Budget Brief No. 29

Have State Corporations Changed Under Devolution?

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Key Points

- **State corporations account for a sizable, and growing, share of Kenya's budget, and perform functions that span the national, regional, and county levels.**

- **The annual division of revenue determines how much money goes to counties and how much remains at national level. This should take into account state corporations. Much of the current debate about whether the national government has fully devolved its functions and finances relates to the roles and budgets of state corporations.**

- **Presently, state corporations performing functions that should have been devolved (as per the 2010 constitution) receive around 78 billion Kenyan Shillings in domestic funds from the budget. If these corporations are reformed, some (but certainly not all) of that money might flow to counties.**

- **Since devolution began in 2012, no fundamental reform of state corporations has taken place. While state corporations performing devolved functions need to be reformed, given the nature of their funding and the complexity of their functions, this will require substantial policy debate.**

- **Even if some state corporation money were released to counties, it might be better to do so through conditional grants, rather than the unconditional equitable share. This would help to ensure that the money is used for specific purposes (e.g., road maintenance) as is currently the case.**

- **In other cases, state corporations performing regional functions should potentially be maintained, but with counties given some managerial control through the boards of state corporations.**

- **Parliament should act immediately to consider how to reform all of the state corporations performing at least some devolved functions, so that this matter will be resolved in time for the next division of revenue.**

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Introduction

Each year, Kenya must determine the "division of revenue" – how much money to keep at national level and how much to devolve to the counties. This decision should be based on a number of factors: the priorities of citizens, a comparison of how much it costs to carry out the functions at each level, and the degree to which funds can be readily shifted from ongoing activities.

In an ideal world, all funding related to devolved functions would pass to counties and all funding related to national functions would remain with the national government. However, there are three challenges to making this happen.

First, there is ongoing debate about which activities correspond to which level (this is sometimes called "functional assignment"). For example, is the hiring of pre-primary teachers a county or national function? This matter has been contested in court. Pre-primary education is clearly a county function, but the hiring of teachers is generally the province of the national Teachers Service Commission. Furthermore, some functions (such as "energy reticulation") are explicitly shared in the constitution. Defining which part of a shared function belongs to which level of government is not always a simple process.

Second, not all functions can be dealt with at one of the two levels. For example, the water sector is a devolved function. But shared resources like water have regional implications that cross county lines. Rather than an individual county administering all of a regional resource, funding for regional functions might be better handled through regional institutions.

Third, and related to the second point, many devolved functions have traditionally been carried out by state corporations. In some cases, these corporations can simply be devolved and their funding passed to counties. In other cases, however, state corporations perform both national and county functions, such as playing both a policy role and an implementation role; or they play a regional role, as in the case of Water Service Boards. Such cases require thoughtful reform. Giving managerial control of these bodies to counties while maintaining them as national or regional entities may be the best solution.

The amount of money that is tied up in state corporations is an important factor affecting how much is available for the division of revenue each year. In earlier analysis we found that state corporations received over Ksh 350 billion – roughly a third of the total budget for all Ministries, Departments and Agencies (MDAs). [1] How much of this sizable share of the budget should be maintained at national level and how much channeled to counties is an important research topic. Using figures from the 2014/15 financial year (FY 2014/15), this brief builds on our earlier analysis to examine what reforms have taken place and how much state corporation funding is now available to be shared among the counties.

Two Years into Devolution: Where Are We?

A total of 157 state corporations received government transfers in the FY 2014/15 budget, up from 132 in FY 2012/13. This increase is largely due to the number of constituent university colleges that, in the past, were counted under the main universities, but are now fully fledged universities and counted as separate state corporations. Furthermore, the National Housing Corporation (NHC), while not a new institution, is now counted as a state corporation in the 2014/15 budget. The NHC was not previously captured in the budget estimates, presumably because it did not receive direct transfers from the budget. Interestingly, this allocation is under the Department of Government Investment and Public Enterprises in the National Treasury and not the Lands, Housing and Urban Development Ministry that deals with housing in the country. For the purpose of analysis in this brief, however, we will classify it under the Land, Housing and Environment sector.

