REPUBLIC OF KENYA

Parliamentary Budget Office

UNPACKING OF THESUPPLEMENTARY ESTIMATES NO.II FOR FINANCIAL YEAR 2019-20

APRIL, 2020

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I. Introduction

1) The second supplementary estimates for financial year 2019/2020 were submitted to the National Assembly on 14th April 2020. This is pursuant to Article 223 of the Constitution and section 44 of the Public Finance Management Act 2012, which provide for supplementary appropriation for any purpose if the amount allocated in the Appropriation Act is insufficient or a need has arisen for expenditure that was unforeseen and had therefore not been provided for in the Appropriation Act.
2) The second supplementary budget for financial year 2019/2020 has been necessitated by the new economic reality following the COVID 19 pandemic that has dampened economic activities leading to significant revenue underperformance. Further, in response to the pandemic, the President pronounced a wide range of measures, some of them relating to areas of taxation entailing reduced rates in the income tax, value added tax and turnover tax. It is estimated that the implementation of these measures will result in the government forfeiting approximately Ksh. 122 billion[1] leading to even lower revenue collection.
3) As indicated in the provided documents, the main purpose of the supplementary II estimates for 2019/20is to address COVID 19 related expenditures, provisions to mitigate against the effect of floods, pending bills, tax refunds, salary shortfalls and job evaluation arrears. Furthermore, the supplementary budget also targets to scale down expenditures in order to achieve the targeted overall fiscal deficit level.
4) The overall budget (excluding CFS) has been reduced by **Ksh. 74.39 billion**. This reduction has been effected primarily on the development budget which has been reduced by **Ksh. 98.73 billion** (13%). This is 3 percentage points above the 10 percent threshold as required by the Public Finance Management Act 2012. Such a significant reduction may have an adverse impact on project implementation and will very likely lead to pending bills especially with regard to ongoing projects. This is despite recent government efforts to settle all pending bills.
5) This reduction has been necessitated by the quest to remain within the targeted overall deficit (including grants) level set at 7.8 percent of GDP.Though it is indicated that expenditure reduction was targeted at slow-moving projects, there is no evidence that the reductions have affected projects that will have the least impact if their implementation is delayed. In addition, there are a number of new projects across several votes which may no be due to pending bills.
6) A detailed review of the progression of the 2019/2020 budget from the original approved estimates through the supplementary budgeting process is provided in Table 1 below:

[1] *Special bulletin, PBO*

Table 1: Summary of Supplementary II Estimates 2019/2020

		Original Estimates	Supplementary I (SI)	Supplementary II (SII)	Gross change (SII – SI)	%Change
National Govt.	*Recurrent*	1,172,521,062,011	1,176,889,018,765	1,200,575,435,254	23,686,416,489	2%
	Capital	697,207,859,308	777,900,948,124	678,603,796,174	(99,297,151,950)	-13%
	Total	**1,869,728,921,319**	**1,954,789,966,889**	**1,879,179,231,428**	**(75,610,735,461)**	-4%
Parliament	*Recurrent*	37,053,741,000	37,053,741,000	33,743,032,175	(3,310,808,825)	-9%
	Capital	2,835,550,000	2,835,550,000	2,185,550,000	650,000,000	-22.9%
	Total	**39,889,291,000**	**35,752,543,156**	**35,928,582,175**	**176,039,019**	0%
Judiciary	*Recurrent*	15,031,670,000	13,401,444,086	14,298,184,457	896,740,371	7%
	Capital	4,170,400,000	3,020,190,000	3,166,400,000	146,210,000	5%
	Total	**19,202,070,000**	**16,421,634,086**	**17,464,584,457**	**1,042,950,371**	6%
CFS	*Public Debt*	696,554,161,979	696,554,161,979	778,847,892,157	82,293,730,178	12%
	Pensions	104,488,896,250	104,488,896,250	86,988,896,250	(17,500,000,000)	-17%
	Salaries & miscall.	4,736,737,060	4,736,737,060	4,644,237,060	(92,500,000)	-2%
	Total	**805,779,795,289**	**805,779,795,289**	**870,481,025,467**	**64,701,230,178**	8%
Total	*Recurrent*	1,224,606,473,011	1,224,277,456,007	1,248,616,651,886	24,339,195,879	2%
	Capital	704,213,809,308	782,686,688,124	683,955,746,174	(98,730,941,950)	-13%
	CFS	805,779,795,289	805,779,795,289	870,481,025,467	64,701,230,178	8%
	Total (Incl. CFS)	**2,734,600,077,608**	**2,812,743,939,420**	**2,803,053,423,527**	**(9,690,515,893)**	0%
	Total (Excl. CFS)	**1,928,820,282,319**	**2,006,964,144,131**	**1,932,572,398,060**	**(74,391,746,071)**	-4%

II. Adherence to the Legal Framework

7) The compliance rate for the second supplementary budget for 2019/20 is estimated at **71.4 percent**. Though the budget has broadly adhered to the legal provisions, there are some concerns particularly with regard to format, provision of adequate details and analysis of the impact of some of the proposed budgetary changes.
8) The following are some of the key observations:

a. Some programs reallocations (which may be unforeseen) exceed the 10 percent threshold e.g. Correctional services (PFM Act, 2012 section 43 (2)(c)) and will, therefore, require the approval of parliament before they are effected.

b. There is a new programme introduced under the presidency, namely, Nairobi Metropolitan Services contrary to the PFM regulations 40(8) which states that no new programmes /projects are to be introduced in the Supplementary Budget.

c. Many of the affected programmes under supplementary budget do not have an analysis of the fiscal impact of the additional/ reduction expenditure for the planned outcomes of the affected programmes e.g. Preventive, Promotive & RMNCAH

d. Information provided for conformity to fiscal responsibility principles and objectives is scanty. Information such as the impact of changes on public debt has not been provided. (Section 44(3),15(2), PFM 26(1), PFM regulations)

A more detailed review of compliance to the legal provisions is provided in Annex I.

