the recent past, the Kenya government has taken the war against poverty a notch higher by initiating Core Poverty Programmes (CPPs), whose expenditure allocations are done within the budget and are 'ring fenced' in the sense that resource allocations determined for them are beyond budgetary cuts or interference even in the face of severe budgetary constraints. The determination of the CPPs is based on a criteria that ensures that they contribute directly towards employment creation; improved access to basic education, clean water, better sanitation, decent shelter; a reduction in gender disparity; rehabilitation of

criminals; increased agricultural activity, improved disaster and emergency management; and protection of the environment, among other things. The CPPs, therefore, are directly targeted at improving the status of the poor, who are usually disproportionately less educated, less skilled, unable to access social services, are usually landless, rely on subsistence farming, have big families, or have employment opportunities that are highly constrained.

The criteria for determining CPPs are usually revised to reflect changing circumstances. For example, they were revised in the 2003-04 fiscal year to reflect priorities contained in the ERS, and this resulted in more resources being allocated for CPPs to the tune of Ksh 45.9 billion from Ksh 28.1 billion in the 2003-03 fiscal year. Their implementation, which is a continuous process aimed at accomplishing priorities outlined in the ERS, is expected to impact directly on the standard of living of the Kenyan people by increasing incomes, especially for the poor.

CPPs are implemented under almost all ministries. To mention a few, CPPs implementation in education recognizes that education determines incomes and, thus, provides a clear exit root from poverty. Besides, it improves people's ability to take advantage of opportunities that can improve their lives and enhance their participation in community activities and markets. On the other hand, CPPs in health recognize that human capital is improved by increasing the poor's access to affordable healthcare and nutrition. The CPPs in health, thus, ensure that fundamental concerns of equity, access, affordability and quality in provision of basic healthcare services and nutrition are met. For all ministries implementing CPPs, therefore, there are goals aimed at reducing poverty that CPPs are supposed to achieve.

4.2 Budgetary Allocations to Core Poverty Programmes

The allocations are compared over two fiscal years, namely 2004/05 and 2005/06. The importance is to determine whether budgetary allocations to Core Poverty Programmes (CPPs) are adhered to and are increasing or decreasing.

Broadly, as shown in Table 3 below, recurrent budgets have gone up by Ksh 35 billion (13%) while development budgets have gone up by Ksh 39 billion (64%). This is quite an achievement as more resources are now geared towards government investment projects, given that the absorption capacity will not constrain investments. As the budget did not consider bilateral financing, leaving the alternative mode of financing being domestic sources, an amount of Ksh 25 billion is stable enough not to trigger any macroeconomic instability. This

assumes the absence of any major external or internal shocks that could adversely affect the economy.

Table 3: Budget summaries for 2004/05 and 2005/06 (Ksh million)

	2004/05	2005/06	Change	% Change
Ordinary revenues	256,036	296,100	40,064	15.7
Appropriation in aid	21,722	30,000	8,274	38.1
Recurrent expenditures	273,562	308,882	35,320	13.0
Development expenditures	61,031	100,024	38,993	63.9
Grants	20,709	27,866	7,157	34.6
Foreign financing	1,397	23,426	22,029	1576.9
Domestic financing	18,000	25,378	7,378	41.0
Privatization proceeds	100	8,000	7,900	7,900.0

Source: Budget Strategy Paper 2005

The allocations can be disaggregated into recurrent and development votes and by ministries to see where the emphasis on expenditures are.

