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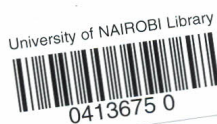
TOPIC: FISCAL DECENTRALIZATION IN KENYA: A CASE FOR AN EFFECTIVE
LEGAL FRAMEWORK FOR INTERGOVERNMENTAL FISCAL RELATIONS

NAME OF STUDENT: EDWARD LIBENDI

REG NO: G62/76927/2009

SUPERVISOR: DR. JANE DWASI

DATE: 4th December, 2012



DECLARATION

I, EDWARD LIBENDI do hereby declare that this is my original work and has not submitted and is not currently being submitted for a degree in any other university

Signed..... 18/12/2012

EDWARD LIBENDI

This Thesis is submitted for examination with my approval as University Supervisor: _____

Supervisor: _____
Signed: _____

DR. JANE DWASI.

Dated at Nairobi this day of 2012

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LIST OF ABBREVIATIONS

ALGAK:	Association of Local Government Authorities of Kenya
BOFED:	Bureaus of Finance and Economic Development () (Ethiopia)
CA:	County Assembly
CBC:	Constituency Bursary Committees
CDF:	Constituency Development Fund
CDFC:	Constituency Development Fund Committee
CEC:	County Executive Committee
CIC:	Commission on Implementation of the Constitution
CRA:	Commission on Revenue Allocation
DANIDA:	Danish International Development Agency
DDC:	District Development Committees
DDO:	District Development Officer
DEO:	District Education Officer
DFRD:	District Focus for Rural Development
DLD:	District (Woreda) Level Devolution (Ethiopia)
DPU:	District Planning Units
DRC:	District Road Committee
DWEFC:	Women Enterprise Fund Committee
ERC:	Energy Regulatory Commission
FFC:	Financial and Fiscal Commission (South Africa)
FPE	Free Primary Education Fund
FSEF:	Free Secondary Education Fund
GPT:	Graduated Personal Tax
GTZ:	German Agency for Technical Cooperation
ICPAK:	Institute of Certified Public Accountants of Kenya
IEBC:	Independent Electoral and Boundaries Commission
IRTC:	Intergovernmental Relations Technical Committee
KLGRP:	Kenya Local Government Reform Programme
KPLC:	Kenya Power and Lighting Company
KRA:	Kenya Revenue Authority

KRB:	Kenya Roads Board
KWS:	Kenya Wildlife Service
LATF:	Local Authority Transfer Fund
LG:	Local Governments (Uganda)
LGFC:	Local Government Finance Commission (Uganda)
MEC:	Member of the Executive Council (South Africa)
MG:	Municipal Government (South Africa)
MOE:	Ministry of Education
MOFED:	Ministry of Finance and Economic Development (Ethiopia)
NACC:	National Aids Control Council
NARC:	National Rainbow Coalition
NDFPD:	National Development Fund for Persons with Disability
NG:	National Government
PEF:	Poverty Eradication Fund
PFMA:	Public Financial Management Act
PG:	Provincial Government (South Africa)
PS:	Permanent Secretary
PWD:	Persons With Disabilities
REPLF:	Rural Electrification Programme Levy Fund
RMLF:	Road Maintenance Levy Fund
SEBF:	Secondary Education Bursary Fund
SIDA:	Swedish International Development Cooperation Agency
SIMBA:	Schools Instructions Materials Bank Account
SRDP:	Special Rural Development Programme
TA:	Transitional Authority
WEDF:	Women Enterprise Development Fund
WSTF:	Water Services Trust Fund
YEDF:	Youth Enterprise Development Fund

LIST OF STATUTES

Kenyan

Commission on Revenue Allocation Act, 2011
Constituency Development Fund Act No. 11 2004
Constitution of the Republic of Kenya, 2010
County Governments Act, 2012
Electric Power Act (1997) (repealed)
Intergovernmental Relations Act, 2012
Local Authority Transfer Fund Act No. 8 of 1998
Persons with Disability Act, 2003
Public Financial Management Act, 2012
Public Procurement and Disposal Act, 2003
Road Maintenance Levy Fund Act, No 9 of 1993
Transition to Devolved Government Act, 2012
Urban Areas and Cities Act 2011
Water Act, 2002

Ugandan

Constitution of the Republic of Uganda, 1995
Local Governments Act, 1997 (Uganda)
Local Governments Statute, 1993 (Uganda)

South African

Borrowing Powers of Provincial Governments Act, No. 48 of 1996
Constitution of the Republic of South Africa, 1996
Division of Revenue Act
Local Government Municipal Finance Management Act, No. 56 of 2003
Municipal Fiscal Powers and Functions Act, No. 12 of 2007
Provincial Tax Regulation Process Act, No. 53 of 2001
Public Finance Management Act, No. 1 of 1999

CHAPTER ONE: INTRODUCTION

1.1 BACKGROUND INFORMATION

This study defines fiscal decentralization as transferring the authority of revenue collection or expenditure responsibility from national level to sub-national levels for the purpose of attaining more efficient public services aimed at improving the public welfare of residents. A scholar has defined it as the devolution by the central government to local governments of specific functions with the administrative authority and fiscal revenue to perform those functions.¹

The Constitution of Kenya 2010 (New Constitution) has devolution as its main objective. To ensure successful devolution, it proposes a fiscal decentralization framework. This framework does not fully comply with the pillars of an effective fiscal decentralization framework. The details of this framework cannot be fully captured in the Constitution, with other details being left to statute. Several statutes have been passed to elaborate on the fiscal decentralization framework. However, these statutes do not fully implement the framework envisaged in the constitution. These statutes also enact a framework replete with aspects of previous unsuccessful attempts at implementing fiscal decentralization in Kenya.

The purpose of this study is to investigate the extent to which the fiscal decentralization framework as provided for in the Constitution of Kenya 2010 adheres to the pillars of effective fiscal decentralization. To this end, the study first examines the constitutional framework within the pillars of effective fiscal decentralization. It then compares it with the legal framework in other countries where devolution has been effective. Insight gained from this study will be helpful in establishing the gaps in the existing policy and legal framework on fiscal devolution in Kenya and proposing far reaching changes that will ensure effectiveness and support the goals of decentralization as envisaged in the Constitution.

During the 1990s, there was a demand by the Kenyan public that public funds for development be availed to them at the grassroots level. This was fanned by the feeling that the existing

¹ Kee James Edwin Prof. (2003), *Fiscal Decentralization: Theory As Reform*, available at: http://www.gwu.edu/~clai/working_papers/James_Kee_fiscal_decentralisation_paper_2003.pdf (last accessed 2nd October, 2012).

devolved funds; namely 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.² Moreover, people 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 decentralizing 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.³ After the failure of SRDP, a new fiscal decentralization initiative was launched in 1983 dubbed, District Focus for Rural Development (DFRD). Its goal was to extend decentralized planning and expenditure to all districts in Kenya. The post of District Development Officer (DDO) was created and District Planning Units (DPU) 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."⁴ Many people felt that availing of more funds at the grassroots without involvement of provincial administration would reduce the effects of corruption and enable faster implementation of development projects.⁵

This desire was not completely misinformed. The researcher opines that implementation of a policy of decentralized economy in all the sectors of the economy is the way to stop economic exploitation and alleviate the plight of the common people. Centralized economy may not be the best way to solve the economic problems of remote villages. It is imperative that economic planning starts from the lowest level, where the experience, expertise and knowledge of the local people can be harnessed for the benefit of all the members of a socio-economic unit.

² Ogolo A (2009), *Devolved Funds Initiatives In Kenya, A Blessing Or A Curse*, p. 1, available at: <http://www.internationalpeaceandconflict.org/forum/topics/devolved-funds-initiatives-in>, (last accessed 7th February 2012).

³ Zaki R. Ergas (1982), *Kenya's Special Rural Development Program (SRDP): Was It Really a Failure?* The Journal of Developing Areas, Vol. 17, No. 1, pp. 51-66, available at: <http://www.jstor.org/stable/4191090>, (last accessed 11th September, 2012).

⁴ World Bank (2002), *Kenya Community Driven Development: Challenges and Opportunities*, Report 24688, p.7, available at: www-wds.worldbank.org/servlet/.../WDSP/.../2002/.../multi0page.pdf, (last accessed 11th September, 2012).

⁵ Barkan Joel D. and Chege Michael (1989), *Decentralising the State: District Focus and the Politics of Reallocation in Kenya*, The Journal of Modern African Studies, Vol. 27, No. 3, Sep. 1989, p. 451, available at: <http://www.jstor.org/pss/161101>, (last accessed 15th January 2012).

The government responded to these demands by adopting an unofficial decentralization policy which led to creation of numerous devolved funds. Some of these funds include: Constituency Bursary Fund, Free Primary Education Fund, Constituency HIV/AIDS Fund, The Roads Maintenance Levy Fund, Rural Electrification Levy Fund, The Women Enterprise Fund, The National Development Fund For Persons With Disability, and The 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 including: 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.⁶ Given the uneven performance of previous initiatives, there has been extensive debate about the desirability of fiscal decentralization in Kenya and how to approach it.⁷

The adoption of the 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.⁸ 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 are harnessed and utilised. It therefore followed that the structure of government was changed radically in the New Constitution so as to position devolution and decentralization to be at the core of national life.

1.2 STATEMENT OF THE PROBLEM

To fully enjoy the benefits of devolution, the fiscal decentralization framework proposed in the New Constitution must be fully implemented, for it largely conforms to the pillars of an effective fiscal decentralization framework. The existing laws implementing the constitutional fiscal

⁶ Bagaka, Obuya (2008), *Fiscal Decentralization in Kenya: The Constituency Development Fund and the Growth of Government*, Proceedings of 20th Annual Conference of the Association for Budgeting and Financial Management October 23-25, 2008, available at: <http://mpra.ub.uni-muenchen.de/11813>, (last accessed 24th October, 2012).

⁷ Kenya Human Rights Commission (KHRC) and Social and Public Accountability Network (SPAN) (2011), *A Study of the Decentralization Development in Kenya: Towards Alignment, Citizen Engagement and Accountability*, p. 15, Joint Research Papers, available at: <http://www.knchr.org/Portals/0/Reports/Nguzo%20za%20Haki-Devolution.pdf>, (last accessed 8th August, 2012).

⁸ Boex Jamie and Kelly Roy (2011), *Fiscal Decentralization in Kenya: A Small Step or Giant Leap?* p. 5, IDG Policy Brief, Available at: www.urban.org/uploadedpdf/412332-fiscal-decentralization.pdf, (last accessed 11th August, 2012).

decentralization framework have numerous short comings that must be addressed. In addition, there are several factors that impeded previous attempts at implementing a fiscal decentralization framework in Kenya including; absence of citizen participation, lack of responsiveness and social accountability of duty bearers, duplication in project implementation among funds, poor legal framework, inadequate capacity within management committees and political interference as the reasons for failure of proper decentralization.⁹

Therefore this study proposes the appropriate legal framework that will support the goals of decentralization as envisaged in the Constitution and make proposals that address any challenges that may arise in the process of fiscal decentralization. It recommends concrete policy and legislative measures to effectively address concerns that may arise in implementation of fiscal decentralization. The proposals and recommendation of this study are informed by past failures in Kenya and also a comparative analysis with other African countries that have implemented fiscal decentralization.

1.3 JUSTIFICATION OF THE STUDY

The New Constitution repeals the provincial administration in its current form and brings under the control of the County Government all major public services within county boundaries.¹⁰ As such, the County Government is to absorb the structures of decentralized development management. There is hereby 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. Moreover, the constitution has weak guidelines governing disputes between the Central Government and devolved units and also for preventing the Central Government from delaying or mismanaging the transition to devolution. The constitution leaves it unclear on whether the motivation behind devolution is principally about deepening democracy or only an instrument for service provision. Previous decentralized initiatives have focused more on efficiency of service delivery than local control. Literature on democratic decentralization argues for a comprehensive form in which service delivery reflects local priorities and control.

⁹ *supra*, note 51.

¹⁰ Fourth Schedule to the Constitution of Kenya, 2010

There are serious doubts on the counties' capacities in comprehensive service delivery, and therefore the calls for a parallel system of decentralised central government functions. This national debate has not yet been consolidated. The absence of clearly expressed principles and separation on this matter in the constitution suggests that it may yet be ambitious to laud the devolved units as vehicles for local accountability, participation and governance for the pursuit of a pro-poor policy agenda.

Moreover, the government is yet to fully implement fiscal decentralization as envisaged in the New Constitution. Attempts at implementation of a fiscal decentralization structure under the New Constitution have been characterized by disagreements and discordance on unified policy and legal approach. The Ministry of Finance and Ministry of Local Government were embroiled in a much publicized dispute over finance sharing laws at the national and county levels delaying the publishing of the Public Finance Management Bill, 2011.¹¹ In the budget policy statement 2012, the ministry of finance unveiled plans to abolish the Constituency Development Fund and replace it with a new fund which conforms to the Constitution.¹² There is also a dispute as to whether to abolish or simply restructure the provincial administration.¹³ 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 statement. This amount will have to be reviewed in view of the county governments.¹⁴

These disagreements have been caused by lack of clarity on the structure for organization of governance and management of state power in a devolved system. This lack of clarity is due to lack of clear legal and policy provisions on devolution.

¹¹ See Daily Nation (17 September 2011), *IMF's Input in Devolution Bill Fuels Dispute Over Control of County Cash*, available at: <http://allafrica.com/stories/201109191310.html>, (last accessed 18th April, 2012).

¹² See Daily Nation (18th April 2012), *Treasury in Budget Plan to Abolish CDF*, available at: <http://www.nation.co.ke/News/politics/Treasury+in+Budget+plan+to+abolish+CDF+/-/1064/1388466/-/nwaovp/-/index.html>, (last accessed 18th April 2012).

¹³ See Kenya Human Rights Commission (2012), *Provincial Administration Stifles Ministries, Departments and Agencies*, available at: <http://www.khrc.or.ke/blog/provincial-administration-stifles-ministries-departments-and-agencies-mdas.html>, critiquing the President's refusal to assent the County Governments Bill, 2011. Also see, The Standard, (2009), *Abolish Provincial Administration*, available at: <http://www.standardmedia.co.ke/archives/InsidePage.php?id=1144019664&cid=159&>, and Daily Nation (May 2010), *Provincial Administration as We Know It Will Be No More*, available at: <http://allafrica.com/stories/201005261148.html>, (All last accessed on 18th April 2012).

¹⁴ See (GOK 2012), *Report for Medium Term Expenditure Framework (MTEF) Period 2010/11 – 2012/13*, available at: www.treasury.go.ke/index.php?option=..., (last accessed on 18th April 2012).

This study opines that the degree to which the changes in Kenya's intergovernmental 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 consider the lessons learnt from the failures in the past and avoiding them in implementation of the fiscal decentralized system as envisaged in the Constitution of Kenya, 2010. There is also need to benchmark with other countries that have implemented successful fiscal decentralization. This is what the study seeks to address.

This study is justified in that it examines the framework of devolution in Kenya, with a focus on fiscal decentralization as provided for in the new Constitution of Kenya. It also examines the relevant enacted laws implementing the Constitution.¹⁵ It finally compares the legal and institutional fiscal decentralization framework in Kenya with the framework in other countries where devolution has been effective. The study, on the basis of the examination and comparison, ends by making specific proposals for legal reforms necessary to implement an effective fiscal decentralization framework.

1.4 CONCEPTUAL FRAMEWORK

There are two approaches that are generally used in the organization of governance and management of state power. The first is the single-dimensional approach which follows a single horizontal dimension in its organization of governance and state power producing a unitary system and structure of government. Centralization and concentration of power forms its basis. This is the approach which pre-existed in fiscal decentralization attempts before the promulgation of the constitution in 2010.

The second is the multidimensional approach. The organization and management of governance and state power is premised along multiple lines by defining, distributing and constraining the use of state power along multiple lines. It combines both the vertical and horizontal dimensions. It forms the foundation of federal systems and structures of government. It is founded upon the

¹⁵Devolved Government Act, Urban Areas and Cities Act, Intergovernmental Relations Act, Public Financial Management Act, and Transition to County Governments Act.

concept of decentralization and devolution of power. This is the system that the Constitution of Kenya 2010 (New Constitution) has adopted.

The New Constitution eliminates the top-bottom approach that follows a single horizontal dimension in organization of governance and state power. It dilutes centralization and concentration of power by creating two levels of government. Article 10 of the constitution identifies devolution of power to be one of the values and principles that should guide the Kenyan governance system. Article 6(2) of the constitution describes the National and County governments to be distinct and interdependent and which should conduct their mutual relations on the basis of consultation and cooperation. This is therefore a devolution not based on the principle of absolute autonomy but instead, on that of inter-dependence and cooperation. It is a cooperative system of devolved government.

Such a system requires a departure from the usual adversarial approach to issues. It presupposes a system of consultation, negotiation and consensus building in the running of the affairs of state. The vertical relationships between National and County governments must be on the basis of cooperative government. Similarly, the horizontal relationships among various County Governments must be based on the principles of cooperative government. It is a system that combines self-governance and shared governance; that is, self-governance at the local level and shared governance at the national level. There is creation of two levels of government that are coordinate and not subordinate to each other. None of the levels of government is a mere agent of the other. Each is created and protected by the constitution. The functions each perform and the resources each use to discharge these functions are also provided for in accordance with constitutional provisions.

The adoption of the multi-dimensional approach has several benefits to Kenya. First, the local population shall be more involved in project identification and management. This ensures that only the projects that resonate with the citizens and their priority needs are implemented. Second, the leaders of the counties, being directly elected by the people, shall be more accountable to the locals, minimizing misuse of public funds. Third, the granting of autonomy to counties entrenches their independence, making them not to be mere agents of the National Government

in implementation of development projects. The National Government does not therefore micromanage project identification and implementation, creating ownership within the local communities. The study consequently recommends full implementation of a multi-dimensional approach in the light of the benefits explained above.

1.5 OBJECTIVES OF THE STUDY

This study seeks to establish the extent to which the policy, legal and institutional framework of fiscal decentralization in Kenya conforms to the pillars of effective fiscal decentralization among them political autonomy, expenditure responsibility, revenue assignment and sub-national borrowing, with the aim of informing on-going constitutional, policy, institutional and legal reforms for a more effective governance and development approach.

This broad objective can be broken down into several specific objectives namely:

- (a) To examine whether the existing Kenyan policy, legal and institutional framework on fiscal decentralization conform to the pillars of effective fiscal decentralization.
- (b) To evaluate attempts to implement fiscal decentralization in Kenya before and after the enactment of the new Constitution.
- (c) To compare Kenya's experience on fiscal decentralization with Ethiopia, Uganda and South Africa.
- (d) To propose reforms needed so as to fully implement the fiscal decentralization structure envisaged in the new Constitution.

1.6 RESEARCH QUESTIONS

The study answers the following questions:-

- (e) How has fiscal decentralization been so far implemented in law and practice in Kenya?
- (f) To what extent does the existing policy, legal and institutional framework on fiscal decentralization conform to the pillars of effective fiscal decentralization?
- (g) What are the shortcomings of attempts to implement fiscal decentralization in Kenya before and after the enactment of the new Constitution?
- (h) What lessons can Kenya learn from Ethiopia, Uganda and South Africa in implementing effective fiscal decentralization?

(i) What additional reforms are needed so as to fully implement the fiscal decentralization structure envisaged in the new Constitution?

1.7 HYPOTHESIS

This study seeks to test the following hypothesis.
The existing Kenyan legal and institutional framework does not fully implement the fiscal decentralization framework envisaged in the New Constitution.

1.8 RESEARCH METHODOLOGY

There are two approaches to inquiry in research; qualitative and quantitative.¹⁶ This study has employed a qualitative approach in the collection and analysis of the data necessary for the research. This approach is used since the study purely examines people’s perspectives, and the approach has the potential of providing adequate information for the study.¹⁷

In the qualitative approach, there are three main methods for collecting data; focus group discussions, direct observation and in-depth interviews.¹⁸ This study has applied the method of in-depth interviews. These interviews were conducted by the researcher through mailed questionnaires and self-administered surveys. These methods allowed for follow-up questions to clarify issues arising.

Personal interviews were conducted with five law practitioners with knowledge on the fiscal decentralization framework in Kenya and five economists who are experts on matters concerning fiscal decentralization. Further, two officials from the Constituency Development Funds Board and also two officials from the LATF Advisory Committee were interviewed.

The legal practitioners with knowledge on devolution and experts on fiscal decentralisation assisted highlight the weaknesses in the fiscal decentralization framework, both before and after

¹⁶ See Family Health International (2010), *Qualitative Research Methods: A Data Collector's Field Guide*, p. 2, available at: <http://www.fhi360.org/NR/rdonlyres/et17vogszehu5s4stpzb3tyqlpp7rojv4waq37elpbyei3tgmc4ty6dunbccfzxtaj2rvbaubzmz4f/overview1.pdf>, (last accessed 9th February 2012).

¹⁷ Johann Mouton, *How to succeed in your Masters and Doctoral Studies: A South African Guide and Resource Book* (11th edn, Van Schaik Publishers, Pretoria 2001) p 194.

¹⁸ See Pennisula Research Development & Support Unit (2011), *Qualitative Research Methods*, p. 2-44, available at: <http://projects.exeter.ac.uk/prdsu/helpsheets/Helpsheet09-May03-Unlocked.pdf>, (last accessed 9th February 2012).

the New Constitution. They gave their understanding of the effectiveness of the various laws and proposed laws implementing the New Constitution in enacting the fiscal decentralisation framework it proposes. They pointed out the weaknesses in these laws and made recommendations on further reforms needed towards full implementation of the framework proposed by the new constitution.

The officials from the Constituency Development Funds Board and the LATF Advisory Committee assisted highlight the legal and operational weaknesses in their respective devolved funds. They then gave recommendations on the pitfalls to avoid in enacting the fiscal decentralisation framework as proposed in the New Constitution.

The interviewees were selected through judgment sampling method,¹⁹ which helps identify the most experienced people and those with more information. Experience of the law practitioners and experts was determined largely by the research and studies done in the area of devolution and the participation in previous decentralized fund initiatives. For the CDF Board and LATF Advisory Committee officials, experience was determined by the length of service in these bodies. A larger sample size would have posed the problems of costs, reliability and scheduling. Moreover, smaller and focused samples are needed for qualitative studies.

The other data collection method the study used is desk review of existing literature.²⁰ This involved analyzing existing documents and literature²¹ on the issue of fiscal decentralization to establish the views of others on the weaknesses of fiscal decentralization existing before the enactment of the New Constitution.²² The literature also provided data on the existing framework

¹⁹ See Web Centre for Social Reserach Methods (2012), *Nonprobability Sampling*, available at: <http://www.socialresearchmethods.net/kb/samprnon.php>, (last accessed 18th April 2012). The method is also called expert sampling. It is a non-probability sampling method where members are selected from the population in some non-random manner. The researcher uses his/her judgement in selecting the units from the population for study. It allows for the choice of respondents who are most advantageously placed or in the best position to provide the information required.

²⁰ See Learning Domain (2011), *Qualitative Data Collection Techniques*, available at: <http://www.learningdomain.com/Chapter2.Methods.QR.doc>, (last accessed 31st May 2012).

²¹ The method is also called document analysis, document review, study of documents or even document study.

²² More details on this method available at: Center for Organization and Delivery Studies (2000), *Study Design in Qualitative Research*, Education for Health, Vol. 13, No. 2, 2000, 263–271, p 267, available at: http://educationforhealth.net/EfHArticleArchive/1357-6283_v13n2s15_713664908.pdf, Association for Information Systems (2012), *Qualitative Research in Information Systems*, available at:

on fiscal decentralization. It finally yielded data on comparative experiences from other jurisdictions that have implemented a devolved fiscal decentralization structure.

1.9 LITERATURE REVIEW

There are several academic writings in the area of fiscal decentralisation in Kenya. These are examined at depth in this section, with a view of illustrating how this study shall contribute to the existing literature on this subject. To complement the writings on this area in Kenya, the study also reviews some literature on the topic from other jurisdictions.

Smith (1985) writes on decentralization.²³ He points out that decentralization involves the establishment of an arena of decision making that lies outside the influence of the central government in which the central government delegates some of its power to local or regional administrators which carry out certain functions on their own.²⁴ In his view, Smith sees decentralization as the delegation of power to lower levels in a territorial hierarchy whether the hierarchy is one of governments within a state or offices within a large-scale organization. Further, Smith notes that decentralization can occur in all geographical areas such as neighbourhoods, field personnel in the area of central departments or within a large organization. From a fiscal perspective, he notes that decentralization refers to a set of policies designed to increase the revenues or fiscal autonomy of sub-national governments.²⁵

Smith's research is useful to this study as it generally informs on the various aspects of decentralization. It is however not specific to the experience of any specific country. This study however goes beyond to narrow down on fiscal decentralisation in the Kenyan context. It examines how the concept has been applied in Kenya, thus enriching the literature.

<http://www.qual.auckland.ac.nz/#Qualitative%20Techniques>, Educational Research (2012), *Qualitative And Naturalistic Research*, available at: <http://education.calumet.purdue.edu/vockell/research/chapter9.htm>, National Science Foundation (2012), *Other Qualitative Methods*, available at: http://www.nsf.gov/pubs/1997/nsf97153/chap_3.htm, Jarkko Suhonen (2009), *Qualitative Research Methods And Data Collection Approaches*, available at: [http://cs.joensuu.fi/pages/suhonen/SciMet2009/week4qualitative methodsdatacollectiontechniques.pdf](http://cs.joensuu.fi/pages/suhonen/SciMet2009/week4qualitativemethodsdatacollectiontechniques.pdf), (all last accessed 31st May 2012).

²³ Smith, B. C. (1985), *Decentralization: The Territorial Dimension of the State*, (George Allen Unwin, London.)

²⁴ *ibid*, p. 8.

²⁵ *ibid*, p. 9.

According to Rondinelli and Nellis,²⁶ decentralization can take three forms: de-concentration, delegation, and devolution. Under deconcentration, the central government shifts some tasks to the local administrative units without allowing local discretion. Under delegation, local jurisdictions have a certain degree of discretion in the provision of public services, but they still follow the central government's directions and requests. Under devolution, local jurisdictions are independent decision makers that respond to their residents' preferences and needs in the provision of public services.²⁷ The two authors opine that though none of these three designs works better than the other in terms of satisfying people's needs, scholars agree that different decentralization designs produce different outcomes depending on the existing political and economic institutions in a country.²⁸ Thus, the "success" of any decentralization design can be argued to be context dependent and an acceptable criteria for judging success of any fiscal decentralization design, is on how well it serves the presumed national policy objectives.

The above literature is informative in classification of Kenya's attempts to implement fiscal decentralization so far. The first initiatives spearheaded by provincial administration, that is, Special Rural Development Programme (SRDP) in 1971 and the District Focus for Rural Development (DFRD) in 1983, can be classified as deconcentration. The government simply shifted tasks for development planning to districts and provinces, headed by provincial administration officials, without much discretion to local citizens in project identification and implementation. The devolved funds initiatives may be classified as delegation. Local authorities and constituency level multi-sectoral committees were given roles to determine project identification and implementation but they still were required to follow strict central government's directions, guidelines and requests. The framework in the New Constitution is classified as devolution, with the counties being independent decision makers that respond to their residents' preferences and needs in the provision of public services.

²⁶Rondinelli Dennis, A. & Nellis, J.R. (1986), *Assessing Decentralization Policies in Developing Countries: The Case for Cautious Optimism*, Development Policy Review, Vol. 4, pp. 3-23, available at: <http://onlinelibrary.wiley.com/doi/10.1111/j.1467-7679.1986.tb00494.x/pdf>, (last accessed 18th April 2012).

²⁷Ibid, p. 5.

²⁸Kumar, Sharma Chanchal (2006), *Decentralization Dilemma: Measuring the Degree and Evaluating the Outcomes*, The Indian Journal of Political Science, Vol. LXVII, No.1. pp.51-64, available at: http://mpira.ub.uni-muenchen.de/204/1/MPRA_paper_204.pdf, (last accessed 18th April 2012).

However, the paper by the authors is general in its application. This study goes further to contextualise the various designs to Kenya. It in detail analyses the design proposed in the New Constitution, that is, devolution, within the pillars of effective fiscal decentralization. This study also examines the implementation of the devolution model in Kenya, with intent to propose improvements that can be made on the proposed devolution model. The study thus improves on the literature through contextualization.

On advantages and disadvantages of fiscal decentralisation, several scholars have added their voice. Different scholars note that in most developing countries, fiscal decentralization is promoted as a panacea for the ills of centralized structures and its potential benefits. For one, fiscal decentralization is associated with improvement in performance of the public sector through allocative efficiency.²⁹ Second, decentralization is associated with improved performance on measures of basic needs such as health and education in developing countries.³⁰ Third, fiscal decentralization is associated with equity. When resources are allocated based on an agreed upon formula, all local jurisdictions are guaranteed a minimum level of per capita expenditures for essential services. Lastly, decentralization brings public services closer to the people unlike centrally planned services located in capital cities. Close proximity, it is argued, enhances accountability, autonomy and participation.³¹

Fiscal decentralization on the other hand poses a number of problems. First, especially in developing countries, it can be captured by local elites to advance their selfish interests. Second, it is difficult to assign taxes/transfers to match local spending needs due to administrative considerations and access to and sharing of information.³² Third, decentralization distorts macroeconomic stabilization policies especially when local jurisdictions engage in expansionary

²⁹ *ibid*, p. 63

³⁰ Lindaman, Kara & Kurt Thurmaier (2002), *Beyond Efficiency and Economy: An Examination of Basic Needs and Fiscal Decentralization*, Economic Development & Cultural Change, Vol. 50, available at: www.jstor.org/stable/1154981, (last accessed 18th April 2012).

³¹ Mark, Turner and Hulme David (1997), *Governance, Administration & Development: Making the State Work*. (Kumarin Press, West Hartford: Connecticut).

³² Tanzi, Vito (2001), *Pitfalls on the Road to Fiscal Decentralization*, Global Policy Program, Working Paper, No. 19, available at: wko.at/wp/extra/.../t_Tanzi_2004_4_Secured.pdf, (last accessed 18th April 2012).

policies while the national government pursues contractionary policies.³³ Lastly, fiscal decentralization may result in higher government expenditures due to loss of economies of scale for some services, increased public employment due to demands for more public services, and thus additional administrative costs for coordination, and auditing.³⁴ From a budgetary perspective, fiscal decentralization may be relatively expensive.

