REPUBLIC OF KENYA

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THE SENATE

ELEVENTH PARLIAMENT – SECOND SESSION

REPORT OF THE SENATE STANDING COMMITTEE ON FINANCE, COMMERCE & BUDGET ON THE CONSIDERATION OF THE PUBLIC FINANCE MANAGEMENT (AMENDMENT) BILL, 2014

PARLIAMENT BUILDINGS
NAIROBI

JULY, 2014

PREFACE

Mr. Speaker, Sir

The Standing Committee on Finance, Commerce and Budget is established pursuant to Standing Order No. 208 and is mandated, *to investigate, inquire into and report on all matters relating to coordination, control and monitoring of the county budgets and to:*

A. *Discuss and review the estimates of County governments and make recommendations to the Senate;*
B. *Examine the Budget Policy Statement presented to the Senate;*
C. *Examine and report on the Budget allocated to constitutional commissions and independent offices*
D. *Examine bills related to the Counties*
E. *Examine the Budget, including the Division of Revenue Bill; and*
F. *Examine and consider all matters related to resolutions and Bills for appropriations, share of*
   national revenue amongst the counties and all matters concerning the National Budget, including public finance, monetary policies and public debt, trading activities and commerce, tourism, investment and divestitures policies, planning and development policy.

Mr. Speaker, Sir

The Committee on Finance, Commerce and Budget was constituted by the House on Thursday 13th March 2014 during the Second Session of the Eleventh (11th) Parliament and comprises of the following members:

1. The Hon. Sen. Billow Kerrow, MP. -**Chairperson**
2. The Hon. Sen. Peter Ole Mositet, MP. -**Vice-Chairperson**
3. The Hon. Sen. Moses Wetang'ula, MP.
4. The Hon. Sen. Beatrice Elachi, MP.
5. The Hon. Sen. Mutahi Kagwe, MP.
6. The Hon. Sen. Boni Khalwale, MP.
7. The Hon. Sen. (Prof.) Peter Anyang' Nyong'o, MP.
8. The Hon. Sen. Zipporah Kittony, MP.

9. The Hon. Sen. James Mungai, MP.
10. The Hon. Sen. Catherine Mukite Nabwala, MP.
11. The Hon. Sen. Mutula Kilonzo Junior, MP.
12. The Hon. Sen. (Prof.) John Lonyangapuo, MP.
13. The Hon. Sen. Paul Njoroge Ben, MP.
14. The Hon. Sen. (Dr.) Wilfred Machage, MP.

Mr. Speaker, Sir,
The Public Finance Management (Amendment) Bill, sponsored by Senator Kithure Kindiki, was published on 4th April, 2014 and subsequently tabled in the House for First Reading on 4th June, 2014 and thereafter committed to the to the Standing Committee on Finance, Commerce and Budget for consideration pursuant to Standing Order 130.

Mr. Speaker, Sir,
The principle object of the Bill is to amend section 15(2)(a) and section 107(2)(b) of the Public Finance Management Act, 2012. The amendment seeks to provide, as a county government fiscal responsibility principle, that a minimum of sixty percent of the budget of the county governments be allocated to development expenditure.

Mr. Speaker, Sir,
Pursuant to the provisions of Article 118 of the Constitution and Standing Order 130 (4), the Committee invited interested members of the public to submit representations on the Bill. The submissions were made both orally and through submission of written memoranda.

Mr. Speaker, Sir,
In examining the Bill, the Committee was in disagreement with the provisions of the Bill. The Committee noted in its deliberations on the Bill that at its sitting held on 11th March 2014where it had undertaken pre-publication scrutiny of the Bill and made the following submissions:

1. On the advice of the Controller of Budget and government financial practice, the recurrent expenditures for most county governments' budgets were at 70% while development expenditure was at 30%.
2. The report of the Controller of Budget on Budget Implementation for County Governments indicated that most county governments had prepared their budgets according to the recommendations by the Office of the Controller of Budget and had set their recurrent budgets at 70% and development budget at 30%.
3. It would be economically unviable for the operations of county governments, to have recurrent budget and development budgets pegged at 40% and 60% respectively.

In view of the above concerns, the Committee had proposed that the legislative proposal be put aside to allow for comprehensive proposals for amendment to the Public Finance Management Act, 2012. This Bill aims to amend the Public Finance Management Act, 2012 so as to make it mandatory for county governments to allocate 60% of their budget to development expenditure and 40% to recurrent expenditure as strategy towards ensuring fiscal responsibility by county governments.

