REPUBLIC OF KENYA

PARLIAMENTARY BUDGET OFFICE

UNPACKING OF THE BUDGET POLICY STATEMENT FOR FINANCIAL YEAR 2025/2026 AND THE MEDIUM TERM

March 2025

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SUMMARY OF KEY ISSUES IN THE 2025 BUDGET POLICY STATEMENT

Macroeconomic and Fiscal Outlook

1. **Economic Growth:** The National Treasury projects that the economy will grow by 5.3 per cent in 2025 compared to 4.6 per cent projected in 2024. The agriculture sector is expected to be supported by favourable weather and implementation of BETA priority value chains; the services sector by investments in the ICT sector and government interventions to boost tourism and the industry sector by the anticipated reduction in production costs and initiatives to support value addition. However, given the slow implementation of key BETA priorities, limited fiscal space for public investments, slowdown in private sector activities, and vulnerability of the agriculture sector this growth projection may not be tenable. Consequently, PBO projects a more modest economic growth rate of 4.8 per cent for 2025.
2. **Inflation**: The BPS posits that overall inflation is expected to remain within the target range of 5±2.5 per cent supported by low food and fuel inflation. However, it is noteworthy that the cooling effect has largely been attributed to externalities such as favourable weather conditions and declining crude oil prices globally. Indeed, core inflation, which excludes volatile items like food and fuel remained elevated, surpassing the headline inflation since October 2024 signifying increasing production costs for goods and services other than food and fuel. The risk of inflation therefore remains elevated due to climate change-related shocks, spikes in global fuel prices, and disruptions in trade and global supply chains.
3. **Employment**: The proposed interventions under the MTP IV were envisaged to create approximately 1.2 million jobs per annum. While total employment increased from 18.1 million to 20 million between 2019 and 2023, there is a notable decline in the growth rate of employment from 4.9 per cent to 4.4 per cent over the same period. This is compounded by the fact that between 2020 and 2023, the combined real wages for both the private and public sectors decreased by 10.7 per cent. Annual average real wages in the private sector have reduced by 8.4 percent while that of the public sector have reduced by 15.8 per cent.
4. **Monetary Developments**: Despite the decline in interest rates due to monetary policy easing, credit to the private sector has largely contracted. Growth in total credit significantly declined from 14.4 percent in November 2023 to 4.6 percent in November 2024. The decline in growth was due to the deceleration of credit to the private sector from 13.2 percent to −1.1 percent in the same period. However, credit to the government grew from 14.4 percent to 16.6 percent posing the risk of crowding out the private sector. The low interest rates and private sector activity may trigger capital outflow as economic agents anticipate low returns.
5. **External Sector**: The BPS highlights that the current account deficit has improved from 4.4 percent of GDP in December 2023 to 3.6 percent of GDP in 2024. However, it is important to note that the decline is partly attributable to a slowdown in imports due to muted demand by households and businesses because of declining purchasing power and investment capacity and not necessarily on account of improved exports. This implies the need to relook at the export promotion strategy to enhance competitiveness and access to markets, especially in view of existing trade agreements such as the AfCFTA and Kenya EU EPA.
6. **Revenue Performance**: The financing of the budget is premised on the assumption that the total revenue including A-i-A is projected at 17.6 percent of GDP in both FY 2024/25 and FY 2025/26 before rising to 18.1 percent of GDP over the medium term. However, total revenue as a share of GDP has reduced from 17.3 percent in FY 2021/22 to 17.1 percent in FY 2023/24 with ordinary revenue reducing from 15.1 percent to 14.5 percent over the same period. Additionally, total revenue fell short of the target by Kshs. 107.7 billion in the first half of 2024/25 FY. This implies that both the baseline and projected revenue targets may not be achieved resulting in either reduction in expenditure or additional borrowing.

SUMMARY OF KEY ISSUES IN THE 2025 BUDGET POLICY STATEMENT

7. **Revenue Mobilization**: The BPS proposes several initiatives to improve revenue collection, including implementing the National Tax Policy, the Medium-Term Revenue Strategy, strengthening tax administration, broadening the tax base, reducing tax expenditures, leveraging technology to modernize tax processes, closing revenue loopholes, and improving tax system efficiency. However, these proposals are not different from the previous policy instruments in previous policy statements, making it unlikely that the projected tax revenue targets attributed to the successful execution of these measures will be achieved. Furthermore, the National Treasury's inability to quantify the anticipated impact of each policy measure rendered it difficult to assess the success or failure of each proposed program.

8. **Fiscal Consolidation**: To foster fiscal consolidation, the BPS projects a decline in total expenditure from 22.8% of GDP in FY 2024/25 to 22.1% of GDP in FY 2025/26. The government's reprioritization and rationalization efforts have led to a reduction in overall expenditure and net lending from 24.6% in FY 2020/21 to 22.4% in FY 2034/24. However, this has come at the expense of development expenditure, which has decreased from 4.2% to 3.4% of GDP, and transfers to county governments, which have fallen from 2.8% to 2.4% of GDP. Recurrent expenditure as a share of GDP has slightly decreased from 16.7% to 16.6%, while interest payments on public debt have significantly risen from 4.5% to 5.2% of GDP. Reduction in development expenditure implies more stalled projects, higher pending bills, longer project gestation, reduction in public investments, and contraction of aggregate demand.

9. **Expenditure Management:** The BPS has proposed several measures and reforms aimed at containing expenditures over the medium term to enhance efficiency, transparency, and sustainability. The measure includes migration to a Treasury Single Account (TSA) to consolidate public funds, a transition to accrual accounting to improve financial reporting, and a zero-based budgeting approach to ensure more effective resource allocation. However, given the inertia in public sector reforms, successful implementation will require strong political will, institutional capacity, and strategic execution. As such, these measures may not yield an immediate outcome in FY 2025/26, and as a result, the current expenditure trend is expected to continue.

10. **Realism of Fiscal Deficit**: The fiscal deficit, including grants, is projected to reduce from 5.6 percent of GDP in FY 2023/24 to 4.3 percent of GDP in FY 2025/26 financial year. This reduction is predicated upon the successful implementation of revenue enhancement policies coupled with limiting expenditure growth. However, given the possibility of revenue underperformance and additional expenditures emanating from the sector ceilings, the actual deficit may be over 5 percent of GDP.

11. **The Debt Anchor**: The Country committed to achieving a debt anchor set at 55 percent of GDP in present value terms by 2029. The debt-stabilizing primary balance of 1.4 percent of GDP is required to maintain the 2024 debt-to-GDP ratio into 2025. This means that for the debt ratio to remain stable, the government needs to achieve a primary budget surplus equivalent to 1.4 percent of GDP. Therefore, the projected primary balance for 2025 of 0.4 percent of GDP is less than what is needed to stabilize the debt-to-GDP ratio.

12. **Financing the Fiscal Deficit**: To finance the fiscal deficit of Kshs. 831 billion, the National Treasury proposes to borrow Kshs. 684.2 billion from the domestic market and Kshs. 146.8 billion from external markets. The external borrowing projection is Kshs. 208.7 billion below the projection for FY 2024/25 and reflects a reduction in receipts from the IMF programme. The reduction in foreign borrowing is set to be matched by a Kshs. 271 billion increase in domestic borrowing in 2025/26 FY. The growth in domestic borrowing, which may be exacerbated by a larger-than-projected fiscal deficit, may result in crowding out lending to the private sector.

SUMMARY OF KEY ISSUES IN THE 2025 BUDGET POLICY STATEMENT

MTP IV Sector Priorities

Finance and Production Sector

13. **Agricultural Extension Services:** The BPS underscores the need for improved agricultural productivity through the structuring of various value chains, however, there is no concise policy pronouncement on the provision of extension services that play a crucial role in bridging the gap between research and practical application in farming. Without adequate funding, it becomes difficult for these services to reach farmers and provide them with the knowledge and technologies necessary to improve their productivity and sustainability.

14. **Value Chain Development:** The MTP IV is concise on the approach to value chain development as a crucial aspect of boosting agricultural productivity and improving the livelihoods of smallholder farmers. However, the BPS continues the traditional approach where interventions are designed in silos. For instance, most of the proposed interventions under various value chains are still stuck at the input supply level with no clear framework for production, value addition and marketing in a sustainable manner.

15. **County Aggregation and Industrial Parks:** These were envisioned as strategic initiatives aimed at boosting the manufacturing sector through enhanced agricultural productivity and agro-processing. The goal was to create a network of industrial parks across the 47 counties to promote value addition, processing, and market access for agricultural products. However, not a single CAIP has been operationalized in phase one yet the BPS proposes to move towards implementation of phase two of the same.

16. **Edible Oils Value Chain**: Given the investments that have gone into the sector, there is a need to shift progress reporting from an input-based to an output-focused approach to ensure accountability and measurable impact. Additionally, full financing of the entire value chain is necessary to achieve sustainable growth and maximize returns on investment.

17. **Wheat Production:** To address Kenya's growing import bill, wheat production should be prioritized as a key focus area in the BPS. However, despite its strategic importance, there are no specific, measurable annual targets for wheat imports, leaving a critical gap in planning. Consequently, enhancing domestic production under irrigation is essential for bolstering food security and reducing dependency on imports.

18. **Leather and Leather Products**: There is a need to integrate the leather sector's growth targets with national industrialization policies to enhance coherence and effectiveness. Furthermore, while infrastructure projects like effluent treatment plants and modern equipment acquisition are positive, clearer timelines and operational plans are necessary for sustainable progress. Additionally, the proposed export of live animals though essential may likely deprive Kenya's leather industry of essential raw materials.

19. **Continuity of NG-CDF projects:** The expenditure ceilings for the State Department for Economic Planning, which includes the funds to the NG-CDF have been reduced significantly. This may imply that the allocation may not be able to support ongoing intervention through the fund

Social Sector

20. **The Means Testing Instrument:** The MTI is supposed to determine the household contribution to SHIF and the placement of students in bands for funding in higher education. However, it has presented several challenges including the provision of inaccurate or incomplete information in determining proper household contribution and banding of students for HELB loans thereby impacting on delivery of social services.

SUMMARY OF KEY ISSUES IN THE 2025 BUDGET POLICY STATEMENT

21. **Financing healthcare reforms**: The resource requirements for various initiatives under the health sector reforms are not well defined. These include the Social Health Insurance Fund, The Primary Healthcare Fund, and the Chronic, Critical and Emergency Illness Fund. Failure to determine this at the planning stage implies the need for additional resources midway which may further impact the fiscal deficit. Further, there have been significant delays in the settlement of claims by SHA for healthcare facilities which has adversely affected the operations of the health sector, especially the primary healthcare facilities.

22. **Reduction in Development AID**: the BPS has not adequately addressed the implication of changes in the development partner priorities including the ongoing defunding of the USAID on various programmes and proposed measures to address the same. It is estimated that various initiatives under the Global Fund for Malaria HIV and TB as well as those under GAVI may be impacted to a tune of over Kshs. 20 billion.

23. **Funding the Education Sector**: The BPS has outlined the various reforms and interventions in the education sector. However, a detailed analysis of the fiscal impact of these interventions leaves the sector largely underfunded. Critical areas that are not adequately funded include: capitation across all levels, higher education funding model, recruitment and promotion of teachers, and infrastructure development. Equally, given the transition to SHIF, there is no clarity on the health coverage of learners that were previously covered by the NHIF.

24. **Transition to Senior School.** Given that the first batch of learners will be transitioning from grade 9 to senior school in 2026, there are concerns about the progression mechanisms under the CBC including the adequacy of the various assessment criteria and how the same is being translated to guide learners toward the various career pathways that have been defined. This underscores the need for continuous stakeholder engagement to build clarity on the entire realm of the CBC.

25. **Talent Monetarization:** The BPS has not addressed the need to review the Sports Act, 2013 and the National Sports Policy to align with the evolving landscape of modern sports. The current legal and policy framework does not provide a conducive environment for monetizing talent or attracting private sector investment, including foreign investors, to develop a sustainable sports industry. This hinders sponsorship opportunities, private sector participation, and commercialization of sports, ultimately undermining the sector's growth. Equally, there is a need to review the framework for the Sports Fund to align it with priority areas that drive the growth and commercialization of sports.

26. **Women Agenda:** The government's medium-term strategy focuses on empowering women economically and addressing gender-based violence and inequality through various initiatives. This may be achieved through monitoring compliance with gender mainstreaming, training on gender-responsive budgeting, and developing a clear framework to implement the constitutional two-thirds gender principle in elective positions. These combined efforts aim to foster a more equitable society by removing barriers to women's economic participation, ensuring their safety, and embedding gender considerations into all levels of policy and decision-making.

Infrastructure Sector

27. **Avenues for alternative financin**g. To alleviate the bottlenecks arising from inadequate resources and given the constrained fiscal space, the government planned to adopt alternative financing arrangements, including public-private partnerships (PPPs). However, the process has faced resistance from stakeholders due to a lack of clear policy guidelines on the implementation of such critical projects under such an arrangement. Hence, there is a need for robust frameworks to ensure that private sector participation does not lead to exploitation or neglect of public interests in the water, road, and energy sectors.

SUMMARY OF KEY ISSUES IN THE 2025 BUDGET POLICY STATEMENT

28. **Pending Bills:** The bulk of the pending bills are within the infrastructure sector resulting in increased project costs and delayed project completion. As of 30th September 2024, the sector accounted for approximately Kshs. 286 billion out of the Kshs. 528 billion pending bills for the National Government. While infrastructure projects, such as roads, rails, water, and electricity, are crucial for economic development, delays can hinder business operations, reduce productivity, and limit access to markets, ultimately slowing down economic growth. The BPS does not address the strategy to settle these pending bills and curb their accumulation.
29. **Affordable Housing Fund:** The objective of the Affordable Housing pillar was to provide an additional 200,000 housing units per annum. However, according to the BPS, only 4,888 are set for completion out of the 124,000 ongoing units. Notably, the resources mobilized through the Affordable Housing Fund are not fully absorbed by the housing sector and they are either idle in the fund or invested in government securities. Further, the anticipated active role of public investment in the construction industry may have slowed down private investments in the sector, thereby reducing the overall contribution of the sector to the GDP.
30. **Water 10,000 Programme**: Envisioned in MTP IV, the program is an ambitious constituency-based water provision initiative aimed at addressing the country's water scarcity issues. The program focuses on implementing 10,000 water projects across the country, including the construction of boreholes, water pans, small dams, and springs. Despite its potential contribution to rural development, the BPS does not provide a clear roadmap towards the attainment of the same.
31. **Cost of Energy:** The cost of energy remains significantly high for the majority of Kenyans hence the need to develop mechanisms for availing off-grid power to regions that are outside the national power grid system as well as upscaling last-mile connectivity to ensure that the existing infrastructure is put to optimal use.
32. **Emergence of Satellite Internet:** The shift from the costly underground fiber optic cable to using Kenya Power transmission lines is welcome. However, given the technological advancements in satellite internet, the government needs to develop a framework for transitioning to it, including options for investing in ground stations and other necessary infrastructure to support satellite connectivity and ease access to remote areas at an affordable investment.

Environment and Natural Resources Sector

33. **The National Tree Growing Programme**: There is a need for more emphasis on leveraging technological solutions such as remote sensing and drones to track reforestation progress, as well as clearer strategies for long-term monitoring and maintenance of planted trees to ensure their survival and effectiveness in combating climate change.
34. **Harnessing the Blue Economy:** The oceanic territory and inland water bodies hold vast resources that can significantly contribute to the country's economy. These resources include fisheries, aquaculture, tourism, maritime transport, and energy production. However, ongoing efforts seem to be losing traction such as the rehabilitation of fish landing sites, the development of the Liwatoni Fish Processing Plant, and the Shimoni Fish Port. There is need to fast-track the completion of these projects to rip the benefits of attendant investments.
35. **Revamping Artisanal Mining:** The MTP IV envisioned the formalization of artisanal and small-scale mining. However, the interventions have not borne the requisite fruits. Given the declining contribution of the mining sector to economic growth due to the exploitation of the base titanium, there is a need to revamp artisanal mining and contribute to job creation and economic transformation.

SUMMARY OF KEY ISSUES IN THE 2025 BUDGET POLICY STATEMENT

Sub-National Government

36. **Fiscal Responsibility Principles:** Compliance with fiscal responsibility remains a key concern among the devolved units. While counties allocate 30% of their total budgets to development during budgeting, they fail to meet the threshold in the implementation. In FY 2023/24, nine counties met the requirement. Additionally, 45 Counties were in breach of expenditures on wages and benefits for their public officers above the set threshold of thirty-five (35) percent of the total revenue.

37. **Persistent Accumulation of Pending Bills:** Pending bills for counties as of the end of September 2024 stood at Kshs.194 billion partly due to delayed exchanger and underperformance of OSR. This trend is expected to be alleviated by treating pending bills as the first charge and adopting of accrual basis of accounting. These include Kshs.91.2 billion of unremitted pension deductions by the counties and KPLC electricity bills to the tune of Ksh.4.4 billion with Nairobi County having the highest portion of Ksh.3.01 billion.

38. **Continued underperformance of the Own Source Revenue**. The performance averaged 65 % of the target in the last decade. Policies to support OSR collection include the Development of a more scientific revenue forecasting model; Operationalization and implementation of the provisions of the National Rating Act, 2024, and Develop an integrated county revenue management system (ICRMS) There have been numerous such proposals that have not born fruits; New regime dynamic in Revenue collection and unique features of the counties.

39. **Sharable revenue is projected at Ksh.2,835 billion**. The vertical share to counties is set at Ksh.405.1 billion, an increase of Kshs.17.7 billion from Kshs.387.4 billion allocated in FY 2024/25. The allocation is 25.79 percent which is above the 15 percent constitutional threshold. The application of the third basis in the Horizontal sharing of Revenue among counties due to delay in the approval of the fourth basis. No different fiscal developments will be expected under the third basis regime.

40. **Additional Allocations to County Governments.** The additional allocations amount to Ksh.69.8 billion of which, donor funds are Ksh.56.91 billion. there has been a yearly delay in the County Government Additional Allocation Bill. No clear roadmap of fast-tracking the implementation of these projects. The loans and grants projects are affected most due to growing commitment fees without timely utilization.

