SECRET

HARAMBEE

REPUBLIC OF KENYA

THE NATIONAL TREASURY

Division of Revenue Bill, 2020

A Legislative Proposal for submission to Parliament

	PAPERS LAID
DATE	13/02/2020
TABLED BY	~~Chairperson CPAIC~~ Leader of Majority
COMMITTEE	CPAIC
CLERK AT THE TABLE	Mango. K

SECRET

THE DIVISON OF REVENUE BILL, 2020

ARRANGEMENT OF CLAUSES

Clause

1—Short title.
2—Interpretation.
3— Object and purpose of the Act.
4— Allocations to National Government and County Government.
5— Variation in Revenue.

SCHEDULE
Equitable share of revenue raised nationally between the national and county governments for the financial year 2020/21.

APPENDIX
Explanatory memorandum to the Division of Revenue Bill, 2020.

A Bill for

AN ACT of Parliament to provide for the equitable division of revenue raised nationally between the national and county governments in 2020/21 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, 2020.

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;

No. 16 of 2011.

"revenue" has the meaning assigned to it under section 2 of the Commission on Revenue Allocation Act, 2011; and

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 2020/21 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 2020/21 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 2020/21.

Type/level of allocation	Amount in Ksh.	Percentage (%) of 2015/16 audited and approved Revenue i.e. Ksh.1,193,619 Million
A. Total Sharable Revenue	**1,856,700,000,000**	
B. National Government*	**1,533,668,000,000**	
Of which:		
1. Leasing of Medical Equipment	6,205,000,000	
2. Compensation for user fees forgone	900,000,000	
3. Level 5 hospitals	4,326,000,000	
4. Supplement for construction of county headquarters	300,000,000	
5. Rehabilitation of Youth Polytechnics	2,000,000,000	
C. Equalization Fund	**6,532,000,000**	**0.55%**
D. County equitable share	**316,500,000,000**	**26.5%**
Memo items		
1. County equitable share	***316,500,000,000***	
2. Additional conditional allocations(National Government share of Revenue) of which;	***13,731,000,000***	
2.1. Leasing of Medical Equipment	6,205,000,000	
2.2 Compensation for user fees forgone	900,000,000	
2.3 Level 5 hospitals	4,326,000,000	
2.4 Supplement for construction of county headquarters	300,000,000	
2.5 Rehabilitation of Youth Polytechnics	2,000,000,000	
3. Allocation from Fuel Levy Fund (15%)	*9,433,265,625*	
4. Conditional allocations (Loans & grants) of which:	***30,204,347,510***	
4.1 IDA-Kenya Devolution Support Program (KDSP) (Level 1)	*2,115,000,000*	
4.2 IDA-Transforming Health Systems for Universal Care Project	4,345,375,741	
4.3 DANIDA-Universal Healthcare For Devolved System Program	900,000,000	

4.4 IDA-National Agriculture & Rural Inclusive Growth Project (NARIGP)	4,261,646,438	
4.5 EU-Instruments for Devolution Advice and Support (IDEAS)	216,014,391	
4.6 IDA (World Bank) - Kenya Climate Smart Agriculture Project (KCSAP)	7,119,726,782	
4.7 World Bank- Kenya Urban Support Program(KUSP)- UDG	6,366,000,000	
4.8 IDA- Water and Sanitation Development Project (WSDP)	3,400,000,000	
4.9 Sweden Agriculture Sector Development Programme II (ASDP II)	652,584,158	
5.0 EU- Water Tower Protection and Climate Change Mitigation and Adaptation Programme (WaTER)	528,000,000	
5.1 Drought Resilience Programme in Northern Kenya	300,000,000	
Total County Allocations= (1+2+3+4)	**369,868,613,135**	**31.0%**

*The National Government share includes Ksh. 4,300 million which is a special grant to the National Health Insurance Fund (NHIF) for free Maternal health care, to be disbursed as a reimbursement to county governments.

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.

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 2020/21.

