Module 3 ■ Revenue Sharing

2 HOURS 30 MINUTES

LEARNING OUTCOMES

By the end of this module, participants will have:

- reviewed the Commission on Revenue Allocation (CRA) formula, which determines how the funds allocated to counties are shared among the counties;
- reviewed and discussed principles and concepts related to sharing of resources;
- debated the advantages and disadvantages of the first approved formula;
- discussed the second revenue sharing formula; as approved by the Senate;
- discussed the reasoning behind the county distribution of resources to its sub-units, wards and sub-counties; and
- discussed alternative mechanisms for distribution of resources across the county.

Module 3 Session 1: Fairness and National Division of Revenue

KEY TAKEAWAYS

- ✓ SHARING OF REVENUE SHOULD BE BASED ON PRINCIPLES OF FAIRNESS SUCH AS NEED, EFFORT AND CAPACITY.
- ✓ THE COMMISSION ON REVENUE ALLOCATION (CRA) IS MANDATED TO RECOMMEND HOW NATIONAL REVENUES WILL BE SHARED AMONG THE COUNTIES.
- ✓ THE CRA FORMULA 2012 TOOK INTO CONSIDERATION THE NEEDS OF COUNTIES BUT DID NOT MEASURE EFFORT OR CAPACITY.
- ✓ THE CRA FORMULA 2016 ATTEMPTS TO LOOK AT NEED IN A NEW WAY BY INTRODUCING ONE NEW PARAMETER: THE DEVELOPMENT FACTOR.
- ✓ THE CRA FORMULA 2016 ATTEMPTS TO MEASURE FISCAL RESPONSIBILITY BY LOOKING AT THE ABILITY OF A COUNTY TO GENERATE ITS OWN REVENUE. THIS IS EXPLAINED AS A MEASURE OF EFFORT, BUT MAY ACTUALLY BE MORE OF A MEASURE OF CAPACITY.

TASK 3.1■REVIEWING REVENUE DISTRIBUTION BY THE NATIONAL GOVERNMENT

1 HOUR

TASK OBJECTIVES

- ❖ UNDERSTANDING PRINCIPLES OF FAIRNESS IN SHARING REVENUES ACROSS THE COUNTRY
- ❖ ASSESSING THE CRA FORMULA(S) AGAINST THE YARDSTICK OF THESE PRINCIPLES

RESOURCES NEEDED

- ✓ Flipchart paper, markers, and tape
- ✓ Infographic on county revenues available at http://www.internationalbudget.org/publications/sources-of-revenue-for-kenyan-counties-infographic/
- ✓ IBP Kenya/LightBox cartoon, Mwita's Dilemma, available at https://www.youtube.com/watch?v=AnQuLlxyUuM

HOW TO RUN THIS TASK

This session has two parts. Here is how to run the two parts:

Part one: Discussing Fairness (30minutes)

1. Begin by asking the discussion question: 'do you agree or disagree with the following statement: It is always fairest to give everyone an equal share. For example, suppose you had 100/= and you wanted to distribute it between four people, how would you go about it? What is the fairest way to do this? Is it to give 25 Ksh to each?" (PM, p. 112).
2. Ask participants to share their answers and to justify them while you note down their comments on a flip chart, particularly any principles they draw on.
3. Try to get them to state their answers in terms of general principles such as need, capacity and effort that are discussed in the cartoon (They may also mention others, such as efficiency). Do not give away everything from the cartoon, but start pushing in that direction so that at least the idea of need and maybe one other principle come out clearly.
4. Then have participants watch Mwita's Dilemma cartoon about revenue sharing.
5. Ask them whether the film has helped to clarify the principles for them, and whether they have questions or comments about any of this.

Part two: Reviewing the Commission on Revenue Allocation (CRA) Formula(30Minutes)

1. Discuss the key elements of the 2012 formula (PM, p. 112).
2. Use the infographic on division of revenues to explain how revenues have been shared under the 2012 formula,
3. Have a discussion on the second formula CRA recommended and approved in 2016, highlighting the small differences with the 2012 formula (introduction of 'development' parameter to assess need; refinement of fiscal responsibility parameter as an attempt to measure effort).

Emphasize: the parameters used in the (new and old) formula are only proxies to measure the need, effort and capacity of each county.