Apart from its policy problems, fiscal decentralization also poses some technical problems. First, fiscal decentralization is rarely designed to improve the fiscal discipline or reduce the size of government.³⁵ Second, poorly designed decentralization structures based on transfers from the central government and where expenditure responsibilities are inadequately defined weaken the center's budgetary constraints due to coordination problems.³⁶

The scholars thus end by noting that for fiscal decentralisation to be effective, policymakers in designing a decentralized fiscal structure will have to find an answer to the question:

"Who pays for what and how?" For decentralization to work adequately, those who initiate local capital projects must be accountable to those who pay for local projects and those who benefit from those projects.

This study at length examines the benefits and problems posed by fiscal decentralisation but majoring on the Kenyan experience. The contextualisation enriches this literature. The study further proposes a viable answer to the question that the policy makers must address in developing a decentralisation model.

³³Ebel, D. Robert & Serdar Yilmaz (2002), *On the Measurement and Impact of Fiscal Decentralization*, World Bank, Policy Research Working Paper No. 2809, available at: ideas.repec.org/p/wbk/wbrwps/2809.html, (last accessed 18th April 2012).

³⁴Oates, Wallace (1985), *Searching the Leviathan: An Empirical Analysis*, The American Economic Review, Vol. 75, No. 4, pp. 748-757, available at: <http://www.ssc.upenn.edu/ier/Political%20Economy%20Archives/Political%20Economy%20Working%20Papers/Searching%20for%20Leviathan.pdf>, (last accessed 18th April 2012).

³⁵Stein, Ernesto (1998), *Fiscal Decentralization and Government Size in Latin America*, Inter-American Development Bank, Working Paper # 368, available at: ideas.repec.org/p/idb/wpaper/4112.html, (last accessed 18th April, 2012).

³⁶Rodden, Jonathan (2003), *Reviving Leviathan: Fiscal Federalism and the Growth of Government*, available at: web.mit.edu/jrodde/www/.../Leviathan.pdf, (last accessed 18th April, 2012).

Oates (1999) writes on fiscal federalism.³⁷ On propounding the theory of fiscal federalism, he notes that this theory conceives the organization of the public sector in a more or less federal way so that different levels of government provide public services and have some scope for *de facto* decision-making authority irrespective of the formal constitution within a nation state.³⁸ From a normative perspective, fiscal federalism identifies three roles for the public sector: macroeconomic stabilization, income redistribution and resource allocation in the presence of market failure.³⁹ The macroeconomic stabilization and income redistribution functions are assigned to the central government while resource allocation function is assigned to sub-national governments.

He notes that the main benefit associated with a federal fiscal structure is economic efficiency, which rests on two assumptions. First, it assumes that a group of individuals who reside in a community or region possess tastes and preference patterns that are homogenous and that these tastes and preferences differ from those of individuals who live in other communities or regions. And second, it assumes that individuals within a region have a better knowledge of the costs and benefits of public services of their region.⁴⁰ Thus, resources devoted for public purposes should be left to the local people to enhance their preferences for public expenditure that optimizes costs.⁴¹

However, since local regions within a jurisdiction may not be equally endowed with resources, intergovernmental grants and transfers are important instruments for allocating resources within a federal structure.⁴² For economic efficiency, he notes that local jurisdictions use transfers that communicate to its households the cost of consuming different levels of public goods.⁴³ He ends by noting that the federal fiscal structure is not without problems. Once created, it produces a new category of interest groups that are geographically located and lobby for greater transfers to enable them to provide more vote generating expenditures to their constituents at no additional

³⁷ Oates, Wallace (1999), *An Essay on Fiscal Federalism*, Journal of Economic Literature, Vol. XXXVII, pp. 1120-1149, available at: www.jstor.org/stable/2564874, (last accessed 18th April, 2012).

³⁸ *ibid.* p. 1121.

³⁹ *ibid.* p. 1122.

⁴⁰ *supra*, note 30, p. 1123.

⁴¹ *ibid.* p. 1125.

⁴² *ibid.* p. 1126.

⁴³ *ibid.* p. 1127.

direct tax cost.⁴⁴ Additionally, a federal fiscal structure financed by transfers from the central government, encourages local jurisdictions to ignore the tax collection burdens of for financing their expenditures while at the same time increasing public expenditure obligations.⁴⁵ The use and adequacy of transfers however, hinges on the goals that the national government seeks to advance. If the national goal is to improve the populations' welfare, then whether transfers export tax burdens to the national government is less important. If, however, the goal of the transfers is to free local jurisdictions from the center's dictates and make them sustainable, then transfers that lack a benefit-taxation principle might be detrimental.

Oates' paper is informative to this study by pointing out possible pitfalls in implementation of a fiscal decentralization framework. It is however generalized, not capturing uniqueness of any specific jurisdiction. It also does not propose how the pitfalls can be addressed towards implementing an effective decentralization framework. This study proceeds to propose a possible remedy for the above problems; being the need for clarity in defining a jurisdiction's fiscal responsibilities and the fiscal instruments needed to support the delivery of the needed public services.⁴⁶ The study further examines fiscal decentralization in the context of Kenya, contextualising Oates' work.

Obuya (2008)⁴⁷ highlights challenges of the devolved funds, with a focus on CDF. He notes that the major challenge to decentralised funds is that the citizens often suffer from fiscal "illusions". Fiscal illusions refer to the inability of local decision makers to grasp the collective financial costs of their independent expenditure decisions on the overall financial standing of the central government. When citizens engage in public policy decisions, the fiscal illusions blind them from seeing the collective financial costs of their expenditure decisions on the central government's general fund.⁴⁸

⁴⁴ *ibid*, p. 1139.

⁴⁵ *ibid*, p. 1140.

⁴⁶ *supra*, note 30, p. 1148.

⁴⁷ Obuya Bagaka (2008), "*Fiscal Decentralization in Kenya: The Constituency Development Fund and the Growth of Government*," available at: mpa.ub.uni-muenchen.de/11813, (last accessed 17th April 2012).

⁴⁸ *ibid*, p. 5

Obuya's paper was however written before enactment of the New Constitution in 2010. It also focuses on only one devolved fund. It also does not propose how fiscal illusions can be addressed towards implementing effective fiscal devolution. This study goes further to propose a model that would incorporate a solution to fiscal illusion. It proposes tenets that need to be infused in the existing legal framework to check fiscal illusion. It also examines the weaknesses of other devolved funds beside CDF. It finally moves beyond devolved funds to examine the fiscal decentralization framework under the New Constitution.

Maina (2004) traces the development of decentralisation in Kenya.⁴⁹ She notes that the Majimbo system implied that the government was seeking to promote widespread participation, but the policy implemented created new arrangements for the central bureaucracy to control local affairs. The central government retained power to veto or modify proposals, through multiple levels of review and approval. This created uncertainty and perplexity among rural peoples, discouraging enthusiastic participation by citizens.⁵⁰

Though the eight regional governments were abolished in 1966, the decentralization policy was maintained through a system of local government operational at the district level and in urban centres. This system was however much weaker due to the centralization of functions and revenue control.⁵¹ The Transfer of Functions Act in 1969 was a major blow to centralization for it transferred major services such as primary education, health and road maintenance back to the central government. The Act also transferred the Graduated Personal Tax (GPT), the major source of revenue for local government, to the central government.⁵²

She ends by noting that previous experiences on decentralization suggest that harmonization is needed to alleviate any resistance to such a plan that might rise among central government civil servants.⁵³ The tendency of centralized ministries to retain lines of communication with the

⁴⁹ Maina Betty (2004), *Monitoring and Evaluation of Support to Decentralisation and Local Governance: Kenya Case Study*, European Centre for Development Policy Management, Discussion Paper No. 61, available at: http://www.ecdpm.org/web_ecdpm/web/content/content.nsf/vwPrint/C47067A3CD17610EC125710900432C53?Opendocument, (last accessed 18th April, 2012).

⁵⁰ *ibid*, p. 5.

⁵¹ *supra*, note 42, p. 6.

⁵² *ibid*, p. 7.

⁵³ *ibid*, p. 15.

district heads is expected to remain. This will likely become a source of friction with counties and ought to be addressed in the devolution legislation as well.⁵⁴

Though her paper is informative on previous fiscal decentralization initiatives, it was written before enactment of the New Constitution. It also identifies only one weakness in the administration of devolved funds. It also does not propose any solution to the friction between devolved units and National Government. This study goes further to identify other weaknesses that plagued the devolved funds. It also examines the Intergovernmental Relations Act, 2011, on its proposed guideline on harmony between the County and National governments. Moreover, this study analyses the effectiveness of the proposed fiscal decentralization structure in the New Constitution. It further draws from previous experiences propose ways to address the challenges faced earlier so as to achieve harmony.

Finally, scholars suggest that different fiscal decentralization designs affect the size of government with mixed results. On the one hand, those who define “size of government” as a ratio of total government receipts to the gross domestic product (GDP), have found positive correlations.

These scholars note that fiscal structures that rely on own revenues as opposed to those that rely on transfers, negatively correlate with growth of the public sector. On the other hand, however, Oates’ studies⁵⁵ failed to establish such correlations, though from a budgetary perspective he noted that fiscal decentralization does increase the central government’s overall expenditures. In the Latin American study on fiscal decentralization and size of government,⁵⁶ a positive correlation was established. From an African perspective, little research has been undertaken to examine how various decentralization schemes have affected the size of the public sector. This study fills that void with emphasis on fiscal decentralization in Kenya.

In summary, the above literature has several gaps. First, most of it was written before the enactment of the New Constitution in 2010, and thus does not address fiscal decentralization as

⁵⁴ *ibid.*

⁵⁵ *supra*, note 27.

⁵⁶ *supra*, note 28.

per the New Constitution. Second, most of the literature on the Kenyan context focuses on individual devolved funds. Third, the international literature is general in nature and does not consider uniqueness's of specific jurisdictions. Finally, despite pointing out weaknesses in fiscal decentralization structures, the literature does not propose legal reforms that are necessary towards addressing the weaknesses.

This study enriches the above literature in several ways. First, it captures the fiscal decentralization framework proposed in the New Constitution. It thus discusses more current information on fiscal decentralization in Kenya. Second, this study discusses the various devolved funds, noting their weaknesses in totality. This enables a generalized way of judging the successes of the devolved funds. Third, the study contextualizes writings of international scholars to the Kenyan context, bringing out uniqueness that may not be covered in the literature. Finally, this study not only identifies weaknesses' in the Kenyan fiscal decentralization framework. It goes ahead to propose legal reforms necessary to address the weaknesses', allowing effective implementation of fiscal decentralization in Kenya.

1.10 SCOPE AND LIMITATIONS

This study examines the legal framework for fiscal decentralization in Kenya. To lay a basis for recommendations on better implementation of fiscal decentralization in Kenya, the study does a comparative analysis of Ethiopia, Uganda and South Africa as some of the countries where fiscal devolution can be said to have been used to a relative degree of success. South Africa is chosen for being the economic super-power of Africa, a goal Kenya is striving towards. It is similar to Kenya in that it has a unitary system of government. It also leads other African countries in the extent of fiscal decentralization in Africa.⁵⁷

Uganda is chosen for being the only East African country to be ahead of Kenya in the extent of fiscal decentralization in Africa.⁵⁸ It is also similar to Kenya in that it has a unitary system of government. Finally, Ethiopia is chosen for being the only Eastern Africa state to run a federal

⁵⁷ Ndegwa Stephen (2002), *Decentralization in Africa: A Stocktaking Survey*, Africa Region Working Paper Series No. 40, p. 5, Figure 3: Extent of Fiscal Decentralization, available at: <http://www.worldbank.org/afr/wps/wp40.pdf>, (last accessed 20th August, 2012).

⁵⁸ *ibid.* Uganda is ranked number 3 in Africa.

system of government. Despite this it has gradually implemented a largely successful system of fiscal decentralization.⁵⁹ Lessons from the federal system are useful for comparison with unitary systems of government. Again, its proximity to Kenya enables easier contextualization in historical and developmental experiences.

The study faced two limitations. First is time constraints as the time was not sufficient to interview a wider range of respondents, which hindered a more detailed study. Second, cost constraints restricted the researcher to relying on secondary data from other countries, with no resources to visit the countries and collect primary data. Third, is the limited research on the area of fiscal decentralization in Kenya with most scholars having concentrated on devolution in general and the devolved funds that existed prior to the new Constitution.

1.11 DESCRIPTION OF CHAPTERS

The study is divided into five chapters.

Chapter one introduces the study. This includes the background information, statement of the problem, research objectives, research questions, hypothesis, research methodology, conceptual framework for the study, literature review, justification of the study and the chapter breakdown.

Chapter two examines the Kenyan legal and institutional framework for fiscal decentralization prior to enactment of the New Constitution in 2010. It identifies the weaknesses that were evident in that framework and takes a peak at the future of those funds given the new Constitutional order.

Chapter three outlines the legal provisions establishing the framework for Fiscal devolution in the Constitution of Kenya, 2010. It analyses the constitutional framework on fiscal decentralization based on the pillars of effective fiscal decentralization. The various Acts of Parliament that implement the fiscal decentralization structure proposed in the Constitution of Kenya, 2010 are also examined. The chapter in its analysis points out the problems and challenges that face the system in the New Constitution.

⁵⁹ *ibid.* Ethiopia is ranked 17th in Africa on extent of fiscal decentralization.

Chapter four compares the legal framework proposed by the new Constitution with the legal framework in other countries where devolution has been effective. On the basis of the comparison, the chapter sets out the requirements for an effective fiscal decentralization system.

Chapter five contains a summary of the findings on the various matters analyzed in the study. It then, drawing from the shortcomings of the previous fiscal decentralisation framework and the comparative analysis, makes recommendations for reforms needed to fully implement the envisaged decentralization system.

CHAPTER TWO: THE FISCAL DECENTRALISATION FRAMEWORK BEFORE ADOPTION OF THE NEW CONSTITUTION

2.1 INTRODUCTION

This chapter examines the fiscal decentralization framework that existed in Kenya before the enactment of the new Constitution. It first defines key concepts as used in the study. It then explores the devolved funds, which the government adopted as the fiscal decentralization avenue then. The chapter shall then examine the weaknesses of the system of devolved funds. These weaknesses made the devolved funds not to be effective avenues for fiscal decentralization.

2.2 DEFINITION OF CONCEPTS

Decentralization 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, decentralisation of administrative power which entails mere transfer of authority from the Central Government to the devolved units but with the Central Government retaining power to make final decisions or decentralisation of political power which entails the central government transferring political, administrative and financial power to the sub-national units, which units can make decisions independent of the Central Government and govern themselves.⁶⁰ By strengthening local institutions through decentralisation of political power, it is assumed that local administration and service delivery can be improved and there is greater likelihood of ownership, sustainability and lasting impact on poverty.

Fiscal decentralization comprises the financial aspects of devolution to regional and local Governments.⁶¹ 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.⁶² It is the aspect of decentralization that defines

⁶⁰ *supra*, note 1, p. 5.

⁶¹ Kenneth Davey (2003), *Fiscal Decentralization*, p. 1, available at: <http://unpan1.un.org/intradoc/groups/public/documents/untc/unpan017650.pdf>, (last accessed 17th January 2012).

⁶² Prof. James Edwin Kee *Fiscal Decentralization: Theory As Reform*, available at: [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) (last accessed 2nd October, 2012).

how and in what way expenditures and revenues are organized between and across different levels of government in the national polity.⁶³

2.3 THE DEVOLED FUNDS AS A FISCAL DECENTRALIZATION FRAMEWORK

Before the adoption of the Constitution of Kenya, 2010, the government implemented an unofficial decentralization policy through creation of numerous devolved funds. These funds were created through; Acts of Parliament, Gazette Notices or even Presidential Decrees. They include the following:

Constituency Bursary Fund or Secondary Education Bursary Fund (SEBF)⁶⁴ was established in 1993/4 through a presidential pronouncement. The fund had the aims of; cushioning the income of the poor and vulnerable groups against negative effects of increasing cost of secondary education, increasing access for poor households to secondary schools, ensuring retention and completion rates of those who enter secondary school, reducing disparities/inequalities in the provision of secondary education and finally, promoting transition rates i.e. from primary to secondary and eventually to the tertiary level.⁶⁵ Annual allocations to SEBF depend on the Ministry of Education's (MOE) budgetary provisions for each year. The bursary funds are allocated in two installments; the first Kshs. 210 million being allocated equally to each constituency and the remaining fund being divided according to students' enrolment in secondary schools in the constituency, the constituency poverty index and the population size.⁶⁶ The fund is administered at the constituency levels by the Constituency Bursary Committees (CBC's) who coordinate and disburse the funds, vet beneficiaries and prepare and submit reports to the Ministry of Education.⁶⁷

⁶³ UNDP (2003), *Fiscal Decentralization and Poverty Reduction*, p.2, available at: <http://content.undp.org/go/cms-service/download/publication/?version=live&id=2219894>, (last accessed 20th June, 2012).

⁶⁴ See TISA (2012), *Constituency Bursary Fund*, available at: <http://www.tisa.or.ke/about-devolved-funds/constituency-bursary-fund/>, (last accessed 20th June 2012).

⁶⁵ *ibid.*

⁶⁶ *ibid.*

⁶⁷ *ibid.*

The Road Maintenance Levy Fund (RMLF) was established in 1993 through the Road Maintenance Levy Fund Act, No 9 of 1993.⁶⁸ By this Act, some levy is charged on fuel and the proceeds from fuel levy are paid into the Kenya Roads Board Fund, for use in rehabilitation of rural roads.⁶⁹ RMLF came into place as an alternative source of funding towards road maintenance, which initially relied on public tolls. Despite the fact that RMLF was intended for road maintenance and repair, the poor state of roads has meant that the funds are used on rehabilitation and reconstruction works. The levy is a charge collected against every litre of petrol or diesel at port of entry from the oil marketing companies by the Kenya Revenue Authority. Main contributors include major petroleum companies (remitters) like TOTAL, CALTEX, KOBIL and SHELL among others. RMLF therefore consists of proceeds from levy on petroleum products and transit toll collections.⁷⁰

From the collected revenue, 57% goes to the Roads Department in the Ministry of Roads for maintenance and repair of major roads that is class A, B and C roads. 24% goes to the Kenya Wildlife Service (KWS) and Local Authorities for repair of roads within their areas of jurisdiction, with the 16% being equally distributed to District Road Committees (DRCs) in all districts to manage class D and E roads. Out of the DRC's share, the road maintenance budget for the Ministry of Local Government is funded based on annual work programmes submitted by local authorities for roads within jurisdictions of local authorities. A maximum of 3% is left with the Kenya Roads Board (KRB) to facilitate its operational costs and recurrent expenditures.⁷¹

The Rural Electrification Programme Levy Fund (REPLF) is another devolved fund that was established in 1998 through sections 129 & 130 of the repealed Electric Power Act (1997) aiming to achieve electrification of the rural and other underserved areas.⁷² The Electric Power Act empowered the Minister to set the quantum of the levy at rates of up to 5% of all the electricity consumed in the country. All electricity consumers in the country are expected to contribute to this fund. REPLF targets rural factories, market centres in rural areas and public

⁶⁸ See Kenya Roads Board website (2012), <http://www.krb.go.ke/index.php/about-us/history>, (last accessed 16th January 2012).

⁶⁹ Ibid.

⁷⁰ *ibid.*

⁷¹ *ibid.*

⁷² See The Rural Electrification Authority website (2012), <http://www.rea.co.ke>, (last accessed 16th January 2012).

facilities such as schools, water projects, health centres, agricultural extension projects, the provincial administration and such others.⁷³ The Ministry of Energy administers the Fund and has a special account into which the Kenya Power and Lighting Company (KPLC) pays all levy collections. These collections according to the Electric Power Act are to be used for programmes relating to the design, construction, equipment, operation and maintenance of rural electrification projects.⁷⁴

There are various institutions which play a role in managing the REPLF. The District Development Committees (DDC), the Constituency Development Fund Committees (CDFCs) and the Local Community Committees for Special Projects assist identify the projects for electrification at the local level. The Ministry of Energy and the Energy Regulatory Commission (ERC) do the administrative work of determining viability of projects, approvals and prioritizing. If found viable, the Kenya Power and Lighting Company is utilized as the implementing agency.⁷⁵ The Permanent Secretary (PS) in the Ministry of Energy serves as the accounting officer, advises the minister on power priorities in the rural areas, works closely with the director of Rural Electrification Programme and other officers in the ministry and sits on the KPLC board with the director of rural energy.⁷⁶

Another devolved fund, the Local Authority Transfer Fund (LATF) was established in 1999 through the LATF Act No. 8 of 1998, with the objective of improving service delivery, improving financial management, and reducing the outstanding debt of local authorities.⁷⁷ LATF receives 5% of the total national income tax. Of this, at least 7% of the total fund is shared equally among the country's 175 local authorities, 60% of the fund is disbursed according to the relative population size of the Local Authorities and the balance (33%) is shared out based on the relative urban population densities. The money is disbursed 3 times a year i.e. 30th September, 31st January and 30th April. 60% of LATF allocations are released if the Council submits required budgets and meets current statutory creditor obligations. The remaining 40% is released

⁷³ *ibid.*

⁷⁴ *ibid.*

⁷⁵ *ibid.*

⁷⁶ *ibid.*

⁷⁷ See The Ministry of Local Government website (2012), www.localgovernment.go.ke, (last accessed 16th January 2012).

based on the respective local authorities' performance.⁷⁸ An advisory committee headed by a private sector representative and comprising of the Ministry of Finance, the Permanent Secretary-Ministry of Local Government (officer administering LATF), various private sector members, and other co-opted members like the Institute of Certified Public Accountants of Kenya (ICPAK) and Association of Local Government Authorities of Kenya (ALGAK) guide LATF operations. The Kenya Local Government Reform Programme (KLGRP) Secretariat provides technical and administrative support.⁷⁹

The Constituency HIV/AIDS Fund was established in 1999 through a Presidential Legal Order Notice No. 170.⁸⁰ Its establishment coincided with the declaration of HIV/AIDS as a national disaster in Kenya. The fund targets individuals infected with and affected by HIV/AIDS (PLWHA), with the focus being on long-term care and support. Structurally, the fund is managed by Constituency Aids Control Committees at the constituency level in consultation with the District Technical Committee. The National Aids Control Council (NACC) under the Ministry of Special Programmes manages the fund nationally.⁸¹

The Poverty Eradication Fund (PEF) was established in 1999 to try and address the high poverty rate in Kenya through supporting development initiatives.⁸² The fund's establishment was in line with a commitment to the United Nations World Summit on Social Development held in 1995 at Copenhagen. The summit set a target of reducing global poverty by half in 2015. The fund was set up with the objectives of; providing and promoting access to affordable credit by the poor, strengthening existing alternative credit among the poor communities, encouraging the poor to save and finally, promoting innovative approaches to provision of basic social services.⁸³ PEF is intended to support community-based projects that can improve people's livelihoods. Preference

⁷⁸ *ibid.*

⁷⁹ *ibid.*

⁸⁰ TISA (2009), *About Devolved Funds*, available at: <http://www.tisa.or.ke/about-devolved-funds/>, (last accessed 20th June 2-12).

⁸¹ *ibid.*

⁸² Kituo Cha Sheria (2011), *Decentralized Funds Regime in Kenya: A Guide to Citizen Participation*, available at: <http://www.urbisnetwork.com/documents/Mombasa-DevolvedFundsToolkit.pdf>, (last accessed 20th June 2012).

⁸³ *ibid.*

is given to well organized groups engaged in income generating activities that benefit individual members of the groups. The fund avoids supporting groups composed of salaried persons.⁸⁴

The Constituency Development Fund (CDF) was established in 2003 through the CDF Act in the Kenya Gazette Supplement No. 107 (Act No. 11) of 9th January 2004.⁸⁵ The Act has since been amended extensively vide the CDF Amendment Act of 2007.⁸⁶ The fund was created with the objectives of; controlling imbalances in regional development brought about by partisan politics, off-loading fundraising burden from Members of Parliament, ensuring citizen participation through decision-making in project identification, implementation, monitoring and evaluation and finally, changing development focus from the district to the constituency.⁸⁷ CDF comprises an annual budgetary allocation equivalent to 2.5% of all the Government ordinary revenue collected in every financial year. Of this, 75% of the fund is allocated equally amongst all 210 constituencies, whereas the remaining 25% is allocated as per constituency poverty levels.⁸⁸

The Constituency Development Fund Committee (CDFC) manages the fund at the grassroots level in consultation with the District Projects Committee. These are directly answerable to the Constituency Development Funds Board which manages the fund nationally. A Committee of Parliament, the Constituency Funds Committee plays an oversight role in implementation of the Act.⁸⁹

The Free Primary Education Fund (F.P.E) was established in January 2003 through a presidential decree pursuant to the National Rainbow Coalition's (NARC) party manifesto.⁹⁰ The fund seeks to address financing and quality challenges in primary schooling. It targets all Kenyan children of primary school going age in public schools. The fund currently comprises of an annual allocation equivalent to Kshs. 1,020 per child. The amount of money disbursed to schools

⁸⁴ *ibid.*

⁸⁵ See Constituency Development Fund Website at <http://www.cdf.go.ke/>, (last accessed 20th June 2012).

⁸⁶ *ibid.*

⁸⁷ *ibid.*

⁸⁸ *ibid.*

⁸⁹ *ibid.*

⁹⁰ Kenya Human Rights Commission (2011), *Harmonization of Decentralized Development In Kenya: Towards Alignment, Citizen Engagement and Enhanced Accountability*, a Joint Collaborative Research Report. December 2010 Version, available at: <http://www.scribd.com/doc/62881677/Harmonization-of-Decentralized-Development-in-Kenya-Towards-Alignment-Citizen-net-and-Accountability>, (last accessed 20th June 2012).

annually is dependent on the number of pupils enrolled in schools within that area. Schools are therefore expected to forward up-to-date statistics on their respective pupil enrolment rates to the Ministry of Education through the District Education Officer (DEO). This is normally done in February, May and September.⁹¹ Each school is expected to open two accounts; the SIMBA (Schools Instructions Materials Bank Account) account and the General Purpose Account in a reputable bank in the District, where the Ministry of Education remits the money by direct wire transfer.⁹²

The National Development Fund for Persons with Disability (NDFPD) was established under the Persons with Disability Act, 2003 for the sole benefit of persons with disabilities.⁹³ Its main purpose is to foster participation in development activities for the persons with disabilities (PWDs). The National Council for Persons with Disabilities through a Board of Trustees manages the fund.⁹⁴ The NDFPD is utilized in the following ways; to contribute to the expenses of organizations of persons with disabilities, to contribute to the expenses of institutions training persons in the care of PWDs, to contribute to Government projects geared towards the benefit of PWDs, to provide or contribute to costs of assistive devices and services and finally, to pay allowances to people with severe disability who are not trainable in any skills, aged PWDs, and single parents with children with disabilities who cannot seek employment.⁹⁵

In 2004, the Water Services Trust Fund (WSTF) was established as a State Corporation under the Water Act, 2002 for mobilizing resources and providing financial assistance towards provision of water and sanitation services in areas that are underserved and marginalized.⁹⁶ The Fund mobilizes resources through government budgetary allocations to the Ministry of Water and Irrigation. It also relies heavily on funding from development partners such as Swedish International Development Cooperation Agency (SIDA), German Agency for Technical Cooperation (GTZ), the Danish International Development Agency (DANIDA) and the World Bank and also grants and donations from institutions and individuals. WSTF is managed by a

⁹¹ *ibid.*

⁹² *ibid.*

⁹³ National Council for Persons with Disabilities (2012), *National Development Fund*, available at: <http://ncpwd.go.ke/national-development-fund-for-persons-with-disabilities/>, (last accessed 20th June 2012).

⁹⁴ *ibid.*

⁹⁵ *ibid.*

⁹⁶ The Water Services Trust Fund website (2012), www.wstfkenya.org, (last accessed 20th June 2012).

Board of Trustees appointed by the Minister for Water and Irrigation. The Board currently comprises of nine Trustees.⁹⁷

Free Secondary Education Fund (FSEF) was established in 2007 with the main objective being financing secondary education.⁹⁸ The fund has been in operation from 2008 and receives funding from the exchequer. The fund is channeled to the Ministry of Education which in turn distributes the money to various public secondary schools in the republic.⁹⁹ However, based on the directive issued by the Permanent Secretary, Ministry of Education, the fund is meant to benefit schools with a minimum of 40 students per class and a maximum of 45 students per class. FSEF allocates Kshs. 10,265 per student per annum, for tuition purposes. The amount covers all expenses for students in day schools, while those in boarding institutions are required to pay, on top of the funding, a maximum of Kshs. 18,000 per year.¹⁰⁰ The Ministry remits the funds to respective institution accounts for various schools. This is based on up to date statistics that schools periodically submit to the Ministry. The fund is sent directly to institutions in three tranches, with the first tranche comprising of 50%, the second tranche 20% and the last tranche 30%. Disbursements are done in the months of January, April and August.¹⁰¹

The Youth Enterprise Development Fund (Y.E.D.F) was launched on 1st February 2007, as a strategic move towards arresting unemployment which is virtually a youth problem. The fund was gazetted on 8th December 2006, providing it with the necessary legal framework to govern its use and operations.¹⁰² The fund has the objectives of providing loans to financial institutions for onward-lending to youth enterprises, attracting and facilitating investment in micro, small and medium enterprises that will be beneficial to youth enterprises, supporting youth oriented micro, small and medium enterprises to develop linkages with large enterprises, facilitating

⁹⁷ *ibid.*

⁹⁸ KCSE Online (2008), *Free Secondary Education*, available at: http://www.kcse-online.info/devolution/free_secondary_education.html, (last accessed 20th June 2012).

