

Fiscal Decentralisation in Kenya and South Africa: A Comparative Analysis

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ABSTRACT

Kenya and South Africa have adopted fiscal decentralisation models in their Constitutions. Though Kenya's system is at its nascent stages and its implementation is slowly progressing, South Africa has, to a great extent, successfully implemented its system since 1996. South Africa leads the African continent in fiscal decentralisation, and is therefore of significant comparative value while analysing the opportunities and limitations of the Kenyan system. The comparative analysis is based on the pillars of effective fiscal decentralisation. Although both systems adhere to the pillars, South Africa has three spheres of devolution whereas Kenya has two. This article establishes that the Kenyan decentralisation system is weaker in a few respects. First, it devolves minor functions to the County Governments, leaving the bulk of the health and education expenditures under the control of the National Government (NG). Second, it devolves taxation powers to County Governments for taxes which, under the previous local authorities system, have historically been low yield and hard to collect. Third, it insists on National Government guarantees, which may be an incentive for irresponsible borrowing by County Governments. However, the Kenyan system is stronger in two respects. First, it creates an equalisation fund, with decisions on amounts being made by Parliament in consultation with the Commission on Revenue Allocation (CRA). This insulates the system from skewed allocations meant to benefit certain areas over others. Second, the Kenyan system has more implementation supervision institutions, including the CRA, the Constitutional Implementation Commission (CIC) and the Transition Authority (TA). The only such body in South Africa is the Financial and Fiscal Commission (FFC), playing a supervisory role in devolution of fiscal matters.

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1 INTRODUCTION

Decentralisation is the dispersion of power and responsibilities from a central government to regional or locally managed units. The regional and local units act as agents for the central government and execute certain functions on its behalf. Decentralisation may be classified into two categories. The first category involves a mere transfer of authority from the central government to the devolved units, but with the central government retaining power to make final decisions. The second type entails decentralisation of political power in which the central government transfers political, administrative and financial power to the sub-national units, which can then make decisions independent of the central government.¹ By strengthening local institutions through decentralisation of political power, it is believed that local administration and service delivery will be improved, leading to economic sustainability and poverty reduction.

Fiscal decentralisation comprises the financial aspects of devolution to regional and local governments.² It is the devolution by the central government to local governments — including states, regions or municipalities — of specific functions together with the administrative authority and fiscal revenue to perform those functions.³ It is the aspect of decentralisation that defines how and in what way expenditures and revenues are organised between and across different levels of government in the national polity.⁴

This article defines fiscal decentralisation as the transferring of the authority of tax collection or expenditure from the national level to sub-national units for the purpose of attaining more efficient public services aimed at improving the public welfare of residents. The purpose of this article is to investigate the extent to which the fiscal decentralisation framework as provided for in the new Constitution of Kenya (adopted in August 2010) adheres to the pillars of effective fiscal decentralisation. To this end, the article examines the constitutional framework within the pillars of effective fiscal decentralisation. It then compares it with the legal framework in South Africa, where devolution has been largely effective, noting the similarities and differences and the best practices that can be borrowed. South Africa is chosen for being the economic super-power of Africa, a goal Kenya is striving towards. In addition, South Africa is similar to Kenya in that it has a

¹ JE Kee, 'Fiscal Decentralisation: Theory as Reform' (2003) 5 *Journal of Public Policy and Public Administration* <[http://www.gwu.edu/~clai/working_papers/James Kee fiscal decentralisation paper 2003.pdf](http://www.gwu.edu/~clai/working_papers/James%20Kee%20fiscal%20decentralisation%20paper%202003.pdf)> accessed on 17 March 2013.

² K Davey, 'Fiscal Decentralisation' (2003) 1 <<http://unpan1.un.org/intradoc/groups/public/documents/untc/unpan017650.pdf>> accessed on 17 March 2013.

³ Kee (n 1) 5.

⁴ UNDP, 'Fiscal Decentralisation and Poverty Reduction' (2003) 2 *UNDP Primer* <<http://content.undp.org/go/cms-service/download/publication/?version=live&id=2219894>> accessed on 16 March 2013.

unitary system of government. It also leads other African countries in the extent of fiscal decentralisation.⁵

The insight gained from this article can be helpful in determining the gaps in the existing legal and policy framework on fiscal devolution in Kenya and proposing changes that may facilitate effectiveness and the achievement of the decentralisation goals envisaged in the 2010 Constitution.

2 BRIEF HISTORY OF FISCAL DECENTRALISATION IN KENYA

During the 1990s, there was a demand by Kenyan citizens that public funds for development be availed to them at the grassroots level. This was fanned by the feeling that the existing devolved funds; for instance, the Secondary Education Bursary Fund (SEBF) (1993) and the Road Maintenance Levy Fund (RMLF) (1993), had been infiltrated by corruption through the provincial administration system.⁶ Moreover, the citizens felt that the Special Rural Development Programme (SRDP) that had been developed in 1971 and the District Focus for Rural Development (DFRD) established in 1983 had failed. The SRDP focused on decentralising resources and planning to the sub-district level; that is, the division, in an attempt to increase rural incomes, employment and welfare. It implemented labour intensive road construction projects and better extension methods for farmers.⁷

After the failure of SRDP, a new fiscal decentralisation initiative, the DFRD, was launched in 1983. Its goal was to extend decentralised planning and expenditure to all districts in Kenya. The post of District Development Officer (DDO) was created and District Planning Units (DPUs) were established. It was felt that these initiatives failed due to widespread corruption in government. They were thought to be, 'mere dispersal of Central Government control outside the national capital without tangible transfers of powers to make decisions at local level'.⁸ Many people felt that availing of more funds at the grassroots without

⁵ S Ndewa, 'Decentralisation in Africa: A Stocktaking Survey' (2002) (5) *Africa Region Working Paper Series No. 40* <<http://www.worldbank.org/af/wps/wp40.pdf>> accessed on 20 March 2013.

⁶ A Ogolo, 'Devolved Funds Initiatives in Kenya: A Blessing or a Curse?' (2009) 1 *Peace, Conflict and Development Research* <<http://www.internationalpeaceandconflict.org/forum/topics/devolved-funds-initiatives-in#.UV4fBDewcSk>> accessed on 18 March 2013.

⁷ ZR Ergas, 'Kenya's Special Rural Development Program (SRDP): Was It Really a Failure?' (1982) 17(1) *Journal of Developing Areas* 51-66.

⁸ World Bank, 'Kenya Community Driven Development: Challenges and Opportunities' (2002) 7 *Report 24688* <www-wds.worldbank.org/servlet/.../WDSP/.../2002/.../multi0page.pdf> accessed on 16 March 2013.

involvement of provincial administration would reduce the effects of corruption and enable faster implementation of development projects.⁹

This desire was not completely misinformed. This article is based on the view that implementation of a policy of a decentralised economy is the appropriate mechanism for eliminating economic exploitation and alleviating the plight of the common people. A centralised economy is often not the best mechanism for addressing the economic problems of remote, predominately rural communities. It is imperative that economic planning should start from the lowest level, where the experience, expertise and knowledge of the local people can be harnessed for the benefit of all members of a socio-economic unit.

The Kenyan government responded to these demands by adopting an unofficial decentralisation policy which led to creation of numerous devolved funds. These funds include: Constituency Bursary Fund, Free Primary Education Fund, Constituency HIV/AIDS Fund, Roads Maintenance Levy Fund, Rural Electrification Levy Fund, Women Enterprise Fund, National Development Fund for Persons with Disability, and Poverty Eradication Fund. Many of these wide-ranging and costly efforts, however, made only modest progress toward meeting their stated goals. They faced several challenges that included the absence of citizen participation, lack of responsiveness and social accountability of duty bearers, duplication among funds, poor legal framework, inadequate capacity within management committees and political interference.¹⁰ Given the uneven performance of previous initiatives, there has been extensive debate about the desirability of fiscal decentralisation in Kenya and the approach that it should adopt.¹¹

The adoption of a new Constitution in August 2010 resolved some contentious issues; among others, the introduction of a new structure of governing power between the Central Government and sub-national regions.¹² At the heart of the clamour for a new Constitution was a determination by the people of Kenya to devolve governance and decision-making so as to give them a greater say in how they and their resources can be harnessed and utilised. The structure of government

⁹ J Barkan and M Chege, 'Decentralising the State: District Focus and the Politics of Reallocation in Kenya' (1989) 27(3) *Journal of Modern African Studies* 451.

¹⁰ B Obuya, 'Fiscal Decentralisation in Kenya: The Constituency Development Fund and the Growth of Government' (20th Annual Conference of the Association for Budgeting and Financial Management 23-25 October 2008) <<http://mpr.ub.uni-muenchen.de/11813>> accessed on 18 March 2013.

¹¹ Kenya Human Rights Commission (KHRC) and Social and Public Accountability Network (SPAN), 'A Study of the Decentralisation Development in Kenya: Towards Alignment, Citizen Engagement and Accountability' (2011) 15 *Joint Research Papers* <<http://www.knchr.org/Portals/0/Reports/Nguzo%20za%20Haki-Devolution.pdf>> accessed on 17 March 2013.

¹² B Jamie and K Roy, 'Fiscal Decentralisation in Kenya: A Small Step or Giant Leap?' (2011) 5 *IDG Policy Brief* <www.urban.org/uploadedpdf/412332-fiscal-decentralization.pdf> accessed on 18 March 2013.

was therefore changed radically by the Constitution to position devolution and decentralisation to be at the core of national life.

