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MEMORANDUM TO THE SENATE ON THE DIVISION OF REVENUE, 2018/19

How Much Should Counties in Kenya Receive in 2018/19?

Each year Kenya's Parliament (National Assembly and the Senate) must decide how national revenue will be shared between national and county governments. This discussion is informed by recommendations from the Commission on Revenue Allocation and the National Treasury. CRA must table its recommendations in parliament by the 1st of January while National Treasury's recommendations are contained in the Budget Policy Statement (BPS) that is tabled in the National Assembly on or before the 15th of March each year. The BPS is tabled together with the Division of Revenue Bill and County Allocation of Revenue Bill. This analysis looks at the recommendations made by both agencies on the equitable share and conditional grants. Three key issues emerge, and they are similar to what we observed in 2017:

1. The National Treasury and the Commission on Revenue Allocation still do not agree on what is the revenue growth factor that should be used to determine the growth of the equitable share between 2017/18 and 2018/19 just like in the last two years. Both agencies have proposed the use of growth in revenue over time and inflation since 2015/16. However, both agencies are now proposing the use of inflation even with revenue growth over the last few years being much higher.
2. The formation and allocation to conditional grants do not seem to follow any predictable pattern and the growth in their allocations from one year to the next seem arbitrary. Based on this trend it's not clear if the allocation to some of the grants are adequate and how sustainable they are in the long term.
3. The distribution criteria for some of the conditional grants is inequitable and is not fair to all the recipient of the funds. The criteria used in the distribution of the grants to Level 5 Hospitals and the Road Fuel Levy Fund is not equitable and should be revised.

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FULL ANALYSIS

Overview

CRA recommendation for the equitable share and conditional grants in 2018/19 is Ksh 367.7 billion which is Ksh 28.2 billion higher than what the National Treasury has recommended. Both agencies differ on their equitable share and conditional grants allocations. CRA's figures are 13 percent higher than what was approved for 2017/18 while National Treasury's recommended allocation is only 4.4 percent higher.

Table 1: CRA and National Treasury recommendations compared to approved allocation for 2017/18

	DORA 2017	CRA Recommendation 2018/19	National Treasury (BPS 2018)	% Change between DORA 2017 and CRA Recommendations	% Change between DORA 2017 and BPS 2018 (National Treasury)
Equitable Share	302.0	337.2	314.0	11.7%	4.0%
Conditional Grants (excluding Loans and Grants)	23.3	30.5	25.5	30.9%	9.6%
Total	**325.3**	**367.7**	**339.5**	**13.0%**	**4.4%**

Source: DORA 2017, CRA Recommendations 2018/19 and BPS 2018

What are the main drivers of their differences? Are we progressively getting clarity on processes and distribution criteria as we start the second cycle of devolution? Are there areas of functional assignment that are still pending that could mean some functions and their funding is still at the national government level?

The revenue growth factor used to adjust the equitable share remains unclear

Every year since the start of devolution in 2013/14, CRA and National Treasury have recommended different figures for the equitable share. This remains the same case in 2018/19, even though the base figure used by both agencies was Ksh 302 billion which was the approved equitable allocation for 2017/18. The revenue growth factor applied by both agencies varies and that has been the case in the last two years. National Treasury proposed a growth factor of 7.8 percent for 2016/17, that fell to 6.7 percent for 2017/18 and has now fallen further to 4 percent for 2018/19. CRA has always applied higher adjustment weights using 15 percent in 2016/17 and 2017/18 but has now lowered that to 8.5 percent. (This includes 7.1 percent is based on a three-year inflation adjustment and 1.4 based expected growth in services). As shown in Table 2 there is no consistent approach in deciding the size of the growth of the equitable from one year to the next. Except for 2015/16, the other

years have seen different measures applied each year and it’s important to note that the National Treasury’s growth factor has been declining each year over this period.

