THE DIVISION OF REVENUE BILL, 2013

ARRANGEMENT OF CLAUSES

Clause

THE DIVISION OF REVENUE BILL, 2013

A Bill for

AN ACT of Parliament to provide for the equitable division of revenue raised nationally between the national and county governments in 2013/14 financial year, and for connected purposes

ENACTED by the Parliament of Kenya, as follows—

Short title.

1. This Act may be cited as the Division of Revenue Act, 2013.

Interpretation.

2. In this Act, unless the context otherwise requires—

"Cabinet Secretary" means the Cabinet Secretary responsible for finance;

No. 16 of 2011

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

"State organ" has the same meaning assigned to it in Article 260 of the Constitution; and

No. 18 of 2012

"wasteful expenditure" has the same meaning assigned to it in section 2 of the Public Finance Management Act, 2012.

Object and purpose of the Act.

3. The object and purpose of this Act is to provide for—

(a) the equitable division of revenue raised nationally between the national and county levels of government for the financial year 2013/14 in accordance with Article 203(2) of the Constitution;

(b) additional resources to facilitate the proper functioning of county governments in accordance with Article 202(2) of the Constitution; and

(c) the financing and continuation of on-going services in accordance with Articles 187(2) and 203(1)(d) of the Constitution.

Allocations to county governments.

4. The revenue raised by the national government in respect of the financial year 2013/14 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 a 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 the regulations by the Cabinet Secretary.

(2) If the shortfall in revenue referred to in subsection (1) exceeds the threshold prescribed by the Cabinet Secretary, the shortfall in excess of that threshold shall be apportioned between the national and county governments on a prorata basis.

(3) If the actual revenue raised nationally in a financial year exceeds the expected revenue set out in the Schedule, the excess revenue shall be apportioned between the national government and county governments on a prorata basis.

Resolution of disputes and payment of wasteful expenditure.

6. (1) Any state organ involved in an intergovernmental dispute regarding any provision of this Act or any division of revenue matter or allocation shall, in accordance with Article 189 of the Constitution and before approaching a court to resolve such dispute, make every effort to settle the dispute with the other state organ concerned, including exhausting all alternative mechanisms provided for resolving disputes in relevant legislation.

(2) If a court is satisfied that a state organ, in an attempt to resolve a dispute has not exhausted all the mechanisms for alternative dispute resolutions as contemplated in section 35 of the Intergovernmental Relations Act, 2012 and refers the dispute back for the reason that the state organ has not complied with subsection (1), the expenditure incurred by that state organ in approaching the court shall be regarded as wasteful expenditure.

No. 2 of 2012

(3) The costs in respect of such wasteful expenditure referred to in subsection (2) shall, in accordance with a prescribed procedure, be recovered without delay from the person who caused the state organ not to comply with the requirements of subsection (1).

SCHEDULE

REVENUE ALLOCATIONS BETWEEN THE NATIONAL AND COUNTY GOVERNMENTS FOR 2013/14
(Figures are in Ksh. unless otherwise indicated)

Type/Level of Government Allocation	**Revenue allocation**	**Percentage of Audited Revenue (Ksh. 608.1 billion)**	**Percentage of 2011/12 Audited Revenue but not approved by Parliament (Ksh. 682.1 billion)**
	Kenya Shillings	%	%
National Allocation	**721,677,308,444**	118.7%	105.8%
Of which: Equalization Fund	3,400,000,000	0.6%	0.5%
County Allocations	198,697,691,556	32.7%	29.1%
Of Which: Unconditional Allocations	154,771,791,752	25.5%	22.7%
Conditional Allocations	43,925,899,804	7.2%	6.4%
TOTAL SHAREABLE REVENUE	**920,375,000,000**		

MEMORANDUM

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, and to provide for additional resources to facilitate the proper functioning of county governments and to ensure on-going services are provided for.

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 from the national government to the county governments in 2013/14 financial year.

Clause 5 of the Bill deals with mechanisms for adjusting for variations in revenues.