⁹⁹ *ibid.*

¹⁰⁰ *ibid.*

¹⁰¹ *ibid.*

¹⁰² *Youth Enterprise Development Fund Order, 2007*, available at: http://marsgroupkenya.org/pdfs/2010/03/YOUTH_ENTERPRISE_DEVELOPMENT_FUND_ORDER_2007.pdf, (last accessed 20th June 2012).

marketing of products and services of youth enterprises in both domestic and international markets and facilitating employment of youth in the international labour market.¹⁰³

The YEDF consists of monies appropriated by Parliament, grants and donations and income generated from the proceeds of the fund. It is managed locally through the Divisional Youth Enterprise Development Fund Committee and the District Youth Enterprise Development Fund Committees. These work closely with the national secretariat headed by a Chief Executive and staff who are competitively recruited. There is an Advisory Board, headed by a Non-Executive Chairperson which oversees the management of the Fund and advises the Ministry generally on the operations of the Fund. The Financial institutions then engage in giving of the loans and recovery.¹⁰⁴

The Women Enterprise Development Fund (WEDF) was conceived in December 2006 by the Government as a strategic move towards addressing poverty alleviation through socio-economic empowerment of women.¹⁰⁵ The fund was set up with the following objectives; to provide loans to financial institutions for on-lending to women enterprises, to attract and facilitate investment in micro, small and medium enterprises that will be beneficial to women enterprises, to support women oriented micro, small and medium enterprises to develop linkages with large enterprises, to facilitate marketing of products and services of women enterprises in both domestic and international markets and finally, to support capacity building of the beneficiaries of the fund and their institutions.¹⁰⁶ WEDF is managed locally through the Divisional Women Enterprise Fund Committee (DWEFC). This liaises with the national secretariat headed by a Chief Executive and staff who are competitively recruited. There is an Advisory Board, headed by a Non-Executive Chairperson which oversees the management of the Fund and advises the Ministry generally on the operations of the Fund. The Financial institutions then engage in giving of the loans and recovery.¹⁰⁷

¹⁰³ TISA (2009), *The Youth Enterprise Development Fund*, available at: <http://www.tisa.or.ke/about-devolved-funds/youth-enterprise-development-fund/>, (last accessed 20th June 2012).

¹⁰⁴ *ibid.*

¹⁰⁵ Ministry of gender, Children and Social Development, *The Women Enterprise Fund – WEF*, available at: <http://www.gender.go.ke/index.php/Women-Enterprise-Fund-WEF/intro-women-enterprise-fund-wef.html>, (last accessed 20th June 2012).

¹⁰⁶ *ibid.*

¹⁰⁷ *ibid.*

2.4 WEAKNESSES OF THE DEVOLVED FUNDS AS A FISCAL DECENTRALISATION FRAMEWORK

The weaknesses the above funds faced are discussed under the following subheadings:

2.4.1 Inadequate Resources and Poor Service Delivery

Most of the decentralized funds in Kenya are financed entirely by the treasury from the general revenue with the exception of the school bursary scheme and the HIV/AIDS fund, which receive additional financing from a number of donors.¹⁰⁸ Devolved funds have taken up a significant portion of development resources. Kenya National Bureau of Statistics estimates that each constituency receives an estimated total of at least Ksh 80 million (about US\$1 million) per year from all the devolved funds.¹⁰⁹ There is no appropriate balance between the amount of decentralized financial resources and the services devolved to local governments at different levels and their technical capacity to effectively utilize the funds.¹¹⁰ This is compounded by the fact that allocation criteria of most of these funds exclude some major considerations such as poverty index, the spatial coverage of the local authority/area of jurisdiction as well as regional cost variations.¹¹¹

2.4.2 Poor Citizen Sensitization and Public Accountability

Citizens' knowledge and participation in the implementation of the various devolved funds is very limited.¹¹² Most of these funds do not have structured citizen engagement and information sharing strategy. As a result, the opportunity for the general public and especially the poor to

¹⁰⁸ View expressed by Eric Okwaro, Economist at Ministry of Finance, during an interview on 12th August, 2012.

¹⁰⁹ Kenya National Bureau of Statistics (2007), *Basic Report, Kenya Integrated Budget Survey, 2005/06*, Revised edition, Ministry of Planning and National Development. Nairobi, Kenya.

¹¹⁰ View expressed by Onesmus Kipchumba Murkomen, an expert on fiscal decentralization, during an interview on 12th August, 2012.

¹¹¹ Kenya Human Rights Commission (KHRC) & Social And Public Accountability Network (SPAN) (2010), *Harmonization of Decentralized Development In Kenya: Towards Alignment, Citizen Engagement and Enhanced Accountability*, p. 42, in relation to LATF, available at www.khrc.or.ke/resources/publications/pdf, (last accessed 31st August, 2012.)

¹¹² For instance with regard to the LATF, LASDAP Consultative forums were and still are generally poorly attended due to lack of public knowledge of the same. This can be attributed to the fact that Local Authorities advertise such meetings in local dailies which are not affordable to the poor.

identify their project priorities is jeopardized.¹¹³ On the other hand, even though a few of these funds are well known by the public, there are no mechanisms to ensure maximum and quality participation by the public in their implementation.¹¹⁴ The nature and quality of the public input during the process of implementation of most of these funds is very poor. There is limited public nomination of members to the implementation institutions of these funds.¹¹⁵ Professionals rarely participate.¹¹⁶ Furthermore there is lack of a proper institutional framework to provide for clear roles and responsibilities for the community in the different levels of project implementation of most of these funds.¹¹⁷

Lack of sensitization and public participation inevitably results to poor accountability in the utilization of these funds. Most of these funds do not have an open information policy to enhance accountability. This makes it easier for the funds to be misused without any real checks being provided.¹¹⁸

2.4.3 Poor Monitoring and Supervision of Resource Use

Effective implementation of devolved funds requires a sound coordination between the central government and de-concentrated central government structures and local authority structures.¹¹⁹ Policy formulation is normally limited to government departments. There is however no clear mechanisms for sharing of resources between the Central Government and lower level governments based on the expenditure responsibilities.¹²⁰

¹¹³ Ministry of Local Government: Kenya Local Government Reform Programme (July 2005), *Guidelines for the Preparation, Implementation and Monitoring of Local Authority Service Delivery Action Plan (LASDAP)*, available at www.dege.biz/kenyaFinal.pdf, (last accessed 31st August 2012.)

¹¹⁴ *ibid*, p. 52. For instance, even though 35.2% of the public were aware of the RMLF only 19.9% got involved in their implementation process in 2010.¹¹⁴ Another good illustration is the FPE. Though statistics in 2010 showed that even though the public were aware of it, only 19.6% of the public participated in its implementation.

¹¹⁵ For instance, the appointment of the CDF Committee does not allow for community participation in free and fair elections. As such, the Members of Parliament exercise discretion in the appointment of people to the committee.

¹¹⁶ *supra*, note 67, p. 45.

¹¹⁷ A good example is the LASDAP guidelines, though well intentioned in their provisions to enhance public participation, it is not clear with whom the community representatives engage.

¹¹⁸ View expressed by Onesmus Kipchumba Murkomen, an expert on fiscal decentralization, during an interview on 12th August, 2012.

¹¹⁹ *supra*, note 67, p. 47.

¹²⁰ Barkan, J. D., & Chege, M. (1989), *Decentralising the State: District Focus and the Politics of Reallocation in Kenya*, Journal of Modern African Studies, available at www.forimfed.org/..StG-crook.pdf, (last accessed 31st August 2012).

It is noteworthy that the functional diversification of the legislature has promoted more complexities in the country's decentralized development and accountability system. Some of these funds are overseen by local Members of Parliament.¹²¹ The rule of separation of powers, require that the executive, judiciary and legislature discretely undertake clearly specified functions without interfering with each other. It can be deduced from this that the legislature is taking over the role of the executive is leaving the system without checks and balances.¹²²

Further, due to the red tape involved in the disbursement of these funds led to delayed projects and initiatives. For example with regard to the LATF, funds for proposed LASDAP projects in a particular financial year were normally disbursed from the Treasury in the next financial year causing delay in the implementation of projects. This meant that consultative meetings for the current Financial Year were convened before the initiation of projects identified in the previous Financial Year.¹²³

The multiplicity of funding channels for local service delivery and development has imposed high administration and transaction costs in the implementation of devolved funds. This in turn lead to lack of comprehensive and composite planning and organization of the development projects at the local level.¹²⁴ It further results in fragmentation of resources and duplication of projects thus undermining the service delivery and developmental objectives of the funding respective.¹²⁵

Moreover, the country has to some extent relied on development assistance initiated by different development partners. The downside to this is that all of these development partners have different policies and objectives, conditions, priorities and practices.¹²⁶ This has led to a disconnected monitoring process of the utilization of the resources. It is also important to note that the Public Procurement and Disposal Act, 2003 is also not community friendly as it doesn't allow community contracting, a situation that affects ownership of projects.

¹²¹ A good example is the CDF.

¹²² View expressed by Patrick Lidovolo, CDF Manager, Migori Constituency, in an interview on 12th August 2012.

¹²³ *supra*, note 75, p. 13.

¹²⁴ View expressed by Anthony Weru, Kenya Private Sector Alliance, in an interview on 13th August 2012.

¹²⁵ Kenya Institute for Public Policy, Research and Analysis (KIPPRA) (2006), *Baseline Survey on Decentralized Funds in Kenya*, Nairobi Kenya, available at www.kippira.or/docs/SP12.pdf, (last accessed 31st August 2012).

¹²⁶ *ibid*, p. 12.

2.4.4 Political Control

Most of the devolved funds are managed through politically driven independent structures.¹²⁷ This has resulted lack or little consultation between the funds. As a result, there has been duplication of projects and initiatives among different funds. This has resulted in the funds being in competition with each other with the actors making every effort to discredit the each other.¹²⁸ There is very little or no partnership between the funds at community level making them competitors rather than partners. A good illustration of this would be the CDF and LATF. With regard to CDF, fund managers are employed to enhance constituencies' compliance and reporting. However, the fund managers are supposed to be politically independent. In most cases, interference from area MPs is evident.¹²⁹ The Board expects fund mangers to maintain a good working relationship with the MP. However, in case of dispute it arbitrates and where things get out of hand, the fund managers are transferred.¹³⁰ The same can be said about LATF where there is also political influence in the whole process. There is scramble for resources with each councilor wanting a project in their own ward. This results in fragmented and piecemeal projects. It's difficult to implement a large, high impact project.¹³¹

2.5 IMPLICATIONS OF THE CONSTITUTION OF KENYA, 2010 ON THE ABOVE FUNDS

The Constitution of Kenya, 2010 introduced two levels of government; the National and the Counties and allocated various functions to each level. This allocation of functions requires a similar allocation of finances to perform those functions. This therefore has implications on place of these devolved funds in the new governance system and if they will be retained, the framework in which they will operate and which level of government will administer the same. From my reading of the Constitution, I am confident to state the following regarding each of the funds:

¹²⁷ *ibid.*
¹²⁸ *ibid.*
¹²⁹ View expressed by Patrick Lidovolo, CDF Manager, Migori Constituency, in an interview on 12th August 2012.
¹³⁰ *supra*, note 67, p. 52.
¹³¹ View expressed by Onesmus Kipchumba Murkomen, an expert on fiscal decentralization, during an interview on 12th August, 2012.

2.5.1 The Constituency Development Fund (CDF)

The new Constitution provides for respect of the principle of separation of powers between the three arms of government at each level. It further outlines how the revenue generated nationally will be shared between the national government and the county governments. The Constitution therefore only allocates funds at two levels of which the Constituency is not one of them. Furthermore the CDF is for all practical purposes managed by the area Member of Parliament which defeats the principle of separation of powers envisaged by the constitution. The fund in my considered opinion has no place in the new governance structure but Members of the tenth Parliament have been working tirelessly to retain the fund in some new form. The Constitution does not however prevent the National Assembly from imposing a charge on the Consolidated Fund and Parliament can therefore use this lacuna to devolve more funds as long as Members of Parliament are divorced from its administration. The Constituency Funds Committee has since gone ahead and developed a draft legislation to establish the Constituency Development Fund to be administered under the National Government¹³².

2.5.2 The Roads Maintenance Levy Fund (RMLF)

The new Constitution allocates to the National Government the function of construction and operation of national trunk roads while that relating to county roads is a function allocated to County governments. Therefore the Roads Maintenance Levy Fund cannot continue existing in the form it does today. It shall have to be restructured to conform to the devolved governance structure. This will require review of the legal framework governing existence of the Fund so that the funds that originally went to the levy are divided equitably between the national and county governments.

2.5.3 The Rural Electrification Programme Levy Fund (REPLF)

The new Constitution allocates to each of the two levels of government the function of electricity and gas reticulation and energy regulation. Electricity distribution is therefore a concurrent function which requires action by both governments. The Rural Electrification Program was however targeted at rural areas which had very little or no electricity connection and those areas

¹³² View expressed by Jeremiah Ndombi Senior Legal Counsel, Kenya National Assembly, in an interview on 30th November, 2012

considered economically unviable to connect electricity. The fund in my opinion is therefore targeted at areas which currently fall under the jurisdiction of county governments and should therefore be administered at that level thus requiring a review of the Energy Act, 2006.

2.5.4 The Constituency HIV/AIDS fund, The Constituency Bursary Fund and Constituency Roads Fund

These funds as currently constituted are managed at the Constituency level with the Member of Parliament having a crucial role in their implementation. The Constitution only recognizes two levels of government at which funds are shared. It therefore allows county governments to transfer functions to the lowest level of governance at which the function can be effectively performed. The above funds will in my view have to be abolished and if it is absolutely necessary to retain them, then they should be administered by the County Governments through legislation enacted by county assemblies.

2.5.5 The Local Authority Transfer Fund (LATF)

This fund is currently established by the Local Authority Transfer Fund Act with the object of supplementing financing of services and facilities that local authorities are required by the Local Government Act to provide. The new Constitution has allocated close to 90% of the functions undertaken by the local authorities to county governments. It also provides for the sources of revenue for the counties to include the equitable share of national revenue, conditional and unconditional grants by national government, property taxes, entertainment taxes and fees levied for services rendered. The new Constitution does not therefore envisage that some additional funds will be transferred to county governments from the national government to supplement funds for provision of services. The LATF in my view is therefore abolished under the new constitution and the County governments are at liberty to establish another fund to be distributed to urban areas and cities to perform similar functions like LATF.

2.6 CONCLUSION

In summary, the above framework shows the fragmented system on fiscal devolution that exists, each with different administrative, policy and legal frameworks and reporting systems. The

framework falls short of the five pillars of effective fiscal decentralization discussed above, including; political autonomy, expenditure responsibility, revenue assignment, inter-governmental transfers and sub-national borrowing.¹³³ Only the Local Authority Transfer Fund (LATF), with its numerous challenges affecting its effectiveness, in the above framework can qualify to be a true fiscal decentralization initiative. Kenya thus had an extremely weak fiscal decentralization framework before enactment of the Constitution of Kenya 2010.

The Constitution of Kenya 2010 sought to introduce a new framework which shall be free from the weaknesses of the decentralized funds regime. This framework is analyzed in the next chapter.

¹³³ UNDP (2003), *Fiscal Decentralization and Poverty Reduction*, available at: <http://content.undp.org/go/cms-service/download/publication/?version=live&id=2219894>, (last accessed 20th June, 2012).

CHAPTER THREE: THE FISCAL DECENTRALIZATION FRAMEWORK ENVISAGED BY THE CONSTITUTION OF KENYA 2010

3.1 INTRODUCTION

This chapter sets out the fiscal decentralization framework that is proposed by the Constitution of Kenya, 2010. It then examines the various Acts of Parliament passed in attempt to implement this new framework.

The examination of the constitutional framework evaluates efforts of the country in creating a devolved system of governance. It reveals whether the proposed fiscal decentralization system in Kenya is within the five pillars of effective fiscal decentralization. The analysis of the Acts drafted to implement the new Constitution evaluates whether the Acts implement the system as proposed. It seeks to identify any weaknesses in the implementation of the framework. It also reveals whether the Acts address any gaps that may not have been addressed by the Constitutional framework.

3.2 PILLARS FOR EFFECTIVE FISCAL DECENTRALIZATION

According to existing literature, effective fiscal decentralization is based on five key pillars. The first is political autonomy. It is perhaps the most crucial element of a decentralized system.¹³⁴ If the local leadership is appointed by higher levels of government, their accountability will be upwards and not downward to the local population. This then creates a system where the efficiency gains that are at the heart of decentralization strategies are not being captured.¹³⁵

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 financial resources are being decentralized.¹³⁶ The assignment of functions should be based on “subsidiarity

¹³⁴ USAID (2006), *Fighting Poverty through Fiscal Decentralization*, p. 17, available at: http://pdf.usaid.gov/pdf_docs/PNADH105.pdf, (last accessed 16th January 2012).

¹³⁵ *ibid.*

¹³⁶ *supra*, note 3, p. 3.

principle".¹³⁷ This principle suggests that government functions should be assigned to the lowest level of government that is capable of efficiently undertaking this function.¹³⁸

Third is revenue assignment. It is an established old adage that finances should always follow function. This means that the devolved units should have adequate resources so as to effectively discharge their functions.¹³⁹ 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.¹⁴⁰ 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.¹⁴¹

Fourth is intergovernmental fiscal transfers. The assignment of revenue sources rarely provides devolved units with sufficient revenues to fund their expenditure functions.¹⁴² 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, enhance equity and fairness but take care so as not to be a negative incentive to local revenue mobilization initiatives.¹⁴³

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. Such a framework needs to be balanced so as to curb the tendency of the devolved units overextending themselves into debts which they cannot pay, but also facilitating responsible borrowing among the devolved units.

¹³⁷ *ibid.*

¹³⁸ *ibid.*

¹³⁹ *Ibid.*, p. 4

¹⁴⁰ Roy Bahl (1998), *Implementation Rules for Fiscal Decentralization*, p. 7, available at: siteresources.worldbank.org/INTDSRE/Resources/3p.pdf, (last accessed 18th January 2012).

¹⁴¹ *ibid.*

¹⁴² *supra*, note 3, p. 5.

¹⁴³ *ibid.*

3.3 THE FISCAL DECENTRALIZATION FRAMEWORK CREATED BY THE CONSTITUTION OF KENYA 2010

The Constitution is the supreme law in the Country and it offers the basis of every other law in Kenya.¹⁴⁴ To this extent it should thus form the basis of all laws relating to fiscal decentralization in the country. Due to the shortcomings of the weak fiscal decentralization framework, and the adverse results of the largely centralized system of governance, the constitution review debate was characterized by a strong call and agitation for devolution. As a result of the constitutional review process, Kenyans entrenched devolution in the Constitution of Kenya 2010 (New Constitution), albeit within a unitary system of government.

The New Constitution identifies devolution of power to be one of the values and principles that should guide the Kenyan governance system.¹⁴⁵ Unlike the former constitution¹⁴⁶, the new Constitution defines the public sector as comprising two levels of government: a National Government as well as a level of 47 County Governments.¹⁴⁷ It further describes the national and County Governments to be distinct and interdependent and to conduct their mutual relations on the basis of consultation and cooperation.¹⁴⁸ This is therefore a devolution not based on the principle of absolute autonomy but instead, on inter-dependence and cooperation. It is a cooperative system of devolved government.

Since devolution is a type of decentralization,¹⁴⁹ the foregoing clearly shows that Kenya has adopted a decentralized form of governance. Such decentralized forms of governance have to be backed by effective fiscal decentralization frameworks. The constitution sets out to create such a framework.

¹⁴⁴ Article 2 of the Constitution of Kenya, 2010

¹⁴⁵ Article 10 of the Constitution of Kenya, 2010

¹⁴⁶ The previous Constitution defined Kenya's public sector as quite centralized, with a vertically deconcentrated territorial-administrative system at the provincial and district levels. It is also noteworthy that although the previous Constitution did not specifically recognize 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.

¹⁴⁷ See Chapter 11 of the Constitution and the First Schedule to the Constitution. County Governments are established under Article 176.

¹⁴⁸ Article 6(2)

¹⁴⁹ Yuliani Elizabeth Linda (2010), *Decentralization, Deconcentration and Devolution: What Do They Mean?* Available at: http://www.cifor.org/publications/pdf_files/interlaken/Compilation.pdf, (last accessed 20th June 2012).

This study assesses the constitutional framework based on the five pillars of an effective fiscal decentralization framework discussed above, namely; political autonomy, expenditure responsibility, revenue assignment, inter-governmental transfers and sub-national borrowing.

On the first pillar of political autonomy, the New 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 National Government and therefore not subject to the control of the National Government. The County Government is made up of a County Assembly (CA) and the County Executive Committee (CEC),¹⁵⁰ the assembly's composition being listed in Article 177 while the CEC is elaborated upon in Article 179. This is akin to the County Government having its own 'cabinet' and 'parliament.'¹⁵¹ Politically, the National Government is only to enact policy and let the counties implement the policies, autonomously and with discretion on means of implementation.

The National Government is headed by the President, who is the Head of State and Government, assisted by the Deputy President and Cabinet Secretaries.¹⁵² The head of the County Government is to be elected as a Governor, assisted by the Deputy Governor and the CEC.¹⁵³ Both the election of the President and the Governors shall be held on the same day as the general election of Members of Parliament, being the second Tuesday in August, in every fifth year.¹⁵⁴ With the governor having a mandate directly from the people, he shall be independent from any influence by the President, and only accountable to the electorate that elected him. 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 under the recommendation of an independent Commission of Inquiry.¹⁵⁵ Even if he uses his discretion to

¹⁵⁰ See Article 176, read together with the First Schedule.

¹⁵¹ View expressed by Onesmus Kipchumba Murkomen, an expert on fiscal decentralization, during an interview on 12th August, 2012.

¹⁵² See Articles 131(1)(a) and (b).

¹⁵³ 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.

¹⁵⁴ Article 136(2)(a) provides for election of the President while Article 180 provides for election of Governor.

¹⁵⁵ Article 192(2)

appoint a partial commission of inquiry which comes up with a biased opinion to suspend the County Government, there is further safeguard in the fact that the Senate must approve the suspension.¹⁵⁶ The Senate may terminate that suspension any time,¹⁵⁷ granting more powers on the decision to suspend the County Government to the senate, not the President.

Further, the New Constitution demands that the County Governments reflect the principle of separation of powers.¹⁵⁸ This shall be accomplished through the elected county assembly holding the Governor and the CEC to account in the same manner that parliament holds the President and Cabinet to account. With reference to the NG, 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. That shows clear separation of power both within the County Government and between the County Government and NG.

The above provisions establish two levels of government separate and distinct from each other. It grants the County Government political autonomy by not making them directly answerable to the National Government. To curb the possible disharmony that may arise with complete autonomy, the Constitution demands for interdependence and co-operation, by providing that the two governments should conduct their mutual relations on the basis of consultations and cooperation.¹⁵⁹ For instance, these two levels of government shall co-operate in the process of preparing plans and budgets. This shall entail the NG allocating the funds through Division of Revenue Bill and the County Governments prepare and adopt their own annual Budget and Appropriation Bills on how to spend the money.¹⁶⁰ Secondly, they are required to cooperate in setting up joint committees and joint authorities to provide concurrent functions.¹⁶¹ They also cooperate in implementing the legislation of the other level of government.¹⁶² The constitutional framework thus meets the threshold of political autonomy, a key pillar of effective decentralization.

¹⁵⁶ *ibid.*

¹⁵⁷ Article 192(4)

¹⁵⁸ See Article 175(a).

¹⁵⁹ Article 6(2) of the Constitution of Kenya, 2010.

¹⁶⁰ Article 218 and 224.

¹⁶¹ Article 189(2)

¹⁶² Article 189(1)(b)

The second pillar of effective decentralization is expenditure responsibility. This entails sharing of functions between the two levels of government, within the principle of subsidiarity. The division of functions and powers between the National Government and the County Governments is set out in the fourth schedule.¹⁶³

The National Government 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.¹⁶⁴ 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.¹⁶⁵ To further strengthen the subsidiarity principle, the New Constitution allows for voluntary transfer of functions or powers of government from one level to a government at the other level by agreement between the governments. This should only happen if the function or power would be more effectively performed or exercised by the receiving government, and no law prohibits such a transfer.¹⁶⁶ 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 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.¹⁶⁷

However, there may be overlaps in these functions between the two levels of government. For instance, National Government is granted control of national betting, casinos and other forms of gambling, whereas the County Governments are also granted control over betting, casinos and other forms of gambling. This may cause conflicts in determining national casinos and county casinos. Similarly, the National Government is in charge of promotion of sports and sports education with the County Governments also being in charge of sports and cultural activities and

¹⁶³ Article 186 of the Constitution of Kenya, 2010

¹⁶⁴ For detailed list of functions, see part 1 of the Fourth Schedule to the Constitution.

¹⁶⁵ For detailed list of functions, see part 2 of the Fourth Schedule to the Constitution.

¹⁶⁶ Article 187

¹⁶⁷ *ibid.*

facilities. This may cause conflicts over management of stadia already under the Stadia Management Board. Further, it places the 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 National Governments have 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 attempt to ensure County Governments are not given functions which they cannot perform.¹⁶⁸ The NG may use this window to set onerous conditions that leaves it in charge of key functions of County Governments. In addition, there lacks clear statistics on the amounts of money needed to meet the expenditure assignments of the County Governments. There is also real danger that the National Government may undermine fiscal decentralization 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 National Government. Parliament is further empowered to clarify any function through legislation.¹⁶⁹ 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.¹⁷⁰ 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

¹⁶⁸ Transitional And Consequential Provisions, Sixth Schedule, Section 15(1).

¹⁶⁹ Article 186

¹⁷⁰ See Sections 4 and 5 of the Sixth Schedule; Transitional and Consequential Provisions.

Constitution, including failure by the central government to transfer functions or funds. The NG however retains the discretion of setting onerous conditions, which it can justify have not been met hence the failure to transfer the function and funds. With the real threat of overlaps and NGs failure to transfer some functions hanging over the fiscal decentralized system, the constitutional framework is weak on the pillar of expenditure responsibility.¹⁷¹

The third pillar of fiscal decentralization is revenue assignment. This has four elements including: taxation powers, budget making autonomy, transparency and a hard budget constraint. An effective fiscal decentralized system should develop structures that entrench the above elements in both levels of government. The New Constitution creates such a framework.

The first element is taxation powers. The Constitution shares 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 National Government (NG).¹⁷² On the other hand, a County Government may impose property rates and entertainment taxes.¹⁷³ Parliament is authorized to allow levying of other taxes by both levels of government but cannot take away the taxation powers of the County Government.¹⁷⁴ Both the National and County Governments are constitutionally empowered to impose charges for the services they provide.¹⁷⁵ These would include charges for services like railways and pipeline for the National Government and ambulance, housing and water for County Government. Other sources of revenue for the County Government besides taxation revenues include; an equitable share of national revenues,¹⁷⁶ conditional or unconditional grants from the government¹⁷⁷ and also proceeds from borrowing.¹⁷⁸ 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

¹⁷¹ Angeline Hongo, Member of the Transition Authority concurs with this view. This was expressed during an in-depth interview on 13th August, 2012.

¹⁷² Article 209(1)

¹⁷³ Article 209(2).

¹⁷⁴ Articles 209(2) and 209(3)(c).

¹⁷⁵ Article 209(4)

¹⁷⁶ Article 204

¹⁷⁷ Article 202

¹⁷⁸ Article 212

that were plugged through direct transfers from National Government via 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 National Government requires the Cabinet Secretary responsible for finance to submit to the National Assembly estimates of the revenue and expenditure of the National Government 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 Parliamentary Service Commission.¹⁷⁹ The Budget Committee of the National Assembly first discusses and reviews the estimates, seeking and considering representations from the public, before making recommendations to the Assembly. The National Assembly then also considers and approves the estimates, which are then included in an Appropriation Bill, which shall be introduced into the National Assembly to authorize 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.¹⁸⁰

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 National Government 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 level of government. These two bills should be introduced in Parliament two months before the end of each financial year.¹⁸¹ It is on the basis of the two bills that each County Government shall then go ahead to prepare and adopt its own annual Budget and Appropriation Bill, authorizing 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.¹⁸² The above budgeting processes of each government are independent of each other, enhancing attainment of revenue assignment pillar.

¹⁷⁹ Article 221

¹⁸⁰ The budget process for national assembly is well captured in Articles 221 and 222.

¹⁸¹ Article 218 of the Constitution

¹⁸² Article 224 of the Constitution

The third element of this pillar is transparency. The constitution entrenches transparency in decentralization and expenditure of the decentralized funds. It achieves this in two ways. Firstly, it lays out the principles of public finance to include openness, accountability and public participation. They also include promotion of an equitable society with fair taxation burdens and revenue sharing towards equitable development.¹⁸³ These principles if implemented would entrench transparency in management of resources in both levels of government. Secondly, it establishes the office of the Auditor General,¹⁸⁴ who audits and reports on the accounts of the national and County Governments¹⁸⁵ including accounts of all their funds and authorities¹⁸⁶ The audit report should confirm whether or not public money has been applied lawfully and in an effective way,¹⁸⁷ and should be tabled before Parliament or the relevant county assembly,¹⁸⁸ which should within three months debate and consider the report and take appropriate action.¹⁸⁹ With Parliamentary and 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.¹⁹⁰ This officer has the role of authorizing withdrawals from all public funds; including Consolidated Fund, County Revenue Fund and the Equalization Fund.¹⁹¹ The Controller of Budget is required to only approve withdrawals that are authorized by law.¹⁹² He further oversees the implementation of the budgets of the National and County Governments,¹⁹³ and makes quarterly reports on implementation of the two budgets to both houses of Parliament.¹⁹⁴ His role can thus be summarized 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.

¹⁸³ Article 201 of the Constitution.

¹⁸⁴ Article 229

¹⁸⁵ Article 229(4)(a)

¹⁸⁶ Article 229(4)(b)

¹⁸⁷ Article 229(6)

¹⁸⁸ Article 229(7)

¹⁸⁹ Article 229(8)

¹⁹⁰ Article 228.

¹⁹¹ This is under Articles 204, 206 and 207, read together with article 228(6).

¹⁹² Article 228(5)

¹⁹³ Article 228(4)

¹⁹⁴ Article 228(6)

secondly, the constitution espouses the principle that public funds must be spent in a prudent and responsible way.¹⁹⁵ 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 way.¹⁹⁶ 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 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 own revenues, undermining attainment of revenue assignment, a key pillar of effective decentralization.