1 Lakin, J. & Kinuthia, J "Government Spending: How Much Money is Tied up in State Corporations?" http://internationalbudget.org/wp-content/uploads/Budget-Brief-no-26-How-Much-Money-is-Tied-up-in-State-Corporations.pdf

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As in FY 2012/13, state corporations make up about a third (33 percent) of the total budget estimates for all MDAs, with a total allocation of 369 billion Kenyan Shillings (Ksh 369 billion) in FY 2014/15. Nevertheless, state corporation spending increased faster than the rest of the MDA budget over this period: a 4.9 percent increase for state corporation budgets versus less than 1 percent for the rest of the MDA budget. In addition, state corporations still account for a significant part of Kenya's development budget: almost half (47 percent) of the total MDAs allocation for development goes to state corporations (Ksh 223 billion out of 476 billion). Until state corporations performing devolved functions are restructured, these funds will likely remain at the national level.

Figure 1: State Corporation Budgets as a Share of the 2012/13 National Budget for Ministries, Departments, and Agencies

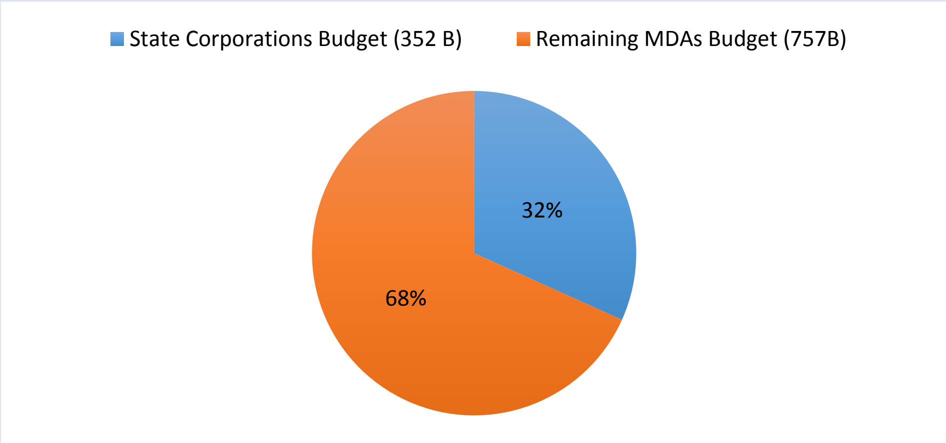
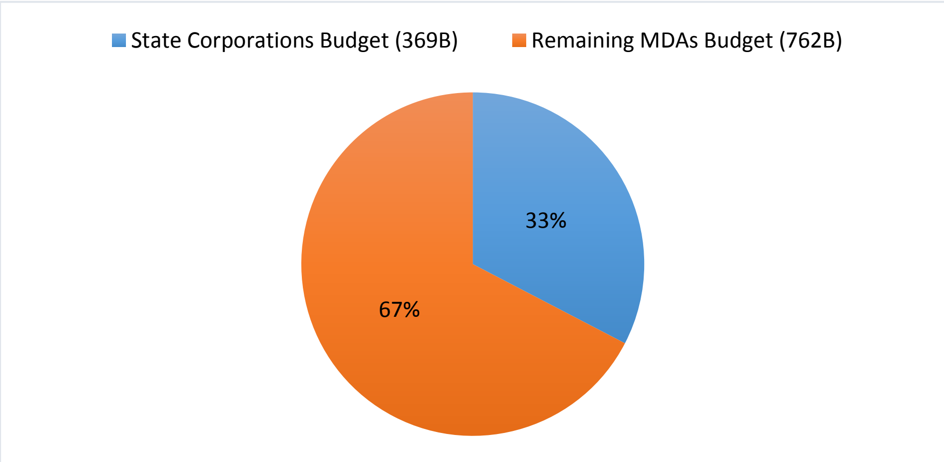


Figure 2: State Corporation Budgets as a Share of the 2014/15 National Budget for Ministries, Departments, and Agencies



To examine corporations at the sector level, we had to make some adjustments to the data. In our brief on state corporations in the 2012/13 budget, we aggregated the 45 votes that contained transfers to state corporations into 12 sectors. However, the rearrangement of ministries in 2013/14 means that some state corporations shifted from one ministry to another. This has led to some changes in our sectors, which are detailed in Annex 1. For comparability between the two years, we moved state corporations into the 2014/15 sectors when analyzing their funds in the 2012/13 budget. For example, to calculate the share for the Water and Regional Development sector, which did not exist in FY 2012/13, we took all the state corporations in that sector in FY 2014/15, and recreated the sector using FY 2012/13 budget numbers (see Table 1).

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With these changes in mind, we can now look at the distribution of state corporation allocations across sectors. The Infrastructure and Energy sector still accounts for over half (55 percent) of the total allocation to state corporations, taking up Ksh 204 billion of funding. If we add the state corporations in the Education sector (17 percent), the two sectors take up 72 percent of the total expenditure. The two sectors had the highest allocation in 2012/13 as well, with 58 percent for Infrastructure and Energy and 16 percent for Education. There have been no major changes in the sector allocations to state corporations between the two years.

