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Balancing priorities in uncertain times

National budget bulletin

April 2022

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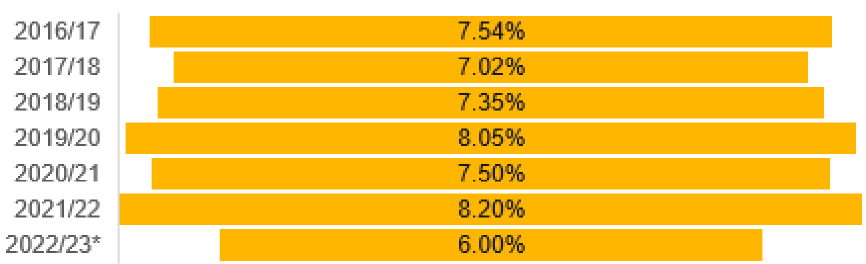
Economy

The road to recovery: Building economic resilience

- The Government has projected a growth of 6% for FY 2022/2023. This is against a backdrop of an economy recovering from the COVID-19 pandemic, rising costs of debt, projected drought, rising cost of goods, elections, among other factors. The plan to achieve this is premised on significant revenue growth. The total expenditure is set to increase from KES 3.2 trillion in FY 21/22 to KES 3.34 trillion in FY 22/23 with a projected ordinary revenue increase from KES 1.81 trillion to KES 2.14 trillion.

- The Government has projected the fiscal deficit to fall from the current KES 1.02 trillion (about 8.2% to the GDP) to KES 862 million (6% to the GDP) in FY 2022/23. To achieve this, the Government will need to restrict growth in recurrent spending through reduction of non-priority expenditure and re-double efforts on revenue collections. It is key to note that the third medium-term plan had projected the deficit to fall from 7.54% to GDP in 2016/2017 to 3.8% to GDP in 2021/2022. This was not achieved.

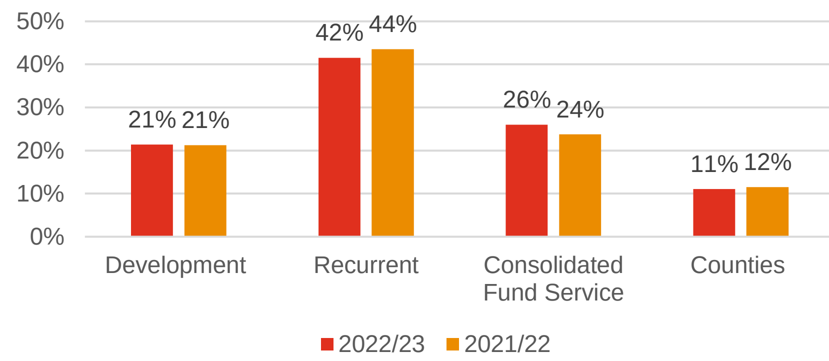
Table 1: Budget/fiscal deficit as a percentage of GDP



- In FY 2013/2014, the first budget for the current Government budget stood at KES 1.32 trillion, rising to KES 3.34 trillion in FY 2022/2023. Ordinary revenue on the other hand for the same period has increased from KES 920 billion to KES 2.14 trillion. Faster growth in expenditure in comparison to revenue is the reason for the expanding fiscal deficit.

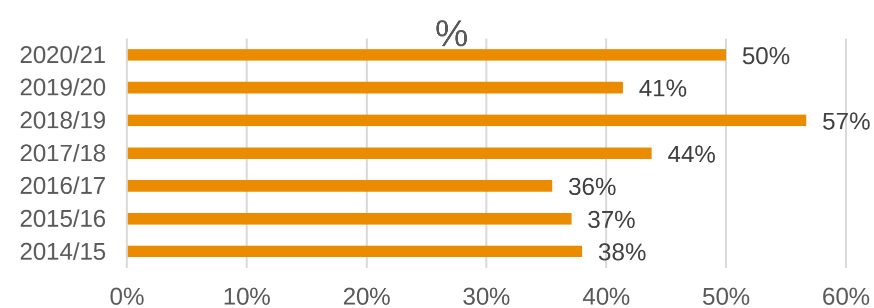
- The gradual development expenditure shrinkage in relation to the total annual expenditure budget should also be of concern. In the budget estimates for FY 2022/23, it represents 21% (KES 715 billion) of total government expenditure, against the requirements of the PFM Act of 30%.

Table 2: Expenditure percentages per year



- Payments for debt are increasingly taking a significant share of the revenues. The total debt service as a percentage of ordinary revenue has increased from 38% in FY 2014/15 to a projected 50% in FY 2022/2023.

Table 3: Percentage of total debt service to ordinary revenue



- Interest payment of debts have been estimated at 869 billion in FY 2022/23 against an expected ordinary tax collection of KES 2.14 trillion. It should be noted that the Government might have to borrow to fund recurrent expenditure given a deficit of KES 862 billion and development expenditure of at least KES 715 billion.

- It is key to note that the Government plans to increase ordinary revenue collection from KES1.81 trillion to KES 2.14 trillion against a background of a recovering economy, projected drought, looming elections among other factors. This will be challenging to achieve. The deficit of KES 862 billion will also have to be met through borrowing raising our total debt towards KES 9 trillion ceiling. The Government is keen on changing the debt ceiling from an absolute number to a percentage of GDP.

- The general policy direction adopted by National Treasury is to accelerate economic recovery through implementation of the Economic Stimulus Package (ESP) as well as Big Four agenda.

- This is the third ESP in a series of stimulus responses to alleviate the adverse effects on the economy as a result of COVID-19. The total cost is estimated at KES 20.6 billion targeting key productive and service sectors. These include agriculture, health, education, employment, drought response, policy, infrastructure, financial inclusion, energy and environmental conservation.

- Key Initiatives include: the “Kazi mtaani” programme to generate youth employment; construction of additional classrooms; recruitment of health interns; support of SMEs to access credit; sectorial agricultural support; support of micro, medium and small enterprises in manufacturing sector; social protection among others.

- It should be noted that the agricultural interventions may not be enough to cushion against the drought. “Kazi mtaani” programme should be analysed from a sustainability position of value creation against short term employment. Framework on the intergovernmental interventions involving agriculture and health should be formulated.

- The Government continues on its quest to achieve its Big Four agenda as indicated by various budgetary allocations. Supporting manufacturing for job creation (KES 10.1 Billion); Food and nutrition security (KES 46.8 billion); Universal Health Coverage (KES 62.3 billion) and provision of affordable and decent housing for all Kenyans (KES 27.7 billion).

Key points

- How Government will balance between revenue mobilization; expenditure rationalization; public debt management and other externalities will be key in achieving the economic growth projected.

- Government should also seek new ways of increasing revenue – predictability in tax system, tax base expansion, simplification of the tax process among others.

- The Government should find ways to reduce recurrent expenditure as it could become unsustainable in the long-term. Leadership and accountability is called for.

- Effective public debt management measures should be adopted. Concessionary loans and grants should be preferred to commercial loans.

Contacts

Benson Okundi
Partner, Assurance
benson.okundi@ke.pwc.com
+254 (20) 285 5241

Anthony Njeeh
Senior Manager, Assurance
anthony.njeeh@pwc.com
+254 (20) 285 5301

Jeremiah Ruita
Manager, Assurance
Jeremiah.ruita@pwc.com
+254 20 285 5236

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Tax

The road towards fiscal consolidation

In an address to the National Assembly, the Cabinet Secretary for National Treasury ("CS, National Treasury") and Planning detailed a raft of tax policy measures proposed for the fiscal year 2022/23 budget. Being the final budget for the current Government, it presents an opportunity for the Government to accelerate implementation of the key projects under the Big Four Agenda.

Corporate Income Tax

Donations to charitable organisations

In recognition of the pivotal role played by charitable organizations in providing social welfare, the National Treasury has proposed an amendment to the Income Tax Act ("ITA") which will allow entities that make cash donations to charitable organizations to deduct such donations from their taxable income.

