REPUBLIC OF KENYA

THE NATIONAL TREASURY AND PLANNING

Division of Revenue Bill, 2022

A Legislative Proposal for submission to Parliament

THE DIVISON OF REVENUE BILL, 2022

ARRANGEMENT OF CLAUSES

Clause

A Bill for

AN ACT of Parliament to provide for the equitable division of revenue raised nationally between the national and county governments in 2022/23 financial year, and for connected purposes.

ENACTED by Parliament of Kenya, as follows—

	PART I— PRELIMINARY
Short title.	**1.** This Act may be cited as the Division of Revenue Act, 2022.
Interpretation.	**2.** In this Act, unless the context otherwise requires—
	"Cabinet Secretary" means the Cabinet Secretary for the time being responsible for matters relating to finance; and
No. 16 of 2011.	"revenue" has the meaning assigned to it under section 2 of the Commission on Revenue Allocation Act, 2011.
Object and purpose of the Act.	**3.** The object and purpose of this Act is to provide for the equitable division of revenue raised nationally between the national and county levels of government for the financial year 2022/23 in accordance with Article 203 (2) of the Constitution.
Allocations to national and county governments.	**4.** Revenue raised by the national government in respect of the financial year 2022/23 shall be divided among the national and county governments as set out in the Schedule to this Act.
Variation in revenue.	**5.** (1) If the actual revenue raised nationally in the financial year falls short of the expected revenue set out in the Schedule, the shortfall shall be borne by the national government, to the extent of the threshold prescribed in Regulations by the Cabinet Secretary.
	(2) If the actual revenue raised nationally in the financial year exceeds the projected revenues set out in the Schedule, the excess revenue shall accrue to the national government, and may be used to reduce borrowing or pay debts.

SCHEDULE (s.4)

Allocation of revenue raised nationally between the national and county governments for the financial year 2022/23.

Type/level of allocation	Amount in Ksh.	Percentage (%) of 2016/17 audited and approved Revenue i.e. Ksh.1,357,698 Million
A. Total Sharable Revenue	2,141,584,412,556	
B. National Government	1,764,099,760,466	
Of which:		
C. Equalization Fund	7,068,474,211	0.52%
D. County equitable share	370,000,000,000	27.25%

MEMORANDUM OF OBJECTS AND REASON

The principal object of this Bill is to provide for the equitable division of revenue raised nationally among the national and county levels of government as required by Article 218 of the Constitution in order to facilitate the proper functioning of county governments and to ensure continuity of county services delivery to the citizens.

Clauses 1 and 2 of the Bill provide for the short title of the Bill and the interpretation of terms used in the Bill.

Clause 3 of the Bill contains the provisions on the objects and purpose of the Bill.

Clause 4 of the Bill prescribes the allocations for the National Government and the county governments from the revenue raised nationally for the financial year 2022/23.

Clause 5 of the Bill outlines the mechanisms for adjusting for variations in revenues emanating from revenue performance during the financial year in which this Bill relates to.

Dated the 26th November, 2021

Hon (Amb). Ukur Yatani, EGH
Cabinet Secretary for
The National Treasury and Planning

APPENDIX

EXPLANATORY MEMORANDUM TO THE DIVISION OF REVENUE BILL (DoRB), 2022

Background

1. This memorandum has been prepared as an attachment to the Division of Revenue Bill (DoRB), 2022 in fulfilment of the requirements of Article 218(2) of the Constitution and Section 191 of the Public Finance Management Act, 2012.

2. Article 218 (2) of the Constitution requires that the Bill be submitted to Parliament every year together with a memorandum explaining:

(a) the proposed revenue allocation set out in the Bill;

(b) the extent to which the Bill has taken into account the provisions of Article 203 (1) of the Constitution; and

(c) any significant deviations from the recommendations of the Commission on Revenue Allocation (CRA).

3. In addition to the above requirements, Section 191 of the Public Finance Management Act, 2012 requires that the Bill be submitted to Parliament together with the Medium-Term Budget Policy Statement accompanied by a memorandum which explains:

(a) the extent, if any, of deviation from the recommendations of the Intergovernmental Budget and Economic Council; and

(b) any assumptions and formulae used in arriving at the respective allocations proposed in the Bill.