Grants from government account for Ksh 173 billion out of the total 369 billion allocated to state corporations. This is a slight increase from 2012/13, when grants totaled Ksh 158 billion. It is also a small increase in percentage terms: grants make up 47 percent of total funding for state corporations in FY 2014/15, up from 45 percent in FY 2012/13. At the same time, the share of external financing is falling. Only 30 percent of the total 2014/15 budget for state corporations is from a combination of external Appropriations in Aid (AiA) and external revenues, a decrease from 39 percent in FY 2012/13.

Table 1: State Corporation Funding by Sector, 2014/15 and 2012/13 (Amount in billions)

Sectors	Total SC Expenditure Estimates,2012/13	Total SC Expenditure Estimates,2014/15	Sector Share of the Total Expenditure (2012/13)	Sector Share of the Total Expenditure (2014/15)
Infrastructure + Energy	203.6	204.0	57.9%	55.3%
Education	56.3	61.0	16.0%	16.5%
Health	16.4	22.7	4.7%	6.2%
Water and Regional Development	25.9	20.9	7.4%	5.7%
State Administration	14.3	17.6	4.1%	4.8%
Agriculture	9.9	16.5	2.8%	4.5%
Lands,Housing and Environment	8.4	11.9	2.4%	3.2%
International Relations and Commerce	6.4	5.8	1.8%	1.6%
Planning and Devolution	3.1	3.9	0.9%	1.0%
Gender,Youth and Culture	6.2	2.8	1.8%	0.7%
Parliament, AG, Judiciary and Constitutional Commissions	0.2	0.9	0.05%	0.25%
Security	1.0	0.9	0.28%	0.23%
Total	**351.7**	**368.8**	**100%**	**100%**
Of which:	-	-		
Government Transfers	**158.4**	**173.0**	**45%**	**47%**
Local Appropriation in Aid (AiA)	**56.3**	**85.5**	**16%**	**23%**
External AIA + External Revenues	**137.1**	**110.4**	**39%**	**30%**

How Much Has Been Devolved?

State corporations run a wide range of government services, including some that relate to functions that have been devolved. A number of these entities could potentially be reformed to align with the new constitution.

Between FY 2012/13 and FY 2014/15, has any state corporation funding been devolved? Our earlier analysis of the 2012/13 budget identified 34 state corporations that could be partially or fully devolved. These include:

- 18 state corporations recommended for devolution in *The Report of the Presidential Taskforce on Parastatal Reforms*.
- Four state corporations were marked for devolution in the 2012/13 budget but were not listed in the taskforce report.
- A further 12 state corporations were, according to our own assessment, running shared functions or functions that could potentially be devolved.

The 2014/15 national budget estimates reveal that funding for all 34 of these state corporations remains at the national level, as does funding to the NHC.

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Of these 35 state corporations, funding for 14 state corporations (including NHC) has been increased by Ksh 27 billion. Two state corporations, the Rural Electrification Authority and the National Irrigation Boards, account for 72 percent of this increase. Funding to the remaining 21 state corporations has been cut by Ksh 17 billion. The budgets of the National AIDS Council, a number of Water Boards, and the Roads Authorities have all been reduced by around a billion or more.

Table 2: State Corporations Performing Potentially Devolved or Shared Functions: What Happened to Their Budget Since 2012/13?

2014/15 Allocations v. 2012/13	Total	Increase from 2012/13	Decrease from 2012/13
Number of State Corporations	35	14	21
Change	+10 billion	+27 billion	-17 billion
Main changes		National Irrigation Board and Rural Electrification Authority	National AIDS Council, Water Services Boards, Kenya Roads Board and Kenya Rural Roads Authority

As far as can be determined, no attempt has been made to carry out functional analysis that would determine the fate of state corporations performing some devolved functions. The presidential taskforce was expected to kick start the process of reforming these agencies to align them to the new constitution, but so far little has happened. While there have been reforms in the agriculture sector, they have not addressed the issue of devolved functions.

