Sharing Revenue Among Kenya’s Counties: The first two formulas and beyond

Jason Lakin, Ph.D.
Country Manager
IBP Kenya
Presentation Highlights

• Why share revenues at all?
• What are the principles that should inform fair sharing?
• What did the CRA do in the first formula?
• How should the first formula be improved?
• What is in the proposed second formula?
• Views from public
• Your views
Why Share?
Why share revenues at all?

• Required by the constitution
• CRA to make a recommendation every five years (every 3 years for first 2) on how to share revenue equitably among the counties
• Recommendation to go to the Senate and be approved; sent to NA where it will be confirmed unless amended/rejected by more than 2/3
• But beyond the constitution…why share?
Why share? (continued)

- Subnational units have more responsibilities than they have resources
- This reflects the fact that the tax system is primarily national (PAYE, VAT, etc.) but many functions are subnational (health, agriculture)
- We could decentralize the tax system instead of “revenue sharing” and let every subnational unit run itself?
- Why not? Inefficient and inequitable
So what do we want to achieve?

• This already gives us a strong hint about what we want to achieve through revenue sharing
• Everyone across the country should have access to a basic level of services
• Subnational units are not forced to provide those services, but should have enough funding to do so
• Determine an objective basis for those minimum services
But that is not all...

• There are parts of the country where, even with an objectively fair amount of resources today would not be able to provide adequate services because of historical gaps

• This reflects in large part poor infrastructure (roads, water, electricity, public facilities)

• So we may need to use revenue sharing to fill these gaps as well
And don’t forget the process!

- Kenyans feel that resources have not been shared fairly in the past
- Revenue sharing process is meant to legitimate the decisions about who gets what
- Process elements: Transparency, open debate, decision approved by Parliament, etc.
- We are in the process of getting the process right...
  but have we decided what we would ultimately consider fair?
How were resources shared before?

Data suggests that:

• The “county” receiving the most (Nairobi) in 2012/13 got 11 times the county receiving the least (Lamu)

• On a per capita basis, though, the county receiving the most (Lamu) received about 6 times the county receiving the least (Mandera)

• Is that fair? Why or why not?
### Was this Fair?

<table>
<thead>
<tr>
<th>Counties</th>
<th>Total Allocation</th>
<th>Per Capita Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lamu</td>
<td>1.6 billion</td>
<td>15,741</td>
</tr>
<tr>
<td>Isiolo</td>
<td>2.1 billion</td>
<td>14,586</td>
</tr>
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<td>Nairobi</td>
<td>16.8 billion</td>
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Figures at KES 190 Billion shared across 47 counties
Principles of revenue sharing
3 Key Principles

• **(Fiscal) Need**: Give more to those who need more

  *Need is defined as what it costs to deliver ongoing services*

  *Need may also refer to filling historical gaps*

• **(Fiscal) Capacity**: Give less to those who have more; rich can pay more for themselves

• **(Fiscal) Effort**: Give more to those who work harder to advance themselves; do not take away from those who make an effort
What does the constitution say?

Article 203 says we must consider:

- **Fiscal capacity** and efficiency of counties
- Developmental and other **needs** of counties
- Economic **disparities** within and among counties
- Affirmative action for disadvantaged areas/groups
- Incentives for counties to **optimize own revenue**
The First Formula
KSH 190 Billion

FISCAL RESPONSIBILITY 2%

LAND AREA 8%

POVERTY 20%

BASIC EQUAL SHARE 25%

POPULATION 45%

The CRA Formula
First Formula: Principles

- Heavy focus on need (arguably 98%)
- Combines two core “need” ideas of giving counties enough to provide services (population, land area), and redistributing to counties with historical gaps (poverty)
- Fiscal Responsibility might have been a measure of effort, but never measured; no measure of capacity
- High basic equal share: Good measure of need? Measure of capacity/effort?
First Formula: Outcomes

• Let’s look at a table showing some outcomes compared to our previous table
## 2013/14 Equitable Share Allocations

<table>
<thead>
<tr>
<th>County</th>
<th>Total Before</th>
<th>Total After</th>
<th>Per Capita Before</th>
<th>Per Capita After</th>
<th>Actual Before PC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lamu</td>
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<td>15,601</td>
<td>11,978</td>
</tr>
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<td>Nairobi</td>
<td>16.8 billion</td>
<td>9.5 billion</td>
<td>5,350</td>
<td>3,029</td>
<td>4,393</td>
</tr>
<tr>
<td>Mombasa</td>
<td>6.2 billion</td>
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<td>6,565</td>
<td>4,047</td>
<td>5,391</td>
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<td>3,923</td>
<td>3,329</td>
</tr>
<tr>
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<td>2.8 billion</td>
<td>6.6 billion</td>
<td>2,731</td>
<td>6,386</td>
<td>2,242</td>
</tr>
</tbody>
</table>
Is this fair?

• Substantial redistribution toward marginalized areas like Mandera
• Reduction in areas that should have higher own capacity to generate revenue
• But...does not “hold harmless” for Nairobi/Mombasa, nor for Kisumu, Homa Bay, Nyeri, Embu.
• Are counties receiving enough to provide services? Not clear.
Improving the Formula
Improving the Formula

• Split two types of “need”: ongoing service costs and redistributive “catch-up” into two grants for transparency
• Service Delivery Transfer and Infrastructure Transfer
• Measures related to population weighted too little relative to basic equal share, but…
• Use a measure of “population needs” rather than population headcount
• Population Needs should measure need/demand for services such as health, agriculture, ECD, etc.
• This should result in “holding harmless”
International cases

• South Africa and Ethiopia both have formulas more closely linked to population, while using population needs.