Explanation of the Allocations to the National and County Governments as Proposed in the Bill

County Governments' Equitable Share

4. The bill proposes to allocate County Governments **Ksh. 370 billion** as equitable share of revenue raised nationally for the financial year 2022/23. This follows an approval of the Third Basis (covering the years 2020/21 to 2024/25 for allocation of the share of national revenue among the County Governments in September, 2020 on condition that the formula's

implementation commencing in the financial year 2021/22 would be preceded by a Ksh.53.5 billion increase in the Counties' equitable revenue share. The equitable share allocation is maintained at Ksh. 370 billion in the financial year 2022/23, a retention of the equitable share allocation in FY 2021/22. The retention in county governments' equitable revenue share is informed by the following prevailing circumstances:

a) the budget for FY 2022/23 is formulated at a time of Covid 19 which has affected revenue mobilization and brought with it significant uncertainty in revenue projection. In consideration of uncertainty in resource mobilization it would be imprudent to raise county shareable revenue above the levels in the approved BPS 2021, taking into account the fact that allocations and transfers to county governments as equitable share are guaranteed under Article 219 of the Constitution, unlike the national government's allocations that may be reviewed downwards when ordinary revenue does not perform as projected;

b) the Government is implementing a fiscal consolidation plan, which is expected to be shared between the two levels of government, so as to lower the fiscal deficit and slow down debt accumulation. To reflect this fiscal tightening, the National Government recurrent ceiling growth has been restricted, declining from a growth of 10.3 percent in FY 2017/18 to 1.2 percent in FY 2022/23. The fact that the growth in recurrent ceiling is below growth in wages, implies that the National Government is reducing its operation budget significantly; and

c) the Consolidated Fund Services (CFS) budget for FY 2022/23 has been revised upwards by Ksh. 46.9 billion and therefore in order to retain the deficit at the 2021 BPS level, the National Government ceiling has already been revised downwards by Ksh. 15.0 billion while maintaining the county equitable share at the same level. However, to accommodate higher interest payments and allow for additional support to some state-owned enterprises facing financial difficulties, the deficit has been eased slightly from 5.7 percent of GDP in 2021 BPS to 6.0 percent of GDP in 2022 BPS.

5. In addition, the fact that the approved Third Basis for allocation of the share of national revenue among the County Governments is now effectively linked to devolved functions (specifically with weighted parameters for health, roads and agriculture) means that it is now possible to achieve policy objectives of some conditional grants directly through the equitable share. For example, in health and agriculture, the new parameters to be used in distributing the equitable revenue share among Counties closely resemble those currently being used to distribute sectoral conditional allocations. Further, the approved revenue distribution criteria contain a

parameter, 'population' with a weight of 18% which is specifically designed to reflect costs of 'other County Services' including village polytechnics.

6. The above proposed Equitable Share for FY 2022/23 of Ksh.370 billion is equivalent to 27.3 percent of the last audited accounts (Ksh.1, 358 billion for FY 2016/17) and as approved by Parliament. The proposed allocation meets the requirement of Article 203(2) of the Constitution that equitable share allocation to counties should not be less than fifteen (15) per cent of the last audited revenue raised nationally, as approved by the National Assembly.

Evaluation of the Bill against Article 203 (1) of the Constitution

7. Article 218(2) of the Constitution requires division of revenue between the two levels of government and across County Governments to take into account the criteria set out in Article 203(1) of the Constitution. The criteria include factors such as: national interest, public debt and other national obligations and needs of the disadvantaged groups and areas, among others.

Table 2 provides an assessment of the extent to which the requirements of Article 203 (1) have been incorporated in estimating the division of revenue between the national and county levels of Government in the financial year 2022/23.

Table 2: Evaluation of the Bill against Article 203 (1) of the Constitution

ITEM DESCRIPTION ***(Kshs. Millions)***	**FY2018/19**	**FY2019/20**	**FY2020/21**	**FY2021/22**	**FY2022/23**
ORDINARY REVENUE (EXCLUDING AIA)	**1,499,757**	**1,573,418**	**1,574,009**	**1,775,624**	**2,141,584**
National Interest [Article 203 (1)(a)]	**84,186**	**94,168**	**86,753**	**83,197**	**90,727**
Enhancement of security operations (police vehicles, helicopters, defence etc.)	27,800	27,974	24,816	22,261	25,967
National irrigation & fertilizer clearance	11,775	11,103	11,375	11,199	14,676
Youth empowerment	7,442	16,226	16,127	14,548	14,364
National social safety net - (for older persons, OVC, child welfare, presidential bursary, severe disability)	26,812	26,362	28,832	29,286	29,817
Primary school digital literacy program	6,333	8,400	1,500	1,800	1,380
School examination fees (KSCE & KCPE& Grade 6(CBC Examination)	4,024	4,103	4,103	4,103	4,523
Public debt (Art. 203 [1][b])	**641,514**	**538,802**	**829,906**	**1,174,013**	**930,354**
Other National obligations (Art. 203 [1][b])	**391,878**	**442,627**	**477,045**	**514,018**	**548,849**
Pensions, constitutional salaries & other	90,573	109,526	124,451	136,978	145,951
Constitutional commissions (Art. 248(2)) i.e., CRA, SRC, NLC, NPSC, IEBC, TSC	233,619	261,387	281,099	299,333	321,968
Independent offices (Art. 248(3)) - i.e., AG & CoB	6,412	6,336	6,295	6,499	6,981
Parliament	34,490	36,240	36,222	37,883	38,477
Other constitutional institutions- State Law Office and DPP	7,602	8,765	8,154	8,371	8,713