Currently, such tax deductions are restricted to donations made to entities registered under the Non-Governmental Organizations Coordination's Act or Societies Act. Donations made to companies limited by guarantee or to trusts will now be tax deductible as long as such legal entities are registered with the KRA as charitable organisations.

Interest restrictions for Microfinance Institutions

The CS National Treasury has proposed to amend the ITA to exclude microfinance banks licensed under the Microfinance Act from interest deductibility restrictions based on earnings before interest, taxes, depreciation, and amortization ("EBITDA"). Currently, Banking institutions and Small and Medium Enterprises are the only entities exempt from such interest restrictions. This amendment will now align the tax treatment across the financial sector.

Gains by non residents from financial derivatives

The CS, National Treasury has proposed amendments to the ITA to subject to tax gains made by non-residents from trading in financial derivatives. The enforcement of this proposal on non residents may give rise to complexities. In addition, further guidelines may be required to determine whether such gains are capital or revenue in nature.

Country by Country Reporting

In a bid to broaden the application of the existing country by country reporting provisions, the CS National Treasury has proposed to amend the country by country reporting provisions to further align them with the global provisions on the same. The previous proposal had appeared to restrict their applicability to multinational entities headquartered in Kenya.

Exemptions to the Statutory Instruments Act

In a proposed amendment to the Statutory Instruments Act, the CS National Treasury has excluded tax related regulations from the expiration limit of ten (10) years from the date of publication. This will go a long way in creating a predictable tax environment.

The road towards fiscal consolidation (continued)

Personal Taxes

The CS National Treasury did not propose any changes on employment taxes. This is not surprising given that there have been considerable adjustments to employment taxes in the last two years.

Tax administration

Payment of disputed taxes

The CS National Treasury has proposed to amend the Tax Appeals Tribunal Act, 2013 to introduce a requirement for a payment of 50%of the tax in dispute to be paid to an account at the Central Bank of Kenya. This will be applicable where a taxpayer appeals to the High Court, a Tax Appeals Tribunal ruling that is in favour of the KRA.

In the event of a favourable ruling to the taxpayer at the final end of the litigation process, the 50% deposit will be refunded to the taxpayer within 30 days. This proposal raises serious concerns, notably, the limitation of taxpayers' access to justice and their right of appeal. It creates a significant barrier for the taxpayer to appeal to the High Court and appears to usurp the powers of the High Court to make decisions in relation to the treatment of sums in disputes.

Given that tax disputes can take several years to be resolved, the provision is likely to significantly affect the cash flows of taxpayers.

It is noted that the provision may create certain disincentives in the dispute resolution process. It may incentivise the KRA to raise exaggerated assessments with the view of collecting 50% of such assessments where it wins such a case at the Tax Appeals Tribunal. It also provides the KRA with a powerful bargaining position in an alternative dispute resolution process as taxpayers may be intimidated to settle cases rather than pursue the litigation process. Finally, the provision also raises issues of fairness as it is not clear whether the 50% deposit will accrue interest at market rates that will be payable to the taxpayer in the event of a successful appeal.

The road towards fiscal consolidation (continued)

Objection decision to be confirmed within 60 days

The CS National Treasury has also proposed to amend the Tax Procedures Act, 2015 ("TPA") to reduce the amount of time it takes the Commissioner to issue a decision on a taxpayer's objection against a tax assessment. Currently, the Commissioner can request for documents from the taxpayer which extends the 60-day limit within which they are required to issue an objection decision.

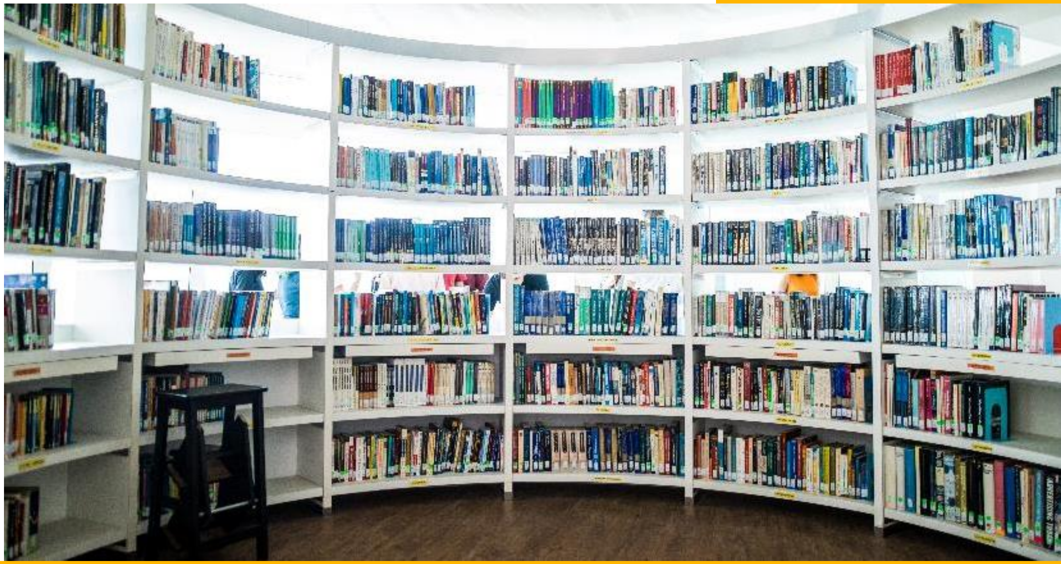
In this proposal, the Commissioner will be required to issue an objection decision within one cycle of 60 days of receiving a valid objection. The proposal will go a long way in ensuring efficiency in dispute resolution. The Commissioner will no longer be able to make several requests for documents to prolong the time within which they are required to make a decision on an objection.

Security for taxes

The CS National Treasury made a proposal to broaden the assets available to KRA that can be used as security for unpaid taxes to include ships, aircrafts, motor vehicles and any other properties that may be used as security for unpaid taxes.

Change of name

In a move to change the perception of KRA's public image from an enforcement agency to a service oriented institution that is focused on taxpayer needs, the CS National Treasury has proposed to amend the Kenya Revenue Authority Act to change the name of the KRA from the "Kenya Revenue Authority" to the "Kenya Revenue Service".



The road towards fiscal consolidation (continued)

Consumption taxes

Value Added Tax

The CS proposed minimal amendments to the Value Added Tax Act, 2013 in this year's budget statement. A number of transactional tax incentives featured within the Budget Statement with healthcare and local automotive manufacturing sectors featuring prominently.

VAT exemptions proposed by the CS include: plant and machinery for use by manufacturers of pharmaceutical products; various medical consumables e.g medical oxygen supplied to registered hospitals, urine bags, adult diapers, artificial breasts, colostomy or ileostomy bags. These proposals are intended to cushion Kenyans against the effects of the ongoing pandemic and its ensuing social economic implications.

The other exemption proposed by the CS includes exemption from VAT on inputs and raw materials used in the manufacture of passenger motor vehicles as well as on the supply of the locally manufactured passenger motor vehicles themselves. These proposals are a welcome incentive in attracting investments in the automotive sector.

While we welcome the proposed incentives, we note that the CS has failed to consider other sectors of the economy which equally need a boost to facilitate economic recovery and reduce the cost of living for Wanjiku. According to data posted by the Kenya National Bureau of Statistics, the overall year on year inflation rate as measured by the Consumer Price Index was 5.56 per cent in March 2022.

The rise in inflation was mainly due to an increase in prices of commodities, mainly food and non-alcoholic beverages. With such a rise in inflation, perhaps it is time for the Government to consider introducing a reduced VAT rate for basic and essential commodities to guard against the high inflationary pressures.

The road towards fiscal consolidation (continued)

Excise Duty

10%

Increase in specific excise duty rates on certain items

Excise duty continues to feature prominently as a preferred revenue collection tool for the Government. In line with this preference, the CS has proposed to increase specific excise duty rates on certain items by 10%, with the exception of petroleum products. This is inspite of an uproar by manufacturers and consumers of excisable products over inflationary adjustments in recent months.

Last year, the High Court of Kenya suspended the inflationary adjustment on petroleum products on the basis that it would put pressure on the cost of living.

