

**COUNTY GOVERNMENTS' SOURCES OF REVENUE: A LEGAL PERSPECTIVE ON  
HOW THE COUNTY GOVERNMENTS ARE FUNDED**

**BY**

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## DECLARATION

I, **Angela Temesi Ambetsa** declare that this thesis is my original work and has not been submitted for the award of a degree in any other university.

Signed: \_\_\_\_\_

Date: \_\_\_\_\_

Researcher: **ANGELA TEMESI AMBETSA**

## APPROVAL

This thesis entitled “**County Governments’ Sources of Revenue: A Legal perspective on How the County Governments are Funded**” has been done under my supervision and has been submitted to the **University of Nairobi, School of Law** for examination with my approval as the candidate’s supervisor.

Signed: \_\_\_\_\_

Date: \_\_\_\_\_

Supervisor: **PROFESSOR ARTHUR ESHIWANI**

## **DEDICATION**

To my Parents, Mr and Mrs Livingstone Ambetsa. Your unwavering support and encouragement brought me this far. This is in your honour.



## **ACKNOWLEDGEMENT**

To you my God, my King, my All... it is you who started the good work in me and I knew you would be faithful to complete it. Here we are!!! Thank you for the grace, thank you for the power and thank you for seeing me through it all. To my supervisor, Arthur Eshiwani, you took the time and heard my concept and you told me to go for it. Thank you for your diligence, patience and thoroughness. To my family: Mum and Dad – thank you for your ceaseless unwavering support and belief in your last born daughter. You made me keep going back and look where I am today. Even when I had given up, you continued praying for me and encouraging me. My siblings: Naphtally, Susan, Biko, Mr & Mrs Waka, Tina, and Chris “Baba”, thank you for encouraging me to keep pressing on and not to quit and for putting up with me. I am eternally indebted to you. My nephews and nieces, Imelda, Karl, Sean, Latisha, Bande, Recho, may your auntie one day be an inspiration to you. To my close friends who stood by me- Vickie, Rose, Makandi, Ruby, Vivian, Maryanne, Ken et all., thank you for standing with me throughout this gruelling journey. To my LL.M (Public Finance and Financial Services Law) classmates: Juliet, Emily, Kuria, Wesonga, Mutembei, Mercy and Wilkister- thank you for enduring the race with me and making it fun while at it. To everyone else that in one way or another helped me along the way, I am most grateful and may our good Lord shower you with His abundant blessings.

**ANGELA TEMESI AMBETSA**

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## **ABBREVIATIONS AND ACRYONYMS**

AIDS	Acquired Immune Deficiency Syndrome
ASAL	Arid and Semiarid Land
BAC	Budget and Appropriations Committee
BPS	Budget Policy Statement
CARB	County Allocation of Revenue Bill
CBF	Constituency Bursary Fund
CBK	Central Bank of Kenya
CDF	Constituency Development Fund
CIC	Commission for Implementation of the Constitution
CKRC	Constitution of Kenya Review Commission
COB	Controller of Budget
CoK	Constitution of Kenya

CORA	County allocation of Revenue Act
CORD	Coalition of Reforms and Democracy
CRA	Commission for Revenue Allocation
DARB	Division of Revenue Bill
DFSRD	District Focus Strategy for Rural Development
DORA	Division of Revenue Act
DPA	Distributable Pool Account
FFC	Financial and Fiscal Commission
FPE	Free Primary Education
FSE	Free Secondary Education
GDP	Gross Domestic Product
HIV	Human Immunodeficiency Virus
KADU	Kenya Africa National Union

KANU	Kenya Africa Democratic Union
KIHBS	Kenya Integrated Household Budget Survey
KRA	Kenya Revenue Authority
LATF	Local Authority Transfer Fund
NMC	National management Committee
NRB	National Rural Development
NT	National Treasury
PEF	Poverty Eradication Fund
PFM	Public Finance Management
RAMLEF	Roads Maintenance Levy Fund
REPLF	Rural Electrification Levy Fund
RMAFC	Revenue Mobilization Allocation and Fiscal Commission
ROK	Republic of Kenya

SEBF	Secondary Education Bursary Fund
SRC	Salaries and Remuneration Commission
TA	Transitional Authority
USA	United States of America
VAT	Value Added Tax
WEF	Women Enterprise Fund
WSTF	Water Service Trust Fund
YEDF	Youth Enterprise Development Fund

## LIST OF STATUTES

### KENYA

*Constituency Development Fund Act (No. 30 of 2013)*

*Constitution of Kenya 2010.*

*Contingencies Fund and County Emergencies Funds Act (2011)*

*County Allocation of Revenue Act (No.34 of 2013)*

*County Government Act (No.17 of 2012)*

*County Governments Public Finance Management Transitions Act*

*Division of Revenue Act (No. 31 of 2013, No. 12 of 2014)*

*Energy Act (No. 12 of 2006)*

*Inter-Governmental Relations Act (No.2 of 2012)*

*Local Authority Transfer Act (Cap 265 laws of Kenya)*

*National Governments Loans Guarantee Act (No.18 of 2011)*

*Public Finance Management Act (No.18 of 2012)*

*Road Maintenance Levy Fund Act (No. 9 of 1993)*

*Transition to Devolved Government Act (No. 1 of 2012)*

*Urban Areas and Cities Act (No.13 of 2012)*

## **GERMANY**

The Constitution of the Federal Republic of Germany (Basic Law)

## **SOUTH AFRICA**

The Constitution of South Africa

## **NIGERIA**

The Constitution of the Federal republic of Nigeria 1999

## **ABSTRACT**

The promulgation of the new Constitution in 2010 and the subsequent General Elections held in 2013 saw the establishment and commencement of operations of the 47 new County Governments. This was in line with the concept of devolution which was firmly anchored in the new Constitution. The previous constitution lacked principles to guide equitable division of national resources, and consisted of highly centralized structures which concentrated power under the executive arm of the government. The legislature hardly had a say in governance matters. This led to regional imbalances as some regions were favored while others were marginalized and lagged behind in terms of development. Although there were some efforts undertaken by the government to decentralize revenue (e.g. CDF, LATF, RMLF, CBF etc.), these programs suffered largely due to lack of adequate funding and corruption. The new Constitution therefore was much welcome remedy to correct these previous abuses by the central government. Not only does it entrench devolution, it also dedicates an entire chapter that governs the management of public finance. This study looks at County Governments' sources of revenue and the challenges thereon by reviewing and appraising the legal framework governing revenue allocation in Kenya under the new Constitution. The study highlights the significant provisions of the laws, critiques the legal framework and draws lessons from another jurisdiction in equitable distribution of national resources in devolved governance. In conclusion, the study makes suggestions on the way forward to ensure that the legal framework remains effective in ensuring equitable distribution of resources.



## CHAPTER ONE

### INTRODUCTION

#### 1.1 BACKGROUND OF THE STUDY

The struggle for constitutional reforms in Kenya has been a long daunting journey, but arguably fruitful. It was mainly rooted in the resolve to correct deficiencies in the post-independence governance framework which was ordained by a highly centralized system of governance that was bestowed by the colonialists.<sup>1</sup>

The central theme running through the various stages during the struggle for reforms has been bringing the national resources closer home to the grassroots levels. This way, the local *mwananchi* will have access to and enjoy basic services such as health, housing and education which haven't been easily accessible to many as a result of rampant inefficiency fueled by corruption and impunity.<sup>2</sup> The people felt detached from the government and exercised no control over the decisions on matters affecting their day to day lives.<sup>3</sup> The culmination of the struggle for reforms was the promulgation of the new Constitution in 2010 which fundamentally altered the governance

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<sup>1</sup> Task Force on the Devolved Government (2011). Final Report of the Task Force on Devolved Government: *A report on the Implementation of Devolved Government in Kenya*. 1.10

<sup>2</sup> Ibid, The Report notes that:

“The post-independence governance framework was characterised by poor governance as evidenced by corruption, ethnic conflict, insecurity, political uncertainty; and poverty. Some of the negative outcomes include the alienation of large portions of society from the mainstream economy; wasteful public investments; massive poverty and ethnic animosity; and cut-throat political competition and intolerance.

<sup>3</sup> Ibid, at p 14 “In excluding local people from the making of decisions that affected their lives, centralisation failed to facilitate local solutions to local problems. This occasioned wastage of resources and misguided priorities. Frustrations arising from the centralized system laid the ground for the struggle for the democratization reforms of the 1990s and for the CoK 2010. This struggle forced the state to introduce various strategies for addressing the problems of the centralized state, including muted efforts at fiscal decentralisation.

framework by entrenching the principle of devolution of political power, responsibilities and resources.<sup>4</sup>

Devolution as envisaged in the Constitution of Kenya entails the sharing of political, administrative and fiscal functions between the National and County Governments. The Kenyan case of geographical or regional inequalities makes a forceful case for devolution as a means of equalizing underdeveloped regions. The Constitution of Kenya 2010 has provided an opportunity and new stimulus for the government to refocus and reengineer its efforts on equity and poverty reduction.<sup>5</sup> In order to do so, a sound legislative framework must be developed that takes into account equity in resource allocation.<sup>6</sup> This is because the constitution is not conclusively self-enforcing. The unit of devolution in Kenya is the county and there are a total of 47 counties. The criteria for distribution of finances at the county level includes but is not limited to geographic size, population density, equity in amounts per county, levels of development of the county, amount and level of infrastructure in the county, amount of natural resources in a county and how much is or can be generated by a county.

Naturally, some counties are more endowed with resources than others or have the capability of generating more resources than others. The National Government role therefore is to be careful in ensuring that resources are distributed in an equitable manner to ensure that each county will be

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<sup>4</sup> Ibid, “The adoption of the CoK 2010 aims at fundamentally altering the governance framework through far reaching reforms. Of these, devolution of political power, responsibilities and resources have the most profound and transformative impact on governance and management of resources. If faithfully implemented, the CoK 2010 in general, and devolution in particular, should lead to revolutionary transformation of Kenya and facilitate achievement of Kenya Vision 2030.

<sup>5</sup> Mukui, J. T. (2012). Inequalities in Kenya: Implications for Development and Revenue Sharing. Retrieved on 22<sup>nd</sup> from <<http://http://www.scribd.com/doc//Inequalities-Revenue-Sharing-in-Kenya-117395841Mukui>>

<sup>6</sup> Ibid.

allocated an amount that will enable it to meet its budgetary projections and the needs of its population.

Kenya has over the years faced challenges in ensuring that there is regional balance in sharing of the “national cake”. This has resulted to both horizontal and vertical socio-economic inequality and disparity in development and growth of regions. Additionally, a culture of poor governance, corruption and negative ethnicity has exacerbated the gravity of regional inequality.<sup>7</sup> Inequitable resource allocation has not only contributed to poverty levels and marginalization in Kenya but also brought discontent and disunity among different communities.<sup>8</sup> Economic growth is skewed towards urban centres and regions supporting the ruling elite with just half the current counties generating 80% of the economic activities.<sup>9</sup> On the other hand, the poverty index in the counties of Wajir, Marsabit, Turkana and Mandera was at 80% which is double the national average.<sup>10</sup> Historical public spending practices and practices have reinforced, rather than mitigated, these disparities.

Inequality and inequitable distribution of resources among other things, has been the main cause of social vices such as robbery among youths, calls for secession, excessive waste of natural resources, insecurity and regional/ethnic conflicts including 2007/2008 post-election conflicts.

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<sup>7</sup> World Bank. 2012. *Main report*. Vol. 2 of *Devolution without disruption: pathways to a successful new Kenya*. Washington, DC: World Bank <http://documents.worldbank.org/curated/en/2012/11/16964608/devolution-without-disruption-pathways-successful-new-kenya-vol-2-2-main-report> Accessed 23<sup>rd</sup> September 2013

<sup>8</sup> Suri, T., D. Tschirley, Irungu, C. R. Gitau and D. Kariuki. (2008). *Poverty, Inequality and Income dynamic in Kenya, 1997-2007*. Tegemeo Institute Working Paper Series, No. 030/2008.

<sup>9</sup> Watkins, K., & Alemayehu, W. (2012). *Financing for a fairer, more prosperous Kenya: A review of the public spending challenges and options for selected arid and semi-arid counties* (Centre for Universal Education Working Papers No 6 of 10) <http://http://www.brookings.edu/research/reports/2012/08/financing-kenya-watkins>> Accessed on July 11, 2013

<sup>10</sup> Ibid. “Poverty incidence in several counties reaches levels in excess of 80%. Poverty in the ASAL counties is also more intense.”

Devolution was, thus, proposed as response to the historical ills that have bedevilled Kenya.<sup>11</sup> Centralized government systems had over time hindered effective public services delivery in Kenya.<sup>12</sup> Effective decentralization would therefore bring about efficient and accountable service delivery as decision making is vested in the lowest feasible level and implementation of such system leads to the optimization of information flow and reduction in transaction costs.<sup>13</sup>

The post-independence structures inherited from the colonial regime increased the gap between the Central Government and the people at the grassroots. This necessitated a reduction of the unnecessary layers of government to make service provision to the populace more effective.<sup>14</sup> Soon after independence, the first attempt towards decentralization was in 1964 with the establishment of the neo-federal (Majimbo) constitution which created regions to which local authority were supposed to be responsible. However, the new Constitution was never implemented.<sup>15</sup>

Another attempt towards decentralization was made in 1969 with the establishment of National Rural Development, meant to address needs of people in the rural areas as envisaged in the Occasional Paper No. 8 of 1982. However, this program did not meet the intended objective. As a

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<sup>11</sup> Institute of Economic Affairs. (2010). Devolution in Kenya: Prospects, Challenges and the Future (Series No. 24). p.8 [http://www.ieakenya.or.ke/publications/doc\\_download/181-devolution-in-kenya-prospects-challenges-and-future](http://www.ieakenya.or.ke/publications/doc_download/181-devolution-in-kenya-prospects-challenges-and-future) Accessed on 8th October 2013 “ Devolution has been advocated as a political response to the ills plaguing fragile and plural societies, such as, conflicts, inequalities, rent seeking, economic stagnation, corruption and inefficient use of public resources.

<sup>12</sup> Mwabu, G., & Kibua, T. N., (2001). *Decentralization in Kenya: New approaches*. University of Nairobi Press.p23

<sup>13</sup> Nyanjom, O. (2011). *Devolution under Kenya's new Constitution* (Working paper No. 4). Retrieved from Society for International Development website: <http://http://www.sidint.net/content/working-papers> on 23<sup>rd</sup> August 2013

<sup>14</sup> Bagaka, O. (2008). *Fiscal Decentralization in Kenya: The Constituency Development Fund and the Growth of Government* (October 23, 2008). Proceedings of 20th Annual Conference of the Association for Budgeting and Financial Management, Chicago, October 23-25, 2008

<sup>15</sup> Ghai, Y.,(2013). *History and Objectives of Devolution*. *The Star*, < <http://www.the-star.co.ke/>> Accessed April 20, 2013

result, between 1983 and 1984, District Focus Strategy for Rural Development (DFSRD) was launched with a focus to strengthen co-ordination of development activities including planning and implementation of projects in rural areas by making districts the central units for rural development. While the strategy was implemented, it however, failed to meet its intended objectives.<sup>16</sup>

There are various institutionalized devolved funds within the constituencies for different purposes aimed at empowering the common *mwananchi* at the grassroots level.<sup>17</sup> However, of all the efforts and among the many institutionalized devolved funds, the Constituencies Development Fund (CDF) is the most recognized fund in its devolution efforts.

In cognizance of the historical injustices that have faced the country and driven by vision to attain high economic growth, reduce individual and regional income disparity and other poverty related inequalities, the Constitution of Kenya 2010 entrenched the concept of devolution by seeking to promote parity in socio-economic development and end past administrative injustices by providing for the creation of facilitative legislation, checks and balances on executive power, independent institutions, and facilitating public participation in governance to safeguard against abuse of

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<sup>16</sup>Okungu, J., (2008). The Beauty and Shame of Kenya's Constituency Development Fund – CDF. <[www.afroarticles.com/article-dashboard/Article](http://www.afroarticles.com/article-dashboard/Article)> Accessed April 15, 2013. The intended objectives of DFSRD were: Planning for regional balance, improving administration of district planning and project implementation, and rationalising finance and budget management systems.

<sup>17</sup> These include: Constituency Bursary Fund (CBF) was meant for needy students, Constituency HIV/AIDS Fund supports people living with HIV/AIDS while Constituencies Development Fund (CDF) meant for promoting development within the constituency. These funds that were utilized at the district level include Local Authority Transfer Fund (LATF) for the improvement of service delivery, financial management and reduction of the outstanding debt of local authorities, Free Primary Education Fund (FPE) and Free Secondary Education Fund (FSE) meant to reduce educational access or disparity. Other funds at the district level were: Roads Maintenance Levy Fund (RAMLEF), Rural Electrification Levy Fund (REPLF) and Water Service Trust Fund (WSTF) to improve infrastructure in rural areas, and Women Enterprise Fund (WEF) among others.

power. The Constitution recognizes the right of communities to manage their own affairs and further their development which would impart, on the people, a sense of identity and self-empowerment. This is in line with the objectives of devolution which are enshrined in the Constitution.<sup>18</sup>This study shall therefore examine all the various sources of revenue available to County Governments as provided under the legal framework. The study will also analyse the extent in which these sources of revenue have served in achieving equity in revenue allocation.

## **1.2 STATEMENT OF THE PROBLEM**

Promulgation of the new constitution in 2010 brought with it high hopes for Kenya owing partly to devolution of resources to the county level. This implies that local citizens will have a say in the spending of public funds. County Governments cannot thrive without adequate and timely funding. The Constitution provides for two broad sources of County Governments' source of funding. These are the revenues transferred to them by the National Government and the revenues they raise on their own. The need for proper and sound legal framework to govern the generation and allocation of revenue can now be appreciated, if devolution is to succeed.

There have been numerous debates revolving around the sufficiency of funds available to County Governments. Several battles have been waged between members of the Senate and the National

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<sup>18</sup> Article 174 (a-g) of the Constitution of Kenya. "To promote democratic and accountable exercise of power; foster national unity by recognising diversity; to give powers of self-governance to the people...; recognize the right of communities to manage their own affairs and to further their development; protect and promote the interests and rights of minorities and marginalized communities; promote social and economic development and the provision of proximate, easily accessible services throughout; ensure equitable sharing of national and local resources throughout Kenya.

Assembly concerning the division of revenue between the two levels of government.<sup>19</sup> The Opposition, together with the Governors have embarked on nation-wide campaigns to garner support from members of the public to amend the Constitution by way of a referendum, to increase the 15% equitable share from the National Government to 45%. This study seeks to appraise the legal framework governing the sources of revenue from which the County Governments are funded. The study further explores the challenges facing the various sources of funding and makes recommendations thereon.

### **1.3 SIGNIFICANCE OF THE STUDY**

Arguably, the new Constitution marked the end of the dark past and ushered in a new Kenya with renewed hopes, through its radical changes, of equal and equitable socio-economic development of all regions in Kenya. It has provided a solid legal and institutional framework for the recognition and protection of the rights of minorities and those of marginalised groups.<sup>20</sup> It marked a break

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19 Ondari, D. (Nairobi, 21st June 2014) Controversy on Division of Revenue Welcome now. *The People Daily*. <<http://www.mediamaxnetwork.co.ke/thepeople/85630/controversy-division-revenue-bill-welcome-now>> Accessed 23rd August 2014. The National Assembly made a move to reject proposed amendments to the Division of Revenue Bill by the Senate, accusing the Senate of conspiracy to cut down government programs. "The committee argued that the Senate's decision if implemented will require an additional amount of money over and above the Sh226.6billion which is not available as this is above the set amount in the Constitution, which is 15 per cent of the national budget." One major bone of contention in the Division of Revenue Bill 2014 was that of funding of Level 5 Hospitals. In an amendment to the bill the Senate proposed an allocation of Ksh 3.74 billion to the Level % hospitals which the National Assembly rejected claiming that this move would significantly reduce the National's government share of revenue. The dispute was referred to a mediation committee comprised of members of both houses pursuant to Article 113 of the Constitution. Also in 2013, the Senate cried foul over the move by the National Assembly to pass the Division of Revenue Bill without seeking consensus from the two houses. This was referred to the Supreme Court for an advisory opinion which stated that indeed the Division of Revenue Bill was a Bill concerning counties and the Senate had power to exercise oversight in the manner in which funds were allocated to county governments.

20 F. E. Stiftung, (2012). *Regional Disparities and Marginalisation in Kenya*. Nairobi: Elite Prepress Ltd <<http://www.fes-kenya.org/media/publications/2013/Regional%20Disparities%20Book.pdf>> Accessed on 1st August 2014

from the past where unbalanced regional development, buoyed by discriminative policies of the colonial power and readily adopted by the power elite of post-independence period, was the norm.<sup>21</sup> Owing to the imbalanced distribution of resources from region to region, the disparity was at some point perceived as taking tribal lines.<sup>22</sup>

From the foregoing, the study will enable policy makers (governments, both at national and county level, and the independent commissions charged with revenues allocation) effectively implement or adjust the legal framework and practices guiding resource allocation so as to bring about equitable distribution and allocation of national resources and promote equal socio-economic growth as envisaged in the Constitution.

The study will also be important for pedagogical purposes as students and researchers will learn about socio-economic disparity in Kenya and legal perspective resource allocation policies, both current and past.

#### **1.4 RESEARCH METHODOLOGY**

Research methodology refers to the sum total of the techniques and procedures of collecting data, analyzing it and presenting the findings. There are two research designs and methodologies available to a researcher while conducting a study. Primary research refers to the first hand research conducted through primary sources of data in which the information first appeared. This includes

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21 Ibid.

22 Muhula, R., (2009) Horizontal Inequalities and Ethno-regional politics in Kenya. Kenya Studies Review (KSR) 1(1), 85-105)



an original study, an original document, observation, interviews and participation. It involves formulation of questionnaires, actual fieldwork and thereafter collating the findings.

The Constitution of Kenya 2010 and subsequent legislation thereto form the main source of primary data in which this study relied upon. The Constitution entrenched the concept of devolution which occurs under three spheres i.e. political, administrative and fiscal. Fiscal devolution is this study's main focus. The study analyses the provisions of Chapter 12 of the Constitution which is dedicated entirely to matters concerning revenue allocation. Additionally, the study analyses the various Acts of Parliament passed to govern the management of public finance in Kenya.

This study also used secondary research. This based on the findings from the analysis other people's research from primary sources. It involves the gathering of the results of other's research from books, articles, journals and other sources from the Internet. This study has selected specific data relating to the research questions and has summarised the findings in accordance with the study's research objectives.

Secondary research is suitable for this study owing to the wide scale trends of research that this study has examined. Further, secondary research was the only option available in as far as historical data used in this study is concerned.

Pursuant to the secondary research conducted, this study further adopted an exploratory method.<sup>23</sup> The choice was guided and informed by the fact that there is very little research on the legal framework on revenue allocation. This is attributable to the fact that the reality of the devolution process as made effective following the conclusion of the March 2013 General Elections which saw Kenyans elect their county representatives for the first time under the new constitution.

## 1.5 RESEARCH QUESTIONS

The following research questions have guided this study so as to achieve the objectives stated below:

- i. Are the sources of funding available to County Governments sufficient for them to run their operations?
- ii. What are the challenges currently facing equitable revenue allocation in County Governments in Kenya?
- iii. Is the current legal and institutional framework sufficient to guide equitable revenue allocation in Kenya?
- iv. What lessons can Kenya learn from other jurisdictions necessary to address the challenges facing equitable revenue allocation?

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<sup>23</sup> An exploratory research intends to explore mainly the research questions that help in having a better understanding of the problem. See also Mugenda, O., & Mugenda, A. (Ed.) (2003). *Research Methods: Quantitative and Qualitative Approaches*. Africa Centre for technology Studies. p 35.

## **1.6 RESEARCH OBJECTIVES**

The study seeks to establish the following:

- i. whether the sources of revenue available to county governments will enhance equitable revenue distribution in Kenya.
- ii. whether the legal and Institutional framework governing revenue allocation is effective in guiding the equitable revenue allocation in Kenya;
- iii. whether there are any vital lessons that Kenya can borrow from the legal framework of other jurisdictions on how their legal framework have addressed the issue of equitable division of revenue;
- iv. the challenges facing County Governments' equitable allocation of revenue in Kenya;
- v. Finally the study summarises the findings and makes some suggestions on the way forward.

## **1.7 HYPOTHESES**

The study will be premised on the following hypotheses:

- i. County governments are not adequately funded to run their operations;

- ii. There are gaps in the legal and institutional framework which if not addressed threaten the equitable distribution of resources;
- iii. Kenya can draw vital lessons from other jurisdictions on how to further develop its legal framework to ensure that equity is achieved when it comes to resource distribution.

## 1.8 THEORETICAL FRAMEWORK

This section is a discussion on selected theories that have shaped this study. These theories are largely focused on the extent in which equity is achieved in revenue allocation. While there is no certain moral principle as to how to achieve equity in revenue allocation, it often follows theories of justice.<sup>24</sup> Justice has been described as “fair, equitable and appropriate treatment in the light of what is *due* or *owed* to an individual”.<sup>25</sup> As such, injustice is a wrongful act or omission which “denies people benefits to which they have a right, or which fails to distribute burdens fairly”.<sup>26</sup> The theoretical framework has, therefore, focused on consequential theories that advocate for equity and justice.