Other statutory bodies (e.g., EACC, RPP, WPA, CAJ, IPOA, NGEC)	5,724	5,937	6,674	7,036	8,462
Judiciary	13,458	14,437	14,150	17,918	18,297
Emergencies [Art. 203 (1)(k)]	**6,419**	**6,418**	**5,000**	**5,000**	**5,000**
Contingencies	5,000	5,000	5,000	5,000	5,000
Strategic grain reserve	1,419	1,418	0	-	-
Equalization Fund [Art. 203 (1) (g) and (h)]	**4,700**	**5,765**	**6,532**	**6,825**	**7,068**
BALANCE TO BE SHARED BY THE 2 LEVELS OF GOVERNMENT	**371,060**	**485,638**	**168,773**	**-7,429**	**559,587**
County Government allocation from revenue raised nationally of which; -	**322,193**	**324,160**	**330,231**	**377,537**	**375,654**
a) Equitable Share of Revenue	304,962	310,000	316,500	370,000	370,000
b) Additional conditional allocations financed from revenues raised nationally	17,231	14,160	13,731	7,537	5,654
Balance left for the National Government of which: -	**48,867**	**161,478**	**-161,458**	**-384,966**	**183,933**
Other statutory allocations/earmarked funds (e.g., NG-CDF, Affirmative Action)	*35,361*	*40,879*	*41,311*	*43,845*	46,420
Net Balance	**13,506**	**120,599**	**-202,769**	**-428,810**	**137,513**

Source: National Treasury and Planning as at 19th November, 2021

8. **National Interests:** These are expenditures which relate to projects and programmes that:

- are critical to the achievement of country's economic development objectives;
- potentially will have significant impact on social well-being of citizens;
- are anchored in the Vision 2030 and the Medium-Term Plan III (2017 – 2022);
- have significant resource investment requirements; and
- have been specified in the 2022 Budget Policy Statement.

These national interests include: activities aimed at enhancing security operations; national irrigation and fertilizer subsidy initiatives; Youth Empowerment; provision of national social safety net for vulnerable groups and primary school digital literacy program, and school examination fees subsidy. Revenue allocation for these programs is expected to increase slightly from Ksh. 83.2 billion in 2021/22 to Ksh. 90.7 billion in 2022/23.

9. **Public Debt:** The Bill has fully provided for all public debt related costs. These comprise of the annual debt redemption cost as well as the interest payment for both domestic and external debt. In financial year 2022/23, the revenue allocation for payment of public debt related costs is expected to decrease from Ksh.1,174 billion allocated in financial year 2021/22 to Ksh. 930.4 billion.

10. **Other National Obligations:** as provided for under Article 203(1) (b) of the Constitution, the Bill has also taken into account the cost of other national obligations, such as, mandatory pension contributions and/or payments, financing for constitutional offices, including Parliament

as well as expenses relating to other statutory bodies. These are estimated to cost Ksh.548.8 billion in financial year 2022/23 up from Ksh.514 billion in financial year 2021/22.

11. **Fiscal Capacity and Efficiency of County Governments:** Fiscal capacity for county governments refers to the potential revenues that can be generated from the tax bases assigned to the counties when a standard average level of effort is applied. In its recommendations to Parliament on the Third Basis for Sharing Revenue Among County Governments, the Commission on Revenue Allocation (CRA) included a 'fiscal effort' parameter with a 2% weight intended to incentivize OSR collection by the Counties. This is consistent with the approach in other jurisdictions, where the formula for horizontal revenue distribution among subnational governments typically incorporates measures of fiscal capacity alongside those of expenditure need. CRA's fiscal effort parameter was defined in terms of each County Government's actual revenue collection relative to the County's Gross County Product (GCP) as computed by the Kenya National Bureau of Statistics (KNBS).