Clause 6 of the Bill contains general provisions which emphasize on dispute resolution before instituting court proceedings and includes provisions on personal liability on public officers who cause a State Organ to incur costs because of referring disputes relating to division of revenue to courts prior to exhausting available alternative dispute resolution mechanism.

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

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

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

(c) explains any significant deviation from the recommendations of the Commission on Revenue Allocation.

EXPLANATION OF REVENUE ALLOCATION AS PROPOSED BY THE BILL

The share of revenue raised by national government to be allocated to the two levels of government was arrived at after costing the functions assigned to each level of government in accordance with the Fourth Schedule of the Constitution.

The costing of devolved functions was a result of extensive consultations between the line ministries overseeing the implementation of functions that have now been assigned to the county governments. The total cost of delivering the devolved functions, including the costs associated with the new administrative structures for county governments in 2013/14 has been estimated at Ksh. 198.6 billion.

This approach of determining revenue allocation, which assures that existing level of service delivery is not disrupted, is consistent with international best practice. International experience suggests that there should not be drastic reduction of revenue to the subnational governments in order to hold them ‘harmless’ in respect of their mandate to deliver the assigned functions. This will ensure that the county governments will have the ability to restructure and rationalise their budgets and operations while at the same time have the requisite resources to perform their assigned function.

The county governments’ allocation comprises of an equitable share of Ksh. 154.7 billion and additional conditional allocations amounting to Ksh. 43.9 Billion to bring total allocations to county governments to Ksh. 198.6 Billion.

1. County Governments’ Equitable Share

The county governments’ equitable share of revenue raised nationally in respect of financial year 2013/14 of Ksh. 154.7 billion was derived as follows:

(a) First, by determining the cost of on-going functions which have been assigned to county governments under the Constitution for the financial year 2013/14. All the functions assigned to county governments as set out in the Fourth Schedule of the Constitution are to be transferred as at July 1, 2013, except those under Regional Authorities. Costing of these functions was done by the National Treasury in consultation with line ministries and the Transition Authority.

(b) Second, the cost of county government administration was added onto the cost of on-going functions. This comprises of the cost of running the county administration, including personnel costs as well as operation and maintenance costs for the county assemblies and the county executives. The cost of running the county assemblies and county executives, which are new structures established by the Constitution, was estimated by the National Treasury in consultation with the Transition Authority.

(c) Third, in computing the total allocations to county governments, the National Treasury has also included the cost of managing the county public finances. These costs were based on an interim structure for public finance management for counties as agreed by the National Treasury and the Transition Authority.

(d) Fourth, county allocations also include finances for county public service boards.

(e) Fifth, the allocations to on-going devolved functions relating to projects and programmes financed by loans and grants were deducted from the total cost of devolved functions in computing the county governments' equitable share of revenue raised nationally. Loans and grants were excluded in the computation of the county governments' equitable share of revenue because they are subject to contractual agreements which stipulate where the funds should be spent and cannot, therefore, be diverted to other areas or use. In addition, loans and grants are not part of the definition of the shareable revenue as per the Commission on Revenue Allocation Act, 2011.

(f) Sixth, allocations to regional referral hospitals were also excluded from the county governments' equitable share in order arrive at a base that does not include the cost of operating institutions that provide services to a cluster of counties.

(g) Seventh, allocations to hold county governments "harmless" and to avoid the disruption of service delivery were also excluded from the sharable revenue as they are specific to certain counties.

Table 1 below shows how the county governments' equitable share of revenue raised nationally was determined.

Table 1: Computation of County Governments' Equitable Share of Revenue Raised Nationally

COST ITEM	***Ksh.***
Cost Of On-Going Devolved Functions	*167,394,580,194*
County Government Administration Cost	*7,562,633,778*
County Pfm Cost	*5,627,115,683*
County Public Service Board	*821,828,571*
Allocation To Hold Counties Harmless	17,291,533,330
Total Cost Of County Functions	***198,697,691,556***
Less: DONOR FINANCING (LOANS AND GRANTS)	*16,581,273,996*
Provincial And Referral Hospitals	*10,053,092,478*
Allocation To Hold Counties Harmless	17,291,533,330
County Governments' Equitable Share	***154,771,791,752***

2. Conditional Allocations to County Governments

Allocations to finance county expenses relating to donor funded development programmes and regional referral hospitals as well as additional allocations to hold harmless the county governments are included as conditional allocations to county governments.

