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What is Fair? Sharing Resources in Kenya

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Introduction and Summary

Many Kenyans feel that resources have not been shared fairly in Kenya over the last 50 years. That is one reason why they voted for a new constitution and supported devolution. They believe that this new political system will help the country to share resources in a fairer way.

But while the 2010 constitution says in many places that resources should be shared fairly, it does not say what that means. How do we know if something is fair or not? What do we mean by a fair share?

This is not a theoretical question. Although the constitution does not define fairness or equity clearly, it does provide for an annual process of resource sharing that is to be guided by fairness. This process is to be led by the Commission on Revenue Allocation (CRA), a new constitutional body that makes recommendations on how to share revenues between national and county governments, and among the 47 counties. These recommendations must be debated in Parliament, potentially amended, and then approved.

The first revenue sharing process under the new constitution happened in June, 2013. This led to the approval of the Division of Revenue Bill by the National Assembly (sharing resources between national and county levels of government), which should be followed by the County Allocation of Revenue Bill (sharing resources between the 47 counties). These laws were in turn based in part on a formula that the CRA had recommended, and Parliament approved, in 2012.

The process of sharing revenues for this year may be over, but it must be repeated every year. A key question to ask about the process we have just completed, and more importantly, about the process that will begin again in 6 months, is whether the decisions the Parliament is taking about sharing resources are fair. That is what this brief is about.

To answer this question, we first meet four Kenyans. Through an examination of their life circumstances, we consider what is fair. We then turn to the policy issues around resource sharing between governments and look at some examples from South Africa and India. Finally, we consider these examples in the Kenyan context in light of the recommendations of the CRA. In a second brief, we look more closely at Kenyan data and inequalities across counties and the implications of this data for resource sharing in Kenya.

In thinking about how to share resources, three principles emerge: needs, capacity and effort. Needs refers to the fact that people have different levels of need. For example, young people need schooling and sick

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people need health care. A first principle of fairness is that people should have sufficient resources to pay for their needs; people with more needs receive more resources. Capacity refers to the idea that people who can afford to contribute more to their needs should pay more. The rich should contribute more than the poor to their own needs. Finally, when we speak of effort, we mean that people should make an attempt to pay for their own needs and should be rewarded, rather than punished, for doing so. Another way of saying this is that we should help people who are trying to help themselves.

These principles, described in more detail below, should inform any policy of revenue sharing between and among levels of government. In the CRA's first formula for sharing revenues among the 47 counties, the focus was almost entirely focused on need. Different needs across counties have been measured in a very simple way, by looking at population, poverty and land area.

While the CRA formula was a reasonable first attempt at fair sharing of resources, we show that other countries, such as India and South Africa, use more complex approaches to revenue sharing. South Africa also focuses on need, but uses more direct measures of the cost of services, such as the school-age population and the use of health services. India also incorporates both the principle of capacity and the principle of effort into its formula.

Unlike Kenya, both countries have also taken a comprehensive approach to revenue sharing. In other words, they have looked at inequality across their states and provinces and recognized that these units are unequal in different ways. Not all of these inequalities can be fixed through a single formula. Therefore, they also recommend a set of conditional grants at the same time that they set the formula. This helps to ensure that the total flow of funds is consistent with principles of fairness.

Going forward, we make the following recommendations:

1. The next version of the formula recommended by CRA and considered by Parliament should incorporate more realistic measures of the cost of providing services (fiscal needs).
2. The next version of the formula should take into consideration not only county needs, but also potentially put more weight on county capacities and effort.
3. The National Treasury, Kenya National Bureau of Statistics and the Commission on Revenue Allocation should work together to generate better data to offer a more realistic formula that is driven by actual costs, capacity and effort.
4. Any further discussion of the formula should be part of a comprehensive review of all transfers (unconditional and conditional) to counties to ensure that, taken together, the flow of funds across counties is fair.

