



COMMISSION ON REVENUE ALLOCATION

Promoting an Equitable Society

**RECOMMENDATION CONCERNING
THE THIRD BASIS FOR REVENUE
SHARING AMONG COUNTY
GOVERNMENTS**

FOR FINANCIAL YEARS

2019/20 - 2023/24

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FOREWORD

The third basis for equitable sharing of revenue among county governments has been prepared in accordance with the provision of Article 216 (1) (b) of the Constitution of Kenya, which mandates the Commission on Revenue Allocation to make recommendations concerning the basis for the equitable sharing of revenue raised nationally among the county governments. Further, Article 217 (2) (b) stipulates that in determining the basis of revenue sharing, the Senate shall request and consider recommendations from the Commission. In accordance with Article 217(1), this basis will be used to share revenue among county governments for the next five financial years, from 2019/20 to 2023/24.

This recommendation was formulated through a consultative process involving local and international experts, and the public. The recommendation is also informed by lessons from a comparative analysis of financing transfer systems in jurisdictions with a fiscal architecture similar to Kenya's, and a comprehensive review of the second basis which was considered transitional.

This recommendation is anchored in a revenue sharing framework which seeks to closely align funding to functions assigned to county governments to enhance service delivery. The framework also takes into account the need to address developmental gaps and economic disparities among counties. In addition, the framework seeks to create incentives for county governments to adhere to principles of fiscal responsibility and to optimize their capacity to raise own revenue.

On implementation of the third basis, the Commission recommends a phasing-in of the formula to avoid disruption in service delivery and development programs. The proposed approach is to set aside 15 percent of the equitable share increment to cushion counties which would see a reduction in the quantum of their equitable share in excess of 5 percent.



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CHAIRPERSON

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The Commission acknowledges the critique provided by the following institutions on the second basis for revenue sharing: National Institute of Public Finance and Policy (India); Georgia State University-Andrew Young School of Public Policy; Kenyatta University – School of Economics; Kenya Institute of Public Policy and Research Analysis; Strathmore University-Institute of Public Policy and Governance; International Budget Partnership; Institute of Certified Public Accountants of Kenya, and the Parliamentary Budget Office. The comments and recommendations from these institutions laid the foundation for the preparation of this third basis recommendation.

To Parliament (both Senate and National Assembly), the Council of Governors and the County Assemblies Forum, the Commission appreciates your active involvement in the entire process. The Commission also acknowledges input from the following line ministries and government agencies for providing vital technical input, sharing data and information, and participating during sectoral discussions: the Kenya National Bureau of Statistics (KNBS); Ministry of Agriculture, Livestock, Fisheries and Irrigation; Ministry of Health; Ministry of Water, and Ministry of Transport, Infrastructure, Urban Development and Housing with its affiliate agencies.

To our development partner, USAID- AHADI, the Commission appreciates your technical and financial support in organizing stakeholder consultations. Lastly, the Commission sincerely appreciates all county governments and Kenyans at large for responding to the Commission’s call for comments. Your feedback through written memoranda and participation during the public consultative forums were valuable.



George Ooko
COMMISSION SECRETARY/CEO

ACRONYMS AND ABBREVIATIONS

| | |
|--------------|---|
| AHADI | Agile Harmonized Assistance for Devolved Institutions |
| AIDS | Acquired Immune Deficiency Syndrome |
| CA | County Assembly |
| CBEF | County Budget and Economic Forum |
| CE | County Executive |
| CRA | Commission on Revenue Allocation |
| FAO | Food and Agriculture Organisation |
| GCP | Gross County Product |
| HIV | Human Immunodeficiency Virus |
| KIHBS | Kenya Integrated Household Budget Survey |
| KNBS | Kenya National Bureau of Statistics |
| KPHC | Kenya Population and Housing Census |
| OSR | Own Source Revenue |
| PFMA | Public Finance Management Act |
| RAI | Rural Access Index |
| USAID | United States Agency for International Development |
| WHO | World Health Organisation |

EXECUTIVE SUMMARY

In accordance with the requirements of Article 216 (1) of the Constitution of Kenya, the Commission on Revenue Allocation presents the recommendation on the third basis for equitable sharing of revenue among county governments. The basis is expected to be used for sharing of revenues for financial years 2019/20 to 2023/24.

This recommendation builds on lessons learnt from a comprehensive review of the second basis, a comparative analysis of financing transfer systems from other countries, and extensive consultations with national government, county governments, public finance experts, and the public.

This recommendation seeks to address four primary objectives; to enhance service delivery, to promote balanced development, to incentivise counties to optimise capacity to raise revenue and to incentivise prudent use of public resources. These objectives are actualized through a framework that links revenue sharing to devolved functions using three components, namely; service delivery, balanced development and, incentive. In aggregate, the framework allocates 65 per cent of the revenue for enhancing delivery of public services, 31 per cent for promotion of balanced development, and 4 percent to incentivise revenue collection and fiscal prudence. The overall framework is summarized in Appendix 3 and the measures defined in Appendix 4.

The service delivery component uses a health index constructed from data on health facility gaps, primary health care visits and in-patient days. The transfer variable for agriculture is based on a county's proportion of rural households while that for other devolved functions is based on a county's proportion of total population. Further, the service delivery component also incorporates a basic minimum allocation to each county.

The balanced development component has four variables; roads, urban services, land area and poverty. On roads, the framework uses a rural access index, urban service uses number of urban households while land area uses the proportion of the land size of a county. On poverty, the framework uses the proportion of poor people.

The incentive component of the framework has two measures; the fiscal effort and prudence indices. The fiscal effort index measures a county's effort to

raise own source revenues from the economic activities within the county. The fiscal prudence parameter is a composite index that measures county’s fiscal responsibility. It takes into account; Auditor General’s audit opinion on county utilisation of resources, average county expenditures on development, establishment of internal audit committee and the County Budget and Economic Forum by a county.

The specific weights assigned to the transfer variables in each revenue component were developed using information on existing policies, agreed conventions, actual county government expenditures and transfer shares for devolved functions.

The third basis for revenue sharing is as summarised in Table 1.

Table 1: Summary of the Third Basis

| Objective | Parameter | Indicator of Expenditure Need | Assigned Weight |
|---|-----------------------|--------------------------------------|------------------------|
| 1. To enhance service delivery | Health services | Health index | 17% |
| | Agriculture services | Agricultural index | 10 % |
| | Other county services | Population index | 18 % |
| | Minimum share | Basic share index | 20% |
| 2. To promote balanced development | Land | Land area index | 8 % |
| | Roads | Rural Access index | 4 % |
| | Poverty level | Poverty head count index | 14 % |
| | Urban service | Urban index | 5% |
| 3. Incentivise fiscal effort | Fiscal effort | Fiscal effort index | 2 % |
| 4. Incentivise fiscal prudence | Fiscal prudence | Fiscal prudence index | 2 % |

Source: CRA 2019

On implementation of the third basis, the Commission recommends a phasing-in of the formula to avoid disruption in service delivery and development programs. The proposed approach is to set aside 15 percent of the equitable share increment to cushion counties which would see a reduction in their equitable share in a quantum in excess of 5 percent. This is in line with the provisions of Article 203(d) and (j)

1.0. INTRODUCTION

The Constitution in Article 216(1) read together with Article 217(2)(b) requires the Commission on Revenue Allocation (CRA) to make recommendations on the basis for the equitable sharing of revenue raised nationally among county governments. This is the third recommendation to be used to share revenue for five financial years from 2019/20 to 2023/24. In formulating this recommendation, the Commission reviewed the current revenue sharing basis and comparable intergovernmental financing frameworks, extensively consulted with various stakeholders as well as sector experts.

This recommendation is structured as follows: section one presents the introduction to intergovernmental fiscal transfers, section two presents the critique on the second basis, section three provides information on comparable countries' experiences on sub national financing, and section four presents the Commission recommendation on the third revenue sharing basis.

1.1. Kenya's Intergovernmental Fiscal Framework

The Constitution of Kenya in Article 6 establishes a two-tier government; the national and 47 county governments. Though these two levels of government are distinct, they are inter-dependent and are therefore meant to conduct their relations on the basis of consultation and cooperation.

The Fourth Schedule of the Constitution assigns functions to each level of government. The National Government has the key roles of policy formulation, legislation and setting of norms and standards while the county governments' roles are policy implementation and provision of services. County governments can also formulate policies and make laws that are necessary for effective performance of functions and exercise of their powers as long as the laws and policies are consistent with prevailing national policies and legislations.

Article 209 assigns tax powers to the two levels of government. County governments are mandated to collect property and entertainment taxes, and

fees and charges for services rendered. However, these taxes are inadequate to finance all the devolved functions. This results in an imbalance between county governments' expenditure responsibilities and revenue raising powers. This fiscal gap needs to be filled through transfers from the revenues collected nationally in accordance with the provisions of Article 202.

Article 203(1) stipulates the criteria for equitable sharing of revenues. The revenue sharing framework recommended by the Commission is not only meant to share revenue equitably among counties but also provide incentives to county governments to optimise their capacity to collect revenues.

Article 217 (1) mandates the Senate to determine, every five years, the basis for allocating among the counties the share of national revenue that is annually allocated to the county level of government

1.2. Objectives of Intergovernmental Fiscal Transfers

Globally, intergovernmental transfers are meant to achieve three primary objectives;

- a) Provide adequate funding to improve the fiscal horizontal imbalances based on assigned functions;
- b) Compensate for the presence of economic disparities between jurisdictions in the provision of services; and
- c) Improve tax administration efficiency.