III. State of the Economy Underpinning the Supplementary II budget for 2019/20

9) The key assumptions underpinning the supplementary II Estimates for FY 2019/20 are as follows:
   i. Revenue projection at 18.2% of GDP;
   ii. Overall expenditure and net lending at 26.4% of GDP;
   iii. Grants at 0.4% of GDP;
   iv. Overall fiscal deficit (inclusive of grants) projected at 7.8% of GDP;
   v. net foreign financing projected at 3.2% of GDP; and
   vi. net domestic financing projected at 3.1% of GDP.

10) Though the supplementary II Estimates for 2019/2020 acknowledges the impact of the COVID 19 pandemic on economic performance, an updated macro-fiscal framework was not included in the Treasury Memorandum that was tabled together with the estimates. The macro-fiscal framework is a very important tool in the budgeting process as it provides the context under which policy choices are set, revenues are projected and expenditures are determined. The macroeconomic framework typically includes GDP projections, the balance of payments projections, assessment of the monetary sector and the fiscal accounts. Without an updated macro framework from the National Treasury, it is difficult to determine the veracity of the projected fiscal deficit and net domestic borrowing as well as the fiscal projections (revenue and expenditure). Indeed, the quantifying of the assumptions as a percentage of GDP makes it difficult to accurately determine any of the projections especially since the National Treasury has not provided its updated GDP projections.

11) The ripple effect of the global health pandemic and subsequent measures to mitigate the spread of the disease has resulted in a significant decline in global economic activities. It is projected that the global economy will achieve negative growth for the year 2020; with the loss approximated at 2 trillion US dollars. This will have an adverse impact, particularly on the Kenyan economy which depends on trade and investment, tourism, foreign expertise and financial assistance from the developed economies.

12) Indeed, the Kenyan economy is already showing signs of distress and it is estimated that there will be a 2.6% to 2.8% reduction in economic growth in 2020[2].Thus, GDP growth is likely to average 2.8% to 3.2% in 2020. Depending on how long the crisis lasts, the outcome could be worse and the negative effects may take longer to resolve, even after the pandemic has ended. As such, economic growth projections should be subject to periodic review and any expenditure adjustments should take this into account.

13) Table 2 below is an outturn prepared after extraction of the numbers from the estimates of expenditure for recurrent and development laid in the House and the revenue projection as had been estimated in earlier documents. This outturn is purely the interpretation of the numbers by the PBO. It assumes that the transfers to counties for 2019/20 will remain as contained in the Division of Revenue Act, 2019 and the County Allocation Revenue Act, 2019. In addition, the Ksh.100 billion shown under CFS for Treasury bill redemption will also require additional funding, hence the financing gap of Ksh.129 billion.

Table 2: A Summary Fiscal Framework for 2019/20 (Including Supplementary II)

	Fiscal Outturn for FY 2019/20		
	Printed Estimates	**Suppl. Estimates 1**	**Suppl. Estimates 11**
Total Revenue	**2,115.8**	**2,084.2**	**1,893.9**
o/w Ordinary Revenue	1,877.1	1,843.8	1,643.4
Expenditure	**2,796.0**	**2,874.1**	**2,774.4**
CFS (Interest+Pensions etc)	***550.00***	***550.00***	***524.67***
Recurrent Ministerial	1,224.6	1,224.3	***1,248.62***
Development Ministerial	704.2	782.7	684.0
County Transfers	316.5	316.5	316.5
Net Lending	0.6	0.6	0.6
Equalization Fund	5.8	5.8	-
Fiscal Balance	**(680.2)**	**(789.9)**	**(880.5)**
Grants	38.8	41.8	44.6
Fiscal Balance (Grants)	**(641.4)**	**(748.1)**	**(835.9)**
Total Financing	**641.3**	**657.4**	**706.8**
Foreign Financing	462.7	484.8	455.0
Debt Repayment	(131.4)	(131.4)	(121.5)
Net domestic Financing	306.8	300.7	321.1
Other Domestic Financing	3.2	3.2	152
Provision for Tills Redemption			(100)

[2]PBO estimations

	Fiscal Outturn for FY 2019/20		
	Printed Estimates	Suppl. Estimates 1	Suppl. Estimates 11
Financing Gap* **	**(0.0)**	**(90.7)**	**(129.1)**
*** During Supplementary I Cash Adjustment of Ksh. 90 billion			

The outlook for key macroeconomic variables:

14) **Inflation:** Inflation was estimated at 6.06% in March2020 with the Consumer Price Index (CPI) having increased by 0.18 percent from 106.33 in February 2020 to 106.53 in March 2020. These statistics are based on the re-based CPI whose base period is February 2019. The inflation statistic for March 2020 is mainly on account of high food prices with the food and non-alcoholic drinks index having increased by 0.55 percent between February and March 2020 while the year on year food inflation in March stood at 11.85 percent. Going forward, inadequate food production is likely to remain the most significant factor contributing to inflation in 2020. Despite a reportedly favourable weather outlook which could potentially improve food availability, farmers have been facing challenges with regard to accessing seeds and fertilizers as well as a shortage of labour due to the ongoing health pandemic. As such, any budgetary interventions should ensure adequate and timely access of seeds and fertilizers to farmers before the planting season is over. If this scenario is not adequately addressed, a food crisis in the coming months will lead to higher food prices leading to higher inflation levels. This will disproportionately affect the urban poor many of whom have already lost their source of livelihood. On the other hand, fuel inflation is likely to remain low on account of reduced demand for transportation which has led to a significant decline in global oil prices. As a result, fuel and transportation costs may not increase significantly. Supply chain disruptions have also contributed to a spike in prices of some commodities but this is likely to be offset by a reduction in aggregate demand due to lower incomes.

