INTERGOVERNMENTAL FISCAL SYSTEMS AND SELF-RULE: A KENYAN CASE STUDY

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DECLARATION

I, HENRY PAUL GICHANA OMBOTO, do hereby declare that *Intergovernmental Fiscal Systems and Self-Rule: A Kenyan Case Study* is my original work and has not been submitted for any degree or examination in any other university or institution of higher learning. While I have relied on numerous sources and materials to develop the main argument presented in the thesis, all the materials and sources used have been duly and properly acknowledged.

Signed ……………………………………………………

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Signature……………………………………………….

ABSTRACT

The conferment of self-rule or autonomy to subnational governments is incomplete without the corresponding conferment of the financial means and discretion necessary to facilitate the exercise of such autonomy. This makes the design of a devolved state's intergovernmental fiscal system and its implementation central to the realisation of subnational autonomy. To facilitate the subnational exercise of autonomy, therefore, an intergovernmental fiscal system needs to be designed in such a manner as to extend and allow the accountable exercise of fiscal autonomy by subnational governments. This entails the accountable exercise of expenditure, revenue and budgetary autonomy. On the basis of these theoretical propositions, this study, interrogates how an integrated devolved state's intergovernmental fiscal system should be designed such as to facilitate the accountable exercise of the margin of autonomy constitutionally extended to its subnational governments.

The study begins by highlighting a pool of design features whose incorporation in the design of an integrated devolved state's intergovernmental fiscal system holds the potential to deliver optimal outcomes for subnational autonomy. Given the similarities in Kenya's and South Africa's financial constitutions, the design and implementation of South Africa's intergovernmental fiscal system is then assessed to examine what design features have been adopted to facilitate the fiscal autonomy of its subnational governments, how their implementation has either enhanced or limited the subnational exercise of autonomy and what lessons it may offer to Kenya.

With respect to the Kenyan case, the study establishes that while the Constitution is explicit in its intention to create distinct (self-ruling) county governments, this autonomy is not absolute. By indicating that the two levels of governments are interdependent, the Constitution recognises the unitary nature of the Kenyan state within which its system of devolution is set. It nonetheless extends county governments a margin of autonomy by requiring the two levels of government to conduct their mutual relations on the basis of consultation and cooperation and further requiring that they respect each other's institutional integrity and constitutional status. The Constitution also lays out the specific objectives which its system of devolution seeks to pursue. While all these constitutional provisions reveal an intention to confer substantial political autonomy to county governments, this study sought to find out whether the financial constitution that embodies Kenya's intergovernmental fiscal system demonstrates a similar intention by conferring a correspondingly similar margin of fiscal autonomy to county governments and, further, whether such fiscal autonomy has been developed and enforced in practice to support the realisation of the political autonomy conferred on counties (and its objectives). The study also explored the extent to which the constitution's design of the system of intergovernmental fiscal controls and oversight serves and has served to facilitate the accountable exercise of fiscal autonomy by county governments.

The study established that in line with the Kenyan constitution's conferment of a margin of autonomy on county governments, its intergovernmental fiscal system is designed and has been implemented in a manner that has extended and allowed the exercise of a degree of expenditure and revenue autonomy. However, the implementation of the constitutional provisions allowing a margin of budgetary autonomy to county governments has been done in a manner that restricts its exercise. Moreover, despite having an elaborate system of fiscal controls and oversight, a reluctance to fully implement it poses a threat to the sustained exercise of fiscal autonomy at the county level as well as threatening the long-term realisation of the objectives of devolution.

DEDICATION

To *magokoro* Bathsheba Bosibori Tai (*In Memoriam);*

To my parents Samuel & Carren Omboto, to whom I am eternally indebted;

To the steadfast kindness of Peter Gachuhi;

and

To the little lion, Leo

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LIST OF ABBREVIATIONS

ADP	Annual Development Plan
AG	Auditor-General
AiA	Appropriation in Aid
ANC	African National Congress
BPS	Budget Policy Statement
CA	County Assembly
CAG	Controller and Auditor-General
CARA	County Allocation of Revenue Act
CARB	County Allocation of Revenue Bill
CDF	Constituency Development Fund
CBEF	County Budget and Economic Forum
CDB	County Development Board
CEC	County Executive Committee
CECMF	County Executive Committee Member for Finance
CFSP	County Fiscal Strategy Paper
CGA	County Governments Act
CHB	Central Housing Board
CIDP	County Integrated Development Plan
CKRA	Constitution of Kenya Review Act
COG	Council of Governors
COGTA	State Department for Cooperative Governance and Traditional Affairs
CPS	County Public Service
CPSB	County Public Service Board
CRA	Commission on Revenue Allocation
CRF	County Revenue Fund
CS	Cabinet Secretary
CoB	Controller of Budget
DDC	District Development Committee

DFRD	District Focus for Rural Development
DORA	Division of Revenue Act
DORB	Division of Revenue Bill
FFC	Financial and Fiscal Commission
FRP	Fiscal Responsibility Principle
GCP	Gross County Product
GPT	Graduated Personal Tax
IBEC	Intergovernmental Budget and Economic Council
IDP	Integrated Development Fund
IGFR	Intergovernmental Fiscal Relations
IGFT	Intergovernmental Fiscal Transfer
IGRTC	Intergovernmental Relations Technical Committee
KRA	Kenya Revenue Authority
LASC	Local Authority Service Charge
LATF	Local Authority Transfer Fund
LGA	Local Government Act
LGES	Local Government Equitable Share
LGLA	Local Government Loans Authority
NCOP	National Council of Provinces
VFA	Vertical Fiscal Asymmetry
VFI	Vertical Fiscal Imbalance
FGT	First Generation Theory of fiscal federalism
MCA	Member of County Assembly
MEC	Provincial Member of the Executive Council
MFMA	Municipal Financial Management Act
MP	Member of Parliament
MPNF	Multi-Party Negotiating Forum
NLGNF	National Local Government Forum
OSR	Own-Source Revenue

NHIF	National Hospital Insurance Fund
NP	National Party
PA	Provincial Administration
PES	Provincial Equitable Share
PFMA	Public Finance Management Act
PIT	Personal Income Tax
PSC	Public Service Commission
RMFLF	Road Maintenance Fuel Levy Fund
RSC	Regional Service Councils
SALGA	South African Local Government Association
SARS	South African Revenue Service
SRC	Salaries and Remuneration Commission
SSA	Statistics South Africa
TA	Transitional Authority
UN	United Nations

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INTRODUCTION

1 Problem statement

Devolution of power, being a derivative of federalism, involves aspects of shared rule and self-rule. Self-rule, or autonomy,[1] is often conferred on subnational governments[2], in the context of devolved states[3], with specific goals in mind. These include: ensuring efficiency in subnational development, facilitating the accommodation of minorities and marginalised groups, enhancing checks and balances on the exercise of power by the national government as well as enhancing democracy and accountability. In the context of devolved states, therefore, subnational autonomy is not conferred as an end in itself but only as a means towards the attainment of these goals (the objectives of autonomy).

However, according to international literature, the realisation of subnational autonomy in practice depends on how a state's intergovernmental fiscal system[4] is structured and implemented. Specifically, subnational autonomy can only be realised if the design and implementation of the intergovernmental fiscal system confers and allows for the exercise of fiscal autonomy by subnational governments. As such, the realisation of the objectives of

[1] While the study utilises self-rule so as to place the discussion in the context of federal theory, 'autonomy' is primarily used in the text as it aligns more with the hybrid federal-type arrangements adopted in South Africa and Kenya that are the focus of the study.
[2] The term 'subnational governments' is used in this study to refer generally to all levels of government outside the national government in a multilevel state context (this includes states, regions, provinces, counties, municipalities among others). See, Alber E 'Intergovernmental financial relations: Institutions, rules and praxis' in Valdesalici A & Palermo F (eds) *Comparing Fiscal Federalism* (2018) 223.
[3] 'Devolved states' is used in this context to refer to those multilevel states formed by the creation of subnational units within a pre-existing unitary state. These are otherwise referred to as holding-together or keeping-together federal and federal-type arrangements as distinguished from aggregative or coming-together arrangements.
[4] An 'intergovernmental fiscal system' refers to the set of rules, institutions and practices (including intergovernmental fiscal relations) that inform and govern the allocation and management of fiscal powers in a multilevel government setting.

autonomy is essentially predicated upon not only the conferment of political autonomy[5] but, equally, upon the conferment and exercise of fiscal autonomy by subnational governments.

According to federal theory, subnational autonomy consists of the powers of initiative and the powers of immunity.[6] Powers of initiative refer to a subnational government's right or liberty to act in its own interests on the authority of previously stipulated rights and privileges. Powers of immunity give finality to a subnational government's actions undertaken within its powers of initiative, by protecting such actions from the review, amendment, negation and/or enforcement powers of higher tiers of government. In this respect, therefore, the extent of a subnational government's autonomy lies in the scope of its powers of initiative and immunity.

Classical federal theories, however, based mainly on analyses of the constitutional design of aggregative federal states, consider subnational autonomy as requiring absolute powers of initiative and immunity. From this perspective, a classification of subnational governments based on the extent of autonomy that they hold adopts a dichotomous typology that classifies them as having or not having either or both powers of initiative and immunity.[7] Moreover, in the elaboration of the components of autonomy, classical federal theory treats autonomy as an end by assuming that immunity ought to be absolute. As a result, it fails to explore the importance or need of limiting subnational powers of immunity in the interest of, inter alia, accountability towards the attainment of the objectives of autonomy.

Recent literature, based mainly on assessments of the constitutional design of devolved states, has however shifted focus from classical federalism's 'absolute autonomy' approach, and has adopted a more flexible and inclusive approach that focuses on the 'margin of autonomy' conferred on subnational governments within a specific constitutional framework.

[5] 'Political autonomy' refers to the conferment on subnational governments of: functional competences and a territorial jurisdiction within which to exercise them; the right to democratically elect own representatives at the subnational level as well as the conferment of executive and legislative authority for the exercise of given competences. See, Fessha Y & Kirkby C 'A critical survey of subnational autonomy in African states' (2008) 38 *Publius: The Journal of Federalism* 255; Vezbergaite I 'Decentralisation policies, subnational autonomy and federal executive power: A comparison of Brazil and Mexico' (2016) 16 *HKJU-CCPA* 59.
[6] Clark GL 'A theory of local autonomy' (1984) 74 *Annals of the Association of American Geographers* 195 – 208.
[7] Clark (1984) 199-201.

From this perspective, a subnational government's autonomy lies on a spectrum between the extremes of total powers of initiative and immunity. This approach, therefore, provides room for devolved states to design their subnational governments' margin of autonomy to fit the specific state's conception of the objectives in pursuit of which such autonomy should be directed. The approach allows for constitutional designs that expand or limit a subnational government's powers of initiative or immunity in the interest of identified objectives of autonomy.

For instance, while subnational accountability is contemplated as part of the objectives of autonomy in devolved states, federal theory conceptualises it merely as a passive end product, and not as an active and integral aspect of autonomy which is a precondition for its continued exercise. Federal theory, in this case, treats subnational accountability as a self-regulating, self-perpetuating product of subnational taxation, which is supported by either the threat of loss of tax base through inter-jurisdictional migration at the subnational level (voting with feet) or through periodical subnational electoral voting (political consequences for subnational decision-making).

However, the public choice school of thought (which is part of the second-generation theories on federal design) argues that political institutions and processes should be modelled with 'explicit attention to the incentives they embody', and with a view to placing constraints on them.[8] In that respect, therefore, the design of subnational autonomy, and fiscal autonomy in particular, requires that attention be paid to the perverse incentives which the conferment of such autonomy embodies. The margin-of-autonomy approach above, hence, allows for the consideration of this perspective to provide for limitations on subnational powers of immunity, in order to create room for an explicit system of oversight and expenditure control, one aimed at ensuring that the subnational exercise of fiscal autonomy is geared towards, and results in, the attainment of the objectives of autonomy.

[8] Oates WE 'Toward a Second-Generation Theory of Fiscal Federalism' (2005) 12 *International Tax and Public Finance* 356.

To facilitate subnational autonomy or self-rule, a devolved state's constitutional framework hence needs to go beyond the conferment of political autonomy to establish and/or provide for the establishment of an intergovernmental fiscal system that not only confers and allows for the exercise of subnational fiscal autonomy but that also ensures that such exercise of fiscal autonomy is accountable towards, among other things, the attainment of the objectives of autonomy.

Literature on fiscal federalism[9] explains subnational fiscal autonomy as consisting of expenditure, revenue and budgetary autonomy. Expenditure autonomy entails the possession of explicit expenditure responsibilities over which a subnational government has discretion as well as finality in decision-making relating to planning, budgeting and implementation. Revenue autonomy entails having revenue resources over which a subnational government can independently exercise autonomy, including its expenditure autonomy. Budgetary autonomy, for its part, relates to discretion to use debt as a subnational budgetary financing tool.

Subnational expenditure autonomy draws on the vertical division of functions among the various levels of government. Functions bestowed on subnational governments then become expenditure responsibilities for which a subnational government has powers to plan, budget for and implement. While the principle of subsidiarity is generally required to guide the vertical division of functions, the constitutional prescription of the nature and scope of the functions determines the extent of the subnational government's powers of initiative and immunity in respect of specific functions.

Federal theory adopts two broad constitutional design approaches to the vertical division of functions and powers, the dualist approach and the integrated approach. The dualist model advocates for the separation of functions and powers, with each level of government having a list of exclusive areas of functional competence. The integrated model, for its part, merges

[9] 'Fiscal federalism' generally refers to the design and implementation of the public finances of various levels of government in a multilevel government setting. See, Valdesalici A 'Defining fiscal federalism' in Valdesalici A & Palermo F (eds) *Comparing Fiscal Federalism* (2018) 16.

separation with concurrence hence while the constitutional design may have significant areas of concurrent competence, each level of government at least has specific areas over which it exercises exclusive jurisdiction. In practice, however, constitutional designs for expenditure autonomy lie on a spectrum with a variety of variations between these two models. In this regard, those functions that lie within the exclusive competence of a level of government confer both powers of initiative and immunity and so extend the highest level of expenditure autonomy to subnational governments. However, functions lying within the concurrent mandate of the various levels of government offer the least autonomy, given that the powers of initiative and immunity, in this case, are not exclusive and are sometimes affected by liberties and/or constraints imposed under national legislation.

Literature places subnational own-choice or prioritisation of policies and development at the core of expenditure autonomy, and links the realisation of this to the concomitant conferment of revenue autonomy.

While fiscal federalism theory had for a while focused on a dualist approach to the constitutional design of the intergovernmental financing framework for subnational revenue autonomy, recent studies have increasingly shifted this focus to integrated models. The dualist model advocates for 'tax' separation, such that each level of government has its own independent sources of revenue. Under this model, the intergovernmental financing framework is required to ensure the matching of, or balance between, a subnational government's expenditure responsibilities with its own revenue sources (vertical fiscal balance). The integrated model, for its part, combines an aspect of 'tax' separation with what has otherwise been referred to in literature as the 'welfare' or 'solidarity' model, which features a system of intergovernmental fiscal transfers. Under this model, subnational governments are financed by a combination of own-source revenue (OSR) and transfers from revenue raised nationally.

The theoretical debate that preceded the integrated intergovernmental financing model had adopted a dichotomous approach that focused on whether the preferable model should focus on matching subnational expenditure responsibilities with OSR or mainly focus on financing subnational expenditure through national transfers. The former approach is associated with James Buchanan's public choice theory, while the latter is linked to Richard Musgrave's modern public finance theory.[10] The public choice school of thought views the state (in the sense of the national/federal government) as a leviathan whose control needs to be kept to the utter minimum, which entails that subnational revenue autonomy (through OSR) is given primacy. Any shortfall in subnational own revenue is therefore viewed as an imbalance (vertical fiscal imbalance, or VFI) that can be rectified only by the reallocation of 'taxation' (OSR) powers. Under the modern public finance theory, the government is seen as always acting in the interest of the people, and therefore revenue and expenditure allocation is done to maximise the economies of a centralised unitary state. In this respect, any form of own revenue shortfall is seen as gap (vertical fiscal gap, or VFG) to be filled by national government grants (transfers), hence little attention is paid to subnational revenue autonomy (through OSR).

However, VFI theorists argue that transfers lead to subnational dependency, are an obstacle to subnational accountability and good fiscal performance, and are also responsible for subnational fiscal profligacy and soft budget constraints.[11] VFG theorists, for their part, argue that a VFG (hence the need for transfers) is essential for the functioning of any decentralised government.[12] This, they argue, is instrumental: in enabling the national government through transfers to not only balance out the mismatch (asymmetry) but to also equalise fiscal capacity and foster horizontal equity in the federation; in countering fiscal externalities imposed by subnational governments on other subnational governments through conditional grants; in protecting subnational governments from idiosyncratic shocks to their fiscal capacities;[13] and in ensuring national minimum standards in the provision of key public services.[14]

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[10] Sharma CK 'Beyond gaps and imbalances: Re-structuring the debate on intergovernmental fiscal relations' (2012) 90 *Public Administration* 105.
[11] Karpowicz I 'Narrowing vertical fiscal imbalances in four European countries' (*IMF Working Papers*, 2012) 10 available at https://www.econstor.eu/handle/10419/189352 (accessed 30 April 2018) 3.
[12] Boadway R & Tremblay JF 'A theory of vertical fiscal imbalance' (2006) 62 *Public Finance Analysis* 1.
[13] Boadway & Tremblay (2006) 1.
[14] Sharma (2012) 105.

Given the dichotomous VFI-VFG approach to the debate on constitutional design for subnational revenue autonomy, the integrated approach sought to merge the two approaches (OSR + transfers), so as to adapt the intergovernmental financing framework to emerging devolved state (margin-of-autonomy) contexts, while also taking advantage of the utility of each of the two models. Under this approach, emphasis is laid on ensuring vertical fiscal equity rather than vertical fiscal balance with the 'imbalance' or 'gap' between subnational OSR and expenditure needs being referred to as a vertical fiscal asymmetry (VFA). However, while fiscal federalism theory has explored various aspects of the integrated model, including its utility for redistribution and/or equalisation (welfare and/or solidarity),[15] literature on its design for subnational revenue autonomy is inadequate.

Although fiscal federalism theory on subnational budgetary autonomy does not adopt a dualist-integration approach, it leans towards an integrated approach where each level of government has own borrowing powers but the national government may borrow to finance the system of intergovernmental transfers. The theoretical debate in this respect has therefore been whether and what scope of borrowing powers to allow to subnational governments. While there is consensus in literature that subnational governments ought to be allowed borrowing discretion, especially with respect to the financing of capital expenditure, on intergenerational equity grounds, a strict no-bail-out policy is however recommended to prevent subnational abuse of budgetary autonomy. Literature, moreover, recommends subnational maintenance of a balanced budget with respect to their recurrent expenditure (also on intergenerational equity grounds); so that the future generation is not burdened by the current's consumption needs. Budgetary autonomy is, however, also linked to a subnational government's revenue autonomy, especially as relates to the capacity of subnational governments to repay debt from their OSR. Subnational budgetary autonomy, similar to subnational expenditure autonomy, is hence largely hinged on the scope for revenue autonomy (OSR-based) extended to subnational governments.

[15] Saunders C 'Financial autonomy vs. solidarity: A dialogue between two complementary opposites' in Valdesalici A & Palermo F *Comparing Fiscal Federalism* (2018).

Although federal theory does not directly address the question of the constitutional design of intergovernmental accountability mechanisms in the context of subnational fiscal autonomy, the Buchanan-Musgrave dichotomous VFI-VFG approaches above provide some insight into the federal treatment of this important issue. While public choice (VFI) advocates rely on subnational 'taxation' (OSR) to provide incentives for downward accountability to the people, modern public finance (VFG) advocates look to transfers to provide vertical accountability to the national government.[16] There is, however, little theory on the constitutional design of an intergovernmental accountability framework in the context of a devolved state's integrated intergovernmental financing framework.

Kenya adopted a new constitution in 2010, hailed as ambitious in every sense[17] and rated, alongside the South African Constitution (on which it was largely based), as one of the most progressive in Africa.[18] Key among the features adopted was a two-tiered system of government that devolved power to county governments. While not federal in its structure, Kenya's devolution adopted a hybrid system with features that lie between those of a federal and a decentralised state. Under this new arrangement, the Constitution sought to confer a margin of autonomy to county governments within a unitary form of government. In this regard, the Constitution recognises the two levels of government as being *distinct* though interdependent and imposes a requirement that they conduct their mutual relations based on consultation and cooperation.[19] Alongside the conferment of autonomy to county governments, the Kenyan Constitution outlines the specific objectives that its system of devolution (hence the conferment of subnational autonomy), should pursue. These include those highlighted above as the objectives of autonomy (efficient development, accommodation, checks and balances as well as democracy and accountability).

[16] Sharma (2012) 105.
[17] Murray C 'Kenya's 2010 constitution' (2013) 61 *Jahrbuch des offentlichen Rechts* 747.
[18] Glinz C 'Kenya's new constitution' available at http://www.kas.de/wf/doc/kas_22103-1522-2-30.pdf?110412154839 (accessed 29 November 2021).
[19] Constitution of Kenya 2010, art 6(2).

The Constitution, moreover, adopted an integrated approach to the vertical division of functions and powers. Power is therefore divided along 'exclusive' as well as concurrent national government and county government competences,[20] thereby demarcating apparent spheres of expenditure autonomy for each level of government. The Constitution also provides for the establishment of political institutions and structures (county legislatures and executive structures) at the county level through which devolved power is to be exercised.[21] It then proceeds to require the two levels of government to respect each other's constitutional status, as well as their functional and institutional integrity when performing the functions and exercising the powers conferred on them.[22]

With respect to the design of the intergovernmental financing system, Kenya also adopts an integrated approach. In this regard, the Constitution bestows on county governments the power to raise their own revenue at the subnational level.[23] It also requires that counties receive an annual unconditional equitable share of revenue raised nationally.[24] Counties are further allowed to receive additional allocations from the national government's share of revenue,[25] as well as from the equalisation fund[26] through grants. All this is aimed at ensuring that county governments, regardless of their geographic, demographic and economic composition, have reliable sources of revenue to enable them to govern and deliver services effectively.[27]

In addition to the above, the Constitution permits borrowing by county governments and sets general basic conditions for this.[28] These include the requirement for the national government's guarantee and the approval of county assemblies in order for county

[20] Constitution (2010), art 186 as read with Fourth Schedule.
[21] Constitution (2010), art 1(3)(*a*) & (*b*) as read with art 176(1).
[22] Constitution (2010), art 189(1)(*a*).
[23] Constitution (2010), art 209(3): This power was confined to the collection of property rates and entertainment tax. The power of county governments to impose any further taxes was left at the discretion of parliament and could be authorised by an act of parliament.
[24] Constitution (2010), art 202(1) & 203(2).
[25] Constitution (2010), art 202(2).
[26] Constitution (2010), art 204(3)(*b*).
[27] Constitution (2010), art 175(*b*).
[28] Constitution (2010), art 212.

governments to borrow. Moreover, the Constitution requires, as a principle of public finance, that the burdens and benefits of the use of resources and public borrowing be shared equitably between the current and future generations.

The Constitution also provides for a system of oversight and expenditure control made up of rules and institutional mechanisms, at both the county as well as at the national level, aimed at ensuring the accountability of county governments in their exercise of fiscal autonomy.

2 Research questions

While it is clear from a cursory review of the Kenyan Constitution that its intention is to confer a margin of autonomy on county governments, what is not clear is the extent to which its approaches to the design of its intergovernmental fiscal system support and advance this autonomy. This study, therefore, seeks to examine how the design and implementation of Kenya's intergovernmental fiscal system has served (and serves) to advance the autonomy of county governments. To answer this question, the following sub-questions are explored:

1. How should intergovernmental fiscal systems in integrated devolved states[29] be designed so as to facilitate the margin of autonomy extended to subnational governments?
2. Given that the design of Kenya's intergovernmental fiscal system borrowed heavily from South Africa, how has the design and implementation of South Africa's intergovernmental fiscal system impacted the autonomy of its subnational governments?
3. What are the goals of Kenya's system of devolution and what role did Kenya's history of decentralisation and decentralised financing play?
4. How has the design and implementation of Kenya's intergovernmental expenditure framework worked to advance the autonomy of counties?

[29] 'Integrated devolved states' is used in this study to refer to those devolved states whose expenditure and financing framework adopts a combined/integrated approach to their design relative to fiscal federalism's dualist approaches.

5 How has the design and implementation of Kenya's intergovernmental financing framework worked to advance the autonomy of counties?

6 How has the design and implementation of Kenya's subnational borrowing framework worked to advance the autonomy of counties?

7 How has the design and implementation of Kenya's system of oversight and expenditure control worked to ensure accountable fiscal autonomy at the county level?

8 Depending on the findings on these questions, is the reform of Kenya's inter-governmental fiscal system necessary?

9 What does the Kenyan case contribute to the theory on subnational autonomy?

3 Argument

This study argues that although there is no universal model of an intergovernmental fiscal system which is best suited to deliver subnational fiscal autonomy in integrated devolved states, literature and state practice provide basic rules and models from which states may draw and improve on, based on their individual historical, socio-cultural, economic and political realities. The study highlights some general design features whose adoption hold the potential to produce optimum outcomes for subnational fiscal autonomy.

The study focuses on the following features whose design is critical to subnational fiscal autonomy: the vertical division of functions and powers and specifically the scope for clear exclusive subnational functions with minimal provision for concurrency; the nature and extent of own revenue sources allocated to subnational governments and the level of control held over them; the mechanism for the allocation of intergovernmental fiscal transfers including grants from revenue raised nationally and specifically the extent to which this is unconditional, independently and objectively determined as well as the promptness of access by subnational governments; the nature and extent of borrowing powers held by subnational governments and the extent of central control held over their exercise; as well as the nature and extent of the intergovernmental financial accountability mechanisms and the extent to which they secure fiscal discipline while allowing room for subnational fiscal autonomy.

With respect to the South African case, this study argues that while the constitutional framework may allow a margin of autonomy to subnational governments, the practice may sometimes obscure the lines. The study also argues that extensive concurrent constitutional mandates hold the potential to limit subnational expenditure autonomy by providing a back-door for recentralisation. The study, moreover, establishes a close link between the exercise of a subnational government's expenditure autonomy and the subnational government's financial self-sufficiency. In respect of the design and implementation of unconditional transfers, the study argues that the specificity of parameters in the revenue division formula limits subnational expenditure discretion by predetermining expenditure. In respect of oversight and expenditure control, the study argues that the implementation of some oversight measures that may otherwise appear limiting to subnational autonomy could be justified in restoring accountable fiscal autonomy. The study, however, argues that the interests of subnational autonomy demand that oversight mechanisms be structured hierarchically.

Kenya's transformative constitution sought to move the country away from a history of centralised exercise of power (including fiscal powers) that had occasioned unequal development and economic marginalisation of communities, as well as failed democracy and accountability. Devolution of power therefore constituted a strategic mechanism for addressing these issues, which then informed the objects of devolution.

However, although the Constitution reveals an intention to delineate exclusive and concurrent functions and powers between the two level of government, it, unlike the South African Constitution, falls short of listing the functions in the Fourth Schedule under explicit exclusive and concurrent lists. This study argues that the subjection of the determination of the specific exclusive county functions to constitutional interpretation exposes the expenditure autonomy of county governments to limitations, depending on the nature of interpretation adopted nationally. The study also argues that, although the current practice is that counties treat and implement the functions listed under Part 2 of the Fourth Schedule as though they are exclusive to the county level with minimal controversy from the national government, this is based purely on national political goodwill and, unless the courts intervene by interpreting county functions broadly or those of the national government restrictively, there are few constitutional limitations should the next government decide to move in to significantly limit the scope for county expenditure autonomy through national legislative interpretation of the functions and powers, which leans in its favour.

The study argues, moreover, that with respect to the revenue autonomy of counties, the Constitution entrenches a VFA which, by default, makes counties reliant on transfers. While the design of the intergovernmental fiscal transfer system has been done such as to extend scope to county governments for the exercise of spending autonomy over their unconditional equitable share, and has previously been able to substantially achieve this, the Commission on Revenue Allocation (CRA) seems to be moving in the direction of South Africa by adopting expenditure-specific parameters in its horizontal revenue division formula which have the potential to limit the expenditure autonomy of counties. The study also argues that constant annual delays by the National Treasury in disbursing the unconditional county equitable share according to the agreed schedule further impacts both the revenue and expenditure autonomy of counties, hence their self-rule.

This is made worse by the fact that access to budgetary autonomy for capital expenditure is in practice restricted by the many preconditions imposed for the issuance of national guarantees. While some counties have been able to access short-term borrowing for bridging purposes, others have been unable to do so due to high commercial lending rates, whose repayment is usually not factored into annual county budgets. The study also makes a case for intergovernmental equity in access to debt, given the impact of the ballooning national debt in the continuing unwillingness by the national government to guarantee or approve county government capital borrowing.

The study further argues that, while the intergovernmental fiscal system provides for a comprehensive system of fiscal controls aimed at ensuring the accountable exercise of fiscal autonomy by counties, these controls have barely been applied effectively in practice. While this has allowed for the exercise of largely unlimited county fiscal autonomy, it undermines effective service delivery and the realisation of the objectives of fiscal autonomy, as well as the long-term sustained autonomy of county governments.

In conclusion, the study argues that, while the design of Kenya's intergovernmental fiscal system provides scope for the advancement of the autonomy of county governments, a combination of various national-level practices arising out of both constitutional and legislative shortcomings have and continue to impact the effective fiscal autonomy exercised by counties in practice. Moreover, the lack of both national and county-level commitment to the facilitation of accountable fiscal autonomy poses a threat to the sustained effective exercise of self-rule by county governments.

The Kenyan case makes a number of contributions to international literature on subnational autonomy in the context of devolved states, as well as to the literature specific to Kenya's system of devolution. While it confirms the centrality of an intergovernmental fiscal system's design to the realisation of subnational autonomy (and its objectives), it illustrates through both what has worked and what has not worked in Kenya): the importance of constitutional clarity in the vertical division of functions for subnational expenditure autonomy; that a well-designed and effectively implemented integrated approach to the financing of subnational governments is equally capable of delivering subnational revenue autonomy; that subnational accountability towards the objectives of devolution is an integral part of subnational autonomy for devolved states and that an explicit, carefully designed and effectively implemented and resilient system of oversight and expenditure control is capable of delivering the accountability outcomes that come with substantial OSR decentralisation. The Kenyan case also illustrates the utility of a strong and independent judicial system in safeguarding the sustained autonomy of subnational governments.

Based on the above arguments, the study makes recommendations relating to the policy implications and reforms which are necessary to facilitate the effective exercise of the margin of autonomy constitutionally extended to counties so as to ensure the realisation of the objects of devolution.

4 Literature survey

There is an extensive body of literature on fiscal federalism internationally as well as that which specifically focuses on devolved developing countries. In discussing the theory on subnational autonomy, its scope and defining components, the study relies on the seminal approach advanced by Clark,[30] despite its aggregated federal states approach, with the scholarly work by Pratchet,[31] and Beer-Tóth[32] providing alternative critical perspectives. The works of De Visser,[33] Bosire,[34] Oates,[35] and others are relied on in deriving the objectives in pursuit of which subnational autonomy is usually directed, with Smoke[36] providing important developing countries' nuances. The writings of Hooghe, Marks and Schakel,[37] Steytler,[38] Fessha and Kirkby,[39] among other scholars, have also been relied on in placing fiscal autonomy at the centre of the realisation of overall subnational autonomy. Beer-Tóth's work, despite focusing on Hungary and having no devolved-state nuances, provides an extensive analysis of the theory of local financial autonomy, including proposals for the design of the intergovernmental fiscal transfer system for subnational fiscal autonomy, and is hence a core

[30] Clark (1984) 195 – 208.
[31] Pratchett L 'Towards a separation of local autonomy and local democracy' (*ECPR joint sessions of workshops Grenoble*, 2001) available at https://pdfs.semanticscholar.org/65d5/1f2f7cc2f1b8e3a4d2922dfed11690b99597.pdf (accessed 18 November 2018)
[32] Beer-Tóth K, *Local Financial Autonomy in Theory and Practice: The Impact of Fiscal Decentralisation in Hungary* (Unpublished PhD thesis, University of Fribourg, 2009)
[33] De Visser J *Developmental Local Government: A Case Study of South Africa* (2005)
[34] Bosire CM *Devolution for Development, Conflict Resolution, and Limiting Central Power: An Analysis of the Constitution of Kenya 2010* (unpublished LLD thesis, University of the Western Cape, 2013)
[35] Oates WE 'Toward a second-generation theory of fiscal federalism' (2005) 12 *International Tax and Public Finance* 351; Oates WE 'An essay on fiscal federalism' (1999) 37 *Journal of Economic Literature* 1120
[36] Smoke P 'Fiscal decentralization in developing countries: A review of current concepts and practice' (2001) 178 available at http://muse.jhu.edu.ezp-prod1.hul.harvard.edu/journals/journal_of_developing_areas/v037/37.1basher01.html%5Cnhttp://muse.jhu.edu.ezp-prod1.hul.harvard.edu/journals/jda/summary/v037/37.1basher01.html%5Cnhttp://muse.jhu.edu.ezp-prod1.hul.harvard.edu/journal (accessed 8 November 2018); Smoke P 'Local revenues under fiscal decentralization in developing countries: Linking policy reform, governance, and capacity' in Ingram GK & Hong Y (eds) *Fiscal Decentralization and Land Policies* (2007).
[37] Hooghe L, Marks G & Schakel A '*The Rise of Regional Authority: A Comparative Study of 42 Democracies* (2010) 20; Marks G, Hooghe L & Schakel A 'Measuring regional authority' (2008) 18 *Regional and Federal Studies* 111.
[38] Steytler N 'The "financial constitution" and the prevention and combatting of corruption: A comparative study of Nigeria, South Africa and Kenya' in Fombad C & Steytler N *Corruption and Constitutionalism in Africa* (2020).
[39] Fessha & Kirkby (2008) 261.

reference for the study's theoretical chapter. This is used alongside the work of Bahl[40] which, inter alia, provides critical developing-country perspectives on the issues of constitutional design for subnational fiscal autonomy. The work of Oates is also widely referenced with respect to constitutional design proposals advanced under the First- and Second-Generation theories of fiscal federalism. Although the design proposals are not specific to integrated devolved states, they are, nonetheless, adaptable to this context.

Fiscal decentralisation in Kenya has received significant scholarly attention since the adoption of the 2010 Constitution. While most of the literature discusses in varying lengths the legal framework of Kenya's fiscal decentralisation, the issues underpinning the various analyses and the parameters of the respective scholarly works vary. This study relies on the scholarly work of Rocaboy, Vaillancourt and Rejane,[41] Smoke,[42] Muia, Ngugi and Gikuhi,[43] Sharp and Jetha,[44] Balkan and Chege[45] as well as the World Bank,[46] to provide a historical background to and developments in Kenya's public finances and the structuring and implementation of its various systems of fiscal decentralisation prior to the adoption of devolution. The work of Kirira[47] is also useful in this respect. Kirira details how, historically, Kenya's fiscal structure and institutions of public finance were designed to give the executive maximum control with citizens having little or no room to influence decisions on how resources were mobilised, allocated and used.[48] His work highlights how the all-powerful national executive had turned

[40] Bahl R 'Opportunities and risks of fiscal decentralization: A developing country perspective' in Ingram GK & Hong Y (eds) *Fiscal decentralization and land policies* (2007); Bahl R and Bird R 'Subnational taxes in developing countries: The way forward' (2008) 28 *Public Budgeting and Finance* 2.
[41] Rocaboy Y, Vaillancourt F & Rejane H 'Public finances of local government in Kenya' in Dafflon B & Madies T (eds) *The Political Economy of Decentralization in Sub-Saharan Africa: A New Implementation Model in Burkina Faso, Ghana, Kenya, and Senegal* (2013).
[42] Smoke P 'Local government fiscal reform in developing countries: Lessons from Kenya' (1993) 21 *World Development* 903.
[43] Muia DM, Ngugi J & Gikuhi R 'Evolution of local authorities in Kenya' in Barasa T & Eising W (eds) *Reforming Local Authorities for Better Service Delivery in Developing Countries: Lessons from RPRLGSP in Kenya* (2010)
[44] Sharp AM & Jetha NM 'Central government grants to local authorities: A case study of Kenya' (1970) 13 *African Studies Review* 43.
[45] Barkan JD & Chege M, 'Decentralising the state: District focus and the politics of reallocation in Kenya' (1989) 27 *The Journal of Modern African Studies* 431.
[46] World Bank '*Kenya - An Assessment of Local Service Delivery and Local Governments in Kenya*' (2002).
[47] Kirira N 'Public finance under Kenya's new constitution' (2011) available at http://sidint.net/docs/WP5.pdf (accessed 23 March 2018).
[48] Kirira (2011) 1.

public budgeting into a political tool to reward and punish regions, rather than serving the general public, thereby leading to selective development and marginalisation.[49] Besides the above, reports of the Constitution of Kenya Review Commission (CKRC)[50] and the Committee of Experts (COE)[51] as well as the scholarly work of Ghai[52] document and provide insights into Kenya's constitution-making phase and how the issues identified by Kirira, among others, informed the objectives assigned to devolution under the Constitution of 2010.

In discussing Kenya's integrated constitutional design for county expenditure autonomy, the work of Mutakha[53] and Bosire,[54] which provide an interpretation of the constitutional framework for the vertical division of functions, is helpful in highlighting the autonomy-enhancing features of the design as well as those that hold the potential to limit county expenditure autonomy, key among the latter being the constitutional lack of functional clarity. World Bank reports[55] on Kenya's constitutional framework for devolution also discuss the question of functional allocation and highlight the clarity problem, pointing out its impact in providing a potential avenue for claw-backs. Steytler and Ghai[56] also weigh in on the functional allocation issue, pointing out, inter alia, that, as in South Africa, there is an ultimate bias in the constitutional framework towards national legislative dominance. Reports of the Taskforce on Devolved Government (TFDG),[57] the Intergovernmental Relations Technical

[49] Kirira (2011) 4.
[50] Constitution of Kenya Review Commission (CKRC) *The Final Report of the Constitution of Kenya Review Commission* (2005).
[51] Committee of Experts on Constitutional Review (COE) *Final Report of the Committee of Experts on Constitutional Review* (2010).
[52] Ghai Y 'Devolution: Restructuring the Kenyan state' (2008) 2 *Journal of Eastern African Studies* 211-226.
[53] Mutakha JK *An Interpretation of the Constitutional Framework for Devolution in Kenya: A Comparative Approach* (LLD thesis, University of the Western Cape, 2014) 268 – 315. Although this thesis was later published in a book (Kangu J *Constitutional Law of Kenya on Devolution* (2015)), this study primarily refers to the thesis which was readily accessible to the researcher electronically for the duration of the study.
[54] Bosire (2013); Bosire CM 'Powers and functions of county governments in Kenya' in Steytler N and Ghai Y (eds) *Kenya-South Africa Dialogue on Devolution* (2015).
[55] World Bank *Devolution without Disruption: Pathways to a Successful New Kenya* (2012); World Bank *Special Focus: Kenya's Momentous Devolution* (2011).
[56] Steytler N & Ghai Y 'Devolution: What can Kenya learn from South Africa?' in Steytler N & Ghai Y (eds) *Kenya-South Africa Dialogue on Devolution* (2015) 452.
[57] Task Force on Devolved Government *Final Report on Devolved Government in Kenya* (2011).

Committee (IGRTC),[58] the National Treasury[59] as well as the Commission on Revenue Allocation (CRA)[60] highlight issues relating to county expenditure autonomy that emerge in practice, among them the duplication of functions arising from the lack of functional clarity, which has contributed to a failure of horizontal accountability.

Literature on Kenya's integrated constitutional design for county revenue autonomy is broader. Bosire[61] classifies Kenya's subnational financing model as the 'World Bank model' which deliberately makes counties dependent on transfers on equity grounds. Although he argues that such dependency (transfers) should not be so much as to eliminate the need for local taxes, Bosire does not venture into what happens where this occurs, nor does he explore the autonomy benefits of the design of Kenya's intergovernmental fiscal transfer system. Kaburu[62] tends to agree with Bosire's elucidation of the Kenyan financing model, arguing that the Constitution purposely granted county governments weak taxation powers that had previously been held by existing local authorities and which had been proven to be inadequate to support subnational expenditure. He states that the revenue sources demarcated for county governments had historically been low-yield and hard to collect under the local authorities hence necessitating direct transfers from the national government. His point, therefore, is that the constitutional design was skewed in favour of fiscal centralisation, thereby contributing to the existing VFA. His work, however, views the integrated financing model as centralisation and does address the autonomy benefits of unconditional transfers.

With respect to county discretion over revenue administration (as part of county revenue autonomy), the World Bank[63] makes a case for the use of the national Kenya Revenue

[58] Intergovernmental Relations Technical Committee (IGRTC) *Emerging Issues on Transfer of Functions to National and County Governments* (2018); Intergovernmental Relations Technical Committee *Finalisation of Outstanding Issues in the Transfer of Functions in the Agriculture Sector* (2018).
[59] National Treasury *Medium Term Budget Policy Statement, 2019* (2019); National Treasury *Medium Term Budget Policy Statement, 2020* (2020).
[60] Commission on Revenue Allocation (CRA) *Recommendation on the Sharing of Revenue Raised Nationally between the National and County Governments for the Financial Year 2016/2017* (2015).
[61] Bosire (2013) 28-29.
[62] Kaburu FN 'Fiscal decentralisation in Kenya and South Africa: A comparative analysis' (2013) *Africa Nazarene University Law Journal* 76-106.
[63] World Bank (2012) 85-86.

Authority (KRA) as a tax administration agent over time as a way of ensuring efficiency in local tax collection. Ambetsa[64] echoes this sentiment, but cautions that such a system would pose a challenge regarding the accountability of the national government institution to the county governments. Ambetsa also highlights the concern by Kenya's Transitional Authority with respect to the impact of utilising KRA on subnational fiscal capacity and autonomy.[65]

With respect to intergovernmental transfers and grants (in relation to county revenue autonomy), although the World Bank[66] acknowledges the limited nature of county OSR and the need for unconditional transfers to facilitate county fiscal autonomy, it nonetheless paradoxically makes a case for minimising unconditional resourcing of counties (by 'limiting the equitable share transfer at–or-close-to the constitutional minimum of 15%'') while maximising the scope for conditional funding. It argues that this would be necessary in light of the radical and experimental nature of Kenya's devolution, and in order for the central government to retain control over the implementation of devolution. The World Bank report, however, fails to consider the long-term impact of its recommendations on the autonomy of county governments.

