



**REPUBLIC OF KENYA**  
**Ministry of Finance**

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**BUDGET OUTLOOK PAPER**

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**2008/09 – 2010/11**

**January 2008**

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## Abbreviations and Acronyms

ASALS	Arid and Semi Arid Lands
BOPA	Budget Outlook Paper
BSP	Budget Strategy Paper
EAC	East African Community
ERS	Economic Recovery Strategy for Wealth and Employment Creation
FY	Financial Year
GDP	Gross Domestic Product
GoK	Government of Kenya
KNBS	Kenya National Bureau of Statistics
MDG	Millennium Development Goals
MPERs	Ministerial Public Expenditure Review
MTEF	Medium Term Expenditure Framework
NFA	Net Foreign Assets
SWGs	Sector Working Groups
VAT	Value Added Tax
VER	Voluntary Early Retirement

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## I. INTRODUCTION

1. This year's budget outlook paper (BOPA2008), the fourth in a row, sets out the background and broad fiscal parameters for the 2008/09 budget and the medium-term that is consistent with Government strategies and policies.
2. The BOPAs continues to help strengthen the link between policy, planning and budgeting, which is vital in the preparation of budgets and management of public resources. Indeed, the 2007 Public Expenditure Reviews (PERs) and the 2006/07 Annual Progress Report of the Investment Program for the Economic Recovery Strategy for Wealth and Employment Creation (ERS) noted the substantial progress made in the allocation of more resources to the priority areas including agriculture and rural development sector. In addition, the PER and the ERS annual progress report noted important progress made towards implementation of the macro framework set out in the ERS through BOPA, Budget Strategy Paper (BSP) and the annual budgets. This reflects policy consistency and continued adherence to the government development strategy.
3. As in last year's BOPA2007, this year's BOPA2008 provides indicative sector ceilings only, and therefore provides the Sector Working Groups (SWGs) with the flexibility in developing the ministerial ceilings. In line with previous practices, the macroeconomic assumptions underlying the BOPA2008 sector ceilings will be updated closer to the Budget in the context of the next BSP to reflect any changes in economic and financial conditions.

## II. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK FOR 2008

### 2007 Update on Economic performance

4. The Kenyan economy continues to grow strongly, benefiting from sound and consistent macroeconomic and structural policies. **Real GDP** expanded by 6.6 per cent and 7.1 per cent in the first and second quarters of 2007, respectively, on the back of strong growth in manufacturing, tourism, transport and communications, and financial services. It is now estimated that real GDP growth will average between 6.5 – 7 percent in 2007, up from 6.1 per cent in 2006. This growth, combined with a strengthening of the shilling against the US\$ has resulted in an increase in our per capita income from slightly above US\$ 400 in 2002 to about US\$ 630 in 2006, an increase of about 55 percent in just 4½ years.
5. The annual average headline **inflation**, though in double digits, has trended down to 10 percent in November 2007 from 14.5 percent in 2006, despite increases in oil prices. The year-on-year headline inflation was in the single digit range for the most of the first half of 2007 before edging up to peak at 13.6 per cent in July 2007

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and later easing to reach 10.6 percent in October 2007. This development followed improved food supplies occasioned by the onset of short rains. However, by November 2007, inflation had picked up to 11.8 percent due to increase in fuel price. The underlying inflation rate, measured by excluding food and energy, has remained around the 5 percent target, a development attributable to prudent fiscal and monetary management and a strengthening shilling against the US dollar.

6. Annual growth in **broad money**, M3, was 16.7 percent in the year to October 2007 compared with 17 percent in a similar period in 2006. Expansion in money supply was supported by strong increase in credit to both the private and government sector. Credit to the private sector accelerated to 17.4 percent in October 2007 from 12.9 percent a year earlier, with most of it benefiting manufacturing, trade, transport and communication sectors. Credit to the Government increased to 17.6 percent from 14.3 percent in 2006. Meanwhile, expansion in net foreign assets slowed to 12.5 percent from 28.9 percent in October 2006.

7. The average **interest rate** on the 91-day Treasury bills rose from 6.6 percent in June 2006 to 7.5 percent in November 2007. Similarly, the average interest rate on the 182-day Treasury bills increased from 7.3 percent to 8 percent during the same period. Longer term (3 to 10-year) Government bonds were issued at a yield ranging from 10 to 15 percent. The increase in interest rates reflected tightening of monetary policy by CBK in the face of incipient inflationary pressures. In August, following the recommendation of the Monetary Policy Advisory Committee, the CBK increased the Central Bank Rate by 25 basis points, to 8.75 percent, to signal a tighter monetary stance. Consequently, rates on repos rose by a further 106 basis points in the third quarter of 2007 to stand at 8.37 percent at end-September.

8. The external current account deficit widened slightly in 2006/07 to about 2.5 percent of GDP from 2.3 percent of GDP in 2005/06. The widening of the deficit reflected deterioration in the trade account following a slower growth of 6.0 percent in exports compared with a growth of 17.4 percent in imports. Much of the increase in imports was as a result of the increase in the import bill for oil and machinery and transport equipment. The trade deficit was, however, partly offset by receipts from tourism, transportation services and unrequited transfers including remittances that increased by 9 percent. With a lower surplus in the capital and financial account, the overall balance of payments recorded a reduced surplus of US\$ 255 million in 2006/07 compared with US\$ 506 million in the previous year.

9. Reflecting the strong external payments position, **official foreign exchange reserves** held by the Central Bank of Kenya rose to US\$ 2.8 billion (equivalent to 3.6 months of next year's imports) at the end of June 2007 from US\$ 2.4 billion at the end of June 2006 (equivalent to 3.9 months of next year's imports). By November 2007, foreign exchange reserves held by the CBK had strengthened further to about US\$ 3 billion.

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10. The **exchange rate** remained relatively stable, with tendencies to appreciate for the greater part of 2007. The shilling exchanged at an average of Ksh 67.7 against the US dollar in first eleven months of 2007 compared with Ksh 72.1 in 2006. Against other major currencies, the shilling appreciation was modest. Overall, in nominal terms, the shilling had appreciated by about 5 percent by September 2007 compared with the level prevailing a year ago. This coupled with higher domestic inflation compared with Kenya's trading partners has resulted in an appreciation of the exchange rate in real terms by about 10 percent -- a development which could have undermined Kenya's export competitiveness. The strengthening of the shilling against the US dollar reflected strong balance of payments position and the general weakening of the US dollar vis-à-vis other major currencies in the international currency markets.

### **2006/07 Fiscal Outturn**

11. **Fiscal outturn for FY 2006/07** was generally satisfactory. The overall budget deficit (commitment basis, including grants) was 1.7 percent of GDP compared with 2.5 percent of GDP recorded in the previous financial year. Domestic borrowing amounted to KSh 34.7 billion compared with the revised target of KSh 41.3 billion and KSh 28.3 billion in the previous year. Key elements of the fiscal performance in 2006/07 were as follows:

- **Total revenue grew by 19.8 percent** from KSh 311.3 billion in 2005/06 to KSh 373.0 billion in 2006/07 and was slightly below the KSh 377.4 billion target for the period. The shortfall was mainly in A-I-A as other revenues were broadly on target. However, in relation to GDP, revenues increased modestly by 0.5 percent compared with the program target of 1 percent of GDP, mainly because of the higher inflation outturn.
- **Total expenditures grew by 9.6 percent** from KSh 382.8 billion to KSh 419.6 billion, with development outlay increasing by about 18.8 percent and recurrent expenditure by 9.5 percent. Despite an improvement in the execution of the domestically financed development budget over the past years, there continued to be delays in the implementation of foreign financed development projects, in part due to problems with slow procurement, poor work plans and implementation capacities in the line ministries. Natural attrition and delays in the hiring of health workers, teachers, security forces, among others, kept the wage bill below program levels.
- **The overall fiscal deficit (before grants) decreased to 2.6 percent of GDP** from 4.6 percent of GDP in 2005/06. However, including grants, the fiscal position recorded a deficit of 1.7 percent compared with a deficit of 2.4 percent of GDP in 2005/06 (Table 1).

- The ratio of **domestic debt (net)** to GDP increased from 18.1 percent in June 2006 to 18.4 percent in June 2007. Meanwhile, with the lower than expected external disbursements, Kenya's total stock of debt in percent of GDP declined from 45.4 percent in June 2006 to 39.9 in June 2007.

