Hunger Safety Net Programme

Evaluation of the Kenya Hunger Safety Net Programme Phase 2

Study on fiscal space for social protection in Kenya

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Executive summary

HSNP provides regular and emergency cash transfers (CTs) to poor households in arid and semi-arid counties of northern Kenya. It is currently implemented by the GoK, with support from DFID Kenya. However, by 2017 it is expected that the GoK will take on the management and the financing of this programme, unless an extension is approved. HSNP is part of the GoK's broader strategy for social assistance, the National Safety Net Programme (NSNP), which brings together all four CT programmes under one umbrella. Critical to this effort is creating a single registry and improving the current institutional framework for social assistance in order to effectively provide universal access to the vulnerable throughout their lifecycle.

This study is part of an independent evaluation of HSNP Phase 2 (HSNP2). It provides a fiscal space analysis for social protection in Kenya. The focus of the analysis is on the social assistance element of the National Social Protection Strategy (NSPP), in particular the four CT programmes under the NSNP. The objective is to explore the current and future fiscal space for investment in social assistance by the GoK under different scenarios. We firstly provide an overview and costing of the social protection sector in Kenya, focusing on CTs. We then proceed to provide forecasts of the fiscal space and financing needs for this sector up to 2030 (based on the 2030 Vision). For this purpose, we make use of a simple financing framework and present different financing needs scenarios based on key fiscal and macroeconomic indicators.[1] Finally, recommendations are made on how much the GoK can afford to spend on social assistance and where additional funds could be generated.

Results of the study show that the GoK is running a fiscal deficit which is expected to continue past 2030. Therefore, if the GoK's current level of contribution to CT programmes is to increase, it will have to either reallocate resources toward this sector, contribute and lobby for additional revenues from the ongoing fiscal reforms, or identify other sources of funding (such as international donors). Based on our calculations, we believe that the best options for the GoK are reallocating resources from other sectors, promoting increases in county government revenues or identifying other financing sources. However, there will have to be an increased lobbying effort on behalf of the relevant institutions for these resources against competing sectors (such as infrastructure, energy or defence). Further institutional support, as well as information and results for CTs being made available to Treasury, will thus be key to ensure not only that the social assistance sector receives enough funds, but also that the GoK is able to sustain the operation of these programmes in a timely and efficient way.

[1] Such as number of beneficiaries, donor contributions, GDP growth or inflation.

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List of abbreviations

AfDB	African Development Bank
CARE	Cooperative for Assistance and Relief Everywhere
CSR	Corporate social responsibility
CT	Cash transfer
DFID	UK Department for International Development
EAC	East African Community
GDP	Gross domestic product
GoK	Government of Kenya
HSNP	Hunger Safety Net Programme
ICT	Information and communication technology
IEA	Institute of Economic Affairs
IMF	International Monetary Fund
KSH	Kenya shilling
MDA	Ministries, departments and agencies
MGCSD	Ministry of Gender, Children and Social Development
MEACL&SP	Ministry of East African Community, Labour and Social Protection
MTEF	Medium-Term Expenditure Framework
NDMA	National Drought Management Agency
NSNP	National Safety Net Programme
NSPP	National Social Protection Policy
OP-CT	Old Persons CT
OPM	Oxford Policy Management
OVC-CT	Orphan and Vulnerable Children CT
P4R	Programme for Results
PFMA	Public Financial Management Act
PWSD-CT	Persons with Severe Disabilities CT
UNICEF	United Nations Children's' Fund
VCI	Vegetation Condition Index

1 Rationale

Poverty and vulnerability alleviation remain a key challenge in Kenya. It is estimated that about 45.9% of Kenyans currently live below the poverty line, 51% in rural areas and 33% in urban areas. Poverty is also disproportionately higher in certain regions of the country, with estimates, for example, that Turkana has 87.5% poverty incidence, while Nairobi has 21.8% (National Bureau of Statistics, 2015). In response to these needs, the GoK has boosted efforts to improve social protection and increase assistance to the poorest and most vulnerable in the country. The 2010 Constitution, the 2030 Vision and the 2011 NSPP set a robust policy framework, upon which the national social protection system is built. Based on the 2010 Constitution, the definition of social protection[2] includes safety nets, contributory schemes, social equity and social services (World Bank, 2012)[3]. The main source of financing for social protection in Kenya is the GoK, followed by financing support from development partners and members of contributory schemes (World Bank, 2012). While the GoK is the largest source of financing of social protection expenditure (at 55%), 88% of this spending in 2013/14 was on contributory programmes, namely the civil service pension. The remainder was spent on other social programmes and social assistance. Expressed as a percentage of GDP, this means that total social protection spending for the GoK is 0.7% of GDP, while social assistance spending amounts to 0.25%–0.3% of GDP. Development partner funding (bilateral and multilateral) was allocated entirely to safety nets, the majority of which went to relief and recovery programmes. Consequently 29% of safety net spending was financed by development partners (World Bank 2012).

The NSPP formally sets out the GoK's ambition to enhance social assistance by supporting the relevant institutions,[4] strengthening operational systems and expanding the coverage of social protection programmes in the country. Under this initiative, the NSNP was created as a framework around which the CT programmes in the country could be increasingly coordinated and harmonised. These currently include the CTs to Orphans and Vulnerable Children (OVC-CT), the Older Persons CT (OP-CT), the People with Severe Disability CT (PWSD-CT) and HSNP (World Bank, 2013). The GoK currently covers the entirety of the cost of OP-CT and PWSD-CT, and shares the cost of OVC-CT with DFID (with 85% funded from the GoK and 15% funded by DFID in 2014/15).

HSNP is the most recently established CT programme, and includes a pioneering system of both regular and 'emergency' CTs to poor households in arid and semi-arid counties. The first phase of HSNP, 2007–2013, provided 69,000 households (496,800 people) with predictable electronic CTs worth approximately £13 per household per month. The second phase of HSNP, which ran from July 2013 until March 2017, will continue to focus on the same

[2] Social protection is defined as 'a set of all initiatives, both formal and informal, that provide social assistance to extremely poor individuals and households, social services to groups who need special care or who would otherwise be denied access to basic services, social security and health insurance to protect people against the risks and consequences of livelihood shocks through earnings-related contributions and benefits, and social equity to protect people against social risks such as discrimination or abuse' (Ministry of Gender, Children and Social Development (MGCSD) 2011:37).

[3] Safety nets can be formal (legally guarantee individuals access to economic or social support) or informal (provide livelihood support to individuals to help them rise up to or remain above the designated minimum standard of living but with no legal guarantee). Social equity includes measures to protect people against discrimination or abuse, including in regard to land rights, racial discrimination, and gender equality. Contributory schemes refer to social security and social health insurance (World Bank, 2012). Finally, social services include access to education, water and sanitation, and essential health care benefits, such as maternity benefits (MGCSD, 2011).

[4] Social assistance is used to refer to 'non-contributory transfer programmes aimed at preventing the poor or those who are vulnerable to shocks from falling below a certain poverty level' (MGCSD, 2011:37).

four counties as HSNP's first phase. By 2017 it is envisaged that 49% of total programme costs will be met by the GoK. However, the GoK is looking to further expand its share of funds and increasingly absorb the entirety of the programme into the State Budget by the end of the standing Memorandum of Understanding with DFID. This is in line with a commitment to increasingly nationalise all CT programmes within the NSNP and to set up a more efficient and comprehensive social assistance system in the country.[5]

This report presents a study on fiscal space for social protection in Kenya, as part of Oxford Policy Management's (OPM) evaluation of the HSNP2 programme[6]. The objective of this work is to explore the current and future fiscal space for investment in social protection by the GoK under different macroeconomic and fiscal scenarios. This will inform policy-makers of the likely cost and funding options in the medium and long term. Social protection is understood in relation to the 2011 NSPP definition and comprises 'policies and actions, including legislative measures, that enhance the capacity of and opportunities for the poor and vulnerable to improve and sustain their lives, livelihoods, and welfare, that enable income-earners and their dependants to maintain a reasonable level of income through decent work, and that ensure access to affordable healthcare, social security, and social assistance' (MGCSD, 2011:5). In particular, based on the GoK's commitment to provide support to extremely poor individuals and households, the study focuses on the GoK's social assistance measures as defined in the NSPP (2011): the 'non-contributory transfer programmes aimed at preventing the poor or those who are vulnerable to shocks from falling below a certain poverty level' (MGCSD, 2011:37). These include the four non-contributory CT programmes currently under the NSNP.

For this study we use a simple financing framework to determine the resources needed to finance social protection spending up to 2030, in line with the 2030 Vision[7]. The framework is based on the latest available GoK, IMF and World Bank data. This yields a baseline scenario, upon which recommendations and alternative scenarios are built. These were identified through reviews of the literature, available models and publications for Kenya, and direct engagement with relevant stakeholders. The alternative scenarios thus allow us to compute alternative resource gaps which now take into account additional resources and possible savings.[8] Finally, recommendations are made on how much the GoK can afford to spend on social assistance and what sources of revenues can yield additional funds in the future.

Through this exercise, we therefore aim to answer the following three questions:

1. What is the de facto fiscal space in the GoK for social protection spending?
2. How much does the GoK currently spend on social assistance and how much can it afford to spend in the near future based on our assumptions?
3. How much should the GoK spend on social assistance?

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[5] See also Sandford *et al.* (2016) 'Evaluation of the Kenya Hunger Safety Net Programme Phase 2: Strategic Policy Review', OPM.
[6] The evaluation includes an independent impact assessment, ongoing routine programme operations monitoring, and a series of policy analyses, of which this study is one. The others comprise a costing study for HSNP2, a strategic policy review, an assessment of HSNP2's targeting performance, an institutional capacity assessment and microsimulations to inform the design of subsequent phases of the programme. The findings of these studies feed into ongoing policy dialogue within Kenya, as well as informing the international research agenda around social protection in developing countries.
[7] The baseline scenario assumes that no additional financing sources or major changes in the institutional, political and economic landscapes take place during the forecasted period.
[8] We also carry out sensitivity analysis which provides upper and lower boundaries around the estimated results based on GDP growth and inflation scenarios.

In responding to these questions we aim to inform the current policy debate and to provide a tool for objective analysis for relevant stakeholders in regard to efforts to harmonise and improve the current social protection system in Kenya.

The remainder of this report is structured as follows: Section 2 provides an overview of the social protection sector in Kenya, including current programmes, relevant policy, legal and institutional frameworks in place for the social protection sector and current international trends in social sector spending in the region. Section 3 presents the macroeconomic and fiscal model and provides an overview of the macroeconomic and fiscal context of Kenya. Section 4 presents the results of the baseline scenario based on economic assumptions used in the model, as well as alternative scenarios. Section 5 provides the conclusion and recommendations.

2 Overview of the social protection sector

The objective of the social pillar of the Kenya Vision 2030 is to build 'a just and cohesive society with social equity in a clean and secure environment'. The key areas covered under the social pillar can be placed within the social protection framework of social assistance, social services, social insurance and social equity. A coherent social protection system is therefore fundamental to the achievement of the social pillar objectives. The NSPP is aimed at improving the coordination, impact, scope and effectiveness of social protection interventions, the goal specifically being to develop and implement a social protection framework for all citizens – and in particular to support the poor and the most vulnerable groups to gain access to better services and income-generating opportunities. Other relevant policies, as highlighted in the *Social Protection, Culture and Recreation Sector Mid-Term Expenditure Framework 2012/13 – 2014/15 Sector Report* include the National Food Security and Nutrition Policy (2007), the National Children's Policy (2010), the National Policy on Older Persons and Ageing (2009), the National Policy on Youth (2006) and the National Gender and Development Policy (2000), the HIV Prevention and Control Act (2006), the Children's Act (2001), the Social Assistance Act (2012) and the Persons with Disabilities Act (2003).

Kenya is also party to various international agreements and instruments that guide social protection: the Universal Declaration of Human Rights (1948), the UN Convention on the Rights of the Child (1989), the Convention on the Rights of Persons with Disabilities (2008), the African Charter on People and Human Rights and the International Labour Organization Convention 102 (1952).

2.1 LEGAL FRAMEWORK FOR SOCIAL PROTECTION IN KENYA

Kenya's efforts to reduce poverty levels and vulnerability in the country, as well as the provision of safety nets and support, were highlighted in the policy dialogue through the 2010 Constitution, the Kenya Vision 2030 and the 2011 NSPP (World Bank, 2012).

As such, Article 43 of the 2010 Constitution asserts the 'right for every person…to social security and Article 43(3) binds the State to providing appropriate social security to persons who are unable to support themselves and their dependants.' The fourth schedule, part 1(14), determines that the GoK commits to providing 'consumer protection, including standards for social security and professional pension plans'. The Constitution therefore defines the duty of the GoK as being to provide safety nets, contributory schemes, social equity and social services. The GoK has furthermore updated its regulatory framework for CTs and social protection by passing the 2013 Social Assistance Act. This act further legitimises and institutionalises the social protection schemes currently undertaken by the GoK (National Gender and Equality Commission: 2014).

As mentioned above, the *Kenya Vision 2030* includes social protection as one of three core pillars, aiming to provide a 'high quality of life for all its citizens by the year 2030' in the economic, social and political spheres. The need to increase financing for safety net programmes for both poverty reduction and promotion of economic growth is therefore emphasised (World Bank, 2013). The second five-year period, as defined in the *Medium-Term Plan (MTP) 2: 2013–2017* outlines the goal as being to 'invest in the people of Kenya', with one of the proposed actions being the establishment of a consolidated Social Protection Fund.

The NSPP (2011) was established to provide a national framework for social protection and to identify policy objectives and create synergies between safety nets and contributory schemes in order to develop a coordinated

approach. For the purpose of this report, we will define social protection as: '*policies and actions, including legislative measures, that enhance the capacity of and opportunities for the poor and vulnerable to improve and sustain their lives, livelihoods, and welfare, that enable income-earners and their dependants to maintain a reasonable level of income through decent work, and that ensure access to affordable healthcare, social security, and social assistance*' (NSPP, 2011:5).

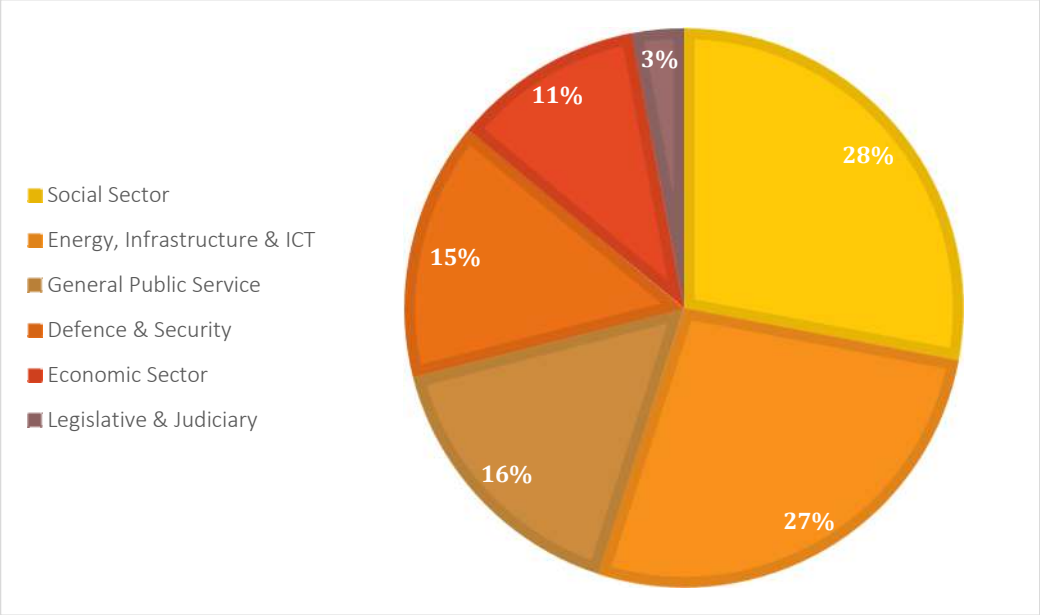
2.2 SOCIAL SECTOR SPENDING

2.2.1 Social protection spending

The budgets for social sector spending, and more specifically the social assistance, are prepared by the Working Group for Social Protection, Culture and Recreation. Within the overall sector budget, individual CT programmes are budgeted under the responsible ministries. Generally, GoK funds are split between the recurrent and development budget. Currently, most CT programmes are captured under the development budget due to informal budget rules (mostly due to the fact that CT programmes are funded with some donor financing). The practice in most countries, however, is that such CT programmes are captured under recurrent expenditure.

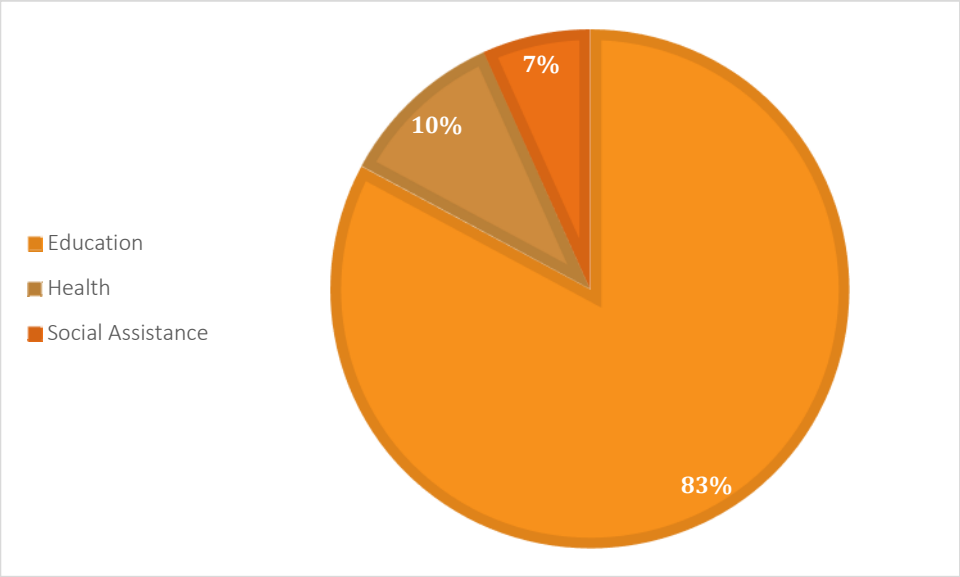
UNICEF's 2012 *Kenya Social Protection Sector Review* found that in the period between 2005 and 2010 social protection expenditure in Kenya increased to approximately 2.28% of GDP. This increase was driven primarily by a sharp increase in spending in contributory programmes, civil service pensions and safety nets. Spending doubled from Kenya shillings (KSH) 11.9 billion (2005) to KSH 20.5 billion (2010), or 0.8% of GDP on safety net spending alone. The increased spending on safety nets was driven primarily by relief and recovery responses to the 2009 drought. Therefore, 53.2% of safety net expenditure from 2005 to 2010 was directed to relief and recovery response, followed by the expansion of the CT programmes from 2009.