With respect to conditional grants, the study draws from the work of Kirira[67] and Ambetsa,[68] among others. Kirira argues for the need for intergovernmental consultation prior to the issuance of conditional grants, in order to address the potential that conditional grants have to interfere with the autonomy of the receiving county, to impose additional costs, and/or to interfere with county operations where additional human resources or equipment are required. Ambetsa argues that over-reliance on grants from the national government subjects the grant process to political manipulation involving the issuance of hefty grants to counties

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[64] Ambetsa AT *County Governments' Sources of Revenue: A Legal Perspective on How the County Governments Are Funded* (unpublished LLM thesis, University of Nairobi 2014) 78-79.
[65] Ambetsa (2014) 78.
[66] World Bank (2012).
[67] Kirira N 'Policy paper on fiscal transfers in Kenya: Unconditional and conditional transfers' (2012) available at *https://www.tisa.or.ke/images/uploads/Policy_Paper_on_Fiscal_Transfers_in_Kenya_2013.pdf* (accessed 30 April 2018) 5-7.
[68] Ambetsa (2014) 78.

that are most favoured by the centre.[69] This, it is argued, causes horizontal disparities across counties while increasing the risk of misappropriation of the funds.

In addition to the above literature on the design of the financing framework for revenue autonomy, the study relies on the National Treasury's annual budget policy statements (including explanatory memoranda to the annual Division of Revenue Bills),[70] the CRA's annual recommendations on vertical revenue sharing,[71] the periodical reports from the Controller of Budget (CoB) relating to county budget implementation, as well as reports and documents by civil society organisations such as the Adam Smith International,[72] Development Initiatives,[73] and the International Budget Partnership Kenya,[74] which highlight implementation-related issues touching on both county OSR as well as transfers.

Literature on county budgetary autonomy is not well developed. This could be attributed to the limited exercise of borrowing by county governments in Kenya, as well as the scarcity of information from those counties that undertake short-term borrowing. The study, therefore, relies mainly on the National Treasury's annual budget policy statements for information regarding national action and developments relating to county borrowing,[75] as well as CRA reports[76] that discuss the failure of counties to utilise their budgetary autonomy for capital

[69] Ambetsa (2014) 103.
[70] National Treasury *National Policy to Support Enhancement of County Governments Own-Source Revenue* (2019).
[71] Commission on Revenue Allocation *Recommendations on Sharing of Revenue Raised Nationally between the National and County Governments for the Fiscal Year 2012 / 2013 and among County Governments for the Fiscal Years 2012/13 - 2014/15* (2012); Commission on Revenue Allocation *Counties' Efforts Towards Revenue Mobilisation - A Stock of the Last Six Years* (2019).
[72] Adam Smith International *Final Report: Own-Source Revenue Potential and Tax Gap Study of Kenya's County Governments* (2018).
[73] Development Initiatives *Strengthening Subnational Government Own-Source Revenue Mobilisation in Kenya - Progress, Challenges and Opportunities* (2018).
[74] IBP Kenya *How Much for Counties in 2017/18? The Commission on Revenue Allocation Versus the National Treasury* (2016); International Budget Partnership (IBP) Kenya *Memorandum to the Senate on the Division of Revenue, 2018/19* (2018); IBP Kenya *Issues, Analysis and Recommendations Related to the Third Formula for Revenue Sharing among Counties in Kenya* (2018).
[75] National Treasury, 'Medium Term 2021 Budget Policy Statement' (2021) 35; National Treasury, 'Medium Term Budget Policy Statement, 2020' (2020) 66.
[76] Commission on Revenue Allocation *Recommendations on the Basis for Equitable Sharing of Revenue between National and County Governments for the Financial Year 2019/2020* (2018).

spending. This study therefore fills this gap by incorporating qualitative data collected from counties.

The works of Mutakha,[77] the World Bank,[78] and Bosire[79] as well as the periodic reports of the CoB, CRA and the Auditor-General are also utilised in this study's discussion of county oversight and expenditure control. Mutakha's argument that the objects of devolution direct and guide legislative development and implementation as well as identifying the 'ultimate ends in pursuit of which power should be deployed'[80] is, for instance, instrumental in establishing them as a constitutionally legitimate constraint on the fiscal autonomy of counties. The World Bank argues with respect to oversight and expenditure control mechanisms that they need to be 'sufficient to lead capacity building and promote application of standards, but limited enough to prevent abuse and excessive control by the centre'.[81] However, the findings in the World Bank's review of Kenya's public expenditure[82] revealed accountability-related issues at the county level, including an increasing failure by the counties to meet the 30 per cent expenditure threshold for development spending given their high and increasing recurrent expenditure.[83] The report also recorded weak budget execution as a major issue amongst counties, one that resulted in positive balances and affected revenue collection at the subnational level.[84] Although the report does not venture to analyse how these issues, arising from the implementation of expenditure at the subnational level, reflect on the effectiveness of expenditure control mechanisms at the county level, the data provided by it, as well as that provided by reports from other institutions at the national level, will be key to establishing the basis for such an analysis.

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[77] Mutakha (2014).
[78] World Bank (2012).
[79] Bosire CM 'Interpreting the power of the Kenyan Senate to oversee national revenue allocated to the county governments: Building a constitutionally tenable approach' (2017) 1 *AJCCL* 35-66.
[80] Mutakha (2014) 136.
[81] World Bank (2012) xv.
[82] World Bank (2012).
[83] World Bank (2014) 12.
[84] World Bank (2014) 35.

Whereas there is a wide variety of literature that generally discusses concepts of intergovernmental fiscal systems and subnational autonomy, and while there's literature that discusses county expenditure, financing (including borrowing) and oversight as separate themes, there is no literature that systematically analyses the intergovernmental fiscal system as a whole with a focus on the impact of its design and implementation on the sustained autonomy of subnational governments in integrated devolved states, generally, and Kenya in particular. It is towards the filling of this gap that this study shall seek to contribute.

5 Research methodology

This study primarily employs a desktop review and analysis of both primary and secondary sources on the subject.

The study relies on available scholarly work on fiscal federalism and decentralisation to lay a theoretical foundation on how intergovernmental fiscal systems are ordinarily designed and implemented in order to advance the autonomy of subnational governments. The study then utilises constitutions and legislative texts, policies, regulations, reports, court cases as well as scholarly work analysing or commenting on these sources, to assess the scope for fiscal autonomy extended to subnational governments in both South Africa and Kenya.

With respect to the analysis on Kenya, however, the study also utilises qualitative data collected both at the national and the county level to supplement the above sources, especially on matters relating to implementation/practice. To this end, two sets of open-ended interviews were conducted over the duration of this study. The first was a preliminary assessment of Kenya's intergovernmental fiscal system and its implementation, which was undertaken in 2019 and involved a cross-section of 11 different stakeholders at the national level. This covered officials from government agencies (the National Treasury, the Intergovernmental Budget and Economic Council, the Senate, the Commission on Revenue Allocation, the Controller of Budget and the Auditor-General), representatives of civil society organisations (the Institute of Economic Affairs Kenya, the Institute of Public Finance Kenya and the International Budget Partnership Kenya), as well as officials from Kenya's constitution-making bodies (the Constitution of Kenyan Review Commission and the Committee of Experts).

The second set of interviews were conducted in 2021 and focused on county government officials. These were either members of the county executive committee or senior county administration officials involved with county finances. Although the study initially intended to cover more counties, the impact of COVID-19, among other factors, compelled the reduction of the sample size from 12 to six counties (Nairobi, Kisumu, Kakamega, Uasin Gishu, Machakos and Makueni). The counties were selected on the basis of a combination of factors such as their historical fiscal performance and their rural/urban classification. Ethical clearance was obtained from the University, and a research license obtained from Kenya's National Commission for Science, Technology, and Innovation (NACOSTI) to conduct these interviews.

6 Chapter outline

This study consists of nine chapters, including this introductory chapter. The second chapter is a theoretical analysis of fiscal federalism literature relating to subnational autonomy in general and subnational fiscal autonomy in particular, and is aimed at setting this study's theoretical foundation. It, inter alia, introduces working concepts and definitions related to multilevel governance and fiscal decentralisation, discusses what self-rule or autonomy is and why it is not an end in itself but a means towards the realisation of specific objectives (the objectives of subnational autonomy) and why subnational fiscal autonomy is crucial to the realisation of these objectives. The chapter also discusses constitutional design approaches that have the potential to deliver subnational fiscal autonomy for devolved states.

Chapter three focuses on South Africa and seeks to establish the extent to which the study's theoretical conclusions are either proved or disproved with respect to design and implementation of subnational fiscal autonomy in South Africa. Given the similarities in Kenya and South Africa's intergovernmental fiscal systems, the chapter also serves as a general mirror to potential capabilities, issues and alternative approaches for the Kenyan case.

Chapter four provides the history and context of subnational fiscal autonomy in Kenya. It discusses the evolution of Kenya's multilevel system of governance since independence, with a focus on the evolution of the fiscal autonomy of subnational levels of government. The chapter then provides an assessment of this history's contribution to the design of Kenya's current system of devolution (and its objectives) including its intergovernmental fiscal system and its provision for subnational fiscal autonomy, before highlighting Kenya's devolved structure and context under the 2010 Constitution.

Chapters five, six and seven explore the scope for fiscal autonomy extended to county governments under both the legal framework, and in practice. Chapter five focuses on expenditure autonomy, chapter six on revenue autonomy, and chapter seven on budgetary autonomy. Each of the chapters discuss factors, both legal and practice-related, that facilitate the expenditure, revenue or budgetary autonomy of county governments, while also discussing what factors (legal and/or practice-related) hinder or constrain the exercise of the various forms of fiscal autonomy by county governments. The conclusions of each of the chapters highlight what scope, if any, for fiscal autonomy is extended and exercised by county governments in Kenya.

Chapter eight focuses on the fact that county fiscal autonomy is not an end in itself and that there ought to be in place systems of fiscal control and oversight to ensure that its exercise is geared towards the attainment of, among other things, the objectives of autonomy (devolution). The chapter looks at how and whether the design and implementation of Kenya's system of oversight and expenditure control has managed to secure the accountable exercise of fiscal autonomy at the county government level.

Chapter nine provides a synthesis of the study's findings in a conclusion, highlights the study's contribution to the literature on subnational (fiscal) autonomy, and also makes policy recommendations.

Chapter Two

INTERGOVERNMENTAL FISCAL SYSTEMS AND SELF-RULE: A THEORETICAL BACKGROUND

This chapter seeks to respond to the first research question by providing an analysis of the theory on how intergovernmental fiscal systems should generally be designed so as to advance the margin of autonomy (self-rule) conferred on subnational governments in integrated devolved states. The chapter therefore provides theoretical lenses through which the design and implementation of the intergovernmental fiscal systems discussed in this study will be examined. The chapter also provides definitions of key concepts and terms that will be utilised in this study.

Central to the chapter is the question of why subnational autonomy matters for devolved states (the objectives of subnational autonomy) and how the design of the intergovernmental fiscal system is critical to the attainment of these objectives. In this regard, the chapter revolves around the specific aspects of the intergovernmental fiscal system that play a role in the attainment of the objectives of autonomy, and how fiscal federalism theories on the design of intergovernmental fiscal systems make a case for or against how they may be structured to deliver optimal outcomes for the self-governance of subnational governments. Throughout the chapter, attention is paid to how the fiscal federalism theories may or may not apply in the context of devolved developing countries. This is aimed at putting the chapter's arguments into perspective for the study's later analysis of the cases of South Africa and Kenya.

The chapter is structured in nine parts. The first part focuses on providing context with respect to the classification of various multilevel state structures and on clarifying the concepts and definitions associated with them. This part also clarifies the applicability of federal theory outside strictly federal contexts, such as in the context of devolved states discussed in this study. The second part establishes the meaning of subnational autonomy (self-rule), with the aim of providing the study with a common understanding of the nature and scope of the concept of autonomy utilised in this study. The third part looks at the objectives sought to be achieved by the conferment of subnational autonomy in devolved states (the objectives of autonomy).

The fourth part, concerning the importance of fiscal autonomy relative to overall subnational autonomy, aims at establishing fiscal autonomy as a central indicator and enabler of subnational autonomy hence the study's interest in how its design and implementation advances subnational autonomy (hence its objectives). The next part seeks to answer the question of what fiscal autonomy entails. This part provides the core components of fiscal autonomy (expenditure, revenue and budgetary) which an intergovernmental fiscal system needs to have in order to attain the objectives of subnational autonomy. In the sixth part, the chapter provides an overview of how each of the components of fiscal autonomy serves the specific objectives of autonomy. The seventh section then examines how fiscal federalism theories make a case for or against how a devolved state's intergovernmental fiscal system may be designed so as to provide optimal outcomes for subnational fiscal autonomy (through its various components). The final section discusses the role subnational accountability plays in the realisation of the objectives of autonomy and why it is, therefore, important for intergovernmental fiscal systems to have explicit systems of oversight and expenditure control. The chapter concludes by providing the study's theoretical conclusion on how intergovernmental fiscal systems in devolved states could be designed so as to produce optimal outcomes for subnational autonomy (self-rule), or at the very least for the margin of autonomy extended to them.

1 Contextualising federal theory, concepts and definitions

An intergovernmental fiscal system refers to the set of rules, institutions and practices (including intergovernmental fiscal relations) that inform and govern the allocation, exercise and management of fiscal powers in a multilevel government setting. Multilevel systems of government (multilevel states)[1] exist on multiple continuums that range from variants of federal state structures to different shades of decentralised state structures.[2] The specific design that an intergovernmental fiscal system adopts therefore may differ, depending on the specific multilevel state structure adopted. Although there is an observable shift, the theory on the design of intergovernmental fiscal systems (fiscal federalism theory) grew out of, and is largely based on, analyses of federal systems of government.[3] The need to apply fiscal federalism theories to devolved state structures in this study thus calls for a clarification of concepts and terminologies.

This study utilises terms such as federalism, devolution and decentralisation whose usage varies both in literature and practice. For instance, while countries such as Kenya and South Africa have all the hallmarks of federal states,[4] reference to 'federalism' in their constitutional framework is avoided in favour of 'devolution' and 'cooperative government', respectively. These concepts are explored below.

Although there is no consensus on the definition of 'federalism', the term is used descriptively to denote a system of government consisting of at least two tiers of government and whose structure combines elements of shared rule and self-rule.[5] These components capture the nature and extent of vertical distribution of power between a national government and autonomous regional governments.[6] The shared rule component refers to the extent to which regional governments take part in decision-making at the national level.[7] Self-rule, for

[1] The term 'multilevel states' is used in this study to refer to all states with two or more tiers of government. See, Parolari S 'From a formal to a substantial approach: Sources of law and fiscal federalism' in Valdesalici A & Palermo F (eds) *Comparing Fiscal Federalism* (2018) 22.
[2] 'State' in this study is used to refer to a country. See, Valdesalici A & Palermo F 'Introduction: Methodological approach and structure of this book' in Valdesalici A & Palermo F (eds) *Comparing Fiscal Federalism* (2018) 2.
[3] Valdesalici A 'Defining fiscal federalism' in Valdesalici A & Palermo F (eds) *Comparing Fiscal Federalism* (2018) 15.
[4] Bosire CM *Devolution for Development, Conflict Resolution, and Limiting Central Power: An Analysis of the Constitution of Kenya 2010* (unpublished LLD thesis, University of the Western Cape, 2013) 14-15.
[5] Elazar DJ 'Self-rule and shared rule - Two peoples one land: Federal solutions for Israel, the Palestinians, and Jordan' (1987) available at http://www.jcpa.org/dje/articles3/fs1.htm (accessed 18 November 2018) 2; Bosire (2013) 15.
[6] Elazar DJ *Exploring Federalism* (1991) 84.
[7] Mueller S 'Self-rule and shared rule' (2017) available at http://50shadesoffederalism.com/theory/self-rule-shared-rule (accessed 9 November 2018) 2 & 4.

its part, refers to the autonomy of regional governments in deciding, financing and implementing their own policies in their territorial jurisdictions,[8] and within limits set by law.[9] Autonomy in this context is equivalent to self-rule and is therefore adopted as the operative term when discussing self-rule in this study.

To understand the above definitions, a historical perspective is imperative. Some of the oldest federal states, such as the United States of America (USA) and Switzerland, were formed by the coming-together of pre-existing politically independent states and are often referred to as 'aggregative' federations or 'coming-together' federations.[10] The resulting federation was therefore made up of the individual merging states and a federal government formed at the national level. With these having been the pioneering prototypes, classical theories of federalism, and hence fiscal federalism theories, were consequently heavily linked and influenced by the two-tiered nature of these federations, which informed the couching of the shared rule and self-rule components of federalism.[11]

As more federal-type states emerged, there was need to develop criteria for the classification of a state as federal. Consequently, the constitutional model of federalism was developed (first advanced by K.C. Wheare and later extended by Ronald Watts).[12] The model is based on a two-tiered multilevel state made up of the central and regional levels of government, and requires that both levels: draw their powers expressly from a written constitution; be directly elected by and be accountable to citizens and have independent powers to act (or not act) in their respective spheres. It also requires that: there be a second (upper) legislative chamber at the centre to represent regions; regional consent be required as a precondition for constitutional amendment especially where such amendment concerns regional governments; there be a system for intergovernmental dispute settlement such as an

[8] Mueller (2018) 2.
[9] De Villiers B 'Federations: Shared rule and self-rule in the search for stable governance' (2012) 39 *Politikon: South African Journal of Political Studies* 396.
[10] Valdesalici & Palermo (2018) 13.
[11] Choudhry S & Hume N 'Federalism, devolution and secession: From classical to post-conflict federalism' in Ginsburg T & Dixon R (eds) *Comparative Constitutional Law: Research Handbooks in Comparative Law Series* (2011) 357 & 359; Valdesalici (2018) 13.
[12] Choudhry & Hume (2011) 357; Bosire (2013) 15.

independent judiciary and, importantly for this study, there be an 'allocation of sufficient revenues to ensure the autonomy of each order of government'.[13]

Worth noting, in this respect, therefore, is that the autonomy of regional governments in a federal state was built into the constitutional framework underlying the federation. It was hence largely not the subject of academic enquiry by literature focusing on the autonomy of subnational governments. The concept of subnational autonomy was generally explored when interrogating the autonomy of local governments.[14] However, the constitutional model of federalism, as well as ensuing fiscal federalism studies, did not address local governments as constituent levels of government since their creation was left to the discretion of regional governments.[15]

The term 'local government' is mostly associated with decentralised states. As a normative concept, decentralisation refers to the flow of power from a central government to either a lower level of government or to an agency located outside of a central government's absolute control.[16] Local government, from this definition, therefore means a subordinated level of government, the extent and permanence of whose autonomy depends on the higher level(s) of government responsible for donating or delegating power to it.[17] This is the same status accorded to local governments in federal states.

With the advent of variants of federal-type state structures, local governments are increasingly being recognised and entrenched as constituent components of the state structure under the constitutional frameworks of federal (and federal-type) states across the

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[13] Choudhry & Hume (2011) 357.

[14] The term 'local government' is used to refer to that level of government which is closest to the people and responsible for the delivery of essential public services (often the third tier in federal and devolved states). See, Gutierrez AH 'What are we talking about when we talk about 'subnational' governments?' (*World Bank Blogs*, 2015) available at http://blogs.worldbank.org/governance/what-are-we-talking-about-when-we-talk-about-subnational-governments (accessed 17 July 2019); Valdesalici & Palermo (2018) 6.

[15] Valdesalici & Palermo (2018) 6.

[16] Bosire (2013) 17. Although, technically, a decentralised state is argued as not being synonymous with a non-centralised state (devolved state), the literature, in some contexts, however often uses the term 'decentralised state', generally to refer to any state that is 'not centralised' (which includes federal and devolved states) and 'decentralisation' (unless used in the technical sense) as an umbrella term to refer to the process of formation of a multilevel state.

[17] Valdesalici & Palermo (2018) 6.

world.[18] One such federal-type state structure is the system of devolution adopted in Kenya and South Africa.

Devolution refers to a non-centralised system of government in which the powers of the various tiers emanate from the people and are constitutionalised rather than flowing from the centre.[19] This therefore protects them from unilateral national-level recentralisation, which is not the case in decentralised states. As a process, the devolution of powers refers to the creation of multilevel systems of government from an already existing unitary state (the devolutionary model of multilevel states).[20] This extends to what are otherwise referred to as 'holding-together' federations as well as decentralised states where lower tiers 'enjoy some permanence of power and autonomy from the central government'.[21]

Devolved states are often considered a hybrid between federalism and decentralisation. This is because they exhibit most of the characteristics of federal states contained in Wheare's constitutional model, including adopting a variant of the shared-rule and self-rule components. Devolution is however also termed a weaker form of federalism.[22] This is partly due to the fact that, although the autonomy of the other tiers of government is constitutionally guaranteed, there exist overrides within the same constitutions that end up conferring a higher status to the central government.[23] This, among other reasons, has compelled the expansion of the focus of fiscal federalism literature on financial autonomy from the classical local governments to include 'equal-status' intermediary levels of government.[24]

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[18] Steytler N & Ayele Z 'Local governments in African federal and devolved systems of government: The struggle for a balance between financial and fiscal autonomy and discipline' in Valdesalici A & Palermo F (eds) *Comparing Fiscal Federalism* (2018) 299; Steytler N, 'Introduction' in Nico Steytler (ed) *The Place and Role of Local Government in Federal Systems* (2005) 3.
[19] Bosire (2013) 18.
[20] Watts RL 'Comparing forms of federal partnerships' in Karmis D & Norman W (eds) *Theories of Federalism: A Reader* (2005) 249; Valdesalici & Palermo (2018) 7.
[21] Bosire (2013) 19.
[22] Bosire (2013) 20.
[23] Bosire (2013) 20.
[24] Valdesalici (2018) 13.

Does the fact that 'autonomy' in federal theory is used in reference to the third tier (local governments) affect the application of its principles to the concept of autonomy of the intermediate level units in devolved states? This study takes the view that it does not. Whereas the essential concept of autonomy, therefore, remains the same, reference to 'local autonomy' in federal theory should hence be construed as referring to subnational autonomy generally in the context of devolved states. What, therefore, does subnational autonomy entail?

2 In search of the meaning of subnational autonomy

There is no consensus on what the definition of subnational autonomy entails, and several theories and approaches have been proffered in an attempt to elaborate its various facets.[25] This study discusses the key ones below.

2.1 Clark's theory of local autonomy[26]

Gordon Clark's theory of local autonomy has been described as the most developed,[27] most complete[28] and most useful[29] legal classification of subnational autonomy. Clark argues that despite local autonomy's rhetorical appeal, its meaning has remained elusive.[30] He proceeds to propose the principles of initiative and immunity, drawn from Bentham's theory of legal powers, as the two primary principles of local autonomy.[31] In this respect, Clark's theory views

[25] Keuffer N 'Local autonomy, a multifaceted concept: How to define it, how to measure it and how to create a comparative local autonomy index' (*International Political Science Association (IPSA)*, 2016) available at http://paperroom.ipsa.org/papers/view/54185 (accessed 29 November 2018) 1.
[26] Clark conceptualised his theory as a theory of 'local autonomy' however its principles are of critical relevance to general subnational autonomy explored in the study.
[27] Pratchett L 'Towards a separation of local autonomy and local democracy' (*ECPR joint sessions of workshops Grenoble*, 2001) available at https://pdfs.semanticscholar.org/65d5/1f2f7cc2f1b8e3a4d2922dfed11690b99597.pdf (accessed 18 November 2018) 5.
[28] Richardson JJ 'Dillon's rule is from Mars, home rule is from Venus: Local government autonomy and the rules of statutory construction' (2011) 41 *Publius: The Journal of Federalism* 672.
[29] US Advisory Commission on Intergovernmental Relations '*Local Government Autonomy: Needs for State Constitutional, Statutory and Judicial Clarification*' (1993) available at http://www.library.unt.edu/gpo/acir/Reports/policy/a-127.pdf (accessed 27 November 2018) 7; Libonati M 'State constitutions and local government in the United States' in Steytler N (ed) *The Place and Role of Local Government in Federal Systems* (2005) 12.
[30] Clark GL 'A theory of local autonomy' (1984) 74 *Annals of the Association of American Geographers* 195.
[31] Clark (1984) 195-208.

the full extent of a subnational government's institutional autonomy as falling along a spectrum of its powers of initiative and its powers of immunity.[32] Powers of initiative in this case refer to a subnational government's power to regulate, legislate and act in its own interests, while the powers of immunity relate to a subnational government's power to act 'free' of the oversight authority and control of higher tiers of government.[33]

In his abstraction of the concept of local autonomy, Clark relies on a 'distinction between social institutions as utopian blueprints and institutions as arenas of dispute and hegemonic control'.[34] He further classifies these as two levels of appearance, the first being a 'realm of social aspirations ... and conceptions of the proper form of society' which are utopian in nature and which find formal expression through constitutional entrenchment, as well as through subsequent rules and regulatory procedures.[35] He argues that at the first level of appearance, local autonomy is but a 'utopian conception of how the powers of social institutions ought to be [vertically and] geographically arranged'.[36]

Clark posits that the second level of appearance concerns itself with practice as well as the political and judicial interpretation of the place and role of social institutions. He argues that this level is full of contention and conflict as the 'exigencies of specific circumstances have to be transformed or adapted' to fit within the confines of the rules emerging from the first level of appearance, thus leading to variations in the implementation of the rules.[37]

On the above basis, Clark explains Bentham's conception of legal power as constituting both the power of 'contrectation' and the power of 'imperation'. The former refers to the right or liberty to act on the authority of prior specifications of rights and privileges conceived under the first level of appearance. The latter refers to the 'power to review, amend, negate or enforce' and is usually backed up by the state and its coercive apparatuses.[38] From the power

[32] Clark (1984) 195-208.
[33] Clark (1984) 195-208.
[34] Clark (1984) 196.
[35] Clark (1984) 196.
[36] Clark (1984) 196.
[37] Clark (1984) 196.
[38] Clark (1984) 197.

of contrectation, Clark draws a subnational government's power of initiative, while conceiving immunity as the protection a subnational government needs from the powers of imperation of higher tiers of the state, when acting within the limits of its powers of initiative. He proceeds to argue that immunity is a central component of local autonomy absent which local governments would have their every action and decision reviewed, amended or even negated.

According to Clark, a local government's power of initiative and immunity (hence discretion) can emanate from either the central government, states or provinces, and may also emanate from local residents or the entire population in a country (through, for instance, a constitution-making process). Knowledge of the source is critical in the understanding the nature and scope of a subnational government's autonomy.

Clark proceeds to develop a typology of local autonomy that classifies subnational governments' autonomy into four ideal types based on varied combinations of the powers of initiative and immunity. Under this typology, subnational governments may be classified into those having powers of:[39]

i **Initiative and immunity** – these have total autonomy and officials at the subnational level have complete discretion with limits on their actions only being set by the local population. Clark terms this model as the city-state model.

ii **Initiative and no immunity –** these have complete authority to regulate and legislate in their own interests but with their actions and decisions being subject to close scrutiny, review, amendment or sometimes outright negation by higher tiers of the state. This is referred to as a model of decentralised liberalism.

iii **No initiative but with immunity –** these lack in powers of initiative hence have their agendas and functions set by higher tiers of the state. They are, however, given liberty to implement such tasks with discretion and without fear of review from higher tiers of the state. The model is termed the representative autonomy model.

[39] Clark (1984) 199-201.

iv **No initiative and no immunity –** these have no local autonomy hence have their every action dictated and closely monitored for compliance by higher tiers of the state. They are essentially administrative arms of higher tiers of the state, and have been described as bureaucratic apparatuses.

Clark's seminal theory has been critical in the understanding of subnational legal autonomy. It has, however, been criticised for being inadequate and overly general[40] and for 'failing to reflect the reality of the extent of local government autonomy as falling along a continuum that lacks bright line boundaries'.[41] Sho Sato and Arvo Alstyne, for instance, add pre-emption as a third category to immunity and initiative. Pre-emption queries the extent to which subnational powers of initiative are limited by laws bestowing a concurrent mandate on higher tiers of government.[42] Clark's theory has also been criticised for assuming that subnational governments are 'goal-oriented, rational actors who strive to maximise their power', as well as for treating autonomy as a valence issue and failing to delve into its consequences.[43]

Essentially, while Clark's theory of local autonomy provides a solid foundation for an analysis of subnational autonomy, and will be utilised as the principal theory underlying subnational autonomy in this study, it falls short of taking into account devolved states whose subnational governments only have a constitutionally regulated margin of autonomy with neither their powers of initiative nor of immunity being absolute. For these states, while they may have constitutional scope for powers of initiative and immunity, the full extent of their autonomy may not strictly fall into any of the classifications in Clark's typology above, but rather exists on a spectrum or continuum whose exact boundaries are set by a specific country's constitution. For these devolved states, therefore, the question is not whether or not they are

[40] US Advisory Commission on Intergovernmental Relations (1993) 8.
[41] Richardson (2011) 675.
[42] Us Advisory Commission on Intergovernmental Relations (1993) 8.
[43] Beer-Tóth K, *Local Financial Autonomy in Theory and Practice: The Impact of Fiscal Decentralisation in Hungary* (Unpublished PhD thesis, University of Fribourg, 2009) 31.

autonomous, but rather what margin of autonomy is extended to them under the specific state's constitutional framework.

2.2 Other theories of subnational autonomy

Other theories have also been advanced in a bid to explain the concept of local autonomy. Pratchett, for instance, discusses three approaches to subnational autonomy: 'freedom from' higher authorities; 'freedom to' achieve particular outcomes and 'the ability of communities to construct their own sense of place'.[44] Beer-Tóth, for her part, makes a case for the conceptualisation of autonomy as constituting both a right and ability.[45] These theories are discussed in detail below.

2.2.1 Autonomy as 'freedom from'

The theory of autonomy as 'freedom from' is akin to Clark's conception of immunity and defines subnational autonomy in terms of the degree of freedom subnational governments have from the central government. Like Clark's theory, the freedom-from perspective relies upon the legal position of subnational governments, what Clark refers to as prior prescriptions made under the first level of appearance.

2.2.2 Autonomy as 'freedom to'

Although the 'freedom-to' approach borrows from Clark's conception of the power of initiative, it extends its focus to the effects and outcomes of such power.[46] According to Pratchett's restatement of this theory by Wolman and Goldsmith, 'the uniqueness of this approach lies in its focus on the residual ability of local authorities … to affect the well-being of their localities'.[47] This study, however, disagrees with this approach (or rather, Pratchett's restatement of this approach) given that it fails to elaborate the content and essence of autonomy and proceeds to explain the concept on the basis of its qualitative impact. This

[44] Pratchett (2001) 1-12.
[45] Beer-Tóth (2009) 36.
[46] Pratchett (2001) 5.
[47] Pratchett (2001) 7.

essentially assumes an underlying common understanding as to what the concept is in the first place. A focus on an outcome does not elaborate the nature of subnational autonomy, given that even Clark's model of a bureaucratic apparatus with no powers of initiative or immunity may still be able to deliver the outcomes envisioned under this approach yet remain absolutely lacking in autonomy. A focus on effects and outcomes may, however, be critical as a basis for any constitutionally legitimate limitations that could be imposed on a subnational government's continued exercise of autonomy in devolved states.

2.2.3 **Autonomy as the social construction of place**

This theory adopts a bottom-up approach to defining subnational autonomy and emphasises the 'activities of communities in defining their own autonomy'.[48] It is argued, under the theory, that 'localities "are made powerful or powerless not by a sovereign, but by those who represent them through events in social life"'.[49] In laying out the theory, Pratchett quotes DeFilippis thus:

> Autonomy is not a discrete commodity that is possessed or not possessed by individuals or localities. Instead, autonomy is a set of power relations. A locality therefore cannot *have* autonomy, since autonomy can only be realized through the social, political, and economic relationships that those within the locality are engaged in with the extra-local world. [50]

Lake, for his part, suggests that communities are capable of constructing their own sense of place through the discourse of participation and negotiation with the state and other actors.[51]

While this study acknowledges the influence power relations may have on the *level* of local autonomy exercised in practice, it finds the theory problematic as a definition of the core of autonomy. The theory appears to proceed under an assumption that communities are free to set their own individual rules of engagement with the extra-local world through negotiations that are unhinged by legal prescriptions. In terms of Clark's conceptualisation, this theory

[48] Pratchett (2001) 8.
[49] Pratchett (2001) 8.
[50] Pratchett (2001) 8.
[51] Pratchett (2001) 8.

appears to ignore or downplay the place and impact of norm prescription (at the first level of appearance) in determining the nature and level of autonomy displayed by localities in their social, political and economic relationships (at the second level of appearance). This study argues that norm prescription is key as a foundational determinant of subnational autonomy, especially for devolved states. In this study's view, the social-construction-of-place theory is more a theory on the maximisation of subnational autonomy than on the nature and substance of subnational autonomy, seeing as it flows from the legally permissible scope of autonomy. The study, however, finds the theory critical when it comes to the determination of a subnational government's effective autonomy (that which is exercised in practice).

2.2.4 **Autonomy as a 'right and ability'**

Beer-Tóth argues that the classical view of autonomy has focused only on autonomy as a right, thereby neglecting capacity which is a pivotal issue with respect to subnational autonomy.[52] Basing her view on the European Charter's definition of local self-governance, Beer-Tóth argues that 'the legal right to regulate and manage certain public affairs must be accompanied by the means of doing so effectively (ability)'.[53] This study is however reluctant to adopt 'ability' as a defining component of autonomy, on the grounds that capacity or ability is more of an enabler of autonomy than a defining factor of the nature of autonomy. The study, though, acknowledges the importance of 'ability' in giving life to autonomy in practice and determining the effective autonomy of a subnational government.

2.3 Construing subnational autonomy

From the foregoing discussion, this study finds Clark's conception of subnational autonomy as the most compelling in terms of detailing the constitutive components that denote autonomy. The use of the phrase 'subnational autonomy' in this study will therefore connote a subnational government's powers of initiative and immunity, with necessary adjustments in their definitions to take into account the special circumstances of devolved states. The powers of initiative will refer to a subnational government's power or liberty to regulate,

[52] Beer-Tóth (2009) 40.
[53] Beer-Tóth (2009) 40.

legislate and act in its own interests on the authority of prior specifications of rights and privileges. Powers of immunity, on the other hand, will refer to a subnational government's power to make final decisions that are free of the control or powers of review, amendment, negation or enforcement of higher tiers of government.[54]

Considering DeFilippis' conception of autonomy as a social construct, Clark's definition above thus becomes only a representation of a subnational government's *formal autonomy* (autonomy as emanating from legal prescription).[55] This study will therefore also delve into DeFilippis' territory of power relations (the actions of the local polity in exploiting formal autonomy, and even pushing the boundaries) and how they impact the extent of autonomy manifested in practice. The resultant autonomy will present a subnational government's *effective autonomy.* A factor that affects autonomy in this study therefore will be construed as one which either enhances or limits either its formal or effective autonomy. Key among these factors are finances, by which the formal discretionary powers may be brought to bear.

3 Why is subnational autonomy important for devolved states?

Clark points out that local autonomy is something that is 'desired by both the left and right' (that is, by both libertarian and conservative political actors).[56] Beer-Tóth argues that, despite the various ways through which it has been interpreted and implemented, local autonomy is largely considered a valence issue (uniformly liked).[57] She points out that 'regardless of their political or ideological affiliation, politicians and voters unanimously view it as something that merits support'.[58] In setting out the relative importance of local autonomy, Beer-Tóth notes that some of the arguments in support of subnational autonomy have also been advanced as benefits of multilevel governance (more so for devolved states), thereby implying that *the*

[54] Note that this definition drops Clark's conception of immunity as freedom from oversight, given the need for it in the context of devolved states, as argued below.
[55] Although Clark conceives a 'second level of appearance' that concerns itself with practice and where exigencies of specific circumstances result in modifications and variations in the implementation of rules, he falls short of factoring this into his conception of the nature of local autonomy (see section 2.1. above).
[56] Clark (1984) 195.
[57] Beer-Tóth (2009) 48.
[58] Beer-Tóth (2009) 52.

very essence of multilevel governance is to grant autonomy to local communities. In this regard, subnational autonomy is argued to: ensure efficiency in subnational development; secure the accommodation of minorities and marginalised groups; enhance checks and balances on central powers and promote democracy and accountability. This section details the key arguments.

3.1 Subnational autonomy ensures efficiency in subnational development

The concept of development in the context of subnational governments has evolved to require the placement of the people at the centre of the process, as active participants in development-related decision-making rather than merely as beneficiaries.[59] Moreover, the essence of subnational governance revolves around the imperative of ensuring that the provision of public goods and services (public outputs) is tailored to the needs, preferences and particular conditions of individual jurisdictions.[60] De Visser classifies this as the 'choice component' that is key in delivering developmental local governance.[61] For this to be achieved, subnational governments ought to be in a position to freely engage local communities and independently assess their needs in terms of the specific types of public outputs demanded, their quality and quantity, and also be free to plan how these can be delivered without any fear of powers of review or negation by higher levels of government.[62] Subnational autonomy therefore capitalises on the proximity of subnational governments to the people to provide room for local communities to prioritise their own developmental needs, thereby facilitating economic efficiency in local development.[63]

[59] De Visser J *Developmental Local Government: A Case Study of South Africa* (2005) 10.
[60] Oates WE 'Toward a second-generation theory of fiscal federalism' (2005) 12 *International Tax and Public Finance* 351; Oates refers to this proposition as the 'Decentralisation theorem.'
[61] De Visser (2005) 10.
[62] This has otherwise been described aptly by De Visser as the components of a 'developmental local government', which is translated to mean 'local government committed to working with citizens and groups within the community to find sustainable ways to meet their social, economic and material needs and to improve the quality of their lives'. See De Visser J 'Developmental local government in South Africa: Institutional fault lines' (2009) *Commonwealth Journal of Local Governance* 9.
[63] Beer-Tóth (2005) 54; Haque SM 'Local governance in developing nations: Re-examining the question of accountability' (1997) 18 *Regional Development Dialogue* 5.

Smoke, however, argues that the truth of the above proposition in developing countries varies in practice, based on, inter alia, the capacity and experience of the local communities with social decision-making.[64] He states that while some communities with considerable experience may be in a position to articulate their demands clearly and forcefully, some may not clearly understand the basic rights and responsibilities of their citizenship, thus lowering the quality of local participation.[65] It is important to note, therefore, that developing genuine community participation is 'a process, not an administrative action'. This is more so for developing countries, and may require time to perfect for it to deliver as expected on the promise of efficiency.[66] Smoke further argues that democratic institutions and decision-making processes at the subnational levels are often dominated by a limited clique of local elites.[67] This distorts collective communal choices that ideally should drive local development into choices made by small, powerful groups whose vested interests may have little or no connection to those of the larger community.[68]

Other than facilitating developmental local governance, subnational autonomy also facilitates experimentation and innovation, which is key for subnational development. According to Boyne, arguing from the perspective of the public choice theory, subnational autonomy is imperative in facilitating inter-jurisdictional competition based on service quantity and quality amongst subnational government units.[69] The competition forces subnational governments to experiment and develop a variety of innovative approaches to improving local service delivery.[70] The autonomy of the various subnational governments allows for experimentation on a small scale, thereby limiting the extent of any risks of failure of any approaches or

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[64] Smoke P 'Fiscal decentralization in developing countries: A review of current concepts and practice' (*Democracy, Governance and Human Rights Programme Paper*, 2001) 178 available at http://muse.jhu.edu.ezp-prod1.hul.harvard.edu/journals/journal_of_developing_areas/v037/37.1basher01.html%5Cnhttp://muse.jhu.edu.ezp-prod1.hul.harvard.edu/journals/jda/summary/v037/37.1basher01.html%5Cnhttp://muse.jhu.edu.ezp-prod1.hul.harvard.edu/journal (accessed 8 November 2018) 18.
[65] Smoke (2018) 18.
[66] Smoke (2018) 18.
[67] Smoke (2018) 18.
[68] Smoke (2018) 18.
[69] Boyne GA *Public Choice Theory and Local Government: A Comparative Analysis of the UK and the USA* (1998) 22.
[70] Boyne (1998) 22; Smoke (2001) 6.

instruments adopted.[71] Subnational autonomy, moreover, provides a chance for other subnational units to pick and choose from a presumably ever-increasing pool of new approaches from other jurisdictions thereby leading to better service provision and subnational development. This has otherwise been referred to by Oates as 'laboratory federalism'.[72]

3.2 Subnational autonomy secures the accommodation of minorities and marginalised groups.

In post-conflict states, as well as in plural states, devolution of power is often adopted as a means of holding the state together by providing an avenue for peace and stability, or as a mechanism for accommodating the different identity groups (religious, linguistic or ethnic) within the state.[73] This is usually aimed at the resolution of internal conflicts, which mainly revolve around the centralisation of power and the consequent marginalisation of national minorities. In this case, the geographical boundaries that create subnational units are often drawn with a view to ensuring that a national majority occupies a single subnational unit. The pursuit of such geographical homogeneity of identity groups is usually aimed at affording subnational units an opportunity to see to their specific needs and preferences, in addition to providing an avenue for the exercise of political power at the subnational level. Autonomy is therefore key in ensuring that each identity group has a 'sense of security in protecting their distinctiveness', in addition to being free to decide on their preferred mix of public outputs and developmental needs.[74]

However, the creation of territorial enclaves for specific national minority groups runs the risk of creating local minority groups within the subnational units. This claws back on the pursuit of accommodation and risks creating local minority conflict.[75] Autonomy in these

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[71] Beer-Tóth (2009) 55.
[72] Oates WE 'An essay on fiscal federalism' (1999) 37 *Journal of Economic Literature* 1132.
[73] Bosire (2013) 43; Choudhry & Hume (2011) 366.
[74] Watts RL *Comparing Federal Systems* (2008) 77; Bosire (2013) 44.
[75] Tranchant JP 'Does fiscal decentralization dampen all ethnic conflicts? The heterogeneous impact of fiscal decentralization on local minorities and local majorities' (2010) available at *https://ideas.repec.org/p/pra/mprapa/22776.html* (accessed 19 July 2019) 5.

circumstances has been argued as posing the risk of providing room for radicalised demands from such minority groups, including secession.[76]

3.3 Subnational autonomy enhances checks and balances on central power

Centralisation of political power was often perceived as a means towards enhancing national unity and realising development in developing states.[77] Over time, however, it was used as a tool for political control, silencing political dissent, and entrenching power within select identity groups. This culminated in skewed development, marginalisation of national minorities, and internal conflict. Devolution of power has therefore been key in divesting the centre of absolute power and checking its abuse.[78] Devolution serves this purpose by providing multiple other centres of political power outside the national government. The constitutional design of political powers under the devolved state is therefore key to ensuring that none of the spheres of government can unilaterally alter the division of power in the state.[79] The grant of both functional and fiscal autonomy to subnational governments is therefore necessary to limit the temptation by the national government to overreach and control matters falling within the jurisdiction of subnational governments. Furthermore, subnational autonomy is crucial in guaranteeing the decisional independence of the devolved units (or their representatives) when taking part in decision-making within institutions of shared rule at the national level.

