COMMISSION ON REVENUE ALLOCATION

Promoting an Equitable Society

RECOMMENDATION ON THE BASIS FOR EQUITABLE SHARING OF REVENUE BETWEEN NATIONAL AND COUNTY GOVERNMENTS FOR THE FINANCIAL YEAR 2018/2019

TRANSMITTAL LETTER

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COMMISSION ON REVENUE ALLOCATION

DATE: 18th December 2017

Clerk of the Senate
Clerk of the National Assembly
Cabinet Secretary, National Treasury
Governors, County Governments
Clerks of County Assemblies
Dear Sir/Madam

RE: RECOMMENDATION ON SHARING OF REVENUE FOR FINANCIAL YEAR 2018/19

Pursuant to Article 216 (1)(a) of the Constitution of Kenya 2010, the Commission on Revenue Allocation is mandated to make recommendations concerning the basis for equitable sharing of revenue raised by the national government between national and county governments. Article 216 (5) requires the Commission to submit such recommendations to the Senate, National Assembly, the National Executive, County Assemblies and County Executives.

Accordingly, the Commission recommends that for financial year 2018/2019, **Kshs. 1,371.2 billion** and **Kshs.337.2 billion** be allocated to national and county governments respectively, as equitable shares. The Commission further recommends that **Kshs. 30.5 billion** be allocated from the national government equitable share to counties as conditional grants.

The equitable share of revenue for each county government for financial year 2018/19 has been included in this document as Table 11. These county allocations are based on the second basis for revenue sharing among county governments approved by Parliament in 2016.

Yours sincerely,

Dr. Jane Kiringai
CHAIRPERSON

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

ACRONYMS & ABBREVIATIONS

AG	Auditor-General
AiA	Appropriation in Aid
ANC	Anti Natal Care
BPS	Budget Policy Statement
CAJ	Commission on Administrative Justice
CBK	Central Bank of Kenya
CBR	Central Bank Rate
COB	Controller of Budget
CRA	Commission on Revenue Allocation
DPP	Director of Public Prosecution
EAC	East Africa Community
EACC	Ethics and Anti-Corruption Commission
FY	Financial Year
GDP	Gross Domestic Product
GECA	General Economic and Commercial Affairs
GWP	Gross World Product
ICT	Information Communication Technology
IEBC	Independent Electoral and Boundaries Commission
IGTRC	Inter Governmental Relations Technical Committee
IPOA	Independent Policing Oversight Authority
JPY	Japan Yen
JSC	Judicial Service Commission
KDSP	Kenya Devolution Support Project
KNBS	Kenya National Bureau of Statistics
KNHCR	Kenya National Commission on Human Rights
KRA	Kenya Revenue Authority
MTP	Medium Term Plan
NCDAP	National Cancer Drugs Access Programme
NGEC	National Gender and Equality Commission
NHIF	National Hospital Insurance Fund
NPSC	National Police Service Commission
OSR	Own Source Revenue
PAYE	Pay As You Earn
PFMA	Public Finance Management Act
PNC	Post Natal Care
PSC	Public Service Commission
SGR	Standard Gauge Railway
SRC	Salaries and Remuneration Commission
TSC	Teachers Service Commission
USD	United States Dollar
VAT	Value Added Tax

EXECUTIVE SUMMARY

Revenue Sharing Context

The Commission on Revenue Allocation makes recommendations on revenue sharing between national and county governments in accordance with Article 202(1&2) and Article 216(1)(a). This specific recommendation has been informed by the Fourth Schedule, requirements of Article 203(1) of the Constitution and the need for fiscal consolidation for a sustainable fiscal framework. It also takes into account functional assignment between national and county governments as well as the overall performance of the economy.

Recommendation for Financial Year 2018/19

The nationally raised sharable revenue for financial year 2018/19 is projected to be Kshs. 1,717 billion. From the projected revenues, the Commission recommends that Kshs. 1,371.2 billion be allocated to national government, Kshs.337.2 billion to county governments as equitable shares and Kshs. 8.6 billion for the Equalization Fund.

The Commission further recommends that Kshs. 30,461 billion be allocated from the national government equitable share to county governments as conditional grants. The conditional transfers include Kshs. 24,461 million for ongoing conditional programmes and Kshs. 6,000 million as new conditional grants for establishment of cancer centres and cancer drug access program.

The last approved audited shareable revenue is Kshs. 936 billion for financial year 2013/2014. In this regard, the proposed allocation to county governments translates to 36 percent of shareable revenue. The equitable share allocation to county governments is shared among the 47 counties based on the second basis for sharing of revenues approved by Parliament in 2016.

The Basis for the Recommendation

First, the Commission recommends the transfer of an additional Kshs. 8.7 billion, for functions previously transferred to county governments without attendant resources. This adjustment increases the baseline for county governments share from Kshs. 302 billion in financial year 017/18 to Ksh.310.7 billion.

Second, the baseline is adjusted for inflation and for growth in service delivery. This means that the shareable allocations for 2017/18 for both levels of government are adjusted for changes in prices of goods. A further adjustment is made to allow for enhancement in service delivery.

Issues for Urgent Attention

Although there has been a challenge in expenditure classification, county governments are meeting the Public Finance Management (PFM) development budget benchmark of 30 percent of county budgets.

However, greater attention needs to be paid to revenue raising efforts especially as the country enters the second phase of devolution. The Commission notes with concern the poor performance of county own sources of revenue. Although both equitable share and expenditures at the county government level have been increasing, the own source revenue performance of the county governments has lagged behind. This has resulted from low revenue collection capacity at the county level, non-compliance in payment of fees, charges and property rates; and pilferage attributed to manual revenue collection.

The huge shortfalls in meeting the own sources revenues targets pose a financial risk to county governments as evidenced by huge pending bills, estimated at Kshs. 35.84 billion as at the end of 30th June 2017.

The Commission further observes an increasing public debt burden that is in turn not only putting fiscal pressure on the national government but eroding the quantum of shareable revenue. Similarly, the Commission takes note of the run-away wage bill that takes the lion's share of recurrent expenditure at both levels of government, inviting a critical review of staffing levels and taking deliberate efforts in steering clear from duplication at both levels of government.

1.0 INTRODUCTION

1.1 Background Information

Revenue raised nationally is shared equitably among the national and county governments. The Commission has been mandated to make recommendations on the basis for the equitable sharing of revenue to the Senate, the National Assembly, the National Executive, County Assemblies and the County Executives six months before the start of the financial year (Public Finance Management Act (PFMA) 2012 section 190). In making the recommendation, the Commission is guided by the functional assignment and resource needs of each government. In addition to the equitable share, county governments receive additional funds from the national government equitable share, to implement specific national policies. These are in the form of conditional grants.

The financial years 2013/14 to 2016/17 marked the first five year of implementing devolution. Over this period and despite many challenges, county governments put in place necessary structures that enabled them to function reasonably smoothly. The Commission has over the same period made five annual recommendations on revenue sharing between national and county governments. The recommendations take cognisance of Article 203(1), which stipulates the criteria to consider when determining the equitable shares between the two levels of government. This recommendation is made at a time when the country has elected new governors, with more than 50 percent of them being new. Given the experiences from the past five years, county governments and indeed the entire economy is poised to experience accelerated development with improved service delivery which is a key objective of devolution.

This recommendation is presented in eight Chapters. Chapter One introduces the recommendation by summarising the overall performance of the economy. In Chapter Two, the fiscal performance of both national and county governments is reviewed while the main thrust of Chapter Three is to articulate the functional assignments for national and county governments. Chapter Four presents the Commission's approach on revenue sharing, paving the way for presentation of the recommendations on the shares of revenue to national and county governments in Chapter Five. In Chapter Six the Commission demostrates how this revenue sharing recommendation meets the requirements of Article 203 (1) of the Constitution of Kenya. Chapter Seven details the sharing of the equitable share allocation to the 47 county governments based on the second basis for horizontal revenue sharing while Chapter Eight concludes the recommendation.

1.2. Overview of Performance of the Economy

Growth in the global economy slowed to 2.9 percent in 2016 from 3.1 percent in 2015. The sluggish growth was an outcome of the slow pace of global investment, dwindling world trade, slow productivity growth and high levels of debt. Low commodity prices, conflicts and geopolitics also affected the global economy. World Gross Product growth is expected to dip marginally to 2.7 percent in 2017 with a modest recovery to 2.9 percent in 2018[1].

During 2016, the real Gross Domestic Product (GDP) in the East Africa Community (EAC) grew by 6.1 percent compared to 5.8 percent in 2015. The growth was fueled by public infrastructure investment, increased private consumption and low oil prices. On average, EAC countries are projected to record slightly higher growth rates in 2017 due to improved business environment. However, the external environment poses a potential challenge to the growth of the EAC economies due to possible terms of trade shocks and tighter external financing compounded by unfavourable weather conditions.

Kenya's GDP growth increased marginally to 5.8 percent in 2016 compared to 5.7 percent in 2015. This growth was driven by growth in accommodation and food services; information and communication; real estate; and, transport and storage. On the demand side, growth was buoyed by consumption in both the public and private sectors. Conversely, growth in construction; mining and quarrying; and financial and insurance activities decelerated in 2016. In addition, persistent drought experienced in the fourth quarter of 2016 hampered growth and negatively impacted agriculture and electricity generation.

Economic growth in 2017 is likely to be influenced more by the domestic rather than external factors. The weather has remained unfavourable, negatively affecting agriculture; electricity generation and water supply. Due to the high share of agricultural contribution to GDP, this will translate into lower rural demand for goods and services, and impact negatively on sectors such as manufacturing and trade that have strong inter-linkages. The deceleration in growth of credit to the private sector that started in 2016 continues and likely to further constrain growth in 2017. The dampened performance of the economy will negatively affect revenue growth and therefore the quantum of resources available for sharing among the two levels of government.

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[1] 2017, World Economic Situation Prospectus by United Nations

The rest of this review of the performance of the economy focuses on recent trends in macro prices and public debt and their implications on shareable revenue.

