



COMMISSION ON REVENUE ALLOCATION

Promoting an Equitable Society

**DEVOLVED FUNCTIONS TRANSFER DEPENDENCE & FISCAL
RESPONSIBILITY: CHALLENGES, RESEARCH DIRECTION, POLICY AND PRACTICE**

Second Annual Development Finance Conference

Theme: Environmental finance for sustainable development

University of Nairobi, School of Business

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Presentation outline

1. Kenya's development planning history
2. Intergovernmental fiscal transfers
3. Stylised facts on fiscal dependence and fiscal responsibility
4. Other challenges
5. Research Directions
6. Policy & Practice

1. What is devolution?

Different phases of decentralization

Transfer of **authority for decision-making**, finance, and management to local government with corporate status. In a devolved system, local governments have clear and legally recognized geographical boundaries over which they exercise authority and within which they perform public functions

Devolution

Delegation

Transfer of responsibility for decision-making and administration of public functions to semi-autonomous organizations not wholly controlled by the central government, but ultimately accountable to it

Deconcentration

It is the transfer of responsibility for the planning, financing and management of certain public functions from the central government and its agencies to field units

2. Kenya's aspirations at independence

Articulated in the 6-points of Sessional Paper No.10 of 1965

1. Political equality
2. Social justice
3. Human dignity, including freedom of conscience
4. Freedom from want, disease and exploitation
5. Equal opportunities
6. High and growing per capita incomes, equitably distributed

Efforts to achieve the aspirations (1965-2008)

- The country pursued various policies, including various sessional papers(National Development Planning History), 9 national development plans (National Development Plans to 2007)
- Deconcentration and delegation of the delivery of public services, including District Focus for Rural Development, Regional development authorities etc.
- The country also faced various shocks, including political crises (the Shift war, 1982 attempted coup, 2007/08 post election violence etc.), 1973 oil crisis, coffee boom (1976-1979), various droughts
- The policies/initiatives and the shocks shaped the extent to which the country achieved the aspirations

By 2008 a lot still need to be done to achieve the aspirations

1. Political equality
2. Social justice
3. Human dignity, including freedom of conscience
4. Freedom from want, disease and exploitation
5. Equal opportunities
6. High and growing per capita incomes, equitably distributed

3. New Constitution Ushered Devolution

*a). Transfer of some functions to the 47 county governments
(Fourth Schedule of 2010 Constitution assigns functions to
county governments and national government)*

- i. National Government: Largely national policy, legislation and Defence
- ii. County governments: Largely service provision- (health, water, Agriculture, roads, etc)
 - i. **Distinct:** both governments have Legislatures and Cabinets
 - ii. **Interdependent :** Shared functions and fiscal responsibilities

Constitutional Provisions for intergovernmental fiscal transfers...

Article 187: Principle of Funds follow

functions

- i. Functions maybe transferred between the two levels of government
- ii. A functional transfer shall be accompanied with resources tranfer

Constitutional Provisions...

a). Article 209: Powers to impose taxes & charges

- i. National government taxes: income tax; VAT; Custom duties; Excise Tax; charges and fees on services rendered
- ii. County government Taxes: Property taxes; Entertainment taxes; charges and fees on services rendered

KRA collects taxes from counties



4. Vertical Equity

Definition of shareable revenue:

- Article 209 and Section 2 of the CRA Act, 2011 defines the shareable revenue as:
 - ✓ All taxes imposed by the national government and any other revenue including investment income authorized by an Act of Parliament.
 - ✓ Excludes revenue referred to under Article 206(1)(a)(b) and Article 209(4).

Vertical Equity ...

Article 216 (1)(a) –*Equity between the national and county governments*

(ii) Criteria for intergovernmental transfers:

- Takes into account:
 - ✓ Article 203(1)- (*National Interest and obligations, Debt, needs of national and county governments, etc*)
 - ✓ *Assignment of functions between the two levels of governments as specified in Schedule Four of the Constitution*
 - ✓ Article 187(2)(a) of the constitution that “*finance should follow functions*”

Vertical Equity ...

