ICPAK POSITION PAPER ON THE DIVISION OF REVENUE BILL 2018

23RD MARCH 2018

Background Information

The Constitution provides mechanisms for equitable share of revenue raised nationally, as well as intergovernmental transfers [1](Articles 202 and 203 of the Constitution). The revenue raised nationally shall be shared equitably among the two levels of government (vertical share) and among forty seven county governments (horizontal share) to enable them provide services and perform functions assigned to them as set out in the Fourth Schedule of the Constitution.

To this end, the Division of Revenue and the County Allocation of Revenue Bills are yearly statutes prepared to share resources equitably between the two levels of governments and among the forty seven county governments respectively.

Division of Revenue Bill 2018 (Vertical Division of Revenue)

The Division of Revenue Bill, 2018 is prepared in fulfillment of the requirements of Article 218 of the Constitution and section 191 of the Public Finance Management Act, 2012. Article 218(2) of the Constitution requires that the Bill be submitted to Parliament every year together with a memorandum explaining; the proposed revenue allocation set out in the Bill; the extent to which the Bill has taken into account the provisions of Article 203 (1) of the Constitution; and any significant deviations from the recommendations of the Commission on Revenue Allocation (CRA).

Objectives

a) Provide for the equitable division of revenue raised by the national government between the national and county levels of government for the financial year 2018/19 in accordance with Article 203(2) of the Constitution;
b) Provide for conditional additional allocations to county governments in accordance with Articles 202(2) and 187(2) of the Constitution.

[1] Article 203(2) For every financial year, the equitable share of revenue raised nationally that is allocated to county governments shall be not less than fifteen per cent of all revenues collected by the national government.

Key Highlights of the Division of Revenue Bill 2018

1. **Total County Allocation:**
   The Division of Revenue Bill, 2018 proposes to allocate county governments **Ksh. 372,741,930,770** in the financial year 2018/19, which comprises of an equitable share of Ksh. 314, 000,000,000 and an additional conditional allocation amounting to Ksh **58,741,930,770.**

2. **Conditional and unconditional allocations**:
   Pursuant to Article 202(2) of the Constitution, the Division of Revenue Bill 2018 allocates conditional funds as follows
   a. Leasing of medical equipment, Ksh. 9.4 billion
   b. Compensation for user fees forgone at 0.9 billion
   c. Level 5 hospitals at Kshs. 4.3 billion
   d. Supplement for construction of county headquarters 0.6 billion
   e. Rehabilitation of youth polytechnics 2 billion
   f. Allocation from Fuel Levy Fund (15%) at Ksh. 8.2 billion
   g. Loans and grants 33.2 billion.

3. **Public Debt**:
   The DORB 2018 allocates Ksh. 687.6 billion for payment of debt related expenses in 2018/19, up from 453.4 billion in the 2017/18 financial year.

4. **Difference with the CRA Recommendations**:
   The proposed division of revenue differs with the recommendations of the Commission on Revenue Allocation (CRA).
   a. Allocation to cater for establishment of two Regional Cancer treatment centres at Ksh. 5.0 billion
   b. Allocation of Kshs. 1 billion to ministry of health for central procurement of drugs through KEMSA

ICPAK RECOMMENDATIONS

<table>
<tr><th>No</th><th>Area</th><th>Issue of Concern</th><th>ICPAK recommendations</th><th>Justification</th></tr>
<tr>
<td>1.</td>
<td>Basis of revenue allocation</td>
<td>The DORB 2018 uses the 2013/14 Audited accounts as the most recent yet the Auditor General finalized and submitted to Parliament reports up to FY 2015/16

Table 1: latest audited revenue accounts
<table>
<tr><th>2013/14</th><th>2014/15</th><th>2015/16</th></tr>
<tr><td>932, 034 million</td><td>1,047,908 million</td><td>1,160,727 million</td></tr>
</table>
Source: Auditor General reports

We also note that for the past three years, Division of Revenue Act (DORA) has used the same 2013/14 audited accounts

Table 2: Division of Revenue base figures
<table>
<tr><th>DORA 2016</th><th>DORA 2017</th><th>DORB 2018</th></tr>
<tr><td>935, 653 million</td><td>935, 653 million</td><td>935, 653 million</td></tr>
</table>
Source: DORA 2016/7/DORB 2018</td>
<td>Use the most current audited accounts to determine revenue allocation.

The National Assembly must expedite its process of considering the audited financial statements as submitted by the Auditor General. We note that we're currently considering 2015/16 reports indicating a lag of two (2) financial years.

Need to amend the constitution to allow for Parliament to adopt the reports as finalized by the Auditor General and oversee implementation of the recommendations therein.</td>
<td>The use of 2013/14 figures affects fairness and equity in the revenue share. This disadvantage county governments given that any surplus accrues to the national government.

Article 203(3) grants National Assembly the mandate to receive and approve most recent audited accounts of revenue for purposes of revenue share.</td>
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<td>2.</td>
<td>Conditional and unconditional allocations-OSR</td>
<td>We note that a significant percentage of the vertical share has been allocated to conditional and unconditional grants in the financial year 2018/19 totaling to Kshs. 58.7 billion.</td>
<td>Own Source Revenue

Include a conditional grant to support counties</td>
<td>Improving OSR is important in achieving balanced budgets at the county level</td>
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<tr><td></td><td></td><td>However, the subject of own revenue generation has not been addressed by the Bill.