The fourth pillar of fiscal decentralization is intergovernmental fiscal transfers. This entails creating a framework of transferring funds from the National Governments 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 mobilization 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 Constitution establishes the Commission on Revenue Allocation (CRA),¹⁹⁷ with the crucial function of recommending the basis of sharing revenues between the National and County Governments. In this undertaking, 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 optimization, stability and predictability of allocations and flexibility in responding to emergencies.¹⁹⁸ The CRA should further consider the need to ensure that County Governments are able to perform the functions

¹⁹⁵ Article 201(d).

¹⁹⁶ Article 227(1) of the Constitution.

¹⁹⁷ Article 215.

¹⁹⁸ The considerations are well elaborated in Article 203.

allocated to them, which emphasizes on service delivery.¹⁹⁹ The constitution also emphasizes the need for economic optimization of each county and provision of incentives for each county to optimize its capacity to raise revenue,²⁰⁰ which ensures the transfers do not act as negative incentives to local resource mobilization.

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 them²⁰¹ and affirmative action in respect of disadvantaged areas and groups²⁰² 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 Equalization Fund is established consisting of 0.5 per cent of all revenue collected by the National Government each year.²⁰³ This fund is to be used for providing, "basic services including water, roads, health facilities and electricity to marginalized 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."²⁰⁴ The National government is also allowed to utilize the Equalization fund through conditional grants to counties with marginalized communities.²⁰⁵

In addition, County Governments may be given additional allocations from the National Government's share of the revenue, either conditionally or unconditionally.²⁰⁶ This allows the National Government leeway to directly participate in development activities in the counties through direct intergovernmental fiscal transfers. Finally, the New Constitution allows the National government to transfer some of its functions and powers to the County Government

¹⁹⁹ Article 203(d)

²⁰⁰ Article 203(i)

²⁰¹ Article 203(g)

²⁰² Article 203(h)

²⁰³ Article 204

²⁰⁴ Article 204(2)

²⁰⁵ Article 204(3)(b)

²⁰⁶ Article 202(2)

through agreement, but also ensure transfer of resources necessary for the performance of the function or exercise of the power.²⁰⁷

The above is a clear framework for inter-governmental funds transfer. It allows the National Government to use intergovernmental transfers for three purposes. First is to assure revenue adequacy for County Governments, second to compensate County Governments for complying with its mandates through conditionalities in optional grants, and third is for implementing National Government programmes that are delegated to the counties.

The only weakness in such a system would be delays and deliberate withholding by the National Government of funds meant for County Governments. In recognizing that the National Government may undermine fiscal decentralization through delays and refusals to transfer funds, the constitution requires National Government to transfer county dues “without undue delay and without deduction...”²⁰⁸ This enhances efficacy of the intergovernmental transfer system. The constitutional framework for inter-governmental transfers thus passes the threshold of a proper inter-governmental transfer system, a major pillar in effective fiscal decentralization.

The final pillar of effective decentralization is sub-national borrowing. This entails creation of a framework for borrowing and issuing bonds 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 New Constitution allows the County Governments to borrow with the approval of their respective County Assemblies and the National Government.²⁰⁹ However, it does not fully stipulate the conditions that the County Governments must satisfy while undertaking any borrowing of funds. The only conditions are that the loan must be guaranteed by the National Government and that it must be approved by the County Assembly.²¹⁰ The requirement of National Government guarantee checks on the tendency of County Governments to over-borrow

²⁰⁷ Article 187

²⁰⁸ Article 219

²⁰⁹ See Article 212 for borrowing by County Governments.

²¹⁰ Article 212(a) and (b)

which could put them in financial constraint and whose ripple effect could be the fiscal and macroeconomic instability of the whole country. It also allows the National Government, 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 New Constitution include the provision that burdens and benefits of public borrowing should be shared equitably between present and future generations.²¹¹ Further, County Government budgets should contain proposals regarding borrowing and other forms of public liability that will increase public debt during the following year,²¹² 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 an Act is empowered to prescribe terms and conditions under which the national government may guarantee loans. This window may be used to place stringent and onerous 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 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 for sub-national borrowing, a key pillar for effective fiscal decentralization framework.

The foregoing discussion on the Constitution of Kenya 2010 points to the fact that the constitution establishes what has the hallmarks of an effective fiscal decentralization framework. It is however not devoid of glaring weaknesses that need to be corrected through amendments and strong statutory enactments. It remains to be seen whether the system envisaged in the constitution shall be fully implemented. That entails enacting Acts of Parliament that elaborate and seal gaps and loopholes in the system to ensure full effectiveness of the envisaged system.

²¹¹ Article 201(c)

²¹² Article 220(1)(c)

The question of whether the Acts of Parliament enacted so far implement this system envisaged shall be addressed in the following section.

3.4 THE VARIOUS IMPLEMENTING ACTS OF PARLIAMENT ENACTED BY OCTOBER 2012

There are several Acts of Parliament which have been enacted so far in an attempt to implement the fiscal decentralization framework envisaged in the New Constitution. These are discussed below.

The Commission on Revenue Allocation Act has been enacted.²¹³ The Act makes further provision as to the functions and powers of the Commission on Revenue Allocation (CRA). It elaborates the functions of the CRA as being to make recommendations for consideration by Parliament prior to any Bill appropriating money out of the Equalization Fund being passed in Parliament and upon request from the Senate, make recommendations on the basis for allocating among the counties the share of national revenue that is annually allocated to the county levels of government.²¹⁴

For successful fiscal decentralization, funds in addition to functions must be allocated to devolved units. Proper fiscal decentralization is only achieved if decisions on amount of funds to devolve and mode of distributing these funds are not left to the discretion of the National Government. CRA, being an independent commission with guaranteed status from the Constitution, plays the role of an independent arbiter in recommending mode of distribution and the amounts to be devolved to the counties. The National Assembly and the Senate are required to act on the recommendations made by the CRA, and not merely ignore them, making it a key body in implementation of fiscal decentralization.²¹⁵ One initial weakness in the Act was the stipulation that the chairperson and members of the Commission serve on a part-time basis.²¹⁶

²¹³ See *The Commission on Revenue Allocation Act, 2011*, available at: <http://www.crakenya.org/cra-download/docs/CRA-Act-2.pdf>, (last accessed 20th June 2012). Bill passed by the National Assembly on the 26th August, 2011, date of Assent: 27th August, 2011.

²¹⁴ Section 10 (1) of the Act.

²¹⁵ Section 10(3) of the Act.

²¹⁶ Section 5(2) in the initial Act.

However, this has since been amended, allowing some commissioners to serve on full-time basis.²¹⁷ This Act, by operationalizing CRA, helps implement revenue assignment, a key pillar in effective fiscal decentralization frameworks.

Transition to Devolved Governments Act, 2012 is another legislation that has been enacted,²¹⁸ establishing a framework for handling the transition to County Governments. The Act establishes the Transition Authority (TA),²¹⁹ which shall play a key role in developing a framework that will usher in County Governments. The authority has fifteen functions.²²⁰ It shall facilitate the analysis and the phased transfer of the functions provided for in the 4th schedule to the Constitution to both the national and County Governments, determine the resource requirements for each of the functions; and develop a framework for the comprehensive and effective transfer of functions as provided for in section 15 of the 6th schedule to the Constitution. Further, it shall coordinate with relevant state organs and other public bodies to facilitate development of transitional budget for County Governments, prepare and validate an inventory of all the existing assets and liabilities of government, public entities and local authorities, make recommendations for effective management of assets of the national and County Governments and provide for mechanisms for effective transfer and vetting of the transfer of assets during the transition period.

Moreover, it shall provide for criteria for phased or asymmetrical transfer of functions to County Governments including transfer of previously shared assets, liabilities and staff of the government and local authorities, undertake an audit of the existing human resources of the government and local authorities, assess the capacity needs of the national and County Governments, make recommendations to ensure national and County Governments have adequate capacity during the transition period to undertake the respective functions, coordinate and facilitate provision of support and assistance to County Governments in building their capacity to effectively provide services. Finally, it shall also advise on the effective and efficient

²¹⁷ Amended through the Statute Law (Miscellaneous Amendments) Act, 2012.

²¹⁸ See *The Transition to Devolved Government Act, 2012*, No. 1 of 2012, available at: <http://www.kenyalaw.org/klr/fileadmin/pdfdownloads/Acts/TransitiontoDevolvedGovernmentActNo1of2012.doc>, (last accessed 20th June 2012). Date of assent: 27th February 2012, date of Commencement: 9th March, 2012.

²¹⁹ Section 4(1)

²²⁰ These functions are laid out in Section 7.

rationalization and deployment of human resource to both levels of government, provide monthly reports to the Commission on Implementation of the Constitution (CIC) and the Commission on Revenue Allocation (CRA) on the progress in the implementation of the transition to the devolved system of government and perform any other statutory function as may be assigned.

The challenge that the authority faces is the short timeline for achieving the above functions. The transition period is defined as the period between commencement of the Act and three years after the first elections under the New Constitution.²²¹ This is a very short period of time to accomplish enormous tasks. The second challenge is lack of clarity in human resource transfers between both levels of government and also from local authorities to County Governments. It may adopt a wholesale adoption of all existing local authority staff into the County Governments, but that shall create a bloated wage bill for the County even before it starts operations. This is made worse by multiplicity of local authorities within some Counties. Further, its function is to advice. It is not clear whether its advice shall be binding on the County Public Service Commission, the ultimate employer of all civil servants in the County. This may undermine its role in transfer of human resource.

Members of this Authority are insulated from external pressures and influence by granting them security of tenure.²²² The members can only be removed by petition to the National Assembly setting out the alleged facts constituting: violation of the Constitution or any other law; gross misconduct, whether in the performance of the member's or office holder's functions or otherwise; physical or mental incapacity to perform the functions of office; incompetence or neglect of duty; or bankruptcy.²²³ The National Assembly is then to forward the petition to the president if it discloses valid grounds. The president is required to appoint a tribunal to investigate the claims, and the recommendations of the tribunal are binding on the president. This security of tenure may secure independence of thoughts and actions for the members of this Authority.

²²¹ Section 2 of the Act.

²²² Section 12 of the Act

²²³ Section 12(1), Transition to Devolved Governments Act.

The TA has powers to decline to transfer a function to a County Government, but assist in capacity building with a view to a future transfer.²²⁴ A County Government may only appeal against such a decision to the Senate, which shall decide on the appeal by majority vote in accordance with Article 123 of the Constitution. By granting it discretion to determine transfer of functions, it gives it a major role in determining expenditure assignment, a key pillar for effective fiscal decentralization.

Further, the Authority is required in every three months to submit a progress report to the President, Parliament, the Commission on Implementation of the Constitution and Commission on Revenue Allocation. This progress report should present the status on transfer of functions to County Governments, any impediments to the transition programme and recommendations to address specific concerns identified by the Authority.²²⁵ This is a useful tool for the Authority to influence policy decisions in the transition process. However, the law does not make their recommendations binding in any way.

Its role in determining transfer of functions and facilitation in developing transitional budgets for County Governments make it a crucial body in achievement of the fiscal decentralization framework under the new Constitution. On 18th June 2012, the President in consultation with the Prime Minister appointed the chairman and members to this Authority.²²⁶ These were sworn into office on 3rd July, 2012.²²⁷ However, its roles have already been usurped by various government agencies. For instance, it is empowered to facilitate the development of the budget for County Governments during Phase One of the transition period. In the 2012-13 Budget Policy statement by the Ministry of Finance, the Treasury allocated Sh148 billion for devolution and setting up of

²²⁴ Section 23, Transition to Devolved Governments Act.

²²⁵ Section 25, Transition to Devolved Governments Act.

²²⁶ See State House Kenya (2012), *President Kibaki Appoints Members of Transition Authority*, available at: <http://www.statehousekenya.go.ke/news/june2012/2012180601.htm>, (last accessed 20th June 2012). The chairman appointed is Mr. Kinuthia Mwangi Wamwangi. The members are; Angeline Awino Hongo, Safia Abdi, Mary Mwangeli Ndeti, Jacqueline Akhalemesi Mogeni, Erastus B. I. Nyaga Rweria, Simeon Pkatey Pkiyach, Bakari Garise Omara and Dabar Abdi Maalim.

²²⁷ Capital News (July 3, 2012), *County Transition Authority Assumes Office*, available at: <http://www.capitalfm.co.ke/news/2012/07/county-transition-authority-assumes-office>, (last accessed 6th October, 2012).

County Governments, including provision for setting up county offices where necessary.²²⁸ The Ministry of Public Works had unilaterally invited tenders for design of the county headquarters without input from the Transition Authority. It is only after public outcry and protest from CIC that the government has shelved the plans to proceed with the construction.²²⁹ The Transition Authority had not been established when these discussions were ongoing and funds for this purpose were not factored in the budget estimates of the financial year 2012/2013. Further, it is the function of the TA to develop a framework for the comprehensive and effective transfer of functions under the Constitution. In disregard of this, the Ministry of Health is undertaking a major reclassification of provincial and district hospitals to national referral hospitals.²³⁰ This is a clear ploy to take away some hospitals from control of the County Governments and force them to build health infrastructure from scratch which will create a vacuum in health provision in the transition period. The Ministry of State for Provincial Administration also appointed officers designated as County Commissioners and deployed them to the counties. It is not clear what function these officers are performing at the county level as the provincial administration which is expected to be restructured to conform to the devolved structure still exists in its original form.

The TA is also taking a long time to embark on its mandate. With only 5 months to the election, it is yet to commence taking inventory of all the existing assets and liabilities of government, other public entities and local authorities. It has not yet determined the resource requirements for each of the functions to be transferred between the two levels of government. Despite the above failures, this body is critical in implementing division of expenditure responsibilities, a key pillar for effective fiscal decentralization. A successful delivery of its mandate will thus go a long way in implementing fiscal decentralization in Kenya.

²²⁸ The Standard (June 15, 2012), *Kenya's Sh1.45 Trillion Expansive Budget*, available at: <http://www.standardmedia.co.ke/index.php/mag/videos/?articleID=2000059886&pageNo=2>, (last accessed 6th October, 2012).

²²⁹ The Standard (September 11, 2012), *Construction of County Offices Postponed*, available at: http://www.standardmedia.co.ke/?articleID=2000065908&story_title=Kenya:%20Construction%20of%20county%20offices%20postponed, (last accessed 6th October, 2012).

²³⁰ The Star (17th August, 2011), *Fifteen Hospitals Set for Referral Status*, available at: <http://allafrica.com/stories/201108180113.html>, (last accessed 6th October, 2012).

Parliament has also enacted the Intergovernmental Relations Act, 2012.²³¹ The Act sets out a framework for consultation and cooperation between the National and County Governments as well as, between County Governments. The Act also provides for the resolution of intergovernmental disputes pursuant to Articles 6 and 189 of the Constitution. It creates three institutions charged with the above functions.

First, it creates the National and County Government Coordinating Summit, comprising of the president and the governors of the 47 counties.²³² Among its functions, is to co-ordinate and harmonize the development of county and National Government policies and facilitate and co-ordinate the transfer of functions, power or competencies from and to either level of government.²³³ These functions overlap with those of the Transition Authority (TA) and CIC, making it a superfluous body. It will therefore be effective in dispute resolution and harmonization of policies and development priorities among the two levels of government. Since the Summit consists of the political heads of both levels of government, it may also assist to foster and maintain political stability for proper implementation of fiscal decentralization.

Second, it establishes the Council of County Governors, consisting of the Governors of the forty-seven counties.²³⁴ The Council has nine functions.²³⁵ The function that links the Council to implementation of fiscal devolution is dispute resolution between counties,²³⁶ considering matters of common interest to County Governments²³⁷ and monitoring of the implementation of inter-county agreements on inter-county projects.²³⁸ Fiscal decentralization encourages consultative development, and this Council shall facilitate such consultations leading to joint projects among different devolved units. It will also play an oversight role in implementation of such projects. In case of any disputes arising from such joint initiatives, this body is best placed

²³¹ See *The Intergovernmental Relations Act, 2012*, Act No. 2, of 2012, available at: <http://www.kenyalaw.org/klr/fileadmin/pdfdownloads/Acts/IntergovernmentalRelationActNo2of2012.doc>, (last accessed 20th June 2012). The Act was passed by the National Assembly on the 23rd February, 2012, Assented to by the President on 27th February, 2012 and shall come into operation upon the final announcement of the results of the first elections under the Constitution.

²³² *ibid*, Section 7.

²³³ *ibid*, Sections 8(j) and (k).

²³⁴ *ibid*, Section 19.

²³⁵ *ibid*, Section 20.

²³⁶ *ibid*, Section 20(d).

²³⁷ *ibid*, Section 20 (i)(c).

²³⁸ *ibid*, Section 20(f).

to deal with the disputes. It may also be helpful in addressing disputes arising from intra-county sharing of revenues. For the income generating public amenities that traverse more than one county, the Council shall be crucial in addressing the potentially explosive issue of how to share revenues from such public amenities among the affected Counties. The Council is thus helpful in implementing the revenue assignment and expenditure responsibility, as pillars of effective fiscal decentralization.

Third, the Act establishes the Intergovernmental Relations Technical Committee (IRTC) to offer administrative support to the summit and the council. This Committee shall take over the functions of the Transition Authority upon its dissolution, after three years.²³⁹ With the CIC also being dissolved after five years²⁴⁰ the Committee shall remain to be the pivotal body to coordinate transfer of functions and smooth working among the various levels of government. It shall also monitor implementation of agreements to transfer functions signed by the two governments. Finally, it is the implementing agency of the decisions of the Summit and of the Council. The Summit and the Council are bound to make decisions that shall have an impact on implementation of fiscal decentralization. It is thus a key body in implementing fiscal decentralization.

The Act encourages the two levels of government to set up alternative dispute resolution mechanisms through agreement.²⁴¹ Should these mechanisms fail, the matters should be referred to the Council of County Governors. Failure of resolution at this level would then invoke indulgence of the National and County Government Coordinating Summit.²⁴² The functions of the Council specifically include dispute resolution between counties.²⁴³ It is when these organs fail that the parties can now seek arbitration, with the alternative of instituting formal judicial proceedings.²⁴⁴ Implementation of fiscal decentralization is bound to generate disputes as to allocation of funds, transfer of functions, territorial jurisdiction and similar matters. Resolution of disputes on funds allocation help facilitate smooth intergovernmental fiscal transfers while

²³⁹ Section 12 of the Intergovernmental Relations Act.

²⁴⁰ Sixth Schedule, Section 5(7), Constitution of Kenya, 2010.

²⁴¹ The whole Part IV of the of the Intergovernmental Relations Act deals with Dispute Resolution Mechanisms. See specifically Section 32 of the Act.

²⁴² Section 33(2)

²⁴³ Section 20 (1)(d)

²⁴⁴ Section 35.

solving of disputes on transfer of functions would also implement expenditure allocation; key pillars of an effective fiscal decentralization framework. The setting up of dispute resolution mechanisms that are not adversarial, but consultative is thus key to ensuring smooth implementation of the devolved structure. The Council and the Summit are part of the non-adversarial dispute resolution process and as such, are key components in implementation of fiscal devolution.

The other law enacted so far is the Urban Areas and Cities Act 2011.²⁴⁵ This Act provides for classification of areas into cities, municipalities and towns. It vests the management of a city and municipality in the County Government.²⁴⁶ It allows for establishment of boards of cities and municipalities, to manage such areas on behalf of the County Governments.²⁴⁷ For towns, a committee appointed by the county governor and approved by the county assembly is to play management roles.²⁴⁸ The County Public Service Board is also allowed to appoint a city or municipal manager,²⁴⁹ and administrator for towns.²⁵⁰ This sets the pace for units of further devolution below counties.

The boards and committees play roles that are vital in implementing fiscal devolution.²⁵¹ Among them are; developing budgets for their areas through a consultative process, formulating and implementing an integrated development plan, controlling land use, land sub-division, land development and zoning by public and private sectors for any purpose, undertaking infrastructural development and services within their jurisdictions, entering into contracts, partnerships or joint ventures for performance of their functions, collecting rates, taxes levies, duties, fees and surcharges on fees as may be delegated by the County Government, implementing tariff, rates and tax and debt collection policies as delegated by the County Government and finally general delivery of services within their jurisdictions.

²⁴⁵ See *The Urban Areas and Cities Act, 2011*, Act No. 13 of 2011, available at: http://cickenya.org/sites/default/files/Acts/Urban%20Areas%20and%20Cities%20Act%2C%202011_0.pdf, (last accessed 20th June 2012). The Act was assented to on 27th August, 2011 and fully commences after the first elections held under the Constitution.

²⁴⁶ Section 12

²⁴⁷ Section 13 and 14.

²⁴⁸ Section 20(2)

²⁴⁹ Section 28, 29 and 30 of the Act.

²⁵⁰ Section 31.

²⁵¹ The functions are laid out in Section 20 of the Act.

These boards thus perform major functions of the County Governments within their areas of jurisdiction. Moreover, they are specifically identified as units of further devolution in the county by the County Governments Act, 2012.²⁵² With the counties being vast and with differentiated requirements between urban and rural areas, these units shall ensure effective fiscal decentralization within urban areas. The Act enhances the political autonomy of counties and implements proportional expenditure responsibility, making the urban areas and cities key bodies in implementing an effective fiscal decentralization framework as envisaged in the New Constitution.

The County Governments Act, 2012 has also been enacted.²⁵³ The Act seeks to create an efficient and effective framework for realization of the County Governments in terms of the county executive, legislature and related matters.²⁵⁴ Key sections of the Act discussed below attempt to implement fiscal decentralization envisaged in the Constitution..

The Act elaborates on the roles of the county assembly to include; approving the budget and, expenditure of the County Government and approving the borrowing by the County Government.²⁵⁵ Further, the assembly is empowered to consider and pass a money Bill dealing with; imposition and collection of taxes; imposition and collection of charges; appropriation, receipt, custody, investment or issue of public money and the raising, or guaranteeing of any loan or its repayment.²⁵⁶ This amounts to empowering the County Government to make decisions on spending of monies allocated to it and also to lay strategies on raising of monies to spend,

²⁵² See Section 48 of the County Governments Act, 2012.

²⁵³ See *County Governments Act, 2012*, available at <http://cickenya.org/sites/default/files/Acts/County-Government-Act-2012.pdf>, (last accessed 20th September, 2012). The bill was first passed by Parliament on Thursday 23rd February, 2012. However, on Monday February 27, 2012, President Mwai Kibaki declined to sign it into law on grounds that sections of it violated the constitution. The president consequently wrote to national assembly speaker Hon. Kenneth Marende, asking MPs to reconsider three areas that in his view attack the relationship between the national government and county governments. MPs revisited the Bill and the new clause which the President had said was infringing on the provisions of Article 6(2) and (3) of the Constitution was deleted as advised by the President. The amended bill was passed by Parliament on 19th June, 2012 and finally assented to by the President on 24th July 2012.

²⁵⁴ See the Pre-amble of the Act.

²⁵⁵ See Section 8 of the Act.

²⁵⁶ See Section 21(4) of the Act.

including through borrowing. If this is implemented to the latter, it allows for political autonomy, expenditure assignment and sub-national borrowing, a sign of effective fiscal decentralization.

The study opines that fiscal decentralization involves not only employment of staff at the devolved unit level, but also ceding significant control powers for the staff to establish structures within the devolved unit. A mere deconcentration by seconding National Government staff to devolved units would not meet thresholds for fiscal decentralization. The County Governments Act, 2012 attempts to implement this by providing for operationalization of the County public service. The Act empowers the county executive committee to determine the organization of the county and its various departments.²⁵⁷ To ensure effective achievement of this function, the Act creates the County Public Service Board²⁵⁸ headed by a County Secretary²⁵⁹ who shall on behalf of the executive committee coordinate the delivery of human resource functions in counties including;²⁶⁰ creation and abolition of offices, recruitment, selection, appointments and promotions, disciplinary control, removal, and related matters. The civil service structure is split into departments headed by County Chief Officers appointed by the Governor with the approval of the county assembly.²⁶¹

The above structure ensures that the county employees are under the control and direction of the county executive committee, enhancing independence from the National Government. This independence may help in developing and implementing policies that are geared towards addressing unique needs of the locals in the counties. To enhance performance, the county executive committee is empowered to design a performance management plan to evaluate these officers. By holding the county civil servants accountable to the County organs, it enhances political autonomy, a pillar of effective fiscal decentralization.

The County Governments Act also adopts a consultative approach to budgeting, so as to harmonize county and national priorities. The county is required to prepare its budgets in

²⁵⁷ Section 46

²⁵⁸ Established by section 56 of the Act

²⁵⁹ Designated as head of County Public Service by Sections 56(2) and 44(3)(a). The secretary is appointed by the Governor under section 44 of the Act.

²⁶⁰ These functions are set out in section 59 of the Act.

²⁶¹ Section 45 of the Act.

lee-way for the National Government to give loans to the County Governments, on the security of the County Revenue Fund.

The Cabinet Secretary responsible for matters relating to finance is empowered to guarantee loans on behalf of the National Government.²⁷⁰ However, in granting the guarantee, the secretary is restricted by five main conditions.²⁷¹ First, the loan should be for a capital project that is revenue generating, with viability of self- servicing the loan repayments. Second, the County Government should in any case be capable of repaying the loan, interest and other amounts payable. Third, the County Government should have a sound and satisfactory medium term financial position. Fourth, the guarantee should be within the fiscal and financial objectives of the National Government. Finally, the loan should not exceed limits set by parliament from time to time. Further, the Cabinet Secretary is required to inform parliament within two weeks of the guarantee.²⁷² Further, any repayment that the National Government may be forced to repay as a guarantor due to default by the borrower becomes a debt due to the National Government from the County Government.²⁷³

Since the government is rated to be reliable in repaying of debts, its guarantee to County Governments will enable them borrow funds for development. The development needs of the counties are expected to be more than the available funds, creating a situation where budget deficits would be inevitable. These can be financed through a system of responsible borrowing for infrastructure projects so as to fully harness the benefits of devolved governance. This will accelerate achievement of the benefits of fiscal devolution. The Public Financial Management Act thus sets up a framework for effective county borrowing, which is critical for implementing an effective fiscal decentralization framework as envisaged in the New Constitution.

However, there is a missing link in issuance of guarantees. There are no provisions allowing a County Government to petition Parliament for a review of the Cabinet Secretary's decision to decline a request by a County Government to guarantee a loan. This may make the guarantee

⁷⁰ *ibid*, Section 58.

⁷¹ These conditions are elaborated in Section 58 of the Act.

⁷² Section 32(1) of the Act.

⁷³ Section 142 of Act.

system a tool of manipulation, patronage and facilitating skewed development, where only specific counties viewed favourably by the National Government shall be able to borrow.

Secondly, successful fiscal decentralization involves ceding control of development funds to a devolved body. The Act cedes control of county funds to the County Treasury comprising of; the County Executive Committee member in charge of Finance as the head of the Treasury, the Chief Officer in charge of Finance and department(s) of the County Treasury responsible for financial and fiscal matters.²⁷⁴ The County Treasury is a powerful organ with powers to investigate financial affairs of county entities²⁷⁵ and even withhold funds to any County Government entity.²⁷⁶ The Act however demands that they adhere to principles of public finance and the fiscal responsibility principles.²⁷⁷

Further, the Act operationalizes the County Revenue Fund²⁷⁸ into which all money raised or received by or on behalf of the County Government is paid into. This separates the revenues of the County Government from National Government revenues. The County Treasury is responsible for administering this Fund.²⁷⁹ Moreover, the County Executive Committee is authorized, with the approval of the County Assembly, to establish a County Emergency Fund.²⁸⁰ The County Executive Committee member for finance is authorized to make advances from this fund.²⁸¹ In addition, the County Treasury is responsible for authorizing the opening, operating and closing of bank accounts for the County Government and its entities.²⁸² The County Treasury also has powers to, in writing, designate persons to be called accounting officers. These are to be responsible for managing the finances of such County Government entities as specified in the designation.²⁸³ The County Executive Committee member for finance is empowered to appoint Receivers of County Government revenue, responsible for collection or recovery, and

²⁷⁴ Section 103(1), *Public Financial Management Act, 2012*. It quotes the functions of the County Treasury as, 'has overall responsibility for managing the financial and economic affairs of the County Government.'

²⁷⁵ *ibid*, Section 105.

²⁷⁶ *ibid*, Sections 105(1)(b).

²⁷⁷ *ibid*, Section 107.

²⁷⁸ *ibid*, Section 109.

²⁷⁹ *ibid*, Section 104(1)(j) and 109(2).

²⁸⁰ *ibid*, Section 110.

²⁸¹ *ibid*, Section 112.

²⁸² *ibid*, Section 109(4)(a).

²⁸³ Sections 105(2) and (3)

accounting for revenues due to the County Government.²⁸⁴ The County has an option, but not an obligation to establish the Kenya Revenue Authority as its Revenue collection agent but even so, with limitations.²⁸⁵ All the above efforts point towards a deliberate effort to ensure control of decentralized funds is delegated to county organs.

The main weakness in the above framework is on revenue collection. The practice currently has been that local authorities collect local taxes within their jurisdiction. These are the same taxes that have been transferred to the County Governments. Experience indicates that most local authorities have had limited capacity to discharge this function, leading to very low tax yields. Tax evasion and massive corruption among the collectors have conspired to deny local authorities of the much needed revenue. Attempts to delegate local authority tax collection to Kenya Revenue Authority (KRA) have not yielded much result, with KRA being highly stretched by collection of national revenues to give local authority taxes much attention.²⁸⁶ The net effect has been heavy indebtedness of the Local Authorities.²⁸⁷ With the new Constitution, it is still a subject of debate whether KRA will collect revenue on behalf of the Counties or whether it shall assist the Counties in building their own capacities to collect their own revenue.

For budgeting purposes, the County Government has an independent budgeting process, devoid of interference by National Government.²⁸⁸ The process begins with integrated development planning process which shall produce both long term and medium term plans. Out of this process, the financial and economic priorities for the county over the medium term shall be derived. There shall then be developed a County Fiscal Strategy Paper. Out of this paper and based on estimation of revenue and expenditure, the budget shall be drafted by the County Treasury and submitted by the County Executive Committee (CEC) Member of Finance to the CEC for approval. This is later submitted to the County Assembly for passage. The budget process shall culminate into the County Appropriation Bill authorizing withdrawals and

²⁸⁴ Section 157.

