HIGH LEVEL CONFERENCE ON KENYA'S ECONOMIC SUCCESSES, PROSPECTS AND CHALLENGES

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DELIVERING BETTER SERVICES THROUGH FISCAL REFORMS AND DECENTRALIZATION

Presentation

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AGENDA

In Summary, my presentation will focus on:

- **Budget reforms in Kenya—An Overview**

  Specifically, I will cover:
  - Where we have come from and where we stand now
  - Recent fiscal reforms and service delivery

- **Policy challenges and Prospects**

- Our perspective of **Fiscal priorities to support growth in Kenya**

BUDGETING IN KENYA—Historical Perspective

From 1960s to mid-2000:

- The budget was a secretive exercise
- Limited collective ownership of the budget
- Limited information to spending ministries with their budget allocation announced without consultation
- Little predictability of funds and flexibility during execution
- Focus was only on one year – no multi-year perspective
- Budgeting was incremental, and focused on inputs

And now……

- There is greater understanding that the Budget is an expression of Government's collective policies and priorities
- Significant progress made towards making the budget comprehensive and realistic
- Ministries/Departments have greater budgetary flexibility - but within a hard budget constraint
- Funds to spending agencies are transparent and reasonably predictable
- Spending agencies have a budget allocation, their intended purpose and expected results
  - *Thanks to programmed-based budgeting*

Overall, over the recent past, reforms have happened in all areas of budget cycle

Policy Based Budgeting

•*Strengthened policy processes* (ERS 2003-2007, MTP of V'30 2008-2012), sector policies and strategies and associated review processes (MPERs)

•*Enhanced budget formulation* **(**The MTEF, BOPA/BROP, BSP/BPS)

•Consultations – SWGs, Public Hearings, Cabinet

Budget Execution and Accounting

•Controller of Budget

•Computerised PFM (IFMIS)

•Cash payment system (G-pay)

•Procurement Reforms (PPD Act)

•Budget Reporting (QEBR)

External Scrutiny and Audit

•Support to Budget Committee (Parliamentary Budget Office)

•Commission on Revenue Allocation – equitable division of revenue

•Strengthened external audit (KENAO)

Fiscal reforms and service delivery

- **Supported growth with macro stability --** before, during and after the global financial crisis of 2008-09
- **Increased pro-poor spending** (free primary/secondary education, health, agriculture/rural development, cash transfers to vulnerable people);
- **Increased pro-growth spending** in infrastructure such as roads, energy, ports, and water;
- Government **borrowing has not crowded-out the private sector** by driving up interest rates, hence resilient economy
- Containment of expenditures while **shifting resources from recurrent toward capital expenditure**

Government’s economic program supported by IMF under ECF arrangement, 2011-14

- Has progressed well with five reviews completed so far and the final one expected in October 2013.
- The policies committed in the program were basically the ones we had set ourselves to do as a Government.
- The program has allowed us to:
  - spend on our investment program without causing undue pressure on the exchange rate; however, recent wage demands has crowded out development budget
  - helped us to maintain fiscal discipline with transition to devolution.
- Disbursements so far has boosted the county’s foreign exchange position and cushioned the exchange rate from excessive volatility

POLICY CHALLENGES

- Accelerating growth, creating more jobs (especially for the youth), and reducing poverty and inequality
- Raising savings to finance investment activity
- Maintaining the ratio of fiscal deficit to GDP at sustainable level
  - eliminate wastage and contain the wage bill
- Raising the tax to GDP ratio to at least 25 percent
- Stabilizing food prices
- Positioning exports as a key driver of growth
- Effective and efficient devolution
- Harnessing natural resources to support growth

GROWTH PROSPECTS

- Looking ahead**, growth prospects are favorable**. Real GDP growth is projected at 5.6 percent in 2013 and over 7 percent over the medium-term, bolstered by:
  - Expected **stable weather conditions**
    - *This will boost agriculture and support cheap sources of power for manufacturing*
  - **Completion of key infrastructure projects** (such as roads and energy)
    - *This will improve competitiveness and boost investments*
  - Continued **stable macroeconomic environment**, and, together with the recent **successful elections**, will bolster investor confidence
  - Further structural reforms especially those targeted toward **improving competitiveness of the private sector** and promoting overall **productivity** in the economy.
  - Exports will continue to benefit from the relatively strong growth in the sub region, and measures to promote Kenya’s exports globally.