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

Dated the ...5th February..., 2020

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

APPENDIX

EXPLANATORY MEMORANDUM TO THE DIVISION OF REVENUE BILL (DoRB), 2020

Background

1. This memorandum has been prepared as an attachment to the Division of Revenue Bill (DoRB), 2020 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

4. The DoRB, 2020 proposes to allocate to County Governments Ksh.369.8 billion in the financial year 2020/21, which relative to the financial year 2019/20 allocation, reflects a decrease of Ksh. 8.6 billion or 2.3 % mainly attributed to a significant decrease of donor funded additional conditional allocations compared with the funding in financial year 2019/20.This allocation

comprises of; equitable share of Ksh. 316.5 billion; additional conditional allocations from the share of national government revenue amounting to Ksh. 13.7 billion; additional conditional allocations from proceeds of loans and grants by development partners amounting to Ksh. 30.2 billion; and additional conditional allocation from Roads Maintenance Levy Fund amounting to Ksh. 9.4 billion.

County Governments' Equitable Share

5. The bill proposes to allocate County Governments' an equitable share of revenue raised nationally for the financial year 2020/21 of Ksh. 316.5 billion

6. This proposal for County Governments' equitable revenue share allocation for FY 2020/21 is informed by five (5) factors--- which are detailed in paragraphs 7 to 12--namely:

a) Continued underperformance in ordinary revenue, which forms the base for the annual division of revenue;
b) The fact that the National Government continues to solely bear shortfalls in revenue in any given FY;
c) There being a Ksh 161 billion funding gap in the FY 2019/20 budget;
d) A 10.3% projected contraction in National Government's net spending in FY 2020/21 vis-à-vis FY 2019/20; and,
e) The proposal by National Treasury that the entire incremental revenue in FY 2020/21 be earmarked for CFS, specifically debt repayment and pensions.

7. Although in the Budget Review and Outlook Paper (BROP) 2019 as well as in the draft BPS 2020, the National Treasury had proposed an equitable share of Ksh 317.8 billion to county governments in FY 2020/21, the revised proposal to allocate Ksh. 316.5 billion is informed largely by the underperformance in ordinary revenue witnessed in recent years. According to the draft 2020 BPS, between FY 2013/14 and FY 2018/19, cumulative ordinary revenue shortfalls amounted to Ksh 932 billion.

8. Additionally, and as per respective annual Division of Revenue Acts (DoRA), over the years the National Government has always borne any revenue shortfall. Accordingly, to balance the budget, this has been achieved by downsizing spending by MDAs; however County allocations have never been affected by the shortfalls. For instance, in FY 2017/18 when ordinary revenue grew by 4% against a target of 13% culminating in a Ksh 195 billion shortfall, Counties' allocation grew by 8% (from Ksh 280.3 billion to Ksh 302 billion). In contrast, the National Government's net issues contracted by 7% (from Ksh 1,149 billion in FY 2016/17 to Ksh 1,072 billion). Similarly,

actual net issues in FY 2018/19 reflects a Ksh 82 billion reduction from what was proposed in the revised budget (II) estimates.

9. In FY 2019/20 the estimated net issues for the National Governments of Ksh. 1,416 billion have a funding gap of Ksh 161 billion; a gap which will occasion further expenditure cuts of a similar magnitude. The scope for these cuts exists only in the development budget and to a small extent in 'other O&M'. Accordingly, the base for the current FY will be adjusted to account for the above funding gap. This means that the National Government's net issues for development and 'other O&M' will drop from Ksh 680 billion to Ksh 519.5 billion.

10. Further, as part of measures to narrow the projected deficit, the National Government has proposed a Ksh 146 billion or 10.3% contraction in the National Government's estimated FY 2020/21 net issues (i.e. from Ksh 1,416 billion in FY 2019/20 to Ksh 1,271 billion).

11. Finally, despite the depressed revised revenue forecasts for FY 2019/20 and 2020/21 vis-à-vis original estimates for both years, collections in FY 2020/21 are now projected to grow by Ksh 89.8 billion (i.e. from Ksh 1766.9 billion to Ksh 1,856.7 billion). The National Treasury proposes that the additional revenue be directed towards Consolidated Fund Services (CFS), specifically debt repayment, pensions and gratuities, and some salaries for Constitutional Offices and Independent Commissions. These are non-discretionary expenditures which take first charge in the public budget.