²⁸⁵ Section 154.

²⁸⁶ Matengo & Associates (2010), *Enhancing Revenue Collection in Local Authorities*, available at: www.icpak.com/download.php?a_id=73&download=196, (last accessed 7th October, 2012).

²⁸⁷ The Standard (July 25th, 2012), *Counties Set To 'Inherit' Sh17 Billion Debt*, available at: http://www.standardmedia.co.ke/index.php?articleID=2000062573&story_title=Counties-set-to-%E2%80%99inherit%E2%80%99-Sh17-billion-debt, (last accessed 7th October, 2012).

²⁸⁸ A brief description of this process is given in Section 125 of the Act.

expenditures from the County Revenue Fund. The Act further establishes the County Budget and Economic Forum, for consultations among various county governments on matters relating to budgeting, the economy and financial management at the County level.²⁸⁹ The only concern on the seemingly independent budgeting process is that it may create disharmony in development objectives and priorities across the country.

The Act allows County Governments to fund development through grants and donations from development partners.²⁹⁰ The CEC member for finance is also allowed to raise a loan on behalf of the County Government, whose terms and conditions must be set out in writing.²⁹¹ This allows the Counties to independently raise additional development funds through grants, donations and loans.

Another key feature of successful fiscal decentralization is devolution of taxation powers. The Act reinforces the power of counties to impose a tax or other revenue raising measures, but provides that such measures must comply with article 209 of the Constitution.²⁹² In addition, the levying of taxes is required to be within the fiscal responsibility principles, majorly, being the requirement that a reasonable degree of predictability with respect to the level of tax rates and tax bases be maintained, taking into account any tax reforms that may be made in the future.²⁹³ It however does not specify the specific taxes to be levied but relies on the constitutional stipulation.

Finally, the Public Financial Management Act (PFMA) provides for financial management in an urban area or a city. It is notable that these units have been identified as units for further devolution in the County Governments Act, 2012.²⁹⁴ The PFMA mandates the County Treasury to appoint an accounting officer for such regions.²⁹⁵ This person is in charge of revenue management for the city or urban area.²⁹⁶ The cities and urban areas are given some level of

²⁸⁹ Section 137.

²⁹⁰ Section 138.

²⁹¹ Section 140.

²⁹² Section 161.

²⁹³ Section 132.

²⁹⁴ See Section 48 of the County Governments Act, 2012.

²⁹⁵ Section 171 of the Act.

²⁹⁶ Ibid.

financial autonomy by being allowed to collect their own revenue arising from rates, fees, levies, charges and retaining a percentage for the purpose of defraying their costs for providing services.²⁹⁷ Though they collect the foregoing as agents of the County Government, they are allowed to retain a percentage. Other sources of funds for the urban areas and cities include donations and grants, loans and most importantly, revenue allocation by the County Governments. The County Governments are thus given the major role of ensuring the cities and urban areas are well financed, within a framework of several considerations including; poverty index, population, revenue collection and area of coverage.²⁹⁸ The city or urban area is allowed to develop its own budget consistent with the County Fiscal Strategy Paper and within the principle of public participation.²⁹⁹

The provisions on cities and urban areas show intent to exercise further devolution within the county, but under the supervision of County Government organs, not National Government organs. It shall assist the County Government to have more effective service delivery in the Cities and urban areas. This further illustrates the extent of powers devolved to the County. It strengthens political autonomy, a key aspect for effective fiscal devolution.

3.5 FEATURES THAT ARE KEY IN IMPLEMENTATION OF AN EFFECTIVE KENYAN FISCAL DECENTRALIZATION FRAMEWORK

The following features are critical to implementation of an effective fiscal decentralization framework in Kenya. If fully reflected in devolution policy, law and practice, they shall help implement a watertight system that enhances effective fiscal decentralization in Kenya. As analyzed above, some have already been included in the devolution policy and law as is. It remains to be seen whether they shall be fully implemented in practice once the fiscal decentralization framework under the Constitution of Kenya, 2010 begins to roll out.

3.5.1 Adequate Legislative and Institutional Enabling Environment

An enabling environment for fiscal decentralization starts with constitutional and legal provisions that guarantee some level of autonomy, rights and responsibilities for sub-National

²⁹⁷ Section 172(a)

²⁹⁸ Section 173(1)

²⁹⁹ Section 175(1)

Governments. The new Constitution has set up County Governments setting the foundation for decentralization.³⁰⁰ It is noteworthy that this foundation in itself does not by any means guarantee successful fiscal decentralization. There are many countries with constitutional clauses and laws on subnational government that have not managed to decentralize successfully. Indonesia which became more fiscally centralized after a major decentralization law was passed in 1974 is a good example.³⁰¹

In order to establish a sustainable enabling environment for effective fiscal decentralization there should be adequate political will to decentralize. It is also important to establish a set of robust and clearly defined constitutional and legal provisions to support decentralization and the strengthening of decentralized levels of government. To complement this, there should be appropriately empowered institutions for coordinating the complex activities associated with decentralization. This shall avoid unwarranted competition and reluctance of central agencies likely to work against each other. Last but by no means least, is the recognition that effective fiscal decentralization needs adequate resources for the County Governments to enhance their capacity to meet their responsibilities under decentralization.³⁰²

3.5.2 Assignment of an Appropriate Set of Functions to County Governments

It is noteworthy that the problems with fiscal decentralization on the expenditure side appear to be related more to a lack of attention to implementation than to decentralizing inappropriate services. It is important to acknowledge that no matter what a constitution or enabling law stipulates, central government agencies rarely have a desire to decentralize services they have been providing, particularly if decentralization involves a loss of prestige and resources to these agencies and they perceive each other as competitors.³⁰³ As a result, the process is slowed down.

³⁰⁰ See the previous chapter for detailed discussion on the relevant provisions of the Constitution.

³⁰¹ Smoke P. and Lewis B. (1996), *"Fiscal Decentralization in Indonesia: A New Approach to an Old Idea,"* World Development, Vol. 24, No. 8. Available at www.gsdrcc.org/docs/open/PO43/pdf, (last accessed on 31st August 2012).

³⁰² Smoke P (2000), *Fiscal Decentralization in East and Southern Africa: A Selective Review of Experience and Thoughts on Moving Forward*, paper prepared for Conference on Fiscal Decentralization International Monetary Fund Washington, DC November 20-21, 2000. New York University. Available at www.gsdrcc.org/docs/open/PO43/pdf, (last accessed on 31st August 2012).

³⁰³ Oates W (1999), *"An Essay on Fiscal Federalism,"* Journal of Economic Literature, Vol. 37, available at: www.jstor.org/stable/2564874/pdf, (last accessed on 31st August 2012).

Further, if too many sectors are decentralized too rapidly and County Governments do not have the capacity to handle these new responsibilities, they are likely to perform ineffectively. If this happens, it is possible that central agencies against decentralization can use poor local performance as an excuse for keeping the services centralized.³⁰⁴ This scenario is directly linked to common concerns about the effects of County Government fiscal behavior on central government deficits and macroeconomic stability.³⁰⁵ Smoke notes that although poor fiscal performance of sub-national governments is often a genuine problem, this does not necessarily prove that fiscal decentralization is inappropriate. It may simply mean that the fiscal decentralization or sub-national government reform program is giving sub-national governments too much functional responsibility too rapidly and without appropriate capacity building and local governance development support from the central government.³⁰⁶

3.5.3 Assignment of an Appropriate Set of Local Own-Source Revenues to County Governments

A general observation is that central governments generally attempt to assign County Governments revenue bases that are relatively immobile and should therefore not lead to serious spatial efficiency effects, that do not compete seriously with central tax bases.³⁰⁷ The following challenges remain pronounced on the revenue part. First, assigned revenues are almost never adequate to meet the local expenditure requirements meaning a continued reliance on the central government transfer programs. Second, County Governments often use too many unproductive revenue sources that barely cover the costs of collecting them. Third, individual local revenue sources suffer from some serious design problems, such as stagnant bases, overly complex structures, and ineffective collection mechanisms.³⁰⁸

³⁰⁴ Litvack J, Ahmad J, and Bird R (1998), *Rethinking Decentralization at the World Bank*, Washington, DC.

³⁰⁵ Shah A. (1994), *The Reform of Intergovernmental Fiscal Relations in Developing and Emerging Market Economies*, Policy and Research Series No. 23. Washington, DC: World Bank, available at: www.gsdrcc.org/docs/open/PO43/pdf, (last accessed on 31st August 2012).

³⁰⁶ *Ibid* note 43.

³⁰⁷ Bahl R and Linn J. (1994), *Fiscal Decentralization and Intergovernmental Transfers in Less Developed Countries*, The Journal of Federalism, Vol. 24, pp. 1-19, available at: www.gsdrcc.org/docs/open/PO43/pdf, (last accessed on 31st August 2012).

³⁰⁸ *Ibid* note 43.

As much as building local revenue systems is important, this must be done cautiously. Attempts to implement too many reforms at once can overwhelm the tolerance of local residents and the capacity of County Governments. It is more viable that County Governments should focus their energies on systematic development of a few local sources of revenue that can provide substantial yields and establish a better link between the taxes local residents pay and the benefits they receive.³⁰⁹

3.5.4 Establishment of an Adequate Intergovernmental Fiscal Transfer System

Intergovernmental transfer programs help to cover County Government fiscal imbalances and supplement inadequate local own-source revenues to improve the ability of County Governments to meet their expenditure responsibilities. They can also be used to meet national redistributional objectives therefore helping to offset fiscal capacity differences among sub-national governments. Further, they can be used to encourage local expenditures on particular goods and services that exhibit positive externalities or are considered to be basic needs that should be distributed less unequally than the ability to pay for them.³¹⁰

However, there are several challenges involved in designing such transfer programs. These challenges may include: no one type of transfer meets all desired objectives;³¹¹ fiscal equalization grants are often considered important, but they are very difficult to design because of the technical and political complexities involved in defining an "optimal" distribution of income across decentralized jurisdictions and in determining a fair way to raise the revenues to be redistributed;³¹² macroeconomic problems can be created if too large a percentage of central resources are guaranteed to County Governments each year; transfer programs may have conflicting objectives or unintended results. A good illustration could be in the form of equalization grant in the form of conditional grants that go to wealthier areas, or grants may substitute rather than stimulate local tax effort;³¹³ too many transfer programs with different allocation criteria create an administrative burden for local officials and provide incentives for

³⁰⁹ Ibid note 47.

³¹⁰ Ibid note 41.

³¹¹ For instance, Unconditional grants, for example, are best for income redistribution purposes, while conditional grants are a more efficient way of encouraging expenditures on particular types of target services.

³¹² Ibid note 41

³¹³ Ibid.

unproductive competition and strategic behavior; and, many transfer systems either by design or by manipulation, are allocated with a degree of subjectivity that undermines basic economic objectives.³¹⁴

In conclusion, it is difficult to make conclusive prescriptions about the appropriate structure of an intergovernmental transfer system. However, the same can be determined by either of the following: national objectives, the extent of service and revenue functions assigned to sub-national governments, the fiscal capacity of sub-national governments, the extent of inequalities across sub-national governments, and the political environment.³¹⁵

Nevertheless, in coming up with these system there should be a careful selection of the overall package of transfer programs to balance key objectives, moving towards consolidated programs with more transparent allocation mechanisms and building incentives for good fiscal behavior into the access criteria and distribution formulae. Effort should also be made to start new programs incrementally, increasing available resources as County Governments develop capacity to behave in a fiscally responsible manner.³¹⁶

5.5 Establishment of Adequate Access by Sub-National Governments to Development Capital

The Constitution allows borrowing by county governments provided such loans are guaranteed by the National Government and has been approved by the county assemblies.³¹⁷ However, where local borrowing occurs, the practice has been that loans are often allocated at least partially according to political criteria, interest rates may be subsidized, and loan repayment is often inadequate with frequent defaults. In many developing countries there is substantial dependence on grants and subsidized loans developed during a period when funds for infrastructure were abundant.³¹⁸

¹⁴ *Ibid.*

¹⁵ *Ibid.*

¹⁶ *Ibid.*

¹⁷ Article 212.

¹⁸ *Supra* note 41

A good fiscal decentralization program requires the development of an appropriate spectrum of options to finance capital investment: from grants and subsidized loans for poorer County Governments and non-self-financing projects, to various types of loans and bonds for fiscally sound County Governments and self-financing projects.³¹⁹

As far as debt capital is concerned, the approach that a central government takes towards enhancing County Government access to loans depends on the fiscal context. This would entail that in cases where decentralized governments are relatively strong, efforts to develop direct access to capital markets make sense, but the central government must regulate municipal bond markets, develop and enforce credit limits, and stop bailing out County Governments that default on their debt.³²⁰

This approach gives central authorities considerable control over borrowing activities of County Governments. However, this power must be structured to minimize abuse.

County Governments must also watch out not to expend all their resources on recurrent expenditure. Experience from the central government and local authorities has shown that over 70% of the revenue collected by these agencies is spent on recurrent expenditure mainly salaries and allowances of staff.³²¹ The same challenge may face County Governments if they fail to exercise fiscal responsibility given the fact that the wage bill in the country is rising at alarming rates and the revenue sources of county governments are low yielding.

Further, the county governments should not be allowed to use the funds borrowed to finance development projects. To ensure the funds are repaid, the development projects should be income generating or those projects which enhance efficiency in service delivery hence generating a lot of savings. To address the above concerns, the Public Financial Management Act imposes a condition on borrowing that County Governments can only borrow funds to finance

³¹⁹ *Ibid.*

³²⁰ *Supra* note 43.

³²¹ http://www.china.org.cn/world/Off_the_Wire/2012-08/21/content_26299049.htm (last accessed on 29th November, 2012)

revenue generating development projects and furthermore, this should only be in cases where the debt was factored in the County Government's debt management strategy for the year.

3.6 CONCLUSION

Despite the clear Constitutional framework and the attempts by various Acts of Parliament enacted so far towards implementing the constitution, there are still impending challenges facing the implementation of an effective fiscal decentralization framework as envisaged in the New Constitution.

First, the laws drafted to implement the constitutional framework have overlaps, which have been highlighted above. Secondly, such implementation shall require competent members and staff of the Transition Authority as well as cooperative and supportive synergies from key institutions such as the Commission for the Implementation of the Constitution, the Commission for Revenue Allocation, ministries, departments, local authorities, state corporations and the Public Service Commission which is charged with the overall constitutional mandate over the concerned human resource. This is not guaranteed going by the numerous disagreements between the National Government and bodies meant to oversee successful implementation of the devolved government framework.³²²

In addition, the National Treasury will have to play a crucial facilitative role to achieve the much needed sound financial management throughout the transitional period. It remains to be seen whether this shall be practically possible, with the County Governments set to celebrate their new found financial freedom from the treasury by resisting any form of control by the Treasury and the National Treasury trying to retain its original powers which have now been devolved.

Finally, an important and urgent assignment will entail instituting relevant administrative systems and processes to bring into effect the various legislative provisions. These are necessary for the implementation of the fiscal decentralization framework in the New Constitution. The

³²² There are several documented disagreements. First is the disagreement between Treasury and the Ministry of Local Governments on the Public Financial Management Bill. There is then the disagreement on the County Governments Bill, with the president declining to assent. Further, disagreement on appointment of County Commissioners is rife, with various constitutional implementing bodies like the CIC and CRA terming the appointments unconstitutional.

various implementing Acts create various offices at the County level. There being 47 Counties, the process shall be enormous and costly. It remains to be seen whether the process shall be smooth and focused on qualifications and competencies, devoid of nepotism and tribalism.

There is need to compare the Kenyan system to similar systems in other countries, so as to draw lessons that can be useful in implementing an effective fiscal decentralization framework. This is done in the following chapter.

CHAPTER FOUR: A COMPARATIVE ANALYSIS OF THE FISCAL DECENTRALIZATION FRAMEWORK UNDER THE CONSTITUTION

4.1 INTRODUCTION

In the previous chapter, the Kenyan constitutional framework was assessed based on the five pillars of an effective fiscal decentralization framework, namely: political autonomy, expenditure responsibility, revenue assignment, inter-governmental transfers and sub-national borrowing.

The effectiveness or otherwise of this framework can be further determined if assessed in comparison with the framework in other countries practicing fiscal decentralization. This chapter will analyze the framework for fiscal decentralization existing in other developing countries of Africa and compare the system with that proposed to be implemented in Kenya, noting the similarities, differences and best practices that can be borrowed. It should be pointed out from the outset that there is no country that has a perfect decentralization framework. The models used by other countries have resulted to a varying degree of success. This chapter identifies Ethiopia, Uganda and South Africa as some of the countries where fiscal devolution can be said to have been used to a relative degree of success. Their decentralization framework will be examined based on the said five pillars and the same be compared to the frame work proposed by the Kenyan constitution.

South Africa is chosen for being the economic super-power of Africa, a goal Kenya is striving towards. It is similar to Kenya in that it has a unitary system of government. It also leads other African countries in the extent of fiscal decentralization in Africa.³²³ Uganda is chosen for being the only East African country to be ahead of Kenya in the extent of fiscal decentralization in Africa.³²⁴ It is also similar to Kenya in that it has a unitary system of government. Finally, Ethiopia is chosen for being the only Eastern Africa state to run a federal system of government. Despite this it has gradually implemented a largely successful system of fiscal

³²³ Ndegwa Stephen (2002), *Decentralization in Africa: A Stocktaking Survey*, Africa Region Working Paper Series No. 40, p. 5, Figure 3: Extent of Fiscal Decentralization, available at: <http://www.worldbank.org/afr/wps/wp40.pdf>, (last accessed 20th August, 2012).

³²⁴ *ibid.* Uganda is ranked number 3 in Africa.

decentralization.³²⁵ Lessons from the federal system are useful for comparison with unitary systems of government. Again, its proximity to Kenya enables easier contextualization in historical and developmental experiences. The features of fiscal decentralization in the countries chosen above are discussed below:

4.2 COMPARATIVE ANALYSIS WITH THE FISCAL DECENTRALIZATION FRAMEWORK IN ETHIOPIA

Ethiopia has developed a decentralization program that is among the most significant and ambitious in the developing world and certainly one of the most impressive in Africa.³²⁶ The drive towards decentralization came as a result of the ethnic identifications of the regions and the secession of Eritrea. Vesting the regional governments with more power was widely seen as a way to hold the ethnically fragmented country together.³²⁷

The Country's Constitution explicitly provides for a federal system. The constitution establishes nine ethnically based regional states to accommodate ethnically diverse societies with a political history of ethnic domination.³²⁸ The Ethiopian Constitution grants the people of Ethiopia the right to a full measure of self-government, including the right to establish institutions of government in their territory and equitable representation in State and Federal governments.³²⁹ Accordingly, it establishes nine regional states: Tigray, Afar, Amhara, Oromia, Somalia, Southern, Gambela, Benshangul/Gumuz and Harari.³³⁰ In comparison, Kenya establishes 47 Counties, largely ethnically based with the exception of a few multi-ethnic counties. The Kenyan system also aims at attaining power of self-governance for the people through enhancing

³²⁵ *ibid.* Ethiopia is ranked 17th in Africa on extent of fiscal decentralization.

³²⁶ Smoke Paul (2000), *Fiscal Decentralization in East and Southern Africa: A Selective Review of Experience and Thoughts on Moving Forward*, presented at Conference on Fiscal Decentralization International Monetary Fund Washington, DC November 20-21, 2000, available at: <http://www.imf.org/external/pubs/ft/seminar/2000/fiscal/smoke.pdf>, (last accessed 17th August 2012).

³²⁷ Cohen J. (1995), *"Ethnic Federalism in Ethiopia"* Development Discussion Paper. Cambridge, MA: Harvard Institute for International Development, available at: http://muse.jhu.edu/journals/northeast_african_studies/summary/v002/2.2.cohen.html (last accessed 17th August 2012).

³²⁸ Andreas E. (2003), *Ethnic Federalism: New Frontiers in Ethiopian Politics*, paper delivered at 1st National Conference on Federalism, Conflict and Peace Building, UNCC, Addis Ababa, 5th-7th May 2003, available at www.humansecuritygateway.com/document/AACORDFederalismConflicts_Ethiopia.pdf, (last accessed 17th August 2012).

³²⁹ *Constitution of the Federal Democratic Republic of Ethiopia*, Article 39(3) available at: http://www.africa.upenn.edu/Hornet/Ethiopian_Constitution.html, (last accessed 20th August, 2012).

³³⁰ *ibid.*, Article 47(1).

participation of the people in exercise of the powers of the State and in making decisions affecting them. They two systems are similar to this extent, only that the Ethiopian regions have more powers as shall be evident below.

Fiscal decentralization in Ethiopia is herein examined based on the pillars of; political autonomy, expenditure responsibility, revenue assignment, inter-governmental transfers and sub-national borrowing.

4.2.1 Political Autonomy

The Ethiopian Constitution establishes two levels of government; the Federation and the State. The executive powers of the Federation are held by the Prime Minister, who is the Chairman of the Council of Ministers, and the Commander-in-Chief of the national armed forces.³³¹ There is provision for the post of President, who is the head of state, but exercising majorly ceremonial functions.³³² In Kenya, the two levels of government are the National Government and the Counties. Executive powers at the national level are exercised by the President, who is both head of State and Government in consultations with the Deputy President and Cabinet Secretaries.³³³

In Ethiopia, the State is fashioned as an autonomous level of government, headed by a State Council, which is the highest organ of State authority. The Council is ultimately responsible to the People of the State, not to the Federal government.³³⁴ The State has legislative, executive and judicial powers.³³⁵ The State administration constitutes the highest organ of executive power³³⁶ with powers to enact and enforce laws on the State civil service³³⁷ and also establish and administer a state police force, and to maintain public order and peace within the State.³³⁸ They also have powers to enact and execute the State Constitution and other laws,³³⁹ formulate and execute economic, social and development policies, strategies and plans of the State³⁴⁰ and

³³¹ Constitution of the Federal Democratic Republic of Ethiopia, *supra* note 7, Articles 72-74.

³³² *ibid*, Articles 69-71.

³³³ Article 131 of the Constitution of Kenya, 2010

³³⁴ *ibid*, Article 50(3).

³³⁵ *ibid*, Article 50(2).

³³⁶ *ibid*, Article 50(6).

³³⁷ *ibid*, Article 52(2)(f)

³³⁸ *ibid*, Article 52(2)(g)

³³⁹ *ibid*, Article 52(2)(b)

³⁴⁰ *ibid*, Article 52(2)(c)

establish a State administration that best advances self-government, a democratic order based on the rule of law.³⁴¹ In Kenya, on the other hand, the Counties are headed by a Governor, backed by County Executive Committee members who are answerable to him. The Counties only have executive and legislative but not judicial powers. The Counties are not empowered to establish their own police force. They only manage the County Civil Service through the County Public Service Board.

The State is empowered to develop further administrative units as units of further devolution. The Constitution demands that adequate power be granted to the lowest units of government to enable the People to participate directly in the administration of such units.³⁴² This has set in motion a process of empowering the lowest constitutionally recognized local government units, which are the Woredas (districts). This process is called the District (Woreda) Level Devolution (DLD). It has been carried out since 2002/03.³⁴³ The main objective of DLD is to improve service delivery to communities by their own local governments and thereby remove reliance on federal and regional state. DLD devolves decision-making powers to local authorities with a full responsibility for consequences of their decisions. In a nutshell, it aspires to enhance the mandate of the districts in setting their own priority, building the capacity to make decisions, and implement them.³⁴⁴ Similarly in Kenya, the Counties are empowered to establish units of further devolution. Cities, Municipalities, Towns and even villages have been identified as units of further Devolution under the County Governments Act. The units of further devolution are thus more in Kenya.

The above provisions create devolved units enjoying high level political autonomy in Ethiopia. The important similarity with the Kenyan system is that the two devolved systems create units that are largely autonomous from the central government as they do not account to the central government for their daily functioning. However, in contrast, the Ethiopian states have greater political autonomy than the Kenyan Counties. The Ethiopian states have powers to establish their

³⁴¹ *ibid*, Article 52(2)(a)

³⁴² *ibid*, Article 50(4)

³⁴³ Mehari Taddele Maru (2008), *Devolution of Power in Ethiopia: The Legal and Political Aspects*, United Nations Conference Center, Addis Ababa, p. 31, available at http://www.arpdafrika.org/index.php?option=com_docman&task=doc_download&gid=8&Itemid=20, (last accessed 17th August, 2012).

³⁴⁴ *ibid*, p. 36

own judiciary, establish and administer a state police service, enact and enforce a state Constitution and finally to demand secession, powers which the Kenyan Counties lack.

4.2.2 Expenditure Responsibility

The Ethiopian Constitution has provisions on sharing of functions between the Federal and State levels of governments. The Federal government is allocated twenty one functions,³⁴⁵ with the State government being allocated seven.³⁴⁶ Functions of State governments include operation of the State police and judiciary. To forestall any disputes, the Constitution provides that powers not given expressly to the Federal Government alone, or concurrently to the Federal Government and the States are reserved to the States.³⁴⁷ To capture the subsidiarity principle, the Federal Government is allowed, when necessary, to delegate to the States powers and functions granted to it.³⁴⁸ The situation in Kenya is different in many respects. First, the functions of the Counties are much less and do not include the police and judiciary. Second, residual functions are allocated to the National Government in Kenya while the same are allocated to State governments in Ethiopia. There is a similarity on subsidiarity, with the Kenyan system allowing transfer of functions.

Despite the above framework, the Ethiopian States do not fully exercise their expenditure responsibilities. They do not effectively spend the budget allocated to them, leading to under-spending.³⁴⁹ To illustrate this, most Woredas do not have their own tailored economic growth strategy contextualized to their specific needs. Although the enabling environment for decentralization is in place, many supporting systems and procedures, such as planning and budgeting, financial management and service delivery mechanisms are not fully developed. As a result, decentralized governments cannot be expected to behave in a fiscally responsible way and meet the service delivery responsibilities that are so critical for local economic development and poverty alleviation.³⁵⁰ The Ethiopian system has thus not effectively implemented the expenditure responsibility pillar of fiscal devolution.

³⁴⁵ *supra*, note 4, Article 51.

³⁴⁶ *ibid.*, Article 52(2).

³⁴⁷ *ibid.*, Article 52(1)

³⁴⁸ *ibid.*, Article 50(9).

³⁴⁹ *supra*, note 17, p. 35.

³⁵⁰ *supra*, note 1 at p. 34.

The Kenyan system on the other hand is yet to be tested at the implementation stage to determine its effectiveness. The implementers should avoid the Ethiopian situation by ensuring participatory planning at the County level is adopted, right from its inception. The capacity of the County Treasuries should also be emphasized and enhanced, since it is the body in charge of prudent management of County Funds.

4.2.3 Revenue Assignment

The Ethiopian system gives the State government significant amount of taxation powers. The State government has powers to levy taxes on employment income from employees of the state government, agricultural tax from farmers, tax on individual traders, houses and other property owned by private persons or regional government, employment, and sales tax from public enterprises owned by the state government, forest products, royalties and land lease fees from small mining undertakings.³⁵¹ On the other hand, federal government has the power to impose federal stamp duties, monopoly tax, value added tax, national lottery tax, fees from licenses issued and services provided by organs of the federal government. It also has a share on royalty and taxes on natural resources mainly gold and natural gas.³⁵² Other tax bases which are not specified in the federal constitution are under the power of the federal government, not under the state governments.³⁵³

In comparison to the Kenyan system, both countries assign separate taxes to be imposed by the two levels of government. However, it is evident that the state governments in Ethiopia have powers to levy more categories of taxes than the Kenyan Counties.

In addition, both levels of government have concurrent taxation powers. The Federal Government and the States jointly levy and collect a number of taxes namely; profit, sales, excise and personal income taxes on enterprises they jointly establish; taxes on the profits of companies and dividends due to shareholders; taxes on incomes derived from large scale mining and all petroleum and gas operations, and royalties on such operations.³⁵⁴ However, an

³⁵¹ *supra*, note 4, Article 97.

³⁵² *ibid*, Article 96.

³⁵³ *Ibid* at p. 33.

³⁵⁴ *supra*, note 4, Article 98.

amendment has since been made on Article 98 of the Federal Constitution which provides for joint taxation areas. This amendment grants taxation of certain businesses to the federal government. This includes trans-regional companies and ventures of petroleum and minerals. The amendment aims to ensure fair tax treatment to corporations engaged in mineral and oil related business in different regional states of Ethiopia. The amendment aims at uniformity of taxation, fair allocation of revenues among different regional states, and efficient tax system by avoiding joint federal and regional parliament meetings. As per the amendment the federal government may delegate this power to a regional state.³⁵⁵ The amendment proposes a system that would see the State governments have significant power to raise revenue through taxes, but relatively speaking, bigger sources of revenue are under the federal government.

In Kenya, there is no provision for concurrent taxation areas. Such a proposal is necessary in Kenya, where companies exploiting natural resources in any County would be taxed jointly by the National and County Governments. If implemented, it would increase the tax base and yield for the respective County Governments, spurring development in the Counties.

In the implementation of revenue assignment, the Ethiopian states have been faced with low tax revenues, caused by tax evasions and lack of effective collection techniques. Though local revenue yields may have generally increased under the decentralization program, they have not met the expected threshold, and federal government grants still account for the bulk of local revenues.³⁵⁶ In fact, State governments are estimated to collect only around 17% of total national revenue yearly, remaining reliant on inter-government transfers.³⁵⁷ It is thus evident that the tax raised by regional government is inadequate.

Similarly, the adequacy of the revenues to be raised from the taxation powers allocated to the County Governments in Kenya is in doubt, with sentiments being that it may not be enough. For instance, the projected revenue from own sources by County Governments is KSh. 16.9 Billion,

⁵⁵ *supra*, note 17, p. 34.

⁵⁶ *supra*, note 1, p. 35.

