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Kenya: How Much for Counties in 2017/18? The Commission on Revenue Allocation Versus the National Treasury

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INTRODUCTION

How much money should counties receive in 2017/18? Every year, this issue is discussed when Parliament debates and approves the Division of Revenue Act (DORA) and the County Allocation of Revenue Act. In making its decision, Parliament is meant to deliberate on recommendations from the Commission on Revenue Allocation (CRA) and the National Treasury.

This process normally takes place in February and March, but this year, due to the elections in 2017, the budget process has been advanced. As a result, CRA has issued its recommendations early, and the National Treasury has released its proposal in the Budget Policy Statement (BPS) early as well. This analysis compares the two sets of recommendations and raises issues for consideration by Parliament. It also considers the recently released Division of Revenue Bill 2017, which adds some additional details to the BPS 2017 proposal from Treasury. Three key points emerge:

1. As in previous years, Treasury and CRA disagree about how much money counties should receive; this is due to different revenue growth factors and differences in funding for additional road and library functions devolved to counties. While CRA's proposal may be optimistic about revenue growth in 2017/18, Treasury's approach gives too little to counties in light of its own revenue projections and is inequitable.

2. Allocations to conditional grants seem arbitrary and in some cases do not cater for the rising costs of the services they are meant to fund.

3. For most grants, the distributional criteria remain vague, but CRA has proposed a fairer distribution of the Level 5 grant, one that does not discriminate against larger facilities with higher inpatient numbers as in previous years.

OVERVIEW

As in the past, CRA has recommended that counties receive more than what the National Treasury has proposed. For 2017/18, CRA has recommended that Ksh 367.6 billion be disbursed to the counties for both the equitable share and additional conditional grants, while the National Treasury has proposed that counties receive Ksh 321 billion (excluding donor-funded loans and grants). CRA's recommendation is 23.2 percent higher than the approved allocations in 2016/17, while National Treasury's figure is 7.5 percent higher.

TABLE 1. CRA AND TREASURY RECOMMENDATIONS FOR 2017/18

	DORA 2016	CRA 2017	National Treasury (DORB 2017)	Change between DORA 2016 and CRA 2017 recommendations	Change between DORA 2016 and DORB 2017 (National Treasury)
Equitable share	280.3	331.6	299.1	18.3%	6.7%
Conditional grants (excluding loans and grants)	18.0	36.0	21.4	99.5%	19.0%
Total	298.3	367.6	320.6	23.2%	7.5%

Below, we look in more detail at some of the main areas of disagreement between the two agencies.

WHAT IS THE RIGHT REVENUE GROWTH FACTOR TO DETERMINE THE EQUITABLE SHARE?

As in past years, the National Treasury and CRA have given very different recommendations on the amount of money that should go to the counties as the equitable share in 2017/18. Both agencies use a "revenue growth factor" as a key input into their proposals, because the total growth in revenue is an indication of how much is available to be shared with both levels of government.

In 2015/16, both agencies agreed to use a growth factor of 10.4 percent, which was based on an average of recent trends in revenue and GDP growth. However, this has changed in the last two recommendations as shown below. CRA has proposed a growth factor of about 15 percent for the last two years, based on audited revenue accounts from the previous three years. National Treasury proposed a growth factor of 7.8 percent for 2016/17 without explanation, and that has fallen to 6.7 percent for 2017/18. In the Division of Revenue Bill (DORB), Treasury states that the growth factor it has used is based on average inflation from 2013/14 to 2015/16.[1] Using inflation as opposed to revenue growth results in substantially lower projections. It also biases the division of revenue process toward national government; if actual revenue growth is 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 revenue sharing.

CRA's approach might overestimate revenue for next year; the last several years of revenue growth could be too high if the economy is not likely to expand as quickly next year (the previous approach of blending revenue and GDP growth tempered optimistic revenue estimates). However, Treasury's own Budget Policy Statement 2017 shows that total ordinary revenue is projected to grow by 13 percent next year. This would suggest that CRA's approach is optimistic, but it does not justify Treasury's figures. Treasury's approach would give counties Ksh 23.7 billion less compared to CRA's figure (Table 2).

