COMMISSION ON REVENUE ALLOCATION

Promoting an Equitable Society

INEQUALITIES IN THE CONTEXT OF AFRICAS STRUCTURAL TRANSFORMATION:

FROM POLICY TO ACTION

EXPERIENCES OF THE COMMISSIONON REVENUE ALLOCATION

9TH AUGUST 2016

PRESENTATION OUTLINE:

1. THE COMMISSION

2. COMMISSION MANDATE

    1. VERTICAL EQUITY

    2. HORINZONTAL EQUITY

    3. EQUALISATION FUND

1.THE COMMISSION

Established under Article 215

Appointment of Commissioners by the president

chairman, 2NA, 5Senate; PS National Treasury

Mandate of the Commission:

Article 216 (1) mandates the Commission on Revenue Allocation to make recommendations concerning the basis for the equitable sharing of revenue raised by the National Government between the national and county governments; and among the county governments.

Further, Article 216 (2) mandates the Commission to make recommendations on other matters relating to financing of, and financial management by county governments; and to encourage fiscal responsibility.

Article 217(1) stipulates that every five years, the Senate shall determine the basis for allocating revenues among counties.

The Sixth Schedule, Section 16 further specifies that the first and second determinations of the basis of the division of revenue among the counties shall be made at three year intervals.

Article 217(2) provides that the criteria in article 203(1) should be taken into account in determining the basis of revenue sharing

1. VERTICAL EQUITY: EXPENDITURE ASSIGNMENT

- The Constitution-Article 6(2) establishes two levels of government that are distinct and interdependent.

- The functions of national and county governments are listed under the Fourth Schedule of the Constitution.

EXPENDITURE ASSIGNMENT

- Transition Authority was mandated to transfer functions within the transition period in line with Article 262 (15) of the Constitution.
  - Unbundling
  - Cost functions
  - Audit assets and liabilities

EXPENDITURE ASSIGNMENT

- National government is largely assigned policy, regulatory, technical assistance and capacity building functions
- County governments are mainly responsible for service delivery.
- Where a function cannot be explicitly distinguished as exclusive or concurrent, it is classified as residual and therefore a national government function.

EXPENDITURE ASSIGNMENT

Article 187 (2) of the Constitution also provides that, if a function is transferred from a government at one level to a government at the other level then arrangements shall be put in place to ensure that the resources necessary for the performance of the function are transferred in line with the principle of *'funds follow functions.*

Counties received funds and personnel from national and the defunct local authorities and have discretion to recruit their own staff: overstaffing/understaffing- hence the need for Staff rationalisation

EXPENDITURE ASSIGNMENT: National Govt

1. Foreign Affairs, foreign Policy and international trade
2. The use of international waters and water resources
3. Immigration and Citizenship
4. The relationship between religion and State
5. Language policy and the promotion of official and local languages
6. National defence and the use of the national defence services
7. Police services

EXPENDITURE ASSIGNMENT: National Govt

8.Courts

9.National economic policy and planning

10.Monetary policy, currency, banking, incorporation and regulation of banking, insurance and financial corporations

11.National statistics and data on population, the economy and society generally

12.Intellectual property rights

13.Labour Standards

14.Consumer protection, including standards for social security and professional pension plans

EXPENDITURE ASSIGNMENT: National Govt

15. Education Policy, Standards, curricula, examinations and grating of university charters

16. University, tertiary education institutions and other institutions of research and higher learning and primary schools, special education, secondary education and special education institutions

17. Promotion of sports and sports education

18. Transport and communications

19. National public works

20. Housing policy

21. General principles of land planning and the coordination of planning by counties

EXPENDITURE ASSIGNMENT: National Govt

22. Protection of environment and natural resources
23. National referral hospitals facilities
24. Disaster management
25. Ancient and historical monuments of national importance
26. National elections
27. Health policy
28. Agricultural policy
29. Veterinary policy
30. Energy policy including electricity and gas reticulation and energy regulation

