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REPUBLIC OF KENYA

THE NATIONAL TREASURY AND ECONOMIC PLANNING

Division of Revenue Bill, 2023

A Legislative Proposal for submission to Parliament

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THE DIVISON OF REVENUE BILL, 2023

ARRANGEMENT OF CLAUSES

Clause

1—Short title.

2—Interpretation.

3—Object and purpose of the Act.

4—Allocations to National Government and County Government.

5—Variation in Revenue.

SCHEDULE

Equitable Share of Revenue Raised Nationally Between the National and County Governments for The Financial Year 2023/24

APPENDIX

Explanatory Memorandum to The Division of Revenue Bill, 2023

A Bill for

AN ACT of Parliament to provide for the equitable division of revenue raised nationally between the national and county governments in 2023/24 financial year, and for connected purposes.

ENACTED by Parliament of Kenya, as follows—

Short title.	**1.** This Bill may be cited as the Division of Revenue Act, 2023.
Interpretation.	**2.** In this Bill, unless the context otherwise requires—
Cabinet Secretary	"Cabinet Secretary" means the Cabinet Secretary for the time being responsible for matters relating to finance; and
No. 16 of 2011.	"revenue" has the meaning assigned to it under section 2 of the Commission on Revenue Allocation Act, 2011.
Object and purpose of the Act.	**3.** The object and purpose of this Act is to provide for the equitable division of revenue raised nationally between the national and county levels of government for the financial year 2023/24 in accordance with Article 203 (2) of the Constitution.
Allocations to national and county governments.	**4.** Revenue raised by the national government in respect of the financial year 2023/24 shall be divided among the national and county governments as set out in the Schedule to this Act.
Variation in revenue.	**5.** (1) If the actual revenue raised nationally in the financial year falls short of the expected revenue set out in the Schedule, the shortfall shall be borne by the national government, to the extent of the threshold prescribed in Regulations by the Cabinet Secretary.
	(2) If the actual revenue raised nationally in the financial year exceeds the projected revenues set out in the Schedule, the excess revenue shall accrue to the national government, and may be used to reduce borrowing or pay debts.

SCHEDULE (s.4)

Allocation of Revenue Raised Nationally Between the National and County Governments for the Financial Year 2023/24.

Type/level of allocation	Amount in Ksh.	Percentage (%) of 2019/20 audited and approved Revenue i.e. Ksh.1,573,418 Million
A. Total Sharable Revenue	**2,571,159,000,000**	
B. National Government	**2,177,867,000,000**	
C. Equalization Fund	**7,867,000,000**	**0.50%**
D. County equitable share	**385,425,000,000**	**24.5%**

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MEMORANDUM OF OBJECTS AND REASON

The principal object of this Bill is to provide for the equitable division of revenue raised nationally among the national and county levels of government as required by Article 218 of the Constitution in order to facilitate the proper functioning of county governments and to ensure continuity of county services delivery to the citizens.

Clauses 1 and 2 of the Bill provide for the short title of the Bill and the interpretation of terms used in the Bill, respectively.

Clause 3 of the Bill contains the provisions on the objects and purpose of the Bill.

Clause 4 of the Bill prescribes the allocations for the National Government and the county governments from the revenue raised nationally for the financial year 2023/24.

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

Dated the.., 2023

Njuguna Ndung'u, CBS

Cabinet Secretary for

National Treasury and Economic Planning

APPENDIX

EXPLANATORY MEMORANDUM TO THE DIVISION OF REVENUE BILL, 2023

Background

1. This memorandum has been prepared as an attachment to the Division of Revenue Bill (DoRB), 2023 in fulfilment of the requirements of Article 218(2) of the Constitution and Section 191 of the Public Finance Management Act, 2012.

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

a) The proposed revenue allocation set out in the Bill;

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

c) Any significant deviations from the recommendations of the Commission on Revenue Allocation (CRA).

