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Kenya: Analysis of the Commission on Revenue Allocation's 2017/18 Recommendations on Sharing Revenue

November 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. This year, CRA has issued its recommendation earlier than in the past, in line with the compressed budget calendar issued by the National Treasury due to the general elections in 2017.

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 (DORA and CARA). These are supposed to be submitted to parliament by February 15 every year. This year, however, they are due to be submitted earlier (by November 10).

SHARING REVENUE BETWEEN THE TWO LEVELS OF GOVERNMENT IN 2017/18

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. Sometimes called “ordinary revenue,” shareable revenue is mainly tax revenue collected locally. This includes income, value-added tax (VAT), and other taxes collected by the national government. Shareable revenue does not include loans or grants.

Shareable revenue in 2017/18 is projected to be Ksh 1.495 trillion, about Ksh 115 billion higher than the shareable revenue for 2016/17 in the Division of Revenue Act 2016. CRA’s annual recommendations begin by taking the revenue counties are receiving in the current year (the “base”) and applying a revenue growth factor. In 2017/18, CRA calculates the revenue growth factor by using an average of audited revenue growth over the last three years. Table 1 shows the average revenue growth between 2013/14 and 2015/16 as calculated by CRA. It is not clear how the 2015/16 figure was calculated, as the 2015/16 national accounts are still being audited.

TABLE 1. GROWTH FACTOR IN SHAREABLE REVENUE FROM PREVIOUS YEAR

	2013/14	2014/15	2015/16	Average
Shareable Revenue	936	1,038	1,185	
% growth	20.44%	10.94%	14.15%	15.18%

Source: Recommendations on Sharing of Revenue 2017/18 (CRA)

In addition to the revenue growth factor, CRA also looks at changes in functions that affect county costs. For 2017/18, the CRA proposes to transfer additional funds to the counties for roads and libraries. The transfer for libraries is in response to two legal notices issued by the Transition Authority (TA) in January and February 2016.[1] In addition, the CRA recommendations indicate that additional roads were transferred though a supplementary notice in April (we have been unable to trace this notice). Based on these notices, CRA recommends that counties should be given an additional Ksh 8.4 billion for construction of county roads and Ksh 319 million for salaries, allowances, and operations of county libraries.

The basis for these figures is unclear. CRA explains that, in 2013/14, the Transition Authority transferred Ksh 27.6 billion to build 90,000km of road under classes E, F and G, approximately Ksh 307,000 per kilometer. This is higher than the Ksh 268,000 per kilometer in the 2017/18 recommendation, though this

[1] See January https://drive.google.com/file/d/0B-Ql9_gM9_E7ODhqbE41VVBiVnM/view and February http://kenyalaw.org/kl/fileadmin/pdfdownloads/LegalNotices/2016/22-Constitution_of_Kenya__Transfer_of_Functions_Under_Legal_Notice_No_2_of_2016_.pdf

new allocation is exclusively for class D roads, which are more expensive to construct and maintain. In addition, both of these figures differ dramatically from those for construction of D class roads in CRA's joint 2015 report with the Transition Authority, "Costing of Government Functions" and there is no explanation for these differences.[2] There is also no explanation of how the Ksh 319 million figure for libraries was derived.

As can be seen in Table 2, the total increase in the county share based on the revenue growth factor and these allocations for additional functions puts CRA's proposal for the equitable share at 22 percent of 2017/18 shareable revenue.

TABLE 2. SHARING PROJECTED SHAREABLE REVENUE 2017/18 (KSH BILLIONS)

	Allocations (billions	**Proportion of Shareable Revenue**
National	1,163	78%
County	332	22%
Total Shareable Revenue	1,495	100%

Source: Recommendations on Sharing of Revenue 2017/18 (CRA)

The 22 percent share of current year shareable revenue to counties in 2017/18 is a slight drop from 23 percent in CRA's 2016/17 recommendations. However, the actual allocation to counties in the Division of Revenue Act 2016 was 20.3 percent, so the CRA recommendation for 2017/18 is about three percentage points higher than the county share in 2016/17.

TYPE, AMOUNT, AND DISTRIBUTION OF CONDITIONAL GRANTS

The CRA recommendations propose to continue existing conditional grants and introduce five new grants. CRA recommends maintaining in 2017/18 all of the six existing conditional grants that the Division of Revenue Act 2016 for the year 2016/17.[3] It also recommends introducing five new grants.