Needs, capacities and effort

To help us understand fairness, let's meet 4 Kenyans: Jackie, Janet, Samuel and Teddy. At the beginning of our story, Jackie and Janet are in primary school. Samuel and Teddy are finishing secondary school. All live in Kenya. Jackie and Janet are like thousands of school children you have met. Samuel and Teddy are just like hundreds of secondary leavers you know.

Janet and Jackie are both in Standard 8 and preparing to take the KCPE exam. The two girls are from the same village and studied at the same school. Both of their parents are farmers who themselves only completed primary school.

They have big dreams for their daughters of completing secondary school, and even going to university.

Jackie and Janet

Now, the time has come to take the KCPE. I tell you that Janet will have 2 hours to complete her mathematics exam, and Jackie will have 2.5 hours. Is that fair?

You will probably say that it is not fair, because we should treat children equally. But what if I tell you that Janet has perfect vision while Jackie is blind? Your view may now change. You may say that giving the children different times to take the exam is fair, because the children are different. In other words, what is fair is not to treat the children equally but to treat them unequally.

Teddy and Samuel

This is a basic difficulty in deciding what is fair. Sometimes, what seems fair is to treat people equally. Sometimes, it is to treat them unequally.

When should we treat people equally and when should we treat them according to their needs? It is common to argue that people should be treated equally in matters in which they are equal, and unequally in matters where they are unequal. For example, many people believe that we are all equal in matters of freedom. Everyone should be treated equally when it comes to their freedoms: freedom of speech, thought, religion, association and so on.

People are not all equal in their opportunities and capabilities, however, and should not therefore be treated equally in this regard. Some people have more educated and wealthier families that allow them to attend better schools and develop themselves to their full potential, while others are from poor homes that lack the capacity to provide such opportunities. Others, like Jackie in the example above, have disabilities that, through no fault of their own, make it more difficult for them to do the same tasks as others. We should not treat poor or disabled people in the same way as rich and able-bodied people.

However, this is only partly helpful, because we also need to allow for differences between people that are not caused by external factors, but by their own motivation and effort. Suppose I give Jackie and Janet Ksh 500 each to buy school supplies. Jackie spends half the money on mandazi and chapati, while Janet uses all the money for supplies.

Next time around, should I give them both the same amount of money? This is a difficult question. It does not seem fair to give Jackie the same money, especially since she misused it. But we want Jackie to have school supplies.

What are our options? We can give her less money and teach her a lesson when she does not have adequate supplies. Or we can buy the supplies and give them to her, rather than giving her the money. That might work, but she might also sell the supplies to get back the money so she can buy more snacks. What is fair in this case?

This brief discussion makes clear that what is fair is based on consideration of people's needs (e.g., are they sick?), abilities (e.g., do they have the resources to take care of themselves?), and efforts (are they trying to improve their own lives?).

Equality of opportunity or outcomes?

When we talk about making people more equal, we don't usually mean making them exactly the same. Most people believe that we are all different and so there will always be some differences in our lives and outcomes. Usually, we want to minimize differences in people's opportunities, but allow differences that result from people's choices.

Let's bring our other two characters into the story. Remember Teddy and Samuel. They are both secondary students. Unlike Jackie and Janet, they have grown up in town, and their parents have government jobs.

Both are expected to complete secondary and university and get good jobs in the city. Both have performed well in secondary and are about to take the next step in their education.

Teddy and Samuel should both have opportunities to go to university, but Teddy may decide not to go and to learn a technical skill instead. That may in turn not pay as much as the job Samuel gets after university. Since Teddy could have gone to university but didn't, we don't necessarily need to compensate him for the fact that he earns less. But if Teddy and Samuel did not have equal chances to go to university because Teddy's family was poor, we may want to compensate him so that he has that choice.

Another way to think about this is that we want equality of opportunity more than equality of outcomes. In other words, we want people to face and be able to make similar choices, but we do not need to worry if they do not make the same choices and therefore do not end up in the same place.

However, full equality of opportunity is nearly impossible to achieve. We can get closer, but some people will always have disadvantages we cannot compensate them for. Therefore, even if we put less emphasis on equality of outcomes, we may still want to put some emphasis on it.