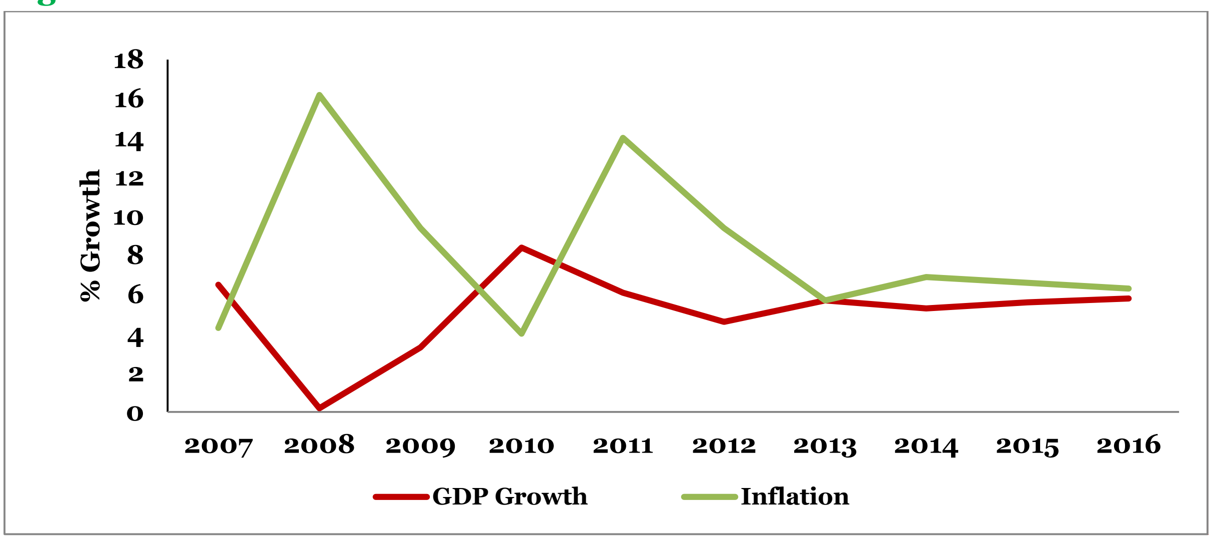
1.2.1 Inflation

Inflation is a key factor taken into account by the Commission in recommending the equitable basis for the sharing of revenue between the national and county governments. This is because high inflation increases the nominal resource needs of both levels government to sustain service delivery. High inflation also undermines the ability of national government to realise revenue targets.

The annual average inflation rate has remained within the government target set at 5±2.5 percent in the Medium-Term Plan II (MTP) and within the EAC convergence criteria of 8.0 percent. It declined marginally from 6.6 percent in 2015 to 6.3 percent in 2016 due to stable transport prices, tight monetary policy, and decline in the cost of electricity, kerosene and cooking gas. However, due to prolonged poor weather conditions and campaign periods experienced in 2017, inflation is likely to increase slightly but remain generally within target.

Figure 1 show trends in inflation and its relationship with growth in GDP growth.

Figure 1: Annual GDP Growth and Inflation Rates



Source: Kenya National Bureau of Statistics, various issues

1.2.2 Interest Rates

Interest rate regimes shape the flow of credit and overall performance of an economy. They also have significant public debt implications especially in countries that heavily rely on domestic borrowing.

The amendment of the Banking Act in August 2016 to cap the lending rates to a maximum of 4 percent above the Central Bank Rate (CBR) has seen a substantial decline in overall credit and skewed the flow of credit towards the public sector. More significantly, the interest rate ceiling may have precipitated macroeconomic incompatibilities that will take a while to deal with. Overall, domestic credit growth decelerated from 20.8 percent in 2015 to 6.4 percent in 2016. The slow credit absorption by the private sector is likely to reduce productivity and further dampen the performance of the economy and revenue growth. A buoyant economy and gradually increasing revenue will be important in the pursuit of Kenya's devolution agenda.

1.2.3 Exchange Rates

In 2016, the Kenya shilling remained stable against major world currencies. This was attributed to narrowing of the current account deficit, largely due to a lower import bill, an improvement in earnings from exports, and increased diaspora remittances.

The Kenyan shilling exchange rate has been relatively stable against major currencies. By the end of June 2017, the Kenya Shilling was exchanging against the US dollar at Kshs. 103.6 compared to Kshs. 101.5 in June 2016. The Kenyan shilling gained marginally against the Sterling Pound and the Japanese yen by 4.3 percent and 0.8 percent respectively.

The exchange rate is expected to remain stable due to a significant level of reserves, the continued growth in remittances and stable shilling supports the performance of the current account and servicing of public debt both of which affect the amount of revenue available for sharing.

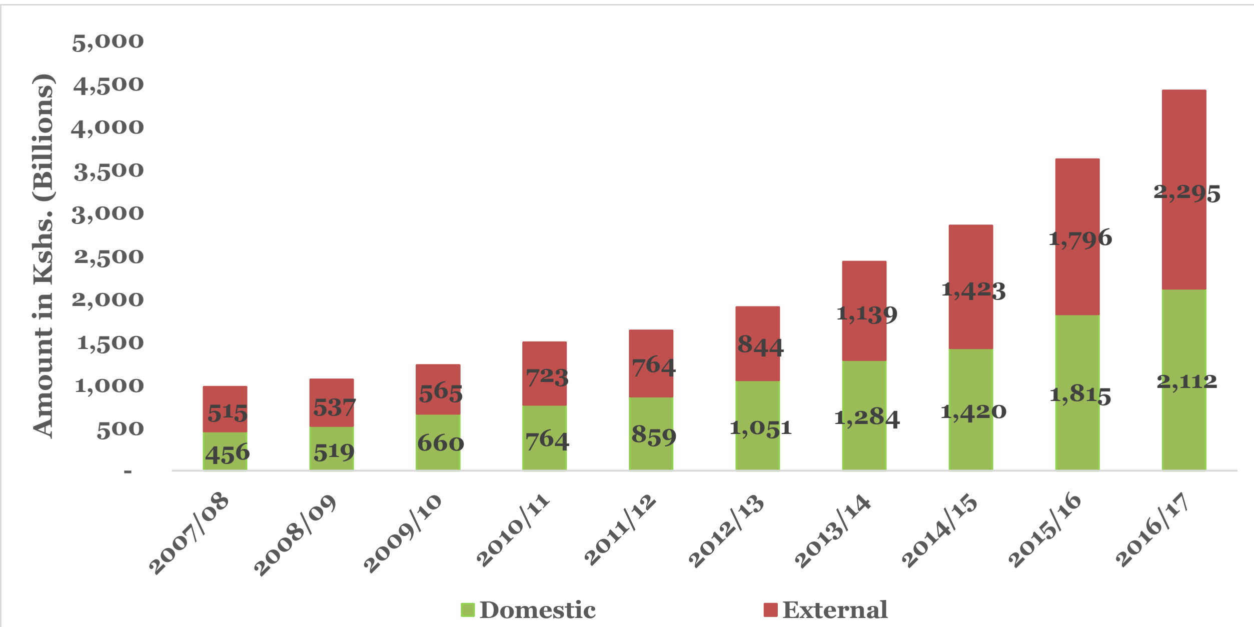
1.2.4 Public Debt

Kenya's public debt increased significantly over time despite the government's policy objective to contain and reduce it in the medium term. The total gross public debt was Kshs. 4,407 billion, equivalent to 47.9 percent of GDP as at the end of June 2017. This comprised 52.1 percent of external debt and 47.9 percent of domestic debt.

The total external debt has risen from Kshs. 1,722 billion by 30th June 2016 to Kshs. 2,295 billion by 30th June 2017. The debt stock comprises of 32.7 percent, 38 percent, 28.6 percent and 0.7 percent owed to bilateral, multilateral institutions, commercial banks and suppliers credit respectively. The domestic debt stock increased to Kshs. 2,112 billion by the end of June 2017 from Kshs. 1,815 billion in June 2016, a 16.4 percent increase.

On debt service, the government paid Kshs. 271.2 billion in 2016 up from Kshs. 215 billion in 2015 in interest payments. These payments comprised of Kshs. 212.9 billion interests on domestic loan and 58.4 billion for external loans. Interest payment has the first charge on the consolidated account. The accumulation of debt exerts fiscal pressure and reduces revenue available for sharing. Figure 2 summarises the trend of total public debt from 2007/08 to 2016/17.

Figure 2: Kenya's Stock of Public Debt in Kshs. Billions



Source: National Treasury Quarterly Economic and Economic Reviews

The rise in public debt has largely been attributed to heavy government investment in infrastructure projects. Though government borrowing is still consistent with the medium-term debt management strategy, which aims at ensuring public debt sustainability, it narrows the window for future borrowing, and increases vulnerability to fiscal risks in the event of an urgent need for borrowing. Furthermore, domestic debt crowds out private sector undermining prospects for future growth. Debt service reduces the quantum of shareable revenue.

2.0 FISCAL PERFORMANCE OF NATIONAL AND COUNTY GOVERNMENTS

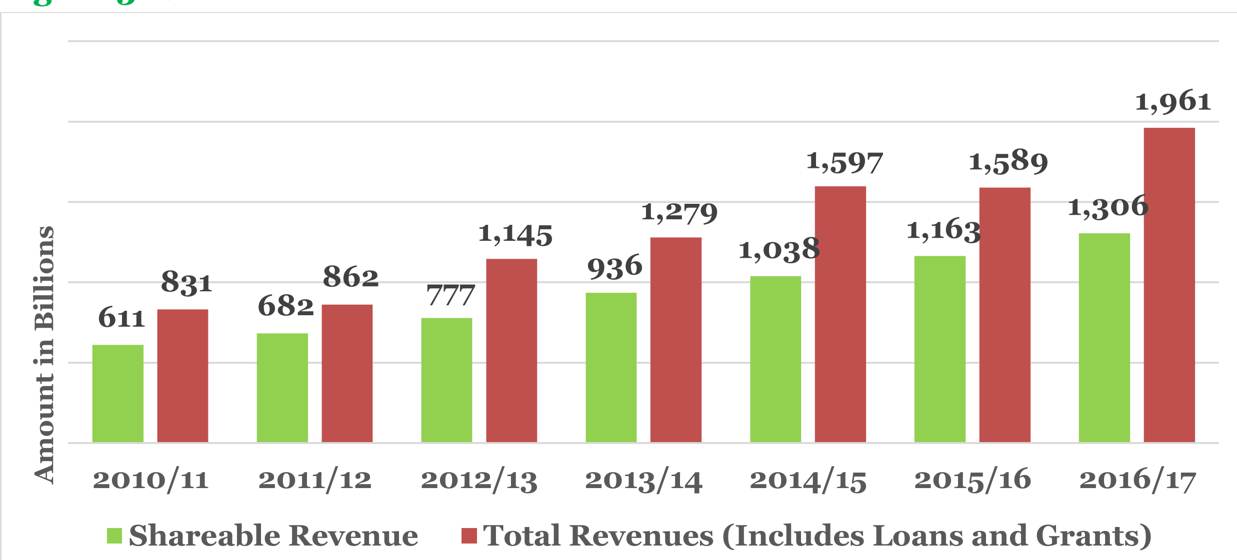
2.1. Introduction

The national and county governments' budget requirements continue to exert pressure on the available nationally raised revenues. This underscores the need for the two levels of government to not only put efforts in broadening their revenue bases but also improving fiscal performance to ensure more efficient use of resources for better provision of services. The section that follows analyses the performance of revenue and expenditures for both national and county governments.