3. Section 191 of the Public Finance Management Act, 2012 requires that the Bill be accompanied by a memorandum which explains:

a) The extent, if any, of deviation from the recommendations of the Intergovernmental Budget and Economic Council; and

b) Any assumptions and formulae used in arriving at the respective allocations proposed in the Bill.

Explanation of the Allocations to the National and County Governments as Proposed in the Bill

County Governments' Equitable Share

4. The bill proposes to allocate County Governments Ksh. 385.425 billion for the financial year 2023/24 as equitable share of revenue raised nationally. The equitable share allocation has been proposed to increase from a base of Kshs. 370 billion allocated in the financial year 2022/23, to an allocation of Ksh. 385 billion in FY 2023/24. The equitable share allocation in the financial year 2023/24 has also been proposed to include Ksh. 425 million as attendant resources for the pay roll relating to the library services transferred from the Kenya National Library Services. Library services is a devolved function as provided for under Second part of the Fourth Schedule of the Constitution.

5. The rationale for the proposed county governments' equitable revenue share allocation is:

a) The proposed equitable share of Ksh 385.425 billion in the FY 2023/24 is equivalent to 24.5 percent of the last audited accounts (Ksh. 1,573,418 Million for FY 2019/20) and as approved by Parliament. The proposed allocation therefore meets the requirement of Article 203(2) of the Constitution;

b) High level of debt financing as well as elevated debt risk;

c) Financing constraints due to limited access to finance in the domestic and international financial markets. As a result, the National Treasury did not disburse Kshs 29.6 billion to county governments in the FY 2021/22 due to financial constraints;

d) The Government is also implementing a fiscal consolidation plan so as to lower the fiscal deficit and slow down debt accumulation. To reflect this fiscal tightening, the National Government recurrent ceiling growth has been restricted, declining from a growth of 10.3 percent in FY 2017/18 to 1.2 percent in FY 2023/24.

e) The fact that the National Government continues to solely bear shortfalls in revenue in any given financial year, while County Governments receive their full allocation despite the budget cuts affecting the National Government entities.

6. The above proposed Equitable Share for FY 2023/24 of Ksh.385.425 billion is equivalent to 24.5 per cent of the last audited accounts (Ksh. 1,573,418 Million for FY 2019/20) and as approved by Parliament. The proposed allocation meets the requirement of Article 203(2) of the Constitution that equitable share allocation to counties should not be less than fifteen (15) per cent of the last audited revenue raised nationally, as approved by the National Assembly.

7. The County Governments' equitable share of revenue raised nationally for the financial year 2023/24 is arrived at by growing the County Governments' equitable share for 2022/23 of Ksh. 370 by a growth of Ksh. 15 billion and additional Ksh 0.425 billion as attendant resources for transferred library services (see Table 1). This growth has taken into consideration performance of revenue in the past which has not been on target.

Table 1: Equitable Revenue Share Allocation to County Governments, FY 2023/24

BUDGET ITEM	AMOUNT (KSH. MILLION)
County Equitable Revenue Share for FY2022/23	370,000
Add:	
Adjustment for Revenue Growth	15,000
Transfer of Library Services	425
Equitable Revenue Share allocation for FY 2023/24	**385,425**

Source: National Treasury

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

8. Article 218(2) of the Constitution requires division of revenue between the two levels of government and across County Governments to take into account the criteria set out in Article 203(1) of the Constitution. The criteria include factors such as: national interest, public debt and other national obligations and needs of the disadvantaged groups and areas, among others.

9. Table 2 provides an assessment of the extent to which the requirements of Article 203 (1) of the Constitution have been incorporated in estimating the division of revenue between the national and county levels of Government in the financial year 2023/24.