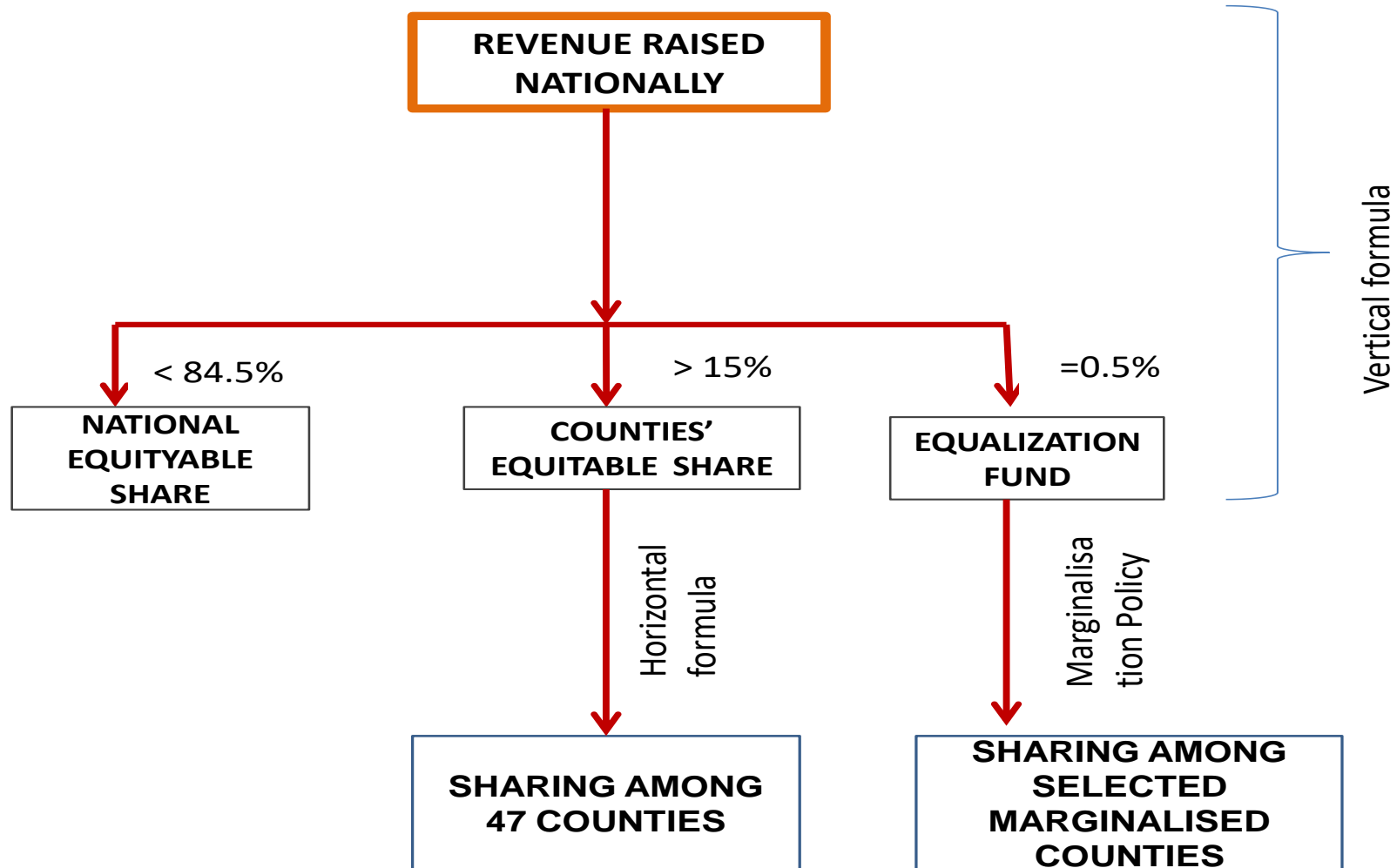
iii. Timelines:

- CRA makes annual recommendations to Parliament, Six months before the beginning of the financial year: PFMA Section 190 (1)(a).

iv. Responsibilities:

- ✓ CRA-Article 216(1)a)
- ✓ National Treasury- Article 218 & PFMA, Section 191(1)
- ✓ Intergovernmental Budget & Economic Council (IBEC)-PFMA, Section 187(2)(g)
- ✓ National Assembly-Article 112,113
- ✓ Senate-Article 112,113