EXPENDITURE ASSIGNMENT: National Govt

31. Capacity building and technical assistance to the counties

32. Public investment

33. National betting, casinos and other forms of gambling

34. Tourism policy and development

EXPENDITURE ASSIGNMENT: County Govts

1. Agriculture
2. County health services
3. Control of pollution
4. Cultural activities, public entertainment and public amenities
5. County transport
6. Animal control and welfare
7. Trade development and regulation
8. County planning and development

EXPENDITURE ASSIGNMENT: County Govts

9. Pre-primary education, village polytechnics, homecraft centres and childcare facilities

10. Implementation of specific national government policies and natural resources and environmental conservation

11. County public works and services

12. Fire fighting services and disaster

13. Control of drugs and pornography

14. Ensuring and coordinating the participation of communities and locations in governance at the local level

VERTICAL EQUITY: REVENUE ASSIGNMENT

NATIONAL

Article 209(1): Assigns the following revenues to national government:

1. **Income tax**
2. **Value added tax**
3. **Customs duties and other duties on import and export goods and**
4. **Excise tax**

COUNTIES

Article 209 (3) Assigns the following taxes to county governments:

1. Property rates
2. Entertainment taxes and
3. Any other tax that it is authorised to impose by an Act of parliament

Article 209(4) provides that the national and county governments may impose charges for the services they provide

COUNTY REVENUES: HIGH OWN REVENUE COUNTIES

No.	County	Equitable share	Own Source Revenue	Total	% of Own Source Revenue to Total Revenue
1	Nairobi City	11,337	11,500	22,837	50
2	Mombasa	4,534	2,493	7,027	35
3	Narok	4,613	1,639	6,252	26
4	Kiambu	6,510	2,111	8,621	24
5	Nakuru	7,080	2,200	9,280	24
6	Machakos	5,904	1,357	7,261	19
7	Kajiado	3,849	786	4,635	17
8	Kisumu	4,956	971	5,927	16
9	Uasin Gishu	4,528	801	5,329	15
10	Nyeri	3,881	681	4,562	15

COUNTY REVENUES: LOW OWN REVENUE COUNTIES

No.	County	Equitable share	Own Source Revenue	Total	% of Own Source Revenue to Total Revenue
36	Lamu	1,790	62	1,852	3
37	Vihiga	3,377	116	3,493	3
38	Siaya	4,357	143	4,501	3
39	Homa Bay	4,915	158	5,073	3
40	Nyamira	3,624	104	3,728	3
41	West Pokot	3,763	104	3,867	3
42	Garissa	5,035	131	5,165	3
43	Marsabit	4,527	99	4,626	2
44	Wajir	6,309	108	6,417	2
45	Turkana	9,141	127	9,267	1
46	Mandera	7,812	88	7,900	1
47	Tana River	3,476	33	3,509	1

1. INTERGOVERNMENTAL TRANSFERS

b) VERTICAL EQUITY

Article 216(1)(a) of the Constitution of Kenya mandates the Commission on Revenue Allocation (CRA) to make recommendations concerning the basis for the equitable sharing of revenue raised nationally between the national and county governments

SHAREABLE REVENUE

- Article 202(1) of the Constitution requires that the revenues raised nationally be shared equitably among the national and county governments.
- The shareable revenue excludes internal and external loans borrowed by the national government.

SHAREABLE REVENUE

- Section 2 of the CRA Act, 2011 defines shareable revenue as:

"all taxes imposed by the national government under Article 209 of the constitution and any other revenue (including investment income) that may be authorized by an Act of Parliament, but excludes revenues referred to under Articles 209 (4) and 206(1)(a)(b) of the Constitution".