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<sup>24</sup> Asante, A. D, Zwi, A. B. & Ho, M. T., (2006) .Equity in Resource Allocation for Health: A Comparative Study of the Ashanti and Northern Regions of Ghana. *Health Policy Journal*, 78, 135– 148.

<sup>25</sup> Kirigia, D. G., (2009). Beyond Needs-Based Health Funding: Resource Allocation and Equity at the State and Area Health Service levels in New South Wales – Australia. PhD Thesis, *University of New South Wales, Australia*, p.48.

<sup>26</sup> Ibid.

### 1.8.1 Distributive justice theory

Distributive justice is concerned with sharing rewards and costs in a socially just manner. Glaring inequalities rarely occur in a society enjoying distributive justice.<sup>27</sup> This theory factors the availability and quantity of resources, the process of distribution and the resulting allocation of the resources to the society. This theory is applicable to this study in the determination of whether the revenue options available to County Governments is sufficient.

Distributive justice is not merely premised on administration of law but on outcomes based on the following distributive norms: equity, equality, power, need and responsibility.<sup>28</sup> The first norm of equity implies that those who contribute more are automatically entitled to get more.<sup>29</sup> In the context of revenue allocation in this study, this theory would imply that counties would receive revenue from the National Government in proportion to the revenue that they individually raise or collect. As this study will demonstrate, this theory is not sustainable as it wouldn't achieve the desired constitutional objectives.

The second norm is equality, which implies that society gets equal treatment (reward and cost) regardless of one's contribution.<sup>30</sup> Again, this study will demonstrate that this approach isn't sustainable as different counties have various needs and resource requirements, some more than others. The third norm is power, where those with control, authority or status get more than those

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<sup>27</sup> Forsyth, D. R., (2006). *Conflict*. In *Forsyth, D. R. Group Dynamics*. (5<sup>th</sup> ed.). (p.388 - 389) Belmont: CA, Wadsworth, Cengage Learning.

<sup>28</sup> Deutsch, M., (1975). Equity, Equality, and Need: What Determines Which Value Will Be Used as the Basis of Distributive Justice? *Journal of Social Issues*, 31, 137–149.

<sup>29</sup> Ibid.

<sup>30</sup> Ibid.

with less.<sup>31</sup> This study will demonstrate that counties that double up as cities require more revenue allocations as a result of their status and population as compared to the counties in the rural setup. The fourth norm is need. This implies those in greatest need get more than those without, regardless of input. This, as we will see, is not entirely practical as there are other factors that are taken into consideration when it comes to allocation of revenue. The last norm is responsibility, whereby those who have are expected to share with those without.<sup>32</sup> This will be demonstrated in this study in the analysis of the revenue allocation formula. Many decentralised governments are guided by this theory when it comes to decisions on the sharing of national revenue and creating the most equitable formula for revenue allocation.

### **1.8.2 Social justice theory**

Social justice can be said to exist when "all people share a common humanity and therefore have a right to equitable treatment, support for their human rights, and a fair allocation of community resources."<sup>33</sup> Where social justice exists, there is no discrimination on the basis of gender, sexuality, religion, political affiliations, age, race, belief, disability, location, social class, socioeconomic circumstances, or other characteristic of background or group membership.<sup>34</sup> This study has adopted this theory as demonstrated by the provisions of the Constitution of Kenya as seen in the objectives of devolution as well as in the principles of public finance which advocate inter alia for the equitable sharing of national and local resources throughout Kenya.<sup>35</sup>

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<sup>31</sup> Ibid.

<sup>32</sup> Ibid.

<sup>33</sup> Robinson, M., (2010). *What is Social Justice?* Appalachian State University. Department of Government and Justice Studies. <http://gjs.appstate.edu/social-justice-and-human-rights/what-social-justice>> Accessed 24<sup>th</sup> June 2013

<sup>34</sup> Ibid

<sup>35</sup> Constitution of Kenya 2010 Article 174; 201 (b).

### 1.8.3 Utilitarianism

The Utilitarian theory is yet another theory that inspires this study. It advances that allocation of resources needs to create most “good” for highest number of people as a means of maximizing value.<sup>36</sup> Utilitarianism postulates society is considered to be just to the extent that its laws, policies and institution fosters its members’ greatest average or overall happiness.<sup>37</sup>

Utilitarianism recognizes that actions have multiple consequences, some of which are good and some of which are harmful. Utilitarianism is thus committed to the maximization of good and the minimization of harm. As a philosophy for business, it focuses attention on the need to weigh carefully all of the benefits and costs of a business action and to pursue only those actions where the benefits outweigh the costs.<sup>38</sup>

This theory has guided this study in its review of the legal framework guiding revenue allocation as it takes into consideration the various stakeholders’ interests in revenue allocation since it forces decision makers to (i) consider collective as well as particular interests, (ii) formulate different alternatives based on the greatest good for all parties involved in a decision and (iii) estimate costs and benefits of alternatives for different groups affected.<sup>39</sup> The theory in the context of this study therefore implies that the overall good is achieved by ensuring that the county governments are adequately funded to ensure that that the counties achieve an improved per capita income,

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<sup>36</sup> Macklin R., (1987). *Mortal Choices*. Houghton Mifflin Company, Boston, 149-164

<sup>37</sup> Slote, M., (1995). *The Main Issue between Unitarianism and Virtue Ethics. From Morality to Virtue*. Oxford University Press. (pp. 227–238)

<sup>38</sup> Hill, W., C., (6<sup>th</sup> Ed). (2009). *Global Business Today*. McGraw-Hill Irwin New York. p 145.

<sup>39</sup> Weiss W. J., (1994). *Business Ethics: A Managerial Stakeholder Approach*. Belmont, California: Wadsworth Publishing Company. p 80.

employment rate, level of education and healthcare system, distribution and redistribution of wealth in line with the objectives of devolution under the Constitution.

Utilitarian's aver that liberty and freedom- both economic and political- are indispensable requisites for happiness. They further contend that in a just society, the government, its institutions, laws, policies and economy must enable as many people as possible to have the opportunity and means to realize their conception of desirable life. Therefore, reforming the institutions towards this objective is in pursuit of greater justice.<sup>40</sup> This is significant in this study's review of the legal and institutional framework responsible for the management of public finance in Kenya.

Utilitarianism is however abstract to the extent those measures of aggregate good are varied and extremely subjective. In the context of this study's analysis of revenue allocation to county governments, there are several dynamics that come into play and law makers have to be careful to balance these dynamics and rank them according to their priority. Nevertheless, the theory approaches the matter indirectly and looks at the presumption of human good; that is, what is required for human beings to flourish is what is good for them and approach this on account of organization and social conditions germane to the realization of this good. <sup>41</sup>Therefore, the legal framework as will be discussed in this study should aim at promoting the good and welfare for the greatest number of individuals. This in effect means that it should promote to the greatest extent possible, equity amongst the 47 counties by ensuring that essential services are brought closer to the people and are run in a more professional, efficient, transparent and in an accountable manner.

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<sup>40</sup> Bredeson, D., (2011). *Utilitarianism vs. Deontological Ethics. Applied Business Ethics: A Skills-Based Approach*. Cengage Learning. p. 7–10.

<sup>41</sup> Ibid.



## **1.9 LITERATURE REVIEW**

The 1963 Constitution did not provide for revenue sharing between national and sub-National Governments leading to poor service delivery at the grassroots level. The 2010 Constitution has brought about major reforms in public finance management. However, most of the legislation on the sharing of revenue was enacted after the 2013 general elections. This explains the fact that there is limited literature on this topic. This study therefore delves into the murky waters of revenue allocation amongst and within the newly formed County Governments. Some of the literature I came across is discussed below.

### **1.9.1 Devolution and Revenue Allocation**

Javas Bigambo looks at devolution by attempting to assess its design and how it shall be implemented.<sup>42</sup> He looks at devolution's intended objective of being an instrument of prompting public participation in decision making with regard to revenue allocation. He also assesses the challenges devolution may bring with regard to revenue allocation and appropriate resource distribution.<sup>43</sup> Bigambo traces us back to the history of the devolution process from the clarion calls by the Civil Society to the eventual enactment of the Constitution of Kenya that introduced a new governance style of a devolved government that would see the introduction of different administrative units in a bid to ensure that service delivery is brought closer to the people. He

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42 Bigambo, J., (2012). County Governments and the challenges of revenue allocation: Perspectives of efficiency, service delivery and resource distribution. <http://bigambo.wordpress.com/2012/07/20/county-governments-and-the-challenges-of-revenue-allocation-perspectives-on-efficiency-service-delivery-and-resource-distribution>. Accessed on 17 August 2014.

43 Ibid.

further observed that the new devolved system combines self-governance and shared governance at the local and national levels, respectively.<sup>44</sup>

Bigambo further observed that devolution (decentralization as often referred to) has three fundamental dimensions, which may occur independently or jointly: the administrative, the political and the fiscal. The fiscal aspect of decentralization will be the main focus of the study. He mentions two key principles that guide revenue allocation in devolved units: vertical revenue sharing and horizontal revenue sharing.<sup>45</sup>

This study shall delve deeper in the analysis of these two principles in order to determine whether the legal framework promotes equitable sharing of resources. Bigambo in his paper failed to discuss all the sources of revenue available to County Governments which this study has exhaustively discussed, to the extent to whether these sources promote equity in resource allocation.

Bahl and Wallace examine the vertical sharing of revenue in a two-fold step. Firstly, they quantitatively analyze the trends and cross-country variations in revenue sharing with a view of establishing the determinants of the vertical share of revenue between levels of government.<sup>46</sup>

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44 Ibid. p 2

45 Ibid. p 3 para 2. "There are two principles that guide revenue allocation. The first is the vertical sharing between the federal or inclusive government and other tiers of governments. The subject sharing schemes is the federally collected revenues. This is because the revenues generated within the jurisdictional areas of the devolved units are not subject to the national sharing formula. Another principle of revenue transfer is horizontal revenue sharing arises out of the variations in revenue generation capacities of the devolved units. Where revenue raising capacities are low, heavier tax burden is imposed relative to higher revenue raising capacities area. This transfer is called "equalization transfer". This transfer is necessary because higher taxation will scare away businesses and the economy of the devolved unit will become more depressed."

<sup>46</sup> Bahl, R. and Wallace, S., (2004). *Intergovernmental Transfers: The Vertical Sharing Dimension*. Working Paper 04-19. Andrew Young School of policy studies <<http://isp-aysps.gsu.edu>> Accessed on 26<sup>th</sup> August 2014.

They use the taxonomy of intergovernmental transfers developed by Bahl and Linn which provides three common approaches to determining the size of the vertical dimension of revenue allocation.<sup>47</sup>

This may be determined (i) as a share of central government revenue, (ii) on an ad-hoc basis, or, (iii) on a basis of cost reimbursement.<sup>48</sup>

Secondly they offer a description of the range of the practice in vertical sharing by attempting to answer the questions as to why some countries choose larger vertical shares than others and why have some countries grown their vertical shares over the years more than others.<sup>49</sup> This analysis gives insight to this study as it examines the 15% equitable share of revenue allocated to County Governments as stipulated in the Constitution, as compared to other models of revenue sharing models adopted by other countries. This study evaluates the impact of the vertical sharing arrangements guided by criteria set in the Constitution.

Obinna holds that revenue allocation is the process of sharing centrally collected funds first between the relevant layers of government and then, among units of the same layer.<sup>50</sup> The sharing of funds among these devolved layers of government can be referred to as vertical allocation, whereas the distribution of funds among units of the state is referred to as horizontal allocation.<sup>51</sup>

In the words of James O'Connor, "allotments of money (and resources) must reflect social and economic conflicts between classes and groups."<sup>52</sup> It is not surprising, therefore, that the basis of

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<sup>47</sup> Ibid. See also Bahl, R. W. and J.F. Linn. (1992). *Urban Public Finance in Developing Countries*. Oxford University Press.

<sup>48</sup> Ibid.

<sup>49</sup> Ibid.

<sup>50</sup> Obinna, O.F., (1997). Public Finance. *Ibadan Journal of Multicultural/Multidisciplinary Studies Volume 8-9*. Pacific Press Ltd. p96-97.

<sup>51</sup> Ikunga, S., (2013). The Politics of Revenue Allocation and Socio-economic Development of Emohua Local government Area, Rivers State, Nigeria. *Research on Humanities and Social Sciences*. Volume 3 (3), 90-94.

<sup>52</sup> O'Connor, J., (1993). *The Fiscal Crisis of the States*. New York: St. Martin's Press: p. 276

devolved statutory revenue allocation has always been one of the most contentious and destabilizing factors in a country's polity. This is because there is a thin line of distinction between the economics and politics of a country.<sup>53</sup>

From the foregoing, devolution raises three salient problems. These are: (a) how to allocate functions rationally, (b) how to allocate taxing powers, and (c) how to share revenue between the governments."<sup>54</sup> In Nigeria, for instance, five major objectives that revenue allocation formula must accomplish include: (i) national unity; (ii) economic growth, (iii) balanced development, (iv) self-sufficiency and (v) high standard of living for the citizens. Yet, the challenge in Nigeria to date is developing a revenue allocation formula which will not only achieve the above objectives but that will also resolve its complex revenue allocation problems that have engulfed the country since independence. Thus, on several occasions, successive governments have been revising revenue allocation formula, of which is to date, elusive.<sup>55</sup>

Salami (2011)<sup>56</sup> discusses the revenue sharing arrangements in Nigeria outlining the two levels of sharing, on one hand being the vertical revenue allocation among federal, state and local councils, and on the other hand, the horizontal allocation among the states and the local governments. He further discussed at depth the principles governing revenue sharing/allocation among states/local governments in Nigeria. These are: equality, population, social development, internally generated

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<sup>53</sup> Ekeh, P. P., (1994). *The Public Realm and Public Finance in Africa*. London: James Curray Limited. P.234.

<sup>54</sup> Adebayo, A. G., (1990). The Ibadan Schools and the Handling of Federal finance in Nigeria. *Journal of Modern African Studies*, 28(2), 245-264: 246

<sup>55</sup> Ojo, E. O., (2010). The Politics of Revenue Allocation and Resource Control in Nigeria: Implications for Federal Stability for Federal Governance. Department of Political Science. University of Ilorin, Nigeria. Volume 7(1), 15-38 p.15. <<http://library.queensu.ca/ojs/index.php/fedgov/article/download/4387/4405>> Accessed on 12th July 2014.

<sup>56</sup> Salami, A., (2011). Taxation, Revenue Allocation and Fiscal Federalism in Nigeria: Issues, Challenges and Policy Options. *Economic Annals* Volume LVI, No. 189. *Scientific Papers* < <http://www.doiserbia.nb.rs/img/doi/0013-3264/2011/0013-32641189027S.pdf>> Accessed on 22nd August 2013.

revenue and land mass/terrain.<sup>57</sup> He contends that these principles represent factors that govern the application of revenue allocation and that the formula refers to their relative weight attached to each principle.<sup>58</sup> Salami's discussion is important to this study as it gives insights to the principles of revenue sharing in Nigeria which this study will compare to the principles governing revenue allocation in Kenya.

He further explains the vertical allocation of federally collected revenues among the tiers of government giving the percentages and how these has changed before independence to date, noting that the federal's government's share has been on the decline in favor of the lower tiers of government. This is a clear indication that there is serious commitment to decentralization in Nigeria. In Kenya, the devolved units are entitled to only 15% of national budgetary allocation annually. This explain the calls by county representatives to amend the laws that will see that County Governments are allocated a much larger share of the national revenue, for effective service delivery. This study shall discuss the basis for such calls to increase this percentage and discuss its impact on service delivery.

### **1.9.2 Challenges of Revenue Allocation in Kenya**

John Mukui highlights the nature of inequalities in Kenya and their implications for growth strategies, poverty eradication and revenue sharing.<sup>59</sup> He discusses the economic and social rights guaranteed under the Constitution, and notes that high levels of inequality will hinder progress

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<sup>57</sup> Ibid p 40.

<sup>58</sup> Ibid p 40 para 2.

<sup>59</sup> Mukui, J., (2012). Inequalities in Kenya: Implications for Development and Revenue Sharing. <<http://http://www.scribd.com/doc//Inequalities-Revenue-Sharing-in-Kenya-117395841Mukui>> Accessed on 22nd November 2013.

towards meeting constitutional rights and undermine the process of meeting the Millennium Development Goals as well as economic growth.<sup>60</sup> Mukui however does not discuss how, if at all, the new Constitution has addressed these inequalities. This study has discussed the extent to which these disparities have been addressed by the Legal and Institutional framework, and further point out the gaps that have emerged in addressing these disparities.

Bigambo states that while the Constitution provides for a phased transfer of functions from national to County Governments within three years after the March 2013 general elections depending on the capacity that the counties have, there is bound to be major challenges in the transition process.<sup>61</sup> Whereas Bigambo did not offer potential solutions to the questions he raised, this study will attempt to do so.

On the collection of revenue, Kamande 2013 notes with concern that it's still debatable whether the Kenya Revenue Authority (KRA) will collect revenue on behalf of the counties or whether it shall assist the counties in building their own capacities to collect their own revenue.<sup>62</sup> He notes that already there have been disputes between the Ministry of Finance and the Transitional Authority over the administration of the revenue of the National and County Governments.<sup>63</sup> This

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60 Ibid.

61 Bigambo, J., (2012). County Governments and the challenges of revenue allocation: Perspectives of efficiency, service delivery and resource distribution. <<http://bigambo.wordpress.com/2012/07/20/county-governments-and-the-challenges-of-revenue-allocation-perspectives-on-efficiency-service-delivery-and-resource-distribution>.> Accessed on 17 August 2014. Bigambo asks at p 4 para 3: "If preceding investments and existing natural resources shall be critical in influencing the capacity levels of the counties and also predetermine the capacity of those counties to raise their own revenue for sustainability, will the skewed development amongst counties result in initial backlash against the central government when disbursements are made to those with capacity? He further asks, "With the proposed formula proposed by the CRA, how will some counties sustain themselves given that such allocated revenue does not potentially suffice the development needs and gaps, overheads and requisite service delivery?"

62 Kamande, D., (2013). The financial aspects of devolution. Accessed 24th June 2014 from <<http://www.capitalfm.co.ke/eblog/2013/06/13/the-financial-aspects-of-devolution>>

63 Ibid. para 8

study shall seek to explore how best these potential conflicts can be avoided and managed. Whereas Kamande doesn't offer solid recommendations, this study will offer suggestion for the County Governments regarding efficient collection of revenue.

Alhaji Ahmed Iliyasu<sup>64</sup> in his paper presented to the members of the Revenue Mobilization Allocation and Fiscal Commission in Nigeria acknowledges that the issue of revenue allocation formula in Nigeria is one of the most controversial and sensitive in Nigeria, in that it appears to be more political in nature than technical.<sup>65</sup> The writer underscores that there must be a thorough understanding of the constitutional responsibilities, tax distribution among the federating units, clear knowledge of other issues not clearly stated or unforeseen, changes in the socio-economic environment and political conditions of Nigeria that have been taking place. These, he argues are very focal factors to consider in the making of a revenue allocation formula. Notably, this is the direction that the CRA has also followed in the proposed revenue allocation formula in Kenya.

Iliyasu notes that the present fiscal arrangements in Nigeria has manifested in weak fiscal capacity of the state and local governments which operate under serious handicaps as their share of the statutory allocation and their taxes are not sufficient to prosecute their development programs and provide the necessary social services that the Constitution has devised.<sup>66</sup> This study particularly seeks out to explore such challenges in the revenue allocation framework in Kenya and suggest recommendations that will ensure that there will be efficient service delivery in the county level.

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<sup>64</sup>Iliyasu, A., (2011).Revenue Allocation Formula in Nigeria: Issues and Challenges. A Paper presented at a Retreat organised for members of the Revenue Mobilisation, Allocation and Fiscal Commission.

<sup>65</sup> Ibid, page 2. "This is because one could gather the necessary parameters and principles of making the formula, but the political dimensions might interplay to create distortions in the final outcome".

<sup>66</sup> Ibid. p 15 para 2.

It is therefore comforting to note that the challenges we are experiencing are not unique to Kenya and we can learn from what other markets have done to address the problems. This goes to support the study's case for a well thought out and equitable revenue allocation formula that will ensure fair distribution of the national resources.

The World Bank, funded by the Government of Australia commissioned the Fiscal Decentralization Knowledge Program Team to prepare a report released in November 2012 titled "Devolution Without Disruption: Pathways to a successful new Kenya".<sup>67</sup> The report touches on various critical issues that affect public finance management under Kenya's new Constitution. The report was released in November 2012 and contains a number of recommendations that would guide the transition process. The report however, has made recommendations before the legal framework was fully operationalized after the 2013 General Elections. This study looks at the legal framework after its implementation and brings out the actual challenges experienced and offers suggestions on the way forward.

## **1.10 PROFILE OF THE STUDY**

The introduction forms chapter one of this study. It is broken down into background of the study where it discusses the uneven economic development in Kenya and the need for laws necessitated by the constitution of 2010 to correct this. It also presents the statement of the problem, objectives

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<sup>67</sup> World Bank. (2012). Devolution without Disruption: Pathways to a successful Kenya. Washington D.C



and hypothesis of the study, significance of the study, the research methodology theoretical framework, and the literature review.

Chapter two builds up from the introduction above by discussing devolution as the premise of the legislative framework on revenue allocation. It is broken down into the history of resource allocation, the need for devolution, an analysis of current legal and institutional framework enshrined in the Constitution and other Acts of Parliament.

Chapter three discussed the challenges facing County Governments' funding. It is broken down into an analysis of the disparity across the counties and the challenges facing the funding of County Governments.

Chapter four examines revenue allocation and resource distribution in devolved governance from a global perspective, with narrowed interest in the Federal Republic of Germany, Federal Republic of Nigeria and South Africa. The Chapter analyses the best practices in resource allocation and lessons that Kenya can borrow to ensure successful revenue allocation.

Chapter five concludes this study by summarizing the findings and suggests the way forward. This chapter summarizes the findings of the previous chapters and concludes by offering some suggestion that this study considers important to ensure that revenue allocation and resource distribution is carried out in a transparent, efficient and equitable manner to ensure quality service delivery to the people of Kenya.

## CHAPTER 2

### LEGAL FRAMEWORK GOVERNING REVENUE ALLOCATION IN KENYA

#### 2.1 HISTORY OF REVENUE ALLOCATION

This first research objective of this study sought to establish whether the legal framework guiding is effective in guiding equitable revenue allocation in Kenya. This Chapter outlines the current legal framework, tracing its history from the precolonial era up to the enactment of the new Constitution and the subsequent legislation. This Chapter forms the backdrop that will guide this study in determining how the new laws will be effective in enhancing the equitable distribution of revenue in Kenya.

During the pre-colonial period, which is before 1897, resource allocation was communal, participatory and efficient.<sup>68</sup> African communities embraced family unity and much of the wealth was jointly owned under the authority of an appointed leader within the community. As such there was division of labour and wealth and one had to work in order to eat. Every family unit or clan was represented in the leadership council to ensure accountability.<sup>69</sup> However, this changed drastically at the onset of colonialism.

The British Empire established the East Africa Protectorate in 1895 which was to be known as the Kenya Colony from 1920.<sup>70</sup> From the reception date on 12<sup>th</sup> August 1897<sup>71</sup>, the public finance

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<sup>68</sup> Ustawi (2012) *Public finance before colonialism: Communal, participatory, efficient*. Accessed 03 September 2012 from <http://www.ustawi.info.ke/index.php/public-finance/public-finance-before-colonialism>

<sup>69</sup> Ibid.

<sup>70</sup> Kenya. *Wikipedia, the free encyclopedia*. Accessed 23<sup>rd</sup> July 2013 from < <http://en.wikipedia.org/wiki/Kenya>>

<sup>71</sup> Judicature Act 1967 Sec 3 (c)

legal framework was characterized by oppression, inequality and injustice. Revenue allocation was predictably geared towards opening the country to colonial exploitation and enriching the white settlers. The colonial government was the sole manager and administrators of finance accountable only to the Queen of England.<sup>72</sup>

After independence, Kenya inherited the colonial system of public finance based on command and control structures.<sup>73</sup> Public finance functions were divided among the three branches of government i.e. the executive, the legislature and the judiciary. There were numerous constitution amendments that saw the other two arms of the government i.e. the legislature and the judiciary have very little influence or control over the use of public resources. These changes saw the President distillate the instruments of public finance under his control and authority. Other subsequent constitutional amendments further centralised power and resources in Nairobi at the expense of the geographical regions. Members of the public had little say and participation in the control and use of public resources.<sup>74</sup>

This period was characterized by extreme levels of sycophancy in the government leading to the Executive assuming total control of how and when money raised was spent. Kenya's development agenda became skewed towards investing only in those areas that were considered as having "potential" based especially on agricultural produce to the detriment of the arid and semi-arid regions.

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<sup>72</sup>Ustawi (2012). *Public finance during colonialism: Oppressive, unfair, unequal*. Accessed 27<sup>th</sup> July from 2013 from <http://www.ustawi.info.ke/index.php/public-finance/public-finance-during-colonialism>

<sup>73</sup> Kirira, N. (2011). *Public Finance under Kenya's new Constitution* (Working paper No. 5) Society for International Development Working Paper. Accessed 8<sup>th</sup> July 2013 from < <http://www.sidint.net/docs/WP5.pdf>>

<sup>74</sup> Ibid.