Sharing of Revenue Raised Nationally



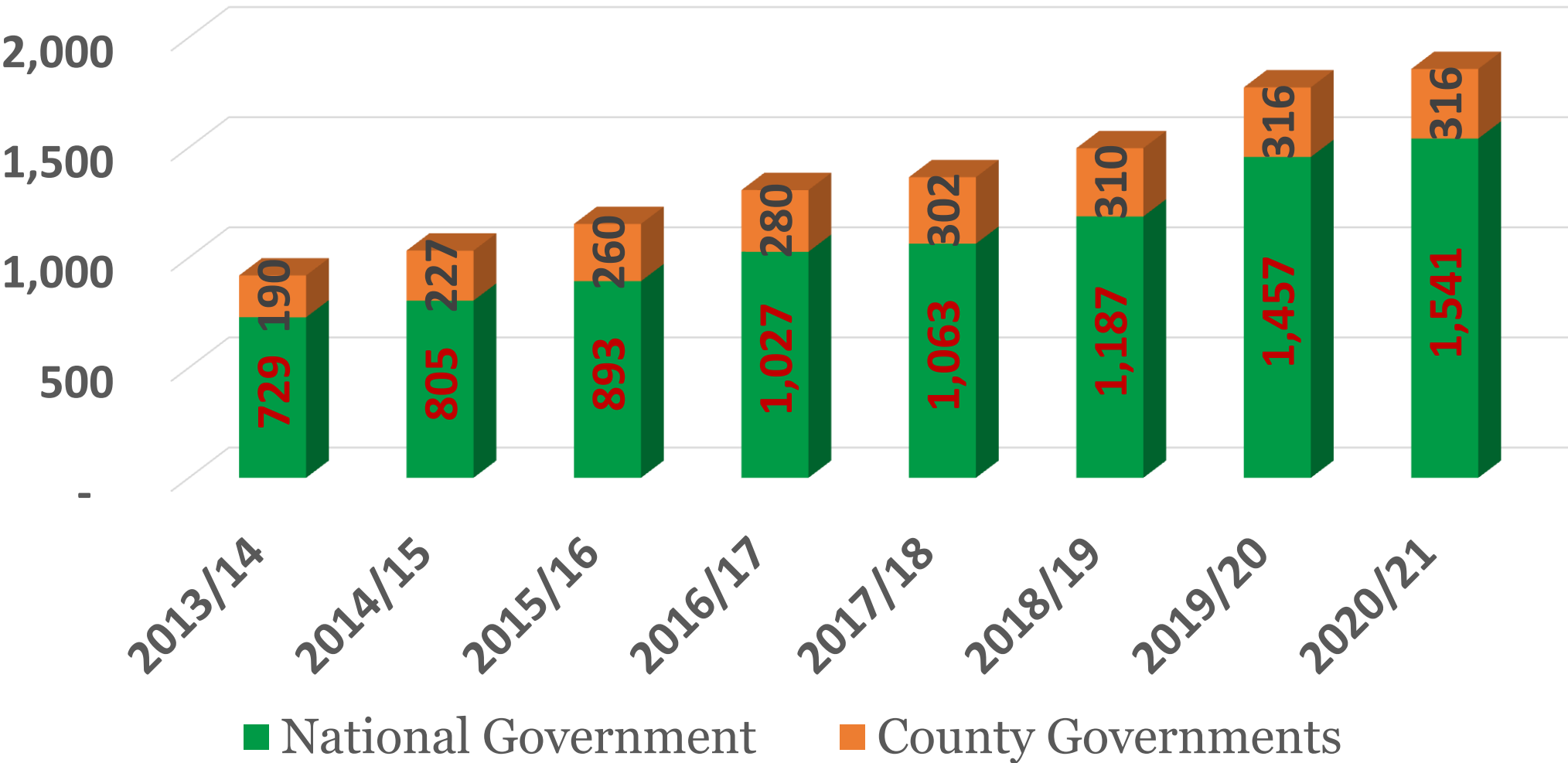
5. What have we seen so far on fiscal dependence (Stylized facts)?

- Since 2011 we now have 9 years of the experience observing fiscal dependence

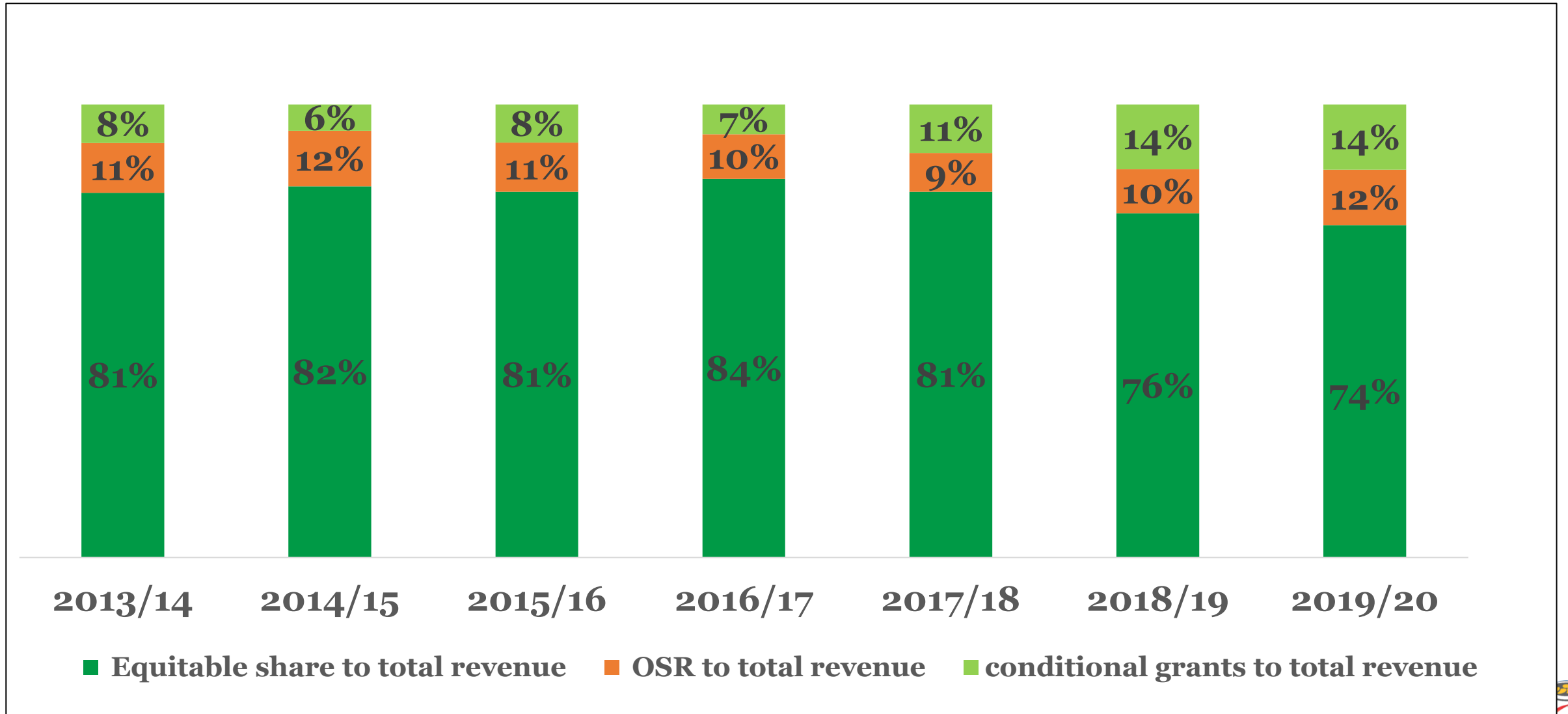
5.1 Total revenues to be shared have been underperforming

