REPUBLIC OF KENYA

THE NATIONAL TREASURY

MEDIUM TERM

BUDGET POLICY STATEMENT

APRIL 2013

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Foreword

This Budget Policy Statement has been prepared when the global economic prospects have somewhat improved but the road to recovery in the advanced economies remains bumpy. In emerging market and developing economies, activity has already picked up steam. These developments together with renewed investor confidence following successful elections bode well for accelerated growth prospects in Kenya.

On the domestic front, we have just gone through a successful general election and commenced the devolution process under a new Administration. Economic growth has improved and remains resilient. Fiscal and monetary policy remains supportive of growth, but current projected growth rates are not fast enough to support the employment creation and poverty reduction that the country requires. The overriding policy thrust of 2013 Budget Policy Statement, therefore, is to accelerate economic growth by sustaining macroeconomic stability; focusing on economic policies and structural reforms; and deepening investment in critical economic infrastructure aimed at promoting productivity and by extension facilitating expansion of the private sector that will spur resilience necessary for employment creation and poverty reduction. This is exactly the agenda of the new Administration.

The fiscal framework presented in the 2013 Budget Policy Statement provides the means for the country to implement the new Administration's economic agenda within a sustainable public finance path. It also facilitates the devolution process, following the coming on board of the county governments in March 2013. This calls for greater transparency and high quality in public financial management at both the county and national governments in order to ensure fiscal discipline and safeguard macroeconomic stability.

JOSEPH K. KINYUA, CBS
PERMANENT SECRETARY/THE NATIONAL TREASURY

Acknowledgement

This is the fifth Budget Policy Statement (BPS) to be tabled in Parliament and the first under the Public Financial Management Act, 2012. It outlines the broad strategic macroeconomic issues and fiscal framework, together with a summary of government spending plans, as a basis of 2013/14 budget and the medium-term. We expect the document to improve the understanding of Kenya's public finances and guide public debate on economic and development matters.

As usual, the preparation of the 2013 BPS continues to be a cooperative effort. Much of the information in this report was obtained from the Ministries and other government departments and agencies. We are grateful for their inputs. We are also grateful for the comments from the Macro Working Group and Public Sector Hearing of November 12-14, 2012 on the 2013/14 Budget Review and Outlook Paper (BROP), which provided inputs to this 2013 BPS, in addition to comments from the Commission for Revenue Allocation and other stakeholders.

A core team in the National Treasury spent a significant amount of time putting together this Statement. We are particularly grateful to the Economic Secretary, Dr. Geoffrey Mwau, Mr. Justus Nyamunga, Director, Economic Affairs, and Dr. KamauThugge, Senior Economic Advisor, for their support in the execution of this task. Special thanks go to contributors including Mr. John Njera, Ms. Naomi Matheri and Mr. Denis Muganga of Economic Affairs Department. In addition, we value the inputs received from Mr. Francis Anyona, Mr. Samuel Kiiru, Mrs Elizabeth Nzioka, and Ms Miriam Musyoki of Budgetary Supplies Department, and the entire team working on Fiscal Decentralization. Since it would not be possible to thank everybody individually in this page, I would like to take this opportunity to commend the entire staff of the National Treasury for their dedication, sacrifice and commitment to public service.

We are convinced working together and remaining focussed we will conquer poverty in all its manifestations.

JOSEPH K. KINYUA, CBS
PERMANENT SECRETARY/THE NATIONAL TREASURY

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Legal Basis for the Publication of the Budget Policy Statement

The Budget Policy Statement is published in accordance with Section 25 of the Public Finance Management Act, 2012. The law states that:

1) The National Treasury shall prepare and submit to Cabinet the Budget Policy Statement for approval.

2) The National Treasury shall submit the Budget Policy Statement approved in terms of subsection (1) to Parliament, by the 15^{th} February in each year.

3) In preparing the Budget Policy Statement, the National Treasury shall set out the broad strategic priorities and policy goals that will guide the national government and the county governments in preparing their budgets both for the following financial year and over the medium term.

4) The National Treasury shall include in the Budget Policy Statement-

   (a) an assessment of the current state of the economy and the financial outlook over the medium term, including macroeconomic forecasts;
   (b) The financial outlook with respect to Government revenue, expenditures and borrowing for the next financial year and over the medium term;
   (c) the proposed expenditure limits for the national government, including those of Parliament and the Judiciary and indicative transfers to county governments; and
   (d) the fiscal responsibility principles and financial objectives over the medium term including limits on total annual debt.

5) In preparing the Budget Policy Statement, the National Treasury shall seek and take into account the views of:-

   (a) The Commission on Revenue Allocation;
   (b) County governments;
   (c) Controller of Budget;
   (d) The Parliamentary Service Commission;
   (e) The Judicial Service Commission;
   (f) The Public; and
   (g) Any other interested persons or groups

6) Regulations made under the PFM Act shall prescribe circumstances and the manner in which persons or groups may make written or oral representations about the contents of the statement.
7) Parliament shall, not later than 14 days after the BPS is submitted to Parliament, table and discuss a report containing its recommendations and pass a resolution to adopt it with or without amendments.
8) The Cabinet Secretary shall take into account resolutions passed by Parliament in finalizing the budget for the relevant financial year.
9) The National Treasury shall publish and publicize the Budget Policy Statement not later than 15 days after submission of the Statement to Parliament.

Fiscal Responsibility Principles in the Public Financial Management Law

In line with the Constitution, the new Public Finance Management (PFM) Act, 2012, sets out the fiscal responsibility principles to ensure prudency and transparency in the management of public resources. The PFM law (Section 15) states that:

1) Over the medium term, a minimum of 30 percent of the national budget shall be allocated to development expenditure
2) The national government's expenditure on wages and benefits for public officers shall not exceed a percentage of the national government revenue as prescribed by the regulations.
3) Over the medium term, the national government's borrowings shall be used only for the purpose of financing development expenditure and not for recurrent expenditure
4) Public debt and obligations shall be maintained at a sustainable level as approved by Parliament (NG) and county assembly (CG)
5) Fiscal risks shall be managed prudently
6) A reasonable degree of predictability with respect to the level of tax rates and tax bases shall be maintained, taking into account any tax reforms that may be made in the future

I. REINVIGORATING GROWTH—OPPORTUNITIES FOR REFORM

Overview

1. The 2013/14 MTEF Budget is being prepared amid transition to a new Administration of the 4th Presidency, following the successful elections in March 2013. It is also happening when we are transiting to a devolved system of government under a new Constitution of Kenya that was promulgated in August 2010. As such, this budget policy statement sets out the priorities of the new administration in the context of medium term.

2. According to the latest IMF World Economic Outlook (April 2013), global economic prospects have somewhat improved but the road to recovery in the advanced economies remains bumpy. World output growth is forecast to reach 3¼ percent in 2013 and 4 percent in 2014. In advanced economies, activity is expected to gradually accelerate, starting in the second half of 2013. In emerging market and developing economies, activity has already picked up steam. These developments together with renewed investor confidence following successful elections bode well for accelerated growth prospects in Kenya.