12. Accordingly, of the above projected additional revenue in FY 2020/21, an estimated Ksh 57.2 billion will be earmarked for debt repayment and the balance (i.e. approximately Ksh 19.7 billion) will be earmarked for retirees' pension payments as well as GoK contribution to civil servants' pension (See Table 1). Clearly, the Ksh 89.8 billion revenue growth will be used to finance the above mentioned CFS items.

Table 1: Allocations towards Consolidated Fund Services (Ksh billions)

Payments	FY 2019/20	FY 2020/21	Variance
Debt repayment (principal)	131.4	174.1	42.7
Debt repayment (interest)	441.5	456.0	14.5
Pensions	108.6	118.7	10.1
Contribution to civil service pension	4.8	14.4	9.6
TOTAL	686.3	763.2	76.9

Source of data: National Treasury

13. The proposed Equitable Share for FY 2020/21 of Ksh. 316.5 billion is equivalent to 26.5 percent of the last audited accounts (Ksh 1,194 billion for FY 2015/16) as approved by Parliament. The proposed allocation meets the requirement of Article 203(2) of the Constitution.

Additional Conditional Allocations to County Governments

14. Article 202(2) of the Constitution provides for additional allocation to County Governments from the National Government's share of revenue, either conditionally or unconditionally. Pursuant to this Article, the National Government proposes to allocate the following additional conditional allocations to support specific national policy objectives to be implemented by County Governments:

- **Additional Conditional Allocation to facilitate the leasing of medical equipment of Ksh 6.205 billion.** This grant which is in its sixth year of implementation, is proposed to increase from Ksh. 6.200 billion in FY 2019/20 to Ksh. 6.205 billion in FY 2020/21 and is intended to facilitate the payment of lease amounts in respect of modern specialised medical equipment in at least two health facilities in each County Government over the medium term. This will facilitate easy access to specialised health care services and significantly reduce the distance that Kenyans travel in search of such services today.

- **Additional Conditional allocation for level-5 hospitals of Ksh. 4.3 billion.** Level-5 hospitals continue to play a critical role in providing specialised health care services to Kenyans. These hospitals provide specialised health care services to citizens residing within and outside their host County, usually for complicated cases referred from lower level health facilities. In order to compensate them for the costs incurred in rendering services to neighbouring Counties, the national government proposes to allocate Ksh. 4.3 billion in financial year 2020/21 to 11 counties with level 5 hospitals.

- **Additional Conditional allocation of Ksh. 900 million to compensate county health facilities for user fees foregone.** It is the intention of government to sustain the Government policy of not charging user fees in public health facilities. In this regard, and in furtherance of this policy, the National Government has proposed an allocation of Ksh. 900 million in the financial year 2020/21 to compensate county governments for revenue forgone by not charging user fees in the county health facilities. This additional conditional allocation, which is in its sixth year of implementation, will further complement government efforts of not only achieving the Universal Health Coverage, but also sustaining its gains.

- **Additional Conditional Allocation for Rehabilitation of Youth Polytechnics of Ksh. 2 billion:** this additional conditional allocation which is in its fourth year of implementation and implemented through the State Department of Vocational and Technical Training, is meant to support county governments in equipping Technical and Vocational Centres and capitation of student fees. The additional conditional allocation aims at enhancing access to quality and relevant vocational skills training.
- **Additional Conditional allocation to supplement county allocation for the construction of county headquarters of Ksh. 300 Million in five counties:** This conditional allocation is intended to further supplement financing for construction of headquarters by five County Governments that did not inherit adequate offices. The five counties are Isiolo; Lamu; Nyandarua; Tana River and Tharaka Nithi. This marks the fourth year of its implementation whereby the National Government contributes 70 percent of the budget while County Governments contributes 30 percent of the total cost of the projects. This allocation has declined from Ksh. 485 million allocated in FY 2019/20 to a proposed allocation of Ksh. 300 million in FY 2020/21.

- **Additional Conditional Allocation from the Road Maintenance Fuel Levy Fund of Ksh. 9.4 billion.** This conditional allocation which is in its sixth year of allocation is proposed to be Ksh. 9.4 billion in FY 2020/21. This allocation is meant to further enhance County Governments' capacity to repair and maintain county roads and is equivalent to 15 percent of the Road Maintenance Fuel Levy Fund. The allocation has increased significantly from Ksh. 8.98 billion allocated to RMLF in FY 2019/20 to the proposed allocation of Ksh. 9.4 billion in FY 2020/21. This is attributed to higher projected revenues from fuel levy in FY 2020/21 compared to projections in FY 2019/20.