15) **Exchange rate:** The shilling is under pressure to depreciate and as at 15th of April 2020, the exchange rate stood at Ksh. 105 to the dollar. This is attributed to a strengthening dollar against all currencies due to massive capital flight and increased demand for the dollar as a safer haven. The Central Bank of Kenya has intervened to manage the depreciation and ensure the Kenya Shilling remains stable against the dollar in order to cushion the economy from the adverse effects of a depreciated shilling. Going forward, reduced export earnings, declining diaspora remittances, reduced foreign capital inflows and the lack of an IMF standby loan facility to help cushion the Kenyan Shilling from economic shocks pose a risk to the exchange rate. With a depreciated currency, it will be expensive for industries continuing with operations to source raw materials and intermediate goods. A depreciated shilling may also wipe out the gains of a reduced oil import bill. However, reduced dollar

demand by some merchandise traders (those relying on imports of raw materials and intermediate goods)as they scale down operations due to reduced consumer demand may balance out the effects thereby stabilizing the exchange rate.

16) **Trade Balance:** the export sector has suffered significant losses on account of the COVID 19 pandemic due to reduced demand for Kenyan exports as well as declining global commodity prices. The floriculture sector is arguably the most affected with the demand for cut flowers having declined significantly. It is estimated that the sector may lose half of its value (approximately Ksh. 60 billion) by the end of 2020. The tourism and hospitality sector has also suffered immense losses due to the ban on international travel. On the other hand, the country could be facing a much lower import bill on account of reduced global oil prices as well as likely reduction in the importation of industrial supplies, machinery and other capital equipment as many industries scale down operations in response to reduced aggregate demand as well as higher input costs occasioned by supply chain disruptions.

17) Foreign Exchange reserves: Forex reserves currently stand at 8,251 million US dollars (5.01 months of import cover) and are expected to provide an adequate buffer against short term shocks, however, downside risks remain evident. Over the past year, Kenya's forex reserves have mostly been driven by remittances. Available statistics on foreign remittances shows a slight decline in February 2020 to 218,991 USD from 259,392 USD in January 2020[3].Though it is still too early to tell the impact, reduced economic activity, declining incomes, increased cost of goods abroad and widespread uncertainty will very likely result in a much further reduction in diaspora remittances.

It is also worth noting that some key sectors have also been severely affected by the health pandemic and this may adversely affect economic growth.

18) **Agriculture:** According to the Famine Early Warning Systems Network, food availability increased in early 2020 and with a forecast of above-average rainfall in the March to May long rains season, food and pasture production should improve further. Cooler temperatures are also likely to mitigate the impact of the desert locust invasion thereby contributing to a favourable food outlook. Recent reports, however indicate that the desert locusts may have changed their behaviour as a survival tactic which has made it difficult for aerial spraying to work. If the locust invasion persists, it will have poor food security outcomes. The health pandemic has also affected agricultural production due to a shortage of labour as well as difficulty in accessing seeds and fertilizers. This is because many agrovets are closed with seed producers having suspended operations in keeping with the government directive to stay at home and minimize movement. As a result, retail shops are selling seeds at very high prices and it is feared some unscrupulous traders could be selling uncertified seeds. As earlier

[3]CBK Statistics

indicated, budgetary interventions should prioritize the distribution of seeds and fertilizers as well as combating the locust invasion.

19) **Manufacturing and Industry:** Industries that rely on imported raw materials and intermediate goods have experienced a sudden disruption in their supply chains and are finding it increasingly hard and/or expensive to source for these inputs in other markets. However, due to the declining purchasing power of consumers, it is likely unprofitable to engage in large scale production. Low profitability, business uncertainty and reduced working hours has led many businesses to scale down operations.

20) **Service sector:** the accommodation and restaurant sub sector has suffered significant losses due to COVID 19 mitigation strategies such as the ban on international travel, social distancing and closure of entertainment venues. Many hotels and restaurants have closed down completely and those still in operation are recording very little activity. The transport and storage sub sector has also registered losses due to restriction of movement which has significantly reduced demand for transportation whether by air, rail or road. It should be noted that the service sector contributed approximately 3 percentage points to the 5.6 percent economic growth registered in 2019. As such, such a significant decline in performance of the service sector will lead to a great loss in GDP growth.

21) **Employment:** Unemployment has gone up and the urban population living below the poverty line is expected to increase in the coming months. Due to the mitigation measures, many businesses have had to reduce their working hours and many others, especially MSMEs, have completely shut down leading to massive job losses and reduced incomes. Many job losses have been registered in the service sector particularly in the accommodation and restaurant sub sector. Smaller businesses such as salons and barber shops, shoe shining, domestic work, roadside hotels and other jobs that require proximity have shut down as people practice social distancing. Traders in second hand clothing (mitumba) are also experiencing losses not only from reduced consumer spending but also the government directive to ban the importation of mitumba as one of the COVID 19 mitigation strategies. Many of these businesses are daily wage earners and will require some form of support from the government to meet their basic needs.

