KENYA: ANALYSIS OF THE COMMISSION ON REVENUE ALLOCATION'S (CRA) 2016/17 RECOMMENDATIONS ON SHARING REVENUE

February 2016

BACKGROUND

Six months before the start of each financial year (by January 1) the Commission on Revenue Allocation (CRA) must submit its recommendations to the National Assembly on how to share revenue raised nationally between the national government and the counties, as well as the criteria that will be used to share conditional grants among the counties. These recommendations are the first step in determining how much counties and the national government will have to fund their budgets for the coming financial year.

The annual recommendations provide two key types of information:

1. Changes over time in the total amount of money available for sharing between the two levels of government and the proposal for national and county shares in the coming year
2. Proposals for the type, amount, distribution and other conditions associated with additional conditional grants to counties to be funded from the national share

The CRA recommendations are not final. The final decision on how revenue will be shared is made by the National Assembly through the Division of Revenue and County Allocation of Revenue Acts. These are supposed to be approved by March 15 every year.

SHARING REVENUE BETWEEN THE TWO LEVELS OF GOVERNMENT IN 2016/17

At the heart of the annual CRA recommendations is the estimate of national "shareable" revenue and how much will go to the two levels of government. Shareable revenue is mainly tax revenue collected locally, sometimes also called "ordinary revenue". This comprises income, VAT and other taxes collected by national government. Shareable revenue does not include loans or grants.

Shareable revenue in 2016/17 is projected to be Ksh 1.445 trillion. To inform its 2016/17 recommendations, CRA has examined growth in shareable revenue. The proposed share for counties is based on a revenue growth factor that is derived from averaging the growth in shareable revenue between 2012/13 and 2014/15 (the last three years for which we have complete data). See Table 1 below.

TABLE 1: GROWTH IN SHAREABLE REVENUE FROM PREVIOUS YEAR

	2011/12	2012/13	2013/14	2014/15	Average
Shareable revenue (Ksh Billions)	682	777	936	1,038	-
Growth in shareable revenue	-	13.9%	20.5%	10.9%	15.1%*

Source: Recommendations on Sharing of Revenue 2016/17 (CRA)

Note: *CRA uses 15.09 percent as the average, a minor difference that appears to be due to rounding

The average growth figure of 15.09 percent is used to increase the size of both the equitable share and conditional grants to the counties in 2016/17.

CRA proposes to allocate 23 percent of 2016/17 shareable revenue to counties as their equitable share. The equitable share is the main funding source for counties: a single, unconditional block grant to carry out devolved functions. National government will retain 76.7 percent of the shareable revenue, while the remaining 0.3 percent will go to the Equalisation Fund, a conditional grant to improve services in marginalized areas.

TABLE 2: SHARING SHAREABLE REVENUE 2016/17 (KSH BILLIONS)

	Total Shareable Revenue	National	County
Ksh (Billions)	1,444.90	1,108.90	331.8
Percentage	100%	76.70%	23%

Source: Recommendations on Sharing of Revenue 2016/17 (CRA)

The 23 percent share of funding to counties in 2016/17 is up from 21 percent in CRA's 2015/16 recommendations. The main reason for this increase is an aggressive stance by CRA on the issue of funding for county roads. CRA points out that the Kenya Rural Roads Authority and the Kenya Urban Roads Authority are still carrying out devolved functions and recommends that their budgets (nearly Ksh 28 billion, based on 2016/17 projections from the current year budget) be included in the equitable share to counties. An additional Ksh 5 billion for public participation at county level also helps to bring the final share for counties up from 21 percent in 2015/16 to 23 percent in 2016/17.

TYPE, AMOUNT, AND DISTRIBUTION OF CONDITIONAL GRANTS

The CRA recommendations discuss both existing conditional grants and proposed new grants. There are five existing conditional grants from 2015/16 (see Table 3). CRA recommends that all of these be maintained in 2016/17 and the revenue growth factor of 15.09 percent discussed above should be applied to four of the five grants. The allocation to counties for the Road Fuel Levy Fund is based on actual fund collections from the previous year. In 2016/17, the amount of money for this grant will increase by 44 percent (see Table 3), reflecting the fact that this fund grew much faster last year than ordinary revenue collection.

TABLE 3: RECOMMENDED ALLOCATIONS FOR EXISTING CONDITIONAL GRANTS IN 2016/17

Item	2015/16 (Millions)	2016/17 (Millions)	% Increase in Allocation
Level 5 Hospitals	3,600	4,143	15%
Free Maternal Health Care	4,298	4,947	15%
Compensation for user fees forgone	900	1,036	15%
Leasing of medical equipment	4,500	5,179	15%
Road Fuel Levy Fund (15% of Actual Revenue for the Fund in 2014/15)	3,300	4,756	44%
Total	**16,598**	**20,061**	**21%**

Source: Recommendations on Sharing of Revenue 2016/17 (CRA)

CRA proposes five new conditional grants in 2016/17 (see Table 4), bringing the total number of proposed conditional grants to ten. This is a major shift by CRA, which largely opposed conditional grants in its first two recommendations (2013/14 and 2014/15). In 2015/16, CRA recommended that counties receive a total of Ksh 65 billion spread across eight conditional grants. However, the CRA did not indicate the mechanism for distributing these grants nor the criteria for sharing them. Therefore, this is the first year that CRA has fully embraced its role in proposing and defining conditional grants.