Figure 1: Sectoral expenditure allocations 2015/16



The GoK identifies the social sector (education, health and social protection) as a key priority, with an allocation of 28% in 2015/16 (as captured in Figure 1 above) and 29% of the total budget for 2016/17. The 2016/17 Budget Policy Statement, however, shows that if we look at social protection, culture and recreation on its own, it will receive only a 2% share of the GoK's total planned expenditure.

Figure 2: Social sector expenditure allocations 2015/16



Social assistance spending (as a percentage of social sector spending) only amounts to 7% of the social sector allocation in 2015/16. GoK expenditure within social sector spending is significantly geared toward improvements in education, rather than social protection and health. As can be seen in Table 1 below, education was the primary beneficiary of this allocation and includes payment of salaries for teachers, free primary education, free secondary education and information and communication technology (ICT) development in primary schools. In health, allocations are prioritised for national referral hospitals, leasing of health care equipment, and free access to maternal health care. Social assistance allocations to vulnerable groups consist of orphans and vulnerable children (KSH 9 billion), elderly persons (KSH 7.4 billion), and persons with extreme disability (KSH 1.2 billion) (Parliamentary Service Commission, 2015).

TABLE 1: SOCIAL PROTECTION EXPENDITURE 2015/16

Key programmes	Implementing ministry/agency	Allocation (millions KSH)	Key areas of expenditure
		2015/16	
Primary education	State Department of Education	35,803	Free primary education (KSH 15.1 billion); ICT capacity development (KSH 17.6 billion)
Secondary education	State Department of Education	34,834	Free day secondary education (KSH 33.3 billion)
University education	State Department of Science and Technology	61,401	Transfers to tertiary institutions (KSH 51.8 billion); HELB (KSH 7.5 billion)
Teacher resource management	Teachers Service Commission	174,302	Primary teachers (KSH 97 billion); secondary teachers (KSH 55.8 billion); tertiary teachers (KSH 21.4 billion)
Curative health services	Ministry of Health	23,470	National referral services (KSH 16.1 billion); leasing of health care equipment (KSH 4.7 billion)
General administration, plan and support services (health)	Ministry of Health	15,127	Free access to maternal health (KSH 4.3 billion); free primary health care (KSH 1.7 billion); doctor/nurses' internships (KSH 3 billion); KEMRI (KSH 2 billion); KMTC (KSH 3.3 billion)
National social safety net	Ministry of Labour, Social Security and Services (now MLEAC&SP)	19,102	Social assistance to vulnerable groups (KSH 19.1 billion)
NDMA	State Department of Devolution	5,731	This includes regular HSNP payments of KSH 800,154,600

Source: Ministry of Finance.

The GoK is the largest source of financing of social protection expenditure (at 55%), but 88% of this spending in 2013/14 was on contributory programmes: namely, the civil service pension. The picture that therefore emerges is that, in 2013/14, 71% of total safety net spending was actually financed by development partners. Although the safety net programmes have been expanding steadily (both geographically and in terms of households reached) coverage still remains relatively low. Despite the accomplishment of providing regular support to 1.6 million people in 279,843 households (4% of population) by 2013 (World Bank, 2013), the four CT programmes cover only a fraction of the poor population (estimated at 46% of the population). The CT programmes have a proven track record of reducing poverty and inequality and enable the targeted households to spend more money on food, fuel, housing and investing in children.

With an allocation of only 2% of the total budget for 2016/17, the relatively low priority given to social protection within the broader social sector hampers the expansion of the social safety net. Investment in social protection is further constrained by a lack of coordination and by fragmentation, undermining the efficient utilisation of resources. Delays in the disbursement of funds affects the performance of CT programmes, particularly those under

the Ministry of East African Community, Labour and Social Protection (MEACL&SP). More on the particular challenges can be found under Section 2.3.

2.2.2 International comparisons of social protection spending

As seen in Figure 3, social protection expenditures in Africa are the lowest in the world. However, despite the fact that coverage and expenditure have been increasing in the past few years there remain wide variations across countries. For example, while the old age grant reaches 2.7 million people in South Africa, the OP-CT in Kenya only has 225,000 beneficiaries. There is a growing body of evidence that shows that these programmes have a positive effect in reducing poverty, and improving nutrition, school attendance and access to health services. This has helped increase support for further financing of social protection systems – in particular, CTs. In South Africa, CTs have reduced the poverty gap by 48%, while in Mauritius, households with both children and older people have had their poverty rates reduced from 30% to 6% as a result of the old age grant (Omilola and Kaniki, 2014).

Partly due to increased evidence of success, some African countries are currently prioritising social protection spending and establishing social grants, health insurance, or public works programmes. Overall, spending on social protection as a share of GDP, coverage and the scope of social protection programmes tend to increase with the rise of per capita income of a country. During the past decade, social protection coverage in general has increased. However, it is still inhibited by fiscal, political, technical and policy constrains (Omilola and Kaniki, 2014). Figure 4 compares government spending on social protection as a percentage of expenditures across a range of countries in Africa. In comparison to other countries in the region, Kenya spends an average amount on social protection systems (3.6% of expenditures in 2011, compared to 0.66% in Burundi, or 4.06% in South Africa[9]). However, given the prevalence of poverty and vulnerability in the continent, there is a continued need to increase and improve the current level of public spending on these programmes across the continent. Future work in this region must focus on improved coordination and capacity building amongst the implementing institutions, more lobbying for this sector within respective governments and higher levels of spending commitments.

[9] This figure is likely to be underestimated, as it does not include any other relief or disaster management funds available in the country.

Figure 3: Social security expenditures[10] (% of GDP)

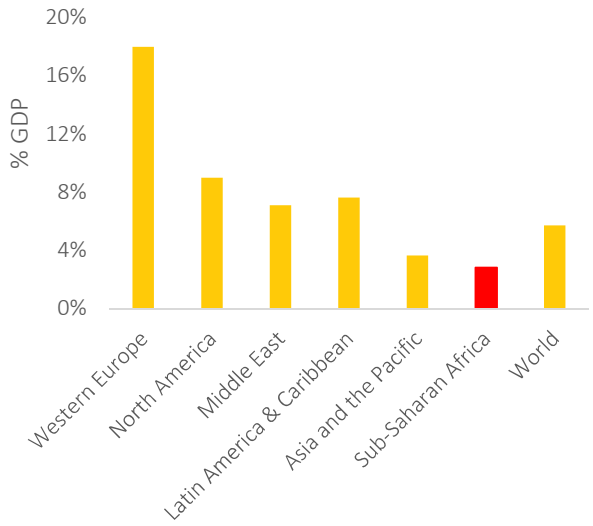
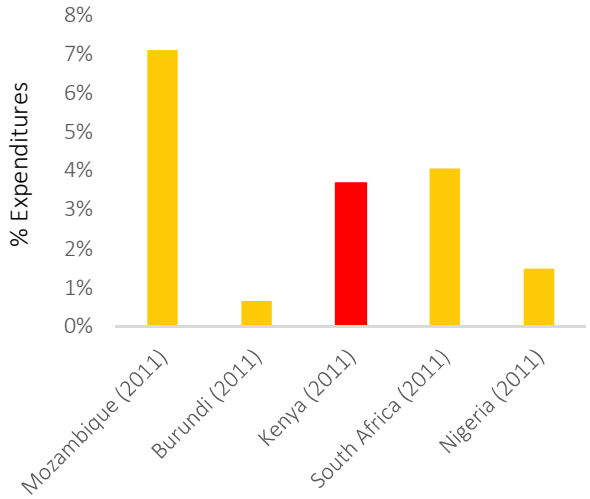


Figure 4: Central government social protection spending (% of expenditures)



Source: IMF COFOG and World Bank Data (2012)[11].

2.3 FUNDS FLOW

Funding for the CT programmes runs through the National Treasury budget preparation, execution, accounting and monitoring processes.

The budget preparation process in Kenya starts with the National Treasury issuing a budget circular. The budget circular outlines the GoK's medium-term fiscal strategy, resource ceilings by sector along with general information on the budget preparation calendar and the sector working groups. The sector Working Group for Social Protection, Culture and Recreation then starts preparing sector budget proposals, aligned to the principles outlined in the budget circular, ministerial expenditure and sector budget reviews, sector policies and strategies, as well as the national Vision 2030 Medium-Term Plan. The Macro-Working Group then prepares a three-year budget policy statement to guide the development of the budget. The sector working group must then prepare detailed budgets for their ministries, departments and agencies (MDAs), which is then presented to Parliament and must be approved before the final budget is completed. The budget proposals for the CT programmes should be based on the estimated number of beneficiaries to be covered and on the operational costs and monitoring and evaluation resources needed to support the implementation. Once the budget is approved by Parliament, National Treasury releases the funds to the Central Bank Account of the MEACL&SP and the State Department of Devolution. Once these amounts are received, the ministries will transfer the amounts into a project account. The CT programmes can then incur expenditure against these accounts (World Bank 2013). HSNP2, however, also has access to funding support provided directly by DFID.

[10] Excluding health expenditure.
[11] These data include budgetary and central government expenditures per country only and exclude any other emergency or relief funds which a government might have.

Disbursements from the Treasury do not always meet the cash flow needs of the CT programmes. This is primarily due to the closing of government accounts at the end of the financial year, resulting in a delay in the disbursements over that period of time (which also then potentially has knock-on effects in the rest of the year). Cash flow constraints within the Treasury itself, resulting in the prioritisation of certain programmes or activities over others can also result in delays in disbursements to certain ministries and subsequently delays in payments to beneficiaries. Discussions with the HSNP OVC-CT and OP-CT programmes highlighted the concern that government funds are currently budgeted for in the development budget, which is not prioritised when it comes to fund release (when cash flow constraints are in place). For funding release the government prioritises:

- intergovernmental fiscal transfers (occur on quarterly basis, but negotiated on monthly basis by the Senate);
- public domestic debt;
- civil servants' salaries (on the 25th of every month);
- recurrent operations and maintenance expenditure and flagship projects; and
- other development expenditure.

This means that when the National Treasury has cash flow constraints during the course of the financial year, items on the development budget are delayed or cut, putting the CT programmes at risk and impacting on the predictability of the CTs. Other reasons for delays in fund release (as highlighted by the CT programmes) include reconciliation processes and pre-audits, unfamiliarity with payment processes and delays caused by payment generation.

Funding for HSNP is more predictable due to its ability to draw on DFID payment support in the case of delays in the release of funds from the Treasury. As evidenced in the table in Annex B.1, HSNP payments are more frequently on time than other programmes, with the maximum delay experienced being 40 days, compared to much more frequent and lengthy delays experienced by the other programmes (with some delays being up to 197 days). The delays to particularly the three CT programmes (OVT-CT, OP-CT and PWSD) can be ascribed to delays in disbursements from the National Treasury, along with a lack of organisation, systems and processes within the CT programmes for timely submission of disbursement requests. Late payments undermine the confidence of beneficiary households and can have severe consequences for their consumption and livelihoods. The predictability of HSNP is critical to ensuring value for money.

2.4 DEVOLUTION

The GoK has embarked on an intensive decentralisation process, based on the 2010 Constitution. This process has resulted in counties having 13 newly devolved sectoral mandates, amongst them Health, Pre-Primary Education and Village Polytechnics, Agriculture, Livelihoods, County Roads, Disaster Management and Water Supply. Underpinning this devolution agenda was the need to: (i) address deeply entrenched disparities in development between regions; (ii) improve equity in access to social and economic services at the county level; and (iii) work progressively toward equalising opportunities for all Kenyans. Experiences from other countries illustrate that fiscal decentralisation can catalyse economic growth but there are also downside risks. The benefits of decentralised government include the following: (i) public policies tailored to local needs through closer proximity to the people; (ii) better governance and accountability structures, since they are closer to the people; (iii) more cost-effective approaches to delivery of services, through peer competition; and (iv) where there is subnational tax autonomy, increased accountability, with a positive relationship with growth. At the same time, there are arguments that devolution can undermine growth, potentially through: (i) increased bureaucratic burdens; (ii) separation of spending and taxing responsibilities, which

can undermine efficiency and lead to arrears; and (iii) newly created subnational governments that may face capacity constraints.

In Kenya, the county governments have taken over the delivery of specific devolved services, starting with an expenditure layout of 5.4% of GDP or 20% of total expenditure in 2013/14 when all newly devolved functions were first budgeted for. At the outset, the intention was to increase productive spending through devolution. The 2013/14 fiscal data, however, reveal important emerging trends in county expenditure, with overall expenditure levels being quite low at 63% of the total approved budget. Recurrent expenditure (specifically administrative expenditure) increased rapidly to consume 78% of total spending as county governments grew to fulfil their expanded mandate while struggling to fulfil their policy, planning, budgeting, financial management and service delivery functions. Only a limited number of counties were able to allocate even a third of their budget to development projects. Counties furthermore experienced an overall revenue gap, due to the low levels of own revenue (local taxes, tariffs, charges) collection[12].

The 2014/15 county budget allocations reflected a shift in counties' general public services, from 84% of the total county spending in 2013/14 to 36% of the total county budget in 2014/15. County governments received KSH 228.5 billion from the national government in direct transfers, while raising 33.6 billion from own revenue (representing 67% of planned revenue collection). Counties furthermore had access to KSH 41.3 billion of unspent funds from the previous financial year and a Danish International Development Agency grant of KSH 733.7 for health sector expenditure (Office of the Controller of the Budget, 2015).

Counties' allocation to the health sector, which is a fully devolved function, increased to 19% of the total county budget in 2014/15. Expenditure allocation to counties' economic affairs sectors, which include agriculture, transport, and other economic affairs subsectors, accounted for 26% of the total county budget in 2014/15, reflecting a broader shift toward productive spending. According to the World Bank's (2016) *Kenya Country Economic Memorandum: From Economic Growth to Jobs and Shared Prosperity*, social protection spending only made up 0.5% of the total county spending in 2014/15. While social protection is not a devolved function, a number of counties have expressed an interest in and even experimented with social assistance programmes[13]. Capacity gaps at county level continue to undermine any constructive contribution to social protection. Attempts by counties to establish their own social protection CTs have run into difficulties, due to a lack of targeting mechanisms, with efforts to distribute funds equally across all sub-counties and households. This has proven unsustainable and unsuccessful. There is, furthermore, little evidence of coordination between county governments regarding successful interventions in the sector. Discussions with national-level stakeholders regarding a more pro-poor household targeting mechanism have also broken down. This lack of coordination between counties, and between counties and national stakeholders, has resulted in an inefficient and ineffective foray into social assistance, which undermines the efficient utilisation of resources. Although social protection is not a mandated devolved function, counties are expected to allocate between 5% and 7% of their total budget to an emergency fund.

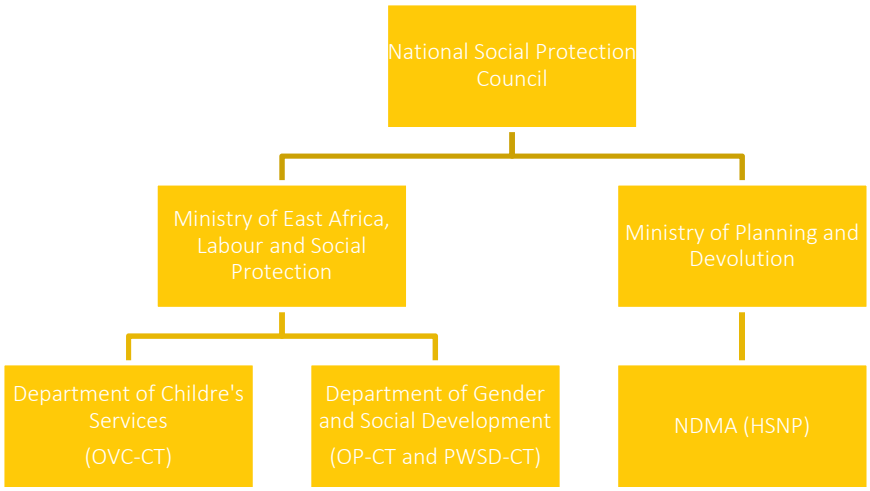
[12] Schedule 4 of the Constitution of Kenya of 2010 outlines counties' sources of revenue. It gives counties the power to collect specific taxes (property tax being the most important own revenue source), levies, rents, forfeitures, rates (both direct and indirect), business permits, licences, parking fees, etc.

[13] The Strategic Policy Review, *Evaluation of the Kenya Hunger Safety Net Programme Phase 2 (2016),* highlights attempts by Turkana, Marsabit, Wajir, Machakos and Baringo counties to operationalise their own cash transfers.

3 The NSNP

The NSNP brings all CT programmes together under a common framework, with the aim of improving efficiency of programme operations and coverage (OPM, 2014). There are currently four non-contributory CTs, which form the core of the GoK's national safety net to support poor and vulnerable households. These are the OVC-CT, the OP-CT, the PWSD-CT and HSNP[14]. Figure 5 shows the institutional arrangement of all CT programmes under the NSNP, which sits under the supervision of the National Social Protection Council. The first three CT programmes are administered by the MEACL&SP; the OVC-CT is implemented by the Department of Children's Services; whereas the OPT-CT and the PWSD-CT is implemented by the Department of Gender and Social Development. HSNP is the responsibility of the NDMA within the Ministry of Devolution and Planning (OPM, 2014).

Figure 5: Institutional framework for NSNP



Source: NDMA

The role of the Social Protection Secretariat (soon to be the National Social Protection Council) is to provide strategic leadership, management support and oversight, and to ensure greater coordination of social protection, through the NSNP, across the various ministries that are involved in this function. The NSNP's stated objective is to improve the efficiency and effectiveness of safety net support to poor and vulnerable populations, particularly through (i) strengthening overall governance, with more robust systems for targeting, beneficiary registration, payments and monitoring; (ii) improving the coherence of the sub-sector by increasing harmonisation of the CT programmes; and (iii) expanding the coverage of the programmes. One of the ways this is being done is with the development of a single registry to capture all beneficiaries of CT programmes and to harmonise payrolls and pay cycles. The Secretariat is currently also exploring the feasibility of a common targeting tool to be used for the identification of new beneficiaries, as well as to cut down on overlapping payments. One of the critical challenges for the Secretariat is to ensure that funding flows are both predictable and timely. The predictability of funding flows is currently a particular challenge for the CT programmes, as shown in the table in Annex B.1.