IV. Key Proposed Changes in the Supplementary II Estimates 2019/2020

22) During the first supplementary budget, adjustments were done geared towards the Big Four Agenda related interventions, pending bill and meeting shortfall in revenue performance. Ideally, any expenditure adjustments in the supplementary II budget for FY 2019/2020 should be directed towards COVID 19 mitigation strategies including provision of critical health infrastructure, food security initiatives, social safety nets for the poor and support to local manufacturing. A review of the current supplementary budget laid in the National on 13th April, 2020, the following are the only notable expenditure interventions related to Covid-19:

- ✓ Direct COVID 19 interventions:
  - o Ministry of Health Ksh.4.9 billion
    - o/w recruitment of workers Ksh.1.3 billion
    - Covid-19 response Ksh.3.9 billion
  - o State Department for Social Protection, Pensions, and Senior Citizens
    - Provision for Vulnerable groups Ksh.10 billion
- ✓ Indirect interventions

  - State Department for Interior Ksh.200 million towards security operations;
  - State Department for Development of ASAL Ksh.400 million for food and non-food commodities for insecure communities;
  - National Intelligence service Ksh.1.5 billion for enforcement ; and
  - Pending bills for SMEs Ksh.13 billion.

Table 2 and 3 below provide an analysis of the major changes in the recurrent and development budgets

Table 3: Major Changes in the Recurrent Budget

Vote	Description *(i.e Ministry or State dept)*	Projects/ Programmes affected	Amount Increased/ Reduced	% Change	Remarks (reasons for increase or decrease)
Major Increments					
1011	The Presidency	Nairobi Metropolitan Services	2,251,600,000		New Program as a result of the transfer of Nairobi City County functions to the National Government.
1023	State Department for Correctional Services	Correctional services	6,718,739,520	26%	To cater for shortfall in personnel emoluments, operation & maintenance, and provision of Ksh. 6.2 billion to cater for payment of pending bills.
1065	State Department for University Education	University Education	8,194,663,723	8%	To cater for Collective Bargaining Agreement (CBA) and doctors-lecturers' allowances.
1165	State Department for Crop Development	Crop Development and Management	10,491,281,319	1,468%	On account of job evaluation for the staff of Bukura Agricultural College & additional funds for combating infestation and spread of desert locusts as well as for Strategic Food Reserve.
1185	State Department for Social Protection, Pensions & Senior Citizens Affairs	National Social Safety Net	9,994,000,000	63%	Cash transfers for elderly persons (above 70 years)

Vote	Description *(i.e Ministry or State dept)*	Projects/ Programmes affected	Amount Increased/ Reduced	% Change	Remarks (reasons for increase or decrease)
1202	State Department for Tourism	Tourism Development and Promotion	1,186,315,583	19%	To cater for the operationalization of the Tourism Promotion Fund (TPF)
1214	State Department for Youth	Youth Empowerment	3,096,497,377	28%	To cater for payment of verified pending bills
1281	National Intelligence Service	National Security Intelligence	3,520,000,000	9%	To cater for enhanced security operations
2091	Teachers Service Commission	Teacher Resource Management	3,322,000,004	1%	To cater for Personnel Emoluments for teachers.
Major Reductions					
1021	State Department for Interior	Policing Services	1,557,359,200	2%	On account of rationalization and austerity measures
		Planning, Policy Coordination and Support Service	1,713,221,717	7%	On account of transfer of allocation for leasing of motor vehicles to The National Treasury
1071	The National Treasury	General Administration Planning and Support Services	15,618,058,783	24%	Reduction of the employer contribution to staff Pensions Scheme as well as housing and car loans schemes to public servants
		Public Financial Management	3,449,229,338	37%	On account of rationalization and austerity measures
1081	Ministry of Health	Preventive, Promotive & RMNCAH	1,850,205,550	47%	On account of budget rationalization
2042	National Assembly	National Legislation, Representation and Oversight	2,514,941,000	11 %	On account of rationalization and austerity measures

Emerging Issues

23) The bulk of the increments is as a result of the shortfall in personnel emoluments on account of job evaluation and CBA agreements as well as for settling of pending bills. There is little information provided in regards to financial measures in place to mitigate COVID-19 apart from providing additional cash transfers to for the elderly.

24) The Crop Development and Management programme has been allocated Ksh.10 billion towards National Food Security programme to boost Strategic Food Reserves. There is a likelihood the funds may not be absorbed by the end of Financial Year as two months are remaining. Additional information should be provided to justify the expenditure.

25) There is significant reduction amounting to Ksh. 1.85 billion towards access to primary health care under Universal Health Care (UHC) in line with the president's directive to reallocate these funds towards recruitment of additional health workers and also enhanced social safety

net among others. Despite these changes the targets of thePreventive, Promotive & RMNCAH program have not been revised to reflect this reduction even though it is quite significant. This makes the budget less credible.

Table 3: Major changes in the Development Budget

Vote Description *(i.e Ministry or State dept)*	Projects/ Programmes affected	Amount Increased/ Reduced	% Change	Remarks (reasons for increase or decrease)
Total Programmes		**(98,730,941,950)**	**-12.6%**	
Major Increments				
1011 The Presidency	**Total Programmes**	**1,160,952,619**	**51.7%**	
	0745000 Nairobi Metropolitan Services	1,526,969,485		New Program as a result of the transfer of Nairobi City County functions to the National Government.
1091 State Department for Infrastructure	**Total Programmes**	**44,269,723,509**	**33.4%**	
	0202000 Road Transport	44,269,723,509	33.4%	Increase on account of pending bills
1165 State Department for Crop Development	**Total Programmes**	**2,272,729,308**	**12.4%**	
	0108000 Crop Development and Management	3,306,199,497	20.6%	Facilitate acquisition of the strategic food reserve. To cater for locust invasion.
1214 State Department for Youth	**Total Programmes**	**1,993,660,000**	**33.5%**	
	0711000 Youth Empowerment	1,993,660,000	33.5%	Provision for pending bills.
Major Reductions				
1041 Ministry of Defence	**Total Programmes**	**(7,434,899,542)**	**-43.5%**	**-**
	0801000 Defence	(7,434,899,542)	-43.5%	
1071 The National Treasury	**Total Programmes**	**(16,372,878,184)**	**-44.6%**	
	0718000 Public Financial Management	(15,584,902,951)	-46.0%	Revenue underperformance, low absorption and emerging issues.
1072 State Department for Planning	**Total Programmes**	**(10,085,534,146)**	**-23.1%**	
	0706000 Economic Policy and National Planning	(9,980,601,146)	-23.8%	Revenue underperformance and low absorption.
1081 Ministry of Health	**Total Programmes**	**(11,867,286,406)**	**-22.5%**	
	0401000 Preventive, Promotive & RMNCAH	(4,053,825,062)	-48.6%	Rationalization due to low absorption.
	0405000 Health Policy, Standards and Regulations	(8,144,203,844)	-24.3%	Rationalization due to low absorption.
1092 State Department for Transport	**Total Programmes**	**(21,123,813,189)**	**-18.6%**	