FISCAL PRIORITIES TO SUPPORT GROWTH

Continued Fiscal discipline

- Supporting economic activity within a context of sustainable public finances
- Pursuing overall deficit consistent with sustainable level of debt
- Maintaining strong fiscal revenue-to-GDP ratio at over 25%
- Keeping budgetary expenditures consistent with medium-term priorities

Observing Fiscal Responsibility Principles in the PFM Act

National Government

- **Development Expenditure**–Not less than **30%** of NG budget over MT.
- **Wages and benefits**—Not to exceed 35% of revenue.
- **Borrowings--**only for development expenditure over the Medium Term.
- **National Public debt --**maintained at a sustainable level approved by Parliament.
- **National Debt--**Not to exceed the level specified annually in the Medium Term debt management strategy submitted to Parliament.
- **Fiscal risks** should be managed prudently.
- **level of tax rates and tax bases--** reasonable degree of predictability.

County Government

- **Recurrent expenditure –**Not less than **30%** of CG budget over MT.
- **Wages and benefits—**Not to exceed a certain % of total county revenue.
- **Borrowings -** only for development expenditure over the Medium Term.
- **County Public debt -** maintained at a sustainable level approved by the county assembly.
- **Level of Debt--**Not to exceed the level specified annually by resolution by county assembly.
- **Fiscal risks** should be managed prudently.
- level of **tax rates and tax bases--** reasonable degree of predictability.

Expenditure priorities to remain pro-growth and pro-poor

- Improving law and order to ensure security for both people and property;
- Scaling up investment in quality infrastructure (roads, energy ports);
- Fully implementing the Constitution, including the devolved system of government;
- Improving access and quality of education at all levels;
- Improving access, quality and outcomes of health care;
- Enhancing food security by investing in irrigation and transforming agriculture into business;
- Enhancing social safety nets for the vulnerable members of the society; and
- Empowering the youth and promoting equitable regional development for social stability.

Continue to improve efficiency in public financial management, in line with Constitution

- Public Finance Management Act (PFM) Act enacted in 2012:
  - Gives effect to ‘**the Principles of public finance**’ with emphasis on:
    - openness, accountability, and public participation in public finance management;
    - equitable sharing of revenues;
    - Equitable sharing of burdens and benefits of public borrowing; and
    - Prudency in management of resources and fiscal discipline
  - Regulations to be tabled in Parliament shortly

Continue to improve efficiency in public financial management, in line with Constitution (Cont…)

- **Controller of Budget** to instill discipline in budget implementation
- **Commission on Revenue Allocation** to help facilitate effective devolution w.r.t. supporting robust equitable sharing of revenue
- Roll out all modules in the **Integrated Financial Management Information System (IFMIS)** across ministries and department, and at the county level
- **Single Treasury Account (STA)** to be implemented at national and county level

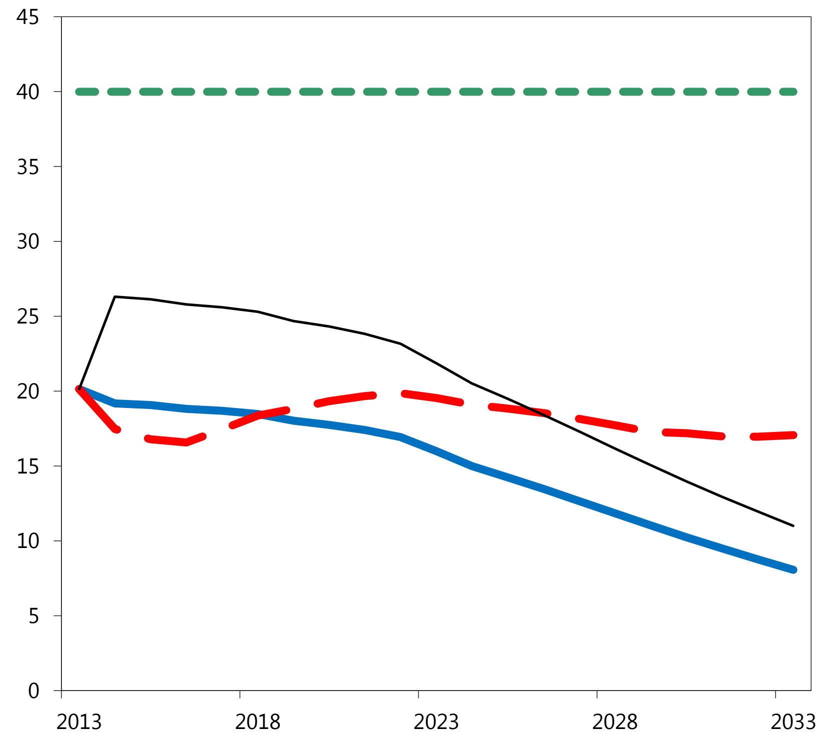
Harmonize procedures in managing aid flows