TABLE 2. CHANGE IN EQUITABLE SHARE DUE TO REVENUE GROWTH FACTORS IN 2016/17 AND 2017/18

2016/17			
	Baseline 2015/16 (DORA 2015) (Ksh billions)	Revenue growth factor	Adjusted baseline based on revenue growth factor (Ksh billions)
CRA	259.8	15.1%	299.0
National Treasury	259.8	7.8%	280.0
2017/18			
	Baseline 2016/17 (DORA 2016) (Ksh billions)	Revenue growth factor	Adjusted baseline based on revenue growth factor (Ksh billions)
CRA	280.3	15.2%	322.8
National Treasury	280.3	6.7%	299.1

Source: DORA 2016, CRA Recommendations 2016 and 2017 and DORB 2017

CHANGES IN FUNCTIONS

The revenue growth factor is a useful starting point for determining the county share, but it assumes that there have been no changes in the functions for which each level of government is responsible. Both CRA and Treasury have considered changes in functions in the past, and recommended additional funding to counties where they have been given new responsibilities. However, they have often disagreed about which functions require additional financing (as they did in 2016/17; see Table 3).

This year, CRA has recommended an additional Ksh 8.7 billion for class D roads and salaries for library staff devolved to counties earlier in 2016. In the Budget Policy Statement, National Treasury has not

[1] See https://www.centralbank.go.ke/uploads/inflation_rates/719587127_Inflation%20rates.csv

allocated any additional funds to counties for these functions. This is not explained in the BPS 2017. In the DORB 2017, Treasury appears to agree with the figures for these functions, but notes that a taskforce report with these recommendations has not been approved by the intergovernmental summit yet. For this reason, they have declined to allocate these funds for 2017/18.

TABLE 3. CRA VERSUS TREASURY RECOMMENDATIONS FOR THE OVERALL EQUITABLE SHARE (2016/17 AND 2017/18)

2016/17						
	Baseline 2015/16 (DORA 2015) (Ksh billions)	Revenue growth factor	Adjusted baseline based on revenue growth factor (Ksh billions)	Funding for additional county functions (Ksh billions)	Total (billions)	% Increase from DORA 2015
CRA	259.8	15.1%	299.0	32.8	331.8	27.7%
National Treasury	259.8	7.8%	280.0		280.0	7.8%
2017/18						
	Baseline 2016/17 (DORA 2016) (Ksh billions)	Revenue growth factor	Adjusted baseline based on revenue growth factor (Ksh billions)	Funding for additional county functions (Ksh billions)	Total (billions)	% Increase from DORA 2016
CRA	280.3	15.2%	322.8	8.7	331.6	18.3%
National Treasury	280.3	6.7%	299.1		299.1	6.7%

Source: DORA 2016, CRA Recommendations 2016 and 2017 and DORB 2017

The taskforce report mentioned by Treasury has not been made available to the public. Neither agency provides an adequate explanation for the figures it is alleged to contain. Nor is it possible to relate the recommendations from CRA to their earlier analysis of the costs of government functions carried out with the Transition Authority.[2] It seems clear that the devolution of thousands of kilometres of roads to counties requires some additional financing, but how much?

In summary, both agencies have provided only partial explanations for their positions. Treasury's position on the revenue growth factor is inconsistent with the notion that revenue should be shared fairly between

[2] Transition Authority and Commission on Revenue Allocation, "Costing of Government Functions – Final Report, November 2015," http://www.crakenya.org/wp-content/uploads/2016/02/COSTING-OF-GOVERNMENT-FUNCTIONS-FINAL-REPORT-11th-November-2015.pdf We assess these disparities in our analysis of the CRA recommendations: IBP Kenya, "Analysis of The Commission on Revenue Allocation's (CRA) 2017/18 Recommendations on Sharing Revenue," http://www.internationalbudget.org/wp-content/uploads/kenya-analysis-cra-2017-18-recommendations-sharing-revenue.pdf

the two levels of government. It is also not clear whether Treasury is proposing to use a supplementary budget to eventually fund the new functions that counties are taking over once the summit has met. CRA on the other hand does not explain the origin of the numbers it has put forward.

CONDITIONAL GRANTS

WHAT CONDITIONAL GRANTS ARE RECOMMENDED IN 2017/18?