To be able to limit central power effectively, subnational units need 'substantial powers which can enhance their autonomy and overall political significance'.[80] While political and administrative autonomy are equally important, the political significance of subnational governments is argued to rest significantly in their fiscal autonomy.[81] Despite subnational autonomy's playing a key role in limiting central power, factors such as 'a politically over-

[76] Bosire (2013) 64.
[77] Bosire (2013) 66.
[78] Bosire (2013) 68.
[79] Bosire (2013) 68.
[80] Bosire (2013) 70.
[81] Bosire (2013) 77.

assertive national executive', party dominance, as well as the subsistence of imperial presidency in devolved states, are argued to hinder the effectiveness of subnational governments in limiting central influence.[82]

3.4 Subnational autonomy promotes democracy and accountability

Literature has often treated subnational autonomy has being synonymous with local democracy, mainly on account of its being the simplest embodiment of 'rule by the people' which democracy seeks to exemplify.[83] Pratchett argues that, for institutions of local democracy to execute their primary mandate of being venues for the articulation and resolution of competing local values and preferences, they, as well as those engaged in them, ought to have a level of power and authority to act; hence the need for subnational autonomy.[84] Moreover, the exercise of subnational democracy through community participation, and its longevity, requires not just the routine expression of views and preferences by local communities, but also (and importantly) due regard to the views of the polity in ensuing local decisions and activities. Subnational autonomy therefore gives subnational governments the requisite 'political teeth' that allow them to act based on their specific local policy choices.

Additionally, the opportunity presented by local participation for the expression of approval or dissatisfaction with subnational policies and actions goes a long way in securing the political accountability of local leaders to their respective communities, while also providing an opportunity for the bottom-up legitimacy of subnational decisions.[85] The sensitivity and responsiveness required of subnational governments in regard to the outputs of such subnational democratic processes is only possible with subnational autonomy.

Smoke, however argues, with respect to the practice in developing countries, that while there is modest evidence of enhanced subnational responsiveness in terms of processes, there is

[82] Bosire (2013) 72.
[83] Pratchett (2001) 1.
[84] Pratchett (2001) 4.
[85] Beer-Tóth (2009) 54.

little evidence to support the existence of responsiveness as to policy outcomes at the subnational levels.[86] He argues that some communities are more content with, and worry more about, the formalities of being consulted, but pay no attention to how or whether their views impact actual subnational policy decisions. Further, the risk of political capture of subnational governments by corrupt and non-accountable local elites poses a threat to subnational democracy.[87] This alienates other local people from participatory opportunities, thereby reducing a subnational government's accountability to accountability to this small group of elites.[88] Furthermore, democratic participation at the subnational level is usually restricted to the pre-planning and budgeting stages, with no fora for participation at the end of a fiscal year or after implementation to give opportunities to local communities to seek accountability over the nature of policies adopted and how they were implemented. Therefore, while subnational autonomy holds the potential to further democracy and accountability, achieving this requires more work and more active accountability mechanisms for devolved developing countries.

Notwithstanding the limitations specific to developing countries, the above arguments underlie the quest for subnational autonomy especially in devolved states, and constitute what this study refers to as the 'objectives of autonomy'. The question that remains, however, is whether there is a connection between subnational fiscal autonomy and the overall autonomy of subnational governments, including its objectives. This is discussed below.

4 The relative importance of fiscal autonomy for subnational autonomy

Given the centrality of a state's finances as a source of state power,[89] fiscal autonomy serves both as an indicator and a facilitator of autonomy. To begin with, fiscal autonomy is a key indicator of subnational autonomy. Several attempts have been made to disaggregate the

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[86] Smoke (2001) 17.
[87] Brosio G, 'Decentralization in Africa' (2000) available at https://www.imf.org/external/pubs/ft/seminar/2000/fiscal/brosio.pdf (accessed 17 July 2019) 4.
[88] Smoke (2001) 18.
[89] Steytler N 'The "financial constitution" and the prevention and combatting of corruption: A comparative study of Nigeria, South Africa and Kenya' in Fombad C & Steytler N *Corruption and Constitutionalism in Africa* (2020).

concept of subnational autonomy and provide it with indices capable of specific measurement.[90] These include attempts by the United States Advisory Commission on Intergovernmental Relations as well as those by individual authors.[91] Of these, the most comprehensive attempt is attributed to the Regional Authority Index (RAI) developed by Hooghe, Marks and Schakel.[92] Of importance for this study, however, is that each of these studies list subnational fiscal autonomy as one of the key indicators of subnational autonomy.

Fiscal autonomy is, moreover, a critical enabler of all other forms of subnational autonomy. Pratchett argues that, while all forms of central-local relations are significant in determining the level of subnational autonomy, the financial independence of local government is the most significant and forms the basis of local self-government.[93] He explains that this view is founded on the fact that any legal, political and organisational autonomy of subnational governments would be 'meaningless without the resources to realise the benefits of such autonomy'.[94] Richardson, for his part, citing Briffault in support of this view, states that 'if local governments lack sufficient financial means to adopt and carry out enabled authority, the authority rings hollow'.[95] Fessha and Kirkby, moreover, point out that financial autonomy is key to ensuring that political decision-making at the subnational level is not subject to financial veto from the centre.[96] Additionally, the United Nations International Guidelines on Decentralization and Access to Basic Services for All (UN Guidelines), as well as the European Charter of Local Self-Government (European Charter), both recognise the importance of financial autonomy in the realisation of subnational autonomy.[97]

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[90] Hooghe L, Marks G & Schakel A '*The Rise of Regional Authority: A Comparative Study of 42 Democracies* (2010) 20.
[91] US Advisory Commission on Intergovernmental Relations (1993) 9; Ocampo RB 'Decentralization and local autonomy: A framework for assessing progress' (1991) XXXV *Philippine Journal of Public Administration* 191.
[92] Marks G, Hooghe L & Schakel A 'Measuring regional authority' (2008) 18 *Regional and Federal Studies* 111.
[93] Pratchett (2001) 6.
[94] Pratchett (2001) 6.
[95] Richardson (2011) 676. Steytler refers to such authority as an 'empty shell'. See, Steytler (2005) 6.
[96] Fessha Y & Kirkby C 'A critical survey of subnational autonomy in African States' (2008) 38 *Publius: The Journal of Federalism* 261.
[97] UN-HABITAT '*International Guidelines on Decentralisation and Access to Basic Services for All*' (2009) para 48; Council of Europe '*European Charter of Local Self-Government and Explanatory Report*' (2010) art 9.

Given the centrality of subnational fiscal autonomy in determining a subnational government's overall autonomy, what does subnational fiscal autonomy entail?

5 What does subnational fiscal autonomy entail?

The assignment of functions to subnational governments sets in motion a cycle of subnational government activity aimed at their implementation. The functions give rise to expenditure needs that require prioritisation through expenditure planning and budgeting, resources to finance them, as well as flexibility on the part of subnational governments to adjust available resources to meet the selected expenditure needs and vice versa.[98] Based on this cycle, subnational financial autonomy has been defined as constituting expenditure autonomy, revenue autonomy and budgetary autonomy.[99] These are discussed in detail below.

5.1 Expenditure autonomy

Expenditure autonomy refers to the freedom[100] to manage a subnational government's property and resources in the interest of the local community.[101] It entails the 'freedom to decide *which* goods and services shall be financed from the subnational public budget and how much money shall be spent on each' as well as 'the freedom to decide *how* the goods and services shall be produced or delivered'.[102] The former gives room for subnational governments to engage in the prescription of policy objectives and development priorities, while the latter allows for discretion in their implementation. This reflects a subnational government's powers of initiative with respect to its finances.

[98] Beer-Tóth (2009) 70.
[99] Beer-Tóth (2009) 70; Bahl R 'The pillars of fiscal decentralization' (2008) 1 available at http://scioteca.caf.com/handle/123456789/257 (accessed 6 June 2019) 4; Bahl R 'Implementation rules for fiscal decentralization' (1999) 851 available at http://ideas.repec.org/a/cuf/journl/y2013v14i3bahl.html (accessed 6 June 2019) 6.
[100] Beer-Tóth uses 'right and ability', drawing from her definition of autonomy as constituting both a right and ability. This study however drops both and adopts 'freedom' based on a reservation expressed herein on autonomy being conceptualised as an 'ability'.
[101] Beer-Tóth (2009) 73.
[102] Beer-Tóth (2009) 73.

From the perspective of immunity, expenditure autonomy would, by extension, require that a subnational government's expenditure decisions be free from the control of as well as the powers of review, amendment, negation and/or enforcement of higher tiers of government. This ideally translates to the freedom to reject and/or negotiate any expenditure policy priorities sought to be imposed on subnational governments and which fall outside constitutional prescription. This may be problematic in practice, however, especially where subnational governments are lacking in own revenue autonomy and so rely on higher tiers of governments to finance their expenditure, which comes with policy, among other, direct and indirect conditionalities.

5.2 Revenue autonomy

Revenue autonomy refers to the discretion a subnational government has over its revenue and revenue sources, including the discretion over the nature of the tax to be administered, the tax base, applicable rates, as well as reliefs applicable to its own sources of revenue.[103] Subnational powers of immunity would demand that subnational decisions in this regard are final and are protected from undue interference by higher tiers of government.

With respect to intergovernmental transfers and grants, subnational revenue autonomy would mean having influence on the size of the shareable pool and distribution formulae, as well as retaining discretion over the use of the transferred resources.[104] From the perspective of immunity, subnational autonomy over transfers and grants would imply protection from any political processes that might have an unprocedural impact on how funds are allocated and disbursed, as well as protection from undue influence or control by higher tiers of government with respect to conditional grants.

5.3 Budgetary autonomy

Budgetary autonomy refers to the freedom to 'adjust revenue levels to spending levels, both within one generation of taxpayers (via taxes and fees) and between successive generations

[103] Beer-Tóth (2009) 73 & 80.
[104] Beer-Tóth (2009) 80.

(inter-temporally, via debt)'.[105] It entails the power of a subnational government to act on both the revenue as well as the expenditure side of the subnational budget, in order to avoid or correct fiscal imbalances.[106] Budgetary autonomy allows a subnational government to either increase taxes, charges or fees; solicit for grants; sell subnational assets; or borrow to balance the revenue side of the budget in the event of fiscal distress[107] or where needed to finance subnational capital spending.

However, given that this definition has been conceptualised broadly to include factors, such as the power to increase or lower taxes and charges, which may otherwise fall under subnational revenue autonomy as drawn from its own sources of revenue, this study narrows the scope of budgetary autonomy to refer only to a subnational government's power to borrow. In this case, therefore, a subnational government's powers of immunity would require that its borrowing powers be protected from interference and/or control from higher tiers of government unless otherwise sanctioned by law.

In summary, expenditure autonomy may be viewed as a subnational government's power to independently develop a priority 'wish list', revenue autonomy as the power to raise revenue and/or have discretion over how revenue will be used, and budgetary autonomy as the freedom to decide which items in the 'wish list' will be financed through debt and how debt financing may be utilised at the subnational level.

6 How does the intergovernmental fiscal system contribute towards the objectives of subnational autonomy?

As discussed above, subnational autonomy seeks to: ensure efficiency in local development; facilitate the accommodation of minorities and marginalised groups; enhance checks and balances on the exercise of central power; and promote democracy and accountability. Given the centrality of finances in facilitating the autonomy of subnational governments, it follows that the objectives of subnational autonomy will be best served by an intergovernmental

[105] Beer-Tóth (2009) 70.
[106] Beer-Tóth (2009) 89; Bahl (2008) 9.
[107] Beer-Tóth (2009) 89.

fiscal system that provides the widest level of fiscal autonomy to subnational units. This section discusses how the fiscal autonomy (expenditure, revenue and budgetary autonomy) of subnational governments contributes to the attainment of these objectives.

6.1 Fiscal autonomy and efficiency in subnational development

Efficiency in subnational development is based on a subnational government's ability to provide public outputs that are tailored to a subnational community's choices. All the three aspects of fiscal autonomy are required to be able to deliver on this objective.

Expenditure autonomy is needed to enable the subnational governments to assess local needs, prioritise them and decide on which and how they will be met. This freedom to plan based on local needs would be meaningless without the capacity to deliver on these needs hence the need for revenue autonomy. A subnational government's autonomy over revenue sources is thus important not only in providing the means of realising local needs but in facilitating the discretion to spend on whichever item of expenditure is deemed needful.

Revenue autonomy, insofar as it relates to discretion in the setting and variation of own tax rates, charges or fees, is crucial for subnational development. Such autonomy serves to link the level and quality of subnational public outputs to the level of taxes imposed, thus allowing local communities to choose the level of services they prefer by either agreeing to pay higher or lower taxes.[108] This is critical in ensuring efficiency in subnational development.

Budgetary autonomy, for its part, gives subnational governments the power to borrow so as to ensure that there are sufficient funds to deliver on local preferences. Budgetary autonomy is therefore key in driving subnational infrastructure development through borrowing for capital spending, as well as in bridging shortfalls in revenue receipts encountered within a financial year.

[108] Ambrosanio MF, Balduzzi P & Peiti C 'Accountability and revenue assignment across levels of government: rules, practices and challenges' in Valdesalici A & Palermo F (eds) *Comparing Fiscal Federalism* (2018) 120.

Boyne makes a case for inter-jurisdictional competition as an incentive for subnational policy experimentation and innovation.[109] Such an exercise would not be possible without the freedom of subnational governments to decide on: which policy issue to experiment on (expenditure autonomy); the discretion to allocate resources towards the experiments without fearing any powers of review and negation of higher tiers of government (revenue autonomy); as well as the freedom to decide whether such experimentation can be supported by the subnational budget and how (budgetary autonomy). Fiscal autonomy is therefore pivotal to any attempt at experimentation, innovation, and overall development at the subnational level.

6.2 Fiscal autonomy and accommodation of minorities and marginalised groups

Group identities are often used as a ground for the denial of access to resources in a state.[110] Identity-based grievances over resources therefore arise as a result of both real and perceived economic exclusion of the respective identity groups.[111] Subnational governments in plural states hence essentially require not only increased access and autonomy over resources, but also discretion in the use of such resources as a means towards achieving the economic inclusion of national minority groups.

Further, the institutionalisation of asymmetric financial arrangements that enable the fiscal autonomy of subnational governments goes a long way in securing accommodation and preventing conflict.[112] A revenue division formula, for instance, which has historical, social, economic and political peculiarities of subnational units built into it assists in contributing to the unconditional pool of resources available to subnational governments. This in turn increases the scope of any unique public outputs that may be required by the various identity groups in subnational units (including those units that are homogenous), thus fostering accommodation and co-existence.

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[109] Boyne (1998) 22.
[110] Bosire (2013) 45.
[111] Bosire (2013) 56.
[112] Kress A 'Accommodating diversity while guaranteeing stability: The role of financial arrangements' in Valdesalici A & Palermo F (eds) *Comparing Fiscal Federalism* (2018) 275.

6.3 Fiscal autonomy and the enhancement of checks and balances

The capacity of subnational governments to counterbalance central influence and prevent any abuse of central power lies in their ability to operate independent of the central government. In this respect, their revenue and budgetary autonomy is of central importance. Revenue autonomy ensures that subnational governments are able to finance most of their expenses independently. Swianiewicz argues that the ability of subnational governments to fund a significant amount of their expenditure from their own local sources is critical in presenting subnational governments as partners, rather than as agents of the central government, and is crucial in granting them financial muscle to check the central government.[113] Over-reliance on the central government to finance subnational expenditure exposes subnational governments to central control, thus compromising their ability to check the centre.

Budgetary autonomy, for its part, is important in ensuring that subnational governments have access to means of offsetting any fiscal deficits in their budgets or shortfalls in revenue receipts. A failure of budgetary autonomy will see subnational governments falling back to the centre to cover their fiscal deficits or shortfalls – a situation that compromises their autonomy hence their ability to check the central government.

6.4 Fiscal autonomy and democracy and accountability

As pointed out above, the utility of institutions and processes associated with subnational democracy lies in their ability to impact and inform the decisions and activities that are undertaken at the subnational level. Subnational governments are therefore only able to convert the outcomes of these local democratic exercises into local policy and action if they have the autonomy to do so, and more so if they have the resources to effect these outcomes. As with the determination of local preferences (discussed above and which is an archetypal illustration of the exercise of subnational democracy), it is the guarantee of expenditure,

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[113] Swianiewicz P 'Foundations of fiscal decentralization: Benchmarking guide for countries in transition' (2003) available at *http://pdc.ceu.hu/archive/00006929/* (accessed 8 November 2018) 9.

revenue and budgetary autonomy that underwrites the continued engagement between subnational governments and the local polity.

Public participation is argued to be a critical tool for guaranteeing the accountability of subnational leaders to the local communities.[114] Bahl argues that the downward accountability of subnational governments to local voters is the most crucial element of a decentralised system of governance and that fiscal decentralisation (autonomy) is central in attaining this.[115]

Beer-Tóth argues that there is an inevitable interconnection between local autonomy and responsibility (accountability) and that the two are 'two sides of the same coin'.[116] She argues that the financing of subnational expenditures primarily from own sources of revenue provides natural incentives for fiscal responsibility. This is only possible where subnational governments are allowed to charge for services and to increase or lower taxes (including charges and fees) in order to finance subnational preferences.[117] Increased taxes force the local community to be interested in how their money is being spent hence facilitating a demand for accountability.[118] The pressure to answer to the local community, coupled with the potential for political backlash from an overtaxed community, moreover, compels subnational governments to limit wastage by adopting hard budget constraints and to increase subnational taxes only when they can justify it to the local polity in terms of public outputs.[119] Revenue autonomy through substantial own-source revenue (OSR) is therefore key for subnational accountability.

Additionally, inter-jurisdictional comparisons, by citizens, of the correlation between tax rates and the quality of public outputs (otherwise referred to as 'yardstick competition')

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114 Hallett AH 'The practicalities of economic federalism: A critical review of how to apply lessons of fiscal autonomy in practice' in Valdesalici A & Palermo F (eds) *Comparing Fiscal Federalism* (2018) 69; Bahl R 'Opportunities and risks of fiscal decentralization: A developing country perspective' in Ingram GK & Hong Y (eds) *Fiscal Decentralization and Land Policies* (2007) 25.
115 Bahl (2007) 17.
116 Beer-Tóth (2009) 54.
117 Bahl (2007) 17.
118 Beer-Tóth (2009) 54.
119 Ambrosanio, Balduzzi & Peiti (2018) 120-122.

incentivises and facilitates the demand for accountability by local communities.[120] This, it is argued, curbs rent-seeking practices in subnational taxation, which enhances the accountability of subnational governments. Ambrosanio, Balduzzi and Peiti, moreover, argue that revenue autonomy facilitates positive tax competition (the 'strategic interaction of tax policy') across subnational jurisdictions.[121] The setting of subnational tax rates is closely linked to the free mobility of factors of production across subnational jurisdictions. This, therefore, poses the threat of loss of tax bases for subnational governments should there be any triggers of mobility. This threat facilitates the accountable setting of tax rates across jurisdictions, given that unreasonable and/or excessive tax rates hold the potential to trigger mobility and the loss of tax bases by subnational governments.[122]

Bahl and Bird, however argue that, for subnational taxation to facilitate the accountability to voters, 'local taxes must be both visible to local voters and large enough to impose a noticeable burden (one that should not be easily exported to non-residents)'.[123] They note that this is difficult to attain in developing countries since they rely on minor levies and nuisance taxes.[124] Moreover, for fiscal autonomy to facilitate accountability, citizens need to have accurate information regarding subnational expenditure and be able to exert a level of influence over their subnational governments, factors which Bahl and Bird argue are lacking in most developing countries.[125]

Bahl further argues, with respect to developing countries, that, although the power to increase taxes (which comes with revenue autonomy) is aimed at pushing local communities to demand accountability, the increases are usually very small in magnitude.[126] This, when coupled with the fact that most subnational expenditure in developing countries is funded by intergovernmental transfers, makes the impact of subnational taxes on the local voter

[120] Ambrosanio, Balduzzi & Peiti (2018) 121.
[121] Ambrosanio, Balduzzi & Peiti (2018) 121.
[122] Ambrosanio, Balduzzi & Peiti (2018) 121.
[123] Bahl R & Bird R 'Subnational taxes in developing countries: The way forward' (2008) 28 *Public Budgeting and Finance* 2.
[124] Bahl & Bird (2008) 5.
[125] Bahl & Bird (2008) 2, 3.
[126] Bahl (2008) 18.

negligible given that they link service levels at the subnational level to transfers rather than subnational taxes.[127] These factors highlight the need for carefully designed mechanisms for facilitating subnational fiscal accountability in devolved developing countries for fiscal autonomy to be able to serve the goal of (democracy and) accountability.

Given the significance of fiscal autonomy in attaining the objectives of subnational autonomy, the structuring of the intergovernmental fiscal system ought to be done in such a way as to ensure optimal outcomes for the fiscal autonomy of subnational governments. The next section explores fiscal federalism principles, and approaches to the design of a financial constitution for subnational fiscal autonomy.

7 Designing a financial constitution for subnational fiscal autonomy

A financial constitution refers to the constitutional principles and rules that dictate the system of public finance in a state.[128] This covers rules on the allocation of tax or revenue authority to the various levels of government, as well as those rules that govern the system of intergovernmental financial relations.[129] In this regard, Parolari argues for a more detailed financial constitution as a measure to safeguard the fiscal autonomy of subnational units.[130] But what does one consider when setting up this constitutional design?

Normative theories of fiscal federalism, especially those focusing on devolved states, revolve around the optimal structuring of decentralised public finance, with a view to ensuring economic efficiency, and the efficient allocation and provision of public outputs, with the objective of maximising social welfare.[131] Some of the relevant theories and principles are discussed below, with a focus on how they influence the constitutional design of

[127] Bahl (2008) 18.
[128] Valdesalici (2018) 19, 20 & 21; Valdesalici argues that the financial constitution extends to those 'unwritten rules that guide fiscal decisions' including 'the principles of the national tax system or economic and financial policies, together with national budgetary policies.'
[129] Parolari (2018) 23.
[130] Parolari (2018) 27.
[131] Bird R & Slack E 'Local taxes and local expenditures: Strengthening the Wicksellian connection' (2013) 34 *Public Administration and Development* 363; Oates (2005) 349-373.

intergovernmental fiscal systems. The principles will be discussed in relation to the three facets of fiscal autonomy (expenditure, revenue and budgetary autonomy).

7.1 Principles relating to constitutional design for subnational expenditure autonomy

Subnational expenditure autonomy is directly linked to the vertical division of functions amongst the various levels of government. It can therefore be exercised only within the limits of the items of public expenditure allotted to a subnational government. Subsidiarity, the notion that 'public responsibilities should be exercised by those elected authorities closest to the citizens',[132] serves as a principal rationale underlying the vertical division of functions.[133] Efficiency in expenditure assignment is therefore ensured by assigning each function to that level of government that can best secure its efficient performance.[134]

However, the nature of expenditure responsibilities, as well as the margin for expenditure autonomy extended to subnational governments are largely determined by the constitutional design for the vertical allocation of functions which is adopted by a particular state.[135] As highlighted in the introductory chapter, constitutional design with respect to intergovernmental allocation of expenditure responsibilities lies on a spectrum between the two general approaches adopted in federal theory and practice in multilevel states, the dualist or the integrated approach.[136] The dualist approach entails each sphere of government having its own exclusive functional competences over which it has discretion to legislate and administer,[137] and is often associated with federal states. Under the integrated approach, both spheres of governments have exclusive functional areas as well as concurrent functional mandates, in varying proportions, over which they may have either or both legislative and

[132] UN-HABITAT (2009) 10.
[133] Keunen S 'Local autonomy and subsidiarity: A two-way principle' (2016) available at http://paperroom.ipsa.org/papers/paper_59120.pdf (accessed 9 November 2018) 1-17; Brezovšek M *Local Self-Government in Slovenia: Theoretical and Historical Aspects* (2014) 2.
[134] Bahl (2008) 11.
[135] Beer-Tóth (2009) 76.
[136] Saunders C 'Financial autonomy vs. solidarity: A dialogue between two complementary opposites' in Valdesalici A & Palermo F *Comparing Fiscal Federalism* (2018) 40.
[137] Saunders (2018) 40.

executive authority.[138] The latter model is often associated with devolved states, given their 'margin of autonomy' approach to subnational autonomy.

Saunders argues that by default, subnational governments in dualist systems have a higher level of autonomy, while those in integrated systems are highly interdependent (hence less autonomous) by design.[139] In respect of the latter, for instance, a subnational government's autonomy to set and implement its own policy objectives in areas of concurrent competence may be constrained by the requirement to implement policies set by higher levels of government. This extends to domains where higher levels of government have the power to set sector-specific norms, standards and regulations regarding service delivery.[140] Also, where government institutions located at the national level set regulations regarding minimum wages and salaries, the expenditure autonomy of subnational governments is limited.[141] This is especially the case in most developing countries.[142] The expenditure autonomy of subnational governments is also constrained where particular expenditures are required to be incurred only upon the prior approval of higher levels of government.

The utility and relevance of subnational expenditure autonomy are supported by various theories and principles, some of which are highlighted below.

7.1.1 Tiebout's theory on household mobility and locality-specific public outputs

The theory on mobility of households as well as the existence of locality-specific goods was first advanced by Charles Tiebout in what is now known as the 'Tiebout Hypothesis', 'Tiebout sorting' or 'Tiebout migration'. The theory is considered by some observers as 'the centrepiece of the theory of fiscal federalism'.[143] In this theory, Tiebout presented 'a model of mobile households that select a community of residence based on their preferences for local

[138] See also, Saunders (2018) 41.
[139] Saunders (2018) 41.
[140] Beer-Tóth (2009) 99; Bahl (1999) 17.
[141] Beer-Tóth (2009) 76; Swianiewicz (2003) 51.
[142] Bahl (2008) 15.
[143] Oates (2005) 354.

public goods'.[144] He argued that 'people effectively sort themselves into groups that are homogeneous in their demands for local services'.[145] This hypothesis was critical in the sense that it made a case for the existence of 'local public goods' as a unique class of goods that can be location-specific, and that could be supplied more efficiently through a system of decentralised public finance that gives room for expenditure autonomy.

The hypothesis, however, assumes the existence of perfect social (spatial) mobility, in other words, that people are able to 'vote with their feet' by selecting to stay in or leave a locality based on their preferences of local public outputs.[146] Clark dismisses the hypothesis as being hardly an adequate description of reality in the sense that it assumes that all voters are rational utility maximising agents with distinct and identifiable preferences which are capable of finding expression either through voting or through loyalty (or disloyalty indicated by migration) to a particular jurisdiction.[147]

Arguing from a developing countries' perspective, Smoke supports the view that the hypothesis is unrealistic and reflects little of reality, if at all.[148] He states that due to limited urban areas, chances for mobility for the rich or those who may prefer 'high levels of public services and wealth-responsive amenities' are limited.[149] Similarly, mobility for the poor is also limited where they are not in a position to foot the costs attendant with mobility. Furthermore, in African countries, culture and communal ties as well as consideration of the ethnic spread of settlements hold more sway in determining where one lives than one's preference for local public outputs.

7.1.2 **Discretionary expenditure for locality-specific public outputs**

Principles on the utility of decentralised public finances (hence discretion over expenditure) flow from Tiebout's conceptualisation of the existence of a locality-specific homogeneity or

[144] Oates (2005) 354.
[145] Oates (2005) 354.
[146] Swianiewicz (2003) 4; Smoke (2001) 6.
[147] Clark GL *Judges and the Cities: Interpreting Local Autonomy* (1985) 69.
[148] Smoke (2001) 6.
[149] Smoke (2001) 5.

semblance of homogeneity in the demand for local public outputs. On this basis, Oates (as part of the first generation theory of fiscal federalism (FGT)) argues that decentralised public finance facilitates the provision of public outputs that are tailored to the demands and particular conditions of individual jurisdictions (otherwise referred to as the decentralisation theorem).[150] This provides room for the maximisation of overall social welfare as compared to maintaining a uniform level of public outputs across all jurisdictions under a centralised government. Oates therefore argues that decentralised public finance (in the sense of subnational discretion over expenditure) is key to achieving economic efficiency.

Although this can, arguably, be achieved by a central government equipped with perfect information as to subnational preferences, the FGT argues that the central government would be constrained by equal service provision laws as well as failures, imperfections or asymmetries in the information provided regarding subnational preferences.[151] While it is acknowledged that there hardly exists a subnational jurisdiction whose demand for public outputs is perfectly homogeneous, the potential welfare gains presented by decentralised public service delivery provide a strong ground for the theory's central argument that fiscal decentralisation (in the sense of expenditure autonomy) is central to attaining economic efficiency.[152]

7.2 Principles relating to constitutional design for subnational revenue autonomy

Principles relating to subnational revenue autonomy revolve around the vertical design of taxes and seek to answer the normative question as to what taxes are best suited for which level of government. They also explore questions regarding the various ways in which a subnational government may fund its functions, as well as the pros and cons of the various sources of subnational revenue. This section also discusses subnational tax administration and how it should be designed to enhance subnational revenue autonomy.

[150] Oates (2005) 354.
[151] Oates (1999) 4.
[152] Oates (2005) 349-373.

Although federal theory takes the view that to be autonomous, subnational governments should be able to fund a significant amount of their expenses from their own sources (dualist approach),[153] the theoretical perspectives set out below seek to explain why most of them, especially those in devolved developing countries, have limited powers of taxation and have to rely mainly on intergovernmental fiscal transfers (integrated approach), and what impact (if any) this has on their fiscal autonomy. The discussion adopts a topical approach in exploring design issues, relating intergovernmental financing in integrated devolved states.

7.2.1 **Characteristics of a good subnational tax (revenue source)**

Bahl and Bird argue that the proper vertical tax assignment design is not clear in principle, and is often controversial in practice.[154] Some of the propositions provided by fiscal federalism theories on the design of subnational taxes include those stipulating that: taxes allocated to subnational governments should be neutral in their effect on economic behaviour; 'benefits and costs of subnational taxes should be clear' (visibility) to the subnational polity; assigning complex taxes should be avoided in order to minimise administration and compliance costs;[155] exportable taxes (to non-residents) should be avoided to facilitate subnational accountability; the yield from assigned taxes should be 'relatively stable and predictable over time to support sound subnational fiscal practices'; that subnational taxes should be flexible to accommodate changing subnational budgetary needs; and further that the tax bases of subnational taxes should be 'spread rather "evenly"' across the subnational units.[156]

According to the FGT, subnational governments operate in a setting where economic units, agents, goods and resources can move freely and costlessly across jurisdictional boundaries.[157] Given the inclination of taxed units as well as the owners of taxed items to seek out jurisdictions with relatively favourable tax treatment, allowing subnational governments

[153] Smoke P 'Local revenues under fiscal decentralization in developing countries: Linking policy reform, governance, and capacity' in Ingram GK & Hong Y (eds) *Fiscal Decentralization and Land Policies* (2007) 40; Bahl (1999) 10.
[154] Bahl & Bird (2008) 6.
[155] Smoke (2001) 7; Bahl & Bird (2008) 3.
[156] Ambrosanio, Balduzzi & Peiti (2018) 136 & 150.
[157] Oates (1999) 1125.

to tax mobile economic units would incentivise the adoption of beggar-thy-neighbour taxation policies by other subnational governments, thereby creating tax-induced migration and distortions in subnational economies that would affect subnational tax bases.[158] The FGT therefore recommends, on efficiency grounds, that subnational governments should avoid taxing highly mobile economic units.

The FGT also recommends that subnational governments should be allowed to impose benefit taxes which are levied for the provision of public services to the subnational units.[159] These include such taxes as property rates as well as user fees. Oates argues that these 'taxes are seen as the 'price' that households pay for their consumption of local public goods'.[160] This leaves higher levels of government as best suited to levy non-benefit taxes such as personal income tax and corporate income tax (often referred to as redistributive taxes).

In practice, however, it should be noted that none of the taxes allocated to subnational governments possess all of the above features.[161] Some of the assigned taxes may actually conflict with the attributes highlighted above for various reasons including historical and political ones.[162]

7.2.2 The case for (and against) subnational own-source revenue (OSR)

OSR for subnational governments mainly consists of subnational taxes, user charges and fees, fines, revenues from leasing and sale of subnational property, as well as local business licences, inter alia.[163] In principle, subnational OSR is ideally required to be sufficient to enable at least the richest subnational government to finance all of its subnational expenditure

[158] Oates (1999) 1125; Ambrosanio, Balduzzi & Peiti (2018) 136.
[159] Oates (2005) 352.
[160] Oates (2005) 352.
[161] Ambrosanio, Balduzzi & Peiti (2018) 137.
[162] Ambrosanio, Balduzzi & Peiti (2018) 137; Farber G 'Taxing powers of subnational entities: Between domestic and supranational constraints' in Valdesalici A & Palermo F (eds) *Comparing Fiscal Federalism* (2018) 152.
[163] Beer-Tóth (2009) 82.

needs.[164] Reliance on OSR therefore theoretically presents an archetypal model for the highest level of subnational revenue autonomy.

Literature lays emphasis on subnational reliance on OSR as opposed to intergovernmental fiscal transfers (IGFTs) as a means of ensuring hard budget constraints at the subnational level.[165] Goodspeed argues that

> In a setting where the fiscal system provides a ready 'bailout' for provincial or local governments, there are virtually irresistible incentives for decentralized governments effectively to raid 'the commons' and extend public programs well beyond efficient levels.[166]

Swianiewicz adds to this by arguing that IGFTs create a fiscal illusion at the subnational level that leads to increased and often unnecessary subnational demands for increased public services.[167] Bird and Slack explain this as being a result of IGFTs' severing the 'Wicksellian Connection' that links subnational expenditure to subnational revenues [tax rates].[168] In this regard, McLure associates IGFTs with subnational tax exportation and argues that 'where jurisdictions have the capacity to export part of their subnational tax burdens onto residents of other jurisdictions, there will exist incentives to expand the subnational budget beyond efficient levels, as the local 'tax-price' will effectively be too low'.[169] Adding to this perspective, Rodden, writing in support of the public choice theory's proposition that tax decentralisation works to reduce the size of government, comes to a finding that associates smaller government with subnational reliance on own revenues.[170]

For subnational governments to be said to have 'proper own taxes', Ambrosanio, Balduzzi and Peiti argue that each subnational unit should have the power to: independently enact their own tax laws wherein they can freely identify the specific subnational taxes to levy;

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[164] Bird RM, 'Intergovernmental fiscal relations: Universal principles, local applications' (2000) 42 available at *https://www.researchgate.net/profile/Richard_Bird2/publication/4737779_Intergovernmental_Fiscal_Relations_Universal_Principles_Local_Applications/links/0c960529e64523d32b000000/Intergovernmental-Fiscal-Relations-Universal-Principles-Local-Applications.pdf* (accessed 3 April 2019) 8; Bahl (2008) 23.
[165] Oates (2005) 354.
[166] Oates (2005) 354.
[167] Swianiewicz (2003) 9.
[168] Bird & Slack (2014) 359.
[169] Oates (2005) 354.
[170] Oates (2005) 355.; See also, Hallett (2018) 69.

determine their respective tax bases and tax rates as well as powers to assess, administer and enforce the collection of subnational taxes.[171] Proper own taxes are argued to provide more fiscal autonomy to subnational governments than subnational taxes raised through base-sharing (surcharges).[172] When a subnational government raises taxes through a surcharge, it concurrently taxes the same tax base as the national government which is in charge of administering the tax. In this case, a subnational government is only allowed to impose an additional rate (which it is allowed to impose often within set limits) on the same tax and whose proceeds are shared by the national government after collection.[173]

Due to the pressure to widen the scope of taxes available to subnational governments, various proposals have been made, ranging from differentiation of taxes that may be levied at the local, intermediate and national level, to tax (base) sharing by surcharging or 'piggybacking' on taxes that had traditionally been reserved for central governments such as personal income tax (PIT), followed by distribution based on the principle of derivation.[174] However, some of these taxes may not be practically desirable in developing countries due to prevailing centrist approaches to tax allocation as well as overriding national priorities such as the 'need for nation building in ethnically fragmented societies'.[175] Administrative as well as political considerations also affect the effectiveness of some taxes suggested for allocation to subnational units in developing countries.

For instance, the FGT recommends unimproved land as an attractive tax base for subnational governments given its inelastic supply and its being incapable of escaping through mobility hence posing no risk of locational inefficiencies.[176] However, with respect to developing countries, property taxes have been argued to lack buoyancy[177] as well as being difficult to

[171] Ambrosanio, Balduzzi & Peiti (2018) 131.
[172] Ambrosanio, Balduzzi & Peiti (2018) 131.
[173] Ambrosanio, Balduzzi & Peiti (2018) 131.
[174] Bahl (2008) 24.
[175] Smoke (2001) 3.
[176] Oates (2005) 352.
[177] Smoke (2001) 24; Smoke however argues that provisions to revalue land at regular intervals and to index between valuations may improve the buoyancy of tax proceeds from land.

administer due to complexity in valuation procedures.[178] Also, communal land tenures in rural municipalities in developing countries affect the imposition of property taxes, thereby making property tax lucrative as a revenue source only to urban governments.[179] Property taxes in developing countries are also politically unpopular either as a result of property being largely owned by local elites, or due to the proximity of subnational governments to the property owners.[180] As a result, property rates tend to be kept low with little to no enforcement of payment, which in turn leads to low tax yields for subnational governments.[181] Generally, therefore, subnational governments in developing countries prefer politically 'cheaper' or painless sources of finances as opposed to those that come with political costs.[182] This informs the low levels of subnational tax receipts and high subnational dependence on IGFTs.

Although OSR has been touted as a principal source of subnational revenue autonomy, where statutory rules seek to regulate every aspect of subnational OSR by, for instance, listing admissible tax types, setting ceilings for rates, earmarking user charges or subjecting subnational taxes and fees to prior approval by agencies of the central government, OSR ends up providing little to no revenue autonomy to subnational governments.[183] The nature and quality of the taxes assigned to subnational governments therefore underlie the utility of OSR as a source of revenue autonomy.

Additionally, while reliance on OSR may enhance subnational revenue autonomy, high reliance on OSR produces a number of negative outcomes. For instance, it inevitably leads to varying levels of subnational revenue receipts between rich and poor regions (even in cases where equal fiscal effort is applied) as a result of differences in fiscal capacity, thus impacting on the level of public outputs across jurisdictions.[184] Moreover, it incentivises tax exportation where subnational governments strive to 'shift the burden of taxation on to non-residents'

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178 Smoke (2001) 23.
179 Steytler & Ayele (2018) 325.
180 Bahl (1999) 14.
181 Bahl (1999) 14.
182 Bahl & Bird (2008) 16.
183 Beer-Tóth (2009) 82.
184 Swianiewicz (2003) 10; Bahl & Bird (2008) 4.

for fear of political unpopularity. This creates a fiscal illusion in the sense that local communities fail to internalise the cost of subnational public services.[185] Also, over-reliance on OSR may also create perverse incentives for predatory tax competition (a race to the bottom) in a bid to attract mobility of factors of production so as to widen own tax bases. Lastly, the quest for OSR is also argued to lead to institutional duplication, especially since each subnational government has to establish its own revenue-collection agencies, which only serves to increase the general cost of tax collection.[186]

Due to the above drawbacks of subnational reliance on OSR, especially for devolved developing countries, the supplementary financing of subnational governments through IGFTs is proposed as a measure to address them.[187] This study discusses this in detail below.

7.2.3 **Responsibility over subnational tax administration**

A subnational government's revenue autonomy drawn from its OSR extends to and is strengthened by the right to administer (assess, collect and enforce) its own taxes.[188] Being able to effectively administer a tax is one of the key considerations when assigning taxes to subnational governments. However, several arguments have been advanced in favour of and against both central as well as subnational administration of taxes assigned to subnational governments.

Generally, subnational governments are criticised as lacking the necessary administrative capacity to be able to effectively administer subnational taxes (incompetence).[189] Central administration is as well criticised for lacking in the incentive to optimise the collection of subnational tax especially since it is not a beneficiary but merely a collecting agent (indifference). The decision between subnational and central administration has hence been argued (in a rather oversimplified manner) as constituting a choice between incompetence

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185 Ambrosanio, Balduzzi & Peiti (2018) 122.
186 Ambrosanio, Balduzzi & Peiti (2018) 122.
187 Ambrosanio, Balduzzi & Peiti (2018) 122.
188 Bird (2018) 193; Farber (2018) 149.
189 Bird (2018) 210.

and indifference.[190] Further arguments have, however, been advanced in favour of both choices.