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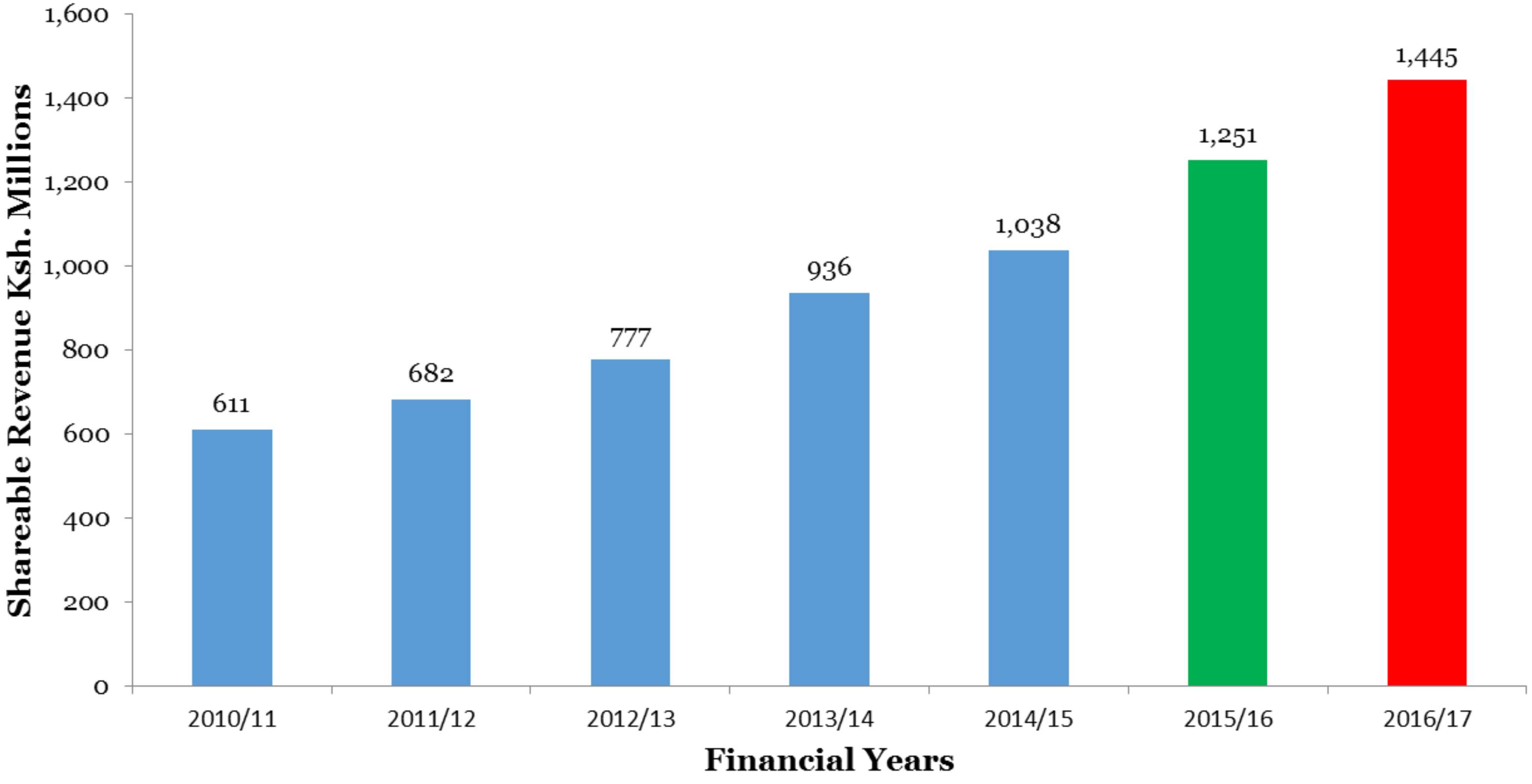
TREND OF SHAREABLE REVENUE IN KENYA



SHAREABLE REVENUE GROWTH FACTOR

NO.	YEAR	SHAREABLE REVENUE KSH. BILLIONS	GROWTH COMPUTATION	GROWTH %
	2011/12	682		
1.	2012/13	777	(777÷682)×100%=113.885	13.89
2.	2013/14	936	(936÷777)×100%=120.441	20.44
3.	2014/15	1,038	(1,038÷936)×100=110.942	10.94
			Total	**45.27**
			Average for three years (45.27÷3)	**15.09**