Unlike last year, where the allocations for these conditional grants were adjusted based on the revenue growth factor, CRA recommends that three of the existing grants — Level 5 hospitals, free maternity, and compensation for user fees forgone — be adjusted only by the target inflation rate of 5 percent. It is

[2] See page 40-41 of the report on the 'Cost of constructing class D roads to bitumen standards' available at http://www.crakenya.org/wp-content/uploads/2016/02/COSTING-OF-GOVERNMENT-FUNCTIONS-FINAL-REPORT-11th-November-2015.pdf

[3] See http://kenyalaw.org/kl/fileadmin/pdfdownloads/Acts/TheDivisionofRevenueActNo9of2016.pdf

unclear what informed this shift in approach to these specific conditional grants. In addition, CRA's actual proposed increase in these grants, as can be seen in Table 3 below (see the fifth column) is far less than 5 percent. It is possible that there may have been a calculation error, as these grants are increasing by about 0.5 percent instead of 5 percent. The emergency medical services grant is maintained at Ksh 200 million. However, CRA does not indicate which facilities or counties will benefit from the facility in 2017/18. In the Division of Revenue Bill 2016, Mpeketoni and Hola hospitals in Lamu and Tana River counties were the health facilities earmarked for the grant. For all of these grants, the proposed increase is less than the rate of inflation, meaning that their value is actually decreasing. Why?

The allocation to the Road Fuel Levy Fund grant has been significantly increased to cater for the increase in the mandate of county governments with respect to county roads. CRA recommends that the allocation to this grant be increased from 15 to 25.3 percent of the Fund, leading to a tripling of the funds going to counties (see Table 3). This increase will come at the expense of the allocation for the Kenya Rural Roads Authority, whose share will be reduced from 21.8 to 10.5 percent.

TABLE 3. RECOMMENDED ALLOCATIONS FOR EXISTING CONDITIONAL GRANTS IN 2017/18

Current Conditional Grants	2016/17 (Millions) CRA	2016/17 (Millions) DORA	2017/18 (Millions) CRA	Proposed % increase from DORA allocation 2016/17	% increase in CRA allocations between 2016/17 and 2017/18 recommendations
Level 5 hospitals	4,143	4,000	4,020	0.5%	-3%
Free maternal health care	4,947	4,121	4,142	0.5%	-16%
Compensation for user fees forgone	1,036	900	905	0.6%	-13%
Leasing of medical equipment	5,179	4,500	4,500	0.0%	-13%
Road fuel levy fund	4,756	4,306	13,296	208.8%	180%
Emergency medical services	200	200	200	-	-
Subtotal	***20,261***	***18,027***	***27,063***	***50%***	***34%***

Source: Recommendations on Sharing of Revenue 2017/18 (CRA)
Note: the 'sub-total' figure under DORA, 2016 does not include conditional allocation financed by other loans and grants from development partners. This was Ksh. 3,871 million.

CRA proposes five new conditional grants in 2017/18 (see Table 4), bringing the total number of proposed conditional grants to eleven. CRA has omitted three of the conditional grants it recommended in the year 2016/17: for personnel emoluments for devolved staff, for rehabilitation of primary and secondary schools, and for establishment of county emergency funds. CRA now appears to believe that counties have the ability to set up their own emergency funds from the revenues recommended for FY

2017/18. There is no reference to the other two conditional grants dropped from the 2017/18 CRA recommendations.

TABLE 4. RECOMMENDED ALLOCATIONS FOR NEW CONDITIONAL GRANTS IN 2017/18 COMPARED TO 2016/17

New conditional grants proposed by the CRA	Recommendations in 2016/17 (millions)	2016/17 (Millions) DORA	2017/18 (Millions) CRA	Remarks
Construction of headquarters in five counties	4,000	This was not approved	1,000	It is unclear why CRA recommends a different amount from its 2016/17 recommendations. CRA recommends that counties should get Ksh 1 billion in 2017/18 as part of a total grant of Ksh 3 billion transferred in equal annual installments. Treasury rejected this recommendation in 2016/17 until counties showed commitment by starting the construction on their own. CRA has not indicated whether this has happened since last year.
Rehabilitation of village polytechnics	6,300	This was not approved	1,500	It is unclear why CRA recommends a different amount from its 2016/17 recommendations. The allocation to this grant has reduced significantly (by 76 percent). Treasury rejected the recommendation in 2016/17, indicating that the project could only be implemented if a donor was identified to fund it. There is no indication in the recommendations of whether this situation has changed since last year.
Construction and equipping of 20 libraries in 20 countries	Not proposed	Not in the DORA	400	It is unclear how CRA arrived at Ksh 20 million for each county. The assumption that putting up these libraries will cost the same for all the remaining counties lacks a clear basis.
Two regional cancer referral treatment centers	Not proposed	Not in the DORA	5,000	It is unclear how CRA arrived at Ksh 2.5 billion for the two regional centers. There is no basis for the cost estimates provided in the recommendations.
National cancer drug access program	Not proposed	Not in the DORA	1,000	It is unclear how CRA arrived at Ksh 1 billion for the national cancer drug access program.
Personnel emoluments for devolved staff	5,196	Not in the DORA	Omitted	CRA does not explain why this grant was left out in its 2017/18 recommendations and whether this is in line with Treasury's view that counties have enough resources to cater for devolved staff.
Rehabilitation of primary and secondary schools	5,000	Not in the DORA	Omitted	CRA does not explain why this grant was left out in its recommendations and whether it now agrees with Treasury that this grant relates to a national government functions and can only be initiated by the ministry responsible for primary and secondary education.