Vote Description *(i.e Ministry or State dept)*	Projects/ Programmes affected	Amount Increased/ Reduced	% Change	Remarks (reasons for increase or decrease)
	0203000 Rail Transport	(18,567,313,189)	-20.6%	Revenue underperformance and emerging issues
	0204000 Marine Transport	(2,400,000,000)	-11.5%	Revenue underperformance and emerging issues
1094 State Department for Housing & Urban Development	**Total Programmes**	**(5,558,100,000)**	**-17.9%**	
	0102000 Housing Development and Human Settlement	(5,666,100,000)	-43.1%	Revenue underperformance, low absorption and emerging issues.
1107 Ministry of Water and Sanitation	**Total Programmes**	**(7,558,228,823)**	**-12.2%**	
	1017000 Water and Sewerage Infrastructure Development	(6,404,931,617)	-15.3%	Revenue underperformance, low absorption and emerging issues.
1122 State Department for Information Communication Technology	**Total Programmes**	**(7,911,000,000)**	**-29.8%**	
	0210000 ICT Infrastructure Development	(5,318,447,105)	-25.1%	Revenue underperformance, low absorption and emerging issues.
	0217000 E-Government Services	(2,582,852,895)	-49.2%	Revenue underperformance, low absorption and emerging issues.
1152 Ministry of Energy	**Total Programmes**	**(21,935,736,718)**	**-28.2%**	
	0212000 Power Generation	(2,870,602,227)	-32.0%	Revenue underperformance, low absorption and emerging issues.
	0213000 Power Transmission and Distribution	(18,565,134,491)	-28.6%	Revenue underperformance, low absorption and emerging issues.

DEVELOPMENT EXPENDITURE BY SOURCE OF FUNDING SUMMARY 2019/20				
	Approved estimates		**Supplementary estimates II**	
	Net	**Gross**	**Net**	**Gross**
GOK Ksh.	393,756,942,379	462,039,942,379	378,153,738,079	442,765,934,557
Donor Ksh.	83,772,852,731	320,646,745,745	66,309,064,339	241,189,811,617
Total Ksh.	**477,529,795,110**	**782,686,688,124**	**444,462,802,418**	**683,955,746,174**

Emerging issues

26) The reductions in development expenditures of most Ministries and State Departments was mainly due to revenue shortfall, low absorption and the need to redirect expenditures towards efforts to mitigate the impact of COVID-19.
27) The development expenditures for road transport and youth empowerment was increased by Ksh. 44 billion and Ksh. 2 billion to cater for pending bills.
28) The locust invasion and the COVID 19 pandemic are expected to have a negative impact on food security. Consequently, the development expenditures for the State Department for Crop Development were increased by Ksh. 3 billion to cater for food security initiatives.
29) There is still a risk of under absorption of development expenditures by some programmes such as road transport. The revised net expenditures for the State Department for Infrastructure is Ksh. 123 billion against exchequer releases of 51 billion as at February 2020.
30) Additional pending bills may arise as a result of major cuts in the development expenditures of some programmes.
31) The government must do what it takes to rescue the vulnerable through cash transfers and through in-kind support. However, there has to be an accountability framework for tracking the same.
32) More resources should have been voted to the manufacturing sector (a form of subsidy to those industries that are making the PDE's)

Pertinent observations under key sectors:

Energy

33) There are no clear re-allocations with respect to expenditure under the foreign and local travel items, in view of the anticipated impact of Covid 19 crisis on the ministerial programmed activities.
34) Most of the reductions pertain to external funding components towards the construction of major transmission projects and other projects that are critical to enhancing access, reduce reliance on expensive power and demand creation such as Olkaria-Lessos Kisumu Power Lines Construction Project.
35) Loiyangalani –Suswa Transmission Line (of Kshs 1.16 billion): The National Assembly recommended a special audit in 2019 following inconsistencies in series of payments vis a vis the outstanding claims as well as disputed invoices and unclear basis for the claims, among others, which to date has not been submitted.

Lands

36) The budget adjustments for the programmes Land administration and management by the National Land Commission have not complied with the provisions of section 43 (2) c of the Public Finance Management Act, 2012 which requires that the sum of all reallocations made to or from a programme **do not exceed 10%** of the total expenditure.

37) Considering the slow uptake of budgeted resources by the Ministry of Lands and Physical Planning throughout the first half of the financial year 2019/20 it will be challenging for the ministry to absorb the additional allocation of Kshs 917.4 million.