**Table 1: 2006/07 Fiscal Outturn and Outlook for 2007/08\***

	2005/06	2006/07		2007/08 Budget
		Target	Prov.	
<b>1. Total Revenue and Grants</b>	<b>331.4</b>	<b>403.8</b>	<b>388.5</b>	<b>469.1</b>
1.1 Total Revenue	311.3	375.4	373.0	428.9
Income Tax	113.9	132.7	124.9	144.2
Import Duty	20.5	28.3	27.5	32.3
Excise Duty	50.3	62.2	56.4	65.6
Value Added Tax	76.3	90.8	96.3	111.8
Other	50.3	61.4	68.3	74.9
1.2 Grants	20.1	28.4	15.5	40.2
<b>2. Total Expenditure</b>	<b>382.8</b>	<b>461.3</b>	<b>419.6</b>	<b>580.4</b>
Recurrent	306.5	338.3	335.5	408.2
Development	67.7	119.9	80.4	169.2
<b>3. Surplus/Deficit (commitment basis)</b>	<b>-51.4</b>	<b>-57.5</b>	<b>-30.7</b>	<b>-109.8</b>
% of GDP	-3.3	-3.3	-1.7	-5.3
<b>4. Adjustment to cash basis</b>	<b>14.3</b>	<b>0.0</b>	<b>0.3</b>	<b>1.5</b>
<b>5. Surplus/Deficit (cash basis)</b>	<b>-37.1</b>	<b>-57.5</b>	<b>-30.4</b>	<b>-108.3</b>
% of GDP	-2.4	-3.1	-1.7	-5.3
<b>6. Total Financing</b>	<b>36.5</b>	<b>57.4</b>	<b>36.6</b>	<b>109.8</b>
Net External	1.2	9.7	-2.0	39.8
Net Domestic	28.3	29.5	34.7	34.0
Other including privatisation proceeds	7.0	18.2	4.0	36.0

\* Figure may not add up due to rounding

\*\*Preliminary Revision

## 2007/08 Budget

12. The macroeconomic assumptions underlying the 2007/08 budget were detailed in the BSP2007 released in May-June 2007. The fiscal framework detailed therein assumed cautious revenues projections for 2007/08 and emphasized increased development spending. The key highlights of 2007/08 budget are as follows:

- **Total revenues are expected to rise by 15.0 percent**, reflecting the continued commitment by the government to accelerate on going reforms in tax and customs administration, and protecting the revenue base by streamlining of the exemption regime. The increase in revenue targets is broadly in line with the commitments to collect about 20.7 percent of nominal GDP, which is broadly consistent with revenue performance in the recent past.

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- **Total expenditures are expected to rise by about 38.3 percent** reflecting mainly a sharp increase by 110.4 percent in development expenditures from KSh 80.4 billion to KSh 169.2 billion as recurrent expenditure increase by 21.7 percent, on account of free secondary tuition fee and the general elections scheduled for December 2007.

- With expenditures rising at a faster pace than revenues, the **overall fiscal position (after grants) is expected to register a deficit of KSh 109.8 billion (equivalent to 5.3% of GDP)**. This is expected to be financed as follows: external sources of KSh 39.8 billion; domestic financing of KSh 33.9 billion; and net privatization receipts of KSh 36.0 billion. The expected domestic borrowing requirement is expected to be broadly within the medium term target of 1.5 percent of GDP to allow significant but non-inflationary expansion of credit to the private sector.

**13. Preliminary outcome in the first four months to October of FY 2007/08 indicate a generally strong fiscal position**, with expenditures kept within target and revenues broadly in line with target, save for the investment income where it is now clear that the expected dividend from CBK of KSh 2 billion will not materialize due to revaluation losses occasioned by the appreciation of the shilling exchange rate. In addition, the execution of foreign financed development budget is expected to be lower than envisaged in budget. These and other developments to December 2007 will be formalised in the forthcoming revised budget to be finalised by March 2008.

14. The Government's pursuit to diversify the sources of funding by accessing the international capital market remains on track, and so is the privatization program. Overall, with improved economic conditions and continued strong revenue performance as well as strict expenditure controls should result in the achievement of domestic borrowing target for 2007/08.

### **Progress in Structural Reforms**

15. Important progress has been made in implementing structural reforms, despite delays in passage of key legislative reform bills by the outgoing parliament.

- Implementation of the **Governance Action Plan** for Building a Prosperous Kenya (GAP) is on track with the enactment of the Miscellaneous (Amendments) Act, which contained important governance reforms. Meanwhile, to strengthen the legal platform against corruption, the Chief Justice issued a Legal Notice in February 2007 to prevent applications for constitutional references from acting as automatic stay of proceedings in cases involving economic crimes and corruption. Other governance developments include approval by Parliament of the Political Parties Bill 2007 in September



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2007, enforcement of the Witness Protection Act 2006, and establishment of a Public Complaints Standing Committee in June 2007 to increase transparency and public access to government information.

- Investigation and prosecution of corruption cases have continued, while capacity is being strengthened. Title deeds for 179 illegally and irregularly allocated parcels of public land have been surrendered to the Ministry of Lands. Two Anglo Leasing cases are in court, and investigations on other dimensions are ongoing.
- Public financial management reforms have deepened while the role of government in the economy has been scaled down. All of the 10 targeted benchmarks of the Public Expenditure Management Action Plan have been met and the risk-based audit approach has now been rolled out. IFMIS is now operational in the headquarters of 24 ministries/accounting units and is being rolled out in another 7 ministries. The operational modules include the accounts payable, general ledger and the purchasing module. The system is running alongside existing accounting systems as its coverage is being extended and problems with the security of the network and availability of back-up servers are being addressed. The criteria for the granting of exemptions and waivers to remove discretion have been established. A final report on developing and implementing a payment plan for pending bills is well advanced, and all claims that have been assessed as payable have already been paid.
- The Public Procurement Oversight Authority (PPOA) is now operating as provided for under the Public Procurement and Disposal Act. All procurement, including security contracts continue to be subject to the transparent and competitive procedures established under the Procurement and Disposal Act.
- 205 business licenses have been eliminated and another 371 simplified under the recently enacted Licensing Laws (Repeals and Amendment Act 2007), bringing the total number of licenses eliminated to 315 and those simplified to 379 (out of a total of 1,325) since 2006. A consolidated regulatory electronic business license registry was launched in November 2007, providing a useful base for enhanced scrutiny, transparency, information disclosure and positive legal security for the licensing regime in Kenya. The World Bank's annual Doing Business Report 2008 (covering developments in 2006/07) recorded significant improvements in Kenya's overall ranking, making the country one of the top 10 global reformers in the ease of doing business. Notable gains included reducing the number of days to start a business from 54 in 2006 to 44 in 2007. Aided by the electronic customs system, the Port of Mombasa has cut its average clearance time from 17 to 5-7 days. The KRA has also dropped off

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Transparency International's bribery index as a result of its improvements in governance.

16. The Government's structural reform efforts have won international recognition. In June this year, Kenya won the United Nations' Public Service Award in the category "Improving Transparency, Accountability and Responsiveness in the Public Service" for comprehensively introducing performance contracts across all cadres in the public service. This latest award is in recognition of the government's efforts to make itself more accountable to its people through initiatives such as the "rapid results initiative," whereby ministries deliver results in 100 days, as well as other reforms including performance contracts for government officials. In September, the Kenyan government was nominated for an international award for improved performance in the public service by the Ash Institute for Democratic Governance and Innovation at Harvard University's John F. Kennedy School of Government.

17. Reflecting the improved confidence in our economy, Standard and Poor's Ratings Services maintained, in September 2007, Kenya's initial sovereign credit rating of "B+" for foreign currency and "BB-" for local currency long-term sovereign debt, and observed that the outlook is stable. Within sub-Saharan Africa, only mineral-rich countries such as Botswana, South Africa, and Nigeria have higher sovereign ratings. Fitch is expected to provide a sovereign credit rating for Kenya in early December 2007.

### **Outlook for 2008**

18. The outlook for 2008 is for continued solid economic conditions with expected economic growth of at least 6½ percent. This projected growth level for 2008 represents the fifth year in a row of economic growth well above the population growth of about 2.7 percent. This is expected to result in improved GDP per capita and, consequently, significant improvement in the living standards of Kenyans.

19. Agriculture is expected to continue performing strongly driven by increased tea and horticultural production, reflecting efficiency and expansion of tea factories and increased investment in the sector. Manufacturing is expected to continue benefiting from sustained increased private investment to meet the strong demand from the sub-region with increased integration, while construction activities will continue to be stimulated by low interest rates and elevated levels of public infrastructure investment associated with the increased expenditure announced in the 2007/08 budget. The growth in transport and communication sector is expected to be sustained with privatization of key state owned enterprises, Telkom (K) and SAFARICOM.

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20. Inflation is expected to continue easing in 2008 with forecast year average growth of about 5 percent, compared with the expected inflation rate of 9.1 percent in 2007. Both the interest rates and the exchange rates are expected to remain reasonably stable in 2008.

21. The risks to the outlook for 2008 include the current spike in international oil prices and unfavourable weather conditions should there be inadequate rainfall.

### III. THE NATIONAL VISION 2030

22. As the ERS comes to a successful end in December 2007, the BOPA2008 will usher in a new Government development strategy -- the national Vision 2030. With a view to upscaling the success achieved under the ERS, the Vision 2030 strategy is based on three pillars, namely, economic, social and political pillars. The economic pillar calls for accelerating annual GDP growth to 10 percent on a sustained basis, with a view to making Kenya a middle-income country by the year 2030; the social pillar calls for a cohesive society enjoying equitable social development; and the political pillar calls for an issues-based, accountable democratic political system. As a step to achieve the Vision 2030 objectives, a medium-term economic strategy is being developed for the period 2008-2012. In the meantime, the Vision 2030 summarised in Box 1-3 will form the basis of prioritising policies consistent with available resources.

