25/02/2014

MEMORANDUM

QUESTIONS AND CONCERNS ON DIVISION OF REVENUE 2014

This memo is divided into two parts. In the first part, we summarize key questions that we encourage Parliament to ask when considering the Division of Revenue Bill (DORB) 2014. In the second part, we go into more detail about these and other issues.

This memorandum will also be made available on our website at **www.internationalbudget.org/kenya**. For further information, please contact us at +254729937158.

Part I: Summary of Key Questions

The International Budget Partnership-Kenya encourages Parliament to ask the following 8 critical questions in debating the DORB 2014:

1. **Is there enough money going to regional hospitals to maintain current services?** Given that the conditional grant provided last year to Level 5 hospitals was cut from Ksh 10 billion to 3.4 billion, and given that there is no such grant this year, it is important to understand whether these hospitals are receiving adequate financing to sustain services.
2. **What is the basis of the reassignment of Ksh 7.1 billion in administrative expenses from national to county governments?** It appears that Treasury believes line ministries should have devolved more of their administrative costs to counties than they have agreed to in the past. (They were asked to to determine which costs should be devolved and which should remain at national level in 2012/13). However, no justification is provided for an adjustment of Ksh 7.1 billion, and it is unclear whether a thorough reassessment of the 2012/13 exercise was done. Given that the initial exercise was always meant to be provisional, it is important to insist on a full review of the 2012/13 figures to clarify responsibilities and costs and ensure each level of government has adequate funds.
3. **Are the country's priorities in 2014/15 the same as they were in 2012/13?** The baseline for determining the share of revenues going to national and county governments is still the cost of all functions that national government managed in 2012/13. In 2012/13, nearly 60 percent of the budget went to education, infrastructure and security, while less than 20

percent went to health and agriculture. Are those still the right priorities today?

4. **Why has the administrative cost of running counties escalated from roughly 14 billion last year to 30 billion this year (34 billion, including pension costs)?** The Treasury has provided inadequate justification for these figures, which are still lower than other figures provided by CRA, which estimates a cost of 48 billion (including pensions) for running county offices.
5. **What is the justification for the Ksh 108 billion allocation for "national strategic interventions" and what exactly are these funds for?** In justifying the share of revenues that is to be retained by national government, there is a large allocation for an undefined item, "national strategic interventions." Parliament should demand further information about these funds, which amount to nearly half the total allocated to counties. While Annex Table 7 of the Budget Policy Statement indicates the sectors for these interventions, it does not tell us what the interventions actually are.
6. **What is the location and timeframe for implementation of all of the donor-funded projects (totaling Ksh 13.9 billion) included in the DORB?** This information was not provided in last year's DORB either, and it makes it difficult to know what kinds of development projects are happening in each county and what the implications should be for county revenues and expenditures. While the County Allocation of Revenue Bill does provide some information about donor projects this year (which is an improvement), there is still no county by county breakdown of allocations or timeframe. This is reflected in the lack of detail in the section labeled "Allocation Criteria" for each donor-financed project in the CARB.
7. **Is the continuing increase in the allocation for debt repayment in the interests of the country, or would it be better to try to limit this spending to ensure funding for other services?** The allocation for debt repayment has increased rapidly from about Ksh 304 to 353 billion between 2012/13 and 2014/15. As a major deduction from the national share of revenues, this spending crowds out other priorities. Debt-financed growth should be balanced against other priorities, and it is Parliament's role to debate the proper balance.
8. **Why is Treasury proposing to distribute the 7.3 billion for rural electrification based on the equitable share ("CRA") formula, rather than the actual demand or need for rural electrification?** These funds will eventually go to the counties as part of their equitable share, but in the meantime, it would make sense to consider the specific need for electrification by county, which may differ from the formula (which does not measure it).

Part II: Detailed Analysis of Issues and Concerns in the DORB 2014

The International Budget Partnership-Kenya wishes to raise the following issues with regard to the Division of Revenue Bill (DORB) 2014 for the attention of Parliament:

1. **The 2014 Division of Revenue Bill eliminates the conditional grant contained in the Division of Revenue Act 2013 for regional hospitals without any explanation**. In 2013, it was recognized that the transfer of provincial hospitals to counties could lead to under-financing of these facilities. The logic was that regional hospitals serve people from many counties, but by transferring them to a single county (where they are located), that county would then be bearing the cost of services for users from many counties. This can lead to under-financing. Moreover, the distribution of funds through the equitable share formula

does not favor counties with regional hospitals, so they would tend to receive inadequate funding to maintain services at these facilities.