Table 2: Changes in the revenue growth factor for the equitable share

	Proposed Growth		*Basis for Proposed Revenue Growth*	
Year	CRA	National Treasury	CRA	National Treasury
2015/16	10.4%	10.4%	3-Year average growth in ordinary revenue	3-Year average growth in ordinary revenue
2016/17	15.0%	7.8%	3-Year average growth in ordinary revenue	Not provided
2017/18	15.0%	6.7%	3-Year average growth in ordinary revenue	3-Year average month on month inflation
2018/19	8.5%	4.0%	3-Year average inflation	Not provided

Source: CRA Recommendations 2015-2018 and BPS 2015-2018

To ensure there is fairness in the division of revenue, the revenue growth factor should be based on the revenue raised in the country and how it grows over time. Using inflation as opposed to revenue growth, results in substantially lower projections for counties. The average growth in ordinary revenue between 2011 and 2017 was 14 percent. Therefore, the use of inflation biases the division of revenue process toward national government; when actual revenue growth has consistently above inflation, then the difference between the inflation rate and the revenue growth is captured entirely by the national government. This is not consistent with the principles of fairness in revenue sharing. In addition, ordinary revenue is projected to grow by 13.6 percent between 2017/18 and 2018/19. Therefore, the adjustments by both agencies for 2018/19 equitable shares are much lower than historical growth and projection for the next year.

Additional funding for new devolved functions

CRA and National Treasury have not recommended any new funding for functions that might have been devolved in 2017. However, CRA does include the costs for additional roads and library services that had been devolved by Transition Authority in 2016, to its 2017/18 base of 302 billion. This adds up to Ksh 310 billion which CRA used as the base before the adjustment for revenue growth. This partially explains the difference in the final recommendation compared to National Treasury together with the use of different inflation rates as shown in Table 1.

Based on this approach, the recommendation by CRA is 12 percent higher than the equitable share

approved for 2017/18 compared to only 4 percent by the National Treasury.

Conditional Grants

The recommended grants for 2018/19

The Budget Policy Statement 2018 has allocations for six conditional grants with a total allocation of Ksh 25.5 billion and this is 9 percent higher compared to the total allocations approved in 2017/18. For the second year, the free maternal healthcare is not allocated any money as a conditional grant as its structure changed from a reimbursement to counties to a special grant to the National Health Insurance Fund (NHIF). This means the allocation will not go to counties as cash grants. The National Treasury list of conditional grants to counties also includes loans and grants, totaling Ksh 33.2 billion, that will be managed by the national government.

CRA has proposed 9 conditional grants that are made up of seven previous grants and two new grants that were also in its recommendations for 2017/18. The two additional grants are related to Cancer diagnosis and treatment. The commission recommends that two regional facilities be built and equipped with their location based on cancer prevalence in the country. Like the recommendation in 2017/18, the commission recommends that the grant be spent by the national government and its unclear why it is listed as a conditional grant to counties.

Table 3: New conditional grants recommended by CRA for 2018/19

	New Conditional Grants Proposed by CRA	CRA Recommendation 2017/18 (Billions)	National Treasury Recommendation 2017/18 (Billions)
1	Two Regional Cancer Referral Treatment Centers	5.00	-
2	National Cancer Drug Access Programme	1.00	-
	Total Allocation	**6.00**	**-**

Source: CRA Recommendations, 2018/19

Growth in allocations to conditional grants

For grants that were in the DORA 2017 and are recommended to continue in 2018 by the National Treasury, three have the same allocations in both years. First, is the grant for fees foregone in dispensaries and health centers in all 47 counties. Both agencies have recommended a grant of Ksh 900 million. CRA recommends that the compensation be based on the number of annual outpatient visits made to these health facilities in each county. The recommendation assumes that the cost for compensation will remain the same. In actual sense, when adjusted for inflation the real value of the grant is lower than Ksh 900 million. In addition, data available in the Statistical Abstracts by Kenya

National Bureau of Statistics for 2015 and 2016 shows that the number of outpatient visits to health facilities is increasing.[1,2] For example the number of visits by children under the age of five increased by 1.5 million visits between the two years. In this case, the costs of delivering outpatient services would not be the same between the two years.