#### **Economic Pillar**

23. The foundation upon which to build a prosperous Kenya with expanded economic opportunity for all has been laid after the successful implementation of various economic and structural policy reforms under ERS. In going forward, Vision 2030 will build on the successes under ERS by consolidating the gains in macroeconomic stability, supported by a deepening of structural reforms and strengthening institutions in order to help deliver high and stable levels of growth and employment. In addition, the Government will create an enabling environment for the private sector to invest in the six key sectors identified to deliver the economic growth rate of 10 percent per annum, as summarised in Box 1 below.

### **Box 1: The Economic pillar – Accelerating and Sustaining Economic Growth**

- **Macroeconomic stability** – The Government will continue to pursue the prudent fiscal management to ensure sustainable debt position. Meanwhile, the Central Bank of Kenya (CBK) will continue to pursue an appropriate monetary policy aimed at achieving a low rate of inflation, adequate level of international reserves and ensuring that sufficient credit goes to the private sector to support economic activities. The exchange rate will continue to be determined by market forces in the interbank market for foreign exchange.
- **Structural reforms**: In combination with prudent macroeconomic policies, the Government will implement policies designed to promote private sector development and growth. In particular, the reform measures introduced in the 2006/07 and 2007/08 budgets, which focus, inter alia, on removing impediments to businesses, creating a favourable environment for investment, and strengthening the efficiency and effectiveness of public sector as well as enhancing competition on key sector will be continued.
- **Key sectors**: To achieve the 10 percent real GDP growth, six priority sectors have been identified:
  - a. **Tourism** – the Government will aim to increase tourist revenue yield in the country's premium safari parks, support the establishment of resort cities and diversify into niche products.
  - b. **Agriculture** – the Government will deepen the reforms in the agricultural sector and continue to increase resources to implement the "Strategy for Revitalization of Agriculture" and livestock development policy for ASALs. In addition, the Government will support innovative measures that would make agriculture commercially oriented and modernised; continue rehabilitating and expanding irrigation schemes; strengthen land management and tenure systems for better utilization of high and medium potential lands; increase market access to small holder farmers; support fisheries, forestry and mining, and protect the environment and natural resources.
  - c. **Manufacturing** – the Government will develop a robust, diversified and competitive manufacturing sector through establishment of special economic clusters and small and medium size industrial parks. In addition, the Government will exploit value addition in agro-based business.
  - d. **Wholesale and retail trade** – the Government will aim to create organised market outlets for small scale operators and reduce the number of players in the supply chain of marketed agricultural products.
  - e. **Business processing outsourcing (BPO)** – to create more jobs for the youth, the Government will facilitate the establishment of a BPO park with the aim of attracting leading BPO players while developing the local capacity in the sector.
  - f. **Financial services** – the Government will aim to develop a vibrant and globally competitive financial sector through reforming the banking sector to facilitate consolidation, improving coverage in pensions sector and deepening capital markets by accessing international capital, among others.

## **Social Pillar**

24. The implementation of various anti-poverty interventions under ERS has resulted in a significant decline in the overall incidence of poverty from 56.8 percent in 2000 to 46 percent in 2006. Vision 2030 will build on this progress to achieve a durable

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prosperity with Kenyans enjoying equitable social development. Box 2 summarises the important interventions in eight key areas.

**Box 2: Social Pillar - Equity and Poverty Reduction as a Basis for Equitable Social Development**

- The Government will continue to focus on providing a significant share of budgetary resources to eight key social sectors, while ensuring efficiency in the utilization of those resources.
  - a. **Education and training** – in addition to funding free primary education, the Government will provide free secondary schools education, while at the same time providing bursaries to poor bright students. It will also provide resources to support technical training, research and technology to enhance the competitiveness of our economy. Other initiatives will include: integrating early childhood into primary education; reforming secondary school curriculum; modernizing teacher training; strengthening partnership with the private sector; developing key programs for learners with special needs; and revising the curriculum for university and technical institutes to emphasis science and technology.
  - b. **Health** – Government will continue to shift focus from curative to preventive care, help to expand immunization coverage, improve reproductive health needs and allocate additional resources to facilitate an effective multi-sectoral response to epidemics such as HIV/AIDS and malaria. In addition, the Government will aim to provide a health services through a robust infrastructure network and scale up the output-based system to enable disadvantaged groups access health care.
  - c. **Water and sanitation** -- The Government will aim to conserve water and enhance ways of harvesting rain and underground water. Specifically, it will aim to rehabilitate hydro-meteorological data gathering network, construct multi-purpose dams and construct water and sanitation facilities to support a growing urban and industrial production.
  - d. **Environment** – the Government will continue to promote environmental conservation, improve pollution and waste management through public-private partnerships initiatives, and enhance disaster preparedness as well as capacity to adopt global climatic changes.
  - e. **Housing and urbanization** – the Government will support the development of affordable housing, enhance access to adequate finance for developers and buyers, provide physical and social infrastructure in slums and develop the city of Nairobi as an all round globally competitive city in business and tourism.
  - f. **Gender, youth and vulnerable groups** – the Government will aim to increase training for women entrepreneurs, establish a consolidated social protection fund for cash transfer to orphans, vulnerable children and elderly, support the disability fund, develop sporting as well as music and performing art talents.

## Political Pillar

25. While a number of governance reforms have been implemented to reduce corruption, improve efficiency and ensure effective service delivery in public sector, there is still more work to be done to secure an accountable democratic political system. Vision 2030 will build on these governance achievements by focusing on

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reform effort in six key areas: rule of law; electoral and political process; democracy and public services delivery; transparency and accountability; public administration and service delivery; and security, peace building and conflict management. Box 3 summarizes the key initiatives under the political pillar.

**Box 3: The Political Pillar - Building an Accountable Democratic Political System**

- The Government will deepen the implementation of governance reforms, including measures to reduce opportunities for corruption. It will also strengthen the justice and internal security reforms as defined in the recently launched comprehensive medium-term National Anti-Corruption Plan (NACP) drawn from the overarching GJLOS strategy. These structural reforms target:
  - a. improved governance, ethics, and integrity;
  - b. enhanced respect for human rights;
  - c. greater access to justice;
  - d. crime prevention, police and penal reforms;
  - e. strengthened public prosecutions, civil litigations and other legal services available to government and the public; and
  - f. reformist-led capacity building directed at attitude and cultural change. Already, the Government is implementing a one-year Governance Action Plan (GAP) framework with monitorable indicators in line with the NACP.
- In addition, the Government will aim at completing the national constitution together with its enabling legislations, continue with security and policing reforms, building a non-partisan professional research centre to enrich Parliament law-making, and develop a program on attitudinal and value change to inculcate a culture of voluntary compliance with the efficiency norm of Vision 2030

26. It is also important to note that the implementation of initial initiatives under Vision 2030 takes into account commitments under MDGs and the work done in comprehensively costing the MDGs related interventions.

#### **IV. MEDIUM TERM OUTLOOK, 2008/09 – 2010/11**

##### **Macroeconomic Framework for Vision 2030**

27. Building on the foundation already laid through the implementation of economic and structural policies under ERS, Kenya's economic outlook is indeed bright, buoyed largely by consumer and investor confidence, continued structural reforms and projected growth in Kenya's trading partners' economies. The growth forecast is projected at 6.6 percent in 2007/08, and is expected to rise steadily to 10 percent by 2012/13 as a result of various interventions including implementation of flagship projects under the economic and social pillars. Sustaining these higher growth rates would provide a strong basis for achieving the MDGs as well as laying the groundwork for achieving an equitable social society.

28. To meet the growth target of 10 percent, the level of investments is projected to expand by over 10 percentage points of GDP raising the level of investments as a ratio of GDP from about 20 percent in 2006/07 to about 32<sup>1</sup>/<sub>2</sub> percent by 2012/13, with more of it coming from private investment including direct foreign investments (Table 2). Public sector investment will be in the form of infrastructure developments (roads, transport, energy, ICT, science, technology and innovation and water and sanitation).

29. The envisaged growth will be driven by the private sector with the Government playing a facilitative role, including creating a conducive environment for private sector growth. The increase in private sector investments will require:

- i. Maintaining a conducive macroeconomic environment;
- ii. Deepening of structural reforms to further increase economic efficiency and effectiveness in public service delivery;
- iii. Crowding-in private sector investments through increased public infrastructure development including public private partnership; and
- iv. Continued improvement in governance.

30. Gross national savings necessary to finance the envisaged investment levels is expected to rise steadily from 15.6 percent as a ratio of GDP in 2006/07 to about 26 percent by 2012/13 and to about 28-29 percent of GDP by 2029/30. The increase in savings will be facilitated by reforms in the financial sector to improve intermediation. The flagship projects identified under the financial services and a comprehensive financial sector strategy being developed by the Government will guide reforms in the financial sector.