3. In the domestic front, we nevertheless recognize that rising imports, stagnating exports, food insecurity, declining agricultural and manufacturing productivity as well as weak transport and logistics remains a major concern to achieving our economy's full potential. In addition, as we transit to a devolved system of government we need to bear in mind that while fiscal decentralization can offer significant gains under the right conditions, it also carries the risk of accentuating inequities and compromising macroeconomic stability. Thus, addressing the challenges facing our economy and establishing strong foundations and correctly sequencing the devolution of responsibilities is critical to attaining good economic and financial governance.

4. Going forward, the Government will build on the current improved macroeconomic environment and implement appropriate economic policies and structural reforms to navigate through the challenges posed by the global and domestic developments in order to accelerate growth under an enhanced fiscal discipline.

5. Achieving the economic and social rights envisioned in the Constitution (Article 43) requires investing in our people through better and quality education and health as well as cushioning the vulnerable groups, while ensuring regional balance. At the same time, it needs a fast growing economy that generates jobs for the youth and ensures that the benefits are shared by all Kenyans. The

commitment and zeal of the new Administration to fundamentally improve the opportunities for all Kenyans is therefore consistent with this approach.

6. The broad development policies of new administration, outlined during the President's address to the Parliament on 16th April 2013, provides government with clear and progressive approach to reinvigorate inclusive growth and move the country to the next level of prosperity.

7. While details of these priorities will be articulated in the Second Medium Term Plan of Vision of 2030 that is currently under preparation, this Budget Policy Statement outlines economic policies and structural reforms as well as sector-based expenditure programmes that the Government intends to implement over the next three financial years in order to achieve the broad goal of the new Administration's development agenda. In particular, it emphasizes continued shift of resources in favour of growth and job creation, and to support stronger private-sector investment in pursuit of new economic opportunities. The proposed fiscal framework ensures continued fiscal discipline and provides support for sustained growth, broad-based development and employment growth that benefits all Kenyans.

New administration's actions to promote growth and development

8. The framework of economic agenda of the administration of the 4th Presidency is premised on anchoring stability to sustain higher and inclusive growth that opens economic opportunities and provides a better future for all Kenyans. Getting the desired higher and better balanced growth depends on choosing the right combination of economic policies and structural reforms and calibrating them correctly.

9. The new administration, in this regard, has set out a **9-point action plan** on which government policy can work in partnership with the private sector and development partners to reinvigorate inclusive growth:

- A first class logistics hub, covering transport, roads, railways, waterways, pipelines, ports, storage & energy.
- A modern agriculture that include opening up at least 1 million acres of new land through irrigation in order to end food insecurity.
- Diversify exports, adding value, creating new products and opening up new markets.
- Seal leakages in our revenue collection system and extend the tax base.

- Drive up value for money from public procurement to get what we pay for.
- Create a business climate that encourages innovation, investment and growth.
- Reduce the cost of the ordinary household's basket of goods, including food, housing, energy and transport.
- Deepen our relationships with our regional partners in order to expand our markets, create jobs and boost growth.
- Invest in our greatest capital resource – our people and provide what our Constitution demands – social protection for every Kenyan.

10. The overarching goal of the above actions is to transform the economy into a middle-income status sooner than later, with our exports competing across the world and powering growth at double-digits rate necessary to create jobs for our youth and lift 10 million of Kenyans out of poverty by 2017.

Time to make tough decisions

11. The Constitution envisages lean and effective Government. Consistent with this, the Government has reduced the number of Ministries from 44 to 18. In addition, the overall public sector is expected to play an effective role in the development agenda by ensuring strategic prioritization of scarce resources. As such, state enterprises and public entities will be rationalized and consolidated in order to remove duplications and overlaps so as to ensure resources are utilized more efficiently and productively towards national development priorities.

12. Also, in line with the policy of streamlining government, the Government will combine the bodies that promote Kenya in all aspects of the economy to create a single agency with the reach, expertise and profile to represent and promote our country abroad, attracting trade, investment and tourism from across the world. In addition, our embassies and missions will be rationalized and remodelled to market Kenya in their respective countries and link directly to this new trade promotion service.

13. Under tight fiscal constraints, difficult choices must be made to ensure that scarce resources are directed towards priority areas of economic development and more effective service delivery, while ensuring that debt levels are sustainable. In addition to rationalization of the public service to make it lean, efficient, effective and accountable, the Government will adopt innovative ways to better deliver public service, including leveraging on ICT and leasing of assets and equipment and public private partnership. It will also develop and strictly enforce cost and standard benchmarks for service delivery, including infrastructure development.

14. The recurrent expenditure is reaching unsustainable levels, squeezing out resources meant for development. At over 12 percent of GDP, the wage bill is well above the internationally accepted standard of 7-8% and accounts for almost half of the revenue collected by Government. This is unsustainable and poses a serious threat to the funding of important development projects, and has the potential to severely affect the country's economic prospects. In addition, salary pressures will also impact on pensions, hence increasing the Government's contingent liability.

15. Over the medium term, government expenditure as a share of GDP will need to moderate so as to guard against accumulating large debt that will be burdensome to our future generation. Pursuing a sustainable level of debt is also vital as a means to provide room for the private sector to expand business and create the much needed jobs within an environment of low and stable inflation, interest rates and stable exchange rate.

16. Therefore, over the medium term, management of wage bill will be given careful attention with emphasis on the principle of moderation. In this regard, the Salaries and Remuneration Commission (SRC) will continue to set the salaries of state officers and recommend salaries of public officers that will ensure fiscal sustainability, among other key public finance principles. All arms of Government must set the example and lead the way in bringing the wage bill to sustainable level.

Policies to reinvigorating growth and making it inclusive

17. The Government recognizes the importance of achieving durable broad-based growth. As such, it will accelerate export-led growth so as to expand the levels of employment and reduce poverty. Key initiatives include enhancing the competitiveness of the economy, accessing new and emerging markets, continued investment in infrastructure, enhanced regional integration, and targeted support for small and medium enterprises.

18. The Government will ensure that the gains from growth are widely distributed through well targeted social safety programme and sustainable employment in order to guarantee a lasting reduction in poverty and progress towards achieving the Millennium Development Goals (MDGs). While increased spending on social sectors such as education and health has supported inclusive growth over the recent past, more needs to be done.

19. With limited resources, the Government will be more efficient in order to make meaningful gains in poverty reduction. Thus, the fiscal framework outlined in this BPS requires greater fiscal discipline and alignment of resources and priorities. In particular, better control of expenditure and a clear focus on core mandates by government departments will be required. Thus, in preparing the 2013/14 Budget and medium term plan, ministries and departments are expected

to identify savings that will contribute to financing government's targeted outcomes, while ensuring adequate devolution of resources to county government levels in line with the Constitution.