In an attempt to acknowledge the potential adverse impact of inflationary adjustments within the context of a struggling economy, the budget has proposed to empower the Commissioner General (“CG”) of the Kenya Revenue Authority to exclude certain products from the adjustments. In our view, it would have been better to hand over this discretionary role to the National Assembly, as opposed to the collector of taxes.

Additionally, we would have expected the Government to propose, at the very least, a biennial inflationary adjustment similar to the treatment adopted by other countries in the East Africa Community (“EAC”).

In keeping with the traditional use of excise duty as a ‘sin tax’, the CS has proposed to introduce excise duty on liquid nicotine at a specific rate per ml rather than per kg as it currently is.

In addition, excise duty at a rate of 15% will apply on fees charged on advertisements of alcoholic, gambling and gaming activities on various media. Television stations, print media, billboards, and radio stations will have an additional tax obligation to contend with as a result.

The CS has proposed to exempt from excise duty eggs for hatching imported by licensed hatcheries upon approval by the responsible CS.

The application of excise duty on imported eggs only took effect from 1 July 2021 hence this is an example where tax changes are not well thought out prior to implementation and remedial measures are considered as an afterthought.

Finally, other incentives include: exemption from excise duty on neutral spirit used by manufacturers of pharmaceutical products, rather than refunds, which the CS has acknowledged take too long to obtain; and exemption of locally manufactured passenger motor vehicles to spur manufacture, in addition to assembly.

The road towards fiscal consolidation (continued)

Other taxes: Levies and custom duties

Miscellaneous fee and levies

Based on the CS' proposal, local manufacturers of pharmaceutical products will also be exempt from Import Declaration Fees ("IDF") and Railway Development Levy ("RDL") which currently apply at 3.5% and 2% respectively on imported inputs and raw materials.

In order to incentivise herders and pastoralists, the CS has proposed the reduction of export levy from 80%/USD 0.5 per kg to 50%/USD 0.32per kg on raw hides and skins.

Customs duty

Whilst Kenya's customs proposals are yet to be deliberated by Ministers of Finance at the EAC level, the CS has indicated that the measures proposed will address three objectives: promotion of the manufacturing sector; enhanced exportation; and protection of local industries from unfair competition.

We can therefore expect to see duty remissions on imported raw materials and other industrial inputs for manufacture, as well as stays on the application of the common external tariffs in order to encourage or deter certain imports. The proposed changes will take effect on 1 July 2022 following publication of the EAC Gazette Notice.

Contacts

Steve Okello
Partner, Tax
Steve.x.okello@pwc.com
+254 20 285 5000

Simeon Cheruiyot
Partner, Tax
simeon.cheruiyot@pwc.com
+254 20 285 5000

Titus Mukora
Partner, Tax
titus.mukora@pwc.com
+254 20 285 5000

Job Kabochi
Partner, Tax
job.kabochi@pwc.com
+254 20 285 5000

Edna Gitachu
Associate Director, Tax
edna.gitachu@pwc.com
+254 20 285 5000

Gideon Rotich
Senior Manager, Tax
Gideon.rotich@pwc.com
+254 20 285 5000

Nicholas Kahiro
Manager, Tax
nicholas.x.kahiro@pwc.com
+254 20 285 5788

Andrew Ragui
Manager, Tax
andrew.ragui@pwc.com
+254 20 285 5000

Corazón Ongoro
Manager, Tax
corazón.ongoro@pwc.com
+254 20 285 5000

Edward Paranta
Senior Associate, Tax
edward.paranta@pwc.com
+254 20 285 5000

Brian Kanyi
Senior Associate, Tax
Brian.kanyi@pwc.com
+254 20 285 5000

Legislative Updates

The proposed legislative reforms pending in Parliament are as follows:

- **Public Procurement and Asset Disposal (Amendment) Bill, 2021** proposes to allow contracts to be awarded to multiple bidders to support better service delivery and participation by local firms;
- **National Rating Bill** to replace the outdated Rating Act and the Valuation for Rating Act;
- **County Governments (Revenue Raising Process) Bill** to regulate the manner in which County Governments introduce fees and charges. These bills are in support of County Governments Own-Source Revenue Policy.

The following amendments are also proposed:

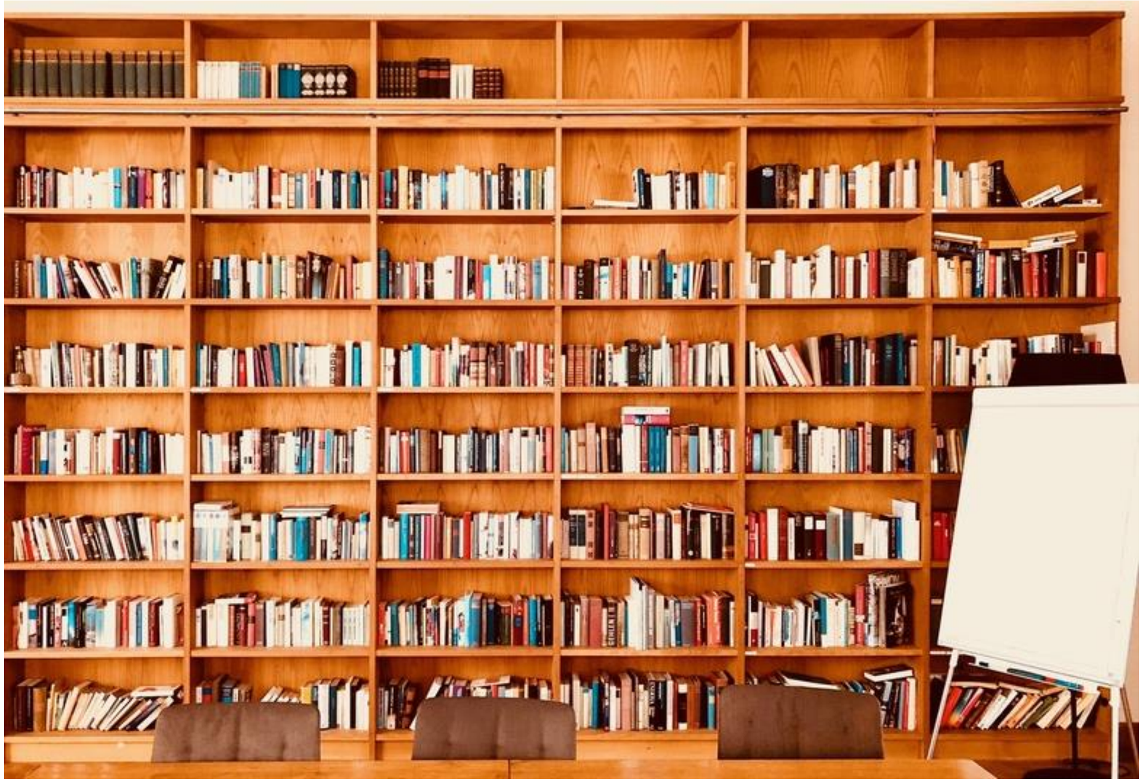
- An amendment to the **Capital Markets Act** to expand the category of persons that may be licensed as investment advisors to include-single-director companies and partnerships to enable more investment advisors offer their services;
- An amendment to the **Unclaimed Financial Assets Act** to allow for a waiver of penalties, fines and audit fees charged on collection of unclaimed financial assets in justifiable circumstances;
- It has further been proposed that a cap on such charges be introduced, limiting them to the value of the asset, and that a 12-month Voluntary Declaration Programme be created to grant a relief from penalties and interest on financial assets delivered to UFAA within the next 12 months.

Legislative Updates (continued)

- An amendment to the **Retirement Benefits Investment Guidelines** to allow pension schemes to invest in unlisted REITs;
- An amendment to the **Insurance Regulations** to require public transport motorcycles and three wheelers to take out insurance for their passengers.

The following policy initiatives are proposed:

- A review of the legal and regulatory framework to address emerging issues in the capital markets space relating to collective investment schemes and investment based crowdfunding;
- An overarching **National Pensions Policy** to set the policy direction on structuring and management of retirement benefits for public servants.