Mr. Speaker, Sir,

The Committee received submissions from the Council of Governors and the Controller of Budget on this Bill.

The Council of Governors in its submissions to the Committee highlighted the following concerns:

1. The proposed 60:40 formula undermines service delivery which is the essence of devolution. The Bill is based on unprincipled excuse for cost cutting and is motivated by the Constituency Development Fund (CDF), the management frameworks which do not consider the recurrent expenditure. For instance some county development portfolios are labour and service intensive thereby requiring significant recurrent expenditure.

2. The intended amendment is unnecessary restraint on the powers of the County Government and is not feasible as it does not appreciate the reality of running a government.
3. The wage bill is still a burden to Counties especially in light of workers absorbed from the National Government.
4. It is imperative that the Bill appreciates how operational expenditures relate with capital projects.

Mr. Speaker, Sir,
The Controller of Budget in her submission to the Committee noted the following:

1. In the FY 2014/15, Counties have allocated 42 per cent of total budgets to development expenditure. The allocation complies with the current fiscal responsibility principle that a minimum of 30 per cent of County governments budgets be allocated to development expenditure.

2. In order to increase development expenditure allocation, Counties will be required to cut down on the recurrent budget. Analysis of the recurrent expenditure by economic classification for the first nine (9) months of FY 2013/14 shows that about 58 per set of the expenditure goes towards Personal Emoluments, 39 per cent to operations and maintenance, while 3 per cent was spent on debt repayment and pending liabilities. There is need for a national policy to rationalise the wage bill. Lean and effective staff at the counties will free more resources to fund development projects.

The Controller of Budget in concluding her recommendations noted that an increase of the development budget allocation from 30 percent to 60 percent is untenable in the short term. This she noted may result in fiscal stress. In addition, inadequate capacity to implement development projects may impose challenges in fund absorption. Her final recommendation in light of the foregoing

was an increase of development expenditure allocation from 30 per cent to 40 per cent at this time. The Controller's full submission is annexed to this report.

Mr. Speaker, Sir,

The Committee will propose appropriate amendments to the Bill in clause 3 with a view to refining the Bill to better help it achieve its object.

Mr. Speaker, Sir,

The Committee is thankful to the Offices of the Speaker and the Clerk of the Senate for the logistical and technical support accorded to it during its sittings. The Committee wishes to thank all the stakeholders for their participation in scrutinising the Bill. Finally, I wish to express my appreciation to the Honourable Senators of the Committee who sacrificed their time to participate in the activities of the Committee and preparation of this report.

Mr. Speaker, Sir,

It is therefore my pleasant duty and privilege, on behalf of the Standing Committee on Finance, Commerce and Budget, to table its report in the House on the consideration of the Public Finance Management (Amendment) Bill, 2014 for consideration and adoption pursuant to Standing Order 134.

Signed ....

(SEN. BILLOW KERROW, MP)

CHAIRPERSON,

STANDING COMMITTEE ON FINANCE, COMMERCE AND BUDGET

Date: ....

infrastructure projects. These loans have to be paid back and ultimately increase the size of Consolidated Fund Services. As the table makes clear, debt is rising, and therefore debt repayment is also rising. While the size of CFS in a given year cannot be negotiated, every loan the government takes eventually leads to higher CFS allocations, and reduces the funds that can be used for other national and county services.

Table 1: Growth in Public Debt and Debt Repayment

Financial Year	2010/11	2011/12	2012/13	2013/14
Public Debt Repayment	158	173	304	337
Consolidated Fund Services	188	210	346	380
Proportion of Public Debt in CFS	84%	82%	88%	89%
% growth in CFS	-	12%	65%	10%

Financial Year	2010/11 (Billions)	2011/12 (Billions)	2012/13 (Billions)	2013/14 (Billions)
Public Debt Repayment	158	173	304	337
Consolidated Fund Services (CFS)	188	210	346	380
Proportion of Debt Repayment to CFS	84%	82%	88%	89%
% growth in CFS	-	12%	65%	10%
Total Budget	999	1155	1455	1640
% of CFS to Total Budget	19%	18%	24%	23%

Source: Budget Estimate Books and Treasury Debt Reports
Note: The Public Debt figures for 2013/14 represent debt at the end of December 2013

Appropriations in Aid

Another part of the government budget that is not generally available for sharing between national and county governments is what is known as Appropriations in Aid (AiA). AiA primarily consists of two main types: donor grants/loans; and revenues collected directly by agencies through service fees and charges. These funds are known as AiA because they tend to be collected directly by agencies rather than passing through Treasury. They are still appropriated during the annual budget process, but they are not actually collected and then passed on to agencies by Treasury.