Table 4 below gives expenditure figures for CPPs for ministerial recurrent votes for the fiscal years 2004/05 and 2005/06. The Ministry of Education, Science and Technology takes the lion’s share of the core poverty recurrent expenditure allocation, with each year having over 42 percent of the total non-wage recurrent expenditures. This has been necessitated by the Free Primary Education (FPE), a major achievement of the government with gains targeted at meeting some of the Millennium Development Goals (MDGs) in education. The Ministry of Health’s core poverty budget went up from 14.4 percent of the total in 2004/05 to 17.5 percent in 2005/2006. This is a sign of the commitment to the health-related MDG goals. The social sector in the economy have their budgets increased in year 2005/2006, indicating that the allocations are actually pro-the-poor. The allocation to the Office of the President (OP) is also high. It handles special programmes such as “Relief and Rehabilitation” and “National Food Security”. The allocations in percentage to their respective totals increased from 14.4 percent to 17.5 percent. Allocations to the Ministry of Roads and Public Works also rose from 16 percent in 2004/05 to 17.3 percent in 2005/06. The Ministry handles the road maintenance programme. The overall total recurrent expenditures registered a net increase of 26.3 percent in the year 2005/06.

Table 4: Core poverty expenditures – recurrent (non-wage) in Ksh million

Non-wage expenditure (Ksh million) Ministry/Department	Printed 2004/2005	Projected 2005/2006	% Change
Education	8,448.2	10,560.3	25.0
Health	2,864.2	4,374.5	52.7
Office of the President	2,379.8	2,734.7	15.0
State House	50.0	50.0	0.0
Home Affairs	133.1	149.7	12.5
Agriculture	306.6	349.7	14.1
Labour	36.9	41.1	11.4
Justice and Constitutional Affairs	139.0	159.8	15.0
Gender and Sports	28.8	32.0	11.1
Local Government	814.2	1,000.0	22.8
Roads and Public Works	3,426.8	4,000.0	16.7
Livestock Development and Fisheries	100.7	125.0	24.1
Water Resources Manpower Development	433.7	567.4	30.8
Environment and Natural Resources	217.8	253.4	16.3
Cooperative Development and Marketing	85.5	164.3	92.2
State Law Office	116.2	185.1	59.3
Total Non-wage Expenditures	19,829.9	25,046.5	26.3
Wage Expenditures	9,354.3	11,225.1	20.0
Total Expenditures	29,184.2	36,271.7	24.3

Source: Budget Strategy Paper 2005.

Table 5 below has the ministerial core poverty expenditures in the development vote for the fiscal years 2004/05 and 2005/06. The development expenditure allocations to all ministries where CPPs fall increased by 15 percent. The Core Poverty Programmes under the Ministry of Health received the highest budgetary allocations with the share being 21.5 percent for each of the two years as a percent of their respective totals. The two major Core Poverty Programmes in the Ministry of Health are “communicable and vector borne” diseases and “rural health centres and dispensaries”. The Office of the President had 17 percent of the total for the two years, though in nominal terms there was an increment in year 2005/06. The Ministry of Water Resources also had a high budget allocation amounting to 12.6 percent of the total expenditures. All the same, education was allocated 11.8 percent of the total development expenditures for the two years. In the overall development budget for the Core Poverty Programmes, there was a 15 percent increase in year 2005/06 as compared to the year 2004/05.

Table 5: Core poverty expenditures – development (Ksh million)

Ministry/Department	2004/05 Printed	2005/06 Projected	% Change
Education	3,821.7	4,394.9	15.0
Health	6,957.1	8,000.7	15.0
Office of the President	5,491.8	6,315.6	15.0
Directorate of Personnel Management	851.5	979.2	15.0
Home Affairs	95.1	109.4	15.0
Gender and Sports	363.6	418.1	15.0
Livestock and Fisheries Development	1,394.8	1,604.0	15.0
Local Government	603.9	694.5	15.0
Roads and Public Works	1,080.0	1,242.0	15.0
Labour	119.7	137.7	15.0
Trade and Industry	406.8	467.8	15.0
Justice and Constitutional Affairs	1,322.2	1,520.5	15.0
Water Resources Management and Development	4,079.0	4,690.8	15.0
Environment	535.3	615.6	15.0
Planning and National Development	245.0	281.8	15.0
Finance and Planning	148.3	170.6	15.0
Energy	1,996.0	2,295.4	15.0
Agriculture	2,415.3	2,777.6	15.0
Cooperative Development and Marketing	48.3	55.6	15.1
Office of the Attorney General	95.0	109.3	15.1
Judiciary Services	287.1	330.1	15.0
Lands and Settlement	21.9	25.2	15.1
Total expenditures	32,379.4	37,236.4	15.0

Source: Budget Strategy Paper 2005.