State Corporations Identified by the Presidential Taskforce

In the 2012/13 budget, the 18 state corporations identified by the presidential taskforce were allocated Ksh 52 billion. As show in Table 3, this has increased to Ksh 57 billion in FY 2014/15. A substantial amount of this funding is in the form of local AiA and external funding, although the share has decreased from 46 percent in FY 2012/13 to 38 percent in FY 2014/15. This means that these corporations are more dependent than before on government transfers, which comprise the other 62 percent of their funding. There are some changes in the expenditure estimates for individual entities, the most notable of which is the increase from Ksh 2.4 billion to Ksh 13.9 billion for the Rural Electrification Authority.

Table 3: State Corporations to be Partially/Fully Devolved According to Presidential Task Force 2013 (Amount in billions)

	State Corporations Performing Devolved Functions in the Parastatal Report	Expenditure Estimates (2012/13)	Expenditure Estimates 2014/15	Proportion of funding by source to the Total Expenditure (2012/13)	Proportion of funding by source to the Total Expenditure (2014/15)
1	Athi Water Services Board	3.5	4.6		
2	Coast Water Services Board	3.7	2.8		
3	Lake Victoria North Water Service Board	0.9	2.2		
4	Lake Victoria South Water Service Board	2.5	2.2		
5	Northern Water Services Board	2.4	0.4		
6	Rift Valley Water Services Board	0.5	2.1		
7	Tana Water Services Board	3.4	0.9		
8	Tanathi Water Services Board	3.4	1.0		
9	Coast Development Authority	0.2	0.2		
10	Ewaso Ng'iro North Development Authority	0.9	0.4		
11	Ewaso Ng'iro South Development Authority	0.2	0.3		
12	Kerio Valley Development Authority	0.6	0.6		
13	Lake Basin Development Authority	0.4	0.3		
14	Tana & Athi Rivers Development Authority	0.6	0.5		
15	Kenya Rural Roads Authority	17.1	15.9		
16	Kenya Urban Roads Authority	9.0	8.0		
17	Rural Electrification Authority	2.4	13.9		
18	Kenya National Library Service (KNLS)	0.8	1.1		
	Total	**52.5**	**57.2**		
	Of which:	-	-		
	Government Transfers	**28.5**	**35.6**	**54%**	**62%**
	Local Appropriation in Aid (AiA)	**1.4**	**4.1**	**3%**	**7%**
	External AIA + External Revenues	**22.5**	**17.6**	**43%**	**31%**

State Corporations Marked for Devolution in FY 2012/14

In the 2012/13 budget estimates, four state corporations were either partially or wholly marked for devolution. These were not part of the list in the Task Force report. In FY 2012/13, these four state corporations had a total allocation of Ksh 32.5 billion, reduced slightly to Ksh 28.2 billion in FY 2014/15. In both years, most of the funding is from local AiA. This was mainly driven by the Kenya Roads Board, which is funded entirely through AiA collected from fuel levy and tax on agriculture (agricultural cess). Meanwhile, as shown in Table 3, there has been a significant drop in the allocation to the National Aids Council. The smaller drop in the local AIA for roads is in line with historical year to year fluctuations.[2] Nonetheless, compared to FY 2012/13 these four state corporations are now relying more heavily on local AIA, and less on government grants or external funds, in FY 2014/15.

Table 4: Additional State Corporations to be Devolved According to Treasury, 2012/13 Budget (Amount in billions)

	State Corporations Devolved in 2012/13 Budget But Not in the Parastatal Report	Expenditure Estimates (2012/13)	Expenditure Estimates (2014/15)	Proportion of funding by source to the Total Expenditure (2012/13)	Proportion of funding by source to the Total Expenditure (2014/15)
1	Kenya Forest Service	3.9	3.9		
2	National AIDS Council	3.2	0.8		
3	National Campaign Against Drug Abuse Authority	1.0	0.6		
4	Kenya Roads Board	24.4	22.8		
	Total	**32.5**	**28.2**		
	Of which:	-	-		
	Government Transfers	**4.5**	**2.7**	**14%**	**9%**
	Local Appropriation in Aid (AiA)	**27.3**	**25.5**	**84%**	**91%**
	External AIA + External Revenues	**0.7**	**-**	**2%**	**0%**

State Corporations Potentially Performing Devolved Functions

A further 13 state corporations are performing functions that could potentially be devolved, based on the division of functions in Schedule Four of the constitution and the subsequent gazette notices by the Transition Authority. In FY 2012/13, these state corporations had a total budget of Ksh 31.8 billion, which has increased to Ksh 41.6 billion in FY 2014/15. This is mainly due to the budget for National Irrigation Board increasing from Ksh 3.4 billion in FY 2012/13 to Ksh 11.4 billion FY 2014/15. Like our first set of corporations, the share of external funding for these corporations dropped substantially in the period, while the share of government transfers increased from 30 to 45 percent.