With respect to central administration, Bird argues that it is key in cutting down administration and compliance costs by taking advantage of economies of scale, making use of state expertise and technology, and backing this up with the state's coercive force, which is key to enforcing compliance.[191] Central administration is additionally argued to provide a 'more uniform and better coordinated administrative system'.[192] Subnational governments in this respect are accused of being conflicted by political considerations that leads to arbitrariness in tax administration; lacking the requisite enforcement machinery to curb tax evasion; being easily influenced and/or captured by subnational interest groups; and being easily corruptible, hence leading to revenue leakages.[193]

With respect to subnational administration, Bird argues that being a direct beneficiary of the tax administration process, subnational governments have the incentive to maximise their tax effort.[194] It is also argued that they have better information and knowledge of the subnational space, and are better placed to identify tax-liable ventures and ensure the taxation of ordinarily unreachable tax bases.[195] Subnational tax administration is also argued to ensure the visibility required of subnational taxation which facilitates democratic responsiveness and incentivises subnational demands for accountability, thereby contributing towards subnational fiscal responsibility.[196] Subnational tax administration has moreover proven to hold the potential of contributing to increased revenue collection due to the visibility component that is linked to accountability; this in turn improves the willingness of the

[190] Bird (2018) 210.
[191] Bird (2018) 210 & 211.
[192] Bird (2018) 211.
[193] Bird (2018) 211; Bahl (2008) 32.
[194] Bird (2018) 211.
[195] Bird (2018) 211, 214 & 216.
[196] Bird (2018) 195.

subnational polity to pay taxes.[197] For these reasons, subnational tax administration is key in enhancing the revenue autonomy of subnational governments.

In respect of the issue of incompetence versus indifference, Bird and Bahl argue that it is easier to remedy incompetence than indifference by building capacity and administrative infrastructure, which may in turn translate to generally improved financial administration and management at the subnational level.[198] It is proposed, moreover, that the subnational revenue collection system be insulated from the direct influence of elected leaders at the subnational level as a measure of increasing the autonomy-enhancing value of subnational tax administration.[199]

7.2.4 Horizontal fiscal imbalances and the need for equalisation

'Fiscal decentralization is inherently counter equalizing.'[200] Differences in access to tax bases and natural resources, as well as the existence of different levels of development across jurisdictions, occasion a horizontal fiscal imbalance among subnational governments. Left to rely solely on their OSR, therefore, risks sustaining the imbalances and causing further marginalisation of poor regions. This necessitates a system of equalisation through income redistribution. According to the FGT, the central government is best suited to hold responsibility for income redistribution.[201] Oates argues that the redistributive potential of subnational governments is limited by the mobile nature of households and firms, hence subnational governments are unable to regulate redistribution without providing undesired incentives for migration.[202] IGFTs, therefore, become key as a means of distributing grants aimed at ensuring fiscal equalisation to eliminate or reduce horizontal inequities, and secure the provision of minimum level standards of public services.[203]

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197 Bird (2018) 212 & 213.
198 Bird (2018) 211 & 218; Bahl (2008) 33.
199 Smoke (2007) 50.
200 Bahl (1999) 4.
201 Oates (2005) 352.
202 Oates (2005) 351.
203 Oates (1999) 1126-1127; Swianiewicz (2003) 22.

The FGT theory, however, contests the need for fiscal equalisation from an efficiency perspective.[204] Oates argues that while equity, the primary rationale for equalisation, is important in creating a level playing field for service provision across jurisdictions, it may stand in the way of development, regional adjustments and the interregional flow of resources through both emigration and immigration motivated by cost differentials.[205] The theory argues that 'low wages and costs in one area can serve as motivation for industrialisation and prosperity'[206] that may be necessary for fiscally weaker subnational governments to develop fiscal resilience over time.

7.2.5 **Revenue sharing arrangements and intergovernmental grants**

Intergovernmental fiscal transfers (IGFTs) arise from either revenue sharing arrangements between levels of government or intergovernmental grants.[207] They can be provided either as conditional (specific) grants or as unconditional (general purpose) grants.[208] Conditional grants are issued with restrictions on their use. Unconditional grants, for their part, are usually provided as lump-sum transfers over which the receiving subnational governments have complete discretion.[209] Prescriptive transfers, which Shah refers to as 'block transfers', however, fall in the grey area between unconditional and conditional grants.[210] Unconditional grants become prescriptive transfers/grants where they are required to be applied towards a general area/sector, such as education, with subnational governments having discretion over specific expenditure allocations within the area.[211]

204 Oates (1999) 1127.
205 Oates (1999) 1128.
206 Oates (1999) 1128.
207 Oates (1999) 1127.
208 Swianiewicz (2003) 23.
209 Oates (1999) 1127.
210 Shah A 'A practitioner's guide to intergovernmental fiscal transfers' in Boadway R & Shah A (eds) *Intergovernmental Fiscal Transfers: Principles and Practice* (2007) 2.
211 Shah (2007) 2.

7.2.5.1 **The utility of IGFTs**

IGFTs are argued to be a critical policy instrument and are vital in ensuring vertical equity (vertical fiscal equity) by balancing out vertical fiscal asymmetries (VFAs); ensuring horizontal equity by providing fiscal equalisation across jurisdictions; internalising spill-over benefits to other jurisdictions; and facilitating an efficient overall tax system.[212]

A VFA occurs where a subnational government's expenditure needs exceed its revenue means.[213] This poses the risk of failure to provide some essential services, or their provision at extremely low levels or quality.[214] This is the case for most subnational governments. IGFTs are therefore key in addressing the asymmetry by providing additional funding aimed at ensuring the fiscal sustainability of subnational governments.[215]

Whereas literature from a subnational fiscal autonomy perspective provides arguments in favour of limiting the use of conditional grants, Oates argues that they are critical in internalising inter-jurisdictional spill-over effects.[216] This comes into play where the provision of a public service or good, such as the construction of a road, stands to bestow unintended benefits to residents of an adjoining subnational government. In this case, the central government provides matching grants (subsidises or finances a specified amount of the projected cost) in order to 'induce policy makers to incorporate externalities and spill-over benefits in their decision-making'.[217] This has otherwise been referred to as the 'traditional Pigouvian theory of subsidies'.[218] Such subsidies have, however, been argued to induce expenditure on non-priority items given the apparent financial 'advantage' presented by the grants, which is hard to reject given the economic realities that subsist at the subnational

[212] Oates (1999) 1127; Swianiewicz (2003) 22.
[213] Sharma CK 'Beyond gaps and imbalances: Re-structuring the debate on intergovernmental fiscal relations' (2012) 90 *Public Administration* 100.
[214] Bahl (2008) 9.
[215] Oates (1999) 1127.
[216] Oates (1999) 1127.
[217] Oates (1999) 1127.
[218] Oates (2005) 351.

level.[219] Subsidies therefore impact on the expenditure autonomy of subnational governments.

With respect to IGFTs as a means towards sustaining a more efficient overall tax system, the FGT theory argues that IGFTs facilitate the central administration of such taxes as non-benefit taxes, which allows the application of a uniform tax rate across the state.[220] This prevents locational inefficiencies associated with varying tax rates being applied to the same tax base across different subnational governments. IGFTs hence prevent the adoption of beggar-thy-neighbour taxation policies across jurisdictions, thereby removing any fiscal incentives for migration.[221]

7.2.5.2 The autonomy advantages of IGFTs (designing IGFTs for revenue autonomy)

Whereas classical fiscal federalism theories argue that over-reliance on transfers hinders the fiscal autonomy of subnational governments, Beer-Tóth points out that:

> Practical experience shows, however, that a well-designed transfer system can grant a higher level of autonomy to subnational governments than an overly restrictive national legal framework on subnational own-source revenues.[222]

Valdesalici adds to this perspective by pointing out that revenue-sharing (through IGFTs) is increasingly gaining ground over tax-base-sharing (OSR) when it comes to subnational financing.[223]

IGFTs are said to provide significant revenue autonomy where the rules regulating sharing are laid down in a constitution or an organic law; subnational governments have a leeway to negotiate the size of the shareable funds as well as the distribution formula; eligibility is determined objectively and the funds transferred are not earmarked for specific projects.[224]

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[219] Saunders C 'Financial autonomy vs. solidarity: A dialogue between two complementary opposites' in Valdesalici A & Palermo F (eds) *Comparing Fiscal Federalism* (2018) 47.
[220] Oates (1999) 1128.
[221] Oates (1999) 1128.
[222] Beer-Tóth (2009) 82.
[223] Valdesalici (2018) 18.
[224] Beer-Tóth (2009) 82.

Also, sharing a defined percentage of revenues raised by higher levels of government gives subnational governments an entitlement to the revenue, provides a degree of certainty of revenue flow, and effectively makes them 'partners in the central tax system'.[225] This holds the potential to grant subnational governments significant autonomy, especially where such transfers are transmitted unconditionally and as soon as they fall due. However, having a fixed percentage of centrally raised taxes that become due to subnational governments limits fiscal flexibility. Also, subnational revenues in this case become vulnerable to central government tax policy changes as well as any other central government policies or activities, such as national borrowing, which may impact its revenue yields. These factors may therefore pose a threat to the revenue autonomy of subnational governments where this is significantly drawn from IGFTs.

Besides the above features that ought to be considered in the constitutional design for IGFTs to confer revenue autonomy to subnational governments, Shah provides additional general design principles: predictability, efficiency, incentive and accountability.[226] In terms of predictability, Shah proposes that the IGFTs should be designed such as to ensure that subnational shares are predictable.[227] To facilitate this, Shah recommends that five-year projections of subnational shares should be published with the grant formula specifying the ceilings and floors for any yearly fluctuations.[228] He also recommends that provisions for 'holding harmless' or 'grandfathering'[229] should be made to shield subnational governments in the event of a major fluctuation in any given year.[230] With respect to efficiency, Shah proposes that the design of IGFTs should be such that it is neutral in its effect on subnational choices of resource allocation across expenditures.[231] As to incentives, Shah recommends that the design of grants should incentivise sound subnational fiscal management while

[225] Bahl (2008) 35.
[226] Shah (2007) 15-16.
[227] Shah (2007) 15.
[228] Shah (2007) 15.
[229] The hold harmless principle requires that in the event of a major fluctuation in national revenues, subnational service provision should be protected (from 'harm') by guaranteeing at least the same allocation to subnational governments as was received in the previous financial year.
[230] Shah (2007) 15.
[231] Shah (2007) 16.

discouraging inefficient practices.[232] Shah's principle of accountability, for its part, requires that mechanisms be put in place for ensuring subnational accountability to both to the 'grantor' (vertically) as well as its citizens (horizontally) for both financial integrity and improvements in service delivery (results).[233] The latter introduces an active and more targeted approach to subnational accountability that is a shift from classical fiscal federalism's passive 'accountability through subnational taxation'.

7.2.5.3 **The negative effects of IGFTs**

While the above discussion makes a case for the utility of IGFTs as a source of subnational revenue autonomy, various critiques exist against the use of IGFTs to finance subnational expenditure. First is the argument that IGFTs incline the spending behaviour of subnational governments towards profligacy.[234] On this basis, Oates argues that IGFTs should not be so large as to undermine fiscal discipline at the subnational level.[235] He points to the 'flypaper effect' (money sticks where it hits) which posits that subnational government expenditure is bound to increase more with increases in IGFTs than it would have if the increased income were occasioned by an increase in the community's private income.[236] A study of the subnational budgets of some developing countries, for instance, revealed that an increase in subnational taxes corresponded with an increase in public services rendered, while an increase in transfers led to increased expenditure on employee benefits and administrative costs.[237]

Another argument against transfers is that it leads to subnational dependency, which negatively impacts subnational fiscal autonomy. Dependency on transfers becomes harmful where subnational governments 'live at the mercy of higher-level authorities over a longer

[232] Shah (2007) 16.
[233] Shah (2007) 16.
[234] Oates (1999) 1129.
[235] Oates (1999) 1128.
[236] Oates (1999) 1129.
[237] Smoke (2007) 50; See also, Gadenne L 'Tax me, but spend wisely? Sources of public finance and government accountability' (2017- 9(1) *American Economic Journal: Applied Economics* 274.

period of time'.[238] This prevents subnational governments from providing subnational public outputs that are tailored to subnational preferences, thus affecting the core object of 'decentralisation' and subnational autonomy.[239]

Lastly, the notion of 'gift money' attached to IGFTs also disincentivises subnational tax effort, promotes wastefulness and risks reducing the 'sense of accountability' of subnational governments to local communities.[240] Availability of funds with no attendant political accountability (to electorates) presents a politically convenient combination for subnational revenue compared to OSR. This runs the risk of substituting subnational taxation rather than stimulating subnational tax effort.[241] Moreover, separating decision-making regarding taxes and tax administration from the level of government that decides on spending creates a fiscal illusion at the subnational level that tends to lead to the wasteful over-provision of public outputs.[242] Such over-provision of public outputs that does not correspond with an increase in subnational tax rates in turn disincentivises local communities from demanding for accountability from subnational governments, thereby defeating a central objective of subnational autonomy.[243]

However, this study argues that a carefully designed intergovernmental fiscal system that combines Shah's principles of predictability, incentive and accountability, discussed above, may hold the potential to address most of the issues identified above in the context of integrated devolved states.

7.3 Principles relating to constitutional design for subnational budgetary autonomy

Generally, the utilisation of debt as a financing tool by subnational governments is highly regulated at the national level. The rationale for this rests on two important factors: the need

[238] Beer-Tóth (2009) 87.
[239] Beer-Tóth (2009) 87.
[240] OECD, *Fiscal Design Surveys Across Levels of Government* (2002) in Beer-Tóth (2009) 88; Ambrosanio, Balduzzi & Peiti (2018) 123.
[241] Smoke (2001) 26; Bahl (1999) 18.
[242] OECD (2002) 88.
[243] Smoke (2001) 7.

to ensure intergenerational equity and the imperative to maintain macro-economic stability.[244] Intergenerational equity demands that the present generation should not burden future generations for its current consumption (recurrent) needs, and that future generations should share in the burden of long-term capital investments undertaken by the current generation. Flowing from this, governments generally tend to restrict subnational deficit financing[245] to capital expenditure with long-term benefits, while prohibiting its use to finance recurrent expenditure.[246] This does not, however, mean that the subnational government cannot borrow to cover recurrent spending; it only means that where such borrowing is allowed, it is mainly required to be short-term (repayable within a financial year), and is usually restricted to bridging revenue shortfalls rather than covering a budget deficit. The maintenance of macroeconomic stability rationale, for its part, requires that the use of debt is closely regulated to ensure the sustainability of government spending, and the maintenance of stability in the financial markets by keeping inflationary pressures low.[247]

Based on the need to ensure intergenerational equity (fiscal discipline) and macroeconomic stability, subnational governments are generally required to maintain a balanced budget.[248] This refers to a budget whose expenditure is equal to its anticipated revenues (obtained from own sources or from guaranteed transfers).[249] However, the Institute of Economic Affairs (IEA Kenya) argues that a balanced budget makes sense only when a (subnational) government is 'not engaged in long-gestation capital projects' such as dams and roads, in which case deficit financing would be justifiable provided the 'assets created are equal or more than the debt'.[250] Economists further argue that developing countries may actually need debt financing in order to stimulate growth through capital investments, hence it falls to

[244] Institute of Economic Affairs *The Citizen's Handbook on the Budget: A Guide to the Budget Process in Kenya* (2007) 51-53.
[245] Deficit financing is used to refer to financing through borrowing that is specifically meant to cover a budget deficit (the difference between expenditure and own revenue in subnational government's budget).
[246] Institute of Economic Affairs (2007) 51.
[247] Institute of Economic Affairs (2007) 52-53; Commission on Revenue Allocation (CRA) *Recommendations on Sharing of Revenue Raised Nationally between the National and County Governments for the Fiscal Year 2012 / 2013 and among County Governments for the Fiscal Years 2012/13 - 2014/15'* (2012) 42.
[248] CRA (2012) 43.
[249] Institute of Economic Affairs (2007) 51.
[250] Institute of Economic Affairs (2007) 51.

economic planners to ensure that public debt (through deficit financing) is kept at a sustainable level without necessarily eliminating it.[251]

In that regard, Bahl argues that large subnational governments in developing countries should be incentivised to use debt, more especially for financing capital expenditure.[252] According to Bahl, the long life of capital assets commends them for financing through debt instruments such as bonds whose maturity should be approximated based on the asset's life. This, moreover, ensures inter-generational equity in the spreading of the tax burden. With a proper regulatory framework, therefore, subnational borrowing serves as a critical tool for the enhancement of the budgetary autonomy of subnational governments.[253]

However, the regulatory framework for subnational borrowing in developing countries is often forbidding. Apart from the macroeconomic considerations behind this, the fluctuating and unstable nature of subnational OSR makes subnational governments unable to sustain loan repayment obligations, thus increasing their risk of default. Only a few cities with sufficient and regular own sources of revenue hold the capacity to repay loans.[254] The constraining borrowing rules however generally prevent them from exercising this option in practice.

8 Constitutional design for accountable subnational fiscal autonomy: The need for explicit systems of oversight and expenditure control

As previously highlighted, autonomy, and fiscal autonomy in particular, is granted to subnational governments in devolved states not as an end but only as means for pursuing and delivering on set objectives. The realisation of these objectives therefore requires a system to be put in place to ensure that the exercise of subnational fiscal autonomy is directed towards delivering on the objectives of autonomy (functional accountability).

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[251] Institute of Economic Affairs (2007) 52-53.
[252] Bahl (1999) 14.
[253] Bahl (1999) 14.
[254] Steytler & Ayele (2018) 325.

Additionally, unlike the FGT that viewed public officials as being altruistic in their actions and motivated by the need to maximise social welfare (thus deserving of rather unrestricted autonomy in their subnational activities), the public choice theory views public decision-makers as being Leviathan-like and driven by the urge to continually maximise the size of their budgets to achieve their own objective functions.[255] Political institutions and processes, under this approach, are therefore required to be modelled with 'explicit attention to the incentives they embody' and with a view to placing constraints on them.[256] Subnational fiscal autonomy therefore, viewed from this perspective, harbours perverse incentives that should be counterbalanced by effective systems of oversight.

For instance, although subnational revenue autonomy (through OSR) is expected to incentivise local communities to push for fiscal responsibility, ineffective subnational institutions and skewed processes of subnational participation may perpetuate impunity and fiscal irresponsibility. Also, budgetary autonomy aimed at giving subnational governments the capacity to address subnational fiscal deficits and cash flow challenges, when coupled with a possibility of fiscal rescue and bail outs, stands to encourage soft budget constraints,[257] induce runaway borrowing and provide a virtually irresistible incentive for fiscally irresponsible behaviour at the subnational level.[258] These perverse incentives necessitate an overriding system of oversight and expenditure control that secures subnational financial accountability.

While Clark's conception of a subnational government with absolute powers of immunity may be desirable for limiting the potential for abuse of central power, the location of subnational governments in devolved states within a unitary setting often demands the limitation of subnational powers of immunity in favour of overriding national objectives such as the need

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[255] Oates (2005) 355.
[256] Oates (2005) 356.
[257] Whereas the term 'soft budget constraint' had been used to describe the fiscal 'behaviour of state-owned entities in socialist economies that could count on being bailed out by the state' in the event of 'chronic financial losses', it has over time been extended to cover the fiscal behaviour of subnational governments that rely on central governments to be bailed out in instances of fiscal distress. See, Oates (2005) 360.
[258] Oates (2005) 360, 361 & 365; Hallett (2018) 72.

for equity and/or macroeconomic stability, as well as ensuring that the national government retains a measure of oversight over the general implementation of devolution. This requires a state's intergovernmental fiscal system to have a system in place that allows for a level of vertical institutional accountability to the national government.

However, despite the above need for an explicit system for facilitating functional, financial and institutional accountability in the subnational exercise of fiscal autonomy, fiscal federalism theory mainly focuses on financial accountability with a central emphasis, not on an explicit and comprehensive system, but rather on an organic form of accountability which is expected to result from and be fuelled by subnational taxation (OSR). However, the unique nuances brought by devolution's adjustments to the classical federal design including the designation of specific objectives in pursuit of which subnational autonomy should be directed, the 'margin of autonomy' approach to subnational autonomy (which allows the conferment of subnational autonomy within a unitary context as well as for integrated approaches to the vertical sharing of expenditure responsibilities) and the adoption of integrated subnational financing models, require an explicit and comprehensive system of oversight and expenditure control to facilitate the functional, financial and institutional accountability of subnational governments.

To achieve the above objective, constitutional frameworks often put in place institutional mechanisms and processes that seek to deliver effective overall subnational-level as well as national-level oversight by placing some constraints on subnational fiscal autonomy. These involve aspects of legal regulation, monitoring, support and, when necessary, intervention.[259] While some of these accountability mechanisms may often tend to limit subnational fiscal autonomy, it is worth noting that autonomy exists within a framework of legal rules (designed under Clark's first level of appearance). Systems of oversight and expenditure control, therefore, exist to ensure that these rules as well as other overriding national objectives are complied with in the exercise of subnational fiscal autonomy.[260] In apparent support of this,

[259] Steytler & Ayele (2018) 326.
[260] Steytler & Ayele (2018) 327.

the World Bank paradoxically points out that in practice, a 'certain level of centralization' is critical for effective decentralisation.[261] In this regard, Sharma argues that the effectiveness of fiscal decentralisation lies in its ability to be dynamically balanced by constantly keeping on 'adjusting the contrasting forces of centralisation and decentralisation to create a system that can ensure good governance'.[262]

However, such strict controls ought to be exercised within constitutional and/or legislative parameters and be properly balanced with subnational fiscal autonomy to ensure that the attainment of the objectives of autonomy set out therein is not undermined.[263] The UN Guidelines, for instance, propose that national supervision should be confined to the posterior verification of the legality of subnational actions.[264] Such oversight should, moreover, be exercised through or in consultation with institutions of shared rule at the national level, in order to ensure that the interests of subnational governments in having fiscal autonomy are protected.[265]

9 Conclusion

Intergovernmental fiscal systems advance the autonomy (self-rule) of subnational governments by making provision for and allowing for the exercise of accountable subnational fiscal autonomy, which in turn serves as a means for the attainment of the objectives of subnational autonomy in devolved states.

Although there is no universal model of a financial constitution that is best suited to deliver subnational fiscal autonomy, the basic rules and theoretical positions set out herein constitute a common pool from which most systems draw. Generally, however, subnational governments in integrated devolved states are said to have fiscal autonomy where they are

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261 World Bank *World Development Report 1997: The State in a Changing World* (1997) 128; Bosire (2013) 36. See also, Sharma CK 'The federal approach to fiscal decentralization: Conceptual contours for policy makers' (2005) XIX (2) *Loyola Journal of Social Sciences* 181-184.
262 Sharma (1997) 169.
263 See also, Steytler & Ayele (2018) 327.
264 UN-HABITAT (2009) 38.
265 Beer-Tóth (2009) 85.

allowed under a state's financial constitution to: set and implement their own policy priorities with respect to subnational expenditure; raise revenue from their own sources over which they have the freedom to set tax bases and tax rates, as well as to administer; receive unconditional shares from centrally-raised revenue whose sharing formula is determined objectively and whose adjustments they (or their representatives at the centre) have a say over; and have the freedom to employ various fiscal instruments to adjust their budgets in order to offset any fiscal deficits or shortfalls in cashflow at the subnational level. Moreover, intergovernmental fiscal relations ought to be structured in such a way that they promote the fiscal autonomy of subnational governments in practice, while retaining a balanced oversight role aimed at ensuring the functional, financial and institutional accountability of subnational governments across the state.

The model of a financial constitution adopted by a state in practice, however, varies based on a series of country-specific factors that touch on its historical, social-cultural, economic, political as well as institutional conditions. This, when coupled with measures adopted to achieve effective oversight and expenditure control, places the margin of autonomy of subnational governments in devolved states on a continuum between the extremes of perfect sovereignty and full dependence.

The next chapter looks into how the theoretical conclusions above are either proved or disproved in the context of the design and implementation of South Africa's intergovernmental fiscal system.

Chapter Three

THE FRAMEWORK AND PRACTICE OF SUBNATIONAL FISCAL AUTONOMY IN SOUTH AFRICA

South Africa has one of the most advanced intergovernmental fiscal systems in Africa. The drafting of the Kenyan Constitution, especially the chapter on finance, was inspired by and drawn from the South African Constitution. Given the similarities in Kenya's and South Africa's intergovernmental fiscal systems, an examination of South Africa's framework for subnational fiscal autonomy, as well as its implementation, provides a general mirror to potential capabilities, issues and alternative approaches to the design and implementation of intergovernmental fiscal systems in devolved states, for the study's later analysis of the Kenyan case.

This chapter seeks to analyse the scope for fiscal autonomy accorded to subnational governments under South Africa's legal framework and the extent to which this has been achieved and/or manifested in practice. It also explores how the intergovernmental fiscal system has sought to ensure accountable subnational fiscal autonomy through autonomy-enhancing internal systemic controls, and where these have failed, through an intergovernmental institutional framework for expenditure control and oversight (external fiscal controls). In light of the nature of external fiscal controls, the chapter will also interrogate the extent to which they hold the potential to constrain subnational fiscal autonomy, and how the system cushions subnational governments from this.

The chapter is divided into three sections. The chapter starts by looking at the historical evolution of South Africa's multilevel government structure, with a focus on the evolution of the fiscal autonomy of its subnational governments, and seeks to establish how such evolution informed the current design and practice of subnational fiscal autonomy. The chapter's second part focuses on South Africa's current legal framework and practice, and in this regard discusses the scope for expenditure, revenue and budgetary autonomy extended to provinces and local governments. As part of the chapter's second part, the study discusses the framework and practice of oversight and expenditure control in relation to each subnational sphere of government, with a view to establishing how these have managed to ensure accountable subnational fiscal autonomy. The chapter closes with an analysis of how the design and implementation of South Africa's intergovernmental fiscal system have worked to further the autonomy of its subnational governments, and what key features and lessons stand out.

1 The historical evolution of South Africa's multilevel government structure

The current South African State was formed by the coming-together of four self-governing British colonies: Cape Province, Transvaal, Natal and the Orange Free State in 1910.[1] The colonies surrendered most of their powers and functions, under the South Africa Act of 1909, to become provinces in the ensuing Union of South Africa (Union).[2] The Act created a unitary state with a strictly hierarchical three-tier system of government made up of the central government, provincial governments and local authorities.[3] Local authorities, however, did not have a constitutional right to exist as self-governing institutions.[4] Instead, provinces were granted the power to establish them and to outline the scope of their functions and powers through provincial ordinances.[5]

As a result of South Africa's apartheid history, the country's system of local governance was delineated in racial terms with separate structures for white, coloured, Indian and Black

[1] Cameron R *Local Government Policy in South Africa 1980-1989 (With Specific Reference to the Western Cape): Devolution, Delegation, Deconcentration or Centralisation?* (Unpublished PhD thesis, University of Cape Town, 1991) 102.
[2] Cameron (1991) 103.
[3] Cameron (1991) 103; Cameron R 'Central-local financial relations in South Africa' (2002) 116 available at *https://open uct.ac.za/handle/11427/22281* (accessed 11 November 2019); Steytler N & De Visser J, *Local Government Law of South Africa* (2016) 1-8.
[4] Cameron (1991) 106.
[5] Cameron (1991) 105; This was provided for under both the South Africa Act of 1909 and the Republic of South Africa Act of 1961; See also, Rawat F *The Constitutional Basis of Local Government* (Unpublished Masters Thesis, University of Witwatersrand, 2000) 5.

populations.[6] Therefore, while a semblance of uniformity of status, functions and powers existed across provinces, the nature and scope of functions and powers of local authorities varied across their racial groupings and across provinces. The latter was reinforced by the fact that each province enacted individual ordinances governing the establishment of local authorities.[7]

Generally, South Africa's overall system of multilevel governance was highly centralised as a result of, among other reasons, the need for an effective mechanism for the implementation of apartheid policies. Consequently, an analysis of the schemes of multilevel governance historically utilised in South Africa reveals a combination of delegation and deconcentration, with limited instances of devolution of power being utilised during South Africa's pre-democracy[8] days.[9]

Incrementally, however, local authorities became more democratised in the lead up to the constitutional negotiations towards a democratic South Africa. The negotiations culminated in the constitutional recognition of local governments as an autonomous sphere of government and their eventual conferment of fully-fledged devolved powers under South Africa's final Constitution of 1996.

1.1 Opposition to federalism, the weakening of provinces, de-racialisation of local governance and the dominant role of the African National Congress (ANC)

As part of the negotiations towards a democratic South Africa, a Multi-Party Negotiating Forum (MPNF) was set up to negotiate the contents of South Africa's interim Constitution of

[6] Financial & Fiscal Commission 'Financial and functional viability, and sustainability of municipalities - Beyond the demarcation instrument', *Paper presented to the MDB Conference on Demarcation and Spatial Transformation (23-24 June 2016)* 3; Steytler & De Visser (2016) 1-6.
[7] Rawat (2000) 5; Madhekeni A *Decentralisation and Recentralisation Waves in Anglophone Southern Africa: Factors Driving the Ebb and Flow of Power* (unpublished LLD thesis, University of the Western Cape, 2019) 50.
[8] Refers to the period between the establishment of the Union of South Africa and the first democratic elections of 1994.
[9] Cameron (2002) 119.

1993.[10] This was required to outline constitutional principles (negotiated principles) that were to guide the Constitutional Assembly that would be elected, in its eventual drafting of South Africa's final Constitution.[11] The final Constitution was then required to be submitted to the Constitutional Court, which was to certify that its contents complied with the negotiated principles.[12] The ANC played a central role in these negotiations, mainly against the ruling white minority National Party (NP).[13]

In the MPNF negotiations on the nature of state to be adopted, the ANC was opposed to federalism and instead advocated for a 'non-racial, unitary state with a strong central government and subordinate subnational entities'.[14] This centralist preference by the ANC was influenced by, among other things, its approach to addressing the divisions and economic disparities created by apartheid. The ANC saw a strong unitary state as being critical for unifying the nation[15] and providing a centralised fiscus that was key for the redistribution of wealth and alleviation of poverty.[16] The ANC's opposition to federalism was due to its fear that federalism held the potential to 'preserve minority interests, undermine majority rule, reinforce racial and ethnic identities and provide homeland elites with a political platform to resist integration'.[17]

However, due to opposition to this centralist stance from the NP and other minority parties, the ANC was compelled to compromise and agree to the decentralisation of some power to provinces.[18] This made the retention of the provincial level of government in the interim Constitution a negotiated compromise made in the interest of peace, to which the ANC reluctantly agreed. This would later come to haunt the continued existence of provinces.

[10] Powell DM *State Formation after Civil War: Local Government in National Peace Transitions* (2017) 217.
[11] Powell (2017) 217.
[12] Powell (2017) 217.
[13] Madhekeni (2019) 64.
[14] Madhekeni (2019) 65.
[15] Powell (2017) 161.
[16] Powell (2017) 161.
[17] Powell (2017) 162.
[18] Madhekeni (2019) 66.

A separate platform, the National Local Government Negotiating Forum (NLGNF), was established to negotiate a new local government system.[19] Key among the raft of changes made to local governance under the interim Constitution was the removal of the racial basis of government, which was achieved through a new demarcation process.[20] Also, local government for the first time received constitutional recognition and protection.[21] However, although the Constitution made provision for the institutional autonomy of local governments, it left the delineation of their functions and powers to national and provincial legislation, thus allowing the latter to regulate the exercise of such autonomy.[22]

Subsequently, the ANC won the first multi-party elections of 1994, which meant that the party would dominate the Constitutional Assembly that was required to draft the final Constitution.[23] However, despite being still opposed to the idea of a provincial level of government, the ANC could not do away with it in the final Constitution as the party was bound by the negotiated principles under the interim Constitution.[24] Therefore, with a view to weakening the hold of provinces, the ANC resorted to supporting the provision for a stronger and more autonomous local government system under the Constitution.[25] This led to the removal of local governments from the control of provinces, and the constitutional entrenchment of a detailed list of their functions and powers, a mandate that was the preserve of provinces under the interim Constitution.[26] The result was a significant diminution of provincial powers and functions, resulting in what has been referred to as an 'hour-glass'

[19] Steytler & De Visser (2016) 1-10.
[20] Madhekeni (2019) 69; Steytler & De Visser (2016) 1-10.
[21] Steytler & De Visser (2016) 1-12; Madhekeni (2019) 66.
[22] Steytler & De Visser (2016) 1-12; the Constitution of the Republic of South Africa, Act 200 of 1993 (Interim Constitution), ss 174(3) & 175(1).
[23] Madhekeni (2019) 71.
[24] Madhekeni (2019) 75.
[25] Mastenbroek R & Steytler N 'Local government and development: The new constitutional enterprise' (1997) 1 *Law Democracy and Development* 240.
[26] Madhekeni (2019) 71; In *Certification of the Constitution of the Republic of South Africa*, 1996 (10) BCLR 1253 (CC) (First Certification Judgment) para 367.

multilevel structure.[27] This diminution was formally acknowledged by the Constitutional Court in both its certification judgments.[28] Also, the ANC's vision of a centralised fiscus found expression in the Constitution through a highly centralised fiscal system which provided it with an instrument for indirect central control.

1.2 The history of subnational fiscal autonomy in South Africa

While the sections above have focused on the general evolution of South Africa's system of decentralisation, this section focuses on the status and evolution of the expenditure, revenue and budgetary autonomy of provinces and local governments. The discussion covers the period from the formation of the Union of South Africa to the adoption of the Interim Constitution of South Africa in 1993 (pre-1994 period). This is helpful in tracing the development of the fiscal autonomy of subnational governments in South Africa, and in understanding how this changed and/or informed any changes subsequently made in the Interim Constitution of 1993 and under the final Constitution of 1996.

1.2.1 The fiscal autonomy of pre-1994 provinces

This section looks into the expenditure and revenue autonomy of pre-1994 provinces. Literature explored so far has been silent on the power of pre-1994 provinces to borrow, and so their budgetary autonomy has not been covered in this section.

[27] Bosire describes an 'hour-glass' structure as one with a stronger national government, a relatively weak meso-level and a strong local sphere of government. See, Bosire CM *Devolution for Development, Conflict Resolution, and Limiting Central Power: An Analysis of the Constitution of Kenya 2010* (unpublished LLD thesis, University of the Western Cape, 2013) 51.

[28] Steytler & De Visser (2016) 1-17; Madhekeni (2019) 76; *First Certification Judgment*, para 364; In *Certification of the Amended Text of the Constitution of the Republic of South Africa*, 1996 (CCT37/96) [1996] ZACC 24; 1997 (1) BCLR 1; 1997 (2) SA 97, para 2. Despite confirmation of the diminution, the Court held the view that it presented no significant obstacle hence proceeded to approve the amended text of the final Constitution.

1.2.1.1 The expenditure autonomy of provinces

Expenditure autonomy refers to the freedom to decide which development policies as well as goods and services are prioritized for financing, the discretion as to how much to spend on each of them as well as the freedom to incur expenses in the process of implementing the selected priorities.

As previously highlighted, expenditure autonomy is linked to subnational functional allocations. Pre-1994 provinces were mainly in charge of white primary and secondary education, hospital services and provincial roads, as well as the supervision of local authorities.[29] However, in the pre-1994 period, provinces largely lacked complete discretion to incur expenditure over these functions and only received earmarked budgets transferred to them by corresponding national departments.[30] This was especially the case under the 1983 Constitution, that abolished the Senate which represented provinces at the national level and effectively converted provinces into administrative structures.[31]

From its inception, elements of centralisation were built into the provincial system.[32] Provincial Councils (legislatures) were subordinated to the national parliament which, through Acts of Parliament, dictated what powers the Councils could exercise and further reserved a corresponding authority to revoke these functions and powers.[33] Additionally, all draft provincial ordinances were subject to the approval of the Governor-General (whose powers were subsequently exercised by an executive president)[34] and could be vetoed if found to be inconsistent with national legislation. Moreover, the power of provincial governments was shared between an elected provincial council and a central government-appointed administrator who served as the council's Chief Executive and wielded diverse

[29] Cameron (1991) 109.
[30] A van Zyl & L Walker 'Juggling central control and provincial fiscal autonomy in South Africa' (1999) 16 *Development Southern Africa* 241.
[31] Van Zyl & Walker (1999) 241.
[32] Cameron (1991) 108.
[33] Cameron (1991) 104.
[34] See, of the Republic of South Africa Constitution Act 110 of 1983, s 95.

powers including the power to introduce all draft financial and appropriation ordinances.[35] The subjection of provincial expenditure mandates to the whims of national legislation, the Governor-General's veto power over provincial legislation, and the domination of provincial councils by provincial administrators immensely curtailed any autonomy provinces had over their own expenditure.

Despite this level of centralisation, provinces were unable to resist the erosion of their powers given that all provincial councils (except Natal) had since 1948 been under the control of the ruling National Party.[36] Therefore, from as early as 1948 it was evident that provinces lacked autonomy over their own expenditures and had essentially become implementers of national policy rather than formulators of their own policies.[37]

1.2.1.2 The revenue autonomy of provinces

Revenue autonomy refers to the discretion a subnational government has over its revenue sources including the discretion over the nature of the tax to be administered, the tax base and rates, and revenue administration.

In terms of the 1910 Constitution, provinces enjoyed broad revenue-raising powers and could, concurrently with the national government, levy company tax, personal tax and income tax.[38] However, following the repeal of these powers in 1957,[39] provinces were forced to rely on central subsidies that were given in the form of untied grants and calculated based on a needs and financial-abilities-based formula.[40] This accounted for approximately 82 per cent of provincial revenue.[41] Provinces subsequently drew their own revenue mainly from motor vehicle licenses, gambling (horse racing) and related taxes.[42] The revenue raised from these

[35] Cameron (1991) 106-107.
[36] Cameron (1991) 109-110.
[37] Cameron (1991) 112.
[38] Van Zyl & Walker (1999) 241.
[39] Van Zyl & Walker (1999) 241.
[40] Cameron (1991) 109.
[41] Cameron (1991) 109.
[42] Cameron (1991) 110.

sources was however minimal relative to central subsidies, hence provinces were heavily reliant on the central government for their revenue needs. The 'untied' nature of these grants arguably provided some level of discretion to provinces in their use. However, when this is viewed from the perspective of the hold the central government had on provincial expenditure and budgeting, highlighted above, it is arguable that provinces ended up serving more as deconcentrated administrative arms of the central government, with little to no fiscal autonomy.

1.2.2 The fiscal autonomy of pre-1994 local authorities

Prior to the creation of the Union of South Africa, all four constituting colonies had well-developed forms of local government.[43] These continued to exist under the ensuing provincial structures. They existed, however, as subordinate entities, having been creatures of various provincial ordinances and were, moreover, race based. As a result, the distinction across them in terms of functions and powers, and even more so in terms of access to revenue, was marked. This was especially so between white and black local authorities which this section touches on. For a long time, the black, coloured and Asian populations did not have functional local authorities of their own. When these were eventually established, they were highly dysfunctional, centrally controlled and were kept in a deliberate perpetual state of underdevelopment.[44] Hence general reference to pre-1994 local authorities in this section should be construed as mainly referring to white local authorities and specific reference will be made to black local authorities as may be appropriate.[45]

[43] Cameron (1991) 104.
[44] Madhekeni (2019) 54-58.
[45] See also, Financial & Fiscal Commission *Financial and functional viability* (2016) 3.

1.2.2.1 The expenditure autonomy of local authorities

As creatures of statute, either provincial or national, local authorities only possessed such powers and functions as permitted under the respective statutes hence such powers could be reviewed, amended or revoked at will by the respective legislatures.

In this regard, municipalities were mainly in charge of water supply, electricity reticulation, refuse collection, trading and business licensing, public transport, street maintenance and traffic regulation.[46] To facilitate the effective delivery of these services, municipal councils were given the power to pass by-laws.[47] Therefore, although local authorities did not have autonomy over what they could or could not do, they had discretion over the implementation of those functions accorded to them. They therefore could set policy for certain functions, set priorities across specific services, and were free to determine the methods of service provision.[48]

With respect to discretion as to how much to spend, local authorities were required to spend within 'the estimated expenditure' and could only exceed the estimate with the approval of the provincial administrator.[49] Additionally, the Department of Finance at the national level reserved the right to approve any capital expenditure exceeding a specified amount.[50] Although it is not clear whether 'estimated expenditure' in this former respect was in terms of a municipal budget, Cameron points out that local authorities had discretion over the amount that they could spend on the different services they offered.[51] This therefore granted them a margin of expenditure autonomy which they could exercise within the scope of their stipulated mandates.

[46] Madhekeni (2019) 51.
[47] Madhekeni (2019) 51.
[48] Cameron (1991) 125.
[49] Cameron (1991) 125.
[50] Cameron (1991) 125.
[51] Cameron (1991) 129.

1.2.2.2 The revenue autonomy of local authorities

The self-sufficiency of local authorities was a key principle of South Africa's pre-1994 local government system,[52] hence most of local government revenue was drawn from their own sources. The main revenue sources for the local authorities included rates on fixed property and income from trading services such as the supply of electricity, water and gas and service charges.[53] Local authorities also received subsidies, often in the form of specific grants from the central and provincial governments, although this constituted a very small portion of their revenue. In 1978, for instance, rates and trading contributed 16.3 per cent and 55.9 per cent respectively towards local government current revenue while revenue from grants only accounted for 4.2 per cent of local government expenditure.[54] White local authorities were therefore largely financially self-sufficient given their access to property rates from central business districts, among other own revenue sources, thus giving them more room for expenditure decision-making.[55]

The notion that local government should be primarily self-funding, although traceable to English municipalities, was utilised to further apartheid objectives by ensuring that black local authorities were kept in a deliberate perpetual state of underdevelopment.[56] This was especially apparent during the rule of the National Party (1948-1994) and its implementation of the apartheid manifesto. Black local authorities, therefore, had limited and unproductive sources of own revenue, especially given their lack of access to fixed property, the lack of any significant industrial and commercial activities in their areas, as well as the prevalence of poverty within their populations that made payment of any local levies and charges difficult.[57] They were therefore largely dependent on transfers and grants from provinces and the

[52] Cameron (1991) 115.
[53] Cameron (1991) 115; Cameron (2002) 116.
[54] Cameron (1991) 116.
[55] Vosloo WB, 'South Africa: Local government in white areas' in WB Vosloo, DA Kotzé & WJO Jeppe (eds), *Local Government in Southern Africa* (1974) 29.
[56] Cameron (1991) 153; Rawat (2000) 6. Local government served as an agent for the implementation and embodiment of apartheid policy.
[57] Cameron (1991) 152-153; Cameron (2002) 116; Madhekeni, (2019) 55; FFC (2016) 4.

national government. Additionally, the grants received were very specific to the intended purposes, thus leaving little room for discretion in decision-making regarding their use.[58] However, this municipal self-sufficiency principle continued way after 1996 under the ANC's Growth, Employment and Redistribution (GEAR) strategy, thereby extending it beyond the apartheid lens.[59]

The establishment of Regional Service Councils (RSC) and Joint Service Boards, in 1985 and 1990 respectively, constituted a key innovation against the racial-segregation background noted above.[60] These were aimed at softening the watertight apartheid divide by providing bulk services across racial municipal boundaries, facilitating multi-racial decision-making and providing an additional revenue source for municipalities through the imposition of an RSC levy.[61] The latter was a levy on the turnover of traders in the region, as well as a tax on the wage bill of employers.[62] While RSCs succeeded in facilitating the redistribution of resources, they failed to ensure the financial viability of black local authorities.[63] Therefore, while white local authorities were fiscally autonomous, black local authorities continued to be dependent on grants.