Overall, the Kenyan transfer framework underpinning this recommendation addresses four objectives; to enhance service delivery, to promote balanced development, to incentivise counties to optimise capacity to raise revenue and to incentivise prudent use of public resources. In realising these objectives, the key challenge is how to strike a balance between providing adequate resources to sustain service delivery and compensating for economic disparities, given the economic diversity of counties and overarching constraint of limited transfers from revenues collected nationally.

1.3. Principles of Intergovernmental Transfers

The following principles of public finance management have informed the preparation of the recommendation on the third basis for revenue sharing among county governments:

- i. **Clarity of objectives:** There should be clear objectives which the inter-governmental transfer systems seeks to achieve. This recommendation has four clear objectives.
- ii. **Equity:** Intergovernmental transfers should promote the constitutional and governmental goal of ensuring that all citizens have access to basic services. Transfers should also treat jurisdictions fairly and according to a uniform set of criteria. The basis developed for this recommendation will be used to share revenues equitably among all the county governments.
- iii. **Autonomy:** Sub national levels have fundamental administrative, functional and political responsibilities to their residents. In order to perform these basic roles, they require a minimum level of institutional and physical infrastructure. Therefore, the transfer system should ensure that each lower level of government operates efficiently and effectively. This recommendation provides for a basic allocation to each county for administrative, institutional and physical infrastructure. Besides, the allocation to counties through this recommendation is a general-purpose transfer that will be sent as a lump-sum to ensure flexibility in spending discretion of county governments.
- iv. **Adequacy:** Sub national governments need to have access to adequate sources of revenue; either own source revenues or intergovernmental transfers. This enables them to carry out the functions that have been assigned to them. In addition, sub national governments should be encouraged to fully exploit these sources of revenue to meet their developmental objectives. This recommendation provides incentives to county governments to optimise capacity to raise revenue and utilise public resources prudently.
- v. **Predictability:** Transfers should be predictable. Without predictability, budgeting and borrowing becomes difficult and expensive to sub national governments. To ensure transfers are

predictable over the medium term, the recommendation once approved, will remain in place for the next five financial years.

- vi. **Simple and Transparent:** Inter-governmental transfer system should be simple and transparent. This recommendation uses a simple and transparent framework based on publicly available data and information to share revenues among counties.
- vii. **Prudence:** Transfers should promote prudence. This is important in ensuring valuable national resources are not wasted through inefficiency. This recommendation has incorporated an incentive allocation to promote fiscal responsibility of all county governments.

2.0. REVIEW OF THE SECOND BASIS FOR REVENUE SHARING

2.1. Introduction

Over the last six years, a total of Kshs. 1,572,736 million has been shared among county governments using two transitional bases. The first basis approved in November 2012 shared Kshs. 956,736 million for financial years 2013/14 to 2016/17. The second basis was approved by Parliament in June 2016 and used to share revenue for financial years 2017/18 and 2018/19 amounting to Kshs 616,000 million. The allocations to each county over the last six years of devolution is detailed in Appendix 1.

2.2. Policy Objectives of the Second Basis

The second revenue sharing basis, was meant to achieve three objectives drawn from Article 203. These were, to:

- i) Provide adequate funding to enable county governments to undertake functions assigned to them;
- ii) Correct for economic disparities and minimize the development gap;
- iii) Stimulate economic optimisation and incentivise counties to optimise capacity to raise revenue.

2.3. Parameters used in the Second Basis

To realize the above objectives, the Commission used six parameters in the second basis as shown in Table 2. These are: a basic equal share, population, land area, poverty, fiscal effort and a development factor.

Table 2: The Second Basis for Revenue-sharing

| No. | Parameter | Weights |
|-----|--------------------|-------------|
| 1 | Population | 45% |
| 2 | Basic Equal Share | 26% |
| 3 | Poverty | 18% |
| 4 | Land Area | 8% |
| 5 | Fiscal Effort | 2% |
| 6 | Development Factor | 1% |
| | TOTAL | 100% |

Source: CRA 2016

The second basis used population as the key proxy measure of county government expenditure needs for devolved functions. Poverty and development indices were used as measures of economic disparities among counties in order to redistribute revenues. A basic equal share was allocated to each county to enable them to set up institutional and administrative structures necessary to run a government. Land area was used as a measure of additional costs of providing comparable services across counties while a fiscal effort measure was used to incentivise counties to maximise capacity to raise revenues.

2.4. Critique of the Second Revenue-Sharing Basis

The Commission invited the public, county governments, academia, research institutions, and policy experts to review the second basis. The section below summarises concerns raised and proposals made to ensure that the third basis shares revenues equitably across the counties. Overall, eight concerns were raised as discussed below.

2.4.1. Disconnect between the Basis and Assigned Functions

The Commission in its vertical recommendation uses functions assigned to county governments in line with the principle of funds follow functions. However, the Commission uses generic expenditure proxies in its recommendation on sharing revenues among county governments (horizontal recommendation). These proxies do not capture expenditure needs of county governments. The two recommendation are summarised in Table 3.

Table 3: Disconnect between Vertical and Horizontal Revenue-sharing

| Vertical Recommendation | | | | Horizontal Recommendation | |
|--|---|--------------------------|----------------|----------------------------------|-------------------------------|
| County Functions | | Actual Allocation | | | |
| A. Devolved Functions | | 2017/18 | 2018/19 | Parameter | Second Basis % weights |
| 1 | Health Services | 86,151 | 90,768 | Population | 45% |
| 2 | Planning and Development | 58,000 | 56,554 | Equal Share | 26% |
| 3 | Agriculture, Livestock and Fisheries | 23,479 | 24,195 | Poverty | 18% |
| 4 | Culture, Public Entertainment and Amenities | 3,596 | 3,858 | Land Area | 8% |
| 5 | Youth Affairs and Sports | 5,202 | 5,582 | Fiscal Effort | 2% |
| 6 | Trade, Cooperative Development and Regulation | 5,210 | 5,590 | Development Factor | 1% |
| 7 | Roads & Transport | 47,489 | 48,958 | | |
| 8 | Lands, Housing and Public Works | 6,778 | 7,275 | | |
| 9 | Water, Natural Resources and Environment | 8,517 | 8,860 | | |
| 10 | Pre-Primary Education | 2,795 | 2,800 | | |
| B. Sub Total Devolved Functions | | 247,217 | 254,441 | | |
| 11 | Recurrent costs of county assemblies and county executive | 54,783 | 59,559 | | |
| C. Total Equitable Share | | 302,000 | 314,000 | | |

Source: CRA 2019

A comparison between the vertical and horizontal recommendations reveals a clear disconnect between the two bases.

2.4.2. Use of a Single Transfer to Address Multiple Objectives

The second basis had three clear objectives, to; provide adequate funding to enable county governments to undertake functions assigned to them, correct for economic disparities and minimize the development gap, and to stimulate economic optimisation and incentivise counties to optimise capacity to raise revenue. All these objectives were financed through a single lump sum

transfer. The transfer basis did not delineate allocations assigned to the respective objectives, posing a challenge in assessing the adequacy of revenues allocated to different counties. A revenue sharing framework driven by multiple objectives should provide for multiple transfer framework.

2.4.3. Poor Measure of Fiscal Effort

The Constitution calls for provision of incentives to county governments to optimise capacity to raise revenue. The measure used in the second basis defined fiscal effort as actual annual revenue increment per capita. The use of the per capita dimension in the measure favoured counties with fewer people, thereby overcompensating them for marginal revenue increments. The volatility in revenue collection by counties also made the measure unstable, thereby benefiting very few counties whose revenues increased at different times. This resulted in significant shifts in revenue allocation year-on-year across counties thereby undermining service delivery.

2.4.4. Generic use of Population as a Proxy for all Expenditure Needs

The second basis allocated a weight of 45 per cent on account of a county's proportion of the population. This parameter was therefore used as a basic measure of expenditure needs of county governments, yet a number of functions assigned to county governments have distinct expenditures measures.

2.4.5. High Weight on Equal Share Allocation

The use of basic equal share in the revenue sharing formula raises fundamental equity and fairness issues. County governments do not have similar and equal administrative expenditure needs to account for 26 per cent of all expenditures built into the second basis. An overstated use of equal shares (high criteria weight) may lead to negative incentives and inefficiency in allocation as various county governments have different expenditure needs.

2.4.6. Inappropriate Measure of Poverty

The second basis used a measure of the depth of poverty- the poverty gap to share revenues. This measure of poverty is volatile over different time periods as household incomes are affected by different factors not necessarily associated with public policy. There exist significant differences in the levels of county poverty gaps as reflected in the data collected in 2005/06; 2009 and 2015/16. These changes made the measure unstable resulting in significant shift in revenue sharing between counties.

2.4.7. Inappropriate Measure of Infrastructure

Land area was used in the second basis as a proxy for cost differentials and infrastructural needs of counties. Large counties were presumed to incur higher costs in providing comparable service to the population. Whereas this is true, the measure failed to recognise the fact that costs increase, but at a decreasing rate and that small counties also incur costs associated with terrain. Administrative costs can be estimated and should be separated from infrastructural costs.

2.4.8. Insignificance of the Development Factor

The development index captured three key functions of county governments; provision of infrastructure for roads, electricity and water. The allocation of one per cent in the second basis implied that the relative importance of development factor in sharing revenue among counties was too low compared to the other parameters. In addition, the development factor captured different dimensions of infrastructure deficiencies across counties and therefore was not a direct measure of expenditure needs. Even where the infrastructure exists, the counties also need resources to maintain the infrastructure.