20. The Government is committed to delivering public services in an open and accountable manner. Thus, it will work with the Judiciary in fast tracking and deepening the reforms that are in progress - to secure access to justice for all Kenyans and promote a society where every person enjoys equal protection of the law.

21. The Government is committed to ensuring that our citizens live and work in a secure environment. While the Government has decisively dealt with external threat to our citizens, there are still challenges in internal security. Thus, the Government will improve security at our frontiers including progressively improving the ratio of police to citizens across Kenya by bringing it closer to the recommended standard of one police officer for every 450 citizens. It will also put in place measures that will strengthen the police service including equipping police units in order to increase effectiveness and rapid response to incidents of crime. It will also work towards ensuring that the police welfare is protected.

22. Unemployment and idleness are breeding grounds for crime and alcohol and drug abuse. The Government will work to put measures in place to harness the time and talents of the youth in order to grow our economy. Thus, sufficient national resource will be set aside to ensure that the youth engage in income generating programmes including making funds easily accessible to citizens in all parts of the country under a better delivery mechanism. Success in this approach will form the basis for consolidating and harmonizing existing youth and women's funds.

23. In line with engaging the youth in productive activities, the Government will foster the sport and the entertainment sectors, including establishing a National Lottery scheme that will support them. In consultation with the county governments, the Government will support the building of sports stadia in main towns across the country.

24. On infrastructure, the Government will continue to prioritize investment in roads, energy, rails and ports to drive economic growth, job creation and deepen our links with our regional partners. In particular, transport plans include new mass transport and commuter networks in cities, and long distance connections to our regional neighbours, as well as improvements to local roads so that our people can move goods easily across the country. Also, the country needs more new housing to meet the current shortage. Plans are underway to construct 250,000 houses annually, up from the present 50,000.

25. The Government will ensure food security by investing in and modernizing the agricultural sector. Through improved financing, irrigation, research & development, and the return of extension services we will enable farmers to move from subsistence to commercial farming.

26. On human capital development, the Government is committed to ensuring the highest attainable standard of health. Policies will aim to ensure that all Kenyans have access to well-equipped health facilities and well trained and motivated health care workers, in addition to developing systems to support and expand health care and improved sanitation. Working with county governments the Government will progressively roll out free primary healthcare to every Kenyan by 2020, starting with children, persons with disability, pregnant women and breastfeeding mothers.

27. The Government will improve the link between education and employment driven by knowledge and technology. Measures to increase the number of institutes of technology in every county will be implemented, in addition to providing locally assembled free-laptops for standard one children starting 2014.

28. Other priorities include facilitating devolution, improving access to clean water and electricity, and adequate allocation to programmes that will deal with drought and floods.

29. The overriding policy thrust for 2013 Budget Policy Statement, therefore, is to accelerate economic growth through sustained macroeconomic stability and focusing on policies and structural reforms outlined above. These initiatives will happen within a disciplined spending path financed through a fiscal deficit (including grants) of 4.6 percent of GDP in 2013/14, moderating to 3.9 percent by 2015/16. Fiscal adjustment will be accompanied by shifts in the composition of public expenditure towards investment and economic development. Measures to strengthen public financial management and modernize and simplify the tax system will be implemented. In addition, the Government will continue to put in place measures to increase access to financial services while ensuring adequate supervision of banks, improve the operating environment for business to flourish, as well as enhanced security and enforcement of the rule of law and order.

Institutional reforms

30. So far, the institutional framework built on the foundation of our new Constitution has proven resilient and capable of mediating the challenges that arise from competition for political power. We have just come through successful general elections that were conducted peacefully and differences resolved constitutionally—thanks to the judiciary reforms built on our new legal framework.

31. Going forward, the President has laid a sound legislative agenda aimed at speedily completing the unfinished business of implementing the Constitution as per the deadlines. As such, a number of legislation aimed at entrenching civil liberties, supporting county governments, enabling public participation in decision, and ensuring diversity and gender balance will be speedily submitted to Parliament.

32. The budget making process in both national and county governments has been strengthened with the implementation of the new Public finance Management (PFM) law, enacted in 2012. The law provide for transparent formulation of budgets and prudent management of public resources, in addition to enhancing the contribution of Parliament to public finance management. Building on this legal framework, the National Treasury will shortly be submitting to Parliament the regulations to ensure effective implementation of the PFM Act.

33. Preparation of this budget policy statement is part of the institutional reforms entrenched in the PFM Act so as to ensure adherence to the principles of public finance outlined in Chapter 12 of the Constitution. The information provided here is to ensure that the processes of budget making are transparent and are consistent with prevailing economic situation and outlook, in addition to ensuring that the policy priorities of the Government are financeable within a sustainable fiscal framework.

34. Finally, aware that corruption limits access to much needed services, stifles efficiency and eats away at public values, and makes our country less attractive as an investment destination, the Government will act swiftly to end the scourge of corruption. In addition, measures will be taken to combat waste and inefficiency as well as reform procurement systems to enhance value for money.

Outline of the 2013 Budget Policy Statement

Recent economic developments and Outlook

35. The next section (II) outlines the economic context in which the 2013/14 MTEF budget is prepared. It provides an overview of the recent economic developments and the macroeconomic outlook covering the global and domestic scene. Overall, the macroeconomic environment has improved after the shocks in 2011, although risks still remain. This calls for caution in budgeting. Real GDP growth is estimated at 4.7 percent in 2012, up from 4.4 percent in 2011. Over the medium-term, growth is expected to pick gradually to over 6 percent, as global conditions improve and macroeconomic stability is sustained. Inflation is

expected to hover around the 5 percent target over the medium term, while interest rates and exchange rates are expected to remain stable.

Fiscal policy and budget framework

36. Section III outlines the fiscal framework that is supportive of the growth over the medium to long term, while continuing to provide adequate resources to facilitate transition to devolution and policy priorities of the new Government.

37. Due to revenue shortfalls and spending pressures from salary awards and security intervention in Somalia, the budget deficit increased in the current financial year. However, with improved revenue performance following tax reforms and moderation in spending, the fiscal position is expected to strengthen over the next three years with the budget deficit declining to about 3.9 percent in 2015/16. This will allow public debt to GDP to decline to below the 45 percent benchmark, by 2015/16.

Intergovernmental fiscal relations and Division of Revenue

38. The 2013/14 Budget will see full operation of the devolved system of governance following the just concluded general elections in March 2013. Section IV provides a framework of managing the transition to decentralised structure in line with the Constitution. The proposed division of revenue between national and county government as well as among counties is set out in this section.

Medium-Term Expenditure Framework

39. Section V presents the resource envelope and spending priorities for the proposed 2013/14 MTEF budget and the medium term. Sector achievements and priorities are also reviewed, along with indicative costing of the devolved functions for the 2013/14 MTEF period.