41. **Allocation to Equalization Fund:** The fund has been allocated Kshs.10.6 billion of which Kshs.7.8 billion is equivalent to the 0.5 percent constitutional requirement, and an extra Kshs.2.7 billion towards the settlement of outstanding arrears. The Ksh.2.7 arrears payment for arrears is only about 6 percent of the total amount of Ksh.49 billion owed to the fund as of June 2024. There is a lack of commitment from the government to honor the payment of the arrears to the Fund, despite the lapse window of the fund being less than 5 years.

42. **Transfer of devolved functions:** Following the delineation of functions in Dec. 2024 by IGRTC, the government there is need to go further to cost the functions for onward transfer to the county governments. Notably, the functions delineated and costed in FY 2022&2023 such as Library Services and Museums Function are yet to be funded despite the functions having been handed over to counties.

1.0 INTRODUCTION

1. Section 25 of the Public Finance Management Act, 2012, requires the National Treasury to prepare and submit to Parliament the Budget Policy Statement (BPS). The BPS provides an assessment of the current state of the economy and the financial outlook over the medium term, including macroeconomic forecasts, the government's overarching policies, resource envelopes, and expenditure ceilings. Consequently, the 2025 Budget Policy Statement was submitted to Parliament on **Thursday, February 13, 2025**, and committed to Departmental Committees and the Liaison Committee.

2. The 2025 Budget Policy Statement is the third to be prepared under the Kenya Kwanza Government, and it sets out the priority programs, policies, and reforms of the administration that will be implemented in the medium term. It is designed to build on the gains under the 2024 BPS that was themed "Sustaining Bottom-Up Economic Transformation Agenda for Economic Recovery and Improved Livelihoods." As such, the 2025 BPS is titled "**Consolidating Gains Under Bottom-Up Economic Transformation Agenda for Inclusive Green Growth".**

3. The BPS proposes expenditure ceilings for the national government, including those of Parliament and the Judiciary, as well as indicative transfers to county governments for the next financial year and the medium term. The proposed ceilings are presented in Table 1$2. Once considered and approved by Parliament, the ceilings will form the basis for the preparation of the national budget for the financial year 2025/2026 and over the medium term, as well as form the basis for the Division of Revenue Bill 2025 and for the county fiscal strategy papers which should be aligned to the national development agenda.

1.1 Proposed Budget for FY 2025/26 and The Medium-Term

4. Total revenue, including appropriation in aid for FY 2025/26, is expected to be Kshs. 3,385.8 billion (17.6 percent of GDP), compared to Kshs. 3,060.0 billion (16.9 percent of GDP) projected during the approval of the supplementary I budget for 2024/25. The revenue projection performance will be underpinned by the ongoing reforms in tax policy and revenue administration.

5. Total expenditures and net lending for FY 2025/26 are projected at Kshs. 4,336.1 billion, compared to Kshs. 3,880.8 billion in the FY 2024/25 Supplementary I Estimates. Recurrent expenditures, including CFS, are estimated at Kshs. 3,217.7 billion, while development and net lending are Kshs. 676.7 billion, up from Kshs. 599.5 billion in the current fiscal year.

6. Indicative expenditure ceilings for the three arms of the government, including shareable revenue to the county governments and Consolidated Fund Services, for the FY 2025/26 are presented in **Table *1*** and **Table *2***.

Table 1: Budget Ceiling for 2025/26 FY and the medium term (Kshs. Billion) As per BPS Sector Ceilings

Budget Ceiling for 2024/25 FY and the medium term (Kshs. Billion) As per BPS Sector Ceilings							
	2024/25		2025/26			2026/27	2027/28
Item	Approved Budget	Suppl No. 1	BPS	Gross Change	% Change	BPS	BPS
Recurrent Estimates	1,632.1	1,591.6	1,851.7	260.1	16%	1,994.8	2,240.9
Capital Estimates	746.3	641.2	710.3	69.2	11%	864.3	953.7
National Government	**2,378.4**	**2,232.8**	**2,562.0**	**329.2**	**15%**	**2,859.2**	**3,194.6**
o/w Parliament	44.6	40.9	42.5	1.6	4%	44.6	46.1
o/w Judiciary	24.6	22.5	25.6	3.1	14%	28.3	31.8
Pensions & Other CFS	169.2	190.4	205.2	14.8	8%	211.2	218.7
Interest	1,009.9	1,009.9	1,129.4	119.5	12%	1,142.5	1,173.6
Contr to civil service pension fund	34.4	37.0	34.4	-2.5	-7%	35.5	36.5
Net lending							
Consolidated Fund Services	**1,213.5**	**1,237.2**	**1,369.0**	**131.8**	**11%**	**1,389.2**	**1,428.8**
County Equitable Share	**400.1**	**410.8**	**405.1**	**- 5.8**	**-1%**	**417.0**	**429.4**
Total	**3,992.0**	**3,880.8**	**4,336.10**	**455.2**	**12%**	**4,665.39**	**5,052.83**
73.0 billion							

Source: BPS,2025

Table 2: Budget Ceiling for 2025/26 FY and the medium term (Kshs. Billion) As per the Fiscal Framework

Budget Ceiling for 2024/25 FY and the medium term (Kshs. Billion) As per the Fiscal Framework							
	2024/25		2025/26			2026/27	2027/28
Item	Approved Budget	Suppl No. 1	BPS	Gross Change	% Change	BPS	BPS
Recurrent Estimates	1,632.1	1,591.6	1,730.3	138.8	9%	1,867.0	2,144.7
Capital Estimates	746.3	641.2	758.7	117.5	18%	901.0	1,014.3
National Government	**2,378.4**	**2,232.8**	**2,489.0**	**256.2**	**11%**	**2,767.9**	**3,159.0**
o/w Parliament	44.6	40.9	42.5	1.6	4%	44.6	46.1
o/w Judiciary	24.6	22.5	25.6	3.1	14%	28.3	31.8
Pensions & Other CFS	169.2	190.4	205.2	14.8	8%	211.2	218.7
Interest	1,009.9	1,009.9	1,129.4	119.5	12%	1,142.5	1,173.6
Contr to civil service pension fund	34.4	37.0	34.4	-2.5	-7%	35.5	36.5
Net lending							
Consolidated Fund Services	**1,213.5**	**1,237.2**	**1,369.0**	**131.8**	**11%**	**1,389.2**	**1,428.8**
County Equitable Share	**400.1**	**410.8**	**405.1**	**- 5.8**	**-1%**	**417.0**	**429.4**
Total	**3,992.0**	**3,880.8**	**4,263.1**	**382.2**	**10%**	**4,574.1**	**5,017.1**

Source: BPS,2025

2.0 MACROECONOMIC FRAMEWORK UNDERPINNING THE 2025 BPS

2.1 Global outlook

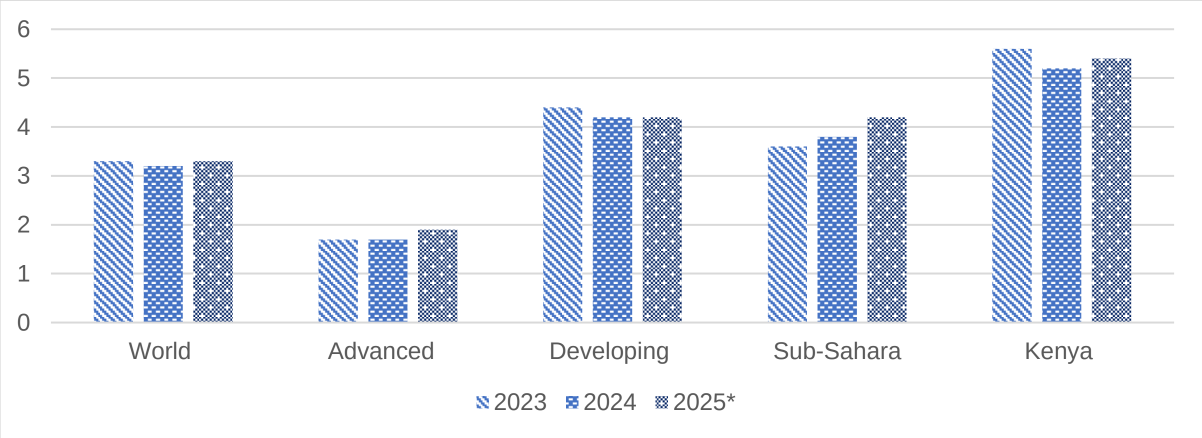
7. **Global growth is estimated at 3.2 percent in 2024 and projected at 3.3 percent in both 2025 and 2026 [1].** Growth in advanced economies is projected to improve from 1.7 percent in 2024 to 1.9 percent in 2025. Notably, the US is expected to raise tariffs and implement tight fiscal policy measures. The ongoing trade tensions between the US and China continue to influence global trade. The tariffs and other barriers have the potential to reduce Chinese export earnings from the US market, impacting China's economic growth. However, these tensions create opportunities for other countries to fill the gaps in the US market where local production is insufficient, potentially leading to new trade partnerships and economic benefits for those nations. In Japan, consumer spending is expected to go up on account of rising real wages arising from negotiations between the government and labor unions.

8. **Growth in developing economies is expected to stabilize at 4.2 percent in both 2024 and 2025, driven by advancements in technology, increasing consumer bases, and expanding infrastructure.** Economic growth in the Sub-Saharan region is anticipated to rebound as global conditions improve and trade opportunities expand. The implementation and facilitation of the African Continental Free Trade Area (AfCFTA) are expected to bolster intra-African trade, supporting regional economic integration and growth. Geopolitical tensions remain a significant risk, with potential supply chain disruptions impacting global and regional trade flows. Another key concern is debt financing, where countries might prioritize debt repayment over essential development spending, thus hindering long-term growth prospects.

9. **Consumer prices are projected to decline from 5.7 percent in 2024 to 4.2 percent in 2025, implying the easing of inflationary pressures.** The Federal Reserve started easing monetary policy in September 2024 by lowering interest rates or ceasing asset purchases, with the intention of supporting economic growth by encouraging borrowing and investment. Central banks worldwide are following a similar approach, and the impact of these measures should potentially improve consumer purchasing power and create a more favorable business environment.

[1] https://www.imf.org/en/Publications/WEO/Issues/2025/01/17/world-economic-outlook-update-january-2025

Figure 1: Growth rates and projections for the period 2023 to 2025

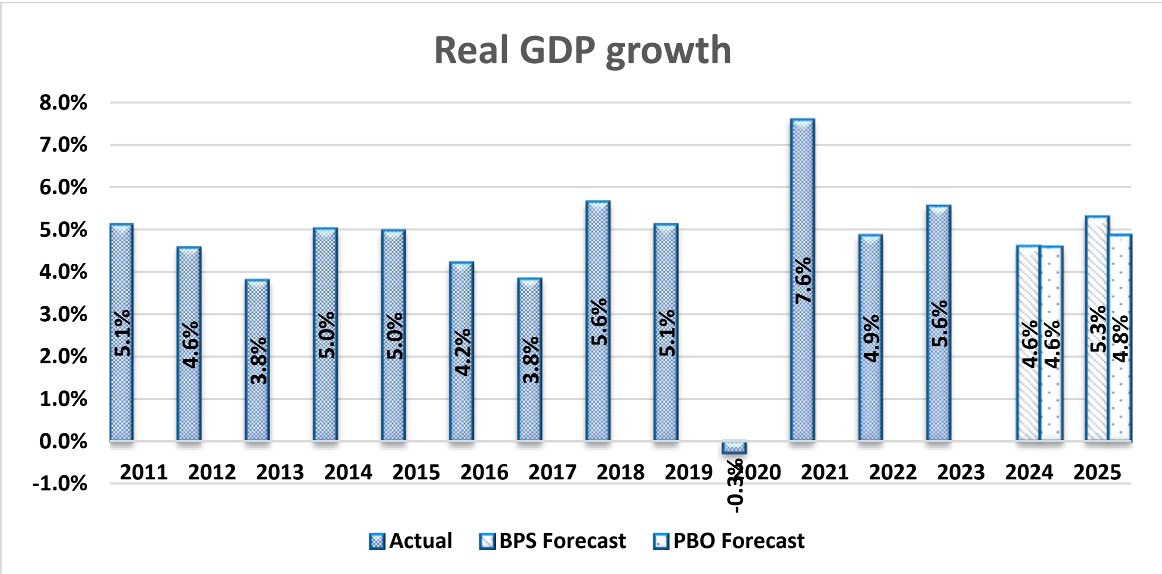


Data Source: IMF World Economic Outlook, 2025

2.2 Economic Growth

10. **The National Treasury estimates economic growth at 4.6 percent in 2024 compared to 5.6 percent in 2023 and projects growth at 5.3 percent in 2025 and 2026.** The 2025 growth projections are premised on the assumptions of improvements in the agriculture sector on account of favorable weather conditions and the implementation of BETA priority programs. The services sector is also expected to support growth in 2025 based on reforms in the ICT sector, as well as government activities to boost tourism and international conferences. The industry sector is also expected to boost growth through the anticipated reduction in production costs and government initiatives to support value addition. Notably, the projections are largely pegged on the implementation of government policies. This indicates that the achievement of growth targets is dependent on the successful implementation of BETA priorities.

Figure 2 Kenya's Economic Growth (%)



Source: PBO, National Treasury

11. **Recent economic developments indicate that domestic growth decelerated from an average of 5.7 percent in the first three quarters (Q1, Q2, and Q3) of 2023 to 4.5 percent in 2024**. Growth in the primary sector declined from 5.7 percent to 4.2 percent on account of a decline in mining and quarrying activities. In addition, there was a modest decline in agriculture. Notably, in the primary sector, agricultural production for export recorded an improvement, particularly in the exportation of coffee by 29 percent and tea by 7 percent; however, horticulture exports declined by 19 percent. Cane deliveries improved by 189 percent on account of favorable government policies targeting sugar production.

12. The National Treasury projects that the primary sector will grow at 4.6 percent in 2024 and 5.3 percent in 2025. Notably, weather-related shocks remain a risk to agricultural output; further, investment in agriculture value chains in the budget is required as it will have multiplier effects on employment generation and export revenue enhancement.

13. **Growth in the industry sector is estimated to have declined at an average of 0.8 percent in 2024 (Q1, Q2, and Q3) from 2.6 percent in the same period in 2023.** The deceleration is caused by declining construction and the electricity and water supply sub-sectors. The manufacturing sector also faced challenges, but it received substantial support from agro-processing, particularly in sugar production, which saw an impressive 197 percent increase due to enhanced local production.

14. The construction sector's decline is notable, especially considering the government's affordable housing program, which was expected to spur investment and activity in this area. However, the decline may be attributed to stalled road construction projects due to significant cuts in the development budget. In addition, there was a decline in both cement production and consumption by 10 percent and 7 percent, respectively, along with a 2 percent reduction in galvanized sheet production.

15. Fuel prices recorded a decline in 2024, driven by the easing of exchange rate pressures, which has been beneficial for manufacturers by lowering their production costs. However, despite the lower fuel costs, manufacturers still face challenges due to existing tax policies, which may offset some of the benefits gained from reduced energy costs, keeping the pressure on manufacturers to manage their costs and maintain competitive pricing.

16. **The services sector is estimated to have grown at an average of 5.6 percent in the first three quarters of 2024 from 7.0 percent in 2023.** Accommodation and food services significantly declined, as well as finance and insurance, information and communication, and real estate resulting in declining performance in the sector in 2024. Notably, wholesale and retail trade and education recorded an improvement in the period. Tourism and international conferences have played a supportive role in the services sector. The government's efforts to promote high-profile international conferences and boost tourism could enhance the performance of the hospitality and transport sub-sectors. The effectiveness of these efforts will largely depend on the policies implemented to encourage private-sector participation.

Table 3: Quarterly growth rates for the period 2023 to 2024

Real GDP Growth (%)							
	2023 Q1	2023 Q2	2023 Q3	2023 Q4	2024 Q1	2024 Q2	2024 Q3
Primary Sector	**5.3**	**6.9**	**4.8**	**5.3**	**5.0**	**4.4**	**3.2**
1. Agriculture	6.4	7.8	5.1	6.2	6.1	4.8	4.2
2. Mining & Quarrying	-11.0	-8.3	0.8	-6.9	-14.8	-2.7	-11.1
Industry Sector	**2.5**	**2.1**	**3.3**	**2.0**	**1.0**	**0.8**	**0.6**
3. Manufacturing	1.7	1.5	2.8	2.0	1.2	3.3	2.3
4. Electricity & Water Supply	3.8	2.8	3.3	1.3	2.4	1.0	0.9
5. Construction	3.0	2.7	4.0	2.2	0.1	-2.9	-2.0
Services Sector	**6.5**	**6.7**	**7.6**	**6.3**	**6.2**	**5.3**	**5.3**
6. Wholesale and Retail Trade	2.9	2.1	3.1	2.8	4.9	4.4	4.8
7. Accommodation & Restaurant	47.1	42.7	34.5	18.1	28.0	26.6	13.7
8. Transport and Storage	6.6	4.6	5.1	8.5	3.9	3.6	5.2
9. Information and Communication	9.5	7.6	8.8	11.0	7.8	7.2	6.1
10. Financial & Insurance	5.9	13.2	15.5	6.3	7.0	5.1	4.7
11. Public Administration	7.6	3.2	4.6	3.4	5.8	5.1	5.4
12. Professional, Admin and Support	8.6	6.6	9.7	12.8	9.9	6.8	7.8
13. Real Estate	7.3	8.1	7.7	6.2	6.6	6.0	5.5
14. Education	2.0	3.1	3.5	3.9	4.0	3.1	3.8
15. Health	5.1	4.7	5.0	4.8	5.5	5.5	4.4
16. Other Services	4.6	2.4	6.4	2.9	2.3	2.0	2.8
GDP Growth	**5.5**	**5.6**	**6.0**	**5.1**	**5.0**	**4.6**	**4.0**

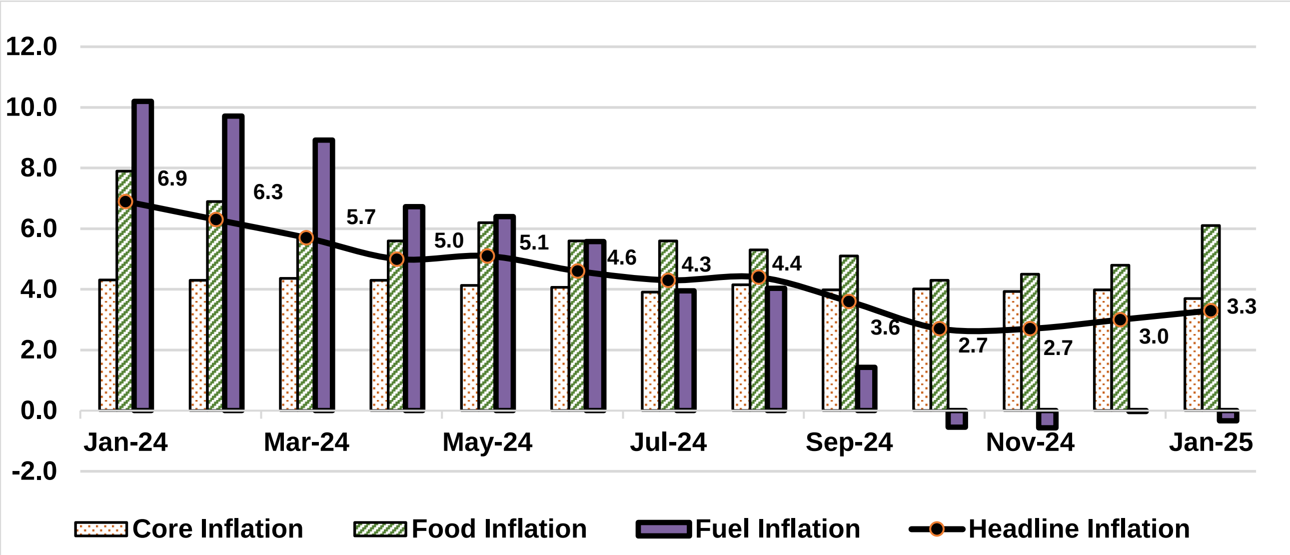
Data Source: Kenya National Bureau of Statistics

2.3 Inflation

17. **The headline inflation has been on a downward trend from 6.9 percent in January 2024 to 3.3 percent as of January 2025, driven by fuel prices and food prices.** Negative fuel inflation since October 2024, indicates a significant decrease in fuel costs. Lower oil prices[2], currency appreciation and the Government to Government (G-to-G) might have contributed to this decline thereby reducing transportation and production costs across the economy. In addition, favourable weather conditions and fertilizer subsidies boosted agricultural yields, leading to increased food supply and lower prices of fruits and vegetables, maize, and other cereals. This directly impacts headline (overall) inflation given the significant weight of food in consumer price indices.