YEAR	PROJECTED REVENUE	ACTUAL/ REVISED REVENUE	REVENUE SHORTFALL
2013/14	1027.2	919.0	108.2
2014/15	1087.1	1031.8	55.3
2015/16	1242.7	1153.0	89.7
2016/17	1380.2	1306.6	73.6
2017/18	1560.3	1365.1	195.2
2018/19	1769.2	1499.8	269.4
2019/20	1877.2	1573.4	303.8
2020/21	1856.7	1523.4	333.3

5,2 Amount for counties has stagnated ...

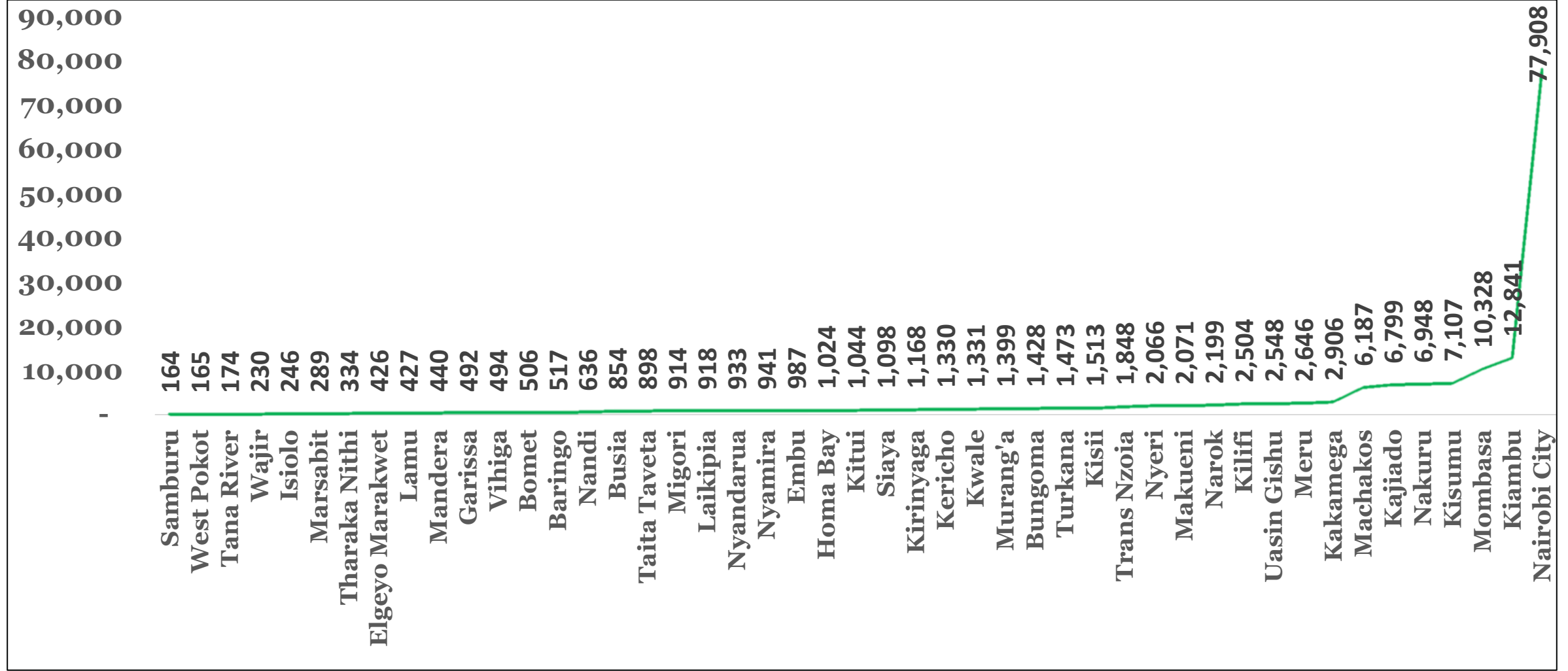


5.3 County equitable share constitutes the largest share of county revenue (Fiscal dependence?)



5.4 Transfer Dependence: Revenue potentials - millions

Only Nairobi county can fully finance its budget if it realized its potential



5.5 Transfer Dependence...

- Transfer dependence is a misnomer
- By establishment, county governments were designed to depend on intergovernmental transfers from nationally raised revenues, which is collected in counties
- Assignment of Non-productive taxes to county governments
- Articles: 202; 203(2); 209; 216(1):