Contacts

Joseph Githaiga
Associate Director, Tax
joseph.githaiga@pwc.com
+254 (20) 285 5401

Gachini Macharia

Manager, Tax
gachini.macharia@pwc.com
+254 (20) 285 5805

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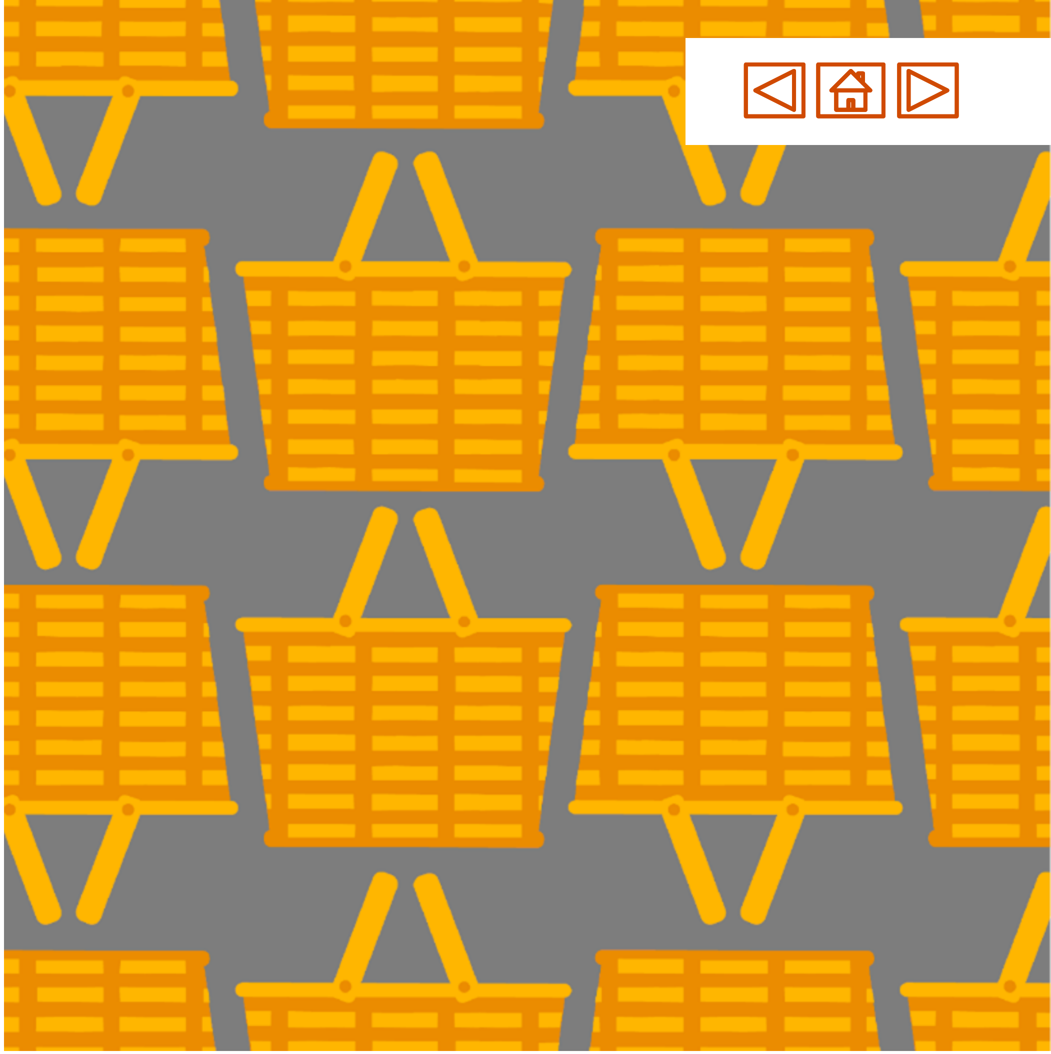
Devolution

Accelerating Economic Recovery for Improved Livelihood



Key FY 2022/23 budget highlights

Equitable & conditional allocations and own source revenue enhancement

Equitable share

The equitable share of KES 370 billion has been retained at the same level as it were in FY 2021/2022 due to:

a) Covid -19 pandemic has affected revenue mobilization and brought with it uncertainty in revenue collection.

b) Government is implementing a fiscal consolidation plan which is expected to be shared between the two levels of Governments, so as to lower the fiscal deficit and slow down debt accumulation.

c) Allocation of the sharable revenue among County Governments is based on the third generation formula approved by Parliament in September 2020.

Elections and transition

- Being an election year, and given that there will be transition to new county administrations, there is need for proper and adequate transition arrangements at the county levels to ensure transparency, accountability and smooth continuation of service delivery and implementation of county flagship projects.

Conditional allocations and transfer of functions

- The County Governments will receive the recommended conditional allocations of KES 37.1 billion, in addition to the equitable share of revenue raised nationally, bringing the total allocation to the County Governments in the FY 2022/23 to KES 407.0 billion.
- Equitable allocation of KES 370 billion represents 27.3 percent of the most recent audited and approved revenue raised nationally.
- A legislation will be developed to operationalize Articles 187 and 189 of the Constitution on transfer of functions and cooperation between the National and the County Governments, in order to ensure that the process of transfer of functions between the National and County Governments is clearly provided for in law.

KES 370 billion – County Governments equitable revenue share FY 2022/23

Own Source Revenue Enhancement

To enhance Counties Own Source Revenue (OSR), the National Treasury has submitted the following bills to Parliament:

- County Governments (Revenue Raising Process) Bill to regulate the manner in which Counties introduce or vary fees and charges. Once passed, this legislation will address the problem of multiplicity of fees and charges within and across counties in line with Article 209(5) of the Constitution.
- The National Treasury in collaboration with the Ministry of Lands and Physical Planning, Council of Governors and other stakeholders have developed the National Rating Bill 2022 to replace the outdated Valuation for Rating Act (Cap. 266) and Rating Act (Cap. 267). This Bill, was submitted to Parliament in January 2022 and once enacted will guide the valuation for rating and imposition of rates on rateable property.

Key FY 2022/23 budget highlights

Sharing of mineral royalty revenues, equalization fund and pending bills

Sharing of Mineral Royalty Revenues

- Following a Presidential directive, the National Treasury has developed a draft framework which provides mechanisms for sharing mineral royalties revenue among the National Government, County Governments and Communities in line with Section 183 of the Mining Act, 2016.
- The framework is currently being subjected to stakeholder consultations and once finalized will provide a basis for ensuring that revenues raised from mineral royalties trickle down to the County Governments and Communities where mining is taking place.

Equalization Fund

- In line with Article 204(1) of the Constitution of Kenya, County Governments have been allocated KES 7.1 billion under the Equalization Fund in the financial year 2022/23, which represents 0.55 percent of the most recent audited accounts of revenue received.
- The National Treasury in collaboration with other stakeholders developed the Public Financial Management (PFM) - Equalization Fund Administration Regulations 2021 which was approved by Parliament in October 2021.
- Following the appointment of the Equalization Fund Advisory Board, and establishment of the Secretariat, it is expected that completion of projects identified under the first policy and the implementation of programmes in the second and subsequent policies will be fast-tracked.

Pending Bills

- Continued delays in payment of pending bills to entities that provide goods and services to both National and County Governments have affected liquidity and operations of these entities. In a number of cases, this has led to closure of businesses, affecting many livelihoods.
- Though some progress was noted in settlement of these bills by the National and County Governments, there are still challenges where a number of suppliers are owed large amounts of money.
- The National and County Governments were urged by the National Treasury to clear all pending bills by 30th June, 2022 and avoid accumulation of pending bills to ensure that payments are made as and when due.

Contacts:

Benson Okundi
Partner, Assurance
benson.okundi@ke.pwc.com
+254 (20) 2855241

Samuel Gikonyo
Senior Manager, Advisory
samuel.g.gikonyo@pwc.com
+254 (20) 2850000

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Sectoral Analysis

Resilience and recovery of the banking sector

The Cabinet Secretary noted that the banking sector remains stable and resilient, and has registered strong recovery from the adverse effects of the COVID-19 pandemic, as evidenced by the strong capital and liquidity buffers.