1.2.2.3 The budgetary autonomy of local authorities

Budgetary autonomy refers to the power to raise funds through borrowing to finance either budget deficits or shortfalls in in-year revenue receipts. In this regard, local authorities were allowed to raise loans for specific purposes subject to prescribed conditions.[64] However, they were not allowed to budget for deficits on their operating account.[65] Also, the purposes for

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[58] Madhekeni (2019) 55.
[59] Cameron (2002) 122.
[60] In terms of the Regional Services Councils Act 109 of 1985 and the KwaZulu and Natal Joint Services Act 84 of 1990; Cameron (1991) 176-177.
[61] Cameron (1991) 202.
[62] Steytler & De Visser (2016) 1-8; These taxes continued to be levied and were only repealed in 2006.
[63] Cameron (2002) 118-119.
[64] Cameron (1991) 115; Rawat (2000) 9; Wandrag R 'The quest for financial discipline at local government level: The regulation of municipal borrowing and financial emergencies' (2003) 7 *Law Democracy and Development* 244.
[65] Cameron (1991) 125.

which money could be borrowed were prescribed by the provincial administrator along with ceilings on the amount that could be borrowed.[66] Additionally, any loans for capital expenditure exceeding R1m were required to be approved by the Department of Finance.[67] Therefore, although allowed to borrow, this municipal borrowing power was subject to strict central controls which limited its exercise.

1.3 South Africa's current multilevel state structure

South Africa has retained its original three 'levels' of government (national, provincial and local) under its current Constitution enacted in 1996 (Constitution). These have however been elevated to 'spheres' of government with the intention of reflecting the relative equality of their constitutional status.[68] To highlight this, the functions and powers of all spheres have been entrenched in the Constitution, with no sphere having the power to confer or revoke those functions and powers of another sphere. This is a departure from the pre-1994 period where functions and powers were conferred down the hierarchy, with higher tiers reserving the power to revoke or recentralise those functions and powers. Generally, however, while the current state structure extends a broader margin of autonomy to each of the subnational spheres of government, it retains an 'undeniable hierarchy' reflective of the pre-1994 period.[69]

The Constitution establishes nine provinces, each with its own legislature and executive.[70] The local sphere of government, for its part, is currently made up of 257 municipalities. These are split into three categories: metropolitan municipalities (Category A),[71] local municipalities (Category B) as well as district municipalities (Category C).[72]

[66] Cameron (1991) 126; Cameron (2002) 117; Wandrag (2003) 244.
[67] Cameron (1991) 126.
[68] Steytler & De Visser (2016) 1-15.
[69] Van der Waldt G & Greffrath W 'Towards a typology of government interventionism in municipalities' (2016) 9 *African Journal of Public Affairs* 152.
[70] Constitution of the Republic of South Africa, 1996 (Constitution (1996)), s 103 & s 104 (1).
[71] These are stand-alone municipalities which command all local government powers. Also referred to as Category A municipalities.
[72] The Constitution (1996), s 155(1); Municipal Structures Act 117 of 1998 (MSA 1998), s 1; Local and district municipalities share local government powers.

The Constitution sets specific objectives which local government is required to achieve.[73] These include: ensuring the sustainable provision of services to communities; promoting social and economic development; providing democratic and accountable government for local communities as well as encouraging the involvement of communities in local government matters.[74] Worth noting is that these objectives align with the objectives of autonomy set out in chapter two, thus implying that their attainment essentially hinges on the (fiscal) autonomy of local governments.

However, although the Constitution allocates specific functions to the provincial sphere of government, it fails to entrench a rationale for the sphere's existence in a manner similar to that of the local sphere above. This mirrors the historic negotiated peace-making rationale that underlay the incorporation of the provincial sphere in the interim Constitution. As a result, the actual need for and continued existence of the provincial sphere has been the subject of perpetual contestation over the years.[75] The incessant debates have mainly been fronted by the ANC, which had opposed their creation *ab initio* and which has been the ruling party since the first democratic elections in South Africa.[76] At the centre of the debate is the continued relevance, in contemporary South Africa, of the negotiated reason for the establishment of provinces, with the argument being that their peace-making purpose has already been served.[77] This led to the commencement of an official review of the future of provinces by the government in 2007, with the ANC playing a central role in this respect and calling for either the modification of their role and functions, a reduction in their number coupled with the modification of their role, or their abolition altogether.[78] Although the ANC

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[73] Constitution (1996), s 152(2).
[74] Constitution (1996), s 152(1).
[75] Steytler N 'The politics of provinces and the provincialisation of politics' in Maluwa T (ed) *Law, Politics and Rights: Essays in Memory of Kader Asmal* (2014) 196.
[76] Steytler (2014) 191.
[77] Steytler (2014) 212.
[78] Steytler (2014) 191 & 194-5.

has since softened this stance[79] and provinces have continued existing as per the Constitution, this crusade has not been without an impact on their functionality over the years.

The Constitution characterises the three spheres of government as distinctive, interdependent and interrelated.[80] The nature of these qualities enjoins the spheres of government to observe and adhere to constitutional principles of co-operative government.[81]

Their being 'distinctive', on one hand, emphasises their autonomy, and obligates them to: respect the constitutional status, institutions, powers and functions of other spheres; not assume any power or function except those constitutionally conferred on them and to exercise their powers and perform their functions in a manner that does not encroach on the geographical, functional or institutional integrity of another sphere of government.[82] This lays the foundation for the fiscal autonomy of subnational governments.

Their 'interdependent and interrelated' nature, on the other hand, imposes an obligation on them to: preserve the indivisibility of the Republic; provide effective, transparent, accountable and coherent government for the Republic as a whole as well as co-operating with one another by, among other ways, coordinating their actions and legislation and consulting one another on matters of common interest.[83] The spheres of government are similarly required to promote cooperative government in their fiscal and financial relations.[84] These principles underlie the functioning of South Africa's intergovernmental fiscal oversight and accountability mechanisms that seek to balance and check any excesses flowing from the fiscal autonomy of the subnational spheres of government.

[79] Steytler (2014) 191 & 200.
[80] Constitution (1996), s 40 (1).
[81] Constitution (1996), s 40(2); See also, s 3(1) & (2) of the Municipal Systems Act 32 of 2000 (Systems Act).
[82] Constitution (1996), s 41(1).
[83] Constitution (1996), s 41(1).
[84] Municipal Finance Management Act (MFMA) 56 of 2003, s 35 as read with s 37(1).

Understanding the import of these qualities and the attendant principles is therefore critical in understanding the design of South Africa's intergovernmental fiscal system and the nature of fiscal autonomy afforded to and exercised by its subnational governments.

Generally, however, the South African intergovernmental fiscal system is highly centralised, with the national government playing a dominant role on various fronts including controlling the major tax sources. Moreover, the system is lined with a series of national-level institutions tasked with various roles in the regulation of the financial and fiscal powers of subnational governments. Worth noting is that the composition as well as the designation of mandates of these institutions point to an intergovernmental fiscal system that leans more on the 'interdependent and interrelated' nature of the spheres of government, and less on their distinctiveness. This holds the potential to constrain the effective fiscal autonomy exercised by subnational governments, and will form part of the discussion under external fiscal controls in this chapter.

2 The fiscal autonomy of subnational governments under South Africa's current legal framework

This section explores the scope for subnational fiscal autonomy provided for under South Africa's legal framework and how it has manifested itself in practice. The section also discusses how the intergovernmental fiscal system has sought to ensure the accountable exercise of such subnational fiscal autonomy, and what impact this has had on its exercise. These aspects are discussed first in respect of provinces, then followed by a similar discussion with respect to the local sphere of government. The discussion on fiscal autonomy explores the expenditure, revenue and budgetary aspects of each subnational government's fiscal autonomy, while the discussion on accountable fiscal autonomy focuses on internal and external fiscal controls.

2.1 The fiscal autonomy of provinces

Coming from a pre-1994 period where provinces were largely under the control of the central government, the Constitution made an effort to mitigate this by, among other things, emphasising the distinctiveness of the provincial sphere and entrenching provincial functions and powers in the Constitution. While the latter was critical in providing certainty as to the scope of functions over which provinces had discretion, such as to prevent the overbearing hand of the national government, there is considerable doubt as to whether the Constitution succeeded in this endeavour. An analysis reveals that, while notable effort is made to present the provincial sphere of government as autonomous, the sphere remains largely emasculated in both the constitutional framework, and in practice.

2.1.1 Provincial expenditure autonomy

To start with, the Constitution makes an effort in explicitly distinguishing those functions that fall within the provincial sphere's exclusive jurisdiction and those that are shared between the national and provincial sphere under their concurrent jurisdiction as part of its integrated approach to vertical functional allocation.[85] This gives the impression that, despite sharing functions with the national government under Schedule 4, provinces have an exclusivity for functions listed under Schedule 5 over which to exercise their expenditure autonomy. However, an examination of the two Schedules reveals that extensive and cost-intensive functions such as education, health and housing are reserved for Schedule 4, hence falling under concurrency, while Schedule 5 is left with simple and less significant functions such as abattoirs, ambulance services and liquor licensing.[86] This weakens the significance of functions over which provinces have exclusive jurisdiction. This is made worse by the fact that, out of the Schedule 5 functions, provinces retain only expenditure autonomy over a few of them (Part A of the Schedule) as most are performed by local governments (Part B) with

[85] Constitution (1996), s 104(1)(*b*) as read with Schedules 4 & 5.
[86] See also, Van Zyl & Walker (1999) 242.

provinces exercising only a regulatory role.[87] Furthermore, even those few functions are further hollowed out by being shared with municipalities under Part B[88] or by having their scope restricted.[89]

Generally, therefore, provinces retain only a residual level of substantive expenditure autonomy over a handful of Schedule 5 functions including provincial planning, provincial cultural matters, veterinary services and ambulance services. These are largely insignificant.[90] Even with these residual functions, the Constitution chips away at their exclusivity by allowing Parliament a general mandate to intervene on any Schedule 5 matter by way of legislation aimed at: maintaining national security, economic unity and essential national standards; establishing minimum standards for service delivery as well as preventing any unreasonable provincial action that may be prejudicial to any province or the country.[91]

Given that provinces are mainly in charge of the provision of social services such as education, health and housing,[92] their major functions are therefore a product of concurrency. In this regard, the national sphere of government is constitutionally empowered to establish binding norms and standards, frameworks and uniform national policies on the performance of these functions.[93] This restricts the exercise of autonomy by provinces over the implementation of these functions. Consequently, the national Department of Finance is argued as having 'moulded a system of intergovernmental fiscal relations in which, by and large, the provinces

[87] Constitution (1996), s 155(7); Some functions under Part A of Schedule 5 are either shared with municipalities or have national services excluded.
[88] These functions include abattoirs, liquor licensing, recreation, sports & roads.
[89] These include archives, libraries and museums which are restricted to only those that are not national in nature.
[90] Constitution (1996), schedule 5.
[91] Constitution (1996), s 44(2).
[92] Khumalo B, Dawood G & Mahabir J 'South Africa's intergovernmental fiscal relations system' in Steytler N & Ghai Y (eds) *Kenyan-South African Dialogue on Devolution* (2015) 204.
[93] Constitution (1996), s 146(2)(*b*).

are expected to follow the national department's game plan'.[94] This hence reflects the overbearing role played by the national government over provincial expenditure.

Additionally, concurrency, when coupled with the open-ended nature in which the concurrent functions are listed under Schedule 4,[95] makes it easy for the national government to recentralise subnational functions by shifting them to the national sphere. This further restricts the space for provincial expenditure autonomy. It has, for instance, taken place in respect of some provincial functions such as the shifting of social security grants as well as the responsibility for technical and vocational education and training to the national sphere.[96] Additionally, the ongoing restructuring of South Africa's public health-care system through a national health insurance scheme also stands to recentralise the health function that is largely run by provinces.[97] This, combined with the intended shifting of housing and public transport functions to the local sphere, have led to the Financial and Fiscal Commission (FFC) arguing that 'provincial governments are being reduced to little more than glorified education providers', and that such gradual attenuation seems to point at an intention to eliminate the provincial sphere.[98]

Further, the ability of provinces to control their personnel expenditure is undermined by the fact that salary levels for about 87 per cent of their staff, mainly in the education and health sectors, are negotiated and collectively bargained nationally.[99] Although personnel costs are

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[94] Watts RL 'Autonomy or dependence: Intergovernmental financial relations in eleven countries' (2005) 43 43 available at *available at* *https://www.semanticscholar.org/paper/AUTONOMY-OR-DEPENDENCE-%3A-INTERGOVERNMENTAL-IN-Watts/d0ca6801cc5553b1d9b94b34475f00e17746e544* (accessed 11 November 2019).
[95] Heymans C 'Local government organization & finance: South Africa' in Shah A (ed) *Local Governance in Developing Countries* (2006) 66; Khumalo, Dawood & Mahabir (2015) 219.
[96] Financial & Fiscal Commission (FFC) *Submission for the 2019/20 Division of Revenue* (2018) 48; Financial & Fiscal Commission *Financial & Fiscal Commission: 20 Year Intergovernmental Fiscal Relations Conference Report* (2015) 33.
[97] Financial & Fiscal Commission *Submission for the 2019/20 Division of Revenue: Technical Report* (2018) 34-35 & 86-87; See also, the National Health Insurance Bill 2019, s 10.
[98] FFC (2015) 33.
[99] Steytler N & Ayele Z, 'Local governments in African federal & devolved systems of government: The struggle for a balance between financial & fiscal autonomy & discipline' in Valdesalici A & Palermo F (eds) *Comparing Fiscal Federalism* (2018) 304; Wehner J, 'Fiscal federalism in South Africa' (2000) 30 *Publius: The Journal of Federalism* 55; Khumalo, Dawood & Mahabir (2015) 222.

paid for from the provincial equitable share (PES), the predetermination of salary levels and norms, such as the number learners per educator hence the precise number of educators required, effectively constrains provincial expenditure discretion.[100] Such central influence therefore reduces the scope of provincial budgets over which provinces have discretion to just about 20 per cent.[101]

In summary, although provinces generally have larger budgets over which they preside when compared to municipalities,[102] the level of discretion they exercise over their expenditure is in practice limited by an overbearing national influence, as discussed above.

2.1.2 Provincial revenue autonomy

A subnational government's revenue autonomy, in an integrated devolved state context, revolves around the extent of powers it has over its own sources of revenue, its power to administer its OSR, as well as the extent of autonomy accorded by intergovernmental transfers.

2.1.2.1 Provincial own source revenue (OSR)

South Africa's 'hour-glass' structure of multilevel governance[103] is best illustrated by an examination of its distribution of own revenue streams.[104] In this respect, provinces are mainly starved of own sources of revenue (OSR) in favour of both the national and local spheres which are allocated the main tax bases.[105]

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[100] FFC (2000) 45-46: Salaries constitute about 90% of education spending, hence their predetermination effectively exhausts any room for discretionary spending on education.
[101] Khumalo, Dawood & Mahabir (2015) 222; Wehner (2000) 55.
[102] Steytler & Ayele (2018) 304.
[103] Bosire (2013) 51.
[104] Ahmad J 'Creating incentives for fiscal discipline in the New South Africa' (1999) 31 available at http://www1.worldbank.org/publicsector/LearningProgram/Decentralization/safrica.pdf (accessed 6 December 2021).
[105] Khumalo, Dawood & Mahabir (2015) 206.

The Constitution grants provinces 'broad' powers to impose taxes, levies and duties in their respective spheres.[106] Provinces are also allowed to impose flat-rate surcharges on any tax, levy or duty imposed by national legislation.[107] While, on the face of it, this appears to confer a broad scope of revenue-raising powers on provinces, the Constitution takes away from these powers by excluding more lucrative sources over which provinces may not tax or impose levies or duties which are assigned to the national and local governments.[108] These include income tax, value-added tax, general sales tax, rates on property or customs duties.[109] Provinces are therefore left with minor own revenue sources, such as gambling (horse-racing and casinos), motor vehicle licensing (including driving licences) and user fees from hospitals.[110]

Most importantly, a province's power to raise own revenue is required to be exercised in terms of an Act of Parliament enacted to regulate its exercise.[111] Compared to the other spheres of government,[112] provinces are unable to directly access their OSR on the basis of the Constitution and have to draw their specific revenue-raising powers from an Act of Parliament. This hence hands the national government more room to specifically restrict the imposition of taxes and levies by provinces. For instance, under the enabling Act, any province intending to impose a new provincial tax is required to obtain the approval of the Minister of Finance, who then presents a bill in Parliament to regulate the imposition of the proposed provincial tax.[113] The Bill is required, among other things, to determine the tax base and the rate band within which a province may impose the tax.[114] The requirement for national

[106] Constitution (1996), s 228(1)(*a*).
[107] Constitution (1996), s 228(1)(*b*).
[108] Khumalo, Dawood & Mahabir (2015) 206.
[109] Constitution (1996), s 228(1).
[110] Khumalo, Dawood & Mahabir (2015) 206; Kaburu F, 'Fiscal decentralisation in Kenya & South Africa: A comparative analysis' [2013] *Africa Nazarene University Law Journal* 93; Rao G 'Intergovernmental finance in South Africa: Some observations' (2003) 12, available at https://ideas.repec.org/p/npf/wpaper/03-1.html (accessed 11 November 2019)
[111] Constitution, s 228(2)(*b*).
[112] Constitution, ss 228 (2)(*b*) & s 229(2)(*b*); Khumalo, Dawood & Mahabir (2015) 207; Steytler & De Visser (2016) 12-3.
[113] Provincial Tax Regulation Process Act (PTRPA) 53 of 2001, s 3.
[114] PTRPA, s 3(6)(*b*).

government approval and the determination of a rate band for the imposition of new taxes inhibits the autonomy of provinces to explore new sources of revenue and to regulate the rate to be imposed over them.

Moreover, provinces are required to exercise their taxation powers in a way that does not materially and unreasonably prejudice: national economic policies; economic activities across provincial boundaries; or the national mobility of goods, services, capital or labour.[115] While this may be argued as being restrictive on the scope of provincial fiscal autonomy, it is critical in ensuring compliance with the constitutional principles of co-operative government. Given the fact that none of these issues are reported to have arisen or been the subject of public discourse in practice, it is left to be determined the extent to which any implementing legislation may impact the taxation powers of provinces.

Although the Constitution allows provinces access to potentially lucrative and buoyant sources of revenue by, for instance, allowing them to impose surcharges on personal income tax as well as fuel levies imposed by the national government, these have not been explored.[116] This is attributed to the failure by the national government to approve the imposition of surcharges by provinces when they were first proposed and the offering of national grants in their place, which provinces then became dependent on.[117] Provinces have thus been unable to tap into these revenue sources and have instead only had access to limited sources of OSR drawn from their functional allocations under Schedule 4 of the Constitution (gambling, motor vehicle licensing and hospital fees). This has therefore rendered provinces reliant on grants, which in turn impacts on the extent of autonomy they are able to draw from them, when compared to having access to a wider pool of their own revenue sources.

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115 Constitution (1996), s 228(2); PTRPA, s 2(1).
116 Calitz E & Essop H 'Fiscal centralisation in a federal state: The South African case' (2013) 17 *South African Business Review* 141; Rao (2003) 8; FFC (2015) 34.
117 Khumalo, Dawood & Mahabir (2015) 208.

Even so, provinces have also been accused of being architects of their own want of revenue autonomy. They are said to have a very limited understanding of their existing revenue streams which has resulted in their failure to explore ways of augmenting them.[118] The fact that the provincial treasury of the Western Cape is the only one on record having formally submitted a request to impose surcharges on fuel levy, as a measure to augment its revenue sources, is presented as evidence of this failure by provinces.[119] Provinces have also failed to optimise revenue collection from their existing sources, though limited. They are argued to have failed to put in place and/or review appropriate structures and systems aimed at maximising their own revenue collection.[120] This therefore contributes to their failure to raise any substantial own revenue, which in turn increases their dependency on national transfers and grants.

As a result of the above, provinces are only able to raise less than 5 per cent of revenue from their own sources.[121] According to the National Treasury, provinces are reliant on national transfers to cover 95 per cent of their budgets, with the equitable share making up 80 per cent of these transfers.[122] This makes the amount of own revenue raised by provinces insignificant relative to their expenditure thereby resulting in a high vertical fiscal asymmetry (VFA).[123] The high VFA then leads to an overwhelming level of dependence by provinces on transfers and grants from the national government, which in turn impacts on provincial responsiveness and downward accountability to the people.[124] The structuring of provincial

[118] Khumalo, Dawood & Mahabir (2015) 208.
[119] Amusa H & Mathane P 'South Africa's intergovernmental fiscal relations: An evolving system' (2007) 75 *South African Journal of Economics* 276-277.
[120] Amusa & Mathane (2007) 276-277.
[121] Josie J 'Principles and practice of national and sub-regional fiscal policy in South Africa's intergovernmental fiscal relations (IGFR) system: A review and analysis of trends' (2012) 23 available at *http://www.forumfed.org/libdocs/2014/Principles_and_practice_of_national_and_subregional_fiscal_policy_in_South_Africa.pdf* (accessed 11 November 2019); Steytler & De Visser (2016) 12-3.
[122] National Treasury, *Budget Review (2019)* 68.
[123] Yemek E 'Understanding fiscal decentralisation in South Africa' (2005) 10 available at *http://www.gsdrc.org/docs/open/cc107.pdf* (accessed 11 November 2019); Watts (2005) 20; Amusa & Mathane (2007) 276.
[124] Amusa & Mathane (2007) 283-184; Watts (2005) 25.

OSR therefore also points to a deliberate design aimed at the emasculation of the provincial sphere relative to the national and local spheres of government.

2.1.2.2 Provincial revenue administration

Given that the entirety of OSR that provinces have access to are drawn from their functional allocations under Schedule 4 of the Constitution, provinces retain discretion over their administration. This is undertaken in terms of provincial own legislation.[125] Under the National Gambling Act,[126] for instance, provincial authorities are granted exclusive jurisdiction to administer gambling taxes, levies and fees.[127]

However, with respect to provincial OSR as envisioned under section 228(2)(b) of the Constitution, the law designates the South African Revenue Service (SARS) as the collecting agent, thereby depriving provinces of discretion over their administration.[128] Additionally, when a new provincial tax is proposed to be imposed, the Minister of Finance is allowed to designate a 'person', other than SARS, to impose the tax.[129] In the latter case, however, a province is permitted to specify a tax collecting authority as well as the methods and likely costs of enforcing compliance with that tax, which extends a level of discretion to provinces over revenue administration.[130] While the administration of provincial taxes by SARS may promote overall efficiency, it stands to weaken the revenue autonomy of provinces by depriving them of control over the revenue effort exerted in the collection process. Practically, however, the impact of this on the maximisation of provincial OSR is yet to be felt, given that none of the revenue sources to which this is applicable are currently being levied by provinces.

[125] See for instance, the Western Cape Gambling & Racing Act 4 of 1996, s 64.
[126] National Gambling Act No 7 of 2004.
[127] S 30(1) as read with s 31(*a*)(vi).
[128] PTRPA, s 4.
[129] PTRPA, s 4.
[130] PTRPA, s (2)(*d*)(*i*).

2.1.2.3 Intergovernmental transfers and grants to provinces

As the scope for provincial revenue autonomy as drawn from their OSR is narrow, focus turns to intergovernmental transfers and the level of fiscal autonomy they afford provinces as part of South Africa's integrated approach to subnational financing. To determine this, this section assesses the vertical (across spheres) and horizontal (across provinces) division of revenue to determine the extent to which it is transparent and objective and has as well provided room for the involvement of the provinces. The section also analyses the extent to which the transfers are unconditional such as to afford spending autonomy to receiving provinces and also explores the impact of conditional allocations on the fiscal autonomy of provinces.

As noted above, provinces are primarily funded by transfers from revenue raised nationally, which account for over 95 per cent of provincial expenditure.[131] These transfers come in the form of either the unconditional provincial equitable share (PES)[132] or as allocations, either conditional or unconditional, from the national government's share of revenue.[133] In this regard, Parliament is required to enact an annual Division of Revenue Act (DORA) to provide for the equitable vertical division of revenue raised nationally[134] and to stipulate each province's share (horizontal) out of the equitable revenue generally assigned to provinces.[135] This share is required to be transferred unconditionally, promptly and without deduction to the provinces, unless stopped due to a national intervention in a province.[136] The DORA also makes provision for conditional allocations as well as the conditions upon which they may be

[131] National Treasury (2019) 68; National Treasury *Explanatory Memorandum* (2020) 13; Amusa & Mathane (2007) 273.
[132] This is aimed at enabling provinces to provide basic services and perform the functions allocated to them (the 1996 Constitution, s 227(1) (*a*)).
[133] Constitution (1996), s 214(1)(c) as read with s 227(1)(*b*).
[134] Constitution (1996), s 214(1)(*a*); See also, Fiscal Relations Act 97 of 1997, s 10.
[135] Constitution (1996), s 214(*b*).
[136] Constitution (1996), s 227 (3).

made.[137] In this regard, provinces received an average of 31 per cent of the revenue raised nationally as their PES in the five financial years, between 2015/2016 and 2019/2020.[138]

The Constitution puts in place measures to ensure the transparency and objectivity of the vertical and horizontal revenue division process, as well as for ensuring the participation of provinces. The process of enacting the DORA involves: obtaining independent recommendations from the FFC regarding the equitable division of revenue and other allocations (including conditions that may be attached to them);[139] undertaking political consultations with provincial governments and organised local government;[140] and finally a legislative process through which the DORA is enacted by the National Assembly with the concurrence of the National Council of Provinces (NCOP).[141] With a view to guaranteeing the objectivity of considerations for revenue division, the Constitution details a list of factors that should be taken into account when enacting the DORA (section 214(2) factors).[142]

However, despite the above measures, the objectivity of the vertical division of revenue remains in question given the absence of a specific vertical revenue sharing formula. Except for a requirement that a memorandum be attached to the annual Division of Revenue Bill (DORB) explaining how section 214(2) factors were taken into account, and by what formulae the vertical shares were arrived at,[143] the vertical division of revenue is largely left to the discretion of the National Treasury. To meet these requirements, the National Treasury usually makes a rather general attempt that falls short of providing a substantive level of

[137] Constitution (1996), s 214(1)(*c*).
[138] Calculations are based on the amounts allocated under Schedule 1 of the division of revenue Acts of these financial years. Note, however, that the National Treasury, in its annual Budget Reviews for the relevant years, reports an average of 43 per cent as the outcome of nationally raised revenue allocated to provinces (which includes grants). See, National Treasury *Budget Review* (2016) iv; National Treasury *Budget Review* (2017) iv; National Treasury *Budget Review* (2018) iv; National Treasury (2019) iv; National Treasury, *Budget Review* (2020) iv.
[139] Constitution (1996), s 214(2) as read with s 9(1) of the Fiscal Relations Act; the Constitution requires that the recommendations of the FFC should be considered before the DORA is enacted.
[140] Constitution (1996), s 214(2).
[141] Fiscal Relations Act, s 10; the 1996 Constitution, s 44(1)(*b*)(ii).
[142] Constitution (1996), s 214(2).
[143] Fiscal Relations Act, s 10(5)(*a*) & (*c*).

transparency and objectivity, in explaining how and what factors were taken into consideration in determining the vertical revenue split.[144] For instance, the national government normally reports to have taken into account '[national] government's spending priorities, each sphere's revenue-raising capacity and responsibilities and input from various intergovernmental forums and the FFC'.[145] However, except for FFC recommendations which the national government is legally compelled to specifically account for (and some of which it often ignores),[146] the role played by the other considerations is not objectively verifiable in the final revenue split.

Although the annual independent recommendations of the FFC would be expected to provide counterweight to the National Treasury's broad discretion in determining the vertical revenue split, the FFC has consistently come short of making direct recommendations on the vertical and horizontal revenue split, rather choosing to play safe and steer away from the political consequences of doing so.[147] This is despite the legal requirement for the FFC to provide such recommendations.[148] The closest the FFC has come to this was its proposal for and development of a costed norms approach to revenue division.[149] Instead of making annual recommendations on the nature of the vertical revenue split that would be equitable, as (arguably) envisioned,[150] the FFC provides recommendations focusing on annually evolving

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[144] The explanatory memoranda of the National Treasury's budget reviews for the five years between 2016-2020, part 2.
[145] The Explanatory memoranda of the National Treasury's budget reviews for the five years between 2016-2020, 4.
[146] The National Treasury is reported to have cumulatively ignored half the recommendations made by the FFC between 2010 and 2014. See, De Visser J & Ayele Z 'Intergovernmental fiscal relations in South Africa and the role of the Financial and Fiscal Commission: A 20-year review' (2014) 16 available at https://dullahomarinstitute.org.za/multilevel-govt/publications/03082014-ffc-20-year-review.pdf (accessed 6 December 2021).
[147] A trend in literature especially classifies FFC recommendations as 'linked to' (De Visser & Ayele (2014) 15) or applicable (directly or indirectly) to the division of revenue rather than being direct recommendation on the division of revenue (see National Treasury responses to FFC recommendations in the explanatory memoranda contained in the budget reviews for the five years between 2016-2020).
[148] Fiscal Relations Act, s 9(1).
[149] Financial & Fiscal Commission, *A Costed Norms Approach for the Division of Revenue: Consultation Document* (2000); Financial & Fiscal Commission and South African Local Governments Association, *Costing of Municipal Services to Inform DORA Allocations* (2013).
[150] Fiscal Relations Act, s 9(1).

thematic policy questions and how the revenue sharing process can be used to address them.[151] While this is argued as being based on a broad interpretation of its mandate,[152] the challenge is that it seems to have obscured an explicit core mandate of making direct recommendations on the division of revenue. Additionally, the FFC's commentary on the annual DORB, while providing a further opportunity for commenting on the equity of the allocations, has hardly been used to provide substantive critique.[153] As a consequence, the vertical division is wholly left at the discretion of the national government, thereby masking its objectivity.

Nonetheless, a measure of transparency and objectivity in the vertical revenue split is sought to be achieved through cooperative decision-making.[154] To this end, the national government undertakes consultations with provinces and local governments at the Budget Council and the Budget Forum respectively. However, there is nothing in the law that requires the three spheres of government to reach an agreement on the vertical split through a cooperative process.[155] As a result, any decisions arrived at in the course of such intergovernmental negotiations, however transparent and objective, have the status of recommendations whose incorporation in the determination of the vertical split lies at the discretion of the national Cabinet.[156] Ultimately, therefore, the vertical division of revenue becomes a product of the national Cabinet's political judgment, thus lacking in the transparency and objectivity that could be derived from a measurable formula whose qualities are capable of enforcement.[157]

As a result of the above, the oversight and protection of provincial interests expected to be provided by the NCOP through section 76 procedures for the annual DORB is thwarted, as the House lacks a measure against which to weigh the objectivity of the vertical division process

[151] See generally, FFC's annual submissions for the division of revenue between 2015 and 2020.
[152] See generally, De Visser & Ayele (2014).
[153] See for instance, Financial & Fiscal Commission *Submission on the 2018 Division of Revenue Bill* (2018).
[154] Van Zyl & Walker (1999) 244-245.
[155] Van Zyl & Walker (1999) 244-245.
[156] Van Zyl & Walker (1999) 244-245.
[157] De Visser & Ayele (2014) 20; Van Zyl & Walker (1999) 245.

hence the equity of the vertical revenue split.[158] This, however, would not be a challenge were the FFC to make direct recommendations on the equity of the revenue division as this would grant the NCOP an objective yardstick for its oversight role. Additionally, the NCOP is argued to receive the annual DORB too late in the process for it to play any significant role in influencing its content.[159] By the time the DORB is tabled in the NCOP it would already have been the subject of 'extensive executive negotiations'[160] which, when coupled with party loyalty that prevails in parliamentary negotiations, reduces the NCOP's role to that of rubberstamping the Bill as received. This therefore allows the overbearing influence of the national government in the determination of provincial equitable share to go unchecked.

However, with respect to the horizontal revenue split among provinces, the FFC developed a formula to guide the distribution of the PES across provinces, hence helping to facilitate the transparency and objectivity of the process. The formula includes a list of objectively determined components that 'capture the relative demand for services across provinces and takes into account specific provincial circumstances'.[161] These, therefore, play a critical role in engendering overall confidence in the fairness and objectivity of the process, and minimising the overbearing influence of the national government in the horizontal revenue allocation process. This goes a long way in setting the stage for the unconditional PES to accord a level of fiscal autonomy to provinces.

However, although the 'unconditional' grants received from the PES are aimed at facilitating provincial discretion with respect to their expenditure[162] as well as boosting their revenue autonomy, this has not been the case. For instance, the manner of structuring of the 'unconditional' provincial equitable share (PES) of revenue as prescriptive grants has only

[158] Van Zyl & Walker (1999) 246.
[159] Wehner (2000) 62.
[160] Wehner (2000) 62.
[161] National Treasury *Explanatory Memorandum* (2020) 17; The 2020 budget for instance takes into account six components and assigns weights to each. These include: an education component (48%); a health component (27%); a basic component (16%); an institutional component (5%); a poverty component (3%) and an economic activity component (1%) which cumulatively make up 100% of the revenue allocated to each province.
[162] Josie (2012) 14.

served to further limit the space for provincial expenditure autonomy. Allocations for education and health, which cumulatively constitute 75 per cent of a province's budget, are for instance earmarked and weighted by the national government as part of the PES.[163] In the 2020/21 PES formula, for instance, the education component is assigned 48 per cent while the health component is assigned 27 per cent of the total PES allocation.[164] Although an effort is made to indicate that the components of the formula [as well as the various weightings] are 'neither indicative budgets nor guidelines as to how much should be spent on functions',[165] the cherry-picking of these functions for inclusion in the formula, coupled with the precise data-backed ('costed norms') approach[166] adopted to determine the allocations made to each of the functions, poses a practical constraint on the discretion provinces have over how much they eventually allocate to these functions.

With respect to the provincial allocation for education, for instance, the formula takes into account the size of a province's school-age population, based on Statistics South Africa's (SSA) annual mid-year population estimates, and the number of learners enrolled in public schools, based on the Department of Higher Education's data collection system, which is constantly verified and tracked.[167] With regard to the allocation for health, the amount allocated is determined by a province's uninsured population, based on specific data from the Council for Medical Schemes' Risk Equalisation Fund, and the number of recorded visits to health facilities, based on data from the District Health Information Services.[168] This ensures a great deal of expenditure precision to the horizontal allocations thus leaving little room for

[163] Khumalo, Dawood & Mahabir (2015) 213; National Treasury *Budget Review 2019* (2018) 67-68.
[164] National Treasury, Explanatory memorandum to the division of revenue', in National Treasury *Budget Review* (2020) 17.
[165] National Treasury (2020) 17.
[166] Financial & Fiscal Commission, *A Costed Norms Approach for the Division of Revenue: Consultation Document* (2000) 1-2 & 33; The FFC defines the costed norms approach as 'a formula-based method for calculating the financial resources necessary for the provision of basic social service levels, given nationally mandated norms and standards'. It proceeds to argue that the rationale is to ensure that there is a 'clear link between any tentative proposal for the provincial equitable share and what that amount will buy in social services'. It also argues that the overall objective is to impose a 'more stable budget constraint' that will restrict the ability to 'play budget games'. See also, Rao (2003) 12; Josie J (2012) 15.
[167] National Treasury (2020) 18.
[168] National Treasury (2020) 20.

provincial discretion. Moreover, the annual weighting of the cost of services is done based on historical expenditure patterns[169] as opposed to basing it on the normative cost, thereby further narrowing down any wiggle room left for provinces in the utilisation of what is otherwise supposed to be an unconditional PES.[170] This has led to the argument that the PES is a *de facto* conditional grant,[171] a factor that constrains the fiscal autonomy sought to be afforded to provinces by the constitutional classification of the PES as unconditional.

Another trend, observed over the years, which impacts the level of fiscal autonomy afforded to provinces by transfers is the proliferation of and the growing emphasis placed on conditional grants relative to unconditional grants.[172] This has been explained in part as being informed by the perceptions of failure by the provinces to prioritise national objectives,[173] as well as by the poor performance by provinces in managing and accounting for grants.[174] As a consequence, the FFC reports that

> On average, over the whole period 2002/03 up to 2020/21 projections, conditional grants illustrate stronger real growth relative to block grants. More specifically, conditional grants grow by a real annual average of 7% relative to the 4.2% growth in block grants. [175]

In addition to the shift towards conditional granting, the FFC also reports that there has been increased earmarking and ring-fencing of the conditional grants, with more stringent conditions.[176] Although justifiable against a background of provincial financial mismanagement, the lack of nuance and differentiation in the application and impact of such

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[169] National Treasury (2020) 17.
[170] Financial & Fiscal Commission *Submission for the 2019/20 Division of Revenue* (2018) 50-51.
[171] Khumalo, Dawood & Mahabir (2015) 214.
[172] Khumalo, Dawood & Mahabir (2015) 215 & 216; Amusa & Mathane (2007) 288; FFC (2018) 50.
[173] Khumalo, Dawood & Mahabir (2015) 215.
[174] Amusa & Mathane (2007) 288.
[175] FFC (2018) 50.
[176] FFC (2018) 50.

increased conditioning and ring-fencing indiscriminately starves provinces of discretion in spending.[177]

Additionally, 'indirect conditional grants' are another phenomenon which is increasingly impacting the fiscal autonomy of provinces.[178] According to the FFC, indirect conditional grants have been increasing at a 'phenomenal rate' relative to direct conditional grants, hence pointing to a trend of financial recentralisation.[179] Generally, given that conditional grants are mainly directed at implementing specific priorities identified by the national government, they effectively take away provincial discretion over the relevance of the items of expenditure and further impose a subsequent perpetual maintenance budget for the completed projects, which adds to provincial unfunded mandates.[180] Indirect conditional grants, for their part, add another autonomy-depriving feature in the sense that, in addition to the ordinary national prioritisation and funding of subnational projects, they allow a national sector department or public entity to go a step further, to perform target subnational functions or implement the specific funded project on behalf of the respective subnational government.[181] This further divests provincial governments of any autonomy over the subjects of such grants, while leaving behind a trail of unfunded mandates. While justification for municipal indirect grants is found in their want of capacity to implement infrastructural projects, provincial indirect grants are mainly aimed at implementing basic norms and standards in schools, or nationwide

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[177] This informed a proposal by SALGA and the FFC for increased differentiation in municipal funding to account for different contexts. See, National Treasury *Budget Review* (2019) 7.
[178] Mtantato S & Peters S 'A review of direct and indirect conditional grants in South Africa – Case study of selected conditional grants' in Financial & Fiscal Commission (ed) *Submission for the 2016/17 Division of Revenue* (2015) 60.
[179] Mtantato & Peters (2015) 60 & 73; Financial & Fiscal Commission, *Submission for the 2016/17 Division of Revenue* (2015) 50. For instance, over a 13-year period, between 2004/05 and 2016/17, 'indirect grants grew by 13% in real terms and 19% in nominal terms, significantly outpacing the marginal growth of 0.3% in direct grants.'
[180] Mtantato & Peters (2015) 60-61; Financial & Fiscal Commission, *Policy Brief: Direct or Indirect Grants? A case Study of Selected Grants* (2015) 2.
[181] Mtantato & Peters (2015) 60. This is contrasted to direct conditional grants, which are transferred directly to subnational governments for use within specified conditions.

initiatives such as the national health insurance scheme.[182] Hence their use could be fashioned in favour of more autonomy-enhancing alternatives.

2.1.3 Provincial budgetary autonomy

Although provinces are allowed to raise loans for both capital and current expenditure, the latter may be raised only for bridging purposes (to cover cash shortfalls within a fiscal year).[183] In practice, this has meant that provinces are not allowed to budget for deficits and have to maintain balanced budgets.[184] However, while the Constitution opens the door for borrowing to finance capital expenditure, section 3(3) of the Borrowing Powers Act appears to restrict provincial borrowing to bridging finance,[185] which is indicative of an attempt at limiting provincial budgetary autonomy.

Provinces have various lines of credit open to them, a factor which goes a long way in enhancing their budgetary autonomy. They are allowed to obtain loans: from the national government; through an institution established by an Act of Parliament or approved by the Minister of Finance for such purpose; from banks or financial institutions; or by issuing public stock, bonds or other financial instruments.[186]

However, various restrictions have been put in place that constrain provincial borrowing discretion. To start with, the Loans Co-ordinating Committee and the Minister of Finance, are granted the power to determine the aggregate amount that may be borrowed by each province within a financial year and provinces are prohibited from exceeding this aggregate by more than half a percent.[187] Additionally, the total amount of interest that may accrue on a provincial government's loans in a year is regulated and capped as a percentage of the total

[182] Mtantato & Peters (2015) 62.
[183] Constitution (1996), s 230(1).
[184] Khumalo, Dawood & Mahabir (2015) 219.
[185] Borrowing Powers of Provincial Governments Act 48 of 1996, s 3(3).
[186] Borrowing Powers Act, s 3(6) (*e*).
[187] Borrowing Powers Act, s 3(6) (*a*), (*b*) & (*c*).

budgeted current revenue of the province.[188] Moreover, provincial governments are allowed to raise loans denominated in foreign currency only with the approval of and subject to the conditions set by the Minister of Finance.[189] Also, the national government is prohibited from furnishing any guarantee for the fulfilment of any provincial loan, unless otherwise provided for in the national Exchequer Act.[190] All these restrictions constrain the discretion of provinces in using debt as a financing tool.