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

	ITEM DESCRIPTION (Kshs. Millions)	FY2019/20	FY2020/21	FY2021/22	FY2022/23	FY2023/24
	ORDINARY REVENUE (EXCLUDING AIA)	**1,573,418**	**1,574,009**	**1,775,624**	**2,141,584**	**2,571,159**
A	**National Interest** [Article 203 (1)(a)]	**94,168**	**86,753**	**83,197**	**90,727**	**92,466**
	Enhancement of security operations (police vehicles, helicopters, defense etc.)	27,974	24,816	22,261	25,967	24,299
	National irrigation & fertilizer clearance	11,103	11,375	11,199	14,676	16,800
	Youth empowerment	16,226	16,127	14,548	14,364	15,290
	National social safety net - (for older persons, OVC, child welfare, presidential bursary, severe disability)	26,362	28,832	29,286	29,817	31,074
	Primary school digital literacy program	8,400	1,500	1,800	1,385	-
	School examination fees (KSCE & KCPE& Grade 6(CBC Examination)	4,103	4,103	4,103	4,523	5,003
B	**Public debt** (Art. 203 [1][b])	**538,802**	**829,906**	**1,174,013**	**930,354**	**1,250,735**
C	**Other National obligations** (Article. 203 [1][b])	**483,507**	**518,356**	**557,863**	**595,269**	**673,864**
	Pensions, constitutional salaries & other	109,526	124,451	136,978	145,951	199,015
	Constitutional commissions (Art. 248(2)) i.e., CRA, SRC, NLC, NPSC, IEBC, TSC	261,387	281,099	299,333	321,968	331,309
	Independent offices (Art. 248(3)) - i.e., AG & CoB	6,336	6,295	6,499	6,981	8,521
	Parliament	36,240	36,222	37,883	50,220	40,402
	Other constitutional institutions- State Law Office and DPP	8,765	8,154	8,371	8,713	9,968
	Other statutory bodies (e.g., EACC, RPP, WPA, CAJ, IPOA, NGEC)	5,937	6,674	7,036	8,462	9,123
	Judiciary	14,437	14,150	17,918	18,297	21,994
	Other statutory allocations/earmarked funds (e.g., NG-CDF, Affirmative Action)	40,879	41,311	43,845	46,420	53,532
D	**Emergencies** [Art. 203 (1)(k)]	**6,418**	**5,000**	**5,000**	**5,000**	**4,756**
	Contingencies	5,000	5,000	5,000	5,000	4,756
	Strategic grain reserve	1,418	-	-	-	-
E	**Equalization Fund** [Art. 203 (1) (g) and (h)]	**5,765**	**6,532**	**6,825**	**7,068**	**7,867**
F	**BALANCE TO BE SHARED BY THE 2 LEVELS OF GOVERNMENT**	**485,638**	**168,773**	**-7,429**	**547,843**	**541,471**
	County Government allocation from revenue raised nationally of which; -	**324,160**	**330,231**	**377,537**	**375,654**	**391,741**
	a) Equitable Share of Revenue	310,000	316,500	370,000	370,000	385,425
	b) Additional conditional allocations financed from revenues raised nationally	14,160	13,731	7,537	5,654	11,016
G	**Balance left for the National Government**	**161,478**	**-161,458**	**-384,966**	**172,189**	**145,030**

10. **National Interests:** These are expenditures which relate to projects and programmes that:

- are critical to the achievement of the country's economic development objectives;
- potentially will have significant impact on social well-being of citizens;
- are anchored in the Vision 2030 and the Medium-Term Plan IV (2022 – 2027);
- have significant resource investment requirements; and
- have been specified in the 2023 Budget Policy Statement.

These national interests include: activities aimed at enhancing security operations; national irrigation and fertilizer subsidy initiatives; Youth Empowerment; provision of national social safety net for vulnerable groups, and school examination fees subsidy. Revenue allocation for these programs is expected to increase significantly from Ksh. 90.7 billion in 2022/223 to Ksh. 92.5 billion in 2023/24.

11. **Public Debt:** The Bill has fully provided for all public debt related costs. These comprise the annual debt redemption cost as well as the interest payment for both domestic and external debt. In financial year 2023/24, the revenue allocation for payment of public debt related costs is expected to increase from Ksh. 930.4 billion allocated in financial year 2022/23 to Ksh 1,250.7 billion allocated in the financial year 2023/24.