4.3 Budgetary Allocations by Ministry

The following analysis considers budgets for the 2004/05 and 2005/06 fiscal years. The intention is to find out whether the pro-the-poor sectors such as education, health, water and sanitation obtained increased allocations targeted at poverty reduction and attainment of MDGs, which are basically social sector-based.

Table 6: Summary of recurrent expenditure by ministry (Ksh millions)

Ministry	2004/05 Gross Estimates	2005/2006 Gross Estimates	% Change
Office of the President	27,695.79	27,817.94	0.44
State House	602.09	863.05	43.34
Directorate of Personnel Management	1,210.79	2,778.49	129.48
Foreign Affairs	5,953.70	6,257.00	5.09
Home Affairs	6,944.05	7,257.57	4.51
Planning & National Development	836.57	835.11	-0.17
Finance	10,997.05	14,179.12	28.94
Defence	21,218.76	26,651.65	25.60
Regional Development Authorities	630.53	535.46	-15.08
Agriculture	3,806.56	5,115.00	34.37
Health	17,515.86	20,209.67	15.38
Local Government	5,499.49	6,133.83	11.53
Roads and Public Works	10,344.03	10,937.50	5.74
Transport	3,047.93	3,266.35	7.17
Labour and Human Resources Development	849.67	871.29	2.54
Trade and Industry	2,104.60	1,678.14	-20.26
Justice and Constitutional Affairs	1,239.21	556.70	-55.08
Gender, Sports, Culture, and Social Services	1,589.47	1,736.87	9.27
Livestock & Fisheries Development	2,291.88	2,476.06	8.04
Water and Irrigation	2,157.55	2,307.39	6.94
Environment & Natural Resources	2,263.43	2,525.11	11.56
Cooperative Development and Marketing	576.70	713.14	23.66
East African and Regional Cooperation	528.11	441.83	-16.34
State Law Office	421.79	666.93	58.12
Judicial Department	1,337.57	1,656.20	23.82
Public Service Commission	169.52	183.69	8.36
Kenya National Audit Office	1,096.65	1,105.58	0.81
National Assembly	5,499.76	5,556.09	1.02
Energy	257.73	325.52	26.30
Education, Science and Technology	78,810.21	88,361.67	12.12
Information and Communications	643.55	757.58	17.72
Electoral Commission of Kenya	1,274.50	1,789.50	40.41
Kenya Anti-Corruption Commission	0	1,200.95	
Lands and Housing	1,773.60	2,446.94	37.96
National Security Intelligence Service	4,195.45	5,200.00	23.94
Tourism and Wild Life	1,698.32	1,628.26	-4.13
Total	227,082.46	257,023.19	13.18

Source: Budget Strategy Paper 2005

Table 6 shows evidence of expenditure restructuring in several ministries, with a downward trend (in a number of ministries) in budgetary allocations between fiscal years 2004/05 and 2005/06. Some of these are the ministries of Planning and National Development; Regional Development Authorities; Trade and Industry; Justice and Constitutional Affairs; East African and Regional Cooperation; Information and Communications, among others.

On the contrary, social sectors like health and education got increments in their respective recurrent expenditure allocations, a clear indication of the 2005/06 budget being pro-poor, in a way, and geared towards the achievement of the MDGs.

The Ministry of Education, Science and Technology got the highest recurrent expenditure allocation, having 34.4 percent of the total ministerial allocation in 2005/06. Although the increment is by about Ksh 10 billion as compared to 2004/05, as a percentage of the total, the allocations were down by 0.3 percent. This provides some food for thought, especially if MDGs have to be pursued relentlessly.