• Perfectly linked to population = equal per capita transfer; degree of deviation from this is:

<table>
<thead>
<tr>
<th>Country</th>
<th>Correlation with Population (Total Allocations)</th>
<th>Dispersion Ratio of Top to Bottom Allocation Per Capita</th>
<th>Deviation from Equal Per Capita Transfer</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Africa</td>
<td>0.917</td>
<td>1.66</td>
<td>17%</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>0.999</td>
<td>3.56</td>
<td>11%</td>
</tr>
<tr>
<td>Kenya</td>
<td>0.861</td>
<td>5.30</td>
<td>25%</td>
</tr>
</tbody>
</table>
Measuring Population Needs

• For example, South Africa measures health facility visits and risk of disease by province to estimate health service costs
• They also look at school enrollment to measure education (provincial function)
• Highly correlated with population, but more legitimate and reasonable measures of service cost given population differences
Capacity and Effort

• For fiscal capacity, those with greater capacity should get less.
• But, we do not want to create incentives that reduce own revenue collection
• Usually done through an estimate of county tax potential rather than actual collections
• For now, we proposed using an estimate of biz permit/land rates revenue collected in the last year before devolution as a proxy for capacity
• No incentive effects because it is old data
Fiscal effort

- CRA has looked at this as “fiscal responsibility”
- We thought part of FR should be focused on transparency and compliance issues
- Couple this with a measure of fiscal effort, which looks at the percentage increase in revenue collection over time
- Measure of effort but using percentage does not punish poor counties
CRA Proposal for 2nd Formula
What has CRA proposed?

- Maintain population at 45%
- Maintain basic equal share at 25%
- Maintain land area at 8%
- Reduce poverty to 18%
- Reduce fiscal responsibility to 1%
- Introduce new parameter of development at 1%
- Introduce new parameter for personal emoluments at 2%
What CRA has NOT done:

- Made any major modification to the formula
- Introduce population needs as a primary measure of service delivery need
- Introduce a separate infrastructure transfer
- Introduce a proper measure of fiscal responsibility, capacity or effort
What CRA HAS done:

• Introduce some direct measures of both service and infrastructure need through the development parameter

• For example, access to electricity, sanitation, home deliveries, etc.

• While small, this does open the door to shifting toward more realistic and legitimate measures of need rather than poverty or population measures
Fiscal Responsibility?

• Split into two parts
• One part given equally for setup of PFM systems
• Why? Already a basic equal share for such things
• Other part gives counties that raise more own revenue more money
• Why? Counties that raise more are likely to have higher capacity and should get less
## Distribution of FR for own revenue

<table>
<thead>
<tr>
<th>County</th>
<th>Own Revenue Score</th>
<th>Receives (at Ksh 190 Bln Equitable Share)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nairobi</td>
<td>17.02</td>
<td>323 million</td>
</tr>
<tr>
<td>Nakuru</td>
<td>5.54</td>
<td>105 million</td>
</tr>
<tr>
<td>Mombasa</td>
<td>3.85</td>
<td>73 million</td>
</tr>
<tr>
<td>Kiambu</td>
<td>3.79</td>
<td>72 million</td>
</tr>
<tr>
<td>Mandera</td>
<td>1.30</td>
<td>25 million</td>
</tr>
<tr>
<td>Wajir</td>
<td>1.15</td>
<td>22 million</td>
</tr>
<tr>
<td>Marsabit</td>
<td>1.11</td>
<td>21 million</td>
</tr>
</tbody>
</table>
Personal Emoluments

• Why did CRA introduce this factor?
• Many counties inherited large staff components from the former local/provincial authorities and cannot retrench them
• Need for a national policy to deal with this, but in the meantime, need to cushion these counties
# Counties with high inherited staff costs (CRA figures)

<table>
<thead>
<tr>
<th>County</th>
<th>Inherited costs of personnel</th>
<th>PE per capita</th>
<th>CRA Factor for PE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nairobi</td>
<td>3.8 billion Ksh</td>
<td>Ksh 1200</td>
<td>8.06</td>
</tr>
<tr>
<td>Nyeri</td>
<td>1.8 billion Ksh</td>
<td>Ksh 2600</td>
<td>3.86</td>
</tr>
<tr>
<td>Nakuru</td>
<td>2.7 billion Ksh</td>
<td>Ksh 1700</td>
<td>5.67</td>
</tr>
<tr>
<td>Mombasa</td>
<td>1.5 billion Ksh</td>
<td>Ksh 1600</td>
<td>3.26</td>
</tr>
<tr>
<td>Kiambu</td>
<td>2.6 billion Ksh</td>
<td>Ksh 1600</td>
<td>5.58</td>
</tr>
<tr>
<td>National Average</td>
<td>1.0 billion Ksh</td>
<td>Ksh 1200</td>
<td></td>
</tr>
</tbody>
</table>
Comments on PE parameter

• Should be a conditional grant to discourage additional hiring; easier to put controls and to wind down

• Not clear if it is allocated properly; CRA data does not fully capture inherited staff

• As captured, counties with biggest wage bills get most, rather than counties with most skewed wage to population ratio.

• But counties with big wage bills because they have high population are already covered by population parameter
## Final Outputs (at 190 billion)

<table>
<thead>
<tr>
<th>County</th>
<th>Per Capita Before CRA</th>
<th>Per Capita 1&lt;sup&gt;st&lt;/sup&gt; Formula</th>
<th>Actual Before CRA</th>
<th>Per Capita 2&lt;sup&gt;nd&lt;/sup&gt; Formula 190 bln</th>
<th>Per Capita 2&lt;sup&gt;nd&lt;/sup&gt; Formula at 258 bln</th>
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<td>4,814</td>
<td>6,537</td>
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<td>8,074</td>
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Views from the public
Watch the movie!
Your views?