12. **Other National Obligations:** As provided for under Article 203(1) (b) of the Constitution, the Bill has also taken into account the cost of other national obligations, such as, mandatory pension contributions and/or payments, financing for constitutional offices, including Parliament as well as expenses relating to other statutory bodies. These are estimated to cost Ksh. 673.9 billion in financial year 2023/24 up from Ksh. 595.3 billion allocated in the financial year 2022/23.

13. **Fiscal Capacity and Efficiency of County Governments:** Fiscal capacity for county governments refers to the potential revenues that can be generated from the tax bases assigned to the counties when a standard average level of effort is applied. In its recommendations to Parliament on the Third Basis for Sharing Revenue among County Governments, the Commission on Revenue Allocation (CRA) included a 'fiscal effort' parameter with a 2% weight intended to incentivize OSR collection by the Counties. This is consistent with the approach in other jurisdictions, where the formula for horizontal revenue distribution among subnational governments typically incorporates measures of fiscal capacity alongside those of expenditure need. CRA's fiscal effort parameter was defined in terms of each County Government's actual revenue collection relative to the County's Gross County Product (GCP) as computed by the Kenya National Bureau of Statistics (KNBS).

14. In approving CRA's recommendations however, Parliament did not include the fiscal effort parameter, effectively shifting the 2% weight to other parameters. The formulae, therefore, does not incentivize counties to strengthen their local revenue collection efforts. There is, therefore, need for County Assemblies, in conducting their oversight role to ensure that county governments enhance their own source revenue collection. It is expected that future revenue sharing formulae may consider reinstating the fiscal effort parameter to incentivize counties to collect more own source revenues.

15. County governments' ability to perform the functions assigned to them and meet other developmental needs of the county governments: As explained above, the baseline for the equitable share allocation for the financial year 2023/24 was derived from the Division of Revenue Act, 2022. This base line is informed by costing of expenditure for devolved functions done at onset of devolution, which has been the basis for equitable share over the years.

16. County governments are allocated equitable share of revenue which is an unconditional allocation to enable counties have autonomy to plan, budget and implement development projects based on county priorities and account for the same. In addition, Article 209 of the Constitution has assigned counties revenue raising powers and as such counties are expected to improve and maintain sustained collection of their own source revenues.

17. Library being a devolved function as provided for under the Fourth Schedule of the Constitution, has been unbundled and attendant resources amounting to Ksh. 425 million identified and proposed to be fully transferred to county governments as part of the equitable share in FY 2023/24. For FY 2023/24, the resources should not be shared using the formulae and, therefore, counties should be held harmless. This amount will be included in the Equitable share allocation for the 33 county governments in a phased approach starting from FY 2023/24 at 100%, 75% for FY 2024/25 (balance of 25% to be shared as equitable) and 25% for FY 2025/26 (balance of 75% to be shared as equitable)). From the fourth FY, that is FY 2026/27, the 33 county government's will be required to integrate the salaries of these staff into their pay roll, after which the entire Ksh 434 million will be available for sharing as equitable share among the 47 county governments, in line with the principle of transferring resources to devolved functions.

18. Additionally, the equitable share to county governments is proposed to increase from Ksh. 370 billion in FY 2022/23 to Ksh. 385.425 billion in FY 2023/24, an increase of Ksh. 15.425 billion, which is meant to facilitate county governments enhance service delivery in performance of their assigned functions under the second part of the Fourth Schedule of the Constitution.

19. It should also be noted that, in order to balance between priority development and performance of the assigned functions, the Third Basis formula is premised on eight parameters which relate to devolved functions assigned to county governments in Part II of the Fourth Schedule of the Constitution. Accordingly, counties will have to allocate a prescribed minimum to specific functions contained in the Third Basis.

20. Thus, the proposed vertical division of revenue proposed in the Division of Revenue Bill, 2023, therefore, takes into account the cost of County Governments' developmental needs and it is expected that county governments will have the ability to perform the functions assigned and transferred to them as contemplated under Article 203(1) (f).