⁵⁷ Eldon Jack and Waddington Catriona (2007), *Federalism, Sub-National Financing And Aid Effectiveness*, p. 11, available at: <http://www.hlsp.org/LinkClick.aspx?fileticket=r0f0SVbiwNQ%3D&tabid=1703&mid=3363>, (last accessed 20th August, 2012).

while the projected costs of the devolved functions is KSh. 149.4 Billion.³⁵⁸ Kenya thus needs to adopt the Ethiopian model by granting more taxation powers to County Governments and considering possible joint taxation areas.

4.2.4 Inter-Governmental Transfers

In Ethiopia the Federal government is granted constitutional power to grant State governments emergency, rehabilitation and development assistance loans.³⁵⁹ The two levels of government are required to share revenue taking the federal arrangement into account.³⁶⁰ To this end the Ministry of Finance and Economic Development (MOFED) has developed a very significant intergovernmental transfer program that accounts for a substantial proportion of central revenues. Clear rules govern the intergovernmental transfer program, making it easier for all parties concerned to understand the basis for resource allocation.³⁶¹ The ministry allocates annual budgets to federal institutions and block grants to regional Bureaus of Finance and Economic Development (BOFED), according to a national equity formula that reflects both population size and relative need. Second, the BOFEDs allocate annual budgets to regional institutions and block grants to Woredas, according to a regional equity formula. Finally, the Woreda Councils allocate budgets to the various sectors based on priorities and annual work plans.³⁶² Budgets are therefore disaggregated at each level and allocated to spending departments, which are accountable, horizontally, to their respective federal, regional and local representative bodies. Designated accountable public bodies manage these funds at each level.³⁶³

In comparison to the Kenyan system, the Ethiopian system is more detailed as far as the level of transfers is concerned. MOFED allocates monies to BOFED which allocates annual budgets to regional institutions and block grants to Woredas. In the Kenyan system, the National Treasury simply allocates the funds to the County Treasuries by depositing the money into the County Revenue Funds. However, the Kenyan system is more detailed on safeguards. The Commission

³⁵⁸ Parliamentary Budget Office (2012), *The MP's Budget Watch*, Appendix 6: County Revenue Potential and Cost of Devolved Functions, p. 32, available at: www.parliament.go.ke/index.php?option=com_docman, (last accessed 20th September, 2012).

³⁵⁹ Constitution of Ethiopia, *supra*, note 4, Article 94(2).

³⁶⁰ *Ibid*, Article 95.

³⁶¹ *supra*, note 1, p. 34.

³⁶² *supra*, note 31, p. 10.

³⁶³ *Ibid*.

on Revenue Allocation makes proposals on the division of the funds and the Constitution outlaws unwarranted withholding of funds by the National Treasury. The Ethiopian system leaves the Federal Government with discretion on amount of funds to allocate and also no proper safeguards, leaving a window for undermining of state governments through reduced allocations. In fact, it has been noted that in Ethiopia, total regional government share of overall national expenditure has fallen in recent years, suggesting silent re-centralization.³⁶⁴ Kenya should maintain its safeguards, so as to avoid Ethiopia's pitfall of silent re-centralization.

4.2.5 Sub-National Borrowing

In Ethiopia, regional states cannot borrow from foreign or domestic creditors without prior approval of the federal government. This shows that regional states do not have guaranteed borrowing powers.³⁶⁵ Federal government reserves the right of external borrowing. These external resources are channeled through MOFED as budget support, to be transferred to the regions, Woredas and sectors in line with fiscal decentralization and sector policies. If a donor provides funds for a particular geographical area or issue, MOFED 'off-sets' these i.e. it includes them in its resource allocation calculations and reduces the government's contribution to that area accordingly.³⁶⁶ The Ethiopian system does not allow sub-national borrowing, a key pillar for fiscal decentralization.

In contrast, the Kenyan Counties have power to borrow, only with the condition of guarantees by the National Government. So they have authority to borrow only that it is constrained. County Governments require the approval of the County Assemblies and the guarantee of the National Government before securing such loans. It is desirable that the Kenyan system maintains the borrowing powers, since it shall be a major source of development funds at the County level.

³⁶⁴ *supra*, note 31, p. 11.

³⁶⁵ *supra*, note 17, p. 35.

³⁶⁶ *supra*, note 31, p. 11.

4.2.6 Lessons for Kenya from the Challenges in the Ethiopian System

The fiscal decentralization process in Ethiopia has succeeded in improving service delivery at the grassroots.³⁶⁷ However, it has also had its challenges. First, the requisite support systems and procedures in Ethiopia, including; planning and budgeting, financial management, service delivery mechanisms have not fully developed.³⁶⁸ The States are thus faced with serious capacity constraints, making them unable to exercise fiscal responsibility and also meet the service delivery responsibilities, critical for local economic development and poverty alleviation.³⁶⁹ Kenya should thus focus on developing the requisite support systems and procedures during the initial phases of the implementation period to enable Counties fully develop their capacity to handle devolved functions.

Second, the Ethiopian Constitution and the relevant legislations are vague about the functions to be decentralized to lower tiers of government. They maintain silence on the levels of government below the regions (the Zones, Woredas and Municipalities). This has allowed arbitrary and inconsistent treatment by higher levels of government, which have few clear standards to govern their dealings with sub-State units.³⁷⁰ The Kenyan Counties have relatively more defined functions. An Act of Parliament should clarify functions such as tourism, betting and casinos and Education so as to remove potential for vagueness though this can be said to have been partly addressed by the Transition Authority while determining the functions to be transferred to County Governments. The County Governments Act should be lauded for being specific on units of further devolution.

Third, there is not a clearly articulated process for implementing and coordinating decentralization in Ethiopia. A strategic and gradual process of decentralization, pragmatically phased and well-coordinated, would have helped decentralize public functions in a way that helps to build capacity and accountability.³⁷¹ Kenya seems to have learnt from this, with the Kenyan fiscal decentralization system being implemented in clearly defined phases, with certain

³⁶⁷ World Bank (2008), *Woreda*, p. 2, available at: http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2008/02/19/000333038_20080219080133/Rendered/PDF/425520PUB0ISBN101OFFICI AL0USE0ONLY1.pdf, (last accessed 3rd October, 2012).

³⁶⁸ *supra* note 1, p. 34.

³⁶⁹ *ibid.*

³⁷⁰ *ibid.*

³⁷¹ *ibid.*, p. 35.

supporting bodies, like the Transition Authority and the Commission for Implementation of the Constitution having their existence pegged to these phases.

Finally, more emphasis has been given to the development of intergovernmental transfer programs than to improving decentralized own sources of revenue. This has left Federal government grants to account for the bulk of state revenues and expenditures, creating dependant devolved units.³⁷² The implementers of the Kenyan System should guard against such wrong emphasis. Currently, the focus in the news is on the amounts of money that shall be transferred by National Government to the Counties,³⁷³ with little focus on self-generated revenues by the Counties. This trend needs to be reversed.

4.2.7 Conclusion

The Ethiopian system assigns State governments more political autonomy, grants more substantive functions and involves more bodies in inter-governmental transfers. It however has its weaknesses by giving the Federal government discretion in determining amounts of inter-governmental transfer, not allowing sub-national borrowing and having weak enforcement of tax revenues by State governments.

The proposed Kenyan system on the other hand has a more elaborate inter-government transfer system and allows sub-national borrowing. It however grants less political autonomy, less substantive functions and less taxation powers compared with the Ethiopian system.

4.3 COMPARATIVE ANALYSIS WITH THE FISCAL DECENTRALIZATION FRAMEWORK IN UGANDA

The legal bases for decentralization in Uganda are the Local Governments Statute of 1993, the 1995 Ugandan Constitution, and the Local Governments Act of 1997. These instruments provide considerable detail about the powers and responsibilities of local governments.³⁷⁴ The Ugandan

³⁷² *ibid.*

³⁷³ The Standard (17th August, 2012), *Counties Scramble for Cake*, available at: <http://www.standardmedia.co.ke/?articleID=2000064240>, and Daily Nation (23rd February, 2012), *Big Counties Will Get More Devolution Cash*, available at: <http://allafrica.com/stories/201202240083.html>, (all last accessed 9th October, 2012).

³⁷⁴ *supra*, note 1, p. 39.

system is again analyzed and compared with the Kenyan system, based on the pillars of effective fiscal decentralization below.

4.3.1 Political Autonomy

With regard to political autonomy, the 1995 Ugandan Constitution gives a clear constitutional base for decentralized governance in the country. It recognizes districts as the devolved units³⁷⁵ and also establishes local governments within the districts as units of further devolution.³⁷⁶ Following the Constitution, the Local Government Act of 1997 was enacted cementing devolution. The decentralized system is based on the District. The City Council of Kampala is given equal status to the Districts. The highest unit of devolved government is thus manned by a District or City Council. However, there is allowed further devolution within the District through lower local governments and administrative units. Local government councils in a district include; the Municipal Council, the City Division Council, the Municipal Division Council, the Sub-County Council and the Town Council.³⁷⁷ Administrative unit councils in a district include; the County Council, the Parish or Ward Council and the Village Council. A local government council is a body corporate with perpetual succession and a common seal. It may sue or be sued in its corporate name.

The Ugandan system is different from the Kenyan system in several aspects. First, the Kenyan Constitution does not recognize units of further devolution beyond the Counties. Second, the Cities and other urban areas are placed under County Governments, not at equal level to Counties. Finally, the Kenyan system has lesser levels of further devolution, namely the cities and urban areas, sub-counties equivalent to the constituencies in the county, wards and Village Councils.

Further, in Uganda, each local government council has a directly elected chairperson, directly elected councilors representing demarcated electoral areas, two councilors (one male, one

³⁷⁵ Government of Uganda (GoU), (1995) *Constitution of the Republic of Uganda 1995*, Articles 5(2), 176, 177 and the First Schedule, all available at: http://www.ugandalawlibrary.com/ull/files/constitution/constitution_1995.pdf, (last accessed 20th August, 2012).

³⁷⁶ Ibid, Article 177(2).

³⁷⁷ World Bank (2003), *Decentralization Policies and Practices: Case Study Uganda*, Participants' Manual, p. 3, available at: <http://info.worldbank.org/etools/docs/library/117196/sloga/docs/sloga/MODA-EN-CaseStudyUganda.pdf>, (last accessed 19th August, 2012).

female) representing the youth, two councilors (one male, one female) representing persons with disabilities and women councilors forming one third of the council. Additionally, every lower local government council has two elderly persons (one male, one female) above the age of fifty five years nominated by the respective executive committee for approval by the respective council. A speaker, elected from among the members presides at council meetings.³⁷⁸ In contrast, the administrative unit councils are not corporate bodies. Their functions are minor; to resolve problems or disputes, monitor the delivery of services and assist in the maintenance of law, order and security.

In the Kenyan system, the Counties have directly elected Governors and Ward representatives. It has allowance for nominations so as to attain one third representation of either gender in the assembly. The only difference is on nominations. In Uganda they are done by the executive committees of the councils, while in Kenya, they are done by political parties through the Independent Electoral and Boundaries Commission (IEBC) depending on their strength in the County Assembly. Finally, the Kenyan Speakers unlike their Ugandan counterparts are elected from among persons who are not members of the County Assembly.

In Uganda, the local government councils hold the highest political authority within their area of jurisdiction and have legislative and executive powers.³⁷⁹ The Districts are headed by a district chairperson who is directly elected by the people and is the political head of the district.³⁸⁰ The district chairperson appoints an executive committee from among the members of the council to assist him discharge executive functions.³⁸¹ The councils are responsible for the delivery of the majority of public functions and services. The district which is the basic unit of local government, is responsible for major functions and services previously carried out by the central

³⁷⁸ Florence, and Edward Mugabi, *Uganda's Decentralisation Policy, Legal Framework, Local Government Structure and Service Delivery*, Paper prepared for the First Conference of Regional Assemblies of Africa and Europe organised by the Regional Assembly of Tuscany under the patronage of the Italian Presidency and the United Nations Department of Economic and Social Affairs (UNDESA), September 17 to 18, 2004, p. 2, available at: <http://unpan1.un.org/intradoc/groups/public/documents/UN/UNPAN031014.pdf>, (last accessed 17th August 2012)

³⁷⁹ See the Ugandan Constitution, *supra*, note 47, article 180(1).

³⁸⁰ *ibid*, article 183(1).

³⁸¹ *ibid*, article 186.

government. Urban councils are responsible for service delivery in urban areas and they enjoy both financial and planning autonomy.³⁸²

On the other hand, the Kenyan Counties are headed by a Governor, not Chairperson. Further, the Kenyan County Executive Committee members are appointed from among persons who are not members of the County Assemblies. Finally, service provision in urban areas is discharged by the boards of the urban areas and not by the County Governments themselves.

In summary, the Ugandan system thus comprises of political autonomous units of devolution in local government councils. In comparison to the Kenyan system, the Ugandan system has arguably a three tier decentralization structure. As much as the District is the basic unit of the local government, there are councils under it that conduct specific functions. The Kenyan Constitution does not expressly provide for an equivalent of these councils. They have however been provided for under the Urban Areas and Cities Act 2011, and placed under the management of County Governments as possible units of further devolution.

It is thus evident that the autonomy of the local governments in the two countries is respected. The Kenyan system however needs to entrench the units of further devolution in the Counties and not to leave this to the discretion of County Governments as the law is, to prevent dictatorial tendencies by the County governments, where they may want to centralize power in the County.

4.3.2 Expenditure Responsibility

The Ugandan Constitution lists the functions of the National Government,³⁸³ and then provides that other functions not listed shall be performed by District Councils.³⁸⁴ It then allows delegation of some of the functions of the National Government to District councils and the councils of lower local government units either on their request, at the option of the National Government or by Parliament through passage of laws.³⁸⁵ Pursuant to this, the second schedule to the Local Government Act, 1997 contains a listing of functions and services to be carried out

³⁸² *supra*, note 50, p. 7.

³⁸³ See the Ugandan Constitution, *supra*, note 47, article 189(1).

³⁸⁴ *ibid*, Article 189(3).

³⁸⁵ *Ibid*, Article 189(2).

by each local government council.³⁸⁶ District councils are responsible for functions and services including but not limited to: primary and secondary education, trade, special and technical education; hospitals other than hospitals providing referral and medical training; health centers, dispensaries and aid posts; the construction and maintenance of feeder roads; the provision and maintenance of water supplies; agricultural extension services, land administration and surveying; and community development.³⁸⁷

In comparison to the Kenyan system, the Ugandan Councils have more responsibilities in the education sector than the Kenyan Counties. They are responsible for primary, secondary, special and technical education, functions that are a preserve of the National Government in Kenya. The Kenyan Counties only control pre-primary and vocational education according to the fourth schedule of the Constitution of Kenya, 2010.

In Uganda, transfer of functions has been slow. This is due to severe local capacity constraints. This has created a situation where only the upper-government tiers, that is; districts, municipalities, towns and sub-counties execute significant expenditures on their own.³⁸⁸ The lower level administrative units execute little expenditures, mainly remuneration of the local councils.³⁸⁹ The implementers of the Kenyan system should guard against such a result, by focusing on capacity building during the transition process. With adequate capacity, the Counties shall be more ready to take up their functions, allowing quick transfer of functions.

In further comparison to the Kenyan system, both countries have separate functions allocated to the devolved governments. However, the Kenyan system has the functions of both levels of government specified in the Constitution, while the Ugandan Constitution does not specify the functions of the local governments, leaving that to legislation. It is noteworthy that through legislation, the Ugandan local governments have been allocated more substantive functions

³⁸⁶ *ibid*, p. 7.

³⁸⁷ Government of Uganda (GoU), (1997), *Local Governments Act*, Second Schedule, available at: <http://www.ulii.org/ug/legislation/consolidated-act/243>, (last accessed 17th August, 2012).

³⁸⁸ Ehtisham Ahmad, Giorgio Brosio, and María González (2006), *Uganda: Managing More Effective Decentralization*, IMF Working Paper WP/06/279, p. 11, available at: <http://cid.bcrp.gob.pe/biblio/Papers/IMF/2006/Diciembre/wp06279.pdf>, (last accessed 16th August, 2012).

³⁸⁹ *ibid*.

especially secondary and primary education, functions which have been left to the National Government in Kenya.

In addition, the problem of concurrent and overlapping functions has been cured in Kenya by the constitution providing that functions conferred on more than one level of government are within the concurrent jurisdiction of both, and that functions not assigned to the County Governments remain to be functions of the National Government. It further allows Parliament by legislation to clarify any function.³⁹⁰ In Uganda, division of functions and services is only working well for the district level. At lower levels, problems related to duplication of service delivery have surfaced, sometimes leading to revenue collection and funding disputes.³⁹¹

4.3.3 Revenue Assignment

The Ugandan Constitution grants local governments power to levy fees and taxes including rents, rates, royalties, stamp duties, personal graduated tax (which has since been abolished), cess, fees on registration and licensing and any other fees and taxes that Parliament may prescribe. Pursuant to the Constitution, the fifth schedule to the Local Government Act 1997 clarifies the taxes as graduated personal tax (GPT), sales tax, property tax, fees and other revenues including; fines on licences and permits in respect of any service rendered or regulatory power exercised by the local council, interest on investments, rents from lease of property owned by the local council, fees and fines imposed by courts administered by the local council, donations, contributions and endowments, charges or profits arising from any trade, services or undertaking carried on by the local council, annual bicycle licences, parking fees, advertisement fees, cess on produce, user charges where applicable, fishing licences, agency fees, charcoal burning licences and any other revenue which may be prescribed by the local government and approved by the Minister. The above is an elaborate framework attempting to grant wide taxation powers to the local governments.

In comparison to Kenya, the Ugandan Councils are empowered to raise graduated personal tax and sales tax, granting them a much wider tax base than that of the Kenyan Counties. The

³⁹⁰ Article 186

³⁹¹ *supra*, note 61 at p. 13.

Ugandan Minister for Local Governments is empowered to approve additional revenue raising measures by local authorities, a preserve of Parliament through legislation in Kenya.

On the allocation of revenue between national and devolved units, the Ugandan Constitution establishes the Local Government Finance Commission.³⁹² This body plays the function of advising the President on distribution of revenue between the central government and local governments.³⁹³ It is thus an important body to ensure national revenue is shared equitably. For intra-local government revenue sharing, the constitution empowers parliament to enact legislation to provide for this. Consequently, a sharing arrangement has been enacted, which ensures that all councils share the revenue allocated to local governments. For instance the city revenue is collected by the division. The division retains 50% of the revenue and transfers 50 % to the city. Revenue from all divisions is placed in a pool and redistributed by formula as grants to the divisions.³⁹⁴

This is similar to the Kenyan revenue sharing arrangements between the two levels of governments. It is important however to point out that in Uganda, the local governments had a much wider tax base through the graduated personal tax (which has since been abolished), and hotels tax, which do not exist in the Kenyan system. The replacements for graduated personal tax (GPT), that is, local service tax and the local hotels tax still do not exist in the Kenyan tax system.

There have been major challenges in implementing revenue assignments in Uganda. Before its suspension, the graduated personal tax (GPT) contributed 80 percent of the local revenues, roughly 60–80 billion Uganda shillings per year.³⁹⁵ It was however felt to be regressive, inelastic and prone to interference.³⁹⁶ The situation was made worse by politicians using it as an avenue to canvass for votes. This led to its abolition in 2005. The treasury initially extended grants to the local governments to compensate them for the loss of revenue arising from GPT abolition, but

See the Ugandan Constitution, *supra*, note 47, article 194.
ibid.

supra, note 50, p. 8.

Bashaasha Bernard, Najjingo Mangheni Margaret and Nkonya Ephraim (2011), *Decentralization and Rural Service Delivery in Uganda*, p. 4, available at: <http://www.ifpri.org/sites/default/files/publications/ifpridp01063.pdf>, last accessed 17th August, 2012).

supra, note 61, p. 9.

that was stopped in the July 2007 budget. The compensation scheme has since been replaced by fresh taxation powers in July 2008, allowing local governments to levy the local service tax and the local hotels tax.³⁹⁷ These new taxes are faced with serious doubts as to their potential yields. For instance, the estimated potential of the Local Service Tax is Ushs 67 billion per year but in 2008/09 only 4.9 billion, inclusive of the Hotel Tax, was collected.³⁹⁸ The amount rose to 9.2 billion in 2009/10.³⁹⁹ This is meager compared to the 60-80 billion Ushs the GPT would yield. It has caused a huge financing deficit that has highly constrained service delivery in local governments.⁴⁰⁰ The other revenue raising avenues and taxes are either of low yield or are difficult to collect.⁴⁰¹

The revenue assignment is thus not effectively implemented in Uganda, and it is feared the situation may replicate itself in Kenya. To avoid such, the study proposes that Kenya should allocate taxation powers for one of the high yield taxes to the Counties, especially sales tax and income tax from County employees. Furthermore, revenue collection methods should be thought out and streamlined in all counties to ensure efficient methods are used and pilferage of the revenue raised is minimized. The County Governments should also apply incentives to attract business in the counties so as to expand their tax base.

4.3.4 Inter-Governmental Transfers

The Ugandan Constitution has provisions on inter-government transfers through the grants system. It establishes three types of grants; an unconditional grant calculated as per a formula provided in the constitution,⁴⁰² conditional grants for specific programs under conditionalities agreed between the governments⁴⁰³ and equalization grants for giving subsidies or making special provisions for the least developed districts.⁴⁰⁴ Further, the Government has developed

³⁹⁷ Uganda Online (2008), *Uganda Replaces Graduated Tax with Local Service Tax*, available at: <http://www.ugee.com/v/videodirectlink/986-leo-by-mr-lenny.html>, (last accessed 17th August, 2012).

³⁹⁸ Local Government Finance Commission (2009), *Annual Report*, p. ii, available at: http://www.lgfc.go.ug/docs/Annual_Report_2009_for_Review.pdf, (last accessed 20th August, 2012).

³⁹⁹ Local Government Finance Commission (2011), *Annual Report*, p. 15, available at: <http://www.lgfc.go.ug/docs/ANNUAL%20REPORT%202011.pdf>, (last accessed 20th August, 2012).

⁴⁰⁰ *ibid.*

⁴⁰¹ *ibid.*

⁴⁰² See the Ugandan Constitution, *supra*, note 47, Article 193(2).

⁴⁰³ *ibid.*, Article 193 (3).

⁴⁰⁴ *ibid.*, Article 193 (4).

very significant, rule-based intergovernmental transfer programs that account for a substantial proportion of total central government revenues.⁴⁰⁵ Moreover, the Local Government Finance Commission (LGFC) has a major role in the intergovernmental transfers system. It has constitutional powers including; advising the President on distribution of revenue between the Government and local governments, recommending to the President the amount to be allocated as the equalization and conditional grants and their allocation to each local government, recommending to the President potential sources of revenue for local governments and advising the local governments on appropriate tax levels to be levied by local governments.⁴⁰⁶ This makes it a key player in ensuring smooth inter-governmental transfers.

In comparison to Kenya, it is important to note that both countries provide for conditional, unconditional and equalization grants. The structure of these grants is quite different. In Uganda, the three grants are treated separately and administered separately. In Kenya on the other hand, we have the revenue share for each county which is an equitable share of the revenue raised nationally and the equalization fund. Conditional and unconditional grants may be awarded to counties from the National Government's equitable share of revenue raised nationally and the equalization fund may also be used as a conditional grant by the National Government to counties with marginalized communities introducing subjectivity on the part of the National Government. We have the Commission for Revenue Allocation (CRA) in Kenya which plays a similar role to the Local Government Finance Commission (LGFC) in Uganda, only that CRA produces binding proposals which are discussed and adopted by parliament. On the other hand, LGFC simply plays an advisory role to the president, with its recommendations not entirely binding. Finally, the formula for calculating grants in Uganda is entrenched in the Ugandan Constitution, while the Kenyan one is to be enacted and reviewed by Parliament periodically though article 203 of the Constitution provides general guidelines.

Implementation of the inter-governmental transfer system has been blamed as being a major disincentive for local revenue generation in Uganda. For instance, in financial year 2010/11, central government transfers to Local Governments (LGs) accounted for 30 to 37 percent of the

⁴⁰⁵ *supra*, note 1, p. 40.

⁴⁰⁶ *ibid*, Article 194(4).

national budget and constituted about 95 percent of LG revenue.⁴⁰⁷ That means revenue generated by LGs from own sources was a meager 5%. Moreover, the suspension of GPT in 2005 and the three years it took before enactment of its replacements, local service tax and the local hotels tax in 2008, made the LGs heavily dependent on the GPT compensation system from the National Government. This has served as a disincentive to engage in aggressive revenue generation through the new taxes. It has thus created a situation of heavy dependence from central government for operations, and a large disincentive to raise local revenues which defeats the essence of devolution.

The implementers of the Kenyan system need to guard against such a state of affairs by affording enough incentive to the Counties to make own source revenue a priority. The existing incentive is the provision that own generated revenues are deposited in the County Revenue Fund, allowing their retention within the County. However, the study proposes pegging of borrowing capacity to the Counties own generated revenues, which may spur more enthusiasm in generating local revenues.

Further, in Uganda, the conditional grants for specific development projects form an average of 88% of total National Government grants with unconditional grants, mainly used for recurrent expenditures forming 11%. The remaining 1% is covered by equalization grants.⁴⁰⁸ These conditional grants are given for specified projects, as prioritized by the National Government, stifling the discretion of local governments to fix their priority areas.⁴⁰⁹ It leaves the National Governments in charge of development agenda in the devolved units, which should be minimized in a fiscally decentralized system. The Kenyan system should guard against such an occurrence by either enacting a sharing formula for the equalization fund or passing a law to regulate conditionalities for the grants from National Government.

⁴⁰⁷ *supra*, note 73, p. 12.

⁴⁰⁸ National Council of Applied Economic Research (2010), *Decentralisation in Uganda*, p. 4, available at: http://www.ruralgov-ncar.org/images/product/doc/13_400450990_DecentralizationinUganda.pdf, (last accessed 17th August, 2012).

⁴⁰⁹ Steven Jean, Tiphany Lee et al (2010), *Local Government Fiscal Discretion in Uganda*, NYU Advanced Project in Management & Policy, p. 3, available at: <http://www.mdpafrika.org.zw/publications/LG%20Fiscal%20Discretion%20Paper.pdf>, (last accessed 21 August, 2012).

4.3.5 Sub-national Borrowing

The Ugandan Constitution allows local governments to borrow money, but with approval of the National Government, and as per rules to be prescribed by parliament.⁴¹⁰ Pursuant to this requirement, the Local Governments Act, 1997, clarifies the power to borrow by way of debenture, issue of bonds, or any other method, but places restrictions. First, the borrowed amounts should not exceed 25 percent of the locally generated revenue. Second, executive committee of the local government should guarantee that the loan repayment shall not adversely affect the ability of the local government (LG) to meet its statutory obligations, including payment of salaries. Third, if the amount to be borrowed exceeds 10 percent of the total amount the local government council is eligible to borrow, the approval of the Minister for Local Government must be sought. Fourth, the Auditor General should have certified the books of account of the preceding financial year, without qualifications. Fifth, the funds should be intended for investment in priority activities as identified by the whole council. Finally, all loans approved by the Minister shall be published in the official Gazette.⁴¹¹ The above provisions set a stringent framework and caps meant to check abuse of borrowing powers. The stringent rules have contained formal indebtedness by the LGs, thus limiting moral hazard and fiscal irresponsibility.⁴¹² However these rules have proved counterproductive as they have constrained the LGs' ability to access additional resources to finance service delivery based on local needs.⁴¹³

In comparison to the Kenyan system, the power to borrow is not pegged on County revenues. Further, the National Government and not the County Executive Committee (CEC) are the guarantors of such borrowing. Moreover, the Cabinet Secretary in charge of devolution matters has no role in approving the borrowing, which responsibility is charged on the county assembly.

Despite an enabling framework in Uganda, there is no record of any successful bond or debenture issue by any LG to raise funds for development. LG borrowing has been limited to temporary loans and overdrafts to finance recurrent expenditure. This shows that implementation

⁴¹⁰ See the Ugandan Constitution, *supra*, note 47, Article 195.

⁴¹¹ For details on restrictions see the *Local Governments Act*, *supra*, note 60, Section 20.

⁴¹² *Supra*, note 61, p. 16.

⁴¹³ *supra*, note 81, p.7.

of issuance of infrastructure bonds is wanting in Uganda. The Kenyan implementers need to do sensitization and awareness on County Treasury bonds and securities, so as to give prominence to this mode of borrowing, as an alternative to loans, by Counties.

In further comparison with the Kenyan framework, both allow sub-national borrowing. However, the Kenyan system involves the county assembly in approval of loans and only requires a guarantee, not approval of the National Government. However this framework is yet to be tested and there are fears that the national government may frustrate county borrowing through unwarranted refusals to grant guarantees. The implementation problems facing the Ugandan system may still resurface in Kenya.

4.3.6 Lessons for Kenya from the Challenges in the Ugandan System

Fiscal Decentralization in Uganda has improved service delivery, promoted welfare growth and enhanced overall rural development.⁴¹⁴ However, it still has faced some challenges. First is the challenge of implementation. Despite there being a strong legal and constitutional basis for decentralized government rights and responsibilities, there has not been a clear process or pragmatic timetable for the transferring of functions. Many central sectoral ministries are reluctant to relinquish responsibilities in a way they perceive to diminish their own power. The implementation roadblocks and bottlenecks are thus a major challenge.⁴¹⁵ There has also been an asymmetric decentralization in different sectors. Some line ministries are reluctant to devolve leading to a slow decentralization process. On the other hand, other ministries, like education, have devolved too rapidly in attempt to comply with the letter of the law, overwhelming the capacity of local governments.⁴¹⁶ The Kenyan system addresses this by setting up Constitutional bodies to manage the transition, namely the Commission for the Implementation of the Constitution (CIC), the Transition Authority (TA) and Commission on Revenue Allocation (CRA), and also providing clear timelines and phases for the transition to the devolved system.

⁴¹⁴ Okidi John & Guloba Mdina (2006), *Decentralization and Development: Emerging Issues from Uganda's Experience*, p. 4, Economic Policy Research Centre, Occasional Paper No. 31, available at: <http://ageconsearch.umn.edu/bitstream/93810/2/op31.pdf>, (last accessed 8th October, 2012).

⁴¹⁵ Paul Smoke, *supra*, note 1, p. 40.