40. Overall, the ratio of Government spending to GDP will remain at around 30 percent over the MTEF period. Education, and Energy, Infrastructure and ICT sectors are the largest category of expenditure, followed by Governance, Justice, Law and Order, Public Administration and International Relations, and Health sectors. Defence expenditure has also risen recently with security intervention along the border and inside Somalia. On the non-discretionary category, debt servicing has been the fastest growing component of expenditure.

41. Section VI concludes.

Summary

42. This budget policy statement outlines the broad strategic macroeconomic issues and fiscal framework, together with a summary of government spending plans, as a basis of 2013/14 budget and medium-term. It also presents public investment strategy towards realizing the priorities outlined by the new Administration to be detailed in the next Second Medium Term Plan of Vision 2030. In this way, it contributes to improve understanding of Kenya's public finances and guide debate on economic and development matters.

II. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

Overview of recent economic performance

43. Economic growth was largely satisfactory in 2012, despite a somewhat stagnating demand for our exports in traditional markets. Favourable rains contributed to good harvests and hydropower generation and private sector activities benefited from improved macroeconomic environment. Inflation has declined steadily from double digits to below the 5 percent target in recent months. Short term interest rates have also eased in line with the drop in inflation, while the shilling exchange rate has stabilized against major currencies.

Growth remain resilient

44. Real GDP growth is estimated at 4.7-5 percent in 2012, up from 4.4 percent in 2011 (Chart 2.1). The improved growth benefited from better than expected rains, which contributed to good harvests and hydropower generation, as well as increased demand of exports in new markets. Growth would have been stronger were it not for the suppressed activities in some sectors of the economy due to tight credit conditions and lacklustre demand of Kenya's exports in the European market.

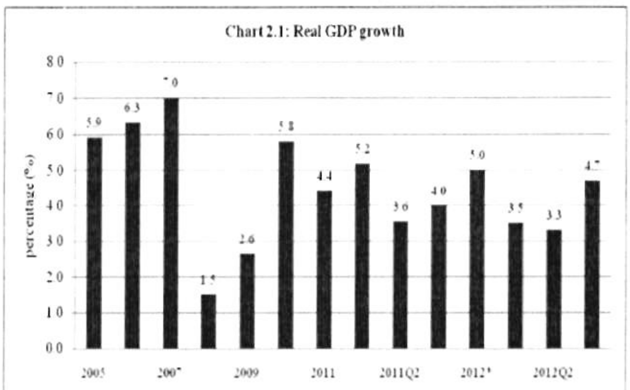


Chart 2.1: Real GDP growth

45. All sectors of the economy are expected to register positive growth. Electricity and water, agriculture, financial intermediation and wholesale and retail trade posted strong growth while performance in other sectors was moderate.

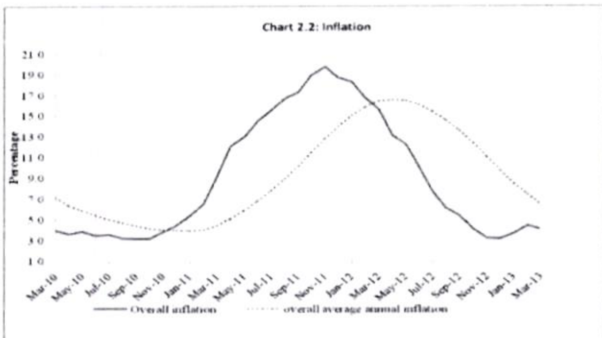
46. Recovery in agricultural production followed favourable weather conditions (adequate rain). Favourable weather also boosted hydroelectric power thus improving value added in electricity industry. Other sectors benefited from increased domestic demand in the run-up to the general elections and somewhat improved credit access with easing of interest rates. In addition, inflationary

47. Expectations were subdued helping to stabilize the shilling exchange rate and sustaining investor confidence.

48. The pace of current growth is, however, still well below the target of Vision 2030 of 10 percent necessary to draw more Kenyans into employment and reduce poverty significantly. Accelerating growth requires scaling up both public and private investment to raise Kenya's economic competitiveness and create more employment opportunities for all Kenyans.

Inflation has dropped consistently over the last one year

49. Overall inflation fell from a peak of 19.7 percent in November 2011 to 3.7 percent in January 2013. By February 2013, inflation had edged up slightly to 4.4 percent before easing again to 4.1 percent in March (Chart 2.2). The average inflation for 2012 was 9.6 percent, down from 14.0 percent in 2011.

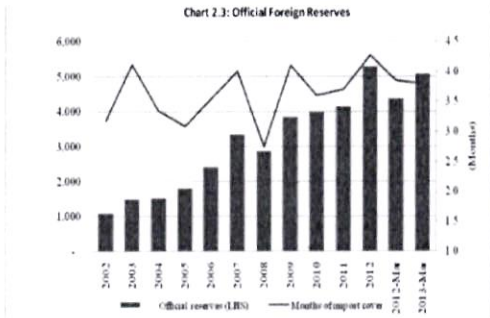


50. The fall in inflation largely reflected a drop in food inflation. Favourable weather condition with adequate rain resulted in increased food supplies and use of hydro generated electricity. This had the effect of suppressing food and electricity prices A stable exchange rate coupled with stable international commodity prices over the recent months has also supported low inflation with less pass-through from import prices.

51. Going forward, we expect inflation to remain within the 5 percent target in the months ahead with appropriate monetary policy, barring any effects from the external shocks such as a surge in commodity prices. The risk to this outlook is the international oil market that still remains volatile due to tensions in the Middle East that could lead to oil supply disruptions.

The external payments position has strengthened

52. Following improvement in the external payments position, official foreign exchange reserves held by the Central Bank of Kenya rose by about 30 percent to over US$ 5 billion (about 4 months of import cover) by the end of December 2012, from US$ 4.1 billion (or 3.6 months of import cover) in a similar period in 2011 (Chart 2.3). By March 2013, foreign



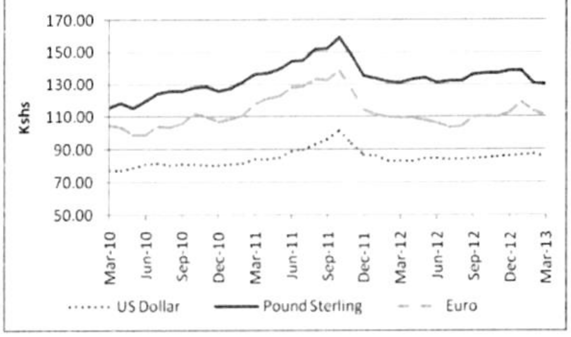
exchange reserves continued to remain at conformable level, despite interventions from the CBK in the foreign exchange market.

53. The deficit in the current account was more than offset by the surplus in the capital and financial account, resulting in a surplus in the overall balance of payment in 2012, a turnaround from a deficit recorded in 2011. The improvement in capital and financial account surplus is attributed to the increase in official medium and long term loans as well as increased foreign direct investments.

