



MEMORANDUM ON DIVISION OF REVENUE BILL 2019

About the Institute for Social Accountability (TISA)

TISA is a civil society initiative committed towards the achievement of sound policy and good governance in local development in Kenya, to uplift livelihoods of, especially, the poor and marginalized. TISA has been operational since March 2008 and is a locally registered trust. TISA has engaged with various relevant state and non-state actors in the quest to promote effective local governance in Kenya.

We hereby make the following submissions with respect to the Division of Revenue bill 2019.

1. Negative Impact of national debt on shareable revenue overlooked

Kenya's public debt has reached unsustainable levels whereby from July, an equivalent of 61 percent of the total projected tax collection of Sh1.87 trillion will be spent on debt repayment, leaving only Ksh 693,854 for recurrent and development expenditure which will lead to a collapse of government services. This implies that the implementation of the big four agenda is not tenable, and more crucially service delivery at county level stands a risk of disruption.

The Controller of Budget and Parliamentary Budget Office have both flagged this threat in their recent reports. It is noteworthy that the constitution places upon parliament the responsibility of ensuring that the national government adhered to constitutional and statutory principles on public finance management. The DoR bill as presently prepared fails to address itself to the shortcomings of the present fiscal management framework, and therefore falls short of the constitutional oversight mandates placed upon parliament.

2. The DORA disregards CRA recommendations on sharable revenue

It is noteworthy that whereas the shareable revenue has been growing in nominal terms, it has been falling in real terms due to a failure to compute it based on the latest audited accounts and the conservative criteria used by Treasury to adjust for inflation. This is further compounded by the failure to cost county functions and a minimalist application of the constitutional requirement of 15%. It is noteworthy that the Auditor General has tabled audit reports up to the 2017/18 financial year, but these have not been approved by parliament.

The division of revenue bill can therefore be construed as offending the following constitutional provisions; Art 202 and 203 - **Resources follow functions**; Art 203 1 (d) financing counties developmental needs in sustainable ways that meets the(current) cost of

operations in undertaking such county functions unless there are fiscal capacity gaps or material breach that may compromise service delivery; **Equity in sharing between the two levels of government which also informs fair allocation among counties** for purposes of balanced and inclusive development and mitigating against fiscal imbalances; Article 174 (f) principle of subsidiarity to ensure services are offered on the basis of proximity and other inherent characteristics for effective delivery and maximum impact that in this case that are mostly in favor of decentralization and devolution; Art 203 (1) of ensuring ‘desirability of stable and predictable allocation of revenue’.

For instance the 2019 BPS identifies several functions that are yet to be devolved and funded including - statistics, land survey, mapping and housing ,cooperatives , mechanical and transport equipment; ferries and harbours which are also critical to actualization of the big 4 plans at the county level.

Recommendation:

- a) **Declare a national debt crisis and institute emergency measures;**
- b) **Urgently revise the National Treasury framework to accord with the constitution and support actual devolution needs by adoption of the CRA proposed allocation to shareable revenue;**
- c) **Institute a process to generate a strategic fiscal plan for attainment of the big four agenda.**

3. Definition of National Interest

The lack of a clear definition and objective criteria for determining national interest has resulted in disputes between the national government and county governments. Following court action by the council of governors the matter has been in mediation since 2016 with no resolution to date. While the process drags on the national treasury continues to use a definition of national interests which is inimical to county interests. It therefore behooves all parties concerned to strive towards a consensus and we have attached an annex which seeks to contribute to the debate. Parliament can contribute to the discourse by including in the division of revenue performance accountability reporting.

Recommendation: The Division of Revenue bill needs to report on the status of implementing or realisation of the previous year national priorities including the status of projects, financial probity and realisation of set targets.

4. Conditional Grants

There framework for the management of conditional grants continues to be weak, and indeed does not meet the constitutional requirements for fiscal prudence and transparency. It is noteworthy that the information on loans and grants in the DoR is incomplete and does not meet the standards for the PFMA s 48. For instance, there seems to be no clear criteria

followed in the determination of the growth factor, size and distribution of conditional grants to county governments. In addition, there is no information that explains the margin of increases over the years or the factor used to explain the increase or reduction of allocations over the years. Performance information on how conditional grants are spent and whether they are reaching the targets set is not available. The national government implementation reports lack clear performance information of each of these grants.