3.0. COMPARABLE COUNTRY EXPERIENCES ON SUB-NATIONAL FINANCING

3.1. Introduction

Revenue transfer is a central component of all intergovernmental relations in both developed and developing countries and a key pillar for fiscal decentralization. This section presents a comparative analysis of intergovernmental fiscal transfer models used in other countries that decentralised much earlier than Kenya. The models therefore, offer useful lessons for Kenya.

3.2. Intergovernmental Fiscal Transfer Systems

Countries have varied reasons for embracing fiscal decentralization. In South Africa, devolution was driven by the need to correct the country's historically skewed distribution of resources and promote equitable levels of service delivery and opportunities. In Uganda, decentralization was meant to improve service delivery by transferring power to the local governments. In Ethiopia, it was meant to correct economic deprivation by highly centralized authoritarian regimes which had led to economic inequality, while in the Philippines, in addition to achieving balanced regional growth, fiscal decentralization was meant to share natural resource revenues to the local governments.

There are different kinds of intergovernmental transfer instruments used to share revenues globally. These are: grants, tax sharing returns, and cost sharing transfers. The transfers are further categorised into general purpose (unconditional) transfers and specific purpose (conditional/categorical) transfers. Section 3.2.1 reviews literature on general purpose transfers, which is the subject of this recommendation.

3.2.1. General Purpose (unconditional) Transfers

General-purpose transfers provide for general budget support, with no conditionalities attached to preserve local autonomy and enhance equity. The general-purpose transfers provide flexibility and discretion to local governments to allocate resources based on local priorities. In Ethiopia, India, South Africa, Philippines and Indonesia the transfers are used to correct

horizontal fiscal imbalance that existed among regions. In the United Kingdom, the general-purpose transfer is mainly used to address regional inequality. The higher the ratio of expenditure need to resources available to a particular local authority, the more grant it receives.

General purpose transfers sometimes incorporate a tax sharing transfer system which entails reimbursement of a portion of central government tax collected within the jurisdiction of a sub-national entity. In India, local governments are reimbursed excise duties collected by the national government, while in Indonesia, local governments are reimbursed collections by national government on property taxes. In Philippines, local governments are entitled to a share of national wealth from resources and minerals and certain taxes collected within their jurisdictions which accounts for 40 per cent of the total nationally collected revenues three years prior to the current year.

In Brazil on the other hand, the tax sharing scheme funds local governments with 25 per cent of their regional Value Added Tax revenues while in Bolivia, most of the revenues especially on natural resources go to the regions in which they are collected, with a small fraction (less than 10 per cent) being reserved for regions with no natural resources. In South Africa, provinces are reimbursed a portion of the revenue they raise to meet costs associated with economic activities such as maintenance of provincial roads. Tax-sharing transfer systems can however be counter equalising since subnational governments with larger tax bases will derive greater amounts of transfer funds.

3.3. Revenue Sharing Frameworks

The framework for sharing of revenue among sub national governments relate to the general purpose/unconditional transfers. There are three approaches to allocating general purpose transfers, namely; derivative approach, ad-hoc approach, and formula-based approach.

3.3.1. Derivative Approach

Under this approach, each local government receives an amount based on tax collected within their jurisdiction. This approach is frequently used to close the vertical imbalance in transition economies. India and Brazil have used this approach to share excise duties and motor fuel taxes respectively, while Philippines and Bolivia have used the approach to share revenues arising from natural resources in the respective local government jurisdictions. This approach favours richer regions with high tax collections, thus perpetuating existing disparities unless they are addressed by other transfers. This approach therefore cannot be used in isolation since it only shares a given proportion of revenues collected in a local government jurisdiction.

3.3.2 Ad-hoc Approach

This approach distributes resources among local governments in a discretionary manner. The national government reserves the discretion on how much to transfer and to which sub national government. This model is widely used within a developing and transition context as it allows for flexibility. However, the approach is not transparent and may lead to significant local-central government negotiations and manipulation. Ethiopia used this approach to transfer unconditional grants to regions during the transition period of 1992/93.

3.3.3 Formula-based Approach

To correct the inefficiencies of inequitable revenue sharing experienced with both derivative and ad-hoc transfer approaches, most countries under consideration in this review allocate general purpose intergovernmental fiscal transfers using an objectively defined formula by way of parameters which ensures transparency and predictability of funds. This approach has two methods; expenditure needs framework and fiscal capacity framework.

The expenditure needs framework provides for similar levels of service affordability in different sub-national governments. In Ethiopia, India and Philippines, the most considered parameters of relative demand for expenditure needs include: population, length of roads and land area. Population is preferred in many transfer systems because it is a simple, objective and transparent indicator that ensures predictability and equal per

capita transfers to all local governments. Land area on the other hand represents the cost of providing services whose costs increase with land size.

In Ghana and South Africa parameters such as education and health services are commonly used since they are the most decentralized sectors. In Ethiopia and India, a factor for environmental protection is included in the formula for the local governments to deal with local and global environmental problems. To bridge sub national developmental gaps and promote equity, South Africa, Ghana, Ethiopia and Indonesia use poverty measures. The choice of poverty measures used varies across countries.

The Second method in the formula-based transfers uses the fiscal capacity framework to create incentives for local governments to mobilize their own resources rather than over rely on transferred funds. In Ethiopia, different ratios namely: own revenue to budget ratio; previous year's capital budget; revenue raising effort; sectoral output performance; and revenue generating capacity have been used at different times to incentivize local governments to raise more revenue. Nigeria and India include a measure of tax effort in the distribution formula measured by the ratio of per capita own tax revenue of a state to its per capita income to incentivise local revenue collection. In Ghana own revenue collection is incorporated in the formula to motivate districts in generating more revenues.

The allocation of weights to different parameters used in the formula approach is often based on factors such as: historical budget allocations; utilization of micro cost data and use of regression analysis. In South Africa, weights are assigned to the functions based on the aggregate expenditure incurred and are revised periodically to consider changes in priorities of the provinces taken in aggregate.

3.4. Lessons for Kenya

From the experiences of the various countries reviewed, certain critical lessons emerge for Kenya that inform the third basis for revenue sharing. These are:

There is no standard number of parameters to be used in a general-purpose transfer framework. This should be guided by the purpose of the transfers and the responsibility of the subnational governments. In the Kenyan case, the number and choice of parameters should be guided by functions of the county governments and the provisions of the Constitution. The general purpose transfer besides allocating revenues to sub national governments, is also used to provide incentives to sub national governments to optimise their capacity to mobilize revenue from taxes assigned to them.

There is no agreed methodology for determining the weights assigned to the various parameters in the revenue transfer framework. Different countries use different approaches to determine the weights. These weights need to be continuously reviewed to take into account changes in policy priorities and changing objectives of the transfer framework.

Unlike other jurisdictions that have few sub national governments, Kenya has a large number of sub national governments, 47 counties. These counties exhibit substantial differences in economic endowments, population and land area, yet they have all been assigned the same functions. This poses a challenge in achieving all the objectives of inter-governmental transfers using a single transfer. The framework developed in section 4 will therefore provide for a revenue sharing framework with three components, with each transfer addressing a specific objective.

4.0. THE RECOMMENDATION ON THE THIRD BASIS FOR REVENUE SHARING

4.1. Introduction

In preparing this recommendation, the Commission has taken into account the functions assigned to county governments by the Fourth Schedule and the criteria provided in Article 203. In addition, the Commission has taken into consideration lessons from review of the second basis and experience from comparable jurisdictions on inter-governmental financing frameworks.

4.2. Framework for the Third Revenue Sharing Basis

The framework for the third basis has four objectives; to enhance service delivery, to promote balanced development, to incentivise counties to optimise capacity to raise revenue and to incentivise prudent use of public resources. These objectives are realised through a transfer framework that provides for three components: service delivery, balanced development, and incentive.

The functions of county governments are mapped into the components to determine expenditure needs and appropriate measures for the parameters used to share revenues. To determine the parameter weights, the Commission has been guided by; existing policies on devolved functions, binding conventions on some of the devolved functions, actual expenditures by county governments and transfer shares from nationally raised revenues for key devolved functions. The objectives, the measurements and weights of each component are elaborated in section 4.2.1 and a summary of the framework and definition of measures presented in Appendices 3 and 4, respectively.

4.2.1. To enhance equitable service delivery

Article 203(d) provides that the criteria for determining equitable share among county governments take into account the need to ensure that county governments are able to perform functions assigned to them in the Fourth Schedule, as shown in Appendix 2. The following functions have been explicitly considered in the service delivery component: county health services and agriculture services. In addition, the service delivery component provides for other devolved functions such as pre-primary education, village polytechnics, homecraft centres and childcare facilities; cultural activities, public entertainment and public amenities; implementation of specific

national government policies on natural resources and environmental conservation. A basic minimum allocation to each county is also considered within the service delivery component.