It was thought that these counties should therefore receive dedicated funding for regional hospitals through a conditional grant. In addition to the 7 provincial hospitals, 4 additional "high volume" Level 5 facilities were included in the list to be subsidized. The initial proposed grant in FY 2013/14 was Ksh 10 billion, which was reduced by Parliament to Ksh 3.4 billion. It was argued that those counties that host such facilities get disproportionate advantage from them and should be forced to use some of their own funding, while this would be topped up through the conditional grant. No research has been done to assess the impact on regional hospitals of this decision, but we are aware that a number of counties, such as Nyeri, did not in fact top up the funding for the health sector in their county budgets for 2013/14.

We urge Parliament to interrogate this issue further and ensure that adequate funds are to be made available for regional hospitals in this year's budgets. Although the issue remains unresolved, we note with concern that there is no conditional allocation for these facilities in this year's Division of Revenue. The assumption would seem to be that host counties will bear the full cost of these facilities. Without further analysis, this seems an extremely risky decision which could negatively impact service delivery at regional/high volume hospitals.

2. **The proposed allocation for counties is based on the incomplete and opaque functional assignment process that informed the 2013 Division of Revenue Act, rather than an updated and improved assessment of what each level of government should be doing.** The basis for the allocation of revenue is still the exercise conducted by Treasury in the 2012/13 budget estimates. This is implicit in Treasury's choice to use the 2013 Division of Revenue as the "baseline" for allocations (page 8 of DORB). This exercise, which led to the coding of certain functions that were then performed by national government as "devolved functions (98)," has never been fully validated. It was the responsibility of the Transition Authority to complete this exercise in a more comprehensive fashion, by fully unbundling all government services and determining, consistent with the Fourth Schedule of the Constitution, which level of government was responsible for which services.

   The failure to update this functional assignment process means that we cannot be sure that funds have been properly divided between the two levels, and that both national and county governments have an adequate share of funding. The use of the 2012/13 budget to assign functions is inadequate, because that budget was based on a set of inputs, rather than functions. There is not a clear alignment between the use of funds in 2012/13 and the functions assigned by the Constitution. This makes it very difficult to know if budget figures for the two levels accurately reflect what each level of government is supposed to do.

   For example, consider the provision of HIV services in the 2012/13 budget. The National Aids Control Programme was allocated Ksh 932 million in 2012/13. Of that, the 2012/13 budget coded Ksh 903 million as "devolved functions" for "specialized materials and supplies." Without knowing what those "specialized materials and supplies" are, we cannot know whether it was proper to devolve this amount to counties and to leave Ksh 29 million at national level or not.

In 2013/14, moreover, the national government allocated 288 million for National Aids Control Programme, a massive increase from the 29 million that was supposed to remain at national level. Most of those funds (about 250 million) were again for "specialized materials and supplies." Because specialized materials and supplies is not a function of government, it is impossible to know why these funds were retained at national level. It is possible that this reflects the fact that certain medicines must continue to be procured nationally or through donor arrangements of some kind. But there is no explanatory information available. This is one example of a problem that is rampant in the budget.

Parliament should demand more comprehensive information and a proper functional assignment to ensure that the estimation of county and national government financial needs is properly done. There is no good reason why no further work has been done since last year to improve upon the existing functional assignment process. This represents the failure of national institutions like the Commission on Revenue Allocation, the National Treasury, the Transition Authority and the national line ministries to perform their functions adequately to inform Parliament.

3. **Following on point 2, it is implicit in the DORB that national ministries allocated themselves administrative expenditures that were too high in the initial functional assignment process, which is why the Treasury proposes a reduction in national administrative costs of Ksh 7.1 billion, but no justification for this particular figure is provided**. Treasury does propose some adjustments to the baseline from 2013, most of which reflect adjustments in the estimated cost of running county administrations. While the bulk of these are based on salaries for new county workers to manage county systems, there is also a Ksh 7.1 billion allocation for "cost of administration transferred from national to county governments." This clearly indicates that national government administrative cost estimates were biased toward national line ministries in the original functional assignment.

   While this shift suggests that some revisions have been made to the functional assignment process carried out in 2012/13 (and discussed in point 2), there is no explanation for the 7.1 billion figure and it is impossible to know if this reflects a full revision to the original process or not. Parliament should request additional information to understand the basis for this figure, and to ensure that it reflects an adequate process of reassessment. It could equally well be either too low or too high if it is not the result of a full reassessment of the initial assignment of functions to ensure that responsibilities and costs are at the right levels of government. In their 2012 submission to Parliament, the CRA had proposed an 18 billion "contingency" fund, which it explained was based on the view that national government ministries might hold back on devolving certain functions/finances. Although there is no known basis for this figure, Parliament would do well to consider whether the true figure is really 7.1 billion as Treasury now suggests, or what the basis for any of these different figures is.