Such tight national controls over provincial borrowing are argued as being informed by the fact that since 'provinces have little or no security of their own to offer' other than national transfers, the loans they take out 'translate into national debt masquerading as provincial debt'.[191] Although these controls, such as the prohibition from using bridging finance as a continuous and unlimited revolving credit,[192] may be useful in securing fiscal prudence, they impinge on the budgetary autonomy of provinces by limiting their freedom to acquire debt. Therefore, a balance is necessary for ensuring access to debt by provinces, while securing fiscal prudence.

In practice, although provinces are stated to have been able to borrow 'mainly in the form of overdrafts' for bridging purposes,[193] there is hardly any record of provincial borrowing.[194] However, there is a record of a moratorium that was entered into between the national government and provinces, under which provinces agreed not to borrow between 1997/98 and 1998/99.[195] This came against a background where the Eastern Cape, KwaZulu-Natal, Free State and, later, Mpumalanga provinces had run up huge deficits due to overspending that

188 Borrowing Powers Act, s 3(7)(a).
189 Borrowing Powers Act, 3(6)(d); PFMA, s 67.
190 Borrowing Powers Act, s 5.
191 Khumalo, Dawood & Mahabir (2015) 209-210.
192 Borrowing Powers Act, s 3(4).
193 Rao (2003) 8.
194 A review of the National Treasury's Budget Reviews for the five years between 2016 – 2020 only indicates a negative surplus on provincial borrowing without any record of actual borrowing. See pages 38, 97, 95, 34 and 32 of the budget reviews, respectively.
195 National Treasury *Provincial Budgets and Expenditure Review: 2001/02 – 2007/08* (2005) 6; Pottie D 'Provincial government in South Africa since 1994' (*Provincial Government in South Africa, Conference held at Umtata on 16-18 August 2000*) (2000) 44-45; Ahmad (1999) 11 & 17.

put them in financial difficulties, hence necessitating national interventions to bail them out.[196] Notwithstanding the moratorium, provinces are said to have been forced to utilise overdrafts to cover their basic salary and administration costs over the moratorium period.[197] It would appear therefore that this practice survived past the period and continues to subsist.

2.1.4 How the legal framework ensures accountable provincial fiscal autonomy

Against the backdrop of the various forms of provincial fiscal autonomy discussed above, there are a variety of ways through which South Africa's legal framework regulates their exercise. This is aimed at ensuring expenditure control and the accountability of provinces towards the attainment of the objectives of autonomy, as well as retaining overall national control over decentralisation. This section looks at internal as well as external fiscal controls that are aimed at regulating the exercise of provincial fiscal autonomy, and the impact of each.

2.1.4.1 Internal systemic controls

Internal systemic controls refer to those accountability-enhancing measures that are built into the intergovernmental fiscal system and aimed at facilitating expenditure control without the intrusion of higher tiers of government. These are situated within the same level of government, and are aimed at ensuring that the exercise of subnational fiscal autonomy is directed towards the attainment of the objects of subnational autonomy discussed in chapter two above.

In this respect, provincial self-regulation with accountability to the provincial legislature plays a key role as a system of expenditure control that is internal to a province. Regulation of the exercise of fiscal autonomy at the provincial level is undertaken jointly amongst departmental accounting officers (who bear the greatest responsibility), departmental executive

[196] As above.
[197] Pottie (2000) 45.

authorities, provincial treasuries, members of the provincial executive council (MECs), as well as provincial legislatures with the support of the Auditor-General (AG).

A provincial department's accounting officer (Officer) is required to ensure that the department has and maintains effective, efficient and transparent systems of financial risk management and internal control, as well as a system of internal audit under the control and direction of an audit committee.[198] He or she is, moreover, required to provide to the provincial treasury details of a department's anticipated as well as actual revenue and expenditure.[199] The Officer is further required to report to the executive authority and the provincial treasury any impending under-collection of revenue due, shortfalls in budgeted revenue, as well as any overspending by the department.[200] He or she is also tasked with complying with any remedial measures imposed by the treasury to prevent overspending.[201]The Officer is additionally required to keep full and proper records of the financial affairs of the department and prepare financial statements for each financial year for submission for auditing to the AG.[202] Upon receipt of the audit report, the Officer is required to submit it together with the department's annual report of the department's activities and the audited financial statements to the provincial treasury as well as to the department's executive authority for tabling before the provincial legislature to facilitate its oversight mandate.[203]

MECs are accountable individually and collectively to the provincial legislature and are required to provide the legislature with full and regular reports concerning matters under their control.[204] The provincial legislatures for their part are required to provide for mechanisms of ensuring that all provincial executive organs are accountable to them and for

[198] PFMA, s 38 (1) (*a*).
[199] PFMA, s 40.
[200] PFMA, s 39 (2) (*b*) & (*c*).
[201] PFMA, s 39 (2) (*b*) & (*c*).
[202] PFMA, s 40.
[203] PFMA, s 40 as read with, Public Audit Act 25 of 2004, s 21(3).
[204] Constitution (1996), s 133.

the maintenance of oversight over the exercise of provincial executive authority.[205] A close examination of this framework reveals a legislative framework intent on laying out a comprehensive system of internal control at the provincial level that covers the exercise of all forms of fiscal autonomy, with the oversight buck stopping with the provincial legislature.

However, provincial legislatures have been accused of failing to probe provincial budgets and further failing to ascertain whether provincial executives actually delivered on priorities laid out in provincial budgets.[206] The failure of internal systems of oversight have resulted in financial mismanagement and dysfunctionality in some provincial departments thereby rendering them unable to meet their service delivery obligations.[207] This has served to highlight the practical need for striking a balance between the value of subnational fiscal autonomy, with a full comprehensive system of internal control, and the need for fiscal controls that are external to provinces such as supervision by the national sphere of government.[208]

2.1.4.2. External fiscal controls: National oversight over provinces

The 'interrelated' nature of South Africa's spheres of government means that they are not independent of each other in the exercise of their autonomy.[209] The national and provincial spheres are charged with supervisory functions, with the National Treasury being generally in charge of supervising subnational financial management.[210] Such supervision covers both the pre-budget as well as the post-budget phases of subnational budget processes. In this respect, the Constitution mandates the National Treasury to ensure and enforce compliance

205 Constitution (1996), s 114(2).
206 Amusa & Mathane (2007) 285.
207 Auditor-General of South Africa *Auditor-General Calls on Government Leaders to 'Act Now' to Halt the Trend of "Disappointing" Audit Results* (2019) 3-4; Auditor-General of South Africa *Auditor-General Reports an Overall Deterioration in the Audit Results of National and Provincial Government Departments and their Entities* (2018) 2-4.
208 Steytler & Ayele (2018) 306 & 326.
209 Steytler & De Visser (2016) 15-5.
210 Steytler & De Visser (2016) 15-5.

with measures put in place to facilitate transparency and expenditure control in each sphere of government.[211]

Supervision, generally, encompasses 'four distinct but interrelated activities: regulation, monitoring, support and intervention.'[212] Regulation entails the setting of frameworks within which subnational fiscal autonomy may be exercised.[213] Monitoring ensures subnational compliance with legislative frameworks, and highlights instances where support is required to facilitate the effective exercise of subnational fiscal autonomy.[214] Intervention, for its part, refers to the duty to direct the activities and outcomes of subnational governments.[215] These aspects of supervision are largely applied sequentially,[216] with interventions being the last in line since they are the most intrusive to subnational fiscal autonomy.

To facilitate the monitoring and support components of the National Treasury's oversight mandate, provincial treasuries are required to submit regular reports to the National Treasury. These include quarterly statements of revenue and expenditure with respect to the provincial revenue fund, specifying the actual provincial revenue, actual expenditure per vote as well as actual borrowings.[217] This provides an opportunity to the National Treasury to identify any expenditure or accountability-related issues that may warrant the exercise of its powers of either support or intervention.[218]

Where the reporting obligation above reveals inability or a failure by a province to fulfil an executive obligation conferred by the Constitution or legislation, the national executive is

[211] Constitution (1996), s 216(1) & (2).
[212] Steytler & De Visser (2016) 15-5.
[213] Steytler & De Visser (2016) 15-5.
[214] Steytler & De Visser (2016) 15-5.
[215] Steytler & De Visser (2016) 15-5.
[216] Department of Provincial and Local Government (DPLG) *Intervening in Provinces & Municipalities: Guidelines for the Application of Sections 100 & 139 of the Constitution* (2007) 1.
[217] PFMA, s 32.
[218] South African Government 'Conditional hand-over of the Limpopo Administration to the Provincial Executive' (2014), 1 available at https://www.gov.za/conditional-hand-over-limpopo-administration-provincial-executive (accessed 13 May 2020). In the case of Limpopo Province, the submission of a request to increase the province's overdraft facility served to alert the National Treasury of the Province's state of financial mismanagement.

allowed to intervene to ensure its fulfilment.[219] Such executive obligations include all functions conferred on the provincial executive,[220] key among them being financial management. Financial mismanagement therefore constitutes a major basis for national intervention in provinces. Such intervention may take the form of a directive to the provincial executive requiring steps to be taken to meet the obligations (s 100(1)(a)), or alternatively it may involve the national executive assuming responsibility for the relevant obligation in the province for purposes of securing compliance (s 100(1)(b)).[221] The latter measure is more intrusive with respect to provincial fiscal autonomy, given that decision-making as well as the performance of the provincial obligation is taken away from the provincial government and taken over by the national executive.

In addition to the power to intervene, the Constitution gives the National Treasury discretion to stop the transfer of funds to a provincial department or administration where a serious or persistent material breach of measures put in place to ensure transparency and expenditure control has been committed.[222] Stoppage of funds effectively impairs the revenue and expenditure autonomy of a province as well as its ability to ensure the provision of services. However, despite serious and persistent financial mismanagement being recorded in various provinces over the years, the national government has been reluctant to utilise this power.[223] Although this may augur well for the continued exercise of provincial fiscal autonomy, it impacts on the accountability of provinces, thereby undermining a core objective of fiscal autonomy.

In the recent past, however, a failure in provincial systems of internal control, resulting in cases of irregular and unauthorised expenditure, accumulation of debt, lack of and failure to follow supply chain management rules, and sheer profligacy in some provinces, has

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[219] Constitution (1996), s 100(1).
[220] DPLG (2007) 2.
[221] Constitution (1996), s 100(1).
[222] Constitution (1996), s 216(2) as read with s 239.
[223] Steytler N 'National cohesion and intergovernmental relations in South Africa' in Steytler N & Ghai Y (eds) *Kenyan-South African Dialogue on Devolution* (2015) 318.

precipitated national interventions in provinces in terms of section 100 of the Constitution.[224] This began with the national executive assuming responsibility for the Department of Education of the Eastern Cape Province in 2011, followed by interventions in various provincial departments in Limpopo, Free State, Gauteng and North West provinces.[225] Out of all these, the interventions in Limpopo and the North West provinces were more extensive and had the most intrusive impact on the exercise of the respective provinces' fiscal autonomy during the prevalence of the interventions. Both interventions involved the complete assumption of responsibility for five provincial departments, with an additional five departments in the North West undergoing the milder section 100(1)(a) intervention.[226] This meant that, for the duration of the interventions, both provinces lost total executive authority, and with it fiscal autonomy, in the running of each of the departments affected by the section 100(1)(b) interventions. Although impacting the exercise of provincial fiscal autonomy, such interventions find justification in the fact that their coming into effect was a manifestation of a failure by the province to utilise its autonomy to ensure effective systems of internal control.

Although the underlying causes for interventions are evident in most cases, there have been claims of politically motivated interventions, which expose the powers of intervention to potential abuse.[227] The intervention in Limpopo province was, for instance, claimed to have been motivated by a failure by the provincial premier to support the re-election of the then president.[228] Although later proven to be baseless,[229] such claims constitute an indictment on

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[224] NCOP Finance 'National government interventions in Gauteng , Free State and Limpopo : Ministerial briefings' (2012), 1 available at *https://pmg.org.za/committee-meeting/13919/* (accessed 18 May 2020); Ad Hoc Committee on North West Intervention 'Inter-Ministerial *Task Team (IMTT) Update on North West Intervention, with Ministers' (2019), 1 available at* https://pmg.org.za/committee-meeting/26847/ (accessed 19 May 2020).
[225] Steytler (2015) 318; Khumalo, Dawood & Mahabir (2015) 223; Ad Hoc Committee on North West Intervention (2019) 1.
[226] Steytler (2015) 318; Khumalo, Dawood & Mahabir (2015) 223; South African Government News Agency 'Government strengthens North West intervention' (*SAnews*, 2018) available at *https://www.sanews.gov.za/south-africa/government-strengthens-north-west-intervention* (accessed 19 May 2020).
[227] Steytler (2015) 319.
[228] Steytler (2015) 318.
[229] Steytler (2015) 318 & 321.

the perceived effectiveness of the NCOP in checking arbitrary action by the national government.

The NCOP is tasked with approving or disallowing interventions upon notification of their commencement by the national executive.[230] This is key in ensuring that interventions are based on objective grounds, and to check any political motivations for such interventions. The NCOP is further required to review ongoing discretionary interventions regularly, and to make appropriate recommendations.[231] Additionally, in the event of stoppage of transfers to a province by the National Treasury, the Constitution requires such decision to be approved by a joint deliberation between the National Assembly and the NCOP, failing which the decision lapses retrospectively.[232] These processes are critical in ensuring the legitimacy of interventions, and in ensuring that interventions do not continue for longer than necessary, thereby securing the continued exercise of fiscal autonomy by subnational governments. However, in practice, the NCOP's role has been limited mainly due to party politics and party loyalty. Its membership being mainly dominated by the ruling party, it becomes difficult for the NCOP to adopt a position that is against the national executive thus undermining its review mandate.[233]

2.1.5 Concluding remarks on provincial fiscal autonomy

Notwithstanding a general constitutional structure that may appear to imply otherwise, provinces largely lack fiscal autonomy. Their being a product of a historically negotiated settlement underlay their constitutional deprivation of scope over which to exercise their expenditure autonomy, which is tied to their lacking in revenue autonomy as well as the tight controls placed over the exercise of provincial budgetary autonomy. The failure of provincial internal control systems, moreover, exposes provinces to external fiscal controls aimed at

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230 Constitution (1996), s 100(2).
231 Constitution (1996), ss 100(2) & 139(2)(*c*).
232 Constitution (1996), s 216 (3)(*a*).
233 Watts (2005) 7; Steytler (2015) 318.

restoring the accountable use of fiscal autonomy thus further constraining provincial access to their limited margin of autonomy.

2.2 The fiscal autonomy of local governments

Historically, despite local authorities having been creations of the higher tiers of government that dictated their functions, they largely exercised more autonomy than provinces. As mentioned above, the 1996 Constitution elevated and conferred more autonomy on local governments. In this regard, the Constitution: confers constitutional status to local governments, entrenches extended functional mandates to them and grants them direct access to more own sources of revenue relative to the provincial sphere. With this, the Constitution grants municipalities the right to govern, on their own initiative, the local government affairs of their communities and so accords them autonomy in their functioning.[234]

Despite this effort to confer more autonomy to local governments, the Constitution subjects its exercise to limits imposed by national and provincial legislation.[235] In this respect, the exercise of municipal executive (and legislative) authority may be constitutionally limited by regulatory legislation enacted by either or both the national and provincial governments.[236] However, in keeping with the principles of cooperative government, the Constitution enjoins the other spheres of government, in the exercise of their powers, not to 'compromise or impede a municipality's ability or right to exercise its powers or perform its functions'.[237] With respect to municipal fiscal autonomy, therefore, while regulatory legislation may hold the potential to restrict its exercise, such restriction remains constitutional hence valid to the extent that it does not compromise or impede a municipality's ability to exercise its powers or perform its functions. This will therefore be the key consideration in assessing the constitutional boundaries of regulatory legislation that seem to inhibit the exercise of

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[234] Constitution (1996), s 151(3); Systems Act s (4(1)(*a*).
[235] As above.
[236] Constitution (1996), s 155(7).
[237] Constitution (1996), s 151(4).

municipal fiscal autonomy. The definitions and scope of each of the aspects of fiscal autonomy will be the same as those applied in the analysis of the provincial sphere above.

2.2.1 **Municipal expenditure autonomy**

Municipalities are mainly in charge of the provision of basic services such as water and sanitation, electricity and refuse removal.[238] Unlike in the pre-1994 period, where the determination of the nature and scope of functions over which local governments could exercise their expenditure autonomy was dictated by national and provincial legislation, the 1996 Constitution made the point of entrenching specific matters over which local governments retain exclusive executive authority and the right of administration. These matters are listed under parts B of both Schedules 4 and 5 of the Constitution, and constitute the 'original' municipal functions. In addition, the Constitution grants municipalities the power to undertake anything that is reasonably necessary for, or incidental to, the effective performance of these functions.[239] Such constitutional entrenchment provides certainty regarding the nature and scope of matters over which a municipality may make expenditure decisions without fearing the powers of review or negation of other spheres of government. The attendant granting of open-ended powers for the performance of the specified functions is also key in securing the municipal exercise of autonomy over local expenditure decisions.

However, as highlighted above, the national and provincial governments retain the power to regulate these municipal functions by setting norms and standards, monitoring their implementation, and intervening in instances where these norms are not attained.[240] This regulatory role therefore holds the potential to encroach on the municipal sphere's executive and administrative constitutional space. However, while this regulatory authority is allowed to extend to the definition of the content of a municipality's functions, it may not replace the

[238] Khumalo, Dawood & Mahabir (2015) 204.
[239] Constitution (1996), s 156(5); See also, Systems Act, s 8(2).
[240] Heymans (2006) 64; Fuo O 'Intrusion into the autonomy of South African local government: Advancing the minority judgment in the Merafong City Case' (2017) 50 *De Jure* 330.

expenditure decision-making authority of municipalities.[241] In this respect, the Constitutional Court has been keen to consistently protect the power of municipalities, to exercise executive municipal powers and to administer municipal affairs, from intrusion by the other spheres of government by way of regulatory legislation.[242] This has meant that the power of municipalities to make final expenditure decisions on matters falling within the exclusive arena of municipal executive or administration mandates is protected from any powers of review or negation of other spheres of government.[243]

However, various forms of overlap and concurrency still exist in the functional allocations of the three spheres of government. Some of these arise from the lack of clarity in the definitions of the various listed competencies.[244] For instance, overlaps exist between provincial and municipal mandates in areas of transport, tourism, trade, health (primary health care), roads, sports, libraries and recreation.[245] These overlaps, when coupled with the power of the national and provincial governments to assign functions to municipalities,[246] result in unfunded mandates[247] at the municipal level.[248] Unfunded mandates impact the fiscal autonomy of local governments by shrinking their policy space, restricting municipal expenditure choices as well as forcing municipalities to apply 'extra budgetary measures to fund service backlogs'.[249]

[241] Steytler & De Visser (2016) 5-27.
[242] Fuo, (2017) 329; See also, *City of Johannesburg Metropolitan Municipality v Gauteng Development Tribunal and Others (CCT89/09) [2010] ZACC 11* para 59; *Minister of Local government, Environmental Affairs and Development Planning Western Cape v Habitat Council* 2014 4 SA 437 (CC) para 11.
[243] Fuo (2017) 345.
[244] Basdeo M 'The impact and dilemma of unfunded mandates confronting local government in South Africa : A comparative analysis' (2012) 1 *Africa's Public Service Delivery and Performance Review* 56
[245] Basdeo (2012) 56 & 60.
[246] Constitution (1996), s 156(1).
[247] These arise when the national or provincial governments impose additional mandates on local governments without providing attendant resources to fund them. This may be a consequence of either a direct transfer/delegation/assignment of functions or a result of policy decisions made in other spheres for implementation at the local level which have financial implications. See, Basdeo (2012) 52.
[248] Amusa & Mathane (2007) 274.
[249] Basdeo (2012) 51; Amusa & Mathane (2007) 275 & 285.

Although the procedural stipulations laid out under the Systems and FFC Acts, and intended to prevent unfunded mandates, are very desirable, they are yet to be realised.[250] There is no record of any legislation or executive actions assigning functions to local governments having ever been prepared in compliance with the stipulations, even though the duties they imposed fell outside of municipal constitutional mandates and had financial implications.[251]

Nonetheless, the Constitution vests the authority to make decisions on all matters regarding a municipality on its municipal council.[252] This provides room for the exercise of municipal autonomy. Municipalities are allowed to make by-laws to facilitate the effective administration of matters falling within their jurisdiction.[253] This extends to the preparation of Integrated Development Plans (IDPs) as well as the passing, adjusting and implementation of budgets aimed at giving effect to the IDPs.[254] Municipal IDPs are critical embodiments of the exercise of municipal expenditure autonomy. In exercising their decision-making mandate, municipal councils are enjoined to consult and encourage communal participation.[255] In this regard, therefore, the views of members of the local community are required to be considered in, among other decision-making processes, the preparation of IDPs as well as in the budgeting process.[256] This is key in ensuring that the exercise of municipal expenditure autonomy is directed at meeting the specific needs of local communities which is a critical objective of subnational fiscal autonomy.

However, the planning undertaken by a municipality is required to give effect to the principles of co-operative government by being aligned with and complementary to the development plans and strategies of other affected municipalities and other organs of state.[257] Municipalities are, moreover, required to participate in national and provincial development

[250] Basdeo (2012) 63.
[251] Basdeo (2012) 64.
[252] Constitution (1996), s 160(1).
[253] Constitution (1996), s 156 (2) & (3).
[254] MFMA, s 16 as read with s 28(1).
[255] Systems Act, s 4(2) & 5(1)(*a*).
[256] MFMA, s 23.
[257] Systems Act, s 24 & s 27(1).

programmes.[258] In this respect, a municipality's IDP is thus required to be compatible with national and provincial development plans and planning requirements binding on the municipality.[259] Additionally, the Minister responsible for local government is empowered to make regulations or issue guidelines to regulate the detail of IDPs and is further allowed to establish national minimum standards for any municipal service or for any matter assigned to municipalities.[260] All these requirements, coupled with the Minister's powers, significantly restrict the autonomy of municipalities (and their communities) to determine their spending priorities and standards suited to their revenue capabilities. . The extent to which all these legislative restrictions actually affect municipal expenditure autonomy in practice is, however, unclear.

Important in this respect, however, is the fact that municipalities (especially metros) raise a substantial amount of revenue from their own sources.[261] This bolsters their revenue autonomy, which is in turn linked to increased municipal expenditure autonomy.[262] This means that municipalities, unlike provinces, are able to set and finance their own expenditure priorities without relying on grants or being inhibited by conditionalities attendant to such grants from other spheres of government.[263] This is however true for metros and emerging cities with wide revenue bases. Other municipalities that are reliant on transfers bank on the unconditionality of the local government equitable share (LGES) to facilitate their discretionary spending. This discretion is however eroded when it comes to conditional grants aimed at pursuing national priorities.[264] Subnational revenue autonomy is therefore instrumental in facilitating municipal expenditure autonomy.

Outside the external factors impacting municipal expenditure autonomy above, the lack of technical and administrative capacity adversely affects the ability of some municipalities to

[258] Constitution (1996), s 153(*b*). See also, Systems Act, s 24.
[259] Systems Act, s 25(1)(*e*); See also MFMA, s 21 (2) as read with s 23.
[260] Systems Act, ss 22(1)(*a*), 37(1)(*b*) & 108(*i*).
[261] Steytler & Ayele (2018) 304.
[262] Steytler & Ayele (2018) 304.
[263] Steytler & Ayele (2018) 327.
[264] Steytler & Ayele (2018) 304 & 326.

design and implement their IDPs.[265] This in turn impacts the ability of municipalities to optimise their expenditure autonomy.

2.2.2 Municipal revenue autonomy

Similar with the discussion under provinces, this section explores the autonomy afforded to municipalities by their OSR, their discretion to administer their OSR, as well as the extent of autonomy accorded to them by intergovernmental fiscal transfers.

Notably, the pre-1994 principle of municipal financial self-sufficiency prevailed under the 1996 Constitution, with municipalities having access to more revenue sources than provinces. Municipal revenue sources are, moreover, not tied to the enactment of an Act of Parliament as is the case with provinces, hence municipalities have direct access to them under the Constitution. Generally, therefore, municipalities have more scope for revenue autonomy when compared to provinces.

2.2.2.1 Municipal own source revenue

Municipalities are accorded two basic sources of own revenue: property rates and surcharges on fees for services provided by or on behalf of the municipalities (including charges for the use of electricity and water and sanitation services).[266] They are, however, also allowed to impose any other taxes, levies and duties as may be authorised under national legislation.[267] In this respect, the Minister of finance is allowed, of his or her own accord or on application by a municipality, group of municipalities or organised local government, to authorise a

[265] Amusa & Mathane (2007) 273.
[266] Constitution (1996), s 229(1)(*a*) as read with Systems Act, s 4(1)(*c*). The Municipal Fiscal Powers and Functions Act (s1) defines a 'municipal base tariff' as the fees necessary to cover the actual cost associated with rendering a municipal service and a 'municipal surcharge' as a charge in excess of the municipal base tariff. In this case, therefore, the municipal base tariff constitutes the 'municipal charge'. This explains the argument by Steytler & De Visser (Steytler & De Visser (2016) 9-18) that 'the power to impose a surcharge on fees for services rendered necessarily implies the constitutional power to charge for those services'. This gives municipalities both the charge and the surcharge as a source of revenue. However, since both are levied as one, they are often referred to together as user fees.
[267] Constitution (1996), s 229(1)(b).

municipal tax by prescribing regulations to govern the imposition of the tax.[268] Although this entails a wider scope of access to OSR than in the case of provinces, the Constitution still excludes and reserves the generally more lucrative revenue sources such as income tax, value added tax, general sales tax and customs duty for the national sphere of government.[269]

In practice, and flowing from the above, municipalities have access to other OSR sources including the sale and/or lease of assets, returns on invested funds, and fines.[270] Additionally, metropolitan and district municipalities had access to RSC levies, which were however abolished in 2006.[271] In their place, district municipalities are given a replacement grant that comes as part of the equitable share, and metros are allowed a share in the fuel levy that is raised nationally.[272] Although these serve to enhance the revenue of municipalities, the fuel levy affords less fiscal autonomy to metros given that the setting and/or varying of its rates and collection is done by the national sphere.[273] This highlights the importance of municipal discretion in the setting and varying of the rates applied in the imposition of property rates and surcharges on the overall fiscal autonomy of municipalities.

With respect to autonomy in the setting of applicable rates, municipal councils are required to adopt a rates policy for the imposition of property rates, as well as by-laws to give effect to the implementation of the policy.[274] Although enjoined to treat persons liable for rates equitably, municipal councils are given a free hand in setting different rates for different categories of property as well as in granting exemptions, rebates or reductions in the rates

[268] Municipal Fiscal Powers and Functions (MFPF) Act 12 of 2007, s 4.
[269] Constitution (1996), s 229(1)(b).
[270] Steytler & De Visser (2016) 12-5.
[271] Stevens C *Mitigating the Effects of the Ever-Widening Fiscal Gap Plaguing Metropolitan Municipalities in South Africa: A Quest for an Additional Own-Revenue Source in the Form of a Local Business Tax* (unpublished LLM thesis, University of the Western Cape, 2019) 11; Josie (2012) 24; Steytler & De Visser (2016) 12-4.
[272] Stevens (2019) 34.
[273] Stevens (2019) 35.
[274] Municipal Property Rates Act (MPRA) 6 of 2004, s 3(1) & s 6(1).

payable.[275] Municipalities are also allowed to classify an area as a special rating zone and levy additional rates in the area.[276]

Such autonomy is not without limitations. For instance, municipal exemptions, rebates or reductions on rates are required to comply with, and be implemented, in accordance with a national framework.[277] Additionally, although a municipality is allowed to determine the criteria for increasing property rates,[278] and is required to annually review its rates as part of its budget process,[279] the law allows the Minister of local government to set an upper limit on the percentage by which rates on properties or a rate on a specific category of properties may be increased, thus limiting the exercise of municipal discretion in this regard.[280] Also, the Minister is allowed to monitor, and from time to time investigate and issue a public report on, the effectiveness, consistency, uniformity and application of municipal valuations for rates purposes.[281] Such reports, however, hold the potential to influence and/or encroach on the autonomy of municipalities to set and review their rates policies.

With respect to the imposition of surcharges for municipal services, municipalities are also required to adopt tariff[282] policies.[283] This allows municipalities to set rates for the use of municipal services. However, similar to the setting of rates for property above, the exercise of this discretion is regulated under national legislation. To begin with, the Minister of Finance is allowed to prescribe compulsory norms and standards for imposing municipal surcharges including: setting the maximum municipal surcharges that may be imposed; determining the basis upon and the intervals at which municipal surcharges may be increased; and determining matters that must be assessed and considered by municipalities in imposing surcharges.[284]

[275] MPRA, s 3(3)(*a*) & (*b*) as read with s 15.
[276] MPRA, s 22(1).
[277] MPRA, s 3(5).
[278] MPRA, s 3(3)(*b*)(iv).
[279] MPRA, s 12(2).
[280] MPRA, s 20(1) & s 83.
[281] MPRA, s 82(1).
[282] Tariff refers to 'a table of charges for items and services'. See, Steytler & De Visser (2016) 9-19.
[283] Systems Act, s 74(1).
[284] MFPFA, s 8(1) & 8(2)(*c*) & (*d*).

Municipalities are obligated to comply with these norms unless exempted by the Minister of Finance.[285] Moreover, the Minister for Water Affairs and Forestry is allowed to prescribe norms and standards in respect of tariffs for water services.[286] Such norms and standards may, among other things: place limitations on surplus or profit; place limitation on the use of income generated by the recovery of charges; and provide for tariffs to be used to promote or achieve water conservation.[287]

From the foregoing, it is apparent that although municipalities are accorded discretion in the setting of applicable rates, this power is highly regulated by national legislation, thus leaving little wiggle room for the variation of applicable rates in line with the quality and demand for municipal services.[288] This further impacts on service delivery and accountability, as municipalities are not free to vary tariffs based on cost considerations, which potentially creates a fiscal illusion as to the actual cost of service provision, thereby disincentivising communal demands for accountability.[289] However, some of these regulations have not been implemented thereby allowing municipalities some autonomy in regulating the applicable rates.[290] Nevertheless, the determination of whether such regulation goes against the margin of autonomy envisioned by the Constitution, hence crossing the permissible boundaries of regulatory legislation, is something to be determined based on the impact of individual regulations on the exercise of municipal powers and performance of their functions, with the Constitutional Court having the final say.[291]

Of importance, however, is the requirement that municipalities exercise their taxation powers in a way that does not materially and unreasonably prejudice national economic policies,

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285 MFPFA, s 9(1).
286 Water Services Act, s 10(1).
287 Water Services Act, s 10(2).
288 Liebig K *et al*, *Municipal borrowing for infrastructure service delivery in South Africa: A critical review* (2008) 80 available at *http://se1.isn.ch/serviceengine/Files/ISN/95842/ipublicationdocument_singledocument/1F872596-3E54-4770-92CD-B60BA5182044/en/Study+34e.pdf* (accessed 20 April 2020).
289 Liebig K *et al* (2008) 80.
290 Khumalo, Dawood & Mahabir (2015) 207.
291 Steytler & De Visser (2016) 13-26 as read with 5-27.

economic activities across municipal boundaries, or the national mobility of goods, services, capital or labour.[292] This is key in ensuring compliance with the principles of cooperative government upon which South Africa's intergovernmental fiscal system is built.

Substantively, and notwithstanding the regulations highlighted above, municipalities have access to relatively broader tax bases and are largely self-financing given that they raise, on average, about 70 per cent of their revenue from their own sources.[293] However, while metropolitan municipalities and some large cities are able to finance over 90 per cent of their budgets from their own sources, the situation varies when it comes to other municipalities with rural municipalities in relatively poor areas, raising a measly 10 per cent or even less.[294] This is because of 'disparities in population size, income distribution and varying degrees in levels of urbanisation and administrative capacity'.[295] Notwithstanding the variations, municipalities generally enjoy relative financial autonomy, which in turn allows them a wide berth of discretion in delivering on their constitutional mandates.[296]

The bulk of municipal own revenues is drawn from 'services fees (mainly electricity, water, sanitation and waste removal) and surcharges on such fees' (jointly contributing 41 per cent) as well as from property rates (which accounts for 15 per cent of the revenue).[297] Metros and large cities, however, raise more than rural municipalities, whose prospects for service fees are limited and who either have small property tax bases or are in charge of communal land over which they cannot impose taxes.[298] Such rural municipalities, moreover, lack the administrative and technical capacity to undertake functions such as 'updating valuation, conducting land/property assessments and valuation of land improvements', which directly

[292] Constitution (1996), s 229(2).
[293] National Treasury (2019) 67; Steytler & Ayele (2018) 302; Heymans (2006) 67.
[294] Liebig K *et al* (2008) 72; Heymans (2006) 68; Steytler & Ayele (2018) 303.
[295] Amusa H, Mabunda R & Mabugu R 'Fiscal illusion at the local sphere: An empirical test of the flypaper effect using South African municipal data' (2008) 76 *South African Journal of Economics* 444.
[296] Steytler & De Visser (2016) 12-3.
[297] Steytler & Ayele (2018) 302.
[298] Steytler & Ayele (2018) 302; Khumalo, Dawood & Mahabir (2015) 209.

impacts on the amount of revenue they are able to collect from property rates.[299] The low levels of own revenue collected therefore constrain the ability of these municipalities to deliver services, with the effect that the viability of some of them has been a major concern.[300] This has translated into heavy reliance by these municipalities on national transfers and grants.[301]

Although municipalities are allowed to apply to the Minister of Finance for authorisation to impose a new municipal tax, this option adopts a prohibitive structure. For instance, when seeking to impose a new municipal tax, municipalities are required to provide an extensive list of particulars in their application including particulars of consultations with provincial governments, organised local government and other municipalities before the application is considered by the Minister.[302] Moreover, unlike the situation with a new provincial tax, the Minister's discretion in respect of proposed municipal taxes is unrestrained, and is only subjected to whether he or she intends to authorise the tax or not.[303] Other than the requirement for municipalities to be given reasons for the Minister's decision, municipalities have no recourse or avenue to challenge the Minister's decision should their application be declined.[304]

Consequently, this option has not been effectively utilised. Only two applications are reported to have been received, one for the imposition of a rural development levy, and the other for the imposition of a local business tax by metros.[305] The latter proposal, although given a green light by the FFC, was not approved by the Minister, on the pretext of the adverse economic

[299] Amusa & Mathane (2007) 279.
[300] Brand D *Local Government Finance: A Comparative Study* (2016) 4; Amusa, Mabunda & Mabugu (2008) 450.
[301] Brand (2016) 140.
[302] MFPFA, s 5.
[303] MFPFA, s 5(2).
[304] MFPFA, s 5(3).
[305] Stevens (2019) 12.

environment at the time.[306] Although its implementation was not ruled out either, this tax is yet to be considered on its merits and/or been implemented.[307]

2.2.2.2 Municipal revenue administration

Municipalities have the power to administer taxes from their own revenue sources, and undertake this exercise in practice.[308] In this respect, a municipality is required to exercise its legislative and/or executive authority by, among other things, imposing and recovering rates, taxes, levies, duties, service fees and surcharges on fees, including setting and implementing credit control and debt collection policies.[309] However, although municipalities are allowed to specify the tax collecting authority for a new municipal tax, when making an application to impose the tax the law allows the Minister of finance to designate a different collecting agent when approving the proposals for new municipal taxes.[310] Although this has yet to take place in practice, its operation would limit the level of revenue autonomy municipalities may draw from the imposition of such taxes as they lack control over the revenue effort employed by such designated collection agent.

Additionally, municipalities are allowed to enforce the payment of municipal taxes and fees. In this regard, a municipality is allowed to: restrict the provision of or terminate municipal services; seize property; and attach money due from an agent or rent payable on a property or extend the liability to a director, trustee or a member if the debtor is a company, trust or a close corporation.[311] Municipalities may also impose higher tariffs or require the payment of reconnection fees after disconnection of water services.[312] These powers of enforcement are

[306] Stevens (2019) 12.
[307] Stevens (2019) 52.
[308] MFPFA, s 7
[309] Systems Act, s 11(3)(i) as read with s 96 & s 98(1)
[310] MFPFA, s 5 (1)(*f*) & s 6(*b*)(ii) as read with s 7.
[311] Systems Act, s 104(1)(*f*); MPRA, s 28(1) & (2) & s 29; Water Services Act, s 11(2)(*g*) as read with s 21(2)(*b*).
[312] Water Services Act, s 21(2)(*c*) & (*d*).

critical for the effective exercise of the municipal powers of administration and serve to enhance the revenue autonomy of municipalities.

Notwithstanding, municipalities are guilty of conduct that defeats their own quest for revenue autonomy. For instance, the phenomenon of large accumulated debt arrears is predominant in most municipalities.[313] For the 2017/18 financial year, for example, 'almost half of the municipalities collected less than 80% of their billed revenue'.[314] This is due to factors such as the lack of appropriate policy frameworks aimed at addressing debt collection; poor administrative capacity to enforce payments; as well as the political imperative not to enforce the payment of taxes against poor households.[315] The result has been low revenue collections, which diminish the revenue autonomy of municipalities and their ability to provide basic services.

2.2.2.3 Intergovernmental transfers and grants to municipalities

South African municipalities are less grant-dependent than those in most other developing countries.[316] Of the three spheres of government, municipalities receive the least share out of the vertical division of nationally raised revenue.[317] For instance, in the five financial years between 2015/2016 – 2019/2020, the local sphere of government received an average of 4 per cent of revenue raised nationally, while provinces and the national government received an average of 31 per cent and 65 per cent, respectively.[318] As noted above, while a few

[313] Amusa & Mathane (2007) 288.
[314] National Treasury (2019) 67.
[315] Amusa & Mathane (2007) 288.
[316] Heymans (2006) 85.
[317] National Treasury (2019) 67.
[318] Calculations based on the amounts allocated under Schedule 1 of the division of revenue Acts of these financial years. The percentage indicated for the national government is before the deduction of grants, general fuel levy sharing with metros, debt-service costs and the contingency reserve. Note however that the National Treasury, in its annual Budget Reviews for the relevant years, reports an average of 9 per cent as the outcome of nationally raised revenue allocated to the local sphere (which figure includes grants). See, National Treasury (2016) iv; National Treasury (2017) iv; National Treasury (2018) iv; National Treasury (2019) iv; National Treasury (2020) iv.

municipalities, mostly metros and some large cities, are largely self-sustaining and rely on own sources for their revenue needs,[319] most rural municipalities rely almost entirely on intergovernmental transfers and grants to facilitate the provision of basic municipal services.[320] It is with the latter in mind, therefore, that the Constitution entitles municipalities to an annual equitable share of revenue raised nationally (local government equitable share (LGES)) in order to guarantee the provision of basic services and the performance of constitutionally allocated functions.[321] Municipalities are, moreover, allowed to receive other allocations from national government revenue, either conditionally or unconditionally.[322]

The LGES and other allocations are required to be provided for in the annual DORA enacted at the national level.[323] Of interest for this section, therefore, is the extent to which the revenue division process that culminates in the annual DORA is inclusive, transparent and objective and whether transfers from revenue raised nationally are unconditional so as to afford fiscal autonomy to municipalities.

In terms of the transparency and objectivity of the vertical division of revenue, the same process discussed above, under provinces, is used in the enactment of the DORA. Of note is the fact that organised local government (represented by the South African Local Government Association (SALGA)) is consulted, and the list of section 214(2) factors provided under the Constitution utilised for the vertical division of revenue.[324] However, although SALGA is 'consulted' in the enactment of the DORA, its ability to influence the process is not guaranteed. As discussed above, the outcomes of intergovernmental negotiations only constitute non-binding recommendations that are subject to the discretion of the national executive.[325] Similarly, as with provinces, the NCOP's mandate of protecting the interests of local governments during the enactment of the DORA is hindered by the lack of objective

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[319] National Treasury (2020) 35.
[320] Heymans (2006) 73 & 85; Steytler & De Visser (2016) 12-5; National Treasury (2020) 35.
[321] Constitution (1996), s 227(1)(a).
[322] Constitution (1996), s 227(1)(b).
[323] Constitution (1996), s 214(1)(a) & (c).
[324] Constitution (1996), s 214(2).
[325] Van Zyl & Walker (1999) 244-245.

measures for ensuring that the vertical revenue split is equitable, thus leaving the process entirely at the discretion of the national executive.[326] The horizontal revenue split therefore becomes the only remaining source of objectivity and transparency for transfers.

Unlike the situation with provinces, the Constitution does not specifically require the DORA to provide for the horizontal division of revenue among municipalities.[327] In practice, however, this is provided for under the annual DORA.[328] To facilitate objectivity in the process, a formula[329] based on municipal demographics as well as other objectively determined data[330] is used to determine the equitable revenue share due to each municipality. It suffices to say, therefore, that the horizontal division of revenue among municipalities is done transparently and objectively, thus allowing the funds to extend a level of fiscal autonomy to local governments.

The DORA has been critical in ensuring predictability and certainty with respect to levels of allocations to municipalities.[331] This is achieved by providing a three-year projection of allocations, which helps municipalities make medium term multi-year budgetary plans. Although the projections are subject to the annual DORA, they are an important source of expenditure autonomy for municipalities to the extent that they allow room for longer-term planning. Such autonomy is enhanced by the fact that municipalities are guaranteed to receive at least 90 per cent of the amount of such indicative allocations for the second year.[332] The annual allocations in the DORA, moreover, come with a guarantee that the amount of funds

[326] Wehner (2000) 64; Watts (2005) 44.
[327] Constitution (1996), s 214(1) & Fiscal Relations Act, s 10.
[328] See generally, the Division of Revenue Acts for the years 2015-2019.
[329] National Treasury, 'Explanatory memorandum to the division of revenue' in National Treasury *Budget Review* (2013) 36. The formula has three parts made up of five components. The parts include: *a basic services component* (providing for the cost of free basic services for poor households); *an administration and governance capacity component* (enables municipalities with limited OSR to afford this cost and is made up three further components – an institutional component, a community services component and a revenue adjustment factor); and *a correction and stabilisation factor* (that provides predictability and stability).
[330] See generally, Financial & Fiscal Commission & South African Local Governments Association, *Costing of Municipal Services to Inform DORA Allocations* (2013).
[331] Steytler & De Visser (2016) 12-8.
[332] National Treasury (2020) 42.

allocated in the respective financial year will be disbursed to municipalities regardless of revenue shortfalls that may be experienced in actual revenue receipts, as the national government bears the burden for these shortfalls.[333] Each municipality's share is moreover required to be disbursed to it by the National Treasury in keeping with a pre-determined regular payment schedule, which enhances the planning discretion of municipalities.[334]

Although section 226(3) of the Constitution envisages the allocation of the LGES and other allocations from the national government through provinces, the annual DORA requires that the national government transfers the LGES directly to a municipality's primary account in accordance with the disbursement schedule.[335] This therefore leaves allocations as possible candidates for transfer to municipalities through provinces. The direct transfer helps reduce administrative bureaucracies, thus extending more room for the exercise of expenditure autonomy by municipalities.