Labour and social welfare

38) **National Social Safety Net:** It is proposed that the recurrent budget for the programme be increased by Ksh. **9,994 million** whereas the Development expenditure be reduced by Ksh. 1,333 million. The resultant effect is an overall increase of Ksh. **8,661** million translating to 28% of its approved allocation.
39) The additional allocation under recurrent is towards Cash Transfer to Older Persons and OVC project with the number of older persons **(over 70 years)** supported increased from **833, 000** to **1 million** persons whereas the number of vulnerable children to be supported has been reduced from 393,000 to 390,500.
40) It's important to note that the **Ksh 9,994 million** allocated for the above programme will be used as follows;
    i. Cash transfer to older persons and OVC **Kshs 9,616 million**
    ii. Cash Transfer to Orphans and vulnerable children **Ksh 300 million**
    iii. Social protection Secretariat **Ksh 78 million**.
41) **Ksh 9,449,440,000** will be disbursed as current transfers to government agencies while **Ksh 550,560,000** will be for use of goods and services**.**

Health

42) The Ministry has been allocated **Kshs 3.9 Billion** to response against the COVID 19 to be utilized as follows:
    i. Kshs 1 Billion for recruitment of Health workers
    ii. Kshs 300 million for operations
    iii. Kshs 2.6 Billion under the development budget
43) Despite the significant changes in the allocation, more so the reductions, the KPI's and targets have not been revised under the Program Based Budget (PBB) in tandem with the observed adjustments.
44) **National Health Institutions on the forefront on the COVID 19 response** – Institutions such as the referral hospitals and KEMRI which are in the forefront in responding to the pandemic have been allocated little/no additional resources. These facilities may be overstretched and may require additional budgetary support in the next two months.
45) **The rollout of UHC allocation-** has been reduced by Kshs 9.4 Billion. However, the KPI's and the targets remain the same despite this reduction. It was expected that the rollout could have been fast tracked to complement efforts towards the response to the COVID 19 pandemic.
46) **Kenya COVID 19 emergency response project-** This is a new development project with an allocation of Kshs 2.6 Billion. The target set is the testing and treating of 100,000 persons of

the COVID 19 disease. The entire allocation is from external funding. This means that the Ministry has minimal funding (both recurrent and development) from the government own resources. Given the magnitude of this pandemic, this allocation seems inadequate given the leading role this sector is playing in response to this pandemic.

47) **External funding support**- There is a significant reduction of external funding support towards various interventions such as TB, Malaria, UHC as well as UHC complementary funding. This is an indication that the development partners have withheld full financial year funding for the various interventions.

Transport, public works and housing

48) **Project lists:** it is noted under the State Department for Infrastructure that Critical emergency intervention roads and spot improvement intervention were allocated **Ksh. 1,750** million and **Ksh.1, 080 million respectively. However, the list of targeted roads is not provided.**

49) There is an allocation of **Ksh. 1,041 million** to projects that had no allocation in the approved budget for FY 2019/20**.**

50) **Policy shift from the Big Four:** The removal of the seed money for National Housing Development fund points to the difficulty in pursuing the programme. There is a need for the State Department of Housing and Urban Development to explain how it will deliver this ambitious agenda.

51) The resources allocated to big four projects under the State Department for Public Works have been slashed substantially depicting a possible policy shift from the big four agenda.

52) **New Project:** under the State Department of Transport, a new project is introduced namely, Rehabilitation of The Nairobi - Nanyuki MGR Branch Line with an allocation of **Ksh. 1,800 million (**The amount is already spent under Article 223).

Administration and National Security

- **Presidency**

53) Introduction of a new programme, Nairobi Metropolitan Services, at the supplementary: While the programme was added on account of transfer of functions in line with Article 187 of the Constitution, it is imperative to note that the PFM Act 2012 prohibits introducing new programmes at the supplementary stage. Further under development expenditure, the proposed allocation of KSh. 1.5 billion to the programmedoes not indicate the projects/programmes it will deliver.

- **Interior**

54) **Leasing of Police vehicles:** The programme which was initially under the National Treasury was transferred to the State Department of Interior with an allocation of KSh. 4.5 billion in 2019/20 budget. The programme has since been transferred back to the National Treasury despite being a House resolution that it be domiciled under the State Department for Interior.

55) **Stalled Projects:** The State Department for Interior had a total of 14 projects which had stalled due to inadequate funding but had been factored in the FY 2019/20 budget. All the projects under this category have been reduced to zero and run the risk of stalling further if no allocation is considered in the next budget.

56) **Public Participation projects**

- All the public participation projects have been proposed for reduction to zero. They include the construction of police stations and purchase of Modern Police Patrol Boat in Lake Victoria.

57) **Correctional Services**

- KSh. 6.2 billion has been proposed to settle historical pending bills under the state department without Parliament receiving a report on the audit that was commissioned to determine their validity

Water and sanitation

58) Increments

a. Construction/rehabilitation of water pans in arid and semi-arid areas Ksh.1.150 billion (program finance) (Catastrophic Deferred Drawdown Option Loan from World Bank (CatDDO) **(new project).** The money is distributed among 18 counties in ASAL areas (Marsabit, Garissa, Mandera, Wajir, Isiolo, Samburu, Turkana, West Pokot, Narok, Kajiado, Makueni, Kitui, Tana River, Lamu, Taita Taveta, Kwale, Kilifi and Laikipia)
b. Drilling of boreholes and installation of tanks in Nairobi Ksh.200 million **(new project)**
c. Korbesa and Malka Galla water supply project Ksh.40 million (**new project)**
d. Mwache water pipeline extension Ksh.125 million
e. Drilling boreholes and installation of tanks in Nairobi Ksh.200 million

59) Reduction

a. Donor funded
    i. Water and sanitation services (Athi Water) Ksh.2.8 billion
    ii. Karimenu water supply Ksh.1.1 billion
    iii. Nairobi metro area bulk water Ksh.700 million
b. GOK funded
    i. Kenya urban water and sanitation Ksh.440 million
    ii. Cross county bulk water and sanitation Ksh.500 million
    iii. Thwake multi-purpose dam Ksh.61 million
    iv. Itare dam Ksh.100 million
    v. Homabay water Ksh.100 million
    vi. Nairobi water harvesting and groundwater exploitation Ksh.300 million

Finance and National Planning

60) The allocation for the Salaries and Remuneration Commission has not been affected. The Commission of Revenue Allocation has a proposed reduction of Ksh. 75.7 million whereas the budget for the Office of the Controller of Budget has been proposed to be enhanced slightly by Ksh. 26.8 million.