12. In approving CRA's recommendations however, Parliament did not include the fiscal effort parameter, effectively shifting the 2% weight to other parameters. This means that during the five-year basis application, it will not be easy to motivate counties to strengthen their local revenue collection efforts. There is therefore need for County Assemblies, in conducting their oversight role ensure that county governments enhance their own source revenue collection. It is hoped that future revenue sharing formulae may consider reinstating the fiscal effort parameter to incentivize counties to collect more own source revenues.

13. **County governments' ability to perform the functions assigned to them and meet other developmental needs of the county governments:** As explained above, the baseline for the equitable share allocation for the financial year 2022/23 was derived from the Division of Revenue Act, 2021 This base line is informed by costing of expenditure for devolved functions done at onset of devolution, which has been the basis for equitable share over the years.

14. It should be noted that allocations for devolved functions were based on the historical cost of those expenditures on devolved functions as determined through a consultative process that involved the line ministries and other independent commissions and offices. Moreover, should any residual function/s and attendant resources be identified, they shall be included in subsequent DoRB.

15. It should also be noted that, in order to balance between priority development and performance of the assigned functions, the Third Basis formula is premised on eight parameters which relate to devolved functions assigned to county governments in Part II of the Fourth

Schedule of the Constitution. Accordingly, counties will have to allocate a prescribed minimum to specific functions contained in the Third Basis.

16. Thus, the proposed vertical division of revenue proposed in the Division of Revenue Bill, 2022 therefore takes into account the cost of County Governments' developmental needs and it is expected that county governments will have the ability to perform the functions assigned and transferred to them as contemplated under Article 203(1) (f).

17. **Economic Disparities within and among counties and the need to remedy them:** Allocation of the sharable revenue (i.e., equitable share of Ksh.370 billion) among counties is based on the Third-generation formula approved by Parliament in September, 2020 pursuant to provisions of Article 217 and Section 16 of the Sixth Schedule of the Constitution. The Third Basis formula which should be applicable from FY 2020/21 to FY 2024/25 has taken into account the following parameters; (i) Population (18%); (ii) Health Index (17%); (iii) Agriculture Index (10%); (iii) Urban Index (5%); (iv) Poverty Index (14%); (v) Land Area Index (8%); (vi) Roads Index (8%), and; (vii) Basic Share index (20%). The horizontal distribution of County Governments' equitable revenue share allocation of Ksh.370 billion for FY 2022/23 shall be based on the Third Basis Formula. Accordingly, in FY 2022/23, the Counties will share an estimated Ksh.370 billion. It should be noted that the Third Basis formula, which will be applied in FY 2022/23, takes into account disparities among counties and aims at equitable distribution of resources across counties.

18. Further, it should be noted that Ksh.7 billion has also been set aside for the Equalization Fund in 2022/23 which translates to 0.52 per cent of the last audited revenue accounts of governments, as approved by the National Assembly. This Fund is used to finance development programmes that aim at reducing regional disparities among beneficiary counties.

19. **Need for Economic Optimization of Each County:** Allocation of resources to County Governments was guided by the historical costing of expenditures for functions assigned to the County Governments. The equitable share of revenue allocated to County Governments in the financial year 2022/23 is Ksh.370 billion, an allocation which remains unchanged from the FY 2021/22. This is an unconditional allocation which means that the County Governments can plan, budget and spend the funds independently. With the resources, therefore, County Governments are in a position to prioritize projects and consequently allocate resources thus optimizing their potential for economic development.

20. **Stable and Predictable Allocations of County Governments' Vertical Share of Revenue:** The county governments' equitable share of revenue raised nationally has been protected from cuts that may be occasioned by shortfall in revenue raised nationally, more so in

the advent of the effects of Covid-19 Pandemic. According to clause 5 of the DoRB 2022, any shortfall in revenue raised nationally is to be borne by the National Government, to the extent of the threshold prescribed in Regulations by the Cabinet Secretary.

21. **Need for Flexibility in Responding to Emergencies and Other Temporary Needs:** Included in the equitable share of revenue for the National Government is an allocation of **Ksh.5 billion** for the Contingencies Fund established pursuant to Article 208 of the Constitution. This Fund will be used to meet the demands arising from urgent and unforeseen needs in all Counties that suffer from calamities in the manner contemplated under Section 21 of the Public Finance Management Act, 2012. In addition, the Public Finance Management Act, 2012 and the PFM (County governments) Regulations, 2015 requires each county government to set up a County Emergency Fund. County governments are expected to set aside at least 2 % of their budget as part of their allocation for this purpose.