Nationally raised revenue shall be shared equitably between the national and county governments

5.5 Disagreement on the vertical revenue formula

- Non-performing revenues at the national level has made it very difficult to agree on the amount of revenue to be shared by county governments
- DORA for 2019/2020 allocates Kshs.316.5 billion which is the same for 2020/21 fiscal year

5.6. Disagreement on the horizontal revenue formula

- So far 3 revenue sharing bases have been developed
- First revenue sharing basis (2013)
- Second revenue sharing basis (2016)
- Third revenue sharing basis (2020): The most contentious of all
- The first and second revenue sharing bases had fiscal responsibility and prudence as a revenue sharing parameter
- However, the final third revenue sharing basis removed fiscal responsibility and prudence

5.6. Disagreement on the horizontal revenue formula cont.

- Additionally, the Constitution left a lacuna since whenever the Senate does not agree with the recommendation from CRA ideally they should return the formula with a memorandum.
- In the third basis the Senate decided to work and recraft the formula
- Final formula is what CRA submitted except for fiscal responsibility and prudence, which were merged with roads parameter

6. What have we seen so far on fiscal responsibility (Stylized facts)?

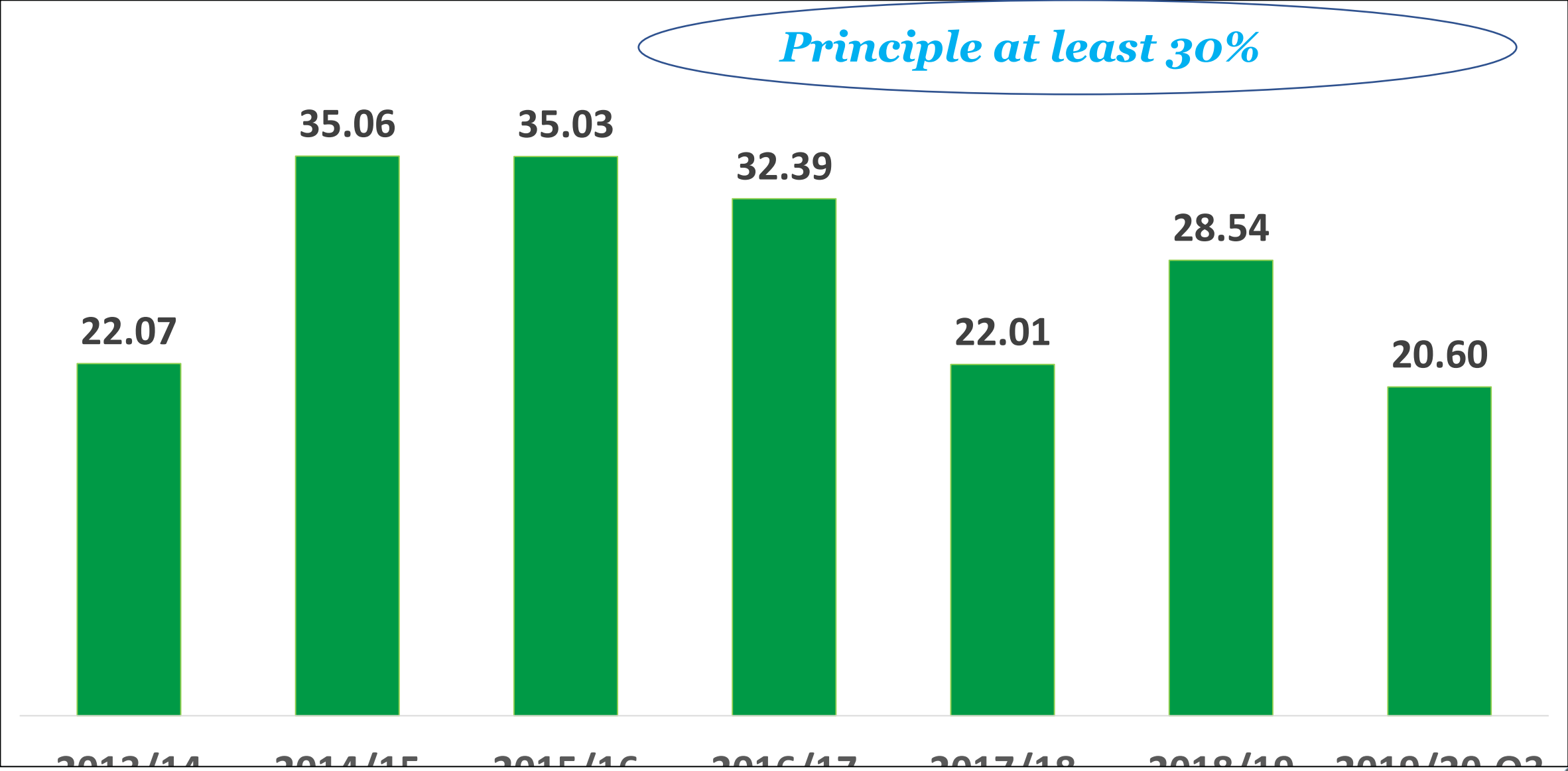
- Since 2011 we now have 9 years of the experience observing fiscal responsibility

