Division of Revenue between National & County Governments

By CPA Nathan Omayio

Presentation outline

- Constitutional Requirements
- Revenue flows –National to County
- Revenue Sharing Rationale
- Devolved revenues since 2013
- Some achievements and challenges
- Way forward

Constitutional provisions on Revenue Sharing

- Revenue raised nationally shall be shared equitably among the national and county governments (Article 202 (1))
- County governments may be given additional allocations from the national government's share of the revenue, either conditionally or unconditionally (Article 202(2))
- Criteria in determining Revenue Sharing (Article 203 (1))
  - the national interest;
  - any provision that must be made in respect of the public debt and other national obligations;
  - the needs of the national government, determined by objective criteria;
  - the need to ensure that county governments are able to perform the functions allocated to them

Criteria Cont'd

- the fiscal capacity and efficiency of county governments;
- developmental and other needs of counties;
- economic disparities within and among counties and the need to remedy them;
- the need for affirmative action in respect of disadvantaged areas and groups;
- the need for economic optimisation of each county and to provide incentives for each county to optimise its capacity to raise revenue;
- the desirability of stable and predictable allocations of revenue; and
- the need for flexibility in responding to emergencies and other temporary needs, based on similar objective criteria

Designated County Revenues

- Each year, not less than 15% of revenues raised nationally (Article 203 (2))
- Revenues referred to above shall be calculated based on the most recent audited accounts of revenue received, as approved by the National Assembly (Article 203(3))
- Equalization Fund –at least 0.5% of revenues collected by National Government (Article 204(1))
- Equalization Fund shall be used in provision of basic services including water, roads, health facilities and electricity to marginalised areas (Article 204(2))
- National Government may use equalization fund: (Art. 204 (3))

✓ If expenditure is approved by Parliament through an appropriation bill

✓ Either directly or indirectly through conditional grants to marginalised communities

Consultation on Revenues of Counties

- On Bills concerning sharing of Revenues, CRA shall consider the provisions and may make recommendations to the National Assembly and the Senate (Article 205(1))
- Any recommendations made by the commission shall be tabled in Parliament and each House shall consider the recommendations before voting on the Bill (205(2))

Division on Revenue

- Once every 5 years, the Senate shall by resolution determine the basis of allocating among counties the National revenue allocated to counties annually (Art. 217(1))
- In exercising this powers the Senate shall (Art. 217(2)):
  - ✓Take into account criteria set in Art. 203(1)
  - ✓Request and consider recommendations by CRA
  - ✓Consult the County Governors, CS for Finance and any other county organization
  - ✓Invite the publics, including professional bodies to make submissions
- Within 10 days after the Senate adopts the resolution, the Senate Speaker shall refer it to the Speaker of the National Assembly (Art. 217(3))

Division on Revenue cont'd

- Within 60 days after the Senate resolution is referred to the NA, then NA may consider the resolution and vote to approve it, with or without amendments, or reject it (Art. 217(4))
- If National Assembly (Art. 217(5)):
  - ✓ Does not take a vote in 60 days, the resolution passes without amendments;
  - ✓ A vote to amend or reject the resolution passed by senate MUST be supported by at least 2/3 of the members of the NA
- If NA amends the resolution, the Senate, at its option, may either;
  - ✓ Adopt the new resolution, or
  - ✓ Request the matter be referred to a Joint Committee of the two Houses of Parliament for mediation
- Any resolution passed under clause (5) shall be biding until another resolution has been passed

Annual Division and Allocation of Revenue Bills

- At least 2 month before the end of each financial year, there shall be introduced in Parliament (Article 218(1));
  - ✓ A Division of Revenue Bill –to divide the revenue raised by the National government among the national and county levels of government as per the constitution
  - ✓ A County Allocation of Revenue Bill –to divide among counties the revenues allocated to the county level of government
- Such Bills shall be accompanied by (Art. 218(2)):
  - ✓ an explanation of revenue allocation as proposed by the Bill;
  - ✓ an evaluation of the Bill in relation to the criteria set out in Article 203 (1); and
  - ✓ a summary of any significant deviation from the CRA's recommendations, with an explanation for each such deviation.