TABLE 4: RECOMMENDED ALLOCATIONS FOR NEW CONDITIONAL GRANTS IN 2016/17

New Conditional Grants	2016/17 (Millions)
Personnel emoluments for devolved staff	5,196
Construction of headquarters in five counties	4,000
Rehabilitation of primary and secondary schools	5,000
Establishment of County Emergency Funds	5,196
Rehabilitation of village polytechnics	6,300
Total	**25,692**

Source: Recommendations on Sharing of Revenue 2016/17 (CRA)

The combined allocation for the two sets of grants is Ksh 45.8 billion. This is 30 percent lower than the Ksh 65 billion that CRA recommended last year, but it is 176 percent higher than the actual allocations for conditional grants in 2015/16 (see Table 3).

ISSUES WITH THE RECOMMENDATIONS

There are several issues that are not addressed by the CRA recommendations. CRA has not indicated the distributional criteria for existing grants. As we have pointed out previously, the basis for distributing those grants is not always clear or equitable. The distribution of the medical leasing scheme on an equal basis across counties does not consider the different health needs or fiscal capacity of counties. The distribution of road maintenance funds using the equitable share formula sees counties with fewer roads receive more money for road maintenance; while road construction funds should perhaps be redistributive, the same does not hold for maintenance grants. The distribution criteria for the Level 5 hospitals have changed several times with no clear rationale.

CRA does indicate distributional criteria for each new proposed grant, though the justification is often weak. Table 5 below shows the rationale and the criteria for sharing each grant proposed by CRA. In general, CRA fails to justify the specific distribution of each grant.

TABLE 5: RATIONALE AND SHARING CRITERIA FOR CONDITIONAL GRANTS IN 2016/17

Grants	Rationale	Sharing Criteria
Level 5 Hospitals	Grants are meant to benefit the health referral hospitals whose catchment areas go beyond the boundaries of a specific county.	Funds to be shared based on the percentage bed occupancy per hospital in 2014.
Free Maternal Health Care	-	Funds to be shared based on county's percentage contribution to total number of maternity deliveries during the FY 2014/15.
Compensation for user fees forgone	The grant was introduced to compensate the counties for the revenue from the user fees charged by health centers and dispensaries.	Shared using annual consolidated facility outpatient attendance.
Leasing of medical equipment	Set up to facilitate the purchase of modern specialized health care equipment in at least two health facilities in each county.	Equal allocations per facility and distributed to two facilities per county.
Road Fuel Levy Fund (15% of Actual Revenue for the Fund in 2014/15)	Established to cater for the maintenance of public roads, including the former local authority unclassified roads.	To be allocated to county governments based on the equitable share formula among county governments.
Personnel emoluments for devolved staff	A short term stop gap measure, to cushion counties against high expenses on salaries as we await the results and implementation of the staff rationalization program.	To be shared proportionately based on the payroll of the devolved staff.
Construction of headquarters in five counties	To help five counties construct county headquarters.	To be shared equally among the five counties.
Rehabilitation of primary and secondary schools	A fund to help rehabilitate the infrastructure in primary and secondary schools.	The grant will be shared among all the counties based on the proportion of a county's population under 18 years.
Establishment of County Emergency Funds	Established to manage urgent and unforeseen expenditure needs at the county level.	To be shared proportionately using the county total revenues for 2014/15.
Rehabilitation of village polytechnics	Developing skills of the youths who don't transit to higher institutions of learning.	To be shared among all the counties based on the equitable share formula.

Source: Recommendations on Sharing of Revenue 2016/17 (CRA)

There are a number of issues with the sharing criteria for specific conditional grants.

- Level 5 Hospitals: the distributional criteria for this grant is based on bed occupancy. This means that only inpatient services are considered, while outpatient needs are ignored. Though it may make sense to focus the work of high-level hospitals on inpatient services, the decision to incentivize the needs of inpatients exclusively should be explained. Internationally, more complex procedures provided by high level facilities can increasingly be done on an outpatient basis.[1]
- Rehabilitation of primary and secondary schools: the distributional criteria for this grant is based on the number of children under the age of 18 in each county. However, the purpose of the grant is not well estimated by the number of children; it should be based on the need for rehabilitation of existing infrastructure. This could be measured by, for example, the number of schools or, ideally, by the number of dilapidated schools in each county. The same holds for the grant for rehabilitating village polytechnics, which is not even based on the number of children but on the formula for the equitable share. Why should this be given as a conditional grant at all? Even if it is, shouldn't it be based on the specific need for polytechnics in each county?
- County Emergency Fund: This fund seems to be based on each county's prior year revenues. This is in line with the Public Finance Management Act 2012, which limits the use of the emergency fund in a given year to two percent of prior year revenues. However, CRA does not justify why county emergency funds should be financed through a conditional grant rather than a county's equitable share. Many counties already receive more than enough from the equitable share to finance their own emergency funds. If there are counties that do not, then a conditional grant could target them.

Finally, more information is also needed about the conditions associated with these grants and how they will be enforced. Until now, there has been very little discussion about this. In most countries, conditional grants require recipients to do certain things in order to receive the funds. If these conditions are not enforced, the grants will not achieve their objectives.

[1] See http://www.hhnmag.com/articles/5005-the-great-migration