21. Economic Disparities within and among counties and the need to remedy them: Allocation of the sharable revenue (i.e., equitable share of Ksh.385 billion) among counties is based on the Third-generation formula approved by Parliament in September, 2020 pursuant to provisions of Article 217 and Section 16 of the Sixth Schedule of the Constitution. The Third Basis formula which should be applicable from FY 2020/21 to FY 2024/25 has taken into account the following parameters; (i) Population (18%); (ii) Health Index (17%); (iii) Agriculture Index (10%); (iii) Urban Index (5%); (iv) Poverty Index (14%); (v) Land Area Index (8%); (vi) Roads Index (8%), and; (vii) Basic Share index (20%). The horizontal distribution of County Governments' equitable revenue share allocation of Ksh.385 billion for FY 2023/24 shall be based on the Third Basis Formula. It should be noted that the Third basis formula applied in FY 2023/24, takes into account disparities among counties and aims at equitable distribution of resources across counties.

22. Further, it should be noted that Ksh.7.867 billion has also been set aside for the Equalization Fund in FY 2023/24 which translates to 0.5 per cent of the last audited revenue accounts of governments, as approved by the National Assembly. This Fund is used to finance development programmes that aim at reducing regional disparities among beneficiary counties.

23. Need for Economic Optimization of Each County: Allocation of resources to County Governments was guided by the historical costing of expenditures for functions assigned to the County Governments. The equitable share of revenue allocated to County Governments in the financial year 2023/24 is Ksh.385.425 billion, an allocation which is 15.425 billion higher than that for FY 2022/23. This is an unconditional allocation which means that the County Governments can plan, budget and spend the funds independently. With the resources, therefore, County Governments are in a position to prioritize projects and consequently allocate resources thus optimizing their potential for economic development.

24. Stable and Predictable Allocations of County Governments' Vertical Share of Revenue: The county governments' equitable share of revenue raised nationally has been protected from cuts that may be occasioned by shortfall in revenue raised nationally more so in the advent of the effects of projected global economic downturn in 2023. According to clause 5 of the Division of Revenue Bill (DoRB) 2023, any shortfall in revenue raised nationally is to be borne by the National Government, to the extent of the threshold prescribed in Regulations by the Cabinet Secretary.

25. Need for Flexibility in Responding to Emergencies and Other Temporary Needs: Included in the equitable share of revenue for the National Government is an allocation of Ksh.4.0 billion for the Contingencies Fund established pursuant to Article 208 of the Constitution. This Fund will be used to meet the demands arising from urgent and unforeseen needs in all Counties that suffer from calamities in the manner contemplated under Section 21 of the Public Finance Management Act, 2012. In addition, the Public Finance Management Act, 2012 and the PFM (County governments) Regulations, 2015 requires each county government to set up a County Emergency Fund. County governments are expected to set aside at least 2 % of their budget as part of their allocation for this purpose.

26. It should be noted that after taking into account all the other factors contemplated under Article 203(1) of the Constitution, including the needs of county governments, there is minimal resources left to finance other National Government needs, such as, defence, roads, energy etc. In fact, this leaves a balance of Ksh. 145,030 million. This is not sufficient to finance the National Government functions such as defence, roads, energy and may occasion additional borrowing which may distort the fiscal framework already set out in the 2023 Budget Policy Statement.

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

27. The Division of Revenue Bill, 2023 proposes to allocate county governments an equitable share of Ksh. 385.425 billion from the shareable revenue raised nationally. The CRA, on the other hand, recommends County Governments' equitable share of revenue of Ksh. 407 billion as an unconditional allocation to be shared among county governments on the basis of the formula for sharing revenue approved by Parliament under Article 217 of the Constitution. The difference in the Commission on Revenue Allocation (CRA) recommendation and the DoRB 2023 proposal emanates from the different approaches used to compute the County Governments' equitable share of revenue. These include;