Recommendation: The Division of Revenue bill should include performance and accountability information on conditional grants to adhere with constitutional requirements. See Annex 2 for more information.

5. Public Participation

There are gaps in public engagement in the division of revenue process despite having in place enabling legal provisions in the Constitution (Article 201 (a) that requires openness and public participation in all financial matters; and the Public Finance Management Act section 35 (2) that places a responsibility on the Cabinet Secretary to ensure public participation in the budget process, and also by way of regulations, prescribe procedures specifying how, when and where members of the public shall participate in the budget process at the national level including the preparing overall estimates in the form of the Budget Policy Statement of national government revenues and expenditures.¹ It is commendable that the BPS 2019 provides a brief report on submission made during the consultation process.

However, there is still a challenge on how the public should be involved in the process and inadequate access to timely and relevant information to enable meaningful public participation.

- There is a need for clear guidance on how the public should engage during the division of the revenue process. This includes the issues that the public should debate on to influence decisions made, the kind of information that government institution should provide to enable the citizens engage accordingly. In addition, a feedback mechanism is required informing on how submissions and inputs from the public are handled.
- Stakeholders should play their oversight role. Parliament needs to ensure the publication and publicization of performance reports on how conditional grants are implemented.
- Pursuant to Article 201 and section 207 of the Public Finance Management Act the cabinet Secretary is required to enact regulations to provide for meaningful public participation in the national budget.

Recommendation.

- **Budget committee to immediately ensure all implementation reports of national government entities are available on their websites;**

¹ Public Finance Management Act 2012, section 35(1)(c)

- **The Division of Revenue bill to provide the standards to ensure all government institutions set aside at least 2% of the annual budgetary allocation for public participation and civic education.**
- **National treasury to urgently convene stakeholders to inform national regulations on public participation**

Annex 1:

The Constitution provides for equitable sharing of revenue raised nationally between the national government and county governments taking into account the criteria under Article 203(1). Article 203(1)(a) identifies national interest as a key criteria in determining equitable share of revenue raised nationally but does not define national interest. This has resulted in a situation where national interest is being defined by the national government on a *defacto* discretionary basis and has been challenged in Court by the Council of Governors, but the case was referred to mediation.² In the Budget Policy Statement 2019³, the National Treasury has stated a commitment to define national interest. It is in this context that TISA undertook a study on Kenya's division of revenue between the national and county government with a focus on the definition of national interest, design of conditional grants and meaningful public engagement in the process and hereby makes submissions as follows.

6. Definition of National Interest

The study found out that there is no clear definition of national interest and distinction of national interest from functions of the national government and the ruling political party manifesto. The National Treasury has been using an arbitrary definition of national interest. For instance, the Division of Revenue Bill 2013 explanatory memorandum states that the national government is exclusively responsible for the functions that serve the national interest, and allocated costs of the functions to the national government.⁴ The functions included: Defense, National Intelligent Services; Parliament; Judiciary; Attorney General; Director Public Prosecutions; Police Services, Teachers Service Commission; Constitutional commissions, Independent offices and Elections. A review of the Division of Revenue Bills and Acts for the financial year 2014/2015 to 2018/2019 reveals changes in the composition of national interests from those in the Division of Revenue Bill 2013 to: Enhancement of Security Operations; National Irrigation and Fertilizer; Youth Empowerment (NYS); National Social Safety Net; Primary School Digital Programme; School Examination Fee.⁵ Most of these are functions of the national government.

