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Are the Taps Dry? Cash Flow in Kenya and the Implications for National and County Spending

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KEY MESSAGES

- Generally, revenue inflows to government are consistent across the last six years, with an average collection of around 20 percent in the first quarter and 47 percent in the second quarter.

- Cash flow challenges do not seem to be a major factor in performance; the 2015/16 cash crunch appears to be due to poor targeting rather than lack of cash.

- Revenue disbursements to counties start slowly in the first half of the year and are below expectation given the flow of national funds to other agencies and expenses. The national government has not given an adequate explanation for this trend.

- At the same time, the Senate-approved county disbursement schedules are unrealistic given actual cash flows and should be revised to avoid creating planning and service delivery problems when anticipated funding does not come on time.

- Data on cash flow is inadequate and inconsistent across sources, making it difficult to draw definitive conclusions on government performance.

INTRODUCTION

In the first quarter of 2015/16, the government had a cash crunch that was covered extensively in the media, such that the National Assembly summoned the Cabinet Secretary for the National Treasury to explain the matter.[1] Yet the reasons for the liquidity problems were never clarified. As the crisis eased, the media and analysts lost interest in understanding the origin of the problem. However, this event raised

[1] http://www.capitalfm.co.ke/news/2015/10/rotich-due-before-mps-to-explain-kenya-cash-crunch/

questions about the national government's ability to manage cash flow properly in order to avoid service disruptions.

Concurrently, numerous questions have been raised in recent years regarding the flow of funds from the national government to the counties. Counties have complained frequently about delays in their disbursements. Here again, it has been difficult to understand the root of the problem, but one possible cause would be poor cash flow management by the national government.

This Budget Brief presents an analysis of the available data on national government cash flow. It focuses on cash inflows to government over the last six years and how that money is disbursed across government agencies at the national and county level. Most of the data used are from Statements of Actual Revenue and Net Exchequer Issues gazettes that are released every month by the National Treasury. However, only about two-thirds of these gazettes were available for public use. We filled in the gaps using quarterly data from reports by the Office of Controller of Budget (OCOB). It is important to note that there are a number of transparency challenges with accessing information on government cash flow, and data are not always consistent across sources.

RECENT TRENDS IN NATIONAL GOVERNMENT CASH FLOW

There is consistency in revenue collection performance over the last six years. On average, the national government raised 20 percent of its annual revenue target within the first quarter. The best performance was in 2014/15 when the government raised 26 percent of the revenue target in that time period, mainly driven by receipts from the sovereign bond in the first half of that year. Based on the six-year performance (see Table 1), it is clear that the national government's cash flow expectations for the first quarter of the year should be around 20 percent of the budget for total revenue.[2] Excluding 2014/15, the first quarter expectation should not be more than 18 percent.

Over the six-year period, average revenue collections at the midpoint of the year is close to 50 percent; when the exceptional 2014/15 year is excluded, the average is around 44 percent.[3] In general, this means the national government should not plan to spend 50 percent of its budget in the first half of the year, as revenues are consistently below that level.

[2] We would expect closer to 25 percent, if revenue was collected evenly across the year.
[3] Good performance (61 percent) at the half year point in 2014/15 was again driven by inflows from the sovereign bond.

TABLE 1. PERCENT REVENUE PERFORMANCE AGAINST ANNUAL TARGETS IN FIRST TWO QUARTERS OF THE YEAR, 2011-2017

	Quarter 1			Quarter 2		
Year	*July*	*August*	*September*	*October*	*November*	*December*
2011/12	4%	8%	14%	0%	0%	40%
2012/13	4%	14%	22%	30%	38%	47%
2013/14	5%	14%	24%	31%	40%	49%
2014/15	4%	11%	18%	25%	32%	41%
2015/16	4%	8%	13%	22%	31%	40%
2016/17	3%	9%	17%	24%	32%	40%
Average	***4%***	***11%***	***18%***	***22%***	***29%***	***43%***
Average excluding 2014/15	***4%***	***11%***	***18%***	***22%***	***28%***	***43%***

Source: Statement of actual revenue and net exchequer issues 2011-2017, National Treasury and IBPK[4]

Over the five years through 2015/16 t**he growth in actual revenue collected has been higher than the growth in revenue targets.** The actual revenue collection grew by an average of 24 percent compared to a growth in targets of only 20 percent in the same period. This means that the government has been raising revenue at a higher rate each year than the projected revenue growth rate.