[2] Crude oil prices also recorded a decline from USD 84.9 per barrel to USD 73 per barrel. According to WEO January 2025, International oil prices are projected to further decline in 2025 by 11.7 percent.

Figure 3: Inflation rates for the period January 2024 to January 2025



Data Source: Kenya National Bureau of Statistics

18. **Core inflation, which excludes volatile items like food and fuel remained elevated, surpassing the headline (overall) inflation since October 2024.** High core inflation could signal increased spending in non-food and non-fuel sectors and persistent supply chain disruptions that increase production costs for goods and services, excluding food and energy, such as in healthcare and education. Despite overall low headline inflation, there was higher core inflation at 3.7 percent as of January 2025, elevated core inflation may continue having a negative effect on both the cost of living and overall economic welfare.

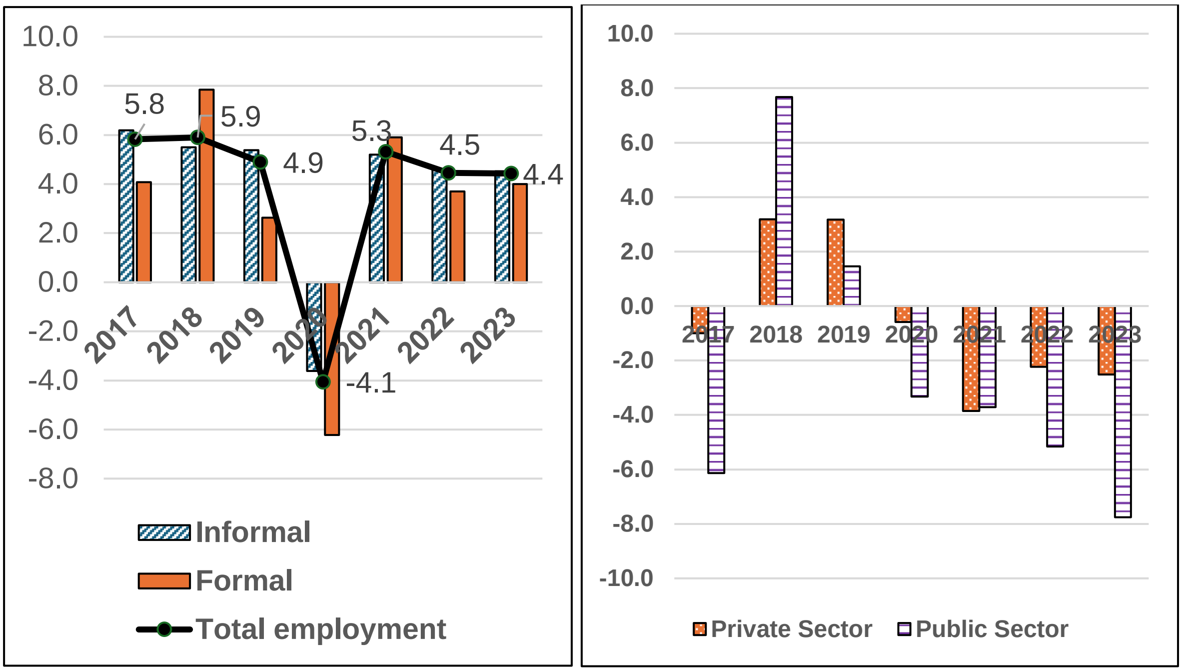
19. Continued investment in agriculture, technology, and infrastructure can sustain low food prices, through more efficient logistics and production processes, and contribute to stable headline inflation. However, over and above the fiscal policy interventions aimed at reducing food inflation, there is a need for the government to implement policies aimed at managing core inflation. Policies may include the provision of tax incentives for businesses that invest in productivity-enhancing technologies that can help reduce long-term production costs and mitigate core inflationary pressures. This might include support for automation and energy efficiency. PBO estimates a 5.1 percent inflation in 2025 which is within the CBK target of 5 percent ± 2.5 percent.

2.4 Employment and Real Wages

20. **Total employment between 2019 and 2023 shows both growth and challenges.** During this period, total employment increased from 18.1 million to 20 million, indicating a rise in the number of employed individuals. However, there was a noticeable decline in the growth rate of employment, dropping from 4.9 percent in 2019 to 4.4 percent in 2023. This slowdown was more pronounced in the formal sector than in the informal sector, suggesting different dynamics and challenges between these two segments of the economy. This could be due to economic uncertainty post-covid 19 pandemic and technological changes.

Figure 4 : Trend in Employment and Real Wages

Trend in growth in employment **Growth in real annual wage per employee**



Data Source: KNBS

21. **A review of sectoral performance indicates that in the formal sector, industries like manufacturing, agriculture, and wholesale & retail were key drivers of formal employment in the private sector.** While in the public sector, education, public administration & defense played crucial roles in offering formal employment. However, while some industries thrived, transport & storage, as well as real estate activities, experienced a decline. This could be attributed to various factors, such as shifts in market demand, operational inefficiencies, or broader economic trends impacting these sectors. The trend indicates the need for targeted policy interventions to address the declining growth in formal employment, especially in sectors facing challenges.

22. **There was a consecutive negative growth in real wages per employee, coupled with rising inflation, signifying a reduction in purchasing power for individuals.** Between 2020 and 2023, real wages declined, illustrating a worsening situation where wages are not keeping up with inflation. Specifically, the real wages of public sector employees decreased more than their private sector counterparts over the past couple of years. The annual average real wages in the private sector were reduced from Kshs. 749,112 in 2020 to Kshs. 686,451 in 2023, a reduction of 8.4 percent while that of the public sector real wages reduced from Kshs. 743,063 in 2020 to Kshs. 625,870 in 2023, a reduction of 15.8 percent.

2.5 Interest rates and credit

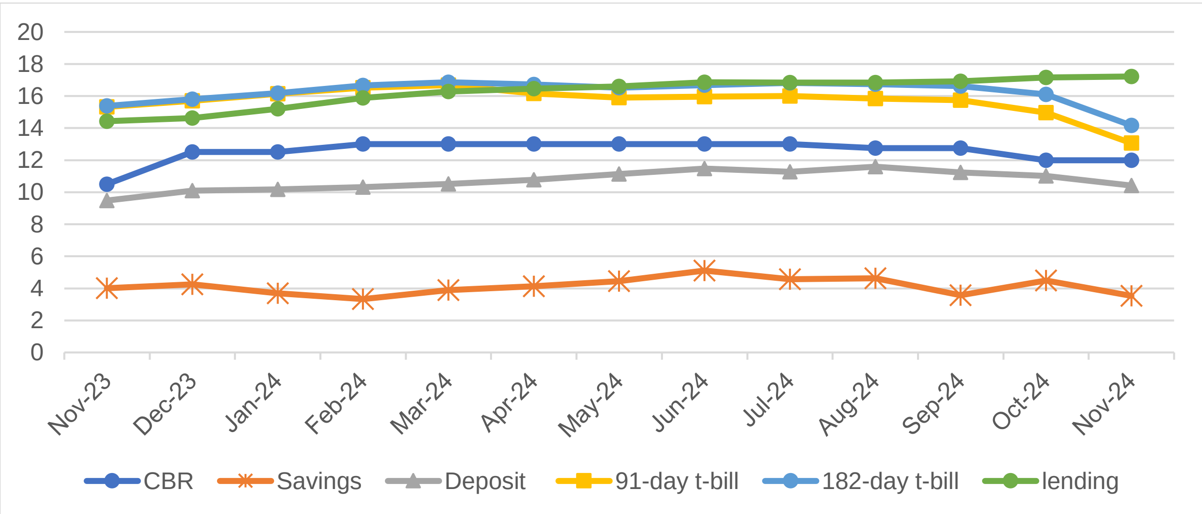
23. **The Central Bank reduced the Central Bank Rate from 13 percent in July 2024 to 10.75 percent in February 2025.** Cutting the benchmark rate implies a gradual reduction in bank interest rates which is expected to promote borrowing by individuals and firms for

investment. There are however underlying risks that might affect borrowing for investment such as consumer risk arising from shrinking incomes which affects the ability of individuals to service loans and declining profits by firms is likely to affect their capacity to grow investments.

24. **Notably, the lending rate increased marginally from 16.84 percent in July 2024 to 16.89 percent in December 2024 and is anticipated to gradually decline with the reduction of the CBR rate**. The savings rate declined from 4.56 percent to 4.25 percent in the same period an indication of a slight decline in the return for bank savings accounts and the deposit rate reduced from 11.28 percent to 10.45 percent. Although responses by banks will vary from bank to bank, the expected general response to CBR rate cuts is a gradual reduction in bank rates.

25. **The 91-day T-bill and 182- day T-bill declined from 15.32 percent and 15.39 percent in November 2023 to 13.06 percent and 14.16 percent in November 2024 respectively.** This indicates a decline in borrowing costs for the government and a decline in returns for investors. The rate was previously on an upward trend as a result of increased domestic borrowing demands by the government. The fiscal consolidation measures implemented at the beginning of FY 2024/25 are likely to have signalled the market and the response was a decline in the rates.

Figure 5: Interest rates for the period November 2023 to November 2024



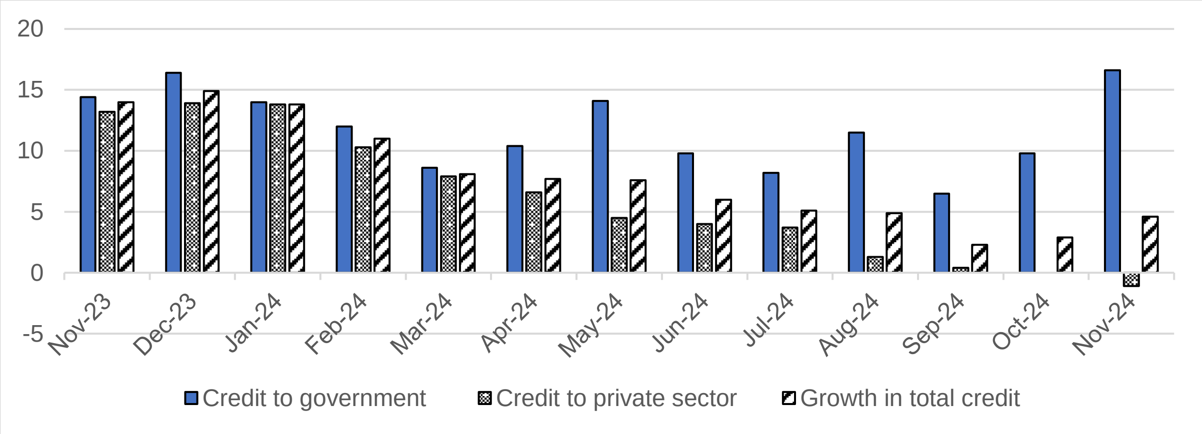
Data Source: Central Bank of Kenya

26. **Growth in total credit in the economy significantly declined from 14.4 percent in November 2023 to 4.6 percent in November 2024.** The decline in growth was because of a decline in credit to the private sector from 13.2 percent to –1.1 percent in the same period. However, credit to the government grew from 14.4 percent to 16.6 percent, and government borrowing being high in the market poses the risk of crowding out of the private sector.

27. Credit to the private sector was on a downward trend in 2024 on account of a decline in credit to manufacturing, trade, building & construction, transport & communication, business services, and trade. However, the trend is expected to change since the CBK is

pursuing monetary policy easing which is expected to result in banks lowering their lending rates. Lower rates are expected to attract borrowers in the private sector who will invest in the economy. Notably, the National Treasury expects that the private sector will support economic growth as the public sector pursues fiscal consolidation. This is dependent on the accessibility and affordability of credit.

Figure 6: Growth in credit for the period November 2023 to November 2024



Data Source: Central Bank of Kenya

2.6 External sector

28. **The current account deficit as a share of GDP narrowed slightly from -3.8 percent in the third quarter of 2023 to -3.5 percent in the third quarter of 2024.** The National Treasury estimates the current account deficit share of GDP at – 4 percent in 2024 and -3.9 percent in 2025. Notably, in 2024 the merchandise trade deficit worsened by 4.2 percent on account of growth in imports pacing the growth in exports. On the other hand, services surplus improved by 37 percent on account of an increase in services exports. The travel account grew by 8.9 percent also contributing to growth in the services account. The primary income deficit slightly improved by 1.5 percent while the secondary income surplus grew by 2.6 percent on account of growth in diaspora remittances. Diaspora remittances continue to support the current account balance. Despite growth in exports, a higher growth in imports will result to a widening of the deficit in the balance of trade. This indicates an opportunity for policies that promote exportation and local production. Compared to remittances, government policies are more likely to directly impact exports and imports which involve trade in goods and services.

29. **Growth in exports is estimated at 11.7 percent in 2024 compared to 11.7 percent in 2023 and it is projected at 11.1 percent in 2025.** Generally, growth in imports is projected to be higher than the growth in exports at 19.8 percent in 2024 compared to 20.4 percent in 2023 and it is projected at 17.9 percent in 2025. Key policies regarding exportation majorly revolve around trade agreements such as the AfCFTA and Kenya EU EPA which are likely to significantly boost the growth in exports. Notably, trade partners in such agreements may also send imports to the country sustaining the growth in imports resulting to a widening of the balance of trade. There is need for diversification and value addition since our key exports that earn the country earnings are majorly primary

agricultural products, majorly; tea and horticulture exports. Notably, the government intends to pursue value addition in FY 2025/26, and this is likely to improve export earnings if the value-added goods will be sold in international markets.

30. **The trend in the capital account remained relatively similar in the first three quarters of 2024 compared to 2023 at an average of 0.1 percent as a share of GDP in both years.** The financial account surplus averaged 3.1 percent as a share of GDP in 2024 compared to 2.2 percent in 2023. This represents growth in net financial inflows, suggesting more foreign direct investment, portfolio investment, or other financial flows in the period. Consequently, the overall balance averaged -0.5 percent as a share of GDP in 2024 and compared to 1 percent in 2023. Increased capital inflows into the country are likely to boost the financial account consequently sustaining the overall balance.