The new Constitution identifies devolution of power to be one of the values and principles that should guide the Kenyan governance system.¹³ Unlike its predecessor,¹⁴ the new Constitution defines the public sector as comprising two levels of government: a National Government as well as 47 County Governments.¹⁵ It further describes the National and County Governments to be 'distinct and interdependent', with the obligation to conduct their mutual relations on the basis of consultation and cooperation.¹⁶ This is, therefore, a devolution not based on the principle of absolute autonomy but instead, on interdependence and cooperation. It is a cooperative system of devolved government.

The 2010 Constitution of Kenya, intended to restructure the provincial administration in its current form and to bring under the control of the County Government all major public services within County boundaries.¹⁷ As such, the County Government is to absorb the structures of decentralised development management. There is, therefore, a need to rationalise the current partnership system in the field, in which almost all government departments and ministries have a presence in the districts; for instance, the District Health Officer, District Agricultural Officer, District Education Officer, among others.

The government is yet to fully implement fiscal decentralisation as envisaged in the new Constitution. Attempts at implementation of a fiscal decentralisation structure under the new Constitution have been characterised by disagreements and discordance on the most suitable legal and policy approach. For instance, the Ministry of Finance and Ministry of Local Government were embroiled in a much publicised dispute over finance sharing laws at the national and county levels, thus delaying the publishing of the Public Finance Management Bill, 2011.¹⁸ In the budget policy statement 2012, the Ministry of Finance unveiled plans to abolish the Constituency Development Fund and

¹³ Article 10 of the Constitution of Kenya, 2010.

¹⁴ The previous Constitution defined Kenya's public sector as quite centralised, with a vertically de-concentrated territorial-administrative system at the Provincial and District levels. It is also noteworthy that although the previous Constitution did not specifically recognise an elected Local Government level, the Local Government Act (Cap 265) provided a legal framework for establishing elected Local (County, Municipal, Town and City) Councils.

¹⁵ See Chapter 11 of the Constitution and the First Schedule to the Constitution. County Governments are established under art 176.

¹⁶ Article 6(2).

¹⁷ Fourth Schedule to the Constitution of Kenya, 2010.

¹⁸ W Menya, 'IMF's Input in Devolution Bill Fuels Dispute Over Control of County Cash' *Daily Nation* (Nairobi, 17 September 2011) <<http://allafrica.com/stories/201109191310.html>> accessed on 18 March 2013.

replace it with a new fund which conforms to the 2010 Constitution.¹⁹ There is also a dispute as to whether to abolish or simply restructure the provincial administration.²⁰ The provincial administration has heavy financial implications with a total of KSh. 11.7 billion being approved for administration services in the 2012/2013 budget policy document.²¹ This amount will have to be reviewed in view of the County Governments. There is thus need to review the effectiveness of the fiscal decentralisation structure proposed in the 2010 Constitution. This article undertakes the review in line with the pillars of effective fiscal decentralisation.

3 PILLARS OF EFFECTIVE FISCAL DECENTRALISATION

According to existing literature, effective fiscal decentralisation is based on five key pillars. The first is political autonomy. It is perhaps the most crucial element of a decentralised system.²² The decentralised units should be autonomous, with their leadership being directly elected by the people. If the local leadership is appointed by higher levels of government, their accountability will be upwards and not downward to the local population. This would create a system where the efficiency gains that are central to decentralisation strategies are not captured.²³

Second is expenditure responsibility. Functions should be assigned to different levels in the overall system of government in a given country. This would entail a framework for division of functions between the national government and sub-national units to whom

¹⁹ A Shiundu, 'Treasury in Budget Plan to Abolish CDF' *Daily Nation* (Nairobi, 18 April 2012) <<http://www.nation.co.ke/News/politics/Treasury+in+Budget+plan+to+abolish+CDF+/-/1064/1388466/-/nwaovp/-/index.html>> accessed on 18 March 2013.

²⁰ Kenya Human Rights Commission, 'Provincial Administration Stifles Ministries, Departments and Agencies' <<http://www.khrc.or.ke/blog/provincial-administration-stifles-ministries-departments-and-agencies-mdas.html>> accessed 18 March 2013, critiquing the President's refusal to assent the County Governments Bill, 2011; D Odipo, 'Abolish Provincial Administration' *The Standard* (Nairobi, 20 July 2009) <http://www.standardmedia.co.ke/?articleID=1144019664&story_title=Abolish-Provincial-Administration->> accessed 18 March 2013; C Kanjama, 'Provincial Administration as We Know It Will Be No More' *Daily Nation* (Nairobi, 26 May 2010) <<http://allafrica.com/stories/201005261148.html>> accessed on 18 March 2013.

²¹ Government of Kenya (GOK), 'Report for Medium Term Expenditure Framework (MTEF) Period 2010/11–2012/13' (2012) 8 <www.treasury.go.ke/index.php?option=>> accessed on 18 March 2013.

²² USAID, 'Fighting Poverty through Fiscal Decentralisation' (2006) 17 *Fiscal Reform in Support of Trade Liberalization Project* <http://pdf.usaid.gov/pdf_docs/PNADH105.pdf> accessed on 17 March 2013.

²³ *Ibid* 20.

financial resources are expected to be decentralised.²⁴ The assignment of functions should be based on the 'subsidiarity principle'.²⁵ This principle suggests that government functions should be assigned to the lowest level of government that is capable of efficiently undertaking the function.²⁶

Third is revenue assignment. It is a well-known adage that finances should always follow functions. This means that the devolved units should have adequate resources so as to effectively discharge their functions.²⁷ To ensure this happens, a framework giving to devolved units a significant amount of taxation powers, budget-making autonomy, transparency and a hard budget constraint is needed.²⁸ The latter forces devolved governments to live within their means, and forces local officials to be accountable for hard choices that they must make. The central government must thus establish expenditure needs for each level of government before tackling the question of revenue assignment.²⁹

Fourth is an inter-governmental fiscal transfer. The assignment of revenue sources rarely provides devolved units with sufficient revenues to fund their expenditure functions.³⁰ This leaves the devolved units with budget deficiencies. One way of addressing these deficits is through establishing a framework of transferring funds from the national governments to the devolved units. Such a system should focus on service delivery, preserving budget autonomy and enhancing equity and fairness while simultaneously ensuring that the policy (of fiscal transfer) does not result in the devolved units abandoning their own, equally important local revenue mobilisation initiatives.³¹

The final pillar is sub-national borrowing. Due to budget deficits, there is need for a well-defined framework for borrowing and issuing bonds by the devolved units.³² Such a framework needs to be balanced so as to curb the tendency of devolved units to incur debts which they

²⁴ World Bank, 'Intergovernmental Fiscal Relations' <<http://www1.worldbank.org/publicsector/decentralization/fiscal.htm>> accessed 18 March 2013.

²⁵ J Steffensen, 'Principles of Expenditure Assignments' (2010) 2 <<http://um.dk/en/~media/UM/English-site/Documents/Danida/Activities/Strategic/Human%20rights%20and%20democracy/Democracy/Fiscal%20decentralisation%20annex%201.ashx>> accessed on 18 March 2013.

²⁶ Ibid 3.

²⁷ R Bahl, 'Implementation Rules for Fiscal Decentralisation' (1998) 7 <siteresources.worldbank.org/INTDSRE/Resources/3p.pdf> accessed on 18 March 2013.

²⁸ Ibid 4.

²⁹ Ibid 8.

³⁰ R Bahl, 'The Pillars of Fiscal Decentralisation' (2008) 30 *CAF Working Papers* <www.caf.com/attach/19/default/200807Bahl.pdf> accessed on 19 March 2013.

³¹ Ibid 32.

³² N Feruglio, 'Fiscal Decentralisation: An Overview' (2007) 6 <<http://siteresources.worldbank.org/PSGLP/Resources/FeruglioandAndersonoverviewoffiscaldecentralization.pdf>> accessed on 20 March 2013.

cannot repay, as well as to facilitate responsible borrowing among the devolved units.³³

Those opposed to full-scale devolution in Kenya argue that the counties are incapable of comprehensive service delivery, and therefore there remains the need for a parallel system in the form of decentralised NG. The absence of a clear position on this matter in the 2010 Constitution suggests that it may be ambitious to laud the devolved units as vehicles for local accountability, participation and governance in the pursuit of a pro-poor policy agenda.

This article is based on the view that the degree to which the changes in Kenya's inter-governmental structure will truly prove to be transformative depends on how the constitutional implementation process will be done. With limited success of previous decentralised fund initiatives, there is, thus, need to investigate the effectiveness of the fiscal decentralised system as envisaged in the 2010 Constitution. This is benchmarked with South Africa, which has, to a large extent, successfully implemented fiscal decentralisation.

4 COMPARATIVE ANALYSIS BETWEEN KENYA AND SOUTH AFRICA

4.1 *Political Autonomy*

On the first pillar of political autonomy, the 2010 Constitution creates two levels of government; that is, the National Government (NG) and the County Government. It provides for an elected government at the National level, and the County level. The county as a devolved unit is autonomous from the NG and therefore not subject to the control of the NG. The County Government is made up of a County Assembly (CA) and the County Executive Committee (CEC).³⁴ The Assembly's composition is listed in art 177 of the Constitution, while the CEC is elaborated upon in art 179. This is akin to the County Government having its own 'cabinet' and 'parliament'. Politically, the NG is only to enact and let the counties implement the policies autonomously and with discretion regarding the means of implementation.