[14] The Urban Food Subsidy CT stopped in 2014.

Although both the Ministry of Devolution and Planning (responsible for HSNP through the NDMA) and the MEACL&SP have a presence at sub-county level, there is little evidence of coordination between counties and central government ministries around social protection activities[15]. This creates an environment within which payments and other social assistance activities may be duplicated and it undermines the potential to expand coverage to more vulnerable households.

The increase in the scope and scale of the CTs under the NSNP will therefore require a progressive increase in government financing in relation to development partner financing, and strengthened implementation capacity (World Bank, 2013). The NSNP is currently financed by a mixture of development partners and the GoK. Direct development partners' financing is expected to decrease in the near future. However, indirect financing through the World Bank Programme for Results (P4R) will continue. P4R can provide up to $250 million to the GoK through disbursements in the form of loans to the Exchequer, conditional on the achievement of agreed targets. Therefore, there is an urgent need to reassess the current as well as potential sources of funding to the NSNP.

TABLE 2: ACTUAL AND FORECAST EXPENDITURES BY CT PROGRAMME (KSH MILLIONS)

Programme	2013/14		2014/15		2015/16		2016/17		2017/18	
	Recurrent	Capital	Recurrent	Capital	Recurrent	Capital	Recurrent	Capital	Recurrent	Capital
OVC-CT	1,618	3,833	1,329	5,118	1,510	5,791	1,716	6,582	1,949	7,473
HSNP	15	213	60	566	69	1,069	78	1,215	88	5,308
OP-CT	371	2,474	756	5,040	859	5,726	976	6,508	1,108	7,389
PWSD-CT	116	770	116	770	131	875	149	994	169	1,129
Total	2,120	7,290	2,261	11,494	2,569	13,461	2,919	15,300	3,314	21,299

Source: MEACL&SP (2016)

Despite the challenges experienced by CT programmes, the budget execution rates of the programmes are above the general budget absorption rate of other programmes and activities of the GoK.

TABLE 3: BUDGET EXECUTION RATE BY CT

CT programmes	2013/14	2014/15	2015/16
OVC-CT	60%	83%	95%
HSNP	55%	95%	96%
OP-CT	90%	94%	72%
PWSD-CT	100%	101%	74%

Source: National Treasury.

3.1 OVC-CT

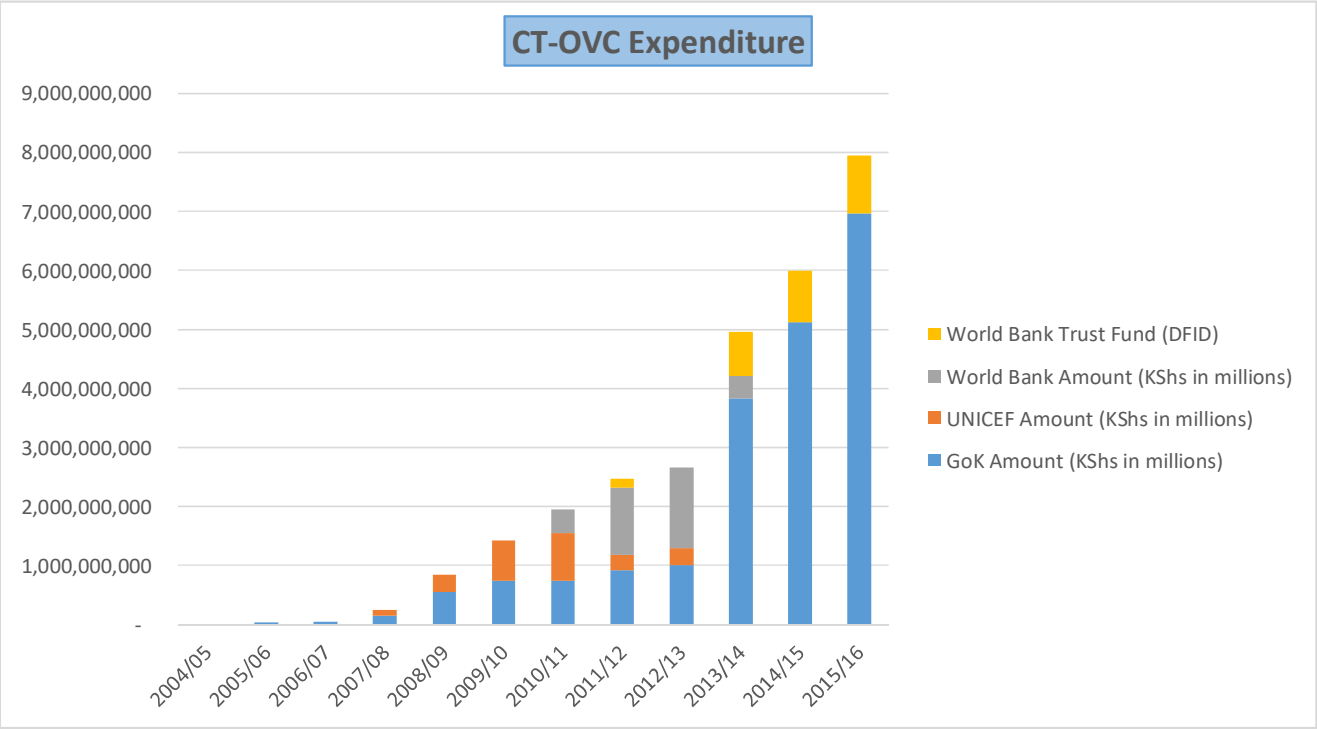
The OVC-CT was established in 2004 with the aim of supporting children orphaned due to HIV/AIDS within their communities, while promoting human capacity development. The OVC-CT programme is built on a wide national and international legal and policy framework: Article 53 of the 2010 Constitution outlines the rights of children and child

[15] Sandford, *et al*. 2016.

protection, supported by the 2005 National Policy on Orphans and Vulnerable Children. To achieve these national and international commitments, the programme provides two monthly cash payments to households caring for orphaned and vulnerable children[16] (World Bank, 2012). Household responsibilities for receiving the money include: ensuring orphan, vulnerable children aged 0–5 years receive immunisation and growth monitoring; that orphaned, vulnerable children aged 6–7 regularly attend basic education; and that orphaned and vulnerable children acquire birth certificates and care givers attend awareness sessions (National Gender and Equality Commission: 2014). Subsequent phases of the programme included the CT component, as well as institution building and support to the government institutions implementing OVC-CT (Alviar and Pearson, 2009).

Initially, the programme was funded by UNICEF and DFID, in seven districts. This lasted till 2009, when the GoK undertook expansion to other districts across the country, which it has carried out in the years since (OPM, 2014). The first phase pilot programme that targeted 500 households was expanded to 13,280 households by 2006/2007. By 2008/2009, total households reached 45,911, with widespread national and international support (including UNICEF, the Swedish International Development Agency, DFID and World Bank, through an International Development Assistance loan). In the 2015/16 budget, the programme aimed at expanding coverage to approximately 353,000 households across 2,671 locations, in 290 constituencies in all the 47 counties.

Figure 6: OVC-CT expenditures



Source: National Treasury and MLEASP (2016).

[16] For the purposes of the programme, these are defined as children who have lost one or both parents, are chronically ill or who have a caregiver who is chronically ill; and/or who live in child-headed households due to being orphaned.

3.2 OP-CT

The OP-CT was launched in 2007/08 as a pilot in three districts: Busia, Nyando and Thika (Ministry of Devolution and Planning, 2013). The programme aims to strengthen the capacity of older persons and to improve their livelihood by providing CTs to extremely poor households that include a member aged 65 or older who is not already receiving a pension or any other type of CT (World Bank, 2013). It is built on the 2010 Constitution (through its commitment to social protection), the 2011 Social Protection Policy and the National Policy for Older Persons: these promote the value of social protection in old age through non-contributory and contributory benefits. Kenya is also a signatory to international instruments, such as the International Plan of Action on Ageing, the UN Principles and Rights of Older Persons and the African Union Policy Framework and Plan of Action on Ageing.

During the pilot phase, 300 households received a monthly transfer of KSH 1,000, which increased to 33,000 households in 2009/10. Since 2009, the programme has been continuously expanded and now aims to reach 225,000 households in the 2015/2016 budget.[17]

3.3 PWSD-CT

The PWSD-CT started in 2011, with a countrywide scope across all counties and the 210 former constituencies. It transfers money to individuals with severe disabilities who require the attention of caregivers (Ministry of Devolution and Planning, 2013). The programme aims to enhance the capacity of caregivers and to improve the livelihoods of people with severe disabilities[18], targeting extremely poor households with a severely disabled person and which are not enrolled in any other CT programme and do not have members receiving other pensions. The PWSD-CT is based on Article 19 of the 2010 Constitution, the National Disability Policy of 2006, the NSPP and the National Development Fund for the Persons with Disabilities.

The programme started in 2010 with 2,100 beneficiaries and has been expanded ever since, reaching 27,200 households in 2013/14 and expecting to reach 47,200 beneficiaries in the 2015/16 budget.

3.4 HSNP

HSNP was designed in 2006/07 and aims to reduce extreme hunger and vulnerability by delivering bi-monthly unconditional CTs to poor households in four arid counties: namely, Marsabit, Mandera, Turkana and Wajir. The programme also works toward reducing Kenya's dependence on emergency relief by supporting those households that are dependent on relief with long-term CTs. The first phase began operations in 2008 and was successfully completed in 2012, covering 69,000 households. The programme is currently at the second phase, which will run from July 2013 to March 2017, with the aim of increasing coverage to 100,000 households.

The programme is jointly funded by DFID and the GoK and is implemented by a range of non-governmental and private sector partners, including Oxfam GB, HelpAge International, Equity Bank, the Financial Sector Deepening Trust and OPM (OPM, 2014). Unlike other CT programmes, the breakout of different activities by various actors allowed for a

[17] Part of this expansion has been possible due to the absorption of the funds from the Urban Food Subsidy Programme in 2014.
[18] Disability in this context is understood as someone who needs permanent care (including feeding, toiletry, and protection from danger from themselves, other persons or from the environment). Eligible people with a disability must require support on a daily basis.

detail-oriented approach to the different components, from the design and targeting, to the disbursement of funds and programme evaluation. The first phase of HSNP was funded by DFID and the Australian Department for Foreign Affairs and Trade. The second phase has been funded by DFID and the World Bank. It is envisaged that by 2017, 49% of total programme costs and 54% of the HSNP caseload will be met by the GoK. Moreover, with the end of the current memorandum of understanding standing between the GoK and DFID in 2017, alternative sources of financing (by the GoK itself or by other donors) are currently being considered.

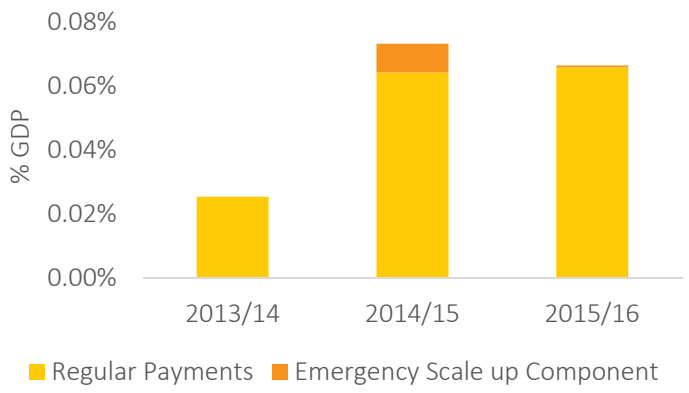
HSNP is different to other traditional CT programmes due to its dual component setup. This system consists of bi-monthly unconditional cash payments (beneficiary Group 1), as well as a scale-up payment system for making payments to a wider number of beneficiaries in emergency drought situations (beneficiary Group 2). Payments are made by means of biometric smartcards, based on bank accounts, which has been a great innovation in comparison to other CTs in the country. Resources are divided across counties by means of a County Resource Allocation formula,[19] which takes into consideration poverty prioritisation and population to allocate resources across counties.

Emergency scale-up

Group 2 beneficiaries benefit from the emergency scale-up component of HSNP, which triggers emergency transfers to a wider range of households in the case of severe drought conditions. Pre-ranked households (which do not already receive regular HSNP transfers) receive transfers which are triggered based on the Vegetation Condition Index (VCI), a remote sensing indicator for measuring the status of grazing resources. The VCI is assessed on a monthly basis according to predefined thresholds specifying severe or extreme drought conditions. Various payments have been made in 2015 and 2016 in response to weather conditions such as el Niño. The emergency component of the programme initiated a pilot scheme in 2015 to 90,000 non-routine beneficiary households in northern Kenya and has since then been triggered during severe droughts (NDMA, 2015). This number is now designed to increase to cover 274,806 households. This component has been completely funded by DFID to date, however there are currently discussions on the potential takeover by GoK of funding this component of the programme. As county governments are expected to budget between 5% and 7% of their budget for emergencies, there is also scope for greater involvement of country governments in this area. Figure 7 shows the value of regular CTs disbursed to regular HSNP beneficiaries, as well as to those receiving scale-up transfers.

[19] This formula currently uses the following weightings: 25% equal share, 30% poverty and 45% population (Pinney 2013).

Figure 7: HSNP expenditures by group (% GDP)



Source: NDMA.

TABLE 4: NUMBER OF BENEFICIARIES PER CT PROGRAMME

	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
OVC-CT	3,000	13,280	33,105	45,911	82,371	124,991	144,931	152,323	253,000	253,000
HSNP	-	-	-	-	-	-	-	-	63,000	81,000
OP-CT	-	-	200	300	33,000	33,000	36,036	59,000	164,000	225,000
PWSD-CT	-	-	-	-	-	2,100	14,700	14,700	27,200	27,200
Total	**3,000**	**13,280**	**33,305**	**46,211**	**115,371**	**160,091**	**195,667**	**226,023**	**507,200**	**586,200**

Source: NDMA and MLEASP (2016).

4 Macro-fiscal context

4.1 FINANCIAL PROGRAMMING FRAMEWORK

The approach for macroeconomic modelling in this paper makes use of a simple financial programming framework. It is built on Kenya's macroeconomic indicators, published by the Treasury and the National Bureau of Statistics. These tables follow the standard format published in the IMF Article IV surveillance. The framework makes use of and expands these data across five sectors of the economy:

- real sector: includes projections of real GDP growth and GDP deflator;
- fiscal sector: includes projections for domestic revenue, expenditure, grants and deficit financing;
- monetary sector: includes projections for credit provided to the private sector;
- external sector: includes projections for imports, exports, exchange rate and gross international reserves.

Debt is not treated as a formal sector, but given its relevance in the context of Kenya it is a key cross-sectoral component in the framework. The following box summarises all accounting identities in the model:

Real sector: GDP = consumption + investment + exports – imports
Fiscal sector: Net borrowing = total revenue – total expenditure
Monetary sector: Broad money = net foreign assets + net domestic assets
External sector: Change in official reserve assets = current account + capital account + financial account

Financial programming frameworks ensure consistency across different sectors in the economy and various interrelated variables in the following ways:

- **When variables are included in more than one sector, these are linked, to ensure consistency.** For example, exports appear both in the external sector (through the balance of payments) and the real sector (through the national accounts). The same assumptions are used for both sectors to produce projections in the external sector which are then linked across to ensure the same data are used to project exports in the real sector. Detailed links for key variables in the framework are summarised in Table 6 of Annex A.
- **Consistency within sectors is ensured by means of a residual.** Each sector can be described by an accounting identity which must always be true. For example, in the real sector, GDP must equal the sum of consumption, investment and the trade balance. Projections are made for all but one of the variables in the accounting identity. The remaining variable is set at a level to ensure that the identity is true and treated as a residual. In the case of the real sector, private consumption is treated as the residual and is set at a level equal to total GDP less all other components.

The financial programming framework provides a simple tool for forecasting the economy across its different sectors based on a set of key assumptions in a clear and consistent manner. It ensures both the direct and indirect links between key macroeconomic and fiscal variables are reflected in the projections.

4.1.1 Incorporating social sector resources

Social sector resources can be counted both as revenues and as expenditures. It is therefore important to ensure there is no double-counting in the model. For example, a grant from a donor can be counted as both revenue and an expenditure by the government. Therefore, we have summarised how resources are incorporated into and linked in the macroeconomic framework in Table 5.

TABLE 5: RESOURCE FLOWS AND SECTOR LINKAGES

Resource type	Resource flow	Sector linkages
Revenues	Government revenues (central and local)	Fiscal
	External project grants included in the budget	Fiscal, external
	External project grants not included in the budget	None
	External project loans	Fiscal, external, (debt)
Expenditures	Government current expenditure	Fiscal
	Government development expenditure	Fiscal
	Expenditure by external project grants not included in the budget	None

Resources which are determined exogenously are linked to the macroeconomic framework so that changes in these variables have a macroeconomic impact. For example, higher grants from external donors may increase government expenditure in the fiscal sector, or increase change in official reserves in the external sector.

Resources which are linked to macroeconomic variables are modelled to reflect their size under different scenarios. For example, domestic resources are linked to GDP growth to see how they change under different scenarios for economic growth.

Through these two different effects, various possible scenarios are modelled taking both external and internal variables into account. These scenarios can be supported by numerous indicators to assess the plausibility of the scenario (e.g. is the share of spending on the social sector sustainable?) and its macroeconomic stability (e.g. is government debt sustainable? Is the balance of payments stable?).

4.2 FINANCING FRAMEWORK FOR KENYA

By applying the financing framework to Kenya, we can analyse the macroeconomic context within which the complete absorption of social assistance spending of GoK can take place. Through this framework we can therefore quantify the amount of available resources for a baseline scenario, as well as for alternative scenarios (which include alternative funding mechanisms, as explored in this report). The macroeconomic and fiscal context of the country places a cap on the amount of resources available domestically, and therefore determines the plausibility of the total funding available for social protection.

Data are based on actual historical data up to 2014/2015 and make use of the 2015 IMF Article IV Mission projections up to 2018/19. The framework then sets a number of high-level assumptions for key macroeconomic variables from 2018/19 until 2029/30. These assumptions draw on projections made by the Kenya Ministry of Finance, the Budgetary Office of the Parliament, the IMF and the World Bank, through their latest reports and interviews with

relevant stakeholders during missions. Table 6 summarises key macroeconomic and fiscal assumptions used in the model, which are further discussed and contextualised throughout the macro-fiscal overview. Finally, results for the projections and alternative scenarios are presented in Section 4.4.