- **External Aid Policy** to be approved by Cabinet
- **Development Partnership Forum** to help facilitate better coordination of aid
- Fully introduce **Electronic Project Monitoring Information System (e-ProMIS)** and integrate it with IFMIS
- **Increase absorption** of donor funds

Strengthen debt management

- **Medium term debt management strategy** to be updated on annual basis
- PFM Act, 2012:
  - Establishes requirement for county governments to seek guarantee from national government to borrow
  - Provides for establishment of Public Debt Management Office

DSA: Current ratios are within threshold (e.g. PV of Debt-to-GDP ratio



Revenue reforms

- **Review of tax legislations:**
  - **Fully implement the new VAT law -** it is simpler, modern, and supports business growth
  - **Excise Bill** to finalized and tabled in Parliament soon
  - Expand **income tax** base
  - Rationalize existing **tax incentives**
  - Enhanced collection of **property taxes** to strengthen the revenue base of counties
- **Strengthen tax administration**:
  - Integrated tax management system (***itax***) to be launched shortly
  - Conduct regular VAT audits
  - Pursue tax collection from rentals
  - KRA to increase automation of its processes to help combat tax evasion and support customs reform

Leveraging on ICT to improve revenue collection and facilitate trade

- Strengthen clearance process through robust **automated custom management system**
- Use **risk management techniques** in customs clearance
- Introduction of **electronic cargo scanning and tracking**;
- **Single customs territory** to be implemented by end-September 2013
- **Port reforms --** it now takes fewer days to clear goods at Port of Mombasa and land border posts
- Implementation of the **Kenya Electronic Single Window System** (KESWS) as a solution to lengthy, manual and uncoordinated trade procedures by end-October 2013

Wage bill reforms

- **Salary and Remuneration Commission** is now fully operational:
  - Continue to set remuneration structure of State Officers
  - Work to adopt a new wage policy aimed at limiting the public wage bill
  - Job evaluation and harmonization of wage structure for public servants is underway
- **Restructuring of ministries and departments** is ongoing:
  - Ministries reduced from 44 to 18
  - Restructuring of ministries and state agencies/parastatals is underway
  - comprehensive payroll cleansing especially after transfer of some function through devolution

Pension Reforms and Social Protection

- **Public servant pension reform:**
  - Replace the defined-benefits scheme with a comprehensive **defined-contribution scheme**
  - Civil servant **contributory fund** to be launched shortly
- **Social protection**:
  - National Social Protection Policy approved by Cabinet
  - Single registry of cash transfer program beneficiaries being finalized
  - Expanded budgetary resources to doubled the number of beneficiaries receiving cash transfers

Facilitating operations of County Government

- Effective assessment and prudent transfer of functions by the Transition Authority (TA)
- Timely disbursement of funds to Counties as per law
- Capacity building in public financial management to counties
- Ensure full operation of IFMIS at county level
- Counties to embrace programme-based budgeting to improve control and accountability

Despite the favorable outlook, downsides risks to growth remain

- Negative effect of **geopolitical uncertainty** on the international oil market will slow down the manufacturing sector
- Continued **weak growth in advanced economies** will impact negatively on our exports and tourism activities
- **Public expenditure pressures** (wage pressures and implementation of the new Constitution and the devolved government) may limited continued funding for development expenditure
- Slow implementation of **structural reforms**

Concluding Remarks

- **Kenya's track record in sound economic management has been validated through independent external reviews by international financial institutions and rating agencies.**
- The latest Country Policy and Institutional Assessment (CPIA) Scores by World Bank placed Kenya at a score of 3.9 out of a maximum 6. This is well above the average for IDA countries (i.e. low income countries) at 3.3.
- The score is even higher for economic management and structural policies which averaged a score of 4.1.
- The Standard and Poor's rating for Kenya is B+ stable
- Fitch Rating's rating for Kenya is B+ positive.

Concluding Remarks….

- Our overriding objective is to create and sustain a stable and predictable macroeconomic environment that is supportive of private investment.
- In this way, we can grow our economy, reduce poverty and ultimately attain our Vision 2030 objectives.
- In short, **Kenya is open for business and ready for take-off**.

THANK YOU