The NG is headed by the President, who is the Head of State and Government, assisted by the Deputy President and Cabinet Secretaries.³⁵ The head of the County Government is an elected Governor, assisted by the Deputy Governor and the CEC.³⁶ The election of the President

³³ Ibid.

³⁴ Article 176, read together with the First Schedule.

³⁵ Article 131(1)(a) and (b).

³⁶ Articles 180 to 182 discuss the offices of the governor and deputy governor, including the terms under which disciplinary action may be taken against them.

and the Governors is held on the same day as the general election of Members of Parliament, being the second Tuesday of August, in every fifth year.³⁷ With the Governor having a mandate directly from the people, he is independent from any influence by the President, and only accountable to the electorate. This autonomy is further buttressed by the fact that the President cannot sack the Governor and can only suspend the County Government in very limited circumstances. He can only suspend it with the recommendation of an independent commission of inquiry.³⁸ Even if the President appoints a partial commission that subsequently recommends the suspension of a County Government, there is a further safeguard in that the Senate must approve the suspension.³⁹ The fact that Senate may terminate that suspension at any time⁴⁰ means that the Constitution grants more powers on the decision to suspend the County Government to the Senate, not the President.

Further, the Constitution obliges County Governments to reflect the principle of separation of powers that operates at the national level.⁴¹ The County Governments accomplish this by making the Governor and the CEC accountable to the County Assembly in the same manner that the President and the Cabinet are made accountable to Parliament. It should also be noted that the same principle holds true for the relationship between the County Governments and the National Government: the Executive Council of the County (and not the NG) makes decisions regarding local service delivery, with the NG confining itself to developing national policy. Thus, the Constitution grants County Governments political autonomy distinct from the NG.

To curb the possible disharmony that may come with complete autonomy, the Constitution demands for interdependence and co-operation between the two levels of government. Thus, it provides that the two governments should conduct their mutual relations on the basis of consultations and cooperation.⁴² Evidence of this can be seen in the preparation of plans and budgets. Here, the National Government allocates funds by means of a Division of Revenue Bill and the County Governments prepare and adopt their own annual Budget and Appropriation Bills on how to spend the funds they receive.⁴³ Secondly, they are required to cooperate in setting up joint committees and joint authorities to provide concurrent functions.⁴⁴ They are also

³⁷ Article 136(2)(a) provides for the election of the President while art 180 provides for the election of the Governor.

³⁸ Article 192(2).

³⁹ Ibid.

⁴⁰ Article 192(4).

⁴¹ See art 175(a).

⁴² Article 6(2) of the Constitution of Kenya, 2010.

⁴³ Article 218 and 224.

⁴⁴ Article 189(2).

to cooperate in the implementation of legislation.⁴⁵ The constitutional framework thus meets the threshold requirement of political autonomy, a key pillar of effective decentralisation.

On the other hand, the South African Constitution of 1996⁴⁶ provides for three spheres of government, namely National, Provincial and Local, which are distinctive, interdependent, and interrelated.⁴⁷ There are nine Provincial Governments: Eastern Cape, Free State, Gauteng, KwaZulu-Natal, Limpopo, Mpumalanga, Northern Cape, North West and Western Cape.⁴⁸ The Local Government consists of municipalities, established for the whole of the territory of the Republic.⁴⁹ It was transformed in two phases. The first phase was in 1995, when 843 transitional municipalities were created under the Local Government Transition Act.⁵⁰ The second phase, in 2000, witnessed the incorporation of urban and rural areas, thus reducing the number of local municipalities to 284 under the Local Government Municipal Structures Act.⁵¹ These are classified into 6 Metropolitan Councils (Category A), 231 Local Municipal Councils (Category B), and 47 District Municipal Councils (Category C).⁵² By comparison, Kenya's devolved government system is fashioned on administrative districts rather than the existing local authorities.

The executive authority of the NG in South Africa is vested in the President, together with the other members of the Cabinet, answerable to him.⁵³ The legislative authority is vested in the National Assembly and the National Council of Provinces.⁵⁴ The Provincial Governments (PGs) are autonomous, with their legislative authority conferred on the Provincial Legislature,⁵⁵ and the executive authority on the Provincial Executive, headed by the Premier and consisting of Executive Council members answerable to the Premier.⁵⁶ The Premier is elected from among the members of the Provincial Legislature.⁵⁷ The autonomy of the PGs is secured through the provision that the NG must secure the approval of the National Council of Provinces before intervening in

⁴⁵ Article 189(1)(b).

⁴⁶ Constitution of the Republic of South Africa, 1996.

⁴⁷ Article 40(1).

⁴⁸ Article 103(1).

⁴⁹ Article 151(1).

⁵⁰ Act No 209 of 1993.

⁵¹ Act No 117 of 1998.

⁵² A Derichs and C Einfeldt, 'World Bank Seminar: Fiscal Decentralisation and Intergovernmental Fiscal Relations in South Africa' (2006) 3 *Strengthening Local Governance Programme, German Agency for Technical Cooperation (GTZ)* <<https://www.giz.de/Themen/de/dokumente/en-fiscal-decentralisation-case-study-south-africa-2006.pdf>> accessed on 20 March 2013.

⁵³ Constitution of the Republic of South Africa, 1996, art 85.

⁵⁴ Article 44.

⁵⁵ Article 104.

⁵⁶ Article 125.

⁵⁷ Article 128.

the functioning of a PG.⁵⁸ The executive and legislative authority of a municipality is vested in its Municipal Council.⁵⁹ The National and Provincial governments are required not to compromise or impede a municipality's ability or right to exercise its powers or perform its functions.⁶⁰ To enhance its autonomy, the Municipal Council is headed by a Chairperson, has an Executive Committee and is empowered to employ personnel that are necessary for the effective performance of its functions.⁶¹ The autonomy of Municipal Governments (MGs) is protected by stringent conditions that PGs must meet before intervening in their functions.⁶²

The above framework thus creates three levels of government that are autonomous and distinctive, yet interdependent and interrelated.

As noted above, South Africa's system of government operates at three levels (National, Provincial and Local), compared to Kenya's two-tier devolution system. Despite this structural difference, both countries have instituted measures to safeguard the autonomy of each level such that one level of government cannot interfere in the functioning of the other levels/level. In addition, both countries support the principles of independence and cooperation upon which the devolved government-national government relationship is based.

Returning to the differences between the two systems of devolution, two further points need to be made. First, in South Africa, the Premier and the Chairperson of the Municipality are elected by, respectively, the Provincial Legislature and the Municipal Council, whereas, in Kenya, the Governor is directly elected by the people. Secondly, the South African system requires the Chairperson and the Deputy Chair of the National Council of Provinces,⁶³ as well as the Speakers and Deputies of the National Assembly⁶⁴ and the Provincial Legislatures,⁶⁵ to be elected from among the members of the legislatures. Under the Kenyan system, the Speakers of both houses of Parliament⁶⁶ and the County Assemblies⁶⁷ are elected from among persons who are not members of the legislatures. The Deputies,⁶⁸ by contrast, are elected from members of the legislatures.

⁵⁸ Article 100.

⁵⁹ Article 151(2).

⁶⁰ Article 151(4).

⁶¹ Article 160.

⁶² Article 139. The intervention must be approved by the Minister for Local Governments, the relevant Provincial Legislature and the National Council of Provinces.

⁶³ Article 64(1).

⁶⁴ Article 52(1).

⁶⁵ Article 111(1).

⁶⁶ Constitution of Kenya, 2010, art 106(1).

⁶⁷ Article 198(1).

⁶⁸ Article 106(1)(b) for Parliament and 178(2)(b) for the County Assembly.

4.2 *Expenditure Responsibility*

The second pillar of effective decentralisation is expenditure responsibility. This entails sharing of functions between the two levels of government, within the principle of subsidiarity. In Kenya, the division of functions and powers between the NG and the County Governments is set out in the Fourth Schedule of the Constitution.⁶⁹ The NG is allocated 35 functions, including, but not limited to: national defence, police services, universities, tertiary educational institutions, primary schools, special education, secondary schools, the construction and operation of national trunk roads, national referral health facilities, and the judicial services.⁷⁰ The County Government is allocated 14 functions, including, but not limited to: county roads, pre-primary education, village polytechnics, home craft centres, childcare facilities, fire fighting services, disaster management, trade development, cultural activities, public entertainment, and public amenities.⁷¹

To further strengthen the subsidiarity principle, the new Constitution allows for voluntary transfer of functions or powers of government from one level to the other by agreement between the governments. This, however, can only happen if the function or power would be more effectively performed or exercised by the receiving government, and where no law prohibits such a transfer.⁷² To comply with the adage that functions come with resources, the new Constitution provides that such a transfer should be preceded by arrangements to ensure that the resources necessary for the performance of the function are also transferred. It however vests the constitutional responsibility for the performance of the function to the transferring level of government as assigned by the Fourth Schedule of the Constitution.⁷³

However, there may be overlaps in these functions between the two levels of government. For instance, the NG is granted control of national betting, casinos and other forms of gambling, whereas the County Governments are also granted control of county betting, casinos and other forms of gambling. This may cause conflicts in determining national casinos and county casinos. Similarly, the NG is in charge of promotion of sports and sports education with the County Governments being in charge of sports and cultural activities and facilities. This may cause conflicts over management of stadia already under the Stadia Management Board. Further, it places the

⁶⁹ Article 186 of the Constitution of Kenya, 2010.