[2] See Kenya Roads Board, Annual Report, 2013.

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Table 5: Other State Corporations that could be Partially or Fully Devolved, 2012/13 (Amount in billions)

	Other state corporations performing functions that could potentially be partially or fully devolved	Expenditure Estimates (2012/13)	Expenditure Estimates (2014/15)	Proportion of funding by source to the Total Expenditure (2012/13)	Proportion of funding by source to the Total Expenditure (2014/15)	Related County Function as per the 4th Schedule of the Constitution
1	Kenya Electricity Transimission Company	23.77	23.38			Electricity and gas reticulation and energy regulation.
2	Kenya National Bureau of Statistics	1.65	0.85			County planning and development, including— (a) statistics
3	Water Services Trust Fund	1.19	1.35			County public works and services, including— (b) water and sanitation services.
4	National Irrigation Board	3.35	11.43			Implementation of specific national government policies on natural resources and environmental conservation, including— (a) soil and water conservationAgriculture, including— (b) crop and animal husbandry
5	National Museums of Kenya	0.73	0.69			Cultural activities, public entertainment and public amenities, including— (g) museums;
6	Kenya Medical Supplies Agency	0.39	1.84			County health services, including, in particular— (a) county health facilities and pharmacies
7	Pyrethrum Board of Kenya	0.20	0.30			(a) crop and animal husbandry
8	Coconut Development Authority	0.20	0.14			
9	Pesticide Control Products Board	0.12	0.09			Agriculture, including— (d) plant and animal disease control
10	Kenya Dairy Board	0.08	0.21			Agriculture, including— (a) crop and animal husbandry
11	National Housing Corporation	-	1.30			
12	Coffee Board of Kenya	0.03	0.01			
13	Tea Board of Kenya	0.01	0.06			
	Total	**31.72**	**41.65**			
	Of which					
	Government Transfers	**9.40**	**18.62**	**30%**	**45%**	
	Local Appropriation in Aid (AiA)	**0.40**	**0.47**	**1%**	**1%**	
	External AIA + External Revenues	**21.92**	**22.56**	**69%**	**54%**	

Conclusion

State corporations performing some devolved functions have a total allocation of Ksh 127 billion in FY 2014/15. This is Ksh 10 billion higher than the FY 2012/13 allocations. In looking at these figures, we should recognize that a substantial share is not easy to devolve. For example, around Ksh 30 billion is local AiA, of which Ksh 22 billion is under the Kenya Roads Board. Around Ksh 9 billion of this is retained at the national level while the rest might be devolved for road maintenance at the county level, but potentially as a conditional grant to ensure it continues to be used for roads. External Funding amounts to Ksh 40 billion, most of it as external AiA, and this too cannot readily be devolved, because it is connected to contracts between national government and donors. In total, 55 percent (Ksh 70 billion) of the state corporation expenditures we identified are funded by local AiA and external funding (See Table 5).

Table 6: Summary of State Corporations that Could Be Partially or Fully Devolved According to Various Analysis, 2014/15 (Amount in billions)

State Corporations	Expenditure Estimates (2012/13)	Expenditure Estimates (2014/15)	Proportion of funding by source to the Total Expenditure (2012/13)	Proportion of funding by source to the Total Expenditure (2014/15)
State Corporations Performing Devolved Functions in the Parastatal Report	52.5	57.2		
State Corporations Devolved in 2012/13 Budget But Not in Parastatal Report	32.5	28.2		
Other state corporations performing functions that could potentially be partially or fully devolved	31.7	41.6		
Total	**116.7**	**127.0**		
Of which:	-	-		
Government Transfers	**42.4**	**56.9**	**36%**	**45%**
Local Appropriation in Aid (AiA)	**29.2**	**30.0**	**25%**	**24%**
External AIA + External Revenues	**45.1**	**40.2**	**39%**	**32%**

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To calculate an upper bound estimate of how much funding could be devolved, we deduct external funding and the AiA under the Kenya Roads Board that would be retained at the national level. This leaves us with up to Ksh 78 billion that could be debated for partial devolution in FY 2014/15, compared to Ksh 62 billion in FY 2012/13.

The exact figure depends on whether state corporations performing some devolved functions are partially or fully devolved and whether or not regional institutions are reformed to be under county managerial control rather than disbanded and their funding devolved. It is also not clear that all funding that could be devolved will be under the equitable share. For example, the money that currently passes through the Kenya Roads Board is from a dedicated revenue source and could be converted into a conditional grant to counties to be spent only on road maintenance, or it could be given free of conditions. More debate is needed to determine which approach should be taken.