- **Transforming Health Systems for Universal Care Project conditional allocation of Ksh. 4.3 billion (World Bank credit):** - This conditional allocation through the Ministry of Health is meant to improve delivery, utilization and quality of primary health care services with focus on reproductive, maternal, new-born, child and adolescent health (RMNCAH) at the county level. This additional conditional allocation is proposed to increase from Ksh. 2.99 billion in FY 2019/20 to Ksh. 4.3 billion in the financial year 2020/21. This is attributed to the structure of project implementation and financing as contained in the Project Appraisal Document. This conditional allocation will complement the National Government efforts on attainment of the Universal Health Coverage policy initiative.

- **DANIDA-Universal Healthcare for Devolved System Program of ksh. 900 million:** The project development objective (PDO) of this programme is "to improve utilization and quality of primary health care services with a focus on reproductive, maternal, new-born, child, and adolescent health services. "The Project will achieve this objective by: (a) improving access to and demand for quality Primary Health Care (PHC) services; (b) strengthening institutional capacity in selected key areas to improve utilization and quality of PHC services; and (c) supporting cross-county and intergovernmental collaboration in the recently devolved Kenyan health system.

  The conditional allocation to this programme is proposed to decline slightly from an allocation of Ksh. 986 million in FY 2019/20 to an allocation of Ksh. 900 million in FY 2020/21. This is attributed to provisions of the financing agreement which envisages gradual decrease of the amounts allocated to the project in each financial year, for sustainability. The program is expected to close in December, 2020.

- **National Agricultural and Rural Inclusive Growth Project; NARIGP of Ksh. 4.26 billion (World Bank credit):** - this additional conditional allocation is proposed to be allocated Ksh. 4.26 in the financial year 2020/21. This additional conditional allocation is meant to further compliment efforts by National Government to attain food security in the country by facilitating counties to increase agricultural productivity and profitability of targeted rural communities in selected counties, and to provide immediate and effective response in case of crisis or emergency. This additional conditional allocation is proposed to decrease from Ksh. 7.2 billion in FY 2019/20 to Ksh. 4.3 billion in the financial year 2020/21 because the project is at advanced stages of implementation as contained in the Project Appraisal Document (PAD) and the implementation work plans.

- **Kenya Urban Support Program (KUSP) – Urban Development Grant (UDG) additional conditional allocation of Ksh.6.36 billion:**-The purpose of the Grant is to provide support to urban boards and administrators within the participating County Governments for financing infrastructure investments in urban areas. This is a performance based grant where the participating county governments are funded based on the score in the Annual Performance Assessment (APA) _ for achievement of urban planning, infrastructure, and service delivery targets. This additional conditional allocation has declined from Ksh. 11 billion in FY 2019/20 to Ksh. 6.36 billion in the financial year 2020/21. The decrease is attributed to the advanced completion of the programme and its planned activities as outlined in the Project Appraisal Document (PAD) and the project implementation work plans.

- **Kenya Devolution Support Program (KDSP) County Capacity Building ("level 1") Grant of Ksh. 2.1 billion.** This is a conditional grant, which is in its second year of implementation, financed by a World Bank credit to support county government's capacity building under the Kenya Devolution Support Program (KDSP) amounting to Ksh. 2.1 billion. This grant is intended to support capacity building initiatives in the counties in the following areas:
  - Strengthening public financial management (PFM) systems;
  - Strengthening County Human resource management;
  - Improving county planning and Monitoring & Evaluation systems;
  - Civic Education and Public Participation; and,
  - Strengthening Intergovernmental relations.

  Although the programme was supposed to come to an end upon disbursement of the Ksh. 1.4 billion allocated to it in FY 2019/20; the National Treasury was not able to disburse Ksh. 2.3 billion allocated the programme in FY 2018/19 due to adjustment in the amount to be paid to county governments against one of the Disbursement Linked Indicators (DLI) under the Kenya Devolution Support Program (KDSP). As such and following clarification by the World Bank on the correct allocation, the Exchequer could not disburse the Ksh. 2.3 billion to the Counties as allocated in the CARA, 2018 pending KDSP's restructuring including increasing the allocation to the afore-mentioned DLI. In this regard, and upon confirmation on restructuring of the DLI, the National Treasury has proposed to allocate Ksh. 2.1 billion to KDSP Level 1 in FY 2020/21 as part of arrears of Ksh. 2.3 billion allocated but not disbursed in FY 2018/19.