2.2. Performance of Nationally Raised Revenues

Ordinary revenue (shareable revenue) has increased steadily despite the slow growth of the economy which has been below the double-digit Vision 2030 target. The total ordinary revenue raised for the financial year 2016/17 is estimated at Kshs. 1,306 billion up from Kshs. 1,153 billion collected the previous financial year, representing a 13.3 percent growth. Total revenue (including A-i-A, loans and grants) was Kshs. 1,427 billion up from Kshs. 1,262 billion, representing a 13 percent growth. The improvement in revenue growth can be attributed to the reforms that the National Treasury and Kenya Revenue Authority have implemented. Figure 3 presents a summary of trends in total government revenues from 2010/11 to 2016/17.

Figure 3: Government Revenues in Kshs. Billions

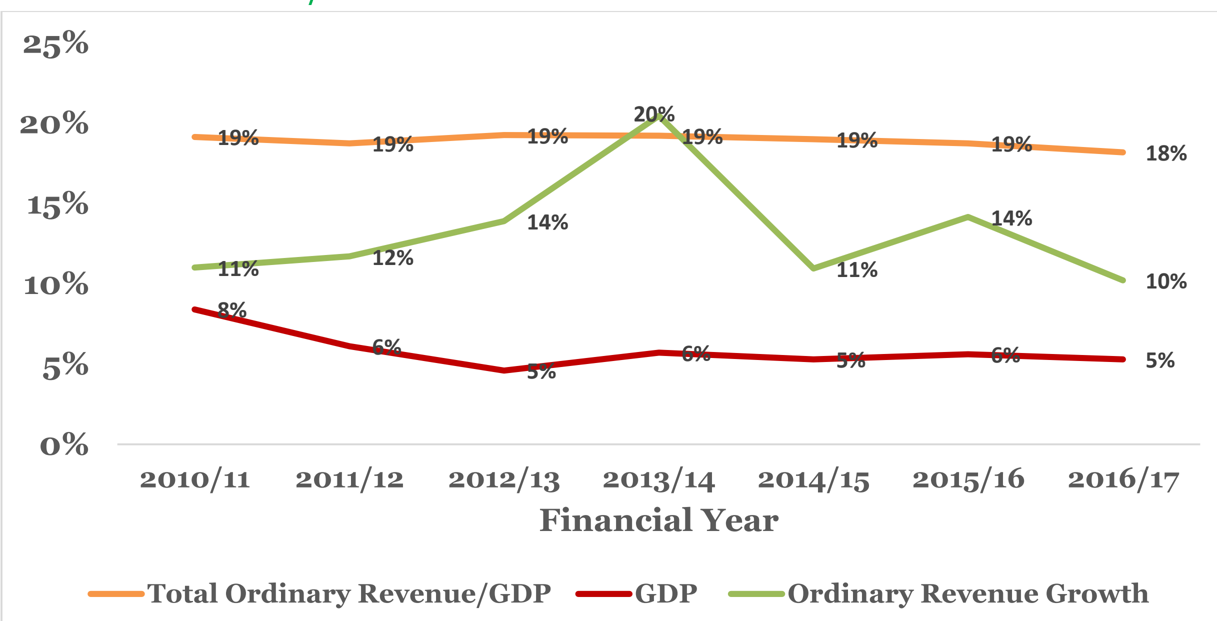


Source: National Treasury Exchequer Accounts, Various Issues

Pay-As-You-Earn (PAYE) and corporate taxes are the main sources of the ordinary revenues. On average, these revenue sources contribute approximately 48 percent of the total revenues collected in financial year 2016/17 with corporate tax growing faster than PAYE from FY2015/16. This is an outcome of either growth in profit by large corporations or the job losses in the labour market. The performance of local VAT has significantly grown while the contribution of non-tax revenues (others) has remained low. Overall, growth of revenue streams has been changing reflecting changes in the structure of the economy.

The total ordinary revenues to GDP ratio has generally remained constant since 2010/11 declining only marginally in 2016/17. The revenue growth has largely remained between 10 to 15 percent except in 2013/14 when it spiked to a record 20 percent. It is also evident from Figure 4 that even though GDP growth and total revenue to GDP ratio is almost constant, revenues growth is somehow volatile.

Figure 4: Ordinary Revenue to GDP Ratio, GDP Growth Rate and Revenue Growth since 2010/2011



Source: National Treasury and KNBS

2.3. County Revenues

The county governments' revenues comprise of equitable share, conditional grants, Own Source Revenues (OSR), loans and grants. The following sub-section analyses the performance of each revenue type.

2.3.1. Fiscal Transfers to County Governments

The county governments' total fiscal transfers since the inception of devolution in financial year 2012/13 amounts to Kshs. 1.4 trillion, comprising of an equitable share of Kshs. 1.3 trillion and conditional grants of Kshs. 116.6 million. This accounts for 84 percent of the total revenues available to the counties. On average, transfers to counties having grown from 80 percent in 2013/14 to 88 percent in 2016/17. County governments depend largely on the equitable share as their main source of revenue. The implication is that either the ability of the county governments to generate their own source revenues is reducing as the equitable share increases or the equitable share may have a perverse effect on generation of own source revenues at the county level. The trend also raises broader concern about possible development of a dependency syndrome at the county level. Total revenue collected by counties decreased in 2016/17. Table 1 presents a summary of revenues to counties by source.

Table 1: County Government Revenue in Kshs. Millions

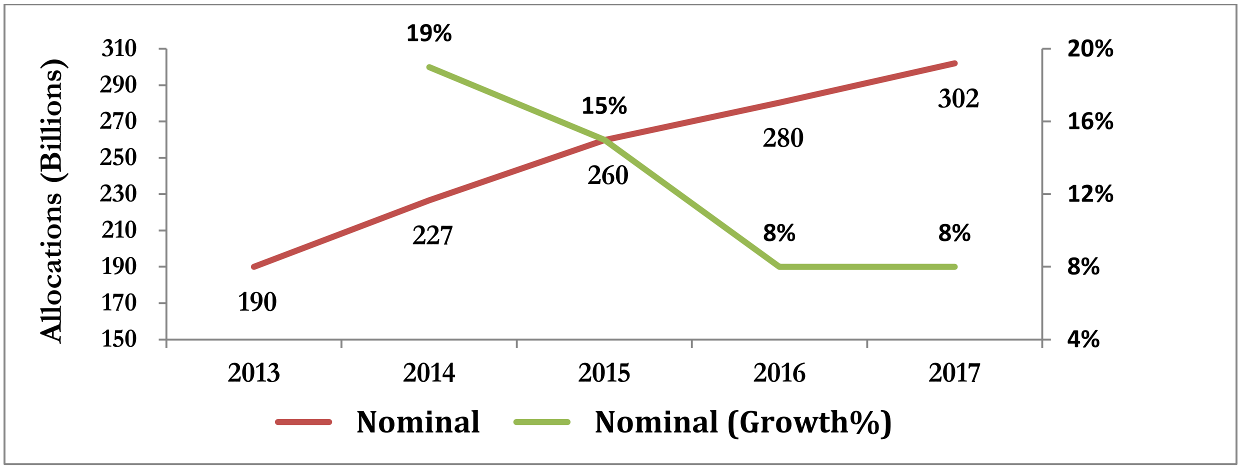
Year	Equitable share	Conditional Grants	OSR	Total County Revenue	% Conditional Grant to Equitable Share	% OSR to Equitable Share
2012/13	9,784	6,658	6,756	**23,198**	68%	69%
2013/14	190,000	20,000	26,296	**236,296**	11%	14%
2014/15	226,661	15,759	33,849	**276,269**	7%	15%
2015/16	259,775	16,598	35,022	**311,395**	6%	13%
2016/17	280,300	18,028	24,710	**323,038**	6%	9%
2017/18	302,000	39,681		**341,681**	13%	
TOTAL	**1,268,520**	**116,724**	**126,633**	**1,511,877**	9%	10%

Source: CARA; County Budget Implementation Review Reports; Various issues

2.3.2. Equitable Share to county Governments

County governments have been allocated a cumulative sum of Kshs. 1.3 trillion from financial year 2012/13 to 2017/18 as equitable share. Figure 5 shows that though equitable share to county governments is growing in absolute terms, the year on year growth has declined from 19 percent in financial year 2014/15 to about 8 percent in FY 2017/18. The equitable share allocation to counties is based on assigned function and the annual growth in ordinary revenues. Except in financial year 2013/14 when the nationally raised revenue grew by 20 percent, the growth has averaged 10 percent.

Figure 5: Equitable Share to County Governments



Source: CARA, Various Issues, CRA Computations, 2017

2.3.3. Conditional Grants

Article 202(2) provides that in addition to the equitable share, counties may receive additional allocations from the national governments' share of revenue, either conditionally or unconditionally. Unlike equitable share which allows counties an opportunity to pursue local level development preferences, conditional allocations are tied to implementation of specific national policies with clear objectives. Table 2 presents a summary of conditional grants to county governments for the financial years 2013/14 to 2017/18.

Table 2: Approved Conditional Grants to Counties

Budget Item	Conditional Grants (Kshs. Billions)				
	2013/14	2014/15	2015/16	2016/17	2017/18
Level 5 Hospitals	3.4	1.8	3.6	4.0	4.2
Free Maternal Health Care	-	-	4.2	4.1	4.2[2]
Compensation For User Fees	-	-	0.98	0.9	0.9
Leasing of Medical Equipment	-	-	4.5	4.5	4.5
Road Levy Fund	-	-	3.3	4.3	11.1
Special Purpose Grant	-	-	-	0.2	-
Danida	-	-	0.8	0.4	0.8
World Bank Loan	-	-	0.508	1.3	4.8
Construction of County Headquarters	-	-	-	-	0.6
Development of Village Polytechnic	-	-	-	-	2
Other Loans and Grants	16.5	13.8	9.3	2.1	10.8
Total	**19.9**	**15.6**	**31.28**	**21.8**	**39.7**

Source: County Allocation of Revenue Act, Various

[2] Utilised through the National Hospital Insurance Fund effective financial year 2017/18

For the 2017/18 financial year, the national government changed the mode of transfer of conditional grant on free maternal health care. The grant is now channelled through the National Hospital Insurance Fund (NHIF) in line with the national government policy to improve the efficiency and management of the grant. This change is meant to increase access to improved health care services by extending the coverage to include the mission and private hospitals.