One such amendment was the addition of Section 48 of the 1963 Constitution<sup>75</sup>, which prohibited Parliament from introducing bills relating to money or making any amendments to increase taxes or expenditure.<sup>76</sup> Any attempt by any Member of Parliament to question revenue allocation and spending led to his immediate detention or reprimanding, those who dared question did so at their own risk. Parliament's role remained to rubberstamp the decisions arrived at by the Executive on matters such as taxation, rates and expenditure.<sup>77</sup> Parliament could also approve the maximum amount of money the government could borrow from both domestic and external sources, however it was provided with limited information on when or how the debt was contracted, the amounts borrowed, and what the funds were used for.<sup>78</sup>

The constitutional offices of the Controller and Auditor General became very weak to the extent that the examination of public accounts was an exercise in futility.<sup>79</sup> The holders of this office were presidential appointees who were not subject to the direction or control of any other person or authority. There was no specific qualifications or tenure of office stated in the constitution for the holder of this office. This era was marked by several cases of gross abuse of abuse of public office

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<sup>75</sup> Repealed by the Constitution of Kenya 2010

<sup>76</sup> Money bills were to be proposed only by the executive, upon the recommendation of the President. This included: (i) the imposition of taxation or the alteration of taxation otherwise than by reduction; or(ii) the imposition of a charge on the Consolidated Fund or any other fund of the Government of Kenya or the alteration of any such charge otherwise than by reduction; or(iii) the payment, issue or withdrawal from the Consolidated Fund or any other fund of the Government of Kenya of moneys not charged upon the fund or an increase in the amount of the payment, issue or withdrawal; or(iv) the composition or remission of a debt due to the Government of Kenya; or(b) proceed upon a motion (including an amendment to a motion) the effect of which, in the opinion of the person presiding, would be to make provision for any of those purposes.

<sup>77</sup> Op cit 74

<sup>78</sup> Op cit 74

<sup>79</sup> Op Ccit 74

and mismanagement of public finances characterised by heavy financial scandals that cost the economy billions of shillings.<sup>80</sup>

The 1963 Constitution had no framework or principles to guide public financial management. There was however scattered pieces of legislation such as the Government Financial Management Act 2004,<sup>81</sup> the Public Procurement and Disposals Act 2005, subsidiary financial regulations issued by the Treasury as well as Treasury Circulars which guided the allocation of revenue. This Constitution failed to provide for how revenue raised nationally was to be shared among regions or provinces, and among the local governments. This led to regional incongruence that saw some regions being marginalised and lagging behind in terms of development. Allocation of public funds was heavily tied to political support and loyalty, leading to waste, haemorrhage and massive theft. There was little consideration for geographically disadvantaged areas or special interest groups. The Treasury remained the sole custodian and administrator of public finance, leading to delays, siphoning and frequent under-utilization of project funds.<sup>82</sup> Ultimately this grave situation partly led to heightened levels of tension and disgruntlement in the manner in which public finance was being handled. Heightened by the curtailment of civil and political rights and institutional dysfunction, it was time for a new Constitution that would represent the interests of all Kenyans.

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<sup>80</sup> Notable scandals include the Goldenberg Scandal which looted about Ksh 57 billion from the Exchequer in the early 1990's. There was also the Anglo-leasing scam that saw phantom contracts in which payments were made against no deliveries.

<sup>81</sup> Repealed by Public Finance Management Act No.18 of 2012

<sup>82</sup> Ustawi.,(2012).*Public Finance Under the Old Constitution: Centralized, Wasteful, Opaque*. Accessed 27<sup>th</sup> July 2013 from <<http://www.ustawi.info.ke/index.php/public-finance/public-finance-under-the-old-constitution>>

## 2.2 EARLY EFFORTS OF FISCAL DECENTRALISATION

During the Lancaster House London constitutional talks in 1962, there was a notable effort by KADU demanding fiscal decentralization as a protection against domination by the ‘big tribes’ under the Kenya Africa National Union (KANU) party.<sup>83</sup> In as much as the independence constitution provided for regional governments (Majimbos), a constitutional amendment in 1965 saw Majimboism abandoned and the adoption of a centralized government structure. After independence, *Sessional Paper No. 10 of 1965*<sup>84</sup> made it possible for the government to concentrate scarce investment resources in the very same areas in which the white settler government had focused. This is ironical as despite the paper repeatedly invoking equity, yet it only served to set the country off on an inequitable development path.

The enactment of Transfer of Functions Act in 1969 led to the transfer of major services such as primary education, health services, roads maintenance and other major local revenue sources such as resident and individual taxes to central government agencies. Other revenue sources were abolished altogether, thinning the revenue base of local government to uneconomically unviable levels.

In an attempt towards decentralization, the establishment of the National Rural Development Fund was established with the objective to address the needs of people in the rural areas (Occasional

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83 Nyanjom, O., (2012). Review of the Constitutional Devolution Bills in Relation to Public Financial Management. Kenya Civil Society Support Program. Accessed 26th August 2014 from <[www.devolutionkenya.com/documents/Analysis\\_of\\_Devolution\\_Bills.pdf](http://www.devolutionkenya.com/documents/Analysis_of_Devolution_Bills.pdf)>

84 Government of Kenya. (1965). Sessional Paper No. 10 on African Socialism and its Application for Planning in Kenya.

Paper No. 8, 1982).<sup>85</sup> However, this program did not meet the intended objective as a result of poor planning and even poorer implementation. As a result, between 1983 and 1984, the District Focus for Rural Development (DFRD) was launched with a focus to strengthen co-ordination of development activities including planning and implementation of projects in rural areas by making districts the central units for rural development. However, its potential was hampered by the persisting centralization of budget revenues in the government ministries.

The period between 1999 and 2007 saw the introduction of several geographically earmarked funds in an attempt to address spatial inequality. The most notable were the Local Authority Transfer Fund, (LATF)-created through the LATF Act No 8 of 1998<sup>86</sup>, the Road Maintenance Levy Fund, (RMLF) created through the Road Maintenance Levy Fund Act of 1993<sup>87</sup>, the Rural Electrification Fund or Rural Electrification Programme Fund created through the Energy Act of 2006<sup>88</sup> and the Constituency Development Fund (CDF), created through the CDF Act of 2003.<sup>89</sup> Other notable decentralisation programs include the Constituency Bursary Fund or Secondary Education Bursary Fund (SEBF), Constituency HIV/AIDS Fund, Youth Enterprise Development Fund (YEDF), Women Enterprise Fund, (WEF), National Development Fund for Persons with Disability and the Poverty Eradication Fund (PEF).

Though ingenious, these most of these programs suffered the same fate – a lack of funding and excessive bureaucratic capture by the central government. Notably, the CDF received recognition

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<sup>85</sup> Republic of Kenya (1983). Report of the Presidential Committee on Unemployment 1982/83, Nairobi.

<sup>86</sup> Local Authorities Transfer Fund Act No. 8 of 1998' Laws of Kenya (1998, Government Printer)

<sup>87</sup> Republic of Kenya, 'Road Maintenance Levy Fund Act No. 9 of 1993' (1993, Government Printer)

<sup>88</sup> Republic of Kenya, 'Energy Act No. 12 of 2006' (2006, Government Printer)

<sup>89</sup> Republic of Kenya, 'Constituencies Development Fund Act No. 10 of 2003' (2007, Government Printer) (Repealed by Act No. 30 of 2013)

and accolades as the most effective in terms of meeting its objectives. The fund was established in 2003 by an Act of Parliament.<sup>90</sup> The CDF Act requires the government to grant the program a minimum of 2.5 percent of the national revenue for each financial year, in addition to other monies to be received through borrowing or other sources, presumably donations received by the National Management Committee (NMC) of the fund.<sup>91</sup> Thus, the financial relationship between the Central Government and the CDF program was made certain as the exact size of the grant to be remitted to the CDF is predetermined by the law. As such, the Central Government could not renege on its obligation as had been the case in previous decentralization programs that were not rooted in law.

The CDF Act also stipulates that all CDF projects are to be managed by a Project Committee, whose work is to handle procurement, make purchases, paying of suppliers and maintain procurement records.<sup>92</sup> The committee also liaises with the relevant government departments, keeps the community informed and carries out oversight of the contractors and suppliers to ensure that they meet project specifications and maintain accountability.<sup>93</sup>

In 2007, the CDF Act was amended in order to address the operational constraints for smooth management and implementation of the CDF. The amendments introduced significant changes in the CDF operations hence beefing up accountability by introducing a management committee that was to be independent of any form of political influence. The CDF budget is included in the national budget every financial year and upon parliamentary approval, the funds are disbursed to

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<sup>90</sup>Chweya, L. (2006). Constituency Development Fund: A Critique. *The African Executive*. Accessed June 7<sup>th</sup> 2014 from <<http://www.africanexecutive.com/modules/magazine/articles.php?article=720>>

<sup>91</sup> CDF Act 2013. Section 4

<sup>92</sup> Ibid. s30

<sup>93</sup> Gikonyo, W., (2008). The CDF Social Audit Guide: A Handbook for Communities. Open Society Initiative for East Africa. Accessed 13<sup>th</sup> August 2013 from < [www.opensocietyfoundations.org/.../popular.pdf](http://www.opensocietyfoundations.org/.../popular.pdf)>



the constituencies to be spent on development projects identified and prioritized by local citizens. Each constituency receives funds based on a formula that includes factors like the population and size of the constituency.<sup>94</sup> Utilization of the CDF has been on the spotlight as this is one of the several devolved funds set up by the Government to mitigate poverty and to harmonize the spread of development throughout the country. The purpose of the fund, therefore, is to ensure that a specific portion of the Government annual revenue is channelled to the constituencies for purpose of development and in particular in the fight against poverty, illiteracy and disease.

While the CDF is an important tool for empowering local communities at the constituency level, its major weakness is that it falls short clear procedures for efficient allocation of the funds and fails to provide clear implementation guidelines.<sup>95</sup> There were no sufficient accountability checks in place, not to mention the low technical administrative capacity which has resulted financial mismanagement, low completion rates and unsustainable projects. It has emerged over the years that the core problem with the CDF is the weak legal framework and near absent oversight mechanisms that limit citizen participation in decision making and project implementation.<sup>96</sup>

The 2013 Act aims at re-aligning CDF to the Constitution. All the provisions regarding citizen participation remain virtually the same, with a few administrative changes introduced. It attempts to curtail the role of MPs as administrators, limiting them to mobilizing community meetings and coordination of selection of committee members by citizens. The administration of CDF will now fall in the hands of a Board official dispatched to the constituency, while MPs exercise oversight

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<sup>94</sup> Ibid.

<sup>95</sup> R. Romero., (2010). *Decentralization, Accountability and the MPs Elections: The Case of the Constituency Development Fund in Kenya*. iiG Briefing Paper. Accessed 26<sup>th</sup> August 2014 from [www.iig.ox.ac.uk](http://www.iig.ox.ac.uk).

<sup>96</sup> National Taxpayers Association. (2013). *Budget Transparency and Citizen Participation in Counties in Kenya*.

over projects.<sup>97</sup> The new Act reduces the number of CDF Committee members down to 10 from 15, while at the same time providing for citizens to nominate who sits in the CDF committees.<sup>98</sup> The MP still sits on the committee ex-officio with voting powers.<sup>99</sup>

## **2.3 APPRAISAL OF THE LEGAL FRAMEWORK**

One objective of this study was to seek to establish whether the legal framework guiding revenue allocation in Kenya is effective in guiding the equitable revenue allocation in Kenya. Public Finance Management under the new Constitution is largely a reaction to the previous excesses and abuses by the central government.<sup>100</sup> The centrally controlled resources had a significant impact on access to basic services such as health, education, and sanitation.

As a result of this, a perception evolved that there would be greater justice achieved if governance and public resources were brought closer to the people thereby allowing them to have a greater participation in their development agenda- hence the rebirth of devolution. This section of the study therefore focuses on the Constitutional provisions guiding the allocation of revenue in a devolved government structure.

Chapter 12 of the Constitution addresses public finance issues in Kenya including revenue allocation which is critical to devolution. This section has focused on the provisions of Chapter 12

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<sup>97</sup> CDF Act 2013. Section 5

<sup>98</sup> Ibid Sec 24

<sup>99</sup> Ibid

<sup>100</sup> Op cit 74.

that forms the legal framework guiding revenue allocation in Kenya, ranging from the guiding principles, sharing of revenues between national and County Governments, as well as the reporting and accounting mechanisms.

### **2.3.1 Principles of Public Finance**

Article 201 of the Constitution provides the framework and principles of public finance. It advocates that public finance shall (i) exhibit openness and accountability, including public participation in financial matters (ii) promotion of an equitable society (fair sharing of the taxation burden, equitable sharing of revenue raised nationally among national and County Governments, and expenditure that promotes the equitable development of the country) (iii) equitable sharing of the burdens and benefits of the use of resources, (iv) public borrowing between present and future generations and, (v) prudent and responsible use of public money.

These principles, if followed to the letter, can alter how policy is formulated as well as the management of public resources for the good of the people of Kenya. They are to be followed in all aspects of public finance.

### **2.3.2 Equitable sharing of revenue**

The new Constitution introduces significant changes in the public finance management framework by acknowledging the diverse economic and development needs of the various counties. To cure this disparity, the Constitution has created a system of devolution that proposes the decentralization of political and economic decision making.<sup>101</sup> Article 202 calls for equitable

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<sup>101</sup> Riaga F., (2012). *Enhancing Professionalism in Kenya. ICPAK's position on the Formula for Revenue Allocation*. Accessed 3 June 2013 from [www.icpak.com/attachments/article/.../Enhancing%20Professionalism.pdf](http://www.icpak.com/attachments/article/.../Enhancing%20Professionalism.pdf).

sharing of revenue raised nationally among the national and County Governments. It further states that County Governments may be given additional allocations from the National Government's share of the revenue, either conditionally or unconditionally.<sup>102</sup>

The Constitution provides for an equitable share of 15% which is to be divided among the counties in accordance with the criteria outlined under of Article 203 (1) of the Constitution. This equitable share should be allocated in such a way to ensure that counties have similar capacity to deliver public services.

Bahl and Linn in their taxonomy of intergovernmental transfers discussed three common approaches to determining the size of vertical share of revenue between levels of government.<sup>103</sup> Kenya's vertical revenue sharing is determined as a percentage or as a share of the total National Government revenue. The Constitution requires that the revenue allocated to the County Governments must be at least 15% of all revenue collected by the National Government.<sup>104</sup> This is an unconditional transfer that is guaranteed to the County Governments. The aim of this unconditional transfer is to ensure that the objects of devolution as outlined under Article 174 are achieved to the fullest extent possible.

For the purposes of determining the equitable share, the Commission of Revenue Allocation Act defines revenue to mean all taxes imposed by the National Government under Article 209 of the Constitution and any other revenue (including investment income) that may be authorized by an

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<sup>102</sup> Unconditional transfers, also known as block transfers, have no "strings" or any prerequisites for them to be allocated to the county governments. On the other hand, conditional transfers are targeted to specific purposes, sectors or beneficiaries.

<sup>103</sup> Bahl, R. W., & J.F. Linn., (1992). *Urban Public Finance in Developing Countries*. Oxford University Press.

<sup>104</sup> Constitution of Kenya. (2010). Article 203(2)

Act of Parliament, but excludes revenue referred to under Articles 209 (4) and 206(1) (a) (b) of the Constitution.<sup>105</sup> This cleared the conflicting definitions of revenue found in the Constitution.<sup>106</sup>

The equitable share is established as a percentage of revenue raised rather than as a fixed amount because doing so would be detrimental to the predictability of transfers to the counties.<sup>107</sup> It is not however very clear how the 15% figure was arrived at by the drafters of the Constitution and no justification has been provided to date. This then begs to raise questions pertaining to whether the criteria to be considered for sharing revenue under Article 203 of the Constitution was followed.<sup>108</sup> It is unlikely that this was, as evidenced by the problems experienced both at the national and county level in managing their respective functions under schedule 4 of the Constitution.

Article 218 provides for the criteria for legislating enabling bills for revenue allocation between national and County Governments, and the allocation of revenue amongst the County Governments. At least two months before the end of each financial year, there shall be introduced to Parliament the Division of Revenue and County Allocation of Revenue Bills. While Division

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105 CRA Act Section 2 (1). The revenues excluded from CRA Act definition referred to in Article 209 (4) relate to fees and charged of national and county governments for services and those in Article 206 (1) relate to: (a) money excluded from the Consolidated Fund by an Act of Parliament and payable into another public fund ( e.g. RMLF and LATF); and (b) money retained by the State organ that received it for the purpose of defraying its expenses.(donor or aid finding)

106 Constitution of Kenya (2010). Article 202 (1) refers to “revenue raised nationally”, while Article 203 refers to “all revenue collected by the national government” and Article 206 describes the money that should go into the consolidated fund as “all money raised or received or on behalf of the national government”.

107 World Bank. (2012). *Devolution without disruption: Pathways to a successful new Kenya*. Accessed 30<sup>th</sup> July 2013 on <<http://documents.worldbank.org/curated/en/2012/11/16964608/devolution-without-disruption-pathways-successful-new-kenya-vol-2-2-main-report>.

108 Constitution of Kenya (2010). Article 203 (1) a), b) and c) specifies three stages to follow which are i) identifying national Interests; ii) providing for national or public debt and other national obligations; iii) using objective criteria to determine value or estimated portion. iv) the need to ensure that county governments are able to perform the functions allocated to them; v) the fiscal capacity and efficiency of county governments; vi) developmental and other needs of counties; vii) economic disparities within and among counties and the need to remedy them; viii) the need for affirmative action in respect of the disadvantaged areas and groups; ix) the need for economic optimization of each county and to provide incentives for each county to optimize its capacity to raise revenue; x) desirability of stable and predictable allocations of revenue; xi) the need for flexibility in responding to emergencies and other temporary needs, based on similar objective criteria.

of Revenue Bill deals with division of revenue raised by the National Government among the two levels of government, County Allocation of Revenue Bill deals with division of revenue among the counties, the revenue allocated to the counties. These Bills are to be accompanied by a memorandum setting out an explanation of revenue allocation, an evaluation of the Bills in relation to the criteria for revenue allocation and a summary of any significant deviation from the CRA's recommendations (if any), with explanation for each such deviation.<sup>109</sup> Article 219 provides that a county's share of revenue collected by the National Government shall be transferred to the county without delays or deductions. Transfers can, however, be stopped in case of the county's serious material breach of financial obligations.<sup>110</sup>

### **2.3.3 Division of Revenue among the 47 Counties**

Article 217 stipulates that Senate shall, once every five years, "by resolution, determine the basis for allocating among the counties, the share of national revenue that is annually allocated to the county level of government".<sup>111</sup> Towards this goal, the Constitution requires that the Senate takes into consideration recommendations from Commission on Revenue Allocation (CRA), views from county governors, the cabinet secretary responsible for finance, as well as public participation and consultation. The speaker of the Senate then takes the resolution to National Assembly which vote to approve it, with or without amendments, or to reject it within 60 days. Otherwise, by default resolution passes as approved.<sup>112</sup> An amendment or rejection by the National assembly requires a two-thirds majority vote. In case of an amendment or a rejection, the Article also provides for

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<sup>109</sup> Ibid. Article 218(2)

<sup>110</sup> Ibid. Article 225

<sup>111</sup> Ibid. Article 217(1)

<sup>112</sup> Ibid. Article 217(5)

mediation by a joint committee composed of an equal number of members of the two Houses of Parliament. A two thirds majority of the Senate can still amend a resolution approved by the National Assembly.

In developing the formula for the horizontal distribution of revenue amongst the County Governments, the CRA adopted combinations of approaches to ensure that the formula would enhance validity and credibility in the equitable division of revenue. These approaches include among others: lessons from other countries; broad-based consultations; and the Commission's own objective analyses.<sup>113</sup>

The National Assembly resolved in pursuant of Article 217 of the Constitution, the basis of revenue sharing shall be as follows: Population 45%, Poverty Index 20%, Land Area 8%, Basic Equal Share 25%, and Fiscal Responsibility 2%. These parameters closely mirror the constitutional emphasis on: (i) matching resources with service delivery needs<sup>114</sup> through the population and land area criteria; (ii) redistribution<sup>115</sup> via the poverty index parameter; and, (iii) incentives for efficient management<sup>116</sup> via the fiscal discipline parameter respectively. Population has the largest allocation as it is the major determinant of a county's needs. The aim is to ensure that the counties are sufficiently resourced to deliver services equally on a per capita basis. The other parameters such as poverty index and land area are intended to redistribute revenues to areas that were historically marginalized. The equal share is meant to ensure that every county receives an

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<sup>113</sup> Commission on Revenue Allocation (2014). Strategic Plan 2013-2015 Accessed 12<sup>th</sup> July 2013 on [www.crakenya.org/wp-content/.../CRA-Strategic-Plan-2013-20151.pdf](http://www.crakenya.org/wp-content/.../CRA-Strategic-Plan-2013-20151.pdf)>

<sup>114</sup> Constitution of Kenya (2010)Article 203 (d)

<sup>115</sup> Ibid (g) and (h)

<sup>116</sup> Ibid (e)

allocation that will cater for fixed cost of running the county such as salaries and other administration expenses, irrespective of the county's population or land mass area. The Fiscal Responsibility component is meant to provide incentives for prudent fiscal management.

The CRA formula provides the public with an opportunity to understand this basis and give their views. One criticism advanced towards the CRA formula is that it not grounded in a detailed estimation of individual county needs and this is likely to create major deficits in county funding. It is focused mainly in redistributing national revenue to correct previous practices that saw revenue allocation through the annual budget being highly centralized and tightly controlled by the Executive with very little transparency about the geographic spread of revenue across the country.

However, there may be potential problems when it comes to assessing each county's needs versus the actual funds allocated to that county. Because it promotes redistribution of revenue, those areas that have been privileged to enjoy a higher allocation of revenue will require much more beyond will be allocated to them, whereas on the flipside those counties that were previously marginalized in the past will receive extra funding relative to what they would require to maintain status quo, hence bringing additional challenges of management of these funds to avoid corrupt practices. At the same time, these regions will face the challenge of rapidly scaling up demand and supply of goods. Another important aspect that was overlooked when coming up with this formula is the revenue raising capacity of the counties. There are huge variations in the counties own revenue raising capacities. As a result, regions that generate huge revenues will continue leading in terms of development while those with less will continue lagging behind.



### 2.3.4 The Equalization Fund

The Equalization Fund is established under Article 204 is of one half percent (0.5%) of revenue collected by the National Government.<sup>117</sup> This equalization, according to international literature on intergovernmental financing takes into account the existing gaps in infrastructure coverage, natural wealth and economic activity.<sup>118</sup> The Constitutionally envisaged use of the Equalization Fund is provision of basic services (water, roads, health facilities and Electricity) to the marginalized areas.<sup>119</sup> This is with the aim of bringing the quality of those services in those areas to the level generally enjoyed by the rest of the nation. The Division of Revenue Act 2013 and 2014 contained an allocation, of KES 3.4 billion to go towards the Equalization Fund. The allocation represented 0.6 percent of the shareable revenue in the year 2013/2014 and 2014/2015. This is a slightly higher than the minimum 0.5 % provided for in the constitution.

The CRA has listed 14 counties to be the beneficiaries of the Equalization Fund These are: Turkana, Mandera, Wajir, Marsabit, Samburu, West Pokot, Tana River, Narok, Kwale, Garissa, Kilifi, Taita Taveta, Isiolo and Lamu.<sup>120</sup> This is in line with the requirements of Article 216 (4) which requires the CRA to publish and regularly review a policy in which it sets out the criteria by which to identify the marginalized areas. The CRA faced serious challenges in coming up with the list identifying the 14 counties categorized as marginalized areas. This is because the term marginalized areas as defined in the Constitution is subject to varying interpretation. The

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<sup>117</sup> Ibid, Article 204(1)

<sup>118</sup> See op cit 108 pg. 91 “It is assumed that the Constitution intends that the equitable share should be allocated in such a way as to ensure counties have a similar capacity to deliver public services.”

<sup>119</sup> See op cit 115, Article 204(2)

<sup>120</sup> Commission on Revenue Allocation. (2012). *Policy on the Criteria for Identifying Marginalised Areas and Sharing of the Equalization Fund*. Accessed 15<sup>th</sup> July 2013 on< <http://www.crakenya.org/news/cra-chairman-launches-marginalisation-policy/>>

Constitution defines both marginalized regions as well as marginalized groups.<sup>121</sup> It then mentions marginalized areas when it comes to the Equalization Fund, but fails to define the same. The CRA obviously attached more weight to the marginalized regions (as per the definition in the Constitution) as opposed to marginalized groups. This has led to the commission receiving numerous complaints from the marginalized groups that felt they were left out from the fund even though they are marginalized.