Table 2: Main Macroeconomic Indicators Underpinning the Vision, 2006/07 – 2012/13							
	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
<i>Medium term projections</i>							
<i>(Annual percentage change)</i>							
National accounts and prices							
Real GDP	6.4	6.6	6.9	7.8	8.7	9.6	10.0
CPI (end of period)	11.1	5.8	5.0	5.0	5.0	5.0	5.0
<i>(In percent of GDP)</i>							
Investment and savings							
Investment	19.2	21.5	24.5	26.2	28.7	31.3	32.6
Gross national savings	15.6	17.6	18.6	20.6	22.7	24.8	26.1
Central government budget							
Total revenue	20.7	20.5	20.9	21.1	21.3	21.5	21.6
Total expenditure and net lending	23.5	26.7	26.4	26.7	27.4	27.9	28.5
Overall balance (incl. grants)	-2.0	-4.7	-3.7	-3.8	-4.3	-4.5	-4.9
Domestic debt, net (eop)	18.2	18.1	18.4	18.7	19.2	19.7	20.3
External sector							
Current account incl. off. transfers	-3.4	-3.9	-5.9	-5.7	-6.1	-6.5	-6.5
Reserves (months of import cover)	3.1	3.3	3.7	3.9	4.1	4.4	4.6



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31. The Government will continue to pursue a monetary policy framework that will continue to deliver low inflation at around the 5 percent target, while ensuring continued stability in long-term interest rates, which are now at their lowest level since liberalization in early 1990s. At the same time, the CBK will continue to improve its monetary policy implementation procedures in line with the new institutional framework of monetary policy outlined in the Finance Act 2007 that will come into force in January 2008.

32. The fiscal policy framework will continue to deliver sound public finances. The Government has reoriented expenditure towards priority sectors in education, health, agriculture and infrastructure under a prudent medium-term expenditure framework (MTEF). The MTEF will be strengthened to bring on board the flagship projects identified under Vision 2030.

33. With Kenya remaining an open economy and exposed to fluctuations in the world economy, the Government has built up adequate foreign reserves to cushion itself from external vulnerabilities including high oil prices and drought. Going forward, and with increased globalization and susceptibility to external shocks, the Government will continue to gradually build international reserve up to about 8 month of import cover by 2030, which is more or less in line with the EAC convergence criteria.

34. With regard to the exchange rate policy, the Government will continue to maintain flexible exchange rate system that facilitates the economy's competitiveness in line with export-led private sector driven growth strategy. So far, the market-determined exchange rate pursued by the Government has served Kenya well in terms of providing cushion to any external shocks. Recent strengthening of the Kenya shillings has caused worries to some firms, especially manufacturers trading with European countries. Accordingly, the Government will continue to monitor closely the developments in the real exchange rate to ensure that it does not undermine Kenya's external competitiveness.

35. It is also important to note that there are other factors other than the exchange rate that determine our competitiveness. These factors include factor productivity as well as the cost of doing business. In this context, the Government is committed to accelerating structural reforms and re-building of our infrastructure in order to enhance productivity of our economy.

### **Medium Term Fiscal Outlook**

36. While the government is gearing its policies to accelerate annual GDP growth towards the Vision 2030 target of 10 percent, the medium term fiscal framework is guided by the need to be prudent. As growth in real GDP accelerates, the medium-



term macro-economic framework will be adjusted accordingly. Table 3 summarises the main macroeconomic indicators underpinning the prudent fiscal framework envisaged in the medium-term. Details of the key indicators are provided in Annex 1.

Table 3: Main Macroeconomic Indicators Underpinning the Medium-Term Fiscal Framework, 2006/07 – 2010/11					
	2006/07	2007/08	2008/09	2009/10	2010/11
	<i>Medium term projections</i>				
<i>(Annual percentage change)</i>					
National accounts and prices					
Real GDP	6.4	6.6	6.7	6.9	7.0
CPI (end of period)	11.1	5.8	5.0	5.0	5.0
<i>(In percent of GDP)</i>					
Investment and savings					
Investment	19.2	21.5	22.8	23.7	24.1
Gross national savings	15.6	17.8	19.1	20.2	20.6
Central government budget					
Total revenue	20.4	20.5	20.8	20.9	21.1
Total expenditure and net lending	23.0	26.7	25.4	25.7	26.0
Overall balance (incl. grants)	-1.7	-4.7	-3.3	-3.3	-3.4
Domestic debt, net (eop)	18.3	18.1	17.8	17.4	17.0
External sector					
Current account incl. off. transfers	-3.4	-3.7	-3.7	-3.5	-3.4
Reserves (months of import cover)	3.1	3.4	3.6	3.8	3.9

37. During the transition to Vision 2030, the medium-term fiscal framework will be guided by the following principles:

- A strong revenue effort to ensure that the revenue-to-GDP ratio is around 21-22 percent of GDP.
- Budgetary expenditures will be consistent with agreed national and sectoral priorities outlined in Box 1-3 above, with continued shift away from recurrent to capital expenditures while ensuring resources for operational and maintenance for increasing capital stock is provided for.
- The overall fiscal deficit will be consistent with achieving a sustainable domestic debt position and should not crowd-out private sector credit, while at the same time providing sufficient fiscal space for infrastructural and social programs necessary to achieving Vision 2030 objectives.
- External borrowing will be guided by the need to ensure our external debt remains sustainable. It will also follow the Kenya Joint assistance Strategy (KJAS) agreed with development partners, as well as the Government's own Kenya External Resources Policy (KERP). While we will continue to get the bulk of funds from multilateral and bilateral sources on concessional terms, we will continue to diversify our sources of funds and will, therefore, remain active in issuing sovereign bonds to the international financial market.
- The Government is committed to ensuring prudence in public expenditure management.

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38. Given the uncertainties in disbursements of bilateral and multilateral budgetary support, this BOPA continues with the practice of excluding these financing from the fiscal framework, while continuing to include both project grants and loans. The approach has worked well in ensuring fiscal predictability and high degree of certainty to line ministries on their allocations.

39. This guiding framework which the Government has followed in the last three years will be continued in the next budget and in the medium-term. The approach has provided a basis for macroeconomic stability – steady economic recovery, low interest rates and a stable exchange rate – and reduction of domestic debt to GDP ratio.

### **Structural reforms**

40. Maintaining macroeconomic stability is in itself necessary but not sufficient to achieve the desired growth under Vision 2030. Improving efficiency and increasing total factor productivity (TFP) is also critical to achieving the Vision 2030 growth targets. Therefore, the Government will continue undertaking structural reforms in various fronts with the aim of improving the efficiency in the allocation and utilization of resources as well as effective public sector service delivery. Priority areas include:

- *Governance*: Deepening governance and anti-corruption reforms in the broad areas of: (i) prevention; (ii) investigation and recovery of corruptly acquired assets; (iii) strengthening the prosecutorial capacity; and (iv) improving governance in priority sectors.
- *Public Expenditure and Financial Management Reforms*: Accelerating reforms in public financial management in order to improve efficiency, enhance transparency and accountability under a coordinated strategy to revitalize Public Finance Management (PFM).
- *Procurement Reforms*: Enhance effectiveness of the Public Procurement Oversight Authority (PPOA) in order to improve efficiency in public procurement and create fiscal space to allow for shifting resources to priority Vision 2030 development projects;
- *Financial Sector Reforms*: Kenya will implement a comprehensive financial sector reform strategy aimed at enhancing access, efficiency and stability in order to facilitate private sector development;

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- *Privatization:* Enhancing effectiveness of the Privatization Commission to oversee implementation of privatization strategy aimed at promoting accountability and efficiency and opening opportunities for private sector investment and new technology in public enterprises;
  - *Private Sector Competitiveness:* Building on recent achievements in business regulatory reforms in which Kenya was ranked amongst the top 10 performing countries in the world, Kenya will undertake additional measures to improve the investment climate and will also implement the comprehensive private sector development strategy.

## **VI. 2008/09 BUDGET FRAMEWORK**

41. The 2008/09 budget framework is set against the background of the medium-term macro-fiscal framework set out above and the Government's objectives described in the Vision 2030 and summarised in Box 1 through Box 3. The transformation of Kenya into a globally competitive and prosperous nation by 2030 is envisaged, with real GDP expected to increase by 6.7 percent in FY 2008/09 underpinned by continued good performance across all sectors. The projected growth assumes normal weather pattern during the course of the year. Headline inflation is expected to ease to about 5 percent, reflecting continued implementation of a prudent monetary policy and an easing of both food and oil prices. Finally, gross international reserves are expected to increase to the equivalent of 3.6 months of import cover by June 2009, up from 3.4 months of import cover at end-June 2008.

### **Revenue Projections**

42. The 2008/09 budget will target revenue collection of about 20.8 percent of GDP. As noted above, this performance will be underpinned by on-going reforms in tax and customs administration. The streamlining of the exemptions regime in line with other East African Community Partner states should help to protect the revenue base. As such, total revenues are expected to be KSh 485.4 billion.