The exchange rate has generally stabilized

54. As a result of the increase in official foreign reserves, the shilling exchange rate against major international currencies has generally stabilised over the recent months after the sharp weakening in late 2011 (Chart 2.4).

Chart 2.4: Exchange Rate (Ksh/Foreign Currency)

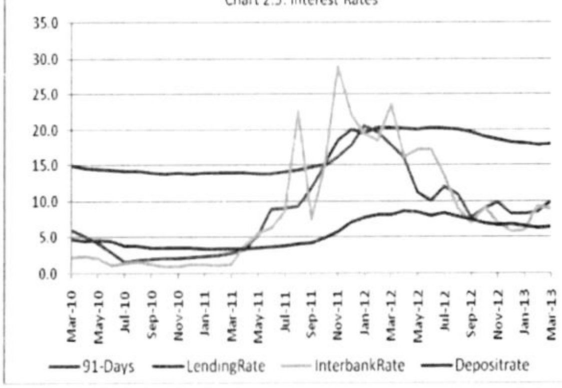


55. In December 2012, the shilling exchanged at KSh 86.0 against the US dollar, KSh.138.8 against the Pound Sterling, and KSh. 112.8 against the Euro, compared with KSh 86.7, KSh 135.1 and KSh114.1 respectively, in December 2011. By March 2013, the shilling had gained further to trade at Ksh 85 per US dollar. The strengthening of the shilling against major international currencies reflects increased capital flows, easing oil prices, and reduced inflationary expectations following the tightening of monetary policy.

Interest rates have eased significantly in line with the drop in inflation

56. The interbank interest rates eased to single digits in recent months from an all-time high of about 30 percent in the last quarter of 2011. The drop in short-term interest rate reflects subdued inflationary expectation and ample liquidity in the financial system. Similarly, the 91-day Treasury bill rates have also dropped from 17.9 percent in December 2011 to 8-9 percent in March 2013 (Chart 2.5).

Chart 2.5: Interest Rates



57. Recent downwards adjustment of the CBK policy rate from 18 percent in November 2011 to 16.5

percent in July 2012, 13 percent in September, 11 percent in November 2012 and further to 9.5 percent in January 2013 has led to reduction in short term interest rates. Commercial banks' lending rates, which had remained high at around 18-20 percent have started easing in recent months. Lending rates had remained sticky downwards due to the high cost of deposits that were locked in by banks during the period of tight liquidity in late 2011. Meanwhile, reflecting the stable liquidity conditions the government borrowing programme has progressed as planned with the cost declining as evidenced by the sharp fall in Treasury bill rates.

58. Activity in the stock market has been vibrant in the year to December 2012. The NSE share index has improved from 3,225 points in January 2012 to 4,417 points January 2013, representing an increase of 36.9 percent. This recent developments indicate improved performance in most of the market indices following return to macroeconomic stability.

Fiscal performance and emerging challenges

2012/13 Budget

59. The macroeconomic assumptions underlying the 2012/13 budget were detailed in the 2012 BPS. The budget assumed continued economic growth and stable macroeconomic environment. In addition, the financial objectives were aimed at containing non-priority and unproductive recurrent expenditure so as to bring the budget deficit down and ensure sustainable public debt.

60. Parliament approved the 2012/13 budget with expenditures amounting to KSh. 1,263.3 billion, comprising of recurrent expenditure of KSh. 805.3 billion, development expenditures of KSh. 447.0 billion, a contingency fund of KSh 5.0 billion, implementation of the Constitution of KSh 3 billion, and KSh 3 billion for Equalization Fund. These expenditures are expected to be financed by total revenue (including A-I-A) amounting to KSh. 955.0 billion, use of LATF funds carried forward from previous years of Ksh 1.3 billion, donor grants of KSh. 56.2 billion, net foreign financing of KSh. 144.1 billion, and domestic borrowing of KSh.106.7 billion.

Implementation progress and emerging fiscal challenges

61. Implementation of the FY 2012/13 budget begun at a slow pace in the early months of the financial year following transition to the new IFMIS platform but subsequently picked up well. Fiscal outcome for the first eight months of the financial year was generally satisfactory, but revenue shortfalls continue to persist amid rising expenditure pressures.

62. Expenditure pressures relate to general elections and salary demands from the health, education and police personnel, in addition to continuing security interventions in the country and Somalia. These raised the recurrent expenditure budget by about Kshs. 50 billion with teachers' salaries and defence taking about Kshs. 30 billion and Kshs. 6 billion, respectively. Expenditure pressures presented a high risks to the stability of the budget for 2012/13 in the face of resource requirements for the implementation of the decentralized governance system.

63. Table 2.1 provides the cumulative budget out-turn for the first eight months of the FY 2012/13 budget. Revenues shortfall has persisted, with cumulative revenue receipts amounting to KSh. 503.2 billion against a target of KSh. 585.9 billion, an underperformance of KSh. 82.7 billion. The shortfall was in respect of KSh. 66.7 billion in ordinary revenue and KSh. 16.0 billion in Appropriations–in–Aid (A-I-A). All major tax heads particularly VAT underperformed. The shortfall in A-i-A partly reflected underreporting by line ministries.

Table 2.1 Cummulative Budget Outturn for FY 2012/13 (Ksh billion)

	July'12-February'13			Jun-13		
	Target	Actual*	Dev.	Budget	Revised	Percent of June'13 Rev. Forecast
TOTAL REVENUE	**585,915**	**503,170**	***(82,745)***	**955,028**	**932,356**	***54.0%***
Ordinary revenue	**540,058**	**473,286**	***(66,771)***	**870,187**	**842,567**	***56.2%***
Taxes on Intl. Trade & Transactions (Import Duty)	44,270	37,906	*(6,364)*	67,384	61,484	*61.7%*
Excise Taxes	59,047	56,523	*(2,524)*	91,910	91,810	*61.6%*
Taxes on Income, Profits & Capital gains (Income Tax)	229,201	214,701	*(14,500)*	383,456	370,600	*57.9%*
Taxes on goods and services (VAT)	149,780	119,700	*(30,080)*	231,523	216,000	*55.4%*
Other Revenue	57,761	44,456	*(13,304)*	95,914	102,673	*43.3%*
Ministerial Appropriation in Aid	**45,858**	**29,884**	***(15,974)***	**84,841**	**89,789**	***33.3%***
TOTAL EXPENDITURE AND NET LENDING	**805,735**	**662,742**	***(142,993)***	**1,263,323**	**1,313,045**	***50.5%***
Recurrent	**521,827**	**501,040**	***(20,787)***	**802,645**	**854,541**	***58.6%***
of which:						
Interest payments	68,655	78,940	*10,285*	105,849	105,849	*74.6%*
Pensions etc	28,677	19,510	*(9,167)*	41,012	41,012	*47.6%*
Wages & Salaries	174,267	184,484	*10,217*	261,400	292,239	*63.1%*
Development	**281,408**	**161,702**	***(119,706)***	**455,678**	**443,721**	***36.4%***
of which:			*0*			
Domestically Financed (Gross)	140,576	113,349	*(27,228)*	227,259	207,799	*54.5%*
Foreign Financed	139,568	47,090	*(92,478)*	225,966	233,468	*20.2%*
Net Lending	1,264	1,264	*0*	2,453	2,453	*51.5%*
CCF	**2,500**	**0**	***(2,500)***	**5,000**	**5,000**	***0.0%***
OVERAL BALANCE (excl. grant)	**(219,819)**	**(159,572)**	***60,248***	**(308,295)**	**(380,689)**	***41.9%***
GRANTS	**32,741**	**11,094**	***(21,647)***	**56,175**	**56,473**	***19.6%***
BALANCE INCLUSIVE OF GRANTS	**(187,078)**	**(148,478)**	***38,600***	**(252,120)**	**(324,216)**	***45.8%***
Adjustments to cash basis	*1,318*	*0*	*(1,318)*	*1,318*	*1,318*	0.0%
BALANCE INCLUSIVE OF GRANTS (CASH BASIS)	(185,760)	(148,478)	*37,282*	(250,802)	(322,898)	*46.0%*
TOTAL FINANCING	185,760	143,955	*(41,805)*	250,802	322,898	*44.6%*
NET FOREIGN FINANCING	89,684	18,854	*(70,830)*	144,062	157,898	*11.9%*
NET DOMESTIC FINANCING	96,077	125,101	*29,025*	106,740	165,000	*75.8%*
Discrepancy	*0*	*4,522*	*4,522*	*0*	*0*	