Table 2 below gives a breakdown of the cost components that were included in the determination of the conditional allocations to county governments.

Table 2: Computation of Conditional Allocations to County Governments

	Component	**Ksh. Billions**
I	Donor Support	16,581,273,996
II	Expenses relating to regional referral hospitals	10,053,092,478
III	Additional amount to hold harmless counties	17,291,533,330
	TOTAL	43,925,899,804

The proposed equitable share of revenue raised nationally allocated to county governments in 2013/14 of Ksh. 154.7 billion translates to approximately 25.5 per cent of the most recent audited revenues for the financial year 2010/11 amounting to Ksh. 608.1 billion. This means that the constitutional provision of Article 203 (2), which requires county governments to be allocated not less than 15 per cent of the revenue raised by the national government based on the last audited revenues approved by the National Assembly, has been met. Additional conditional allocations amounting to Ksh. 43.9 billion or 7.2 per cent of audited revenue were set aside for county governments for purposes of continuation of financing of donor programmes and regional referral hospitals as well as holding harmless county governments' provision of services. This brings the total allocations to county government to about 32.7 percent of the most recent audited revenues as approved by Parliament.

EVALUATION OF THE BILL AGAINST ARTICLE 203 (1) OF THE CONSTITUTION

Article 218 (2) (b) of the Constitution requires that a Division of Revenue Bill be accompanied by a memorandum that explains how the provisions of Article 203 (1) of the Constitution have been taken into account in the Bill. In this section we provide an assessment of the extent to which the requirements of Article 203 (1) have been incorporated in the Division of Revenue Bill, 2013. Table 4 in the annex provides a summary of revenue allocation to various needs of the national and county governments in accordance with the criteria set out in Article 203 (1) of the Constitution.

1. *National Interest*

   Under the Fourth Schedule of the Constitution the national government is exclusively responsible for the functions that serve the national interest. These national interests are best served when they are centralized at the national government and include: national defence services, the National Intelligent Services (NIS), police services, judicial services, national elections, parliamentary services as well as other services rendered by the constitutional commissions and independent offices. Revenue allocation equivalent to the cost of these functions, estimated at Ksh. 351 billion, has been allocated to the national government.

2. *Public Debt and Other National Obligations*

   In allocating the equitable share of revenue raised nationally between the national and county governments, the Bill has fully provided for all debt related costs as well as other obligations mandated by the Constitution such as pension contributions, salaries for constitutional office holders and contributions to international organizations. This amounts to approximately Ksh. 392.6 billion.

3. *Fiscal Capacity and Efficiency of County Governments*

   It should be noted that local taxes and revenues assigned to the counties under Article 209 are primarily property and entertainment taxes as well as user charges imposed on services rendered by county governments. The establishment of county governments will facilitate the compilation and availability of official data on county fiscal capacity and the efficiency of revenue collection. That data will then inform the future division of revenue between the national and county governments.

4. *County governments' ability to perform the functions assigned to them and meet other developmental needs of the county governments*

   There are primarily two ways in which this Bill ensures adequate financing of the developmental needs of the county governments.

(a) First, by providing conditional allocations equivalent to cost of running regional hospitals and on-going devolved programmes financed by loans and grants, as well as additional allocation to hold harmless the county governments' service delivery, the Bill secures financing for on-going county development programmes; and

(b) Second, in determining the vertical allocation for the county governments, the cost of operationalizing new governance structures for county governments, which were previously non-existent has been estimated and adequate resources allocated to facilitate those structures.