Transfer of Equitable Share

- A county's share of revenue from national government shall be transferred to the county without undue delay and without deduction, except when the transfer has been stopped under Article 225
- Instances in which transfer can be with-held;
  - ✓ Based on Recommendation of the CoB;
  - ✓ Material breach of the PFM laws
  - ✓ A vote by Parliament

Revenue Sharing Basis

- The 6th Schedule of the constitution provided that the 1st and 2nd determinations of the basis of the division of revenue among the counties were to be made at 3 year intervals.
- Subsequently at 5 years Interval.

First Formula (2013-2015)

The CRA initially carried out studies and recommended five parameters to be used as the basis for revenue allocation.

- population
- basic equal share
- poverty index
- county land area
- fiscal responsibility

•Selection of these parameters was broadly informed by:

- Constitutional stipulations
- Stakeholder consultations
- Causal connections
- Measurability
- International experiences.

Parameters and Rationale

Credibility. Professionalism. Accountability

❑ County Population

- The formula uses county population data obtained in 2009 from KNBS.
- *Reasons*

i. It is a simple, objective and transparent indicator of expenditure needs of counties.

ii. It ensures equal per person allocation of revenue allocated to all counties. It treats every Kenyan equally.

❑ County Poverty Index

- Uses official county poverty data from the KNBS of 2005/2006.
- Reasons

i. Poverty is linked to expenditure needs differentials of counties.

Parameters and Rationale cont’d

ii. Introduces a re-distributive element by treating every poor Kenyan equally

iii. Poverty data is less likely to be influenced by counties.

❑ **Basic Equal Share**

It has equalizing effect in that all counties are treated equally regardless of size or population.

Reasons

• All counties have some basic expenses that need to be met irrespective of their size e.g. salaries and others expenses for County Government administration.

Parameters and Rationale cont'd

❑ Fiscal Responsibility

Used in order to encourage counties to manage their fiscal resources prudently and optimize revenue-raising potential.

Reasons

- Upholds one of the key principles of public finance that, "public money shall be used in a prudent and responsible way."

Initially there was no established history and track record of financial management of county governments hence an equal weighting all counties at the same level.

Allocation

The weights attached to each of the parameters in the recommendation adopted by Parliament were:

- Population – 45%,
- Basic equal share – 25%,
- Poverty index – 20%,
- Land area – 8%, and
- Fiscal responsibility – 2%

Second Formula: 2016 - 2019

- Similar parameters in first formula adopted with addition of development factor which considered access to water, electricity and roads, to capture infrastructure needs of counties.
    - Population – 45%,
    - Basic equal share – 26%,
    - Poverty index – 18%,
    - Land area – 8%,
    - Fiscal responsibility – 2%, and
    - Development factor- 1%

Critique of the revenue sharing formula

- Generic use of Population for all Expenditure Needs -Different functions assigned to county governments have distinct expenditures measures.
- High Weight on Equal Share Allocation- County governments do not have similar and equal administrative expenditure needs.
- Inappropriate Measure of Poverty as poverty level keeps changing.
- Inappropriate Measure of Infrastructure- use of land area and excluding administrative costs.
- Insignificance of the Development Factor

Third Formula: 2020 - 2024

Objectives

- To enhance service delivery
- To promote balanced development
- To incentivise counties to optimise capacity to raise revenue
- To incentivise prudent use of public resources.

To enhance equitable service Delivery – 65%

The commission considered the following components:

- County health – 15%
- Agriculture – 10% (Maputo Declaration 2003)
- Other county services- 18% (pre-primary polytechnics, homecraft centres and childcare facilities, cultural activities, public entertainment and public amenities, natural resources and environmental conservation).
- Basic equal share - 20% (planning and governance)

To promote balanced development – 31%

- This considered the need to address poverty and provide infrastructure - roads. Parameters used:
    - ❖ Land Area - 8%
    - ❖ Poverty Levels -14 % (Kenya Integrated Household Budget Survey 2015/16)
    - ❖ Urban Services - 5% (Waste mgt, pollution, public works)
    - ❖ Roads - 4% (rural access index)

Incentive to counties to optimize capacity to raise revenue – 2%

- The constitution requires that the need for economic optimisation of each county and the need to provide incentives for counties to optimise their capacity to raise revenue be consider in allocating revenue (Article 203(i)).
- The allocation will change every year based on performance of county governments.