The national government also approved two additional conditional grants, one for construction of five county headquarters and another for developing village polytechnics. The counties to benefit from the construction of county headquarters are Isiolo, Lamu, Nyandarua, Tana River and Tharaka Nithi. All counties will benefit from the grant on village polytechnics. A special purpose grant that benefitted Lamu and Tana River only was meant to enhance healthcare provision in the two counties. A conditional grant to Level 5 hospitals benefit 11 hospitals across the country that are county level referral hospitals. These conditional grants meet urgent development needs that could be missed in the general financing framework. However, the identification of projects supported through conditional grants is at the moment ad-hoc and risks becoming supply driven. A more systematic approach would optimize benefits from such grants.

2.3.4. County Own Sources Revenues

Article 209 (3) empowers county governments to collect revenues from taxes, user fee and charges. A review of the performance of county governments in this regard indicates that they have performed poorly against their own revenue targets. Their actual revenue collection has remained volatile, not only missing target but often, less revenue is being collected in subsequent years.

The inability of county government to realise targeted revenues has been attributed to the low capacity of counties to collect revenues; unrealistic forecasts, non-compliance with payment of fees and charges and property rates; pilferage due to manual collection systems and resulting failure to adequately report all revenues collected at the county level. Most counties seem to intentionally prepare unrealistic revenue forecasts as a balancing mechanism to meet the PFM Act 2012 requirement of a balanced budget. The huge shortfalls in OSR collections in respect of meeting revenue targets poses a financial risk as evidenced by huge pending bills estimated at Kshs. 35.84 billion by the end of 30th June 2017[3]. It also perpetuates dependency on equitable share. Appendix II presents a summary of county OSR targets and actual collections. Considering this trend, mechanisms

[3] Annual County Governments Budget Implementation Review Report FY2016/17

must be put in place for encouraging counties to put greater effort in raising their own revenues.

2.3.5. Fiscal Effort

It is primarily for purpose of encouraging greater effort in raising revenue from own sources that the second horizontal revenue sharing formula has an inbuilt mechanism for incentivising improvements in OSR performance. The fiscal effort factor which has a weight of 2 percent of the shareable revenue among county governments, uses per capita revenue effort to encourage counties to increase their revenue raising effort. This factor varies from year to year to ensure that counties continuously put more effort in broadening their revenue bases and increasing efficiency in revenue administration and collection.

For financial year 2018/2019, the fiscal effort factor is calculated using the revenue performance of counties' OSR for FY 2015/16 and financial year 2016/17. On this account Mombasa, Lamu, Machakos, Bomet and Samburu substantially increased their revenues. Over the same review period, Nakuru, Kiambu, Narok and Nairobi registered significant decline in revenue.

2.4. Analysis of Expenditure

The total expenditure for both national and county governments for the financial year 2016/17 was Kshs. 2,143.1 billion of which Kshs. 1,824 billion was for national government and Kshs. 319.1 for county governments. Of these expenditures, the national government spent Kshs. 646 billion on development (35 percent) and Kshs. 1,178 billion on recurrent expenditure (65 percent). The county governments spent Kshs. 103.3 billion on development (32 percent) of the total expenditures and Kshs. 215.7 billion for recurrent (68 percent). In line with the PFMA, 2012 provisions on fiscal responsibility, both levels of government spent about a third of their budgets on development.

2.4.1. Analysis of National Government Expenditure

The overall expenditure by national government pre-and post devolution has been on the rise benefitting from the increased performance of the ordinary revenues and increased borrowing. The growth in expenditure is driven by public wage bill, debt payment, social sector spending and infrastructure development. Table 3 shows the national government's development expenditure between financial years 2013/14 to 2014/15 increased from Kshs. 355 billion to Kshs. 549 billion due to increased investment in infrastructure development, especially the standard gauge railway.

Table 3: National Government Expenditure in Kshs. Billion

Financial Year	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Recurrent	**584**	**650**	**816**	**753**	**861**	**1,014**	**1,178**
Wages and Salaries	*198*	*219*	*274*	*281*	*298*	*307*	*337*
Other Recurrent	*386*	*432*	*542*	*471*	*563*	*707*	*842*
Development	**236**	**295**	**306**	**355**	**549**	**490**	**646**
% of Development to Total Expenditure	29%	31%	27%	32%	39%	33%	35%

Source: National Treasury Quarterly Economic Review Reports

The public sector's wage bill has been growing steadily since the onset of devolution. Both levels of governments have faced industrial unrests by health workers, teachers and lecturers at public universities. This has resulted in downtime at public hospitals, including loss of life by patients unable to meet the cost of health care at the mission and private hospitals and disruption of learning in institutions. It has also an upward pressure on the wage bill.

2.4.2. Analysis of County Governments Expenditure

The county governments' expenditure for financial year 2016/17 amounted to Kshs. 319 billion against a budget of Kshs. 399.24 billion. As shown in Table 4, counties spent on average over 40 percent of their total expenditures on the wages against provisions of the PFMA 2012 fiscal responsibility principles that require the wage bill to be contained at 35 percent. At the onset of devolution, the counties spent 46 per cent of their expenditures on wages which reduced to 40 percent but surged to 48 percent in the financial year 2016/17. The growth in the counties' wage bill undermines national efforts to attain the national target of 7 percent of GDP. This also underscores the need to encourage county governments to urgently undertake outstanding staff rationalization.

Table 4: County Revenue & Expenditure Analysis in Kshs. Billions

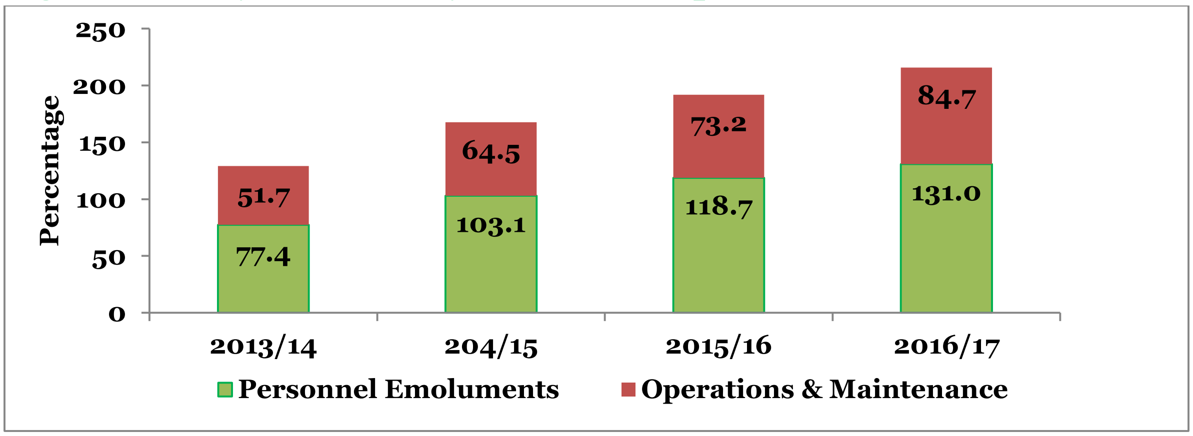
Item	2013/14	2014/15	2015/16	2016/17
Revenue	**216.3**	**262.35**	**294.79**	**312.82**
National Transfers	190	228.5	259.77	280.30
Local Revenue	26.3	33.85	35.02	32.52
Recurrent	**132.8**	**167.56**	**191.85**	**215.71**
Personnel Emoluments	77.4	103.1	118.65	130.97
Operations & Maintenance	51.7	64.46	73.2	84.74
%Recurrent To Total Expenditure	78%	65%	65%	68%
Development	**36.6**	**90.44**	**103.45**	**103.34**
%Development To Total Expenditure	22%	35%	35%	32%
Total	**169.4**	**258**	**295.3**	**319.06**
Deficit/Surplus	46.9	4.35	-0.51	-6.23

Source: CRA; COB, Various Issues

The counties' expenditures on recurrent and development have consistently increased since devolution (Table 4). Total expenditure has increased over the last three financial years from Kshs. 169.4 billion in financial year 2013/14 to Kshs. 295.3 billion in financial year 2015/16. Expenditure in these years has been directly proportional to county revenue. i.e. Kshs. 216.5 billion in financial year 2013/14 to Kshs. 295 billion. This demonstrates the county governments' dependency on national transfers which are generally adjusted to take account of increases in cost of living. On the other hand, own source revenues have not been growing at a rate sufficient to complement national transfers. It will be very difficult to increase access to public services going forward without putting greater effort in raising additional revenues at the county level.

A large component (68%) of county resources are used on recurrent costs. Figure 6 presents a breakdown of the county governments' recurrent expenditure between personnel and operations and maintenance.