*Preliminary

Source: National Treasury

64. Expenditure execution lagged behind but the pace of execution was higher than last year. Total expenditure (based on disbursement) amounted to

KSh. 662.7 billion against a target of KSh. 805.7 billion. This reflected an overall under-spending of KSh. 143 billion, of which KSh. 20.8 billion was in respect of recurrent expenditure and KSh. 119.7 billion was in respect of development expenditure. Most of the under-execution in development expenditures was in respected to those financed through foreign resources, which were below target by KSh. 92.5 billion.

65. A large part of the deficit was financed through domestic sources with cumulative domestic borrowing as at end of February 2013 surpassing the target by KSh. 29.0 billion to stand at KSh. 125.1 billion compared to the target of KSh. 96.1 billion.

66. To confront the challenges of revenue shortfall and expenditure pressures, the Government has stepped up efforts in tax administration and mobilization of revenue to eliminate leakages and increase revenue collection as targeted in the FY 2012/13. We have also rationalized expenditures so as to live within the fiscal framework.

67. A revised budget for 2012/13 was approved by Parliament in January 2013. We have accommodated wage increases for doctors, nurses, teachers, and lecturers, while reprioritizing expenditures and preserving the expanded coverage of the social safety nets and allocation for implementation of devolution. The Government will take additional measures including further adjustments to the budget considering that the revenue shortfall that is expected to the entire financial year.

Macroeconomic policies and outlook

External environment

68. According to the IMF latest World Economic Outlook released in April 2013, global economic prospects have somewhat improved again but the road to recovery in the advanced economies will remain bumpy. World output growth is forecast to reach 3¼ percent in 2013 and 4 percent in 2014 (Table 2.2).

69. In advanced economies, activity is expected to gradually accelerate, starting in the second half of 2013. The projections are based on the assumption that policy makers in Europe will adopt policies that would gradually ease financial constraints in periphery economies such as Greece and that the USA would carefully manage fiscal policy in order to avoid major cutback in spending that would disrupt the economy.

Table 2.2: Annual percentage change in GDP and CPI for selected regions/countries, 2011 – 2014								
	2011	2012	2013	2014	2011	2012	2013	2014
Region/Country	**Actual**		**GDP Proj.**		**Actual**		**CPI Proj.**	
World	**3.9**	3.2	**3.3**	**4.0**				
Advanced Economies	**1.6**	**1.2**	**1.4**	**2.2**	**2.7**	**2.0**	**1.7**	**2.0**
USA	1.8	2.2	1.9	3.0	3.1	2.0	1.8	1.7
Euro Area	1.4	−0.6	-0.3	1.1	2.7	2.5	1.7	1.5
Japan	−0.6	2	1.6	1.4	-0.3	0.0	0.1	3.0
UK	0.9	0.2	0.7	1.5	4.5	2.8	2.7	2.5
Emerging & Developing Economies	**6.3**	**5.1**	**5.3**	**5.7**	**7.2**	**5.9**	**5.6**	**4.8**
Developing Asia	**8.1**	**6.6**	**7.1**	**7.3**	**6.4**	**4.5**	**5.0**	**5.0**
China	9.3	7.8	8.0	8.2	5.4	2.6	3.0	3.0
India	7.7	4	5.7	6.2	8.9	9.3	10.8	10.7
MENA	**3.9**	**4.7**	**3.1**	**3.7**	**9.7**	**10.7**	**9.4**	**9.0**
Sub-Saharan Africa	**5.3**	**4.8**	**5.6**	**6.1**	**9.3**	**9.1**	**7.2**	**6.3**
South Africa	3.5	2.5	2.8	3.3	5.0	5.7	5.8	5.5
Kenya***	4.4	4.7	5.8	6.2	14.0	9.4	7.9	5.0
Tanzania	6.4	6.9	7.0	7.2	12.7	16.0	9.0	5.9
Uganda	6.7	2.6	4.8	6.2	18.7	14.1	5.5	5.0

Source: IMF World Economic Outlook, April 2013

70. In emerging market and developing economies, activity has already picked up steam. Developing Asia comprising of China and India are expected to grow by 7.1 percent and 7.3 percent, respectively, for 2013 and 2014, while the sub-Saharan region is expected to expand by 5.6 percent in 2013 and 6.1percent in 2014. Real GDP growth in Latin America is projected at 3.0 percent in 2012.

71. Kenya is well integrated with the world economy and any favourable developments are likely to impact positively on our growth prospects. Thus, the somewhat expected improved external environment could potentially have a positive impact on the demand for our exports such as horticulture and tourism. This together with the strong growth in the sub-region bodes well for accelerated growth prospects in Kenya.

Growth prospects

72. While there is renewed optimism in the global arena, the macroeconomic framework underpinning this 2013 BPS is cautious given the high uncertainties in the global projections witnessed over the recent years. In addition, we face daunting domestic reform challenges, including managing the challenges that come with a devolved system of governance. Nonetheless, with the continued favourable weather conditions and completion of key infrastructure projects in

the roads and energy sub-sectors, the domestic economic prospects remain sanguine, but with downside risks.

73. Real GDP is expected to grow by 5.6 percent in 2013, up from about 4.7 percent in 2012. Over the medium term, growth is expected to pick up to over 6 percent. In terms of fiscal years, the projections translate to 5.9 percent for 2013/14, 6.3 percent for 2014/15 and 6.6 percent for 2015/16 (Table 2.3).

