THE EVOLUTION OF FISCAL DECENTRALIZATION UNDER KENYA'S NEW CONSTITUTION: OPPORTUNITIES AND CHALLENGES

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INTRODUCTION

With the passage by popular referendum of a new constitution in 2010, Kenya has embarked on a fundamental restructuring of its government system (Kramon and Posner, 2011). Local governments have long existed in Kenya, but the new Constitution mandates an intergovernmental system that substantially differs from the one that has evolved since the colonial period. The new system has positive features, but there are also major design issues and the country faces considerable implementation challenges. This paper describes and critically assesses what is known about the emerging system.

Kenya has a history of local decision making, both from its ethnic traditions and the fairly autonomous local governments established during British colonial rule.[1] The latter were intended to serve settlers, but they were retained and restructured after independence in 1963. Debates about how to organize government in the ethnically fragmented country occurred from the start. Those favoring a more centralized system ultimately prevailed.

Accordingly, local governments were weakened under the banner of "national unity" promotion, but they continued to provide key services, collect revenues, and be governed by elected councils. Elite capture and other governance problems common in post-colonial states existed, but Kenyan local governments were long more empowered and less fiscally dependent on the central government than those in most African countries.

Unfortunately, relative to their legal powers and long history, local governments have generally performed well below their potential and inadequately responded to the growing needs of a progressively more informed population. Central officials blamed the situation on local incompetence and corruption, but seemed powerless or unwilling to help. Local officials claimed they could not improve without a reduction of excessive central interference and an increase in resources. Local citizens, of course, were the losers of this situation, but were not in a strong position to affect meaningful change.

Although several local government reforms were initiated over the years and some progress was made, these efforts never really took off. Only after terrible ethnic violence following December 2007 elections did momentum build for meaningful change and development of the new Constitution, which provides for robust devolution.

THE CURRENT SYSTEM (PRE-IMPLEMENTATION OF CONSTITUTIONAL REFORMS)

Kenya's intergovernmental system has long been problematic (Smoke, 2008; Government of Kenya, 2011). A provincial/district system under the Office of the President (deconcentration) exists in parallel with semi-independent elected local authorities (devolution) under the oversight of the Ministry of Local Government (MoLG). The system was fairly stable for years, but in the 1990s numerous new districts and local governments — many not viable service providers — were created to meet political objectives without systematic analysis.

The fiscal importance of local governments is modest, generally accounting for less than 6 percent of expenditures and less than 5 percent of revenues (excluding provinces/districts that are under the national budget). Local governments had responsibility for infrastructure (roads, water, etc.), although exact functions depended on central decisions, local capacity, and rural vs. urban location, and some functions were reorganized to diminish the role of local governments. A few municipalities provide health and education, otherwise covered by provinces/districts and NGOs.

In terms of revenues, local governments have relied heavily on property rates and, from the late 1980s, a local authority service charge (LASC). This was abolished in 2000 and replaced by the Local Authority Transfer Fund (LATF), the first such fund since Kenya eliminated most transfers during post-colonial recentralization. LATF initially accounted for about 12 percent of local revenues. It has grown, but is unevenly important across local governments, now accounting for

18-82 percent of revenues. LATF is largely earmarked for development and has had a strong urban bias. Local governments also have access to various local fees, licenses, and other minor revenues.

Kenya has a bifurcated system of subnational planning and budgeting that reflects the dichotomy between the deconcentrated provincial-district system and the semi-autonomous elected local authority system (Cohen and Peterson, 1999; Government of Kenya, 2005). National development planning conducted under the Ministry of Planning and National Development (MPND) reaches down to the administrative units at provincial and district level. Provincial and District Development Plans (PDPs and DDPs) are prepared by MPND field staff. The subnational process, however, is essentially simultaneous with the national process and neither flows directly from nor substantially influences the national plan/budget.

Local Authority Development Plans (LADPs) were initiated in the early 1980s by MoLG, but they were not coordinated with DDPs or linked to local budgets. The Local Authority Service Delivery Action Plan (LASDAP) initiated in 2000 to allocate LATF resources was partially linked to local budgets and effectively replaced LADPs.