Table 7: Summary of development expenditure by ministry (Ksh millions)

Ministry	2004/05 Gross Estimates	2005/2006 Gross Estimates	% Change
Office of the President	5,474.92	7,609.08	38.98
State House	250.00	250.00	0
Directorate of Personnel Management	945.76	273.40	-71.09
Foreign Affairs	100.20	100.00	-0.20
Home Affairs	922.67	1,491.50	61.65
Planning and National Development	1,301.32	2,098.40	61.25
Finance	19,952.52	20,933.22	4.92
Regional Development Authorities	202.03	609.05	201.47
Agriculture	2,763.40	3,114.80	12.72
Health	4,458.01	9,943.17	123.04
Local Government	1,740.62	1,305.79	-24.98
Roads and Public Works	9,127.89	17,750.95	94.47
Transport	1,603.96	7,833.13	388.36
Labour and Human Resource Development	123.86	194.00	56.63
Trade and Industry	459.21	825.81	79.83
Justice and Constitutional Affairs	1,233.00	922.29	-25.20
Gender, Sports, Culture, and Social Services	163.96	266.52	62.55
Livestock and Fisheries	1,039.68	1,380.95	32.82

Development			
Water and Irrigation	4,254.44	7,755.20	82.28
Environment and Natural Resources	686.37	604.96	-11.86
Cooperative Development and Marketing	1,467.33	58.90	-95.99
State Law Office	125.00	145.25	16.20
Judicial Department	287.50	281.00	-2.26
Energy	5,906.39	8,060.51	36.47
Education, Science and Technology	5,883.25	8,385.87	42.54
Information and Communications	26.84	26.00	-3.13
Lands and Housing	268.72	791.75	194.64
Tourism and Wildlife	1,214.04	1,209.00	-0.42
Total	71,982.85	104,220.49	44.79

Source: Budget Strategy Paper 2005

The restructuring is also evident in development expenditure allocations. In total, development expenditure allocations to the ministries increased by Ksh 33 billion, a good pointer to the pursuit of MDGs. As noted in the BSP, restructuring of expenditures is expected to reflect the shift in resources towards the priority areas identified in the ERS, namely the social and economic sectors. Therefore, the combined share of health, education, agriculture, and physical infrastructure in total expenditure is expected to rise gradually from about 55.9 percent in 2004/05 to about 64 percent in 2007/08. Excluding education, the ratio rises from 26.4 percent to 34.6 percent. However, the ministries of finance, roads and public works got the largest share of the total development expenditure allocations of 20 percent and 17 percent, respectively, in fiscal year 2005/06.

On the other hand, agricultural and rural development has had a number of developments. A number of measures have been taken, such as an injection of Ksh 1.5 billion to Agricultural Finance Corporation (AFC) for provision of credit to farmers, and the revival of farmer's institutions that are key to agricultural growth, such as the Kenya Farmers Association (KFA) and the Kenya Cooperative Creameries (KCC). To further improve this sector, the government proposes to increase resources to this sector by 74% over the next three years.

For the private sector to become competitive and play its rightful role in development, it is absolutely critical to improve the physical infrastructure. Thus, resources allocated to this sector will increase by about 86 percent over the next three years, which is more than any other sector. For 2005/06 alone, the resources allocated increased

by over 36 percent. The increase in resource allocation from Ksh 44.6 billion in 2004/05 to Ksh 82.8 billion in 2007/08 will raise the share of total government expenditure allocated to infrastructure from 15.6 percent to 20.5 percent during the same period.

Based on cutting one's coat according to one's size, in recognition of the 2005/06 budget's theme of "Reorienting Expenditure to Achieve Rapid Economic Growth and Poverty Reduction", and as indicated in the BSP, the budget deliberately factored out budgetary support from bilateral development partners. This became necessary to accelerate the reform agenda in such areas as procurement and privatization. In the event that bilateral partners provide any budgetary support, it will be used to reduce government domestic borrowing and to upscale spending on CPPs.