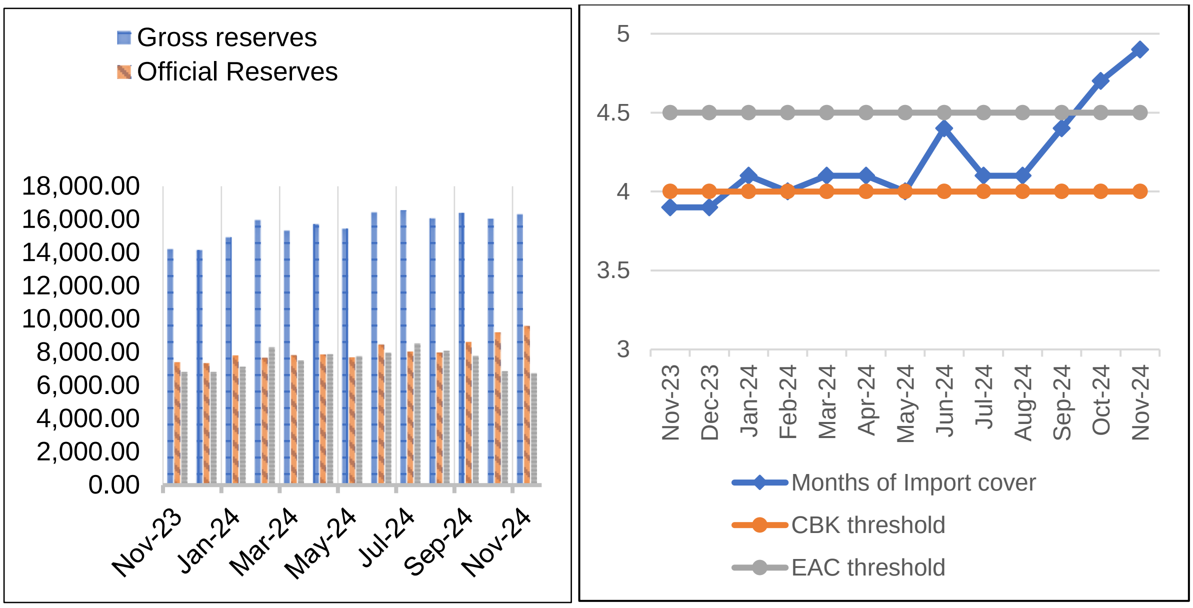
Table 4: Components of BOP as a share of GDP and 2025 BPS projections

BOP as a share of GDP	2023 Q1	2023 Q2	2023 Q3	2023 Av.	2024 Q1	2024 Q2	2024 Q3	2024 Av.	2024 BPS estimation	2025 BPS projection
Overall balance	**3.5%**	**-4.1%**	**3.6%**	**1.0%**	**0.9%**	**-2.0%**	**-0.4%**	**-0.5%**	**-**	**-**
A) Current account	**-3.0%**	**-4.3%**	**-3.8%**	**-3.7%**	**-3.2%**	**-2.5%**	**-3.5%**	**-3.1%**	**-4.0%**	**-3.9%**
Merchandise Trade	-8.4%	-9.5%	-8.9%	-8.9%	-8.4%	-8.2%	-8.6%	-8.4%	-	-
Goods: exports	6.3%	6.7%	7.3%	6.8%	7.3%	6.7%	7.2%	7.1%	-	-
Goods: imports	14.7%	16.2%	16.2%	15.7%	15.7%	14.9%	15.7%	15.5%	-	-
Net services	1.1%	0.7%	0.5%	0.8%	0.6%	1.1%	0.6%	0.8%	-	-
o/w travel	0.9%	0.9%	0.7%	0.9%	0.6%	0.8%	0.7%	0.7%	-	-
Goods and services exports	7.4%	7.8%	8.1%	7.8%	8.1%	7.6%	8.0%	7.9%	11.7%	11.1%
Goods and services imports	19.0%	21.0%	20.6%	20.2%	19.9%	18.7%	20.0%	19.5%	19.8%	18.5%
Net primary income	-1.7%	-1.9%	-2.2%	-1.9%	-2.2%	-1.1%	-2.0%	-1.8%	-	-
Net Secondary income	6.0%	6.4%	6.9%	6.4%	6.7%	5.8%	6.5%	6.3%	-	-
O/w remittances	3.5%	3.8%	4.2%	3.8%	4.4%	3.8%	4.1%	4.1%	-	-
B) Capital account	**0.2%**	**0.1%**	**0.1%**	0.1%	**0.2%**	**0.2%**	**0.03%**	0.1%	-	**-**
C)Financial account	**2.3%**	**-8.9%**	**0.03%**	-2.2%	**-3.0%**	**-4.8%**	**-1.6%**	-3.1%	-	**-**

31. **Gross reserves remained steady at Kshs. 1.1 trillion in the third quarter of 2024 compared to the third quarter of 2023, providing a steady buffer over shocks that can affect the exchange rate.** Growth in reserves is essential for the stability of the Kenyan shilling, however, downside risks arise from foreign debt obligations which ought to be met using reserves. Foreign gross reserves maintained an upward trend in the 12 months leading to November 2024 and this resulted in an improvement in the months of import cover. Months of import cover improved from 3.9 months in November 2023 to 4.9 months in November 2024. This is above the CBK threshold of 4 months of import cover and the EAC threshold of 4.5 months. The National Treasury projects 4.3 months of import cover in 2025. Notably, this is pegged on the sustainability of reserves.

Figure 7: Gross Reserves and Months of Import Cover

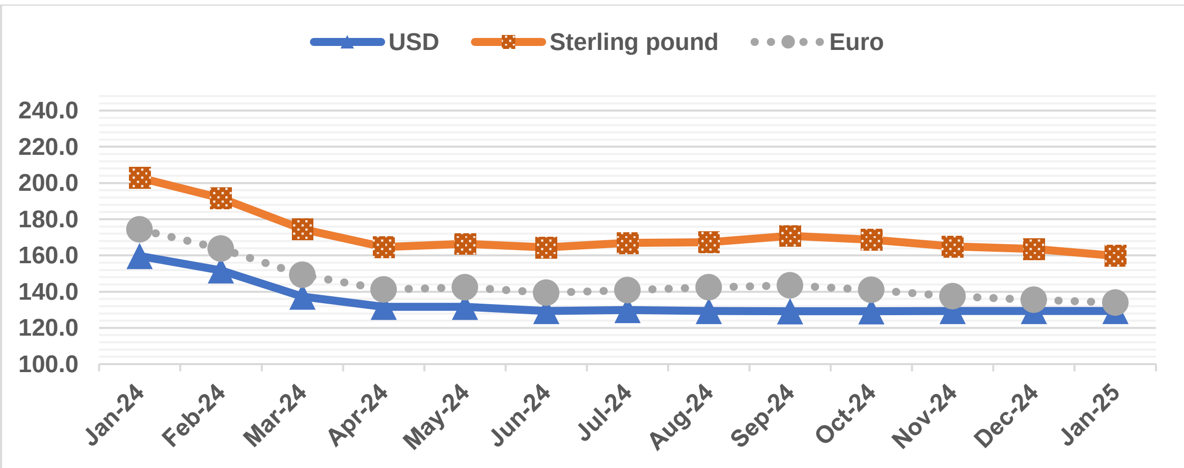
Gross Reserves **Months of import cover**



Data Source: Central Bank of Kenya

32. **The Kenyan shilling strengthened against the US dollar, the Pound Sterling, and the Euro.** The Kenyan Shilling has appreciated against the US Dollar, **strengthening** from Kshs. 159.7 per USD in January 2024 to Kshs. 129.39 per USD in January 2025. Further, the exchange rate has remained stable at the 129 mark for seven consecutive months between June and December 2024. The Kenyan Shilling also appreciated against the Pound Sterling from Kshs. 202.9 in January 2024 to Kshs. 159.8 in January 2025. The Euro also weakened against the Kenyan Shilling from Kshs. 174.3 to Kshs. 134, during the same period. If the implementation of trade agreements such as the Kenya EU EPA agreement and the AfCFTA promote export earnings, as well as growth in diaspora remittances, resulting in increased reserves, this is likely to further stabilize the Kenyan Shilling.

Table 4: Exchange rates for the period November 2023 to November 2024



Data source: Kenya National Bureau of Statistics

3.0 HIGHLIGHTS OF THE FISCAL FRAMEWORK 2025/26

3.1 Revenue Outlook

33. In the 2023 Budget policy statement, the National Treasury projected an ordinary revenue collection of Kshs. 2,571.2 billion for FY 2023/24. However, the actual ordinary revenue collection for 2023/24 FY was Kshs. 2,702.7 billion. As a result of the revenue over projection, coupled with the maintenance of the expenditure targets contained in the BPS, the actual fiscal deficit was over Kshs. 160 billion above the set target, resulting in additional borrowing.

Table 5: Fiscal Operations for the 2023/24 financial year

Fiscal Operations (Kshs. Billion)							
	2019/20	2020/21	2021/22	2022/23	2023/24		
	Actual	Actual	Prel Actual	Prel Actual	PBO Proj Feb 2023	Actual Dec 2024	NT Proj Feb 2023
Revenue and grants	1,821.6	1,949.5	2,230.8	2,383.6	2,758.5	2,724.7	2,943.0
Total Revenue	1,797.7	1,892.6	2,199.8	2,360.5	2,726.3	2,702.7	2,894.9
Ordinary Revenue	1,573.4	1,633.8	1,917.9	2,041.1	2,396.1	2,288.9	2,571.2
Appropriation-in-Aid	224.2	258.9	281.9	319.4	330.2	413.7	323.8
Grants	23.9	56.8	31.0	23.1	32.2	22.0	48.1
Total Expenditure & Net Lending	2,629.5	2,797.4	3,027.8	3,221.0	3,685.8	3,605.2	3,663.1
Overall Balance incl grants	(807.9)	(847.9)	(797.0)	(837.4)	(927.2)	(880.5)	(720.1)
Overall Balance Excl grants	(831.8)	(904.8)	(828.0)	(860.5)	(959.4)	(902.5)	(768.2)

34. **Total revenue fell short of the target (Kshs.1,456.3 billion) by Kshs. 107.7 billion in the first half of 2024/25 FY**. This was majorly occasioned by the underperformance of the ordinary revenue to the tune of Kshs. 93.3 billion. Further, total revenue growth dipped from 14.5 percent in the first half of the 2023/24 financial year to 1.6 percent in the first half of the 2024/25 financial year.

Table 6: Half-Year Revenue Performance for FY 2024/25

	First Half of FY 2024/25 Fiscal Performance (Kshs. Billion)					
	FY 23/24		FY 24/25			
	Pre. Act	%Growth	Target	Pre. Act.	Dev.	% Growth
Total Revenue and Grants	**1,318.7**	**14.5**	**1,456.3**	**1,342.1**	**-114.2**	-8.5
Total Revenue	1,313.2	14.5	1,442.3	1,334.6	-107.7	-8.1
Ordinary Revenue	1,088.6	10.5	1,251.0	1,157.7	-93.3	-8.1
Import Duty	68.2	1.7	77.6	71.5	-6.1	-8.5
Excise Duty	139.8	7.3	155.0	141.3	-13.7	-9.7
Income Tax	491.3	8.7	559.5	530.8	-28.7	-5.4
VAT	**317.9**	**20.3**	**340.6**	**304.1**	**-36.5**	-12.0
Other Revenue	71.4	-0.3	118.3	110	-8.3	-7.5
AiA	224.6	38.6	191.3	176.9	-14.4	-8.1
External Grants	5.5	27.1	14.0	7.5	-6.5	-86.7

	First Half of FY 2024/25 Fiscal Performance (Kshs. Billion)					
	FY 23/24		FY 24/25			
Total Expenditure and Net Lending	**1,704.7**	**16.1**	**1,795.9**	**1,795.80**	**-0.1**	0.0
Recurrent Expenditure	1,296.3	15.6	1,331.2	1,372.10	40.9	3.0
Development	265.9	28.9	244.5	232	-12.5	-5.4
County Allocation	142.5	1	219.2	191.6	-27.6	-14.4
Contingency fund	_	_	1.0	_		
Balance Exclusive of Grants	-391.5	21.6	-353.6	-461.2	-107.6	23.3
Balance inclusive of Grants	-386.0	-12.3	-339.6	-453.7	-114.1	25.1
Discrepancy	-22.4	64		-51.9	-51.9	100.0
Total Financing	**363.3**	**-17.1**	**339.7**	**401.8**	**62.1**	15.5
Net Foreign Financing	153.6		284.8	-6.6	-291.4	4415.2
Net Domestic Financing	210.0		54.9	408.4	353.5	86.6
Nominal GDP	**16,131.5**	**15.2**	**18,054.3**	**18,054.3**	**0.0**	0.0

Source: National Treasury

35. **Over the past five fiscal years, tax revenue (and its components) as a percentage of GDP has remained constant at an average of 16.9%.** The revenue-raising measures put forth in several BPSs over the period failed to achieve their goal. Furthermore, the National Treasury's inability to quantify the anticipated impact of each policy measure rendered it difficult to assess the success or failure of each proposed program.

36. The 2025 BPS proposes several initiatives to improve revenue collection, including but not limited to implementing the National Tax Policy and the Medium-Term Revenue Strategy (2024/25–2026/27), strengthening tax administration, broadening the tax base, reducing tax expenditures, leveraging technology to modernize tax processes, closing revenue loopholes, and improving tax system efficiency. Additionally, the National Treasury aims to focus on non-tax revenues that MDAs can generate through public services. However, these proposals are not different from the previous policy instruments in previous BPSs, making it unlikely that the projected tax revenue targets attributed to the successful execution of these measures will be achieved.

Table 7: Fiscal Framework for the FY 2025/26 Budget as per sector ceilings

Fiscal Framework in Kshs. Billion							
	2022/23	2023/24	2024/25		2025/26		
	Prel Actual	Prel Actual	Budget Est	Suppl No. 1 (S)	BPS (B)	Change (B-S)	% Change
Revenue and grants	**2,378.1**	**2,724.7**	**3,395.0**	**3,112.8**	**3,505.0**	**392.8**	**13%**
Total Revenue	**2,355.0**	**2,702.7**	**3,343.2**	**3,060.0**	**3,458.8**	**398.8**	**13%**
Ordinary Revenue	**2,041.1**	**2,288.9**	**2,917.2**	**2,631.4**	**2,835.0**	**203.6**	**8%**
Income tax	941.6	1,043.1	1,230.2	1,180.3	1,324.3	144.0	12%
VAT	550.4	645.5	812.2	723.8	775.0	51.2	7%
Import duty	130.1	133.9	187.4	160.0	163.0	2.9	2%
Excise duty	264.5	276.7	429.6	324.8	332.7	8.0	2%
Other tax revenue	154.5	189.7	257.8	242.5	240.0	(2.5)	-1%
Appropriation-in-Aid	313.9	413.7	426.0	428.6	623.7	195.2	46%
Grants	23.1	22.0	51.8	53.2	46.2	(6.0)	-12%
Total expenditures & net lending	**3,221.0**	**3,605.2**	**3,992.0**	**3,880.8**	**4,336.1**	**455.2**	**12%**
Recurrent expenditure	**2,311.6**	**2,678.4**	**2,841.9**	**2,826.2**	**3,217.7**	**391.4**	**14%**
Wages & salaries National gvt	547.2	575.3	613.6	602.7	682.5	79.7	13%
Pensions & Other CFS	120.4	143.9	169.2	190.4	205.2	14.8	8%
Interest	687.3	840.7	1,009.9	1,009.9	1,129.4	119.5	12%
On domestic debt	533.1	622.5	750.0	750.0	851.4	101.5	14%
On foreign debt	154.2	218.2	259.9	259.9	278.0	18.0	7%
O&M and other recurrent	866.1	1,026.1	1,011.2	920.3	1,095.1	174.7	19%
Contribution to civil ser pension fund	29.6	34.2	34.4	37.0	34.4	(2.5)	-7%
Development & net lending	**493.7**	**546.4**	**701.5**	**599.5**	**676.7**	**77.2**	**13%**
Development expenditure	481.3	528.9	693.5	591.5	666.1	74.6	13%
Net lending	12.3	17.4					
Contingency Fund			4.0	4.0	5.0	1.0	25%
Transfer to Counties	415.8	380.4	444.5	451.1	436.7	(14.4)	-3%
Equitable Share	399.6	354.6	400.1	410.8	405.1	(5.8)	-1%
Conditional Allocation	16.2	25.8	44.4	40.2	31.6	(8.6)	-21%
Parliamentary service	41.2	37.3	44.6	40.9	42.5	1.6	4%
Judicial Service	19.8	21.0	24.6	22.5	25.6	3.1	14%
Equalization Fund			8.0	8.0	10.6	2.6	32%
Overall balance including Grants	**(842.9)**	**(880.5)**	**(597.0)**	**(768.6)**	**(831.0)**		
Overall balance excluding grants	**(866.0)**	**(902.5)**	**(648.8)**	**(820.9)**	**(877.3)**		
Adjustment to cash basis	37.0	45.4					
Deficit incl grants cash basis	**(805.9)**	**(835.1)**	**(597.0)**	**(768.6)**	**(831.0)**		
Revenue and grants	**16.6%**	**17.2%**	**18.8%**	**17.1%**	**18.2%**		
Total Revenue	16.5%	17.1%	**18.5%**	**16.9%**	**17.9%**		
Ordinary Revenue	14.3%	14.5%	**16.2%**	**14.6%**	**14.7%**		
Total expenditures and net lending	**22.5%**	**22.8%**	**22.1%**	**21.5%**	**22.5%**		
Overall balance including grants	**-5.9%**	**-5.6%**	**-3.3%**	**-4.3%**	**-4.3%**		
Overall balance excluding Grants	**-6.1%**	**-5.7%**	**-3.6%**	**-4.5%**	**-4.6%**		
Primary Balance incl grants	**-0.8%**	**-0.3%**	2.3%	1.3%	**1.5%**		
Nominal GDP	**14,299**	**15,826**	**18,054**	**18,054**	**19,273**		

37. The projected ordinary revenue collection for 2025/26 is **Kshs. 2,835.0 billion,** representing a growth of 8 percent (Kshs. 203.6 billion) relative to what was projected in the 2024/25 supplementary I estimates. This is a more realistic revenue projection when compared to the projection of Kshs.3,018.8 billion that was contained in BROP. However, it is noted that the projected revenue collection for 2025/26, which is based on a baseline figure for FY 2024/25 that might not be attained, is still high. Consequently, the actual total revenue collection for 2025/26 may be around Kshs. 100 billion below target.

3.2 Expenditure Outlook

38. **Development expenditures and county transfers fell short of their respective half-year targets by Kshs.12.5 billion and Kshs. 27.6 billion, respectively, while the recurring expenditures exceeded the target of Kshs.40.9 billion**. Overall, total expenditure for the period was on target at Kshs. 1,795.8 billion against Kshs.1,796 billion. The underperformance of revenue coupled with the maintenance of the overall expenditure target implies a wider-than-projected fiscal deficit. Consequently, the domestic borrowing exceeded the set target by close to Kshs. 100 billion.

39. **As a percentage of GDP, expenditure has remained relatively stable, ranging between 21.5% to 24% in the recent fiscal years**. The government has streamlined expenditures, resulting in a reduction of overall expenditure and net lending from 24.6% of GDP in FY 2020/21 to an estimated 22.8% in 2023/24 FY. During this period, recurrent expenditure has averaged 16% of GDP, with key components such as wages and salaries, operations and maintenance (O&M), and interest payments averaging 3.6%, 5.3%, and 6%, respectively.

40. The National Treasury has proposed several measures and reforms aimed at containing expenditures over the medium term to enhance efficiency, transparency, and sustainability. The measures, which include a Treasury Single Account (TSA) to consolidate public funds, a transition to accrual accounting to improve financial reporting and a zero-based budgeting approach, will ensure more effective resource use allocation.