² Council of Governors versus Attorney General & 5 Others [2018] eKLR <http://kenyalaw.org/caselaw/cases/view/163505/>

³ Budget Policy Statement 2019, page 64 and 65 <http://www.treasury.go.ke/component/jdownloads/send/203-budget-policy-statement/1348-2019-budget-policy-statement.html>

⁴ http://www.kenyalaw.org/kl/fileadmin/pdfdownloads/bills/2013/Division_of_Revenue_Bill_2013.PDF

⁵ Division of Revenue Bill 2018 page 120, http://kenyalaw.org/kl/fileadmin/pdfdownloads/bills/2018/DivisionofRevenueBill_2018.pdf

The National Treasury has continuously included items in the division of revenue bill as national interest without giving further elaborations and explanation on why those allocations are considered national interests. A review of the trends in allocation to national interests from the financial year 2013/2014 to 2018/2019 also reveals inconsistencies in allocations. For instance, that enhancement of security operations has been included in the list of national interests since the financial year 2013/2014 to 2018/2019, but allocations have reduced drastically over the years. National irrigation and fertilizer was introduced as national interest in the financial year 2014/2015, but there have been changes in allocations over the years but no explanation given on the trade-offs made and how the decision to allocate increased amounts to the programme came about. National social safety net programme was introduced in the financial year 2014/2015 and allocations to it have been increasing over the years. Youth empowerment (NYS) was introduced in the financial year 2014/2015 and allocations to it have increased over the years despite accountability gaps in the fund. Primary school digital program was introduced in the financial year 2014/2015 and allocation to its have decreased over the years. The school examination fee subsidy programme was introduced in the financial year 2016/2017 and allocations to it has been increasing significantly in the subsequent three years.

The Division of Revenue Bill 2018 explanatory memorandum states that national interest expenditure relates to projects and programmes that are critical to the achievement of the country economic development objectives; have significant impact on social wellbeing of citizens; are anchored in Vision 2030 and Medium-Term Plan (MTP III); have significant resource investment requirement; and those specified in the Budget Policy Statement (BPS). However, a review of some of these government policy documents that should provide initial information on national interest priorities do not contain consistent information or detailed explanation or criteria on what should be considered national interest. For instance, the BPS 2018 states that expenditures should be aligned to MTP III and other strategic interventions of 'national interests' as outlined in the government economic agenda but it is not clear what 'strategic interventions of national interest' are from the list of economic transformational agenda.

The ruling political party manifesto has also been used to provide justification for allocations to national interests. For instance, after the general elections in 2017, the ruling party political manifesto outlining the Big Four Agenda, made it into the national government agenda. This implies that national interest could be whatever the ruling political party's manifesto has as its agenda and not necessarily what is decided upon by the two levels of government. Hence there is a danger of political promises affecting the division of revenue process.

The lack of a clear definition and objective criteria for determining national interest has resulted in disputes between the national government and county governments whereby both levels of government either want to receive (county governments) or retain (national government) the allocations made to national interest. Under the present erroneous definition of national interest, the national government is encroaching on county government functions thus withholding funds that would rightly go to county governments. According to the

Commission on Revenue Allocation (CRA)⁶, “*decisions on national interest priorities have financial implications on the constitutional functions of both the national and county governments.*” Therefore, national interest relates to both the national government and county governments and should balance the claims of both levels of government. Thus, national interest must be distinguished from the needs of the national government. National interest should focus on broader concerns affecting both levels of government and to ensure proper functioning and realization of devolution.⁷ The general principle is that finances must follow functions and the basis of revenue allocation process should be the cost of devolved functions. The division of revenue process must ensure counties have reliable sources of revenue to enable them to govern and deliver services effectively, are able to perform functions allocated to them, and take into consideration developmental and other needs of counties.

Best Practices and Recommendations

National Interest and Accountability

- i. A clear definition of national interest and an objective criterion for determining allocations to national interests.

CRA⁸ interprets national interest to mean agreed policies, goals, priorities, and resultant programmes that have fiscal implications and benefit the whole country. Additionally, the priorities defined in the MTP, BPS, Budget Review Outlook Paper define the national interest. They determined the level of funding necessary to accomplish “national interest” annually through the process outlined in the Public Finance Management Act on preparation of budgets that incorporates intergovernmental consultation through the Intergovernmental Budget and Economic Council (IBEC) and the Summit. Although CRA has the constitutional mandate to make recommendations for equitable share of revenue raised nationally, its recommendations are not binding.