5. *Economic Disparities within and among counties and the need to remedy them*

The allocation of the sharable revenue among counties was based on the formula approved by Parliament which takes into account disparities among counties and aims at equitable distribution of resources. It should also be noted that Ksh. 3.4 Billion has been set aside for the equalization fund in 2013/14. This fund will be used to finance development programmes that aim to reduce regional disparities among counties. The establishment of county governments should facilitate the compilation and availability of official data on economic disparities within counties, which can be used to inform future division of revenue between the national and county governments.

6. *Need for Economic Optimization of Each County*

Adequate resources have been allocated to county governments to ensure that on-going services assigned to those governments will not be disrupted. In this regard, the proposed conditional allocations to provide for funding of regional referral hospitals and to ensure that service delivery is not disrupted will help to mitigate the adverse economic impact of a sharp reduction in resource allocations.

7. *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 provided such shortfalls do not exceed a threshold determined by the Cabinet Secretary to be significant.

8. *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 addition, the Public Finance Management Act, 2012 requires each county government to set up a County Emergency Fund. County governments are expected to set aside part of their allocation for this purpose.

After taking into account the above criteria as specified in Article 203 of the Constitution, there is no revenue left for other national government needs. Indeed there is a shortfall of Ksh. 13.9 billion which is equivalent to 2.2 percent of the most recent audited revenue. This therefore means that other national government needs have to be financed largely by loans and grants. The county governments' needs on the other hand are financed to the tune of Ksh. 198.6 billion which is equivalent to 32.7 per cent of the most recent audited revenue.

EXPLANATION OF DEVIATION FROM RECOMMENDATIONS OF THE COMMISSION ON REVENUE ALLOCATION

There are differences between the National Treasury's proposal on the revenue allocation among county governments and CRA's recommendations. The differences stem from the different approaches used in the computation of the county governments' equitable share.

In determining the county governments' revenue allocation, the National Treasury was guided by:

(a) The provisions of Article 203 of the Constitution;

(b) Revenue allocation criteria approved by Parliament;

(c) Cost of running county government structures;

(d) Costing of the on-going devolved functions; and

(e) The need to hold harmless the county governments and therefore minimize the risks of service disruption.

The Division of Revenue Bill, 2013 proposes a county governments' allocation of Ksh. 198.6 billion, including an equitable share of Ksh. 154.7 billion for the financial year 2013/14 while the CRA recommends county governments' allocation and equitable share of Ksh. 231.1 billion (see Table 3 below for an illustration).

Table 3: Comparison of Recommendations of the Commission on Revenue Allocation and the National Treasury (Figures in Ksh. Billions)

	2012/13		**2013/14**	
Expenditure Item	**CRA**	**National Treasury**	**CRA**	**National Treasury**
Cost of Devolved Functions	148	175	N/A	184.7
Remuneration (County Executive and Assemblies)	15	7.5	N/A	5.9
Administration Expenses	7.5	2.3	N/A	1.7
County PFM expenses	13.8	0.7	N/A	5.6
County Public Service Boards	0	0	N/A	0.8
Contingency	18.4	0	N/A	0
TOTAL	**202.7**	**185.5**	**231.1**	**198.7**

N/A means "not available"

The proposal in the Bill differs from that of the CRA's due to the following reasons:

In determining the vertical allocation for county governments for 2013/14, the CRA starts with a base of Ksh. 203 billion for 2012/13 which is then increased by 14 per cent to get the figure for 2013/14 of Ksh. 231.1 billion. The figure for 2012/13, however, has several problems:

(a) First, Article 216 of the Constitution requires that in formulating recommendations, the CRA shall seek "to promote and give effect to the criteria set out in Article 203(1)". This is to ensure an equitable distribution of resources between the two levels of government. The recommendations from the CRA do not seem to give effect to the criteria in Article 203(1) of the Constitution.

(b) Second, CRA's Ksh. 148 billion costing of devolved functions is not consistent with the budget approved by Parliament. The National Treasury's estimate of the cost of functions for 2012/13 is Ksh. 185.5 billion, including allocations to county governments for the last four months of FY2012/13, as derived from the budget approved by Parliament.