⁴¹⁶ *Ibid.*

Second is the challenge of weak institutional support structure. The bodies formally charged with coordinating the decentralization process, namely the Decentralization Secretariat and the Local Government Finance Commission, have not been performing well.⁴¹⁷ They have inadequate authority to command cooperation from other key agencies. They lack clear political mandate, appropriate strategies to move forward and adequate authority to enforce cooperation, relegating their roles to mere coordination and advisory. This coupled with cautious attitude about decentralization by National Government, slows down the pace of devolution, undermining their capacity to effectively perform the complex task of managing decentralization.⁴¹⁸ The Kenyan system attempts to avoid such a situation by providing for constitutional institutions, whose advice on certain devolution matters is binding on various state organs, including the National Government. The enacted laws like the Transition to Devolved Governments Act also attempt to provide security of tenure to members of the Transition Authority to ensure they undertake their mandate without undue influence.

Third is capacity constraint. Most local governments (LGs) suffer from severe incapacity to discharge their mandates effectively. Functions end up being decentralized to LGs who cannot perform them responsibly. There is thus need for extensive technical assistance to LGs as they assume new duties which by far exceed their capacity to deliver.⁴¹⁹ To avoid recurrence of such a situation in Kenya, implementers of the Constitution should focus on enhancing capacities for Counties in the initial stages before transferring some functions to them.

The final challenge is inadequate local revenue. Emphasis has been on the development of intergovernmental transfers, rather than improving local sources of revenue. There also lacks adequate incentives in the transfer formulas to encourage local revenue generation. Though local revenue yields have generally increased under the decentralization programs in Uganda, they are much less than expected, and grants still account for the bulk of local revenues.⁴²⁰ This problem risks occurring in Kenya and should be addressed by allocating taxation powers for more high yield taxes to County Governments. Efforts should be made to find efficient and cost effective

⁴¹⁷ Paul Smoke, *supra*, note 1, p. 40.

⁴¹⁸ *ibid.*

⁴¹⁹ *ibid.*

⁴²⁰ *ibid.*, p.41.

methods of revenue collection including widening the tax base and curbing pilferage of collected revenue.

3.7 Conclusion

The Ugandan decentralized system assigns local governments (LGs) more substantive functions, including primary, secondary and tertiary education. It further grants the LGs power to levy higher yield taxes including; sales tax, local service tax and the local hotels tax. It however has weaknesses by granting the Local Government Finance Commission (LGFC) mere advisory roles, which leaves the National Government with discretion in determining amounts of inter-governmental transfer. The grants system is also clogged by conditional grants, with the numerous conditionalities nullifying LGs' ability to have fiscal discretion on priority areas for investment and service delivery.

The Kenyan system shares some similarities especially in the comparative roles of CRA and LGFC. However, the Kenyan system gives more powers to CRA, making their decisions binding and not merely advisory. In addition, the Kenyan system has less government control on sub-national borrowing. On the other hand, the Kenyan system lacks clear structures on further devolution beyond Counties leaving the task of determining further units of devolution to the County Assembly..

1.4 COMPARATIVE ANALYSIS WITH THE FISCAL DECENTRALIZATION FRAMEWORK IN SOUTH AFRICA

The election of Nelson Mandela as president in 1994 and the subsequent dismantling of apartheid in the Republic of South Africa (RSA) ushered in an era of fiscal decentralization. This was based on the desire to address the challenges of the previously marginalized 88% black majority. This system is henceforth analyzed within the framework of the five pillars of an effective fiscal decentralized system.

4.1 Political Autonomy

The South African Constitution of 1996⁴²¹ provides for three spheres of government namely national, provincial and local, which are distinctive, interdependent, and interrelated.⁴²² There are nine provincial governments; namely, Eastern Cape, Free State, Gauteng, KwaZulu-Natal, Limpopo, Mpumalanga, Northern Cape, North West and Western Cape.⁴²³ The local government consists of municipalities, established for the whole of the territory of the Republic.⁴²⁴ The Local government was transformed in two phases. The first phase was in 1995, when 843 transitional municipalities were created under the Local Government Transition Act.⁴²⁵ The second phase, in 2000, saw incorporation of urban and rural areas, reducing the number of local municipalities to 284, under the Local Government Municipal Structures Act.⁴²⁶ These are classified into 6 metropolitan councils (Category A), 231 local municipal councils (Category B), and 47 district municipal councils.⁴²⁷ In Comparison, Kenya has only two levels of devolved governments though both are under a unitary system. The devolved system in Kenya is fashioned on administrative districts rather than the existing local authorities.

The executive authority of the National Government is vested in the President, together with the other members of the Cabinet, answerable to him.⁴²⁸ The legislative authority is vested in the National Assembly and the National Council of Provinces.⁴²⁹ The Provincial Governments (PGs) are autonomous, with their legislative authority being conferred on the provincial legislature,⁴³⁰ and the executive authority being conferred on the provincial executive, headed by the Premier and consisting of Executive Council members answerable to the premier.⁴³¹ The Premier is

⁴²¹ See Government of South Africa (GOSA) (1996), *Constitution Of The Republic Of South Africa*, 1996, available at: http://www.ffc.co.za/docs/submissions/government_submissions/Constitution%20of%20the%20Republic%20of%20South%20Africa%20No%20108%20of%201996%20as%20amended%20as%20at%203%20April%202009.pdf, (last accessed 20th August, 2012).

⁴²² *ibid*, Section 40(1).

⁴²³ *ibid*, Section 103(1).

⁴²⁴ *ibid*, Section 151(1).

⁴²⁵ Act No. 209 of 1993.

⁴²⁶ Act No. 117 of 1998

⁴²⁷ Anka Derichs, Christiane Einfeldt (2006), *World Bank Seminar: Fiscal Decentralisation and Intergovernmental Fiscal Relations In South Africa*, Strengthening Local Governance Programme, German Agency for Technical Cooperation (GTZ), p. 3, available at: <https://www.giz.de/Themen/de/dokumente/en-fiscal-decentralisation-case-study-south-africa-2006.pdf>, (last accessed 20th August, 2012).

⁴²⁸ See South African Constitution, *supra*, note 93, Section 85.

⁴²⁹ *ibid*, Section 44.

⁴³⁰ *ibid*, Section 104.

⁴³¹ *ibid*, Section 125.

elected from among the members of the provincial legislature.⁴³² The autonomy of the PGs is secured through the provision that the National Government must secure approval of the National Council of Provinces before intervening in the functioning of a PG.⁴³³ The executive and legislative authority of a municipality is vested in its Municipal Council.⁴³⁴ The national or a provincial government are required not to compromise or impede a municipality's ability or right to exercise its powers or perform its functions.⁴³⁵ 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.⁴³⁶ The autonomy of Municipal Governments (MGs) is protected through stringent conditions that PGs must meet before intervening in their functions.⁴³⁷ The above framework thus creates three levels of government that are autonomous and distinctive, yet interdependent and interrelated.

In comparison to the Kenyan system, the South African model provides for a three tier devolution system while the Kenyan system only provides for two. Further, both systems place stringent requirements to be met before one level of government can interfere with the functioning of the other, safeguarding the autonomy of each level. In addition, both countries appreciate independence and cooperation of the devolved governments between themselves and the National Government. Another difference is that in South Africa, both the premier of the province and chairperson of the municipality are elected by the provincial legislature and the municipal council respectively, whereas the governor in Kenya is directly elected by the people.

Another difference is that in South Africa, the Chairperson and the Deputy Chair of the National Council of Provinces⁴³⁸ and also the Speakers and Deputies of both the National Assembly⁴³⁹ and the Provincial Legislatures⁴⁴⁰ are elected from among the members of the legislatures. In the

⁴³² *ibid*, Section 128.

⁴³³ *ibid*, Section 100.

⁴³⁴ *ibid*, Section 151(2).

⁴³⁵ *ibid*, Section 151(4).

⁴³⁶ *ibid*, Section 160.

⁴³⁷ *ibid*, Section 139. The intervention must be approved by the Minister for Local Governments, the relevant provincial legislature and the National Council of Provinces.

⁴³⁸ South African Constitution, *supra*, note 93, Section 64(1).

⁴³⁹ *ibid*, Section 52(1).

⁴⁴⁰ *ibid*, Section 111(1).

Kenyan system, the Speakers of both houses of Parliament⁴⁴¹ and the County Assemblies⁴⁴² are elected from among persons who are not members of the legislatures, with the Deputies⁴⁴³ being elected from among members of the legislatures.

4.4.2 Revenue Assignment

On revenue generation, 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.⁴⁴⁴ They are also given authority to levy a flat-rate surcharge on personal income.⁴⁴⁵ Further, the Provincial Tax Regulation Process Act⁴⁴⁶ provides a framework by which PGs can introduce new taxes. The provincial 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.⁴⁴⁷ The main provincial own-source revenue is road traffic fees, including motor vehicle licenses and registrations and driver's licenses and learner's permits.⁴⁴⁸

As for the Municipal Governments (MGs), the constitution empowers them to levy rates on property and surcharges on fees for services provided by or on behalf of the municipality,⁴⁴⁹ other taxes, levies and duties appropriate to local governments except income tax, value-added tax, general sales tax or customs duty.⁴⁵⁰ Further, the Municipal Fiscal Powers and Functions Act⁴⁵¹ allows introduction of new taxes by municipalities. The Minister of Finance on his own accord or on application by municipalities may authorize new municipal taxes in consultation with the Minister for Local Government, affected municipalities and Financial and Fiscal

⁴⁴¹ Kenyan Constitution, Article 106(1).

⁴⁴² *ibid*, Article 178(1).

⁴⁴³ *ibid*, Articles 106(1)(b) for Parliament and 178(2)(b) for County Assembly.

⁴⁴⁴ *ibid*, Section 228(1).

⁴⁴⁵ *ibid*.

⁴⁴⁶ Act No. 53 of 2001, available at: <http://www.ffc.co.za/docs/acts/Provincial%20Tax%20Regulation%20Process%20Act%20No%2053%20of%202001.pdf>, (last accessed 20th August, 2012).

⁴⁴⁷ *ibid*, Section 3. The section gives procedure for introduction of new taxes by the province.

⁴⁴⁸ *supra*, note 99, p. 4.

⁴⁴⁹ *South African Constitution, supra, note 93, Section 229(1)(a)*.

⁴⁵⁰ *South African Constitution, supra, note 93, Section 229(1)(b)*.

⁴⁵¹ Act No. 12 of 2007, available at: <http://www.ffc.co.za/docs/acts/Municipal%20Fiscal%20Powers%20and%20Functions%20Act%20No%2012%20of%202007.pdf>, (last accessed 20th August, 2012).

Commission (FFC).⁴⁵² The major sources of revenue for municipalities include; surcharges on the sale of bulk services like water and electricity, property rates⁴⁵³ and other sources like traffic fines, business licenses, rental fees, entrance fees for use of municipal facilities and fresh produce markets.⁴⁵⁴

The National Government is left to levy the remaining taxes, which form the substantial part of tax revenues, including; broad-based taxes such as income and corporate tax, value-added tax (VAT), customs and excise, and fuel levies.⁴⁵⁵ In comparison to Kenya, the South African system, by allowing surcharge of personal income by provincial governments (PGs), devolved greater taxation powers. The Kenyan constitution also limits the sources from which County Governments can derive own revenue. 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 a prerogative of Parliament, without the involvement of Counties.

The South African system devolves substantial revenue raising functions to both the provincial governments (PGs) and municipal governments (MGs). However, despite enabling laws, PGs revenue assignment has been characterized by a low tax base, with revenue yield recording low percentage increase in recent years.⁴⁵⁶ This has left the provinces heavily dependent on the National Government for revenue, with National Government grants forming over 97% of the

⁴⁵² *ibid*, Section 4. As per the Budget Review, *supra*, Note 126, by 2012, only two such applications had been received by the National Treasury. The first application is 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 proposes the introduction of a local business tax for businesses operating within the jurisdiction of metropolitan municipalities.

⁴⁵³ The Municipal Property Rates Act regulates the power of municipalities to impose rates on properties. It came into operation in 2005.

⁴⁵⁴ Stanton Anne (2009), *Decentralisation and Municipalities in South Africa: An Analysis of The Mandate to Deliver Basic Services*, Thesis Submitted in fulfillment of the requirements for the degree of Doctor of Philosophy (Policy and Development Studies) in the Faculty of Humanities, Development and Social Sciences at the University of KwaZulu-Natal, Pietermaritzburg, p. 171, available at: <http://researchspace.ukzn.ac.za/xmlui/bitstream/handle/10413/623/Stanton%20A%20PHD.pdf?sequence=1>, (last accessed 20th August, 2012).

⁴⁵⁵ GOSA (2012), *Budget Review 2012*, National Treasury Republic of South Africa, p. 39, available at: <http://web.up.ac.za/sitefiles/file/40/2012%20Budget%20review.pdf>, (last accessed 20th August, 2012). National tax revenues were R625.1 billion in 2008/09 FY, 598.7 billion in 2009/10 FY, 674.1 billion in 2010/11 in FY, 738.7 billion in 2011/12 FY and is projected to grow to 826.4 billion in 2012/13 FY.

⁴⁵⁶ *ibid*, p. 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.

total provincial revenues.⁴⁵⁷ On the other hand, the MGs 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 like water and electricity, which are high yield taxes. Consequently, they survive on lower levels of government grants. For instance, MGs have steadily financed over 80% of their expenditure on their own revenues.⁴⁵⁸ As a consequence, the MGs receive much lower percentages of national revenue through National Government grants.⁴⁵⁹

In further comparison to Kenya, both countries allocate separate tax bases for the different levels of government. It is noteworthy however that in South Africa, the MGs have a much wider tax base and even surcharge fees for bulk services like 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 provincial governments (PGs) in South Africa, making counties over-reliant on National Government grants. Moreover, the Minister for Finance is given a key role in authorizing additional taxes to be levied by the devolved units in South Africa, whereas such powers in Kenya are the preserve of parliament which in fact cannot exercise such powers to deprive a County Government of a constitutionally allocated revenue base.

4.4.3 Sub-national Borrowing

The PGs in South Africa are allowed to take loans for capital or current expenditure, but loans for current expenditure may be raised only when necessary for bridging purposes.⁴⁶⁰ Parliament is empowered to pass national legislation for managing PG borrowing.⁴⁶¹ Pursuant to this power,

⁴⁵⁷ *ibid*, p. 16.

⁴⁵⁸ GOSA (2011), *Local Government Budgets and Expenditure Review*, National Treasury Republic of South Africa, p. 18, available at: <http://www.treasury.gov.za/publications/igfr/2011/lg/02.%202011%20LGBER%20-%20Final%20-%202013%20Sept%202011%20%28renumbered%29.pdf>, (last accessed 20th August, 2012). Figure 2.5, revenue trends per major source captures the data since 2005/06 FY to 2011/12 FY.

⁴⁵⁹ *supra*, note 120, p. 110. MGs received the following percentages of national revenue; 7.8% in 2009/09 FY, 7.5% in 2009/10 FY, 8.2% in 2010/11 FY and 8.4% in 2011/12 FY.

⁴⁶⁰ South African Constitution, *supra*, note 93, Section 230 (1).

⁴⁶¹ *ibid*, Section 230(2). Parliament must however first consider recommendations of the Financial and Fiscal Commission.

Parliament has since enacted the Borrowing Powers of Provincial Governments Act⁴⁶² and the Public Finance Management Act.⁴⁶³ The latter Act authorizes the Member of the Executive Committee (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.⁴⁶⁴ However, the PG cannot issue the foregoing for loans denominated in foreign currency.⁴⁶⁵

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.⁴⁶⁶ The National Government may guarantee a loan for PG, but that is limited to guarantees for loans issued in foreign currency.⁴⁶⁷ The two Acts thus authorize PGs to issue its 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.⁴⁶⁸ Their borrowing is thus restricted to majorly bank overdrafts.

The municipal governments (MGs) in South Africa are also authorized to raise loans for capital or current expenditure, with loans for recurrent expenditure only limited to loans for bridging purposes.⁴⁶⁹ However on guarantees, the council of the MGs is required to bind itself and a future Council to secure loans.⁴⁷⁰ Parliament is empowered to pass national legislation for managing MG borrowing.⁴⁷¹ Pursuant to this power, parliament has enacted the Local

⁴⁶² Act No. 48 of 1996, assented to 27 September 1996, available at: <http://www.info.gov.za/view/DownloadFileAction?id=70887>, (last accessed 20th August, 2012).

⁴⁶³ Act No. 1 of 1999, Assented To: 2 March 1999, available at: www.treasury.gov.za/legislation/PFMA/act.pdf, (last accessed 20th August, 2012).

⁴⁶⁴ *ibid*, Section 66(2)(b).

⁴⁶⁵ *ibid*, Section 67.

⁴⁶⁶ *Supra*, note 132, Section 4(b)(vi).

⁴⁶⁷ *ibid*, Section 5.

⁴⁶⁸ Momoniat Ismail (2001), *Fiscal Decentralisation In South Africa: A Practitioner's Perspective*, p. 8, available at: <http://info.worldbank.org/etools/docs/library/128819/Momoniat%202001%20South%20Africa.pdf>, (last accessed 20 August, 2012).

⁴⁶⁹ South African Constitution, *supra*, note 93, Section 230A(1)(a).

⁴⁷⁰ South African Constitution, *supra*, note 93, Section 230A(1)(b).

⁴⁷¹ *ibid*, Section 230A(2). However, in making the law, Parliament must consider recommendations of the Financial and Fiscal Commission.

Government Municipal Finance Management Act (LGMFMA).⁴⁷² 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.⁴⁷³ It must, however, pay off the short-term debt within the financial year, and cannot extend it to the next year.⁴⁷⁴ 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.⁴⁷⁵ However, the additional requirements of considering written comments by the public, the National Treasury and the relevant Provincial Treasury, before approval of the loan are placed.⁴⁷⁶ The Council is required to give its own security for its loans,⁴⁷⁷ and also execute its own guarantees.⁴⁷⁸ In case of default by the council, it allows for a form of judicial intervention, clarifying the rights of lenders.⁴⁷⁹ The MGs are however barred from borrowing loans in foreign currency,⁴⁸⁰ which minimizes municipal exposure to external market volatility. The above provisions promote responsible borrowing for MGs, reducing the need for national and provincial guarantees. However, the two levels of government are left with the discretion of granting guarantees for municipal government (MG) borrowing.⁴⁸¹

In comparison to Kenya, the Counties are not restricted to capital loans like the provincial governments (PGs). They are given freedom to borrow, just like the MGs. However, the security through guarantees is furnished by the National Government and not the County Governments themselves. Kenya should consider binding the Counties to provide their own security since by giving self-security, the counties may be encouraged to engage in prudent borrowing. It also serves as an incentive to repay the loans, based on the knowledge that County property may be seized and sold in attempts to repay the loans.

⁴⁷² Act No. 56 of 2003, assented to 9 February 2004, commenced 1 July 2004, available at: <http://www.ffc.co.za/docs/acts/Local%20Government%20Municipal%20Finance%20Management%20%20Act%20No%2056%20of%202003%20as%20amended.pdf>, (last accessed 20th August, 2012).

⁴⁷³ *ibid*, Section 45.

⁴⁷⁴ *ibid*, section 45(4).

⁴⁷⁵ *ibid*, Section 46(2).

⁴⁷⁶ *ibid*, Section 46(3).

⁴⁷⁷ *ibid*, Section 48.

⁴⁷⁸ *ibid*, Section 50.

⁴⁷⁹ *ibid*, Part 3 on debt relief and restructuring, Sections 151-156.

⁴⁸⁰ *ibid*, Sections 47(a) and 163(1).

⁴⁸¹ *ibid*, Section 51.

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.⁴⁸² They even issue municipal bonds in stock markets.⁴⁸³ 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.⁴⁸⁴ Despite the above measures, the prudent fiscal stance of National Government provides room for expanded borrowing by municipalities, with most municipalities generally not fully utilizing the borrowing space available to them.⁴⁸⁵

In comparison to Kenya, it is important to note that both allow sub-national borrowing. However, the South African system is more prudent, insisting on self guarantees and minimal National Government 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 National Government guarantees for county borrowing. It is also yet to be tested in terms of limits and controls so as to determine its effectiveness.

4.4.4 Inter-Governmental Transfers

Intergovernmental transfers play a major role in financing provincial governments (PGs) and municipal governments (MGs). This is due to several reasons including; low own-source revenues, the constitutional mandate on the National Government to provide basic public services, and the extremely unequal income distribution.⁴⁸⁶ The South African Constitution

⁴⁸² Department of Finance (2000), *Policy Framework for Municipal Borrowing and Financial Emergencies*, Pretoria, South Africa, p. 5, available at: <http://www.info.gov.za/view/DownloadFileAction?id=70340>, (last accessed 20th August 2012).

⁴⁸³ Budget Review 2012, *supra*, note 126, p. 63. For instance, outstanding municipal bonds increased from R11.6 billion in 2010 to R13.2 billion in 2011 in the Johannesburg Stock Exchange. Johannesburg and Ekurhuleni councils are major issuers.

⁴⁸⁴ *ibid*, p. 43.

⁴⁸⁵ Local Government Budgets and Expenditure Review, *supra*, note 130, p. 18.

⁴⁸⁶ Dollery B. (1998), *An Initial Evaluation of Revenue-Sharing Arrangements in the New South African Federalism*, The Journal of Federalism, Vol. 28, No. 2, p. 223, available at: <http://publius.oxfordjournals.org/content/28/2/129.full.pdf>, (last accessed 17th August, 2012).

provides for two categories of transfers to the devolved units. The first is the equitable share of nationally collected revenues.⁴⁸⁷ This enables the PGs and MGs 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 ten factors be taken into account in determining the proportions to allocate PGs and MGs including; national interests, debt levels, fiscal capacity, expenditure efficiency, developmental needs, backlogs, provision for emergency funding, among others.⁴⁸⁸ The Constitution demands that these funds be transferred promptly and without deduction.⁴⁸⁹ Parliament is empowered to make law, providing for the determination of the allocations.⁴⁹⁰ The transfer system takes four dimensions; first, from National Government to provincial; second, from provincial government to local; third, from national to local; and fourth, from local to local.⁴⁹¹

The second is a set of both conditional and unconditional grants.⁴⁹² These accomplish different purposes including; staff salaries, electricity and water services subsidy, fund management support, capacity-building initiatives, among others. These have a component of agency payments from national departments.⁴⁹³ This system is similar to the Kenyan one, which also has equitable shares and an equalization fund, to be utilized through conditional and unconditional grants.

To address disagreements on disbursement amounts, the South African Constitution establishes the Financial and Fiscal Commission (FFC).⁴⁹⁴ The FFC is independent, impartial and subject only to the Constitution in discharging its work.⁴⁹⁵ It is an advisory institution on financial and

⁴⁸⁷ South African Constitution, *supra*, note 93, Section 214 and 227(1)(a).

⁴⁸⁸ *ibid*, Section 214(2).

⁴⁸⁹ *Ibid*, Section 227(3).

⁴⁹⁰ *ibid*, Section 214(1) and (3). The Intergovernmental Relations Act (no 97 of 1997) gives effect to the Constitution, requiring the Cabinet to consult with the FFC, provinces and organised local government (South African Local Government Association (SALGA)) when determining budget allocations between the spheres.

⁴⁹¹ Yemek Etienne (2005), *Understanding Fiscal Decentralization in South Africa*, IDASA Occasional Papers, Budget Information Service -Africa Budget Project, p. 10, available at: <http://www.gsdr.org/docs/open/CC107.pdf>, (last accessed 20th August, 2012).

⁴⁹² South African Constitution, *supra*, note 93, Section 227(1)(b)

⁴⁹³ *supra*, note 162, p. 11.

⁴⁹⁴ South African Constitution, *supra*, note 93, Sections 220 and 221.

⁴⁹⁵ *ibid*, Section 220(2).

fiscal matters, including division of funds among governments. Its recommendations are considered in developing a sharing formula.⁴⁹⁶ It is required to report regularly both to Parliament and to the provincial legislatures.⁴⁹⁷ 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.⁴⁹⁸ This response is typically contained in an Annexure to the annual Division of Revenue Act. The Commissioners also serve in an executive capacity.⁴⁹⁹ It is thus an important body in ensuring an effective, equitable and sustainable system of intergovernmental fiscal relations is maintained.

The FFC in South Africa plays a similar role to the Commission on Revenue Allocation (CRA) in Kenya. The only difference is that the CRA commissioners in Kenya serve on non-executive capacities.⁵⁰⁰ Moreover, CRA's recommendations are subject to consideration by parliament, but parliament may deviate without any justifications. Already the Kenyan Members of Parliament have indicated inclination towards revising the revenue allocation formula proposed by CRA.⁵⁰¹ Kenya needs to borrow from the South African System, by demanding an annexure of CRA proposals to bills generated on related matters indicating extent to which the CRA proposals have been factored in the legislation. That may inform debate both in parliament and also 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 provincial governments (PGs)⁵⁰² and municipal governments (MGs)⁵⁰³ have steadily

⁴⁹⁶ *ibid*, Section 214(2).

⁴⁹⁷ South African Constitution, *supra*, note 93, Section 222.

⁴⁹⁸ See FFC's website; <http://www.ffc.co.za/index.php/faq.html>, (last accessed 9th October, 2012).

⁴⁹⁹ *ibid*.

⁵⁰⁰ Commission On Revenue Allocation Act, No. 16 Of 2011, Section 5(3).

⁵⁰¹ The Standard (28th April, 2012), *MPs Poke Holes in County Revenue Allocation Plan*, available at: <http://www.standardmedia.co.ke/?articleID=2000057189&pageNo=1>, The Star (12th June 2012) *Budget Committee Faults Revenue Allocation To Counties*, available at: <http://www.thestar.co.ke/newsshow.php?nid=1004&head=Budget%20Committee%20Faults%20Revenue%20Allocation%20To%20Counties>, (all last accessed 9th October, 2012).

⁵⁰² Budget Review 2012, *supra*, note 126, *Table W1.3: Division of Nationally Raised Revenue, 2008/09 – 2014/15*, Annexures p.7. 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 into R309 billion in 2012/13 FY, R328.9 billion in 2013/14 FY and R349.3 billion in 2014/15 FY.

⁵⁰³ *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 into R37.9 billion in 2012/13 FY, R40.6 billion in 2013/14 FY and R 43.6 billion in 2014/15 FY.

increased over the period. However, the grant system has faced numerous shortcomings. First, though the total amounts of the grants to PGs⁵⁰⁴ and MGs⁵⁰⁵ have been much lower than the equitable shares, they carry conditions for disbursement of funds and reporting, which limit discretion of the devolved units in expending them. Second, their allocation mechanisms are highly centralized and fragmented. Third, the wide range of grants creates planning and budgeting coordination problems at national as well as sub-national government levels. Finally, equity is not enforced to the latter in the distribution of grants.⁵⁰⁶ 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; the equitable revenue share, conditional and unconditional grants from the National Government revenue share and the Equalization Fund. The Kenyan system needs to guard against skewed distribution of the grants and equalization 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 on the Kenyan system. The Kenyan government has in the past delayed in disbursing Constituency Development Fund (CDF),⁵⁰⁷ Local Authority Transfer

⁵⁰⁴ *ibid*, the PG allocations have been R45 billion in 2008/09 FY, R56.3 billion in 2009/10 FY, 57.7 billion in 2010/11 FY and R70.9 billion in 2011/12 FY. They are projected to grow into R75.4 billion in 2012/13 FY, R82.1 billion in 2013/14 FY and R87.6 billion in 2014/15 FY.

⁵⁰⁵ *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 into R30.4 billion in 2012/13 FY, R33.6 billion in 2013/14 FY and R36.9 billion in 2014/15 FY.

⁵⁰⁶ For a detailed analysis of the weaknesses, see Fiscal Decentralization in East and Southern Africa: A Selective Review of Experience and Thoughts on Moving Forward, *supra*, note 1, p. 24.

⁵⁰⁷ The Standard, (October 9, 2009), *Haste Leads to Waste In CDF Funding*, available at: <http://www.standardmedia.co.ke/?id=1144025976&cid=16&articleID=1144025976>, (last accessed 20th August, 2012).

Fund (LATF),⁵⁰⁸ and Free Primary Education⁵⁰⁹ among other funds. Without adequate measures, this trend may continue, crippling operations of County Governments.

4.4.5 Expenditure Responsibility

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 national and provincial competence to include; agriculture, animal and disease control, property transfer fees, tourism, air pollution, municipal health services, electricity and gas reticulation.⁵¹⁰ Further, the National Government retains expenditure responsibility for functions and issues of national interest that bridge 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.⁵¹¹

Areas of exclusive provincial legislative competence include; abattoirs, ambulance services, cemeteries, licensing of dogs, street lighting, traffic and parking.⁵¹² PGs 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 national and provincial governments, although their delivery rests with the provinces.⁵¹³ MGs are left to deliver basic services and responsibilities including; water, sanitation, electricity and refuse collection.⁵¹⁴

⁵⁰⁸ See The Star (26th April, 2011), *Funds Delay Cripples City Hall Operations*, available at: <http://allafrica.com/stories/201104270080.html>, The Standard (June 7, 2012), *Council Workers Strike Over Delayed Funds*, available at: http://www.standardmedia.co.ke/index.php/business/sports/business/?articleID=2000059413&story_title=Council-workers-strike-over-delayed-funds, (all last accessed 20th August, 2012).

⁵⁰⁹ See The Star (28th May, 2012), *Primary Heads Protest Delay in School Funds*, available at: <http://allafrica.com/stories/201205300998.html>, The Star (27th May, 2012), *School Crisis Over Delayed FPE Cash*, available at: <http://allafrica.com/stories/201205281391.html> and The Standard (31st May, 2012), *Knut, Kuppet Issue Ultimatum Over FPE Funds*, available at: http://www.standardmedia.co.ke/?articleID=2000059070&story_title=Knut,Kuppet-issue-ultimatum-over-FPE-funds, (all last accessed 20th August, 2012).

⁵¹⁰ South African Constitution, *supra*, note 93, Schedule 4.

⁵¹¹ *ibid*.

⁵¹² *ibid*, Schedule 5.