⁷⁰ For a detailed list of functions, see part 1 of the Fourth Schedule to the Constitution.

⁷¹ For a detailed list of functions, see part 2 of the Fourth Schedule to the Constitution.

⁷² Article 187(1)(a)-(b).

⁷³ Article 187(2)(b).

County Governments in charge of ferries and harbours, leaving the Kenya Ferry Services, a national body, in a precarious situation. Finally, electricity and gas reticulation and energy regulation is a function given to County Governments, while NG has the function of energy policy including electricity and gas reticulation and energy regulation. This amounts to granting some power for electricity distribution to County Governments. It is not clear how that relates to the current exclusive function of Kenya Power, a national body charged with electricity distribution.

Moreover, there is no clear demarcation on how expenditure related to these functions is generated and spent. Further, the NG is to set the criteria and conditions to be met before transfer of particular functions to County Governments, in an attempt to ensure County Governments are not given functions which they cannot perform.⁷⁴ The NG may use this window to set onerous conditions that leave it in charge of key functions of County Governments. In addition, there are no clear statistics on the amount of money needed to meet the expenditure assignments of the County Governments. There is also real danger that the NG may undermine fiscal decentralisation through refusal to transfer functions and funds.

To cure the overlaps, the Constitution provides that functions conferred on more than one level of government are within the concurrent jurisdiction of both, and functions not assigned to the County Governments remain to be functions of the NG. Parliament is further empowered to clarify any function through legislation.⁷⁵ To deal with refusal to transfer functions and funds, the Constitution establishes a select committee of Parliament to be known as the Constitutional Implementation Oversight Committee and also the Commission on the Implementation of the Constitution.⁷⁶ These bodies are responsible for overseeing the implementation of the Constitution including addressing establishment of the infrastructure necessary for the proper operation of each county; for instance, locating offices and assemblies and establishment and transfers of staff and also ensuring the devolution of powers and functions to the counties. They are to address any impediments to the process of implementing the Constitution, including failure by the NG to transfer functions or funds. With the real threat of overlaps and the NG's failure to transfer some functions hanging over the decentralised units, Kenya's constitutional framework is weak on the pillar of expenditure responsibility.

Conversely, the South African Constitution divides roles between the various spheres of government, defining which spheres are responsible for what expenditure. It defines areas of concurrent

⁷⁴ Transitional and Consequential Provisions, Sixth Schedule, s 15(1).

⁷⁵ Article 186.

⁷⁶ See ss 4 and 5 of the Sixth Schedule; Transitional and Consequential Provisions.

national and provincial competence to include: agriculture, animal and disease control, property transfer fees, tourism, air pollution, municipal health services, electricity and gas reticulation.⁷⁷ Further, the NG retains expenditure responsibility for functions and issues of national interest that transcend provincial boundaries, such as: national defence, police, prisons, trade and industry, labour regulation and international relations. It develops policy, defines minimum norms and standards for programmes, and coordinates government policy between spheres.⁷⁸ Areas of exclusive provincial legislative competence include: abattoirs, ambulance services, cemeteries, licensing of dogs, street lighting, traffic and parking.⁷⁹ Provincial Governments are primarily tasked with social services, as well as roads and regional economic planning and development. Education, health and welfare services are the three most expensive items in the country's budget and are therefore functions shared by the NG and PG, although their delivery rests with the provinces.⁸⁰ Municipal Governments are left to deliver basic services and responsibilities including: water, sanitation, electricity and refuse collection.⁸¹

Compared to Kenya, South Africa has decentralised more expenditure responsibilities to the devolved units. For instance, PGs are responsible for the bulk of education⁸² and health⁸³ expenditures. However, there is still shared responsibility between the NG and PGs on health and education. Conversely, most of the above sectors in Kenya are centralised. In education, for example, the National Government is in charge of universities, tertiary educational institutions and other institutions of research and higher learning, primary schools, secondary schools and special education institutions, leaving County Governments in charge of only pre-primary education, village polytechnics, home craft centres and childcare facilities. In health, the NG is in charge of national referral health facilities, leaving County Governments in charge of county health facilities, pharmacies and ambulance services. This places a heavier expenditure responsibility on the NG in respect of these two largest government expenditures. It is notable that the Kenyan system is yet to be tested and therefore it is too early to judge on the same. Kenya should apply lessons learnt from the South African experience and decentralise more expenditure responsibilities like primary education to counties to improve on service delivery.

⁷⁷ Constitution of the Republic of South Africa, 1996 Schedule 4.

⁷⁸ Ibid.

⁷⁹ Schedule 5.

⁸⁰ Derichs and Einfeldt (n 52) 16.

⁸¹ Ibid 17.

⁸² A Elhiraika, 'Fiscal Decentralisation and Public Service Delivery in South Africa' (2007) 10 (58) *African Trade Policy Centre Research Papers* <<http://new.uneca.org/Portals/atpc/CrossArticle/1/WorkinProgress/58.pdf>> accessed on 20 March 2013. This presents an average of 80% of total national expenditure on education.

⁸³ Ibid 10. This presents an average of 94% of total national expenditure on health.

4.3 Revenue Assignment

The third pillar of fiscal decentralisation is revenue assignment. This has four elements: taxation powers, budget-making autonomy, transparency and a hard budget constraint. An effective fiscal decentralised system should develop structures that entrench the above elements in both levels of government.

The 2010 Constitution of Kenya seeks to create such a framework. The first element is taxation powers. The Constitution divides taxation powers between the two levels of government. The power to levy the main taxes: that is, income tax, value-added tax, customs duties and other duties on imports and exports, and excise duty, is allocated to the NG.⁸⁴ On the other hand, a County Government may impose property rates and entertainment taxes.⁸⁵ Parliament is authorised to allow levying of other taxes by both levels of government but cannot take away the taxation powers of the County Government.⁸⁶ Both the National and County Governments are constitutionally empowered to impose charges for the services they provide.⁸⁷ Other sources of revenue for the County Government besides taxation revenues include: an equitable share of national revenues;⁸⁸ conditional or unconditional grants from the government;⁸⁹ and proceeds from borrowing.⁹⁰ The Constitution merely transfers the taxation powers of existing local authorities to County Governments. These taxes have already proved to be inadequate to run local authorities, creating well documented financing problems that were plugged through direct transfers from National Government *via* the Local Authority Transfer Fund (LATF). The County Governments thus have extremely weak taxation powers that may not raise substantial revenue unless more substantive taxes are allocated to them.

The second element is budget-making autonomy. The Constitution maintains budgeting autonomy between the two levels of government. The budgeting process for NG requires the Cabinet Secretary responsible for finance to submit to the National Assembly estimates of the revenue and expenditure of the NG for the next financial year at least two months before the end of each financial year. This should also include estimates from the Judicial Service Commission and the Parliamentary Service Commission.⁹¹ The Budget Committee of the National Assembly first discusses and reviews the estimates, seeking and considering representations from the public, before making

⁸⁴ The Constitution of Kenya, 2010, art 209(1).

⁸⁵ Article 209(2).

⁸⁶ Article 209(2) and 209(3)(c).

⁸⁷ Article 209(4).

⁸⁸ Article 204.

⁸⁹ Article 202.

⁹⁰ Article 212.

⁹¹ Article 221.

recommendations to the Assembly. The National Assembly then also considers and approves the estimates, which are then included in an Appropriation Bill, which is introduced into the National Assembly to authorise the withdrawal from the Consolidated Fund of the money needed for the expenditure, and for the appropriation of that money for the purposes mentioned in the Bill.⁹²

On the other hand, the budgeting process of the County Government has to wait for the tabling of the Division of Revenue Bill, dividing revenue raised by the NG among the National and County levels of government and the County Allocation of Revenue Bill, dividing among the counties the revenue allocated to the County Government. These two Bills should be introduced in Parliament two months before the end of each financial year.⁹³ It is on the basis of the two Bills that each County Government prepares and adopts its own annual Budget and Appropriation Bill, authorising withdrawal from the County Revenue Fund, the money needed for the expenditure, and for the appropriation of that money for the purposes mentioned in the Bill.⁹⁴ The above budgeting processes of each government are independent of each other, enhancing attainment of revenue assignment pillar.

The third element is transparency. The Constitution entrenches transparency in decentralisation and expenditure of the decentralised funds. It achieves this in two ways. Firstly, it lays out the principles of public finance to include openness, accountability and public participation. Further principles include promotion of an equitable society with fair taxation burdens and revenue sharing for the purpose of achieving equitable development.⁹⁵ These principles, if implemented, would entrench transparency in management at resources at both levels of government. Secondly, the Constitution establishes the Office of the Auditor General,⁹⁶ who audits and reports on the accounts of the National and County Governments,⁹⁷ including accounts of all their funds and authorities.⁹⁸ The audit report should confirm whether or not public money has been applied lawfully and in an effective way,⁹⁹ and should be tabled before Parliament or the relevant County Assembly,¹⁰⁰ which should within three months debate and consider the report and take appropriate action.¹⁰¹ With Parliamentary and

⁹² The budget process for the National Assembly is well captured in arts 221 and 222.

⁹³ The Constitution of Kenya, 2010, art 218.

⁹⁴ Article 224.

⁹⁵ Article 201.

⁹⁶ Article 229.

⁹⁷ Article 229(4)(a).