The allocation parameters to enhance service delivery are:

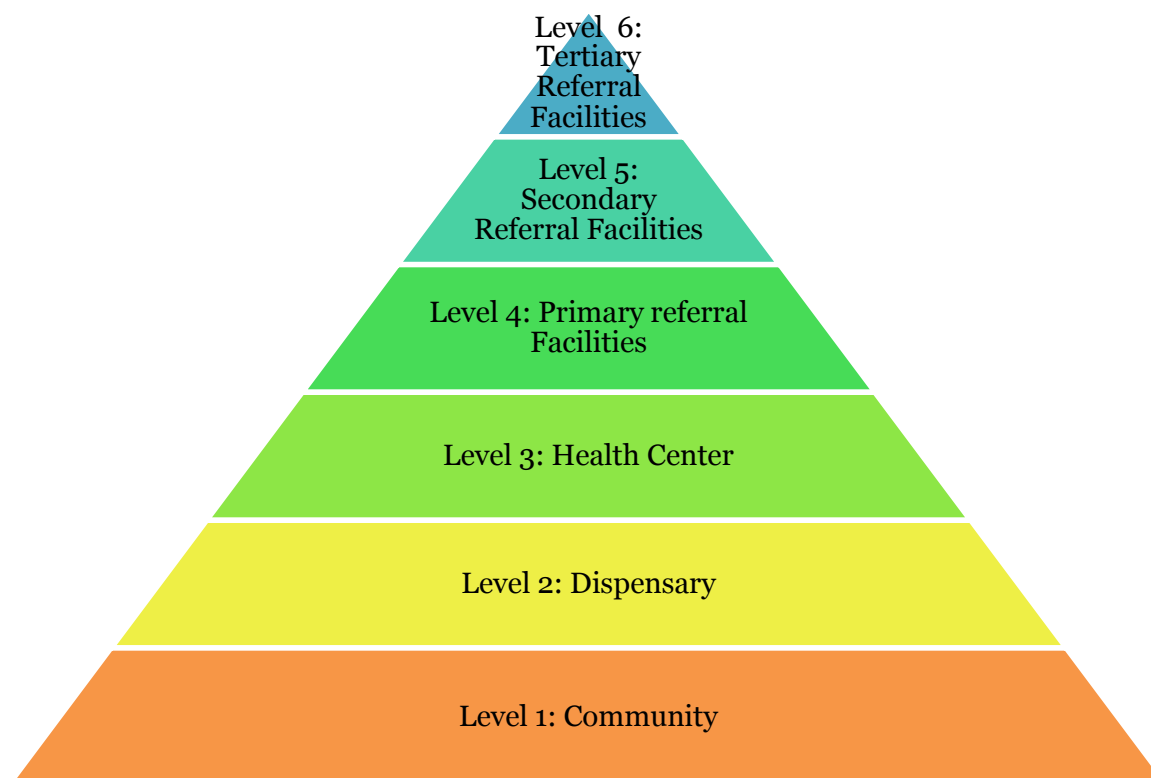
i. Health Services

County health services include: county health facilities and pharmacies; ambulance services; promotion of primary health care; licensing and control of undertakings that sell food to the public; veterinary services (excluding regulation of the profession); cemeteries, funeral parlours and crematoria; and refuse removal, refuse dumps and solid waste disposal.

Three measures are used to determine health expenditure needs of counties. These are: health facility-gaps, three years average number of primary health care visits to levels 2 and 3 health facilities and three years average in-patient days in levels 4 and 5 hospitals. Variation in disease burdens across counties result in different health service demands as measured by in-patient and out-patient attendances in each county. The facility-gap measure is weighted at 20 per cent, primary health care visits is weighted at 60 per cent and in-patient days is weighted at 20 per cent of the health index.

Kenya's healthcare system is essentially a referral system structured in a pyramid with six levels of care, with the lowest unit being public health care and the highest level tertiary referral. The structure consists of six levels as shown in Figure 1. The county governments are responsibility for levels one to five while national government is responsible for level six.

Figure 1: Structure of Kenya's Health Care System



Source CRA 2019

The referral system depicts an escalation to greater costs of care. Two approaches can be used to measure health needs: health outcomes and expenditure needs. Health outcome measures such as mortality rates are a result of the existing health care system that do not necessarily reflect demand for health services. This recommendation therefore uses health expenditure needs as determined by the health infrastructure gaps and workload.

The requirements for physical facilities for each county are measured based on population norms of each level of facility and workload across all the county governments based on data from the Ministry of Health. On average, for every 5,000 people, a community unit needs to be established. A dispensary should exist for every 10,000 persons while a health centre should be established to serve a population of 30,000. Primary referral facilities, serve a population of 100,000. The secondary referral facilities, Level 5, are required to serve a population of approximately 1 million persons while the tertiary referral facilities which focus on highly specialized services

serve a cross-county population of approximately 5 million persons. Population based norms however, do not take into account population density posing challenges in determining the infrastructure gap needs of counties. The health parameter is weighted at 17 per cent which is above the Abuja Declaration made in 2001 that all member states should allocate at least 15 per cent of their annual budgets to the health sector.

ii. Agriculture Services

Agriculture services provided by county governments include: crop and animal husbandry; livestock sale yards; county abattoirs; plant and animal disease control; and fisheries. County governments provide agriculture extension services to farmers in each sub-sector of agriculture. The agriculture services measure is based on a county's proportion of rural households as provided in the Kenya Population and Housing Census (KPHC) of 2009.

There are several norms in provision of extension services. For instance, the Food and Agriculture Organisation (FAO) norm requires that one extension officer serves 400 farmers. In Kenya, each administrative ward should be served by five extension officers for each sub sector (crop, livestock, veterinary, fisheries and irrigation). Nonetheless, in the absence of a farmers register, the third basis uses rural households as a measure of need for extension services.

The agriculture services parameter is weighted at 10 per cent. This allocation is in line with the Maputo Declaration of 2003 which requires that governments allocate at least 10 per cent of their total budgets to agriculture and rural development.

iii. Other County Services

These other services include: pre-primary education; village polytechnics; homecraft centres and childcare facilities; cultural activities, public entertainment and public amenities; animal control and welfare; fire-fighting services and disaster management; control of drugs and pornography and implementation of specific national government policies on natural resources and environmental conservation. Given that these services are largely population-based, total county population is considered an appropriate measure of expenditure needs. The measure for other county services is

therefore a county's proportion of population based on the KPHC 2009. The population parameter is weighted at 18 per cent.

iv. Basic Share

The basic share allocation guarantees all counties a minimum allocation to establish administrative structures and coordinate participation of communities in county planning and governance at the local level. The measure is assigned a total weight of 20 per cent in the sharing framework, of which, 19 per cent is shared equally among all counties and one per cent based on the inverse of a county's population.

In total, the revenue sharing framework allocates 65 per cent of the county equitable share for enhancing service delivery. Allocations to each county are presented in Table 4.

Table 4: County Allocations to Enhance Service Delivery (Kshs Million)

| No | County | Population 2009 | Other Services (18%) | Health (17%) | Agriculture (10%) | Basic Share (20%) | Total (65%) |
|----|-----------------|-------------------|----------------------|---------------|-------------------|-------------------|----------------|
| 1 | Nairobi City | 3,138,369 | 4,864 | 3,327 | 35 | 1,356 | 9,582 |
| 2 | Kakamega | 1,660,651 | 2,574 | 2,963 | 1,776 | 1,367 | 8,680 |
| 3 | Nakuru | 1,603,325 | 2,485 | 2,273 | 1,196 | 1,368 | 7,321 |
| 4 | Bungoma | 1,375,063 | 2,131 | 2,415 | 1,341 | 1,372 | 7,259 |
| 5 | Kiambu | 1,623,282 | 2,516 | 2,096 | 965 | 1,367 | 6,945 |
| 6 | Meru | 1,356,301 | 2,102 | 1,728 | 1,709 | 1,372 | 6,911 |
| 7 | Kisii | 1,152,282 | 1,786 | 1,773 | 1,158 | 1,377 | 6,094 |
| 8 | Machakos | 1,098,584 | 1,702 | 2,131 | 707 | 1,379 | 5,919 |
| 9 | Kilifi | 1,109,735 | 1,720 | 1,651 | 783 | 1,378 | 5,532 |
| 10 | Migori | 917,170 | 1,421 | 1,620 | 1,054 | 1,386 | 5,482 |
| 11 | Murang'a | 942,581 | 1,461 | 1,276 | 1,298 | 1,385 | 5,420 |
| 12 | Kitui | 1,012,709 | 1,569 | 1,360 | 1,039 | 1,382 | 5,351 |
| 13 | Kisumu | 968,909 | 1,502 | 1,806 | 636 | 1,383 | 5,327 |
| 14 | Makueni | 884,527 | 1,371 | 1,353 | 970 | 1,387 | 5,081 |
| 15 | Turkana | 855,399 | 1,326 | 1,541 | 621 | 1,389 | 4,876 |
| 16 | Siaya | 842,304 | 1,305 | 1,097 | 1,067 | 1,389 | 4,859 |
| 17 | Uasin-Gishu | 894,179 | 1,386 | 1,421 | 658 | 1,387 | 4,852 |
| 18 | Trans-Nzoia | 818,757 | 1,269 | 1,325 | 794 | 1,391 | 4,779 |
| 19 | Nyeri | 693,558 | 1,075 | 1,406 | 896 | 1,399 | 4,776 |
| 20 | Homa-Bay | 963,794 | 1,494 | 1,118 | 701 | 1,384 | 4,697 |
| 21 | Nandi | 752,965 | 1,167 | 1,337 | 797 | 1,395 | 4,696 |
| 22 | Mandera | 1,025,756 | 1,590 | 1,032 | 635 | 1,381 | 4,638 |
| 23 | Bomet | 730,129 | 1,131 | 1,302 | 756 | 1,396 | 4,586 |
| 24 | Busia | 743,946 | 1,153 | 1,203 | 814 | 1,395 | 4,566 |
| 25 | Kwale | 649,931 | 1,007 | 1,549 | 579 | 1,403 | 4,539 |
| 26 | Kericho | 752,396 | 1,166 | 1,314 | 661 | 1,395 | 4,536 |
| 27 | Kirinyaga | 528,054 | 818 | 1,315 | 776 | 1,417 | 4,325 |
| 28 | Narok | 850,920 | 1,319 | 568 | 926 | 1,389 | 4,202 |
| 29 | Nyandarua | 596,268 | 924 | 1,010 | 698 | 1,408 | 4,040 |
| 30 | Mombasa | 939,370 | 1,456 | 1,132 | 35 | 1,385 | 4,008 |
| 31 | Baringo | 555,561 | 861 | 953 | 587 | 1,413 | 3,814 |
| 32 | Embu | 516,212 | 800 | 911 | 658 | 1,418 | 3,787 |
| 33 | Nyamira | 598,252 | 927 | 675 | 698 | 1,408 | 3,707 |
| 34 | Kajiado | 687,312 | 1,065 | 594 | 543 | 1,400 | 3,602 |
| 35 | West Pokot | 512,690 | 795 | 851 | 531 | 1,419 | 3,595 |
| 36 | Vihiga | 554,622 | 860 | 687 | 527 | 1,413 | 3,487 |
| 37 | Wajir | 661,941 | 1,026 | 433 | 469 | 1,402 | 3,329 |
| 38 | Garissa | 623,060 | 966 | 470 | 335 | 1,405 | 3,176 |
| 39 | Laikipia | 399,227 | 619 | 618 | 493 | 1,440 | 3,170 |
| 40 | Elgeyo-Marakwet | 369,998 | 573 | 647 | 422 | 1,448 | 3,090 |
| 41 | Tharaka-Nithi | 365,330 | 566 | 448 | 425 | 1,449 | 2,889 |
| 42 | Taita-Taveta | 284,657 | 441 | 426 | 370 | 1,479 | 2,716 |
| 43 | Marsabit | 291,166 | 451 | 326 | 299 | 1,476 | 2,552 |
| 44 | Tana-River | 240,075 | 372 | 380 | 266 | 1,504 | 2,522 |
| 45 | Samburu | 223,947 | 347 | 310 | 260 | 1,515 | 2,432 |
| 46 | Lamu | 101,539 | 157 | 155 | 139 | 1,722 | 2,173 |
| 47 | Isiolo | 143,294 | 222 | 184 | 134 | 1,612 | 2,151 |
| | Total | 38,610,097 | 59,835 | 56,511 | 33,242 | 66,483 | 216,070 |