41. While the proposed fiscal reforms aim to enhance efficiency, several challenges could hinder their success. For instance, the Treasury Single Account (TSA) may face resistance and coordination issues, while transitioning to accrual accounting requires significant capacity building and accurate asset valuation. Additionally, Zero-Based Budgeting, though effective, is complex and may delay budget preparation. Successful implementation will require strong political will, institutional capacity, and strategic execution. As such, the above measures may not yield an immediate outcome in the FY 2025/26, and as a result, the current expenditure trend is expected to continue.

42. The proposed budget ceiling for 2025/26 FY is Kshs. 4,336.1 billion, which is 12 percent (Kshs. 455.2 billion) above the approved expenditures for the 2024/25 supplementary I budget. The main driver of the increase in the proposed expenditure is the National Government ministerial expenditure, which is set to increase by 15 percent (Kshs. 329.2 billion), with the bulk of the increase resulting from an increase of 16% (Kshs.260 billion) in recurrent expenditure.

Table 8: Budget Ceiling (Kshs. Billion) As per Sector Ceilings

Budget Ceiling for 2024/25 FY and the medium term (Kshs. Billion) As per BPS Ceilings							
	2024/25		2025/26			2026/27	2027/28
Item	Approved Budget	Suppl No. 1	BPS	Gross Change	% Change	BPS	BPS
Recurrent Estimates	1,632.1	1,591.6	1,851.7	260.1	16%	1,994.9	2,241.0
Capital Estimates	746.3	641.2	710.3	69.2	11%	864.3	953.7
National Government	**2,378.4**	**2,232.8**	**2,562.0**	**329.2**	**15%**	**2,859.2**	**3,194.6**
o/w Parliament	44.6	40.9	42.5	1.6	4%	44.6	46.1
o/w Judiciary	24.6	22.5	25.6	3.1	14%	28.3	31.8
Pensions & Other CFS	169.2	190.4	205.2	14.8	8%	211.2	218.7
Interest	1,009.9	1,009.9	1,129.4	119.5	12%	1,142.5	1,173.6
Contr to civil service pension fund	34.4	37.0	34.4	-2.5	-7%	35.5	36.5
Net lending							
Consolidated Fund Services	**1,213.5**	**1,237.2**	**1,369.0**	**131.8**	**11%**	**1,389.2**	**1,428.8**
County Equitable Share	**400.1**	**410.8**	**405.1**	**- 5.8**	**-1%**	**417.0**	**429.4**
Total	**3,992.0**	**3,880.8**	**4,336.1**	**455.2**	**12%**	**4,665.4**	**5,052.8**

43. Over the last couple of years, development expenditures have been below the peak of Kshs. 646 billion attained in FY 2019/20. This was a result of fiscal consolidation efforts, mostly targeting a reduction in development expenditures. Further, the proposed development expenditure during BPS has systematically been adjusted downwards in both the main budget estimates and supplementary budgets.

44. The consolidated fund services expenditures of Kshs. 1,369.0 billion proposed in the BPS are 11 percent (Kshs.131 billion) above the 2024/25 supplementary I estimates. Interest payment on public debt is set to increase by 12 percent (Kshs. 119.5 billion) from Kshs. 1,009.9 billion to Kshs. 1,129.4 billion. The rapid growth in interest payments is a continuation of a trend that has seen interest payment as a share of GDP increase from 2 percent to 4 percent over the last decade.

45. The overall budget presented above is based on the sector ceilings contained in the BPS Annex Table 4. However, the budget ceiling for 2025/26 FY as per the fiscal framework contained in Annex Table 2 is Kshs. 4,263.1 billion. Consequently, to align with the fiscal framework, the ministerial expenditure ceilings may be revised downwards by Kshs. 73 billion. The budget summary as per the fiscal framework is presented in Table 10.

Table 10: Budget Ceiling (Kshs. Billion) As per the Fiscal Framework

Budget Ceiling for 2024/25 FY and the medium term (Kshs. Billion) As per Fiscal Framework							
	2024/25		2025/26			2026/27	2027/28
Item	Approved Budget	Suppl No. 1	BPS	Gross Change	% Change	BPS	BPS
Recurrent Estimates	1,632.1	1,591.6	1,730.3	138.8	9%	1,867.0	2,144.7
Capital Estimates	746.3	641.2	758.7	117.5	18%	901.0	1,014.3
National Government	**2,378.4**	**2,232.8**	**2,489.0**	**256.2**	**11%**	**2,767.9**	**3,159.0**
o/w Parliament	44.6	40.9	42.5	1.6	4%	44.6	46.1
o/w Judiciary	24.6	22.5	25.6	3.1	14%	28.3	31.8
Pensions & Other CFS	169.2	190.4	205.2	14.8	8%	211.2	218.7
Interest	1,009.9	1,009.9	1,129.4	119.5	12%	1,142.5	1,173.6
Contr to civil service pension fund	34.4	37.0	34.4	-2.5	-7%	35.5	36.5
Net lending							
Consolidated Fund Services	**1,213.5**	**1,237.2**	**1,369.0**	**131.8**	**11%**	**1,389.2**	**1,428.8**
County Equitable Share	**400.1**	**410.8**	**405.1**	**- 5.8**	**-1%**	**417.0**	**429.4**
Total	**3,992.0**	**3,880.8**	**4,263.1**	**382.2**	**10%**	**4,574.1**	**5,017.1**

Table 9: Proposed Fiscal Framework for the FY 2025/26 Budget

Fiscal Framework in Kshs. Billion							
	2022/23	2023/24	2024/25		2025/26		
	Prel Actual	Prel Actual	Budget Est	Suppl No. 1 (S)	BPS (B)	Change (B-S)	% Change
Revenue and grants	**2,378.1**	**2,724.7**	**3,395.0**	**3,112.3**	**3,432.0**	**319.8**	**10%**
Total Revenue	**2,355.0**	**2,702.7**	**3,343.2**	**3,060.0**	**3,385.8**	**325.8**	**11%**
Ordinary Revenue	**2,041.1**	**2,288.9**	**2,917.2**	**2,631.4**	**2,835.0**	**203.6**	**8%**
Income tax	941.6	1,043.1	1,230.2	1,180.3	1,324.3	144.0	12%
VAT	550.4	645.5	812.2	723.8	775.0	51.2	7%
Import duty	130.1	133.9	187.4	160.0	163.0	2.9	2%
Excise duty	264.5	276.7	429.6	324.8	332.7	8.0	2%
Other tax revenue	154.5	189.7	257.8	242.5	240.0	(2.5)	-1%
Appropriation-in-Aid	313.9	413.7	426.0	428.6	550.7	122.2	29%
Grants	23.1	22.0	51.8	52.3	46.2	(6.0)	-12%
Total expenditures & net lending	**3,221.0**	**3,605.2**	**3,992.0**	**3,880.8**	**4,263.1**	**382.2**	**10%**
Recurrent expenditure	**2,311.6**	**2,678.4**	**2,841.9**	**2,826.2**	**3,096.3**	**270.1**	**10%**
Wages & salaries National gvt	547.2	575.3	613.6	602.7	682.5	79.7	13%
Pensions & Other CFS	120.4	143.9	169.2	190.4	205.2	14.8	8%
Interest	687.3	840.7	1,009.9	1,009.9	1,129.4	119.5	12%
On domestic debt	533.1	622.5	750.0	750.0	851.4	101.5	14%
On foreign debt	154.2	218.2	259.9	259.9	278.0	18.0	7%
O&M and other recurrent	866.1	1,026.1	1,011.2	920.3	973.7	53.4	6%
Contribution to civil ser pension fund	29.6	34.2	34.4	37.0	34.4	(2.5)	-7%
Development & net lending	**493.7**	**546.4**	**701.5**	**599.5**	**725.1**	**125.6**	**21%**
Development expenditure	481.3	528.9	693.5	591.5	714.5	123.0	21%
Net lending	12.3	17.4					
Contingency Fund			4.0	4.0	5.0	1.0	25%
Transfer to Counties	415.8	380.4	444.5	451.1	436.7	(14.4)	-3%
Equitable Share	399.6	354.6	400.1	410.8	405.1	(5.8)	-1%
Conditional Allocation	16.2	25.8	44.4	40.2	31.6	(8.6)	-21%
Parliamentary service	41.2	37.3	44.6	40.9	42.5	1.6	4%
Judicial Service	19.8	21.0	24.6	22.5	25.6	3.1	14%
Equalization Fund			8.0	8.0	10.6	2.6	32%
Overall balance including Grants	**(842.9)**	**(880.5)**	**(597.0)**	**(768.6)**	**(831.0)**		
Overall balance excluding grants	**(866.0)**	**(902.5)**	**(648.8)**	**(820.9)**	**(877.3)**		
Adjustment to cash basis	37.0	45.4					
Deficit incl grants cash basis	**(805.9)**	**(835.1)**	**(597.0)**	**(768.6)**	**(831.0)**		
Revenue and grants	**16.6%**	**17.2%**	**18.8%**	**17.1%**	**17.8%**		
Total Revenue	16.5%	17.1%	**18.5%**	**16.9%**	**17.6%**		
Ordinary Revenue	14.3%	14.5%	**16.2%**	**14.6%**	**14.7%**		
Total expenditures and net lending	**22.5%**	**22.8%**	**22.1%**	**21.5%**	**22.1%**		
Overall balance including grants	**-5.9%**	**-5.6%**	**-3.3%**	**-4.3%**	**-4.3%**		
Overall balance excluding Grants	**-6.1%**	**-5.7%**	**-3.6%**	**-4.5%**	**-4.6%**		
Primary Balance incl grants	**-0.8%**	**-0.3%**	2.3%	1.3%	**1.5%**		
Nominal GDP	**14,299**	**15,826**	**18,054**	**18,054**	**19,273**		

3.3 Fiscal Deficit

46. The fiscal deficit, including grants, is projected to reduce from Kshs. 880.5 billion (5.6 percent of GDP) in 2023/24 to Kshs. 831 billion (4.3 percent of GDP) in 2025/26 financial year. This reduction in the deficit is predicated upon the successful implementation of revenue enhancement policies coupled with limiting expenditure growth. However, given the possibility of revenue underperformance and additional expenditures emanating from the sector ceilings, the actual deficit may be over Kshs. 950 billion (over 5 percent of GDP).

47. To finace the fiscal deficit of Kshs. 831 billion, the National Treasury proposes to borrow Kshs. 684.2 billion from the domestic market and Kshs. 146.8 billion from external markets. The external borrowing projection is Kshs. 208.7 billion below the projection for 2025/26 and reflects a reduction in receipts from the IMF programme.

48. The reduction in foreign borrowing is set to be matched by a Kshs. 271 billion increase in domestic borrowing in 2025/26 FY. The growth in domestic borrowing, which may be exacerbated by a larger-than-projected fiscal deficit, may result in crowding out.

Table 10: Financing of the Fiscal Deficit (Kshs. Billion)

	2022/23 Prel Actual	2023/2024 Prel Actual	2024/25 Suppl No. 1	2025/26 BPS	Change
Fiscal Balance (incl. grants) Cash Basis	(805.9)	(835.1)	(768.6)	(831.0)	
TOTAL FINANCING	770.3	818.3	768.6	831.0	62.5
NET FOREIGN FINANCING	310.8	222.7	355.5	146.8	(208.7)
Disbursements	548.2	760.5	686.2	623.9	(62.3)
Commercial Financing	102.2	286.9	168.8	221.2	52.4
o/w Export Credit- Commercial Financing	-	-	-	-	-
Sovereign Bond other Commercial Financing	102.2	286.9	168.8	221.2	52.4
External Debt Operations - Refinancing					
Semi concessional Loans					
Project Loans AIA	74.2	68.3	113.8	107.9	(5.9)
Project Loans Revenue	62.0	87.4	111.2	103.0	(8.2)
Project Loans SGR _Phase I_ AIA				-	
Project Loans SGR _ PHASE 2A_AIA				-	
Use of IMF SDR Allocation	42.8	-		-	
Programme Loans	266.9	317.8	292.4	191.8	(100.6)
O/W P for R Programme Loans	-	18.2	3.5	-	(3.5)
IMF - RCF/ECF/EFF	-	135.1	138.3	-	(138.3)
Development Policy Operations - WB	-	154.1	123.9	170.5	46.6
Support for COVID-19 Vaccine Purchase	-	-	-	-	-
Development Policy Operations - ADB	-	10.4	26.7	21.3	(5.4)
Debt repayment - Principal	(237.4)	(537.8)	(330.7)	(477.0)	
NET DOMESTIC FINANCING	459.5	595.6	413.1	684.2	271.1
Discrepancy	(35.6)	(16.8)			

3.4 Proposed Sectoral Ceilings FY 2025/26

49. The total allocation for ministerial expenditure is set to increase to Kshs. 2.56 trillion, compared to Kshs. 2.3 trillion in FY 2024/25. With regard to the current financial year, most sectors have their expenditure ceilings increased except for Public Administration and International Relations (decrease of Kshs. 15 billion).

50. The health sector has witnessed the highest expenditure ceiling increment. The sector is expected to receive an additional budgetary allocation of Kshs. 85.6 billion as compared to the current fiscal year allocation. This enhanced ceiling is attributed to the fact that the sector aims to expand UHC and strengthen the health system's resilience as a key pillar in the BETA vision. Some of the key priorities necessitating this significant ceiling include expanding primary healthcare infrastructure, focusing on maternal and child health, and improving supply chains for essential health products. Further, the project on digital health infrastructure to connect healthcare facilities with the National Optic Fibre Backbone Infrastructure (NOFBI), targeting expanded coverage to over 6,000 health facilities by 2028, is among the drivers of enhanced budgetary allocation.

51. Some of the health sector programs with huge increments in the ceiling include General administration, from Kshs. 16 billion to Kshs. 95.5 billion, National referral and specialized services, from Kshs. 55.5 billion in the current fiscal year to Kshs. 56 billion in FY 2025/26, and health policy standards from Kshs. 3.9 billion to Kshs. 8.6 billion.

52. The education sector will also receive substantial resources amounting to Kshs. 723 billion, which is close to 30% of the total ministerial allocation. This is occasioned by activities being implemented under Basic Education on Competency-Based Curriculum (CBC) and priority funding for the Tertiary and Higher Education department to ensure that Kenyans receive the knowledge, skills, and attitudes they need to satisfy Kenya's industrialization goal.

53. It is also worth noting that the ceiling for the general administration planning and support services programme under the State Department of Agriculture has significantly increased from the current Kshs. 9.4 billion to Kshs. 17 billion.

54. However, reductions in public administration and international relations result from a significant decrease in expenditure ceilings for the economic policy and National Planning (Kshs.70 billion) program. Table 2 provides a summary of allocation by sector.

Table 11: Summary of Expenditure Ceilings by Sectors for FY 2025/26(Kshs. Mlns)

	SECTORS	Supp I Estimates 2024/25 (A)	% of total Ministerial expenditure	2025/26 BPS ceilings (B)	% of total Ministerial Expenditure	% change from Supp I 2024/25 (B-A)	% change (B-A)
1	Agriculture, Rural and Urban Development	73,933.04	3.3%	77,671.60	3.0%	3,738.56	5.1%
2	Energy, Infrastructure, and ICT	444,289.70	19.9%	504,604.10	19.7%	60,314.40	13.6%
3	General Economics and Commercial Affairs	45,625.54	2.0%	59,139.20	2.3%	13,513.66	29.6%
4	Health	118,856.31	5.3%	204,494.80	8.0%	85,638.49	72.1%
5	Education	627,767.23	28.1%	723,890.00	28.3%	96,122.77	15.3%
6	Governance, Justice, Law and Order	231,060.80	10.3%	265,872.70	10.4%	34,811.90	15.1%
7	Public Admin and International Relations	301,781.30	13.5%	286,759.00	11.2%	(15,022.30)	(5.0%)
8	National Security	219,303.10	9.8%	257,023.10	10.0%	37,720.00	17.2%
9	Social Protection, Culture and Recreation	68,942.20	3.1%	78,785.80	3.1%	9,843.60	14.3%
10	Environmental, Water and Natural Resources	101,197.20	4.5%	103,764.60	4.1%	2,567.40	2.5%
	Grand Total	**2,232,756.42**	**100%**	**2,562,004.90**	**100%**	**329,248.48**	**14.7%**

Source: The National Treasury

4.0 THE THRUST OF THE BUDGET POLICY STATEMENT.

55. The Fourth Medium-Term Plan of Vision 2030 envisioned a value chain approach towards delivering concise interventions that were aimed at reducing the cost of living, eradicating hunger, creating jobs, expanding the tax base, improving foreign exchange balances, and inclusive growth. This section reviews the progress made toward the attainment of these objectives, highlights existing policy gaps, and evaluates the MTP IV sectors and linkages to the 2025 Budget Policy Statement. The section strives to provide insights on whether the country is on a path to achieving the intended objectives, the inherent challenges, and to what extent the policy pronouncements in the BPS contribute towards the attainment of the MTP IV objectives.

4.1 Evaluation of the Gains: Progress Towards the Objectives

56. Cost of Living: The BPS indicates that the cost of living has significantly declined, with the price of basic commodities, including food, fuel, and fertilizer, among others, declining. There are concerns about what is attributable to the government's policy interventions and what may be attributed to other externalities. For instance, the high cost of basic commodities at the time in reference was attributed to the prolonged drought that the country was facing and overreliance on rain-fed agriculture.

57. While MTP IV emphasizes the importance of transitioning to irrigation-based agriculture, including through public-private partnerships, progress has been minimal. This raises concerns about how well the country would handle a similar drought today. Additionally, although fuel prices have declined due to global reductions and fewer supply chain disruptions, these benefits may not last if such volatility continues.

58. Although not explicitly stated as a government policy, there has been a noticeable trend of transferring the financial responsibility of government programs indirectly onto households rather than financing them through conventional taxation. This encompasses initiatives such as the affordable housing programme, the social health insurance fund, the new university funding model, and proposed adjustments to the social security fund. These changes could potentially reduce household disposable income, thus adversely impacting aggregate demand.