4.4 Governance, Budget and Pro-poor Policies

Broadly, governance can be defined as the process by which institutions exercise authority in a country.⁶ The primary components of governance include: the process by which governments are selected; the capacity of governments to manage resources efficiently and formulate, implement, and enforce sound policies and regulations; and the respect for the institutions that govern economic and social interactions. This broad definition places emphasis on the importance of the political process in determining public policies and the allocation of public resources. To track governance, each of the components in the definition can be evaluated by indicators of government inputs and outcomes as shown in Table 8 below.

Table 8: Indicators of good governance

Attribute	Input	Outcome
Process of government selection, monitoring, and replacement	Voice and accountability	Political stability and lack of violence
Capacity of government to manage resources and to formulate, implement and enforce policies and regulations	Quality of regulatory framework	Effectiveness of service delivery and regulation
Respect for institutions that govern economic and social interactions	Rule of law (including respect of property rights)	Control of corruption

⁶ This section draws on World Bank (2000); Kaufmann, Kraay, and Zoido-Lobaton (1999a); World Bank (1999), and Kaufmann, Kraay, and Zoido-Lobaton, (1999b).

Creating pro-poor budgets and designing revenue policies that promote economic growth among the poor depends critically on the definitional attributes and the inputs, which reflect in the outcomes. Good governance correlates positively with growth, and bad governance negatively affects poverty initiatives, especially through corruption. Evidence from Uganda, for example, demonstrates the gap between budgetary allocations and actual expenditure for designated purposes. Detailed expenditure tracking studies reveal disparities of upwards of 70 percent in the funds received (and utilized for client populations) as compared to the funds allocated in the budget.⁷ Analytical approaches of governance should be part of fiscal policy, with a focus on strengthening budgetary process, fiscal policy and implementation of pro-the-poor allocations devoid of anti-poverty expenditure leakages.

⁷ Ablo, J. and Reinikka, R. (1998). On the basis of detailed, facility-level expenditure tracking surveys, the authors report that less than 30 percent of non-salary funds in education reached schools during the 1991-95 period. Leakage in spending on health was similar in magnitude, with less than 30 percent of funded prescription to medicines distributed to the public.

5. Conclusions and Recommendations

The budget process is much improved than it was before the Public Expenditure Management (PEM) review of 1997. Public Expenditure Management introduced timelines upon which specific activities within the budget cycle are expected to be accomplished. Nevertheless, delays on accomplishment of these tasks within schedule are common. Adherence to the timelines would improve efficiency and outcomes of budget processes.

Comparative analysis of the previous fiscal year's budget and the current has been rather difficult despite the attempts made. This is because of the change to the new SNA 93, which changed codes making direct comparisons tricky. At the same time, some expenditure line items have been aggregated. For example, expenditure allocations to roads within a district are amalgamated to the extent that it is impossible to tell which road is being done.

Although the government in its policy formulation documents envisages increased allocation to development expenditures, a more than proportionate share of budgetary allocations still go to recurrent expenditures, implying that development of capacity and crucial infrastructure of various sectors continues to suffer.

In addition, pro-poor programmes still receive less expenditure allocations voted for them. Thus, resources allocated to them are not 'ring fenced' as envisaged. The implication is self-explanatory in the war being lost to poverty. More than half (and still increasing ratio) of the population live on less than a dollar a day.

The outcome in the economic performance was higher than the targets set in the ERS, FSP and even the budget (2004/05). While the growth differences are mainly as a result of the changes in the measurement methodology, other outcomes show much improvement in the indicators. In certain instances, the targets seemed lower than the outcome and portrayed a case where the government adopts a pessimistic approach, hence tying the targets at extremely low levels. This is particularly true with the revenue targets that were widely surpassed by actual collections. Whereas the government needs to adopt a pessimistic estimate for revenues, following the argument that higher targets could have adverse effects on expenditure execution especially when the targets are not met, it is important that revenue targets are made more realistic. This would allow the government to design adequate expenditure programmes.