Source CRA 2019

4.2.2. To Promote Balanced Development

Article 203(f),(g),(h) provides that the criteria for determining equitable share among county governments consider the developmental needs and economic disparities within and among counties. In promoting balanced development, the third basis has taken into account the need for county governments to address poverty and provide infrastructure, especially county roads. In allocating revenues to promote balanced development, the framework uses the size land area, number of poor people, access to roads, and number of urban households as measures. These are further discussed below.

i. Land Area

The measure used for this parameter is the county's proportion of the land area. The allocation of revenues based on land parameter is meant to provide counties with adequate resources to cater for costs related to service delivery. This is informed by the fact that a county with a larger area incurs additional administrative costs to deliver comparable standards of service to citizens. However, the differences in the costs of providing services increase with the size of a county, but only at a decreasing rate and that, beyond a certain threshold, incremental costs become negligible. Taking this marginal incremental costs into consideration, the Commission has capped the maximum proportion of land area at seven per cent. The parameter is assigned a weight of 8 per cent.

ii. Poverty Levels

The poverty parameter uses poverty head count which is defined as a county's proportion of poor people as provided in Kenya Integrated Household Budget Survey (KIHBS) 2015/16. The measure is highly correlated with measures of underdevelopment and therefore is used as a proxy for developmental needs and economic disparities among counties. The poverty measure is a redistributive parameter meant to promote the constitutional goal of ensuring that all Kenyans have access to basic services, irrespective of where they live. The poverty parameter is weighted at 14 per cent.

iii. Urban Services

The urban services measure is defined by a county's proportion of urban households as provided in the KPHC of 2009. Counties are responsible for provision of urban-based services including: solid waste management; control

of air pollution, noise pollution, other public nuisances and outdoor advertising. County governments are also responsible for county public works and services such as storm water management. Urban service needs are household-based. Therefore, a county's proportion of urban households has been considered as measure of expenditure needs. The urban services parameter is weighted at five (5) per cent.

iv. Roads

County governments are responsible for construction and maintenance of county roads. Trunk roads have been assigned in the Fourth Schedule to the national government. The roads measures is defined by the county's rural access index (RAI). RAI is defined as the proportion of a county's population who have access to a motorable road within two kilometers based on data from the Kenya Roads Board for 2017. The roads parameter is assigned a weight of 4 per cent.

In aggregate, the development component shares 31 per cent of the county equitable share among the counties as shown in Table 5.

Table 5: Allocations to Promote Balance Development (Kshs million)

| No | County | Poverty (14%) | Land Area (8%) | Urban (5%) | Roads (4%) | Total (31) |
|----|-----------------|------------------|-------------------|---------------|---------------|----------------|
| 1 | Nairobi City | 2,114 | 37 | 4,907 | 4 | 7,062 |
| 2 | Turkana | 2,441 | 2,149 | 82 | 1,058 | 5,730 |
| 3 | Mandera | 1,566 | 1,373 | 112 | 1,270 | 4,321 |
| 4 | Wajir | 816 | 2,149 | 71 | 912 | 3,947 |
| 5 | Nakuru | 1,679 | 396 | 1,053 | 692 | 3,820 |
| 6 | Kitui | 1,480 | 1,611 | 167 | 490 | 3,747 |
| 7 | Kilifi | 1,844 | 666 | 358 | 744 | 3,612 |
| 8 | Garissa | 802 | 2,149 | 124 | 219 | 3,294 |
| 9 | Marsabit | 571 | 2,149 | 59 | 342 | 3,121 |
| 10 | Kiambu | 1,235 | 134 | 1,543 | 65 | 2,977 |
| 11 | Kajiado | 1,006 | 1,157 | 432 | 332 | 2,927 |
| 12 | Tana-River | 536 | 2,030 | 39 | 250 | 2,855 |
| 13 | Kakamega | 1,908 | 159 | 287 | 345 | 2,699 |
| 14 | Narok | 690 | 947 | 82 | 745 | 2,464 |
| 15 | Uasin-Gishu | 1,320 | 177 | 490 | 359 | 2,345 |
| 16 | Bungoma | 1,573 | 160 | 237 | 303 | 2,273 |
| 17 | Mombasa | 911 | 12 | 1,336 | 5 | 2,264 |
| 18 | Samburu | 611 | 1,110 | 45 | 288 | 2,054 |
| 19 | West Pokot | 1,057 | 484 | 44 | 421 | 2,006 |
| 20 | Kisii | 1,594 | 70 | 263 | 64 | 1,990 |
| 21 | Machakos | 788 | 328 | 743 | 121 | 1,979 |
| 22 | Kwale | 1,103 | 437 | 145 | 270 | 1,955 |
| 23 | Busia | 1,652 | 90 | 104 | 108 | 1,954 |
| 24 | Kisumu | 1,089 | 110 | 617 | 85 | 1,902 |
| 25 | Homa-Bay | 1,020 | 168 | 330 | 359 | 1,878 |
| 26 | Baringo | 790 | 582 | 82 | 397 | 1,851 |
| 27 | Migori | 1,317 | 137 | 159 | 179 | 1,793 |
| 28 | Makueni | 948 | 423 | 131 | 269 | 1,772 |
| 29 | Isiolo | 230 | 1,338 | 73 | 95 | 1,735 |
| 30 | Nandi | 973 | 152 | 120 | 465 | 1,711 |
| 31 | Trans-Nzoia | 1,001 | 132 | 200 | 356 | 1,689 |
| 32 | Meru | 809 | 366 | 168 | 280 | 1,623 |
| 33 | Bomet | 1,269 | 147 | 94 | 68 | 1,578 |
| 34 | Taita-Taveta | 328 | 902 | 69 | 138 | 1,437 |
| 35 | Siaya | 946 | 134 | 111 | 245 | 1,435 |
| 36 | Laikipia | 661 | 500 | 125 | 139 | 1,424 |
| 37 | Kericho | 812 | 114 | 264 | 105 | 1,296 |
| 38 | Murang'a | 778 | 135 | 196 | 31 | 1,140 |
| 39 | Nyandarua | 678 | 171 | 151 | 106 | 1,106 |
| 40 | Vihiga | 769 | 30 | 195 | 8 | 1,001 |
| 41 | Elgeyo-Marakwet | 578 | 160 | 57 | 169 | 964 |
| 42 | Nyeri | 436 | 176 | 271 | 50 | 933 |
| 43 | Nyamira | 649 | 47 | 88 | 31 | 815 |
| 44 | Embu | 447 | 149 | 125 | 89 | 811 |
| 45 | Tharaka-Nithi | 266 | 139 | 110 | 113 | 628 |
| 46 | Kirinyaga | 345 | 78 | 136 | 15 | 575 |
| 47 | Lamu | 103 | 331 | 24 | 97 | 556 |
| | Total | 46,538 | 26,593 | 16,621 | 13,297 | 103,049 |

Source CRA 2019

4.2.3. To incentivise Counties to Optimise Capacity to Raise Revenue

Article 209(3) mandates county governments to raise revenues by imposing property and entertainment taxes, charges and fees for services rendered. In determining the criteria for revenue sharing, Article 203(i) further provides that the basis for equitable sharing of revenue takes into account the need for economic optimisation of each county and the need to provide incentives for counties to optimise their capacity to raise revenue. The Gross County Product (GCP) measures the size and structure of a county's economic activity and the changes taking place within the county. The GCP therefore provides a better proxy to estimate a county's revenue potential.