In addition to resources provided for local public services through the provincial-district and local government systems, Parliament created a Constituency Development Fund (CDF) in 2003 to fight poverty by providing basic services. Rather than try to fix existing systems, Parliament opted to find another way to channel resources for local service delivery — one that served their own political interests.[2] The CDF further confused accountability channels open to Kenyan citizens. Unlike LATF, however, the CDF has had a pro-rural bias. In recent budgets, an increasing proportion of resources under other programs also have been allocated on a constituency basis.[3]

THE CONSTITUTION AND FOLLOW-UP LEGISLATION: DEVOLUTION PROVISIONS AND POLICIES

Chapter 10 of the Constitution outlines a new structure of devolution, creating 47 new county governments that are distinct from existing government units and generally mix urban and rural areas.[4] In principle, their empowerment could overcome much of the planning and budgeting fragmentation outlined above, and they will be directly accountable to local residents. The first county governments will be elected in late 2012.

The structure of county governments mirrors the national level, with separation of executive and legislature in a presidential system. Governors will be elected by simple majority and nominate a cabinet from outside the assembly. Assemblies will be mainly comprised of representatives from single member constituencies, with a few representing women and marginalized groups selected from party lists. The Independent Electoral Boundaries Commission has released preliminary proposals for 1,450 county wards, around half the number in existing local authorities.

After the March 2013 election the national Parliament will have two houses: the National Assembly responsible for the budget and a Senate of 47 county representatives with special powers in relation to county government. The new system incorporates substantial checks on executive power, with the Assembly empowered to approve cabinet appointments and to require a president to fire a cabinet member.

Fiscal provisions borrow heavily from South Africa but with some important differences. County governments are guaranteed an equitable share of not less than 15 percent of national revenues (based on the last audited revenues, a two year lag). The vertical sharing must be defined annually in a Division of Revenue Bill passed by the National Assembly. The horizontal allocation will be through a separate annual County Allocation of Revenue Bill over which the Senate will have the last say. The basis for horizontal sharing is decided by resolution of the Senate every five years. A constitutionally mandated Commission on Revenue Allocation (CRA) provides advice on both vertical and horizontal sharing. Its recommendations are public but not binding.

The Constitution outlines the broad framework of many new institutions, including devolution, and requires further detail in laws that must be enacted within specified timelines. The first county laws were required in August 2011 (one year after the adoption of the Constitution), and the second larger batch must be passed by February 2012. A constitutional Commission on Implementation of the Constitution (CIC) is overseeing the process of preparing legislation required by the Constitution. Kenya's limited policy capacity, stifled during decades of government rule by presidential fiat, is being severely taxed by the enormity of the constitutional reform agenda and time frame.

At both county and national levels, the move to a presidential system in which legislatures can initiate and amend money bills is likely to fundamentally change the balance of power between legislature and executive regarding resource allocation. Diffusion of national executive authority is a core objective of the Constitution generally, and devolution specifically, and this is shaping policy choices as the details of the new system are developed. There is a long history of antipathy between the two factions in the current government of national unity, the post-2007 election power-sharing arrangement between the Party of National Unity (PNU) and the Orange Democratic Movement (ODM). Individual ministries divide along factional lines, inhibiting coordination on key policy issues, such as how public finances and public servants will be managed.

Responsibility for developing laws on devolution has been divided between the ODM Deputy Prime Minister (and Minister for Local Government) and the PNU Deputy Prime Minister (and Minister for Finance). The former appointed a Task Force on Devolved Government (TFDG) comprised of academics, consultants, and public servants to propose policies and laws on devolution. It produced a final report (Government of Kenya, 2011) and six draft laws, including county public financial management (PFM) and intergovernmental fiscal relations that covered much the same ground as the Ministry of Finance (MoF) PFM bill. Inability to resolve disagreements led to a withdrawal of the PFM bill and the submission of two less inclusive bills to Parliament.

The recently formed CIC has so far not demonstrated a capacity to manage these policy disputes well, and it becomes involved only when policy positions are already locked into draft laws. It is not clear that the CIC has the mandate to revisit policy questions, yet it also lacks bureaucratic networks through which to encourage ministries to revise bills they have prepared. The outcome of this problematic process is that bills that fundamentally shape the architecture of devolved government have gone and may continue to go to Parliament with little opportunity for robust consideration of their impacts and risks.