Table 2.3: Macroeconomic indicators underlying the Medium Term Fiscal Framework, 2011/12-2015/16

	2011/12	2012/13	2013/14	2014/15	2015/16
	Prov.	Proj.		*Projection*	
	Annual percentage change				
National account and prices					
Real GDP	4.5	5.1	5.9	6.3	6.6
GDP deflator	11.1	7.4	7.4	7.9	7.7
CPI Index (eop)	10.1	6.3	6.4	6.0	5.5
CPI Index (avg)	16.1	5.9	6.7	6.2	5.8
Terms of trade (-deterioration)	3.0	5.7	1.0	4.3	5.4
	In percentage of GDP				
Investment and saving					
Investment	20.2	21.9	23.9	24.9	25.4
Gross National Saving	8.8	10.9	13.5	15.6	17.7
Central government budget					
Total revenue	23.1	23.7	23.7	23.8	24.0
Total expenditure and net lending	29.2	32.6	30.1	29.5	29.3
Overall balance (commitment basis) excl. grants	-6.2	-8.9	-6.4	-5.6	-5.3
Overall balance (commitment basis) incl. grants	-5.5	-6.8	-4.7	-4.0	-3.7
Nominal public debt, net	45.7	47.4	45.8	44.2	42.2
External sector					
Current external balance, including official transfers	-11.4	-11.0	-10.5	-9.2	-7.7
Gross international reserve coverage in months of imports	3.7	3.7	3.8	3.9	4.1

Source: National Treasury

74. Growth will be bolstered by production in agriculture following expected receipt of adequate rain, initiatives to revamp irrigation schemes, completion of key infrastructure projects (such as roads and energy), further structural reforms especially those targeted toward improving competitiveness of private sector and promoting overall productivity in the economy, and exports that are expected to continue to benefit from the relatively strong growth in the sub region. Finally, domestic demand is expected to be robust following a drop in inflation, and increased investor confidence following the successful general elections.

75. As indicated earlier, the new Administration will continue with strategic interventions to accelerate growth, improve competitiveness and promote exports. Specifically, the following strategies will be implemented:

- ***Continuing investment in infrastructure***: Over the recent past, the Government has provided significant resources in the energy, roads, rail, telecommunications and water sub-sectors to ease bottlenecks and reduce costs of doing business, while improving access to export markets.

Investment in key infrastructure projects will be continued as they are vital for achieving our national development objectives of higher growth, employment creation and poverty reduction. With the new Public Private Partnerships legislation, private-sector participation is expected to increase in these sectors.

- ***Addressing the root causes of weak competitiveness:*** Specific policies will include maintaining the cost of food items and other goods consumed by wage earners at competitive rates through greater productivity; reducing the cost of fuel pump price through measures to reduce the cost of supply and distribution chain of fuel including the refinery system; reducing transport and distribution cost through better transport and digital infrastructure and logistics, especially with completion of upgrading of the road network system; providing more competitive power rates through reducing use of thermal power and other energy sector reforms; enhancing employees skills and knowledge base to increase productivity; and addressing corruption and simplifying business procedures.

- ***Supporting small and medium enterprises (SMEs) and agribusiness***: To address unemployment and promote regional development including reducing rural poverty, reforms and introduction of better delivery mechanism of the existing programmes such as Youth Fund, Women Fund, SMEs Fund, and AGRIBUSINESS Fund will be instituted to enhance credit to small scale enterprises, technology and marketing information.

- ***Supporting manufacturing:*** To accelerate growth, investment and employment, incentives will focus on industries that are labour intensive, with the potential to export, join global supply chains and become competitive logistics hubs.

- ***Maximizing the use of the country's natural resources***: Consideration will be given to wealth creating projects in mining and exploration and exploitation of natural resources. In addition, the government will maximize on the geographical competitive advantage through modernizing the Port of Mombasa and expansion of Jomo Kenyatta International Airport to serve as the regional hub.

- ***Deepening regional integration***: While significant progress in integration has been achieved under the East Africa Community, there is much potential for expanded trade and investment in the COMESA and the rest of Africa. The Government will continue with collaborative infrastructure investment, and removing inefficient customs procedures including complicated rules of origin and other non-tariff barriers, in line with the existing Protocols.

76. Taking into account limited public resources, the Government will deepen its reform agenda aimed at enhancing the role of the private sector as the main driver of Kenya's economy and sustainable development. These calls for faster implementation of the privatization program (disposal of nonstrategic public enterprises); provide for private sector participation in infrastructure development; promote appropriate regulation of private sector activity; and provide for greater private sector access to finance. All this will require sustaining macroeconomic stability, implementation of a robust private sector development strategy, deeper structural reforms, and improvements in enabling legislations.

77. Apart from providing an appropriate environment for businesses to thrive, sustaining growth requires us to continue building transparent, responsive, accountable, efficient and effective national and county governments.

78. Equally important is the need to ensure that the gains from growth are widely distributed through sustainable employment in order to guarantee durable reduction in poverty. Therefore measures to address socio-economic inequities, improve the country's human capital, inculcate national cohesion for durable stability and prosperity, and increase devolution of resources to local levels in line with the Constitution will need to be implemented. In addition, the socio-economic priority programs articulated in the new Administration's growth agenda will be crucial to complement these measures.

79. Appropriate macroeconomic policies should ensure delivery of low inflation around the 5 percent target, while ensuring continued stability in long-term interest rates. This is based on the expectation that international oil prices will continue to remain stable and weather conditions will also remain favourable.

80. Whereas the projected growth is still below the target envisioned in Vision 2030 needed to increase labour absorption and reduce poverty, the Government recognizes that further up scaling would require mobilizing larger amounts of resources, raising factor productivity, and moving to a higher value-added and more efficient production structure to increase export growth. While these reforms are underway it is expected that it will take time before translating to higher growth.

External current account

81. Owing to continued public investments, the external current account deficit is projected to decline only gradually to 7.7 percent of GDP by 2015/16 from the current level of 8-11 percent of GDP. Export receipts are expected to recover with measures to boost exports as import bill stabilizes with stable international oil prices and reduced food imports.

82. The government has built up adequate foreign exchange reserves to cushion itself from external vulnerabilities including high oil prices and drought. As the balance of payments position improves in the medium term with strong capital inflows arising from improvement in investor sentiment and higher receipts from export services, the Government will continue to gradually build foreign exchange reserves up to about 4.5 months of import cover by 2015/16.

Risk to the outlook

83. The risk to the outlook for 2013/14 and medium-term include further weakening in global economic growth and unfavourable weather conditions should there be a dry spell in 2013 and beyond. Also, reversal in the current easing of international oil prices may fuel inflation and weaken growth. Finally, poor transition to a decentralized system of government could weaken investor confidence and slow down growth. However, the Government will remain alert and ready to undertake appropriate measures to safeguard macroeconomic stability and critical development spending.