Own Source Revenue

We note persistent spikes in revenue collection across revenue streams and counties in the last ten years- 2007/08-2016/17. This indicates systemic weakness in the revenue sources available to the counties.</td><td>Own Source Revenue (OSR)- through measures such as investment in ICT.

Allocate resources to support identification of the underlying issues affecting local revenue collection

Incentivize good performance around Own Source Revenue (OSR). This can be realized by factoring OSR within the parameters of horizontal share.

Amend the law to provide for additional revenue streams for the county governments</td><td>Improved OSR would lessen county dependence on national transfers.</td></tr>
<tr><td></td><td></td><td>Leasing of Medical Equipment
We note a consistent allocation and double provision to the leasing of medical equipment as illustrated below;
<table><tr><th>2015/16</th><th>2016/17</th><th>2017/18</th><th>2018/19</th><th>Total</th></tr><tr><td>4.5</td><td>4.5</td><td>4.5</td><td>9.4</td><td>22.9</td></tr></table>
This is in line with the government “Big Four” agenda. However, the country needs to develop capacity to run the equipment.</td><td>We need sustained effort to train health professionals and specialists ahead of purchase.

Develop an overarching policy to guide the implementation of this item</td><td>For long term sustainability and building local capacity</td></tr>
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<tr><td>3.</td><td>Equalization Fund</td><td>We note the decline in allocation to the Equalization from Kshs. 7.7 billion in 2017/18 to Kshs. 4.7 billion in 2018/19 representing 39 % decline yet there is no status report on the level of improvement of services within the marginalized counties.

On average, national revenues have grown above 10% while the economy is projected to grow at 5.9%. There's thus necessity for the increase in budgetary allocation to the equalization fund.</td><td>Consider using an inflationary index when adjusting allocations</td><td>Article 204(2) of the Constitution anticipates that the national government shall use the fund to bring basic services in the marginalized areas to the quality enjoyed by the rest of the country. So far there is no report on utilization of the fund</td></tr>
<tr><td>4.</td><td>Public debt</td><td>We note the increase in allocation to public debt related expenses from 453.4 billion in the 2017/18 to Ksh. 687.6 billion in 2018/19 financial year. This translates to forty percent (40%) of ordinary revenues going into debt servicing.

<table>
<tr><th></th><th>2014/15</th><th>2015/16</th><th>2016/17</th><th>2017/18</th><th>2018/19</th></tr>
<tr><td>Ord. revenue</td><td>1032</td><td>1153</td><td>1306</td><td>1486</td><td>1688</td></tr>
<tr><td>Debt service</td><td>250.9</td><td>250.4</td><td>307.2</td><td>453.4</td><td>687.6</td></tr>
<tr><td>County allocatins</td><td>229.9</td><td>273.1</td><td>294.0</td><td>314.2</td><td>331.2</td></tr>
<tr><td>Bal for national allocation</td><td>218.7</td><td>249.8</td><td>277.6</td><td>259.9</td><td>164.3</td></tr>
</table>
In comparative terms, it can be demonstrated that the rate at which the economy is accumulating public debt is higher than the amount left for national government service delivery. This points to a mismatch between the fiscal policy and the broader economic policy</td><td>We propose:
Prudence in debt management;
Re-negotiate debt at concessionary terms covering both the cost and tenure of resulting debt</td><td>This implies that some of the resources meant for service delivery have been allocated to debt servicing</td></tr>
<tr><td>5.</td><td>County Government's Equitable Share</td><td>The growth factor used in adjusting the equitable share keeps changing each fiscal year. The growth factor declines from 6.7% in 2017/18 to 4.0% in 2018/19

<table>
<tr><th></th><th colspan="2">Proposed Growth factor</th></tr>
<tr><th>Year</th><th>CRA</th><th>National Treasury</th></tr>
<tr><td>2015/16</td><td>10.4%</td><td>10.4%</td></tr>
</table></td><td>Develop a common, consistent, reliable and predictable model in determining the growth factor over</td><td>To enable accurate predictions for revenue growth</td></tr>
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<tr><td></td><td></td><td><table><tr><td>2016/17</td><td>15.0%</td><td>7.8%</td></tr><tr><td>2017/18</td><td>15.0%</td><td>6.7%</td></tr><tr><td>2018/19</td><td>8.5%</td><td>4.0%</td></tr></table>
Source: IBP</td><td>the medium-term period.</td><td></td></tr>
<tr><td>6.</td><td>Incorporate CRA Recommendations</td><td>We note that the Division of Revenue Bill has not factored in CRA recommendations on two Regional Cancer Treatment centres and the National Cancer Drug Access programme.

According to the Kenya Cancer Network:
Cancer is the 3rd highest cause of morbidity in Kenya, that is, 7% of deaths annually
Estimated 39000 new cases of cancer each year with more than 27, 000 deaths.
Over 10,000 Kenyans travel to India annually to seek cancer treatment. Recently, it was revealed that 13 MPs in the current Parliament are among the thousands of Kenyans seeking cancer treatment in India.
Annually Kenyans spent approximately Ksh. 10 billion on cancer treatment, which translates to about 20% of budgetary allocation to the Ministry of Health.</td><td>While we agree with the CRA proposals, there's need to restructure the CRA proposal to support expansion of at least two level 5 hospitals into regional cancer facilities.</td><td>Need to develop local capacity to manage and treat cancer in Kenya.</td></tr>
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FCPA Julius Mwatu

Chairman, ICPAK