There are definitely more than 14 marginalized counties in Kenya and hence the inadequacy in the Fund to address the vast needs of Kenya's marginalized communities, and of the counties in which they live. This was recently admitted by the director of fiscal affairs of the Commission who responded by saying that the commission would be looking to receive adequate data to determine the marginalized counties to ensure that all marginalized areas are included in the new criteria that will determine the allocation of the fund.<sup>122</sup>

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<sup>121</sup> Article 60 of Kenya's Constitution defines "marginalized community" as: (a) a community that, because of its relatively small population or for any other reason, has been unable to fully participate in the integrated social and economic life of Kenya as a whole; (b) a traditional community that, out of a need or desire to preserve its unique culture and identity from assimilation, has remained outside the integrated social and economic life of Kenya as a whole; (c) an indigenous community that has retained and maintained a traditional lifestyle and livelihood, based on a hunter or gatherer economy; or, (d) pastoral persons and communities, whether they are: (i) nomadic; or (ii) a settled community that, because of its relative geographic isolation, has experienced only marginal participation in the integrated social and economic life of Kenya as a whole. Article 260 also defines "marginalized group" as a group of people who, because of laws or practices before, on, or after the effective date, were or are disadvantaged by discrimination on one or more of the grounds in Article 27 (4); according to Article 27 (4)-(4), "the State shall not discriminate directly or indirectly against any person on any ground, including race, sex, pregnancy, marital status, health status, ethnic or social origin, colour, age, disability, religion, conscience, belief, culture, dress, language or birth".

<sup>122</sup>Muchiri, J., (Nairobi, 11 June 2013). Team's bid to end row in marginalization Fund. *The Standard*. Accessed 24<sup>th</sup> August 2013 on < <http://www.standardmedia.co.ke/?articleID=2000085698>> accessed 24 August 2013. Stephen Masha "The 0.5 per cent of the revenue to counties allocated to the equalisation fund is not significant hence we will start with the 14 counties that we identified as marginalised. The criteria used will, however, change and a reviewed one will be in force in three years' time."

A potential threat to the success of this Fund, which may significantly derail its intended objective is weak planning and budgeting decisions that were similarly experienced by the CDF Funds in these marginalized regions.

### **2.3.5 Funding from within: Revenue Raising Powers of County Governments**

Article 209 gives the County Governments power to impose: (a) property rates; (b) entertainment taxes; and, (c) any other tax that it is authorized to impose by an Act of Parliament. Additionally, County Governments are given power to impose charges for the services they provide.<sup>123</sup> However, these revenue raising powers should not be exercised in ways that “prejudices national economic policies, economic activities across county boundaries or the national mobility of goods, services, capital or labor”.<sup>124</sup> Presently, these taxation sources are insufficient to sustain County Governments and therefore they are wholly dependent on transfers from the National Government.

The Constitution also gives the CRA the responsibility for assisting County Governments to tap into additional sources of raising their own revenue.

### **2.3.6 Borrowing by Counties**

The Constitution makes a provision for borrowing by County Governments under Article 212 subject to the loan being guaranteed by the National Government after being approved by the County Assemblies. The County Governments can borrow from the National Government, local financial Institutions as well as foreign lenders. However, there is need for regulation of these

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<sup>123</sup> Ibid. Article 209(4)

<sup>124</sup> Ibid. Article 209(5)

borrowing powers. Where sub-national Governments are allowed to borrow without restriction, decentralisation may result in inefficiency as debt levels could grow to unsustainable levels.<sup>125</sup>

The Public Finance Management Act contains provisions that govern borrowing by the County Governments. The provisions of the Act with specific regard to borrowing by County Governments reflect the provisions of Article 213 of the Constitution that provides for an Act of Parliament to prescribe terms and conditions under which the National Government may guarantee loans. For loans to be guaranteed by the Cabinet Secretary in charge of Treasury on behalf of the National Government, a number of criteria must be satisfied.<sup>126</sup>

A county Government may make short term borrowing arrangements for purposes of managing cash flows.<sup>127</sup> Longer-term borrowing may be made for capital projects such as infrastructure. The Act also provides that the guarantee should not exceed the limit set by Parliament and if does, a resolution of both houses of Parliament is prerequisite. The resolution must however take into consideration that the loan is in public interest, borrowers must be in a good financial position to

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125 Ter-Minassian, T and J. Craig., (1997). Control of Sub-National Government Borrowing: Fiscal Federalism in Theory and Practice. Washington, DC: International Monetary Fund. Pp167-69

126 Public Finance Management Act, Section 58. The Cabinet Secretary shall not guarantee a loan under subsection (1) unless— (a) the loan is for a capital project; (b) the borrower is capable of repaying the loan, and paying any interest or other amount payable in respect of it; (c) in the case of a private borrower; there is sufficient security for the loan; (d) the financial position of the borrower over the medium term is likely to be satisfactory; (e) the terms of the guarantee comply with the fiscal responsibility principles and financial objectives of the national government; (f) where Parliament has passed a resolution setting a limit for the purposes of this section— (i) the amount guaranteed does not exceed that limit; or (ii) if it exceeds that limit, the draft guarantee document has been approved by resolution of both Houses of Parliament; (g) the Cabinet Secretary takes into account the equity between the national government's interests and the county government's interests so as to ensure fairness; (h) the borrower complies with any conditions imposed by the Cabinet Secretary in accordance with the regulations; (i) the Cabinet Secretary has taken into account the recommendation of the Intergovernmental Budget and Economic Council in respect of any guarantee to a county government; and (j) the loan is made in accordance with provisions of this Act and any regulations made thereunder.

127 Ibid, section 142. Such borrowing is limited to not more than five percent of the most recent audited revenues of the entity. In addition a county government entity that has any such borrowing shall ensure that the money borrowed is repaid within a year from the date on which it was borrowed.

repay the loan and accompanying charges and the loan must be directed at stimulating the County's economic growth.

It has been argued that the above provisions undermine the autonomy of County Governments and goes against the spirit of devolution. Besides, the process of having all loans guaranteed by the National Government creates a lot of unnecessary delay to fund crucial projects. This is one control that the central government has over the County Governments spending.

### **2.3.7 Assigning Functions to County Governments**

The Constitution provides for a phased transfer of functions from national to County Governments depending on the capacity that the counties have. The Constitution provides in Section 6, Article 15 that the National Government will build the capacity of County Governments to take over their functions. It is not clear what capacity building mechanisms have been put in place to enable counties take over their responsibilities in the new financial year. It is also not clear how the transfer of staff will take place to sustain service delivery and ensure a fair and transparent process. Further, the Constitution assigns functions across the national and the counties too broadly, without delving into detailed functions. The danger in this is that in the cases where similar functions are to be performed by either level of the government, there may be overlapping roles and responsibilities.

There is a need to establish an effective mechanism for coordination between the two levels of government so as to avoid this duplication and wastage of resources. Further, devolving identical functions to all the counties will further perpetrate marginalization of those areas that have not

enjoyed significant development in the past.<sup>128</sup> The planned first phase of transfer of functions should have been completed before March 4th 2013 general elections and indeed before the anticipated the second phase transfer on July 1, 2013. This yet to occur. The Transitional Authority set up under the Transition to Devolved Government Act 2012 is in charge of facilitating the analysis and the phased transfer of functions provided under the 4<sup>th</sup> Schedule of the Constitution.

### **2.3.8 Revenue from Natural Resources**

Preceding investments and existing natural resources are be critical in influencing the capacity levels of the counties. They also predetermine the capacity of the counties to raise their own revenue for sustainability. The law is silent on the issue of entitlement to benefits from a natural resource whose benefits are shared nationally or benefit more than one county. A good example includes the recently discovered oil reserves in Turkana, The Maasai Mara Game reserve that is among the top tourist attractions in Africa, the Port in Mombasa etc. There a spirited move by local communities where these resources are located to control their perceived assets. While the local communities' participation in the management of the natural resources is important, there must be some oversight by the national government. This can be done through the county government. If the management of these natural resources are left entirely to the local communities, the country's macro-economic structure may be at risk.

The Mining Bill 2014 proposes to ensure that there is equitable sharing of resources between the National government, the County Government and the communities living in the resource rich mining areas. The Bill provides that there shall be sharing of benefits derived from the minerals,

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128 Ibid.

and further provides the exact percentage to be shared. This is similar to the principle of derivation that is practiced in Nigeria as discussed under chapter 4. The Bill imposes strict conditions on the communities in order for them to receive their share of the national resources. The communities are to provide an annual report on the usage and the management of the resources. This is to promote transparency and accountability on the use of the resources.

### **2.3.9 The Budget Process**

Unlike in the past, the budget process has become more consultative as provided for in the new Constitution and the PFM Act. It begins by the preparation of the draft Division of Revenue Bill (DORB) and the County Revenue Allocation Bill (CARB), which are submitted alongside the Budget Policy Statement (BPS).<sup>129</sup> The second step is where budget estimates are prepared consistently with the BPS and submitted to Parliament which is required to amend the budget estimates in accordance with the Division of Revenue Bill and the resolutions adopted with regard to the Budget Policy Statement.<sup>130</sup>

The approval deadlines of the BPS, DORB and CARB by the separate parliamentary committees are not synchronized.<sup>131</sup> The National Assembly is required to pass a resolution based on the recommendation from the Committee by 1<sup>st</sup> March<sup>132</sup> whereas the Senate budget committee is not required to review the CARB and DORB until 30<sup>th</sup> April, almost 2 months later.<sup>133</sup> A

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<sup>129</sup> The BPS, DORB and the CARB are to be submitted to Parliament no later than 15<sup>th</sup> February.

<sup>130</sup> Public Finance Management Act section 39 (3) The amendments are meant to ensure that “(i) an increase in expenditure in a proposed appropriation is balanced by a reduction in expenditure in another proposed appropriation; or (ii) a proposed reduction in expenditure is used to reduce the deficit.”

<sup>131</sup> The BPS and DORB are referred to the budget committee in the National Assembly, while the CORB is referred to the Senate Budgetary Committee.

<sup>132</sup> Public Finance Management Act section 25 (7)

<sup>133</sup> Ibid. s 8 (1) (b) “to review the County Allocation of Revenue Bill and the Division of Revenue Bill in accordance with Article 218(1)(b) of the Constitution at least two months before the end of the financial year;

contradiction of this section is found in section 42 of the Act which provide that Parliament shall consider the Division of Revenue and County Allocation of Revenue Bills by 15<sup>th</sup> March, which translates to not later than thirty days after the Bills have been introduced with a view to approving them, with or without amendments.

The Act is silent on the deadline by when the National Assembly Committee is required to give a report on the DORB. This conflicting provisions creates a risk in that the resulting Division of Revenue Act may significantly diverge from the original Budget Policy Statement. This is because the time limit given under the Act for Senate committee's review of the DORB falls on the same day as the deadline by which Parliament is required to approve both the DORB and the CORB, with or without amendments, in spite of the fact that the senate's committee review may significantly differ from the BPS. This may lead to Parliament abusing its powers and derail the entire budget process especially with regards to the vertical division of revenue between national and County Governments. In addition this could undermine the Senate's powers to exercise oversight over the allocation of national revenue among the County Governments, as the Senate is the custodian of all matters concerning counties in Parliament.

Furthermore, the ambitious timelines for considering the fiscal framework in the BPS i.e. from 15<sup>th</sup> February to 1<sup>st</sup> March (14 days) may not be adequate to manage the different perspectives that need to be accommodated in order to ensure that the budget can pass through Parliament.<sup>134</sup> This risk was recently actualized where there was a difference occurred between the two houses over the Division of Revenue Bill that the President assented into law without a consensus being arrived

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<sup>134</sup> See op cit 108 at pg. 147.



at by the two houses. The Senate cried foul and branded the resulting Division of Revenue Act as unconstitutional.<sup>135</sup>

In line with the principle of public participation, the Constitution stipulates that the budget must be presented to the National Assembly and that the Budget Committee of the Assembly must seek public input before making its own recommendations.<sup>136</sup> This means that members of the public not only have the responsibility to tell Parliament what they think about the way government is spending their money, but also what government's spending priorities should be. This is done when the government releases the Budget Policy Statement<sup>137</sup> to Parliament that must have the collective views of members of the public. The Cabinet Secretary for Finance shall issue a circular to all National Government bodies that lays out in more detail how the public can participate in the budget-making process.<sup>138</sup>

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135 See Advisory Opinion between the Speaker of the National Assembly & Another and The Hon. Attorney General and Another (2013) eKLR. On 29 April 2013 the National Assembly, under the direction of its Speaker, published the Division of Revenue Bill; and on 3 May 2013 he wrote a letter to the Speaker of Senate seeking an agreement that this Bill was, in the terms of the Constitution, "a Bill concerning county government." The Senate Speaker duly agreed, by his letter of 9 May 2013. The constitutional implication of this was that both the National Assembly and the Senate would participate in the debates on, and the passing of the Bill, for it to become law. On 29 April 2013 the National Assembly, under the direction of its Speaker, published the Division of Revenue Bill; and on 3 May 2013 he wrote a letter to the Speaker of Senate seeking an agreement that this Bill was, in the terms of the Constitution, "a Bill concerning county government." The Senate Speaker duly agreed, by his letter of 9 May 2013. The constitutional implication of this was that both the National Assembly and the Senate would participate in the debates on, and the passing of the Bill, for it to become law. The Senate and its Speaker moved the Supreme Court, by virtue of Article 163(6) of the Constitution, to give an Advisory Opinion interpreting the law on the relations between the two Chambers, regarding the principle of devolution which lies at the centre of Kenya's constitutional dispensation. Therefore, it was unconstitutional for the Speaker of the National Assembly to by-pass the Senatorial process, by not going through the mediation arrangement provided in the Constitution. The Supreme Court advised that the current Constitution has made a striking departure from previous ones, by establishing State organs that must consistently operate in harmony, and with transparency and accountability, for the purpose of effective delivery, in the public interest.

<sup>136</sup> Constitution of Kenya (2010) Article 221 (5)

<sup>137</sup> This is the first official document released by government laying out its broad plans for the next budget year. It normally includes a discussion of economic trends and an estimate of overall spending and revenues. The BPS must be tabled in Parliament by mid-February, and published for the public by end of February

<sup>138</sup> Public Finance Management Act (2012). Sec 36 (2).

However, in as much as the public is entitled to give its views, there is no evidence that suggests these views are actually incorporated in the budget. This seems to be a mere public relations exercise. Besides, the timelines given for public views to be collected and adopted into the Budget Estimate are too narrow, and this is likely to be overlooked altogether as the public may not give any, meaningful input. Furthermore the law states that the budget estimates should be made known to the public “as soon as practicable” after tabling in the National Assembly. Similarly, the PFM Act does not clearly state when the county budget proposal should be made public.

The County Executive Committee member for finance is only required to make the county budget proposal public “as soon as is reasonably practicable” after submitting it to the County Assembly. This is rather vague and judging by history, this may as well be never. The burden is thus imposed on the citizens who must keep demanding to receive the proposals before they are passed by Parliament or the County Assemblies.

### **2.3.10 Other Decentralized Funds**

The fate of these decentralized funds has been the subject of debate. There are views that these funds should continue in existence in addition to the equitable share allocated to the counties. Proponents of their continued existence acknowledge that these funds are useful at the grass root levels and a more transparent management of the funds will ensure that service delivery objectives at the county level are met.

The enactment of the 2013 Act was largely in view of re-aligning the CDF to the provisions of the Constitution. However, the CDF Act contains some provisions that overlap the Constitution in several ways.

To begin with, the allocation of the CDF to constituencies fails to follow the criteria set out under Article 203 of the Constitution.<sup>139</sup>The CDF is divided equally amongst the constituencies without determining their needs and capacities. The CDF Act also usurps the County Government's functions as assigned by the Constitution thereby failing to respect the constitutional division of functions between the County and National Governments. This has led to overlapping of functions between the national framework and the County Governments.

Any projects that relate to functions within the exclusive competence of the County Government cannot be undertaken by an entity created and managed through the National Government frameworks, in the manner provided for by the CDF Act. If the National Government desires to create a fund through which it carries out programs in the counties, these can only be in relation to functions assigned to the National Government by the Constitution.<sup>140</sup> In addition to the above, public participation in decision making is still not clearly defined and no safeguards are in place to prioritize community needs.<sup>141</sup>

The restructuring of the CDF means that there are two parallel channels of funds disbursement from the National Government to the county level. The Constitution states that the grants as

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139 The criteria set under Article 203 factors the following: (a) the national interest;(b) any provision that must be made in respect of the public debt and other national obligations;(c) the needs of the national government, determined by objective criteria;(d) the need to ensure that county governments are able to perform the functions allocated to them;(e) the fiscal capacity and efficiency of county governments;(f) developmental and other needs of counties;(g) economic disparities within and among counties and the need to remedy them;(h) the need for affirmative action in respect of disadvantaged areas and groups;(i)the need for economic optimisation of each county and to provide incentives for each county to optimise its capacity to raise revenue;(j)the desirability of stable and predictable allocations of revenue; and(k) the need for flexibility in responding to emergencies and other temporary needs, based on similar objective criteria.

140 National Taxpayers Association (2013).Budget Transparency and Citizen Participation in Counties in Kenya. Accessed on 12<sup>th</sup> August 2014 at <[http://www.nta.or.ke/reports/special/nta\\_county\\_budget\\_participation\\_guide.pdf](http://www.nta.or.ke/reports/special/nta_county_budget_participation_guide.pdf)>  
141 Ibid.

conceived under 202 (2) can only be made to County Governments, and not to entities created in a sub county framework. In disbursing the monies directly to the Fund and then to constituencies, hence bypassing the County Governments, the Act contravenes the clear provisions of Article 202(2) of the Constitution. If the National Government decides to disburse any of its allocation for development of the constituencies as contemplated by the Act, the monies would have to be channelled through the County Governments subject to such conditions as the National Government, or the law may determine.<sup>142</sup>

The CDF Act is also in conflict with the provisions of Division of Revenue under Article 202 and 218 of the Constitution that requires that all revenues raised nationally be divided between the National and County Governments on the basis of the criteria set out in Article 203. Section 4(a) of the CDF Act 2013 implies that the monies accruing to the Fund will be deducted from the revenue raised nationally before distribution of the funds to the two levels of government. This is unconstitutional. The Act would need to unequivocally state that monies accruing to the Fund will be sourced from National Government share of allocated revenue if the intention is for the National Government to provide grants to the sub-counties (Constituencies). As stated above even then consultations with the County Governments are necessary unless the fund will only be used to fund National Government functions at this level.<sup>143</sup>

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142CIC Press Release (2013). *CDF Act is Unconstitutional*. Accessed September 9th 2013 at <<http://www.cickenya.org/index.php/newsroom/press-releases/item/308-constituencies-development-fund-cdf-act-2013-is-unconstitutional#.UiTENTJmim4>>

<sup>143</sup> Ibid.

## 2.4 INSTITUTIONAL FRAMEWORK

### 2.4.1 Commission on Revenue Allocation (CRA)

The Commission on Revenue Allocation (CRA), is an independent Commission set up under Article 215 of the Constitution of Kenya 2010. It is headed by a chairman nominated by the President and approved by Parliament. To qualify to be a member, a person shall have extensive professional experience in financial and economic matters.<sup>144</sup> Its core mandate is to recommend the basis for equitable sharing of revenues raised nationally between the national and the County Governments, and among the County Governments.<sup>145</sup> The functions of the Commission include (i) Recommend the basis of equitable sharing of revenue raised by National Government between national and County Governments. (ii) Recommend the basis of equitable sharing of revenue raised by National Government among County Governments, (iii) Recommend on matters concerning the financing of both the National Government and County Governments, (v) Recommend on matters concerning financial management of both national and County Governments.<sup>146</sup>

Though the recommendations of the CRA are of a technical nature, they are not made unilaterally or in ignorance, given that the sharing of revenues is by its very nature, a part of a wider political process. The CRA's formulae are to be guided by a legislative framework enacted mostly by the Senators in their capacity as political representatives of the people of the counties. The CRA and the Senate must therefore maintain a close working relationship. Article 217 states that “once every five years, the Senate shall, by resolution, determine the basis for allocating among the counties

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<sup>144</sup> Constitution of Kenya (2010). Article 215 (4)

<sup>145</sup> Commission on Revenue Allocation. (2013) <<http://www.crakenya.org/cra-overview/>> Accessed 14<sup>th</sup> August 2013

<sup>146</sup> Constitution of Kenya (2010). Article 216

the share of national revenue that is annually allocated to the county level of government. In determining the basis of revenue sharing under clause (1), the Senate shall— (b) request and consider recommendations from the Commission on Revenue Allocation.<sup>147</sup>

#### **2.4.2 Commission for the Implementation of the Constitution (CIC)**

The Commission for the Implementation of the Constitution (CIC) was established with the sole mandate of overseeing the implementation of the constitution. This owes to the tendency of the government to detract constitutional implementation and watering down devolution as happened in 1960s when *Majimboism* was completely done away with. The Constitution dictates that all bills are to be tabled in Parliament after the Attorney-General has consulted the Commission for the Implementation of the Constitution.<sup>148</sup> According to the sixth schedule, the functions of the Commission are to: “monitor, facilitate and oversee the development of legislation and administrative procedures required to implement the Constitution; and, co-ordinate with the Attorney-General and the Kenya Law Reform Commission in preparing, for tabling in Parliament, the legislation required to implement this Constitution”.

#### **2.4.3 Office of the Controller of Budget (OCOB)**

The Office of the Controller of Budget of Kenya is an Independent Office established under the Constitution under Article 228. The holder of this office shall be a person with extensive knowledge of public finance or at least ten years’ experience in auditing public finance management who is nominated by the President and with the approval of the National Assembly,

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<sup>147</sup> Ibid, Article 217

<sup>148</sup> Ibid, Article 261

appointed by the President.<sup>149</sup> The COB will exercise control over expenditure of national and County Governments.

All Public Funds are subject to the oversight and authority of the Controller of Budget and this office will have representation in at least all of the 47 counties. It is thus not possible for County or National executives to make unilateral withdrawals out of a Public Fund. Generally, any withdrawals from any Fund must get the green light from the Controller of Budget. The County Governor is the only elected official who directly be involved in the day-to-day administration of a public fund. The Controller of Budget shall oversee the implementation of the budgets of the national and County Governments by authorizing withdrawals from public funds only if he is satisfied that the withdrawal is authorized by law.<sup>150</sup> Every four months, the Controller of Budget shall submit to each House of Parliament a report on the implementation of the budgets of the national and County Governments.<sup>151</sup>

#### **2.4.4 Office of the Auditor-General**

The Office of the Auditor-General is established under Article 229 of the Constitution. It acts as a watchdog office for the people of Kenya, to protect how their public funds are used deviating from the past when the office was combined by that of Controller of Budget under the office of the Controller and Auditor-General. The office is mandated to audit and report on finances of National and County Governments, and other state organs (public body and any entity that is funded from public funds including political parties).<sup>152</sup> These accounts include: the accounts of the national

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<sup>149</sup> Ibid, Article 228 (1,2)

<sup>150</sup> Ibid. Article 228 (4,5)

<sup>151</sup> Ibid. Article 228 (6)

<sup>152</sup> Ibid. Article 226(3)

and County Governments; the accounts of all funds and authorities of the national and County Governments; the accounts of all courts; the accounts of every commission and independent office established by this Constitution; the accounts of the National Assembly, the Senate and the county assemblies; the accounts of political parties funded from public funds; the public debt; and, the accounts of any other entity that legislation requires the Auditor-General to audit.<sup>153</sup> Therefore, the Auditor-General role is to assure Kenyans that public resources are safeguarded from misuse and above all employed efficiently and effectively for the benefit of all Kenyans.

The Public Finance Management Act requires that a receiver of revenue for national and County Governments is to furnish the office of the Auditor-General with a report as to the revenue received and collected, all waivers and variations of taxes, fees or charges granted by the receiver or collector within three months after the end of each financial year.<sup>154</sup> The National and County Treasury is also expected to submit consolidated financial statements and summaries to the Auditor General at the end of each financial year. These audited reports are to be submitted to Parliament or the relevant county assembly who then debate, consider the report and take appropriate action.<sup>155</sup> To ensure that it carries its functions without interference, Article 248 and 249 of the Constitution provides for the independence of the Office of the Auditor General.

#### **2.4.5 The National Treasury**

Pursuant to Article 225 of the Constitution, the Public Finance Management Act established National and County Treasury as an entity of the national and County Government respectively.<sup>156</sup>

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<sup>153</sup> Ibid, Article 229

<sup>154</sup> Public Finance Management Act. (2012) s80, 82, 163, 165

<sup>155</sup> Constitution of Kenya (2010). Article 229(7)

<sup>156</sup> Public Finance Management Act. (2012).s 11, 103



The functions of the National Treasury (NT) are to: formulate, implement and monitor macro-economic policies; manage the level and composition of national public debt, national guarantees and other financial obligations of National Government; formulate, evaluate and promote economic and financial policies that facilitate social and economic development; mobilise domestic and external resources for financing national and County Governments. The NT is further mandated to design and prescribe an efficient financial management system for the national and County Governments to ensure transparent financial management and standard financial reporting as stipulated by Article 226 of the Constitution. Further to that, the NT is mandated to develop a policy for the establishment, management, operation and winding up of public funds. It also prepares the annual Division of Revenue Bill and the County Allocation of Revenue Bill with the recommendation of Commission on Revenue Allocation and the Intergovernmental Budget and Economic Council. Additionally, the NT is required to assist County Governments to develop their capacity for efficient, effective and transparent financial management.<sup>157</sup> As stipulated in Articles 189 and 190, upon request from the County Treasury, the NT can second to a county treasury for purposes of capacity building, such number of officers as may be necessary for the county treasury to better carry out its functions.<sup>158</sup>

The functions of county treasury include: monitoring, evaluating and overseeing the management of public finances and economic affairs of the County Government. This includes: developing and implementing financial and economic policies; preparing the annual budget including revenue and expenditure and co-ordinating its preparation; mobilising resources for funding; the budgetary

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<sup>157</sup> Ibid. s 12

<sup>158</sup> Ibid. s 14

requirements of the county; putting in place mechanisms to raise revenue and resources; managing the County Government's public debt and other obligations; custodian of the inventory of the County Government's assets; maintaining proper accounts of county's public funds (County Revenue Fund, the County Emergencies Fund). The County Treasury further strengthens financial and fiscal relations between the national and County Governments in performing their functions including providing the National Treasury with information required in carrying out its responsibilities. It also reports regularly to the county assembly on the implementation of the annual county budget.<sup>159</sup> Most importantly, the County Treasury ensures proper management and control of, and accounting for the finances of the County Government and its entities in order to promote efficient and effective use of the county's budgetary resources.