The first bill to follow this path was the Urban Areas and Cities Act, enacted by Parliament in August 2011. The Constitution is particularly vague on the governance of urban areas. Responsibility for functions of the 175 existing local authorities and their own revenue sources (property tax, entertainment tax, and business licenses) are, in effect, recentralized to new county governments. Various articles in the Constitution suggest further decentralization below the county level, and a national law on urban areas is mandated but with a lack of specific direction. The TFDG recommended and prevailed with a model of corporatized urban boards appointed by county governors, with their functions and revenues being determined by the county executive committee.

The Constitution clearly creates great opportunities. It empowers elected local governments with powers and resources; eliminates nonviable local governments and districts created for political purposes; consolidates the bifurcated provincial-district and local government systems; and improves the predictability and transparency of resource sharing among levels of government. There are, however, daunting challenges.

FISCAL DEVOLUTION ISSUES UNDER THE NEW CONSTITUTION

How key intergovernmental and county fiscal systems and processes are defined will depend on pending decisions about institutional structures, leadership of the decentralization process, and political economy factors that drive and shape the overall reforms. A number of important fiscal issues, however, can be identified specifically.

Addressing Disparities and Managing the Economy

Great disparities exist among counties in terms of population, geographic size, population density, capacity, service access, productivity, and ethnic composition (table 1). These have major implications for fiscal decentralization. Historically, inequitable treatment underpins the political economy context that generated momentum for the new constitution, which indicates horizontal sharing should seek to address key disparities. The fiscal climate for doing so, however, is challenging (World Bank, 2011).

The MoF will likely propose an initially minimalist approach to vertical sharing, transferring only funds reassigned from existing programs to be devolved. The CRA will then face a difficult challenge in recommending horizontal sharing criteria. A formula that redistributes to underser-

Table 1
Ranges of Key Indicators of Diversity/Disparity Across County Governments

Variable	*Indicator/ Unit*	*Highest*		*Lowest*	
Population	Population	3,514, 612	Nairobi	101,539	Lamu
Land area	Square km	107,928	Turkana	219	Mombasa
Density	Persons per sq/km	4,291	Mombasa	5.7	Isiolo
Health services	Persons per inpatient bed	4,204	Mandera	372	Isiolo
Sanitation access	% of persons with access	89.2	Vihiga	0.7	Kwale
Water access	% of persons with access	94.7	Nairobi	6.8	Kitui
Immunization	% of children immunized	87.6	Kirinyaga	35.6	Tharaka Nithi
Gross output	Annual average 2005-2010, KES million	703,062	Nairobi	2,158	Samburu
Per capita output	Annual output per capita, KES million	0.22	Nairobi	0.1	Numerous counties

Source: World Bank, 2011. Compiled from Kenya National Bureau of Statistics and World Bank data.

viced counties may leave others with insufficient funds to meet the costs of staff and facilities they will inherit with devolved functions.

Functional Assignments

Although the Constitution provides guidance on the sharing of functions, many details must still be worked out. Counties are broadly responsible for implementation and the center for policy, but with important caveats. Primary and secondary education are national functions, while social welfare, women's rights, social protection, and HIV are assumed to be national because the Constitution fails to mention them.

Functional assignment is deeply political, with devolution advocates jealously guarding the spirit of the Constitution against perceived encroachments. Yet the interpretation of some assignments in a way that favors county governments raises questions of feasibility, affordability, and managing services with spillovers, such as provincial hospitals. The Constitution provides for asymmetric assignments during transition to cater to variable capacity, but it appears to envisage that all counties — from Lamu (about 100,000 residents) to Nairobi (more than 3.5 million residents) — will be responsible for the same functions by the end of the transition period in late 2015.

National ministries are being left to work out function assignments through ad hoc processes and sector working groups for the 2012/2013 budget. Without centrally managed processes using common policies on asset and staff deployment, creeping recentralization through ministerial narrowing of functional assignments could occur. Deep divisions between the two government factions also create transition challenges. For example, two separate ministries were created after the last election to accommodate PNU and ODM demands for a role in health. The impact on both ministries will likely be substantial, with an estimated 87 percent of current health staff being transferred to county governments.[5]

Own-Source Revenues

The own-source revenue bases assigned to county governments by the Constitution are currently under local authorities that will lose their independent status. Some new counties include multiple such authorities, and decisions will have to be made regarding how to use, alter, or discard revenue systems and staff currently in place. Various stakeholders believe that the Kenya Revenue Authority (KRA) should collect county revenues, but it is not clear that the KRA has the capacity or inclination to do so.