59. Job Creation: The proposed interventions under the MTP IV were envisaged to create approximately 1.2 million jobs per annum. The BPS highlights progress in job creation in several sectors, including 164,000 jobs in affordable housing, 2,079,658 youths trained and linked to online jobs under the Ajira Digital Programme, and 4,000 jobs from Constituency Industrial Development Centers, among other interventions.

60. While these efforts are commendable, there are concerns about the quality of the reported jobs. Additionally, there are ongoing concerns that unemployment and underemployment remain persistent, with many citizens, especially the youth, struggling to find stable and quality employment. This is compounded by the fact that between 2020 and 2023, the combined **real wages** for both the private and public sectors **decreased by 10.7 percent**. Annual average real wages in the private sector have reduced from Kshs. 749,112 in 2020 to Kshs. 686,451 in 2023, a reduction of 8.4 percent while that of the public sector reduced from Kshs. 743,063 in 2020 to Kshs. 625,870 in 2023, a reduction of 15.8 percent.

61. **Expanding the Tax Base**: The MTP IV envisaged expanding the tax base and enhancing revenue collection as a share of GDP from a baseline value of 16.5 percent in FY 2022/23 to 18.8 percent by FY 2024/25 and 19.0 percent in FY 2025/26. However, the attainment of this objective has been impeded by a confluence of factors, including Public Perception of Tax Reforms, Low Tax Compliance, a huge Informal Sector, and Persistent Economic Shocks, among others. The BPS has an indicative target of 17.6 percent for FY 2025/26. Addressing these challenges will require a comprehensive and adaptive approach to tax policy and administration.

62. Despite the efforts to expand the tax base, revenue shortfall continues to hinder the smooth implementation of various government programmes. For instance, by the close of FY 2023/24, the overall revenue shortfall was approximately Kshs. 200 billion, while in the first half of FY 2024/25, **tax revenue collection was Kshs.107 billion below** the revised target.

63. **Improving Foreign Exchange Reserves:** The BPS reports notable progress with regard to the enhancement of foreign exchange reserves. Specifically, the increase of months of import cover from 3.9 months in November 2023 to 4.9 months in November 2024. It is, however, notable that the improvement is not solely attributable to structural changes in the economy but includes other determinants such as appreciation of the Kenyan Shilling, foreign inflows from IMF support programs, and a decline in imports that has been attributed to the contraction of disposable incomes and business prospects. This is demonstrated by the fact that foreign reserves expressed in months of import cover stood at 4.3 and 5.1 months in November 2022 and 2021, respectively. Going forward, there is a need to focus on promoting foreign exchange earnings through exports, diaspora remittances, and foreign investments.

4.2 Consolidating the Gains: Linkage to MTP IV Sectors.

64. **The Fourth Medium Term Plan's key priorities are clustered into five key sectors**: Finance and Production, infrastructure, social, environment and Natural Resources, and Governance and Public Administration. This section evaluates whether the policy proposals in the BPS are adequate to support the dream emblemed in MTP IV and, ultimately, Vision 2030.

4.2.1 Infrastructure Sector

65. **The infrastructure sector of the MTP IV houses two of the strategic pillars of the bottom-up economic transformation agenda**: Affordable Housing and the Digital Superhighway. The other subsectors are defined as important enablers and include roads and transport, water and irrigation, and energy infrastructure.

66. The BPS notes that the Affordable Housing Programme is expected to increase the supply of affordable houses from the current 2 percent to 50 percent by facilitating the delivery of 200,000 housing units annually and increasing the opportunity for manufacturers,

developers, and the Jua Kali industry to produce high-quality construction products and provide employment to different types of professional services.

67. **Although the Affordable Housing Fund was established, preliminary reports indicate that the construction sector has not absorbed resources.** These resources are either idle in the fund or invested in government securities. This is an indication of systemic inefficiencies in the implementation of the programme. Further, the anticipated active role of public investment in the construction industry may have impacted the private investments in the sector, thereby reducing the overall contribution of the sector to the GDP as well as a reduction in credit to the private sector for the building and construction sector.

68. **The building and construction sub-sector majorly comprises the roads and buildings construction**. With the slowdown in road construction due to fiscal constraints and the low uptake of the affordable housing programme, the sector is expected to continue operating sub-optimally. Therefore, the affordable housing fund needs to be relooked at its entire architecture to ensure that it focuses on areas with the requisite absorptive capacity and high impact in terms of contribution to economic activity.

69. **The BPS notes that the Government has constructed 2,766 kilometers of roads over the last two years**. Other significant achievements include rehabilitating 280 kilometers of roads, maintaining 10,320 kilometers of roads under Performance Contracts, maintaining 117,294 kilometers of roads under routine maintenance, maintaining 2,389 kilometers of roads under periodic maintenance, and constructing 77 bridges across the country.

70. **While these efforts are notable, the road sector continues to face a multiplicity of challenges**. These include **pending bills of over Kshs. 170 billion**, multiple stalled projects, pending land compensation cases, and equity in the distribution of road projects. The extended project completion timelines have resulted in additional cost overruns for the government. The sector also has multiple institutions implementing similar roles, creating room for duplication of functions and systemic inefficiencies. Going forward, there is a need to monitor the impact of the merging of some of the road agencies as well as financing mechanisms to enhance efficiency within the sector.

71. **The Government has connected an additional 5,843,258 people to safe water over the last two years.** To enhance access to water for domestic, irrigation, and industrial use, the BPS further indicates that an additional 280,000 households have been connected to improved sanitation, increased water storage per capita from 107 cubic meters to 108 cubic meters, and an additional 181,069 acres of land put under irrigation for rice, maize and other value chains among other interventions.

72. **Despite huge investments, some projects and programmes have not been able to accrue the necessary benefits.** The water and irrigation sub-sector is a critical enabler of not just food and nutrition security but also decent livelihoods. However, due to delayed completion of projects and others being stalled, these projects are yet to benefit the people. Flagship projects such as the Galana Kulalu Irrigation project and Thwake Dam have been

under implementation for a long time, denying beneficiaries' potential benefits. This calls for improved coordination among stakeholders to address water resource challenges.

73. **Avenues for alternative financing.** To alleviate the bottlenecks arising from inadequate water resources and given the constrained fiscal space, the government planned to adopt alternative financing arrangements, including public-private partnerships (PPPs). However, the process has faced resistance from stakeholders due to a lack of clear policy guidelines on the implementation of such critical projects under such an arrangement. Hence, there is a need for robust frameworks to ensure that private sector participation does not lead to exploitation or neglect of public interests in the water sector.

74. **Role of National and County Governments**. Notably, given that water and irrigation are a shared function between the National and County Governments, the National government should stop the implementation of micro projects such as boreholes and water pans and concentrate on small, medium, and large-scale irrigation projects. There is also a need to carefully relook at the number of government agencies in the sector to merge or fold those with duplicate mandates to enhance efficiency and ease coordination.

75. **The BPS reports that 774,000 more customers are connected to the grid, bringing the total number of customers connected to electricity to 9,791,575.** To expand access to electricity, the government has, over the last two years, installed an additional 240MW of electricity, thus increasing the total installed capacity from 3,243 MW; constructed 675 kilometers of transmission lines; installed 1,266.7 kilometers of medium-voltage distribution lines; and constructed 30 distribution substations.

76. **Despite these efforts, the cost of energy remains significantly high for the majority of Kenyans and also in comparison to the region.** For instance, the average residential electricity price per kWh in Kenya is USD 0.26, Uganda is USD 0.17, Tanzania is USD 0.09, South Africa is USD 0.12, and Ethiopia is USD 0.006. [3] High energy costs can be a burden on households and businesses, affecting their overall economic well-being. Addressing these costs requires innovative approaches, including modernizing power infrastructure, improving energy efficiency, and increasing renewable energy sources. Mechanisms for providing off-grid power to regions outside the national power grid system and upscaling last-mile connectivity are needed to ensure that the existing infrastructure is put to optimal use.

77. **Extension of National Fiber Optic Backbone infrastructure to ensure universal broadband availability.** The BPS notes that the government has expanded last-mile fiber-optic connectivity by 13,712 kilometers using the extensive Kenya Power transmission lines network to the most remote and underserved areas of the country. Further plans are on schedule to establish 1,450 ICT in each ward to provide digital literacy training, support content creation, and facilitate access to Government services. This is expected to create a foundation for digital transformation, enabling IT economy workers, young digital creators, and entrepreneurs to access a wealth of opportunities both locally and globally.

[3] www.globalpetrolprices.com

78. **The shift from the costly underground fiber optic cable is a welcome move.** The high costs associated with laying the cables have hindered efforts to enhance the network's geographical reach. However, even with the shift, there is a need to ensure that the infrastructure is well-secured from vandalism, for instance, by ensuring that the fiber optic cable is above the power lines to deter vandalism.

79. **Consideration of investing in satellite internet connectivity**. Given the technological advancements in satellite internet, the government needs to develop a framework for transitioning to it, including options for investing in ground stations and other necessary infrastructure to support satellite connectivity and ease access to remote areas at an affordable investment.

4.2.2 Social Sector

80. The social sector comprises six subsectors: Health, education, labor, and Social Protection, Public Service, Performance and Delivery Management, gender, Culture, the Arts and Heritage, and Youth and Sports. The sector aims to improve the quality of life of all Kenyans by accelerating human capital development and social welfare. The health sector is equally one of the pillars of the bottom-up economic transformation agenda.

81. The BPS notes that to promote Universal Health Coverage, the government shifted from the National Health Insurance Fund Model to Taifa Care, which is fundamental and radical in both scale and character. The newly established Social Health Insurance Fund (SHIF) empowers citizens to contribute towards accessing a broad range of healthcare benefits. Once the transition from NHIF is complete and SHIF becomes fully operational, Kenya will have a healthcare system that guarantees dignity, peace of mind, and equitable access for every citizen.

82. **Prompt settlement of claims by Social Health Authority (SHA) for primary healthcare facilities**. There have been significant delays in the settlement of claims by SHA for healthcare facilities due to challenges faced when transitioning from the National Health Insurance Fund (NHIF) to the Social Health Insurance Fund (SHIF). These have adversely affected the operations of the health sector, especially the primary healthcare facilities. The government’s directive to pay claims within 90 days of being lodged has not been effective, and most primary healthcare facilities are still facing delays.

83. **Clarity of the Means Testing Instruments (MTI).** The transition to the Social Health Insurance Fund is based on a Means Testing Instrument that is supposed to determine the household contribution to the fund. This involves the household providing information on their socioeconomic status. This has presented several challenges, including the provision of inaccurate or incomplete information and the adequacy of the MTI in determining proper household contribution. This has hindered the uptake of the fund and will have a bearing on the overall delivery of UHC, especially in the informal sector.

84. **Education Sector Reforms.** To boost education and training outcomes, the BPS posits that the government has invested significant resources and implemented radical changes in the education sector, including resolving uncertainty around the Competency-Based Curriculum, new student-focused higher education funding model, improving the student-

teacher ratio by employing 56,000 teachers for primary and secondary schools and infrastructure improvement in primary, JSS, secondary and tertiary institutions.

85. Despite these efforts, there are concerns about the progression mechanisms under the CBC. This includes the adequacy of the various assessment criteria and how they are being translated to guide learners toward the various career pathways that have been defined. This underscores the need for continuous stakeholder engagement to build clarity on the entire realm of the CBC.

86. Although the judiciary has halted the implementation of the new funding model for higher education, stakeholders have also raised concerns about its clarity and fairness. Some households may appear to have sufficient income based on the means-testing mechanisms but struggle financially due to multiple dependents or irregular income streams. The income bands used to categorize students have been highlighted for not accurately reflecting the financial situations of beneficiaries.

87. The government's medium-term strategy focuses on empowering women economically and addressing gender-based violence and inequality through various initiatives. This may be achieved through monitoring compliance with gender mainstreaming, training on gender-responsive budgeting, and developing a clear framework to implement the constitutional two-thirds gender principle in elective positions. These combined efforts aim to foster a more equitable society by removing barriers to women's economic participation, ensuring their safety, and embedding gender considerations into all levels of policy and decision-making.

4.2.3 Finance and Production Sector

88. The finance and production sector aims to create synergies among the subsectors by adopting the value chain approach to production, value addition, and market access while ensuring quality assurance and standards. The sector encompasses two of the key BETA pillars: the agricultural transformation and the MSME pillar.

89. **Agricultural Growth and Contribution:** The MTP IV and the World Bank's Economic Update 2024 emphasize the agriculture sector as a key driver of the nation's economic growth, poverty reduction, and job creation. Agriculture remains central to the country's development strategy, with a projected growth rate of 4.5% in 2025 and an average contribution of 21.6% to GDP over the last five years. The priority value chains highlighted in the BPS cover diverse sectors such as leather, dairy, tea, maize, coffee, and indigenous poultry, focusing on agricultural diversification and industrial growth.

90. **Leather and Leather Products value chain**: the major policy is the transformation of Kenya's leather sector, which involves strategic interventions aimed at boosting production, job creation, and value addition. Key measures include policy alignment, infrastructure investments, market development, and capacity building. Notable efforts include the establishment of the Kenya Leather Industrial Park at Kenanie. However, the BPS could better integrate the leather sector's growth targets with national industrialization policies to enhance coherence and effectiveness. Furthermore, the project has been under implementation for nearly ten years implying that by now it should be moving to self-sustenance.

91. **Dairy Value Chain.** The BPS posits that the dairy sub-sector saw a 14% increase in milk production in 2023, reaching 5.2 billion litres, with projections indicating further growth in 2024. Export values of dairy products nearly doubled from Kshs. 4.8 billion in 2022 to Ksh 7.2 billion in 2023. The government has also supported broader livestock value chain improvements, including an 8.6% rise in meat exports and a 42% increase in live animal exports. The sector, however, continues to face challenges, including seasonality of feeds and fodder, erratic milk prices, and extension services.

92. **Veterinary and disease control initiatives:** To ensure the health and productivity of livestock, the government launched an ambitious program to vaccinate over 22 million cattle and 50 million goats against diseases like Foot and Mouth Disease and Peste des Petits Ruminants (PPR). These efforts are essential for protecting livestock health and ensuring consistent productivity. However, the BPS lacks farmer sensitization efforts to overcome negative perceptions of livestock vaccination. Furthermore, the plan does not provide clear operational details for Artificial Insemination (AI) programs, which are critical for improving dairy genetics and production.

93. **Textiles and Apparel Value Chain**: The BPS also outlines significant efforts in the textiles and apparel sector, including the revitalization of cotton production and ginning modernization. Key interventions include expanding cotton acreage from 26,000 to 200,000 acres and enhancing ginning facilities to improve raw material supply. These efforts align with MTP IV's goals of agricultural modernization and industrialization. However, greater policy integration, particularly with the National Cotton, Textile, and Apparel Policy 2024, is needed for a comprehensive national strategy. Additionally, expanding infrastructure throughout the entire textile value chain, from cotton production to finished products, would help streamline operations and improve competitiveness in the sector.

94. **Edible Oils Value Chain**: The BPS highlights key interventions in the edible oils sector, with a strong alignment to the MTP IV strategic goals of agricultural modernization, value chain development, and import substitution. By promoting local production of oil crops such as sunflower, canola, and soybeans, the BPS aims to reduce Kenya's reliance on imported edible oils, enhancing food security. However, given the investments that have gone into the sector, there is a need to shift reporting progress from an input to an output perspective.

95. **Price Stabilization and Market Access**: The BPS also emphasizes price stabilization and market access in the edible oils sector, targeting both local and export markets. Efforts such as contract farming, export market sensitization, and commercial representation aim to mitigate price volatility and ensure long-term stability. While price stabilization is critical, the BPS would benefit from clearer strategies on how to manage global price fluctuations and climate variability. Additionally, the export market strategy could be expanded to

focus on market diversification, with a greater emphasis on packaging and branding to make Kenyan oils competitive globally.

96. **Tea and Coffee Sub-sectors**: The BPS outlines multiple interventions aimed at enhancing Kenya's tea and coffee sectors, with a focus on improving competitiveness, sustainability, and value addition. Efforts to modernize processing, develop research and development factories, and diversify into specialty teas and coffees will enhance product differentiation and competitiveness. The government's support for smallholder farmers through cooperatives and financial assistance aligns with MTP IV's focus on inclusive growth. However, the BPS should provide a more systematic approach to climate resilience, including climate-smart farming techniques to safeguard the sub-sectors against environmental challenges as well as enhance the competitiveness of Kenyan tea and coffee to safeguard the global market quota.

97. **Rice Production and Support**: The BPS outlines key interventions for enhancing rice production in Kenya, focusing on irrigation expansion, seed distribution, land allocation, and water infrastructure development. Notably, irrigation expansion is seen as a key strategy to improve agricultural productivity and mitigate climate change risks. The BPS plans to expand irrigation areas by 500,000 acres, particularly in regions like Bura and Mwea, aligning with the MTP IV's objectives. However, this could be improved by emphasizing community engagement and capacity-building efforts to ensure local farmers can manage these projects effectively. Additionally, the integration of climate-smart practices into rice farming could be strengthened to better align with the MTP IV's sustainability goals.

98. **Sugar subsector:** The BPS outlines a series of initiatives aimed at revitalizing the industry, improving sugarcane production, and enhancing competitiveness**.** There is alignment with MTP IV's goals of industrialization and increasing agricultural productivity, including the restoration of sugar factories and expansion of domestic sugar production through the establishment of 4 new factories. While value addition in the sugar industry is noted, there is little focus on expanding into diverse products like ethanol and biofuels, which MTP IV highlights as opportunities for increasing the sector's profitability and sustainability. The BPS could also explore long-term financing models to support the sugar industry's growth, including public-private partnerships.

99. **The MSME sector is central to Kenya's Bottom-Up Economic Transformation Agenda, driving inclusive growth and job creation.** MSMEs contribute significantly to the economy, creating 30% of jobs, contributing 40% to GDP, and forming 98% of all businesses. The government recognizes the challenges faced by MSMEs, including limited access to finance, infrastructure gaps, regulatory hurdles, and market access issues. To address these challenges, the government has introduced initiatives like the Hustler Fund, aimed at providing affordable credit, capacity building, and facilitating MSME market access, particularly in sectors like construction and low-cost housing.