⁹⁸ Article 229(4)(b).

⁹⁹ Article 229(6).

¹⁰⁰ Article 229(7).

¹⁰¹ Article 229(8).

County Assembly proceedings being public, this ensures transparency in the use of public funds at both levels of government.

The final element of this pillar is hard budget constraint. The Constitution achieves this in two ways. Firstly, it establishes the Office of the Controller of Budget.¹⁰² This officer has the role of authorising withdrawals from all public funds; including the Consolidated Fund, the County Revenue Fund and the Equalisation Fund.¹⁰³ The Controller of Budget is required to only approve withdrawals that are authorised by law.¹⁰⁴ He further oversees the implementation of the budgets of the National and County Governments,¹⁰⁵ and makes quarterly reports on implementation of the two budgets to both houses of Parliament.¹⁰⁶ His role can thus be summarised as ensuring that funds are spent within the approved budgets and for lawful purposes. In discharging his role, a hard budget constraint is placed on both levels of government.

Secondly, the Constitution espouses the principle that public funds must be spent in a prudent and responsible way.¹⁰⁷ This is buttressed by the constitutional requirement that contracting for goods and services by public entities must be done in a competitive and cost-effective manner.¹⁰⁸ The above provisions ensure that public funds are not wasted and budget constraints are considered in appropriation of public funds.

By maintaining budget autonomy, ensuring transparency and imposing a hard budget constraint, the constitutional framework attains key elements of the threshold requirement of revenue assignment. Its only weakness is that it allocates weak taxation powers to the County Governments. This may end up creating counties that are over-dependent on National Government fund transfers rather than their own revenues, thus undermining attainment of revenue assignment, a key pillar of effective decentralisation.

Comparatively, the South African Constitution allows Provincial Governments to impose taxes on any base except personal and corporate income, general sales, value-added, customs, and property.¹⁰⁹ They are also given authority to levy a flat-rate surcharge on personal income.¹¹⁰ Further, the Provincial Tax Regulation Process Act¹¹¹ provides a framework by which PGs can introduce new taxes. The

¹⁰² Article 228.

¹⁰³ This is under arts 204, 206 and 207, read together with art 228(6).

¹⁰⁴ Article 228(5).

¹⁰⁵ Article 228(4).

¹⁰⁶ Article 228(6).

¹⁰⁷ Article 201(*d*).

¹⁰⁸ Article 227(1).

¹⁰⁹ Constitution of the Republic of South Africa, 1996, art 228(1).

¹¹⁰ *Ibid*.

¹¹¹ Act No. 53 of 2001 <<http://www.ffc.co.za/docs/acts/Provincial%20Tax%20Regulation%20Process%20Act%20No%2053%20of%202001.pdf>> accessed on 20 March 2013.

Members of the Executive Council (MEC) in charge of finance forward the proposal to the Minister for Finance who consults the Budget Council and the Financial and Fiscal Commission (FFC), and with their approval, tables a Bill in Parliament to bring into effect the new tax.¹¹² The main provincial own-source revenue is road traffic fees, including motor vehicle licences and registrations, drivers' licences and learners' permits.¹¹³

As for the MG, the South African Constitution empowers them to levy rates on property and surcharges on fees for services provided by or on behalf of the municipality,¹¹⁴ as well as other taxes, levies and duties appropriate to local governments except income tax, value-added tax, general sales tax or customs duty.¹¹⁵ Further, the Municipal Fiscal Powers and Functions Act¹¹⁶ allows for the introduction of new taxes by municipalities. The Minister of Finance on his own accord or on application by municipalities may authorise new municipal taxes in consultation with the Minister for Local Government, affected municipalities and the FFC.¹¹⁷ The major sources of revenue for municipalities include: surcharges on the sale of bulk services such as water and electricity; property rates;¹¹⁸ and other sources such as traffic fines, business licences, rental fees, entrance fees for use of municipal facilities and fresh produce markets.¹¹⁹ The NG is left to levy the remaining taxes, which form the substantial part of tax revenues,

¹¹² Section 3. The Section gives procedure for introduction of new taxes by the Province.

¹¹³ Elhiraika (n 82) 4.

¹¹⁴ Constitution of the Republic of South Africa, 1996, art 229(1)(a).

¹¹⁵ Article 229(1)(b).

¹¹⁶ Act No. 12 of 2007 <<http://www.ffc.co.za/docs/acts/Municipal%20Fiscal%20Powers%20and%20Functions%20Act%20No%2012%20of%202007.pdf>> accessed on 20 March 2013.

¹¹⁷ Ibid s 4. As per the National Treasury of South Africa, only two such applications had been received by the National Treasury. The first application was for the introduction of a rural development levy in areas where municipalities struggle to implement the valuation rolls necessary to impose municipal rates. The other application proposed the introduction of a local business tax for businesses operating within the jurisdiction of metropolitan municipalities. National Treasury of the Republic of South Africa 'Budget Review 2012' (2012) 39 <<http://web.up.ac.za/sitefiles/file/40/2012%20Budget%20review.pdf>> accessed on 20 March 2013.

¹¹⁸ The Municipal Property Rates Act regulates the power of municipalities to impose rates on properties. It came into operation in 2005.

¹¹⁹ A Stanton, 'Decentralisation and Municipalities in South Africa: An Analysis of the Mandate to Deliver Basic Services' (PhD thesis, University of KwaZulu-Natal 2008) 171 <<http://researchspace.ukzn.ac.za/xmlui/bitstream/handle/10413/623/Stanton%20A%20PHD.pdf?sequence=1>> accessed on 20 March 2013.

including broad-based taxes such as income and corporate tax, value-added tax (VAT), customs and excise duties, and fuel levies.¹²⁰

In comparison to Kenya, the South African system, by allowing Provincial Governments to levy a surcharge on personal income, devolved greater taxation powers. The Kenyan Constitution also limits the sources from which County Governments can derive their own revenues. The South African system, however, has a procedure of introducing new taxes that is initiated by the devolved units themselves, as opposed to the Kenyan system where introduction of new taxes is the prerogative of Parliament, without the involvement of counties.

The South African system devolves substantial revenue-raising functions to both the PG and MG. However, despite enabling laws, Provincial Governments' revenue assignment has been characterised by a low tax base, with revenue yield recording low percentage increase in recent years.¹²¹ This has left the Provinces heavily dependent on the National Government for revenue, with the NG grants forming over 97% of the total Provincial revenues.¹²² On the other hand, the MG are largely able to finance much of their budgets through local revenues. This may be largely attributed to them being allowed to exclusively levy property tax and surcharge for services such as water and electricity, which are high-yield taxes. Consequently, they survive on lower levels of government grants. For instance, municipalities have steadily financed over 80% of their expenditure from their own revenues.¹²³ As a consequence, they receive much lower percentages of national revenue through NG grants.¹²⁴

Both countries allocate separate tax bases for the different levels of government. It is noteworthy, however, that in South Africa, MG have a much wider tax base and even surcharge fees for bulk services such as water and electricity. In Kenya, the services of water and electricity are offered by incorporated companies and not the County Governments. Due to the low-yield taxes allocated to County Governments, it is feared the situation may resemble that of the PG in South Africa,

¹²⁰ National Treasury of the Republic of South Africa (n 117) 39. National tax revenues were R625.1 billion in 2008/09 FY, R598.7 billion in 2009/10 FY, R674.1 billion in 2010/11 FY, and R738.7 billion in 2011/12 FY and is projected to grow to R826.4 billion in 2012/13 FY.

¹²¹ *Ibid* 39. Provincial taxes yielded R74.6 billion in 2008/09 FY, R84 billion in 2009/10 FY, R87.7 billion in 2010/11 FY, and R95.6 billion in 2011/12 FY.

¹²² Stanton (n 119) 16.

¹²³ National Treasury of the Republic of South Africa, 'Local Government Budgets and Expenditure Review' (2011) figure 2.5 18<<http://www.treasury.gov.za/publications/igfr/2011/1g/02.%202011%20LGBER%20-%20Final%20-%2013%20Sept%202011%20%28renumbered%29.pdf>> accessed on 20 March 2013.

¹²⁴ National Treasury of the Republic of South Africa (n 117) 110. MGs received the following percentages of national revenue: 7.8% in 2008/09 FY, 7.5% in 2009/10 FY, 8.2% in 2010/11 FY and 8.4% in 2011/12 FY.

making Counties over-reliant on NG grants. Moreover, the Minister for Finance is given a key role in authorising additional taxes to be levied by the devolved units in South Africa, whereas such powers in Kenya are the preserve of Parliament. However, Parliament cannot exercise such powers to deprive a County Government of a constitutionally allocated revenue base.

4.4 *Inter-Governmental Fiscal Transfers*

The fourth pillar of fiscal decentralisation is inter-governmental fiscal transfers. This entails creating a framework of transferring funds from the NG to the devolved units. Such a system should focus on among others, service delivery, preserving budget autonomy, enhance equity and fairness but take care so as not to be a negative incentive to local revenue mobilisation initiatives. To ensure equity and enhance fairness, the determination of the amounts to be transferred should not be solely left to the discretion of the national government.