Enhancing access to affordable housing

The Cabinet Secretary noted that the Kenya Mortgage Refinancing Company (KMRC), which was established to offer long term loans at concessionary rates to mortgage lenders, had disbursed loans amounting to KES 2.2 billion to 7 primary mortgage lenders for onward lending, with an additional KES 7 billion currently being processed.

KMRC's seed capital was provided by its shareholders as part of initial capital raising, as well as from concessionary funding by the government.

To expand its funding base, KMRC recently issued a KES 10.5 billion Medium Term Note (MTN), of which KES 1.4 billion has already been drawn down.

Given that the MTN was issued at commercial terms (i.e. 12.5%), there may be an impact on the lending rates provided to the mortgage lenders and therefore, the onward concessionary lending rate to homeowners.

Enhancing access to affordable credit

The Cabinet Secretary noted that the credit guarantee scheme had surpassed KES 2.2 billion in advances to Micro, Small and Medium Enterprises (MSMEs).

There was no direct budgetary allocation included in the budget. In 2021, KES 2 billion was allocated to the scheme. However, the Cabinet Secretary announced that the Government will seek the support of development partners to increase the scheme's capital from the current KES 4 billion to KES 10 billion over the medium term.

Financial services (continued)

Pension reforms

The Cabinet Secretary acknowledged that there is need to improve the pensions policy framework and the Government, through the National Treasury will develop a National Pensions Policy that will set out the guiding principles for application on the structure and management of retirement benefits for public servants.

The Cabinet Secretary widened the scope of the areas where pension funds can invest through his proposal to amend the Retirement Benefits Investment Guidelines to include the unlisted Real Estates Investment Trusts incorporated in Kenya that are approved by the Capital Markets Authority. The limit for this asset class under the investment guidelines will remain at 30%.

To cater to the informal sector, the government has registered the Kenya National Entrepreneurs Savings Trust (KNEST) which will target the over 15 million informal sector workers. The Cabinet Secretary stated that the government will restructure the M-Akiba bond platform to incorporate the heterogeneous informal workers across all 47 counties.

Insurance reforms

The cabinet secretary weighed in on the ongoing proposed reforms to the motorcycles transport sector.

Acknowledging the increased use of the motorcycles “boda boda” and three wheelers “tuk tuk” in the commercial fare paying passenger business, accompanied by the increased accident rates in this business, he proposed a change in Insurance Regulations to require motorcycles and three wheelers used by fare paying passengers to take out insurance for their passengers. This will cater to the treatment of injuries or compensation in case of death or accidental damages.

Operationalisation of Nairobi International Financial Centre (NIFC)

Following the directive issued by the Cabinet Secretary in the 2021/2022 budget statement, NIFC has now developed the required operating framework and regulations aimed at attracting foreign investments into the country.

Despite the slow pace in its operationalisation, NIFC is expected to be a key catalyst for economic growth once it is officially opened later this year.

Financial services (continued)

Proposed changes to the Unclaimed Financial Assets Act (UFA Act)

In a bid to boost the reporting and recovery of the unclaimed financial assets, the Cabinet Secretary proposed the following amendments to the UFA Act, 2011:

- Introduction of a 12-month voluntary disclosure program to grant relief of penalties and interest on unclaimed financial assets declared and submitted to the authority in the next twelve months;
- Waiver of the penalties, fines and audit fees charged to holders of unclaimed financial assets where there are valid circumstances;
- Introduction of a cap on penalties and interest payable to the value of the unclaimed asset.

Proposed change to the Capital Markets Act

The Cabinet Secretary proposed an amendment to the Capital Markets Act to expand the category of persons that may be licensed as investment advisors.

Tax measures

The Cabinet Secretary proposed:

- An amendment to the Income Tax Act to exclude microfinance institutions licensed under the Microfinance Act from interest deductibility restrictions;
- To tax gains accruing from trading in financial derivatives by non-residents.

Contacts:

Richard Njoroge
Partner, Assurance
richard.njoroge@pwc.com
+254 (20) 2855604

Brian Ngunjiri
Associate Director, Assurance
brian.ngunjiri@pwc.com
+254(20)285 5310

Enhanced productivity and agriculture contribution to labor participation

Overview

The agricultural sector remains the cornerstone of the Kenyan economy with a significant contribution to GDP and employment. Agriculture contributes 26% directly to Gross Domestic Product (GDP), and up to 27% indirectly through linkages with other sectors. 40% of Kenyan citizens are gainfully employed in this sector. This makes the industry is an important pillar in both the Economic Recovery Strategy (ERS) and the Big Four Agenda.

Despite its economic significance, the sector is yet to realize its full potential due to low mechanization and productivity, limited market access, lack of value addition, inadequate agricultural inputs, uneconomical sub-division of land and change in land use, adverse effects of climate change, and post-harvest losses among others.

Budgetary allocation

The FY 2022/23 agricultural sector allocation of KES 63.9 billion represents a decline of 16% compared to the prior year of KES 75.7 billion (including supplementary allocation).

63.9B allocated to agriculture sector in this year

The proposed allocations intended to spur economic productivity and accelerate labor participation among others include:

- Rural and value chain inclusion projects;
- Climate smart agriculture projects;
- Blue economy;
- Commercialization of livestock farming;
- Legitimacy of land ownership

The budgeted Government contribution for the above interventions mirror prior year allocations. From the final printed budget estimates, the additional resources mobilized for this sector from other sources including donors was approximately KES 15 billion. This explains the need to develop interventions to attract more private capital to the sector in order to increase their scalability of the interventions.

Key productive and strategic interventions in the FY 2022/23 budget

Market access continues to be a key impediment to agricultural investment. Interventions aimed especially at addressing this problem should be developed in the future. More initiatives on value chain development, value addition, and post-harvest loss reduction methods in particular, are needed. County governments need to play their role to create a conducive environment for agriculture to thrive.

The proposed allocation for National Agricultural and Rural Inclusivity project of KES 4.2B, Small Scale Irrigation and Value Addition Project of KES 1.5B, National Value Chain Support Project of KES 1.6B, Fertilizer subsidies of KES 2.7B and Kenya Climate-Smart Agriculture Project of KES 7B will enhance productivity. There is, however, a need to have specific and measurable implementation plans to guarantee intended benefits.

We note the following areas were not sufficiently addressed:

1. Decline in budget allocation of about 16% to the sector, limiting scalability on economic recovery and food security.
2. Inadequate drought mitigation measures, especially allocation to irrigation given its capital intensive nature.
3. Due to devolution of the agricultural activities, the framework of collaboration between the National Government and the County Governments is unclear.

In our view, Kenya’s economy has been on a path to recovery in 2021/22 following the slump in 2020 occasioned by the negative effects of the Covid-19 pandemic. The policy measures proposed within the agriculture sector will continue to stimulate resilient and sustainable economic recovery in the short and medium terms. However, decline in budget allocation might impact negatively on government plan for food security, as captured in the Big 4 Agenda. There is need to focus on effective implementation of agricultural interventions through effective governance and accountability frameworks to increase productivity, investments and effective consumption.

Contacts

Simon Mutinda
Partner, Advisory
simon.mutinda@pwc.com
+254 (20) 285 5350

Michael Wanjohi
Senior Associate, Assurance
michael.wanjohi@pwc.com
+254 (20) 285 5000

Titus Rotich
Manager, Assurance
titus.rotich@pwcc.om
+254 (20) 285 5000

Virginia Maneno
Senior Associate,Assurance
virginia.maneno@pwc.com
+254 (20) 285 5000

Jinalo Mwangi
Senior Associate, Assurance
Jinalo.mwangi@pwc.com
+254 (20) 285 5000

Despite the adverse impact of the COVID-19 pandemic and the ongoing conflict in Eastern Europe, the government remains committed to supporting Manufacturing as a key pillar of the Big Four Agenda.

KES 10.1b

Amount allocated for the development of the industry

Sector Allocation

The Cabinet Secretary indicated the government will support the industry with an allocation of KES 10.1 billion, a 50% decline from the 2021/22 budget allocation of KES 20.5 billion, under various implementing Ministries, Departments and Agencies.