In South Africa the definition of national interest is contained in its National Development Plan (NDP) as “goals that the nation seeks to achieve which are beneficial to the whole nation”. The interests listed in the NDP are further complimented by the strategic integrated projects. The MTEF outlines how resources would be allocated to the priorities. There is a clear distinction between national interest and needs of the national government. Needs of the national government implies functions which are better performed by the national government and help protect and achieve the overall national interest of the Republic. The allocations towards financing the national interests has been concurrent.

The Division of Revenue Act needs to classify national interest projects and distinguish these from the functions of the national government. The national government needs to identify the functions which are better performed by the national government to help protect and achieve the overall national interest of the Republic.

⁶ Commission on Revenue Allocation, First Commissioners’ End Term Report 2017, Page 27 and 28 <https://www.crakenya.org/wp-content/uploads/2017/04/CRA-FIRST-COMMISSIONERS-REPORT-TECHNICAL-VERSION.pdf>

⁷ John Mutakha Kangu, Constitutional Law of Kenya on Devolution, page 263

⁸ Commission on Revenue Allocation, First Commissioners’ End Term Report 2017, Page 27 and 28 <https://www.crakenya.org/wp-content/uploads/2017/04/CRA-FIRST-COMMISSIONERS-REPORT-TECHNICAL-VERSION.pdf>

ii. Clarity on National Priorities

The Division of Revenue Act needs to clearly outline the national government priority outcomes, sectors and projects as the basis for division of revenue. The BPS's should also report on how it is increasing funding to these sectors, the attainment of key performance indicators and attainment of international commitments.

iii. Consultation between the National Treasury and the Commission on Revenue Allocation

There is a need to review the present consultative process, especially between CRA and the National Treasury, to ensure uptake of CRA recommendations. This may be achieved through consultation between the National Treasury and CRA prior to IBEC consultations. Consultations should also be guided by a clear framework based on clarity of national interest as recommended above (ii). The framework further needs to be informed by the unbundling and costing of functions framework. This should help in addressing the differences in allocations since there have been differences between the allocations suggested by the National Treasury and recommendations by CRA.

iv. Performance measurement and accountability

The Division of Revenue Act needs to report on the status of implementing or realisation of the previous year division of revenue before allocating more resource. For instance, in South Africa, the National Treasury has authority to discontinue the equitable share allocation if there is persistent and serious noncompliance with the Division of Revenue Act⁹. Further, the South Africa Constitution section 216 empowers the National Treasury to discontinue transfers to municipalities in the event of serious or continuous non-compliance with measures specified in the Constitution. Additionally, section 3 of the Division of Revenue Act 2016 South Africa states that if National Treasury anticipates substantial underspending or overspending on the allocation it may stop the funding or a part thereof.

v. Financial probity

The Division of Revenue Act needs to capture and respond to the recommendations of the annual audits by the Auditor-General examining performance information and compliance with all laws and regulations governing municipal financial matters.

⁹ Section 38- 40 MFMA.

Annex 2:

The administration of conditional grants in Kenya does not follow a clear guideline or framework within which such allocations are made. An analysis of the Division of Revenue Bills and Acts from the financial year 2013/2014 to 2018/2019 reveals that conditional grants have been changing in terms of allocations and introduction of new grants while some have remained the same with the same allocations over the years.

The number of conditional grants increased from two in 2013/14 to nine in 2018/19 financial years. However, there is no information that explains the margin of increases over the years or the factor used to explain the increase or reduction of allocations over the years. There seems to be no clear criteria followed in the determination of the growth factor, size and distribution of conditional grants to county governments.

Although the National Treasury released a framework for the management of conditional grants in June 2018, there is no explanatory information on updating of a conditional grant. There is no data available to the public on expenditure performance of conditional grant to enable them to analyze the spending of the grants allocated and comparing the allocation vis a vis the expenditure, having in mind the cost benefits of the intended grant. Additionally, performance information on how conditional grants are spent and whether they are reaching the targets set is not available. The national government implementation reports lack clear performance information of each of these grants. At the county level, the findings show that since 2015, counties have not been publishing implementation reports.

Lastly, there is a gap on the conditions attached to the grants. For example, level 5 hospital criterion is based on bed occupancy rate arrived at by daily midnight counts of in-patients. Bed occupancy rate does not translate into meeting infrastructural needs such as staff, facility, drugs and the outpatients seeking services.