Towards this end, the 2010 Constitution of Kenya establishes the Commission on Revenue Allocation (CRA),¹²⁵ with the crucial function of recommending the basis of sharing revenues between the National and County Governments. In this undertaking, the CRA shall be guided by several considerations including but not limited to: national interest; objective criteria; the fiscal capacity and efficiency of County Governments; developmental and other needs of Counties; economic disparities within and among counties; affirmative action; economic optimisation; stability and predictability of allocations; and flexibility in responding to emergencies.¹²⁶ The CRA should further consider the need to ensure that County Governments are able to perform the functions allocated to them, which emphasises service delivery.¹²⁷ The Constitution also emphasises the need for economic optimisation of each County and provision of incentives for each County to optimise its capacity to raise revenue,¹²⁸ which ensures the transfers do not act as negative incentives to local resource mobilisation.

Though Parliament decides the amounts allocated through the Division of Revenue Bill and the County Allocation of Revenue Bill, there is attainment of stable and predictable allocations of revenue, since the County is in a position to predict its allocation beforehand. Further, there are provisions requiring consideration of economic disparities within and among Counties and the need to remedy them¹²⁹ and affirmative action in respect of disadvantaged areas and groups¹³⁰

¹²⁵ Article 215.

¹²⁶ The considerations are well elaborated in art 203.

¹²⁷ Article 203(d).

¹²⁸ Article 203(i).

¹²⁹ Article 203(g).

¹³⁰ Article 203(h).

all of which are geared towards enhancing fairness and equity in the inter-governmental transfers.

Moreover, in recognition of the vast regional and other inequalities across the country, an Equalisation Fund is established consisting of 0.5% of all revenue collected by the NG each year.¹³¹ This fund is to be used for providing, 'basic services including water, roads, health facilities and electricity to marginalised areas to the extent necessary to bring the quality of those services in those areas to the level generally enjoyed by the rest of the nation, so far as possible'.¹³² The NG is also allowed to utilise the Equalisation Fund through conditional grants to Counties with marginalised communities.¹³³ County Governments may be given additional allocations from the NG's share of the revenue, either conditionally or unconditionally.¹³⁴ This allows the NG leeway to directly participate in development activities in the Counties through direct inter-governmental fiscal transfers. Finally, the Constitution allows the NG to transfer some of its functions and powers to the County Government through agreement, and also ensure transfer of resources necessary for the performance of the function or exercise of the power.¹³⁵

The above is a clear framework for inter-governmental funds transfer. It allows the NG to use inter-governmental transfers for three purposes. First, to assure revenue adequacy for County Governments; second, to compensate County Governments for complying with their mandates through conditionalities in optional grants; and third, for implementing NG programmes that are delegated to the Counties. The only weakness in such a system would be delays and deliberate withholding by the NG of funds meant for County Governments. In recognising that the NG may undermine fiscal decentralisation through delays and refusal to transfer funds, the Constitution requires National Government to transfer County dues 'without undue delay and without deduction...'.¹³⁶ This enhances efficacy of the inter-governmental transfer system. The constitutional framework for inter-governmental transfers thus passes the threshold requirement of a proper inter-governmental transfer system, a major pillar in effective fiscal decentralisation.

In South Africa, inter-governmental transfers play a major role in financing provincial and municipal governments. This is due to several reasons, including: low own-source revenues; the constitutional mandate on the NG to provide basic public services; and the extremely

¹³¹ Article 204.

¹³² Article 204(2).

¹³³ Article 204(3)(b).

¹³⁴ Article 202(2).

¹³⁵ Article 187.

¹³⁶ Article 219.

unequal income distribution.¹³⁷ The South African Constitution provides for two categories of transfers to the devolved units. The first is the equitable share of nationally collected revenues.¹³⁸ This enables the PGs and MGs to provide basic services to poor residents. Under this system, nationally raised revenue is divided among the three spheres of government, after national debt-servicing needs and a contingency reserve for emergencies are taken into account. The Constitution requires 10 factors to be taken into account in determining the proportions to be allocated to PGs and MGs, including national interests; debt levels; fiscal capacity; expenditure efficiency; developmental needs; backlogs; and provision for emergency funding.¹³⁹ It also demands that these funds be transferred promptly and without deduction.¹⁴⁰ Parliament is empowered to make laws providing for the determination of the allocations.¹⁴¹ The transfer system takes four dimensions; first, from NG to provincial; second, from provincial government to local; third, from national to local; and fourth, from local to local.¹⁴²

The second is a set of both conditional and unconditional grants.¹⁴³ These accomplish different purposes including staff salaries, electricity and water services subsidy, fund management support and capacity-building initiatives. These have a component of agency payments from national departments.¹⁴⁴ This system is similar to the Kenyan one, which also has equitable shares and an equalisation fund, to be utilised through conditional and unconditional grants.

To address disagreements on disbursement amounts, the South African Constitution establishes the FFC.¹⁴⁵ The FFC is independent, impartial and subject only to the Constitution in discharging its work.¹⁴⁶ It is an advisory institution on financial and fiscal matters, including division of funds among governments. Its recommendations are considered in developing a sharing formula.¹⁴⁷ It is required to

¹³⁷ B Dollery, 'An Initial Evaluation of Revenue-Sharing Arrangements in the New South African Federalism' (1998) 28(2) *Journal of Federalism* 223.

¹³⁸ Constitution of the Republic of South Africa, 1996, arts 214 and 227(1)(a).

¹³⁹ Article 214(2).

¹⁴⁰ Article 227(3).

¹⁴¹ Article 214(1) and (3). The Intergovernmental Relations Act 97 of 1997 gives effect to the Constitution, requiring the Cabinet to consult with the Financial Fiscal Commission, Provinces and organised Local Government (South African Local Government Association (SALGA)) when determining budget allocations among the spheres.

¹⁴² Y Etienne, 'Understanding Fiscal Decentralisation in South Africa' (2005) 10 *IDASA Occasional Papers, Budget Information Service- Africa Budget Project* <<http://www.gsdc.org/docs/open/CC107.pdf>> accessed on 20 March 2013.

¹⁴³ Article 227(1)(b).

¹⁴⁴ Etienne (n 142) 11.

¹⁴⁵ Articles 220 and 221.

¹⁴⁶ Article 220(2).

¹⁴⁷ Article 214(2).

report regularly both to Parliament and to the Provincial Legislatures.¹⁴⁸ The South African Minister of Finance is required to respond to the proposals of the FFC indicating the extent to which he has taken into account the Commission's recommendations.¹⁴⁹ This response is typically contained in an annexure to the annual Division of Revenue Act. The Commission also serves in an executive capacity.¹⁵⁰ It is thus an important body in ensuring that an effective, equitable and sustainable system of inter-governmental fiscal relations is maintained.

The FFC in South Africa plays a similar role to the CRA in Kenya. The only difference is that the CRA commissioners in Kenya serve in a non-executive capacity.¹⁵¹ Despite the similarity, Kenya needs to borrow from the South African system, by demanding an annexure of CRA proposals to Bills generated on related matters indicating the extent to which the CRA proposals have been factored in [in to] the legislation. That may inform debate both in Parliament and in public participation on the division of revenue laws.

The equitable share system in South Africa has largely been effective. The amounts transferred to both the PGs¹⁵² and MGs¹⁵³ have steadily increased. However, the grant system has faced numerous shortcomings. First, though the total amounts of the grants to PGs¹⁵⁴ and MGs¹⁵⁵ have been much lower than the equitable shares, they carry conditions for disbursement of funds and reporting, which limit the discretion of the devolved units in expending them. Second, their allocation mechanisms are highly centralised and fragmented. Third, the wide range of grants creates planning and budgeting coordination problems at national as well as sub-national government levels. Finally,

¹⁴⁸ Article 222.

¹⁴⁹ FFC's website <<http://www.ffc.co.za/index.php/faqs.html>> accessed on 19 March 2013.

¹⁵⁰ Ibid.

¹⁵¹ Commission on Revenue Allocation Act 16 of 2011, s 5(3).

¹⁵² National Treasury of the Republic of South Africa (n 117) Annexures 7, 'Table W1.3: Division of Nationally Raised Revenue, 2008/09 — 2014/15'. The PG allocations have been: R201.7 billion in 2008/09 FY, R236.8 billion in 2009/10 FY, R265.1 billion in 2010/11 FY and R291.7 billion in 2011/12 FY. They are projected to grow to R309 billion in 2012/13 FY, R328.9 billion in 2013/14 FY and R349.3 billion in 2014/15 FY.

¹⁵³ Ibid. The MG allocations have been: R25.6 billion in 2008/09 FY, R23.8 billion in 2009/10 FY, R30.5 billion in 2010/11 FY, and R32.9 billion in 2011/12 FY. They are projected to grow to R37.9 billion in 2012/13 FY, R40.6 billion in 2013/14 FY and R43.6 billion in 2014/15 FY.

¹⁵⁴ Ibid. The PG allocations have been R45 billion in 2008/09 FY, R56.3 billion in 2009/10 FY, R57.7 billion in 2010/11 FY and R70.9 billion in 2011/12 FY. They are projected to grow to R75.4 billion in 2012/13 FY, R82.1 billion in 2013/14 FY and R87.6 billion in 2014/15 FY.

¹⁵⁵ Ibid. The MG allocations have been R19.9 billion in 2008/09 FY, R20.9 billion in 2009/10 FY, R22.8 billion in 2010/11 FY and R26.7 billion in 2011/12 FY. They are projected to grow to R30.4 billion in 2012/13 FY, R33.6 billion in 2013/14 FY and R36.9 billion in 2014/15 FY.

equity is not enforced to the latter in the distribution of grants.¹⁵⁶ These challenges undermine the general effectiveness of the inter-governmental transfers system.