6.1 Components of fiscal Responsibility...

PFMA Section 107 defines the following FR measures:

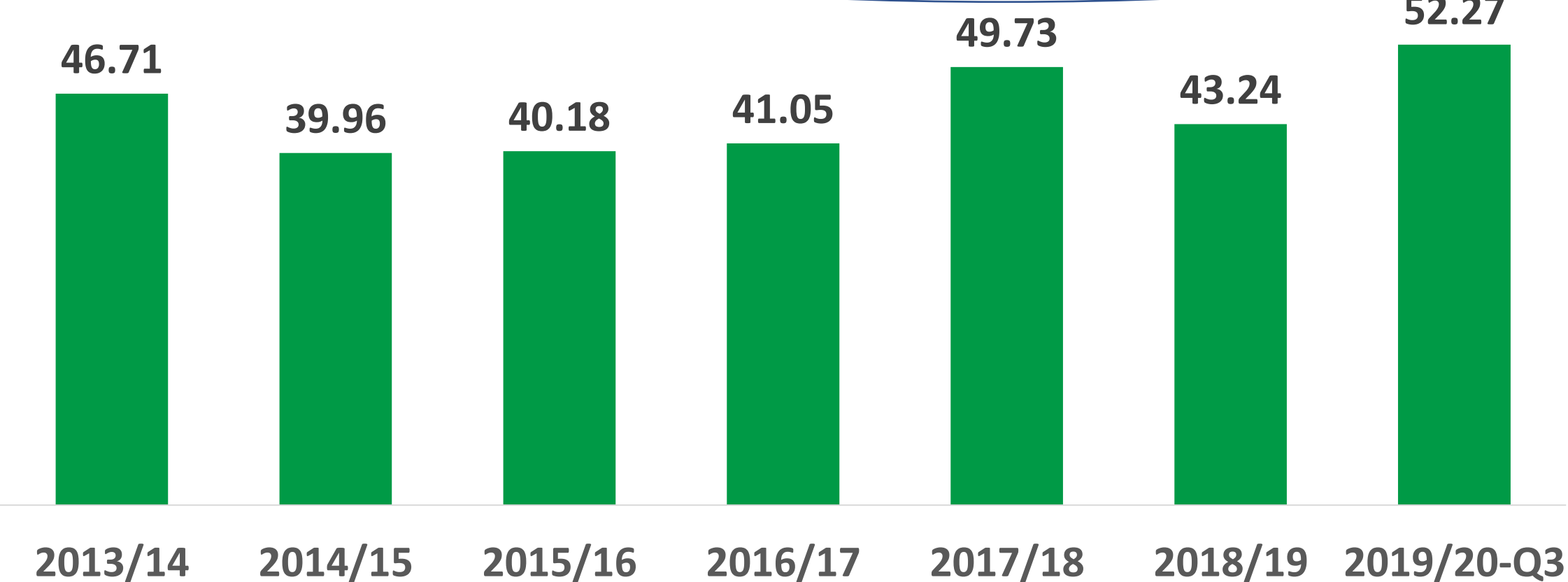
- i. Recurrent expenditure shall not exceed county government total revenues
- ii. A minimum of 30% of the county's budget shall be allocated to the development expenditure
- iii. County expenditure on wages benefits shall not exceed 35% of county's budget
- iv. County borrowing shall be used only for financing development
- v. County debt shall be maintained at sustainable levels
- vi. Fiscal Risks shall be managed prudently
- vii. A reasonable degree of predictability with respect to the level of tax rates and tax bases shall be maintained