While average growth over the period is impressive, gazette notices show significant variations in growth rates each year, ranging from 12 to 44 percent (see Table 2).[5] This variation seems to be partially related to the sovereign bond in 2014/15, which caused a leap in revenue growth as compared to the years prior and following. However, the gap between the growth in actual revenues received and the growth in the revenue target in 2012/13, a year without sovereign bond receipts, was even greater than 2014/15. Notably, in 2015/16 the growth in revenue was less than the growth in the target. This happened only once during the period, and occurred during the year of the cash crunch.

Might the overestimation of revenue in the year following the sovereign bond have been a cause of the cash crunch in 2015/16? If not a cause, per se, the crunch may have been exacerbated by the debt repayment obligation in the first month of 2015/16 that was significantly higher than that of the first month of 2014/15. The National Treasury's gazettes show a growth in disbursements for debt payments from Ksh. 3 billion to Ksh. 25 billion at a time when revenue estimates were too ambitious. This combination of high debt payments and expenditure based on inflated revenue estimates may have led to the cash crunch.

However, it is difficult to be certain about the aforementioned patterns, as several official sources contradict them. For example, the 2013 Budget Review and Outlook Paper (BROP) shows an increase

4 In cases where there were data gaps, we interpolated and extrapolated to get estimates for the missing data.

of only 18 percent in revenue collection in 2012/13, not 44 percent as National Treasury and Budget Implementation Review Report suggests (see Table 2). Additionally, the debt repayment in the first month of 2015/16 was reported to be only half as large in the Monthly Debt Bulletin of July 2015 as the disbursement reported in the gazette notice.[6] The same issue arises in August 2015, in that the Monthly Debt Bulletin shows that Ksh. 31.7 billion was spent in July and August in domestic and external debt service, while the August Treasury gazette reported disbursements of Ksh. 72.7 billion.[7] . It is not clear why there are such large discrepancies between disbursements and payments.

TABLE 2. GROWTH IN REVENUE TARGETS AND COLLECTION BETWEEN 2011-2016

Years	Growth in Revenue Targets	Growth in Revenue Collection
2011/12 - 2012/13	31%	44%
2012/13 - 2013/14	5%	12%
2013/14 - 2014/15	21%	25%
2014/15 - 2015/16	22%	16%
Average	***20%***	***24%***

Source: Statement of actual revenue and net exchequer issues 2011-2017, National Treasury and Budget Implementation Review Report 2011-2013, Controller of Budget

The government is becoming more reliant on revenue sources beyond taxes over time. In the last six years, the proportion of revenue collected from taxes has decreased from an average of over 73 percent of total revenue between 2011/12 and 2013/14 to 59 percent between 2014/15 and 2016/17. Targets set by the government in these two periods reflect the change, with the tax share target falling from 72 to 65 percent. Revenue from domestic and external borrowing has increased as a share of total revenue, growing from 21 percent to 27 percent in the same period However, the government still gets most of its first quarter revenue from taxes (see Table 3), levelling out as other revenue sources increase during the year. Given this shift, will reduced reliance on tax revenue have an impact on cash flow in the first part of the year and on subsequent disbursement to ministries, departments, and agencies (MDAs) and counties?

[6] Although, the payment reported in the Monthly Debt Bulletin is still larger than in the previous year
7 http://www.treasury.go.ke/publications/pdmo/category/50-2015.html

TABLE 3. REVENUE SOURCES AS A SHARE OF THE TOTAL REVENUE 2011-2017, PERFORMANCE BY QUARTER AND PERIOD

	Average for the period 2011/12 - 2013/14				Average for the period 2014/15 – 2016/17			
	Qtr. 1	*Qtr. 2*	*Qtr. 4*	*Average Proportion in Annual Estimates*	*Qtr. 1*	*Qtr. 2*	*Qtr.4**	*Average Proportion in Annual Estimates*
Opening Balance							4%	0%
Revenue from Taxation	88%	73%	73%	72%	68%	63%	59%	65%
Non-Tax Revenue	1%	2%	3%	3%	1%	3%	2%	2%
Domestic Borrowing	8%	20%	21%	19%	12%	18%	27%	23%
External Loans	3%	2%	2%	5%	11%	8%	6%	9%
Grants	0%	2%	0%	1%	0%	1%	1%	1%
Other Revenue	0%	0%	0%	0%	1%	0%	0%	0%
Total	100%	100%	100%	100%	100%	100%	100%	100%