The ability of the unconditional LGES to accord expenditure discretion to municipalities is affected at various levels. For a start, the Minister for Local Government is allowed to make regulations and issue guidelines on the use of the unconditional LGES to subsidise municipal tariffs for poor households, a factor that has compelled municipalities to develop indigency policies.[336] While this may be appropriate in the case of conditional grants, the imposition of these regulations or guidelines on unconditional transfers, though lawful, inhibits municipal discretion in the use of the LGES. Additionally, municipalities are under an obligation to provide free basic services to all members of the local community.[337] This, when coupled with the national government's Free Basic Services policy that stipulates standards for free basic services, compels municipalities to provide free basic water, electricity, sanitation and refuse

[333] Steytler & De Visser (2016) 12-8.
[334] Steytler & De Visser (2016) 12-8
[335] See, s 5(3) of the annual DORAs from 2015-2019. However, until 1997, provinces used to channel most transfers to municipalities (See, Financial & Fiscal Commission *a Costed Norms Approach* (2000) 89)
[336] Systems Act, s 86A(1)(*b*).
[337] Systems Act, s 73(*c*).

removal.[338] The consequence has been that a substantial amount of municipal expenditure from the LGES is spoken for, thus restricting municipal discretion.

Moreover, the national government has also been accused of imposing additional unnecessary processes (red tape) in the administration of intergovernmental transfers. These processes often stand in the way of timely disbursement of funds to municipalities.[339] Delays occasioned as a result of this hinder municipal expenditure discretion as municipalities are unable to plan to incur expenses as and when needed.

With respect to additional allocations from the national government, the national government is reported to have shown a preference for conditional grants relative to unconditional ones.[340] The former have been accused of being: often *ad hoc* and with unpredictable lifespans, hence being detrimental to long-term municipal planning;[341] project-focused, hence lacking regard for sustainability considerations such as responsibility for infrastructural maintenance;[342] not adequately consultative and poorly coordinated, hence failing to follow relevant municipal plans[343] as well as being administratively, and often financially, burdensome on implementing municipalities.[344] All these characterisations, when coupled with the emergence of so-called indirect conditional grants that allow the national

338 Tissington K *Targeting the Poor? An Analysis of Free Basic Services (FBS) and Municipal Indigent Policies in South Africa* (2016) 15.
339 City of Tshwane 'The interrogation of the division of revenue: A specific focus on enhancing local government's capacity to deliver (Summary)' (2015), 8 available at *http://www.tshwane.gov.za/sites/Council/Ofiice-Of-The-Executive-Mayor/EI/Documents/The interrogation of the Division of Revenue A Specific.pdf* (accessed 11 November 2019).
340 Amusa & Mathane (2007) 281; City of Tshwane (2015) 6. While there are several infrastructure-focused conditional grants, only two unconditional grants are provided: the RSC levies replacement grant and a grant for special support for councillor remuneration and ward committees. See, National Treasury (2020) 42.
341 Amusa & Mathane (2007) 281; City of Tshwane (2015) 5.
342 Heymans (2006) 89-90.
343 Heymans (2006) 90; City of Tshwane (2015) 8.
344 Amusa & Mathane (2007) 281.

sphere to spend funds on behalf of a struggling municipality,[345] lend credence to the view that conditional grants are increasingly furthering 'centralization by stealth'.[346]

However, indirect conditional grants are used to fund municipal infrastructural development given the poor historical performance of municipalities in infrastructural development, and on behalf of those municipalities lacking in capacity.[347] While this justifies their use, such an approach to addressing poor performance and capacity issues weakens local accountability and risks poor maintenance budgeting.[348] The need for differentiation in municipal funding has, however, led to the introduction of some grants that allow for increased municipal discretion.[349]

Although literature suggests that transfers create fiscal illusions at the local level which then result in increased and/or more wasteful expenditure than would have been experienced had the subnational revenue been drawn from OSR (the flypaper effect), contrary results were obtained from an empirical study conducted on South African municipalities. The study concluded that subnational revenue drawn from OSR 'have higher (and positive) marginal effects on local government expenditure' compared to revenues emanating from transfers.[350] Under the study,

> a marginal 1% increase in collections from own revenue sources increases local government spending by 0.89%. On the other hand, an extra 1% increase in LES [local equitable share] allocations to municipalities increases local government expenditures by a mere 0.05%.[351]

The authors argue that their finding of a negative correlation between transfers and subnational expenditure compared to OSR 'perhaps captures the 'accountability' obligation

[345] Steytler & Ayele (2018) 303.
[346] Heymans (2006) 89.
[347] Mtantato & Peters (2015) 61.
[348] Mtantato & Peters (2015) 61.
[349] National Treasury, 'Explanatory memorandum to the division of revenue' in National Treasury *Budget Review* (2019) 7-8.
[350] Amusa, Mabunda & Mabugu (2008) 458-460.
[351] Amusa, Mabunda & Mabugu (2008) 458.

of local government authorities'.[352] Essentially, the argument is that the more OSR collected, the more subnational authorities feel (or are made to feel) the obligation to account or demonstrate to local communities that their taxes are being utilised effectively by increasing municipal expenditure.[353] However, the study focuses on the quantitative aspect of the impact and does not undertake a qualitative analysis of the impact so as to assess the impact on wastefulness.

Another theoretical position with respect to subnational reliance on transfers is that it crowds out (diminishes) subnational own revenue by reducing municipal fiscal effort or substituting OSR.[354] Contrary to this, a study by Shai[355] as well as a report from the FFC[356] found that increased transfers (LGES) to local municipalities led to an increase in revenues drawn from property rates.[357] This was linked to the likelihood that the municipalities used the LGES to improve their capacity to bill and collect OSR.[358] However, a later report from the National Treasury indicated that a rapid growth in transfers between 2007 and 2010 may have unintentionally occasioned a reduction in municipal revenue efforts and disincentivised creditworthy municipalities from borrowing to finance their long term expenses, hence having a 'muting' effect on local accountability.[359] The overall impact of subnational reliance on transfers is therefore mixed.

2.2.3 Municipal budgetary autonomy

Municipalities are generally required to maintain a balanced budget and are not allowed to plan for deficits. They are, however, allowed to raise loans for both capital and current

[352] Amusa, Mabunda & Mabugu (2008) 458.
[353] Amusa, Mabunda & Mabugu (2008) 458.
[354] Shai L 'The effect of the local government equitable share on own revenue generation in South African municipalities' (2017), 2 available at https://2017.essa.org.za/fullpaper/essa_3514.pdf (accessed 11 November 2019).
[355] Shai (2017) 2.
[356] FFC (2018) 80-85.
[357] Shai (2017) 4 & 12.
[358] Shai (2017) 4.
[359] National Treasury *The State of Local Government Finances and Financial Management as at 30 June 2018: Fourth Quarter of the 2017/18 Financial Year* (2018) 7.

expenditure.[360] However, loans for current expenditure are required to be raised during a fiscal year (short-term)[361] and only when necessary for bridging purposes.[362] Such short-term loans are required to bridge shortfalls or capital needs within the financial year and may be taken only when a municipality expects to receive specific realistic income within that financial year, or specific funds from enforceable allocations, or long-term debt commitments that will enable it to repay the loans.[363] Pegging municipal access to debt on municipal income, however, limits the ease of access to debt to those municipalities with wider tax bases and consistent own sources of revenue, compared to most rural municipalities that can only use allocations to access loans.

In addition to short-term borrowing, municipalities are also allowed to incur long-term debt.[364] This is, however, only allowed for the purpose of financing capital expenditure or re-financing existing long-term debt.[365] However, national and provincial governments are generally prohibited from guaranteeing municipal debt, hence municipalities are required to fully shoulder the burden of their own debt repayment.[366] Municipalities are also obligated to invite written comments or representations from the Treasury prior to incurring any long-term debt, which impacts on the exercise of their budgetary autonomy.[367]

In practice, South Africa has had a long tradition of municipal borrowing, hence its municipal borrowing market is more developed compared to other middle-income countries.[368] Given their broad own tax bases and access to assets that can be used as security for loans, municipalities have relatively greater discretion to employ debt in financing their

360 Constitution (1996), s 230A (1)(*a*).
361 Short-term debts are required to be paid within the financial year and municipalities are prohibited from renewing or refinancing such debts if it will result in the extension of the debt period beyond the relevant financial year. See, MFMA, s 45(4).
362 Constitution (1996), s 230A(1)(*a*).
363 MFMA, s 45(1).
364 MFMA, s 46(1).
365 MFMA, s 46(1).
366 MFMA, s 51.
367 MFMA, s 46(3)(*a*)(ii).
368 Liebig K *et al* (2008) 1 & 74.

expenditure.[369] This includes taking loans from government as well as private institutions, and extends to the floating of bonds in the capital markets.[370] Municipalities have generally exploited their power to borrow to finance a substantial portion of their capital budget.[371] For instance, in the ten years between 2009-2019, 18 per cent of the municipal capital budget was drawn from borrowing.[372]

The scope of borrowing, however, varies across the various types of municipalities, with metros and large urban cities having more access to the debt market than rural municipalities.[373] This is linked to the fact that metros and large cities are considered more creditworthy, and have credit ratings from rating agencies based on the fact that they have broader tax bases from which they are able to raise regular and sufficient own revenue to service their loans.[374] These categories of municipalities also attract better staff and have better financial management as well as technical project implementation capabilities compared to other categories, which enhances their creditworthiness.[375] Although the law restricts the national government from issuing guarantees for municipal debt, metros and large cities are argued as enjoying implicit guarantees and bail-out exceptions, due to their being perceived as being too big to fail.[376] This gives them an added advantage in exercising their discretion to borrow.

Consequently, only large metros such as Johannesburg, Ekurhuleni, Cape Town and eThekwini have been able to successfully issue municipal bonds in the capital markets for the financing of their capital projects.[377] Other municipalities have been hesitant to take up debt instruments from the capital markets due to costs involved. More innovative approaches to

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369 Khumalo, Dawood & Mahabir (2015) 210.
370 Kaburu (2013) 102.
371 Kaburu (2013) 102.
372 National Treasury *Municipal Borrowing Bulletin* (2019) 2.
373 Steytler & Ayele (2018) 325; Liebig et al (2008) 2.
374 Steytler & Ayele (2018) 325; Liebig et al (2008) 74; Heymans (2006) 85.
375 Liebig K *et al* (2008) 5.
376 Liebig K *et al* (2008) 5.
377 Steytler & Ayele (2018) 303; Kaburu (2013) 102; Liebig K *et al* (2008) 84-85.

municipal bonds, such as bond pooling, retail bonds and revenue bonds, have been proposed as a way to encourage the expansion of the municipal bond market so as to allow more room for municipalities to exercise their discretion to borrow.[378]

2.2.4 How the legal framework ensures accountable municipal fiscal autonomy

Given the expanded space for the exercise of fiscal autonomy by municipalities, the legal framework puts in place measures aimed at guaranteeing expenditure control, transparency and accountability in its exercise. This section looks at internal controls that are built into the intergovernmental fiscal system to regulate the exercise of municipal fiscal autonomy, as well as controls imposed through the supervision of the national and provincial spheres of government.

2.2.4.1 Internal systemic controls

A number of legislative measures have been adopted to guide the exercise of fiscal autonomy at the municipal level. These are aimed at facilitating fiscal responsibility, prudence and accountability in the exercise of municipal fiscal autonomy, without intrusion from other spheres of government. The measures cover the three facets of fiscal autonomy discussed herein, and are spread out across the planning and formulation, approval, execution and oversight (including audit and reporting) stages of the municipal budget process.[379] This section discusses the measures under three classifications: regulation by providing guiding principles and specifying procedures to be followed; accountability through the requirement for communal participation as well as those measures adopted to secure municipal self-regulation and accountability to the municipal council.

[378] Liebig K *et al* (2008) 6 & 8.
[379] Khumalo, Dawood & Mahabir (2015) 218.

2.2.4.1.1. **Regulation by providing guiding principles and specifying procedures**

National and provincial legislation as well as regulations made under them establish general principles and guidelines which, while governing the exercise of local fiscal autonomy with a view to ensuring its accountable exercise, do not encroach on its exercise. For instance, in terms of providing procedural guidelines, municipalities are required when tabling budgets, to ensure they provide alongside the budget: a draft resolution imposing municipal taxes and setting tariffs; a projection of cash flow per revenue source; particulars of municipal investments, among other particulars. This is critical in ensuring that municipal budgets are backed with proof of availability of funds to cater for it hence being balanced.[380]

Additionally, in the exercise of municipal discretion to levy fees for municipal services, the Systems Act sets out a list of basic principles that such a municipal tariff policy should reflect. The amount charged is, among other things, required to generally be in proportion to the users' use of the municipal service and be set such as to reflect the costs reasonably associated with the rendering of the service with an allowance being made for the imposition of a surcharge on the tariff.[381]

Also, when considering giving exemptions, rebates, reductions and exclusions in their rates policies, municipalities are required to identify and quantify, in terms of cost to the municipality and any benefits that they will confer to the local community.[382] This is key in ensuring that such exercise of municipal discretion is justified and not used for ulterior motives or with the intention of defeating accountability.

Moreover, guidance is provided as to which persons are authorised to withdraw municipal funds (including the manner of authorization) and the purposes for which such funds may be

[380] MFMA, s 17 (3).
[381] Systems Act, s 74(2).
[382] MPRA, s 3(3)(*e*).

withdrawn.[383] Timelines are also set within which a municipal manager is required to provide a consolidated report to the municipal council detailing all withdrawals made.[384] This goes a long way in maintaining control over and ensuring accountability for the use of municipal funds.

2.2.4.1.2. Accountability through the requirement for community participation

Community participation is used as tool to regulate the exercise of municipal discretion at the planning and formulation, execution and oversight stages of the budget process thus covering the exercise of expenditure, revenue and budgetary autonomy of municipalities.

With regard to municipal expenditure autonomy, members of the local community are granted the right and the council of a municipality required to consult and encourage the involvement of the local community in decision-making regarding the level, quality, range and impact of municipal services, the available options for service delivery as well as in the monitoring and review of municipal performance.[385] In this regard, the municipal administration is required to provide full and accurate information to the local community regarding the level and standard of municipal services they are entitled to receive, the costs involved, their rights and duties as well as the available mechanisms of community participation.[386] A municipality is further required to maintain and place specified municipal documents on its website within five days of their tabling in the council.[387] In return, the local community has the right to submit oral or written complaints to the council or to another political structure or office-bearer and to receive prompt responses to them.[388] This therefore

[383] MFMA, s 11.
[384] MFMA, s 11 (4).
[385] Systems Act, s 5(1) as read with ss 4(2) & 16(1).
[386] Systems Act, s 6(2)(*e*) & (*f*) as read with ss 18 & 95.
[387] Systems Act, s 21*A* as read with MFMA, s 75.
[388] Systems Act, s 5(1).

ensures a continuous system of communication and feedback that is key in facilitating fiscal prudence and accountability to local communities.

To ensure that communities are consulted in municipal planning, municipalities are required, when submitting a copy of their adopted IDPs to the MEC for local government, to provide a summary of the process followed and a statement that the required process, which includes community participation, has been complied with.[389] Where this has not been done, the MEC is mandated to request the relevant municipal council to comply and make consequential adjustments to the IDP.[390] This therefore adds a layer of oversight above the municipality that secures consistent communal participation.

With respect to the exercise of municipal revenue and budgetary autonomy, a municipality is required to consult the local community before: the adoption or amendment of its rates policy; the classification of an area as a special rating area and before incurring a long-term debt.[391] This is crucial for ensuring accountability while at the same time fostering the autonomy of municipalities as participation holds the potential to ease the payment of ensuing tax obligations.

Lastly, with respect to municipal oversight, the meetings of a municipal council discussing the municipality's annual report are required to be open to the public and the council is required to allow a reasonable time for members of the local community to address the council and for any written submissions received from the local community to be discussed.[392] This gives room for local communities to be involved in what is otherwise the last stage of the internal accountability processes at the municipal level. Community participation at this stage, therefore, ensures that municipalities are accountable for the nature and level of services actually delivered or reported to have been delivered.

[389] Systems Act, s 32(1)(*a*) &(*b*).
[390] Systems Act, s 32(2).
[391] MPRA, s 4 (1) as read with s 5(2); MPRA, s 22(2) & MFMA, s 46(3)(*a*)(ii).
[392] MFMA, s 130.

2.2.4.1.3. **Municipal self-regulation and accountability to the municipal council**

Municipalities bear the primary duty to avoid, identify and solve their financial problems.[393] To facilitate this, the law assigns primary accounting responsibilities to the municipal manager, requires the establishment of internal municipal oversight units/committees, and further requires annual auditing, reporting and oversight by municipal councils. This is aimed at creating a self-regulating system at the municipal level that ensures fiscal prudence and accountability.

In this respect, a municipal manager (who serves as a municipality's accounting officer) is generally tasked with the implementation of a municipality's approved budget, which includes all aspects of revenue, expenditure and budgetary adjustments.[394] In this regard, he or she is required to ensure that the municipality has and maintains an effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds.[395] He or she is, moreover, required to ensure that the municipality has and maintains a management, accounting and information system which recognises expenditure when it is incurred, and accounts for payments made.[396]

In addition, municipalities are required to establish internal audit units which are in charge of internal audit plans, programs and controls as well as advising the municipal manager, and are required to report to an audit committee.[397] Municipalities are also required to have audit committees which are independent advisory bodies tasked with advising the municipal council, political office-bearers, the municipal manager and management staff of the municipality on matters relating to internal financial controls and internal audits, among other

[393] MFMA, s 135.
[394] MFMA, s 69.
[395] MFMA, s 65(2)(*a*).
[396] MFMA, s 65(2)(*b*).
[397] MFMA, s 165.

functions.[398] Audit committees are also required to respond to the municipal council on any issues raised by the Auditor-General in the municipality's audit report, and to carry out such investigations into the financial affairs of the municipality as the council may request.[399]

Municipalities are further required to prepare annual reports for each financial year and table them in the municipal council.[400] The report provides a record of municipal activities and its performance against the budget for the financial year, and is aimed at promoting accountability to the local community for decisions made throughout the year by the municipality.[401] The report includes particulars of any corrective action taken or proposed to be taken in response to issues raised in the audit reports.[402] The council of a municipality is required to consider the report and adopt an oversight report containing the council's comments on the annual report.[403] These serve as critical accountability tools.

In addition, municipalities are required to monitor, measure and review their performance annually, which must then be audited internally.[404]

All the measures above are undertaken with the aim of facilitating expenditure control and accountability, while respecting the right of municipalities to exercise their fiscal autonomy. External systems of fiscal control therefore come into play only where the above systems of internal control have failed.

2.2.4.2. **External fiscal controls: National and provincial oversight over the exercise of municipal fiscal autonomy**

Despite the elaborate constitutional and legislative framework for ensuring internal systemic controls, discussed above, the internal financial controls and accountability mechanisms of

398 MFMA, s 166(2).
399 MFMA, s 166(2).
400 Systems Act, s 46.
401 MFMA, s 121(2).
402 MFMA, s 121(3).
403 MFMA, s 129(1).
404 MFMA, s 71(1).

municipalities have often proven to be weak thus resulting in irregular, unauthorised and wasteful expenditure as well as rampant corruption.[405] As a result, the national Department for Cooperative Governance and Traditional Affairs (COGTA) is reported to have stated that, while a third of municipalities are functional, a third are dysfunctional, while the remaining one-third are at the risk of being dysfunctional.[406] This makes supervision by 'higher' spheres of government, though potentially intrusive on municipal fiscal autonomy, a necessary balancing tool in instances where municipal functioning becomes 'deficient or defective in a manner that compromises' such autonomy.[407] This, as discussed above under provinces, often comes in the form of either legal regulation, monitoring, support and/or intervention (which is the most intrusive).[408] Such supervision, however, is subject to the cooperative governance principles set out under section 41(1)(e) – (h) of the Constitution that underscore the need to respect the distinctiveness of the spheres of government.

Generally, however, municipalities tend to be subject to more intrusive and more frequent interventions than provinces, as a result of high levels of financial mismanagement.[409] As of June 2019, a total of 140 interventions had been attempted by provinces with 48 of these being in respect of repeat offenders (municipalities that had previously undergone more than one intervention).[410] Although 15 of these were set aside,[411] the remaining 125 interventions

[405] Khumalo, Dawood & Mahabir (2015) 220; Steytler & Ayele (2018) 305. See also, Auditor-General of South Africa *Auditor-general releases municipal audit results under the theme - 'not much to go around, yet not the right hands at the till'* (2020); Auditor-General of South Africa *Auditor-general flags lack of accountability as the major cause of poor local government audit results* (2019).
[406] FFC (2016) 1; See also, Steytler & Ayele (2018) 304.
[407] Mathenjwa M 'Contemporary trends in provincial government supervision of local government in South Africa' (2014) 18 *Law, Democracy and Development* 179 & 183; Steytler & Ayele (2018) 306 & 326; *First Certification Judgment,* para 373.
[408] Steytler & Ayele (2018) 326.
[409] Steytler (2015) 319.
[410] Ledger T & Rampedi M, *Mind the Gap: Section 139 Interventions in Theory and in Practice* (2019) 7; See also, Van der Waldt & Greffrath (2016) 160; November J *The Role of Provinces in the Use of Interventions in Terms of Section 139(1)(a)-(c) of the Constitution* (unpublished MPhil thesis, University of the Western Cape, 2015) 33; National Treasury *The State of Local Government Finances* (2018) 50.
[411] Ledger & Rampedi, (2019) 7; This was done 'either during the oversight process, or by mutual agreement between province and the municipality, or by a court order'.

that proceeded are indicative of the deteriorated levels of fiscal prudence at the municipal level, which necessitate external fiscal controls.

This section, therefore, discusses provincial and national oversight over municipalities, with a focus on aspects that hold the potential for intrusion as well as those that actually intrude into municipal fiscal autonomy.

2.2.4.2.1. **Provincial oversight over municipalities**

Provinces bear the primary responsibility for the general supervision of municipalities.[412] Although the National Treasury is generally in charge of enforcing compliance with measures aimed at facilitating transparency and expenditure control in terms of municipal financial management, provincial treasuries are enjoined to assist in this.[413] In this regard, provincial treasuries are required to monitor municipal compliance with financial management laws and are allowed to take appropriate steps whenever a municipality is in breach.[414] This subsection discusses an aspect of provincial monitoring, as well as provincial interventions in municipalities.

While provincial monitoring usually involves the largely innocuous power to observe and to keep municipal functioning under review,[415] section 106 of the Systems Act makes provision for a more intrusive form of monitoring.[416] In this regard, the MEC for local government is allowed to designate a person or a commission of inquiry to initiate investigations into a municipality where he or she has reason to believe that the municipality is not fulfilling or is unable to fulfil a binding statutory obligation, or that maladministration, fraud, corruption or any other serious malpractice has occurred or is occurring in the municipality.[417] The conduct

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[412] Steytler & De Visser (2016) 15-7; Constitution (1996), s 155(6) and Systems Act, s 105(1).
[413] Constitution (1996), s 216 (1) & (2) as read with MFMA, s 5(3)(c).
[414] MFMA, s 5(4).
[415] Mathenjwa (2014) 181.
[416] Steytler & De Visser (2016) 15-11; Mettler J 'Provincial-municipal relations: A few challenges' (2000) *Law Democracy and Development* 220.
[417] Systems Act, s 106; Steytler & De Visser (2016) 15-14.

of such investigations therefore intrudes into the fiscal space of municipalities, given that some investigations impose additional reporting obligations or require the halting of municipal expenditure decision-making and/or discretion in the affected areas.

However, in a bid to protect municipalities from any potential abuse of this provincial mandate, the Act requires 'reasonable belief' as a jurisdictional fact, and the courts have held that such belief ought to be objectively determined[418] and that municipalities are still availed of the constitutional protection of their autonomy during the process.[419] Moreover, section 106(3)(a) of the Systems Act requires the MEC to notify the NCOP and to motivate the basis for such investigation. Although the NCOP does not have specific powers to halt such investigation, this obligation goes a long way in ensuring a measure of objectivity in the use of this power, thus providing a mild safeguard against its abuse.

Nonetheless, there are cases where this aspect of monitoring is reported to have been abused by some provinces as a pretext to intervene into, for instance, Langeberg and Mquma municipalities, thereby necessitating the involvement of the courts to put an end to these interventions.[420] A similar situation occurred in the Abaqulusi municipality, where the provincial government of KwaZulu-Natal used a commission of inquiry as a smoke-screen to hide its intention of dissolving the municipality's council.[421] The province proceeded to intervene, contrary to the recommendation of its own commission.[422] This highlights the potential for abuse held by this form of monitoring.

Flowing from the above is a province's power of intervention, which is entrenched under section 139 of the Constitution and which constitutes the most intrusive form of supervision. Three forms of interventions are envisioned in terms of the Constitution, one of which is

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[418] Steytler & De Visser (2016) 15-11. See also, *Democratic Alliance Western Cape and Others v Minister of Local Government, Western Cape and Others* 2005 (3) SA 576 (C).
[419] Steytler & De Visser (2016) 15-17. See also, *City of Cape Town v Premier, Western Cape* 2008 (6) SA 345 (C)
[420] Mathenjwa, (2014) 184-185; *Democratic Alliance Western Cape v Minister of Local Government Western Cape 2005 (3) SA 576 (C)*; *Mnquma Local Municipality v Premier of the Eastern Cape [2009] ZAECBHC* (*Mnquma*) 14.
[421] Mathenjwa (2014) 195.
[422] Mathenjwa (2014) 195.

discretionary and two of which are mandatory.[423] To protect such power of intervention from potential abuse, the Constitution provides jurisdictional facts which must be present for each type of intervention to warrant the exercise of this power.[424] Such facts are not left to the discretion of a province but are required to be objectively determined, and are independently determinable in court in the event of a dispute as to their existence.[425]

The first, and the most commonly used, form is a general discretionary intervention provided for under section 139(1) of the Constitution.[426] Under this type of intervention, a provincial executive is allowed to intervene where a municipality fails or is unable to fulfil an executive obligation imposed by the Constitution or legislation.[427] Although criticised for lack of clarity,[428] such 'executive obligations' warranting intervention have been argued to include any municipal action that is neither legislative nor judicial in nature.[429] These include policy formulation, implementation of legislation, as well as the obligation to deliver services, among others.[430] Additionally, where a municipality's failure to fulfil an executive obligation is caused by or results in a serious financial problem, section 136 of the MFMA makes provision for a separate intervention procedure to be followed.[431] In effecting the intervention, the provincial executive is granted wide discretion to take 'any appropriate steps' to ensure that the relevant obligation(s) is fulfilled. Such steps may include either issuing a directive to the municipal council, describing the extent of the failure and stating steps required to meet the subject obligation(s), or assuming responsibility for the relevant obligation(s) to the extent necessary to achieve set objectives.[432] Where section 136 of the MFMA is applicable, the

[423] Mathenjwa (2014) 184; Greffrath W & Van der Waldt G 'Section 139 interventions in South African local government, 1994-2015' (2016) 75 *New Contree* 144; Wandrag (2003) 256.
[424] Mathenjwa (2014) 183.
[425] November J (2015) 17; *Mnquma,* para 50.
[426] November J (2015) 38-40; Wandrag (2003) 256.
[427] See also MFMA, s 136(1)(*c*).
[428] Greffrath & Van der Waldt (2016) 145.
[429] Steytler & De Visser (2016) 15-20.
[430] Steytler & De Visser (2016) 15-20.
[431] Wandrag (2003) 260.
[432] Constitution (1996), s 139(1)(*a*) & (*b*).

provincial executive is allowed to impose a financial recovery plan.[433] In exceptional circumstances, however, the provincial executive is allowed to dissolve the municipal council and to appoint an administrator until a new council is elected.[434]

Outside the sweeping powers to take 'any appropriate steps', each mode of intervention envisioned under section 139(1) of the Constitution, as well as that provided for under section 137 of the MFMA, impacts the exercise of fiscal autonomy by the subject municipality. Specifically, directives (depending on their content) restrict the exercise of municipal discretion; the assumption of responsibility for obligations effectively takes away all executive discretion in so far as the subject obligation(s) is concerned (and may involve the taking away of a municipal council's legislative powers).[435] The implementation of a financial recovery plan envisioned under section 137 of the MFMA allows for changes to be made to a municipality's budget and revenue-raising measures, as well as spending limits and budget parameters to be adopted by the municipality at the behest of the intervening provincial executive.[436] While such recommendations are only binding on the exercise of municipal executive authority,[437] they may, however, compel the adoption of attendant legislative measures for fear of the provincial intervention progressing to the dissolution of the municipal council. Although within statutory authority, this impairs the exercise of municipal fiscal autonomy over the relevant matters. Lastly, the dissolution of a municipality completely takes over both the fiscal and institutional autonomy of the municipality, and is hence the most intrusive.

A second form of intervention is mandatory, and takes place in instances where a municipality has budgetary problems.[438] A provincial executive is required to intervene where a municipal council fails or is unable to fulfil its obligation to approve a budget or revenue-raising

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[433] MFMA, s 137.
[434] Constitution (1996), s 139(1)(*c*).
[435] Hoffman-Wanderer Y & Murray C 'Suspension and dissolution of municipal councils under section 139 of the Constitution' (2007) 1 *Tydskrif vir die Suid-Afrikaanse Reg* 144-145.
[436] MFMA, s 137(1)(*c*) & s 142(2)(*b*).
[437] MFMA, s 145(2).
[438] Steytler & De Visser (2016) 15-38.

measures to give effect to the budget.[439] In this regard, the provincial executive is required to take steps to ensure that the budget or revenue-raising measures are approved, failing which it may proceed to dissolve the council, appoint an administrator and approve a temporary budget and revenue-raising measures to facilitate the continued functioning of the municipality until a new council is elected.[440] While it is arguable that municipalities retain fiscal discretion where the former mode of intervention is pursued, the latter mode is, as highlighted above, the most deleterious to municipal fiscal autonomy as it completely takes over its exercise. However, in keeping with the principles of co-operative government, provincial governments are, in this regard, required to have considered effective but less intrusive modes of intervention before resorting to dissolution of a municipal council.[441] This was the ruling of the Court in *Premier of the Western Cape v Overberg District Municipality* 2011 (4) SA 44 (SCA), where it found that the province had failed to consider a more appropriate remedy before resolving to dissolve the Municipality for failing to approve a budget within the required time.[442]

The last form of intervention, which is also mandatory, is undertaken in instances where, as a result of a crisis in its financial affairs, a municipality is in serious or persistent material breach of its obligations to provide basic services or to meet its financial commitments, or where it admits to being unable to meet its obligations or financial commitments.[443] In this case, the provincial executive is required to intervene by imposing a recovery plan and assume responsibility for the implementation of the recovery plan, or by dissolving the municipal council and appointing an administrator.[444] In case of the latter, the provincial executive is required to take steps to ensure the continued functioning of the municipality by, among other things, approving a temporary budget or revenue-raising measures or any other

439 Constitution (1996), s 139(4).
440 Constitution (1996), s 139(4).
441 Steytler & De Visser (2016) 15-28(4); *Mnquma*, paras 97-98.
442 Mathenjwa (2014) 185.
443 Constitution (1996), s 139(5) as read with s 139 of the MFMA. Also, s 140, MFMA provides a criterion for determining when a municipality is in serious or persistent material breach of its financial commitments.
444 Constitution (1996), s 139(5).

measures giving effect to the recovery plan.[445] In addition to all the effects of these modes of intervention on municipal fiscal autonomy discussed above, the recovery plan adopted in this case binds the exercise of both the executive and legislative mandates of the subject municipality.[446] Therefore, all expenditure, revenue and budgetary decisions made in the course of the intervention are required to be made 'within the framework of, and subject to the [spending and budgetary] limitations of the recovery plan'.[447] This hence impacts municipal discretion on each of these decisions. Although largely under-utilised, this form of intervention has been applied in effecting five interventions in the period between 1998 and June 2019.[448]

Despite various measures built into the supervision framework to protect municipalities from politically motivated interventions, these are not bulletproof.[449] In addition to cases highlighted under provincial monitoring above, arguments have been proffered to the effect that interventions are occasionally used as a tool for advancing local and regional political ends rather than as instruments for restoring the balance of prudent fiscal autonomy.[450] Political party affiliations are, for instance, reported to motivate the decision whether or not to intervene where a municipality is led by a party that is different from or similar to that leading a province.[451] Also, provinces experiencing 'high levels of factionalism within local and provincial ANC structures' are, for instance, stated to coincide with provinces that experience more frequent interventions, hence revealing an arguably causative correlation.[452] This is argued to be the case in provinces such as Mpumalanga, North West and Free State which, despite having comparatively higher levels of service delivery than provinces such as the

[445] Constitution (1996), s 139(5).
[446] MFMA, s 146(2).
[447] MFMA, s 146(1)(*b*) & s 142(2)(*a*).
[448] Ledger & Rampedi (2019) 9, 19 & 33-36. See also, Steytler & Ayele (2018) 305; Steytler & De Visser (2016) 15-44(1).
[449] Mathenjwa (2014) 199; Van der Waldt & Greffrath (2016) 156.
[450] Greffrath & Van der Waldt (2016) 136 & 137.
[451] Mathenjwa (2014) 200.
[452] Greffrath & Van der Waldt (2016) 149.

Eastern Cape and Limpopo, experience higher levels of intervention.[453] Provincial interventions hence require an effective system of oversight to prevent potential abuse.

In this respect, the NCOP is expected to play a central role as the main protector of subnational interests. Provincial executives are variously required to notify the Minister for local government, the provincial legislature as well as the NCOP in the event of any intervention being undertaken.[454] The Minister and the NCOP are then given powers to approve or disapprove an intervention or to set aside a dissolution undertaken in terms of section 139(1) (discretionary interventions).[455] Moreover, where a provincial executive has intervened by assuming responsibility for a municipal obligation(s), the NCOP is required to review such an intervention regularly, and to make recommendations as may be appropriate.[456] This places the NCOP in a position to maintain the balance of power and secure the fiscal autonomy of municipalities by checking the exercise of the provincial power to intervene, at least in so far as discretionary interventions are concerned.

However, the NCOP and the Minister have no explicit constitutional mandate to monitor or stop mandatory interventions upon notification of their commencement.[457] Murray and Hoffman-Wanderer argue that this was a deliberate watering down of the NCOP's mandate, occasioned by a 2003 constitutional amendment that made provision for the mandatory interventions.[458] They argue that this envisioned circumstances under which it may be permissible for provinces to intervene in municipalities without the requirement for NCOP approval, and that this object cannot be restricted by the general requirement for NCOP approval for all interventions required under sections 34(3)(b) and 4(b) of the Municipal

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453 Greffrath & Van der Waldt (2016) 148-149.
454 Constitution (1996), s 139(2), (3) (& (6).
455 Constitution (1996), ss 139(2)(*b*) & 3(*b*).
456 Constitution (1996), s 139(2)(*c*).
457 Constitution (1996), s 139(6) as read in contrast with s 139(2). See also, Murray C & Hoffman-Wanderer Y 'The National Council of Provinces and provincial intervention in local government' (2007) 18 *Stellenbosch Law Review* 12.
458 Murray & Hoffman-Wanderer (2007) 9.

Structures Act.[459] This theoretical argument, therefore, absent explicit constitutional protection in instances of mandatory interventions, leaves municipal fiscal autonomy exposed to provincial interventions that are unchecked by the NCOP.

Even then, the effectiveness of the NCOP in checking politically motivated interventions has been in doubt. Outside the argument that the scrutiny of provincial grounds for intervention by NCOP committees lacks rigour,[460] Mathenjwa argues that a keen analysis of the composition of the NCOP points to a membership that pays little attention to the representation of the interests of municipalities.[461] In this regard, the Constitution fails to directly require the representation of local governments in the NCOP, choosing to leave this for provision in national legislation.[462] Further, the Constitution requires the participation of organised local government in the NCOP only 'when necessary' and, even worse, deprives organised local government of voting power when taking part in the NCOP thus reducing its participation to bystander/observer status. This, Mathenjwa argues, waters down the effectiveness of representation of the interests of municipalities in the NCOP by provinces, which are bound to protect the interests of intervening provinces more than those of the subject municipalities.[463] Municipalities are therefore put in a defenceless position in instances where their fiscal autonomy is threatened by hidden political motives for intervention.

In conclusion, while provincial supervision is critical in ensuring accountable municipal fiscal autonomy, the intergovernmental fiscal system is not effectively equipped to safeguard it from potential abuse. This calls for measures aimed at shielding municipalities by, inter alia, adopting legislation and policy guidelines for a uniform approach to interventions,[464] as well as constitutional review to expressly require the NCOP's approval for mandatory intervention

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459 Murray & Hoffman-Wanderer (2007) 12.
460 Murray & Hoffman-Wanderer (2007) 21.
461 Mathenjwa M 'Challenges facing the supervision of local government in South Africa' (2014) *Tydskrif vir die Suid-Afrikaanse Reg* 145-146.
462 Constitution, s 60 as read with 163(*b*)(ii).
463 Mathenjwa (2014) 146 & 150
464 November (2015) 80.

and the granting of full membership rights to municipalities in the exercise of the NCOP's oversight mandate.

2.2.4.2.2. National oversight over municipalities

Steytler and De Visser argue that national supervision of municipal financial management constitutes a dominant feature of the 1996 Constitution, one which has increased in scope over the years.[465] In this regard, the Constitution subjects the exercise of municipal powers to national legislation and further requires national legislation to prescribe measures, including uniform treasury norms and standards aimed at ensuring transparency and expenditure control in each sphere of government.[466] The National Treasury is then charged with enforcing compliance with such prescribed measures, and is allowed to take appropriate steps whenever a municipality is in breach.[467] In this respect, the National Treasury undertakes oversight over municipal financial management on behalf of the national government.

In terms of monitoring, the National Treasury is required to monitor the implementation of municipal budgets, municipal expenditure, revenue collection and borrowing, with a view to promoting good budget and fiscal management.[468]

In terms of intervening in municipalities, the National Treasury is empowered to intervene by stopping the transfer of a municipality's equitable share of revenue as well as any other allocations from the national government where the municipality commits a serious or persistent breach of the measures aimed at ensuring transparency and expenditure control, or where it fails to comply with conditions attached to the allocations.[469] For instance, in 2015, the National Treasury is reported to have stopped the transfer of the equitable share to 58 municipalities for being in arrears with their payments to water boards and to the national

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[465] Steytler & De Visser (2016) 15-5.
[466] Constitution (1996), s 155(7) & 216(1).
[467] Constitution (1996), s 216(2) as read with s 5(2)(*e*) & (*f*) of the MFMA.
[468] MFMA, s 5(2)(*b*).
[469] MFMA, s 38 (1) as read with s 214(1)(c) & 216(1) of the 1996 Constitution.

electricity provider.[470] This was the case until the affected municipalities made arrangements for the repayment of these debts. While this impacts on the revenue and expenditure autonomy of municipalities, it is a critical tool in furthering transparency and fiscal prudence.

Additionally, where a provincial executive is unable or fails to adequately intervene in a municipality, as required under section 139(4) and (5) of the Constitution, the national executive is enjoined to intervene in its place. However, despite there having been clear cases where provinces have failed to intervene in municipalities, the national government has been reluctant and/or unwilling to do so. This has been illustrated by cases where courts have had to force provinces to intervene in clearly failing municipalities, yet this failure ought to have prompted a national intervention. This was the case in *Coetzee and Others v Premier, Mpumalanga Province and Others* where the Gauteng High Court compelled Mpumalanga Province to intervene in the Emalahleni municipality that was facing a crisis in its financial affairs.[471] Similarly, the Eastern Cape High Court had to compel the Eastern Cape Province to intervene in Makana Municipality, which had failed to implement a financial recovery plan imposed by the Province.[472] While the failure to intervene arguably allows the continued exercise of municipal fiscal autonomy, it defeats the purpose for which such autonomy is exercised in the first place. Autonomy is not an end in itself but ought to be directed towards efficient and accountable municipal service delivery; hence an effective system of external controls is crucial.

2.2.5. Concluding remarks on municipal fiscal autonomy

On the whole, municipalities are granted and exercise more fiscal autonomy in practice. However, each aspect of fiscal autonomy is closely regulated, thereby allowing a rather limited margin for the exercise of such autonomy. Moreover, systems of internal control in

470 Steytler (2015) 318 – 319; Steytler & Ayele (2018) 305.
471 Stevens C 'Provincial governments are not intervening when they are supposed to: The Case study of Emalahleni Local Municipality' (2019) 14 *Local Government Bulletin 1*
472 *Unemployed Peoples Movement v Premier, Province of the Eastern Cape and Others* (553/2019) [2020] ZAECGHC 1.

municipalities have been unable to secure expenditure control and fiscal prudence thereby necessitating external fiscal controls which expose municipal fiscal autonomy to potential intrusion, especially in light of the ineffectiveness of the NCOP in protecting the interests of municipalities. Such intrusion is, however, key in ensuring accountable municipal fiscal autonomy.

3 Conclusion

The South African case highlights key issues and lessons with respect to the role the design and implementation of intergovernmental fiscal systems plays in advancing the autonomy of subnational governments in devolved states.

As a newly devolved state, with a constitution that provided for extensive subnational autonomy, South Africa put in place centralised structural features that were aimed at guaranteeing the functionality of the new system. These include: the general subjection of subnational functions and powers to national legislation, which opens room for their regulation; the retention of central control over subnational functions and powers through concurrent mandates which allows the national government to impose norms, standards and regulations aimed at ensuring uniformity in service provision as well as allowing it to recentralise functions where this is necessary; and the retention of a continuing as well as a residual oversight mandate on the exercise of subnational autonomy, which allows it to monitor the effectiveness of internal systemic controls and to intervene where these fail. As a consequence, South Africa ended up with a rather centralised fiscus. What this has meant in practice is that, although the two subnational spheres command varying levels of fiscal autonomy, a common feature is that the national sphere is highly involved in the exercise of such autonomy.