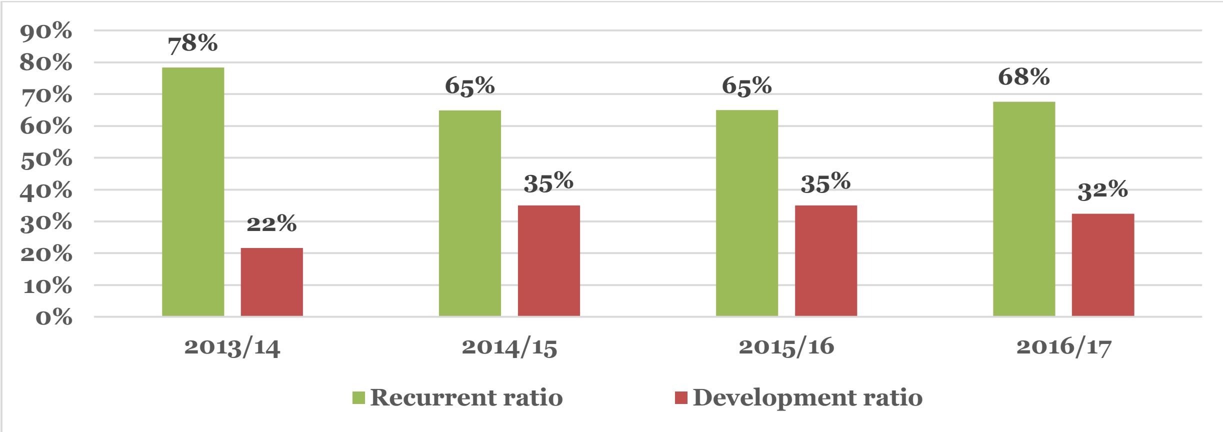
Figure 6: Analysis of County Recurrent Expenditure in Kshs. billions



Source: CoB Budget Implementation Reports

The proportion of recurrent expenditure on personnel emoluments has gradually increased over the three fiscal years from Kshs. 77.4 billion in 2013/14 to Kshs. 118.65 billion in 2015/16. Figure 6 reveals the peculiarity in the counties where the personnel emolument costs are higher than operations and maintenance over the four financial years. This could be due to the misclassification of the expenditure items by counties when reporting.

Figure 7: County Recurrent and Development Expenditure



Source: CRA Computations, 2017

The recurrent–to-development budget ratio is an important tool in measuring the county governments' effort to balance development for effective delivery of services. Figure 7 provides the recurrent and development expenditures by counties as a percentage of their total expenditures over the five years. Development expenditure increased from 22 percent in 2013/14 to 35 percent for 2014/15 and 2015/16 before declining slightly to 32 percent in 2016/17.

The results show that for financial year 2013/14, counties did not meet the requirement of PFM Act 2012 which sets development expenditure to be pegged at least 30 percent of the total budget. Between financial year 2014/15 and financial year 2015/16 counties improved their development expenditure by investing 35 percent of the budget on projects. However, it should be noted that county governments are still experiencing challenges with the classification of budget line items between recurrent and development. It will therefore take some time before the information is sufficiently clear for the actual situation to be known.

3.0 SHAREABLE AND NON-SHAREABLE REVENUE

The shareable revenue as stipulated under Article 202(1) of the Constitution requires that the revenues raised nationally be shared equitably among the national and county governments. The shareable revenue excludes internal and external loans borrowed by the national government. The allocation to counties is based on shareable revenues defined in the Constitution and Section 2 of the Commission on Revenue Allocation Act, 2011 as:

"all taxes imposed by the national government under Article 209 of the constitution and any other revenue (including investment income) that may be authorized by an Act of Parliament, but excludes revenues referred to under Articles 209 (4) and 206(1)(a)(b) of the Constitution".

Table 5 presents a summary of shareable and non-shareable revenue for financial years 2013/14 to 2016/17.

Table 5: Shareable and Non-Shareable Revenues in Kshs. Millions

NO.	PARTICULARS	2013/14	2014/15	2015/16	2016/17
	SHAREABLE REVENUE				
1.	Opening Balance	496	162	-	-
2.	Income Tax from Individuals (P.A.Y.E)	249,873	279,796	286,166	305,164
3.	Income Tax from Corporations	199,717	228,785	278,397	322,305
4.	Immovable Property	-	-	5,336	-
5.	V.A.T. on Domestic Goods & Services	105,888	127,905	160,389	194,220
6.	V.A.T. on Imported Goods & Services	126,911	131,781	128,824	144,814
7.	Excise Taxes	102,029	115,872	139,540	165,474
8.	Licenses under Traffic Act	3,323	2,825	3,652	2,755
9.	Royalties	-	-	654	-
10.	Customs Duties	67,555	74,048	79,188	89,943
11.	Other Taxes from International Trade & Transactions	26,678	26,993	25,245	22,947
12.	Stamp Duty	9,987	11,468	10,424	8,596
13.	Interest Received	586	1,609	2,074	2,531
14.	Profit & Dividends from CBK	-	-	4,818	-
15.	Other Profits and Dividends	10,181	12,873	16,103	29,098
16.	Rent of Land	1,588	1,774	1,443	919
17.	Land Adjudication and Case Fee	-	-	124	920
18.	Immigration Visas and Other Consular Fees	775	2,509	3,904	6,562

NO.	PARTICULARS	2013/14	2014/15	2015/16	2016/17
19.	Work Permit Fees	1,121	1,489	4,828	2,706
20.	Passport Fees	170	11	755	81
21.	Fishing Rights	-	211	337	171
22.	Betting Control	-	3	3	-
23.	Registration Services	129	505	310	519
24.	Fines, Penalties & Forfeitures & Other Charges	1,443	2,491	2,278	1,518
25.	Others	1,023	678	3,313	3,292
26.	Miscellaneous Revenue	26,180	14,249	4,406	1,776
	SUB TOTAL-SHAREARABLE REVENUE	**935,653**	**1,038,035**	**1,162,513**	**1,306,310**
	NON-SHAREABLE REVENUE				
27.	Recurrent Recovery Over Issues 2008/09 & 2009/10	66	-	-	-
28.	Development Recovery Over Issues 2008/09 & 2009/10	17	-	-	-
29.	Grants from Foreign Govt. through Exchequer	6,431	6,631	5,703	28
30.	Contribution from Govt. Emp. To S.&W.S within Govt.	-	120	-	-
31.	Loans from Foreign Govt. through Exchequer	28,432	30,310	6,705	38,131
32.	Loans to Non-Financial Public Enterprises	1,148	2,695	2,366	1,750
33.	Loans to Financial Institutions	119	203	353	-
34.	Domestic lending-T/Bills	-	37,000		86,000
35.	Domestic lending-T/Bonds	160,660	255,680	191,149	328,990
36.	Grants from International Organizations	-	3,843	13,662	7,008
37.	Borrowing from International Organizations	-	3,454	37,087	-
38.	Commercial loan	34,648	215,470	162,545	186,303
39.	AMISON Grants	4,695	3,843	6,440	6,787
40.	Net Domestic Borrowing(CBK)	106,700	-	-	-
	SUB TOTAL -NON-SHAREABLE	**342,917**	**559,248**	**426,010**	**654,997**
	GRAND TOTAL	**1,278,570**	**1,597,283**	**1,588,523**	**1,961,307**

Source: National Treasury Exchequer Account Various Reports

4.0 FUNCTIONAL ASSIGNMENT AND FINANCING

The Constitution establishes two levels of government that are distinct and interdependent. The functions of national and county governments are listed in the Fourth Schedule of the Constitution.

Article 186(2) makes provision for concurrent functions that are performed by more than one level of government. Residual functions or power not assigned by the constitution or national legislation to a county are a function of the national government.

Article 187 (2) of the Constitution also provides that, if a function or power is transferred from a government at one level to the other level, then arrangements shall be put in place to ensure that the resources necessary for the performance of the function or exercise of the power are transferred in line with the principle of *'funds must follow functions.'* In the 2018/19 financial year, there are no new functions approved for transfer to either level of government.

However, some functions were transferred from national to county governments under Gazette Notice No. 2238 of 1st April 2016, notably Libraries and Class D roads without the attendant resource due to delays in convening of the Summit to ratify a recommendation by the adhoc technical committee established by the Summit in February 2016.

Tables 6 and 7 present summaries of the Commission's recommendation for financing of the county and national government functions in the recent past and into 2018/19.

Table 6: Financing of National Government Functions in Kshs. Millions

No	Sector	Actual Expenditure 2016/17[4]	2017/18 Estimate	2018/19 Ceiling	% change (2017/18 & 2018/19)
1	**Social Protection, Culture and Recreation:** Sports, Culture and Arts; Labour Social Security and Services	50,511	46,180	54,945	19%
2	**Education:** Education; Science and Technology; TSC	325,505	374,987	429,007	14%
3	**National Security:** Defence, National Intelligence Services)	130,194	130,223	143,413	10%
4	**Environment Protection, Water and Natural Resources:** Environment & Natural Resources;	59,015	73,587	79,158	8%

[4] Provisional figures

No	Sector	Actual Expenditure 2016/17[4]	2017/18 Estimate	2018/19 Ceiling	% change (2017/18 & 2018/19)
	Water & Regional Authorities; Mining				
5	Health	56,597	61,700	64,531	5%
6	**Agriculture, Rural and Urban Development:** Land, Housing and Urban Development, Agriculture, Livestock, Fisheries, NLC	40,680	38,397	40,132	5%
7	**Public Administration and International Relations:** Presidency; Planning; Devolution; Foreign Affairs & International Trade; National Treasury, Parliamentary Service Commission, CRA, PSC, SRC, AG, CoB ; IGTRC; & CAJ)	175,192	270,191	277,029	3%
8	**Energy, Infrastructure and ICT:** Infrastructure; Transport, ICT; Energy and Petroleum)	428,262	415,743	408,413	-2%
9	**Governance, Justice, Law and Order**: Interior; Coordination of National Government; Attorney General & Justice; The Judiciary; EACC; DPP; Registrar of Political Parties, KNCHR, IEBC, JSC, NPSC; NGEC; IPOA	181,334	202,551	197,821	-2%
10	**General Economic and Commercial Affairs:** Industrialization & Enterprise, East African Affairs; Commerce & Tourism)	19,467	19,794	19,072	-4%
	Total	**1,466,757**	**1,633,354**	**1,713,520**	**5%**
11	**Other Government obligations:** Loan repayments, pension and other expenses	335,200	356,900	431,500[5]	20%