Summary

84. The current economic conditions call for caution in fiscal dispensation. While the economy remains resilient and the macroeconomic environment has improved significantly, current growth rates are not fast enough to support the employment creation and poverty reduction that the country requires. Therefore, there is need to pursue deeper structural reforms to accelerate growth and translate the gains into more jobs.

85. Looking ahead, the world economy is recovering though the road to recovery in the advanced economies remains bumpy. Kenya's economic growth also remains resilient, and is expected to pick up over the medium term. Sustaining macroeconomic stability will be critical to supporting growth. This should be complemented with deeper structural reforms to strengthen the economy's resilience and raise growth to a higher trajectory while ensuring that the benefits of growth are shared by all Kenyans.

III. FISCAL POLICY AND BUDGET FRAMEWORK

Overview

86. The 2013 Medium-Term Fiscal Framework aims at striking an appropriate balance between support for growth and continued fiscal consolidation, while providing room for implementation of the Constitution and decentralization. It also continues with prudent fiscal policy to reinforce Government's commitment to debt sustainability over the medium to long term. Specifically, the 2013 Budget Policy Statement emphasizes:

- fiscal consolidation that started in 2010/11 budget, while at the same time ensuring that the level of expenditure is adequate to sustain growth through continued public investment in infrastructure; the overall budget deficit is expected to ease to 4.7 percent in 2013/14, and further to 3.7 per cent by 2015/16;

- efficiency and improving the productivity of expenditure while at the same time ensuring that adequate resources are available for operations and maintenance, and implementation of the Constitution and devolved system of governance; and

- bringing down the ratio of public debt to GDP to around 42 percent, well below the benchmark of 45 percent, through a moderation and efficiency in spending as well as improved tax performance following reforms in expenditure management and tax legislations. The sustained easing of debt to GDP ratio will provide the Government with room to conduct countercyclical fiscal policy should the economic situation worsen in the future.

Continuing with prudent fiscal policy

87. Fiscal policy will continue to support economic activity while allowing implementation of the new Constitution within a context of sustainable public financing. Over the recent years, the Government has reoriented expenditure towards priority programmes in education, health, agriculture and infrastructure under the medium-term expenditure framework (MTEF). This process will be strengthened with a revamped legislative framework to enable accommodation of critical programmes that will accelerate socio-economic development. The overall fiscal balance (after grants) is projected to decline from 6.8 percent of GDP in 2011/12 to a sustainable level of about 3.7 percent of GDP over the medium term. This will allow public debt to decline gradually from about 44.3

percent of GDP in June 2012 to about 42.2 percent of GDP by 2015/16 (Table 3.1).

Table 3.1: Central Government Fiscal Projections, 2011/12-2015/16

	2011/12	2012/13			2013/14		2014/15		2015/16
	Prov.	*BPS'12*	*Budget*	*BPS'13*	*BPS'12*	*BPS'13*	*BPS'12*	*BPS'13*	*BPS'13*
Revenue and Grants	763.5	984.7	1,011.2	942.2	1,119.5	1,054.8	1,265.6	1,214.3	1,398.8
% of GDP	*23.5%*	*25.5%*	*26.2%*	*25.7%*	*25.5%*	*25.3%*	*25.7%*	*25.4%*	*25.5%*
Revenue	748.2	936.5	939.3	866.8	1,071.2	987.3	1,209.2	1,138.6	1,313.7
% of GDP	*23.1%*	*24.2%*	*24.3%*	*23.7%*	*24.4%*	*23.7%*	*24.6%*	*23.8%*	*24.0%*
Tax Revenue	639.3	780.8	794.5	724.5	895.9	839.5	1,013.3	969.5	1,120.5
Non-Tax Revenue	108.9	155.6	144.9	142.3	175.3	147.9	195.9	169.2	193.2
Grants	15.3	48.3	71.9	75.4	48.4	67.4	56.4	75.7	85.1
Expenditure	947.8	1,148.5	1,263.3	1,194.4	1,286.2	1,252.2	1,437.3	1,407.4	1,603.9
% of GDP	*29.2%*	*29.7%*	*32.7%*	*32.6%*	*29.3%*	*30.1%*	*29.2%*	*29.5%*	*29.3%*
Recurrent	647.1	778.3	816.3	879.6	858.9	867.0	943.8	925.4	1,065.0
Development	300.7	370.2	447.0	314.8	427.3	385.2	493.5	482.0	538.9
Budget Balance (-Deficit, +surplus)	(184.3)	(163.8)	(252.1)	(252.2)	(166.6)	(197.4)	(171.7)	(193.1)	(205.1)
% of GDP	*-5.7%*	*-4.2%*	*-6.5%*	*-6.9%*	*-3.8%*	*-4.7%*	*-3.5%*	*-4.0%*	*-3.7%*
Net External Financing	98.5	60.7	144.1	17.1	52.6	90.8	96.9	100.7	122.7
Disbursements/loans	123.9	88.9	170.3	44.1	138.8	176.0	133.2	131.6	153.9
Repayment due	(25.4)	(28.2)	(26.2)	(26.9)	(86.2)	(85.3)	(36.3)	(31.0)	(31.2)
Domestic borrowing	63.4	106.7	106.7	164.9	114.1	106.7	74.8	92.5	82.5
% of GDP	*2.0%*	*2.8%*	*2.8%*	*4.5%*	*2.6%*	*2.6%*	*1.5%*	*1.9%*	*1.5%*
Public Debt to GDP (net of deposits)	*44.3%*	*47.2%*	*45.7%*	*47.4%*	*47.2%*	*45.8%*	*47.9%*	*44.2%*	*42.2%*
Nominal GDP (Ksh billion)	3,244.5	3,866.5	3,866.5	3,662.6	4,382.5	4,164.6	4,916.4	4,775.3	5,480.5

Source: National Treasury

Observing fiscal responsibility principles

88. The Government recognizes that the fiscal stance it takes today will have implications into the future. Therefore, and in line with the Constitution and the Public Finance Management (PFM) Act of 2012, the principle of sharing the burdens and benefits of the use of resources and public borrowing between the present and future generation implies that we have to make prudent policy decisions today so that we do not impose unwarranted debt burden to our future generations.

89. In this regard, the Government will observe the fiscal rules set out in the PFM law so as to entrench fiscal discipline.

90. Fiscal responsibility has become even more important since the Constitution requires the Government to progressively provide for a minimum basic standard of economic and social rights to its citizens within available resources. In order for spending to increase on a sustainable basis to meet these basic needs, we should be prepared to match the increased expenditure demands with a corresponding increase in tax revenue yield through efficient collection, widening of tax bases, and reasonable tax rates. It is therefore imperative to reform and modernize the tax regimes to ensure stability of revenue effort, while at the same time continuing to restructure expenditure systems to ensure efficiency and create fiscal space required to fund these basic needs expenditures on sustainable basis.