The fiscal effort measure is defined as a ratio of a county's actual OSR to the GCP based on data from the Controller of Budget and KNBS, respectively. The fiscal effort parameter is weighted at two per cent and will change every year based on performance of county governments' OSR collections.

4.2.4. To Incentivise Prudent Use of Public Resources

The Constitution requires county governments to exercise prudence: Article 216(3)(c) requires that the Commission's recommendations encourage fiscal responsibility. Article 174(a)(c)(d)(i) provides for transparent and accountable governance while Articles 201(d)(e) requires county governments to ensure prudent and responsible use of public finances.

Further, the Public Finance Management Act (PFMA) 2012 holds county governments to a number of fiscal responsibility measures: Section 107 (2)(b) of the PFMA requires county governments to allocate a minimum of thirty percent of their budget to development expenditure over the medium term; Section 155(5) requires county governments to establish internal audit committees for both the county assembly (CA) and the county executive (CE) and Section 137 requires counties to establish County Budget and Economic Forum (CBEF). Overall, Article 229 mandates the Auditor General to conduct an independent audit and report on the accounts of all public entities to ensure public funds are applied lawfully and in an effective way.

The fiscal prudence measure is therefore a composite index that considers; the external auditor's opinion of a county's expenditures, use of funds for development and establishments of internal audit committee and the CBEF across all the counties. Calculation of the index is detailed in Appendix 4. The prudence parameter is weighted at two per cent and will change annually.

A total of 4 per cent is allocated to counties as an incentive to optimise capacity to raise revenue and utilise revenues prudently. Table 6 shows allocations to each county.

Table 6: Allocations to Incentivise Revenue Collection and Prudence (Kshs. Million)

| No | County | Effort (2%) | Prudence (2%) | Total (4%) | No | County | Effort (2%) | Prudence (2%) | Total (4%) |
|----|--------------|-------------|---------------|------------|----|-----------------|--------------|---------------|---------------|
| 1 | Narok | 587 | 83 | 670 | 25 | Nakuru | 223 | 42 | 266 |
| 2 | Samburu | 420 | 88 | 508 | 26 | West Pokot | 73 | 179 | 253 |
| 3 | Mombasa | 325 | 166 | 491 | 27 | Nyeri | 201 | 51 | 252 |
| 4 | Makueni | 127 | 300 | 427 | 28 | Turkana | 70 | 170 | 241 |
| 5 | Kilifi | 167 | 248 | 415 | 29 | Kisumu | 161 | 79 | 240 |
| 6 | Kajiado | 221 | 174 | 395 | 30 | Bomet | 59 | 179 | 239 |
| 7 | Kitui | 136 | 257 | 393 | 31 | Siaya | 66 | 170 | 236 |
| 8 | Isiolo | 263 | 126 | 388 | 32 | Mandera | 63 | 170 | 234 |
| 9 | Kakamega | 102 | 252 | 355 | 33 | Kirinyaga | 137 | 92 | 229 |
| 10 | Nairobi City | 215 | 132 | 347 | 34 | Nyamira | 41 | 174 | 215 |
| 11 | Machakos | 168 | 170 | 338 | 35 | Lamu | 83 | 123 | 206 |
| 12 | Bungoma | 161 | 174 | 335 | 36 | Murang'a | 113 | 92 | 204 |
| 13 | Kiambu | 159 | 174 | 333 | 37 | Taita-Taveta | 158 | 45 | 203 |
| 14 | Baringo | 163 | 170 | 333 | 38 | Wajir | 69 | 132 | 201 |
| 15 | Laikipia | 226 | 92 | 318 | 39 | Tana-River | 66 | 132 | 199 |
| 16 | Uasin-Gishu | 190 | 124 | 315 | 40 | Meru | 89 | 83 | 172 |
| 17 | Migori | 91 | 210 | 301 | 41 | Homa-Bay | 44 | 123 | 167 |
| 18 | Kwale | 127 | 170 | 297 | 42 | Trans-Nzoia | 83 | 83 | 166 |
| 19 | Kericho | 122 | 175 | 296 | 43 | Garissa | 80 | 83 | 163 |
| 20 | Nyandarua | 82 | 212 | 295 | 44 | Nandi | 71 | 92 | 162 |
| 21 | Embu | 168 | 123 | 291 | 45 | Tharaka-Nithi | 77 | 79 | 156 |
| 22 | Busia | 99 | 179 | 278 | 46 | Kisii | 70 | 83 | 153 |
| 23 | Vihiga | 97 | 170 | 267 | 47 | Elgeyo-Marakwet | 41 | 51 | 92 |
| 24 | Marsabit | 96 | 170 | 267 | | Total | 6,648 | 6,648 | 13,297 |

Source: CRA 2019

4.3. Aggregate Framework for the Third Basis

The framework for revenue sharing is an allocation framework and not a budgeting tool. Effectively, this framework is used to make a general-purpose transfer to all county governments. The transfer has two components. An allocation of Kshs. 332, 416 million to all counties based on third revenue sharing basis and a one-off cushioning component as explained in Section 4.4. Allocations to each county based on the third basis is shown in Table 7.

Table 7: Total Allocations based on Kshs.332,416 Million

| No | County | Allocation Factor | Total Allocation | No | County | Allocation Factor | Total Allocation |
|----|-----------------|-------------------|------------------|----|---------------|-------------------|------------------|
| 1 | Baringo | 1.804 | 5,998 | 25 | Marsabit | 1.787 | 5,940 |
| 2 | Bomet | 1.926 | 6,402 | 26 | Meru | 2.619 | 8,706 |
| 3 | Bungoma | 2.968 | 9,867 | 27 | Migori | 2.279 | 7,575 |
| 4 | Busia | 2.045 | 6,798 | 28 | Mombasa | 2.034 | 6,763 |
| 5 | Elgeyo-Marakwet | 1.247 | 4,146 | 29 | Murang'a | 2.035 | 6,764 |
| 6 | Embu | 1.471 | 4,888 | 30 | Nairobi City | 5.111 | 16,991 |
| 7 | Garissa | 1.996 | 6,634 | 31 | Nakuru | 3.431 | 11,407 |
| 8 | Homa-Bay | 2.028 | 6,741 | 32 | Nandi | 1.976 | 6,569 |
| 9 | Isiolo | 1.286 | 4,275 | 33 | Narok | 2.207 | 7,336 |
| 10 | Kajiado | 2.083 | 6,924 | 34 | Nyamira | 1.425 | 4,737 |
| 11 | Kakamega | 3.530 | 11,734 | 35 | Nyandarua | 1.637 | 5,441 |
| 12 | Kericho | 1.843 | 6,128 | 36 | Nyeri | 1.793 | 5,962 |
| 13 | Kiambu | 3.085 | 10,255 | 37 | Samburu | 1.502 | 4,994 |
| 14 | Kilifi | 2.876 | 9,560 | 38 | Siaya | 1.965 | 6,531 |
| 15 | Kirinyaga | 1.543 | 5,129 | 39 | Taita-Taveta | 1.311 | 4,356 |
| 16 | Kisii | 2.478 | 8,237 | 40 | Tana-River | 1.677 | 5,576 |
| 17 | Kisumu | 2.247 | 7,469 | 41 | Tharaka-Nithi | 1.105 | 3,672 |
| 18 | Kitui | 2.855 | 9,491 | 42 | Trans-Nzoia | 1.996 | 6,634 |
| 19 | Kwale | 2.043 | 6,791 | 43 | Turkana | 3.263 | 10,847 |
| 20 | Laikipia | 1.478 | 4,912 | 44 | Uasin-Gishu | 2.260 | 7,512 |
| 21 | Lamu | 0.883 | 2,934 | 45 | Vihiga | 1.430 | 4,755 |
| 22 | Machakos | 2.478 | 8,236 | 46 | Wajir | 2.249 | 7,477 |
| 23 | Makueni | 2.190 | 7,280 | 47 | West Pokot | 1.761 | 5,854 |
| 24 | Mandera | 2.765 | 9,192 | | Total | 100 | 332,416 |

Source: CRA 2019

4.4. Implementation of the Third Revenue Sharing Basis

The Commission is cognizant of the fact that the sharing framework should not destabilise functionality of county governments. The Commission therefore recommends that the third revenue sharing basis be implemented in a phased manner over a period of one year to cushion counties whose allocations for the financial year 2019/2020 will be significantly reduced from disruptions in their development expenditure. For this reason, the Commission recommends the setting aside of 15% of the annual increment in equitable share allocation to counties for financial year 2019/20 to cushion 8 counties with a negative reduction in revenue exceeding 5 per cent. This is in line with the provisions of Article 203(d) and (j) that require the criteria to take into account the need to ensure that county governments are able to perform functions allocated to them and the desirability of stable and predictable allocations of revenue. The phasing in criteria to 8 counties is shown in Table 8.

Table 8: Additional Allocations to Cushion Counties (Kshs. Million)

| No | County | Allocation Factor | Additional Allocation |
|----|--------------|-------------------|-----------------------|
| 1 | Mombasa | 0.19746 | 642 |
| 2 | Kilifi | 0.17167 | 558 |
| 3 | Marsabit | 0.14328 | 466 |
| 4 | Wajir | 0.13499 | 439 |
| 5 | Mandera | 0.12807 | 416 |
| 6 | Kwale | 0.10049 | 327 |
| 7 | Lamu | 0.08279 | 269 |
| 8 | Garissa | 0.04125 | 134 |
| | Total | 1.0000 | 3,250 |

Source CRA 2019

The Commission also notes that new population data will be available from the 2019 KHPC. This will affect three measures that use population, namely; agriculture, urban and other services. Once the 2019 KHPC data is available, the three measures will be updated automatically. However, should the 2019 KHPC reveal significant shift in movement of population across counties as to cause significant disruptions in revenue sharing across the counties, Parliament may choose to amend the third basis within the provisions of Article 217 (8).