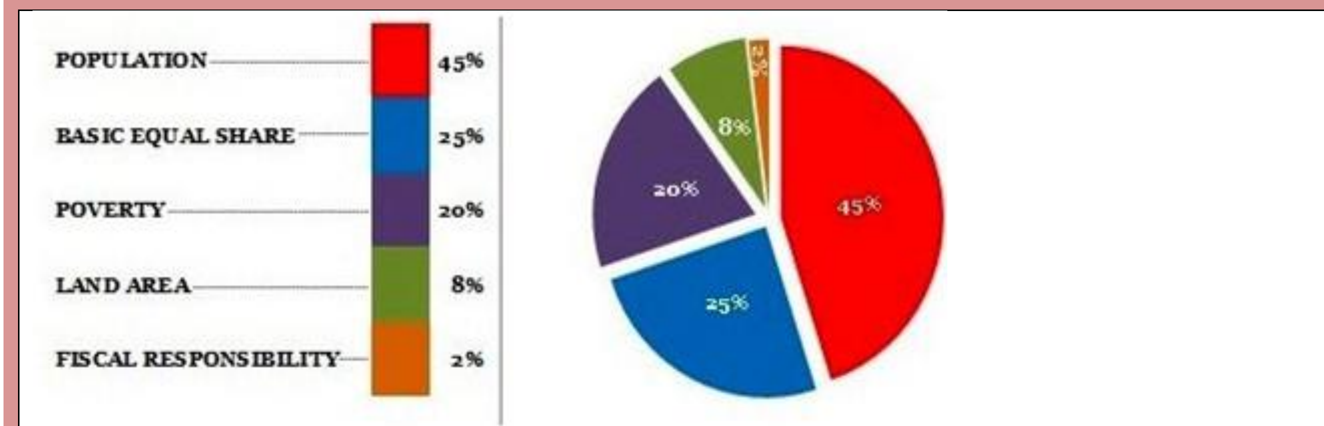
4. You can either allow participants 20 minutes to review the infographic and discuss it, or take 20-30 minutes to lead them through the infographic and ensure they understand it.
5. Then ask them whether the current formula is consistent with the principles discussed previously (need, capacity, effort) and why or why not.

6. Note down the key issues emerging from participants in this part.

BACKGROUND INFORMATION

Part 2: Reviewing the Commission on Revenue Allocation (CRA) Formula 2012

- The CRA is a constitutional body that is mandated to make recommendations about how to share resources between the various levels of government in an equitable way. The commission tables its recommendations in Parliament by January every year.
- The Commission on Revenue Allocation (CRA) recommended, and the National Assembly adopted, a formula for sharing resources among counties in 2012. The following picture summarizes the key parameters in the 2012 formula.



According to the CRA, the parameters serve the following purposes:

a. Population: intended to measure the needs of a county for expenditure on major services
b. Basic equal share: guarantees a minimum funding for certain key administrative costs (governor salary, operations of county headquarters etc.).
c. Poverty: This measures the development need and economic disparities among counties (using the poverty gap).
d. Land area: meant to compensate counties that incur additional logistical/administrative cost due to having larger areas.
e. Fiscal responsibility: this parameter incentivizes counties to maximize revenue collection.

- The formula determines how the money that is allocated for counties will be shared, but not how much money in total is to be shared. A county receives money based on its population, poverty, land area, and fiscal responsibility. You can see how the formula works below, looking at the first 11 counties from the County Allocation of Revenue Act 2013:

DIVISION OF REVENUE AMONG COUNTY GOVERNMENTS 2013-2014
SHAREABLE REVENUE: KSHS. 190,000,000,000

NO.	COUNTY	45% POPULATION (SHILLINGS)	20% POVERTY (SHILLINGS)	8% LAND AREA (SHILLINGS)	25% BASIC EQUAL SHARE (SHILLINGS)	2% FISCAL RESPON-SIBILITY (SHILLINGS)	100% TOTAL REVENUE (SHILLINGS)
1	BARINGO	1,230,260,196	666,964,954	259,138,703	1,010,638,298	80,851,064	3,247,853,215
2	BOMET	1,603,671,262	610,719,813	136,758,186	1,010,638,298	80,851,064	3,442,638,623
3	BUNGOMA	3,611,616,334	1,340,802,999	136,758,186	1,010,638,298	80,851,064	6,180,666,881
4	BUSIA	1,080,816,049	1,103,340,563	136,758,186	1,010,638,298	80,851,064	3,412,404,160
5	ELGEYO-MARAKWET	819,340,832	344,423,211	136,758,186	1,010,638,298	80,851,064	2,392,011,591
6	EMBU	1,143,123,935	435,711,208	136,758,186	1,010,638,298	80,851,064	2,807,082,691
7	GARISSA	1,379,733,130	710,950,923	1,039,260,300	1,010,638,298	80,851,064	4,221,433,715
8	HOMA-BAY	2,134,270,396	758,911,881	136,758,186	1,010,638,298	80,851,064	4,121,429,825
9	ISIOLO	317,316,918	230,722,751	596,054,306	1,010,638,298	80,851,064	2,235,583,337
10	KAJIADO	1,522,015,757	98,662,186	515,242,554	1,010,638,298	80,851,064	3,227,409,859
11	KAKAMEGA	3,677,423,046	1,609,840,164	136,758,186	1,010,638,298	80,851,064	6,515,510,758

Note: Fiscal responsibility was never measured under the 2012 formula, which is why all counties received an equal amount for that variable. This is because there was not sufficient data on county behavior to measure it.

CRA gave its recommendation for a new formula in 2014, and then revised this in 2015/2016. Below is a table showing the final proposal from CRA against the 2012 formula.

Table 1: Revenue Sharing Formula

No	Parameter	Current Formula	CRA Revised Recommendation
1	Population	45%	45%
2	Basic Equal Share	25%	26%
3	Poverty	20%	18%
4	Land Area	8%	8%
5	Fiscal Responsibility	2%	2%
6	Development Factor	-	1%
	TOTAL	100%	100%

Source CRA 2016

It is important to note that the broad parameters remain the same except for the 'development factor.' This new parameter considers access to water, electricity and roads and is meant to capture economic disparities and developmental needs of counties. The second formula also uses new data on the poverty gap for the poverty measure ('a measure of welfare' of citizens looking at 'the economic and environmental disparities that exist between counties' (Senate Hansard, 12/4/2016)), and measures fiscal responsibility by looking at increases in county own sources revenue per capita between FY 2013/14 and 2014/15. Below is a table showing how these parameters are measured.

Table 1: Measuring Each Parameter in the 2016 Revenue Sharing Formula

Parameter	CRA Recommendation (adopted by the Senate)	How each parameter is measured to obtain amount to be transferred to each county.
Population	45%	This parameter measures the county's share of the national population. The parameter ensures equal per capita allocation to all counties.
Basic Equal Share	26%	This parameter is based on the assumption that the administrative cost of running county governments is similar for all counties and therefore ensures an equal share to counties to run their governments. The amount to be distributed equally is divided into 47 equal parts.
Poverty	18%	This parameter uses the poverty gap measure for all counties. Poverty gap measures the extent to which individuals or households fall below the (rural/urban) poverty line. This is calculated using the Kenya Integrated Household Budget Survey 2005/06 and the 2009 Kenya Population and Housing Census.
Land Area	8%	This parameter measures the land area of a county as a percentage of the total land area in Kenya.
Fiscal Responsibility	2%	This is calculated from each county's annual revenue increase per capita. This seeks to incentive counties to maximize revenue collection and encourage fiscal prudence.
Development Factor	1%	This parameter considers water, electricity and roads to capture economic disparities and developmental needs of a county. [1]

The Senate adopted the above second basis for equitable sharing of revenue on Wednesday, 20h April, 2016 as recommended by CRA.[2]

Note: the parameters above are just proxies to measure and rank the need, effort and capacity of counties. These parameters however, are not accurate. Consider the case of need of health services for each county.

[1] It is not clear from the second submission by the CRA to the Senate how the relevant factors (water, electricity and roads) will be weighted to measure the amount that should go to a county but borrowing from the first submission on the second formula by CRA; it may take into consideration households with access to improved water, households with access to electricity and total unpaved roads in a county.

[2] Motion to adopt is available at Senate Debates, the Hansard April 20,2016 http://www.parliament.go.ke/the-Senate/house-business/hansard/item/download/2311_4372ebe2cc8edbb2aa42909e6e07fdfc
The Report on the Second Basis for Equitable Sharing of Revenue among County Governments by The Finance, Commerce and Budget Committee was tabled in Senate on the 30th March, 2016. The report which adopted fully the formula recommended by CRA The discussion on this report can be found in The Senate Hansard, 13th, 14th & 19th, April, 2016. Available at http://www.parliament.go.ke/index.php/the-Senate/house-business/hansard

While it is expected that there would be more people attending health facilities in an area of high population, it is not always true. The better way of measuring the need for health services would be comparing the number of people visiting health facilities in each county. Consider the example below: while Kule has a higher population Hapa has more people visiting health facilities and as such can be said that Hapa has more need for health services as it has a highest share of health facilities attendance (60%).