SHAREABLE REVENUE GROWTH FACTOR

Growth in Revenues for FY 2011/12 - 2014/15 (%)

Item	2011/12	2012/13	2013/14	2014/15	Ave
Total Revenues	3.7	32.9	11.6	24.6	
Of Which					
1. Sharable Revenue	11.7	13.9	20.4	10.9	
2. Non Shareable Revenue	-18.3	104.8	-6.9	62.0	

Source: Audited Exchequer Accounts, Auditor General's Reports

CRITERIA FOR SHARING REVENUE

Article 203 stipulates criteria to be taken into account in determining the equitable shares among the national and county governments. These are:

a)the national interest;

b)any provision that must be made in respect of the public debt and other national obligations;

c)the needs of the national government, determined by objective criteria;

d)the need to ensure that county governments are able to perform the functions allocated to them;

e)the fiscal capacity and efficiency of county governments;

CRITERIA FOR SHARING REVENUE

f) developmental and other needs of counties;

g) economic disparities within and among counties and the need to remedy them;

h) the need for affirmative action in respect of disadvantaged areas and groups;

i) the need for economic optimization of each county and to provide incentives for each county to optimize its capacity to raise revenue;

j) the desirability of stable and predictable allocations of revenue; &

k) the need for flexibility in responding to emergencies and other temporary needs, based on similar objective criteria.

DETERMINING THE SHARE DUE TO COUNTY GOVERNMENTS

	ITEM	2015/16 Ksh. Million	2016/17 Ksh. Million
A	EQUITABLE SHARE TO COUNTIES		
1	**Latest Audited Accounts**	**2012/13**	**2013/14**
2	Shareable Revenue based on Audited Accounts	776,858	935,653
3	**Equitable Share (Baseline)**	**259,775**	**259,775**
4	**Adjust by the three year average revenue growth of 15.09 percent**		**39,200**
5	Add Allocation for County Roads		27,790
6	Add Allocation for Public Participation	-	5,000
7	**Total Equitable Share to Counties5**	**259,775**	**331,765**
8	**Percentage Share to Counties**	**33.44%**	**34.53%**

FISCAL FRAMEWORK FOR FY 2016/17

Budget Items		**Ksh Billions**	**Percentage**
Projected Ordinary Revenues for 2016/17		1,444.9	**100%**
Of Which			
	Equalisation Fund	4,236	**0.3%**
	National Government	1,108.9	**76.7%**
	County Governments	331,765	**23.0%**

Minimum Allocation Requirement

Article 203(2) stipulates that for every financial year, the equitable share of revenue raised nationally that is allocated to county governments shall be no less than fifteen percent of all revenue collected by the national government.

Article 219 provides that a county share of revenue be transferred to the county without undue delay and without deduction.

HORIZONTAL EQUITY

The choice of a specific basis for a transfer system is guided by the ultimate objective of the transfer program:

Kenya's transfer system serves the following purposes:

1. Closing the vertical fiscal imbalance,
2. Equalizing fiscal conditions,
3. Redistribution to address marginalisation.

PARAMETERS USED IN THE FORMULA

Population

- a good measure of the expenditure needs of a County.
- It is a simple, objective and transparent measure that ensures predictability.
- Article 203 (1)(j) provides for stable and predictable allocations of revenues to counties.
- Provides for equal per capita transfers to all counties, thereby ensuring that people are treated equally, irrespective of which county they live

Equal Share

- guarantees a minimum funding for certain key functions, such as administrative costs of setting up and a running a government.
- based on the assumption that a number of expenditures are similar for all county governments.
- the basic equal share is not without challenges.
    - An exaggerated use of equal shares (high criteria weight) may lead to bad incentives and inefficiency in allocation as various county governments do not have the same expenditure needs due to differences in size as defined by population size, land area and geographical location.