In further comparison to the Kenyan model, the two countries have an elaborate inter-governmental transfer system. However, in South Africa, they have two major channels; that is, the equitable share and the conditional or unconditional grants. In contrast, the Kenyan system has three channels, namely the equitable revenue share, conditional and unconditional grants from the National Government revenue share and the Equalisation Fund. The Kenyan system needs to guard against skewed distribution of the grants and Equalisation Fund by providing formulae or guidelines for distribution of such funds through an Act of Parliament.

To address the problem of delayed disbursement, the South African Constitution requires prompt disbursement, while the Kenyan Constitution demands disbursement without undue delay. Both work towards timely disbursement. The South African system has functioned without undue delays, but there are imminent fears regarding the Kenyan system. The Kenyan government has in the past delayed in disbursing the Constituency Development Fund (CDF),¹⁵⁷ the Local Authority Transfer Fund (LATF),¹⁵⁸ and the Free Primary Education Fund,¹⁵⁹ among others. Without adequate measures, this trend may continue, crippling operations of County Governments.

4.5 *Sub-National Borrowing*

The final pillar of effective decentralisation is sub-national borrowing. This entails creation of a framework for borrowing and issuing bonds

¹⁵⁶ For a detailed analysis of the weaknesses, see P Smoke, 'Fiscal Decentralisation in East and Southern Africa: A Selective Review of Experience and Thoughts on Moving Forward' (Conference on Fiscal Decentralization International Monetary Fund, Washington DC 20-21 November 2000) 24 <<http://www.imf.org/external/pubs/ft/seminar/2000/fiscal/smoke.pdf>> accessed on 19 March 2013.

¹⁵⁷ D Kipkorir, 'Haste Leads to Waste in CDF Funding' *The Standard* (Nairobi, 9 October 2009) <<http://www.standardmedia.co.ke/?id=1144025976&cid=16&articleID=1144025976>> accessed on 20 March 2013.

¹⁵⁸ M Geoffrey, 'Funds Delay Cripples City Hall Operations' *The Star* (Nairobi 26 April 2011) <<http://allafrica.com/stories/201104270080.html>> accessed 20 March 2013; K Miruka, 'Council Workers Strike Over Delayed Funds' *The Standard* (Nairobi, 7 June 2012) <http://www.standardmedia.co.ke/index.php/business/sports/business/?articleID=2000059413&story_title=Council-workers-strike-over-delayed-funds> accessed on 20 March 2013.

¹⁵⁹ H Wanyama, 'Primary Heads Protest Delay in School Funds' *The Star* (Nairobi, 28 May 2012) <<http://allafrica.com/stories/201205300998.html>> accessed 20 March 2013; M Ndanyi, 'School Crisis Over Delayed FPE Cash' *The Star* (Nairobi, 27 May 2012) <<http://allafrica.com/stories/201205281391.html>> accessed 20 March 2013; A Oduor, 'Knut, Kuppet Issue Ultimatum Over FPE Funds' *The Standard* (Nairobi, 31 May 2012) <http://www.standardmedia.co.ke/?articleID=2000059070&story_title=Knut,Kuppet-issue-ultimatum-over-FPE-funds> accessed on 20 March 2013.

by the devolved units. Such a framework should balance the need for borrowing with checks and balances to ensure responsible borrowing and curb abuse of such power.

The Constitution of Kenya allows County Governments to borrow with the approval of their respective County Assemblies and the NG.¹⁶⁰ However, it does not fully stipulate the conditions that County Governments must satisfy while undertaking any borrowing of funds. The only conditions are that the loan must be guaranteed by the NG and that it must be approved by the County Assembly.¹⁶¹ The requirement of NG guarantee checks on the tendency of County Governments to over-borrow, which could put them in financial constraint, and whose ripple effect could be the fiscal and macro-economic instability of the whole country. It also allows the NG, using fiscal policy on guarantees, to help County Governments regulate their ability to borrow. The requirement of approval by County Assembly allows scrutiny so as to ensure borrowing is only done when absolutely necessary.

Further conditionalities by the Constitution include the provision that burdens and benefits of public borrowing should be shared equitably between present and future generations.¹⁶² Further, County Government budgets should contain proposals regarding borrowing and other forms of public liability that will increase public debt during the following year,¹⁶³ so as to allow debate on the sustainable levels of indebtedness of the county during budget-making.

The power to borrow, being a constitutional power, may not be limited by Parliament. The only weakness is that Parliament, through legislation, is empowered to prescribe terms and conditions under which the NG may guarantee loans. This window may be used to place stringent terms, making it difficult to obtain the guarantees. If this happens, it may stifle this constitutional right of County Governments.

In conclusion thus, though not completely elaborate, the Kenyan Constitution lays out the basic framework for County Government borrowing, leaving out the details to be elaborated in an Act of Parliament. This ensures that the constitutional framework passes the threshold requirement for sub-national borrowing, a key pillar in effective fiscal decentralisation.

The PGs in South Africa, on the other hand, are allowed to take loans for capital or current expenditure, but the latter may be raised only when necessary for bridging purposes.¹⁶⁴ Parliament is empowered to pass national legislation for managing PG borrowing.¹⁶⁵ Pursuant to

¹⁶⁰ Constitution of Kenya, 2010, art 212 on borrowing by County Governments.

¹⁶¹ Article 212(a) and (b).

¹⁶² Article 201(c).

¹⁶³ Article 220(1)(c).

¹⁶⁴ Constitution of the Republic of South Africa, 1996, art 230(1).

¹⁶⁵ Article 230(2). Parliament must however first consider the recommendations of the Financial and Fiscal Commission.

this power, Parliament has enacted the Borrowing Powers of Provincial Governments Act¹⁶⁶ and the Public Finance Management Act.¹⁶⁷ The latter Act authorises the MEC for finance in the province to borrow money, or issue a guarantee, indemnity or security, or enter into any other transaction that binds or may bind the Provincial Revenue Fund to any future financial commitments.¹⁶⁸ However, the PG cannot issue the foregoing for loans denominated in foreign currency.¹⁶⁹

The Borrowing Powers of Provincial Governments Act places certain limitations on borrowing powers of PGs. The approval of the Minister for Finance is required. A formula for determining limits on amounts to borrow is also given.¹⁷⁰ The NG may guarantee a loan for PG, but that is limited to guarantees for loans issued in foreign currency.¹⁷¹ The two Acts thus authorise PGs to issue their own guarantees on bridging finance and loans in local currency, as a charge on the Provincial Revenue Fund. Despite the PGs being empowered by the above legal framework to borrow, they have traditionally only been allowed to borrow to secure bridging finance and not capital loans.¹⁷² Their borrowing is thus restricted to mainly bank overdrafts.

The MGs in South Africa are also authorised to raise loans for capital or current expenditure, with loans for recurrent expenditure only limited to loans for bridging purposes.¹⁷³ However, on guarantees, the Council of the MGs is required to bind itself and a future Council to secure loans.¹⁷⁴ Parliament is empowered to pass national legislation for managing MG borrowing.¹⁷⁵ Pursuant to this power, Parliament has enacted the Local Government Municipal Finance Management Act (LGMFMA).¹⁷⁶ Under the Act, a Municipal Council is allowed to incur short-term debts for bridging purposes through resolutions of the Council, signed by the Mayor and the accounting officer.¹⁷⁷ It must, however, pay off the short-term debt within the financial year,

¹⁶⁶ Act No 48 of 1996, assented to on 27 September 1996 <<http://www.info.gov.za/view/DownloadFileAction?id=70887>> accessed on 20 March 2013.

¹⁶⁷ Act No 1 of 1999, assented to on 2 March 1999 <www.treasury.gov.za/legislation/PFMA/act.pdf> accessed on 20 March 2013.

¹⁶⁸ *Ibid* s 66(2)(b).

¹⁶⁹ *Ibid* s 67.

¹⁷⁰ Act No 48 of 1996 (n 166) s 4(b)(vi).

¹⁷¹ *Ibid* s 5.

¹⁷² M Ismail, 'Fiscal Decentralisation in South Africa: A Practitioner's Perspective' (2001) 8 <<http://info.worldbank.org/etools/docs/library/128819/Momoniati%202001%20South%20Africa.pdf>> accessed on 20 March 2013.

¹⁷³ Constitution of the Republic of South Africa, 1996, art 230A(1)(a).

¹⁷⁴ Article 230A(1)(b).

¹⁷⁵ Article 230A(2). However, in making the law, Parliament must consider the recommendations of the Financial and Fiscal Commission.

¹⁷⁶ Act No 56 of 2003, assented to on 9 February 2004, commenced 1 July 2004 <<http://www.ffc.co.za/docs/acts/Local%20Government%20Municipal%20Finance%20Management%20%20Act%20No%2056%20of%202003%20as%20amended.pdf>> accessed on 20 March 2013.