The majority of AiA is in the form of loans and grants that cannot be easily shared with counties because they are generated through contracts between international donors and the national government. Unless donors/creditors agree to redistribute these funds to counties, they are not available for sharing. These funds are often spent on major national infrastructure programs and are part of the debt mentioned above that ultimately becomes part of Consolidated Fund Services.

AiA generated by agencies through service charges also presents a challenge for revenue sharing. These fees are often used by the institution that generates them to fund operational costs. For example, Kenyatta National Hospital generates user fees that are used to run the hospital. These are part of the budget but should remain with the hospital. When a facility or department is devolved to counties, these fees can also be devolved. When an agency remains at national level, however, the fees should not be considered part of shareable revenue. AiA should not be considered part of revenues that can be shared with counties unless it is in the form of agency fees for departments that are being devolved.

In addition to AiA, the government also collects funds from donors that pass through the Consolidated Fund and are then passed to ministries and departments. These funds are not called AiA, but are known simply as external revenues. Nevertheless, like AiA, they cannot be easily shared due to contracts with donors and various conditions.

The table below shows the AiA and external revenue estimates in 2012/13.[1] Note that when added together over 80 percent of AiA and external revenue is foreign, rather than domestically generated by ministries. In addition to the 226 billion in AiA received by government in 2012/13, there was an additional 52 billion in external revenue.

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1 For an explanation of how we classified ministries into sectors, please see our brief "The Right Priorities? Understanding what the Kenyan government spends money on," available at http://internationalbudget.org/wp-content/uploads/Understanding-What-the-Kenyan-Government-Spends-Money-On.pdf

Altogether, this constituted roughly 25 percent of the total MDA budget in 2012/13.[2] Taken together, AiA, external revenue and CFS accounted for almost 625 billion in 2012/13.

Table 2: Appropriations in Aid (AiA) and external revenue estimates in 2012/13

	AiA		External Revenue	Total
Sectors	Recurrent	Development		
Infrastructure + Energy	18.5	109.7	16.4	154.8
Water and Irrigation	2.0	19.4	4.2	25.6
Health	3.9	14.4	7.2	25.5
Education	19.0	11.5	0.8	31.5
State Administration	0.1	11.2	3.5	15.0
Regional Development	0.1	5.7	3.9	31.2
Agriculture	0.0	2.8	5.2	8.2
Gender,Youth and Culture	0.0	1.8	7.0	8.9
Lands,Housing and Environment	2.5	1.4	3.6	8.4
Security	0.4	0.2	0.1	1.0
International Relations and Commerce	1.4	0.2	0.2	1.9
Parliament, AG, Judiciary and Constitutional Commissions	0.1	0.0	0.1	0.3
Total (AiA and External Revenue)	47.8	178.5	52.3	278.6
Of Which;				
Grants				*20%*
Loans				*61%*
Local Sources				*20%*
CFS				346.0
Total CFS,AiA and External Revenue				624.6
Total MDAs Budget				1,109.0
Total Budget				1,455.0
% of the Total (AiA and External Revenue) to Total MDA Budget				25%
% of CFS, AiA and External Revenue to Total Budget				43%
Budget after remove CFS, AIA and Ext Rev				830.4

Source: Budget Estimates 2012/13; Author calculations

Conclusion: What is available for sharing?

While CFS is not a revenue source, Kenya must essentially set aside this amount of revenue each year for debt repayment and other obligations. At the same time, the funds that are raised through AiA and external revenues cannot be shared with counties. Taken together, this means nearly 43 percent out of a total 2012/13 budget of Ksh 1455 billion were not available for sharing, leaving about Ksh 830 billion for negotiation.

2 In calculating recurrent AIA, we removed Ksh 21.5 billion for the Local Authority Transfer Fund (LATF) Grant, which was classified as AiA in 2012/13, but has been devolved. We also removed Ksh 8.5 billion from the Ministry of Roads that was devolved in 2012/13. Finally, we deducted Ksh 3.5 billion generated by MDAs but not attached to any specific state corporations or agency operating costs, on the assumption that this could potentially be shared with counties.