Incentive on prudent use of public resources – 2%

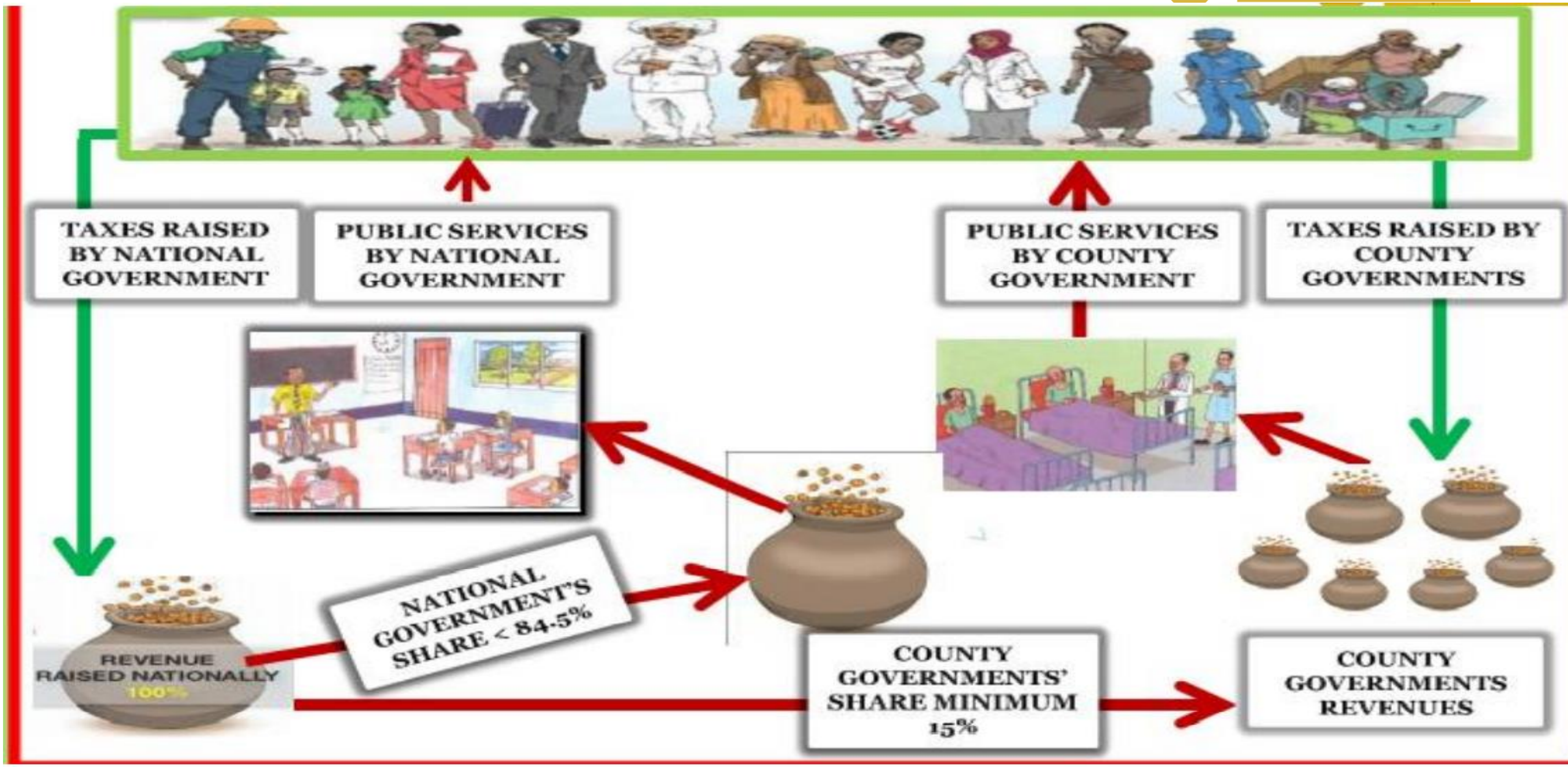
- This is to encourage prudence, fiscal responsibility, transparency and accountable governance by counties as per regulations.
- The fiscal prudence measure is a composite index that considers; external auditor’s opinion of a county’s expenditures and use of funds.
- The prudence parameter is weighted at two per cent and will change annually.