22. It should be noted that after taking into account all the other factors contemplated under Article 203(1) of the Constitution, including the needs of county governments, there is minimal resources left to finance other National Government needs, such as, defense, roads, energy etc. In fact, this leaves a balance of Ksh.183 .9 billion. This balance includes the requirements of Ksh.46.4 billion for "*Other statutory allocations/earmarked funds (e.g., NG-CDF, Affirmative Action)*" which if included pushes the balance to Ksh.137.5 billion of the total sharable revenue raised nationally. This is far less than the Ksh.377.5 billion allocated to county government's needs.

Response to the Recommendations of the Commission on Revenue Allocation (CRA)

23. The Division of Revenue Bill, 2022 proposes to allocate county governments an equitable share of Ksh.370 billion from the shareable revenue raised nationally. The CRA also recommends County Governments' equitable share of revenue of Ksh.370 billion as an unconditional allocation to be shared among county governments on the Third Basis of the formula for sharing revenue approved by Parliament under Article 217 of the Constitution in September 2020. In this case there is no differences in the amounts of proposed allocation of equitable share to county governments by both CRA and the National Treasury. CRA's recommendation is premised on the following seven criteria provided for in Article 203(1) of the Constitution; (i) National interest, (ii) provisions in respect of the public debt and other national obligations; (iii) the needs of the national government, determined by objective criteria; (iv) the need to ensure that county governments are able to perform the functions allocated to them; (v) the fiscal capacity and efficiency of county governments; (vi) the

desirability of stable and predictable allocations of revenue; and (vii) the need for flexibility in responding to emergencies and other temporary needs, based on similar objective criteria.

24. CRA recommendation is based on the following:

i. **Economic growth**: The Commission is cognizant of the need to stimulate the economy following the slump occasioned by the COVID-19 global pandemic. However, given the limited fiscal space the Commission recommends that each level of government restructures its expenditures to stimulate the economy.

ii. **Revenue performance**: The expected slow recovery of the economy and the 2022 general election are likely to affect revenue performance negatively in the financial year 2022/23. To contain the fiscal deficits within the recommended target there is need for equitable shares to be retained at the financial year 2021/22 levels.

iii. **Debt Sustainability**: Persistent underperformance of revenues has led to increased fiscal deficits occasioning the accumulation of more debt to finance government functions. This call for fiscal consolidation to contain the public debt.

iv. **The 2022 General Election**: The general election will be held in August 2022. It is important that the national government restructures its expenditures to finance the election as a matter of national interest.

25. Table 3 analyses the approaches by CRA the National Treasury in computing the proposal on the division of revenue between the national and county governments in FY 2022/23.

Table 3: Comparison of approaches towards recommendations of the Commission on Revenue Allocation and the National Treasury on the equitable share of revenue proposed for FY 2022/23 (Figures in Ksh. Millions)

Expenditure Item	CRA	National Treasury	Variance
	A	B	C=(A-B)
1. Equitable Revenue Share in FY 2022/23	370,000	370,000	-
2. Adjustment for revenue growth in FY 2022/23 as determined in the framework	-	-	-
TOTAL EQUITABLE OF REVENUE = (1+2)	**370,000**	**370,000**	-

Source: National Treasury and Planning

26. Although there are no differences on the proposed amount of equitable share to county governments, there are differences occasioned by consideration for additional conditional allocations financed from National government share of revenue amounting to Ksh.5.6 billion; -

Whereas CRA has not made any additional proposals to fund Counties, the National Treasury has proposed Ksh.5.6 billion to be financed from the National Government share of revenue.

Conclusion

27. The proposals contained in the Bill take into account the fiscal framework set out in the BPS 2022 and are intended to ensure fiscal sustainability specifically against the backdrop of escalating expenditure pressure on the fiscal framework occasioned by increase in Consolidated Fund Services (CFS) and the persistent under performance of the ordinary revenue.

28. The National Treasury has also taken into account the approved Third Basis for Revenue Allocation among county governments pursuant to Article 217 of the Constitution, whose implementation in the FY 2021/22 was preceded by a Ksh.53.5 billion increase in the Counties' equitable revenue share. It is expected that with a successful implementation of the Third Basis formula from FY 2020/21 to 2024/25, county governments will now be able to plan, budget and spend in accordance with areas of need as envisaged in the formula as well as achieve their developmental needs.

29. The proposed equitable share allocated to county governments in the Division of Revenue Bill, 2022, at 27.3 per cent of the most recent audited revenue, as approved by the National Assembly, is way above the minimum threshold required under Article 203(2) of the Constitution.