¹⁷⁷ Section 45.

and cannot extend it to the next year.¹⁷⁸ The Council is also allowed to incur long-term debts for capital expenditure through resolutions of the Council signed by the Mayor and the accounting officer.¹⁷⁹ However, the Act requires that, before approval of the loan, views of the public and National Treasury must be taken into consideration.¹⁸⁰ The Council is required to give its own security for its loans,¹⁸¹ and also execute its own guarantees.¹⁸² In case of default by the Council, judicial intervention, clarifying the rights of lenders, is allowed.¹⁸³ The MGs are, however, barred from borrowing loans in foreign currency,¹⁸⁴ which minimises municipal exposure to external market volatility. These provisions promote responsible borrowing by MGs, reducing the need for national and provincial guarantees. However, the two levels of government are left with the discretion to grant guarantees for MG borrowing.¹⁸⁵

Kenyan Counties are not restricted to capital loans like the PG of South Africa. Rather, they are given freedom to borrow, just like the MGs. However, the security for guarantee is furnished by the NG and not the County Governments themselves. Kenya should consider binding Counties to provide their own security since by so doing, they may be encouraged to engage in prudent borrowing. This may also serve as an incentive to repay the loans, based on the knowledge that County property may be seized and sold to repay the loans.

In South Africa, the MGs have exploited their borrowing powers to a great extent. Loans have historically accounted for a substantial portion of the capital budget of South African metropolitan and some other urban municipalities, with the largest source of loans being government institutions.¹⁸⁶ They even issue municipal bonds in stock markets.¹⁸⁷ However, since the LGMFMA entrenched a policy of insistence on self-guarantees and security, long-term borrowing has rapidly decreased, leaving short-term borrowing as the major borrowing by MGs. The National Treasury is further working towards lower municipal debt issuance in its budget policy.¹⁸⁸ Despite the above

¹⁷⁸ Section 45(4).

¹⁷⁹ Section 46(2).

¹⁸⁰ Section 46(3).

¹⁸¹ Section 48.

¹⁸² Section 50.

¹⁸³ Part 3 on debt relief and restructuring, ss 151-156.

¹⁸⁴ Sections 47(a) and 163(1).

¹⁸⁵ Section 51.

¹⁸⁶ Department of Finance, 'Policy Framework for Municipal Borrowing and Financial Emergencies' (2000) 5 <<http://www.info.gov.za/view/DownloadFileAction?id=70340>> accessed on 20 March 2013.

¹⁸⁷ National Treasury of the Republic of South Africa (n 117) 63. For instance, outstanding municipal bonds increased from R11.6 billion in 2010 to R13.2 billion in 2011 on the Johannesburg Stock Exchange. Johannesburg and Ekurhuleni Councils are major issuers.

¹⁸⁸ *Ibid* 43.

measures, the prudent fiscal stance of NG provides room for expanded borrowing by municipalities, with most municipalities generally not fully utilising the borrowing space available to them.¹⁸⁹

In comparison, it is important to note that both Kenya and South Africa allow sub-national borrowing. However, the South African system is more prudent, insisting on self-guarantees and minimal NG guarantees. It is also more pronounced on limits on borrowing and the type of borrowing to engage in, discouraging borrowing for recurrent expenditure. The MGs also have access to the stock markets through issuance of municipal bonds. The Kenyan system insists on NG guarantees for County borrowing. It is also yet to be tested in terms of limits and controls so as to determine its effectiveness.

5 LESSONS FOR KENYA

The fiscal decentralisation system in South Africa is not devoid of several challenges. The first is low revenue generation. The devolved units, especially the PGs, generate minimal revenues, making them heavily over-reliant on NG transfers.¹⁹⁰ Kenya should avoid such a situation by reviewing the taxation powers of the Counties to include high-yield taxes. Second, there lacks an overall oversight body to supervise the implementation of the fiscal decentralisation system.¹⁹¹ The FFC's role is limited to fiscal matters, with other details not wholly coordinated. This leaves the NG with leeway to delay implementing other aspects of fiscal decentralisation without recourse for the devolved units. The Kenyan system has partly addressed this through formation of the CIC and the Transition Authority (TA). The only weakness is that these bodies are temporary, the CIC being in existence for five years and the TA for three years.

The third predicament is complexity. The MGs are categorised using a complex classification, with some sharing jurisdiction over certain areas and matters.¹⁹² This makes it hard to comprehend for the common citizens, limiting their input in the functioning of the MGs. It makes only the elite and educated have a voice and input in the running of the devolved units at the expense of common citizens who cannot comprehend the complex system. The Kenyan system is relatively simple, with only two levels which are clearly defined. Complexity may arise on delivery of functions which are shared between Counties or between Counties and the NG which have been partly addressed by the Inter-governmental Relations Act, 2012.

¹⁸⁹ National Treasury of the Republic of South Africa (n 123) 18.

¹⁹⁰ Institute for Democracy in South Africa (IDASA), 'What the National Budget Means for Municipalities' (2012) 6 <http://www.idasa.org/our_products/resources/output/what_the_national_budget_means> accessed on 23 March 2013.

¹⁹¹ Dollery (n 137) 225.

¹⁹² Etienne (n 142) 22.

Fourth is that the extensive inter-governmental transfer system serves as a disincentive to local revenue generation. Most MGs and PGs rely heavily on the transfers to finance substantial portions of their recurrent expenditure, which should not be the case.¹⁹³ The Kenyan system needs to devise incentives for strengthening local revenue generation, to stem over-dependence on NG transfers. Finally, the challenge of inequality still remains. Reeling from the previous apartheid policy of strict racial segregation, some areas were long neglected and it shall take a prolonged period of preferential treatment to bring them at par with other areas.¹⁹⁴ The same situation exists in Kenya, with the former Upper Eastern, North Eastern, parts of Coast and Rift Valley regions requiring extensive preferential treatment to bring them to the same level as other areas. The Equalisation Fund will go a long way towards alleviating historical inequities in these regions.

6 CONCLUSION

The foregoing discussion points to the fact that Kenya, through the 2010 Constitution, has made significant attempts to bring about fiscal decentralisation. The Constitution establishes what has the hallmarks of an effective fiscal decentralisation framework. It provides a skeletal structure of how the system ought to work. It is, however, not devoid of glaring weaknesses that need to be corrected through amendments and strong statutory enactments. The Constitution acknowledges that a lot of work is to be done by Parliament through passing the appropriate legislations. The experiences of South Africa, considered in this article, show that enactment of relevant laws that encapsulate all the elements of an effective fiscal decentralisation is the starting point in achieving the same.

The comparative analysis has established that Kenya and South Africa have largely similar systems of fiscal decentralisation, with the Kenyan legal framework seeming to have borrowed extensively from the South African one. Both systems provide extensive frameworks for fiscal decentralisation.

¹⁹³ R Govinda, 'Intergovernmental Finance in South Africa: Some Observations' (2010) 3 <http://www.nipfp.org.in/working_paper/wp03_nipfp_001.PDF> on accessed on 20 March 2013.

¹⁹⁴ Smoke (n 156) 9.

Generally, the Kenyan system is at par with South Africa on political autonomy. The Counties are largely autonomous and insulated from external interferences and political pressures. On expenditure assignment, the Kenyan system is weak. It devolves minor functions to the County Governments, leaving the bulk of the health and education expenditures under the control of the NG. This reduces the capacity of the County Governments to address the real developmental challenges facing the local populations, which largely lie in the above two expenditure categories.

The Kenyan system is equally poor on revenue assignment. It devolves taxation powers to County Governments for taxes which have been historically low-yield and hard to collect. The local authorities have been collecting such taxes, with most of them facing low revenue yields, and being forced to rely heavily on LATF funds for operations. It remains to be seen whether the County Governments will succeed where the local authorities have failed. If they do not, it will create devolved units which are largely reliant on NG funding through revenue shares and grants, which is undesirable in a fiscal decentralisation framework.

On the inter-governmental transfers system, the Kenyan system is comparatively better. It creates an Equalisation Fund, and grants decisions on amounts to Parliament in consultation with the CRA. This insulates the system from skewed allocations meant to benefit certain areas over others. However, due to extensive inequalities that have evolved historically among the various Counties, it shall take time for equity in development to be achieved using this transfer system.

On sub-national borrowing, the Kenyan system is at par with its South African counterpart. Its only major weakness is the insistence for NG guarantees, which may be an incentive to irresponsible borrowing by County Governments. However, it is hoped that a healthy fiscal management system will be developed to minimise this negative effect.

Despite the similarities between the fiscal decentralisation systems of the two countries, there are glaring differences. The South African system, for example, creates three spheres of devolution whereas the Kenyan one creates only two. Moreover, the devolved units in South Africa have wider mandates and functions compared to the Kenyan Counties. The PGs, for instance, have a greater expenditure assignment on health and education, with the MGs also having the extra role of provision of essential services such as water and electricity. The Kenyan system has more implementation supervision institutions, including the CRA, the CIC and the TA. The only such body in South Africa is the FFC, playing a supervisory role in devolution of fiscal matters.

Before the enactment of its 2010 Constitution, Kenya was ranked sixth in Africa in fiscal decentralisation, trailing South Africa, Nigeria, Uganda, Cote d'Ivoire and Zimbabwe.¹⁹⁵ With full implementation of the system under the new Constitution, it is hoped that the country will jump places to be second in Africa, only behind South Africa.¹⁹⁶ The Kenyan Constitution provides for this important foundation and it is upon Parliament to enact legislations to make fiscal decentralisation effective. That would entail enacting laws that elaborate up on and seal gaps and loopholes in the system to ensure its effectiveness. It remains to be seen whether the National Assembly and Senate shall rise to the occasion and oversee full implementation of fiscal decentralisation in Kenya.

¹⁹⁵ Ibid 5.

¹⁹⁶ Interview with M Masinde, Senior Economist in the Parliamentary Budget Office (Nairobi, 20 January 2013).