4. **The continued use of the 2012/13 budget allocations as a baseline is problematic, because it assumes that Kenya's priorities do not change from year to year; yet the**

Division of Revenue is the time to question whether the country should shift its priorities in the coming year. Even if the functional assignment process in 2012/13 was perfect, using it now would mean that we continue to have the same priorities as a country as we did in 2012/13. But the annual budget process is designed explicitly to allow us to debate that every year and to change our priorities over time. That discussion should happen now, when we debate the DORB, and not only later, during the debate over the full Budget Estimates.

In 2012/13, nearly 60 percent of the budget went to education, infrastructure and security, while less than 20 percent went to health and agriculture. For further details of the budget, please see the Annex Table 1 at the end of this memo. The key question Parliament must ask is if we want to continue to distribute the budget in these ways. If, rather, we decide to spend more on health or agriculture, then this would necessitate giving more shareable revenues to counties and less to national. On the other hand, if we believe security and infrastructure deserve more funding, the reverse would be true.

5. **The total cost of administration at county level has risen from 13.6 billion last year to Ksh 30.2 billion, in addition to pension payments at 4.2 billion for staff transferred from national to county government, but there is inadequate justification for these numbers.** At a time when government is discussing the need to control the wage bill, it is important that every increase in staff/administration costs be discussed rigorously. It is therefore important to have additional information on the exact calculations behind the increase in administrative costs.

   Parliament should demand more detailed information on the staff numbers and remuneration that are driving the increase in administrative costs at county level. This is also important because Treasury's figures are lower than the comparable estimates from CRA, which puts the cost of staff remuneration at 38 billion, plus another 10 billion in administrative costs, for a total of 48 billion. Parliament should satisfy itself as to the reasons for the difference between Treasury's 34.4 billion for staff, pensions, and administration, and CRA's figure of 48 billion covering the same.

6. **There is no proper justification for the Ksh 108 billion earmarked for "national strategic interventions" under the national share of revenues.** This line is allocated a figure of 90.9 billion in the 2013/14 budget, according to the DORB 2014, but it was not mentioned in the 2013 DOR Bill. In fact, this is a new item under "national interest" funding, which is one of the criteria that is required by Article 203 of the constitution: Article 203(1)a says that revenue should be shared in a way that advances the "national interest."

   Last year, in the DORB 2013, Treasury proposed a definition of national interest under which it included the cost of running all 3 arms of national government, as well as security spending, education, etc. It calculated the 2013/14 costs of these "national interest" functions at Ksh 351 billion (total). This year, in DORB 2014, it has increased its estimate of *2013/14 (not 2014/15, but the current year, 2013/14)* national interest spending to Ksh 473 billion (see Annex Table 2 below). Why should there be such a large difference in 2013/14 estimates of the cost of "national interest" allocations?

Of that difference of Ksh 122 billion, nearly Ksh 91 billion is due to the inclusion of "national strategic interventions." The rest is driven by an increase in the allocation for Teachers Service Commission, the inclusion of the Presidency as an office of national interest, and smaller increases in the budget for defense and Parliament.

Beyond the sudden introduction of the category of "national strategic interventions" into this table in 2013/14 estimates, there is also an increase of over 17 billion in this item between 2013/14 and 2014/15. That is an increase of roughly 19 percent, which is quite considerable for an ill-defined area of the budget that is now taking almost half of what counties are to receive under the DORB.

Parliament must ask whether the massive increase in "national interest" spending is in fact in the national interest, keeping in mind that money spent here is money taken from other priorities. From Annex Table 7 of the Budget Policy Statement, it appears that some of this money is for national programmes in health or agriculture (over Ksh 20 billion), but that requires further discussion to determine whether such funding should really remain at national level for functions that are to be implemented by counties. Beyond the broad sector allocations, there is no further detail about the contents of "national strategic interventions" in the 2014 Budget Policy Statement, or why these should be considered "national interest" spending.

7. **The DORB should be accompanied by an annex that lists all donor projects by counties, with allocations for this year and the next two years at least.** Last year, Ksh 16.6 billion was set aside for donor projects, and this year the figure has fallen to Ksh 13.9 billion. While IBP understands and agrees with the ongoing need to organize these as national allocations with county participation in planning and implementation, we believe that the list of projects and their costs must be made available each year to Parliament and the public. Last year, it appears that the figures were not properly calculated and information about the projects, and their lifespans, were not made available in a timely fashion to counties, the public or Parliament. Parliament cannot be kept in the dark about the distribution of these funds when deciding on overall allocations to counties. While the County Allocation of Revenue Bill 2014 does provide more information about donor-financed programmes than last year, it still does not provide county by county information nor any timeframe for these projects (are they for this year only, or for how many years will they continue in their current form?)