(a) **Use of different revenue adjustment factor**: CRA adjusts the county equitable share (using a base of Ksh 370 billion) of revenue using the projected increase of revenue raised nationally of 17 percent from Ksh. 2,192 billion in the financial year 2022/23 to Ksh. 2,571.2 billion in the financial year 2023/24. Informed by the performance of revenue, the Commission recommends an increment in the allocation to each level of government for the financial year 2023/24. Therefore, the national government allocation be increased from Ksh. 1,814.8 billion to Ksh. 2,150.3 billion and county governments' allocation be increased from Ksh. 370 billion to Ksh. 407 billion. However, the National Treasury proposes to adjust the county equitable share (using a base of Ksh 370 billion) by Ksh. 15

billion, from an allocation of Ksh. 370 billion in FY 2022/23 to Ksh. 385 billion in FY 2023/24. The adjustment by the National Treasury is informed by: -

i. High level of debt financing, and noting that the overdraft at the Central Bank is exhausted. The Government has already reduced borrowing by Ksh 119 billion in FY 2022/23 in order to ensure public debt is maintained at sustainable levels;

ii. Financing of Priority government expenditure relating to drought intervention, fertilizer subsidy and the Hustlers Fund;

iii. In the medium term, sharing of resources will be pegged on the financing constraints and not on the budget. Availability of resources is key and it should be noted that National Treasury did not disburse Kshs 29.6 billion to county governments in the FY 2021/22 due to financial constraints;

iv. The Government is also implementing a fiscal consolidation plan, which is expected to be shared between the two levels of government, so as to lower the fiscal deficit and slow down debt accumulation. To reflect this fiscal tightening, the National Government recurrent ceiling growth has been restricted, declining from a growth of 10.3 percent in FY 2017/18 to 1.2 percent in FY 2023/24. The fact that the growth in recurrent ceiling is below growth in wages, implies that the National Government is reducing its operation budget significantly;

v. The fact that the National Government continues to solely bear shortfalls in revenue in any given financial year. County Governments continue to receive their full allocation despite the budget cuts affecting the National Government entities.; and

vi. The Consolidated Fund Services (CFS) budget for FY 2023/24 has been revised upwards by Ksh. 44.679 billion.

(b) **Transfer of library Services: -** Additionally, the DORB 2023 proposes additional Ksh.425 million as attendant resources for the pay roll of transfer of library services from the Kenya National Library Services to county governments whereas CRA has not provided for the transfer of Library Services.Library services is a devolved function as provided for under Second part of the Fourth Schedule of the Constitution.

28. Table 3 analyses the differences between the CRA recommendations and the National Treasury proposal on the division of revenue between the national and county governments in FY 2023/24.

Table 3: Comparison of approaches towards recommendations of the Commission on Revenue Allocation and the National Treasury on the equitable share of revenue proposed for FY 2023/24

	CRA	National Treasury	Variance
Expenditure Item	A(million)	B(million)	C=(A-B(million))
1. Equitable Revenue Share in FY 2022/23	370,000	370,000	-
2. Adjustment for revenue growth in FY 2023/24 as determined in the framework	37,000	15,000	15,000
3. Transfer of library services	-	425	
TOTAL EQUITABLE OF REVENUE = (1+2)	**407,000**	**385,425**	**18, 275**

Source: National Treasury and Economic Planning

Conclusion

29. The proposals contained in the Bill take into account the fiscal framework set out in the 2023 BPS and are intended to ensure fiscal sustainability specifically against the backdrop of escalating expenditure pressure on the fiscal framework occasioned by increase in Consolidated Fund Services (CFS) and the persistent under performance of the ordinary revenue.

30. The proposed equitable share allocated to county governments in the Division of Revenue Bill, 2023 has also taken into account the approved Third Basis for Revenue Allocation. The proposed Kshs 385.425 billion allocation among county governments pursuant to Article 217 of the Constitution is equivalent to 24.5 per cent of the FY 2019/20 revenue which is the most recent audited and approved revenue by the National Assembly. This is above the minimum threshold required under Article 203(2) of the Constitution.