For example, suppose that Samuel and Teddy are of equal intelligence and put equal effort into their education, but Samuel's father is suddenly killed in a car accident while he is studying. As a result, he has to work part-time to support his family and cannot dedicate as much time to studying. This happens by chance; it is not Samuel's fault. Suppose that this has the same effect: he does less well at his studies and gets a worse job than Teddy in the end. Is that fair?

We cannot reward somebody who has not performed, but we should not punish people for things that are out of their control either. This leads us to the view that we should prioritize equality of opportunity, but not ignore equality of outcomes. Only people who have had the opportunity to live a good life but decided not to exert any effort on their own behalf can be said to deserve poor outcomes. People who have bad luck or are otherwise disabled should be given a chance at a better life. Because we cannot give everyone equal opportunities, we also may want to look at outcomes and ensure that the degree of inequality in outcomes is not too high.

Getting to equality: how Jackie meets Janet

Let's find Jackie and Janet again. The two girls have grown and are working. Janet works in a large private company where she earns more than Jackie, who is now running a small *jua kali* business.

Suppose that Janet earns twice as much as Jackie and we have decided that this is unfair. We may have decided this because, although Jackie made an effort in life, she is blind, or because she was born poor and did not have the same opportunities as Janet. We feel it is fair for her to have a better life to compensate her for these disadvantages.

We have decided that Jackie and Janet should be more equal. But how do we achieve this? To get to greater equality is a process. In that process, we have to make choices. Let's look at the choices we can make (These choices are explained with examples in Box I below).

- One option is to take away a quarter (1/4) of Janet's income and give it to Jackie. This will make Jackie better off and Janet worse off. After this, they both earn the same amount.
- Another option is to double Jackie's income and leave Janet as she is. This will improve Jackie's life without affecting Janet.
- A final option is to increase the incomes of both, but to increase Jackie's by more. For example, we could increase Jackie's salary by multiplying it by 3. We could increase Janet's salary by multiplying it by 1.5. Both are better off, but Jackie is much better off compared to Janet who is only a little better off.

Which of these three options is best? The easiest and cheapest option is the first. It costs 5000 Ksh, and we can take the money directly from Janet. However, this option leaves Janet worse off. Is that fair? It might be, if Janet stole the money she has to get ahead, or was given that money because of patronage or corruption. But if she earned it through her efforts and if she is a productive worker, we might not want to make her worse off. Think, too, of Janet's children. Perhaps if we reduce Janet's salary, she will have to pull a child out of school for lack of fees. That might not be fair to the child, even if it is fair for Janet.

Box I: Three Ways to Get to Equality

1. Jackie gets richer, Janet gets poorer

Jackie starts with an income of 10,000 Ksh
Janet starts with an income of 20,000 Ksh
We take ¼ of Janet's salary (1/4*20,000=5,000) and give it to Jackie

FINAL RESULT:

Jackie: 15,000 Ksh
Janet: 15,000 Ksh

2. Jackie gets richer, Janet stays the same

Jackie starts with 10,000; Janet with 20,000 Ksh
We give Jackie 10,000 Ksh
We give Janet nothing

FINAL RESULT:

Jackie: 20,000 Ksh
Janet: 20,000 Ksh

3. Jackie and Janet both get richer, but Jackie gains more

Jackie starts with 10,000; Janet with 20,000 Ksh
We multiply Jackie's salary by 3, so 3*10,000 = 30,000 Ksh
We multiply Janet's salary by 1.5, so 1.5*20,000 = 30,000 Ksh

FINAL RESULT:

Jackie: 30,000 Ksh
Janet: 30,000 Ksh

However, if we have no other source of income, and we think the gap between Janet and Jackie is unfair, we may have to consider this option. We might think, for example, that the very large salaries earned by some in our society are not fair when others do not have enough to eat. Even if the people with high salaries did not do anything illegal to get them, it is still not fair to have so much inequality.