TABLE 6: SELECTED MACROECONOMIC INDICATORS (FIVE-YEAR AVERAGES, 2005/06–2029/30)

	2014/2015–2019/2020	2020/2021–2024/2025	2025/2026–2029/2030
Real GDP growth	6.7%	6.8%	6.8%
CPI (annual average)	5.7	5.0	5.0
		As a Percentage of GDP	
Gross investment	24.7%	24.6%	22.4%
National savings	16.0%	18.5%	18.0%
Overall fiscal balance	-6.6%	-5.7%	-3.6%
Excluding grants	-7.0%	-6.1%	-4.0%
Current account balance	-8.4%	-6.5%	-4.7%
Public debt	52.3%	55.8%	52.6%
Gross international reserves	3.8	3.2	3.9

Source: Authors' own calculations based on IMF Article IV projections and the Kenyan macroeconomic framework.

Macro-fiscal overview

Kenya is considered an east African hub for financial, transportation and communications services (Central Intelligence Agency, 2016). Real GDP composition is mostly service based (63.4%), followed by agriculture (20.7%) and industry (15.9%) (African Development Bank (AfDB), 2014)[20]. Major industries include agriculture, forestry and fishing, mining and minerals, industrial manufacturing, energy, tourism and financial services. The inflation rate has been increasing in recent years, but has been kept within the established bands. Monetary policy is prudent and tight, with the Central Bank keeping the inflation rate at 5 ± 2.5% (AfDB, 2014).

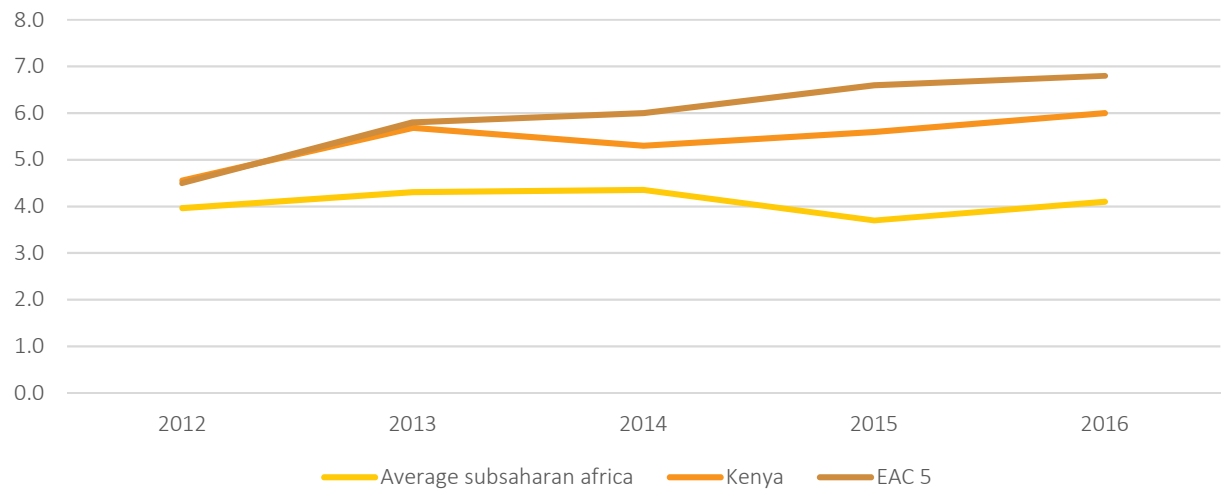
GDP growth between 2012 and 2015 has been moderate (around 5.3%), below the average of east African (EAC-5) countries, but higher than the sub-Saharan average in recent years. GDP growth in Kenya has been largely supported by consumption, particularly from the private sector (contributing around 97% of GDP and providing 80% of formal employment (AfDB, 2014)). Going forward, GDP growth is expected to be in the range of between 6.5% and 10%, due to higher than expected investment and higher consumption (driven by a growing middle class, more access to credit and higher income received from abroad) (World Bank, 2016).

GDP growth could be hampered by a growing trade imbalance, heightened through the capital imports for the development of the energy sector and expected higher fuel prices, without a matching increase in exports as a percentage of GDP (World Bank, 2016). The trade imbalance reached-19.2% GDP in 2014/2015 and is projected to remain within the range of-16% GDP in the medium and long term. Trade imbalances have also recently been negatively affected by movements in the exchange rate. The recent appreciation of the Kenya shilling vis à vis other

[20] These numbers refer to 2013 real GDP.

currencies in the region has exerted a negative pressure on exports. However, this has been offset by cheaper imports of fuel stemming from the recent fall in oil prices (World Bank, 2016).

Figure 8: Real GDP growth: international comparisons



Source: World Bank data.

High remittances, as well as positive capital and financial account balances, counteract a persistent current account deficit. Remittances in Kenya experienced a very strong increase in 2015, reaching 2.7% of GDP, far exceeding the sub-Saharan Africa average of 1.9% (World Bank, 2016). Kenya's capital market is the third largest in terms of capitalisation in sub-Saharan Africa, after South Africa and Nigeria, dominated by equities and government bonds, and with a balanced mixture of national and international investors (World Bank, 2016). Foreign direct investment remains lower than in other neighbouring countries, but is expected to continue rising, especially due to increases in investments from BRICS countries, especially India and China, in emerging extractive industries (AfDB 2014).

As seen in Figure 9, the GoK has been running a recurring overall negative fiscal balance, which reached-8.1% of GDP in 2014/15. Revenue and grants reached 19.9% of GDP[21], mostly driven by income tax revenues. Grants played a much more marginal role, reaching 0.5% of GDP in 2014/15. Expenditures, on the other hand, were mostly driven by recurrent expenditures (particularly on salaries and wages, and goods and services). Capital expenditures are expected to increase in the short and medium term, with higher government spending on large-scale infrastructure. County governments currently play a negligible role, with revenue collection and spending amounting to 0.5% and 4.2% of GDP respectively. However, this contribution is expected to increase with the strengthening of the county governments, following the country's strategy for devolution.

[21] This includes central and local government revenues as well as grants.

Figure 9: Current GoK fiscal gap (% GDP)

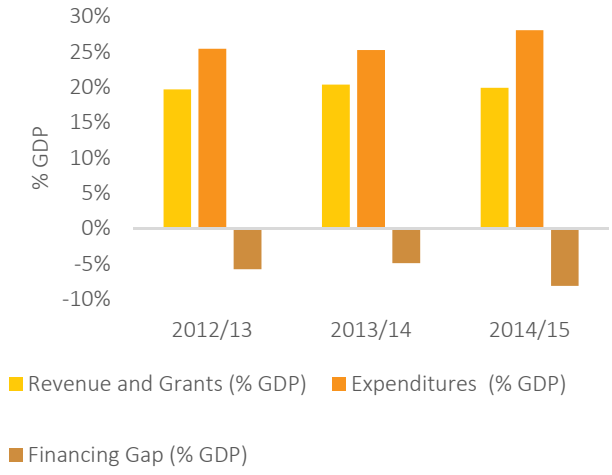
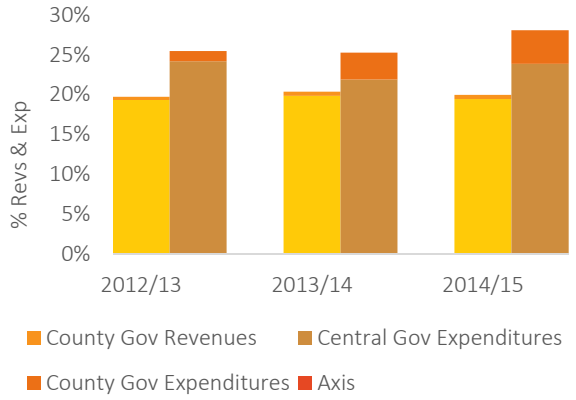


Figure 10: Central and county gov. revenues and expenditures (% GDP)

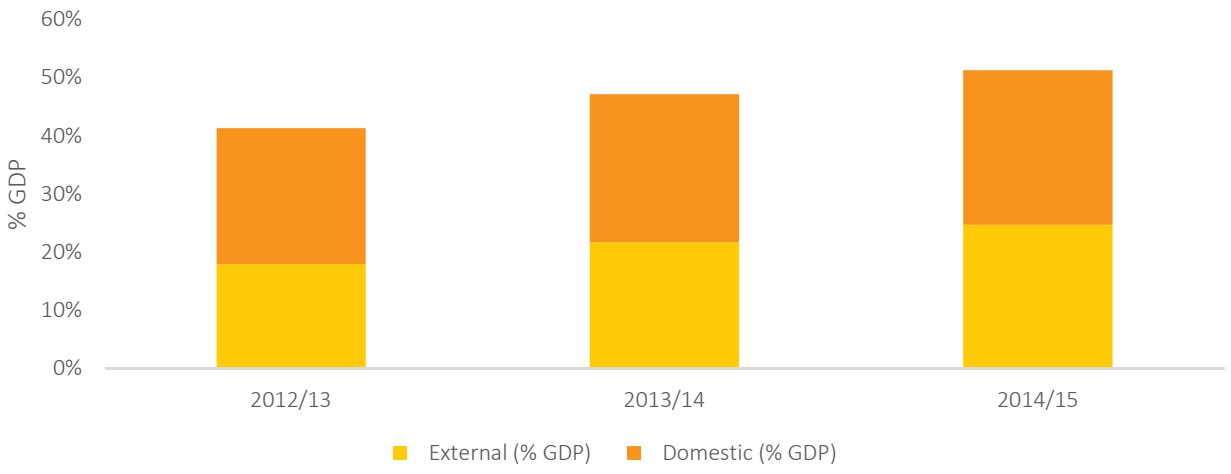


Source: IMF (2015).

Consequently, Kenya's overall public debt has been accumulating at a faster rate in recent years but remains sustainable. Most of Kenya's external public debt remains on concessional terms. Nevertheless, its non-concessional component (and, in particular, the commercial component) is increasing, particularly after the 2014 issuance of the first sovereign bond issuance. Non-performing loans have also been increasing in recent years due to both rate hikes and revenue shortages, which have resulted in delayed disbursement to ministries and payments to contractors. External debt reached 24.7% of GDP in 2014/2015, supported by increasing use of external lenders for financing government infrastructure projects (World Bank, 2016). Public domestic debt was around 26.6% of GDP in 2014/2015, mostly issued in the form of Treasury bonds and Treasury bills. Debt is expected to rise as a percentage of GDP in the near term, mainly due to the Eurobond placement and the semi-concessional $3.8 billion loan in 2014 from China to finance the Standard Gauge Railway. However, this is likely to be counteracted by the authorities' commitment to fiscal consolidation and enforcement of the procedures for controlling borrowing by counties, which include the requirement for counties to obtain government-approved guarantees channelled through the Debt Management Department of the National Treasury and the Intergovernmental Budget and Economic Council, for which clear procedures will be established[22] (IMF, 2014).

[22] At the moment, borrowing by counties requires government guarantees according to the constitution and should only be used to finance development projects. The National Treasury is determined to provide guarantees to counties only after they develop an adequate capacity to monitor their fiscal risks, with resources being made available in line with the counties' capacity to repay and with debt sustainability.

Figure 11: Actual debt stock (% GDP)

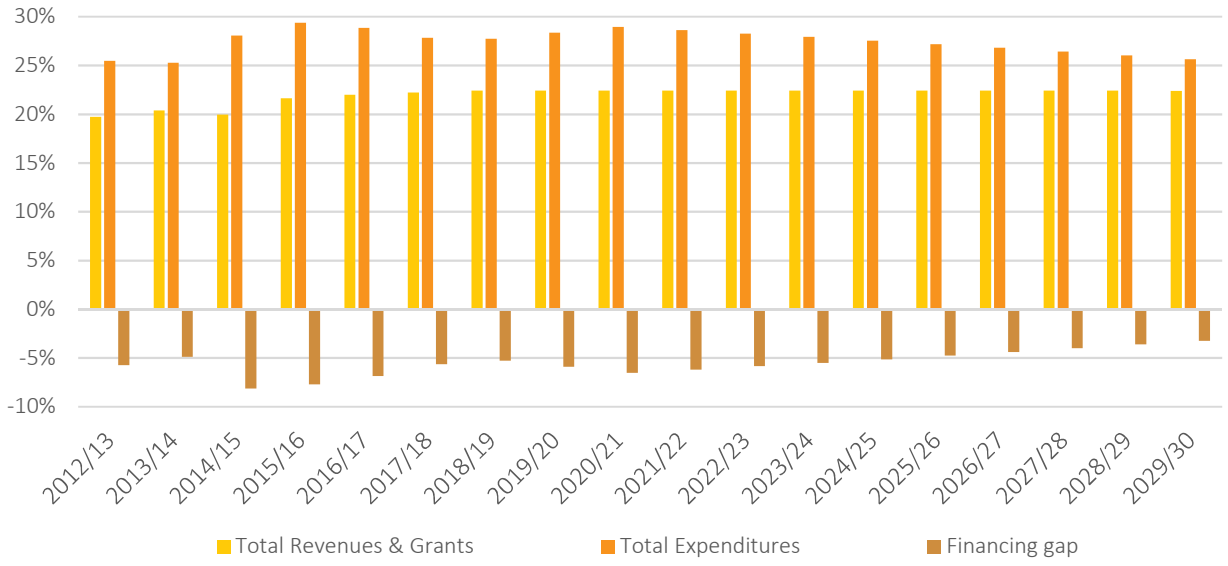


Source: IMF (2015).

4.3 BASELINE SCENARIO

Given the political, macroeconomic and fiscal landscape in Kenya there is a financing gap, which means the GoK cannot sustain its current level of spending, given revenue collections, and has to resort to external and domestic financing. The gap for 2015/2016 reached 7.7% of GDP; 40% of this was financed through external borrowing and 60% was financed through domestic borrowing. This gap is expected to continue going forward, with a fiscal deficit averaging-4.7% of GDP 2020–2030 and debt stock accumulating to approximately 54% of GDP.

Figure 12: Baseline scenario financing gap (% GDP)



Source: Authors' calculations.

Sources of revenues and financing for the GoK include domestic revenue collection (both at county and central government level), budgetary and off-budgetary grants and loans. The two graphs below show the available revenues and borrowing accrued during 2012–2015, and expected until 2030. Under this baseline scenario, overall revenues are expected to increase to 22.4% of GDP by 2030: central government revenues are expected to increase to 21.5% of GDP in the medium and long term, county government revenues are expected to remain at 0.6% GDP[23].

The sources of expenditure are recurrent (which includes interest payments) and capital expenditure. Recurrent expenditure is continuing on a growth trajectory in line with GDP growth, whereas capital expenditures are expected to increase in the medium term, as large planned infrastructure projects are implemented (such as the railway), and to slowly decline in the long term as these projects come to an end[24]. Total borrowing is thus expected to increase in the short term and then decrease in the long and medium term, as revenues grow and capital expenditures moderately decrease. However, due to the accumulated accrued fiscal deficits, the stock of debt will remain at 50% of GDP in 2030.

Figure 13: Baseline sources of revenues (% GDP)

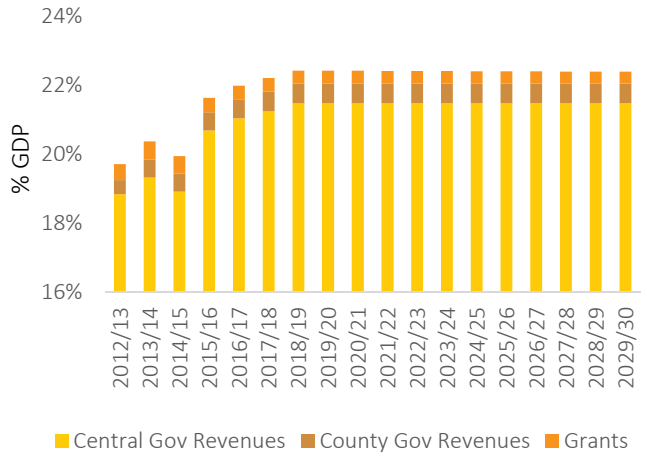
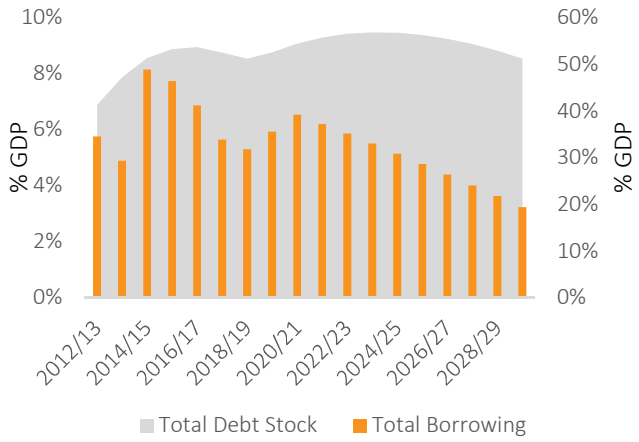


Figure 14: Baseline borrowing and debt stock (%GDP)



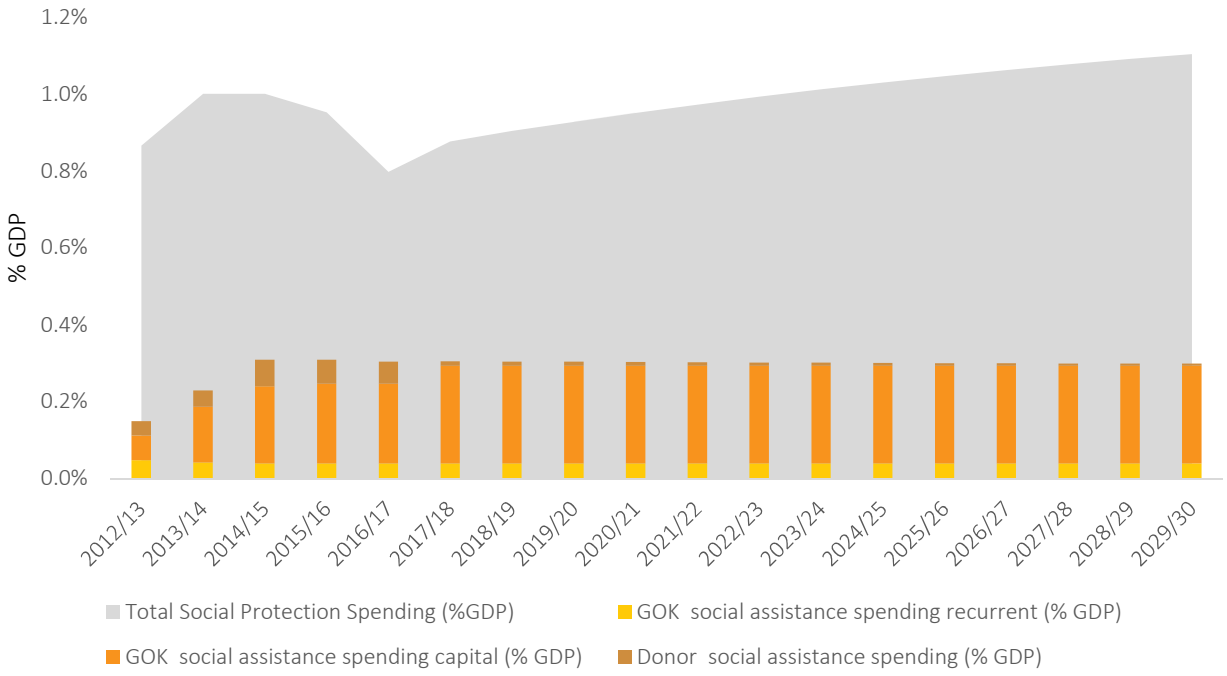
Source: Authors' calculations.