It is implicit in the Constitution that county governments will enact their own revenue laws, but many of them will struggle to develop the technical capacity to draft laws, which has been challenging even for the CIC and TFDG. The alternative is to pass a uniform national enabling law and require short county laws that further define bases and rates. To ensure constitutional validity, these laws should be enacted before county governments come into existence, but it is not clear that they are seen as a priority.

Vertical Sharing

The base for the minimum 15 percent of national revenue mandated for county governments is defined to include 'all revenues collected by the national government,' but the MoF and TFDG disagree about what constitutes revenue. The TFDG proposed including user charges, proceeds of asset sales, donor loans and grants and all funds for which the national government has power of appropriation. The MoF-sponsored Commission on Revenue Allocation Act included a narrow (possibly unconstitutional) definition that excludes user fees, funds not in consolidated revenues, and revenues retained by ministries to defray their costs, known as appropriations-in-aid.

From a technical perspective, the question of what is counted in the base is less important than the amount of the county share relative to needs. If the base is more narrowly defined, the percentage can be increased to derive the appropriate amount. The preoccupation with the definition of the base reflects political, rather than technical, considerations; devolution proponents believe that the central government has for too long dominated the national resource cake. The key issue, however, should be the real shares derived from the constitutional provisions. In this regard, it is noteworthy that the equitable share is calculated on past collections, so it is likely to yield substantially less than 15 percent of national revenues in the year in which the transfers are made (table 2).

It is important to emphasize that the equitable share is a minimum (and generally considered to be unconditional) transfer, but it is not the only transfer allowed. Additional (conditional or unconditional) transfers can also be paid from the national government share, but there is not yet a clear process for coordinating decisions about how transfers will collectively relate to aggregate expenditure needs. If more expenditure needs are met through conditional grants, the equitable share might be smaller.

Kenya's fiscal decentralization arrangements draw substantial inspiration from South Africa, but are different in some important respects. In the context of South Africa's parliamentary democracy, the real negotiation over vertical sharing occurs within Cabinet, such that the equitable share and conditional grants can be decided together. In Kenya, the separation between the executive and legislature, as well as Parliament's powers to initiate money bills, make vertical sharing and budgeting processes more uncertain. This is primarily so if the executive and Parliament are controlled by different parties (as at present). The design of the budget process, in particular how agreement is reached on vertical sharing, will be crucial to provide counties with a predictable estimate of transfers early in the budget process.

Horizontal Sharing

It is not yet clear whether the CRA will recommend a familiar formula (CDF uses population, poverty, and equal shares; LATF uses population, urban population, and poverty) or a more complex formula with components tailored to specific functions. Equal shares and poverty favor counties with small, disbursed populations who need considerable capital funding (but have limited capacity to spend it). Even a simple population formula would

Table 2
Minimum Equitable Shares (MES)

Year of transfers	*Base year*	*Base year revenues (KES billions)*	*MES (15% of base year revenues)*	*Transfer year revenues*	*MES as % of transfer year revenues*
2010/11	2008/09	454.4	68.2	686.4	9.94
2011/12	2009/10	515.8	77.4	774.4	9.99
2012/13	2010/11	614.8	92.3	887.0	10.39
2013/14	2011/12	714.2	107.1	989.9	10.82

Source: Estimated from current Kenya budget data.

involve marked redistribution.[6] Given the uneven distribution of staff, high dependence on transfers in many counties, and the high proportion of existing spending on personnel, there will be a need for a "hold harmless" provision.