Source: CRA Computations

[5] BROP2017 projection

Table 7: Financing of County Government Functions in Kshs. Million

	FUNCTIONS	Actual Kshs. Million		Recommendation
DEVOLVED FUNCTIONS		**2016/17**	**2017/18**	**2018/19**
1	Health Services	76,677	89,131	95,846
2	Planning & Development	57,661	54,694	58,815
3	Agriculture, Livestock and Fisheries	21,881	26,452	28,445
4	Culture, Public Entertainment & Public Amenities	3,351	3,272	3,519
5	Youth Affairs and Sports	4,848	6,481	8,969
6	Trade, Cooperative Development & Regulation	4,855	6,096	6,555
7	Roads &Transport	44,256	49,596	59,677
8	Lands, Housing and Public Works	6,316	6,754	7,263
9	Water, Natural Resources & Environmental Conservation	7,937	8,119	8,731
10	Pre-Primary Education	2,605	4,241	4,560
SUB TOTAL DEVOLVED FUNCTIONS		**230,387**	**254,836**	**282,380**
11	New County Structures	49,913	47,164	54,783
TOTAL EQUITABLE SHARE		**280,300**	**302,000**	337,163
CONDITIONAL ALLOCATIONS				
12	Level 5 Hospitals	4,000	4,200	4,500
13	Free maternal Health Care	4,121	3400	4,142
14	Establishment of six regional Cancer Referral Hospitals	-	-	5,000
15	Establishment of a national Cancer Drug programme	-	-	1,000
16	Compensation for user fees	900	900	900
17	Leasing of Medical Equipment	4,500	4,500	4,500
18	Road Fuel Levy Fund	4,307	11, 068	8,269
19	Special Purpose Grant for Emergency Medical Services	200	-	-
20	Construction of Headquarters in five Counties	-	605	605
22	Rehabilitation of Village Polytechnics	-	2,000	2,000
TOTAL CONDITIONAL ALLOCATIONS		**18,028**	**26,694**	**30,174**
TOTAL		**298,328**	**314,205**	**367,337**

Source: CRA 2017

5.0 RECOMMENDATIONS ON EQUITABLE SHARES OF REVENUE BETWEEN NATIONAL AND COUNTY GOVERNMENTS

5.1 Equitable Share of Revenue Financial year 2018/19

The nationally raised revenue for financial year 2018/19 is projected at Kshs.1,885 billion, out of which, Kshs. 1,717 is shareable. In accordance with the provisions of Article 216(1)(a) and Article 203(1), the Commission recommends that, Kshs. 1,371.2 billion and Kshs. 337.2 billion be allocated to national and county governments, respectively as equitable shares for financial year 2018/19 as shown in Table 8.

Table 8: Revenue Shares for National and Counties for FY 2018/19

Budget Items		Kshs. Billions	Percentage
Projected Sharable Revenues For 2018/19		1,717.0	**100**
TO BE ALLOCATED AS FOLLOWS:			
1	National Government	1,371.2	**79.9**
2	County Governments	337.2	**19.6**
3.	Equalization Fund	8.6	**0.5**

Source: Budget Review Outlook Paper September 2017 & CRA 2017

This recommendation uses the 2017/2018 actual allocation to counties amounting to Kshs. 302 billion as the base. The base is adjusted by Kshs. 8. 43 billion for construction and rehabilitation of 31,356 kilometers of class D roads and Kshs. 319 million for salaries and operations of devolved libraries. These functions were transferred from the national to county governments through a Kenya Gazette supplement of April 2016. The combined base of Kshs. 310.7 billion was adjusted for cost of living using a three-year average inflation of 7.1 percent and 1.4 percent to provide for growth in services. The provision for growth in services is computed from relative county and national government development expenditures observed from the recent past. The Commission considers growth in development expenditure important in increasing the capacity of county governments to improve delivery of services to the public. The growth factor has been kept modest to obviate bursting of the national fiscal framework.

These adjustments translate into an allocation of Kshs. 337.2 billion to the counties for financial year 2018/2019. The resultant equitable revenue sharing outcomes between the national and county governments are presented in Table 8. For purposes of completeness, the Commission has also responded to the requirement of Article 204 (1) which is that one half percent of revenues collected by the national government every year be put into the Equalization Fund for addressing marginalization. For financial year 2018/2019, this amounts to Kshs. 8.6 billion.

5.2 Conditional Grants to Counties

Article 202(2) provides for additional allocation to county governments from the national governments share of revenue, either conditionally or unconditionally. Conditional allocations are tied to implementation of specific national policies with specific objectives. Table 9 presents a summary of current conditional allocations and provision for new conditional allocations.

Table 9: Conditional Allocations to County Governments in Kshs. Millions

	Conditional Transfers	Actual Allocation 2017/18	Recommendation 2018/19
A		**Current Conditional Transfers**	
1	Level 5 Hospitals	**4,200**	**4,500**
2	Free maternal Health Care	**3,400**	3,400
3	Compensation for user fees forgone	**900**	900
4	Leasing of Medical Equipment	**4,500**	4,500
5	Road Fuel Levy Fund	**11,089**	8,556
6	Development of Youth Polytechnics	**2,000**	2,000
7	Supplement for construction of county headquarters	**605**	605
	Total Current Conditional Transfers	26,694	**24,461**
B	**Recommended New Conditional Transfers**	-	**6,000**
1	Establishment of two Regional Cancer Referral Centres at a cost of Kshs. 2.5 billion each	-	5,000
2	Establishment of a National Cancer Drugs Access Programme	-	1,000
	Total Conditional	26,694	**30,461**

Source: CRA 2017

As noted in Table 9 above, the Commission further recommends that Kshs.30.5 billion be allocated to county governments as conditional transfers to support existing and new county level programmes. The on-going conditional allocations amount to Kshs. 24,461 million comprising of allocations for Level 5 Hospitals, Maternal Health Care, Compensation for User Fees Forgone, Leasing of Medical

Equipment, Road Fuel Levy Fund, development of Youth Polytechnics and the construction of county headquarters in five counties[6].

5.2.1 A Note on the new Conditional grants

Cancer is the third leading cause of death after infectious and cardiovascular diseases in Kenya. The annual incidence of cancer is close to 37,000 new cases with an annual mortality of over 28,000[7]. Treatment of cancer is either through surgery, chemotherapy, radiotherapy or a combination of two or all. Although many county referral hospitals can now diagnose cancer and undertake surgical operation, chemotherapy can only be done at either Kenyatta Referral Hospital, Moi Referral Hospital or at Nyeri level 5 hospital. Radiotherapy can only be done at Kenyatta Referral Hospital.

Article 202(2) provides that county governments may be given additional allocations from the national government share of revenue, either conditionally or unconditionally. Based on these requirements, the Commission recommends that provision be made for a conditional grant to be spent by the national government on behalf of the county governments to establish two additional regional cancer centres. The Commission further recommends for a National Cancer Drug Access Programme starting financial year 2018/19. In order to kick off this initiative, the Commission recommends a grant of Kshs. 5.0 billion for construction and equipping of the centres and a further Kshs. 1 billion for the Cancer Drugs Access Programme be allocated to the Ministry of Health. This will ensure that cancer can not only be appropriately diagnosed but also adequately treated. This programme will be a major step in realizing the country's dream of universal healthcare.

While conditional grants are important in actualizing specific national policies, the Commission urges that their sharing among counties be equitable, with their distribution done in a way that protects the independence of the county governments with respect to budgeting, planning and budget execution. For efficient execution of budgets, county governments require budget flexibility to decide expenditure priorities and the choice of both the output mix and techniques of production within budget guidelines and other public finance limits.

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[6] Tharaka Nithi, Isiolo, Nyandarua, Lamu and Tana River

[7] http://kehpca.org/wp-content/uploads/KENYA-NATIONAL-CANCER-CONTROL-STRATEGY-2017-2022.pdf

6.0 HOW THE RECOMMENDATION MEETS REQUIREMENTS OF ARTICLE 203

Article 203 of the Constitution provides the criteria to be considered in determining the basis for equitable sharing of revenues between the national and county governments. In this recommendation, the Commission has considered the criteria as detailed below.

6.1. National Interest

National interest refers to agreed policies, goals, priorities, and resultant programs which have fiscal implications and benefit the whole country. Decisions on national interest priorities do have financial implications on the functions of either level of government.

The Commission considers the following priorities defined in Third Medium Term Plan (2018-2022) and the Budget Review Outlook Paper 2017 as a basis for determining national interest. These are:

(a) Programmes focusing on employment creation
(b) Establishment of a government sponsored apprenticeship for all university and TVET graduates
(c) Doubling in the number of vulnerable citizens supported through the cash transfer programme (INUA Jamii) and all senior citizens above the age of 70 years
(d) Provision of health insurance cover through the NHIF for all citizens above the age of 70 years
(e) Enhancement of the education programme to include free day public secondary schools;
(f) Expanding free maternity programme to include NHIF cover for postnatal care for one year;
(g) Increasing connectivity to reliable and affordable electricity (on or off-grid) by 2020;
(h) Expansion of food and agricultural production and increase in the fertilizer subsidy initiative to reduce the cost to farmers

6.2. Public Debt and other National Obligations

6.2.1. Public Debt

Public debt is defined in Article 214 as all financial obligations attendant to loans raised or guaranteed and securities issued or guaranteed by the national government. Article 203(1) provides for consideration of public debt service during revenue sharing. The Commission in preparing this recommendation has taken into account that the national government will spend Kshs. 596.1 billion on debt repayment for financial year 2018/19.

6.2.2. Other National Obligations

National obligations refer to those obligations that the National government may have, and which affect the entire country. Excluded from these are those obligations that arise as part of the National government's functions. Obligations that are outside the national government functions considered in this recommendation include the cost of shared institutions such as the Judiciary, Parliament, Constitutional Commissions, and Independent Offices.

6.2.3. Needs of National Government, Ability of Counties to Perform Functions Allocated to them and Developmental needs of Counties

The Commission has considered the functions of the National and County governments as set out in Fourth Schedule of the Constitution which relates to both recurrent and development needs. Tables 6 and Table 7 provides for financing of national and county government functions, at Kshs. 2,227,300 million and Kshs. 367,337 million respectively, for financial year 2018/2019.

6.2.4. Flexibility in Response to Emergencies

The Constitution allocates to both levels of governments the function of disaster management, which incorporates the management of emergencies at a national and/ or county level. Indeed, the Constitution requires the setting up of a Contingency Fund to manage unforeseen and urgent expenditure, which would include disaster management. The Contingency Fund has already been set up under the PFM Act 2012 Section 20(2) with a ceiling of Kshs. 10 billion. Based on practice, the national government funding summarized in Table 6 provides for the Contingency Funding at Kshs. 5,000 million budgeted under other government obligations.

The County governments are also required to establish an emergency fund to manage urgent and unforeseen expenditures for which there is no specific legislative authority to deal with emergencies that may affect Counties. The PFMA Section 110 provides that county government may establish an emergency fund not exceeding two percent of their total revenues. County governments have discretion of planning and budgeting. From the revenues allocated to them for 2018/19, and indeed from their own source revenues, counties have adequate revenues from which to set up emergency funds.