5.0. THE APPLICATION OF ARTICLE 203

5.1. Introduction

Article 216 (3) provides that in determining the basis for revenue sharing among counties, the Commission should take into account the criteria set out in Article 203. The criteria in Article 203(1) can be divided into two; Article 203 (1) (a) to (c), which are applicable in determining the equitable shares between the national government and the county governments and Article 203 (1) (d) to (k) which are applicable in determining the equitable shares among the county governments. Section 5.2 explains how the parameters selected for the third revenue sharing basis meet the requirements of Article 203 (1) (d) to (k).

5.2. Application of Article 203.

i. *Article 203(1)(d): Ability of county governments to perform functions allocated to them*

The functions assigned to county governments as specified in the Fourth Schedule include: health, water, agriculture, urban services, pre-primary education, village polytechnics, cultural activities, environmental conservation and sanitation. The basis has considered financing of these functions within the service delivery component. Further, the basis has provided for a minimum allocation to each county.

ii. *Article 203 (1) (e) and (i): Fiscal capacity and efficiency of county governments and the need to incentivize counties to optimize capacity to raise revenue*

The basis provides incentives to optimise capacity to raise revenue and achieve efficiency in use of public resources. This is achieved by incorporating fiscal effort index and fiscal prudence index in the basis.

iii. *Article 203 (1) (f) (g) and (h): Developmental needs and economic disparities within and among counties and the need to remedy them through affirmative action*

Three parameters in the basis, namely; land area, poverty and roads are used to redistribute revenue among counties to address development needs and economic disparities within and among of counties.

iv. Article 203 (1) (j): Desirability of stable and predictable allocations of revenue

The recommended basis has judiciously selected stable parameters on the various measures of expenditure needs of county governments. Once approved, the basis will be used to share revenues for a period of five financial years from 2019/20 to 2023/24. Over this period, revenues allocated to counties on account of the basis will remain relatively stable and predictable, promote multi-year planning and overall budget certainty.

v. Article 203 (1) (k): The need for flexibility in responding to emergencies and other temporary needs, based on similar objective criteria

The basis allocates a lump sum amount to all counties thereby preserving their budget autonomy. Lump sum allocation provides county governments spending discretion including flexibility in responding to emergencies and other temporary needs.

APPENDICES

Appendix 1. Equitable Share Allocations to Counties for Financial Years 2013/14 to 2018/19 (Kshs Millions)

| No | County | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 | TOTAL |
|--------------|-----------------|----------------|----------------|----------------|----------------|----------------|----------------|------------------|
| 1 | Baringo | 3,248 | 3,875 | 4,441 | 4,791 | 4,983 | 5,087 | 26,425 |
| 2 | Bomet | 3,443 | 4,123 | 4,725 | 5,079 | 5,255 | 5,935 | 28,559 |
| 3 | Bungoma | 6,181 | 6,698 | 7,676 | 8,282 | 8,758 | 8,949 | 46,543 |
| 4 | Busia | 3,412 | 4,747 | 5,440 | 5,870 | 5,829 | 5,966 | 31,264 |
| 5 | Elgeyo/Marakwet | 2,392 | 2,854 | 3,270 | 3,529 | 3,624 | 3,768 | 19,437 |
| 6 | Embu | 2,807 | 3,349 | 3,838 | 4,141 | 4,107 | 4,459 | 22,701 |
| 7 | Garissa | 4,221 | 5,036 | 5,772 | 6,228 | 6,659 | 6,939 | 34,856 |
| 8 | Homa Bay | 4,121 | 4,917 | 5,635 | 6,080 | 6,523 | 6,688 | 33,965 |
| 9 | Isiolo | 2,236 | 2,667 | 3,057 | 3,298 | 3,775 | 3,925 | 18,958 |
| 10 | Kajiado | 3,227 | 3,850 | 4,413 | 4,761 | 5,768 | 5,997 | 28,017 |
| 11 | Kakamega | 6,516 | 7,773 | 8,908 | 9,612 | 9,936 | 10,331 | 53,075 |
| 12 | Kericho | 3,295 | 3,915 | 4,487 | 4,861 | 5,225 | 5,715 | 27,498 |
| 13 | Kiambu | 5,459 | 6,512 | 7,464 | 8,053 | 9,664 | 9,357 | 46,508 |
| 14 | Kilifi | 5,443 | 6,492 | 7,441 | 8,029 | 9,951 | 10,833 | 48,189 |
| 15 | Kirinyanga | 2,588 | 3,087 | 3,538 | 3,818 | 4,409 | 4,113 | 21,553 |
| 16 | Kisii | 5,188 | 6,190 | 7,094 | 7,654 | 7,429 | 7,693 | 41,248 |
| 17 | Kisumu | 4,155 | 4,957 | 5,681 | 6,130 | 6,553 | 6,908 | 34,385 |
| 18 | Kitui | 5,315 | 6,340 | 7,267 | 7,841 | 8,652 | 8,729 | 44,146 |
| 19 | Kwale | 3,749 | 4,473 | 5,126 | 5,531 | 7,248 | 7,536 | 33,662 |
| 20 | Laikipia | 2,523 | 3,010 | 3,450 | 3,722 | 4,500 | 4,113 | 21,318 |
| 21 | Lamu | 1,501 | 1,790 | 2,052 | 2,214 | 2,476 | 3,548 | 13,581 |
| 22 | Machakos | 4,951 | 5,906 | 6,769 | 7,303 | 7,399 | 8,321 | 40,649 |
| 23 | Makueni | 4,366 | 5,209 | 5,970 | 6,441 | 6,825 | 7,128 | 35,939 |
| 24 | Mandera | 6,550 | 7,814 | 8,956 | 9,663 | 9,740 | 10,142 | 52,865 |
| 25 | Marsabit | 3,796 | 4,528 | 5,189 | 5,599 | 6,584 | 7,002 | 32,698 |
| 26 | Meru | 4,749 | 5,666 | 6,494 | 7,007 | 7,701 | 8,007 | 39,624 |
| 27 | Migori | 4,269 | 5,093 | 5,837 | 6,298 | 6,463 | 6,720 | 34,679 |
| 28 | Mombasa | 3,802 | 4,535 | 5,198 | 5,609 | 8,154 | 8,227 | 35,524 |
| 29 | Muranga | 3,917 | 4,673 | 5,356 | 5,779 | 6,191 | 6,249 | 32,165 |
| 30 | Nairobi | 9,506 | 11,340 | 12,997 | 14,024 | 15,402 | 15,794 | 79,062 |
| 31 | Nakuru | 5,936 | 7,082 | 8,116 | 8,758 | 9,271 | 9,451 | 48,615 |
| 32 | Nandi | 3,478 | 4,149 | 4,755 | 5,131 | 5,104 | 5,369 | 27,986 |
| 33 | Narok | 3,868 | 4,614 | 5,288 | 5,706 | 6,523 | 6,374 | 32,372 |
| 34 | Nyamira | 3,039 | 3,625 | 4,155 | 4,483 | 4,621 | 4,773 | 24,694 |
| 35 | Nyandarua | 3,150 | 3,758 | 4,307 | 4,647 | 4,772 | 4,930 | 25,564 |
| 36 | Nyeri | 3,254 | 3,882 | 4,449 | 4,801 | 4,953 | 5,024 | 26,363 |
| 37 | Samburu | 2,598 | 3,099 | 3,552 | 3,833 | 3,805 | 4,427 | 21,315 |
| 38 | Siaya | 3,654 | 4,358 | 4,995 | 5,390 | 5,527 | 6,029 | 29,952 |
| 39 | Taita | 2,421 | 2,887 | 3,310 | 3,571 | 3,896 | 4,051 | 20,135 |
| 40 | Tana River | 2,914 | 3,476 | 3,985 | 4,299 | 5,345 | 5,558 | 25,578 |
| 41 | Tharaka Nithi | 2,295 | 2,737 | 3,138 | 3,385 | 3,684 | 3,642 | 18,882 |
| 42 | Tranzoia | 3,730 | 4,450 | 5,100 | 5,503 | 5,647 | 5,621 | 30,050 |
| 43 | Turkana | 7,664 | 9,143 | 10,479 | 11,307 | 10,072 | 10,770 | 59,436 |
| 44 | Uasin Gishu | 3,797 | 4,530 | 5,191 | 5,601 | 5,708 | 5,935 | 30,761 |
| 45 | Vihiga | 2,832 | 3,379 | 3,871 | 4,177 | 4,409 | 4,459 | 23,127 |
| 46 | Wajir | 5,290 | 6,311 | 7,233 | 7,804 | 8,139 | 8,478 | 43,255 |
| 47 | West Pokot | 3,155 | 3,763 | 4,314 | 4,655 | 4,741 | 4,930 | 25,558 |
| Total | | 190,000 | 226,661 | 259,775 | 280,300 | 302,000 | 314,000 | 1,572,736 |

Source: CRA 2019

Appendix 2: Functions of County Governments

The functions and powers of the county are—

1. Agriculture, including; crop and animal husbandry; livestock sale yards; county abattoirs; plant and animal disease control; and fisheries.
2. County health services, including, in particular; county health facilities and pharmacies; ambulance services; promotion of primary health care; licensing and control of undertakings that sell food to the public; veterinary services (excluding regulation of the profession); cemeteries, funeral parlours and crematoria; and refuse removal, refuse dumps and solid waste disposal.
3. Control of air pollution, noise pollution, other public nuisances and outdoor advertising.
4. Cultural activities, public entertainment and public amenities, including: betting, casinos and other forms of gambling; racing; liquor licensing; cinemas; video shows and hiring; libraries; museums; sports and cultural activities and facilities; and county parks, beaches and recreation facilities.
5. County transport, including: county roads; street lighting; traffic and parking; public road transport; and ferries and harbours, excluding the regulation of international and national shipping and matters related thereto.
6. Animal control and welfare, including: licensing of dogs; and facilities for the accommodation, care and burial of animals.
7. Trade development and regulation, including: markets; trade licences (excluding regulation of professions); fair trading practices; local tourism; and cooperative societies.
8. County planning and development, including: statistics; land survey and mapping; boundaries and fencing; housing; and, electricity and gas reticulation and energy regulation.
9. Pre-primary education, village polytechnics, homecraft centres and childcare facilities.
10. Implementation of specific national government policies on natural resources and environmental conservation, including: soil and water conservation; and forestry.
11. County public works and services, including: storm water management systems in built-up areas; and water and sanitation services.
12. Fire-fighting services and disaster management.