61) The budget for the State Department for Devolution is proposed to be reduced by Ksh. 5.252 billion mainly on account of a reduction of Ksh. 4.59 billion capital expenditure that was meant for devolution support programme for results. However, there is an increase of Ksh. 400 million in recurrent expenditure for emergency relief.

62) The National Government Constituencies Development Fund (NG-CDF) budget is proposed to be reduced by Ksh. 10 billion

63) The budget for the National Treasury is proposed to be reduced by Ksh. 35.5 billion. However, it is noted that the Kenya Revenue Authority's budget is proposed to be enhanced by Ksh. 10 billion to cater for tax refunds.

64) There is no new programme or project introduced and targets for 2019/20 remain largely unchanged.

Supplementary II FY 2019/20 Consolidated Fund Services Expenses (CFS)

65) The Consolidated Fund Services (CFS) expenses relate to the mandatory expenses that form a first charge to the consolidated fund. CFS services expenditures will continue to impact the revenue resources available between March and the end of the Financial Year. As at the end of February 2020, 67% of CFS expenditure had been met leaving a balance of Ksh.262.9 billion (33%). Majority of these expenditures will relate to public debt servicing expenditures, of which Ksh.483.1 billion (or 69% of the debt servicing expenses for the FY 2019/20 worth Ksh.696.6 billion) had been met leaving a balance of Ksh.213.5 billion (31%).

Table 5: Consolidated Fund Service expenses as at end of February 2020 (Ksh. Millions)

	Approved Estimates	Amount Paid	Balance (Ksh.)	% Balance
Public Debt	696,554	483,077	213,477	31%
Pensions and gratuities	104,489	57,655	46,834	45%
Salaries, Allowances and Miscellaneous	4,736	2,119	2,617	55%
Total CFS Expenditure	805,779	542,851	262,928	33%

Source: Kenya Gazette, March 2020

66) Amendments by the supplementary II FY 2019/20 indicate a review of the Consolidated Fund Expenses in line with the government's budget expenditure priorities. The Supplementary II Estimates indicates that the net domestic borrowing remain at Ksh.300.7 billion, however, there is other domestic borrowing estimated at Ksh.150 billion.

67) The CFS expenses are projected to increase by Ksh.64.7 billion (8%) to reach Ksh.870.5 billion. The increase is on account of the projected rise in public debt servicing expenses by Ksh. 82.3 billion (12%) while pension and other miscellaneous expenses reduce by Ksh. (17.6) billion (16%) in line with government austerity measures designed to redirect resources to address current economic and health sector challenges.

Table 6: Expenditures related to the Consolidated Fund Services (Ksh. Millions)

	Estimates 2019/20	Supplementary I	Supplementary II	Deviation (Ksh.)	Deviation (%)
Interest - Internal Debt	290,540	290,540	301,812	11,272	4%
Interest - External Debt	150,941	150,941	131,868	-19,074	-13%
Sub-Total	441,481	441,481	433,680	-7,801	-2%
Redemption - Internal Debt	123,691	123,691	223,691	100,000	81%
Redemption - External Debt	131,382	131,382	121,477	-9,905	-8%
Sub-Total	255,073	255,073	345,168	90,095	35%
Total Interest rate & Redemption Expenses	696,554	696,554	778,848	82,294	12%
Pensions	104,489	104,489	86,989	-17,500	-17%
Salaries and Allowances	3,965	3,965	3,985	20	1%
Miscellaneous Services	128	128	16	-113	-88%
Guaranteed Debt	644	644	644	-	0%
Subscriptions to International Organizations	1	1	1	-	0%
Sub – Total	109,226	109,226	91,633	-17,593	-16%
Total CFS Expenditure	805,780	805,780	870,481	64,701	8%

Source: Supplementary II Estimates FY 2019/20

68) Both external interest rate expenses and redemption expenditure are projected to decline while internal debt (both interest rate and redemption expenditure) will increase substantially. As such, domestic debt servicing is the primary reason behind the increase in CFS expenditure. The Ksh.19.1 billion decline in external debt interest expenses relate to the reduction of interest expenses intended for new loan acquisition in FY 2019/20 by Ksh. 39.9 billion (from Ksh. 40.4 billion to Ksh. 441 million) and Ksh. 10.5 billion reduction interest for loans owed to the Exim Bank of China. Major increases will relate to the new inclusion of interest payments worth Ksh. 10.1 billion and Ksh. 7.7 billion payments for the 2019 Eurobond, USD 1.2 billion and USD 900 Million, respectively.