#### **2.4.6 Parliament: The Senate and National Assembly**

The Constitution sought to create appellate hierarchy in the enactment of laws through the two-chamber parliament; that is, one chamber to review the laws and decisions of the other chamber regarding devolution. According to Article 93 of the Constitution, Parliament of Kenya consists of the National Assembly and Senate.<sup>160</sup>

The law requires that before introduction of any bill on the floor of any House, both speakers must jointly resolve any question as to whether it is a Bill concerning counties and, if it is, whether it is a special or an ordinary Bill. Article 110, provides that when a house passes a bill concerning counties, it passes it to the other house, and when passed in its original form, the originator of the

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<sup>159</sup> Ibid, sec 104

<sup>160</sup> Constitution of Kenya. (2010). Article 93

Bill passes it to the President for assent within seven days. Should the Bill touch on devolution and the Houses fail to agree on a Bill, then, two remedies are stipulated.<sup>161</sup> First, in the case of a special Bill<sup>162</sup>, the National Assembly may amend or veto the Special Bill which has been passed by the Senate if it can get a resolution that is supported by at least two thirds of its members. If they fail to get this resolution, the Bill will move on for Presidential Assent.<sup>163</sup> In the case of an ordinary Bill<sup>164</sup>, if the Bill is amended, it will be referred back to the originating house for reconsideration. If the Bill is rejected, then it will be referred to a mediation committee comprising of an equal number of members from each house who will attempt to develop a version of the Bill that both houses will pass. Each House will then have to vote on whether they accept the amended version. If both Houses agree on the amended version, then it passes through. If either House votes it down, the Bill is defeated. If the mediation committee fails to agree on an amended version of the Bill, then the Bill is defeated as well.<sup>165</sup>

The Constitution sets the role of the National Assembly under Article 95, which includes among other things: “to enact legislation, determining the allocation of national revenue between the levels of government, appropriating funds for expenditure by the National Government and other national State organs and exercising oversight over national revenue and its expenditure.”<sup>166</sup> As the people's representatives, the members of the National Assembly have been entrusted with the stewardship of Public Funds. The sharing and distribution of these funds has been a sensitive

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<sup>161</sup> Ibid, Article 101

<sup>162</sup> Relating to election of members of a county assembly or a county executive; or, annual County Allocation of Revenue Bill (bill dividing among the counties the revenue allocated to the county level of government)

<sup>163</sup> Ibid, Article 111

<sup>164</sup> This is a bill concerning counties but cannot be categorized under special Bill

<sup>165</sup> Constitution of Kenya. (2010). Article 113

<sup>166</sup> Ibid, Article 95 (4) (a)-(c)

social-political concern in the past and the people of Kenya will be looking up to the National Assembly to address the issue fairly and equitably. In line with the New Constitution, the National Assembly will regularly determine the amounts of funds to allocate to governments, make arrangements for the allocation and transfer of those funds to State offices and organs that are entitled to the funds, and oversee how those funds have been utilised.<sup>167</sup>

The National Assembly has received enhanced responsibility with regard to revenue mobilization, allocation, monitoring and control. Article 221 (4 and 5) of the Constitution and the Public Finance Management Act, 2012 contemplates a committee of the National Assembly to oversight the budget process. In this regard, the Budget and Appropriations Committee is established pursuant to the provisions of Standing Order 207.<sup>168</sup>

The First Senate in independent Kenya was established in 1963 mainly to ensure a safeguard for rights of the minority groups in Kenya. It existed for four years during which time it had little influence on legislative and executive governance, and was consequently scrapped in January of 1967 and Kenya became a unicameral state. The role of the Senate is stipulated in the Constitution under Article 96 and this includes representing the counties and protecting the interests of the counties and their governments, participating in the law-making function of Parliament by

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167 Ustawi. (2012). *National Assembly under the New Constitution*. Accessed on 13<sup>th</sup> August 2014 at <http://www.ustawi.info.ke/index.php/national-assembly/national-assembly-under-the-new-constitution?>

168 Kenya National Assembly. Budget and Appropriations Committee. Accessed 29<sup>th</sup> July 2014 on <<http://www.parliament.go.ke/plone/national-assembly/the-standing-orders/standing-orders/part-xxii-select-committees/general-provisions/207.-budget-and-appropriations-committee>> The specific mandate of the committee is “to inquire into, investigate and report on all matters related to coordination, control and monitoring of the of the national budget; discuss and review the estimates and make recommendations to the House; examine the Budget Policy Statement presented to the House; examine Bills related to the national budget, including Appropriations Bills; and, evaluate tax estimates, economic and budgetary policies and programs with direct budget outlays..”

considering, debating and approving Bills concerning counties,<sup>169</sup> determining the allocation of national revenue among counties,<sup>170</sup> exercising oversight over national revenue allocated to the County Governments,<sup>171</sup> participating in the oversight of State officers by considering and determining any resolution to remove the President or Deputy President from office.

It is important to note at this stage that the Senate's role in law making is not exclusive and will always be subject to that of the National Assembly to the extent that the National Assembly may amend or veto a special Bill that has been passed by the Senate only by a resolution supported by at least two-thirds of the members of the Assembly.<sup>172</sup> For example, whereas Article 217 confers powers to the Senate once every five years, by resolution, to determine the basis for allocating among the counties the share of national revenue that is annually allocated to the county level of government, this resolution is subject to amendment or even veto by the National Assembly. This provision is likely to create friction between the Senate and the National Assembly that has the potential to scuttle devolution gains and hinder economic growth.<sup>173</sup> The Senate has powers to summon any of the Commissions, the Auditor-General or the Controller of Budget to submit a report on a specific matter.<sup>174</sup>

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<sup>169</sup> According to Ustawi, this Article makes the Senate by default the law making National Institution for law making for the commonwealth of the counties.

<sup>170</sup> The Constitution provides that a minimum of fifteen per cent of National Revenue each year, be allocated to the 47 devolved governments. It is the Senate that will apportion and share out that money among the various Counties.

<sup>171</sup> This acts as a checks and balances mechanism in the revenue allocation process.

<sup>172</sup> Constitution of Kenya (2010). Article 111 (1).

<sup>173</sup> This was recently witnessed on June 6<sup>th</sup> 2013 when the National Assembly rejected a senate amendment to the Division of Revenue Bill. The Senate had demanded changed to the bill so that funds allocated for county governments be increased. In rejecting the amendment the National Assembly said the Senate lacked the power to change the bill, which was directly sent to the president for approval, which was assented into law on 10<sup>th</sup> June 2013.

<sup>174</sup> Constitution of Kenya (2010). Article 254 (2)

### 2.4.7 The Salaries and Remuneration Commission (SRC)

The Constitution established a Salaries and Remuneration Commission (SRC) to harmonise, set and review the salaries of all state officers in the context of equity and fairness.<sup>175</sup> The SRC is composed of representatives of all constitution commissions, the Senate and the County Governments, and a representative of the Department of Public Finance.<sup>176</sup> In addition, the Commission also comprises of one person each nominated by an umbrella body representing trade unions, employers, professional bodies, the Principal Secretary for Finance, the Attorney General and a human resource specialist in the public service sector nominated by the Cabinet Secretary for Public Service.<sup>177</sup>

The Commission is to be guided by the principle of ‘equal remuneration to persons for work of equal value’.<sup>178</sup> As such, the Commission is expected to minimize disharmony in the public sector including County Governments and encourage orderly wage and benefit negotiations.<sup>179</sup> Article 230 also stipulates the functions of the SRC which is to advise the national and County Governments on the remuneration and other benefits of all public officers. As such, the Commission is expected to obtain and analyse accurate data on the output of every State officer

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<sup>175</sup> Ibid, Article 230

<sup>176</sup> Ibid, Article 230 (2) The commission is to include a representatives from constitutional commissions namely, the Parliamentary Service Commission ,Public Service Commission, Teachers Service Commission, Judicial Service Commission, National Police Service Commission, the Defence Council, the Senate (on behalf of county governments)

<sup>177</sup> Ibid, Article 230 (2) c-e

<sup>178</sup> ‘Salaries And Remuneration Commission Act No. 10 of 2011’ (2011, Government Printer) s12

<sup>179</sup> Kirira, N., (2011). *Public Finance under Kenya’s new Constitution* (Working paper No. 5) Society for International Development Working Paper. Accessed 18 July 2014 at < <http://www.sidint.net/docs/WP5.pdf>>

for reward accordingly. The Article further states the Commission shall recognise productivity and performance; and transparency and fairness.<sup>180</sup>

The creation of this Commission is a welcomed move as wages and salaries within the public sector were not harmonised and varied according to the political influence of the Chief Executives of government organizations and head of parastatals who were mainly political appointees. Members of parliament could at will pass legislation that would see their salaries raised and allowances increased without regard to the prevailing economic realities. This Commission will serve, for the first time to create some form of order in the public wage sector by laying some ground rules for orderly wage and benefits negotiation and review based on performance and productivity.

#### **2.4.8 The Transition Authority**

Established by the Transition to Devolved Government Act, the Transition Authority mandated to facilitate and co-ordinate the transition to the devolved system of government.<sup>181</sup> This includes: facilitating analysis and phased transfer of function between national and County Government; determining the resource required for each function; developing a framework for comprehensive and effective transfer of functions; preparing and validating an inventory of all existing assets and liabilities of government, other public entities and local authorities and recommending the effective management of the assets including those of the county; providing a mechanism for the transfer of assets and vetting such transfers during the transition; developing the criteria to

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<sup>180</sup> Constitution of Kenya (2010) Article 230(5)

<sup>181</sup> Ibid. s4,7

determine the transfer of functions (including transfer of previously shared assets, liabilities and staff of national and local governments) from the national to County Governments; assess the capacity needs of national and County Governments.<sup>182</sup>

Additionally, the Transition Authority is mandated to recommend measures to ensure that both national and County Governments have adequate capacity during the transition period to enable them undertake their assigned functions. This includes co-ordinating and facilitating the provision of support and assistance in building such capacities; advising on the effective and efficient rationalization and deployment of the human resources and submitting monthly reports to the Commission for the Implementation of the Constitution and the Commission on Revenue Allocation on the progress in the implementation of the transition to the devolved system of government.<sup>183</sup>

## **2.5 CONCLUSION**

The drafters of the new Constitution sought inspiration from other jurisdictions, particularly from the 1996 Constitution of the Republic of South Africa, particularly with regard to devolved government. There is striking similarity in the laws governing revenue allocation to the devolved units.

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<sup>182</sup> Ibid. s7

<sup>183</sup> Ibid. s7



This Chapter has discussed the myriad of legislation that has been enacted pursuant to Chapter 12 of the Constitution. These collectively form the legal framework governing revenue allocation in Kenya. As we shall see in the Chapter 3, there are couple of shortcomings and loopholes found in these laws that need to be addressed as the country moves forward with the devolution agenda.

One observation this study had made is that there is over proliferation of legislation tackling public finance. With proper planning and strategy, some of these acts could have been merged as they are all geared towards achieving equity in the allocation of national resources. Some of these statutes were passed largely without sufficient stakeholder consultation, to comply with the deadline provided under the Constitution. A consolidation of these laws and institutions should be undertaken to ensure that there is neither wastage of public funds nor duplication of functions.

The existence of various institutions has also brought about inter institutional battles of supremacy. For instance, as discussed above, the Senate has been struggling to maintain its relevance as the custodian for devolution amidst opposition from the National Assembly which has on several occasions undermined the Senate's Authority. The Salaries and Remuneration Commission came under threat of disbandment by the National Assembly.<sup>184</sup> This move was a gross abuse of power of the National Assembly who failed to acknowledge the independence of the commission in discharging its functions. Similarly the Transition Authority has come under threat of disbandment, this time by the governors, backed by the National Government and the CIC who

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184 Mwere, D., (Nairobi, May 3rd, 2013). Linturi files motion to disband, prosecute Salaries Commission. *The Star*. <<http://www.the-star.co.ke/news/article-119012/linturi-files-motion-disband-prosecute-salaries-commission>> Accessed on 23rd October 2014. The reasons the South Igembe MP Justin Linturi gave for his petition to remove the SRC chair and the commissioners were alleged: violation of the Constitution, violation of the law, gross misconduct in the performance of their functions; and serious incompetence in the performance of their duties.

propose that it be replaced by the Inter-Governmental Relations Technical Committee of the Summit.<sup>185</sup> The Senate rejected this proposal arguing that it was a wrong move and that the TA should be allowed to complete its mandate.<sup>186</sup>

All institutions created under the Constitution are required to discharge their functions without any interference from the National Government as well as the County Governments, However, this independence is under threat particularly from the National Government. The National Assembly (a majority of members who come from the President's Jubilee party) vets and approves the Commissioners who have been nominated by the President. This implies that the Commissioners will protect the National Government's interest. County Governments' representation in these institutions is very minimal. Furthermore, these institutions are highly centralized as they lack replication at the county level thereby undermining the constitutional threshold on public participation. Similarly, the office of the Auditor General is directly funded by the Treasury. This demonstrates lack of independence as the National Government may decide to limit the Auditor General's budget which will interfere with the proper discharging of its functions.

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185 Obala, R., (Nairobi, November 13th 2013). CIC, Governors want TA Disbanded. *Standard Digital* Accessed on 23<sup>rd</sup> October 2014 at <[http://www.standardmedia.co.ke/?articleID=2000097569&story\\_title=cic-governors-want-transition-authority-disbanded&pageNo=2](http://www.standardmedia.co.ke/?articleID=2000097569&story_title=cic-governors-want-transition-authority-disbanded&pageNo=2)> Devolution Cabinet Secretary (CS) Ann Waiguru, CIC chairman Charles Nyachae and Council of County governors chairman Isaac Ruto while issuing a joint statement before the committees, explained that the move is to avoid mandate overlap and inevitable conflict between the two institutions. The statement read "Establishment of the committee will strengthen inter-governmental relations between national and county levels of government."

186 Kiplagat, J., (Nairobi, October 23rd 2013).Senators reject move to disband Transition Authority. *Daily Nation* Accessed 23<sup>rd</sup> October December at <http://mobile.nation.co.ke/News/Senators-reject-proposal-to-disband-Transition-Authority/-/1950946/2043784/-/format/xhtml/-/b4xtnt/-/index.html>>

## **CHAPTER THREE**

### **CHALLENGES FACING COUNTY GOVERNMENTS' FUNDING**

#### **3.1 INTRODUCTION**

Chapter 2 of this study gives an outline and appraisal of the legal framework on revenue allocation guided by the principles of public finance as enshrined in the Constitution. Implementation of the legal framework is no easy task considering the numerous challenges facing devolution. As the utilitarian theory posits, there are some intricate dynamics that govern revenue allocation. These dynamics take into consideration the various stakeholders and how the legislative framework affects their assorted interests.

This chapter highlights the existing disparities facing County Governments and gives an analysis of the extent in which the legal framework has addressed the disparities. The chapter also highlights the challenges that face the County Governments with respect to funding their operations.

#### **3.2 DISPARITY AMONGST THE COUNTIES**

##### **3.2.1 Socio-economic disparity**

Kenya is a very diverse country with about 42 ethnic groups. A major challenge that the country has faced since independence is inequality. Most Kenyans feel deprived when it comes to their development needs being met. Devolution proponents saw that the county level governments will be better placed than the National Government to bring about equitable distribution of national revenue and therefore address socio-economic inequalities.

Regional disparities in the quality and quantity of public services delivered may lead to disparities in socioeconomic wellbeing among regions.<sup>187</sup> Access to public services such as healthcare, education, transportation, water supply, electricity, among others has direct impact on the welfare and economic development of a society. The socio-economic disparity in Kenya is difficult to ignore. For instance, the proportion of households with piped water in their houses in urban areas is five times that in rural areas, about 19.2% and 3.8% respectively.<sup>188</sup> Going by the enrolment rates, practically every child in Central province attends primary school compared to about one out of three children in North Eastern go to school.<sup>189</sup> The difference is bigger for secondary schools. When it comes to access to health services, the disparity is magnified. In central province, the doctor patient ration is one doctor for every 20,000 people. The ratio in North Eastern province is that there is one doctor for every 120,000 people.

The Constitution has sought to address these inequalities by bringing about equitable distribution of resources. It provides that any revenue allocation formula or arrangement must factor in these inequalities. This will therefore ensure that the county governments have access to basic social and public services that will lead to their even development. The Equalization Fund also seeks to address this disparity by allocating additional revenue to the historically marginalised regions in order to bring them to the same level as the rest of the regions.

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<sup>187</sup> Mwenda A.K., (2010). *Economic and Administrative Implications of the Devolution Framework Established by the Constitution of Kenya*. Institute for Economic Affairs Accessed on 19<sup>th</sup> August 2013 at <[http://www.ieakenya.or.ke/publications/doc\\_download/235-economic-and-administrative-implications-of-the-devolution-framework-established-by-the-constitution-of-kenya](http://www.ieakenya.or.ke/publications/doc_download/235-economic-and-administrative-implications-of-the-devolution-framework-established-by-the-constitution-of-kenya)>

<sup>188</sup> Society for International Development. (2004). *Pulling Apart Facts and Figures on Inequality in Kenya*. Accessed on 20<sup>th</sup> October 2014 at <<http://www.sidint.net/docs/pullingapart-mini.pdf>>.

<sup>189</sup> Ibid.

### 3.2.2 Demographic and Geographical disparity

It is fundamental to appreciate the demographic and geographical diversity of the 47 counties when discussing the devolved financial, administrative and service delivery arrangements in Kenya. The counties are substantially diverse in terms of endowments, economic capacity and social settings, yet they all have received similar functions under the Constitution. The ten most populated counties that form 40% of the country's total population occupy approximately one tenth of Kenya's total land area.<sup>190</sup> The two most populated counties of Nairobi and Mombasa have population densities of over four thousand people per square kilometres as compared to the least populated counties in the North-Eastern regions which on average have a population density of less than twenty persons per square kilometre.<sup>191</sup> Generally, regions with low population density and vast geographic coverage, such as North Eastern province, parts of Coast province and the North Rift, tend to have poor access to essential infrastructure services, such as roads and electricity.<sup>192</sup>

These two variables are extremely crucial as they are drivers of service delivery needs and cost differentials. The CRA took into account both variables (Population and Land Area) in determining a revenue allocation formula to be recommended to the Senate. Sparsely populated regions with vast land areas will receive lower allocations of revenue judging from the CRA formula that attached the highest percentage weight to the population parameter. The danger in

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190 World Bank. (2012). Devolution without disruption: Pathways to a successful new Kenya. < <http://documents.worldbank.org/curated/en/2012/11/16964608/devolution-without-disruption-pathways-successful-new-kenya-vol-2-2-main-report>> Accessed 30th July 2013

191 Commission on Revenue Allocation. (2014).< <http://www.crakenya.org/>> Accessed 27th August 2014

192 See Op cit 186

this is that these regions tend to spread their revenue too thinly, ending up in low productivity levels.

### **3.2.3 Poverty Index disparity**

Poverty is the inability to attain a minimal standard of living. It is the deprivation of the most basic human survival needs such as food, clothing, shelter, healthcare and education. According to a report released by CRA, Kenya's richest county is Kajiado County while the poorest is Turkana County.<sup>193</sup> The two counties have an 80% point gap in terms of poverty prevalence.<sup>194</sup> According to the Kenya Integrated Household Budget Survey (KIHBS)2005/06, the proportion of the rural population living below the poverty line was 49.1% with the lowest in Central province (30.4%), followed by Nyanza (47.6%), Rift Valley (49.0%, Eastern (50.9%), Western (52.2%), Coast (69.7%) and North Eastern Province (73.9%).<sup>195</sup> These figures corroborate the study's earlier observation in the introduction, that the Kenyatta regime concentrated national revenue in the central region. This demonstrates how political interference or manipulation enhances disparity in revenue allocation. The CRA released a county fact sheet based on a survey to determine the number of people living below poverty line, in order to base the basis for allocation of National Revenue.<sup>196</sup>

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193 Commission on Revenue Allocation. (2013). CRA Policy on the criteria for identifying Marginalized communities. <<http://www.crakenya.org/wp-content/uploads/2013/10/CRA-Policy-on-marginalization-criteris.pdf>> Accessed 24th August 2013

194 See Op cit 186 at p21. This means that in Turkana, almost all the household fall below the poverty lies while very few do in Kajiado County.

195 Kenya National Bureau of Statistics. (2005-2006). Kenya Integrated Household Budget Survey (KIHBS) Basic Report. Accessed on 24<sup>th</sup> August 2013 at <<http://statistics.knbs.or.ke/nada/index.php/catalog/8>>

196 See op cit 189.

Just like population, distribution of poverty levels will influence allocation of revenues and as counties are preparing to set up to deliver services, there will be glaring differences in terms of poverty levels with each county having a different starting point. CRA's formula for the horizontal sharing of national revenue had poverty as a variable with a weight of 20%.

One important factor that must not be overlooked is the inequalities within the counties themselves. This is in relation to the rural and urban locations within the counties. About 85% of the poor population live in rural areas. The poor population living in the urban areas has however been on a steady increase since 1997.<sup>197</sup> Even if revenue is shared equitably across the counties they may yield different results depending on where and how they are spent within the counties.<sup>198</sup> Overall, poverty is more prevalent in rural areas as compared to urban areas in counties.

### **3.3 CHALLENGES FACING COUNTY GOVERNMENTS' FUNDING IN KENYA**

There is no doubt that the new Constitution has brought rather impressive reforms in the administration of public finance management and administration. For majority of Kenyans, its implementation will ultimately lead to improved service delivery and an improved quality of life. Its complete implementation will not happen overnight and there is bound to be some serious false starts and hiccups along the way especially in terms of logistics and costs when settling into the County Governments.

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197Oxfam GB (2009). *Urban Poverty and Vulnerability in Kenya*. (unpublished). Accessed on 23<sup>rd</sup> September 2014 at <[http://www.irinnews.org/pdf/urban\\_poverty\\_and\\_vulnerability\\_in\\_kenya.pdf](http://www.irinnews.org/pdf/urban_poverty_and_vulnerability_in_kenya.pdf)>

198Oyugi, L. N., (2008). *Fiscal decentralisation in Kenya: The case of Local Authority Transfer Funds*. Institute of Economic Affairs. Accessed on 23<sup>rd</sup> September 2014 at <[http://www.ieakenya.or.ke/publications/doc\\_download/118-fiscal-decentralisation-in-kenya-priority-issues-for-consideration](http://www.ieakenya.or.ke/publications/doc_download/118-fiscal-decentralisation-in-kenya-priority-issues-for-consideration)> See also Kibua, T. N., & Mwabu, G., (2008). *Decentralization and Devolution in Kenya: New Approaches*. Nairobi: The University of Nairobi Press.

The devolution process in the Constitution is highly ambitious, making it very risky in terms of the massive capacity and resources that will be required to see its full implementation. If no safeguard measures are put in place, the entire process is bound to be derailed taking the nation back to the dark days. Already creaks have emerged, with disgruntled voices claiming that County Governments are not adequately funded, therefore placing devolution at risk.

### 3.3.1 The Legal Framework

A weak legal and institutional framework will impart a measure of unpredictability and instability to the system of intergovernmental relations. The success of decentralization and devolution is dependent on the design and implementation of the framework put in place.<sup>199</sup>

It has been two years since the roll out of the county governments and yet the legal and institutional framework has been subject to shifts in focus and has reflected political compromises. The Division of Revenue Bill demonstrates the unpredictability of the revenue to be shared between the two levels of government. The use of the words “not less than 15%” leaves the exact determination of revenue to political debate. This vague provision is one of the contributing factors that has led to the *Pesa mashinani* and *Okoa Kenya* campaigns for a referendum to increase the allocation. The draft Constitution of Kenya 2010 (Amendment) Bill 2014 has framed some key

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<sup>199</sup> Kumar, S., (2005). *When does decentralization deliver? The Dilemma of Design* MPRA Paper 250, University Library of Munich, Germany. Accessed 27<sup>th</sup> August 2014 at < <http://mpra.ub.uni-muenchen.de/250/>.



issues that the Governors want addressed through a referendum. This, if passed, will increase the county allocation from 15% to about 45% among other demands.<sup>200</sup>

Another major challenge in the legal framework is that the 15% share is calculated on the basis of the most recent audited and approved accounts. As it currently stands, Parliament is still yet to approve or reject the audited accounts for the financial year 2010/2011 as well as the financial year 2012/2013. The last audited and approved accounts relate to the financial year 2009/2010 which formed the basis of national revenue to be shared between the two levels of government during the 2013 and 2014 financial years (see Table 1A and 1B). Ideally, the Division of Revenue Act 2014 should have been based on the audited and approved accounts for the financial year 2012/2013. This grave situation is not only in violation of the Constitution<sup>201</sup> but also a potential source of corruption and financial scandals. It also poses a threat to fiscal devolution as the County Governments receive lower allocations based on historical figures which have not factored in inflation at its current rates.