6.2 County Expenditure on Development (%)



6.3 County Expenditure on Remuneration(%)

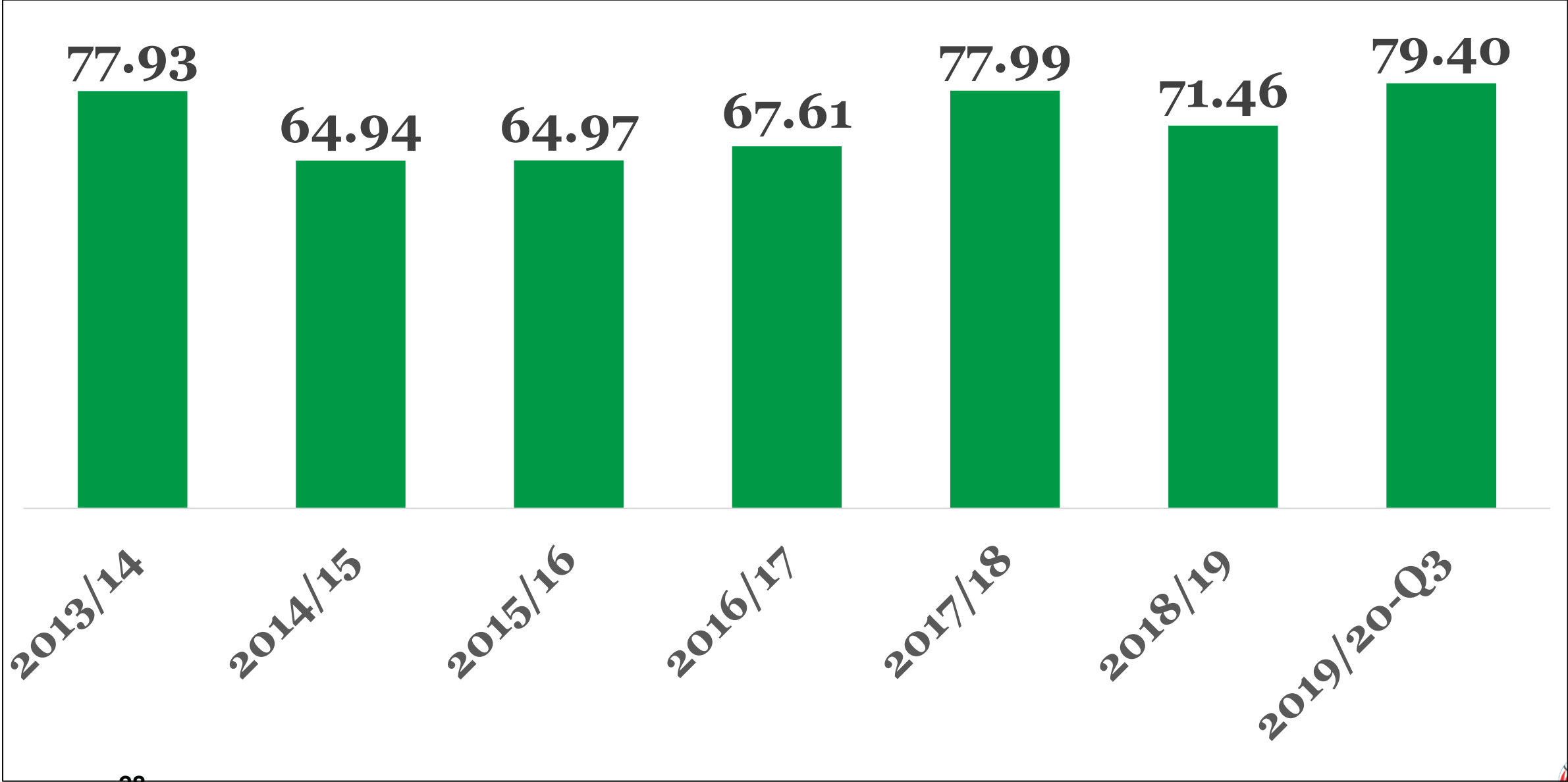
Principle: at most 35%



Caused by inherited unsustainable wage bills



6.4 Total County Recurrent Expenditure (%)



7. Other Challenges:

- i. Delays in transfer of funds to counties by the national government
- ii. Low absorption of development funds
- iii. Political wrangles at the county level
- iv. Political wrangles between county executive and the Senate
- v. Misappropriation of public resources
- vi. Duplication of roles between the national and county governments:
Expenditure for devolved functions by the national government has been rising instead of declining
- vii. Too many conditional grants- erodes county budget discretion
- viii. Challenges of delivering the health services by county governments
- ix. High public debt which is a first charge on national revenue