- **EU-Instruments for Devolution Advice and Support (IDEAS) grant of Ksh. 216 million:** This grant which is proposed to be allocated Ksh. 216 million in the financial year 2020/21 is in its fourth year of implementation. The grant is meant to support national and county government's capacities for the management of the devolution process and the responsible transfer and use of resources for the achievement of local economic development at the county level. This additional conditional allocation has declined from an allocation of Ksh. 492 million in FY 2019/20 to the proposed allocation of Ksh. 216 million in the financial year 2020/21. This is attributed to advanced completion rate of the programme and its planned activities as outlined in the Project Appraisal Document (PAD) and the project implementation work plans.

- **IDA (World Bank) - Kenya Climate Smart Agriculture Project (KCSAP) of ksh. 7.1 billion:** The project development objective (PDO) of this project is "to increase agricultural productivity and build resilience to climate change risks in the targeted smallholder farming and pastoral communities in Kenya, and in the event of an Eligible Crisis or Emergency, to provide immediate and effective response.

  KCSAP, which is in its third year of implementation, focuses on increasing agricultural productivity and enhancing resilience to impacts of climate change; reductions in Greenhouse Gas (GHG) emissions will be a co-benefit.

  The allocations to this programme has increased significantly from an allocation of 3.6 billion in the financial year 2019/20 to the proposed allocation of Ksh. 7.1 billion in financial year 2020/21. This increase can be attributed to increase in the number of mobilized beneficiary groups from which projects to be funded have been identified and approved by the National Steering committee. This programme which targets both the Vulnerable & Marginalized and Common Interest groups; is bound to build equity and equality among the marginalised persons in the society such as the disabled , women and youths through the empowerment projects.

- **IDA – Water and Sanitation Development Project (WSDP) World Bank Credit of ksh. 3.4 billion:** The Project Development Objective (PDO) of this program, financed by this additional conditional allocation, is to improve water supply and sanitation services in six select counties located in the coastal and north eastern regions of Kenya. This is achieved by investing in water supply and sanitation infrastructure in urban centers in these counties. The project will also improve services by strengthening institutional capacity in areas, such as, reducing Non-Revenue Water (NRW), improving billing and revenue collection systems, and developing medium-term business plans. In addition, the WSDP will establish a results-based financing mechanism at the national level to provide incentives to the Water Services Providers (WSPs) to accelerate access to water supply and sanitation services and improve operational and financial performance.
- **Agricultural Sector Development Support Programme (ASDSP) II- Ksh. 652 million-** ASDSP II, which is in its third year of implementation, is part of the implementation strategy of the Agricultural Policy (AP) for the national and county governments. In line with the AP, the overall goal of ASDSP II is to contribute to "transformation of crop, livestock and fishery production into commercially oriented enterprises that ensure sustainable food and nutrition security". The Programme Purpose is "to Develop Sustainable Priority Value Chains (PVCs) for improved income, food and nutrition security", which will contribute to achievement of the "BIG

FOUR" agenda of the Government on food security. This additional conditional allocation has significantly declined from an allocation of Ksh. 7.2 billion in FY 2019/20 to the proposed allocation of Ksh. 652 million in the financial year 2020/21. This is attributed to the advanced completion rate of the programme which is within the approved programme timelines and as specified in the implementation work plans.

- **EU- Water Tower Protection and Climate Change Mitigation and Adaptation Programme (WaTER) - Ksh. 528 million:** -The purpose of this additional allocation, which is in its second year of implementation, is to facilitate the implementation of the national climate change action plan and the master plan for the conservation of water catchment areas of Cherangany Hills and Mount Elgon.

  The program is being implemented in Cherangany Hills and Mount Elgon ecosystems and includes Lake Victoria and Turkana basins. It is also addressing a number of cross-cutting issues like climate change, gender equality, good governance and human rights and is meant to benefit eleven Counties i.e., Bungoma, Busia, Elgeyo Marakwet, Kakamega, Kisumu, Nandi, Siaya, Trans Nzoia, Uasin Gishu, Vihiga and West Pokot.