100. In terms of policy alignment, the BPS emphasizes various initiatives supporting MSME growth, including expanding job creation opportunities in sectors such as leather

manufacturing. The Hustler Fund has been extended to target SMEs, to transition 2 million entrepreneurs into the formal banking system to promote financial inclusion. However, MSMEs may face challenges in transitioning due to limited financial literacy and the high-risk nature of small businesses. Despite these hurdles, the government's focus on linking MSMEs with large enterprises and government institutions is expected to improve market access and foster inclusive economic growth.

101. **Capacity building for MSMEs in the leather and textile sectors.** The government plans to provide training in areas such as leather design, finishing, and fashioning, as well as in textile manufacturing. While these initiatives are positive, there is a need for more targeted programs focused on advanced skills, innovation, and marketing to improve the competitiveness of Kenyan MSMEs in global markets. Additionally, the BPS mentions legal reforms, including the review of key acts and the Micro, Small Enterprise (MSE) 2020 Policy, aimed at reducing barriers to MSME growth. However, more emphasis is needed on enforcing these reforms to ensure their effectiveness.

4.2.4 Environment and Natural Resources Sector

102. **The sector focuses on environmental protection, water resources, the blue economy, and enhancing the value chains of minerals.** A key target is to increase tree and forest cover to 21% and 17%, respectively, by 2027, with a focus on adaptation and mitigation measures to climate change. These efforts are expected to create green jobs, reduce greenhouse gas emissions, and enhance community resilience, particularly in Arid and Semi-Arid Lands (ASALs). Additionally, there are targeted interventions aimed at reducing human-wildlife conflicts in vulnerable counties to support sustainable environmental management.

103. **Enhancing the agroforestry value chain.** The government is working on policies and regulatory frameworks to attract climate finance for establishing 5 million acres of agroforestry woodlots, particularly in ASALs. This initiative aims to support sustainable land management and increase forest cover, contributing to environmental conservation and climate change mitigation efforts. The development of such frameworks is essential for attracting funding to scale up agroforestry practices that can improve local livelihoods and ecosystems, making a significant contribution to the broader climate agenda.

104. **The National Tree Growing Programme.** A core part of the Financing Locally-led Climate Action (FLLoCA) program, is set to plant 15 billion trees by 2030. This ambitious initiative will help restore degraded forests, expand tree nurseries, and involve both public and private sectors in environmental conservation. The program aims to produce 300 million seedlings annually and restore 175,000 hectares of degraded public natural forests. However, there is a need for more emphasis on leveraging technological solutions such as remote sensing and drones to track reforestation progress, as well as clearer strategies for long-term monitoring and maintenance of planted trees to ensure their survival and effectiveness in combating climate change.

105. **Climate Change Mitigation and Adaptation:** In the area of climate change mitigation and adaptation, the government aims for a 32% reduction in emissions by 2030.

This includes halting deforestation, combating desertification, and reversing biodiversity loss. Priorities include promoting biomass energy, agroforestry, and solid waste management as sustainable solutions. While these initiatives align with Kenya's Nationally Determined Contributions (NDCs) under the Paris Agreement, the BPS could better articulate how green technologies will foster private sector innovation, job creation, and climate-smart infrastructure. More specific strategies for measuring and tracking emission reductions, along with clearer frameworks for ensuring that climate finance reaches marginalized rural communities, would enhance the overall impact of these efforts.

106. **Extended Producer Responsibility (EPR) model for waste management**: BPS commits to the EPR model, which emphasizes the responsibility of businesses to manage the lifecycle of their products, thereby promoting recycling and waste reduction. In tandem, the focus on developing agroforestry woodlots in dryland areas aligns with Kenya's broader environmental goals of land restoration while simultaneously providing economic opportunities for rural communities. However, some opportunities could be explored by creating the appropriate links between the EPR model, climate finance, and the creation of green jobs.

107. **The blue economy is recognized as a key driver of inclusive economic growth in Kenya, with potential across both marine and freshwater resources.** The BPS projects significant growth in this sector from Kshs. 20 billion to Kshs. 80 billion over the next five years, creating jobs and contributing to regional economic development. The BPS outlines key government investments in infrastructure, particularly within the fishing industry, such as the rehabilitation of fish landing sites, the development of the Liwatoni Fish Processing Plant, and the Shimoni Fish Port. These projects are expected to improve fish production and enhance the value chain. While these infrastructure investments are vital, the sector could benefit from emphasizing private-sector partnerships and technological innovations to further support the sector's growth.

108. **The tourism sector is a key contributor to Kenya's economy, accounting for approximately 10% of GDP and 9% of total employment.** The government aims to unlock its potential by promoting diversification, developing niche products, reviewing the Tourism Act to align with emerging sector needs; strengthening the country's capacity to host meetings; and fostering collaborations between county governments, local communities, and the private sector. Additionally, youth empowerment and innovation are emphasized, particularly through digital platforms. However, while sector diversification is essential, the BPS could further explore synergies with industries like agriculture, crafts, and cultural heritage to strengthen inter-sectoral linkages, which could enhance the overall impact of tourism.

109. **Land Reclamation Efforts:** The BPS notes that the government is working on the Land Reclamation Policy 2024, which aims to reclaim degraded and marginal lands, focusing on restoring ecological balance and increasing land productivity. However, it is not clear why the same could not be mainstreamed into the National Land Policy which has a section on Restoration and conservation of land quality to avoid duplication and enhance coordination of efforts.

5.0 COUNTY GOVERNMENT FINANCIAL MANAGEMENT.

5.1 Fiscal Risks among County Governments

110. The Budget Policy Statement 2025 has highlighted how the forty-seven County Governments have complied with the Fiscal Responsibility Principles as provided for in the Public Finance Management laws. The assessment is undertaken on allocation and actual expenditures on Development and employee compensations as well as the levels of borrowing and collection of revenue in counties. The BPS also addresses the issues around fiscal risks and the controls to be applied.

111. All counties have conscientiously allocated more than 30% of their total budgets to development, and this is evidenced in the allocation in the last three financial years, in which the allocation averaged 33.6 percent. However, the actual development expenditures by the end of the financial year trail below the minimum thirty percent requirement. **In FY 2023/24, nine counties met this requirement,** implying that counties do the allocation for approval purposes and fail to actualize the implementation. To address this, the BPS calls on the Controller of Budget to ensure compliance during the approval of expenditure requisitions.

Table 12: County Budget Allocation and Actual Expenditures (Kshs. Billions).

	FY 2021/22		FY 2022/23		FY 2023/24	
	Budget Estimate	**Actual expenditure**	**Budget Estimate**	**Actual expenditure**	**Budget Estimate**	**Actual expenditure**
Total Expenditures	535.7	401	515.2	428.9	562.75	446.7
Total Recurrent	342.2	302.5	354.6	330.9	372.82	337.53
OW % of the Total	**63.9%**	**75.4%**	**68.8%**	**77.2%**	**66.2%**	**75.6%**
Total Development	193.5	98.5	160.5	98	189.9	109.2
OW % of the Total	**36.1%**	**24.6%**	**31.2%**	**22.8%**	**33.8%**	**24.5%**

Source: BPS 2025.

112. Over time, nearly all counties have had expenditures on wages and benefits for their public officers above the set threshold of thirty-five (35) percent of the total revenue received by the county. In FY 2023/24, County Governments' expenditure on employee compensation and other benefits amounted to Kshs.209.8 billion, accounting for 47.6% of the total revenue of Kshs.440.7 billion. **Only three counties, namely Tana River, Narok, and Kilifi, had expenditures on wages, and salaries were below the threshold.**

113. The government does not provide a framework for how it intends to address this challenge, which continues to rise. A large part of the annual increase in equitable share and other revenues to counties goes to defray recurrent expenditures such as salaries and wages, leaving very limited fiscal room for development spending. The government should formulate a policy that prioritizes service delivery through such additional resources. The government should also develop policies to tighten up the employment uncertainties in county governments.

114. **The BPS points out the growing pending bills burden in counties totaling Kshs.181.9 billion by the end of FY 2023/24.** This was equivalent to a 10% growth (an increase of Kshs.17.22 billion) from Kshs.164.76 billion reported in the previous FY 2022/23. Further, as of September 2024, the pending bills stood at Kshs.194 billion, representing a 6 percent growth in the First Quarter of FY 2024/25.

115. Nairobi City County has the highest pending bill of Kshs.121.1 billion (as of September 2024), which represents 62.4 percent of the entire stock of pending bills. This amount is more than five (5) times the total revenue received by Nairobi County as equitable share. This means it may be difficult for the county to settle the Bills even in the medium term. The government should pursue a different approach to help the county create enough fiscal space to clear these outstanding obligations.

116. The government pronouncement on pending bills being a first charge on the County Revenue Fund has not yielded any positive results; the accumulation rate of pending bills continues to outdo the settlement rate. The government expects the proposed transition from cash to an accrual basis of accounting to substantially reduce the stock of pending bills. While this is a good policy option, counties are still accruing debts, citing delayed exchequer releases and underperformance in their own source revenues as the root cause of the problem.

Table 13: Summary of County Pending Bills as of 30th September 2024

	Development Pending Bills	Recurrent Pending Bills	Total
County Executive	43,595.24	147,970.52	191,565.76
OW Nairobi	**5,314.68**	**115.77**	**5,430.45**
County Assembly	915.28	1,524.83	2,440.11
Total	**44,510.52**	**149,495.35**	**194,005.87**

Source: Controller of Budget.

117. County governments are still lagging in remitting pension deductions from the staff to the relevant retirement benefits authorities. The outstanding non-remitted fund totaled Kshs.91.2 billion as of October 2024. The Outstanding Pension remittances are owed to Local Authorities Provident Fund (LAPFUND)-DC-Kshs. 45.7 billion, Local Authorities Pension Trust (LAPTRUST)-DB-Kshs. 39.5 billion and County Pension Fund (CPF) -DC-Kshs. 5.9 billion.

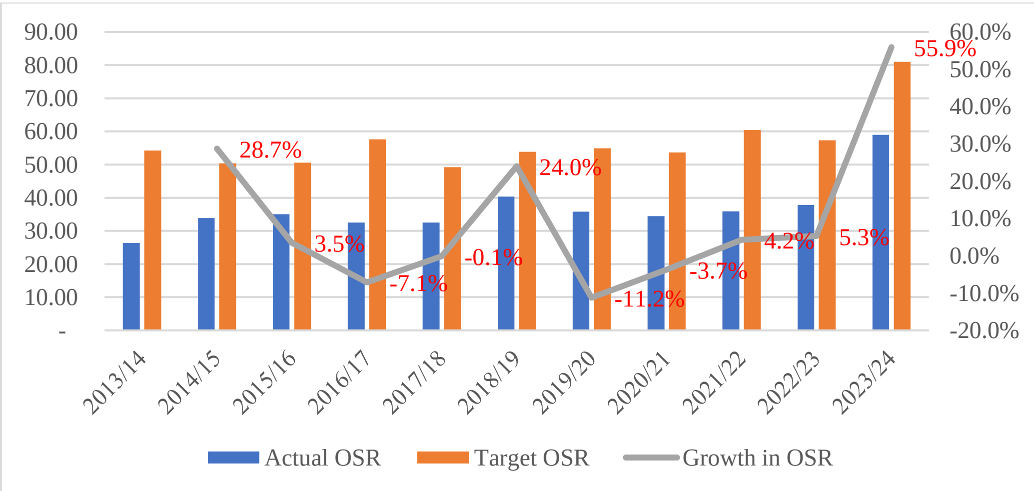
118. Analysis shows that the debts increased by Kshs.17.8 billion from August 2023 which had an outstanding balance of Kshs.73.4 billion. This accumulation rate (24.5 percent increase) is alarming and would lead to staff retiring without pensions. The risk would be having retirees leaning on social security from the government to stay afloat, which calls for the diversion of resources from the economy's productive sector. Besides the recommendation in the BPS of having the County enhance record keeping of the arrears

and prioritization of their payment, the government can employ some form of sanctions over counties that continue to delay these remittances.

119. There is a significant concern about the underperformance of the Own Source Revenue by Counties. In FY 2023/24, revenue collection of the 47 counties amounted to Kshs.58.9 billion, Kshs.22 billion (or 27.2 percent) less than the target of Kshs.80.9 billion. This amount consists of the ordinary OSR and the Facility Improvement Fund (FIF), which are funds collected and retained by health facilities under the Facilities Improvement Financing Act of 2023. Of the Kshs.58.9 billion collected in the period under review, Kshs.16.7 billion was collected and retained by public health facilities under the FIF programme.

120. The implementation of the Facilities Improvement Financing Act has resulted in significant growth of OSR between FY 2022/23 and FY 2023/24. During the period, the revenue collection exceeded the previous collection by 56 percent, from the actual collection of Kshs.37.81 billion (FY 2022/23) to Kshs.57.37 billion in FY 2023/24. This implies that the application of the revenues collected in the facilities at source improved efficiency and accuracy. Further, a separate analysis of ordinary OSR and the FIF performance shows a great difference; While FIF recorded a 91.4 percent outturn, Ordinary OSR registered a 68 percent performance.

Figure 8: Own Source Revenue Performance between FY 2013/14 to FY 2023/24



Source: Controller of Budget.

121. The government proposes several policy measures towards supporting county government to enhance Own Source Revenue collection. According to the BPS, the government intends to;

i. Develop a revenue forecasting model that uses a more scientific approach for accurate revenue projection. This is being undertaken by the National Treasury in collaboration with the State Department for Devolution, Commission on Revenue Allocation (CRA), National Bureau of Statistics (KNBS), Council of Governors (COG), Kenya Revenue Authority (KRA), and Kenya Institute of Public Policy Research and Analysis (KIPPRA).

ii. Operationalization and implementation of the provisions of the National Rating Act, 2024. The government aims to develop implementing Regulations and a model rating bill for adoption by County Governments. This is expected to improve property rate collection, a key revenue source for county governments.

iii. Development of regulation of the introduction of taxes, fees, and charges by the County Governments through the enactment of the Revenue Raising Process Bill, which is under consideration by Parliament.

iv. Develop an integrated county revenue management system (ICRMS) to replace the fragmented county revenue management systems currently operated by counties.

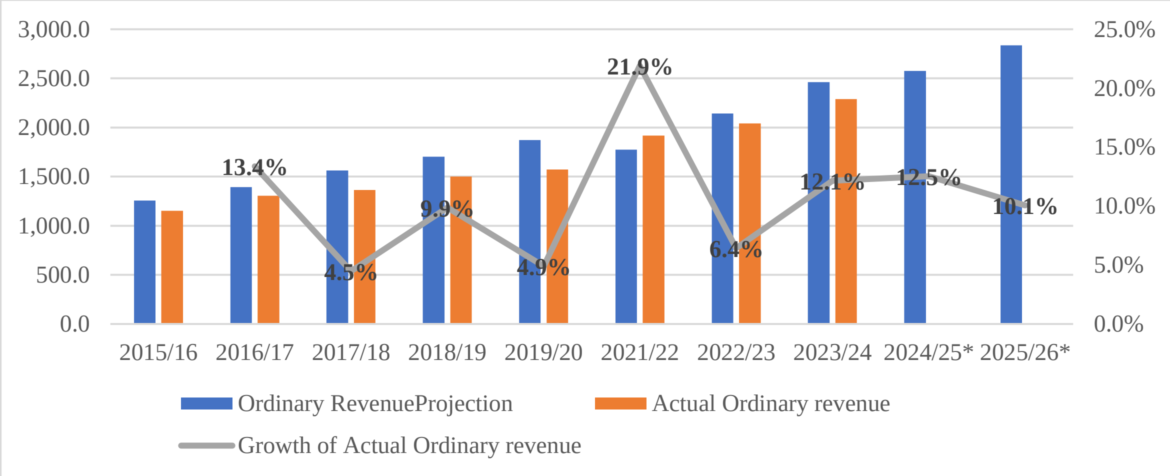
122. Despite these numerous interventions, the county government's uniqueness in terms of land and production of goods and services should not be underestimated. While property rates are a considerable source for enhancing the fiscal space for counties, it is not potential for all counties. The impact would be limited in rural counties that are characterized by lands without title deeds, low values of land, and the inability of citizens to meet their obligations. Further, other countries have limited agricultural production capacity and, hence, rely more on levying cess on goods in transit.

5.2 The Sub-National Transfers In FY 2025/26.

5.2.1 Vertical sharing of revenue in FY 2025/26.

123. Post-Covid, sharable revenue, which is a function of ordinary revenue, has been depicting inconsistent growth. While the performance of ordinary revenue surpassed targets in FY 2021/22 by 8 percent and registered a growth of 21.9 percent, in successive years, revenue fell short of targets by high margins going beyond Kshs.100 billion. In FY 2025/26, the shareable revenue is expected to grow from the projected Kshs.2,575.9 billion in FY 2024/25 to Kshs.2,835 billion. This represents a growth of 12.5 percent; however, to the end of the financial year 2024/25, the growth may dwindle further due to unmet targets.

Figure 9: Ordinary Revenue performance.



Source: National Treasury, DORA. ***Projections***

124. **The BPS proposes to allocate the county governments Kshs.405.1 billion in FY 2025/26 as equitable share.** This is equivalent to 14 percent of the projected ordinary revenue of Kshs.2,835.1 billion. The allocation is an increase of Kshs.17.7 billion from Kshs.387.4 billion allocated in FY 2024/25. The proposed Kshs.405.1 billion is equivalent to 25.79 percent of the last audited and approved actual revenues raised nationally of Kshs.1,570,563 million for the FY 2020/21, hence compliant with the requirement of Article 203(3) of the Constitution.

125. It is highlighted that the sharing of revenue between the two levels of government took into account the mandatory expenditures under Article 203(1) of the Constitution. These include national interest expenditures such as defense, irrigation, and safety net programs, public debt servicing, Pensions, Constitutional Services and Other National obligations, and allocations to the Emergencies and Equalization Fund.

126. Despite the equitable share allocation being set out in the yearly BPS and subsequently enacted through the Division of Revenue Act, there have been budget carryovers on equitable share at the beginning of the financial year. **In FY 2024/25, Kshs.30.8 billion was allocated to counties as a carryover from the previous FY 2023/24,** giving the impression of an enhanced allocation being set aside for counties. These delays disrupt budget implementation in the present financial year and distort the already formulated budgets in counties. The government must commit to disburse allocations to counties within the financial year in which the allocation is made.