Another challenge facing the legal framework is that the transfer of functions to the county governments is incomplete. This creates gaps in the legislation arising from the lack of well-defined criteria to allocate adequate finances to the county governments to enable them discharge

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<sup>200</sup> Daily Post. (Nairobi, Friday 24<sup>th</sup> October 2014). Governors now reveal details of their pesa mashinani and why referendum is a must.< <http://www.kenyan-post.com/2014/10/governors-now-reveal-details-of-their.html>> Accessed 27<sup>th</sup> October, 2014. A summary of what Governors want Kenyans to pass in the referendum: (i) Not less than 45% of revenue based on the most recent audited accounts. (ii) 3.4 billion Equalization Fund placed under management of County Governments, monitored by CRA. (iii) Counties retain mineral wealth and local communities retain 5%. (iv) No impeachment of Governors and their deputies unless the grounds for impeachment are confirmed by the High Court. (v) The Senators decision for county allocations is final and the National Assembly cannot reverse unless there is a quorum of 314 members and above.(vi) No summoning of Governors for grilling by the Senate.

<sup>201</sup> Article 229 of the Constitution places an obligation on the Auditor General to audit and report on the accounts of the National Government within six months after the end of the financial year and they submit to parliament for debate and approval. Parliament is then obligated to debate and consider the reports of the Auditor General within three months.

their functions under the constitution. As it currently stands there are overlapping, poorly defined roles and unclear divisions of power which have brought about confusion and friction between the National Government and the County Governments. This could result in the disruption of service delivery with serious implication on the country's socioeconomic development. Another danger is that there may be enhanced corruption and lack of accountability at the county level if funds are devolved before proper costing and functions are transferred to them.

The legal framework also fails to recognize the significant management and administrative capacities of the counties, especially when it comes to public finance management. There are currently no policies and strategies in place to address these challenges. For example, many county governments have been found to lack a financial management systems. Although the installation is complete in some counties, its actual use is a great challenge due to connectivity issues, as well as incompetency of users to use the system.<sup>202</sup> A financial system is important in that it ensures effective planning of county budgets and provide accurate reports on revenue and expenditure needs. The Office of the Controller of Budget would then disburse funds based on these reports. This will ensure that funds are applied for their intended usage and also acts as a guard against misuse of resources. The lack of this system has adversely affected the monitoring of county expenditure at the county level.<sup>203</sup>

The lack of county representation at the Institutional level is also a concern and may threaten the devolution agenda if not addressed. As we saw previously, majority of the institutions are largely

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<sup>202</sup> Republic of Kenya, Office of the Controller o Budget (2014). County Budget Implementation Report Half year 2013. Accessed on 23<sup>rd</sup> October 2014 at </14<http://www.cob.go.ke/index.php/virtual-downloads/category/5-counties-report?download=83:cbirr-quarter-three-fy-2013-2014.pdf>>

<sup>203</sup> Ibid.

controlled by the National Government and they lack replication at the county level as they are all centred in Nairobi. This makes them out of touch with the stakeholders at the county level whose interests they have been tasked to represent and protect.

### **3.3.2 Political Interference**

The Senate and the National Assembly have been embroiled in supremacy wars and egocentricity which if not resolved will threaten the devolution agenda.<sup>204</sup> On the other hand, the Governors have also been at war with the members of the National Assembly. This is against the spirit of the constitution which envisioned the two houses supporting, cooperating, complimenting each other and sharing responsibility in implementation devolution. Thus, a harmonious working relationship between the two Houses is important.<sup>205</sup> In 2013 the feud was centred on the controversial division of revenue bill where the National Assembly ignored the recommendations given by the Senate on the division of revenue. The move was declared unconstitutional by the Supreme Court.<sup>206</sup>

Recently there was a move by the National Assembly to introduce a motion to in parliament to amend the Constitution and have the Equalization Fund managed at the Constituency level rather than at the county level. The Governors have in turn vowed to go to court to oppose this move.<sup>207</sup> The two houses have refused to recognize that devolution is about equitable sharing of

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<sup>204</sup> Kilonzo D., (Nairobi, June 2013). Senate, National Assembly row threatens devolution. *The Standard* <http://www.standardmedia.co.ke/?articleID=2000086065> Accessed 16 June 2013

<sup>205</sup> Murunga S., (Nairobi, 31<sup>st</sup> July 2103). The devolution debate has been polluted by acrimony and self-seeking behaviour. *The Daily Nation*

<sup>206</sup> Mureithi, F., (Nairobi, 6<sup>th</sup> March 2014). Governors vow to fight Equalisation Fund. *The Star*. Accessed 25<sup>th</sup> August 2014 at < <http://www.the-star.co.ke/news/article-126959/governors-vowoto-fight-Equilisation-Fund> >

<sup>207</sup> Ibid

resource and self-governance which should not be subordinated by their internal wrangles and battles of supremacy.

There have also been increased calls for a referendum by some Governors and members of Parliament from the Opposition led by CORD who are seeking to amend the constitution to increase revenue allocation to County Governments to from 15% to 45% of the total audited national revenue. The governors argue that the Sh210 billion<sup>208</sup> allocated to them in the 2013/14 fiscal year and Sh226 billion<sup>209</sup> allocated in the 2014/15 financial year is not enough to provide services to the electorate. The governors argue that a huge chunk of funds has been left at the national level yet major services in agriculture, health and roads sectors have been devolved to the counties. This drive by the governors has been dubbed the “*pesa mashinani*” campaign and that of CORD is known as “*Okoa Kenya*”.

The calls for amending the Constitution through a referendum has received strong opposition from various sectors, especially from the Jubilee government and the CIC. The Chairman of the CIC terms the proposed amendment as premature and states that any efforts towards the same may have the effect of derailing the implementation process.<sup>210</sup> The Commission opposes the proposal to increase the minimum equitable share citing that the complete transfer of functions as envisaged under the Fourth Schedule of the Constitution is not over, and it would be an unwise move to increase the equitable share before the final costing of these functions is carried out.<sup>211</sup> The TA

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<sup>208</sup> Division of Revenue Act 2013

<sup>209</sup> Division of Revenue Act 2014

<sup>210</sup> Mwadime, R., (Nairobi, August 28<sup>th</sup> 2013) CIC rubbishes CORD’s push for referendum. *The Star*. Accessed 4<sup>th</sup> September 2013 at < <http://www.the-star.co.ke/news/article-133715/cic-rubbishes-cord-push-referendum>>

<sup>211</sup> Ibid. “The basis of revenue sharing is to enable counties carry out their functions under the fourth schedule. The transfer of these roles is not yet complete. They have not been costed and the three year transfer period contemplated

has also opposed the calls for a referendum urging CORD and the Council of Governors (CoG) to take their plight to the National Assembly which is yet to consider and approve the audited reports from the Auditor General. This way, according to the TA Chairman, the National Assembly can increase the allocations to the County Governments and avoid the process of conducting a referendum.<sup>212</sup> He further stated that once the costing exercise was underway and once concluded, counties would automatically receive more funds.<sup>213</sup>

### **3.3.3 Lack of infrastructure and capacity at the county level**

Fiscal decentralisation can only be successful if the counties have adequate capacity and infrastructure to handle the devolved functions. Currently as it stands and as confirmed by the Transitional Authority, only a handful of the counties are ready to handle all the devolved functions. County Governments are in their infancy and hence there are bound to be valid questions raised pertaining to their ability to handle the devolved funds. They lack the capacity and resources to fully and successfully absorb and effect their functions under the Constitution.<sup>214</sup>

One major challenge currently facing counties in collecting revenues is that there lacks legal authority for counties to collect county revenues and charges that the local authorities previously collected. Most county assemblies are yet to pass legislation empowering the County Governments

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in section 15 of the sixth schedule has only just begun.” Charles Nyachae. He further warned that the proposed amendments are dangerous because they are not for the benefit of the people.

<sup>212</sup> Ibid. “TA’s chairman Kinuthia Wamwangi said if Parliament approved recent audited reports by the Auditor General Edward Ouko that guide the sharing of national revenue, counties would get higher allocations. “Instead of pushing for a referendum, direct your attack to Parliament where audited reports are yet to be considered and approved. This resulted in this financial year revenue sharing being based on audited and approved accounts of the year 2009/2010,” he said.

<sup>213</sup> Ibid.

<sup>214</sup> Kilonzo, K., ( Nairobi, 29<sup>th</sup> September 2014). National Government Must Protect Devolution. *Standard Digital* . Accessed 6h October 2014 at < <http://www.standardmedia.co.ke/article/2000136365/national-government-must-protect-devolution/>>

to collect revenue. This is currently undermining the authority and effectiveness of the County Governments.

The Final Report of the Taskforce on Devolution recommended that the revenue collecting powers of the County Governments should vest in the Kenya Revenue Authority, and that the KRA Act should be amended to make KRA a shared institution that serves the two levels of government. This, according to the report will have the added advantage of enforcing uniform standards and the generation of reliable data on county tax revenues that can be used in the determination of equitable share of national revenue. The report suggests that the use of KRA in tax collection and administration will result in economies of scale lower tax administration costs as well as enhance tax revenues.<sup>215</sup> Indeed, county governors have started discussions with KRA with the aim of formulating a framework that will see the taxman collect their county dues and remit the money back.<sup>216</sup> This arrangement has however faced criticism by the Transitional Authority who argue that in the long term, if the County Governments are suppressed leaving the control of finances in the hands of the National Government Institutions, the whole concept of devolution will be defeated.<sup>217</sup>

There are however some limitations in using KRA as tax collection agents by the County Governments. KRA is very rigid when it comes to tax collection and will not hesitate to impose stiff penalties on defaulters. This may discourage some county residents who may historically have not been paying taxes from compliance. Additionally, the County Governments may not be in a

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<sup>215</sup> See Op cit 1.

<sup>216</sup> Kagwe. W., (Nairobi, 17<sup>th</sup> August 2013). KRA to collect Taxes on behalf of the 47 Counties. *The Star* <http://allafrica.com/stories/201308190687.html>> Accessed 19<sup>th</sup> August 2013

<sup>217</sup> See Op cit 63.

position to hold KRA to account for the taxes collected For example. Finally, by acting as collection agents, KRA may impose collection fees on the County Governments which will eat into the total County revenues. This may be expensive for the County Governments to sustain in the long run.

Health is one function that has been assigned to the County Government according to Schedule 4. However, it has been proven that indeed counties are not prepared to handle health workers salaries as demonstrated by their frequent strikes. This forced the National Government to step in and facilitate payment of health workers. To avoid this and other such obstacles, there needs to be effective capacity building efforts at the county level to ensure that once the final phase of transfer of functions is completed and the functions have been fully assigned, service delivery is not disrupted. For this to be done, the National Government must take full responsibility in ensuring that before functions are transferred to the County Governments, they must have adequate capacity to handle the same.<sup>218</sup>

### **3.3.4 Excessive County Budgets**

The Office of Controller of Budget released a report in February 2014 on the county Budget implementation.<sup>219</sup> During the financial year 2013/14, the total County Governments budget

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<sup>218</sup> Ibid. “ For this period, and after, the National Government has a continuous responsibility to provide, at no cost, technical assistance to the counties and to assist them in capacity building. It has a constitutional and legal duty to see to it that these County Governments have all the financial and other resources necessary for them to succeed. No function should have been transferred to any County Government unless and until the National Government was satisfied that it had the capacity to successfully take over and perform.

<sup>219</sup> The Constitution of Kenya, 2010 Article 228 (6) stipulates that the Controller of Budget shall submit to each House of Parliament a report on the implementation of the budgets of the National and County Governments every four months. Section 39(8) of the Public Finance Management (PFM) Act, 2012 also requires the office of Controller of Budget to ensure that members of the public are given information on budget implementation both at the national and county government levels in line with the provisions of Article 228 of the Constitution.

amounted to Ksh 275.8 billion.<sup>220</sup> This comprised of Ksh. 163.7 billion (59.3%) for recurrent expenditure and Ksh 112.2 billion (40.7%) for development projects.<sup>221</sup> The county assemblies have been accused of endorsing budgets which allocate more funds to recurrent expenditure as opposed to development projects.<sup>222</sup> The biggest allocation of this expenditure went to salaries which amounted to 47.8% of the total expenditure.<sup>223</sup> This places an unbearable strain on the county wage bill, the consequences of which is an increased burden on the taxpayer and a limit on the funds available for County Governments to carry out their constitutional functions. There is evidence of governors' lavish spending of public funds allocated to County Governments channelled to entertainment allowance and luxury vehicles.<sup>224</sup> The MCA's sitting allowance amounted to 35.9% of the total budgetary allocation.<sup>225</sup> This is distinctly a case of misplaced priorities in the budget process as funds that are set aside for development needs are re-directed to cater for recurrent expensed. Ultimately, this will threaten the devolution process by undermining service delivery.

### **3.3.5 Funding vs. Function**

Function assignment in the context of fiscal decentralisation is also known as expenditure assignment where distinct and discrete functions are assigned to the separate units of devolution.<sup>226</sup>

A common failing at the start of devolution is to pay too much attention to funding and overlook

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<sup>220</sup> Republic of Kenya, Office of the Controller of Budget (2014) County Budget Implementation Report Half year 2013/14 <http://www.cob.go.ke/index.php/virtual-downloads/category/5-countireport?download=57:countybudget-implementation-review-report-half-year-fy-2013-2014>>Accessed on 23<sup>rd</sup> October 2014.

<sup>221</sup> Ibid

<sup>222</sup> Ibid

<sup>223</sup> Ibid

<sup>224</sup> Mureithi, F., (Nairobi, 5<sup>th</sup> July 2013.) Lavish" county Governors risk prosecution. *The Star*. Accessed 27<sup>th</sup> August 2014 at < <http://www.the-star.co.ke/news/article-126959/lavish-county-governors-risk-prosecution>>

<sup>225</sup> See op cit 221

<sup>226</sup> See Op cit 108 at pg. 30



the need to ensure assigned functions and funding match. In a number of cases, this has led to the centralized government giving away funding, but being left with functions that it can no longer afford to perform adequately.<sup>227</sup>

In Kenya, the debate is skewed towards the amount that is allocated to the County Governments as opposed to matching the functions assigned to the counties to the cost of service delivery. The danger of focusing on the amount before determining the functions is that it is likely that service delivery will get worse rather than improve, especially for critical services such as health and agriculture, which are now in the County Government's docket. This additionally puts the credibility of the data on expenditure needs as well as the fiscal capacity of the County Governments into question. In this respect, both the 15% equitable share reserved for County Governments as well as the CRA formula for horizontal sharing of revenue both rely on inaccurate data. This places the equitable allocation of revenue at a great risk. Best practices dictate that allocations should follow the sharing of expenditure responsibilities.

The Transition Authority has already faced allegations that it is biased in its structuring of the County Governments roles. The procedure is not very transparent, with some sectors arguing that the National Government is reluctant to give up power and control of resources that it has exercised since independence.<sup>228</sup> The Chairman of the TA has admitted that the costing exercise conducted by the treasury was based on historical costing which led to some counties being disadvantaged in

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227 Ibid.

228 Kibwana K., (2013). *Examining Legal and Administrative Challenges to Devolution*. A Paper presented at the Law Society of Kenya Annual Conference held in August 2013 in Mombasa.

receiving funds.<sup>229</sup> In addition, the TA lacks an asset register for all the counties which would guide the process of costing.<sup>230</sup> It is therefore evident that the transfer of additional functions without completing the functional assignment process makes it impossible to accurately assess the degree to which counties are being provided with functions consistent with the Fourth Schedule and whether National Government is retaining functions that accord with its constitutional mandate.

The delay in allocating and costing of the functions has resulted in the County Governments opting to take matters into their own hands by exercising political, administrative and fiscal powers which have not been legislatively assigned to them, arguing that the process is too slow and this was diluting the intended spirit of devolution. A good example is the tussle between the two levels of governments as to who should control and finance healthcare facilities.

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229 Obala, R., (Nairobi, 6th October 2104). Transition Authority opposes referendum push, blames Parliament: Standard Digital. Accessed 6<sup>th</sup> October 2014 at < <http://www.standardmedia.co.ke/article/2000137216/ta-opposes-referendum-push-blames-parliament>>

230 Ibid “Wamwangi (The Chairman of the Transitional Authority) acknowledged that the challenges facing devolution had come as a result of not having an asset register and failure to cost functions before devolving them.

## CHAPTER 4

### REVENUE ALLOCATION: LESSONS FROM SELECTED COUNTRIES

#### 4.1 INTRODUCTION

A country's political decision to follow a unitary system, confederation or a federation will ultimately impact its fiscal management, economic development and its social stability.<sup>231</sup> Kenya has a unitary system of the government that has decentralized its powers and functions to the county level using devolution which is entrenched in the constitution. Other forms of decentralization of power included federalism which is practiced in 24 countries including United States of America, Germany, Switzerland and Nigeria- among others.<sup>232</sup>

One of the research objectives of this study was to investigate whether there are any vital lessons that Kenya can borrow from the legal framework of other jurisdictions. This chapter is an examination of other decentralized governments' jurisdictions' practices in revenue allocation, and in particular how these countries have addressed the challenge of equity in revenue allocation. The study has selected the Federal Republic of Germany, the Federal Republic of Nigeria and the Republic of South Africa. These countries are regional giants in their own respect and have decentralised government structures. Nigeria is an important study as it is a federal state in Africa and the revenue sharing arrangements can be traced to the colonial eras. South Africa on the other

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<sup>231</sup> Salami, A., (2011). Taxation, revenue allocation and fiscal federalism in Nigeria: Issues, challenges and policy options. *Economic Annals*, 59(189), 2750. doi:10.2298/EKA11890275

<sup>232</sup> Globally, there are only 24 of the world's 193 countries including four African countries namely Comoros, Nigeria, Ethiopia and South Africa with clear federal constitutions. Other countries outside Africa that operate federal political systems include America, Canada, Switzerland, Germany, Australia, India, Argentina, Brazil and Belgium. Iraq, Sudan, Sri Lanka and the Democratic Republic of Congo (DRC) are either considering the option or are in transition to a federal system.

hand is not a federation in the strict sense but as a fast developing country, its experience in financial devolution is relevant for Kenya which is a developing country in Africa facing similar challenges, and which recently promulgated its devolution constitution in 2010. Germany is an important study as it is one of the most advanced federations and its financial equalisation system is one of the most highly developed in the world.

The chapter will look at the intergovernmental revenue sharing arrangements from a constitutional and political context, noting the allocation and transfer of funds at each level of government and reviewing the effectiveness and sufficiency of the applicable laws. This chapter summarizes the best practices in revenue allocation and lessons which Kenya can learn from in implementing the revenue allocation formula towards efforts in achieving equity in County Governments.

## **4.2 GERMANY**

The Federal Republic of Germany is divided into a three level administrative structure consisting of the Federal government (Bund), the 16 states (Länder) and over 14,000 municipalities (Gemeinden). Each state represents an independent level of government endowed with its own rights and obligations. The Constitution of Germany (Basic Law) lays out the relationship of these three levels of government by defining the functions and powers of each level.<sup>233</sup> In order to fulfil their constitutional mandates, each state must be equipped with adequate resources and the autonomy to be able to discharge its functions of service delivery to the people at the same time

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<sup>233</sup> Constitution of the Federal Republic of Germany ( Basic Law) Article 70-74

creating and maintaining equal living conditions to its people.<sup>234</sup> As the federal government does not have administrative capacity to collect taxes, the states perform this function as their own concern.

#### **4.2.1 Division of Revenue**

In Germany, tax revenue forms the subject of distribution among the three levels of government. The Constitution apportions the various taxes accruing to each level of government.<sup>235</sup> There are four aspects of distribution of this tax revenue. These are vertical distribution, horizontal distribution, the equalization system and supplementary federal grants.<sup>236</sup>

This Basic Law outlines the vertical sharing of revenue by explicitly listing all the taxes attributed to the federal government, the states and the municipalities. Income tax, corporate tax and VAT are known as joint taxes and these are subject to sharing.<sup>237</sup> The municipalities are entitled to a share of the income tax and VAT but not to corporate tax. Income tax and Corporate Tax generate the lion's share of revenue in Germany. See Table 2 for a summary of the allocation of the joint taxes in 2014.<sup>238</sup>

The second level of distribution of tax revenue is the horizontal distribution which sees the tax revenue belonging to the states as a whole is distributed among the individual states. Apart from VAT, the individual states are entitled, in principle, to the tax revenue which is collected by the

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234 Ibid Article 107

235 Ibid Article 106

236 The Federal Financial Equalization System in Germany(2014).<<http://www.bundesfinanzministerium.de/>> Accessed 25th August 2014

237 Basic Law Article106 (3). See also ibid on page 1

238 See op cit 299 See also: Buetner, T. (2005). The Finances of the German States. See also Table 2.

revenue authorities on their territory (principle of local revenue).<sup>239</sup> When it comes to income tax each state will receive approximately the income tax revenues collected from its inhabitants- whether inside of outside its territory.<sup>240</sup> Similarly when it comes to corporation tax each states share of corporate tax revenue is collected centrally and allocated to the states according to the location of the establishment. In the case of multi-state companies, a formula allocates overall revenue according to the state's share of the payroll.<sup>241</sup>

Horizontal sharing of VAT revenue takes a different approach as up to 25 % of the state's share of VAT goes as a supplementary portion to the states to close the gap between fiscally weak states whose share from the income tax, the corporation tax and the land taxes per capita are lower than the per capita average of all the states. This in effect means that VAT is not distributed according to the principle of local revenue. The exact amount of the VAT supplementary portions depends on the amount by which the per capita tax revenue of a Lander (state) falls below the average per capita tax receipts for all states.<sup>242</sup> A linear-progressive topping-up schedule is used to calculate the exact amount of the VAT supplementary portions.<sup>243</sup> The remainder 75% of the state's share of VAT is distributed according to the population of each state.

#### **4.2.2 Equalization**

The German fiscal equalization mechanism, is a formula-based mechanism and governs financial relations between states after revenues from shared taxes have been split between the federal

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<sup>239</sup> The Federal Financial Equalization System in Germany(2014).<<http://www.bundesfinanzministerium.de/>> Accessed 25th August 2014

<sup>240</sup> Ibid. "This is effected by special regulations (allotment) which are passed to correct the principal of local revenue."

<sup>241</sup> Ibid.

<sup>242</sup> Ibid.

<sup>243</sup> Ibid.

government and the state.<sup>244</sup> It entails an elaborate system of redistribution of intergovernmental transfers with the aim to reduce fiscal disparities among the states. The equalization system follows the distributive objective based on the Basic Law of establishing equivalent living conditions throughout the federal territory.<sup>245</sup> It regulates tax revenue allocation among states after the revenues from shared taxes have been divided between the federal government and the states.<sup>246</sup> The principle is grounded in the Constitution, although the particular mechanisms used are subject to frequent changes and are therefore regulated by federal legislation.<sup>247</sup> However it should be noted that this equalization is partial in order to maintain the fiscal autonomy and sovereignty of the States.<sup>248</sup> The extent of the equalization is determined using the following formula:

$$\text{TR} = (\text{Fiscal Capacity} - \text{Resource Need})^{249}$$

Fiscal capacity represents the Total revenue of the states (this includes 64% revenue from the municipalities in each state)<sup>250</sup>, and the Resource Needs is the product of the population of each state and the average tax revenues for that particular state. The difference between fiscal capacity and resource needs determines whether a state pays or receives additional, horizontal transfers under the equalization principle. The fiscal capacity of a state takes into consideration the

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<sup>244</sup> Hepp, R., & Hagen, J., (2010). *Fiscal Federalism in Germany: Stabilization and Redistribution Before and after Unification*. Accessed 15<sup>th</sup> August 2010 <[http://faculty.fordham.edu/hepp/vHH\\_MZ02\\_Paper\\_2010\\_0830\\_web.pdf](http://faculty.fordham.edu/hepp/vHH_MZ02_Paper_2010_0830_web.pdf)>

<sup>245</sup> Thomas, L., (2008). *Reform of the financial equalization scheme in Germany: A never-ending story?* A paper prepared for the International Colloquium. Competitive Federalism- International Perspectives organized by the Liberal Institute. <http://www.fnf.org.ph/downloadables/Reform%20Financial%20Scheme%20Germany.pdf>

<sup>246</sup> Ibid

<sup>247</sup> Any federal legislation affecting the States must get approval by the Bunderstat (Upperhouse of the German Parliament) which is composed of representatives of the state governments.