At this point, we believe that Parliament should intervene to ensure that the national government engages in a serious debate about how to reform state corporations. This policy debate will ultimately determine how much money that is currently controlled by these corporations will flow to counties either through the equitable share or through a set of conditional grants. In our view, the bulk of the money that is still up for debate in the annual division of revenue discussion is the money controlled by state corporations, and there can be no resolution of how this money is shared without fundamental policy reform.

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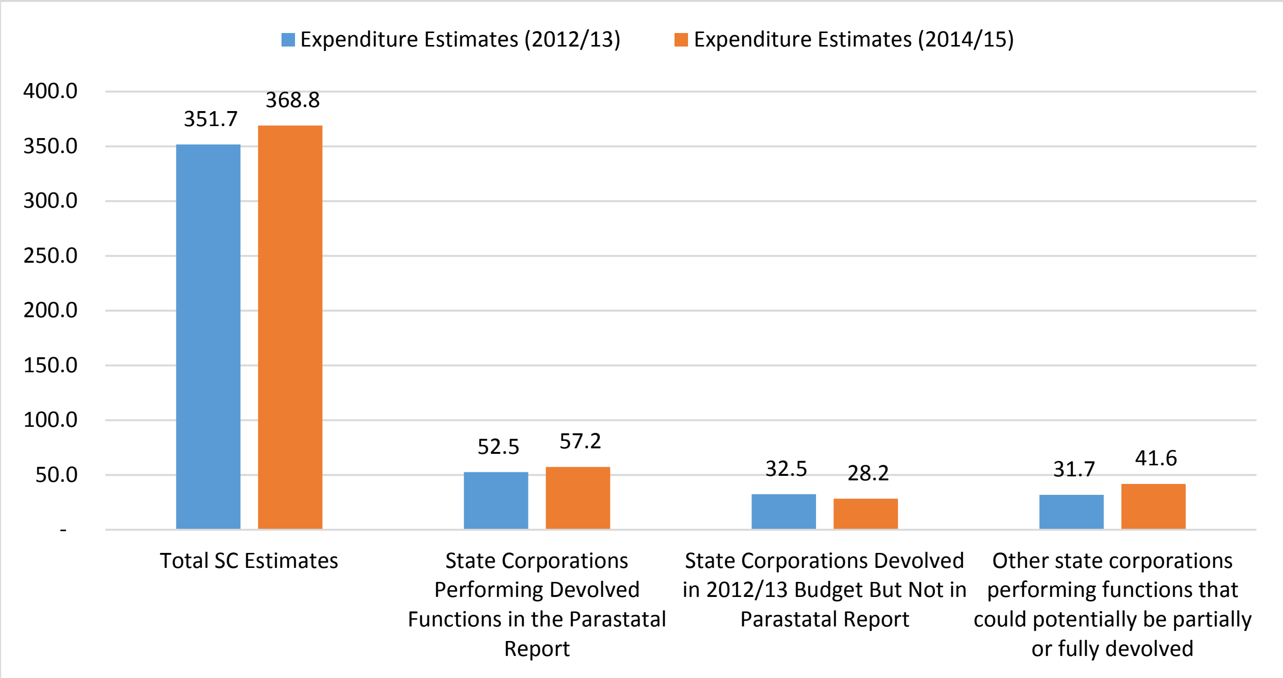
Annex 1: State Corporations Allocation Trends Between FY 2012/13 and FY 2014/15



Annex 2: State Corporations that moved from the original sectors in 2012/13 to align with other sectors in the 2014/15 National Budget

	State Corporations	Sector in 2014/15 and in recreated 2012/13 sector figures in Table 1 above	Original sector in 2012/13
1	National Irrigation Board	Agriculture	Water and Irrigation
2	Kenya Leather Council	International Relations and Commerce	Agriculture
3	Brand Kenya Board	International Relations and Commerce	Infrastructure + Energy
4	Kenya Investment Authority	International Relations and Commerce	State Administration
5	Ewaso Nyiro South Development	Lands,Housing and Environment	Regional Development
6	Ewaso Nyiro North Development		
7	Kerio Valley Development Authority		
8	Lake Basin Development Authority		
9	Tana and Athi Rivers Development Authority		
10	Coast Development Authority		
11	Kenya Film Classification Board	Gender,Youth and Culture	Infrastructure + Energy
12	Kenya Film Commission		

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