8. **The rising allocations for debt repayment should be debated by Parliament in order to ensure that the country has the proper balance between debt and current services.** According to the figures in this year's DORB, debt payment has risen by about 22 billion from last year, which is an increase of roughly 7 percent in the funds which national government needs to meet its obligations. This will take the total size of the budget going to debt payment to over Ksh 350 billion. This is a considerable increase since 2011/12, when it was only Ksh 210 billion. Since the share of the budget that must be set aside for debt payment and other national obligations must be catered for in the national share, this reduces the funding available for other services.

9. **It is not clear why Treasury proposes to distribute Ksh 7.3 billion in rural electrification funds to counties on the basis of the equitable share formula for**

counties, approved by Parliament in 2012. While this is not unreasonable, it would be preferable to consider whether the distribution of these funds should be done according to the need/demand for rural electrification, which may not be distributed across counties in the same way as the formula. Until this function is transferred to counties as part of the equitable share, it is not clear that there is any advantage to using a formula that does not take into account the demand for the specific service that is being financed.

Parliament should request from Treasury and other departments the relevant information to assess whether or not distributing rural electrification funds according to the equitable share formula is the most appropriate way of allocating this money to meet the need for rural electrification in different counties.

10. **Parliament should interrogate further the reasons for the basic disagreement between Treasury and CRA over the source of the baseline figures to be used for estimating the cost of all functions, leading to a difference of Ksh 40 billion.** Treasury states that CRA uses the forward estimates from the 2012/13 budget for 2014/15 as the baseline in calculating the allocation for functions. (In other words, the 2012/13 budget contains projections for 2013/14 and 2014/15. CRA has used the figures projected for 2014/15 that were contained in the 2012/13 budget.) Treasury argues that this is not appropriate, because the baseline should really be the political agreement reached in the 2013/14 budget, which deviates, as budgets usually do, from the projections the prior year.

    For Parliament, the relevant point is to understand the source of the differences in the figures generated by Treasury and CRA for the cost of functions. Neither has given adequate explanation for the source of their figures. For Parliament to adjudicate a difference of nearly Ksh 40 billion in estimated costs of delivering services, they must have more information about the source of the differences. Moreover, there is also a figure from the Intergovernment Budget and Economic Council (IBEC) mentioned of 238 billion total, which is in between the total figure from Treasury and total figure from CRA (279 billion) but with no explanation. It is problematic for figures to be discussed without reference to their basis in estimates of cost or other considerations.

ANNEX TABLES:

Table 1: 2012/13 Allocations for Major MDAs

FY 2012/13	Recurrent	Development	Total	Share	Cumulative Share
Education	209	27	236	21%	21%
Infrastructure + Energy	40	198	238	21%	42%
Security	158	8	166	15%	57%
Health	55	32	87	8%	65%
Ministry of Finance	21	39	60	5%	70%
Water and Irrigation	6	34	40	4%	74%
Agriculture	15	20	35	3%	77%
Parliament, AG, Judiciary and Constitutional Commissions	53	6	59	5%	82%
Total	555	360	915	82%	
Total MDAs	656	453	1109	100%	-
Other MDAs	99	90	189	18%	

Source: Budget Estimates 2012/13

Table 2:						
National Interest Allocation 2013/14 as per DORB 2013 v. DORB 2014						
Millions of Ksh	FY 2013/14	FY 2013/14	Difference	FY 2014/15	14/15-13/14 Difference	%
Source:	2013 DOR	2014 DOR		2014 DOR	2014 DOR	
Defense/NSIS	80,394	89,444	9,050	80,071	-9,373	-10.5%
Parliament	16,713	20,004	3,291	19,243	-761	-3.8%
Judiciary	15,188	15,700	512	17,687	1,987	12.7%
DPP	2,212	1,475	-737	2,144	669	45.4%
Police	73,479	67,386	-6,093	68,481	1,095	1.6%
TSC	145,373	165,739	20,366	162,345	-3,394	-2.0%
Other Commissions/Offices	8,799	8,949	150	8,902	-47	-0.5%
Elections	4,016	4,160	144	3,816	-344	-8.3%
Attorney General	4,954	2,947	-2,007	3,014	67	2.3%
National Strategic Interventions	0	90,984	90,984	108,211	17,227	18.9%
*Presidency**	0	5,988	5,988	4,383	-1,605	-26.8%
Total	**351,128**	**472,776**	**121,648**	**478,297**	**5,521**	**1.2%**
**Presidency was not allocated 0 Ksh in the budget in 2013/14, but it was not included in "national interest"*						

Source: Division of Revenue Bill 2013 & Division of Revenue Bill 2014