(c) Third, the CRA estimate for remuneration of county executives and assemblies as well as the administration expenses of the new county structures amounting to Ksh. 36.3 billion appear overstated and not supported by a clear basis of costing. Furthermore, these estimates do not reflect the new lower salary structures gazzetted by the Salaries and Remuneration Commission (SRC). Treasury's estimates for Salaries for county executive and assembly members assume the new SRC salaries structure. Administration costs are assumed to be 30 percent of total remuneration.

(d) Fourth, it is unclear how the figure of Ksh 18.4 billion (the 10 percent contingency for tendency to hold on to functions at the centre by ministries) was derived. The proposal by the CRA to increase allocations for county governments without indicating which Ministries' allocations would be reduced would result in a financing gap of Ksh. 18.4 billion. It should be noted that it is the responsibility of the Transition Authority to ensure Ministries do not hold onto functions that have been devolved.

(e) Fifth, the CRA assumes the total allocations, including loans and grants, form the equitable share and are therefore sharable using the formula approved by Parliament. However, loans and grants are subject to contractual agreements and relate to specific projects and therefore cannot be diverted to other uses or to other counties.

(f) Sixth, the CRA's recommendation assumes that funding for institutions which are currently providing services to more than one county (the regional referral hospitals) should be shared among the 47 counties. The National Treasury on the other hand excludes costs relating to such institutions in computing the county governments' equitable share—these funds are then allocated to the relevant county as conditional transfers. If revenue for running these institutions is shared among the 47 counties, the provision of health services will be adversely affected as a particular county may not want to allocate sufficient funds to these institution given they serve other counties as well and those counties are not providing financial support.

(g) Seven, National Treasury has also proposed that the additional allocations to "hold harmless" the county governments be excluded in the determination of the vertical division. This is necessary in order to ring-fence these allocations so as to ensure delivery of services will not be disrupted. It is, however, proposed that these allocations be phased out over a period not exceeding three years from the date of the first election under the Constitution, in line with section 15 of the Sixth Schedule of the Constitution.

The above differences notwithstanding, the National Treasury's proposed vertical allocation to county governments in the Division of Revenue Bill, 2013 is above the minimum threshold required under Article 203(2) of the Constitution.

Table 4: Evaluation of Revenue Allocation in Relation to Article 203 (1) of the Constitution (Figures in Ksh. Millions)

	BUDGET ITEM	2012/13	2013/14
A	**Ordinary Revenue (excluding AIA)**	**849,700**	**920,375**
B	**National Interest [Article 203 (1)(a)]**	**313,364**	**351,128**
	1. Defence and National Intelligence Services(NIS)	*83,500*	80,394
	2. Parliament	*15,294*	16,713
	3. Judiciary	*14,991*	15,188
	4. Office of the Attorney General & Department of Justice	*1,831*	4,954
	5. Directorate of Public Prosecutions	*972*	2,212
	6. Police Services	*53,441*	73,479
	7. Teachers Service Commission	*119,802*	145,373
	8. Other Constitutional Commissions and Independent Offices	*5,953*	8,799
	9. Elections	*17,580*	4,016
C	**Public Debt and Other Obligations (Article 203 [1] [b])**	**344,633**	**392,640**
	1. Debt Interest payment	*105,849*	120,471
	2. Debt principal payment	*197,784*	212,515
	3. Pensions, constitutional salaries & other	*41,000*	59,655
D	**Emergencies [Article 203 (1)(k)]**	**5,000**	**5,000**
E	**Equalisation Fund [Article 203 (1) (g) and (h)]**	**3,536**	**3,400**
F	**County Governments Allocations [Article 203 (1) (f)}] less Loans and Grants**	**168,974**	**182,116**
G	**Balance available to National Government after Article 203 (1)**	**14,193**	**(13,909)**

Dated the ……………………………………, 2013.

ADAN DUALE,
***Member of Parliament*.**