  This additional conditional allocation has slightly declined from an allocation of Ksh. 880 million in FY 2019/20 to the proposed allocation of Ksh. 528 million in the financial year 2020/21. This is attributed to a delay in start of the project implementation by one year; a delay which was occasioned by the need for assessment of the readiness of beneficiary counties as well as a pending programme restructuring by the EU and the Kenya Government.

- **Drought Resilience Programme in Northern Kenya (DRPNK) - Ksh. 300 million-** This is a project financed by proceeds of a loan and grant from the German Development Bank in Turkana and Marsabit counties. The programme objective is *"to* ensure that *Drought resilience and climate change adaptive capacities of the pastoral and agro-pastoral production systems and livelihoods in selected areas of Turkana and Marsabit County are strengthened on a sustainable basis by expanding and rehabilitating relevant infrastructure."* The expected projects outputs are to ensure: - access to water is improved for humans and livestock; fodder basis is improved; access to market infrastructure is improved; and rural transportation is improved in the two counties.

  This programme is in its second year of implementation and the additional conditional allocation towards its financing has slightly declined from an allocation of Ksh. 350 million in FY 2019/20 to the proposed allocation of Ksh. 300 million in FY 2020/21.

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

15. 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.

16. 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 2020/21.

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

	EVALUATION OF THE BILL AGAINST ARTICLE 203 (1) OF THE CONSTITUTION					
	ITEM DESCRIPTION *(Kshs. Millions)*	FY2016/17	FY2017/18	FY2018/19	FY2019/20	FY2020/21
	ORDINARY REVENUE (EXCLUDING AIA)	**1,306,568**	**1,365,063**	**1,651,517**	**1,843,775**	**1,856,700**
A	**National Interest** [Article 203 (1)(a)]	**79,685**	**82,696**	**84,186**	**94,168**	**84,182**
	Enhancement of security operations (police vehicles, helicopters, defence etc.)	18,900	20,556	27,800	27,974	24,816
	National irrigation & fertilizer clearance	8,700	8,880	11,775	11,103	10,575
	Youth empowerment	18,544	18,544	7,442	16,226	14,621
	National social safety net - (for older persons, OVC, child welfare, presidential bursary, severe disability)	16,924	17,305	26,812	26,362	28,567
	Primary school digital literacy program	13,408	13,408	6,333	8,400	1,500
	School examination fees (KSCE & KCPE)	3,209	4,003	4,024	4,103	4,103
B	**Public debt (Art. 203 [1][b])**	**307,155**	**462,243**	**637,396**	**585,703**	**630,100**
C	**Other national obligations** (Art. 203 [1][b])	**334,108**	**359,077**	**391,878**	**442,627**	**466,309**
	Pensions, constitutional salaries & other	60,169	68,702	90,573	109,526	118,651
	Constitutional commissions (Art. 248(2)) i.e. CRA, SRC, NLC, NPSC, IEBC, TSC	208,763	224,623	233,619	261,387	272,437
	Independent offices(Art. 248(3)) i.e. AG & CoB	4,723	5,177	6,412	6,336	6,247
	Parliament	31,480	30,915	34,490	36,240	36,222
	Other constitutional institutions- State Law Office and DPP	6,359	6,498	7,602	8,765	8,095
	Other statutory bodies (e g. EACC, RPP, WPA, CAJ, IPOA, NGEC)	4,855	5,484	5,724	5,937	6,606
	Judiciary	17,759	17,678	13,458	14,437	18,051
D	**Emergencies** [Art. 203 (1)(k)]	**7,245**	**9,294**	**6,419**	**6,418**	**5,000**
	Contingencies	5,000	5,000	5,000	5,000	5,000
	Strategic grain reserve	2,245	4,294	1,419	1,418	
	Equalization Fund [Art. 203 (1) (g) and (h)]	**6,000**	**7,727**	**4,700**	**5,765**	**6,532**
E	**BALANCE TO BE SHARED BY THE 2 LEVELS OF GOVERNMENT**	**572,375**	**444,026**	**526,937**	**709,094**	**664,577**
F	**County Government allocation from revenue raised nationally of which;-**	**295,020**	**314,205**	**331,231**	**330,660**	**330,231**
	a) Equitable Share of Revenue	280,300	302,000	314,000	316,500	316,500
	b) Additional conditional allocations financed from revenues raised nationally	14,720	12,205	17,231	14,160	13,731
G	**Balance left for the National Government of which :-**	**277,355**	**129,821**	**195,706**	**378,434**	**334,346**
	Other statutory allocations/earmarked funds (e.g. NG-CDF, Affirmative Action)	*37,635*	*39,512*	*35,361*	*40,879*	*41,311*
	Net Balance	**239,720**	**90,309**	**160,345**	**337,555**	**293,035**