The second option does not harm Janet and helps Jackie even more. However, it costs twice as much (10,000 Ksh) and we cannot take the money from Janet. Where will the money come from? There are only two ways to get this money: either we take it from somebody else in the economy (for example, from Teddy or Samuel or someone even richer), or we raise the money through increased economic growth or more efficient use of existing money. It is usually easier to take money from others than to become more efficient or grow faster, but taking money from others is not always fair (remember, we were trying to avoid taking money from Janet and that is why we chose this instead of the first option) and it could make it harder to grow the economy.

The third option is attractive because everyone wins. Both Jackie and Janet are better off, and they are also more equal. However, it is the most expensive option, as it costs 30,000 Ksh. It is expensive because we need to give new money to both Jackie and Janet. Just as in option 2, we have to figure out where to get the money from. Again, we could take it from people like Samuel or Teddy, or others that are richer than Jackie or Janet, but we also have to consider if this is fair, and we need to take even more from them now. Or we can try to get the extra money by growing the economy and becoming more efficient. This might be the best option, but it may be slow and it may not be fair to make Jackie wait so long to be made more equal.

Both options 2 and 3 allow Janet to maintain her current standard of living and are sometimes referred to as options that “hold harmless.” That just means that they do not harm those who are better off in the quest for greater equality. Instead they hold those who are better off in their place (or do not allow them to advance as quickly) while others catch up. In this case, Janet is “held harmless” while Jackie’s life is improved.

Samuel and Teddy: unequal in many different ways

Let’s find Teddy and Samuel again. Teddy went for a technical education and got a job working in a factory; Samuel finished university and is a manager in a state corporation. Samuel earns a lot more than Teddy and lives in a nicer neighborhood, closer to where his children go to school. Teddy has to live in a less expensive neighborhood and his children spend more time on the bus to get back and forth. By our normal standards, Samuel is better off than Teddy.

Now, suppose that Samuel suffers from a genetic disorder that requires him to make an expensive visit to the health clinic every month. And suppose that his wife is killed in a car accident, leaving him without help in raising his two children. Teddy on the other hand is healthy, and his wife owns a small shop and brings in extra income for the household, while also helping to take care of the children. When we look beyond Samuel and Teddy’s incomes to the condition of their broader lives and families, it is no longer clear that Samuel is better off than Teddy in all ways. In some ways, Teddy is better off.

If we were to just try to make Samuel and Teddy more equal by increasing Teddy’s income (like we did with Jackie and Janet above) that would not necessarily be fair. After all, while Samuel has a higher income, he also has higher expenses and may need special help with his health and children.

This is a general problem: people are unequal in many ways, and not all of these ways lead to the same set of people being better off than others. In other words, some people are better off in some ways (e.g., income) while they are worse off in others (e.g., health). If we just use a single approach to making people more equal, we may miss this problem and treat people unfairly.

For this reason, we often use more than one approach to making people equal. For example, we may use some of our funds to make Samuel and Teddy more equal when it comes to income, but we may also create a special fund to support people who are sick and need health care. Samuel may not get any money to supplement his income, while we increase Teddy’s income. But then when it comes to health care, Samuel may receive a kind of bursary or voucher he can use at the health clinic to reduce his health spending, while Teddy does not receive this support.

We might think this is the fairest approach since it recognizes the differences between people and tries to help them in the ways that are appropriate to their needs and capacities.

What this all means for sharing resources between and among governments in Kenya

Now, let's leave Janet and Jackie and Samuel and Teddy and turn to the whole of Kenya.

Sharing national resources is hard. But it must be done, and it must be based on some set of widely accepted principles. As we saw, the experts who drafted Kenya's 2010 Constitution gave the main job for thinking about these issues to a new constitutional body called the Commission on Revenue Allocation. The CRA is supposed to make recommendations. These recommendations should help to guide a wide public debate about how best to share resources.

The sharing in this case is not between individuals, but between the national and county levels of government (known as the "division of revenue"), and among all of the 47 counties (known as the "county allocation of revenue"). The CRA only provides advice; Parliament must make the final decision, and the bills submitted to Parliament may also come with recommendations from the National Treasury.