⁵¹³ Understanding Fiscal Decentralization in South Africa, *supra*, note 163, p. 16.

⁵¹⁴ *Ibid*, p. 17.

Compared to Kenya, South Africa has decentralized more expenditure responsibilities to the devolved units. For instance, PGs are responsible for the bulk of education⁵¹⁵ and health⁵¹⁶ expenditures. However, there is still shared responsibility between the National Government and PGs on health and education. On the other hand, much of the above sectors are centralized in Kenya. In Education, the National Government is in charge of universities, tertiary educational institutions and other institutions of research and higher learning and primary schools, special education, secondary schools and special education institutions, leaving the County Governments to be in charge of only pre-primary education, village polytechnics, home craft centers and childcare facilities. In Health, the National Government is in charge of national referral health facilities, leaving the County Governments in charge of county health facilities and pharmacies and ambulance services. This places a heavier expenditure responsibility on the National Government in respect to these two largest government expenditures. It is notable that the Kenyan system is yet to be tested and therefore it is early to judge on the same. Kenya should apply lessons from the South African experience and decentralize more expenditure responsibilities like primary education to Counties to improve on service delivery.

4.4.6 Lessons for Kenya from the Challenges in the South African System

The fiscal decentralization system in South Africa is not devoid of several challenges. First, is low revenue generation. The devolved units, especially the PGs generate minimal revenues, making them heavily over-reliant on National Government transfers.⁵¹⁷ Kenya should avoid such a situation by reviewing the taxation powers of the Counties to include more higher yield taxes. Second, there lacks an overall oversight body to supervise the implementation of the fiscal decentralization system.⁵¹⁸ The FFC's role is limited to fiscal matters, with other details not wholly coordinated. This leaves the National Government with leeway to delay implementing other aspects of fiscal decentralization without recourse for the devolved units. The Kenyan

⁵¹⁵ Elhiraika Adam B. (2007), *Fiscal Decentralization and Public Service Delivery in South Africa*, African Trade Policy Centre, no. 58, p. 10, available at: <http://new.uneca.org/Portals/atpc/CrossArticle/1/WorkinProgress/58.pdf>, (last accessed 20th August, 2012). This presents an average of 80% of total national expenditure on Education.

⁵¹⁶ Ibid, presents an average of 94% of total national expenditure on Health.

⁵¹⁷ IDASA (2012), *What the National Budget Means for Municipalities*, available at: http://www.idasa.org/our_products/resources/output/what_the_national_budget_means, (last accessed 23rd August, 2012).

⁵¹⁸ An Initial Evaluation of Revenue-Sharing Arrangements in the New South African Federalism, supra, note 158, p. 225.

system has partly addressed this through formation of the CIC and the TA. The only weakness is that these bodies shall be temporary, CIC being in existence for five years and the TA for three years respectively. Third is complexity. The MGs are categorized using a complex classification, with some sharing jurisdiction over certain areas and matters.⁵¹⁹ 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 National Government which have been addressed partly by the Intergovernmental Relations Act, 2012.

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.⁵²⁰ The Kenyan system needs to devise incentives for strengthening local revenue generation, to stem over-dependence on National Government transfers. Finally, the challenge of inequality still remains. Reeling from the Apartheid strict racial segregation policy, some areas were long neglected and it shall take long periods of preferential treatment to bring them at par with other areas.⁵²¹ The same situation is existent in Kenya, with Upper Eastern, North Eastern, parts of Coast and Rift Valley regions requiring extensive preferential treatment to bring them at the same level with other areas. The equalization fund shall go a long way in alleviating historical inequities for these regions.

4.4.7 Conclusion

Both the Kenyan and the South African systems provide extensive frameworks for fiscal decentralization. Both protect political autonomy by protecting devolved units from unwarranted interferences in their functions. However, the South African system creates three spheres of devolution whereas the Kenyan one creates only two. Moreover, the devolved units in South

⁵¹⁹ Understanding Fiscal Decentralization in South Africa, *supra*, note 163, p. 22.

⁵²⁰ Rao Govinda (2010), *Intergovernmental Finance in South Africa: Some Observations*, p. 3, available at: http://www.nipfp.org.in/working_paper/wp03_nipfp_001.PDF, (last accessed 20th August, 2012).

⁵²¹ Fiscal Decentralization in East and Southern Africa: A Selective Review of Experience and Thoughts on Moving Forward, *supra*, note 1, p. 9.

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 of water and electricity.

The Kenyan system has more implementation supervision institutions, including the CRA, CIC and the Transition Authority (TA). The only such body in South Africa is the FFC, playing a supervisory role in devolution of fiscal matters.

The two systems are however largely similar in comparison as the Kenyan legal framework seems to have been borrowed from the South African one.

4.5 CONCLUSION

Kenya through the new Constitution has made significant attempts to bring about fiscal decentralization. The constitution provides a skeletal structure of how the system ought to work and a lot of work is to be done by Parliament through passing the appropriate legislations. The experiences of the countries considered in this chapter show that enactment of relevant laws that encapsulate all the elements of an effective fiscal decentralization is the starting point in achieving the same. The Kenyan Constitution provides for this important foundation and it is upon parliament to enact legislations to make fiscal decentralization effective.

The above comparison exposes the strengths and weaknesses of the fiscal decentralization structure proposed by the new Constitution in Kenya. Generally, the Kenyan system is at par with the other systems 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 National Government. 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.

On revenue assignment, the Kenyan system is also poor. 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 the taxes devolved, 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 can succeed where the local authorities have failed. If they do not, it shall create devolved units which are largely reliant on National Government funding through revenue shares and grants, which is undesirable in a fiscal decentralization framework.

On the inter-governmental transfers system, the Kenyan system is better comparatively. It creates an equalization 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 also at par comparatively. Its only major weakness is the insistence on National Government guarantees, which may be an incentive to irresponsible borrowing by the County Governments. However, it is hoped that a healthy fiscal management system shall be developed to minimize this negative effect.

Kenya, under the fiscal decentralization system before enactment of the new constitution, was ranked sixth in Africa, behind South Africa, Nigeria, Uganda, Cote d'Ivoire and Zimbabwe.⁵²² With full implementation of the system under the New Constitution, it is hoped that Kenya shall jump places to be second in Africa, in the extent of fiscal decentralization, only behind South Africa.⁵²³

The implementation of the Kenyan system will thus need to avoid the implementation bottlenecks faced by the system that existed before enactment of the new Constitution and by the countries reviewed in this chapter. How this can be achieved is discussed in the next chapter.

⁵²² Decentralization in Africa: A Stocktaking Survey, *supra*, note 1, p. 5, Figure 3: Extent of Fiscal Decentralization.

⁵²³ The views of Martin Masinde, senior economist in the Parliamentary Budget office, interview by Libendi Edward, 13th August, 2012.

CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS

5.1 INTRODUCTION

The purpose of this study was to establish the extent to which the Kenyan policy, legal and institutional framework is in tandem with the pillars for effective fiscal decentralization. Based on the analysis, the study was to identify gaps and propose recommendations on how best Kenya can implement an effective fiscal decentralization framework. The study sought to identify the shortcomings of attempts to implement fiscal decentralization in Kenya before the enactment of the New Constitution. It then set out to examine the effectiveness of the fiscal decentralization framework proposed in the New Constitution, establishing whether the Acts of Parliament enacted pursuant to the New Constitution are effective in implementing the fiscal decentralization structure it envisages. It also compared the framework for fiscal decentralization in other African jurisdictions with that existing in Kenya. Based on the analysis, the study was to recommend additional reforms needed so as to fully implement an effective fiscal decentralization structure in Kenya.

This chapter summarizes the conclusions of the study. It sums up the points and statements of opinion reached in the study. It captures a summary of the researcher's opinions on the fiscal decentralization framework before enactment of the new constitution. It also sums up the findings on the fiscal decentralization framework proposed in the new constitution. It finally gives a concise brief on the findings from the comparative study.

This chapter also states the recommendations of the study. These are based on the challenges faced by the fiscal decentralization systems in other countries and also by the system in Kenya before the enactment of the New Constitution. They are also informed by the respondents views expressed in the in-depth interviews during data collection.

5.2 SUMMARY OF CONCLUSIONS

Based on the analysis in the preceding chapters, the study makes several conclusions as set out herein below.

5.2.1 Conclusions on the Fiscal Decentralization Framework before Enactment of the New Constitution

This framework was characterized by multiple devolved funds. These devolved funds were operationalized through either Acts of Parliament or Presidential Decrees. They thus had a weak legal framework for operations, which could be altered and even repealed by parliament and the executive at will. The funds established grassroots structures, mostly up to constituency, divisional or local authority level. That produced a framework characterized by multiplicity of committees at the grassroots level administering different devolved funds. These funds were also subject to levels of executive control through the respective ministers, ministry officials or even provincial administrators. The executive used its control to direct and influence the decisions on development projects to be implemented, stifling ownership and discretion on priorities by the locals.

These funds were plagued by several weaknesses. First was political interference with Members of Parliament (MPs) and Councilors using their influence at the grassroots to interfere with the operations of these funds. Second was lack of awareness, with most people not aware of their existence and their objectives. This led to disinterest and lack of participation in their operations by the local persons. The third weakness was inadequate resources. Though the devolved funds had taken up a significant portion of the development budget, the development needs at the grassroots were enormous, overstressing the capacity of the funds at the grassroots. This left many projects unimplemented and some uncompleted. Fourth, the public participation was poor. Their implementation frameworks lacked clear roles and responsibilities for the community in the different stages of project implementation.

The fifth weakness was lack of accountability. Some of the funds did not have an open information policy to enhance accountability. This made it easier for the funds to be misused without any real checks being provided. Sixth was a weak monitoring and evaluation system. Most funds did not have effective monitoring units to ensure efficient and honest use of the funds. This led to ‘ghost’ projects which only existed on paper but were never implemented on the ground. The seventh weakness was delayed disbursements. Funds requested at the beginning of a financial year would be released as late as the next financial year. This led to delayed

projects and initiatives. The eighth challenge was duplicity. Several funds were targeting similar objectives, for instance the LATF bursary, CDF bursary and the Secondary Bursary Fund. This led to fragmentation of resources and duplication of projects thus undermining the service delivery and developmental objectives of the funding respective.

In addition to the above weaknesses, most funds were not in tandem with the pillars for effective fiscal decentralization, namely political autonomy, expenditure responsibility, revenue assignment, inter-governmental transfers and sub-national borrowing. Only the LATF was close to attaining the above pillars, though heavily deficient on some of the pillars.

The study thus concludes that the framework before enactment of the Constitution of Kenya, 2010 did not meet the requirements of effective fiscal decentralization.

5.2.2 Conclusions on the Fiscal Decentralization Framework Enacted in the New Constitution

The New Constitution sought to address the challenges in the previous fiscal decentralization framework by proposing a new system of fiscal decentralization based on a devolved system of governance. This new framework has the hallmarks of an effective fiscal decentralization framework to some extent.

The Kenyan Constitution implements political autonomy, a key pillar of effective fiscal decentralization. The Counties, led by the governor are largely autonomous from the National Government led by the President. They have their own county assemblies with limited but substantial legislative powers and do not account to the National Government for their day to day operations.

It however represents a weak attempt to implement expenditure responsibility, a second pillar of effective fiscal decentralization. Though the Fourth Schedule divides functions between the two levels of government, many functions, however, cannot be neatly categorized as county or national. They will require a combination of centralization and decentralization. This risk is certain as the fourth schedule of the Constitution that delineates the local and national

responsibilities is open to varying interpretations. Consequently, sub-national units of government could exceed their authority in the exercise of their political, administrative and fiscal powers. For example, local governments may engage in policy making in areas that are of concurrent jurisdiction, for instance environmental protection policy or preventive public health intervention. Such responsibility lies in the National Government and not the County Governments.⁵²⁴ The exact split of responsibilities between the National and County Governments will however become clear once the implementation of the constitution gets underway.⁵²⁵ This means that a mismatch between the resources and responsibilities may arise.

Its attempt to implement revenue assignment is inadequate. It allocates entertainment and property tax as the two substantive taxes to be levied by County Governments. It further allows levying of charges and fees for services. This is a wholesome transfer of the taxes being levied by current local authorities to the County Governments. The yield from these taxes has already proved to be insufficient for the operations of the local authorities leading to creation of LATF. The Constitution thus creates a framework that shall have the Counties heavily dependent on inter-governmental transfers for their operations.

On inter-governmental transfers, it enacts an elaborate framework with checks and balances to eliminate abuse by any level of government. The Kenyan Constitution requires that not less than 15 per cent of annual national revenue be assigned to the counties. A further 0.5 per cent is to be set aside for the Equalization Fund. It also creates avenues for transfer of additional revenue to the County Governments through conditional and unconditional grants. There are however two gaps on this pillar. First is the discretion on the National Government to determine the amounts and distribution of the Conditional and unconditional grants. This may lead to skewed allocation of these grants meant to develop only certain areas that are favorable to the regime in power. Second, the Constitution leaves room for the Commission on Revenue Allocation and Parliament to exercise discretion in determining the allocation of national revenue between the county and the National Governments. In such circumstances, there is risk of significant vertical imbalances either in favour of National Government or in favour of the sub-national governments. Large

⁵²⁴ Ibid.

⁵²⁵ As per Angeline Hongo, Member of the Transition Authority. This view was expressed during an in-depth interview on 13th August, 2012.

vertical imbalances in favour of the National Government may create expectation of gap-filling transfers by the National Government to the sub-national governments. It may lead to deficit financing and excessive debt accumulation by the sub-national governments, especially in respect to mandatory statutory payments. On the other hand, substantial vertical imbalances in favour of the sub-national governments may promote excessive spending on functions initially assigned to them. This would make it difficult for them to accommodate within their budgets the additional spending responsibilities that may subsequently be transferred to them.

Finally, the Constitution allows sub-national borrowing. The Counties through approval by the County Assemblies may borrow, from both national and international sources. This is however subjected to limits and conditions aimed at entrenching responsible borrowing. The loans must be guaranteed by the National Government. The major gap in the conditions is the discretion granted to the Cabinet Secretary in charge of finance to decide whether or not to grant guarantees. There is no provision for independent review of the refusal to guarantee by the Cabinet Secretary. This may lead to unwarranted and unjustified refusals, a clog and a fetter to the right to borrow by the Counties.

In conclusion, even with the explicit proposals on sharing of resources enshrined in the Constitution, political pressures or expectation of efficiency gains may motivate decentralization of spending responsibilities without transferring to the sub-national governments adequate resources to meet these responsibilities.

5.2.3 Conclusions on the Various Acts of Parliament Enacted to Implement the Fiscal Decentralization Framework in the New Constitution

The provisions in these Acts if properly applied are largely effective in implementing the framework. They establish the various bodies necessary for implementing the constitutional framework and also elaborate on the constitutional provisions creating clarity.

The Commission on Revenue Allocation (CRA) Act operationalizes the CRA. It ensures the functions and independence of the CRA are maintained and elaborated. Its only weakness is granting non-executive roles to the Commissioners. The Transition to Devolved Government

Act, 2012 establishes the Transition Authority (TA). It allocates the TA functions necessary for being the lead agency in facilitating fiscal decentralization in the transition stage. However, the Act leaves two gaps. First, it makes some functions of the TA purely advisory, for instance staffing rationalization. The advice given is not made binding on the Counties, specifically the County Public Service Board. This leaves lack of clarity on secondment of staff from both the Local Authorities and National Government to the Counties during the transition period. Second, The Act provides that the TA shall stand dissolved three years after the first general elections under the New Constitution. This study envisages that the transition to devolved governments especially on fiscal decentralization aspects may take much longer. It thus grants the TA a very wide mandate to execute within very limited time, a fete which may not be accomplished.

The County Governments Act addresses the gap on further devolution by identifying urban areas, constituencies/sub-counties, villages and wards as possible units of further devolution. It further enhances political autonomy by creating County Public Service Boards, placing the civil service in the county under the control of County Governments. The Act attempts to address civil service transition by providing that public officers appointed by the Public Service Commission serving in the Counties shall be deemed to be in the service of the County Government on secondment from National Government on operationalisation of County Governments. It further empowers the TA in consultation with the Public Service Commission and relevant ministries to facilitate the redeployment, transfers and secondment of staff to the national and County Governments. That closes the gap on civil service transition.

The Intergovernmental Relations Act, 2012, creates a framework for co-operation and consultation among the National and County governments. It establishes the National and County Government Coordinating Summit, the Council of County Governors and an Intergovernmental Relations Technical Committee to offer administrative support to the Summit and the Council. The major weakness of the Act is that it hands over functions of the Transition Authority (TA), upon its dissolution to the Intergovernmental Relations Technical Committee. The functions of the TA are major and will determine the pace and effectiveness of implementing fiscal decentralization in Kenya. This study opines that such functions are better

performed by an independent body, and not a body subject to capture by both the executive and political considerations.

Finally, the Public Financial Management Act, 2012 operationalizes revenue assignment, budget autonomy and sub-national borrowing, key pillars of fiscal decentralization. It has two main gaps. First, it does not allocate any additional high yield taxes to County Governments. This leaves the counties with meager means of raising revenue through taxation, a recipe for low revenue collections as already explained above. Second, in elaborating on borrowing powers by the Counties, it does not provide for the County Government to petition Parliament for a review of the Cabinet Secretary's decision to decline a request by a County Government to guarantee a loan. This may lead to unjustified denials, starving the Counties of much needed development funds.

In summary, it is the researcher's view that these Acts of Parliament have tended to restate the Constitutional framework, without sufficiently addressing gaps in the constitutional framework.

5.2.4 Conclusions on Comparative Analysis from Other Jurisdictions

Other jurisdictions have implemented fiscal decentralization with varying degrees. On expenditure responsibility, Ethiopia allows State governments to set up their own police force and judiciary. Uganda clothes Local Governments with responsibility for primary, secondary, special and technical education. In South Africa the Provincial Governments implement expenditure on primary and secondary education and tertiary institutions. All these functions highlighted above are a preserve of the National Government in Kenya. The Kenyan system does not devolve hugely substantive functions to County Governments.

On revenue assignment, the State governments in Ethiopia have powers to levy taxes on employment income from employees of the state government and sales tax from public enterprises owned by the state government. In addition, both levels of government have some concurrent taxation powers. The Ugandan Local Governments initially had power to levy graduated personal tax (GPT) and sales tax which were major revenue sources. GPT has since been abolished and replaced with local service tax and the local hotels tax. The South African

Provincial governments have power to levy a flat-rate surcharge on personal income. The taxation powers granted to the Kenyan Counties lack all these forms of taxes. Kenya has only taxation powers for taxes which have proved to be low yield, difficult to collect and inadequate for functioning of such governments.

On Inter-governmental transfers, the Ethiopian Federal government allocates block grants to regional Bureaus of Finance and Economic Development (BOFED), according to a national equity formula that reflects both population size and relative need. Second, the BOFEDs allocate annual budgets to regional institutions and block grants to Woredas, according to a regional equity formula. Finally, the Woreda Councils allocate budgets to the various sectors based on priorities and annual work plans. The Ugandan Constitution provides for three types of grants; an unconditional grant calculated as per formula provided in the constitution, conditional grants for specific programs under conditionalities agreed between the governments and equalization grants for giving subsidies or making special provisions for the least developed districts. The South African Constitution provides equitable share of nationally collected revenues, based on ten factors including; national interests, debt levels, fiscal capacity, expenditure efficiency, developmental needs, backlogs, provision for emergency funding, among others. It also provides for both conditional and unconditional grants for specific projects. The Ethiopian system is more advanced than the Kenyan one on levels of transferring funds. The Ugandan system is better for having a sharing formula stipulated in the Constitution. The South African system also has the building blocks to establishing a revenue sharing formula by stipulating the considerations in dividing funds. The Kenyan system thus has a lot to learn from these jurisdictions.

On sub-national borrowing, the Ethiopian system does not allow sub-national borrowing. The Ugandan system allows borrowing, but on self-guarantees from the Local Governments. In South Africa, the provincial governments (PGs) are allowed to borrow on National Government Guarantees. However the municipal governments (MGs) should borrow on self guarantees. Both the PGs and MGs cannot borrow from foreign sources. The Kenyan Constitution allows borrowing by Counties even from foreign sources. However it insists on National Government guarantees.

The study thus concludes that the proposed Kenyan system of fiscal decentralization compares fairly with other jurisdictions. It is stronger on certain pillars, but can learn from the other jurisdictions in certain pillars.

5.2.5 Conclusions on the hypothesis

This study set out to test the following hypothesis.

The existing Kenyan legal and institutional framework does not fully implement the fiscal decentralization framework envisaged in the New Constitution.

The study has proved this hypothesis to be true due to several reasons. First, we are still in transition and fiscal decentralization initiatives established under the old order are yet to be amended to conform to the new constitution or be abolished all together. The various Acts of Parliament and subsidiary legislation operationalizing the system of devolved funds remain intact, there being well publicized disputes as to how to align them to the New Constitution.

Second, the various Acts of Parliament enacted to implement the fiscal decentralization framework under the New Constitution are replete with gaps. The Transition to Devolved Governments Act, 2012 makes the functions of the Transitional Authority (TA) in staffing rationalization purely advisory, leaving the advice given not binding on the Counties. It also provides for dissolution of the TA three years after the first general elections under the New Constitution, by when the researcher opines that it may not have achieved its objectives. The Intergovernmental Relations Act, 2012 hands over functions of the Transition Authority (TA), upon its dissolution to the Intergovernmental Relations Technical Committee. This study opines that this shall leave the determination of the pace and effectiveness of implementing fiscal decentralization in Kenya to a body subject to capture by both the executive and political considerations. The Public Financial Management Act, 2012 does not allocate any additional high yield taxes to County Governments, leaving them with meager means of raising revenue through taxation. It also leaves Counties at the mercy of the national government when it comes to borrowing funds which requires national government guarantees as the Cabinet Secretary may wrongly refuse to approve guarantees for borrowing without remedy of petitioning the senate or

national assembly for a review of the decision. For these reasons, the above hypothesis is thus proven true.

5.3 SUMMARY OF RECOMMENDATIONS

The foregoing conclusions and analysis presented in the whole of this paper forms a basis of several recommendations as discussed below:

5.3.1 Recommendation on Assignment of Functions between the National and County Governments

The study recommends an amendment on division of functions between the National and County Governments. This is vital to ensure that there is a certainty of interpretation. Clarity on identification of betting, casinos and other forms of gambling that are under the mandate of each level of government should be made through legislation. The role of the Counties in promotion of sports and sports education needs to be harmonized with the role of the Sports Stadia Management Board and the other national sports bodies. The role of Counties in manning ferries and harbours needs to be harmonized with that of the Kenya Ferry Services and Kenya Ports Authority. Finally, the role of County Governments in electricity and gas reticulation and energy regulation should be clarified so as not to clash with the role of Kenya Electricity Generating Company (Ken Gen) and Kenya Power Ltd.

This clarity can be achieved through two options. One is amending the Fourth Schedule of the Constitution to ensure this clarity is evident. The Second option is utilizing parliament's power to clarify any functions by enacting an Act of Parliament to entrench clarity and eliminate ambiguities in the functions.

In addition, a revision on the schedule of allocation of functions is necessary. There is need to delegate a more substantial responsibility to Counties in the three highest National Government spending areas, that is, education, health and agriculture. The study proposes granting control of primary education to County Governments. This would put Counties at the forefront in provision of basic education, giving them a substantial role in national development.

5.3.2 Recommendation on Assignment of Taxation Powers between the National and County Governments

The tax base given to the County Governments by the constitution is relatively the same as the one allocated to the local authorities by the previous regime. As already pointed out, these tax bases were not sufficient for the local authorities to operate and discharge their functions. It is therefore obvious that the resource base for the County Governments may not be sufficient. The study proposes an amendment to grant wider taxation powers to County Governments. It proposes devolution of one or more high yield taxes to boost tax revenues of Counties. These taxes may include taxation of employment income from employees of the state government, agricultural tax from farmers, sales tax from public enterprises owned by the state government all borrowed from the Ethiopian system. The new taxation powers may also include local service tax and local hotels tax, borrowed from the Ugandan system. Finally, the taxes can also include flat-rate surcharges on personal income as borrowed from the South African System.

The above can be achieved through two options. First is through a constitutional amendment. This option has the advantage of permanently entrenching the wider taxation powers and guarding them from arbitrary change. Secondly, Parliament may make use of its Constitutional power of law making to grant additional taxation powers to County Governments to pass an Act of Parliament operationalizing taxation power for these new taxes. The advantage of this approach is flexibility for change, through a statute amendment, if any of the new taxes proves hard to implement.

Further, Article 210 (1) of the constitution provides that no tax may be imposed without a legislative basis. This is important as it prevents counties from imposing new taxes arbitrarily. However, this limits the counties from generating their own taxes based on the unique need and resources in the said counties thereby increasing their tax bases. The study recommends an amendment in the constitution to allow the County Governments to generate their own tax bases based on their resources and needs with the necessary checks and balances from the National Government.

5.3.3 Specialized Revenue Collector for County Governments

The Public Finance Management Act provides that the Counties may engage the Kenya Revenue Authority to collect taxes on their behalf. Such an arrangement in respect to Local Authorities has failed to produce higher yields in tax revenues before.

For effective collection of revenue for the counties, this study proposes establishment of an agency that will specifically deal with the collection of taxes for the counties. This agency should have branches in all the counties dealing with the revenue collection within the county. A proposed name for such an agency would be County Revenue Authority. The agency could be made accountable to parliament or any other relevant national body and to the respective county assemblies. In Uganda for example, there is a Local Government Finance Commission which determines and collects local authorities' revenue. This will ensure a level of specialization between the KRA and this agency which in turn will ensure effectiveness of revenue collection.

Alternatively, a specialized department dealing with revenue collection could be set up under the KRA to deal with county revenue collection. This department could then have county departments in every county to deal with revenue collection in the specific county. The above amendment will be beneficial as the agency or the departments through their county offices would maximize revenue collection in each county at minimal cost thereby increasing the amount of taxes collected.

5.3.4 Recommendation on Inter-governmental Transfers

The study recommends that there be more legal cover to Articles 203 and 204 to guard from vertical imbalances, as far as exercise of the jurisdiction of the Commission on Revenue Allocation (CRA) and Parliament in determining the allocation of national revenue between the county and the National Governments is concerned. Like in South Africa, Parliament should be bound to consider and attach the CRA recommendations as an annex to the Division of Revenue Bill. This would guide public participation and debate of the Bill in the house, ending up with an informed formula that is insulated from political considerations.

Like in Uganda, the study recommends that the formula of revenue sharing should be entrenched in the Constitution, subject to amendments/ review every three years. The study also proposes enactment of a law to guide allocation of conditional and unconditional grants from the National Government. This would ensure that while promoting development in marginalized areas, the National Government does not take advantage of the lacuna in considerations to perpetuate inequity by allocating funds to specific regions.

5.3.5 Recommendations on County Borrowing

Borrowing by Counties is essential as it will avail more development funds to County Governments. The study recommends amendment of the Constitution to provide for a hybrid system of guarantees. This is informed by the rapid collapse of the Local Governments Borrowing system under the Local Government Loans Act in the previous decentralized framework. Local authorities failed to repay the loans and misappropriated the funds, leaving the treasury heavily indebted.

In this hybrid system, two guarantees would be executed; self and National Government guarantees. Before enforcing the national guarantee against the treasury, the lender should provide evidence that he has attempted enforcing the self-guarantee and the County Government is impecunious and not in a position to pay. Such a system would provide incentive to County Governments to service loans and eliminate the moral hazard that comes with the assurance that the National Government shall simply take up County Governments' debts in case of failure to service.

Further and in the alternative, there is need to provide remedy for refusal by the Cabinet Secretary for Finance to execute a National Government Guarantee for County borrowing. The County should be allowed to petition either the Senate or the CRA to review such a decision. This would eliminate unwarranted and unjustifiable refusals by the Cabinet Secretary, unlocking avenue for much needed development funds in the Counties.

5.3.6 Recommendations on Amendments to Acts of Parliament

The Commission on Revenue Allocation Act should be amended to allow the Commissioners to exercise executive roles. Also the provision that Commissioners may serve on full time basis should be revisited. It should be made mandatory for them to serve on full-time basis.

The Transition to Devolved Governments Act, 2012 should be amended to grant absolute and binding discretion on the Transition Authority (TA) on transfer and redeployment of staff between the former Local Authorities, National Governments and the County Governments during the transition period. The TA should be granted power to second the staff after a vetting process, with the status of the seconded staff automatically shifting to be County Employees under the County Public Service Board.

Further, the TA being an independent body should play oversight and coordination role in implementation and operation of fiscal decentralization and largely devolution in Kenya. The Act should thus be amended to increase its life to terminate after the general elections that will follow the 2013 ones. This shall ensure stability in operation of devolved units until the 2017 general elections.

The Intergovernmental Relations Act, 2012 should be amended to harmonize the functions of the National and County Government Coordinating Summit, the Council of County Governors and the Intergovernmental Relations Technical Committee. The amendment should remove those functions that conflict with functions of the TA and CIC. The provision transferring functions of the TA to the Technical Committee should be amended based on the amendments in the Transition to Devolved Government Act, 2012 proposed above.

Finally, the Public Financial Management Act, 2012 should be amended. It should allocate more taxation powers to County Governments as proposed above. It should also elaborate the County borrowing guarantee system as proposed above. Finally, it should provide for a procedure of reviewing the decision of the Cabinet Secretary in charge of Finance to decline to guarantee County Borrowing.

5.4 CONCLUSION

It is evident that though the fiscal decentralization framework existing before the promulgation of the constitution had improved service delivery to the people, the management of the same has been riddled with immense challenges. It was therefore important that these challenges be addressed by the new dispensation bench marked by the passing of the new constitution. The New Constitution itself explicitly provides a prescriptive framework for effective fiscal decentralization encapsulating the five pillars of the same. The Acts of Parliament discussed provide for the implementation of the same. This is not to suggest the new dispensation is perfect and devoid of challenges and therefore this study has proposed a few amendments to the same.

Should the above recommendations be implemented to the latter, the study foresees a very effective fiscal decentralization framework in Kenya, that would see Kenya jump rankings to be the first in Africa in levels of fiscal decentralization.

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