6.2.5. Economic Disparities within and among Counties and the Need for Affirmative Action

Article 202 (2) stipulates that county governments may be given additional allocations from the national government's share of revenue, either conditionally or unconditionally. The Commission has recommended that Kshs. 30.5 billion be allocated to county governments as conditional allocations to cater for other needs of counties and address economic inequalities. These conditional allocations also consider specific counties for special grants under the affirmative action, to include building of county headquarters and establishment of additional regional cancer treatment centres based on prevalence of cancer in the country.

6.2.6. The desirability of stable and predictable allocations of revenue.

The recommendation on equitable sharing of revenue to both national and county governments has remained stable and predictable. In making the recommendation, the Commission has ensured that both the national and county government functions are not subjected to volatile budgets. This has been achieved using a three-year average inflation rate to smooth revenue allocation cross the years for both levels of government.

7.0. BASIS FOR SHARING REVENUE AMONG COUNTIES FOR 2017/18

In accordance with the provision of Article 217, and the Sixth Schedule Section 16, Parliament determined in June 2016, the second basis for allocating among the counties, the share of revenue raised nationally that is annually allocated to the county governments. This basis is summarized in Table 10.

Table 10: Second Basis for Revenue Sharing among Counties

NO	PARAMETER	FIRST BASIS	SECOND BASIS
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

The approved basis for the sharing of revenues among county governments provides that the parameter on Fiscal Effort weighted at two per cent be revised annually. The county fiscal effort is based on a county's actual own source revenue increment per capita for the previous two financial years. Appendix V presents the revised Fiscal Effort index used for the sharing of two per cent of the counties' equitable share of revenue for financial year 2018/19. The Commission notes with concern that except two counties, namely Marsabit and Turkana, all other counties not only failed to realize their revenue targets, but also that 19 counties collected less revenues in 2016/17 compared to 2015/16. This is shown in Appendix II.

As provided for in the second basis for revenue sharing among county governments, Table 11 presents the revised basis for sharing revenue for financial year 2018/19. Further, the table details the allocations to all the 47 county governments based on the Commission recommendation that Ksh.337,163 million be allocated to counties as equitable share.

Table 11: Summary of Equitable Share among County Governments

No	County	1st Basis Allocation Factor	2nd Basis Allocation Factor	Allocations to Counties 2018/19 (Kshs. Millions)
1	Baringo	1.71	1.62	5,468
2	Bomet	1.81	1.89	6,381
3	Bungoma	2.95	2.85	9,603
4	Busia	2.09	1.90	6,408
5	Elgeyo-Marakwet	1.26	1.20	4,053
6	Embu	1.48	1.42	4,787
7	Garissa	2.22	2.21	7,465
8	Homa-bay	2.17	2.13	7,185
9	Isiolo	1.18	1.25	4,223
10	Kajiado	1.70	1.91	6,432
11	Kakamega	3.43	3.29	11,098
12	Kericho	1.73	1.82	6,138
13	Kiambu	2.87	2.98	10,061
14	Kilifi	2.86	3.45	11,620
15	Kirinyaga	1.36	1.31	4,433
16	Kisii	2.73	2.45	8,279
17	Kisumu	2.19	2.20	7,425
18	Kitui	2.80	2.78	9,359
19	Kwale	1.97	2.40	8,106
20	Laikipia	1.33	1.31	4,438
21	Lamu	0.79	1.13	3,813
22	Machakos	2.61	2.65	8,945
23	Makueni	2.30	2.27	7,640
24	Mandera	3.45	3.23	10,883
25	Marsabit	2.00	2.23	7,525
26	Meru	2.50	2.55	8,598
27	Migori	2.25	2.14	7,207
28	Mombasa	2.00	2.62	8,817
29	Murang'a	2.06	1.99	6,706
30	Nairobi city	5.00	5.03	16,960
31	Nakuru	3.12	3.01	10,140
32	Nandi	1.83	1.71	5,767
33	Narok	2.04	2.03	6,834
34	Nyamira	1.60	1.52	5,131
35	Nyandarua	1.66	1.57	5,278
36	Nyeri	1.71	1.60	5,386
37	Samburu	1.37	1.41	4,742
38	Siaya	1.92	1.92	6,478
39	Taita-taveta	1.27	1.29	4,352
40	Tana-river	1.53	1.77	5,962
41	Tharaka-nithi	1.21	1.16	3,902

No	County	1st Basis Allocation Factor	2nd Basis Allocation Factor	Allocations to Counties 2018/19 (Kshs. Millions)
42	Trans-nzoia	1.96	1.79	6,050
43	Turkana	4.03	3.43	11,573
44	Uasin-gishu	2.00	1.89	6,360
45	Vihiga	1.49	1.42	4,773
46	Wajir	2.78	2.70	9,088
47	West pokot	1.66	1.57	5,291
	Total	**100.00**	**100.00**	**337,163**

Source, CRA 2017

8.0 CONCLUSION

The 2018/2019 recommendation is based on the actual allocations of Ksh 302 billion to counties for financial year 2017/2018. This base is adjusted for functions transferred to counties without attendant allocations. Further adjustments are made to provide for changes in the cost of living and modest growth in the provision of services keeping in mind the need to obviate bursting of the overall national fiscal framework. These considerations lead to a specific recommendation for allocation from equitable share amounting to Kshs. 337.2 billion to the counties. Conditional grants recommended for the counties amount to Kshs. 30.5 billion, most of it on on-going conditional programmes.

The recommendation comprehensively responds to the demanding requirements of Article 203 of the Constitution of Kenya 2010. In accordance with PFMA 2012 Section 190(1)(b) (2)(b), the Commission subjects the recommended allocation of equitable share of revenue to the counties amounting to Kshs. 337.2 billion to the second basis for sharing of revenue among counties. This is done by making the necessary adjustments on the fiscal effort factor to reflect the performance of county governments in collection of OSR.

In the recommendation, the Commission considers not only the national and county governments' revenue collection efforts but also the overall performance of the economy. The Commission takes note of the disappointing revenue raising performance of the county governments.

Concern is raised in this recommendation about the recent interest rate regime that has skewed the flow of credit towards the public sector. Interest rate ceilings are likely to have undermined national productivity by reducing private sector's access to credit.

The wage bill at both levels of government takes the lion's share of recurrent expenditure, pointing at the need to refine division of responsibilities at both levels of government. National debt has also ballooned in the recent past not only eroding the quantum resources available for sharing, but also raising sustainability- related questions.

APPENDICES

Appendix I: Revenue from Road Maintenance Levy Fund

KRB

Financing Road Maintenance

KENYA ROADS BOARD

3rd Floor, Kenya Re-Towers, Off Ragati Road, Upper Hill
P. O. Box 73718 - 00200, Nairobi, Kenya.
Tel: +254 (020) 2722865/6/8, Fax: + 254 (020) 2723161
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KRB/F/29/01/A/Vol. II (14)

7th November 2017

Mr. George Ooko
Commission Secretary/CEO
Commission on Revenue Allocation
14 Riverside Drive
Grosvenor Block, 2nd Floor
NAIROBI

RECEIVED
08 NOV 2017

Dear Mr Ooko,

RE: FUEL LEVY FUND FORWARD BUDGET ESTIMATES FOR FINANCIAL YEARS 2017/18 TO 2019/20

Reference is made to letter Ref. No. CRA/CSO/OM&SC/3/VOL. III (01) of 2nd November 2017.

As requested in the referenced letter, the estimates for Road Maintenance Levy Fund and anticipated allocation to counties are as follows:

	FY 2017/18	FY 2018/19	FY 2019/20
	Kshs	Kshs	Kshs
Fuel Levy Estimates (excluding Roads Annuity Fund)	52,500,000,000	57,041,666,667	59,893,750,000
Allocation to County Governments	11,068,192,369	8,556,250,000	8,984,062,500

These estimates may change in future, in light of emerging economic conditions.

Yours Sincerely,

Eng. Jacob Z. Ruwa, OGW
EXECUTIVE DIRECTOR

ISO 9001:2008 Certified

Appendix II: Performance of County Governments Revenues

County	Target OSR (Kshs. Millions)			OSR Actual Collection (Kshs. Millions)			Performance OSR (%)		
	2014/15	2015/16	2016/17	2014/15	2015/16	2016/17	2014/15	2015/16	2016/17
Baringo	452	300	330	250	279	289	55	93	87
Bomet	380	335	275	206	167	237	54	50	86
Bungoma	1,075	820	732	505	631	662	47	77	90
Busia	766	543	588	315	334	257	41	62	44
Elgeyo/Marakwet	85	150	160	129	128	97	152	85	61
Embu	748	631	804	401	397	416	54	63	52
Garissa	500	500	350	131	106	82	26	21	23
Homa Bay	402	182	192	158	184	144	39	101	75
Isiolo	361	360	250	134	110	95	37	31	38
Kajiado	1,847	1,135	1248	786	651	557	43	57	45
Kakamega	874	1,000	894	517	504	443	59	50	50
Kericho	671	553	603	414	434	490	62	78	81
Kiambu	3,374	3,683	3070	2,111	2,461	2033	63	67	66
Kilifi	1,000	1,407	1586	545	519	620	55	37	39
Kirinyaga	729	500	743	312	390	321	43	78	43
Kisii	974	700	725	297	306	272	30	44	37
Kisumu	2,843	1,864	1585	971	979	1004	34	53	63
Kitui	650	608	669	321	416	315	49	68	47
Kwale	500	300	261	254	249	221	51	83	85
Laikipia	400	500	670	400	471	463	100	94	69
Lamu	65	107	100	62	57	77	95	53	77
Machakos	2,533	2,372	2862	1,357	1,122	1259	54	47	44
Makueni	501	400	330	215	213	216	43	53	66
Mandera	251	199	266	88	88	56	35	44	21
Marsabit	48	130	120	99	112	129	206	86	107
Meru	902	998	773	539	548	553	60	55	71
Migori	300	400	420	355	339	291	118	85	69
Mombasa	6,936	4,072	5290	2,493	2,944	3166	36	72	60
Murang'a	1,140	850	994	562	618	507	49	73	51
Nairobi City	17,763	17,528	19566	11,500	11,710	10930	65	67	56
Nakuru	2,708	2,911	2597	2,200	2,295	1548	81	79	60
Nandi	456	256	362	298	237	245	65	93	68
Narok	3,909	3,507	2892	1,639	1,753	1534	42	50	53
Nyamira	219	241	198	104	107	94	47	44	47
Nyandarua	211	392	390	241	279	297	114	71	76
Nyeri	1,344	1,082	1095	681	710	643	51	66	59