Current Criteria for Revenue Sharing among counties

- Passed by Senate on 17th September 2020

❑ Population	18%
❑ Health Index	17%
❑ Agriculture index	10%
❑ Urban index	5%
❑ Poverty index	14%
❑ Land Area	8%
❑ Roads index	8%
❑ Basic Share index	20%

Actual Revenue Flows



Objectives of the devolved funds

Constitution: Objects of Devolution

ICPAK
Credibility. Professionalism. Accountability

❑ Chapter 11 of the constitution: Article 174

- Promote democracy and accountable exercise of power
- Foster national unity -embrace diversity
- Appropriate powers of self-governance and participation of the people
- Rights of communities to manage their own affairs and development
- Protect and promote interests and rights of minorities
- Promote social and economic development
- Ensure equitable sharing of national & local resources
- Facilitate decentralization of services from Nairobi
- Enhance checks and balances –separation of powers

Constitution: Principles of Devolution

- Chapter 11 of the constitution: Article 175

- Democracy and separation of powers
- Reliable sources of revenues
- Gender parity –no more than 2/3 in representation of same gender

Credibility. Professionalism. Accountability

Devolution scorecard

The good …

Vision: A world class Professional Accountancy Institute.

The ugly …

ICPAK
Credibility. Professionalism. Accountability

County Revenues

How much money has gone into the counties 7 years of devolution?

Budget Analysis: 2013/14 - 2017/18

ICPAK
Credibility. Professionalism. Accountability

Budget & Expenditure Analysis -2013/14 -2017/18					
Budgets	2013/14	2014/15	2015/16	2016/17	2017/18
Aggregate budget	261.1	326.29	367.44	399.24	410.1
Recurrent Budget	160.5	181.38	208.2	240.89	271.32
Development Budget	100.4	144.91	158.62	158.36	139.18
Revenues					
Equitable share & conditional grants	193.4	229.264	269.412	299.751	328.85
Local Revenues	26.3	33.85	35.02	32.52	32.49
Balance b/f	4.3	41.67	36.07	37.19	25.75
Total revenues	224	304.784	340.502	369.461	387.09
Expenditure					
Overall absorption	169.4	258	303.47	319.06	303.83
Recurrent Exp.	132.8	167.56	195.72	215.71	236.94
Development Exp.	36.6	90.44	103.45	103.34	66.89
Absorption rates					
Overall absorption	64.90%	79.10%	80.40%	79.90%	78.50%
Recurrent Exp.	82.70%	92.40%	91.90%	89.60%	87.30%
Development Exp.	36.40%	62.40%	65.20%	65.30%	48.10%

Budget Analysis: 2013/14 - 2017/18

- ❖ Total revenues = Ksh. 1625.837 billion (1.625837 trillion)
- ❖ Total absorption = 1353.76 billion (1.35376 trillion)
- ❖ Recurrent Absorbed =948.73 million
- ❖ Development Absorbed = 400.72 million

 Absorption Rate

- ❖ Recurrent Exp. = 70.08%
- ❖ Development Exp. = 29.6%

Issues from the analysis

- From the budget analysis there are key notable observations
  - ✓ Low absorption of development expenditure
  - ✓ Insignificant growth on local revenues
  - ✓ Huge absorption of recurrent expenditure
  - ✓ Mainly recurrent expenditure is on personal emoluments and operations and maintenance*** (not shown since data not complete for all the years)
  - ✓ Equitable share from national government often disbursed in full & a large percentage of conditional grants*** (but there could have been delays in disbursements)
  - ✓ Significant pending bills at the counties remain unpaid, this has negatively impacted economic spending activities and thus economic growth

Options going into the future

- Counties must re-focus on county economies to grow own source revenues.
- Statistics suggest absence of investments in the county economies –otherwise there would be observable growth on own source revenues
- On data not presented –most of the recurrent expenditure is on personal emoluments, local and international travels and operations and maintenance (largely personnel welfare). This not sustainable and ultimately shall undermine growth into the future.
- Probably we shall need a radical re-design of county government structures and refocus on investments as opposed to consumption
- There is need for counties to reverse the trend of over reliance on the national government revenue allocation,
- It is however noted that the national government is making deliberate efforts to help counties improve their performance in generating revenue locally.
- It will be interesting to see how the Integrated Revenue Management System for internal county revenues and the proposed bill to regulate county levies will impact county revenues.

Thank you