County	Population	Health Facilities Attendance	Share of Facilities Attendance
Hapa	5000	3000	60%
Kule	10000	2000	40%

Further the share of people attending health facilities may be refined to look at those coming to the facilities for treatment, preventive medication or training. This can be further broken down by looking at the prevalence of specific diseased in each county and so on.

The main point here is that due to unavailability of data and the need to ensure the sharing of revenue is not too complex, proxies are used to measure needs capacity and effort.

What does equity mean?

Sharing resources fairly means basing our decisions on widely accepted principles. This series of pamphlets looks at those principles and then applies them to practices of resource sharing in Kenya. How fair are our current approaches to sharing resources? You decide.

Most people share the idea that creating a more equal society may require us to treat people differently depending on their differing circumstances. This idea is the basis for the concept of equity. From this notion, we can develop some additional principles of fairness.

The need principle

The need principle states that people should be treated according to their needs. If we are distributing resources for health care, a person who is sick should receive more than a person who is healthy. This examples relate to the population's need for services and the immediate costs of providing them. For example, if it costs Ksh 100 to provide health care to one individual for a year, and we have 10 sick individuals in one area and five in another, we will want to give more to the area with 10 people. However, we may also need to take into account the starting position of the two areas. If the area with ten people has a well-stocked hospital, and the area with five people lacks a facility, then need would suggest we should give some additional funding to the area with fewer sick people to "catch up" to the area with more.

The capacity principle

Capacity is the idea that we should not do for people what they can do for themselves. A rich person can afford to pay for more of their own services than a poor person. Assuming that both a rich and a poor person are sick (they have the same need for health care), we would be likely to give more to the poor person because they have lower capacity to meet their needs.

The effort principle

Effort is the idea that we should reward, or at least not punish, people who do more for themselves with what they have. Consider two poor people who are both sick. They have the same needs and the same capacity. One of the poor people decides to sell his second cow to pay for his health care, while the other keeps both of his cows and requests help from the government. We would feel that the first person was making more of an effort to cater for his own needs given his capacity, while the second was not. We would be uncomfortable giving money to the second person while giving nothing to the first, because this would reward people who do less for themselves.

The efficiency principle

Capacity and effort both relate to how much people have and how much they can generate for their needs. Efficiency is about how people use the resources they have. Returning to our poor, sick farmers: one farmer may use the funds they have to purchase highly effective medicines at a low price, while another may choose to spend funds on ineffective procedures at a clinic known for over-charging patients. We would likely feel that we should not give as much money to someone who chooses to spend it on ineffective or over-priced services as we should to someone who uses money prudently.

The basic minimum principle

The principle of a basic minimum is that when we distribute funds, we may look at need, effort, capacity, efficiency, and even other principles not discussed here. After doing so, we might end up deciding that all of the funds should go to one person, or one community or one region. The basic minimum principle would tell us that we should first ensure that everyone gets some small share of the total before we distribute the rest according to other principles. Many people would feel that everyone should get at least a token from the resources available, so that everyone feels that they are part of the system and receive something from it.

The fair process principle

The fair process principle emerges from the realization that the principles above may conflict with one another, and that balancing them is a difficult task. There is no one right way to do this. For example, we might find that the person with the greatest needs makes the least effort. What should we do in this case? We will want to give them more due to their needs, but we will want to give them less due to their lack of effort. As there is no one correct solution to this problem, the only way to address it is to ensure that we make the decision through a fair and transparent process in which people give their reasons, these are thoroughly debated, and a decision that people may disagree with, but can agree is well-reasoned, is reached.