Source: National Treasury and Planning

17. **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 2019 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 decrease slightly from Ksh. 94.2 billion in 2019/20 to Ksh. 86 billion in 2020/21.

18. **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 2020/21, the revenue allocation for payment of public debt related costs is expected to increase significantly to Ksh. 630.1 billion from Ksh. 585.7 billion allocated in financial year 2019/20.

19. **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 and Funds. These are estimated to cost Ksh. 466.3 billion in financial year 2020/21 up from Ksh. 442.6 billion in financial year 2019/20.

20. **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. The second generation formula developed by the Commission on Revenue Allocation for sharing equitable share of Revenue has provided for 2 % weight to fiscal responsibility parameter. This measure takes into account variations in fiscal capacity and efficiency in OSR collection across counties in the sharing of revenue raised nationally.

21. **County governments' ability to perform the functions assigned to them and meet other developmental needs of the county governments:** Based on the factors listed in paragraph 6 key among them:-persistent revenue shortfalls, increased CFS financing, existing funding gap and the proposed contracting of the National Government expenditures, it is proposed that County Governments' equitable revenue share for FY 2020/21 be retained at Ksh 316.5 billion. The

implication of this is that there will be no additional funding from the equitable revenue share for County Governments' wage and salary costs as well as development and other O&M costs. Nevertheless, the National Treasury notes that an opportunity exists for the Counties to finance any planned growth in their expenditures from own-source revenue (OSR).

22. According to the Controller of Budget (CoB), Counties raised Ksh 40.3 billion in FY 2018/19 from OSR, equivalent to 75% of targeted collections, and a 24% improvement from recorded collections in FY 2017/18. Thus, assuming that Counties maintain this growth trajectory in OSR collections in FY 2019/20 and FY 2020/21, there should be sufficient additional resources to finance all functions assigned and transferred to them as contemplated under Article 203(1) (f) of the Constitution as well as improve service delivery.

23. **Economic Disparities within and among counties and the need to remedy them:** Allocation of the sharable revenue (i.e. equitable share of Ksh. 316.5 billion) among counties is based on the second generation formula approved by Parliament in June, 2016 pursuant to provisions of Article 217 and Section 16 of the Sixth Schedule of the Constitution. The formula takes into account disparities among counties and aims at equitable distribution of resources across counties. The formula takes into account population (45%), land area (8%), poverty (18%), a basic equal share (26%), fiscal responsibility (2%) and Development factor (1 %). Further, it should be noted that Ksh. 6.532 billion has also been set aside for the Equalization Fund in 2020/21 which translates to 0.55 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 counties.

24. **Need for Economic Optimization of Each County:** Allocation of resources to county governments was guided by the costing of the functions assigned to the county governments. The equitable share of revenue allocated to county governments in the financial year 2020/21 is Ksh. 316.5 billion. This is an unconditional allocation which means that the county governments can plan, budget and spend the funds independently. With the additional resources, therefore, county governments are in a position to prioritize projects and consequently allocate resources thus optimizing their potential for economic development.

25. **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 necessitated by shortfall in revenue raised nationally. According to clause 5 of the DoRB 2020, 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.

26. **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 Capital of the Contingencies Fund. 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.

27. 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, only Ksh. 334.3 billion or 18 % of the total revenue raised nationally is left to finance other National Government needs, such as, defence, roads, energy etc. This includes Ksh. 41.3 billion for "*Other statutory allocations/earmarked funds (e.g. NG-CDF, Affirmative Action)*" which if netted out only Ksh. 293 billion or 16 % of the total revenue raised nationally is left to finance these other National Government needs. This is less than the Ksh. 330.2 billion or 18 % allocated to county government's needs.