Equal Share Cont'd: Challenges

- In addition, the use of equal shares as a factor in the allocation formula raises a question of basic fairness.

- If the equal share system is used as an allocation principle, regions with fewer residents would receive much larger transfers per person. This violates a basic principle of fairness in a democratic system of county government governance and may lead to pressure to establish new and non-viable county government units.

Poverty

- A poverty index provides a measure of welfare of the citizens. It is therefore a good proxy of developmental needs and economic disparities among counties.
- Use of this parameter in the formula guarantees allocations of revenue to disadvantaged areas which also happen to be the counties with the greatest need.
- This is in line with Article 203 (1)(f)(g)(i). More resources need to be given to counties with the greatest need

Land Area

- The use of the size of a county (Land Area) as a parameter in the formula for sharing of revenues is informed by the fact that a county with a larger area has to incur additional administrative costs to deliver a comparable standard of service to its citizens.
- However, it is important to note that the differences in the costs of providing services may increase with the size of a county, but only at a decreasing rate and that beyond a certain point, incremental costs may became negligible.

Fiscal Effort

- The formula recommends the use of fiscal effort as measured by the increase in county own revenue per capita for the financial years 2013/14 and 2014/15.
- This is to encourage fiscal prudence in accordance with the provisions of Article 216 (3) (c) which provides for provision of incentives for each county to optimize capacity to raise revenue

Development Index

- The development factor provides a measure of developmental needs of counties using data on counties' access to roads, water and electricity.

Formula: Additive

$$CA_i = 0.45PN_i + 0.26ES_i + 0.18PI_i + 0.08LA_i + 0.02FE_i + 0.01DF_i$$

Where:

CA_i Is revenue allocation of the $\boldsymbol{i}^{\text{th}}$ County; $\boldsymbol{PN_i}$ is Population Factor; $\boldsymbol{ES_i}$ is Equal Share Factor; $\boldsymbol{PI_i}$ is Poverty Gap; $\boldsymbol{LA_i}$ is Land Area Factor; $\boldsymbol{FE_i}$ is Fiscal Effort Factor;; and $\boldsymbol{DF_i}$ is Development Factor.

CRA Chosen Parameters and Weights

No.	Parameter	First Revenue Sharing Formula	Second Revenue Sharing Formula As Submitted to Senate
1	Population	45	45
2	Equal Share	25	25
3	Poverty	20	18
4	Land Area	8	8
5	Fiscal Responsibility	2	1
6	Development Factor	-	1
7	Personnel Emoluments Factor	-	2
	Total	100	100

Equalisation Transfer

- Article 204 establishes the Equalisation Fund in Kenya
- Amount paid into the Fund is equal to one half per cent of all revenue collected by the national government, audited and approved
- Funds are earmarked only for provision of basic services including water, roads, health facilities and electricity
- Transfer and meant to compensate counties to wide fiscal localities among localities

Allocation Formula for EF

- Based on the inverse of the county development index (CDI)
- the index is developed using weighted indicators for water, roads, health facilities and electricity and poverty
- Fourteen Counties were identified to receive the allocations from this fund
- In the graph below, the marginalized counties have the highest total revenues per capita