### **Expenditure Forecasts**

43. The key policy document guiding the Government's funding allocation decisions will be the Vision 2030, which provides the overarching development priorities. In 2008/09, overall expenditures are projected at 25.4 percent of GDP (or KSh 594.7 billion), down from 26.7 percent (KSh 580.4 billion) in 2007/08 owing to one-off items including expenditure on general elections.

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## Recurrent Expenditure

44. Recurrent expenditures are expected to decline slightly from 19.8 percent of GDP in 2007/08 to 18.4 percent of GDP in 2008/09, on account of a moderately lower wage bill, adjustment of one-off items and robust growth in nominal GDP.

- *Consolidated fund services:* These 'first call' expenditures are dominated by interest payments and pensions. Domestic interest payments are expected to decline relative to GDP to 2 percent in 2008/09 from 2.1 percent in 2007/08 with stable interest rates, while pension expenditures are assumed to grow by 15 percent annually based on projections from the actuary report of 2004.
- *Wages and salaries:* With the continuation of a policy of restraining growth in wage payments to free resources for development purposes, the wage bill is projected to decline to 6.7 percent of GDP in 2008/09, notwithstanding the increase in civil service wage bill in 2007/08.
- *Transfers:* Government will continue maintaining the nominal value of transfers to parastatals and semi-autonomous government agencies at 2007/08 level so as to provide fiscal space for expenditures on core-poverty programs. Any wage adjustments from these agencies is expected to be made within the ministerial ceilings.
- *Goods and services:* These are expected to rise in line with nominal economic growth and adjusted to take into account one-off expenditures in 2007/08 including the December 2007 general elections.

## Development and Net Lending

45. Consistent with the objective of increasing resource allocation towards development outlays and after adjusting for one-off items in 2007/08, the ceiling for development expenditures will increase to about 7 percent of GDP in 2008/09 (equivalent to KSh 162.3 billion). Most of the outlays are expected to support critical infrastructure that will crowd in private sector investment in the flagship projects identified under Vision 2030.

46. Project loans and grants not tied to conditionalities from development partners are expected to rise moderately to 3.3 percent of GDP in 2008/09 from 3.1 percent in 2007/08. With improvement in procurement system, the absorption capacity of project funds is expected to increase significantly, resulting in a higher investment level in infrastructure activities including those toward vision 2030 flagship projects.

47. As was the case in 2007/08 budget, a drought expenditure of KSh 1 billion and contingency provision of KSh 2 billion will be provided in the budget for 2008/09.

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## **Overall Deficit and Financing**

48. The overall budget deficit (including grants) in 2008/09 is projected to be about KSh 78.1 billion (equivalent to 3.3 percent of GDP). Net external financing amounting to KSh 35.3 billion (1.5 percent of GDP) is expected to cover part of this budget deficit, leaving about KSh 43 billion (1.8 percent of GDP) to be financed through domestic borrowing of about KSh 37.7 billion (or 1.6 percent of GDP) and privatization receipts estimated at KSh 5 billion (or 0.2 percent of GDP).

49. As in 2007/08, the Government will continue with the maturity structure of government debt at 75:25 ratio in favour of long term bonds, while ensuring sustainable low interest rates. The Government will continue accessing the international capital markets when and if necessary to ease domestic pressure on interest rates while setting a benchmark profile to the private sector to follow suit.

## **Conclusion**

50. The set of policies outlined in this BOPA are consistent with the national strategic objectives pursued by the Government as a basis of allocation of public resources. Details of the strategic objectives will be provided under the 5-Year Medium Term Plan currently being developed as the first phase of implementation of the national Vision 2030. The policies and sector ceilings annexed herewith will guide the line ministries in preparation of the 2008/09 budget in accordance with the circular issued in October 2007.

Annex 1: Selected Economic Indicators – 2005/06-2010/11									
	2005/06	2006/07	Medium-Term						
			2007/08		2008/09		2009/10		2010/11
		Prov.	Budget	BOPA'08	BSP'07	BOPA'08	BSP'07	BOPA'08	BOPA'08
<i>Annual percentage change, unless otherwise indicated</i>									
<b>National account and prices</b>									
Real GDP	5.9	6.4	6.4	6.6	6.4	6.7	6.5	6.9	7.0
GDP per capita	3.1	3.6	4.4	3.9	4.4	4.0	4.5	4.3	4.5
GDP deflator	5.9	10.9	5.9	7.6	5.2	5.0	5.3	5.2	5.2
CPI Index (eop)	10.9	11.1	5.0	5.8	5.0	5.0	5.0	5.0	5.0
CPI Index (avg)	11.1	10.4	5.9	8.0	5.1	5.0	5.0	5.0	5.0
Terms of trade (-deterioration)	-2.2	-0.9	-0.9	-3.1	-1.1	-0.9	-0.8	-0.1	-0.2
<b>Money and credit (end of period)</b>									
Net domestic assets	8.0	19.9	5.1	16.0	8.2	12.5	9.1	13.0	12.7
Net domestic credit to the Government	5.0	33.3	11.8	11.6	11.1	10.8	10.5	10.9	10.5
Credit to the rest of the economy	14.1	11.3	13.3	14.5	13.2	14.4	13.5	14.6	14.7
M3 (M2 plus foreign currency deposits)	15.6	18.8	12.7	14.2	12.7	14.2	12.8	14.5	14.6
Reserve money	14.0	17.4	12.7	14.0	12.7	14.3	12.8	14.5	14.6
<i>In percentage of GDP, unless otherwise indicated</i>									
<b>Investment and saving</b>									
Investment	18.1	19.2	23.2	21.5	24.7	22.8	26.2	23.7	24.1
Central Government	4.3	4.3	8.1	6.0	7.3	6.8	7.8	7.2	7.6
Other	13.7	14.9	15.1	15.5	17.4	16.0	18.5	16.5	16.5
Gross National Saving	16.0	15.8	20.7	17.8	21.7	19.1	22.9	20.2	20.6
Central Government	0.0	1.6	1.0	1.0	2.5	2.3	3.1	2.6	2.8
Other	15.9	14.2	19.7	16.8	19.1	16.9	19.8	17.6	17.8
<b>Central government budget</b>									
Total revenue	20.2	20.7	20.8	20.5	21.1	20.8	21.4	20.9	21.1
Total expenditure and net lending	24.8	23.5	28.2	26.7	26.0	25.4	26.2	25.7	26.0
of which : wages and salaries	7.3	7.0	7.0	6.9	6.6	6.7	6.5	6.6	6.6
Interest payments	2.7	2.3	2.5	2.4	2.3	2.3	2.2	2.2	2.2
Development expenditures	4.4	4.4	8.2	7.1	7.4	6.9	7.9	7.3	7.7
Overall balance (commitment basis) excl. grants	-4.6	-2.8	-7.4	-6.2	-4.9	-4.7	-4.7	-4.7	-4.9
Overall balance (commitment basis) incl. grants	-2.4	-2.0	-5.4	-4.7	-3.1	-3.3	-2.9	-3.3	-3.4
Net external borrowing	0.1	-0.1	1.9	1.4	1.2	1.5	1.3	1.7	1.9
Net domestic borrowing	1.8	1.8	1.6	1.6	1.6	1.6	1.5	1.6	1.5
Total donor support (grant & loans)	1.9	1.4	4.2	3.1	3.7	3.3	3.9	3.5	3.6
<b>Balance of payments</b>									
Exports value, goods and services	26.8	25.2	24.6	24.5	25.7	25.2	26.4	25.7	26.3
Imports value, goods and services	35.5	35.0	33.3	34.0	34.7	34.5	35.5	34.6	35.0
Current external balance, incl. official transfers	-2.1	-3.4	-2.5	-3.7	-3.0	-3.7	-3.3	-3.5	-3.4
Current external balance, excl. official transfers	-2.3	-3.4	-2.6	-3.8	-3.0	-3.7	-3.3	-3.4	-3.4
Gross international reserve coverage in months of next year imports (end of period)	3.1	3.1	3.9	3.4	4.1	3.6	4.3	3.8	3.9
<b>Public debt</b>									
Nominal central government debt (end of period)	45.9	40.3	40.3	39.5	39.3	39.2	38.2	39.1	38.7
Domestic (net)	18.0	18.2	18.3	18.1	18.0	17.8	17.6	17.4	17.0
External	27.9	22.1	22.0	21.4	21.3	21.4	20.6	21.6	21.7
<b>Memorandum items</b>									
Nominal GDP (in Ksh millions)	1543.9	1821.1	2059.1	2087.8	2304.9	2337.1	2584.8	2629.2	2960.2