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

28. The Division of Revenue Bill, 2020 proposes to retain the allocation to county governments at Ksh. 316.5 billion in financial year 2020/21 from the shareable revenue raised nationally as it were the case in financial 2019/20. The CRA, on the other hand, recommends County Governments' equitable share of revenue of Ksh. 321.74 billion as an unconditional allocation to be shared among county governments on the basis of its proposed third basis formula of revenue sharing. However, this basis has not been approved by Parliament pursuant to Article 217 of the Constitution.

29. The difference in the Commission on Revenue Allocation (CRA) recommendation and the DoRB 2020 proposal emanates from the proposal by the National Treasury that County Governments' equitable revenue share for FY 2020/21 be retained at Ksh 316.5 billion based on the factors listed in paragraph 6 and explained in paragraphs 7 to 12. Key among these factors are persistent revenue shortfalls, increased CFS financing, existing funding gap in financial year 2019/20 and the proposed contraction of the National Government expenditures in financial year

2020/21. On the other hand, CRA has proposed an adjustment to the county equitable share of revenue for financial year 2019/20 of Ksh. 316.5 billion using the actual three-year average development expenditure for each level of government. The 5.7 per cent adjustment is based on the country's three-year (2016-2018) average economic growth. The adjustment by CRA translates to additional allocation of Kshs. 5.24 billion to the counties thus translating to a proposed allocation of equitable share to county governments of Ksh. 321.74 billion in financial year 2020/21.

30. Table 2 analyses the differences between the CRA recommendations and the National Treasury proposal on the division of revenue between the national and county governments in 2020/21.

Table 2: Comparison of Recommendations of the Commission on Revenue Allocation and the National Treasury on the equitable share of revenue proposed for FY 2020/21 (Figures in Ksh. Millions)

Expenditure Item	CRA	National Treasury	Variance
	A	B	C = (A-B)
1. Equitable Revenue Share in FY 2019/20 (Base)	316,500	316,500	0
2. Adjustment for revenue growth in FY 2020/21	5,240	-	5,240
TOTAL EQUITABLE SHARE OF REVENUE = (1+2)	**321,740**	**316,500**	**5,240**

Source: National Treasury and Planning

31. **Differences occasioned by additional conditional allocations financed from National government share of revenue amounting to Ksh. 13.7 billion;** - Whereas CRA has not made any additional proposals to fund Counties, the National Treasury has proposed Ksh. 13.7 billion to be financed from the National Government share of revenue.

32. **New conditional transfers for financing of five (5) cities:** - CRA has proposed an allocation of Ksh. 5 billion starting FY 2019/20 to finance five cities in Urban Areas and Cities Act, 2011, namely: Nairobi, Mombasa, Kisumu, Nakuru and Eldoret. These cities are centres of growth and provide unique and critical services to the residents.

The National Treasury and Planning recognizes and appreciates the unique services offered by these cities such as sewerage system, water reticulation, solid waste disposal and storm water drainage and management.

In order to support these cities and other urban areas, the National Treasury and Planning has in the FY 2020/21 provided Ksh. 6.36 billion for Kenya Urban Support Program (KUSP) as an Urban Development Grant (UDG) financed from proceeds of a grant by the World Bank to complement efforts of county governments in carrying out this function. The purpose of this grant is to establish and strengthen urban institutions to deliver improved infrastructure and services in participating counties in Kenya. It should be noted that these services are part of the devolved functions and county governments should be encouraged to plan and budget for them. We note that Nairobi and Mombasa City are not covered under the KUSP. In light of the constrained fiscal framework, however the National Treasury may not be able to provide additional resources beyond what has been provided.

33. Finally, the National Treasury has proposed an allocation amounting to Ksh. 30.2 billion as additional conditional allocations from proceeds of loans and grants by various development partners to finance respective programs and projects in the financial year 2020/21.

Conclusion

34. The proposals contained in the Bill take into account the fiscal framework set out in the BPS for 2020/21 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).

35. It should, however, be noted that the proposed equitable share allocated to county governments in the Division of Revenue Bill, 2020, at 26.5 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.