The other two grants are for the development of youth polytechnics and construction of county headquarters in Isiolo, Lamu, Nyandarua, Tana River and Tharaka Nithi counties that are allocated Ksh 2 billion and Ksh 600 million respectively.

Level 5 hospitals were allocated Ksh 4.2 billion in 2017/18, CRA recommends an increase of seven percent to 4.5 billion while treasury has a lower adjustment of three percent. None of the them explain their allocation for the facilities and the basis for this increase. However, both agencies' recommendations are lower than year on year inflation average over the last three years to June of 2017, which stands at 7.3 percent. Therefore, in real terms the recommended allocations are lower than what was allocated in 2017/18. However, the distribution criteria that is based on percentage beds occupancy in the previous two years which is a reversal from the criteria proposed by CRA for 2017/18 where each hospital's proportion of in-patient days was used.

The use of percentage bed occupancy ignores the main driver of costs in these facilities, which is the difference in the number of people who actually visit the facilities. This criterion gives less funding to counties with higher bed capacity or higher number of visits (inpatient and outpatient).[3] In addition, the approach only looks at one measure of hospital needs which in inpatient care but ignores other drivers of needs such as staffing and hospital infrastructure.

The allocation for road maintenance under the Road Fuel Levy is to decrease by about one quarter based on recommendations from both agencies. The allocation to counties is 15 percent of what the Kenya Roads Board is projected to collect in the current year, in this case 2017/18. Both documents do not explain why the 15 percent proportion is lower for 2018/19 than what was in 2017/18. In addition, in its 2017/18 recommendations CRA had proposed an increase in the allocation to counties to 25 percent after the additional roads that were devolved to counties in the Transitional Authority gazette of 2016. It does seem plausible that additional roads would mean additional resources for road maintenance. That discussion is not included in CRA's recommendation for

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[1] https://www.knbs.or.ke/download/statistical-abstract-2017/ and https://www.knbs.or.ke/download/statistical-abstract-2016/

[2] https://www.knbs.or.ke/download/statistical-abstract-2016/

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

2018/19 and the Senate should explore this issue further.

Furthermore, CRA recommends that the fund be distributed based on its equitable revenue sharing formula. However, the formula does not directly measure the length of existing roads that counties are meant to maintain. Therefore, the criteria recommended would be unfair in its approach.

Lastly, the allocation to the leasing of medical equipment is increased by 109 percent based on the recommendation from National Treasury. The grant was allocated Ksh 4.5 billion in 2017/18 and CRA has recommended a similar amount for 2018/19. The BPS does not explain the increase in allocation to the grant.

Tale 4: Growth in conditional grants between 2017/18 and 2018/19

	Current Conditional Grants (Billions)	2017/18 DORA	2018/19 CRA Recommendation	2018/19 National Treasury Recommendation	% Increase of CRA Grants to DORA	% Increase of National Treasury Grants to DORA
1	Level 5 hospitals	4.2	4.5	4.3	7%	3%
2	Free maternal health care		3.4	-	-	-
3	Compensation for user fees forgone	0.9	0.9	0.9	0%	0%
4	Leasing of medical equipment	4.5	4.5	9.4	0%	109%
5	Road Fuel Levy Fund	11.1	8.6	8.3	-23%	-25%
7	Development of Youth Polytechnics	2.0	2.0	2.0	0%	0%
8	Supplement for construction of county headquarters	0.6	0.6	0.6	0%	0%
	Sub-Total*	***23.3***	***24.5***	***25.5***	***5%***	***9%***
	Conditional allocations (loans and grants)	20.4	-	33.2		***63%***
	Total	**43.7**	**24.5**	**58.7**	***13%***	***34%***

Source: DORA 2017, CRA Recommendations 2018/19 and BPS 2018

Conclusion

As counties start the next cycle of five years, the Division of Revenue discussion has to focus on learning from previous years to improve the process going forward. The National Treasury ad CRA still do not seem to have a common approach to how the adjust the equitable share each year. In 2015/16 the agreement was to use a three-year revenue growth average as the growth factor but for 2018/19 that seems to have changed to inflation. This shift is not explained but it does affect the predictability of county revenue in the coming years. In addition, the use of inflation is unfair to county because the revenue collected by government has grown by margins that are larger than inflation over the last five years. Secondly, conditional grants funding and how they are distributed needs more focus if their objectives are to be met. How much is to be allocated to these funds each year and how these allocations grow should be explained and justified.