Under the baseline scenario, current total social protection spending for the GoK is 0.7% of GDP and social assistance spending is 0.25%–0.3% of GDP. This is a very small portion of the expenditures and should not impose a heavy burden on the GoK. Nevertheless, this amount could increase at a fast pace based on the GoK's contribution to CT programmes, the number of beneficiaries and the value of transfers disbursed in the future. The baseline scenario assumes that the GoK takes on the full cost of the HSNP2 by 2017, the total number of CT beneficiaries remains at 546,200,[25] and cost per beneficiary is kept constant[26]. OVC-CT is assumed to continue to be partly funded by donors and HSNP2 is assumed to be completely funded by the GoK by 2017. Under this scenario, expenditures for

[23] This scenario assumes increases in revenue collection based on the current policy strategy and without a fiscal consolidation or fiscal reform agenda going forward.
[24] Any further large-scale infrastructure projects would increase the required financing.
[25] 253,000 for OVC-CT, 81,000 for HSNP2, 225,000 for OP-CT and 27,200 for PWSD-CT. GoK funds circa 85% of OVC-CT and circa 26% of HSNP.
[26] We assume recurrent costs grow at the GDP growth rate, as all other GoK recurrent costs. Development costs grow at the GDP growth rate.

social assistance will remain at a steady level of 0.3% GDP per year, which is approximately the financing level the GoK can currently maintain. Figure 15 shows the required funds for recurrent, capital and donor projections for social assistance and overall social spending 2012–2030. These figures are obtained by extrapolating the current NSNP programmes and costs as a basis for future projections. Donor contributions have been forecast based on expected future contributions as currently agreed. While this is a realistic approach, it may not indicate the full resources needed to cover the needs of the growing population in the future.

Figure 15: Required financing for social protection and social assistance (% GDP)[27]

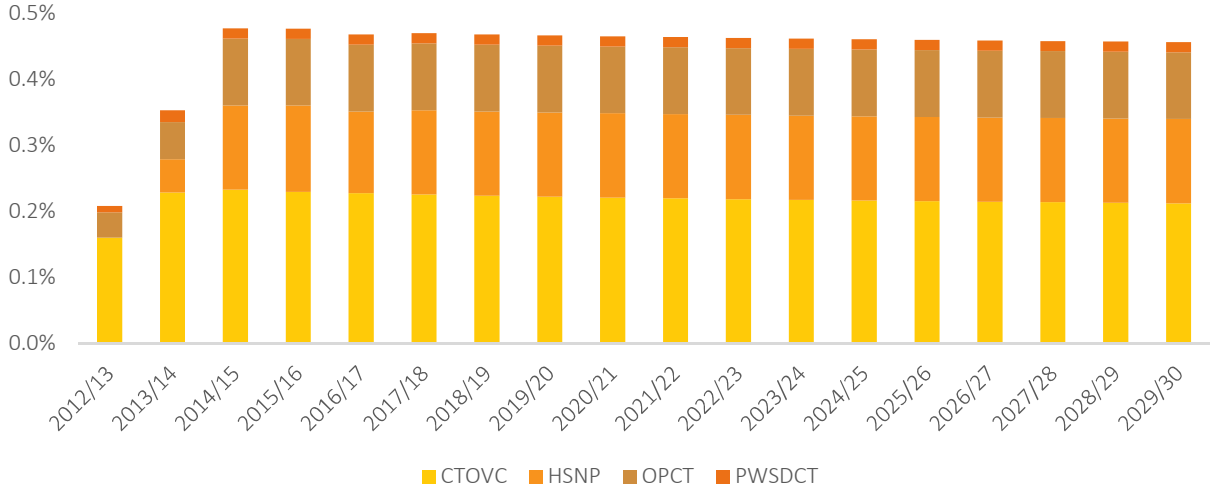


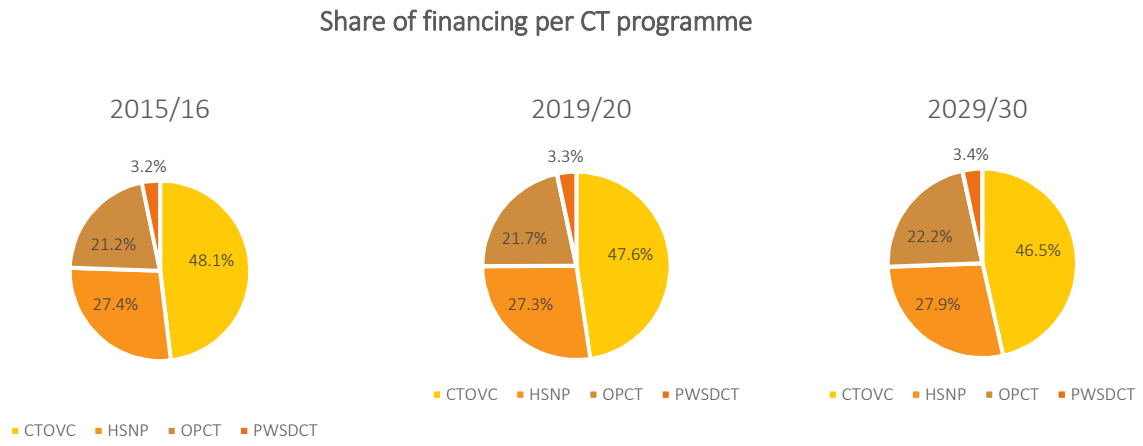
Source: Authors' calculations

Due to the fact that the GoK is already running a fiscal deficit, alternative scenarios would thus require resource reallocation from other sectors, or revenue increases. The following sections develop these points in more detail. Within the NSNP, the four CT programmes are expected to have different financing requirements. Figure 16 shows current financing and financing needs per CT programme as a percentage of GDP, and the share of total financing which each CT programme will require for 2014/2015, 2019/2020 and 2029/2030. Summary tables, with a breakdown of financing needs by CT programme as a percentage of GDP, expenditures and revenues, are presented in Annex B. OVC-CT will require the largest share of financing (between 46.5% and 48.1% of total required financing), followed by HSNP (between 27.3% and 27.9% of total required financing), OP-CT (between 21.2% and 22.2% of total required financing) and PWSD-CT (between 3.2% and 3.3% of total required financing). If the emergency scale-up component of HSNP is continued, it is also likely that the financing needs for this CT programme will be larger than those stated in these figures. Further analysis with regards to this component is presented below.

[27] Social protection figures are based on actuals and budget figures (with an applied execution rate) until 2017. As medium-term estimates are not as robust as short-term estimates, there appears to be a fall in required financing. However, these figures will be revised for future budget figures.

Figure 16: Total financing needs per CT programme (% GDP)



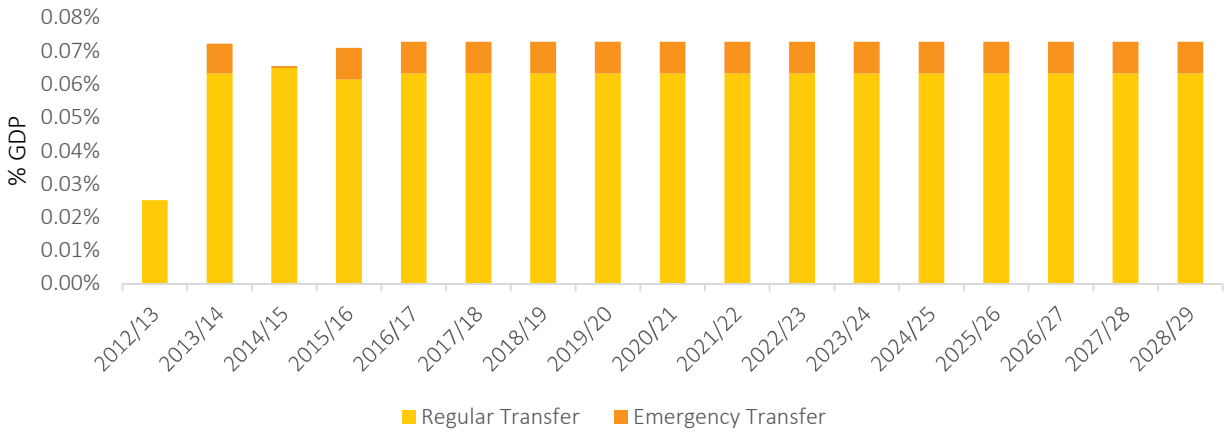


Source: Authors' calculations.

Under this scenario, the forecasts for required HSNP funding do not include the emergency scale-up transfer payments. As described in previous sections, one of the most innovative aspects of HSNP is the ability to scale up emergency payments in response to severe drought conditions in selected counties. The following graph presents the actual and required financing scenarios for both components of the HSNP. Regular payments and emergency transfers for HSNP under the baseline scenario are expected to reach 0.06% and 0.01% of GDP, respectively. Due to the irregular nature of the emergency scale-up component, forecast figures are merely indicative and are based on the total amount of targeted households[28].

Figure 17: Forecast HSNP financing needs (% GDP)

[28] Although these figures are in line with the financing needs foreseen by the NDMA, in reality the programme would likely not have to cover all these households in a given year, or could potentially require additional funds if droughts were to be particularly severe.



Source: Authors' calculations.

4.4 ALTERNATIVE SCENARIOS: SOCIAL ASSISTANCE RESOURCE NEEDS

The previous section revealed the size of the financing gap (7.7% GDP in 2015/16) which the GoK is currently facing and is expected to face until 2030. Based on the baseline scenario, the required funds for social assistance are only a very small part of these expenditures, therefore the GoK can afford to maintain its current level of spending. However, if the contribution of the GoK, the number of beneficiaries or the value of the transfers were to increase, resource needs for social assistance would escalate and more funds would be required for this sector. The following tables outline the value of resources needed by the GoK given different scenarios for number of beneficiaries and donor contributions[29].

If the GoK were to increase the number of beneficiaries to the forecast 1,140,000 that the NSNP policy aims to reach by 2017, the cost for social assistance would reach 0.5% GDP by 2029/ 2030 and social protection expenditures would reach almost 1.3% GDP[30]. Currently, all four CT programmes cover around 34% of households that could benefit from these transfers. If the GoK were to expand coverage to all potential beneficiary households (as identified in various policy reviews and plans), the cost of social assistance would rise to 1.2% of GDP in the medium run and the overall cost of social protection would reach 1.9% GDP. Although these figures are still relatively modest compared to the budget allocations other sectors receive, covering all potential households would imply increasing the budget toward CTs almost fivefold.[31]

[29] We have not provided scenarios for changes in the values of the transfers, as we have assumed these increase with the inflation rate.
[30] This scenario assumes donor and GoK contributions remain as they are.
[31] This assumes each CT programme covers every eligible household in all counties (for OVC-CT, CT-OP, CT-PWSD) and all arid counties requiring food assistance based on the long-rains needs assessment. The table in the annex specifies these numbers in more detail.

Figure 18: Costs if number of beneficiaries increase to 2017 plan

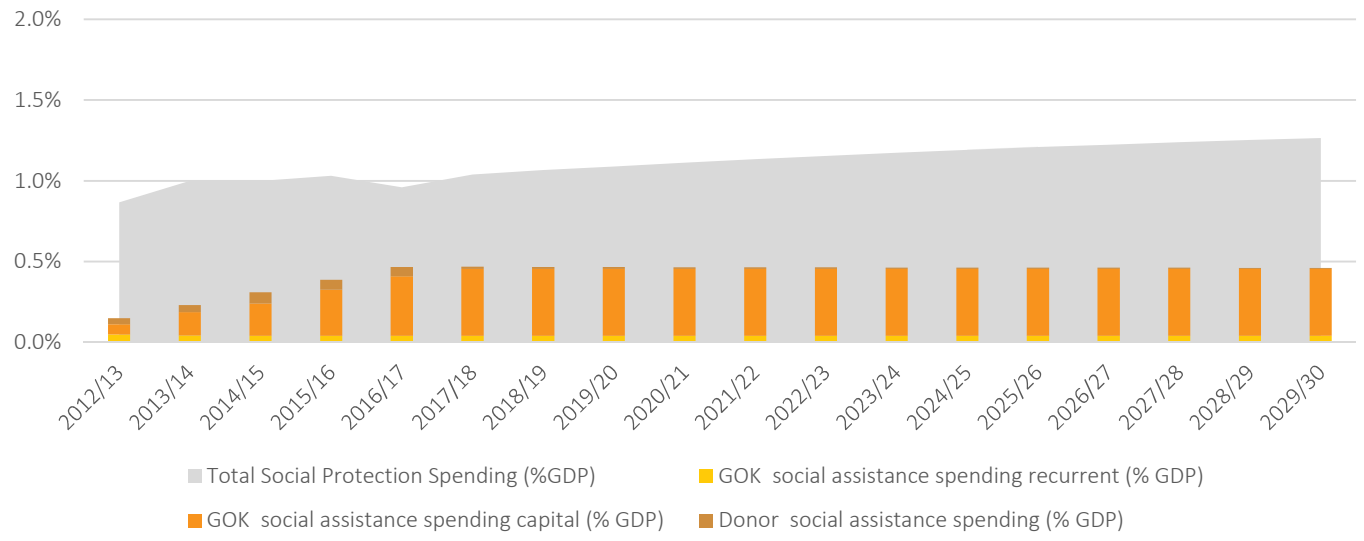
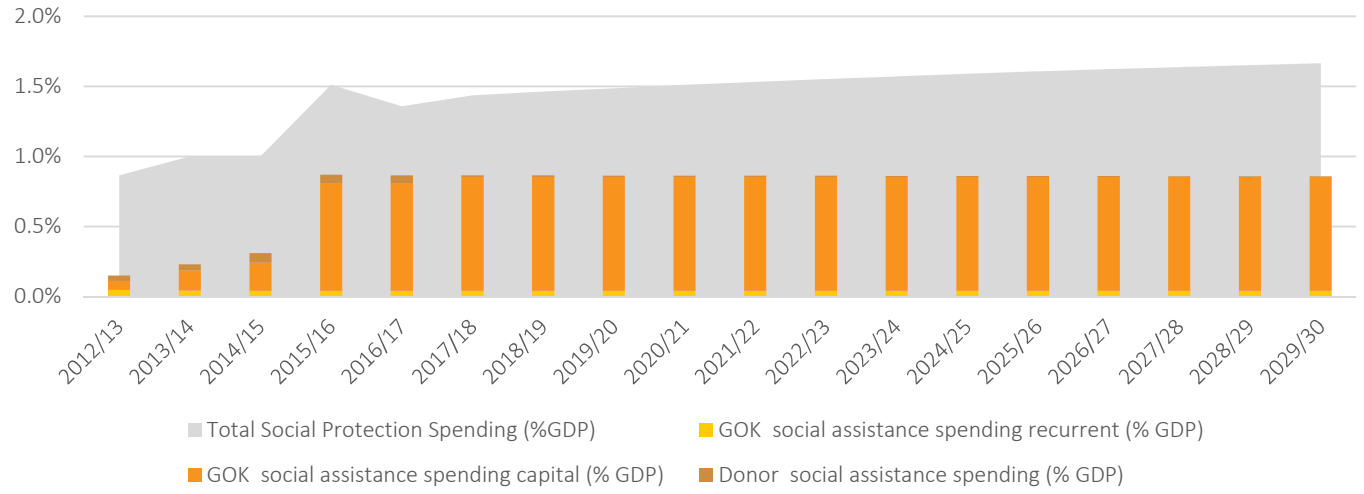


Figure 19: Cost if beneficiaries cover all potential households



Source: Authors' calculations.

If the GoK were to absorb the full cost of the NSNP, the required funds would increase by 0.1 percentage points and would reach 0.3% GDP by 2030/2029. On the other hand, if the GoK were to maintain its current contribution to the programmes, the cost to the GoK would be 0.25% GDP.