Best Practices and Recommendations

- i. The CRA should embark on consultations to prepare criteria for national interest and conditional grants.
- ii. Categorization of conditional grants in terms of their type, nature, administration and trends in allocations

The DORA needs to categorise conditional grants by objective which may include one or more of the following;

- i) correct vertical imbalances or inequities
- ii) address horizontal inequities or imbalances (in revenue raising)
- iii) ensure sub-national governments deliver on their functions
- iv) correct negative externalities or spillovers
- v) facilitate national government implement national policies

- vi) promote flexibility of national government to carry out targeted functions

For example, conditional grants in South Africa are classified according to the following categories:

- Schedule 4 – grants to the provinces and the municipalities to *supplement* the funding of programmes or functions funded from municipal or provincial budgets.
- Schedule 5 - grants that fund *specific purposes* of national interests without requiring funding from the municipal or province own budgets
- Schedule 6 - these are *in-kind allocation* for specific purpose in nature which fund special programmes
- Part A of schedule 7 – comprise of special grants released to the provinces or municipalities as a *disaster response* in accordance to Disaster Management Act, No 57 of 2002 (South Africa DoR submission, 2013/14, pg. 61).

- iii. Prudent utilization of grants and access to information.

The DORA needs to include key accountability information on conditional grants including

- clear policy goals and objectives supported by data on demographic and developmental targets, e.g. data on the number of households without access to basic services as derived from census data, proportion of the national backlog for particular basic services in each county/administrative area and proportion of the country's poor households located in individual counties.
- adequacy of funding vi a vis the fiscal gap between expenditure responsibilities and capacity to finance of the particular service, sector or project;
- statement on fiscal capacities and how inadequacies are being addressed;
- statement on functional alignment regarding to the extent to which the transfer aligns to functional mandates as provided in the constitution;

- iv. Division of revenue principles for conditional grants

The DORA needs to lay explicit principles which inform conditional grants or transfers which are subject to specific conditions that may include;

- i) targets use, by sector or purpose e.g. capital investment, pre-school facilities, to fund marginalized groups or areas, etc
- ii) requirement for matching (i.e. matching grants) which require recipients to contribute part of costs, one shilling to one, or any other ratio
- iii) requirement to meet specified targets, outputs or results e.g. access to health facilities, school enrolment

- iv) one off-funding or over a period, e.g. revenue enhancement study
- v) may be open ended, like the case with LATF but with requirements to achieve specified performance ratios e.g. debt, revenue etc

For example, the Fiscal Commission of South Africa proposed principles that need to be observed in the administration of conditional grants as follows:

- There must be a mandatory and systematic process for designing and planning of individual grants, effective monitoring and independent evaluation of the grants to ensure administrative accountability.
 - To enhance transparency in the criteria used to allocate conditional grants, the FCC indicated that grants should be tailored to a particular problem depending on the nature and magnitude of the problem to be resolved. Further, infrastructure-specific grant scheme must have a project proposal designed to meet predetermined funding criteria which is transparent and understood by all.
 - That accounting for delivery be a prerequisite for grants and that municipalities and provinces report on the delivery which would provide a basis for being awarded grants. This calls for a documented agreement between the departments responsible for the grant and the recipient government.
 - Achieving results-oriented accountability through incentive-oriented grants whereby additional grants may be provided as incentives for improving performance or achievement of good results.
- v. Performance evaluation
- There is a need to ensure that funds are traceable to avoid double funding and blurring of reporting;
 - Another accountability measure is that national departments must report to Parliament the outcome of grants allocated for specific purpose.
 - There is need for the inclusion of an implementation work plan and monitoring and evaluation mechanism in the existing framework for management of conditional grants.
 - The allocation and introduction of conditional grants should be based on past performance data;

There is a need for publicly available information on the performance of each conditional grant from the national government's share of revenue to assist provide oversight on the execution of the grants at the county level. It is noteworthy that the recipients of conditional grants are required to submit reports, the Treasury should ensure that this performance information is included in DORA. Such information would include; amount of grants previously received, status of fiscal gap, how they performed in terms of spending and absorption over the years. The reports should also report on attainment of Key Performance Indicators.