Source: Ministry of Finance

BOPA = Budget Outlook Paper

BSP = Budget Strategy Paper

**Annex 2: Central Government Financial Operations 2006/07 - 2010/11**  
(In billions of Kenya Shillings)

	2006/07			2007/08		Medium-Term				
	Budget	Rev Bg	Prov.	Budget	PRGF	2008/09		2009/10		2010/11
						RSP07	BOPA08	BSP07	BOPA08	BOPA08
<b>TOTAL REVENUE</b>	<b>375.4</b>	<b>381.0</b>	<b>373.0</b>	<b>428.9</b>	<b>427.5</b>	<b>497.3</b>	<b>485.4</b>	<b>554.1</b>	<b>550.7</b>	<b>624.8</b>
Ordinary Revenue (excl. LATF)	336.9	339.2	340.0	389.2	387.9	443.2	441.3	504.4	500.8	568.4
Income tax	132.7	124.2	124.9	144.6	144.2	165.3	164.8	189.4	189.5	218.2
Import duty (net)	28.3	28.3	27.5	32.3	32.3	38.3	37.9	44.1	42.9	48.0
Excise duty	62.2	58.0	56.4	65.2	65.6	73.7	74.1	83.5	83.4	93.9
Value Added Tax	90.8	91.6	96.3	112.2	112.5	126.8	127.2	143.6	143.1	161.1
Investment income	3.6	5.3	6.6	4.7	2.7	5.3	3.0	5.9	3.4	3.8
Other	25.8	31.8	28.4	30.2	30.6	33.8	34.3	37.9	38.6	43.4
LATF	6.6	6.5	6.6	7.6	7.6	8.3	8.2	9.5	9.5	10.9
Ministerial and Departmental fees (AIA)	32.0	35.3	26.4	32.0	32.0	35.9	35.9	40.2	40.3	45.4
<b>EXPENDITURE AND NET LENDING</b>	<b>461.3</b>	<b>483.4</b>	<b>419.6</b>	<b>580.4</b>	<b>557.5</b>	<b>599.6</b>	<b>594.7</b>	<b>676.7</b>	<b>674.7</b>	<b>768.7</b>
Recurrent expenditure	338.3	355.3	335.5	408.2	406.7	425.9	430.1	470.4	480.2	537.9
Interest payments	37.6	42.1	42.5	50.7	49.7	54.0	53.1	57.6	58.5	63.8
Domestic interest	32.3	36.4	36.9	44.0	44.0	47.6	46.6	51.5	52.3	57.1
Foreign interest	5.3	5.7	5.7	6.8	5.7	6.5	6.5	6.2	6.2	6.7
Wages and benefits (civil service)	129.3	130.6	127.3	144.0	144.0	153.0	155.6	167.6	172.9	194.2
Civil service reform	1.4	1.4	1.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Pensions etc	20.4	23.1	20.4	24.4	24.4	27.3	27.3	30.5	30.6	34.4
Other	116.2	124.6	115.2	142.9	142.5	147.9	147.5	165.8	166.0	186.9
Defense and NSIS	33.5	33.6	28.7	45.7	45.7	43.2	46.1	48.3	51.8	58.2
Pending bills change	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Development and Net lending	119.9	124.3	80.4	169.2	147.8	170.7	162.3	203.3	191.8	227.8
Domestically financed	58.5	62.3	53.5	85.1	85.1	82.0	81.7	98.8	97.9	117.4
Foreign financed	58.6	59.5	26.1	81.7	60.3	85.9	77.8	101.8	91.3	107.4
Net lending	2.8	2.5	1.5	2.4	2.4	2.8	2.8	2.6	2.6	3.0
Pending bills (change)	0.0	0.0	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Drought Expenditures	1.0	3.7	3.7	1.0	1.0	1.0	0.0	1.0	0.0	0.0
Contingencies	2.0	0.0	0.0	2.0	2.0	2.0	2.3	2.0	2.6	3.0
<b>Balance (commitment basis excl. grants)</b>	<b>-85.8</b>	<b>-102.4</b>	<b>-46.5</b>	<b>-151.6</b>	<b>-130.0</b>	<b>-112.3</b>	<b>-109.3</b>	<b>-122.6</b>	<b>-124.0</b>	<b>-143.9</b>
Adjustment to cash basis	0.0	0.8	0.3	1.5	0.4	0.0	0.0	0.0	0.0	0.0
Project grants	28.4	29.6	15.5	36.5	26.9	41.6	31.3	47.5	36.5	42.6
Programme grants	0.0	4.9	0.0	3.8	3.7	0.0	0.0	0.0	0.0	0.0
<b>Balance (cash basis including grants)</b>	<b>-57.4</b>	<b>-67.2</b>	<b>-30.7</b>	<b>-109.8</b>	<b>-98.9</b>	<b>-70.7</b>	<b>-78.1</b>	<b>-75.1</b>	<b>-87.5</b>	<b>-101.3</b>
Statistical discrepancy	0.0	0.0	5.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>FINANCING</b>	<b>57.4</b>	<b>67.2</b>	<b>36.3</b>	<b>109.8</b>	<b>99.0</b>	<b>70.6</b>	<b>78.1</b>	<b>75.1</b>	<b>87.6</b>	<b>101.4</b>
Net foreign financing	9.7	16.2	-2.4	39.8	29.0	27.7	35.3	33.6	43.8	56.2
Project loans	30.2	29.9	10.6	45.2	33.4	44.3	46.6	54.3	54.9	64.8
Programme loans	0.0	0.0	0.0	0.0	1.3	0.0	0.0	0.0	0.0	0.0
Commercial financing	0.0	0.0	0.0	20.4	19.8	0.0	5.4	0.0	9.6	14.8
Repayments due	16.5	16.7	16.7	17.8	17.1	16.7	16.7	20.7	20.7	23.4
Change in arrears	-4.0	-0.4	0.7	-8.1	-8.4	0.0	0.0	0.0	0.0	0.0
Rescheduling/Debt swap	0.0	3.3	3.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization proceeds	18.2	18.2	4.0	44.9	44.9	5.1	5.1	1.6	1.6	0.0
Bank/TKL restructuring costs	0.0	0.0	-20.0	-9.9	-8.8	0.0	0.0	0.0	0.0	0.0
Expenditure arrears securitization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure arrears securitization costs	0.0	0.0	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Financing bank restructuring cost	0.0	-20.0	20.0	1.1	-1.1	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.5	0.0	0.0	1.1	0.0	0.0	0.0	0.0	0.0
Restructuring Costs	0.0	-0.5	0.0	-26.5	-26.5	0.0	0.0	0.0	0.0	0.0
Restructuring Financing	0.0	20.0	0.0	26.5	26.5	0.0	0.0	0.0	0.0	0.0
Net domestic borrowing	28.3	32.8	34.7	34.0	34.0	37.9	37.7	39.9	42.2	45.1
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Memo Items</b>										
Domestic Debt (Gross)	357.8	406.6	406.1	462.1	460.5	517.3	507.8	580.1	561.5	619.5
Domestic Debt (Net)	277.7	322.0	334.7	377.0	378.7	415.0	416.2	454.9	458.4	503.5
Nominal GDP	1,543.9	1,754.3	1,821.1	2,059.1	2,087.8	2,304.9	2,337.1	2,584.8	2,629.2	2,960.2

Source: Ministry of Finance  
Notes:  
BOPA = Budget Outlook Paper  
BSP = Budget Strategy Paper