ANNEX I

1.1 ALLOCATION FOR LEVEL 5 HOSPITALS

Level 5 hospitals are the second highest level of health care facility in Kenya. This class of hospitals includes all of the former provincial hospitals and four additional high volume facilities. These are Thika, Kisii, Meru and Machakos Level 5 (L5) hospitals. These facilities have a regional catchment area and serve as referral hospitals for more than one county. They are managed by individual host counties under devolution and a conditional grant has been introduced to ensure that they continue to offer regional referral services to their broader catchment areas beyond the host county. The facilities were allocated Ksh 8.87 billion in the first three years of devolution.

HOW IS THE L5 GRANT ALLOCATED AND WHY?

The table below shows the criteria for distributing funds to these facilities prior to devolution.

MINISTRY OF HEALTH RESOURCE DISTRIBUTION CRITERIA FOR L4S AND L5S

Variable	Weight
Poverty	20%
Beds utilized	40%
Outpatient cases	20%
Accident prone facilities	5%
Fuel costs	15%
Total	100%

Source: Health Rights Advocacy Forum, "Mapping Government Decentralized Health Funds," 2011

Since 2013/14, the criteria used in the Division of Revenue process to allocate money among the facilities has been unclear. In 2015/16 the single criteria for allocating the grant among the 11 hospitals was the bed occupancy rate. This is also the criteria CRA and Treasury have used in their recommendation for distributing the fund among the facilities in 2016/17. The amount allocated to each facility in the County Allocation of Revenue Bill 2016 is based on their bed occupancy rate as shown in the table.

SHARE OF ALLOCATIONS FOR L5S BASED ON BED OCCUPANCY FOR 2016/17

Facility	**Bed occupancy rates**	***Bed capacity***	***Occupied beds***	**CARB 2016 county allocation (million)**	**Share of county allocation based on the CARB criteria**	**Share of occupied beds to the total**	**Allocation based on number of occupied beds as a share of the total (million)**
Machakos	79%	*375*	*296*	365	9%	8%	339
Embu	62%	*618*	*383*	287	7%	11%	439
Garissa	71%	*224*	*159*	328	8%	5%	182
Kakamega	88%	*449*	*395*	407	10%	11%	453
Meru	77%	*306*	*236*	356	9%	7%	270
Mombasa	80%	*499*	*399*	370	9%	11%	457
Nakuru	77%	*588*	*453*	356	9%	13%	519
Nyeri	84%	*323*	*271*	388	10%	8%	311
Kisumu	76%	*457*	*347*	351	9%	10%	398
Thika	85%	*265*	*225*	393	10%	6%	258
Kisii	86%	*379*	*326*	398	10%	9%	373
Total		***4,483***	***3,491***	**4,000**	**100%**	**100%**	**4,000**

Source: CARB and Ministry of Health www.ehealth.or.ke

IS THE LEVEL 5 HOSPITALS GRANT DISTRIBUTED FAIRLY?

Is the use of bed occupancy as the basis of distribution fair? Kakamega Level 5 has the highest bed occupancy rate (88 percent) and is allocated the most funds (Ksh 407 million). Embu Level 5 has the lowest occupancy rate and is allocated the least (Ksh 287 million). But given the wide variation in the actual number of beds in each facility, using bed occupancy rates actually introduces a distortion. While Nakuru and Meru have the same occupancy rates, Nakuru has almost twice the number of beds than Meru. Given that actual costs are a reflection of how many people use the facility, this is not an equitable or efficient allocation criteria. A more equitable approach (and one more typical of revenue sharing formulas) would look at a facility's actual occupancy as a share of total occupancy for all facilities. Were we to do this, as in column 5 above, Nakuru would receive nearly double what Meru receives (13 percent versus 7 percent).