TASK 3.1
(QUESTIONS AND ANSWERS)

Part I: Discussing Fairness

> **Do you agree or disagree with the following statement: It is always fairest to give everyone an equal share? Supposing you had 100Ksh, how would you distribute it among four people? 25 Ksh each or in some other way?**

Usually, it is not fair to treat people equally without considering the differences between them. We need to take into consideration differences in fiscal need, fiscal capacity and fiscal effort.

a. **Need:** This principle can mean at least two different things: ongoing needs (more people=more need for services) and historical needs (poor access in past=more need today to catch-up to service levels of others). It is not always easy to measure need, but we generally want to look beyond just the number of people to their actual demand for services. For example, two populations of 100 people might have similar needs, but one might be sicker than the other, implying higher needs.

b. **Capacity:** This principle looks at the fiscal ability (measured in available resources) to meet the needs of people. It should be a measure of the capacity of a people or a unit to generate resources, reflecting their natural endowments, their size, the size of the economy, etc. Fiscal capacity is not about ability to spend, but capacity to generate. For this reason, those with lower capacity are generally given more to compensate them.

c. **Effort:** This principle prescribes that those who show fiscal effort should be rewarded to encourage then to collect more and use resources more efficiently. Effort and capacity are often confused. Capacity is more innate and changes very slowly. Effort is more about behavior. We want to incentivize good behavior, meaning raising more revenue from a given economy. So two units may have similar capacity, but one makes more of an effort to generate revenue than the other and should be rewarded.

Note: People often think of capacity as 'spending capacity', or the capacity to use revenue properly. Capacity to spend is actually more similar to efficiency, described below. Capacity and effort in our terms both relate to how people or counties raise revenue, rather than how they spend it. The easiest way to think about it is to think of a rich family and a poor family: the rich family has more capacity to pay. Then think of two rich families. Both have the same capacity to pay, but now one makes more of an effort to actually work and increase its revenue than the other. They have the same capacity but different effort.

Other principles for sharing revenue include

d. **Basic minimum**: this suggests that everyone deserves at lease something from pooled resources
e. **Fair process:** creating a balance of the competing principles based on an open, reasonable and legitimate process
f. **Efficiency**: this reflects the belief that resources given to different people or places do not always yield the same benefit to society. Thus it may make sense to give more to areas/people that are more efficient for the good of society. However, this can also end up privileging those who are already privileged, so it is usually coupled with requirements for some redistribution of the efficiency gains.

Part 2: Are the 2012 and 2016 CRA formulas consistent with these principles?

The 2012 formula focused only on need and largely ignored capacity and effort (fiscal responsibility was initially intended to look at effort but was not measured). The measures of need are fairly rough.

The 2016 formula brings in a refined measure of need through a very small development parameter. It also defines fiscal responsibility by looking at per capita revenue changes in time. While this is supposedly a measure of effort, it actually confuses capacity and effort. Because it is not calculated in percentage terms, the counties that have the largest economies and largest tax capacity today are the ones who tend to benefit. For example, a county collecting 10 Ksh per person that increases this to 20 Ksh, will have only increased by 10 Ksh per person, but a 100% increase from their original base. This requires more effort than a county that increases from Kshs. 1000 per person to 1015Ksh per person, but the way CRA has measured it, the latter county would be rewarded with a greater allocation.

Note: Not everything can be dealt with through a single formula. Some counties may have backlogs that need to be dealt with through a conditional grant. The Equalization Fund in the constitution is one example where the drafters believed it was better to set aside separate funds to deal with development backlogs

FURTHER READING:

i. Jason Lakin, "Revising the county allocation formula," Sunday, July 27 2014 http://www.nation.co.ke/oped/Opinion/Revising-the-county-allocation-formula/-/440808/2399192/-/150f9rt/-/index.html

ii. Jason Lakin and John Kinuthia, "Effective, Fair, and Transparent Sharing of County Revenues," September 2014 http://internationalbudget.org/wp-content/uploads/Kenya-County-Revenue-Sharing.pdf (Simplified version)

iii. Submission by IBPK: Issues And Recommendations Related to the Second Formula For Revenue Sharing Among Counties In Kenya http://www.internationalbudget.org/wp-content/uploads/CRA-Submission.pdf

iv. IBPK/ LightBox movie, "A Measure of Fairness" https://www.youtube.com/watch?v=0L-SRYKWTmA

v. CRA, "Brief on the CRA Recommendation on the Basis Concerning Equitable Sharing of Revenue among the County Governments: Senate Committee on Finance Commerce and Economic Affairs," November 19th 2015 http://www.crakenya.org/wp-content/uploads/2015/11/CRA-Second-Submission-on-Second-Formula-Senate-committee-on-Finance-Nov-19th-2015.pdf