Figure 20: Cost if donors remove support for CTs (% GDP)

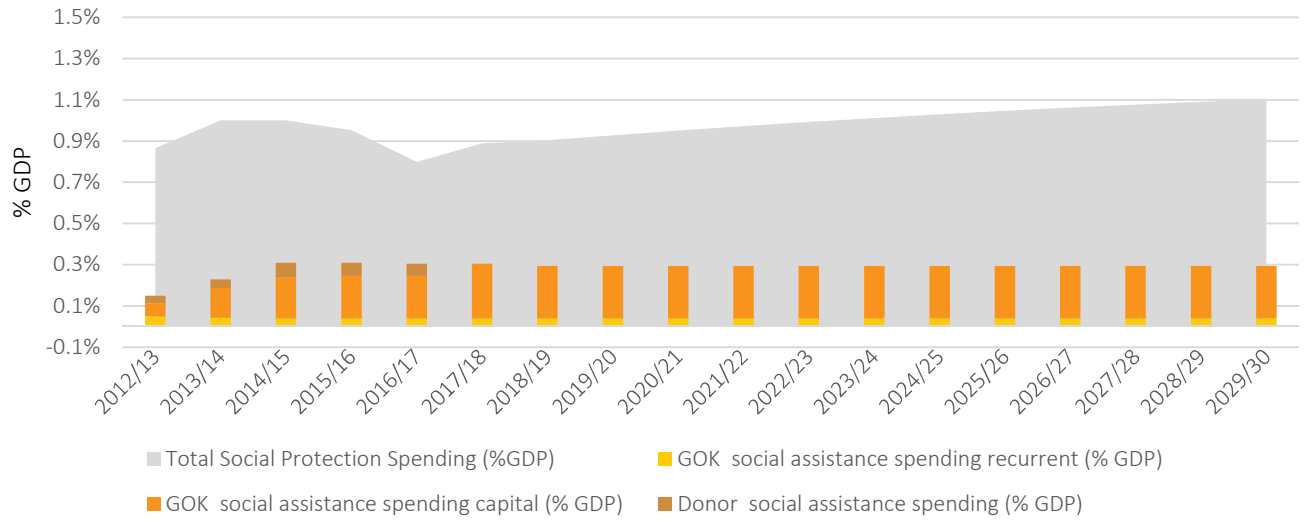
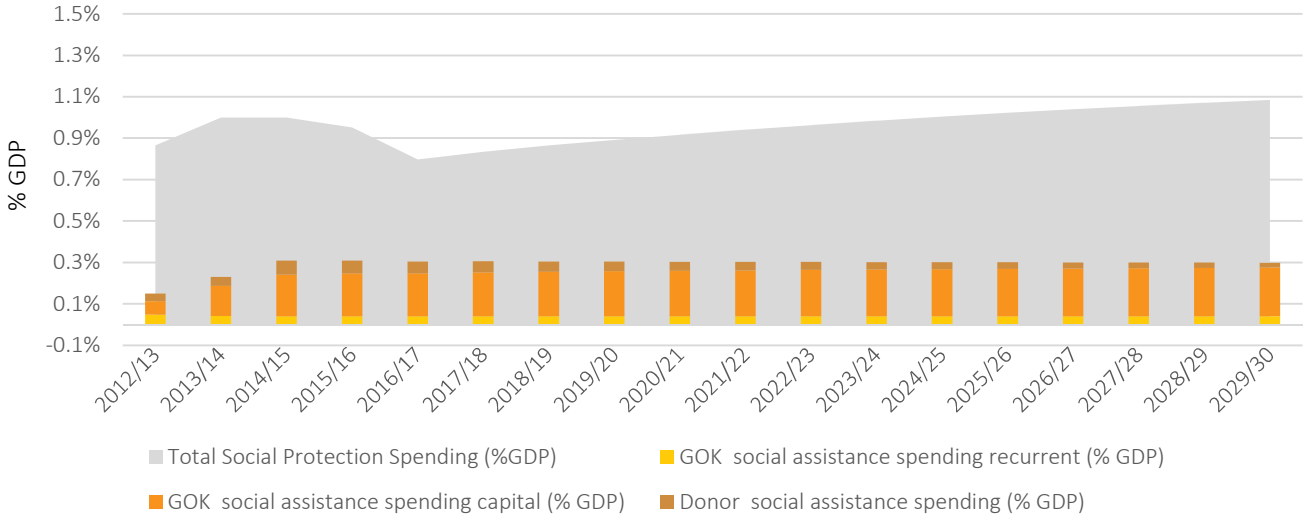


Figure 21: Cost if DFID continues HSNP funding (% GDP)



Source: Authors' calculations.

Given these different scenarios, if the GoK were to decide to increase the resources required for social assistance, spending would either have to be reallocated or further revenues would have to be raised, either from domestic sources or through alternative external financing sources.

The following sections expand on these options.

4.4.1 Resource reallocation toward social assistance

One option the GoK has is to increase the resources for social assistance and therefore to reprioritise resource allocations from other sectors. There are currently no earmarked revenues in Kenya, therefore the reprioritisation of funds would require an analysis of possible sources of funds and increased lobbying efforts from GoK officials. Currently, the CT programmes are not strongly represented in the sector working groups and the Medium-Term Expenditure Framework (MTEF) negotiation process. Treasury departments indicate that this is due to the quality of the programme design, which does not have a strong rationale. Therefore, strengthening the programme design will enhance their role through higher or better structured allocation of resources under the MTEF budget ceiling, with support from the Economic Affairs Department, and a higher profile and prioritisation within the sector working group decision-making process, with support from Budget Department. Sources of funds reallocation could be identified based on the three criteria set out below.

1. ***Efficiency savings***

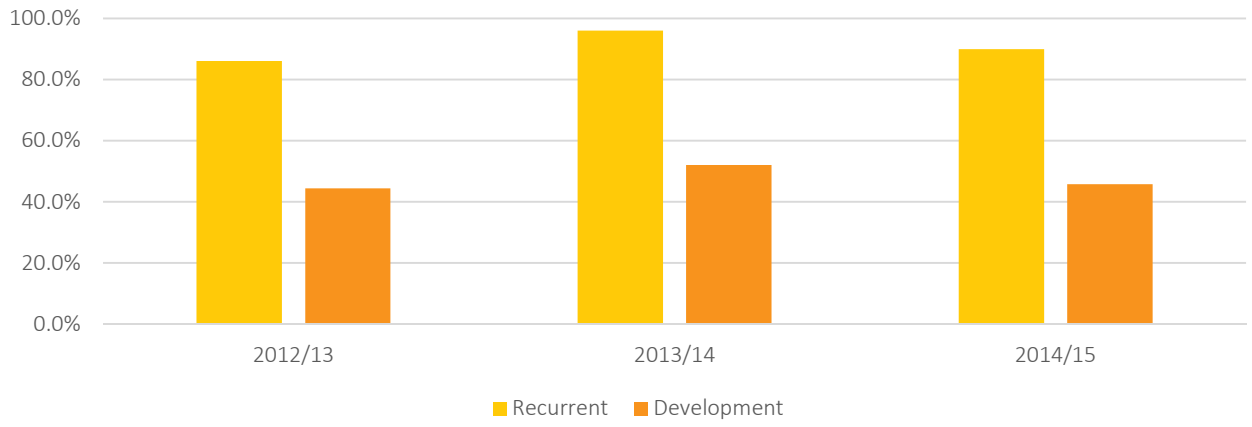
There is room for efficiency gains in spending through rationalisation, consolidation and reallocation of funds. This can be done both within and across sectors by cutting back budget allocations toward inefficient or regressive forms of social protection (public sector pensions for example) or from inefficient and/or regressive forms of public expenditure in other sectors. Other CT programmes around the world (such as Progresa/Oportunidades in Mexico or Indonesia's targeted CTs) have relied on the reallocation of funds from less efficient and more regressive programmes in their respective countries (DFID, 2011). For example, infrastructure spending has received the bulk of budget allocations in recent years, the State Department of Infrastructure, which received 8% the budget allocations for 2014/15, allocated 90% of its budget to roads and bridges. However, the value for money obtained in these investments was generally low, partly due to disagreements between key stakeholders on the assignment of functions: as stated in the Fourth Schedule of the Constitution, national trunk roads are the responsibility of the, while county roads are the responsibility of counties. However, there were many reported delays in construction throughout the year due to disagreements over the responsibility to supervise approved road projects (Institute of Economic Affairs (IEA), 2014).

The Budget Department, has indicated that it plans to undertake a number of steps to promote greater efficiency in spending by MDAs. One such step is that the department will place recurrent spending requests, especially non-productive expenditure requests such as travel and hospitality, under greater scrutiny and limit it to essential items only. The department also plans to analyse the current public wage bill in order to identify wastage. This is also recommended for counties, as personnel expenditure constituted 61.5% of recurrent and 39.7% of total expenditure in 2014/15. On the development budget, the 2016/17 development budget will be approved at a project level. MDAs will therefore be allocated funds against specific projects, instead of providing lump sum allocations to the development budget. This will mean that projects will be captured as budget heads and linked to the achievement of specific outputs. Along with the tightening of budgeting regulations, the Budget Department will also implement monthly monitoring of the most significant projects to aid in the proactive identification of challenges and to ensure those are addressed. The Ministry of Finance also plans to release implementation guidelines to assist MDAs in the development of credible cash flow and procurement plans. These steps are very much echoed by the Parliamentary Budget Office. The Parliamentary Budget Office, in its *Rise of the African Tiger: Budget Options for 2015/16 and the Medium Term*, goes further by highlighting the need for a review of public spending to identify poorly performing programmes, low priority activities and inefficient policies to utilise efficiency savings for well performing programmes and high priority activities.

2. Unspent capital

The Budget Department (Ministry of Finance) and Parliamentary Budget Office efforts to tighten control over development spending specifically are borne out by analysis of MDA expenditure levels, which show that development expenditure levels of MDAs are traditionally low. Overall, the absorption rate for development spending (across all government MDAs), was at 45.8% in 2014/15, 52% in 2013/14 and 44.4% in 2012/3 (average of 47.3% from 2012/13-2014/15).

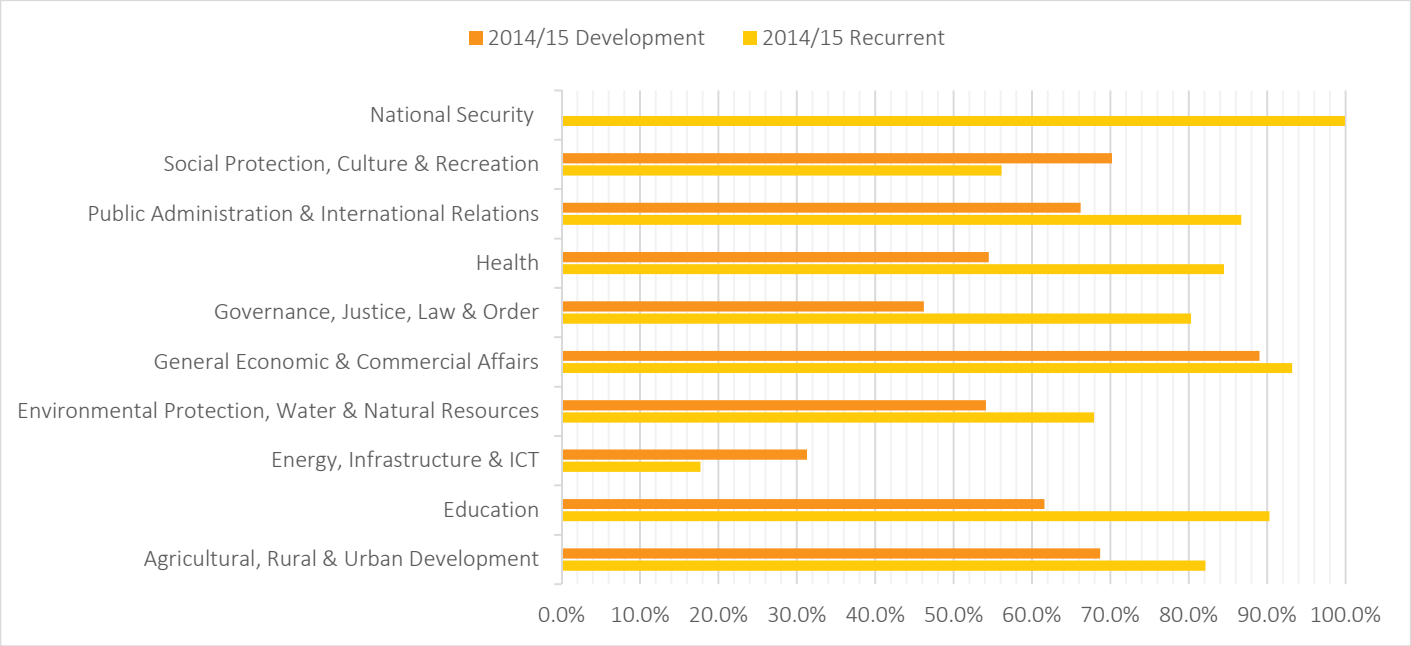
Figure 22: Expenditure performance (actual expenditure as % of approved expenses)



Source: Authors' calculations.

There is scope for reallocating funds from sectors which are not able to spend all the funds assigned to them through the budget process. This amounts to unspent funds of KSH 243.5 billion in 2012/13, KSH 222.5 billion in 2013/14 and KSH 378 billion in 2014/15. There is therefore considerable scope for efficiency savings to be made if planning and budgeting is improved. Such efficiency savings could potentially be utilised to increase funding levels for social assistance programmes. Figure 23 below provides an overview of budget absorption rate for key sectors in the period of 2013/14 and 2014/2015.

Figure 23: Expenditure by sector (approved vs actual)

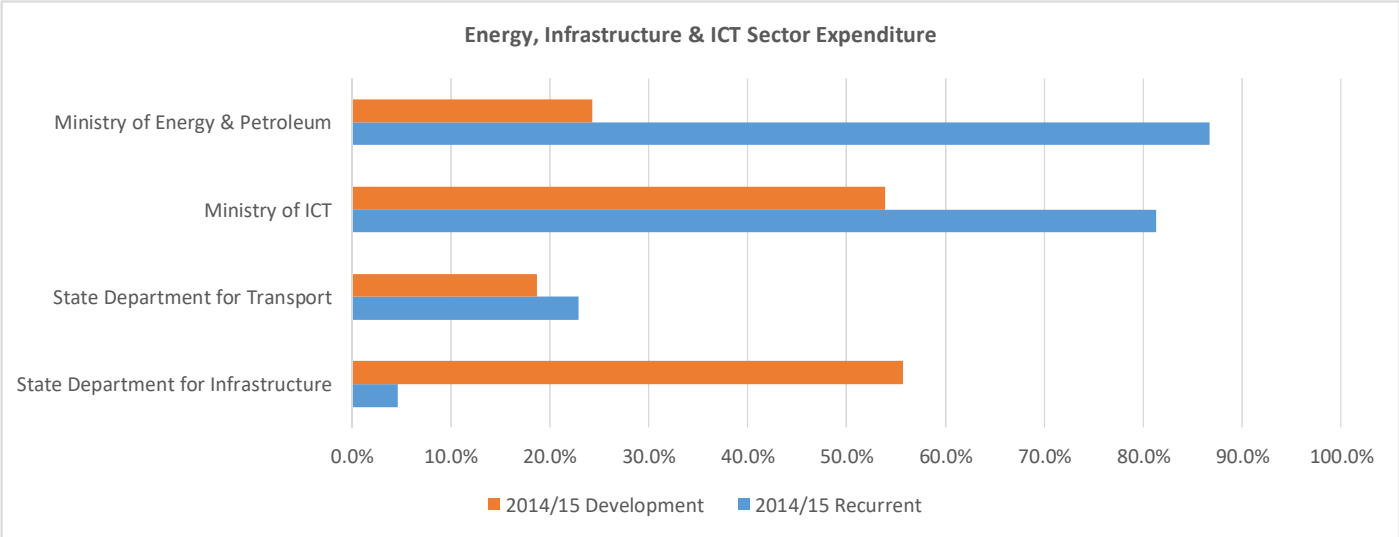


Source: Authors' calculations.

The energy, infrastructure and ICT sector has very low levels of absorption in regard to the allocated recurrent and development budget. The sector, which comprises the State Department for Infrastructure, the State Department for Transport, the Ministry of Information Communication and Technology and the Ministry of Energy and Petroleum, only spent 17.7% of its allocated recurrent budget and 31.3% of the development budget allocated in 2014/15. While this certainly needs further analysis as to the reasons for the low expenditure levels, the ability of this sector, and particularly the State Department for Transport and the State Department for Infrastructure, to spend current levels of allocated funds may be in question.

The ability to spend is a critical consideration in both planning, budget preparation and budget implementation. Improving these processes could free potential development funds for other priority sectors, such as social protection – and specifically for social assistance programmes.

Figure 24: Energy, infrastructure and ICT sector expenditure (approved vs. actual)



Source: Authors' calculations.

4.4.2 Resource mobilisation toward social assistance

If the GoK decides to provide further resources for social protection and social assistance it will also have to look into resource mobilisation both as an alternative and/or in conjunction to resource reallocation. Based on the current policy and economic landscape, this can be done through the planned fiscal reform, increases in county revenue collection and/or international sources of financing.

3. Fiscal reform

If the current programme of fiscal reform is successful, central government revenues are expected to reach 24% of GDP by 2020. This would significantly reduce the size of the financial gap going forward. 2015/2016 was a difficult year for the GoK, due to lower than expected revenue flows halfway through the year that constrained funds. Consequently, the National Treasury embarked on a series of measures to ensure this did not happen again, including curbing tax exemptions, broadening the tax base and reviewing existing income tax bands. In 2014/15, the GoK simplified and modernised the VAT legislation, consolidated all the appeals in the tax legislation, simplified the Excise Duty legislation, enacted Tax Procedure legislation and will shortly review the Income Tax Act (The National Treasury, 2016). As seen in Figure 25, given the baseline scenario presented above, increasing central government revenues to 24% of GDP by 2020 would result in an increase in revenues of up to 2.6 percentage points per year, and could thus result in a complete closing of the financing gap by 2027/2028[32].

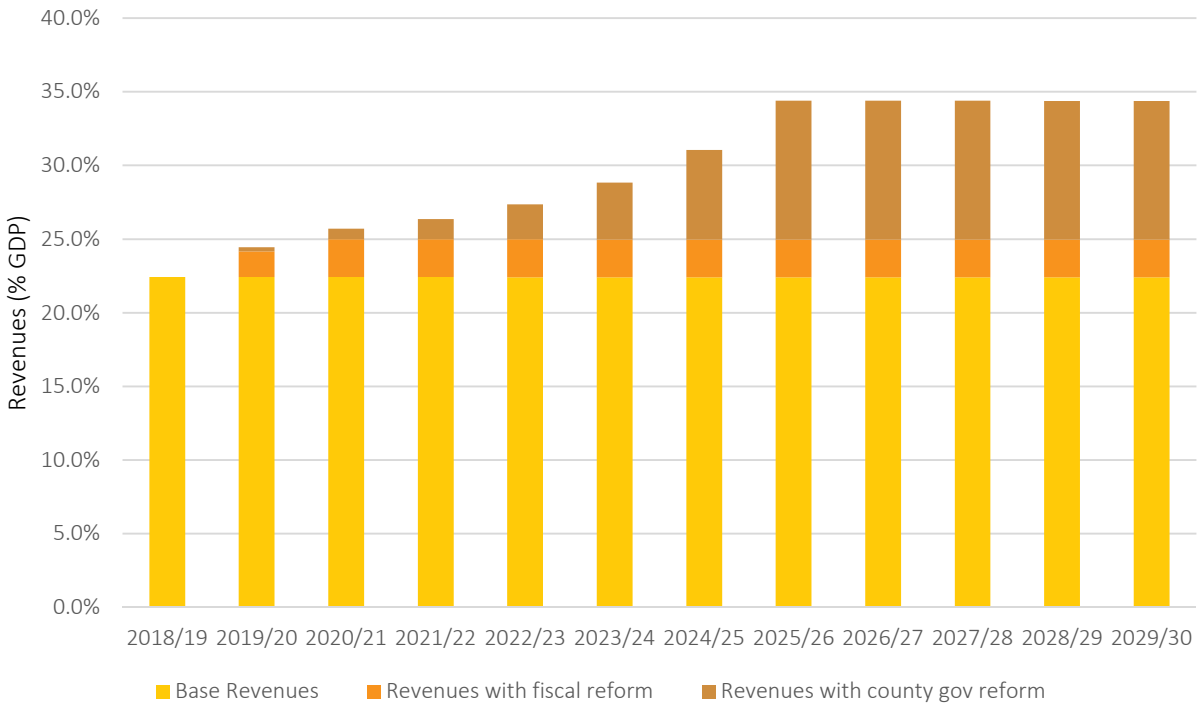
4. County government revenues increases

Given historical trends prior to the 2012 Constitution, county government revenues could increase to 10% of GDP in the medium term[33]. The National Treasury has looked into promoting capacity building and system improvement at county level, as well as stimulating other key tax revenue sources, such as property tax. Furthermore, through the

[32] This figure assumes there are no changes to the assumptions under the baseline scenario.
[33] Information provided by the National Treasury during key stakeholder interviews.