In the BPS, National Treasury has proposed allocations for five conditional grants, all of them continued from 2016/17. The DORB adds one more matching grant to support 70 percent of the cost of construction of county headquarters in five counties, with counties paying the rest. Though Treasury claims this is an old grant, it did not appear in the DORA 2016 and the BPS also appears to show it as a new grant. The special grant to improve emergency services in Lamu and Tana River in 2016/17 was considered a one-off grant by Treasury and does not appear in 2017/18. Taking all Treasury grants together, including conditional allocations to be managed by national government, these sum to nearly Ksh 34 billion.

On the other hand, CRA has maintained the emergency services grant in 2017/18, though without explanation. Overall, CRA has proposed 11 conditional grants in 2017/18 at a total cost of Ksh 36 billion (not including allocations to be managed by national government). Six of these grants were initially allocated to counties in 2016/17, while five of them are new grants (never approved before, including the headquarters grant that Treasury now says is not new). A total of Ksh 8.9 billion is attached to the new grants proposed by CRA.

The library grant caters for the 20 counties that do not have libraries, with the goal of ensuring that each has one.[3] The cancer grants are meant to complement the existing medical leasing grant, which is mainly investing in diagnostic equipment. CRA argues that improved diagnostics will lead to a need for enhanced treatment and related infrastructure. The selection of the two regions that will benefit from the centers each year is based on cancer prevalence rates. However, the fund will be managed by the national government, so it is not clear in what sense it will be a “conditional grant.” National Treasury argues that this type of proposal should emerge from the Ministry of Health’s planning and policy process and not from the division of revenue process.

[3] As we showed previously, however, there should only be 15 counties without libraries at this point. See http://www.internationalbudget.org/wp-content/uploads/kenya-analysis-cra-2017-18-recommendations-sharing-revenue.pdf

TABLE 4. NEW CONDITIONAL GRANTS PROPOSED BY CRA FOR 2017/18

New conditional grants proposed by the CRA	2017/18 CRA (Billions)	DORB 2017 (Billions)
Construction of headquarters in five counties	1.00	0.61
Rehabilitation of village polytechnics	1.50	
Construction and equipping of 20 libraries in 20 counties	0.40	
Two regional cancer referral treatment centers	5.00	
National cancer drug access program	1.00	
Total allocation	**8.90**	**0.61**

In its rejection of the proposal for a village polytechnic grant in 2016/17, National Treasury indicated that it would only support this program if a donor funded the proposal. The draft BPS for 2017/18 shows that there is a small sum for rehabilitating youth polytechnics (Ksh 97 million). This is part of conditional allocations, apparently funded by an Italian debt swap, to be implemented by the national government on behalf of the counties, but there is no further discussion of these matters by either agency. CRA does not make any provision for this type of donor-funded conditional allocation in its proposal for conditional grants.

GROWTH FACTOR FOR CONDITIONAL GRANTS

Even for grants recommended by both institutions, there are differences in terms of size, reflecting different approaches to annual adjustments. CRA recommends adjusting three existing health grants (Level 5 hospitals, free maternity and user fees foregone) by 5 percent for inflation. As shown in Table 5, they seem to have miscalculated this. In Treasury's case, funding for forgone user fees is projected to remain the same in 2017/18 as in 2016/17. This is at odds with data on disease patterns and with projected inflation. Available data from the Economic Survey 2016 shows that disease incidences across the country are on the rise.[4] In addition, inflation in 2017/18 is projected at 5 percent, so unless the transfer is adjusted up by that amount, it is actually going to experience a real cut in value in 2017/18. Indeed, the value of this grant has not changed since 2015/16. Treasury's proposals for Level 5 hospitals is increasing by 5 percent which is the same as the inflation rate, while that of free maternal health care is decreasing by 18 percent.

There is a significant difference between CRA and Treasury on the road maintenance grant. National Treasury has maintained that counties should continue to receive 15 percent of the Road Maintenance Levy Fund (RMLF), while CRA adjusted its allocation factor up to 25 percent to cater for new roads

[4] See Economic Survey 2016 http://www.knbs.or.ke/index.php?option=com_phocadownload&view=category&download=862:economic-survey-2016&id=107:economic-survey-publications&Itemid=1181 (Page 65)

devolved to counties in 2016. This dispute turns again on the taskforce report that also covers the funding for road construction and libraries. Treasury again notes that this report, which does appear to recommend 25 percent of the RMLF for counties, has not been adopted by the intergovernmental summit. But they also indicate some disagreement with the report's findings, suggesting that national roads are costlier than the report allows.