An additional KES 3 billion has been allocated to support access to finance and enterprise recovery.

The government will make further investments towards the revival and enhancement of cash crops output, with an allocation of KES 212.1 million for modernization of cooperative cotton ginneries and a further KES 250.4 million for the cotton industry revitalization.

Continued investment in special economic zones

Investment in the manufacturing pillar will enable the Kenyan youth to acquire skills necessary for industrial growth, job creation and improved living conditions.

The government will continue focusing on special economic zones with these proposed cash injections:

- KES 2.6 billion for Dongo Kundu Special Economic Zone;
- KES 295 million for the development of the Special Economic Zone Textile Park in Naivasha, Kinanie Leather Industrial Park and Athi River Textile Hub;
- KES 50 million for the Freeport and Industrial Park Special Economic Zone in Mombasa;
- KES 410.4 million for the modernization of RIVATEX.

Manufacturing (continued)

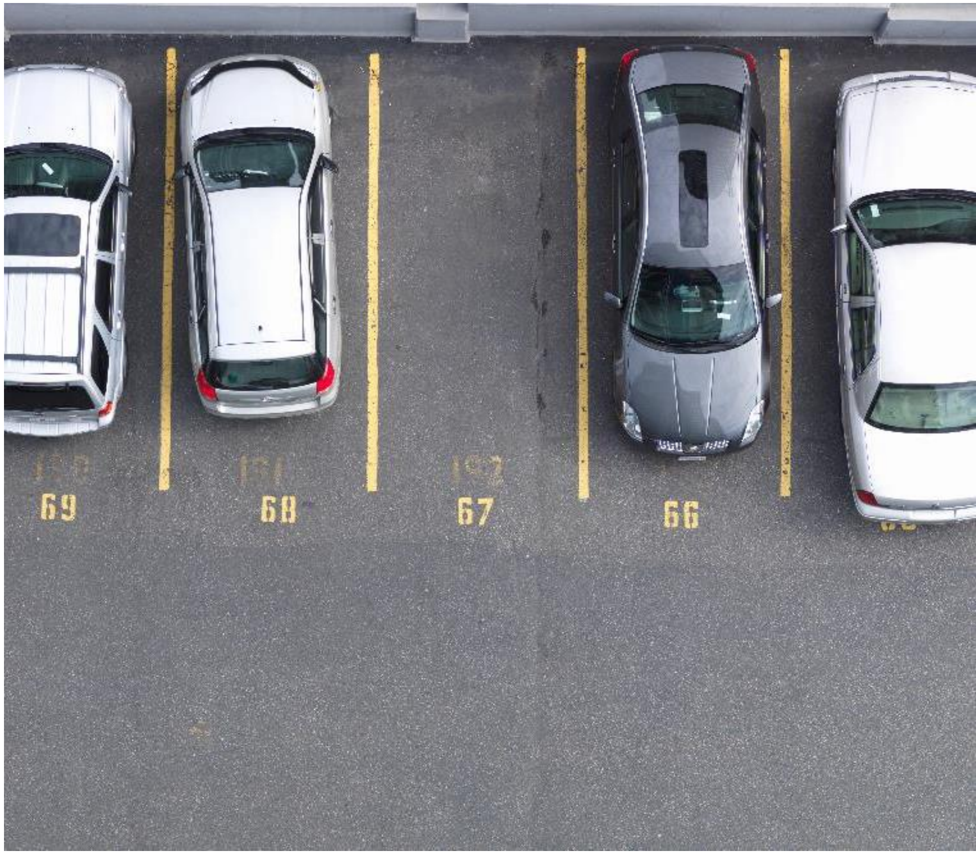
The government continues to explore opportunities to boost growth of local manufacturing for job creation.

Local manufacturing and vehicle assembly

The Government proposed the following tax incentives to support the growth of local manufacturers and vehicle assemblers:

- VAT and excise duty exemption for locally manufactured passenger vehicles;
- VAT exemption for inputs and raw materials used in the manufacture of passenger motor vehicles;
- VAT exemption for plant and machinery used by manufacturers of pharmaceutical products;
- Exemption from Import Declaration Fees and Railway Development Levy for inputs and raw materials imported by manufacturers of pharmaceutical products.

The Cabinet Secretary further indicated that the government has submitted various proposals for consideration during the EAC Pre-Budget consultations aimed at promoting the manufacturing sector and enhancing the country’s exports.



Manufacturing (continued)

Supporting Micro Small and Medium Enterprises (MSME)

The Government is undertaking practical steps towards the formalization of the informally operating MSMEs, to build their capacity and promote them to sustainable business enterprises.

Over the years, the National Government has invested on supporting the growth of MSMEs to enable them to sell their products both locally and in external markets. However, MSMEs continue to face challenges from the production stage to availing their final products to the consumer markets.

Since the launch of the Credit Guarantee Scheme in December 2020, total loans extended to Micro, Small and Medium Enterprises under this scheme had surpassed KES 2.2 billion by December 2021.

The government will seek the support of development partners to increase the scheme's capital from the current KES 4 billion to KES 10 billion over the medium term.

Finally, KES 626 million has also been allocated for provision of finances to Micro, Small and Medium Enterprises through the Kenya Industrial Estate.

KES 626 million allocated for provision of finances to Micro, Small and Medium Enterprises through the Kenya Industrial Estate

KES 1 billion

Allocated towards the Credit Guarantee Scheme to enhance access to affordable credit by Micro, Small and Medium Enterprises in the manufacturing sector

The government plans to use targeted interventions to stimulate the industry that has been significantly impacted by the COVID-19 pandemic.

Sector Recovery

The tourism sector is undoubtedly one of the worst-hit sectors in Kenya following the outbreak of the COVID-19 pandemic and the resultant containment measures including travel restrictions. Nevertheless, the sector is expected to continue to recover gradually following the ease of travel restrictions.

The government has supported hotel renovations through soft loans channeled through the Tourism Finance Corporation and supported Kenya Wildlife Services to engage 5,500 community scouts.

The 2021 annual tourism sector performance report indicates that the number of international visit arrivals to Kenya grew from 567,848 in 2020 to 870,465 in 2021.

Tourism Sector Allocations

The Government has allocated KES 3.2 billion to the Tourism Fund and KES 1.8 billion to the Tourism Promotion Fund to support the continued recovery of the sector.

The Cabinet Secretary acknowledged the effects of the COVID-19 pandemic contrary to the revival of the sector and indicated the government's continued support to tourism recovery under the Economic Recovery Programme.

Air Travel

The Government has plans to restructure Kenya Airways by undertaking specific policy interventions to improve efficiencies, reduce costs and increase revenue.

53% Growth in international visitor arrivals from 2020 - 2021

Source: The 2021 annual tourism sector performance report

Contacts

Michael Mugasa
Partner, Assurance
michael.mugasa@pwc.com
+254 (20) 285 5000

Alex Murage
Associate Director, Advisory
alex.murage@pwc.com
+254 (20) 285 5453

Nelson Ogara
Associate Director, Tax
nelson.ogara@pwc.com
+254 (20) 285 5000

Chris Wanyoike
Manager, Advisory
chris.wanyoike@pwc.com
+254 (20) 285 5000

Shanice Obongo
Associate, Advisory
Shanice.obongo@pwc.com
+254 (20) 285 5000

Infrastructure highlights

Introduction

Infrastructure continues to be a key economic enabler. The government has specifically identified the development of critical infrastructure in roads, rail, energy and water sectors as one of the key focus areas to accelerate economic recovery and improve livelihoods under the Economic Recovery Programme.

Under the last budget regime of President Uhuru Kenyatta, a lot of emphasis was placed on the achievements of his government observed since 2013. These included achievements in the infrastructure space. The jury is out on the tangible nature of these achievements.

Furthermore, it is evident that the government continues to seek alternative ways of funding infrastructure developments.

A number of thematic areas were covered in the budget statement including transportation, energy, housing, Public Private Partnerships (PPPs) and special economic zones.