The 2005/06 budget, however, is largely in conformity with the macroeconomic framework spelt out in the budget strategy papers. Whereas certain differences are observable, the differences are justifiable based on the fact that the budget is often prepared after the budget strategy paper has been adopted. This, therefore, requires that adjustments be introduced in the budget to reflect the realities of the time. A particular example is the case where the budget growth estimates had to be revised to reflect the changes in the measurements in GDP, especially after the adoption of the SNA93. The government should take appropriate measures to revise the targets set in the ERS, since the higher than expected outcomes could as well mean the achievement of the ERS targets, which may obviously not be the case but attributable to the methodological changes.

The Macroeconomic Working Group should also identify major social indicators to focus on, just as it identifies major macroeconomic indicators to target and use to define the macroeconomic framework. By targeting given social indicators, progress being made in the social sector can be tracked and be used, at the same time, to determine resource allocations to the respective social sectors to boost outcomes. Besides, targeting social indicators will especially help trace the path towards meeting most MDGs, which are basically social sector-based. Thus, the expenditure restructuring evident in the comparison of the last two fiscal year budgets should continue as it ensures more resources go to the social sectors.

It is also important to capitalize on the strengths of the MTEF budget process. The MTEF is structured well up to the district level, but its district-based institutions have not worked as envisaged. They are supposed to solicit views of the people on their prioritized needs via a participatory process and for which budgetary allocations should make the process all-inclusive. This, however, has remained theoretical partly because of lack of adherence to the process and partly because of lack of a strong legal framework. The existing legal framework for budgeting does not cover the MTEF budgetary process. The absence of this legal framework also contributes to the common violation of activity timelines, for example when the Treasury Circular to initiate the whole process is released late. A strong legal framework to support the MTEF budget process should be established to ensure adherence to the MTEF process and enhance local participation to make the process all inclusive for efficient resource allocations.

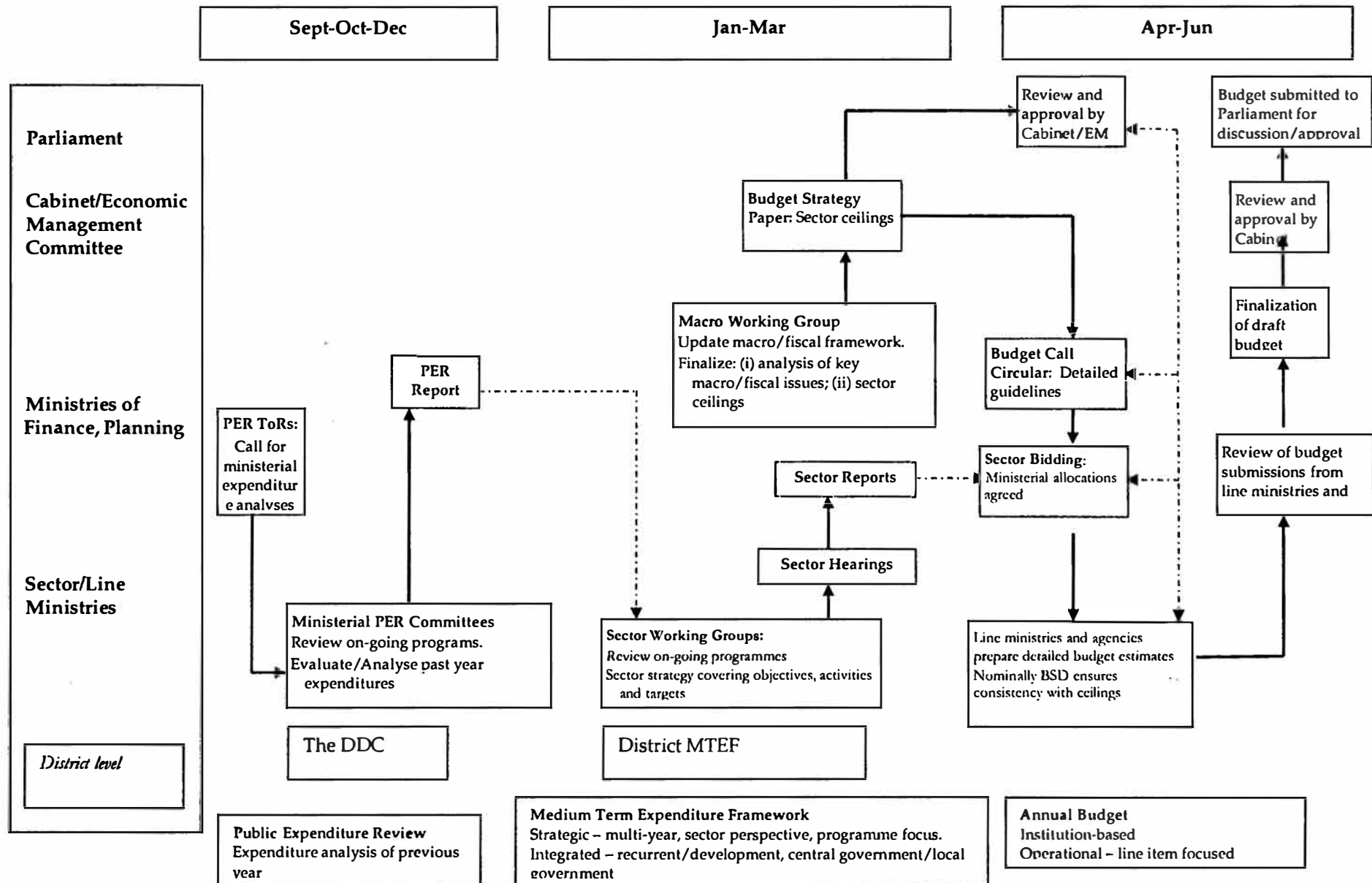
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Annex 1: The PER, MTEF and budget preparation cycle in Kenya