TABLE 5. CHANGES BETWEEN 2016/17 AND 2017/18 FOR EXISTING CONDITIONAL GRANTS

Current conditional grants (billions)	2016/17 DORA	CRA 2017	DORB 2017	% Increase of CRA grants to DORA	% Increase of National Treasury grants to DORA
Level 5 hospitals	4.00	4.02	4.20	0.5%	5.0%
Free maternal health care	4.12	4.14	3.37	0.5%	-18.2%
Compensation for user fees forgone	0.90	0.91	0.90	0.6%	0.0%
Leasing of medical equipment	4.50	4.50	4.50	0.0%	0.0%
Road fuel levy fund	4.31	13.30	7.88	208.8%	82.9%
Emergency medical service	0.20	0.20	-	0.0%	-100.0%
Subtotal	18.03	27.06	20.84	50.1%	15.6%
Conditional allocations (loans and grants)	3.87	-	12.54		224.0%
Total	21.90	27.06	33.39	23.6%	52.5%

Sources: DORA 2016, CRA Recommendations 2017 and DORB 2017

DISTRIBUTION OF CONDITIONAL GRANTS

The distribution of conditional grants is one factor determining how equitable the overall distribution of public funds is. We have raised concerns about the distribution of these grants in the past.

For the last two years, the distribution of the Level 5 grant has been based on the bed occupancy rates in each of these facilities. Using occupancy rates ignores the main driver of cost: the actual numbers of patients.[5] This is because two facilities with the same rate, say 70%, may have very different numbers of actual patients (70% of 100 beds is much less than 70% of 1000 beds). CRA has proposed distributing

[5] See "How Fair is the Way That Major Regional Hospitals in Kenya Receive Funding?" http://www.internationalbudget.org/wp-content/uploads/ibpkenya-equity-week-2016-issue-4-regional-hospital-funding.pdf

the grant based on each hospital's proportion of total in-patient days across all facilities.[6] This would ensure that facilities with more inpatients receive greater funding, which is an improvement, though it still ignores key factors driving hospital costs beyond inpatient care. Treasury has made no proposal this year regarding distribution of this grant.

The distribution of the free maternal care grant will also change slightly this year. In previous years, the reimbursement amounts were based on the number of deliveries from the previous year. In 2017/18 the reimbursement will be done through the National Hospital Insurance Fund (NHIF) and the distribution will be based on the number of deliveries in 2017/18 itself. Both agencies agree on this.

In 2016/17, CRA recommended that the Road Fuel Levy grant be distributed based on the equitable share formula. Neither agency has proposed any criteria for distribution in 2017/18.

The new grants proposed by CRA have somewhat vague criteria. The regional cancer centers will be distributed based on prevalence rates of cancer in the country. It is not clear what is intended by the use of the term "region" here: the counties, the former provinces or another formation more consistent with the demand for medical services. The grant for rehabilitation of village polytechnics is to be distributed based on county population, but lacks details of which schools will benefit from it or how beneficiaries will be identified. Treasury has not supported either grant, and there is no information about the distribution of the Italian-funded polytechnic program mentioned in the BPS.

CONCLUSION

This is Kenya's fourth division of revenue discussion and it is useful to take stock of how far we have come. There is still disagreement on the right way to adjust the equitable share each year, reflecting different views of county funding. Treasury's focus on inflation suggests that counties are entitled only to what they were entitled to the previous year, adjusted for the price level, whereas the spirit of the constitution is that the revenue available is shared equitably across the two levels of government. Though contentious at the start, conditional grants have become more prominent each year. However, a number of these grants do not appear to be well conceived. For example, CRA's proposal for cancer centers this year is not well justified as a conditional grant. Finally, when it comes to clarifying whether grants are

[6] Using the same example of the two facilities with 70% occupancy, if we use the new approach proposed by CRA, the total number of inpatient days would be 770, and the first hospital would have 70/770 while the second would have 700/770. This would ensure that the second hospital, with many more patients, would receive greater funding.

equitably distributed, we are regressing. Compared to 2016/17, there is actually less discussion of the distribution of conditional grants, particularly by Treasury.