County	Target OSR (Kshs. Millions)			OSR Actual Collection (Kshs. Millions)			Performance OSR (%)		
	2014/15	2015/16	2016/17	2014/15	2015/16	2016/17	2014/15	2015/16	2016/17
Samburu	407	357	346	196	167	188	48	47	54
Siaya	302	343	270	143	128	173	47	37	64
Taita/Taveta	522	310	356	217	173	172	42	56	48
Tana River	120	120	60	33	28	27	28	23	46
Tharaka - Nithi	250	248	200	116	139	79	46	56	39
Trans Nzoia	670	389	500	301	365	218	45	94	44
Turkana	500	200	180	127	134	186	25	67	104
Uasin Gishu	1,193	1,037	1192	801	719	664	67	69	56
Vihiga	378	252	220	116	139	96	31	55	44
Wajir	102	200	230	108	82	76	106	41	33
West Pokot	96	177	122	104	98	83	108	55	68

Source: Budget Implementation Review Report, Various Issues

Appendix III: County OSR Per Capita Collection

County	Population	OSR Actual Collection (Kshs. Millions)			OSR per Capita Collection (Kshs.)		
		2014/15	2015/16	2016/17	2014/15	2015/16	2016/17
Baringo	555,561	250	279	289	450	502	519
Bomet	730,129	206	167	237	282	229	324
Bungoma	1,375,063	505	631	662	367	459	481
Busia	743,946	315	334	257	423	449	345
Elgeyo/Mara kwet	369,998	129	128	97	349	346	263
Embu	516,212	401	397	416	777	769	806
Garissa	623,060	131	106	82	210	170	132
Homa Bay	963,794	158	184	144	164	191	150
Isiolo	143,294	134	110	95	935	768	663
Kajiado	687,312	786	651	557	1,144	947	811
Kakamega	1,660,651	517	504	443	311	303	267
Kericho	752,396	414	434	490	550	577	651
Kiambu	1,623,282	2,111	2,461	2033	1,300	1,516	1,252
Kilifi	1,109,735	545	519	620	491	468	559
Kirinyaga	528,054	312	390	321	591	739	607
Kisii	1,152,282	297	306	272	258	266	236
Kisumu	968,909	971	979	1004	1,002	1,010	1,036
Kitui	1,012,709	321	416	315	317	411	311
Kwale	649,931	254	249	221	391	383	340
Laikipia	399,227	400	471	463	1,002	1,180	1,159
Lamu	101,539	62	57	77	611	561	758
Machakos	1,098,584	1,357	1,122	1259	1,235	1,021	1,146
Makueni	884,527	215	213	216	243	241	244
Mandera	1,025,756	88	88	56	86	86	54
Marsabit	291,166	99	112	129	340	385	442
Meru	1,356,301	539	548	553	397	404	407
Migori	917,170	355	339	291	387	370	317
Mombasa	939,370	2,493	2,944	3166	2,654	3,134	3,371
Murang'a	942,581	562	618	507	596	656	538
Nairobi City	3,138,369	11,500	11,710	10930	3,664	3,731	3,483
Nakuru	1,603,325	2,200	2,295	1548	1,372	1,431	966
Nandi	752,965	298	237	245	396	315	325
Narok	850,920	1,639	1,753	1534	1,926	2,060	1,803
Nyamira	598,252	104	107	94	174	179	157
Nyandarua	596,268	241	279	297	404	468	498

County	Population	OSR Actual Collection (Kshs. Millions)			OSR per Capita Collection (Kshs.)		
		2014/15	2015/16	2016/17	2014/15	2015/16	2016/17
Nyeri	693,558	681	710	643	982	1,024	927
Samburu	223,947	196	167	188	875	746	838
Siaya	842,304	143	128	173	170	152	205
Taita/Taveta	284,657	217	173	172	762	608	604
Tana River	240,075	33	28	27	137	117	114
Tharaka - Nithi	365,330	116	139	79	318	380	215
Trans Nzoia	818,757	301	365	218	368	446	266
Turkana	855,399	127	134	186	148	157	218
Uasin Gishu	894,179	801	719	664	896	804	742
Vihiga	554,622	116	139	96	209	251	173
Wajir	661,941	108	82	76	163	124	115
West Pokot	512,690	104	98	83	203	191	162
Total	**38,610,097**	**33,849**	**35,022**	**32,523**	877	907	842

KNBS, 2010; Budget Implementation Review Report, Various Issues, CRA 2017

Appendix IV: County Level Programme Supported through Existing Conditional Grants

Below is a detailed description of existing conditional transfers from national to county governments.

Level Five Hospitals

These grants are meant to benefit referral hospitals whose catchment areas go beyond the boundaries of specific counties to provide specialized health care services. The grant compensates for the "spillover effect" or such costs as may be incurred in rendering the services to residents of neighbouring counties. Unfortunately, there is no way of ascertaining whether the amount spent in practice is in tandem with the benefits that accrue to the nonresidents. Furthermore, the national government has enables counties to equip two hospitals with modern equipment thereby minimizing the need for referrals. Allocation among counties is based on the percentage bed occupancy per hospital in the two years preceding the financial year being financed. As more counties apply for level 5 accreditation, the necessity of this grant will need to be reassessed.

Free Maternal Health Care

The main objective of the free maternal health care grant was to facilitate the access to free maternal health care services to reduce maternal and child mortality rates in the country. The grant is transferred to counties on a reimbursement basis after confirmation from county government that the county has provided maternal health care services. The national government, beginning financial year 2017/18 replaced the cash transfer to county health facilities with an insurance scheme through the National Hospital Insurance Fund (NHIF). The scheme guarantees mothers access to free maternal health care in various approved health facilities including mission and private health care. The NHIF uses the grant to reimburse such health care providers.

Leasing of Health Care Equipment.

The main objective of the grant is to facilitate the county governments to procure modern specialized medical equipment to equip two health facilities per county. This will ease access to specialised healthcare services at county level instead of travelling long distances in search of services. The grant is managed by the national government. Under this initiative, each county annually receives equal amount of Ksh. 95 million for this purpose.

Compensation of user fees forgone

This grant was introduced by the national government to compensate the counties for the revenue lost from the user fees charged by health centers and dispensaries. The National Treasury used the annual consolidated facility outpatient attendance workload to share the money across health centers and dispensaries within the county, using the total county population as a sharing factor.

Road Maintenance Fuel Levy Fund

The Road Levy Fund was established in 1993 through the Roads Maintenance Levy Fund Act to cater for the maintenance of public roads, including county roads. A conditional allocation of 15 per cent is extended to county governments from the annual proceeds of the Fund collected from the levy of Ksh.18 per litre of fuel, and shared based on the approved revenue sharing formula. This allocation is expected to be used exclusively road maintenance at the county level.

KDSP County Capacity Building Grant

This grant to counties is from a credit financed by World Bank to support capacity building initiatives in the counties in the following areas; strengthening public financial management systems and county human resource management; improving county planning and monitoring and evaluation systems; civic education and public participation and strengthening the intergovernmental relations.

The program has two levels of grants subject to different criteria the allocation criteria for level 1 grants is 50% shared equally and 50% shared based on he approved revenue sharing formula in accordance with Article 217 of the constitution. The grants under level 1 target capacity building at the county level and are accessible to all county governments. Level 2 grants on the other hand are accessed through a self-selection process and performance of the legible counties. Level 2 grant is shared based on the score attained by participating counties. The scoring criteria on term based on an intergovernmental agreement and subject to the Commission’s revenue formula.

Conditional Grant from Denmark and Loan from World Bank

This grant is to support the delivery of health services in county health facilities with a view to moving the country towards universal health care especially the intended among the poor.

Appendix V: County Fiscal Effort

No	County	County OSR (Kshs. Millions)			Per Capita Revenue Increment	Fiscal Effort Index[8]
		2014/15	2015/16	2016/17		
1	Baringo	250	279	289	17	1.390
2	Bomet	206	167	237	95	7.742
3	Bungoma	505	631	662	22	1.804
4	Busia	315	334	257	-	-
5	Elgeyo-Marakwet	129	128	97	-	-
6	Embu	401	397	416	37	3.028
7	Garissa	131	106	82	-	-
8	Homa-bay	158	184	144	-	-
9	Isiolo	134	110	95	-	-
10	Kajiado	786	651	557	-	-
11	Kakamega	517	504	443	-	-
12	Kericho	414	434	490	74	6.034
13	Kiambu	2,111	2,461	2033	-	-
14	Kilifi	545	519	620	91	7.388
15	Kirinyaga	312	390	321	-	-
16	Kisii	297	306	272	-	-
17	Kisumu	971	979	1004	26	2.096
18	Kitui	321	416	315	-	-
19	Kwale	254	249	221	-	-
20	Laikipia	400	471	463	-	-
21	Lamu	62	57	77	197	15.944
22	Machakos	1,357	1,122	1259	125	10.137
23	Makueni	215	213	216	4	0.299
24	Mandera	88	88	56	-	-
25	Marsabit	99	112	129	57	4.660
26	Meru	539	548	553	3	0.279
27	Migori	355	339	291	-	-
28	Mombasa	2,493	2,944	3166	237	19.188
29	Murang'a	562	618	507	-	-
30	Nairobi city	11,500	11,710	10930	-	-
31	Nakuru	2,200	2,295	1548	-	-
32	Nandi	298	237	245	10	0.833
33	Narok	1,639	1,753	1534	-	-
34	Nyamira	104	107	94	-	-
35	Nyandarua	241	279	297	30	2.417
36	Nyeri	681	710	643	-	-
37	Samburu	196	167	188	92	7.483
38	Siaya	143	128	173	53	4.317

[8] Fiscal effort measure is based on county's increment in own source revenue per capita for the financial years 2015/16 and 2016/17.

No	County	County OSR (Kshs. Millions)			Per Capita Revenue Increment	Fiscal Effort Index[8]
		2014/15	2015/16	2016/17		
39	Taita-Taveta	217	173	172	-	-
40	Tana-River	33	28	27	-	-
41	Tharaka-Nithi	116	139	79	-	-
42	Trans-Nzoia	301	365	218	-	-
43	Turkana	127	134	186	61	4.960
44	Uasin-Gishu	801	719	664	-	-
45	Vihiga	116	139	96	-	-
46	Wajir	108	82	76	-	-
47	West Pokot	104	98	83	-	-
	Total	33,849	35,022	32,523	1,233	100

Source: CRA 2017

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