<sup>248</sup> Buetner, T. (2005). *The Finances of the German States*

<sup>249</sup> Ibid

<sup>250</sup> The Federal Financial Equalization System in Germany. (2014). Accessed on 25<sup>th</sup> August 2014 at <<http://www.bundesfinanzministerium.de/>>

municipalities' revenues as each state is responsible for providing their municipalities with appropriate and adequate financial resources. Some states such as Berlin, Bremen and Hamburg, city-states that simultaneously both municipalities and States in their own right. They have a much higher financial requirement per inhabitant than the normal States. It would therefore be wrong to assume that they have the same financial capacity per inhabitant as the other States. Therefore, for the purposes of the equalization system where the fiscal need of a state may be higher, the respective state's population figures are proportionately increased.<sup>251</sup>

### **4.2.3 Supplementary Federal grants**

Supplementary federal grants are grants which the federal government makes to fiscally weak states to complement financial equalization among the states. After the equalization processes discussed in the previous sections, some states will still fall short of their required revenues. Any state with less than 99.5% of the average state tax revenues will receive 77.5% of the remaining revenue shortfall from the federal government.<sup>252</sup> This in effect results in almost 100% equalization of the states to ensure no state lags behind in economic and social growth. This is the general supplementary federal grants. There is a second category of federal supplementary federal grants for special needs. These funds are not legally tied to a specific purpose and serve to compensate individual poor states for special burdens they have to bear. The states receiving such federal grants for special needs bear sole responsibility for their use. The exact amount of

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251 The Federal Financial Equalization System in Germany. (2014). Accessed 25th August 2014 at <<http://www.bundesfinanzministerium.de/>>

252 Ibid.



Supplementary federal grants for special needs is listed in the law on Financial Equalization and is thus not related to the financial capacity of the receiving States.<sup>253</sup>

## **4.3 REPUBLIC OF SOUTH AFRICA**

### **4.3.1 Division of Revenue**

The Constitution of Kenya and that of South Africa both have devolution as a key theme running through them. Just like in Kenya, South Africa follows a unitary system of government that is decentralized. It is not federal. While in Kenya there are 2 levels of government, the Constitution in South Africa establishes a three tier system of government which are independent of each other while at the same time interrelated. These include a National Government, nine provincial governments and 284 local governments.<sup>254</sup> Each level of government has its own powers and responsibilities assigned to it.

The national's government's primary role is to manage the country's affairs as a whole and also provides basic services such as national education, water, health and housing. Provincial governments in South Africa are responsible for implementing social services such as school education, health, housing and provincial roads. Local governments are responsible for the provision of public goods such as access roads, streetlights, garbage disposal and town planning, and user services being water and electricity.<sup>255</sup>

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<sup>253</sup> Ibid.

<sup>254</sup> Department of Provincial and Local Government, *South Africa*. Accessed 20<sup>th</sup> August 2014 at < [www.dplg.gov.za](http://www.dplg.gov.za)

<sup>255</sup> The 4<sup>th</sup> and 5<sup>th</sup> Schedule of the Constitution of South Africa divide functions between the three spheres of government.

Prior to 1998, South Africa used discretionary transfers for its revenue-sharing model. The Constitution in South Africa provides for the revenue sharing arrangement between the three levels of government.<sup>256</sup> It provides for a law that ensures the equitable division of revenue raised nationally among the national, provincial and local government as well as the determination of each province's equitable share of the provincial share of that revenue. In addition, the law is to provide for any other allocations to provinces, local government or municipalities from the National Government's share of that revenue, and any conditions on which those allocations may be made. This means that the allocated funds must be used for specified purposes in the targeted sectors. It is worth noting that the provinces do not have a specified revenue base and are totally dependent on transfers from the National Government. Local government and municipalities have control of property taxes and also generate income from selling services such as water, electricity and sanitation. This has resulted in the local government generating over 70% of its own income as compared to the provincial government that generates only 3% of its own revenue, relying heavily on transfers from the National Government.

The equitable transfer to the provincial governments in South Africa takes into consideration the following parameters: (i) Population of the province (weighted at 14%); (ii) Education share based on the size of the school age population and the average number of learners enrolled in public schools over the previous three years ( weighted at 51%); (iii) Health share based on the proportion of the province's population without access to medical aid ( weighted at 26%); (iv) An institutional component divided equally among the provinces (weighted at 5%); (v) a poverty component based on the poverty incidence ( weighted at 3%) and (iv) and output component based on province level

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<sup>256</sup> Constitution of the Republic of South Africa ( 1996) Section 214

GDP ( weighted at 1%).<sup>257</sup> An interesting comparison can be made with Kenya's approved CRA formula that applies the following parameters: Population 45%, Poverty Index 20%, Land Area 8%, Basic Equal Share 25%, and Fiscal Responsibility 2%. South Africa gives the most weight to the education parameter and health, which are not factored in Kenya's formula. Population comes in third as compared to Kenya where it is given the most weight.

Section 214 of the Constitution (Act 108 of 1996) requires that an Act of Parliament be promulgated annually to provide for the equitable sharing of nationally-raised revenue among the national, provincial and local spheres of government. The Division of Revenue Act (DORA) is primarily directed at supporting the principles of co-operative governance<sup>258</sup> and strengthening inter-governmental relations, as stipulated in the Constitution. The Fiscal and Financial Commission<sup>259</sup> in South Africa is tasked with the responsibility of ensuring equitable division of revenue between the three tiers of government and among provinces and local governments in a transparent, predictable and equitable manner. The commission is also tasked with creating an equalization fund.

### **4.3.2 Equitable Share**

The equitable share for local government was introduced for the first time in the 1998 / 99 fiscal year. The primary objective of the equitable share is to ensure that all South Africans have access

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<sup>257</sup> See Op cit 108 at pg 94.

<sup>258</sup>Momoniati, I., (1998). *Fiscal Decentralisation in South Africa: A practitioner's Perspective*. Accessed 27<sup>th</sup> August 2014 at < <http://info.worldbank.org/etools/docs/library/128819/Momoniati%202001%20South%20Africa.pdf>> The principle of cooperative governance is a principle entrenched in the constitution that obliges the three spheres of government to cooperate and legally enforces negotiation, rather than litigation to resolve political (and budgeting) problems between all the levels of government.

<sup>259</sup> Constitution of South Africa (1996) Section 199

to basic services. This is an unconditional transfer i.e. local government must use its discretion in utilizing the equitable share. In exercising discretion, municipalities must take into consideration their Constitutional mandates.

### **4.3.3 The Budget process**

The Constitution provides that national, provincial and municipal budgets and budget processes must promote transparency, accountability and the effective financial management of the economy debt and public sector.<sup>260</sup> The Constitution further stipulates that the National legislation must prescribe the form of national, provincial and municipal budgets<sup>261</sup>, the date these budgets must be tabled,<sup>262</sup> and that these budgets must show the sources of the revenue and the way in which proposed expenditure will comply with national legislation. Further budgets in each level of government must outline proposals for financing any anticipated deficit and any borrowing intentions that will increase public debt during the ensuing years.<sup>263</sup>

### **4.3.4 Conditional and Unconditional inter-governmental grants**

Each province and the local governments is entitled to an equitable share of revenue raised nationally to enable it to provide basic services and perform the functions allocated to it. The provinces and local governments may also receive other allocations from National Government revenue, either conditionally or unconditionally. Additional revenue raised by provinces or municipalities may not be deducted from their share of revenue raised nationally, or from other allocations made to them out of National Government revenue. Equally, there is no obligation on

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<sup>260</sup> Ibid Section 215

<sup>261</sup> Ibid

<sup>262</sup> Ibid

<sup>263</sup> Ibid

the National Government to compensate provinces or municipalities that do not raise revenue commensurate with their fiscal capacity and tax base. This is a notable difference with Kenya's as well as Germany's revenue allocation framework where the Constitution provides for additional conditional or unconditional transfers from the National Government to the County Governments in where the County Governments fall below their financial requirements.

#### **4.3.5 Municipal fiscal powers and functions**

A municipal government may impose rates on property and other charges for services it provides. Any other taxes (with the exception of income tax, value added tax, general sales tax and customs duty) collected by a municipality must be authorized by national legislation.<sup>264</sup> These powers of local governments to raise taxes must be in alignment with the national economic policies and may be regulated by national legislation.<sup>265</sup> Before enacting any legislation, the municipalities must consult with the local governments as well as the Financial and Fiscal Commission and any recommendation thereon considered.

#### **4.3.6 Borrowing powers of Provincial and Local governments**

The Constitution provides that a province or municipality may borrow capital for capital expenditure in accordance with national legislation which is enacted after any recommendations of the Financial and Fiscal Commission have been considered. Loans for current expenditure however may only be raised when necessary for bridging purposes during a fiscal year. The same must be repaid within 12 months.<sup>266</sup>

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<sup>264</sup> Ibid Section 229

<sup>265</sup> Ibid

<sup>266</sup> Ibid Section 230

### **4.3.7 Principles of Revenue Allocation**

Just as is the case in Kenya, the revenue sharing arrangements in South Africa are guided by certain principles. The Constitution in South Africa outlines certain guidelines that are to guide revenue allocation in South Africa.<sup>267</sup> These are:

- a) the national interest;
- b) national debt and other national obligations
- c) the needs and interests of the National Government, determined by objective criteria;
- d) the need to ensure that the provinces and municipalities are able to provide basic services and perform the functions allocated to them;
- e) the fiscal capacity and efficiency of the provinces and municipalities;
- f) developmental and other needs of provinces, local government and municipalities;
- g) economic disparities within and among the provinces;
- h) obligations of the provinces and municipalities in terms of national legislation;
- i) the desirability of stable and predictable allocations of revenue shares; and
- j) the need for flexibility in responding to emergencies or other temporary needs, and other factors based on similar objective criteria.

## **4.4 THE FEDERAL REPUBLIC OF NIGERIA**

The subject of equitable revenue allocation in Nigeria has over the years been one of the most contentious issues, having been subjected to several discussions and analyses. It has also over the

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<sup>267</sup> Constitution of the Republic of South Africa Section 214 (2)

years evoked high tensions and emotions on all the stakeholders.<sup>268</sup> Nigeria has a population of more than 155 million people. It has one federal government, 36 state governments and 774 local governments. Each tier has its own constitutional responsibilities. The history of revenue sharing can be traced back to 1951 with the institution of commissions to help allocate revenue in an equitable manner. However, since then, no acceptable formula that is equitable and efficient has been arrived at to date. The process of finding an acceptable formula has often been hindered by political and ethnic considerations that have stalled the process.<sup>269</sup>

#### **4.4.1 Evolution of the Revenue Allocation Formula in Nigeria**

In 1946, Nigeria was a unitary government divided into three administrative regions. The first ever commission set up by the colonial masters to look into revenue allocation was the Phillipson Commission. The Commission's recommendation was based on the principles of derivation, even progress of the states and population.<sup>270</sup> The Hicks/Philipsons Commission of 1951<sup>271</sup> came up with four principles namely: Independent revenue, derivation, need and national interest.<sup>272</sup> The Central government shared the centrally collected revenue equally with the regions, and the

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<sup>268</sup> Orokopo, Ogbole, F., & Robert, S. R. (2012). Revenue Allocation Commissions and the contradictions in Nigeria's Federal System: A revisit. *Journal of Social Science and Policy Review*, 4, 81. Retrieved from [http://www.academia.edu/2614756/revenue\\_allocation\\_commissions\\_and\\_the\\_contradictions\\_in\\_nigerias\\_federal\\_system\\_a\\_revisitation](http://www.academia.edu/2614756/revenue_allocation_commissions_and_the_contradictions_in_nigerias_federal_system_a_revisitation) Accessed on 17th August 2011

<sup>269</sup> Agba, D. (Nigeria, 12<sup>th</sup> July 2013). Welcoming Nigeria's new revenue formula. *Blueprint Newspaper* <http://www.blueprinting.co/new/2013/07/12/welcoming-nigerias-new-revenue-formula/> Accessed 30<sup>th</sup> September, 2014.

<sup>270</sup> Ikeji, C. C., (2011). Politics of revenue allocation in Nigeria: A re-visitation. *Mediterranean Journal of Social Sciences*, 2(3), 299. doi:10.5901/mjss.2011.v2n3 p299 Also, see Op cit 269. p 85. "The period during the Phillipson Commission was characterized by strong federal's government's presence in fiscal matter.

<sup>271</sup> Op Cit 269 "The Hicks Philipsons Commission appointed 1950 under a new Constitution which marked a first step to strengthen federalism in Nigeria. The recommendations of the commission were to take effect in 1952/53. By this time, the regional councils were assigned fiscal powers with independents revenues and tax jurisdictions

<sup>272</sup>Ibid. "The Commission's report recommended that the Regions should be given power to raise, regulate and appropriate certain items of revenue.

regions shared revenues amongst themselves based on the principle of derivation.<sup>273</sup> The recommendations of the Hicks Phillipson Commission was a departure from the previous commissions to the extent that population was not considered as a criterion of revenue distribution. Thereafter the Chiks Commission was appointed once again to review the revenue allocation formula.<sup>274</sup> Its main recommendation was the derivation principal. The Northern and Eastern Regions were each allocated a weight of 30% (in line with the derivation principle) while the Western Region was allocated 40%.<sup>275</sup>

Nigeria officially became a federation in 1954 and attained its independence in 1960. Post-independence Nigeria saw the establishment of several commissions between 1959 and 1967. There was a lot of dissatisfaction with the derivation principle which led to the Raisman Commission<sup>276</sup> which recommended that mineral producing areas should have a lion's share from the revenue accruing from the mineral wealth ( regional retention of independent revenues), and saw 50% of the oil revenue going to the region of origin and 20% to the federal government and 30% to the Distributable Pool Account (DPA)<sup>277</sup> where the states of origin also share from, in addition to complete regional jurisdiction over income tax and export duty.<sup>278</sup>

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<sup>273</sup> Op cit 269 at pg.8

<sup>274</sup> The Chicks Commission headed by Sir Louis Chick was appointed to review the revenue sharing formula upon the adoption of the Lyttleton Constitution.

<sup>275</sup> Okoye, E. I., Ogbada, E. I., & Ezugwu, C. I., (2007). The critical appraisal of the performance of Revenue Sharing Formula towards a sustainable Fiscal Federalism in Nigeria. *Journal of Policy and Development Studies*, 1(2), 1-8. Retrieved from ISSN 1597-9385

<sup>276</sup> This was under the Chairmanship of Sir Jeremy Raisman. The Commission's report was published in 1968

<sup>277</sup> See Op cit 269

<sup>278</sup> Ibid.



The Binns Commission of 1964<sup>279</sup> recommended the increase of the share of the DPA from 30% to 35% and the continued retention by the regions of 100% of the import and export duties. In 1967 the military regime divided the country into 12 states<sup>280</sup> and therefore the Binns formula that was still applicable at the time had to be revised. This saw an increase of the revenue to the Federal government and a reduction of the amount allocated to the state government. The Dina Committee report of 1969<sup>281</sup> was rejected as it recommended a slight reduction of the powers and functions of the states which did not sit well with the government of the Federation.<sup>282</sup>

In 1977, the military government appointed the Aboyade Technical Committee to review the revenue sharing formula. Its major recommendation was the statutory requirement that local governments should have a share of the national revenue.<sup>283</sup> In 1980 the Okigbo Committee revised the vertical revenue allocation formula into a horizontal revenue allocation formula that factored in national interest, derivation, population, even development, equitable distribution and equality of states.<sup>284</sup>

The Babanginda administration reviewed the revenue allocation formula several times between 1985 and 1989. During that time the formula of vertical allocation formula was Federal government at 55%, State government at 32.5% and local government at 10%.<sup>285</sup> Between 1992

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<sup>279</sup> Mr. K. J. Binns was appointed in 1964 to review the revenue sharing arrangements.

<sup>280</sup> Decree no. 15 of (1967)

<sup>281</sup> See Op cit 269

<sup>282</sup> Ibid. See also Op cit 279 at pg. 86. "The Committee stressed the most urgent problem facing the nation as the gross imbalance in economic development among various states of the federation. It thus introduced a minimum responsibility of government as a revenue sharing criterion. It also recommended the need of creating an independent and permanent revenue planning and fiscal commission.

<sup>283</sup> Ibid

<sup>284</sup> See Op cit 269.

<sup>285</sup> Ibid at pg. 129

up to 1999 during the Abacha administration, the revenue allocation formula was as follows: federal government 48.5%, state government 24%, local government at 20% and the Special Fund at 7.5%.<sup>286</sup>

#### **4.4.2 The 1999 Constitution**

The 1999 Constitution gave the Revenue Mobilization Allocation and Fiscal Commission (RMAFC) legal mandate to develop a revenue allocation formula.<sup>287</sup> This put an end to the several commissions that largely operated on an ad hoc basis. Its major task involved making recommendations on principles of revenue sharing and developing principles on how revenue in Nigeria would be shared between the three levels of government subject to the approval of the National Assembly subject to the approval of the National Assembly. All revenues collected by the government of the federation shall be paid into a Federation Account established by the Constitution.<sup>288</sup>

The National Assembly is empowered to approve the recommendation of the RMAF on the revenue allocation formula tabled before it, taking into account the allocation principles especially those of population, equality of states, internal revenue generation, land mass, terrain as well as population density.<sup>289</sup> It also entrenches the principle of derivation stating that it shall be constantly reflected in any approved formula as being not less than thirteen per cent of the revenue accruing

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<sup>286</sup> Oladeji, B., (14<sup>th</sup> November 2011) Nigeria: Revenue Sharing Formula- Can National Assembly break the jinx? *Leadership* <http://www.allafrica.co./stories/2011> Accessed 14th august 2014

<sup>287</sup> Paragraph 32 (b) Part 1 of the Third Schedule to the 1999 Constitution of the Federal Republic of Nigeria ( as amended)

<sup>288</sup> Ibid, Section 162(1)

<sup>289</sup> Ibid, Sub-section (2) of section 162

to the Federation Account directly from any natural resources.<sup>290</sup> This implies that the natural resources must be located within a State to enable it qualify for this allocation of funds from the Federation Account.

#### **4.4.3 Obasanjo Regime (1999-2007) and the Resources Control Suit**

Following its constitutional mandate, the RMAFC submitted to the National Assembly a proposal on the revenue allocation formula where the Federal Government – 41.3% State Government – 31% and Local Government – 16%. And Special funds at 11.7%. This proposal did not make it to the National Assembly for debate as it was challenged before the Supreme Court<sup>291</sup> which in its verdict declared the allocation of Special funds as unconstitutional, illegal, null and void as it was in contravention of Section 162 (3) of the Constitution. This led to the proposal being withdrawn for further consultation and review to align it with the provisions of the Constitution.

In March 2003, President Obasanjo invoked an executive order revising the RMAFC proposal and came up with a new formula<sup>292</sup> which is as follows: Federal Government – 52.68% State Government – 26.72% and Local Government – 20.60%. This has remained the current revenue allocation formula to date. There have been numerous attempts to review this formula by the RMAFC which has initiated several processes to review the formula by involving participation by all stakeholders, in order to ensure a credible fair and equitable new revenue allocation formula.

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<sup>290</sup> Ibid.

<sup>291</sup> SC28/2001 Attorney General of the Federation and Attorney General of Abia State and 35 others: The Supreme Court ruling instituted by the then Attorney General and the Minister of Justice which declared the special funds unconstitutional.

<sup>292</sup> The Initial Presidential Executive Order was FG 56% States 24, 72 and Local Government at 20.62%. There was a massive outcry by the states who were against the massive allocation to FG and this led to its current revision of 52.68%, and increased the states to 26.72%.

The Commission has invited stakeholder participation and sensitization campaigns and advocacy programs have been rolled out. From the foregoing, it can be deduced that the debates and discussions over an acceptable revenue sharing formula in Nigeria revolve around three issues namely: (i) the percentage of federal revenues to be shared among the federal government, the state governments and the local governments i.e. vertical allocation; (ii) the sharing of the revenues among the state governments and the local governments (horizontal allocation) and (iii) the principle of derivation that dictates that a specified percentage of oil revenue collected at the federal level should be returned to the oil bearing states.<sup>293</sup>

#### **4.4.4 The Oil Factor in Nigeria**

The discovery of crude oil which became the major source of revenue changed the dynamics in Nigeria as far as allocation of revenue was concerned. Oil is recognized as the major foreign exchange earner for Nigeria and contributes over 80% of Nigeria's Gross Domestic Product (GDP).<sup>294</sup> It is without a doubt the most important economic activity in Nigeria. As a matter of fact, the national budget in Nigeria is prepared based on the expected annual production and the price of crude oil.<sup>295</sup>

Oil is the major driver of the economy's growth and development in Nigeria. In what is considered to be a baffling irony, some oil producing states have been facing untold hardships and neglect by the Federal government. This is influenced by selfish political ambitions which has resulted in resource endowed regions being deprived of the proceeds of their resources. During this debate,

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<sup>293</sup> See Op cit 269

<sup>294</sup> Ibid.

<sup>295</sup> Ibid.

disconcerted voices were of the view that allocating the lions' share of revenue to the oil producing states to receive the lion's share of the resources would lead to uneven development of the states with others lagging behind.

The principle of derivation that has been practiced over the years in Nigeria has been eroded with the discovery of crude oil leading to imbalances and disparity in development among the different regions. This has led to unrest, bitterness from the oil producing states who have continued to clamor for an increase in the 13% allocation in the Constitution. This in turn has led to political problems that has seen disunity in Nigeria. The rationale advanced behind this reasoning is that if the resource producing states were to receive the lion's share of funds from their resources, there would be disproportionate development with the less endowed regions lagging behind. However, this instead has seen the heavily populated states in Nigeria flourishing in terms of revenue as compared to the minority states that are underdeveloped. Thus, rather than contributing to democratic governance and economic growth, Nigeria's oil resource wealth has weakened state institutions, undermined equitable economic growth, and triggered ethnic conflict.<sup>296</sup>

#### 4.4.5 Summary

The various commissions and committees of revenue allocation in Nigeria have been guided by certain principles in a quest to come up with a revenue allocation formula.<sup>297</sup> There is an ongoing

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<sup>296</sup> KO, V., (2014). Nigeria's "Resource Curse": Oil as an Impediment to True Federalism < <http://www.e-ir.info/2014/07/20/nigerias-resource-curse-oil-as-impediment-to-true-federalism/>> Accessed 28<sup>th</sup> August 2014

<sup>297</sup> Lukpata, V. I., (2013). Revenue Allocation Formulae in Nigeria: A continuous Search. *International Journal of Public Administration and Management Research*, 2(1), 32-38. Retrieved from ISSN 2350-2231. The fourteen principles of revenue sharing in Nigeria are: (i) Basic needs; (ii) Minimum Material Standards; (iii) Balanced Development; (iv) Derivation; (v) Equality of Access to Development Opportunities; (vi) Independent Revenue/Tax effort; (vii) Absorptive Capacity; (viii) Fiscal Efficiency; (ix) Minimum responsibility of Government; (x) Population; (xi) Social Development Factor; (xii) Equality of States; (xiii) Landmass and Terrain; and (xiv) Internal Revenue Generation Effort.

controversy among the state governments as well as between the Federal government and the country's Revenue Mobilization, Accounts and Financial Commission (RMAFC) regarding the distribution of Nigeria's revenues from natural resources and other areas. The Federal government's proposal on the allocation of revenue differs from the proposal of the state governments and RMAFC. Based on a 100-percent total allocation, the Federal government wants the breakdown: 56 percent (Federal), 24 percent (states) and 20 percent (local governments). The RMAFC is lobbying for a revenue deal of 47 percent (Federal), 33 percent (states) and 20 percent (local governments). The difference is nine percent less for the Federal government, nine percent more for states and no change for local governments. The RMAFC plan means a 16-percent reduction in income for the Federal government. Some analysts say that such a reduction could send the country into financial crisis, especially if the decrease is not accomplished gradually. They recommend that, if necessary, the RMAFC strategy should allow four to eight years for a phase-in period. Several experts suggest that state governments in Nigeria should seek to generate income from sources outside of the revenue stream they share with the Federal government. This would shield certain income sources from the Federal government's scope of influence and therefore corrupt politicians would not have access all of the states' funds.

The design of Fiscal Federalism in Nigeria remains a contentious issue. Sub-National Governments (State and Local Governments) continue to point to an imbalance between their responsibilities to deliver critical public goods and services (such as primary healthcare, primary education, and water & sanitation) and the proportion of revenue they actually receive under the vertical revenue allocation rule which determines how national tax revenues are shared between the three levels of government (Federal, State and Local) – as stipulated in the 1999 Constitution.

## **4.5 LESSONS THAT KENYA CAN LEARN FROM OTHER COUNTRIES**

### **4.5.1 Fiscal Autonomy in the devolved Units**

The proponents of the fiscal federalism theory advocate for greater fiscal autonomy of the devolved units. Where the devolved units rely solely on the grants from the central governments, economic efficiency may not be achieved as the process may be open to political manipulation with hefty grants being allocated to “favourable regions.” This has been experienced in Nigeria. Counties in Kenya should be encouraged to raise their own revenue where possible. The National Government obviously should be in charge of collecting the major tax bases such as income tax, VAT and Corporate tax. Federations like the USA and Canada are designed in a way that gives the states discretion over their own taxes as most states levy their own corporate tax and personal income taxes. However the danger here is that this can lead to disparities amongst the counties as their revenue raising capacities may vary, and an additional risk of misappropriation of funds due to weak administrative capacities. In order to succeed, Kenya must strengthen the counties’ capacity to raise and collect revenues in order to empower counties. This will lessen their dependence on the National Government and thereby go a long way to provide services to the people.

However, there should be some limits imposed on fiscal autonomy. Jurisdictions with different levels of income and wealth will have very different tax resources at their disposal, and the need to ensure that citizens have access to a roughly equal level of public services will imply some degree of redistribution between sub-central governments. For this reason no country has opted for complete fiscal autonomy. Best practice dictates that redistribution of resources can be

achieved through the use of transfers funded from national revenue, or by implementing tax-sharing arrangements designed to benefit poorer states.