Transportation

Railways, Roads and Aviation

Enhance economic growth and regional trade

Development of critical infrastructure development in roads and railways across the country continues to be received as a focal point to ease movement of people and goods, reduce the cost of doing business and enhance access to social amenities.

This is evident in the proposed budget allocations which are highlighted alongside. The debut of an allocation for the Bus Rapid Transport system demonstrates the government's commitment to ease traffic congestion in Nairobi.

Unlike previous years, the aviation sector did not receive any sizeable allocation, which is likely to erode the gains in making and defending Kenya's position as a regional aviation hub. However, the government has indicated that it has plans to de-fleet and restructure the national carrier, Kenya Airways (KQ).

Budget Allocation

- KES 212.5 billion allocated to construction, rehabilitation and maintenance of roads and bridges;
- KES 18.5 billion for the development of the Standard Gauge Railway (SGR);
- KES 1.1 billion for Railways Metro Lines;
- KES 439 million for rehabilitation of locomotives;
- KES 264 million for development of ERP system for SGR;
- KES 1.2 billion to support the Nairobi Bus Rapid Transport Project.

Energy

Power Generation, Transmission and Distribution

Reliable, green and affordable energy

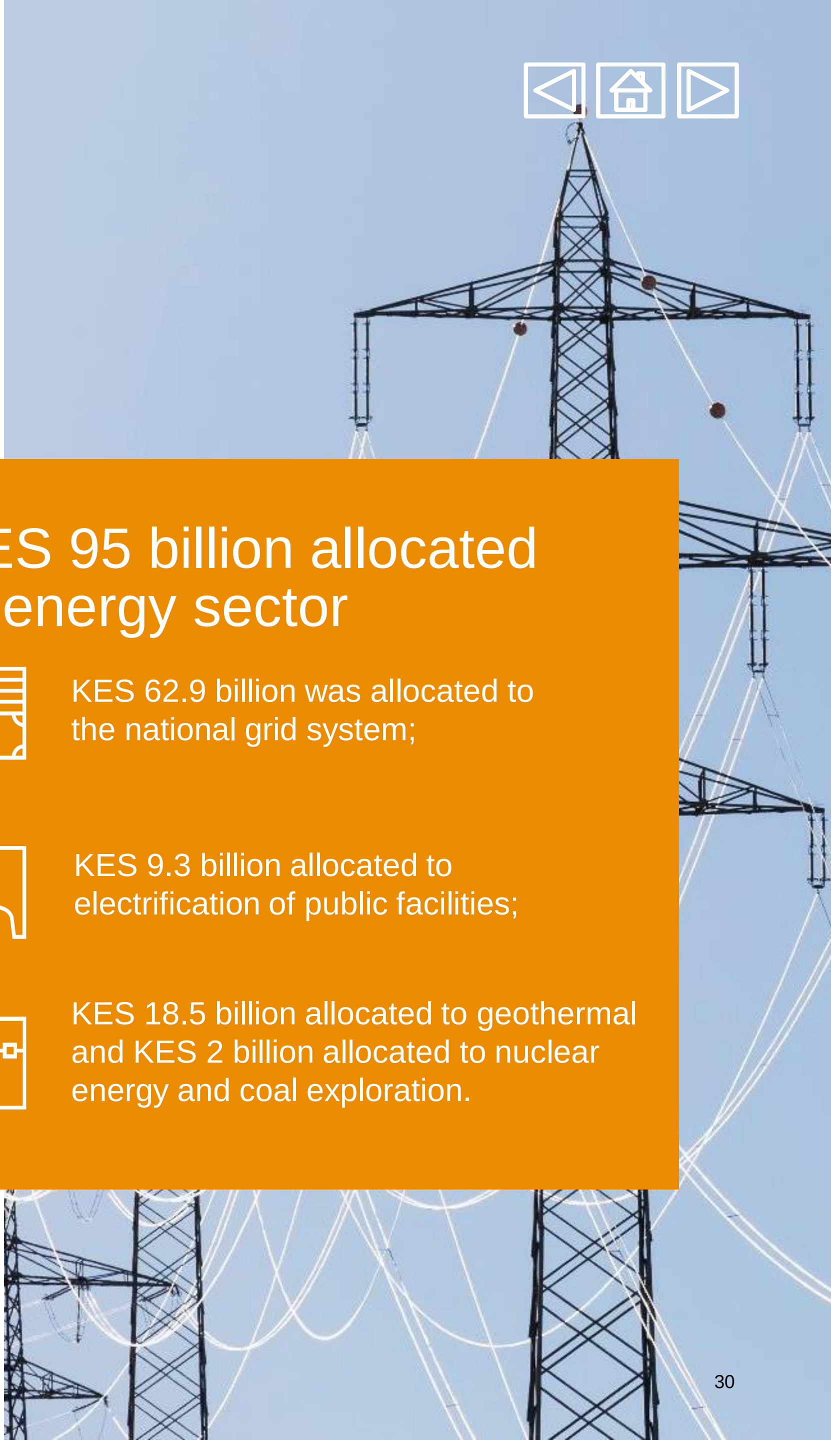
The government remains focussed on energy as one of the key infrastructure pillars.

The Cabinet Secretary reiterated the government's intention to continue to support Kenya Power on its efficiency journey, with the end goal of transferring these efficiencies downstream in the form of decreased tariffs. This is in addition to the KES 62.9 billion allocation to power distribution and transmission.

Missing from the budget statement was a mention of other renewable energy sources like wind and solar. Further incentives in this area would have been welcome.

The government was clear to highlight its energy sector achievements which included significantly increasing the energy generation capacity (with 73% of power generated being from green sources), and increasing household coverage to 8.3 million homes.

The additional allocation to nuclear energy is welcome, but it remains to be seen whether the country's ambition to join the league of nuclear generators will be achieved.



KES 95 billion allocated to energy sector

KES 62.9 billion was allocated to the national grid system;

KES 9.3 billion allocated to electrification of public facilities;

KES 18.5 billion allocated to geothermal and KES 2 billion allocated to nuclear energy and coal exploration.

Affordable Housing

Housing remains a priority for government as part of the Big Four Agenda, with the Kenya Mortgage Refinance Company (KMRC) playing an increasingly important role in the sector.

Since September 2020, KMRC has disbursed KES 2 billion to seven primary mortgage lenders. To boost their funding and additional disbursements in the future, the lender recently successfully issued a corporate bond for KES 1.4 billion.

KES 27.7 billion has been allocated to the Affordable Housing Programme, directed towards KMRC for, construction of affordable housing, and Social Housing Units.

Contacts

Edward Kerich
Partner,
Risk Assurance Services
+254 (20) 285 5397
edward.kerich@pwc.com

Isaac Otolo
Partner, Transaction Advisory
+254 (20) 285 5690
isaac.otolo@pwc.com

Job Ngunu
Senior Manager - Assurance
+254 (20) 285 5097
job.ngunu@pwc.com

The future of development…

Public Private Partnerships (PPPs)

As part of the measures to manage its public funding, the government has sought to do away with the debt ceiling in favour of a debt anchor at 55% of GDP. With different priorities demanding financing, allocations towards infrastructure are likely to come under pressure. Increasingly, PPPs are expected to help bridge the infrastructure funding gap.

The recent enactment of the 2021 PPP Act has streamlined processes and strengthened the institutional framework by elevating the PPP Unit to a Directorate within the National Treasury.

The government intends to operationalise the PPP Project Facilitation Fund to support the activities of the PPP Directorate.

Economic zones

As part of the implementation of the Big Four agenda and the Economic Recovery Programme, the government continues to facilitate industrial investments through Special Economic Zones (SEZ). Among the allocations, KES 2.6 billion has been proposed for Dongo Kundu SEZ, KES 295 million for the Naivasha textile SEZ, and KES 410 million for Rivatex modernisation.

This is not the first time that these projects are being funded through the budget and there is hope for industrialists to soon begin to utilise and enjoy the intended benefits of these anticipated SEZ.

55%

The proposed debt anchor as a percentage of GDP to replace the current debt ceiling.