Although the CRA makes recommendations every year, some of the choices that are made about how to share resources last for more than a single year. For instance, the choice about which government funds are to be included in the calculation of the division of revenue (the amount that goes to national and the amount that goes to counties as a whole) are written in law. To give just one example, national loans are not shared, but remain at national level. The way the money is shared among the 47 counties is also determined in part by a formula which is revised every 5 years.[2]

Before we look at what CRA has done so far, it is useful to think about the ways in which it is possible to share revenues. Kenya is not the first place to try to figure out a fair way to share resources between and among governments. India, South Africa and other nations have faced similar challenges and come up with unique solutions. It is sometimes helpful to look at what other countries have done and think about whether these are useful ideas in Kenya or whether they are not appropriate for the Kenyan context. The CRA itself has indicated that it looked at examples from around the world before settling on its own approach.

When we look at other countries, we should keep in mind the stories of Jackie and Janet and Samuel and Teddy, and remember that sharing resources is about finding a fair way to treat real people.

How do other countries move toward equality? A comprehensive approach

The Indian version of the CRA is called the Finance Commission. The Finance Commission sits every 5 years to decide how revenues should be shared between the national and state governments in India. The Finance Commission take a comprehensive approach and considers all transfers, conditional and unconditional, to states.

South Africa has a Financial and Fiscal Commission (FFC). The FFC makes annual recommendations for how to share resources across and among levels of government that must be considered in the Division of Revenue Bill. The Division of Revenue Bill in South Africa also takes into consideration all revenues and all transfers to provinces and municipalities. Like the Finance Commission in India, it takes a comprehensive approach to sharing money.

Looking at all money that is to be shared makes sense. For example, suppose that in any country, the Finance Commission looked only at one type of transfer, like a Health Grant to states to help them improve their health systems. Maybe this grant would give Chini state more than Juu state for health in order to improve Chini's health system. Now imagine that there was another grant called a Social Services Grant

2 The first two formulas are actually revised after 3 years. And the Senate can revise the formula at any time if more than 2/3 of the Senators decide to do so.

that was supposed to help pay for both education and health services, but that this grant gave more to Juu than Chini state. In the end, the two grants could cancel each other out. This would keep the situation as it is, rather than making the two states more equal. So it makes sense to look at both grants together and make sure both of them work to achieve those goals.

Another thing both countries do, which Kenya has also chosen to do, is to use formulas to share at least part of the funding. Formulas have the advantage that they are transparent and consistent and reduce opportunities for unfair sharing of resources outside of public view. However, formulas also have disadvantages. They are usually based on only a small set of factors, which may not take into consideration all of the reasons why states or counties are different. Formulas tend to put counties or states in specific categories. There are some that are "disadvantaged" and need more funding, while there are others that are "advantaged" and need less. However, this is not always correct. A state or county may have fairly good roads or access to water, but very poor health services. The formula may not capture this complexity.

Remember Samuel and Teddy. Samuel was advantaged in some ways, but disadvantaged in other ways when compared to Teddy. We said that it might make sense to use different ways to address these inequalities and not just a single formula.

Because formulas for revenue sharing cannot take into account everything we might think is important, they are often coupled with additional targeted grants. For example, we might want to ensure that a very specific service, like local roads, gets adequate investment. So we might create a special roads grant. It may be that our formula favors areas that are densely populated and poor, and that those areas already have a number of roads. We may want to favor areas with fewer people and fewer roads. So we can target our roads grant differently than our formula.

In summary, it is important to take a comprehensive look at all finances for county governments, not just one. Otherwise, we may not achieve our objectives for fairness. This is in fact the approach that the Indian and South African governments take. Let's take a closer look.