#### **4.5.2 Finance Follows Functions**

Best international practice dictates that allocations to the subnational governments should be in accordance with the sharing of the expenditure responsibilities. This essentially means that finance should follow functions. This is the case in South Africa. Unfortunately in Kenya the approach taken is that of “how much does each county get”. The current calls of amending the constitution through a referendum to increase the 15% equitable share is a reflection of this reality yet the counties cannot manage the amount allocated to them. Furthermore, the phasing of functions from the National Government to the County Governments is yet to be completed, therefore this move may be premature.

#### **4.5.3 Equity in Revenue Allocation**

The lower tiers of government in virtually all jurisdictions are faced with the common challenge of horizontal imbalances which occur naturally in decentralization when it comes to revenue sharing arrangement. If one state or county or province has less fiscal capacity than the other then it would be disadvantaged in providing basic facilities to its residents and would result in both inefficiency and inequity on those jurisdictions. The revenue allocation formula to distribute revenue among the states must factor in all parameters to ensure as much as possible that equity is achieved as that is one of the most fundamental principles when it comes to revenue sharing in any decentralized system of government. The concept of equalization ought to be constitutionalized, as in the case with Germany. Kenya’s Constitution provides for an equalization fund but it does



not contain provisions on how this equalization is to take place. Germany's equalization system has a considerable effect in redistributing disposable per capita income and thereby reducing disparities in the states by about 37%.<sup>298</sup> This results in ensuring that all the states have the financial capacity to provide public services to their residents.

#### **4.5.4 Importance of Intergovernmental relationships**

In decentralized governments, it is common to find shared jurisdiction or at times overlapping jurisdiction between the different levels of government. The importance of intergovernmental cooperation and dependence needs to be emphasized for successful fiscal decentralization to take place especially when it comes to crucial functions such as tax collection and harmonization.<sup>299</sup> Another important aspect of intergovernmental interdependence would be to avoid duplication of functions and avoid wastage.<sup>300</sup> Article 6 (2) of the Constitution of Kenya provides that the governments at the national and county levels are distinct and interdependent and shall conduct their mutual relations on the basis of consultation and cooperation. This is a best practice in that it combines to a certain extent the autonomy of the counties at the same time encouraging joint and collaborative action and decision making.

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<sup>298</sup> See Op Ct 283

<sup>299</sup> Boadway, R., & Watts, R., (2004) *Fiscal Federalism in Canada USA and Germany* Working Paper 2004 (6) © 2004 IIGR, Queen's University < <http://queensu.ca/iigr/WorkingPapers/watts/wattsboadway.pdf>> Accessed 10<sup>th</sup> August 2014

<sup>300</sup> An example in Kenya is the overlapping role of the CDF fund that has made efforts towards health care and education but many projects have been abandoned due to the duplication with the county governments. Education is also duplicated.

#### **4.5.5 Devolved Units retaining their own revenue/ Principle of derivation**

Nigeria is the only federation that practices the principle of derivation whereby a state retains a share of revenue obtained from the exploitation of its natural resources within its territory. This is embedded in the Nigerian Constitution to ensure that mineral producing states benefit from their share of revenues to the federal government. Currently in Nigeria, the oil producing states are authorised to retain 13% of the total revenues derived from oil mining, although there are calls to have this percentage increased. Germany to a lesser extent practices what is known as the principle of local revenue, which is more or less similar to the principle of derivation in Nigeria. This is however not entrenched in the German Constitution. The principle of local revenue in Germany applies to income tax and corporate tax where revenues from the inhabitants of the respective states are retained by the individual states. This ensures resource rich counties benefit from their resources- to some extent and are not drowned by the equalization agenda.

#### **4.5.6 Role of the Local Government in Revenue Allocation**

The local governments in Kenya were replaced by the County Governments. In Germany, the role of the local government (municipalities) in financial arrangements are expressly provided for in the constitution.<sup>301</sup> Similarly, in South Africa, the local governments' share of the national revenue is provided in the Constitution. They have control over the property taxes, Municipalities are mandated to generate income from selling services such as water, electricity and sanitation, which accounts for 70% of their income. The remainder of their income is from the equitable share of the

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<sup>301</sup> Basic Law Article 28(2) and Part X Articles 104a-115. It however should be noted that three of the 16 federal states are city-states (Berlin, Bremen and Hamburg). These three federal states do not separate their municipal budgets from their respective federal budgets and thus only have a federal budget.

revenue raised nationally as well as conditional grants. In Kenya no reference is made in the Constitution regarding the funding lower levels of governments such as municipalities.

Some lessons can be drawn from the above. First, the measure of accountability that a devolved unit owes its residents is directly related to the amount of revenue it collects from them. In South Africa, the provinces receive almost all their revenue from the National Government and therefore they are totally accountable to the National Government. In contrast, the municipalities are dependent on their residents for revenue and are directly answerable to its residents.

#### **4.6 Concluding Remarks**

The Kenyan legal and institutional framework of devolution largely mirrors that of South Africa. Both countries have adopted centralised financial system for its devolved units. The National Governments controls the major revenue bases. However, unlike counties, the provincial governments in South Africa have no constitutionally entrenched taxing powers. The two countries have different set of circumstances that influenced their devolution agendas. In South Africa, devolution was largely a reaction against the white minority rule that controlled majority of the resources and propagated the apartheid system. In Kenya, the reasons behind devolution as we have seen was that Kenyans were against the centralisation of power and resources and therefore wanted a more inclusive government closer to the people, which would lead to equitable development.

Germany is a developed country and has had many years to perfect its revenue sharing arrangement, which as we have seen seems to be ideal. The German system of sharing income tax,

corporate tax and VAT (joint taxes) may not be viable in Kenya as it may impose extremely high taxation burdens on the people in order to raise an optimal amount of revenue to be shared between the two levels of government. Kenya can however learn from Germany's highly elaborate system of Equalization that entails an elaborate system which aims at reducing fiscal disparities amongst the states. The Constitution in Kenya provides for an Equalization Fund for marginalised regions but as we have seen, it is highly unlikely that this fund will achieve its intended objectives. The CRA's criteria for determining marginalised regions has been put under scrutiny and the Fund is under threat as the MP's are lobbying to have control over it. Rather than having an Equalization Fund, there should be a formula, just like in Germany that takes into account fiscal capacity and resource needs of the counties. After funds received from the National Government have been shared amongst the counties (using CRA formula), the equalization formula can be applied in order to bring the counties to the same level to the greatest extent possible.

Kenya still allocates far less revenue to its devolved units as compared to Nigeria and South Africa. Even with the 33% allocation which is above the minimum 15% set in the constitution, the counties still yearn for a higher allocation in order to discharge their mandates. Only Germany seems to have found the right balance in the tax revenue allocation and equalization. Kenya should aim to achieve this balance.

## CHAPTER 5

### CONCLUSION AND SUGGESTIONS

The new Constitution has given Kenyans renewed hopes for a fairer, more equitable distribution of resources. Being a unique feature, the Constitution has entrenched the devolution of political power, responsibilities and resources to the county level. Like one of the hypothesis adopted, devolution is indeed the solution to bring socio-economic development and put an end to disparities by bringing about equitable distribution of national revenue. This in turn will address some major challenges that the country has faced over the years including high levels of poverty, inequality, poor service delivery and lack of transparency and accountability. The success of devolution will be measured on the basis of the country's success in overcoming these challenges.

Kenya's devolution is very ambitious and to a certain extent challenging because it involves transferring substantial powers and resources to entirely new units of government. It implies major changes to political and administrative institutions. The control over national resources in Kenya has been highly centralized ever since independence, and devolution has necessitated a major reorganization of the legal and institutional framework. The new counties have had to set up new institutions, recruit staff and build capacity to enhance revenue collection. There are bound be several challenges in implementing the legal and institutional framework provided in the Constitution.

This study has opted to combine the conclusion together with the suggestions on the way forward as discussed below.

## **5.1 Equitable Division of Revenue between the two levels of government**

The previous chapters have discussed division of revenue between the National Government and the County Governments which we have seen according to Article 206, the County Governments are entitled to at least 15% of the audited revenue from the National Government. The Constitution provides for a minimum allocation but fails to specify the maximum limit the counties are entitled to, leaving this for Parliament to determine. This has been one of the major sources of conflict as far as the allocation of revenue is concerned.

The opposition and the county governors want the Constitution to be amended to increase this figure from 15% to 45%. That way, they argue, the counties will discharge their functions efficiently. When compared to other jurisdictions discussed previously, Kenya's share to County Governments is amongst the lowest. However, this study submits that it is too early for a constitutional amendment. The 15% allocation should be left to work for a period of at least five years. By this time, a proper costing and transfer of functions to county governments will have taken place using accurate data. It is upon this that an assessment will be conducted by the Commission on Revenue allocation who would then recommend whether there is need to increase the allocation to the county governments.

This study further submits that the allocation raised nationally between the National and County Governments each year should be based on the preceding years' audited revenues approved by the National Assembly. The National Assembly should therefore act in accordance with the law and debate the audited accounts presented by the Auditor General in time. This way, public resources

are safeguarded from misuse and above all employed efficiently and effectively for the benefit of all Kenyans.

## **5.2 Equity between the various County Governments**

The CRA's formula for allocating the equitable share across Kenya's 47 counties takes into account five parameters of population, equal share, poverty, land size and fiscal discipline. One major concern however is that as the transfer of functions to the counties is yet to be completed, the credibility and completeness of the data on expenditure needs and fiscal capacity of the County Governments is questionable. As it currently stands, the CRA formula may not achieve the equalization objective as each counties fiscal capacity is unknown. Germany, in comparison has a clear methodology of determining the fiscal capacity of each state that guides in determining the exact amount of allocation.

Article 217 of the Constitution provides flexibility in the revision of the formula every five years to allow for adjustment as circumstances change. This study therefore recommends that the current formula should be monitored closely and tested. Once the complete phasing of functions to the counties is completed, the formula should be revised in the next five year cycle using credible empirical data collected during the five years. Until then, additional county financial revenues should be complemented by other conditional and unconditional instruments as well as their own revenue raising capacities.

### 5.3 The Equalization Fund

The Equalization Fund which is constitutionally set at 0.5% of the total revenues is meant to serve those extremely marginalized counties in providing basic services such as water, health facilities and roads, in order to bring them to the same level ( to the extent possible ) as other counties. In the financial year 2013/14, this amounted to Ksh 3.4 Billion. This is rather an insignificant amount as compared to the magnitude of infrastructural projects that would need to be undertaken in these marginalized areas to correct the historical marginalization and imbalance across the regions in Kenya.<sup>302</sup> This study that submits that although small in size, the fund should be retained and the percentage allocation should be reviewed upwards in the next cycle.

In order to make the Equalization fund achieve its intended objectives, the CRA criteria for identification of marginalized areas should be polished such that it is transparent. This study submits that legislation should be enacted by parliament that will oversee the administration of the fund, which should be managed nationally. Any efforts to have the fund managed at the constituency level by members of parliament should be rejected. This will ensure that the fund is not diverted to be used for other purposes rather than correcting the historical marginalization of some communities. With the right legal framework that determines an objective allocation criteria as well as an accountable oversight mechanism, the fund could make a huge difference in the lives of Kenyans in marginalized communities.<sup>303</sup>

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302 Young, L. A., & Sing"Oei, A. K., (2013). Maximizing Kenya's Equalization Fund. *A Devolution Policy Brief by Prorights Consulting*. Accessed 25<sup>th</sup> October 2014 at <<http://www.prorigthsconsulting.com/wp-content/uploads/2013/05/Maximizing-Eq-Fund-ProRights-2013.pdf>>

303 Ibid.



## **5.4 National and County Budgets**

This study has discussed in detail the budgeting process in Kenya under Chapter 2. The budgeting process is a welcome step especially now that public participation in the budget process is anchored in the Constitution. The study reiterates the importance of citizens' participation in formulating both the National and county budgets. However, this public participation needs to be real and not just perceived. The citizens should be actively involved in planning and budgeting at the county level and equipped with the tools to make significant contributions. In this regard there should be an open system that records monitors such public participation, and an open criterion that accepts or rejects the public views.

## **5.5 Assigning functions to County Governments**

From the discussion regarding the allocation of functions by the Transitional authority, it is evident that the TA is slugging on its mandate. The final phasing of functions is to be completed by 2016. The process of assigning functions should have been finalized in order to guide the expenditure and revenue assignment. The county governors after much struggle have somehow managed to have almost all the functions under schedule 4 of the Constitution transferred to the counties. This is despite concerns raised by the CIC that this rushed transfer would create problems if the counties lacked capacity to manage these functions. Indeed, the responsibility of ensuring this is done squarely rests with the National Government as the custodian and protector of devolution as Kethi Kilonzo observed.

This study submits that as a matter of priority, the National Government should embark on building capacity at the county level in order to ensure that the phasing of functions to the County Government is seamless.

## **5.6 Revenue from National Resources**

Kenya is a vast territory that has natural resources spread out across the various counties. The benefits of these natural resources are crucial in adding to the revenue of the National Government and in some cases the County Governments. The issue of sharing revenue derived from these natural resources often constitutes a source of conflict both between levels of Government, and with local communities who feel entitled to this revenue. In years to come their potential may increase vastly as demonstrated by the recent discovery of oil in Turkana County. The question however remains- to what extent are these resources considered public?

This study recommends that for the time being, the National Government should be responsible for collecting the revenue relating to natural resources. This is because the National Government has capacity to do so as compared to the County Governments and it is better placed to ensure that this revenue is distributed in an equitable manner. If each county was left to collect all the revenue within its boundaries, the wealthier counties would be reluctant to share the same and this will enhance the inequalities that the constitution has fought to eliminate.

The Mining Bill 2014 if passed by Parliament will change the dynamics as far as control of natural resources by local communities is concerned. For the first time, the bill will introduce the principle of derivation whereby local communities would retain a share or percentage of the proceeds obtained from exploring the natural resources. This is a positive step that will see the local

communities benefit from the natural resources. It seems that Kenya has learnt valuable lessons from the Nigeria which has experienced numerous challenges in addressing the distribution of oil revenue between the oil producing states and the federal government. Nigeria is yet to get this right as demonstrated by the crisis facing the people of the Niger delta which produces the highest numbers in terms of oil revenues yet its people are faced with extreme poverty levels.

### **5.7 Fate of other decentralized Funds**

As a matter of urgency, the government must develop a policy that will decide the fate of existing decentralized funds. As it stands there is considerable wastage of public funds due to the lack of coordination between the County Governments, the line ministries as well as the CDF managed by members of Parliament. The implementation of administering the funding regimes of the decentralized funds has been particularly challenging as they lack adequate administrative capacity and have been subject to abuse by politicians in advancing their selfish needs.<sup>304</sup>

The study submits that there is no place for these funds under the new Constitution, and that they should all be repealed. This will eliminate wastage of public resources and duplication of functions. The unit of devolution is the county, and revenue from the national government should be disbursed at the county level, and not at the constituency level.

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<sup>304</sup> Nyamori, R.O., (2009). Making Development Accountable: A critical Analysis of the Systems of Accounting and Accountability for the Constituency Development Fund in Kenya. *Journal of Accounting and Organizational Change*, Vol. 5 (2); 197-227

## 5.8 Own County Revenue Capacity

The Constitution empowers the counties to collect their own revenues. This is a giant leap from the previous constitution in that a revenue base has been created for the lower levels of government. As progressive as this may be in the spirit of devolution, the revenue base available to County Governments under Article 209 of the Constitution still remains modest. According to the Half year County Budget Implementation Report for the financial year 2013/14, the County Governments had collectively targeted to collect Ksh 67.8 billion locally but only managed to collect a mere Ksh 9.0 billion.<sup>305</sup>

County governments are given power under Article 209 of the Constitution to impose property taxes, entertainment taxes and any other taxes that it is authorized to impose by an act of parliament. So far, no act of parliament has been enacted to enable the County Governments impose any other type of tax. The Commission on Revenue Allocation recently launched the Model County Revenue Legislation Handbook<sup>306</sup>This Handbook is to guide the County Governments in drafting their legislation that would lead to efficient collection of revenue. The Chairman of the CRA noted that County governments are not collecting as much revenue as compared to the former local authorities.<sup>307</sup>

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<sup>305</sup> Republic of Kenya, Office of the Controller of Budget (2014) County Budget Implementation Report Half year 2013/14 <file:///C:/Users/aambetsa/Downloads/countybudget%20implementation%20review%20report%20half%20year%20fy%202013-2014.pdf>> Accessed on 23<sup>rd</sup> October 2014

<sup>306</sup> Commission on Revenue Allocation ( July 17<sup>th</sup> 2014) Press Release on the Launch of the model County Revenue Legislation handbook < <http://www.crakenya.org/press-release-on-the-launch-of-the-model-county-revenue-legislation-handbook/>> “The need for the development of the Model County Revenue handbook was informed by Counties seeking concepts and setting parameters for revenue generation and revenue enhancement presented by the new constitution.”

<sup>307</sup> Odongo, P., (Nairobi, July 11<sup>th</sup>, 2014). County Governments’ Revenue down by 25pc. *Standard Digital Business* < <http://www.standardmedia.co.ke/business/article/2000127736/county-governments-revenue-collection-down-25pc>> Accessed on 23<sup>rd</sup> October 2014. Speaking at the launch of the “Model County Revenue Legislation Handbook

In light of the above, this study therefore submits that the tax revenue base at the county level should be broadened. Parliament should therefore enact legislation that allows County Governments to impose additional taxes that may be outside the list provided under Article 209 of the Constitution. This will encourage County Governments to come up with innovative ways of raising their own revenues through taxation. For example, as practiced in Germany, corporations in each state pays tax to that state in which it is located. This can be adopted in Kenya now that devolution has opened up counties to investors. Many companies are setting base in the various counties and corporate tax should be explored as a viable source of revenue for the County Governments. This study agrees and reiterates the recommendations of the County Budget Implementation Review Report on increasing their revenue collecting capacity.<sup>308</sup> These include strengthening the internal control systems at the county level which would reduce revenue leakages.<sup>309</sup> Additionally, county Governments should avoid spending revenue collected at source, and instead transfer all monies collected to the County Revenue Fund for allocation.<sup>310</sup>

With regards to county tax collection, his study agrees with the recommendation of the Taskforce of Devolved Government that recommends that county governments should make use of the KRA as its tax agents to collect its revenue on their behalf. This is due to the fact that KRA has infrastructure and capacity to collect revenues. As the County Governments are relatively young, they have no capacity within themselves to efficiently collect taxes. This is especially true with

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for County Governments in Kenya, the CRA Chairman said that it is surprising that most county governments cannot collect revenues as earlier projected. CRA boss said there was 25 per cent reduction in revenue collection across the board.

308 Republic of Kenya, Office of the Controller of Budget (2014) County Budget Implementation Report Half year 2013/14 <http://www.cob.go.ke/index.php/virtual-downloads/category/5-counties-report?download=57:countybudget-implementation-review-report-half-year-fy-2013-2014>> Accessed on 23rd October 2014

309 Ibid

310 Ibid

regards to property taxes where the county governments may lack capacity to collect, and should thus enlist the help of KRA. This will generate more revenue for the counties.

The implementation of the Integrated Financial Management System should be accelerated, and training availed to county government staff over its use and management. This will be in line with one of the principles of public finance which states that financial management shall be responsible, and fiscal reporting shall be clear. Therefore, the manual system needs to be overhauled completely.

### **5.9 Institutional reforms**

A strong legal framework needs an efficient institutional framework to support it. The institutions created under the new Constitution are tasked with oversight over its implementation. For them to discharge their mandates efficiently, they need to operate in an independent environment, free from the interference by the Executive, the Legislature as well as the Judiciary. The institutions must be adequately funded and staffed in order to efficiently discharge their functions. Lack of coordination of roles, underfunding and lack of capacity are some of the issues ailing these institutions.

This study recommends that the Senate, as the guardian of devolution must be consulted before any bill is passed in Parliament that concerns the functioning of these institutions. This will safeguard their independence.

Lastly, the study recommends that these Institutions should have presence at the county level. This can be achieved by maintaining an offices in each of the 47 counties that would operate as information control and collection centers. This will also enhance public participation.

### **5.10 Concluding remarks**

The study was guided by the assumption that devolution will be the solution to bring socio-economic development to the people and put an end to inequalities experienced over the years as a result of centralization. It was therefore one of the objectives of this study to determine how devolution influences equitable revenue allocation in Kenya. This study, therefore, resoundingly concludes that effective devolution of resources to the county levels is a good step towards achieving and enhancing self-reliance of the County Governments to a greater extent, and public participation in decision making at the county level.<sup>311</sup> It will also lead to improved service delivery as county governments are better placed than the central government to address the challenges of the people. Devolution of resources will encourage the County Governments to be innovative in ways of raising their own revenue and to avoid over dependence on transfers from the national government.

The Ministry in charge of devolution has its role cut out to ensure that it provides clear pro-devolution policy implementation guidelines and manpower that genuinely supports and believes in devolution. The public, including the civil society groups and public watchdog groups as well

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<sup>311</sup> Bigambo, J., (2012). *Devolution in Kenya: Balancing Issues and Risk Factors For County Governments*. Accessed 27 August 2014 at <http://bigambo.wordpress.com/2012/07/19/devolution-in-kenya-balancing-issues-and-risk-factors-for-county-governments/>

as human rights activists must demand an open and publicly available-on-request electronic and paper record of all income and expenditure at each County Government level in order to assess the efficiency of the County Governments. This will encourage transparency and thereby accountability in the spending of resources at the county level and hold the county representatives accountable on all levels.

For devolution to be effectively realized, effective public participation and vigilance is critical. Meaningful participation of locals in public service delivery within the devolved units requires informed citizens. Unless the public knows the functions assigned to the two levels of government, who the beneficiaries are, and how much they cost, it cannot demand more effective public service delivery. The media can motivate the National Government's responsiveness by disseminating information of how public funds are being utilized. The media, both print and broadcast, therefore, play an important role as the source of information about government actions, responsiveness and performance.<sup>312</sup>

Kenya can draw vital lessons from other jurisdictions on how to further develop its legal framework to ensure that equity is achieved when it comes to resource distribution. However each country is unique when it comes to political dynamics that influence the allocation of revenue. The objectives of devolution differ from country to country, and therefore no simple, uniform revenue allocation formula can be applied universally. Each country must develop its laws on revenue allocation which reflect its citizen's needs as well as its dynamic political culture.<sup>313</sup>

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<sup>312</sup> See Op cit 108 at p 63.

<sup>313</sup> Boadway, R & Watts, R., (2004). *Fiscal Federalism in Canada USA and Germany* Working Paper 2004 (6) IIGR, Queen's University. > Accessed 10<sup>th</sup> August 2014 at < <http://queensu.ca/iigr/WorkingPapers/watts/wattsboadway.pdf>



This study has critically analysed the legal framework governing revenue allocation noting the considerable gains it has made towards ensuring the equitable distribution of national resources. However, as one of the hypothesis submitted, there are notable gaps that have emerged now that its implementation is in full gear. These gaps pose a risk in the long run if not addressed. This study suggests that the Commission for Revenue Allocation should play a key role by forming a legal reforms committee whose mandate will be to identify any gaps, inconsistencies, conflicts and overlaps in legal framework and make the proposed changes as necessary. These recommendations can then be forwarded to Parliament for debate.

Finally, this study has highlighted the role of politics in revenue allocation. Political goodwill is necessary to ensure that the implementation of the legal and institutional framework is carried out to the letter.

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## APPENDIX

**Table 1A: Revenue Allocations - National and County Governments for 2013/14**

<b>Type/Level of Government Allocation</b>	<b>Revenue Allocation (Ksh)</b>	<b>Percentage of Audited Revenue* (Ksh608.1 Billion) in %</b>	<b>Percentage Of 2011/12 Audited Revenue But Not Approved By Parliament (Ksh.682.1 Billion) in %</b>
National Allocation	730,375,441,286	120.1%	107.1%
Of which:			
Conditional Allocations to Counties	20,000,000,000	3.3%	2.9%
Equalization Fund	3,400,000,000	0.6%	0.5%
County Equitable Share	190,000,000,000	31.2%	27.9%
Total Shareable Revenue	920,375,441,286		

*Source: Division of Revenue Act 2013*

**Table 1B: Revenue Allocation- National and County Governments for 2014/15**

<b>Type/Level of Government Allocation</b>	<b>Revenue Allocation (Ksh)</b>	<b>Percentage Of Audited Revenue* (Ksh 593.3 Billion) in %</b>
National Allocation	799,650,000,000	134.78%
Conditional Allocations to Counties	1,450,000,000	
Conditional Allocation for Level 5 Hospitals	1,870,000,000	
Equalization Fund	3,400,000,000	
County Equitable Share	226,660,000,000	43%
Total Shareable Revenue	1,026,310,000,000	

*Source: Division of Revenue Act 2014*

**Notes.**

- County Equitable Share increased from 31.2% in 2013/14 to 43% in 2014/15

- Revenue Allocation is to be based on the most recent audited accounts debated and approved by the National Assembly. The above figures were based on the audited accounts for the financial year 2009/10.

**Table 2: Division of Tax Revenue in Germany 2014**

<b>Type of Tax</b>	<b>Federal Government</b>	<b>Lander(States)</b>	<b>Municipalities</b>	<b>Total</b>
<b>Income Tax</b>	42.5%	42.5%	15%	100%
<b>VAT</b>	53%	45%	2%	100%
<b>Corporate Tax</b>	50%	50%	-	100%