**Annex 3: Central Government Financial Operations 2006/07 - 2010/11**  
(In percent of GDP)

	2006/07			2007/08		Medium-Term			2010/11	
	Budget	Rev Bgl	Prov.	Budget	PRGF	2008/09		2009/10		
						BSP'07	BOPA'08	BSP'07		BOPA'08
<b>TOTAL REVENUE</b>	24.3	21.7	20.5	20.8	20.5	21.1	20.8	21.4	20.9	21.1
Ordinary Revenue (excl. LATF)	21.8	19.3	18.7	18.9	18.6	19.2	18.9	19.5	19.0	19.2
Income tax	8.6	7.1	6.9	7.0	6.9	7.2	7.1	7.3	7.2	7.4
Import duty (net)	1.8	1.6	1.5	1.6	1.5	1.7	1.6	1.7	1.6	1.6
Excise duty	4.0	3.3	3.1	3.2	3.1	3.2	3.2	3.2	3.2	3.2
Value Added Tax	5.9	5.2	5.3	5.4	5.4	5.5	5.4	5.6	5.4	5.4
Investment income	0.2	0.3	0.4	0.2	0.1	0.2	0.1	0.2	0.1	0.1
Other	1.7	1.8	1.6	1.5	1.5	1.5	1.5	1.5	1.5	1.5
LATF	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Ministerial and Departmental fees (AIA)	2.1	2.0	1.5	1.6	1.5	1.6	1.5	1.6	1.5	1.5
<b>EXPENDITURE AND NET LENDING</b>	29.9	27.6	23.0	28.2	26.7	26.0	25.4	26.2	25.7	26.0
Recurrent expenditure	21.9	20.3	18.4	19.8	19.5	18.5	18.4	18.2	18.3	18.2
Interest payments	2.4	2.4	2.3	2.5	2.4	2.3	2.3	2.2	2.2	2.2
Domestic interest	2.1	2.1	2.0	2.1	2.1	2.1	2.0	2.0	2.0	1.9
Foreign interest	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2
Wages and benefits (civil service)	8.4	7.4	7.0	7.0	6.9	6.6	6.7	6.5	6.6	6.6
Civil service reform	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pensions etc	1.3	1.3	1.1	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Other	7.5	7.1	6.3	6.9	6.8	6.4	6.3	6.4	6.3	6.3
Defense and NSIS	2.2	1.9	1.6	2.2	2.2	1.9	2.0	1.9	2.0	2.0
Pending bills change	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Development and Net lending	7.8	7.1	4.4	8.2	7.1	7.4	6.9	7.9	7.3	7.7
Domestically financed	3.8	3.6	2.9	4.1	4.1	3.6	3.5	3.8	3.7	4.0
Foreign financed	3.8	3.4	1.4	4.0	2.9	3.7	3.3	3.9	3.5	3.6
Net lending	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Pending bills (change)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Drought Expenditures	0.1	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contingencies	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
<b>Balance (commitment basis excl. grants)</b>	-5.6	-5.8	-2.6	-7.4	-6.2	-4.9	-4.7	-4.7	-4.7	-4.9
Adjustment to cash basis	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Project grants	1.8	1.7	0.9	1.8	1.3	1.8	1.3	1.8	1.4	1.4
Programme grants	0.0	0.3	0.0	0.2	0.2	0.0	0.0	0.0	0.0	0.0
<b>Balance (cash basis including grants)</b>	-3.7	-3.8	-1.7	-5.3	-4.7	-3.1	-3.3	-2.9	-3.3	-3.4
Statistical discrepancy	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>FINANCING</b>	3.7	3.8	2.0	5.3	4.7	3.1	3.3	2.9	3.3	3.4
Net foreign financing	0.6	0.9	-0.1	1.9	1.4	1.2	1.5	1.3	1.7	1.9
Project loans	2.0	1.7	0.6	2.2	1.6	1.9	2.0	2.1	2.1	2.2
Programme loans	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Commercial financing	0.0	0.0	0.0	1.0	0.9	0.0	0.2	0.0	0.4	0.5
Repayments due	1.1	1.0	0.9	0.9	0.8	0.7	0.7	0.8	0.8	0.8
Change in arrears	-0.3	0.0	0.0	-0.4	-0.4	0.0	0.0	0.0	0.0	0.0
Rescheduling	0.0	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization proceeds	1.2	1.0	0.2	2.2	2.2	0.2	0.2	0.1	0.1	0.0
Bank restructuring costs	0.0	0.0	-1.1	-0.5	-0.4	0.0	0.0	0.0	0.0	0.0
Expenditure arrears securitization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure arrears securitization costs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing bank restructuring cost	0.0	-1.1	1.1	0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Restructuring Costs	0.0	0.0	0.0	-1.3	-1.3	0.0	0.0	0.0	0.0	0.0
Restructuring Financing	0.0	1.1	0.0	1.3	1.3	0.0	0.0	0.0	0.0	0.0
Net domestic borrowing	1.8	1.9	1.9	1.6	1.6	1.6	1.6	1.5	1.6	1.5
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Memo Items</b>	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic Debt	23.2	23.2	22.3	22.4	22.1	22.4	21.7	22.4	21.4	20.9
Domestic Debt (Net)	18.0	18.4	18.4	18.3	18.1	18.0	17.8	17.6	17.4	17.0
Nominal GDP	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Ministry of Finance  
**Notes:**  
 BOPA = Budget Outlook Paper  
 BSP = Budget Strategy Paper



Annex 4: Sector Ceilings -- Recurrent Expenditure (Ksh Million), 2007/08 - 2010/12

NAME OF SECTOR		RECURRENT EXPENDITURE				% SHARE OF TOTAL RECURRENT			
		2007/08 Est.	2008/09 Ceiling	2009/10 Proj.	2010/11 Proj.	2007/08 Est.	2008/09 Ceiling	2009/10 Proj.	2010/11 Proj.
PRODUCTIVE SECTOR	Gross	20,293	21,407	22,765	23,221	6.0%	6.6%	6.5%	6.4%
	A-I-A	1,047	742	1,976	1,441	0.3%	0.2%	0.6%	0.4%
	Net	19,246	20,665	20,789	21,779	5.7%	6.3%	5.9%	6.0%
PHYSICAL INFRASTRUCTURE	Gross	40,182	34,644	38,266	39,765	11.9%	10.6%	10.8%	11.0%
	A-I-A	31,539	25,089	27,744	29,374	9.3%	7.7%	7.9%	8.1%
	Net	8,643	9,555	10,522	10,391	2.6%	2.9%	3.0%	2.9%
EDUCATION	Gross	110,054	118,546	124,884	127,382	32.6%	36.3%	35.4%	35.1%
	A-I-A	98	101	106	109	0.0%	0.0%	0.0%	0.0%
	Net	109,956	118,445	124,778	127,273	32.6%	36.3%	35.4%	35.1%
HEALTH	Gross	22,745	25,209	30,124	30,726	6.7%	7.7%	8.5%	8.5%
	A-I-A	77	81	85	87	0.0%	0.0%	0.0%	0.0%
	Net	22,668	25,128	30,039	30,640	6.7%	7.7%	8.5%	8.4%
GOVERNANCE, JUSTICE, LAW & ORDER	Gross	55,879	49,791	53,800	56,453	16.5%	15.3%	15.3%	15.6%
	A-I-A	3,283	3,418	3,569	3,558	1.0%	1.0%	1.0%	1.0%
	Net	52,596	46,373	50,231	52,894	15.6%	14.2%	14.2%	14.6%
PUBLIC ADMINISTRATION	Gross	31,246	22,319	25,754	26,270	9.2%	6.8%	7.3%	7.2%
	A-I-A	1,199	1,308	1,372	1,399	0.4%	0.4%	0.4%	0.4%
	Net	30,047	21,011	24,382	24,871	8.9%	6.4%	6.9%	6.9%
MANPOWER AND SPECIAL PROGRAMMES	Gross	9,364	8,822	9,314	9,946	2.8%	2.7%	2.6%	2.7%
	A-I-A	123	67	71	129	0.0%	0.0%	0.0%	0.0%
	Net	9,242	8,755	9,243	9,817	2.7%	2.7%	2.6%	2.7%
NATIONAL SECURITY	Gross	45,730	43,200	45,849	46,766	13.5%	13.2%	13.0%	12.9%
	A-I-A	623	635	3,994	661	0.2%	0.2%	1.1%	0.2%
	Net	45,107	42,565	41,855	46,105	13.4%	13.0%	11.9%	12.7%
INFORMATION COMMUNICATION TECHNOLOG	Gross	2,303	2,270	1,954	2,502	0.7%	0.7%	0.6%	0.7%
	A-I-A	105	103	103	108	0.0%	0.0%	0.0%	0.0%
	Net	2,198	2,168	1,851	2,394	0.7%	0.7%	0.5%	0.7%
TOTAL	Gross	337,796	326,208	352,710	363,030	100.0%	100.0%	100.0%	100.0%
	A-I-A	38,094	31,544	39,020	36,866	11.3%	9.7%	11.1%	10.2%
	Net	299,702	294,664	313,690	326,164	88.7%	90.3%	88.9%	89.8%

Annex 5: Sector Ceilings -- Development Expenditure (Ksh million), 2007/08 - 2010/12