In conclusion

The continued allocation of budget resources to infrastructure is a clear signal that the government understands the importance of infrastructure as an enabler.

However, the allocation to infrastructure as a percentage of the total budget remains low at 22%.

With a significant stock of government debt having been procured to fund infrastructure, project prioritisation needs to emphasise on projects that generate faster economic returns so that these can contribute to raising revenue to fund debt repayments.

Overall, to achieve its objectives in the infrastructure space, the government will need to define clear and sustainable goals and put in place an efficient delivery mechanism. In addition, with increasing pressure on revenue allocations, it will need to continuously think ‘outside the box’ on how to fund infrastructure projects.

Technology is an integral part of the digital economy with potential to accelerate socio-economic development and improve livelihoods

Over the last 8 years, there has been significant innovation and improvement in the technology sector in Kenya. However, the ICT budget has decreased from 20.9 billion in 2021 to 15.6 billion this year due to a reduction in the amount allocated to infrastructure projects.

The ICT budget allocation can be categorized as follows:

Infrastructure development

Infrastructure is the backbone of any economy and the first necessary layer of connectivity. Improved ICT infrastructure is essential for the government to be able to drive and expand its digital agenda across the country to all citizens. The allocation of the budget to infrastructure projects is as follows:

- KES 5.2 billion for the development of Konza Horizontal Infrastructure phase 1;
- KES 3.8 billion for Konza Data Centre and Smart City Facilities;
- KES 1.4 billion for installation and commissioning of Eldoret-Nadapal Fibre Optic Cable;
- KES 2.7 billion for maintenance and the rehabilitation of last mile connectivity network;
- KES 1.2 billion for maintenance and rehabilitation of the National Optic Fibre Backbone Phase 2 Expansion Cable;
- KES 620.0 million for Government Shared Services.

ICT Education

Enhancement of ICT skills and innovation is critical to ensure the populace can take advantage of technology initiatives. The Kenyan government has done this by scaling up the digital literacy programme, AJIRA programme and presidential digital talent programme. To further enhance this, the budget has an allocation of **KES 310 million** for the Digital Literacy Programme and ICT integration in secondary schools.

15.6B

The allocation in Kenya Shillings to fund initiatives in the Information, Communication and Technology (ICT) sector compared to KES 20.9 Billion in 2021/22.

Technology platforms and digitization

Digitization is essential to improve the productivity and output of various sectors of the country. Kenya has derived great benefits from the implementation and use of its eCitizen and iTax platform amongst others. Some of the key system implementation initiatives highlighted in the budget are as follows:

- e-Government procurement system currently to be rolled out to all Ministries, Departments and Agencies (MDAs) in January 2023;
- Government Investment Management Information System (GIMIS);
- Re-engineered pension management system for management and processing of pension benefits;
- Development of an ERP system for Standard Gauge Railway (SGR);
- Development of a digital health platform to support effective monitoring of the health sector;
- Installation of a new Central Securities Depository System at the Central Bank of Kenya to support planned reforms in secondary trading of government bonds.

In conclusion

The ICT focus areas show that the government is keen to push digital transformation to all citizens through infrastructure development.

However, with rapid digitization comes new risks such as cyber risks, data privacy risks, fraud and system breakdown. These can lead to loss of confidence in digital systems. To address these risks, the government should continue implementing robust policies and regulations to support digital transformation and adoption.

As digital platforms and ERP systems are being implemented to drive efficiency and productivity, it is essential to put proper controls and accountability frameworks in place so the systems achieve their intended objectives and the expected benefits are realized.

Lastly, to enhance digital innovation and growth, the government should work with policymakers and citizens to establish an inclusive innovation ecosystem which can drive greater uptake and usage of digital services.

Contacts

Laolu Akindele
Associate Director, Risk Assurance
Laolu.x.akindele@pwc.com
020 285 5612

Jackson Nginya
Manager, Advisory Technology
Jackson.Nginya@pwc.com
020 285 1623

Felix Omondi
Manager, IT Risk Assurance
Felix.omondi@pwc.com
020 285 5073

Universal Health Coverage:
Does the budget set a pace for the next Government?

Highlights of health sector budget

- Universal Health Coverage (UHC) was a key pillar under the Jubilee Government.
- Under this pillar, the target was to achieve 100% UHC by 2022 and approximately 51.5 million people would have access to healthcare.
- The government carried out a UHC pilot programme in 4 counties which was deemed a success with some critical learning points.
- In February 2022, President Uhuru Kenyatta launched the national scale-up of the UHC to all 47 Counties.
- The UHC Policy of 2020-2030 to guide the acceleration of the progress in attaining Universal Health Coverage was launched, this is expected to ensure continuity of this agenda even in the next government.
- KES 62.3 billion has been allocated towards the UHC

FY2022/23 budget has increased from KES 121 Billion in FY 2021/2022

KES 146.8 billion allocated to the health sector to support the various programmes aimed at improving health outcomes.

Supporting enablers

National Hospital Insurance Fund is a key pillar towards achievement of UHC. The implementation of the NHIF Amendment Act to enhance establishment of a centralized healthcare provider management system, to ensure efficient management and payment of claims, as well as data collection is critical.

The medical cover for the elderly and severely disabled persons in our society with ensure coverage of vulnerable groups.

Expanding the number of healthcare facilities and provision of specialized medical equipment is key. The key area of concern is coverage, cost and timelines of the implementation.

Continuation of the Free Maternity program dubbed “Linda Mama” is welcomed. At implementation level, there is a need to address the issue of low uptake by private and faith based facilities on account of low reimbursement rates and timeliness, inadequate emergency services, referral protocols among others.

The fight against cancer receives a boost. This is through establishment of the National Cancer Institute, construction and equipping of comprehensive cancer centres at KNH in Mombasa, Nakuru and Garissa Counties, and additional support to 10 County Referral Hospitals to operationalize chemotherapy clinics.

The right to health is indeed an inalienable right for every person as espoused in Kenya’s 2010 constitution.

Achievement of this will greatly spur economic growth and contribute to poverty reduction.

UHC funding has a multiplier effect in unlocking many economic benefits to the country and improving the quality of life for its citizens.

Where the KES goes: Key budgetary allocation to other sector priorities.

Potential UHC challenges to reflect on

- Financing is the biggest hurdle facing the universal health coverage program in Kenya.
- Given the erratic projection of government revenue, financing of UHC through taxes is not sufficient to guarantee sustainability.
- Dependency on donors to fund health remains high. With the country's target of achieving upper middle-income status by 2030, there is a need for acceleration in government funding. This is a key task for the next government.

Specific allocations for various activities and programmes include

- KES 7 billion for purchase of COVID-19 vaccines and related expenditures;
- KES 4.1 billion for Free Maternity Health Care;
- KES 5.2 billion for the Managed Equipment Services;
- KES 1.8 billion to provide medical cover for the elderly and severely disabled persons in our society.

To further improve health service delivery:

- KES 18.1 billion has been proposed for the Kenyatta National Hospital;
- KES 11.7 billion for the Moi Teaching and Referral Hospital;
- KES 7.7 billion for the Kenya Medical Training Centres;
- KES 2.9 billion for the Kenya Medical Research Institute;
- KES 1.1 billion for the construction of Kenya National Hospital Burns and Paediatrics Centre;
- KES 1.2 billion for procurement of family planning and reproductive health commodities;
- KES 300 million for procurement of CyberKnife radiotherapy equipment;
- KES 1.3 billion for construction of a cancer centre at the Kisii Level 5 Hospital;
- KES 619 million for procurement of equipment at the National Blood Transfusion Services.

To enhance the vaccines and immunizations programme, an allocation of KES 5.2 billion has been proposed.

Contacts

Francis Muriu
Partner, Assurance
francis.muriu@pwc.com
+254 20 285 5000

Joseph Kagiri
Senior Manager, Assurance
joseph.kagiri@pwc.com
+254 20 285 5141

Stella Githinji
Senior Manager, Assurance
stella.githinji@pwc.com
+254 20 285 5000

Erick Gikaria
Senior Manager, Assurance
erick.gikaria@pwc.com
+254 20 285 5000

Thank you

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