Back to needs, abilities and effort

Remember where we started: Jackie gets more time to take her KCPE exam than Janet. The reason we said that was fair was because Jackie needed more time than Janet. When we spoke of Samuel and Teddy, we also spoke of need. We said that Teddy might do poorly at university if his father passed away and he had to play a bigger role in supporting his family. Looking at people and county needs is the first way to think about equality. **This is the main way in which South Africa looks at equality.**[3]

We also looked at Jackie and Janet and Samuel and Teddy according to abilities. By ability, we meant two things. First, we talked about Teddy coming from a poor family, meaning that they did not have the ability to pay for university. Later, we talked about Samuel having a higher paying job and more capacity to pay for housing and schooling for his children. We also talked about ability as capability to do well. In this case, Teddy's ability to perform well in school was not as high as Samuel's. Looking at people and county abilities is another way to think about equality. **This is one of the main ways in which India looks at equality.**

The main resource we are talking about when we look at resource sharing between national and county governments is money. So resource sharing formulas focus on the fiscal needs of the counties (how much spending is needed to cater for their populations?) and the fiscal capacity of counties (how much of their own money do they have to meet their spending?).

Why do some states or counties have higher or lower fiscal needs? Suppose that we spend public money on health care to insure that all citizens have a reasonably healthy life. Now suppose that some states have a sicker population. Those states would need more money for health than states with a healthier

3 South Africa's provincial governments do not have their own revenue-raising powers, so this is the main reason for focusing on their needs rather than their capabilities.

population. Larger populations, sicker populations and more dispersed populations will all lead to higher costs. This means a higher fiscal need. The health needs of the population are one of the factors that South Africa considers in its formula.

Why do some states or counties have higher or lower "fiscal capacity"? Fiscal capacity is basically about the ability of a state or county to raise money from taxing its people. In a state or county with a smaller economy, for example, it is harder to raise funds through taxation to cover costs. Those states with smaller economies may not be able to provide services without extra funding. This means they have a lower fiscal capacity. This is one of the main factors that India considers in its formula.

Measuring fiscal Needs and fiscal capacity

Fiscal Need

We have said that South Africa's formula for sharing revenues, the equivalent of Kenya's "equitable share" (minimum 15 percent for counties), focuses on fiscal needs. Let's look at how they do this.

The South African formula is based on six criteria, but the most heavily weighted factors in the formula are those that measure fiscal need (also known as expenditure need).

The largest factor in the South African formula (weight=48%) is education. The second largest factor is health (weight=27%). These two factors are based on measures of expenditure need. For example, the education factor is based on the size of the school-age population and the enrollment in each province. Larger school-age populations and higher enrollment mean more money is needed for education spending. So provinces that have higher education needs are given more funding.

For health, the measure is based largely on an estimate of the uninsured population and their relative healthiness (known as "risk" of illness). In addition, health "output" is considered: number of visits to health care facilities in a province, for example, as a share of national visits.[4] Taken together, these factors help to estimate the need for health funding. Those South Africans who are uninsured and sick are more likely to visit health facilities. The measure also looks directly at the number of visits. The larger number of visits means higher costs and provinces receive more funding to cover these.

The formula also puts a small weight on poverty (3%), which is also a measure of the need for government services, and therefore fiscal need. Taking these three factors together—health, education, and poverty—the South African formula puts a weight of 78% on fiscal needs.

The Indian formula is shown below in Table I.[5] It also includes two measures of fiscal need: population and area. States with more population will have higher service costs, so this is given a weight of 25%. States with larger areas are also presumed to have higher costs, because administering a larger area means more offices and higher transport costs to provide the same services to the population. Area is given a weight of 10%.

Fiscal Capacity

While India's formula weighs fiscal needs, nearly half of the formula is based on something called "fiscal capacity distance." This is India's measure of the fiscal capacity, or fiscal ability, of states to meet the needs of residents. Remember that fiscal capacity is a measure of the resources that a state has rather than the needs of its residents.