Annex 2: The PER, MTEF and budget preparation schedule

Deadline	Activity	Responsibility
August 2005	Revise and update Ministerial Strategic Plans	Ministries/Departments
August 2005	Develop PER work plan; Terms of Reference and timetable for ministerial PERs/PER	Treasury/Ministry of Planning and National Development
September 2005	Launch Sector Working Groups and initiate preparation of ministerial PERs	Treasury
Sept.-October 2005	Develop a Budget Outlook Paper (BOPA)	Treasury/Macroeconomic Working Group
October 2005	Stakeholders consultation on BOPA	Treasury
October- November 2005	Submission of district inputs to Ministry headquarters	Line ministries
November 2005	Finalize BOPA, present to Cabinet	Treasury
December 2005	Finalize ministerial PERs	Ministries/Sector Working Groups
December 2005	Issue MTEF guidelines together with approved BOPA	Treasury
December 2005	Issue revised budget circular	Treasury
Dec.-Jan. 2004	Finalization of PER and sector reports	Treasury/Ministry of Planning and National Development; Line ministries
Last week January 2006	Finalize review of sectoral priorities and submit sector report to Treasury	Treasury/Ministry of Planning and National Development
January 2006	Submission of revised estimates	Line ministries
Early February 2006	Hold sector hearings	Treasury/Ministry of Planning and National Development
Mid February 2006	Finalization of the revised estimates	Treasury
February-March 2006	Prepare the Budget Strategy Paper (BSP)	Treasury/Macroeconomic Working Group
Late March 2006	Stakeholders' consultation on the BSP	Treasury
March/April 2006	Consultation with donor partners	Treasury
April 2006	Submit BSP to Cabinet for approval	Treasury
April 2006	Submission of itemized budget by line ministries	Line ministries
May 2006	Review and finalization of itemized budget	Treasury
June 2006	Presentation of Budget to Parliament	Minister for Finance

Source: Budget Outlook Paper (BOPA) 2006/07-2007/08