NAME OF SECTOR		DEVELOPMENT EXPENDITURE				SHARE OF TOTAL DEVELOPMENT			
		2007/08 Est.	2008/09 Ceiling	2009/10 Proj.	2010/11 Proj.	2007/08 Est.	2008/09 Ceiling	2009/10 Proj.	2010/11 Proj.
PRODUCTIVE SECTOR	Gross	15,023	14,141	14,790	16,179	7.4%	9.0%	9.5%	9.8%
	Loans	4,516	4,516	-	-	2.2%	2.9%		
	Grants	4,990	4,990	-	-	2.5%	3.2%		
	GOK	5,261	4,367	-	-	2.6%	2.8%		
	Local AiA	255	268	-	-	0.1%	0.2%		
PHYSICAL INFRASTRUCTURE	Gross	82,439	76,691	80,156	84,163	40.9%	49.1%	51.4%	51.2%
	Loans	30,408	30,273	-	-	15.1%	19.4%		
	Grants	10,558	10,203	-	-	5.2%	6.5%		
	GOK	38,702	33,306	-	-	19.2%	21.3%		
	Local AiA	2,770	2,908	-	-	1.4%	1.9%		
EDUCATION	Gross	9,666	12,685	10,170	10,678	4.8%	8.1%	6.5%	6.5%
	Loans	3,386	3,386	-	-	1.7%	2.2%		
	Grants	4,526	4,526	-	-	2.2%	2.9%		
	GOK	1,754	4,773	-	-	0.9%	3.1%		
HEALTH	Gross	11,609	12,191	12,800	13,440	5.8%	7.8%	8.2%	8.2%
	Loans	818	818	-	-	0.4%	0.5%		
	Grants	7,881	7,881	-	-	3.9%	5.0%		
	GOK	2,909	3,491	-	-	1.4%	2.2%		
GOVERNANCE, JUSTICE, LAW & ORDER	Gross	7,803	7,972	9,325	9,735	3.9%	5.1%	6.0%	5.9%
	Loans	-	-	-	-	0.0%	0.0%		
	Grants	2,051	2,051	-	-	1.0%	1.3%		
	GOK	5,751	5,924	-	-	2.9%	3.8%		
PUBLIC ADMINISTRATION	Gross	63,345	20,509	21,579	22,642	31.4%	13.1%	13.8%	13.8%
	Loans	1,876	1,876	-	-	0.9%	1.2%		
	Grants	4,955	4,955	-	-	2.5%	3.2%		
	GOK	56,514	13,677	-	-	28.0%	8.8%		
MANPOWER AND SPECIAL PROGRAMMES	Gross	7,709	8,032	6,229	6,505	3.8%	5.1%	4.0%	4.0%
	Loans	2,079	2,079	-	-	1.0%	1.3%		
	Grants	1,440	1,440	-	-	0.7%	0.9%		
	GOK	4,190	4,513	-	-	2.1%	2.9%		
INFORMATION COMMUNICATION TECHNOLOGY	Gross	4,057	4,085	944	1,035	2.0%	2.6%	0.6%	0.6%
	Loans	2,148	2,148	-	-	1.1%	1.4%		
	Grants	79	79	-	-	0.0%	0.1%		
	GOK	1,830	1,858	-	-	0.9%	1.2%		
TOTAL	Gross	201,651	156,306	155,993	164,378	100.0%	100.0%	100.0%	100.0%
	Loans	45,233	45,098	-	-	22.4%	28.9%		
	Grants	36,481	36,126	-	-	18.1%	23.1%		
	GOK	116,912	71,909	-	-	58.0%	46.0%		
	Local AiA	3,025	3,176	206,871	217,735	1.5%	2.0%		

**Annex 6: Sector Ceilings -- Total Expenditure (KSh million), 2007/08 - 2010/12**

NAME OF SECTOR	TOTAL EXPENDITURE				% SHARE OF TOTAL EXPENDITURE			
	2007/08 Est.	2008/09 Ceiling	2009/10 Proj.	2010/11 Proj.	2007/08 Est.	2008/09 Ceiling	2009/10 Proj.	2010/11 Proj.
PRODUCTIVE SECTOR	35,316	35,548	37,555	39,400	6.5%	7.4%	7.4%	7.5%
PHYSICAL INFRASTRUCTURE	122,621	111,335	118,421	123,928	22.7%	23.1%	23.3%	23.5%
EDUCATION	119,720	131,231	135,054	138,060	22.2%	27.2%	26.5%	26.2%
HEALTH	34,354	37,400	42,924	44,167	6.4%	7.8%	8.4%	8.4%
GOVERNANCE, JUSTICE, LAW & ORDER	63,682	57,763	63,125	66,188	11.8%	12.0%	12.4%	12.5%
PUBLIC ADMINISTRATION	94,591	42,828	47,333	48,911	17.5%	8.9%	9.3%	9.3%
MANPOWER AND SPECIAL PROGRAMME	17,074	16,855	15,543	16,452	3.2%	3.5%	3.1%	3.1%
NATIONAL SECURITY	45,730	43,200	45,849	46,766	8.5%	9.0%	9.0%	8.9%
INFORMATION COMMUNICATION TECHN	6,360	6,355	2,898	3,537	1.2%	1.3%	0.6%	0.7%
<b>TOTAL</b>	<b>539,447</b>	<b>482,515</b>	<b>508,703</b>	<b>527,409</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

**ANNEX TABLE 6: 2008/09 – 2010/11 MTEF BUDGET PREPARATION SCHEDULE**

<b>ACTIVITY</b>	<b>RESPONSIBILITY</b>	<b>DEADLINE</b>
Revise and update Ministerial Strategic Plans	Ministries/Departments	August 2007
Develop MTEF Guidelines	Treasury/MPND	August 2007
Launch of Sector Working Groups	Treasury	September 2007
Issue MTEF Guidelines	Treasury	September 2007
Capacity building on Programme Based Budgeting and Mainstreaming of Vision 2030 in the Budget	Treasury/MPND	September – October 2007
Undertake Ministerial Public Expenditure Reviews	Ministries/Departments	October 2007
Develop Budget Outlook Paper (BOPA)	Macro Working Group	October 2007
Stakeholders Consultation on BOPA	Treasury	October 2007
Submission of District Inputs to Ministry Headquarters	Ministries/Departments	November 2007
Finalize BOPA and present to Cabinet	Treasury	November 2007
Finalize MPEs	Ministries/Sector Working Groups	November 2007
Circulate approved BOPA to Accounting Officers	Treasury	December 2007
Finalize review of programmes and submit sector report to Treasury	Treasury	Last week of December 2007
Issue Circular on revised budget	Treasury/	December 2007
Finalization of Revised Estimates	Treasury	January 2008
Hold Sector Hearings	Treasury/MPND	February 2008
Publish Sector Reports based on PBB	Sector Working Groups	March 2008
Prepare the Budget Strategy Paper (BSP)	Macro Working Group	March 2008
Submit BSP to Cabinet for approval	Treasury	End march 2008
Submit BSP to Parliament	Treasury	April 2008
Circulate BSP to Accounting Units	Treasury	April 2008
Develop both ministerial itemized and indicative Programme Based Budgets	Ministries/Departments	April 2008
Submission of itemized and indicative Programme Based Budgets	Ministries/Departments	April 2008
Review and finalization of budget Estimates	Treasury	May 2008
Publish Indicative Programme Based Budgets	Ministries/Departments	May 2008
Submission of Budget Estimates to Cabinet for Approval	Minister for Finance	End May 2008
Printing of Itemized Budget Estimates	Treasury	End May 2008
Presentation of Budget To Parliament	Minister for Finance	Mid June 2008

## ANNEX II: MTEF INSTITUTIONAL ARRANGEMENTS:

### (a) Sector Composition

	Name of Sector	Sector Ministries/Agencies
1	Productive Sector	<ul style="list-style-type: none"> <li>• Agriculture</li> <li>• Livestock &amp; Fisheries Development</li> <li>• Trade &amp; Industry</li> <li>• Tourism &amp; Wildlife</li> <li>• Environment and Natural Resources</li> <li>• Lands</li> <li>• Regional Development Authorities</li> <li>• Cooperative Development and Marketing</li> </ul>
2	Education	<ul style="list-style-type: none"> <li>• Education</li> <li>• Science and Technology</li> </ul>
3	Health	<ul style="list-style-type: none"> <li>• Health</li> </ul>
4	Manpower and Special Programmes	<ul style="list-style-type: none"> <li>• Labour &amp; Human Resource development</li> <li>• State for Youth Affairs</li> <li>• State for National Heritage</li> <li>• Gender, Sports, Culture &amp; Social Services</li> <li>• State for Special Programmes</li> </ul>
5	Physical Infrastructure	<ul style="list-style-type: none"> <li>• Roads &amp; Public Works</li> <li>• Kenya Wildlife Services - Roads &amp; Airstrips</li> <li>• Housing</li> <li>• Water &amp; Irrigation</li> <li>• Local Government</li> <li>• Energy</li> <li>• Transport</li> </ul>
6	Governance, Justice, Law & Order	<ul style="list-style-type: none"> <li>• Immigration &amp; Registration of persons</li> <li>• OVP and Ministry of Home Affairs</li> <li>• Justice &amp; Constitutional Affairs</li> <li>• Provincial Administration &amp; Internal Security</li> <li>• State Law Office</li> <li>• Judiciary</li> <li>• Kenya Anti-corruption Commission</li> <li>• Kenya National Audit Office</li> <li>• National Assembly</li> <li>• Electoral Commission of Kenya</li> </ul>
7	Information Communication Technology	<ul style="list-style-type: none"> <li>• Information and Communication</li> <li>• Kenya National Bureau of Statistics</li> <li>• Cabinet Office (e- Government Dept.)</li> <li>• Finance - GITS</li> <li>• Environment &amp; Natural Resources (Dept. of Resource Surveys &amp; Remote Sensing)</li> </ul>
8	National Security	<ul style="list-style-type: none"> <li>• Ministry of State for Defense</li> <li>• National Security Intelligence Service</li> </ul>
9	Public Administration	<ul style="list-style-type: none"> <li>• State House</li> <li>• Cabinet Office</li> <li>• Ministry of State for Public Service</li> <li>• Foreign Affairs</li> <li>• Finance</li> <li>• Planning &amp; National Development</li> <li>• East African Community</li> <li>• Public Service Commission of Kenya</li> </ul>
10.	Macro Working Group	<ul style="list-style-type: none"> <li>• Ministry of Finance</li> <li>• Planning &amp; National Development</li> <li>• Central Bank of Kenya</li> <li>• Kenya Revenue Authority</li> <li>• Kenya Institute of Public Policy Research and Analysis</li> </ul>