There is skepticism about the veracity of local authority revenue reporting, but there is general agreement that many underperform (Devas and Kelly, 2001; Kelly, 2004; Government of Kenya, 2011). This raises the thorny problem of whether to consider revenues in the allocation process, and if so, how to avoid rewarding poor tax effort. There is limited data to proxy tax capacity, but there is documentation of great variation in current own-source revenues, from over 2,500 Kenyan shillings (KES) per head in Nairobi, to less than KES 100 per head in West Pokot.[7]

In addition to the other transfers, the Constitution provides for an equalization fund. Although this could help to offset some of the disparities across the new county governments, the volume of funds to be made available for this purpose is relatively small compared to what is to be channeled through the general program.

Urban Issues

The revenues generated by county governments will come mainly from urban areas that will lose their status as independent local governments. If predominantly rural county governments allocate these resources away from urban services, the viability of urban centers that drive Kenya's economy may be undermined. This risk, however, was not the focus of the debate on the urban bill, which centered on classifying the urban areas to which it would apply. The population threshold for the most empowered status, the city and municipal boards, was negotiated to be 250,000, which currently qualifies only three urban areas. All other urban areas will have even more limited authority.

The challenges of ensuring that urban services will be adequately funded by predominantly rural county governments raises the question of whether some functions could be funded by conditional or matching grants with conditions requiring the recipient county governments to delegate revenue collection to urban boards. This, of course, does not fundamentally change the relatively weak downward accountability of the urban boards, and there is the question of what happens in places that will not have them.

SUMMARY AND CONCLUSIONS

There has been disagreement since independence negotiations about the appropriate intergovernmental structure in Kenya. Clearly, the effects of this debate and the ethnic issues in which it is grounded (and in which post-2007 election violence was rooted) underlie the 2010 Constitution and related devolution debates and reforms.

Another key factor is the record of Kenya's government in serving its people. Reformers predominantly wanted to break with the present system and the anemic performance and corruption associated with it. This is embodied in the disempowerment of the provincial-district system (seen as part of an elite, rent-seeking, top-down system) and marginalization of existing local governments (perceived as unaccountable and ineffective). Other reformers are concerned about undermining entities and systems they consider to be poorly managed but not inherently or irreparably flawed.

In this environment, Kenya has embarked on a substantial process of potentially transformational reform. The selective discussion of fiscal, transition, and political economy issues in this paper, however, indicates that much work remains to be done to make the constitutionally mandated devolution in Kenya work effectively

In terms of fiscal issues, several key decisions and challenges need attention. These include determining details of functional assignments to new county governments, defining how these functions are to be carried out, deciding on the level of resources to be shared with county governments, and determining the details of how these resources are to be allocated. A number of important issues, including how urban areas are to be governed and resourced, have headed in a direction that raises nontrivial concerns.

Even once the basic fiscal structures are better defined, the transition process for implementing the new system will need to be worked out. Key issues and considerations on this front include laying out the strategy, sequencing and pace for implementation, defining leadership and coordination mechanisms to manage the implementation process, determining the disposition of the provincial/district administration system, and organizing the rules and systems for public service management.

Both structural and transitional considerations are unfolding in a complex political economy context, the realities of which will determine if a sustainable system of genuinely devolved government will eventually emerge. This article notes some of these realities, including divisions between the two dominant political parties, tensions between centralists and proponents of local autonomy, and the dynamics that will be set in motion with the rebalancing of executive and legislative power. Other important actors and debates are not discussed, including concerns of small political parties and civil society groups about the role that citizen engagement will play in the new system and the alleged capture of reforms by establishment actors whose influence they are intended to reduce.

The promise of Kenya's constitutional devolution is great, but so are the challenges it faces. Those with an interest in Kenya, and in devolution more generally, will be watching with great interest as these reforms unfold.

Notes

1. See Smoke (1993, 2003, and 2008) and Steffensen (2006) for details on Kenyan local government.
2. See Bagaka (2010) and Constituency Development Fund Act, Government of Kenya Law No. 10 of 2003.
3. For example, a percentage of the Road Maintenance Levy Fund (RMLF) is allocated by constituency.
4. The 47 counties are listed in the Constitution and can only be changed by constitutional amendment.
5. Based on data from 2011-12 Kenya National Budget. Assumes staff attached to rural health facilities, district health management teams, and district hospitals are transferred to counties.
6. Based on simulations by Kenya World Bank staff. See World Bank (2011, p.38).
7. World Bank calculations based on LATF Annual Report 2008/09 and 2009 population census.

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