*The average for Q4 does not include figures from 2016/17

Source: Statement of actual revenue and net exchequer issues 2011-2017, National Treasury and Budget Implementation Review Report 2011-2013, Controller of Budget

Domestic borrowing has been above target in recent years, but public documents offer no explanation as to why this has occurred. Net domestic borrowing in 2012/13, 2013/14, and 2015/16 was above target.[8] The performance against targets in these years was 119 percent, 128 percent, and 118 percent, respectively. In 2015/16 commercial borrowing was 203 percent of the target of Ksh. 36 billion. The National Treasury gazettes lack any narrative that explains why the government has consistently borrowed above target in recent years.

TABLE 4. DOMESTIC AND EXTERNAL BORROWING AS A PERCENTAGE OF THE TARGET BETWEEN 2012-2016

	2012/13			2013/14			2014/15			2015/16		
	Qtr. 1	*Qtr. 2*	*Qtr. 4*	*Qtr. 1*	*Qtr. 2*	*Qtr. 4*	*Qtr. 1*	*Qtr. 2*	*Qtr. 4*	*Qtr. 1*	*Qtr. 2*	*Qtr. 4*
Opening Balance												
Revenue from Taxation	19%	42%	90%	22%	46%	97%	22%	45%	95%	21%	43%	97%
Non-Tax Revenue	5%	33%	76%	1%	29%	86%	11%	44%	109%	7%	43%	105%
Domestic Borrowing	*0%*	*40%*	*119%*	*18%*	*57%*	*128%*	*13%*	*57%*	*86%*	*12%*	*46%*	*118%*
External Loans	13%	26%	63%	16%	27%	62%	139%	114%	139%	6%	73%	79%
Grants	9%	23%	75%	5%	20%	53%	9%	15%	67%	11%	31%	57%
Other Revenue			0%									
Total	***14%***	***40%***	***95%***	***20%***	***46%***	***101%***	***27%***	***61%***	***105%***	***17%***	***45%***	***99%***

Source: Statement of actual revenue and net exchequer issues 2011-2017, National Treasury and Budget Implementation Review Report 2011-2013, Controller of Budget

[8] This probably would have happened in 2014/15 as well, if the sovereign bond had not brought in a significant amount of external funds in that year.

High borrowing does not seem to be driven by poor collection of other sources. Generally, there is no evidence of other revenue sources underperforming in the first half of the year, thereby prompting the government to borrow beyond target. However, external borrowing in 2015/16 was not as strong as it was in 2014/15, which might have forced the government to borrow more domestically to fill a gap. The share of external revenue in the first half of 2015/16 dropped to 2 percent down from 26 percent in 2014/15, indicating that the government did not have access to as much funding in the first quarter of 2015/16 as it did in the first quarter of the previous year.

In general, disbursements to counties are slower in the first six months of the year than disbursements to other sections of government, such as Consolidated Fund Services and national government MDAs. On several occasions, the Council of Governors has complained about slow disbursement of approved county funding.[9] In some cases this has also been cited as the reason for low budget absorption by counties in County Budget Implementation Review Reports from the Office of the Controller of Budget (OCOB).[10]

Counties may not receive money as fast as they would like or as the Senate approves, but that may simply reflect the overall cash flow challenges facing government. Alternatively, counties may receive less than would be expected, even accounting for overall cash flow challenges. How do we assess these possibilities? One way is to compare what counties receive to what other government entities receive.

By the end of the first quarter, the average disbursement across government was 19 percent, while counties received the lowest disbursement at 16 percent of their annual target (see Table 5). At the half-year mark, the scenario was the same (note that the problem begins immediately in July, when counties have yet to receive any funds at all; we will return to this point below). This data suggests that revenue inflows are skewed toward national government entities relative to counties.