127. It is indicated that part of the expected sharable revenue (ordinary revenue) is allocated to programs that are of National Interest and other key pillars of the economy, However, part of the project implementation is left as an obligation to county governments. Projects such as Universal Health Care being implemented through Community Health Promoters (CHPs), County Aggregation, and Industrial Parks (CAIPs), and contributions towards the Housing Levy and Social Health Insurance tend to constrain the fiscal space of counties, hence depriving them of the resources to implement their core flagship projects.

5.2.2 Horizontal sharing of Revenue in FY 2025/26.

The sharing of Revenue among county governments is reserved in the Constitution in Article 217(1). Parliament is required to consider and approve the revenue-sharing basis every five years. The third basis which is in place has been applied between FY 2020/21 and FY 2024/25. The BPS envisages the application of the third basis on the proposed allocation of Kshs.405.1 billion since the fourth basis is yet to be approved by Parliament. When applied, the percentage increase in allocations in counties ranges between 7.1% and 8.3% from FY 2024/25 to FY 2025/26.

128. The recommendation of CRA in the fourth basis proposes to retain the Population Parameter weighted at 42%, as opposed to 18% as contained in the Third Basis, The Poverty index is maintained at the same weight of 14%, the Basic Share index is enhanced to 22% from the previous 20%, while land area is given an additional unit from 8% to 9%. The proposed formula has incorporated a new parameter referred to as Income Distance weighted at 9%. The Health Index, Agriculture Index, Urban Index, and Road index parameters have been dropped from the Basis. Notably, parameters and the weights in the proposed fourth basis lean towards the first basis of sharing revenue.

129. Transitioning from one basis to another has had diverse and undesirable effects. At times the effects have led to the expansion of the fiscal framework to give counties an amount that would ensure harmlessness. Such substantial changes in the sharing of revenue between the two levels of government may be detrimental to the policies in the BPS.

5.2.3 Additional Allocations to County Governments in FY 2025/26.

130. The government proposes to allocate additional revenues to county governments in FY 2025/26, totaling Kshs.69.8 billion. The additional resources are conditional and unconditional proceeds from the National Government's share of revenue amounting to Kshs.12.89 billion and Kshs.56.91 billion from loans and grants from Development Partners. Table 10 summarizes the allocations and programs funded under additional allocation.

Table 14: County Government Additional Allocations for FY 2025/26

SN	Project description	Amount (Mns)
1	Allocations financed from court fines	11.5
2	allocations financed from the 20% Share of Mineral Royalties	2,934.9
3	Payment of Phase II doctor salary arrears	1,759.1
4	Supplement for Construction of County Headquarters	454.0
5	Community Health Promoters (CHPs) Programme	3,234.9
6	County Aggregated Industrial Parks (CAIPs) Programme	4,500.0
	Sub-total of National Government's revenue	**12,894.5**
7	Aquaculture Business Development Programme (ABDP	200.0
8	Locally- Led Climate Action Program-County Climate Institutional Support (FLLOCA-CCIS)	121.0

SN	Project description	Amount (Mns)
9	Financing Locally- Led Climate Action Program-County Climate Resilience Investment (FLLOCA-CCRI)	6,187.5
10	Financing Locally- Led Climate Action Program-County Climate Resilience Investment (FLLOCA- CCRI)	1,200.0
11	Food Systems Resilience Project (FSRP)	3,200.0
12	Drought Resilience Programme in Northern Kenya (DRPNK)	1,276.7
13	Kenya Devolution Support Program - Institutional Grant (Level 1 Grant) (KDSP)	1,762.5
14	Kenya Devolution Support Program - Service Delivery and Investment Grant (Level 2 Grant) (KDSP)	13,042.5
15	Kenya Livestock Commercialization Project (KELCOP)	634.5
16	Kenya Urban Support Project- Urban Development Grant (KUSP 2-UDG)	10,325.75
17	Kenya Urban Support Project - Urban Institutional Grant (KUSP 2-UIG)	1,300.0
18	Kenya Water, Sanitation and Hygiene (K-WASH)	4,607.5
19	National Agricultural Value Chain Development Project (NAVCDP)	7,700.0
20	Primary Health Care in Devolved Context (PHC)	510.0
21	Water and Sanitation Development Project (WSDP)	3,000.0
22	Kenya Informal Settlement Project (KISIP)II-AfD	1,000.0
23	Kenya Informal Settlement Project (KISIP)II-WB	840.0
	Sub-total for Development partners	**56,907.9**
	Grand Total	**69,802.4**

Source: BPS,2025.

131. The county government's additional allocations have faced numerous challenges since its separation from the County Allocation of Revenue Act. The underlying issue has been the two levels of appropriation of the funds in that there has to be a provision in the annual appropriations and the second level of enacting the Bill (*the County Government Additional Allocations*) in which the sharing framework of the funds is provided for. The contention has been the Bill having allocations that are not sufficiently provided in the Appropriations Act or Supplementary Appropriations within the year varying allocations in the Bill.

132. Arising from such challenges the County Government Additional Allocation Bill for FY 2023/24 was approved four months to the end of the financial year. Due to the constrained time of implementation, County Governments received Kshs.29.37 billion as their additional allocations, equivalent to 63.35 percent of the Kshs.46.36 billion allocated to County Governments in FY 2023/24. Further, eight months into the FY 2024/25, the Bill has yet to be approved.

133. Despite this significant policy distortion, the BPS has not provided policy options to address this budget process dilemma. Additionally, there has been no pronouncement on how the government plans to fast-track the non-disbursed additional allocations, especially those funded from the GOK. The proceeds from loans and grants suffer exchange rate fluctuations, resulting in losses in programme implementation. The BPS does not address this policy disconnect.

5.2.4 Allocations to the Equalisation Fund in FY 2025/26.

134. The BPS proposes to allocate Kshs.7.8 billion to the Equalization Fund, the amount equivalent to the 0.5 percent constitutional requirement, and an extra Kshs.2.7 billion towards the settlement of outstanding arrears owed to the Fund totalling Kshs.10.6 billion in FY 2025/26. However, the arrears to the Fund at the end of FY 2023/24 was Kshs.49 billion. Five years after the lapse of the Fund as per Article 204(6), the government is still lagging in the full operationalization of the fund. Whereas there have been consistent allocations and appropriations to the Fund by the Parliament, the government has been delaying transfers to the Fund.

135. In the period between the inception of the Fund (FY 2011/12) to June 2024, total disbursement to the Fund was Kshs.13.4 billion out of the total entitlement of Kshs.62.4 billion. The Kshs.13.4 billion is being applied to projects identified in 14 counties under the first Marginalization Policy (Kshs.12.4 billion) and Kshs.1 billion to Projects identified in 34 counties under the second marginalization policy. There is a lack of commitment from the government to honor the payment of the arrears to the Fund. For instance, in FY 2024/25 the government has committed to pay Kshs.147 million, while in FY 2025/26 the arrears are being funded by Kshs.2.7 billion.

Table 15: Equalisation Fund Allocation &Disbursement Status.

FY	Amount Disbursed	Fund Entitlement (0.5% of most recent audited and approved revenues) (Kshs. Mlns)
2011/12	0	2,340.8
2012/13	0	2,646.5
2013/14	0	2,646.5
2014/15	400	2,646.5
2015/16	6,000	3,884.5
2016/17	6,000	4,678.3
2017/18	0	4,678.3
2018/19	0	4,678.3
2019/20	0	5,190.2
2020/21	0	6,788.5
2021/22	0	6,788.5
2022/23	0	7,068.5
2023/24	1,000	8,368.5
Total	**A= 13,400**	**B= 62,403.9**
	Total arrears (B-A)=	**49,003.9**
	Other allocations	
2024/25		8,000.0
	Of which Arrears	*147.1*
2025/26		10,589.6
	Of which Arrears	*2,736.8*

Source: National Treasury & Equalization Fund Advisory Board.

6.0 Statement of Specific Fiscal Risks

136. The Public Finance Management Act of 2012 outlines that there be prudent risk management in public finance. In line with this provision, **the Statement of Specific Fiscal Risks (SSFR)** section in the Budget Policy Statement (BPS) identifies and assesses potential economic and financial risks that could impact Kenya's macroeconomic targets and assumptions underpinning the fiscal projections. The specific fiscal risks include:

6.1 Risk in changes in macroeconomic assumptions

137. Macroeconomic variables are important since they form the baseline for revenue projections and play a key role in formulating the government's budget. The National Treasury conducted a sensitivity analysis by introducing percentage shocks to certain macroeconomic variables to assess the impact of the shocks on revenues, expenditures, and the fiscal deficit, as shown in **Table *16***.

Table 16: Fiscal sensitivity to key macroeconomic variables

Fiscal sensitivity to key macroeconomic variables (Kshs. billion)												
	Revenues				Expenditures				Budget balance			
Reduction in real GDP (%) by 1% point	-12.5	-13.8	-15.2	-16.7	-6.5	-7.2	-8.8	-8.8	-6.0	-6.6	-7.9	-7.9
Increase in inflation rate (%) by 1% point	13.0	14.5	16.7	17.7	7.0	7.8	9.6	9.6	6.0	6.7	8.2	8.2
Depreciation in the exchange rate (Kes/USD) by 10%	19.9	22.8	25.6	27.7	4.1	4.6	5.6	5.6	15.8	18.2	22.1	22.1
Increase in value of imported goods (USD) by 10%	11.6	-5.2	-5.5	-5.6	0.0	0.0	0.0	0.0	11.6	-5.2	-5.6	-5.6
All shocks combined	**33.0**	**17.8**	**20.4**	**22.5**	**4.5**	**5.1**	**6.3**	**6.3**	**28.5**	**12.7**	**16.2**	**16.2**

i. Reduction of Real GDP by 1% (from 5.3 percent to 4.3 percent in 2025)

138. The shock would have a higher impact on revenues compared to expenditures. This scenario would reduce revenue collection by Kshs.12.5 billion in FY 2025/26 and expenditures would decline by Kshs. 6.5 billion. Consequently, the fiscal deficit would increase by Kshs. 6 billion. Over the medium term, the shock would result in a decline in revenues and expenditures as well as a higher fiscal deficit.

ii. 1% increase in inflation rate

139. In this scenario, revenues would increase by Kshs. 13 billion while expenditure by Kshs. 7 billion in FY 2025/26. This would result in a decline in the fiscal deficit, as shown in **Table *16***. However, it should be noted that increased inflation may have adverse effects on the welfare of Kenyan consumers, especially among poor households. Further, this scenario does not take into consideration the effect of inflation on consumer behavior. Changes in consumption patterns may wipe out the expected revenue boost from inflation.

iii. 10% depreciation of the exchange rate (Kes/USD)

140. Similarly, this shock would have a higher impact on revenues relative to expenditures. In the scenario, revenues would increase by Kshs. 19.9 billion while expenditures would increase by Kshs. 4.1 billion in FY 2025/26. Consequently, Kshs would reduce the fiscal deficit. 15.8 billion. However, the depreciation of the Kenya shilling will also have a negative impact on both the debt stock and interest payments on external debt. Therefore, additional expenditures from this scenario may not necessarily have a positive impact on Kenyans' economic well-being. Further, depreciation may reduce import revenues.

iv. 10% increase in the value of imported goods

141. This scenario would result in an increase in revenue collection by Kshs. 11.6 billion. Notably, it would result in a decline in revenues over the medium term, due to changes in consumer behaviour.

v. Assessment of past forecast accuracy for FY 2021/22 to FY 2023/24

142. In the period FY 2021/22 to FY 2023/24, the key macroeconomic variables (Real GDP and inflation) assumptions have majorly had minimal deviations while the fiscal aggregates (revenue, expenditure, and fiscal deficits) have had large variations, although the fiscal deficit consolidated over the period.

143. The deviation for real GDP between the projected and the actual was minimal, and it was within target as shown in Table 17. The average deviation for inflation in the three financial years is 0.4 percent, which is also relatively minimal.

144. Notably, the fiscal aggregates had huge deviations. The total revenue deviated from the actual by an undercollection of Kshs. 128 billion on average. Ordinary revenue deviated with an average of Kshs. 98 billion, AiA by an average of Kshs. 31 billion and grants by an average of Kshs. 29 billion.

Table 17: Deviations in macroeconomic and fiscal aggregates

	2021/22			2022/23			2023/24			2024/25	Av. Dev	SDs
	Proj	Actual	Dev.	Proj.	Prel Actual	Dev.	Proj.	Prel Actual	Dev.	Proj		
						I. Key Macroeconomic Assumptions						
Real GDP	5.9%	6.2%	0.3%	5.2%	5.2%	0.0%	5.5%	5.1%	-0.4%	5.0%	0.0%	0.3%
Inflation Rate (avg)	5.6%	6.9%	1.3%	7.8%	7.7%	-0.1%	6.3%	6.1%	-0.2%	4.8%	0.4%	0.7%
Exchange rate (Ksh/US$), avg		113.8%			133.4%			135.3%				
Export growth		10.6%			8.0%			5.0%				
Import growth		16.4%			3.9%			-3.5%				
						II. Fiscal Aggregates (in Ksh billion)						
Total Revenue	**2,192**	**2,300**	**8**	**2,479**	**2,361**	**(118)**	**3,071**	**2,703**	**(368)**	**3,060**	**(128)**	**25**
Ordinary Revenue	1,852	1,918	66	2,145	2,041	(104)	2,625	2,289	(336)	2,576	(98)	48
AiA	340	282	(59)	333	319	(14)	446	414	(32)	484	(31)	43
Grants	63	31	(32)	42	23	(19)	47	22	(25)	50	(29)	37
Total Exp.	**3,286**	**3,028**	**(258)**	**3,367**	**3,221**	**(146)**	**3,903**	**3,605**	**(298)**	**3,973**	**(205)**	**201**
Recurrent	2,227	2,135	(92)	2,368	2,312	(56)	2,760	2,678	(82)	2,938	(59)	65
Devt	658	540	(117)	561	494	(67)	718	546	(171)	590	(117)	114
Domestic	411	378	(33)	337	344	7	438	377	(61)	388	(29)	31
External	239	162	(78)	194	138	(56)	250	152	(98)	179	(79)	81
Net Lending	-	-	-	16	12	(4)	19	17	(1)	20	(1)	-
Eq. Fund	7	-	(7)	14	-	(14)	11	-	(11)	3	(8)	5
County Allocation	401	352	(49)	436	416	(21)	424	380	(43)	446	(28)	35
Balance	**(1,031)**	**(785)**	**246**	**(846)**	**(800)**	**46**	**(785)**	**835**	**(50)**	**(863)**	**72**	**117**
Financing	1,031	748	(283)	846	770	(76)	785	818	33	863	(88)	201
Net Foreign Financing	343	143	(201)	363	311	(52)	362	223	(139)	269	(122)	157
Net Domestic Financing	688	605	(83)	484	460	(24)	423	596	173	594	34	76
						Memo Items:						
Nominal GDP (Ksh billion)	12,844	12,698	(146)	14,336	14,274	(61)	16,132	15,826	(305)	17,435	(106)	121

145. Total expenditure underperformed by an average of Kshs. 205 billion, with development expenditure recording the highest deviation by Kshs. 117 billion on average while recurrent expenditure deviated by Kshs. 59 billion on average. The National Treasury intends to limit the underperformance of development expenditure by halting the initiation of new projects until the completion of ongoing projects.

146. The fiscal deficit had an average deviation of Kshs. 72 billion. Notably, in FY 2021/22 and FY 2022/23, the deficit was over projected, resulting in a lower fiscal deficit. In FY 2023/24, the deficit was under projected, and the actual deficit was higher than the projection.

Fiscal Risk Associated with Public Debt

147. There is a direct link between the macroeconomic environment and debt sustainability parameters. Global market conditions, high interest rates, and a weak currency pose severe risks to Kenya's debt sustainability. For instance, the depreciation of the Kenya shilling poses a huge risk to the overall debt stock as nearly 50% of Kenya's debt is from external sources. However, to prevent fiscal crises, fiscal consolidation strategies and domestic debt market reforms aim to mitigate these risks.

Fiscal Risks Related to Devolution

148. County Governments are required to adhere to fiscal responsibility principles as outlined in section 107 of the PFM Act 2012. A key fiscal risk emanating from counties is unsanctioned borrowing in the form of loans and overdrafts from commercial banks without proper approvals. This unregulated borrowing creates financial risk as it may lead to unsustainable debt. Additionally, pile up of payables, delayed payments for statutory deductions, and failure to maximize local revenue collection pose significant fiscal risks necessitating the call for reforms in financial management.

Climate Change-Related Fiscal Risks to the Economy

149. Kenya faces significant exposure to various climate-related natural hazards, particularly droughts and floods, which have profound social, economic, and environmental consequences. These calamities lead to loss of life, heightened food insecurity, water shortages, decreased economic productivity, and extensive damage to infrastructure.

150. The climate-related risks highly affect the primary sector like agriculture and mining of Kenya's economy leading to heightened vulnerability. Further, such climate-related disruptions impact other core drivers of the economy including but not limited to road transport and energy sectors thus posing serious macroeconomic and fiscal implications. Mitigating the impact of climate change is therefore critical in the realization of a sound macroeconomic environment as well attainment of fiscal targets in the medium term.

Contingent Liabilities from State/Government-Owned Enterprises (GOEs)

151. **C**ontingent liabilities are potential obligations to the government that may arise in the long run depending on the occurrence of uncertain future events. These obligations are not recognized as direct liabilities in the government's budget or financial statements. They can be commitments such as government loan guarantees or government interventions such as bailouts of state-owned enterprises. These obligations pose fiscal risks by creating hidden liabilities that can lead to unplanned expenditures, increased public debt, and long-term fiscal instability.

152. State corporations are the key sources of contingent liabilities for the government, primarily due to their inability to meet financial obligations such as government loans, guarantees, pending bills, and commercial debts. Debt-ridden state corporations pose a significant fiscal risk; hence, the government ultimately bears these financial risks.

153. To mitigate such fiscal risks, the government has initiated reforms, including merging 42 state corporations into 20, dissolving nine state corporations and transferring their mandates, and divesting or dissolving 16 state corporations with outdated roles or where private sector alternatives exist. These reforms reduce their reliance on the Exchequer, creating more fiscal space for priority projects.