6. Research Directions:

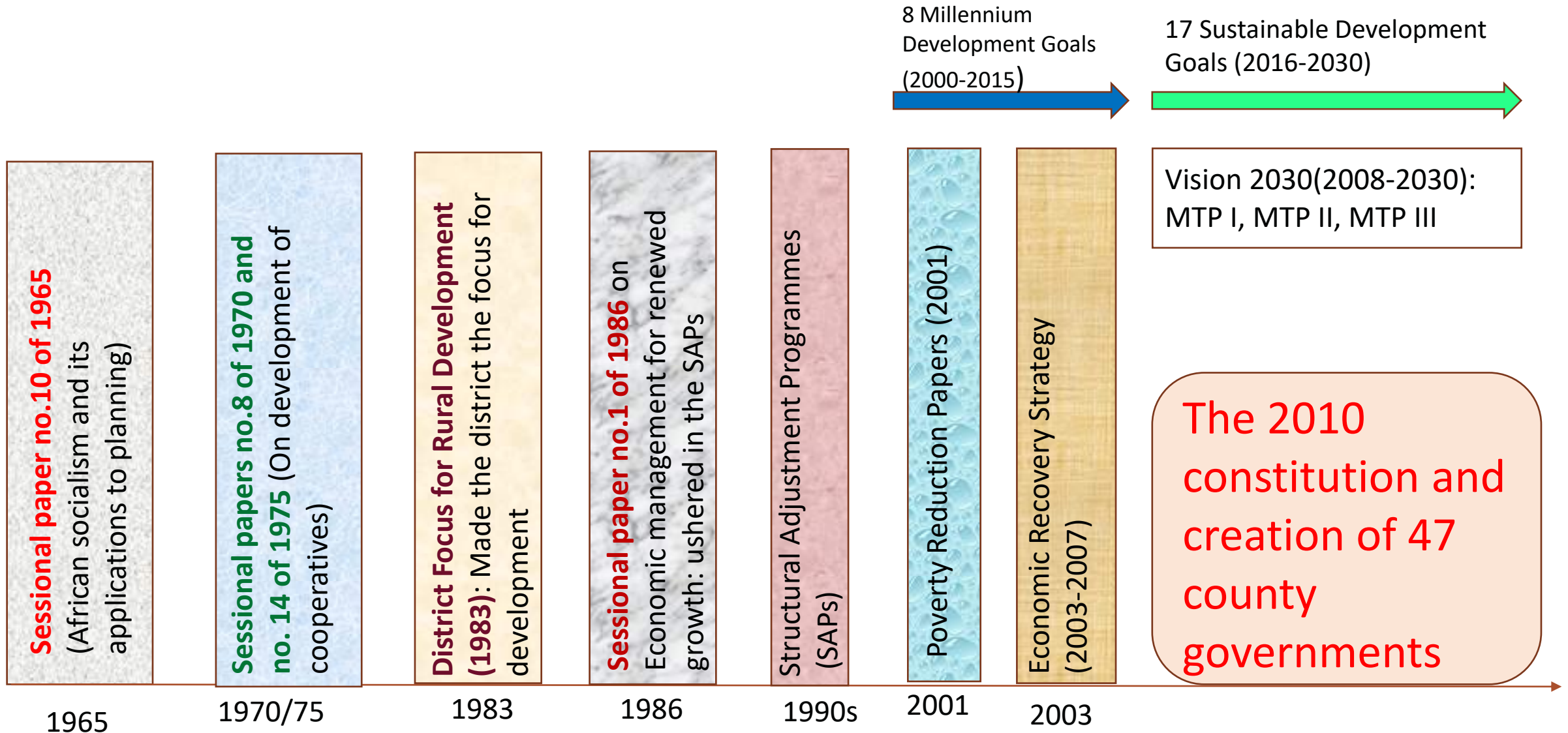
- i. Costing of all government functions
- ii. Political economy of revenue sharing in light of the country's socio-economic and political dynamics
- iii. Optimisation of tax assignments between national and county governments
- iv. Tax productivity at county level
- v. Tiers of devolution (Do we need a third tier as is the case in India?)

7. Policy and Practice

- i. Public Expenditure Reviews at county level
- ii. Inter-county competition and cooperation
- iii. County government borrowing vs national public debt
- iv. County stabilization fund to cushion counties for shocks

Thank you

Kenya's development planning history



National Development Plans in Kenya (1965-2007)

I: UNCLEAR DEVELOPMENT VISION REGIME (1965-2008)

1st National Development Plan (1965-1970): Raise standard of living of Kenyans

2nd National Development Plan (1970-1974): Theme was “Rural Development”

3rd National Development Plan (1974-1978): Theme was “Employment and Income Distribution”

4th National Development Plan (1979-1983): Theme was “Alleviation of Poverty”

5th National Development Plan (1984-1988): Theme was “Mobilizing Domestic Resources for Equitable Development”

6th National Development Plan (1985-1993): Theme was “Participation for Progress”

7th National Development Plan (1994-1996): Theme was “Resource Mobilization for Sustainable Development”

8th National Development Plan (1997-2001): Theme was “Rapid Industrialization for Sustainable Development”

9th National Development Plan (2002-2008): Theme was “Effective Management for Sustainable Economic Growth and Poverty Reduction”

National Development Plans in Kenya(2008-Present)

II: KENYA VISION 2030 (2008-2030): “A Globally Competitive and Prospective Kenya”

1st Medium Term Plan (MTP I: 2008-2012): Done before 2020 Constitution

2nd Medium Term Plan (MTP II:2013-2017): Theme was “Transforming Kenya: Pathway to Devolution, Socio-Economic Development, Equity and National Unity

3rd Medium Term Plan (MTP III: 2018-2022): Theme is “Transforming Lives: Advancing Socio-Economic Development Through the “Big Four”

4th Medium Term Plan (MTP IV: 2023-2027):?

5th Medium Term Plan (MTP IV: 2028-2030):?