Intergovernmental Budget and Economic Council, the National Treasury is expected to review existing legislation. This national legislation framework will regulate how county governments can introduce new taxes, fees, service charges and business licences within the standards of Article 209 and 210 of the Constitution, as well as Section 161 of the Public Financial Management Act. These changes were thoroughly reviewed at the National Conference on County Own Source Revenue Enhancement held in September 2015 and are expected to commence in the near future (the National Treasury, 2016). Based on the predictions relayed above, increasing county government tax revenue to 10% of GDP by 2020 would increase revenues by up to 9.4 percentage points a year, and could thus reduce the financing gap by 2025/2025 (see Figure 25). This would yield a substantial impact on the overall revenue collection for the government and consequently the fiscal gap going forward.

Figure 25: Additional revenues by type of reform (% GDP)



Source: Authors' calculations.

5. Other sources of financing

Other sources of financing include funds from international organisations (in the form of grants) and domestic sources (i.e. the private sector). These alternative sources of funding can be arranged directly by the institutions involved in the NSNP and have the benefit of being able to be channelled directly into the budget for social assistance. However, the drawbacks of relying on overseas development assistance support is that these funds are normally inflexible and unsustainable in the long run, which will simply delay the inevitable need for the GoK to take on the responsibility of financing these programmes in the long term (DFID, 2011).

There is strong support for social assistance amongst international donors, particularly toward CT programmes. This type of assistance comes in the form of both financial and technical support. In their review of CT programmes in sub-Saharan Africa, Garcia and Moore (2012) found that the organisations that most subsidise CT programmes in the

sub-Saharan region include DFID, the World Bank and UNICEF, whereas the most common funders from the non-profit sector included Oxfam, Save the Children, and Cooperative for Assistance and Relief Everywhere (CARE) (Garcia and Moore, 2012). The African Risk Capacity is another potential source of funding for HSNP and therefore for the NSNP. The GoK currently pays $9 million per year and could further negotiate terms and use of funds for the future. NDMA is looking into channelling more of these funds for HSNP emergency funds through a contingency fund into which other donors and financing sources can pay, which would release the burden of required financing for social assistance. The GoK could look into the possibility of expanding international social assistance for the NSNP through other major donors and not-for-profit sources of funding (DFID, 2011).

Increased domestic sources of funding, through further engagement with the private sector, is also another possibility for the GoK to explore further. Many countries around the world rely on private sector corporate social responsibility (CSR) to fund social assistance initiatives. CSR is defined by the World Bank as 'the commitment of business to contribute to sustainable economic development, working with employees, their families, the local community, and society at large to improve their quality of life, in ways that are both good for business and good for development.' Although traditionally this has been done through foundations and non-governmental programmes, the GoK could look into creating partnerships with the private sector to increase financing for social assistance. As seen in the figure below, welfare is the fifth largest area of CSR funds channelling in the sampled countries, under which CT programmes would fall. Many private firms are engaging in CSR in Kenya, with the most popular causes being health and medical provision; donations directed to education and training; HIV/AIDS; agriculture and food security (Forstater, Zadek, Guang, Yu, Hong, and George, 2010). Examples in Kenya include funding by Toyota Kenya to SOS Children's Villages, or the foundation Safaricom, which funds a wide range of initiatives, including for female empowerment, health and education.

5 Conclusion and implications for policy

HSNP is part of the GoK's common framework for social assistance in the country, the NSNP. The aim of the NSNP is to channel and coordinate all existing CT programmes, improve social protection for the population and increase assistance to the poorest and most vulnerable in the country. This is a priority in Kenya, where 45.9% of Kenyans living below the poverty line.

The NSNP is composed of four unconditional CT programmes. It currently covers 586,200 beneficiary households and is funded by a combination of donor and GoK funds. The popularity of CT programmes has meant that the size and scope of these programmes has been increasing steadily in the last few years, from 115,371 beneficiary households in 2009/2010 to a potential 1,146,000 envisioned by 2016/2017. This poses a challenge for the GoK as regards funding these programmes going forward.

Within the NSNP, HSNP aims to reduce vulnerability to droughts through two channels: regular transfers to a set of beneficiary households and emergency scale-up transfers to a wider set of beneficiaries in the case of severe drought. HSNP is an example of innovative shock responsive social protection, making use of strong international support and developing national social assistance systems through new ways of targeting and disbursement of funds.

This study on the fiscal space for social protection in Kenya has contributed to the evaluation of HSNP2 by providing answers to the following three questions:

1. What is the de facto fiscal space in the GoK for social protection spending?
2. How much does the GoK currently spend on social assistance and how much can it afford to spend in the near future based on our assumptions?
3. How much should the GoK spend on social assistance?

For this purpose, the study has presented an overview of the current landscape and cost of social protection in the GoK. Firstly, we have analysed the current cost of social assistance and social protection in Kenya. Currently, the spending on social assistance and social protection amounts to 0.2% and 0.7% of GDP, respectively[34]. Within the NSNP, OVC-CT receives 48.8% of the funding, HSNP 26.7%, OP-CT 21.2% and PWSD-CT 3.2%.

Secondly, by means of a financing framework, we have presented different forecasts for the size of the fiscal gap until 2029/2030, as well as various expected cost scenarios which the NSNP is likely to face over time[35]. The baseline scenario revealed that the GoK currently faces a fiscal deficit of 8.1% of GDP, which will decline to 3.2% of GDP by 2029/2030. This means that the government cannot sustain its current level of expenditures without borrowing from domestic or external sources. If the current setup and level of beneficiaries do not change, the total cost for social protection and social assistance will slightly increase over time, reaching 1.1% and 0.3% of GDP, respectively, by 2029/2030. Regular payments and emergency transfers for HSNP under the baseline scenario are expected to reach 0.06% and 0.01% of GDP, respectively. However, if the number of beneficiaries increases with the existing expansion plans, the cost of social assistance will reach 0.5% GDP by 2029/2030. If donors remove all financial support for HSNP by 2017, the cost of social assistance will be 0.3% GDP 2029/2030. The GoK can therefore afford to maintain its current commitment to social assistance as it stands today. However, if it is to increase the size of the

[34] Social protection excludes pensions and health insurance.
[35] Different scenarios have been developed based on the changing size of the financing needs for these programmes due to the number of beneficiaries and the donor contributions.

programmes or its share of financing it will either have to reallocate money from other sectors or mobilise additional resources.

Reallocation of resources can come from efficiency savings, or the use of unspent funds. The Ministry of Finance is currently reviewing existing programmes and areas of spending where the GoK is investing many resources but getting limited results. An example of this is infrastructure: the State Department of Infrastructure received 8% of the budget allocations for 2014/15, but there were severe delays in and poor quality of spending. Use of unspent capital is also an important source of additional resources. CT programmes have high execution rates (around 90% of budget allocations), compared to 17.7% spending by the energy, infrastructure and ICT sector. The outcome of the reallocation process is thus determined by a combination of the information which the relevant stakeholders have on GoK funds and flows, the power they hold in Parliament and other decision-making organs, as well as the quality of spending they carry out throughout the year. While the GoK's commitment to the improvement of the wellbeing of its citizens is demonstrated by the allocation of 29% of the total budget to the social sector, the bulk of this is allocated to education, with only 2% being allocated to social assistance. Within the social sector, the GoK will therefore have to prioritise the allocation of resources to social assistance to expand coverage of social assistance to all vulnerable groups.

Resource mobilisation can stem from either the ongoing fiscal reform, increase in county government revenues or other sources of financing. By means of the current fiscal reform, which aims to increase central government revenues to 24% of GDP by 2020, the additional revenues could be large enough to offset the financing gap by 2027/2028,[36] whereas increasing county government revenues to 10% of GDP (many counties had the capacity to generate this level of resources prior to the 2012 Constitutional reform) the amount of potential revenues generated could be enough to offset the fiscal deficit by 2025/2026. Finally, other sources of financing include international donors and the private sector. CT programmes are a popular area for donor support at the moment. The GoK can therefore look for a broader range of donor organisations to provide additional funds for the NSNP (such as the AfDB, Care International or Oxfam)[37]. However, a clear strategy will have to be developed, as CSR has traditionally worked with non-governmental initiatives. It must also be noted that due to a lack of earmarked revenues and fiscal rules that channel resources toward social assistance, relevant institutions will have to engage in strong lobbying efforts throughout the budget process to ensure additional revenues are spent on social assistance.

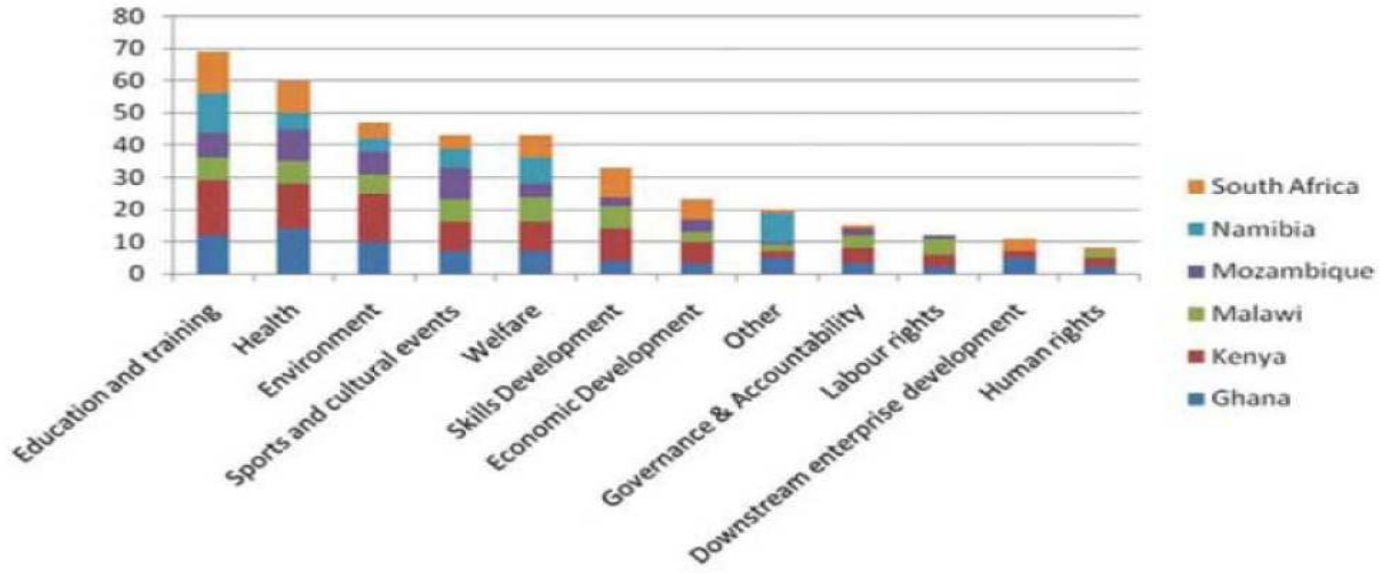
Finally, the extent to which the GoK ought to increase funding will be based on decisions of how much the sector can afford and how much coverage it wishes to provide to the population. Preliminary estimates reveal that the four CT programmes currently cover around 34% of all potential beneficiaries. However, scaling up these programmes will not only be costly, it will also require institutional support and development to ensure the current systems that are in place are able to disburse and monitor such an increased flow of funds in a predictable manner. There is a case to be made for greater investment in HSNP, as opposed to other CT programmes, as its stronger internal systems and controls, and therefore higher predictability of disbursements, provides an argument for its better value for money (compared to other CT programmes). Increasing the scale will also necessitate more intensive consultations with the National Treasury to ensure that fund disbursement rates, and their predictability, can keep pace with the scaling-up

[36] This is provided there are no other change in the underlying macro-fiscal assumptions.

[37] Private sector contributions were another potential source of untapped revenues for social assistance mentioned by some stakeholders: the private sector contributes around 97% of GDP (AfDB, 2014). However, the notion of social assistance as the fruit of private/external money rather than part of the social contract and legislated redistribution poses a number of problems both from philosophical and sustainability perspectives.

process. However, the recent reforms have resulted in low capacity and there is still limited ability to carry out these tasks at county level. Further supporting this level of government within the NSNP strategy will therefore be central to ensuring the social assistance framework can expand and maintain its commitment to provide adequate social assistance to the poor and vulnerable in Kenya.

Figure 26: CSR focus areas of businesses in six African countries



Source: Forstater, Zadek, Guang, Yu, Hong and George (2010).

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Annex A Overview of the macroeconomic framework

The macroeconomic framework used in this study adopts a financial programming framework, which is a numeric model that aims to assist in the development of a consistent approach to the different aspects of economic policy. The framework builds a comprehensive view of the national economy, based on five key sectors:

- the real sector: includes projections of real GDP growth and GDP deflator;
- the fiscal sector: includes projections for domestic revenue, expenditure, grants and deficit financing;
- the monetary sector: includes projections for credit provided to the private sector;
- the external sector: includes projections for imports, exports, exchange rate and gross international reserves.

Debt is a cross-cutting area which is included in a separate sheet but is not formally considered as a sector as it does not formally satisfy an accounting identity.

The macroeconomic framework is a tool for ensuring the consistency between different sets of assumptions about the future course of the economy. By starting with a set of assumptions about the economy (e.g. GDP growth), the framework assesses the impact of different policy options on the four sectors of the economy in a consistent manner. It is important to recognise that it is an economic *framework*, rather than a formal *model*, in that it does not consist of behavioural equations that attempt to predict the change and interaction between different sectors of the economy. In economic terminology, the macro-fiscal framework is not based upon a set of econometrically estimated behavioural relationships which drive economic outcomes. Rather, it is a framework that considers the possible fiscal impact of different policy choices and outcomes, based upon a set of assumptions chosen to reflect the most likely conditions facing the economy over the medium term.

A.1 KEY COMPONENTS

The starting point for the macroeconomic framework is the tables published by the IMF on the country's macroeconomic performance. These tables are produced in a standard format for all countries as part of the IMF's Article IV surveillance activities. The standard IMF documents include five tables that are replicated in the macroeconomic framework used for this analysis. These are:

- Table 1: Selected Economic Indicators, containing summary data from the real, fiscal, monetary and external sectors;
- Tables 2 (a–d): Financial and Fiscal Operations of Central Government, describing the government budget and its financing;
- Table 3: Monetary Accounts, showing the paths of broad money, net foreign assets and net domestic assets; and
- Tables 4 (a–b): Balance of Payments, including indicators on gross international reserves.

These tables are transposed into Excel and expanded further as necessary, to produce data for the fours sectors of the economy described above. This is done through the following six worksheets:

- **Overview:** The Overview sheet includes projections for headline macroeconomic variables, such as real GDP growth, GDP deflator and the exchange rate.
- **Real:** The Real sheet provides the projections of the real sector, including values for GDP and its components.

- **Fiscal:** The Fiscal sheet provides information on the annual budget for the government, including projections for domestic revenue, expenditure, grants and deficit financing.
- **Money:** The Money sheet provides projections for the monetary sector. It includes the path of key monetary aggregates, such as credit to the private sector.
- **External:** The External sheet provides forecasts for the Balance of Payments, including projections for imports, exports, and gross international reserves.
- **Debt:** It takes the debt disbursements, combining these with the existing debt stock and forecast repayments, to project the debt variables into the future.

The different sheets are all linked to each other to ensure consistency, as discussed further below. Additional worksheets are used to group together the key macroeconomic assumptions, to include the data on social protection resources and to present charts of macroeconomic indicators.

A.2 THEORETICAL APPROACH

The framework uses four sectors in the economy, each with a macroeconomic accounting identity to ensure consistency between the different sectors. A macroeconomic accounting identity is a relationship between a set of economic variables that must hold true by definition. For example, GDP must be equal to the sum of its components (investment, consumption, imports and exports). Consistency across the sectors is ensured in two ways:

Firstly, all accounting identities are met in the macroeconomic framework. This is ensured by means of a 'residual' item, which is set via a formula to ensure that the identity is always true. For example, if we have already determined GDP, investment, imports and exports, then there can only be one value for consumption that is consistent with the accounting identity for the real sector (i.e. consumption = GDP – investment – exports + imports). In this case, consumption is known as the 'residual'.

Secondly, whenever a variable features in more than one sector, the projections for that variable have to be the same in both sectors. For example, imports feature in both the real sector (as a component of GDP) and the external sector (as a component of the current account).

A.3 MACROECONOMIC ACCOUNTING IDENTITIES

The accounting identities and the residual used in the model for each section are described below:

The real sector

Accounting identity:
GDP = consumption (private + public) + investment (private + public) + exports – imports

Residual:
Private consumption

The primary assumption in this sector is growth in real GDP, which is used to extrapolate the current figure for GDP into the coming years. The projection for the GDP deflator is also assumed separately in order to convert between real GDP and nominal GDP.

Once the projection for GDP is complete, the projection for its different components is made. Public consumption (i.e. government current expenditure) and public investment (i.e. government development expenditure) are determined by the Fiscal sheet (see below). By making assumptions about the share of investment in GDP it is possible to produce forecast figures for investment. Imports and exports are linked from the External sheet (see below). The residual component, private consumption, is set to ensure consistency with the basic accounting identity, i.e. GDP plus imports, less exports, private investment and total government spending.

The fiscal sector

Accounting identity:
Total revenue – total expenditure = net borrowing

Residual:
Net disbursements of domestic debt

This sector is focused on the government revenues, expenditures and financing, as portrayed in the annual state budget. Firstly, tax revenue, together with grants and non-tax revenue, is projected based on an assumption about its share of GDP.[38]

On the expenditure side, assumptions are made about the government's spending across each of the major categories (wages, operational, transfers etc., but excluding debt service). The interest payments on debt are calculated in the Debt sheet, so that a higher deficit in one year is reflected in higher interest payments in the subsequent year.