69) On Domestic debt, redemption expenses are expected to increase by Ksh.100 billion which are allocated towards meeting shortfalls in redemption of Treasury bills whereas domestic debt interest costs are projected to increase by Ksh.11.3 billion on account of tap issues and rollover of primarily long-term debt (See Annex). The allocations meant to cater for new debt issuance i.e. April to June issues and New Loans worth Ksh.9.8 billion and Ksh.9.4 billion respectively, have been removed. In addition, the Ksh.17.5 billion reduction in pension expenditure is as a result of a reduction under the following heads:

i. Ordinary pension – relating to the reduction in the monthly pension for retired presidents by Ksh. 7 million to Ksh. 67 million for FY 2019/20
ii. Commuted pension (Gratuities) by Ksh.17.4 billion – relating to the reduction of gratuities for civil servants, Members of Parliament, Military and retired presidents by Ksh.10 billion, Ksh. 900 million, Ksh. 5 billion and Ksh. 1.5 billion, respectively.
iii. Reduction for Refund of Contributions to Widows and Children's Pension Scheme (WCPS) & Other Exgratia by Ksh. 80.1 million

70) Salaries, Allowances and Miscellaneous expenses will have the following changes:

i. Increase in Salaries, Allowances by Ksh. 20 million i.e. Ksh. 3 million and Ksh. 17 million salary and wage increases for the Attorney General and the Auditor General, respectively.
ii. Reduction in Employer contribution to N.S.S.F by Ksh.112.5 million from 125 million to 12.5 million.

Emerging issues

71) The reduction of the external debt servicing expenses and the increase in domestic debt-related expenses indicate the uptake of domestic debt to finance necessary government initiatives. However, its impact on the approved FY 2019/20 borrowing strategy has not been provided.

72) On domestic debt redemption, the amount allocated towards meeting shortfalls in redemption of Treasury bills has been increased from Ksh.10 Billion to Ksh.110 billion.

Annex 1: Legal Compliance of Supplementary Estimates II of 2019/20 Budget

Item	Constitution	PFM Act	PFM Regulations	Score	Comments
GENERAL OVERVIEW					
1. Additional expenditure should be on account of either insufficiency of amounts provided, need arisen for which no amounts were allocated or withdrawal from contingency fund	223(1)	44(1)		5 out of 5	Information provided
2. Spending should be sought within 2 months after the first withdrawal	223(2)	44(1)		5 out of 5	Information provided
3. Overall budget change should not be more than 10 percent of the printed estimates unless Parliament approves a higher percentage.	223(5)	44(1)		5 out of 5	Complied.
CONFORMITY TO THE PROVISIONS OF THE PFM LAW AND ITS REGULATION					
4. Reallocation changes per program should not exceed 10 percent of total approved budget of a program unless for unforeseen circumstances		43 (2) (c)		2 out of 5	Partly Complied
5. Conformity to budget circular			40(1)	5 out of 5	Complied
6. Conformity to Fiscal Responsibility Principles		44(3),15(2)	26(1)	2 out of 5	Some of the principles haven't been adhered e.g. no information has been provided revenue and debt changes
7. Conformity to Financial Objectives		44(3)		5 out of 5	No information provided in regards to the financial objectives in 2019 BPS
8. Presentation in a Programme Based Budgeting Format			40(6)(a)	5 out of 5	Achieved
9. Information on budget performance (actual expenditure and outstanding liabilities/commitments)			40(6)(b)	2 out of 5	No information on outstanding liabilities
10. Details of supplementary changes (amount, reasons for change, basis for calculation)			40(6)(c)(d)	5 out of 5	Information Provided
11. Sources for funding of additional expenditure			40(6)(e)	0 out of 5	No information has been provided on updated revenue
12. Analysis of the fiscal impact of the additional expenditures for the planned outputs and outcomes of the affected programmes			40(6)(f)	2 out of 5	Some planned outputs and outcomes of some programmes have not been varied

Item	Constitution	PFM Act	PFM Regulations	Score	Comments
					despite reduction in the budget. E.g. Sub-programme: National Grid System
13. Updated Fiscal Projections			40(6)(h)	5 out of 5	Information provided
14. No new programmes /projects to be introduced in the Supplementary Budget			40(8)	2 out of 5	There new projects introduced in the supplementary budget e.g. Nairobi Metropolitan Services
Total				**71.4 percent**	

Annex 2: Supplementary II changes on Domestic Debt Servicing Expenses

Interest Debt Servicing Expenses							
Issue No.7	Principal	Due Yr.	Tenor	Estimates	Supplementary II	Deviation (Ksh.)	Deviation (%)
MAB2/2017/3	891	2020/09	3YRS	44	76	31	71%
FXD1/2008/15	34,790	2023/03	15YRS	4,474	4,349	(125)	-3%
FXD2/2019/05	39,201	2024/05	5YRS	-	4,262	4,262	
FXD3/2019/5	28,485	2024/12	5YRS	-	1,637	1,637	
FXD1/2012/15	48,937	2027/09	15YRS	2,980	4,182	1,201	40%
FXD2/2013/15	30,261	2028/04	15YRS	3,631	4,785	1,154	32%
FXD3/2019/10	45,005	2029/08	10YRS	-	2,592	2,592	
FXD4/2019/10	28,344	2029/11	10YRS	-	1,740	1,740	
FXD4/2019/10	51,327	2029/11	10YRS	-	496	496	
FXD1/2018/15	49,255	2033/05	15YRS	1,673	5,058	3,385	202%
FXD1/2019/15	30,567	2034/01	15YRS	3,942	3,930	(12)	0%
FXD2/2019/15	42,447	2034/04	15YRS	-	5,405	5,405	
FXD3/2019/15	50,553	2034/07	15YRS	-	3,119	3,119	
FXD1/2019/20	14,542	2039/03	20YRS	-	936	936	
April-June Issue	80,000	various		9,780	-	(9,780)	-100%
New Loans				9,423	-	(9,423)	-100%
Internal Debt Redemption Expenses							
Redemption of Treasury Bills - Shortfall				10,000	110,000	100,000	1000%

Source: Supplementary II Estimates, FY 2019/20