Establishment of county emergency funds	5,196	Not in the DORA	Omitted	CRA acknowledges that counties have adequate revenues from which to set up emergency funds.
Subtotal for new grants	***25,692***	***n/a***	***8,900***	
Total for all grants	***45,953***	***18,027***	***35,963***	
Increase in CRA recommendations from DORA 2016			*99.5%*	
Increase in CRA recommendations between 2016/17 and 2017/18			*-21.7%*	

Source: Recommendations on Sharing of Revenue 2017/18 (CRA)
Note: The 'total for all grants' under DORA, 2016 does not include conditional allocation financed by other loans and grants from development partners. This was Ksh. 3,871 million. The

The combined allocation for old and new grants is Ksh 36 billion. The total allocation for conditional grants is 22 percent lower than what CRA recommended for 2016/17, but double the approved conditional grants in 2016/17 in the DORA 2016.

For the second year, CRA has included a conditional grant to help five counties build their county headquarters. In its rejection of this recommendation last year, the National Treasury indicated that this is a responsibility of the counties. However, if the counties had started constructing these headquarters on their own, Treasury was willing to consider providing assistance. CRA has not indicated whether this has happened or not, but has again included the grants in their recommendations for 2017/18. This year, CRA recommends that Ksh 1 billion should be transferred annually to the relevant counties for the next three years as opposed to last year's proposal of a lump sum grant. The total size of the overall funding has also reduced by Ksh 1 billion, from Ksh 4 billion last year to Ksh 3 billion now. It is not entirely clear why, but it appears that CRA is expecting the counties to make a contribution for the balance of 1 billion so that this becomes a matching grant as Treasury had requested.

The 2016 TA gazette notices mentioned above transferred libraries to counties. The first notice transferred libraries to 27 counties, while the second transferred libraries to an additional five counties. This leaves 15 counties without any libraries. The CRA recommends funds for libraries in 20 counties rather than 15, suggesting that it has incorrectly ignored the second notice.

ISSUES AND RECOMMENDATIONS

While there are some improvements in the CRA's recommendations this year, there are also a number of challenges:

- CRA follows the same approach to calculating the revenue growth factor as it did last year. But in 2016/17, the CRA recommended growth factor was much higher than what was eventually used by National Treasury and approved by parliament. Given that the CRA's approach was rejected last year, it would be important for the recommendations to reflect on why this happened and why the commission has decided to pursue the same approach this year.

- It is unclear why the conditional grants to maternal care, Level 5 hospitals, and forgone user fees have been adjusted for inflation alone (if indeed that was the intention, though we have shown that these are wrongly calculated in the report). The CRA should explain how it determines whether the services funded by these grants are likely to remain at the same level or not. In 2016/17, the commission seemed to believe that they should grow faster than inflation.

- The CRA has changed the criteria for the distribution of the Level 5 hospitals grant. The shift from using the bed occupancy rate to using each hospital's proportion of total in-patient days across the 11 facilities is a step in the right direction. We have shown elsewhere that bed occupancy rate punishes larger hospitals.[4] However, it is unclear how inpatient days will be measured and how it is different from bed occupancy, beyond the laudable shift from using the facility rate to the overall proportion across facilities.

- The criteria for distribution of the village polytechnics rehabilitation grant has also been changed from the equitable share formula to the county's proportion of total population. Population is a reasonable if imperfect proxy for demand for polytechnics, but it does not measure the need for infrastructure particularly well. A more accurate measure would be based on the number of village polytechnics in each county and their physical status relative to the demand.

- The distribution of the medical leasing scheme and county libraries grant on an equal basis across counties does not consider the different health needs or fiscal capacities of counties.

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[4] See http://www.internationalbudget.org/wp-content/uploads/ibpkenya-equity-week-2016-issue-4-regional-hospital-funding.pdf

- Some of the conditional grants recommended by the CRA have a vague rationale. CRA could have considered the relative merits of having national cancer facilities versus regional facilities run by counties, and made a case for setting up regional centers run by counties with a conditional grant. There is no argument of this type in the recommendations.