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[9] http://www.capitalfm.co.ke/news/2015/10/treasury-releases-details-of-cash-disbursements/

[10] http://cob.go.ke/?wpdmdl=10035 Page 321

TABLE 5. AVERAGE MONTHLY DISBURSEMENT AS A SHARE OF ANNUAL ALLOCATION TO PARTS OF GOVERNMENT INCLUDING COUNTIES 2011-2017[11]

	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June
Revenue Inflows	5%	12%	20%	28%	35%	47%	54%	60%	70%	79%	88%	103%
Disbursement to CFS	4%	12%	*21%*	27%	31%	*42%*	48%	55%	*63%*	68%	70%	*90%*
Disbursement to MDAs	5%	13%	*19%*	26%	35%	*43%*	50%	58%	*65%*	74%	65%	*92%*
Average Disbursement to Counties 2013/14-Q3 2016/17	0%	7%	16%	21%	30%	37%	46%	52%	62%	72%	84%	100%
Average disbursement across government incl Counties	***3%***	***11%***	***18%***	***25%***	***32%***	***41%***	***48%***	***55%***	***63%***	***71%***	***73%***	***94%***

Source: Statement of actual revenue and net exchequer issues 2011-2017, National Treasury and Budget Implementation Review Report 2011-2013, Controller of Budget

The counties do not receive disbursements according to the Senate schedule, which is likely due to the unrealistic assumptions about how much money can flow to counties each quarter made in the schedule. The monthly disbursement schedule for counties is approved on an annual basis as part of the County Allocation of Revenue Act, but the schedule for disbursement is not available online. Table 6 illustrates the 2016/17 schedule, acquired from the Council of Governors. The projected disbursements are nearly equal each month, between 8-9 percent of the total. Therefore, counties should receive 26 percent of the revenue by the end of the first quarter, and 51 percent by the end of December. We have already seen that these expectations are not realistic; the national government only takes in 20 percent of total revenue in the first quarter, and 46 percent by the end of December. Additionally, the data show that neither MDAs nor CFS receives even 46 percent by the end of the second quarter; on average, MDAs receive 43 percent of their annual revenue by December. It is unlikely that counties receive more than this.

A comparison between the projected disbursement rates and historical disbursements confirms that the schedule sets unrealistic revenue expectations. The average disbursements to counties for the period between the first quarter of 2013/14 through the third quarter of 2016/17 varies each month and quarter, but this variability is not reflected in the 2016/17 projected monthly disbursements (Table 6). To improve funding predictability and avoid service interruptions, the Senate should ensure that the cash flow approved for county funding is pegged on realistic expectations of revenue and approvals from the OCOB office.

[11] The county monthly average is from the first quarter 2013/14 to the third quarter of 2016/17

TABLE 6. CUMULATIVE COUNTY DISBURSEMENTS AGAINST SENATE-APPROVED DISBURSEMENT SCHEDULE

	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June
Average cumulative disbursement to counties 2013/14-Q3 2016/17	0%	7%	16%	21%	30%	37%	46%	52%	62%	72%	84%	100%
Projected disbursement per Month (CoG), 2016/17	8%	9%	8%	9%	9%	8%	8%	9%	8%	9%	8%	8%
Projected cumulative disbursement per month (CoG), 2016/17	8%	17%	26%	34%	43%	51%	59%	68%	76%	84%	93%	100%
Average disbursement across government incl Counties	3%	11%	18%	25%	32%	41%	48%	55%	63%	71%	73%	94%

Source: Statement of actual revenue and net exchequer issues 2013-2017

While these figures suggest a small skew against counties in distributions during the first half of the year, these patterns could be partially explained by late approval of county budgets. Not all county budgets are approved and submitted to the OCOB by the end of June as required by the Public Finance Management (PFM) 2012 law. In cases where the budget is not submitted on time, it is unlikely that requisitions could be done in time for counties to receive funds in July; this may explain why no funds were released to county revenue accounts in the month of July.

Counties generally have substantial bank balances at the end of each year, which also could be a factor contributing to lower disbursements to counties in the first quarter. These balances would allow counties to cover their costs even in the absence of fresh disbursements. At the end of 2015/16, counties had a total of Ksh. 27.87 billion unspent in their revenue accounts. In July 2016, counties collected Ksh. 2.27 billion from local sources, meaning they had balances totalling over Ksh. 30 billion in that month. This is likely more than most counties would spend in the first month of the year, and substantially more than they would have received from the disbursement schedule. This surplus distinguishes counties from MDAs and CFS, neither of which can hold bank balances. This may partially explain why disbursement from the consolidated account in the early part of the year is higher for MDAs and CFS than for counties.