13. Control of drugs and pornography.
14. Ensuring and coordinating the participation of communities and locations in governance at the local level and assisting communities and locations to develop the administrative capacity for the effective exercise of the functions and powers and participation in governance at the local level.

Appendix 3: Objectives, Functions & Indicators of Third Basis

| Public Sector Function | Constitutional Functions & Powers | Indicator of Expenditure | Weight |
|---|--|--|-------------------|
| Objective 1. Enhance services delivery | | | |
| 1.1 Health | <ul style="list-style-type: none"> County health services | Health index | 17% |
| 1.2 Agriculture | <ul style="list-style-type: none"> Agriculture Animal control and welfare | Agricultural index | 10 % |
| 1.3 Other county services | <ul style="list-style-type: none"> Pre-primary education, village polytechnics, homecraft centres and childcare facilities. Cultural activities, public entertainment and public amenities | County population | 18 % |
| 1.4 Public Administration | <ul style="list-style-type: none"> County planning and development Implementation of specific national government policies on natural resources and environmental conservation Ensuring and coordinating the participation of communities in governance at the local level | Basic share index | 20% |
| Objective 2. Promote balanced development | | | |
| 2.1 Infrastructure | <ul style="list-style-type: none"> County transport Trade development and regulation | Land area Rural access index Poverty | 8 % 4 % 14% |
| 2.2 Urban Services | <ul style="list-style-type: none"> Urban services and environment ✓ Control of air pollution, noise pollution, other public nuisances and outdoor advertising. ✓ Fire-fighting services and disaster management. ✓ Control of drugs and pornography. ✓ County public works and services for storm water management, water and sanitation services | Urban households | 5 % |
| Objective 3. Incentivize capacity to raise revenue | | | |
| 3.1 Revenue collection | <ul style="list-style-type: none"> County revenue collection | Fiscal effort index | 2 % |
| Objective 4. Incentivize prudent use of public resources | | | |
| 4.1 Prudent use of public resources | <ul style="list-style-type: none"> Establishment of Internal audit committee Establishment of the County Budget and Economic Forum Expenditure on development Opinion of the External Auditor | Prudence index | 2 % |

Source CRA 2019

Appendix 4: Indices used in the Third Basis

1. Population

Allocation to counties is based on the share of 2009 KHPC with a weight of 18 per cent

$$\text{Population index}_i = \frac{\text{Population in county } i}{\sum_{i=1}^{47} \text{Population in county } i}$$

2. Basic Share

The basic share provides a minimum allocation to all counties. This is allocated a weight of 20 per cent in the sharing framework, of which 19 per cent is shared equally among all counties and one per cent based on the inverse of county's population.

Basic share index

$$= 0.19 * \text{Equal Share index} + 0.01 * \frac{\text{inverse of population in county } i}{\sum_{i=1}^{47} \text{inverse of population in county } i}$$

3. Health

Three variables are used; facility-gap, number of primary health care visits to Level 2 & 3 health facilities and average in-patient days in Level 4 & 5 hospitals. Facility gap is weighted at 20 per cent, primary health care visits weighted at 60 per cent and in-patient days weighted at 20 per cent. The health index is then computed as follows and weighted at 17 per cent;

$$\text{Facility gap factor}_i = \frac{\text{Facility gap funding in county } i}{\sum_{i=1}^{47} \text{facility gap funding in county } i}$$

$$\text{Primary health care factor}_i = \frac{\text{No. of primary health care visits in county } i}{\sum_{i=1}^{47} \text{No. of primary health care visits in county } i}$$

$$\text{In – patient days factor}_i = \frac{\text{No. of in – patient days in county } i}{\sum_{i=1}^{47} \text{No. of in – patient days in county } i}$$

4. Agriculture Services

Allocation to counties is based on the share of rural households as of 2009 census and minimum share. The measure is assigned a weight of 10 per cent.

$$\text{Agriculture Index}_i = 0.005 * \text{Minimum Share index} + 0.095 * \frac{\text{Rural households in county } i}{\sum_{i=1}^{47} \text{Rural households in county } i}$$

5. Urban Services

Allocations to counties is based on the share of urban households as of 2009 census. The weight assigned to this parameter is 5 per cent

$$\text{Urban index}_i = \frac{\text{Urban households in county } i}{\sum_{i=1}^{47} \text{Urban households in county } i}$$

6. Roads

Allocation to counties is based on the share of a population who cannot access all weather roads within 2 km as of 2017 survey. The parameter is assigned a weight of 4 per cent and the index computed as follows;

$$\text{Roads index}_i = \frac{\text{Rural access index in county } i}{\sum_{i=1}^{47} \text{Rural access index in county } i}$$

7. Land Area

Allocation to counties is based on the proportion of county land area, capped at a maximum of 7 per cent. The parameter is assigned a weight of 8 per cent. Below is the computation of land area index,

$$\text{Land area index}_i = \frac{\text{Land area in county } i}{\sum_i^{47} \text{Land area in county } i}$$

8. Poverty Levels

Allocation to counties is based on proportion of poor people in a county as of 2015/16 KIHBS. The parameter is assigned the weight of 14 per cent and the index computed as follows;

$$\text{Poverty index}_i = \frac{\text{No. of poor people in county } i}{\sum_{i=1}^{47} \text{No. of poor people in county } i}$$

9. Fiscal Effort

Allocations to counties is based on the ratio of a county's own revenue collection for 2017/18 to their computed Gross County Product for 2017

$$\text{Fiscal effort index}_i = \frac{\text{OSR collections of county } i}{\text{GCP of county } i}$$

10. Fiscal Prudence

Fiscal prudence indicator is measured based on audit reports of county governments' performance by Auditor General and some PFMA provisions, namely; expenditure on development, establishment of CBEF, and audit committees. The Fiscal Prudence Index for each county is a composite index based on measures as summarised in Table 9

Table 9: Fiscal Prudence Measure

| No. | Variable | Indicator | Score | Responsible | Weighting |
|-----|----------------------------------|---------------|-------|-----------------------------|------------------|
| 1 | Audit Reports | Non-Qualified | 4 | County Executive & Assembly | CE=90% CA=10% |
| | | Qualified | 2 | | |
| | | Adverse | 0 | | |
| | | Disclaimer | 0 | | |
| 2 | Development Expenditure | At least 30% | 1 | County Government | 100% |
| | | Below 30% | 0 | | |
| 4 | Internal Audit Committee | In place | 1 | County Executive & Assembly | CE=90% CA=10% |
| 4 | County Budget and Economic Forum | In place | 1 | County Government | 100% |
| | | Not In place | 0 | | |

Source CRA 2019

$$\text{Prudence index}_i = \frac{\text{Audit Reports}_i + \text{Audit Systems}_i + \text{Development Exp}_i + \text{CBEF}_i}{4}$$

Where

$$\text{Audit Reports}_i = \frac{0.9 * \text{County Executive score}_i + 0.1 * \text{County Assembly score}_i}{\sum_{i=1}^{47} (0.9 * \text{County Executive score}_i + 0.1 * \text{County Assembly score}_i)}$$

$$\text{Audit Committee}_i = \frac{0.9 * \text{County Executive score}_i + 0.1 * \text{County Assembly score}_i}{\sum_{i=1}^{47} (0.9 * \text{County Executive score}_i + 0.1 * \text{County Assembly score}_i)}$$

$$\text{Development Exp}_i = \frac{\text{County Government performance score}_i}{\sum_{i=1}^{47} (\text{County Government performance score}_i)}$$

$$\text{CBEF}_i = \frac{\text{County Government performance score}_i}{\sum_{i=1}^{47} (\text{County Government performance score}_i)}$$

Aggregate Allocation Framework

Total county allocation is equivalent to:

$$\begin{aligned} \text{County Allocation}_i &= 0.18 * \text{Population Index}_i + 0.17 * \text{Health Index}_i \\ &+ 0.10 * \text{Agriculture Index}_i + 0.05 * \text{Urban Index}_i \\ &+ 0.14 * \text{Poverty Index}_i + 0.08 * \text{Land Area Index}_i \\ &+ 0.02 * \text{Fiscal Effort}_i + 0.04 * \text{Roads Index}_i \\ &+ 0.02 * \text{Prudence Index}_i + 0.20 * \text{Basic Share Index}_i \end{aligned}$$