4 Republic of South Africa, National Treasury, *Explanatory memorandum to the Division of Revenue*, 2012.

5 Thirteenth Finance Commission (India), *Report of the Thirteenth Finance Commission 2010-15*, December 2009.

Table I: India's Formula for Sharing Resources (13th Finance Commission)

Table 8.1: Criteria and Weights for Tax Devolution

(*per cent*)

Criteria	Weight
1. Population (1971)	25.0
2. Area	10.0
3. Fiscal Capacity Distance	47.5
4. Fiscal Discipline	17.5

So how is fiscal capacity measured in India? The approach is somewhat complex, so we have provided an example in Box II. Fiscal distance is calculated by first determining the average amount of tax collected as a share of the total amount of money that is generated by individuals, businesses, and others in each state, and then estimating for each state how much revenue it would collect if it taxed its citizens at that average rate. This is then compared to the richest states to get a sense of how far short each state falls from the ability of wealthier states to pay for services. The farther a state is from the wealthier states, the more money it is given by the formula to compensate it.

Box II: Using India's Fiscal Distance Indicator with Kenyan counties

To use fiscal distance in Kenya, we would take all 47 counties and look at how much they taxed their citizens relative to county income. Suppose that, on average, each county had an income of Ksh 100 billion and on average, each county collected about Ksh 25 billion in taxes. This would mean that the average tax to income ratio would be 25/100, or 25%. Now suppose that one county, let's call it County Chini, had an income of 60 billion, below the average. If that county were to collect taxes at a 25% rate, it would collect about 15 billion in taxes (1/4* 60). Compared to the average of 25 billion, this would mean that Chini was Ksh 10 billion short of the average, or 10 billion "far" from the average, to use the language of distance. In India, however, they do not compare Chini to the average, but to the wealthiest states, which means that the distance is even further. For example, County Juu has an income of 160 billion, which means that at the average tax rate, it would collect ¼*160, or 40 billion. Thus the Indian formula compares Chini to Juu and the distance is 40 billion – 15 billion, or 25 billion.

There is one missing step in the description above: the calculations are actually based on per capita revenue, not just revenue. So if Chini collected 15 billion in taxes, this would then be divided by its population. Suppose Chini's population was 1 million. Then its tax revenue per capita would be 15,000 Ksh. Suppose Juu had a population of 2 million. Then its revenue per capita would be 40 billion divided by 2 million, or 20,000 Ksh. Then the distance between Chini and Juu would be 5,000 Ksh per capita.

Effort

When we looked at Jackie, Janet, Samuel and Teddy, we also looked at effort. We considered how to treat Jackie and Janet when Jackie wasted some of the funds she was given. We looked at people not only based on how their lives turned out, but based on the choices and efforts they made.

In India, there is one additional variable that measures neither need nor ability, but effort. This is fiscal discipline. Fiscal Discipline carries a weight of 17.5%. It is designed to reward efforts by states to manage their finances well. The way this is measured is by looking at the share of spending that is covered by a state's own revenues. In other words, how much effort do states make to raise their own funds for what

they want to buy? In Kenya, own revenues would mean the revenues collected through entertainment and property tax, as well as any fees. Let's take an example. If County Juu raises Ksh 10 million in own revenue, but spends Ksh 100 million, then it would have a share of own revenues to total spending of 10% (10/100).

This is a measure of a state's effort, because it does not include transfers from national government. The Indian formula gives states that have improved their ratio over time more funding. So if Juu moves from 10% to 15% while other counties do not improve, it will be rewarded. If other counties improve their percentages more than Juu, then it will receive less than those other states.[6]

What has Kenya's Commission on Revenue Allocation already said about fairness and equality?

Let's come back to Kenya. What has the CRA done so far to address the issue of fairness in sharing resources?

In its first report to Parliament in 2012, the CRA explained that there were three ways to think about sharing resources.[7] We have discussed two of them already: fiscal need and fiscal capacity.

The third way to think about this issue is by looking at the fiscal "gap". This is a pretty simple idea: it basically means looking at the difference between the needs of each county or state, and the capacity of that county or state. For example, if we knew that a county needed exactly $100 to deliver all of the services it was required to deliver, and it had a fiscal capacity of $90, then the fiscal gap would be $10. The goal of a fair resource sharing policy would be to fill that fiscal gap for each county. Those counties with bigger fiscal gaps would get more money from the formula.