While counties did not receive any disbursement in the first month of 2016/17, in the following month they received Ksh. 29.5 billion, an amount almost equal to the balances and local revenue available to counties at the end of July. Regarding individual counties, it appears those with low balances in their

County Revenue Fund (CRF) received higher allocations in August compared to those with higher balances.[12]

TABLE 7. COUNTIES WITH THE HIGHEST AND LOWEST DISBURSEMENTS IN AUGUST 2016/17

County	CRF Balances 01/07/2016	Total Cash Released in August 2016/17	August Disbursement Against Annual Target
Mombasa	28,040,603	1,016,351,141	17%
Nairobi	144,368,418	2,383,996,171	17%
Tana River	323,688,890	730,898,313	17%
Isiolo	9,684,991	560,672,446	17%
Siaya	959,770,222	431,199,285	8%
Nyamira	631,795,746	358,623,962	8%
Baringo	626,640,195	383,315,055	8%
Elgeyo Marakwet	568,727,728	282,307,782	8%
Total	***27,866,406,527***	***29,493,975,664***	***10%***

Source: Statement of actual revenue and net exchequer issues September 2016, National Treasury.

While high cash balances at the end of the year could be one factor leading to low disbursements in the beginning of the next year, questions remain about how counties access these balances. Counties do not know the exact size of their balances when they budget for the coming year, suggesting they may not correctly budget for them. Indeed, counties may need supplementary budgets to access these funds. If this is indeed the case, disbursements of national transfers should not be reduced during July.

Without narrative information in public reports explaining disbursements, it is difficult to know why counties do not receive as much in the first or second quarter as other government entities. The exchequer issues do not come with any narrative on the figures presented in the document. Implementation reports from OCOB also contain exchequer numbers but fail to explain trends in MDA disbursement, especially in cases where they do not align with approved budgets at the end of the year.

There is no clear pattern of MDAs that receive low disbursements in the beginning of the year continuing to receive low disbursements for the entire year. There is relatively little correlation between disbursements to MDAs in the early quarters of the year and final spending. There are some cases, such as in 2011/12 and 2015/16, where there is a stronger relationship, but in most cases a slow start to the year does not handicap an MDA's annual performance. This is a promising sign that cash flow

[12] The National Treasury released a list of bank balances on 8th of July 2016 in the dailies which has slightly different figures but the pattern across all the counties was similar to the numbers from the Council of Governors.

challenges at the MDA level do not generally lead to disruption in spending, though this may not have been the case in 2015/16.

TABLE 8. CORRELATION BETWEEN DISBURSEMENT IN THE FIRST TWO QUARTERS OF THE YEAR AND THE END OF THE YEAR

Year	Q1 and Q4	Q2 and Q4
2011/12	0.3225	0.3030
2012/13	0.0249	0.1451
2013/14	0.0976	0.2337
2014/15	0.1312	0.2447
2015/16	0.4169	0.5586

Source: Statement of actual revenue and net exchequer issues 2011-2017, National Treasury

As expected, independent commissions and MDAs with large recurrent budgets generally seem to have higher disbursement rates earlier in the financial years compared to some large or development heavy MDAs. Commissions such as the Teachers Service Commission, in which wages constitute a significant proportion of their budgets, consistently receive higher disbursements of their funds in the first half of the year. MDAs such as the Ministry of Foreign Affairs, the Ministry of State for Public Service, and the Ministry of Interior also have large recurrent budgets as compared to their development estimates and receive similar treatment.

There are some commissions and independent offices that receive much lower disbursements during the first half of the year. Examples of those that receive lower disbursements in the first two quarters include the Office of Controller of Budget and the Judicial Service Commission. Conversely, development-heavy MDAs - especially in the infrastructure sector - seem to get lower disbursements in the earlier part of the year and throughout the rest of the year. This is also the case for MDAs under lands, urban development, water and natural resources also fall under this category.

CONCLUSION

Analysis of government cash flow is hampered by incomplete information, but the available data suggests that cash flow is not the primary cause of recent resource challenges in Kenya. Instead, the evidence suggests that the national cash crunch in 2015/16 was due mainly to poor forecasting, while disbursements to counties are below what would be expected, and what is actually received by other government agencies, based on available cash flow. In the case of counties, it is possible that low disbursements at the beginning of the year are mainly driven by delays in budget approval and the fact that counties have cash balances in their revenue funds. However, if counties are late in approving budgets, they may not be able to access these cash balances. A possible solution would be to use a vote on account that would allow counties to continue operating as the budget is agreed, but there is no public data on how many counties have used such a vote on account in recent years. This points to the inadequate narratives in official government reports, and the lack of important details about when, how, and why funds are or are not disbursed throughout the year.