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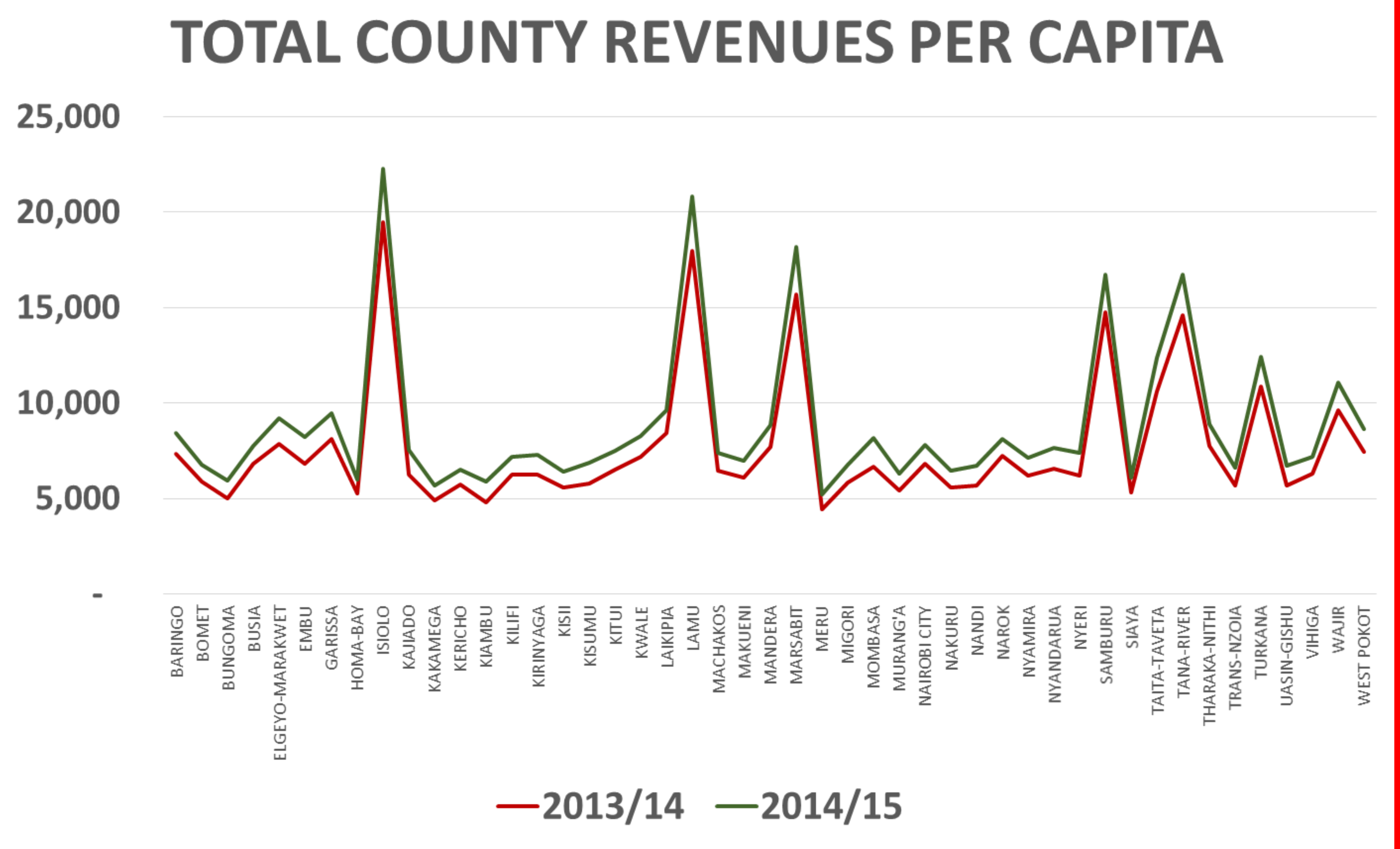

Equalisation Transfers

- This is a national government Fund (Article 204(2)
- The national government may use the EF directly or indirectly through conditional grants to counties in which marginalized communities exist
- Due to various political interest, the allocation to this Fund have not been disbursed for the last six years

ADDRESSING INEQUALITY

- IS A POLITICAL ECONOMY QUESTION:
  - WHAT DO OUR LEADERS WHAT?
  - WHAT DO THE CITIZENS WHAT?
  - PARADOX????
  - WHAT KIND OF POLICIES DO WE HAVE IN PLACE?
  - WHAT ARE THE PRIORITIES OF GOVERNMENTS
  - CAN WE HOLD OUR LEADERS ACCOUNTABLE?
  - SHOULD OUR CONCERN BE EQUALITY OR EQUITY

Promoting an Equitable Society

THANK YOU

16th October 2015