The projections of government revenues and expenditures result in the government's overall deficit and hence the government's borrowing requirement. Future disbursements and principal repayments on external debt are determined by assumption and converted to local currency using the exchange rate. All that remains is to determine the net disbursements on domestic debt. This is the residual in this sector and it set at a level to balance government borrowing with the overall deficit.

The monetary sector

Accounting identity:
Net foreign assets + net domestic assets = broad money

Residual:
Net claims on other sectors (a component of net domestic assets)

[38] External grants are converted to local currency using the exchange rate.

Net foreign assets are determined by the net flow of foreign currency into the country. This is calculated by means of the change in official reserves in the balance of payments (i.e. from the External sheet).

Net domestic assets include net claims on government and net claims on other sectors (i.e. the private sector). Net claims on government is determined by the outstanding stock of government debt, which is taken directly from the Debt sheet. Net claims on other sectors is the residual in this sector and therefore calculated at the end.

Broad money can be derived from the economic relationship between nominal GDP, broad money and the velocity of money (assumed at a rate of 2.5). Broad money is therefore calculated by dividing nominal GDP by an assumed figure for the velocity of money.

Having determined everything else using the above assumptions, net claims on other sectors is the residual and is set to ensure compliance with the accounting identify for this sector. It is equal to broad money less net foreign assets and less net claims on government.

The external sector

Accounting identity:
Current account + capital account + financial account + errors and omissions = change in official reserve assets

Residual:
Change in official reserve assets

The external sector is the balance of payments, which captures the flow of foreign currency into and out of the country. This would include transactions that take place through the current account (imports and exports of goods and services, income and current transfers) and the capital and financial account (foreign direct investment, portfolio investment etc.). The current account projection is determined by assumptions about the import and export of goods and services, income and remittances. Also included in the current account are government interest payments on external debt (taken from the Debt sheet) and external budget support grants (taken from the Fiscal sheet).

The capital account includes external project grants (taken from the Fiscal sheet). The financial account requires assumptions about foreign direct investment and portfolio investment. The only other significant components of the financial account are the disbursements and repayments of external loans to government, which are taken from assumptions in the Fiscal sheet.

Errors and omissions are assumed to be zero in the future. Whereas the change in official reserve assets, which is used as the residual to ensure consistency in this sheet. The change in official reserves is therefore given by the sum of the current account, the capital account and the financial account.

Key linkages between the sectors

Using only one set of forecasts wherever a variable appears in two different sectors is the second form of consistency in the model. Table 6 summarises the linkages between different sheets in the model, as described throughout this

section. It is important to note that the direction of the link is from the sheet listed on the left-hand side to the sheet list along the top of the table (i.e. imports from the External sheet are transferred to the Real sheet.).

TABLE 7: KEY INTER-SECTOR LINKAGES IN THE MACROECONOMIC FRAMEWORK

To / from	Real	Fiscal	Debt	Money	External
Real		GDP (for revenue projections)		GDP (for broad money projections)	
Fiscal	GoK spending		Net disbursements on domestic debt Disbursements on external debt		External grants Disbursements on external debt
Debt		Interest payments Principal repayments on external debt		Debt stock (for net domestic assets)	Interest on external debt Principal repayments on external debt
Money					
External	Imports Exports		Exchange rate	Change in official reserve assets	

Using the above framework simplifies the forecasting exercise for the whole economy to a more manageable list of key assumptions in order to create economic projections going forward. In the case of Kenya, the framework therefore operates by retaining the IMF projections for the short and medium term, as presented in the Article IV Mission Report (until 2019), and then making a number of high-level assumptions for key macroeconomic variables over the long term. These assumptions are based upon an extrapolation of the medium-term IMF projections and an analysis of the available information on the economy of the country in question.

Incorporating social protection resources

Social protection resources are introduced into the model as both revenues and expenditures. However, determining what resources are expenditures and what resources are revenues is important, in order to avoid double-counting: for example, a grant from a donor would be included as a revenue but may also be counted as an expenditure by the government.

Resources which are determined exogenously (either through external factors or by policy decisions) are linked to the macroeconomic framework so that changes in these variables have a macroeconomic impact in different sectors. For example, higher grants from external donors may (i) increase government expenditure in the fiscal sector and (ii) increase the change in official reserves in the external sector (amongst other effects). Equally, a decision to increase taxes to finance social protection will (i) increase the deficit and domestic borrowing and (ii) by higher interest payments on that debt, further increase the deficit in future years (again, amongst other effects).

Social protection resources can also be linked to macroeconomic variables in a way that makes it possible to model their size under different scenarios. For example, domestic resources can be linked to GDP growth to see how they change under different scenarios.

Using the framework above, it is therefore possible to insert different assumptions for key macroeconomic variables and different social protection financing mechanisms to examine scenarios for the fiscal space in the future. These scenarios can be supported by various indicators to assess the plausibility of the scenario and its macroeconomic stability. In so doing, they offer policy-makers a wide range of policy options and flexible tools for analysis based on needs and preferences.

Annex B Trends for social protection and social assistance

B.1 PREDICTABILITY IN DISBURSEMENTS

TABLE 8: TIMELINESS OF FUNDS DISBURSEMENTS BY CT PROGRAMME

OnTime
Late

Payment Cycle	HSNP	OPCT	PWSD-CT	CT-OVC	NSNP - All
Jul 2013 - Aug 2013	N/A	Late 47 days	Late 47 days	Late 57 days	Late
Sep 2013 - Oct 2013	N/A	On Time	On Time	Late 70 days	Late
Nov 2013 - Dec 2013	N/A	Late 76 days	Late 197 days	Late 67 days	Late
Jan 2014 - Feb 2014	Late 37 days	Late 17 days	Late 139 days	Late 8 days	Late
Mar 2014 - Apr 2014	Late 19 days	Late 125 days	Late 79 days	Late 9 days	Late
May 2014 - Jun 2014	Late 44 days	Late 15-79 days[a]/	Late 34 days	On Time	Late
Jul 2014 - Aug 2014	Late 1 day	Late 98 days	Late 163 days	Late 92 days	Late
Sep 2014 - Oct 2014	On Time	Late 63 days	Late 102 days	Late 113 days	Late
Nov 2014 - Dec 2014	On Time	Late 2 days	Late 41 days	Late 51 days	Late
Jan 2015 - Feb 2015	Late 4 days	Late 50 days	Late 42 days	Late 65 days	Late
Mar 2015 - Apr 2015	On Time	On Time	On Time	On Time	On Time
May 2015 - Jun 2015	On Time	On Time	On Time	On Time	On Time
Jul 2015 - Aug 2015[b]/	On Time	Late	Late	Late	Late
Sep 2015 - Oct 2015	On Time	Late	Late	Late	Late
Nov 2015 - Dec 2015	On Time	Late	On Time	Late	Late

Notes: [a]/ New beneficiaries experienced a payment delay of 79 days, while initial beneficiaries experienced a payment delay of 15 days. [b]/ Data on the number of days on which payments were made late were not available in time for this report.

MLEASP (2016).

B.2 EXPENDITURES ON SOCIAL PROTECTION AND SOCIAL ASSISTANCE

TABLE 9: EXPENDITURES ON SOCIAL PROTECTION AND SOCIAL ASSISTANCE

	2012/2013–2014/2015	2015/2016–2019/2020	2020/2021–2024/2025	2025/2026–2029/2030
		Actual (million KHS)		
Social protection	44,678	75,777	151,541	291,256
Social assistance	21,367	39,818	70,403	123,572
OVC-CT	11,736	19,099	33,220	57,632
HSNP	4,588	10,813	19,415	34,431
OP-CT	4,238	8,593	15,413	27,333
PWSD-CT	805	1,313	2,355	4,176
		% GDP		
Social protection	0.96%	0.89%	0.99%	1.08%
Social assistance	0.18%	0.31%	0.30%	0.30%
OVC-CT	0.12%	0.12%	0.12%	0.12%
HSNP	0.14%	0.23%	0.23%	0.24%
OP-CT	0.07%	0.10%	0.10%	0.10%
PWSD-CT	0.01%	0.02%	0.02%	0.02%
		% expenditures		
Social protection	3.64%	3.14%	3.51%	4.08%
Social assistance	0.68%	1.08%	1.07%	1.13%
OVC-CT	0.45%	0.44%	0.43%	0.45%
HSNP	0.14%	0.23%	0.23%	0.24%
OP-CT	0.27%	0.36%	0.36%	0.38%
PWSD-CT	0.05%	0.05%	0.05%	0.06%
		% revenues		
Social protection	4.77%	4.03%	4.42%	4.80%
Social assistance	0.90%	1.38%	1.35%	1.34%
OVC-CT	0.59%	0.56%	0.54%	0.53%
HSNP	0.19%	0.29%	0.29%	0.29%
OP-CT	0.36%	0.46%	0.45%	0.45%
PWSD-CT	0.07%	0.07%	0.07%	0.07%

Source: Authors' calculations.

B.3 FORECASTS FOR NUMBER OF BENEFICIARIES

The table below presents the forecast number of beneficiaries used for the alternative scenarios in Section 4. These are based on the current NSNP expansion plans as well as programme evaluations carried out for each of the CT programmes.

TABLE 10: HOUSEHOLDS PER CT

CT programme	2014/15 households	2017 plans	Potential households
OVC-CT	253,000	351,422	819,485
HSNP	81,000	90,610	283,760
CT-OP	225,000	301,925	302,789
CT-PWSD	27,200	77,000	301,344

Source: Sandford *et al*. (2016) and MLEASP (2016). Notes: Numbers have been adjusted for potential double-dipping households in the sample, based on MLEASP (2016) figures.

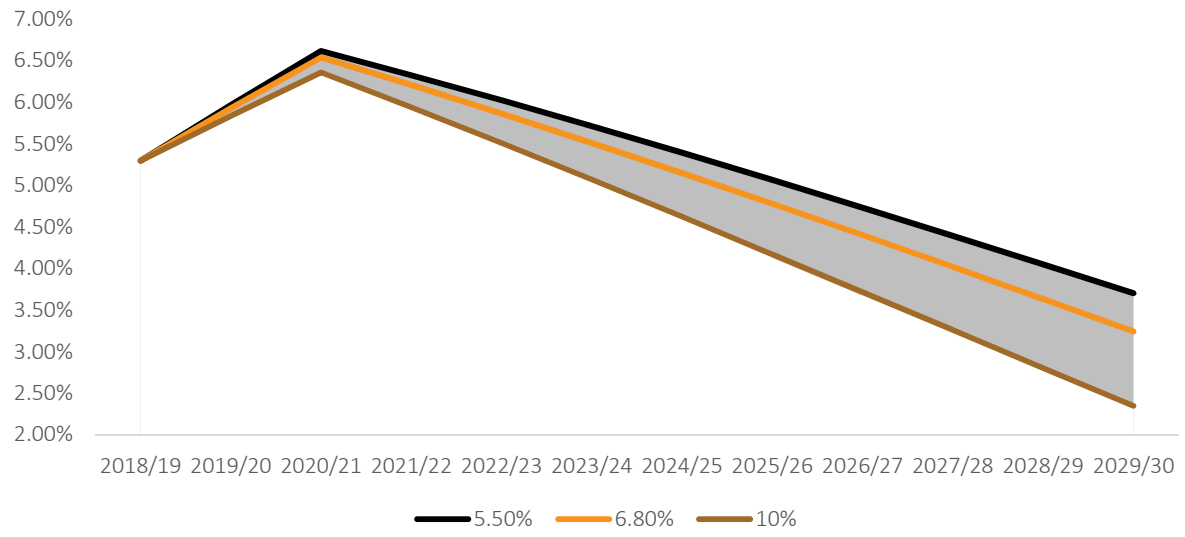
Annex C Sensitivity analysis

This section provides a sensitivity analysis for key macroeconomic assumptions in the model. It compares changes to the fiscal balance in the baseline scenario based on changes in key macroeconomic variables, namely GDP growth and inflation. These have been set at the baseline scenario at median rates given various policy options, and affect the fiscal balance through different channels, as described in the methodology. These scenarios provide an indication of the relative fluctuation of forecasts based on key macroeconomic variables and the fiscal consolidation strategy of the country. Ultimately, forecasting is not an exact science and forecasts can easily fluctuate within given rates based on policy decisions, macroeconomic shocks or the security situation.

Other shocks and variables that could affect the forecasts presented throughout this study, and that have not been included this section, are the commercialisation of oil products and liabilities of subnational governments. Firstly, the oil sector is still very nascent in Kenya and there are currently no estimates for the revenues which are expected by the GoK. Secondly, the magnitude of subnational governments has still not been verified and is disputed in some counties, which entails a risk for the debt stock going forward. However, the burden of this debt is still unknown. The National Treasury is in the process of developing guidelines on county borrowing and of establishing a database of county financial information to assess the fiscal capacity of counties and their debt sustainability (IMF, 2014). Future reports should aim to include these variables in the sensitivity analysis, once more precise data are obtained.

GDP growth underlies both forecasts for revenues and expenditures throughout the forecasting framework. Figure 27 provides forecasts for the size of the fiscal deficit based on average 5.5%, 6.8% and 10% growth rates. The first rate is the lowest growth rate achieved in the past five years; the second scenario is the average expected long run growth rate; and the last scenario is built on the Vision 2030 growth rate.

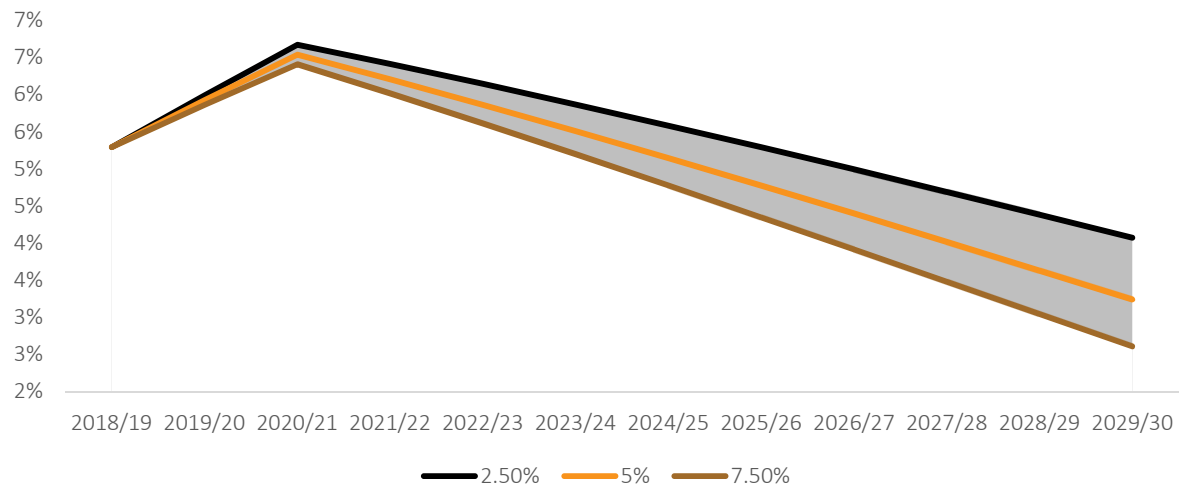
Figure 27: Size of the fiscal deficit by GDP growth rate



Source: Authors' calculations.

Figure 28 presents a sensitivity analysis based on the inflation rate used throughout the financing framework. We have accounted for a 2.5%, 5% and 7.5% inflation rate, as stated by official GoK policy and official inflation bands maintained by the Central Bank.

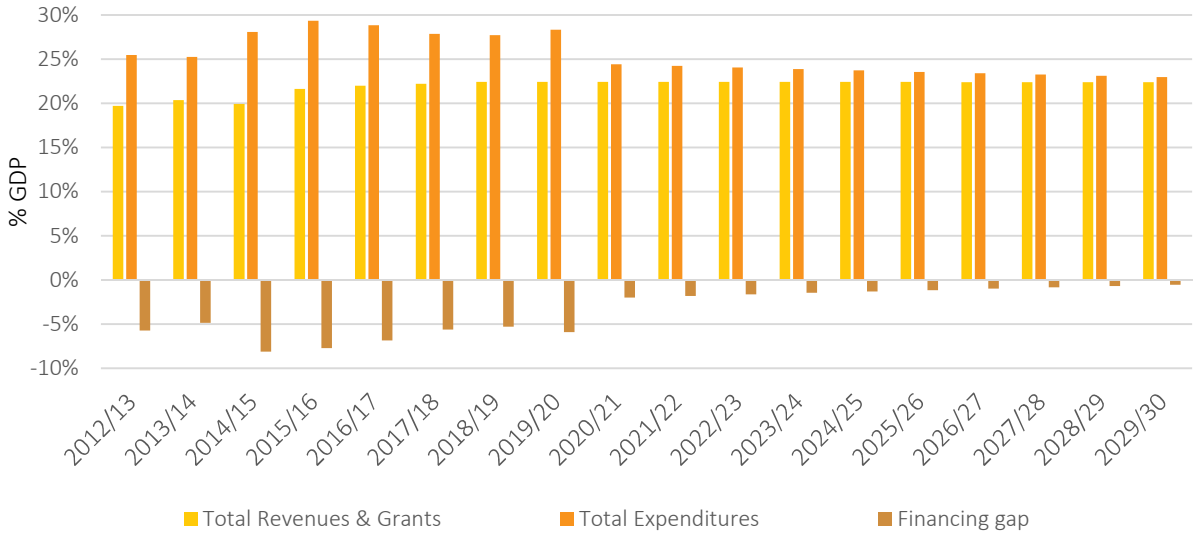
Figure 28: Size of the fiscal deficit by inflation rate



Source: Authors' calculations.

Given recent trends in debt accumulation, the GoK announced a plan to undergo a process of fiscal consolidation in the next few years, which will cap the stock of debt at 45% of GDP in the medium term. This process is expected to reduce the burden on monetary policy in demand management, maintain public debt sustainability and support the reduction in the current account deficit (IMF, 2016). The process of fiscal consolidation is expected to take place through a cutback in recurrent spending, supported by restraint in capital spending, a drop in interest rates payments and wages and salaries (World Bank, 2016). Although this process will be challenging to complete, given the plan for large-scale infrastructure and the upcoming 2017 elections, ensuring the stock of debt does not grow far beyond its current level is the sustainable option for the GoK in the long run (IMF, 2016). Consequently, based on the baseline scenario presented in the previous section, capping the total debt stock at 45% of GDP in the medium term will yield a reduction in the deficit to-3.7% of GDP and will mean the stock of debt reaches 29.4% of GDP by 2029/2030.

Figure 29: Fiscal gap with fiscal consolidation



Source: Authors' calculations.