CRA said that it preferred to use this third, fiscal gap approach, but that it didn't have the data to do so. One of the key missing data points to follow the Indian approach is county "gross domestic product." This is just a measure of the size of the county's economy (all of the goods and services it produces). Recall that in the Indian example, this is needed to determine how much tax the county can raise, India's measure of fiscal capacity.

In light of the data constraints, CRA opted to use the fiscal need approach. In other words, the CRA opted to broadly follow the South African model we discussed. Here, too, though, the CRA said that it faced data limitations to be able to capture the fiscal needs of each county. For this reason, the CRA formula is quite different from the South African formula, even though both are intended to measure fiscal need.

What did CRA actually do? The CRA formula has the following inputs and weights:

- county population (45 percent)
- a basic share that is equal for all counties (25 percent)
- county poverty level (20 percent)
- land area of the county (8 percent)
- and county's level of fiscal responsibility (2 percent)

There are some similarities to the South African formula here, but also some big differences. Like South Africa, population and poverty are key variables. Most of the inputs are measures of fiscal need, but none is as specific as the criteria used in South Africa. In other words, none of these are direct measures of the need or demand for services, like visits to the health clinic.

6 Technically, each state is compared to the average percentage and a ratio constructed. For example, if Juu were to collect 10% while other states collected 15%, the ratio would be 10/15, or .66. If over time, Juu were to increase to 15% while the average were to remain at 15%, then its ratio would increase to 15/15 or 1.0. The increase is then captured in another ratio, which is 1/.66, or 1.51. Then this ratio is compared to other states. Those with higher ratios relative to other states receive more.

7 Commission on Revenue Allocation (Kenya), *Recommendations on sharing of revenue nationally between the national and county governments for the fiscal year 2012/13 and among county governments for the fiscal years 2012/13-2014/15*, 8 August 2012.

Like the Indian formula, the CRA formula also takes effort into consideration under the “fiscal responsibility” criterion, however this has yet to be defined. In the first year, all counties will receive the same amount under this criterion because there is no way to measure past fiscal responsibility for counties that have just come into existence.

Discussion

Let’s look at the CRA approach in light of Jackie, Janet, Teddy and Samuel, as well as the experiences of India and South Africa.

1. The CRA formula emphasizes need, but has very rough measures of that need. These lack actual measures of demand for services. While the formula is a good start, better data and a more sophisticated assessment of needs would help ensure that it was properly targeted to enhance fairness.
2. The CRA formula does not take into consideration capacity. Better data on capacity may be important to collect. The CRA says it eventually wants to base its formula on the fiscal “gap” between needs and capacity. To do so, more data on capacity needs to be collected, and used, by the Commission. The Kenya National Bureau of Statistics has a role to play here in generating county-level GDP data.
3. The CRA does not give a lot of weight to effort. It is possible that more attention should be paid to the measurement of effort and more weight given to it in the formula.
4. The CRA approach is not comprehensive. The equitable share formula does not do anything to maintain current service delivery levels (“hold harmless”) those counties that are better off today. Recall that in our discussion of Jackie and Janet and the 3 ways to make them more equal, we discussed the possibility that helping Jackie without hurting Janet would be a reasonable goal. Now, no formula can do this on its own, but this is why a formula should be considered at the same time as other conditional grants that can do this. The CRA has not said very much about how it would use conditional grants to hold counties harmless. In the 2013/14 budget debate, CRA seemed to oppose all conditional grants.
5. A formula is always only an approximation of the inequalities between counties. It is usually the case that some counties are better off than others in certain ways, but worse off in other ways. Again, a formula may not solve this problem, so it should be considered alongside other conditional grants. This is the problem of Samuel and Teddy being unequal in different ways (income v. health).

So, what do you think? How would you share resources? Does Kenya have anything to learn from South Africa or India? Or do you think those countries got it wrong?

By 2015, the CRA formula will be revised again. It is not too early to start thinking about how it should look. When thinking about how to share resources and what is fair, it is also useful to look at what we know about county inequalities. We review this data in a second brief, *Fair Play: Inequality Across Kenya’s Counties and What It Means For Revenue Sharing*.