An analysis of the subnational fiscal autonomy of South Africa's provinces and municipalities confirms that subnational fiscal autonomy is more of a spectrum rather than a duality, and as such the question is not whether subnational governments have or do not have fiscal autonomy but rather what margin of fiscal autonomy held and exercised by them. In that respect, therefore, South Africa has sought to allow a margin of subnational fiscal autonomy, while ensuring that its exercise is constantly balanced in favour of service delivery (the objectives of subnational autonomy), equity and macroeconomic stability. Some of the lessons gathered from the South African experience include the following:

1. Subnational revenue autonomy is closely linked with expenditure autonomy hence the financial self-sufficiency of a subnational government (which offers the highest level of revenue autonomy) plays a critical role in the realisation of its expenditure autonomy.
2. Although unconditional transfers hold the potential to afford fiscal autonomy to subnational governments, the predetermination of their use at the national level takes away from such autonomy.
3. While budgetary autonomy in the sense of the discretion to borrow may be granted under the law, it may not be realised in practice in instances where a subnational government lacks substantial OSR.
4. Extensive concurrent mandates as a structural issue need clear laws, regulations and guidelines on their exercise to safeguard against their use to stifle the fiscal autonomy of subnational governments.
5. While the costed norms approach to the division of revenue raised nationally provides a basis for transparency and objectivity, it also provides room for the predetermination of subnational expenditure which in turn restrict subnational budgeting discretion.
6. Although the Constitutional framework may present a picture of subnational distinctiveness and autonomy, the practice may sometimes obscure the lines in favour of maintaining an overall effective system that delivers on the objectives sought by subnational fiscal autonomy. As such, measures that may otherwise come across as limiting subnational autonomy or recentralising subnational powers may be justified where subnational autonomy results in dysfunctionality and/or a failure of service delivery and their use is channelled towards restoring the balance of prudent subnational fiscal autonomy.

7 To maintain the balance between central supervisory control and subnational fiscal autonomy, a hierarchical system of expenditure control is most appropriate. This allows subnational governments to utilise their own systems of internal control to ensure prudent subnational fiscal autonomy before resorting to external fiscal controls.

8 External systems of oversight hold the potential for abuse hence a strong second chamber that protects the interests of subnational governments is key. An even stronger judicial system is also essential in filling any gaps in such a system of oversight, as well as in ensuring accountable subnational fiscal autonomy.

The next chapter looks at how Kenya has structured its intergovernmental fiscal system for the autonomy of county governments, and how it has addressed or learnt from the lessons highlighted above.

Chapter Four

THE HISTORY AND CONTEXT OF SUBNATIONAL FISCAL AUTONOMY IN KENYA: FROM INDEPENDENCE (1963) TO THE 2010 CONSTITUTION

Kenya's current system of devolution was preceded by various forms of decentralised governance dating back to pre-colonial days. Kenya's intergovernmental fiscal system therefore evolved alongside the evolution of its multilevel government structure. While most features, especially those relating to the scope for subnational fiscal autonomy, changed over time, some managed to survive temporal attrition, with some informing the features that were eventually adopted in subsequent systems, as well as in Kenya's current intergovernmental fiscal system.

This chapter explores the historical evolution of Kenya's multilevel system of government, with a focus on the evolution of the scope for fiscal autonomy afforded to the various subnational levels of government that existed at the various periods in Kenya's history. The aim is to provide a background to Kenya's current intergovernmental fiscal system while also tracing the origin and rationale for some features that are contained in Kenya's current framework, as well as practices that have prevailed in the implementation of Kenya's current intergovernmental fiscal system.

The chapter is presented in six parts. The first provides a general historical overview of the evolution of Kenya's multilevel governance structure at and after Kenya's independence in 1963. The second part narrows this down to provide a historical evolution of the fiscal autonomy of Kenya's subnational levels of government. This discussion focuses on the brief post-independence period during which Kenya had a regional system of governance (*Majimbo*), and analyses the scope for fiscal autonomy (expenditure, revenue and budgetary) that was extended to the regions as well as to the local governments established by and under the regions. The part then discusses developments with respect to the fiscal autonomy of post-*Majimbo* local governments/authorities, and highlights the systemic centralisation of power that followed and continued until the adoption of the Constitution of Kenya 2010. The chapter also looks at the systems of oversight and expenditure control that existed for each of the periods and what impact, if any, they had on the fiscal autonomy of the subnational governments.

The chapter's third part then provides an assessment of what impact this history had during the transition period, and at the design of Kenya's succeeding intergovernmental fiscal system and its provision for subnational fiscal autonomy under the Constitution of Kenya 2010. The fourth part focuses on the current context of devolution under the 2010 Constitution and highlights its key basic features including institutions supporting Kenya's current system of intergovernmental fiscal relations. The last part provides a conclusion to the chapter.

1 The historical evolution of Kenya's multilevel government structure

Kenya had a highly centralised pre-colonial state structure, made up of a combination of a deconcentrated system, based on a system of provincial administration (PA), and a decentralised system made up of largely administrative local authorities.[1] However, this system was mainly designed for control, with local authorities undertaking largely administrative and regulatory functions with no room for autonomous decision-making.[2] Although Kenya adopted a system of regional governance (*Majimbo*) at independence, made up of strong and more autonomous regions alongside a system of local governance, the re-emergence of pre-colonial centrism immediately after independence saw the abolition of regions and the incremental weakening of local governments in favour of a more powerful central government run through the pre-colonial deconcentrated PA system. This system

[1] Rocaboy Y, Vaillancourt F & Rejane H 'Public finances of local government in Kenya' in Dafflon B & Madies T (eds) *The Political Economy of Decentralization in Sub-Saharan Africa: A New Implementation Model in Burkina Faso, Ghana, Kenya, and Senegal* (2013) 161; Smoke P 'Local government fiscal reform in developing countries: Lessons from Kenya' (1993) 21 *World Development* 903.

[2] Bosire CM *Devolution for Development, Conflict Resolution, and Limiting Central Power: An Analysis of the Constitution of Kenya 2010* (unpublished LLD thesis, University of the Western Cape, 2013) 83; Muia M, Ngugi J & Gikuhi R 'Evolution of local authorities in Kenya' in Barasa T & Eising W (eds) *Reforming Local Authorities for Better Service Delivery in Developing Countries: Lessons from RPRLGSP in Kenya* (2010) 16.

prevailed until the adoption of the devolved system of government under the Constitution of Kenya of 2010. This evolution is discussed in detail in this section.

1.1 The rise and fall of regionalism (*Majimbo*) under the Independence Constitution

At independence, the Constitution of Kenya, 1963 (Independence Constitution)[3] made provision for three levels of government: the central government, regional governments (*Majimbo*) and local governments. At the regional level, Kenya was divided into the seven regions, with the Nairobi Area being set up as an additional independent city under the legislative jurisdiction of the National Assembly.[4] Each of the regions had an elected regional assembly presided over by a president elected by members of the assembly from its membership.[5] A region's executive authority was vested in its Finance and Establishments Committee (chaired by the regional assembly's vice-president)[6] and was also subject to delegation to other persons or committees in the region.[7]

Regional assemblies had the power to pass legislative enactments (laws) through which they were allowed to establish local authorities in their respective areas.[8] Some of this legislative power was exclusive to regional assemblies, while some was concurrent with that of Parliament.[9] In respect of the latter, however, where any regional law was inconsistent with that made by Parliament, the law made by Parliament prevailed.[10]

However, immediately after independence, Kenya amended the Independence Constitution and repealed, among other things, the power of regions to establish local authorities in their

[3] This was contained under Schedule 2 of the Kenya Independence Order in Council, 1963.
[4] Constitution of Kenya, 1963 (Constitution (1963)), s 91 as read with s 66(2); The regions were: Coast, Eastern, Central, Rift Valley, Nyanza, Western and North-Eastern regions.
[5] Constitution (1963), s 92 & s 108(*a*).
[6] Constitution (1963), s 113(5); the Committee was made up of the President and the Chairpersons of all other committees established by the Regional Assembly.
[7] Constitution (1963), s 105 (1).
[8] Constitution (1963), s 224(1).
[9] Constitution (1963), s Schedule 1.
[10] Constitution (1963), s 62(4).

areas.[11] This power was centralised with the authority to establish local governments and their functions being vested in Parliament.[12]

Subsequently, in 1965, the Constitution was further amended to convert the existing regions into provinces with regional assemblies becoming provincial councils.[13] With this, Parliament was given sweeping concurrent legislative powers on all matters that could be legislated on by provincial councils.[14] Three years later (1968), another constitutional amendment saw the repeal of all laws made by both provincial councils and the former regional assemblies as well as the complete scrapping of provincial councils.[15] With this, all reference to regions and provincial councils in the Independence Constitution was done away with. What remained of the Independence Constitution, therefore, which was reproduced in a later amendment,[16] made no mention of subnational governance either at the regional or local level. The closest it came to recognising multilevel governance was through indirect general references to local government authorities. This marked the end of the constitutional recognition and entrenchment of subnational governance, and the start of the statutory creation and regulation of local governance in Kenya.

Subsequently, Parliament adopted the pre-colonial PA system, alongside the system of local governments, which divided Kenya into administrative provinces through which central power was exercised.[17]

1.1.1 Weak protection of regional (fiscal) interests in the national legislative process

The *Majimbo* era was supported by a bicameral parliament made up of two Houses: the Senate and the House of Representatives.[18] The Senate represented districts (being 40 districts and

[11] Constitution of Kenya (Amendment) Act No 28 of 1964, First Schedule.
[12] Constitution of Kenya (Amendment) Act No 28 of 1964, s 223.
[13] Constitution of Kenya (Amendment) Act No 14 of 1965, Part II, First Schedule.
[14] Constitution of Kenya (Amendment) Act No 14 of 1965, Part I, First Schedule.
[15] Constitution of Kenya (Amendment) Act No 16 of 1968, ss 5 & 6 as well as the Schedule to the Act.
[16] Constitution of Kenya (Amendment) Act No 5 of 1969.
[17] Districts and Provinces Act No 5 of 1992, ss 2 & 3.
[18] Constitution (1963), s 34.

the Nairobi Area, at independence)[19] while the House of Representatives represented constituencies (being between 110 and 130 in number).[20] Although legislators in the Senate were not elected at the regional level, their mandate extended to legislating on matters touching on regions and local governments at the national level. The Senate's role in intergovernmental finance legislation, as well as its relationship with the House of Representatives in this regard, is therefore of interest.

Either House was allowed to originate any Bill, save for Money Bills[21] that could only originate in the House of Representatives, and each House was required to send all of its approved Bills for concurrence by the other.[22] However, where a Money Bill was sent for concurrence to the Senate and the Senate failed to pass it without amendments within a month, the House of Representatives was granted the discretion to present the Bill for assent.[23] No provision was made for the Senate to propose amendments to Money Bills; hence the Senate's concurrence was largely procedural. Any dissatisfaction with the Bill, on the part of the Senate, could then only be signified by a failure to pass the Bill, which the House of Representatives could overlook unless it 'resolved otherwise'.[24] No circumstances were laid out, nor factors listed, that would inform the House of Representatives' decision whether or not to bypass the Senate's failure to pass a Money Bill. The consequences of a resolution not to bypass the Senate were also not outlined. Therefore, this appears not to rule out the possibility of informal negotiations on the substance of the Bills, or the possibility of an extension of time

[19] Constitution (1963), s 35 as read with s 36.
[20] Constitution (1963), s 37 as read with ss 38 & s 49.
[21] Under s 63 of the Independence Constitution, a 'Money Bill' meant 'a Bill that contains provisions dealing with: the imposition, repeal, remission, alteration or regulation of taxation; the imposition of charges on the Consolidated Fund or any other Fund of the Government of Kenya or the variation or repeal of any such charges; the grant of money to any person or authority or the variation or revocation of any such grant; the appropriation, receipt, custody, investment, issue or audit of accounts of public money; the raising or guarantee of any loan or the repayment thereof; or subordinate matters incidental to any of those matters: Provided that the expressions 'taxation', 'public money' and 'loan' do not include any taxation, money or loan raised by local government authorities or other local bodies or by any Region.
[22] Constitution (1963), s 59.
[23] Constitution (1963), s 61(1).
[24] Constitution (1963), s 61(1).

for the Senate to pass the Bill. Nonetheless, the Senate role was greatly subordinated to that of the House of Representatives.

A reading of section 63 of the Independence Constitution on what constitutes a 'Money Bill' points to a situation where the Senate could originate Bills that were akin to 'Money Bills', and which covered such matters as were covered under Money Bills, as long as it was with respect to regions or local authorities. While this may have been important for ensuring the safeguarding of subnational financial interests, this only covered money or loans *raised* by subnational governments. However, as discussed later in the chapter, some taxation and revenue-raising was done at the national level on behalf of regions. This, therefore, meant that the Senate was excluded from originating bills touching on these matters and/or making any substantive contributions on them, and further that any contrarian action regarding the Bills could be vetoed by the House of Representatives. As such, the financial interests of regions touching on revenues raised nationally were not adequately protected under the national legislative process.

Although the Senate was allowed to propose amendments for all other Bills, the House of Representatives retained veto power where the two houses could not agree on amendments.[25] In the end, therefore, the Senate lacked any decisive voice on any legislative matters that, though being outside the scope of Money Bills, may have touched on, for instance, the expenditure mandates of regional governments. Therefore, this left regions with weak protection in the national legislative process.

The Senate's subordination to the House of Representatives, and it not having had any decisive voice in the national legislative process, explains why it was relatively easy for various successive constitutional amendments to be passed to strip regional governments of their powers, and to eventually abolish them. It also explains why it was possible for the House of Representatives to amend the Constitution to do away with the Senate itself, and to collapse

[25] Constitution (1963), s 61(8).

its membership into an expanded National Assembly.[26] This was done as culmination of the State's scheme to do away with *Majimbo* and its constitutional institutions so as to usher in a more centralised system of governance.

1.1.2 The evolution of local governments after independence

Although local governments were constitutionally recognised as a level of government, at independence, they were required to be established by regions under regional laws.[27] However, with the disestablishment of regions and provincial councils after independence, local government became the only subnational level of government in Kenya and was regulated under the Local Government Regulations of 1963 and later the Local Government Act (LGA) of 1977. The new system of local government established under the Act, though free from an intermediate level in the form of either regions or provincial councils, was highly centralised. For instance, the Minister of Local Government had the power to establish or disestablish local authorities (municipalities, counties or townships) and could amalgamate counties or transfer a part of them, as well as establishing divisions within a county.[28] Additionally, the Minister had the power to determine the number of councillors in the council of a local authority and to nominate any number of councillors to represent the national government or any special interests of the council.[29] This gave the national government significant control over local government. Nonetheless, this centralised system of local government prevailed post *Majimbo* until the adoption of the system of devolution in 2010.

2 The history of subnational fiscal autonomy in Kenya

The transition from *Majimbo* (with local governments) to an era of local governments only (post-*Majimbo*) came with a shift in terms of the fiscal autonomy accorded to these levels of

[26] Constitution of Kenya (Amendment) Act No 40 of 1966, First Schedule & s 6 as read with the Third Schedule.
[27] Constitution (1963), s 224(1).
[28] Local Government Act (LGA) Cap 265, s 5 as read with s 9(1).
[29] LGA, s 12(1) as read with s 26(1); s 28(1) as read with s 39(1) & s 41(1) as read with s 46(1).

government. This section discusses the scope for fiscal autonomy afforded to the subnational governments under these two eras.

2.1 The fiscal autonomy of subnational governments at independence (under *Majimbo*)

Although the Constitution, at independence, made provision for two subnational tiers of governments, regions and local government, regions were in existence for only about a year before their abolition hence they were not effectively operationalised and their real fiscal autonomy was not tested in practice.[30] This section, therefore, only discusses the scope for fiscal autonomy that was afforded to the regions under the constitutional framework. The section also covers what little fiscal autonomy may have been accorded to the local governments created under this era.

2.1.1 The fiscal autonomy of regional (*Majimbo*) governments

In discussing the fiscal autonomy of the regional governments, this section looks at their expenditure, revenue and budgetary autonomy.

2.1.1.1 The expenditure autonomy of regional governments

The expenditure autonomy of regions was facilitated by the constitutional entrenchment of regional functions and powers over which they were free to make expenditure-related decisions, as well as by the Constitution's express specification as to which of these functions and powers fell within either the exclusive or concurrent executive or legislative competence of the regions.[31] The Constitutional establishment of an institutional framework in the form of regional assemblies and regional Finance and Establishments Committees that would give effect to a region's legislative and executive functions and powers respectively, also served to facilitate their expenditure autonomy.

[30] See also, Bosire (2013) 116.
[31] Constitution (1963), ss 66, 72, 102 & 106.

Some of the matters over which regions had exclusive legislative competence include: primary, intermediate and secondary school education, with the exception of some listed institutions; housing; medical institutions and facilities with the exception of some listed facilities; refuse and effluent disposal; specified matters relating to agriculture; places of public entertainment or recreation; and the licensing of traders.[32] However, matters relating to economic development, public health, public order and safety, indigency, as well as some relating to agriculture, fell under the concurrent legislative competence of both the regional assemblies and parliament.[33]

Despite regions having areas of exclusive legislative competence, the retention of overall standard-setting, advisory as well as coordinating competences by Parliament and the national executive over these areas, held the potential to limit the scope of autonomy regions could exercise over the areas. Parliament, for instance, retained exclusive competence over the setting of education standards as well as over the stipulation of the terms of service of teachers.[34] Parliament also had exclusive legislative competence with respect to the standard to be attained in the provision of health services by hospitals and like institutions.[35] The national executive, for its part, was granted general advisory and coordinating authority over the activities of regions with Parliament holding the power to establish bodies for this purpose.[36] Although regions were allowed to appoint representatives to these advisory and coordinating bodies,[37] the involvement of the national government in these ways nonetheless served to limit regional discretion over the affected competences by, for instance, preventing regions from linking the standard of a service they provided to the revenue available to them. The national government's general standard-setting mandate also had the potential to stand in the way of regions matching specific regional taxes and fees with the demanded level of services within their jurisdictions, thereby limiting their revenue autonomy.

[32] Constitution (1963), 1963, s 66(2) as read with Part I of Schedule 1.
[33] Constitution (1963), 1963, Part II of Schedule 1.
[34] Constitution (1963), s 15 of Schedule 2.
[35] Constitution (1963), s 23 of Schedule 2.
[36] Constitution (1963), s 119(1).
[37] Constitution (1963), s 119(2).

The constitutional requirement for regional assemblies to give (or withhold) consent to any delegation by the national government of its executive authority also served to safeguard the expenditure autonomy of regions.[38] This gave regions discretion in assessing and negotiating the terms of delegation, including the financial impact of such delegation, as part of a regional assembly's mandate to [consider and] give consent to such delegation of national government functions.

In addition to the above, the discretion regions had over their budgeting enabled them to freely incur expenditure over their functions, hence serving to extend their expenditure autonomy. In this regard, a region's Finance and Establishments Committee was annually required to prepare and table in the regional assembly estimates of revenue and expenditure, as well as an appropriation bill that would authorise regional expenditure for each financial year.[39] Moreover, regions were allowed to prepare and table supplementary estimates in instances where the amount earlier appropriated proved insufficient or a need not catered for in the appropriation had arisen.[40] Also, in instances where funds had been expended in excess of those appropriated for a purpose, or for a function that had not be catered for in the appropriation, regions were allowed to prepare and table a statement of excess expenditure for approval by the region's assembly.[41] However, a region's executive was required to consult the Finance Minister in the preparation of its estimates (both primary and supplementary) before tabling them in the regional assembly.[42] Although the Constitution did not specify the nature of consultation and the weight of the Minister's input to the regions' budgets, this requirement held potential as an avenue for the national executive to interfere with a region's discretion in the preparation and adoption of their budgetary estimates.

However, while a region had executive authority over all the above matters over which it had legislative competence,[43] the exercise of a region's executive authority was generally

[38] Constitution (1963), s 74(1).
[39] Constitution (1963), s 132.
[40] Constitution (1963), s 132(3)(*a*).
[41] Constitution (1963), s 132 (3)(*b*).
[42] Constitution (1963), s 132(4).
[43] Constitution (1963), s 106(1).

subjected to compliance with the law and was also required to be exercised such as not impede or prejudice the exercise of the national government's executive authority.[44] To this end, the national government was allowed to give directions to a regional assembly where necessary or expedient.[45] Parliament was also allowed to assume the legislative functions of a regional assembly, in the event that a region's exercise of executive authority was declared to contravene this requirement, until compliance was restored.[46] While the taking away of a region's autonomy in circumstances of non-compliance with the law may have been warranted to facilitate prudence, the lack of mechanism to check the exercise of this power under the Constitution, especially as relating to contravention of national executive authority, held potential for its abuse to the detriment of the fiscal autonomy of regions.

In summary, although regions had substantial room for the exercise of their autonomy over expenditure, this exercise, as seen above, was not completely free from national government involvement and/or potential interference.

2.1.1.2 The revenue autonomy of regional governments

The Independence Constitution made provision for a somewhat complex framework for raising and sharing revenue between the national government, regions and local government. Regional own-source revenue, for instance, included an aspect of both horizontal revenue sharing and vertical tax sharing (through concurrent taxes) while also including a component where the national government imposed and collected some taxes on behalf of regions. This was in addition to a system of vertical transfers. Of note, however, is that all powers of regions to raise revenue under this section, while provided for under the Independence Constitution, were worded in a permissive manner that made them applicable only if provided for under an Act of Parliament.[47] Therefore, this meant that regions could not refer to the Constitution directly as the source of their revenue-raising powers.

[44] Constitution (1963), s 106(2).
[45] Constitution (1963), s 72(4).
[46] Constitution (1963), s 70(1).
[47] See for instance, Constitution (1963), s 138, 139 & 140.

2.1.1.2.1 **The autonomy of regions over their own-source revenue (OSR)**

Under the Independence Constitution, regions drew their OSR from three pools: revenue that was directly levied and collected by them; revenue collected within the region by local authorities and due to regions by way of a revenue-sharing arrangement; and revenue that was due to regions but was levied and collected by the national government.

With respect to own levied and collected revenue, regions were entitled to: proceeds of any tax, duty or fee that was levied on the licensing of motor vehicles or the drivers of motor vehicles;[48] royalties for produce drawn from forests located in their areas;[49] and fees imposed by a regional assembly for defraying any administrative expenses associated with its legislative function or its exercise of any executive authority bestowed upon it.[50] While regions may have had discretion to determine the applicable rates to most of these revenue sources, the rate applicable to motor vehicle licences was required to be uniform throughout the country,[51] which implied that this was set at the national level, hence translating to a limitation on the autonomy of regions in this regard.

Although regions were allowed to legislate for the imposition of personal income tax;[52] property rates (on land and buildings);[53] poll taxes;[54] entertainment taxes;[55] and royalties from common minerals extracted in the region,[56] revenue from these sources was levied, collected by and accrued to local government authorities within the region.[57] While the Constitution fixed the maximum amount that could be levied in any given calendar year for personal income tax (Ksh 600) and for poll taxes (Ksh 100), with only Parliament having the

48 Constitution (1963), s 139.
49 Constitution (1963), s 140(5).
50 Constitution (1963), s 147 (1).
51 Constitution (1963), s 139(*a*).
52 Constitution (1963), s 142(1)(*a*) as read with s 142(2).
53 Constitution (1963), s 142(1)(*b*).
54 Constitution (1963), s 142(1)(*c*).
55 Constitution (1963), s 142(1)(*d*).
56 Constitution (1963), s 142(1)(*e*).
57 Constitution (1963), s 143(2).

power to increase this limit,[58] regions generally retained the power to determine the scale or rates applicable to each of the taxes, the assessment principles as well as the manner of administration of the revenues, a factor that facilitated their revenue autonomy.[59] Besides this, regions also held the power to set, under regional legislation, an amount or proportion to be paid by local authorities out of these revenue sources to the region.[60] The sharing of revenue raised from these sources therefore contributed to the revenue autonomy of the regions.

While the legislative competence of regions over personal income tax was concurrent with that of Parliament, the constitutional prohibition of Parliament from exercising this concurrent mandate in such manner as would prevent the exercise of the concurrent power of regions served to ensure that Parliament could not claw-back or limit the power of regions to legislate for the imposition of personal income tax in their areas.[61] The constitutional protection of this concurrent mandate, therefore, served to enhance the autonomy regions had over the tax.

In terms of revenue that was due to regions but collected by the national government, the Constitution required the national government, to levy, collect and distribute among regions all proceeds[62] of petrol or diesel oil.[63] The distribution among regions was required to be in proportion to the respective amounts of petrol or diesel oil that had been distributed for consumption within each of the regions in the specific financial year.[64] In addition, proceeds from the distribution of petrol or diesel oil within the Nairobi Area were also required to be distributed among the regions in specified proportions.[65] Although no rationale was provided

[58] Constitution (1963), s 142(5) & (8).
[59] Constitution (1963), s 143(1).
[60] Constitution (1963), s 145(1).
[61] Constitution (1963), s 142(10).
[62] Proceeds in this case referred to what remained after all costs and expenses associated with the collection of the tax had been deducted. See, Constitution (1963), s 137(3) & 143(6).
[63] Constitution (1963), s 137(1).
[64] Constitution (1963), s 137(2)(*a*).
[65] Constitution (1963), s 137(2)(*b*): one-fifth to the Eastern Region; two-fifths to the Central Region; one-tenth to the Rift Valley Region; 98% of the remaining three-tenths to the Coast Region and the rest to the North-Eastern Region.

for the latter proportions, the Constitution made provision for their review at two-to-three-year intervals by an Advisory Commission made up of, among others, regional representatives.[66] The Commission was required to advise Parliament, which would then decide on whether or not to alter the proportions subject to the consent of at least four regional assemblies.[67] The involvement of regions in this process therefore ensured a measure of objectivity and equity in the distribution of the revenue.

While regions evidently had substantial revenue autonomy, the financial provisions touching on regions were the major victims of the very first constitutional amendment after independence. This, for instance, saw the proceeds of petrol and diesel oil going to regions restricted to a proportion prescribed by Parliament instead of the entirety of the proceeds, as well as the repeal of all provisions empowering regions to raise their own revenue.[68] The same constitutional amendment also saw the repeal of the power of regions to authorise the raising of revenue by local authorities, which effectively did away with any revenue regions may have been entitled to from their local government authorities.[69] Whatever remained in terms of the revenue of regions and revenue due to regions was also repealed by later constitutional amendments, alongside the abolition of regions.

2.1.1.2.2 The autonomy of regions over revenue administration

The administration of revenue due to regions was done both by the national government as well as regions, on their own or through their local authorities. While the national government administered the revenue drawn from petrol, diesel oil as well as museums, personal income tax, property rates, poll taxes, entertainment taxes and royalties from common minerals were administered by the local authorities within the region.[70] This meant that majority of the revenue due to regions was not directly administered by them. Although the regions retained control over the rates, principles, and manner of administration of the revenue collected by

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[66] Constitution (1963), s 156(1).
[67] Constitution (1963), s 156(1).
[68] Constitution of Kenya (Amendment) Act No 28 of 1964 (Amendment 1).
[69] Constitution of Kenya (Amendment) Act No 28 of 1964.
[70] Constitution (1963), s 143(1).

local authorities,[71] their revenue autonomy was nonetheless weakened by their inability to administer the bulk of the revenue that accrued to them, as the regions were unable to determine the extent of revenue effort applied in their administration.

2.1.1.2.3 **Intergovernmental transfers and grants and regional autonomy**

The Independence Constitution made provision for both unconditional transfers as well as conditional grants from the national government to regions. Section 138 of the Constitution, for instance, required the national government to pay to the regions 32 per cent of the proceeds of any tax or duty on any commodity other than petrol, diesel oil or any Kenyan-produced agricultural produce. These funds were required to be paid to the regions in proportion to the number of each region's inhabitants, based on the latest census.[72] Similar to the provision for distribution of proceeds of petrol and diesel oil discussed above, this provision was required to be reviewed periodically with the involvement of, and, if proposed to be altered, with the consent of, the regions.[73] Of importance was the requirement for the Prime Minister to consult regional presidents in instances where any bill or instrument being considered by Parliament would result in a reduction of the amount payable to the regions as transfers.[74] This ensured that no unilateral decision could be made at the national level that would have an adverse effect on transfers due to the regions, and that any variations of the proportions of transfers under the Constitution was done with their involvement and consent. All these safeguards served to ensure that the financial interests of the regions were protected.

Additionally, where any royalty was levied for the extraction of minerals and mineral oils (other than soda) and the proceeds for a particular financial year exceeded £100,000, the national government was required to pay two-thirds of the excess to regions.[75] Of the two-thirds, one-sixth was required to be divided among the regions where the minerals were

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[71] Constitution (1963), s 143(1).
[72] Constitution (1963), s 138(2) & (4).
[73] Constitution (1963), s 156(1).
[74] Constitution (1963), s 150(1) as read with s 60(2).
[75] Constitution (1963), s 140(1).

extracted while one-half would be divided equally across all regions.[76] However, with respect to the extraction of soda, the national government was required to pay any proceeds of royalties levied for the extraction of soda from Lake Magadi soda deposit to the Rift Valley region.[77] Although this was due to the fact that the Lake was located in the region, the reason behind the asymmetrical treatment of this region is not clear.

In addition to the above, regions were entitled to receive an annual conditional grant from the national government in the form of a police grant.[78] This was set at half the expenditure incurred by a region in relation to the region's contingent of the police force. The exact amount payable annually was however subjected to the National Security Council's discretion based on what it considered reasonable.[79] The objectivity of this process was impaired, though, by the lack of a framework or formula that would guide the Council's discretion, thus providing room for the unequal treatment of regions.

However, the constitutional amendment of 1964 saw the reduction of the proportion of the mineral royalty proceeds going to regions from two-thirds to 10 per cent of the excess as well as the repeal of the provision for a police grant. A subsequent amendment also saw the repeal of all provisions touching on the financial relations between the centre and the regions, thus effectively rendering the functions of regions (and their successor, provincial councils) unfunded (under the constitutional framework) until they were eventually abolished in 1968.[80]

2.1.1.3 The budgetary autonomy of regional governments

Although regions were allowed to borrow, their ability to borrow within Kenya was generally subjected to parliamentary regulation.[81] However, due to the limited time that regions were

[76] Constitution (1963), s 140(1).
[77] Constitution (1963), s 140(3).
[78] Constitution (1963), s 141.
[79] Constitution (1963), s 141.
[80] Constitution of Kenya (Amendment) Act No 38 of 1964 (Amendment 2).
[81] Constitution (1963), s 148.

in existence, no regulations were put in place to govern their borrowing. Nonetheless, the Independence Constitution vested in them a general authority to borrow by way of a bank overdraft.[82] Although this was limited to a maximum of one-third of the region's annual revenues, it nonetheless gave them room to exercise a level of budgetary autonomy.

2.1.1.4 **Oversight and expenditure control of regions**

A couple of controls were built into the Constitution to facilitate a level of oversight over the operation of regions so as to ensure their accountability. These ranged from controls aimed at ensuring fiscal discipline and responsible financial management at the regional level to those that were aimed at providing support to the regions to ensure their own fiscal discipline and accountable financial management, while also providing room for monitoring and intervention by the national government where this was necessary (or expedient).

To ensure fiscal discipline and responsible financial management at the regional level, the Independence Constitution prohibited the withdrawal of funds from either a regional fund or any other fund of a region unless such was authorised under an appropriation enactment or any other law.[83] Additionally, although regional assemblies were granted the discretion to stipulate the manner in which withdrawals could be made from any fund of the region,[84] the Constitution required any withdrawals from the Regional Fund to receive prior approval from the Controller and Auditor-General (CAG) or by a CAG-approved auditor.[85] These measures served to ensure that any expenditure or withdrawal of funds by regions was authorised.[86]

In addition to the above, the Constitutional requirement for all public accounts of a region as well as its authorities (except local authorities) to be audited annually by the CAG or a CAG-approved auditor[87] served to ensure oversight, while supporting a region's efforts at securing

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[82] Constitution (1963), s 148.
[83] Constitution (1963), s 130(1) & (3) as read with s 131.
[84] Constitution (1963), s 130(4).
[85] Constitution (1963), s 130(1).
[86] Constitution (1963), s 136 (1).
[87] Constitution (1963), s 136(2).

its own fiscal discipline and responsible financial management. Although the requirement for audit reports to be submitted to the region's Finance and Establishments Committee for tabling before the regional assembly[88] implied a role for regional assemblies in a region's fiscal oversight, little detail was provided under the Constitution regarding the nature and extent of this oversight mandate. The requirement, nonetheless, served to facilitate oversight hence the accountability of regions.

The Constitution also made provision for a system of oversight and intervention in regions by the national government. As part of the national government's monitoring mandate, it was granted the authority to issue directions to any regional assembly, where necessary or expedient, for the purpose of ensuring that a region's authority was exercised in keeping with the law, and in such manner as to not impede or prejudice the exercise of the national government's executive authority.[89] In the event of a failure by the region to comply with any such directions, the Governor-General was allowed to appoint a Special Commissioner who had powers to, among other things, take over and carry out any region's function or service(s) that was the subject of the national directive.[90] Such a take-over was required to expire after six months unless the period was renewed by the Senate. Although this power to renew the take-over implies an oversight mandate on the part of the Senate, upon its exercise, the Constitution fell short of making express provision for an oversight mechanism to monitor and check the exercise of this power by the national government, especially where directives were issued based on expediency, or on the basis that a region's exercise of authority had prejudiced the exercise of national executive authority. This, therefore, left regions exposed to potential abuse of this power at the expense of regional autonomy.

2.1.2 The fiscal autonomy of local governments under *Majimbo*

While local governments were recognised under the Constitution as the third tier of government, their regulation was done under both the Local Government Regulations of

[88] Constitution (1963), s 136(3).
[89] Constitution (1963), s 72(4).
[90] Constitution (1963), s 73(1).

1963, as well as in regional laws.[91] This part discusses the scope for expenditure, revenue and budgetary autonomy that was afforded them mainly under the constitutional framework.

2.1.2.1 **The expenditure autonomy of the *Majimbo* local governments**

Although local governments had been granted extensive responsibilities by the colonial government shortly before independence as a scheme to contain growing anti-colonial sentiment, these functions and powers were overshadowed by the creation of regions and regional governance at independence.[92] Local authorities, under the Independence Constitution, could only undertake those functions and exercise those powers conferred on them by regional laws, or those delegated to them by either the regional or the national executive.[93] However, given the brevity of the existence of regions and the fact that they had hardly been operationalised by the time they were abolished, the operations of local governments during the period were largely governed by the provisions of the Local Government Regulations of 1963.

The Regulations, however, granted extensive powers to the national government's Minister of Local Government (Minister) which effectively turned local authorities into administrative arms of the national government, with no autonomy over their own expenditure. Under the Regulations, the Minister had the power to: approve the exercise of specific powers by local authorities; make adoptive by-laws and approve all by-laws made by local authorities; approve their annual, revised and supplementary estimates; advise on the appointment of specific local government officials whose dismissal was subject to his or her approval; and also to determine the maximum allowances for mayors and chairmen of the councils of local authorities as well as the rates of allowances for members of local authorities.[94] The broadness of these powers, in effect, undercut any expenditure autonomy that may have been held by local authorities, thereby converting them into administrative arms of the

[91] Rocaboy, Vaillancourt & Rejane (2013) 162.
[92] Rocaboy, Vaillancourt & Rejane (2013) 162.
[93] Constitution (1963), s 224(4) as read with s 237.
[94] Republic of Kenya *Report of the Local Government Commission of Inquiry* (1966) 30.

national government. Moreover, the requirement for approval of local budgetary estimates was affected by delays at the Ministry.[95] This therefore created uncertainty as to what expenditures could be incurred by local authorities pending the approval, and any late approvals provided little room for implementation of budget items thus further impacting on the expenditure autonomy of local authorities.[96]

2.1.2.2 The revenue autonomy of the *Majimbo* local authorities

In assessing the revenue autonomy of the *Majimbo* local authorities, this section looks at their scope for own-source revenue, their control over the administration of the revenue from their own sources, as well as whether there was a system of intergovernmental transfers that was provided for to supplement their OSR.

2.1.2.2.1 The autonomy of the *Majimbo* local authorities over their own-source revenue (OSR)

Local authorities did not have direct powers to raise revenue from their own sources under the Constitution, and their power to raise OSR was subject to its being provided for under regional laws. In this regard, section 142 of the Independence Constitution required regional assemblies to pass laws to authorise local government authorities to impose: personal income taxes on persons resident within a local government's jurisdiction (concurrently with the national government); rates on land or buildings within the local government area (as well as contributions in lieu of rates from national government entities); poll taxes on their residents; entertainment taxes; and royalties from common minerals.[97] However, as pointed out above, the Constitution imposed limits on the extent of a local government's power to raise its own revenue by capping annual personal income tax at Ksh 600 and poll tax at Ksh 100.[98] A local authority's revenue bases were also limited by the power granted to Parliament to exempt

[95] Republic of Kenya (1966) 28.
[96] Republic of Kenya (1966) 28.
[97] See also, Constitution (1963), s 143(2) as read with s 142(11).
[98] Constitution (1963), s 142(5) & s 142(8).

entertainments of a national character from taxation by a local government authority.[99] The discretion of local government authorities to raise own revenue was further limited by power bestowed on a region's assembly to dictate the scale/rates, principles applied, as well as the manner of levying of taxes, duties, rates or fees by local government authorities.[100]Therefore, although they may have had a level of autonomy over their OSR, such autonomy was closely restricted.

Moreover, although the Constitution stated that the proceeds of any revenue raised by or on behalf of a local government authority belonged to it, regional laws were allowed to require that a fixed amount or proportion of such revenues be paid to the relevant region to be part of that region's revenue.[101] The fact that no national standards or uniform rate was applied nationally meant that regions were open to apply varying rates, thus translating to less revenue autonomy for those local authorities bearing higher rates. However, where a local authority considered the amount demanded from it by a region excessive, it had the right of appeal to the Senate's standing advisory committee, which had the power to either direct the local authority to pay as demanded, or pay a reasonable smaller amount.[102]

However, the post-independence Constitutional amendments repealed all revenue-raising powers of local government authorities in so far as these were drawn from and based on regional laws.[103] The revenue autonomy of the succeeding local authorities is discussed below.

2.1.2.2.2 The autonomy of the *Majimbo* local authorities over revenue administration

Local authorities were allowed to levy and collect their own revenue.[104] However, given the inter-jurisdictional nature of some taxes such as personal income tax, other local authorities were allowed to collect and remit taxes on behalf of other authorities.[105] Any sense of revenue

[99] Constitution (1963), s 142(9).
[100] Constitution (1963), s 143(1).
[101] Constitution (1963), s 145(1) as read with s 143(2).
[102] Constitution (1963), s 145(5) & (6).
[103] See, Amendments 1 & 2 above.
[104] Constitution (1963), s 143(1).
[105] Constitution (1963), s 143(3) & (4).

autonomy that would have been drawn from local governments administering their own revenue (reinforced by their determination of own tax effort) was hence divided.

2.1.2.2.3 **Intergovernmental transfers and grants and the autonomy of the *Majimbo* local authorities**

While no provision was made in the Independence Constitution for transfers or grants to be provided to local government authorities, regions are reported to have provided substantial grants to local authorities for the performance of their functions.[106] The details of the nature and extent of these grants is however not clear in literature.

2.1.2.3 The budgetary autonomy of the *Majimbo* local authorities

While scope for borrowing was allowed to local government authorities under the Independence Constitution, the level of control retained by regions over access to loans had potential to hinder the exercise of any budgetary autonomy by local authorities. The Constitution had established two bodies at the national level to facilitate local government borrowing. These were the Central Housing Board (CHB), which was mandated to issue loans to local authorities for housing purposes, and the Local Government Loans Authority (LGLA), which was required to make loans to local governments for other purposes outside housing.[107] However, regions retained significant control over access to loans by local authorities from these institutions. In addition to regions being members of these bodies,[108] a regional assembly's prior approval was required before local authorities could access loans from the CHB,[109] while loans from the LGLA could only be applied through a regional assembly which was required to provide its recommendation on the application when forwarding it to

[106] Muia, Ngugi and Gikuhi (2010) 17.
[107] Constitution (1963), s 149.
[108] Constitution (1963), s 149.
[109] Constitution (1963), s 149(3).

the LGLA.[110] Therefore, the close grip held by regions over access to borrowing held the potential to limit the exercise of budgetary autonomy by local authorities.

However, local government authorities were granted general discretion to use bank overdrafts, provided the loan taken did not exceed one-third of their annual revenues.[111] Though limited, this gave room for the exercise of local budgetary autonomy unhindered by regional approvals.

2.1.2.4 **Oversight and expenditure control of the *Majimbo* local authorities**

To facilitate oversight of the expenditure of local government authorities, the Independence Constitution made provision for mechanisms of audit, monitoring and, where necessary, intervention. With respect to the audit of local authorities, the Constitution required the Minister of local government to annually appoint an auditor for purposes of auditing their accounts.[112] The report emanating from such audit was required to be submitted to the individual local government authority, to the relevant regional assembly as well as to the Minister.[113] Although little was provided under the Constitution as to the specific oversight powers of either of these recipients upon receipt of the reports, the provision of auditing and audit reports to these institutions was aimed at securing expenditure control and responsible financial management at the local level.

The Constitution further imposed a monitoring mandate on regional assemblies over the affairs of local government authorities, and empowered them to take measures to intervene in specified instances.[114] In this respect, a regional assembly was required to commission an inquiry into the affairs of a local government authority in instances where it was apparent that the authority was either unlikely to meet its financial commitments, or was failing to exercise

[110] Constitution (1963), s 149(4).
[111] Constitution (1963), s 148.
[112] Constitution (1963), s 232(1).
[113] Constitution (1963), s 232(3).
[114] Constitution (1963), s 235.

its functions in the best interests of its inhabitants.[115] Based on the findings of the inquiry, the regional assembly was allowed to issue an order removing all councillors of the respective local government from office, and appointing in their place a Commission charged with performing all the duties of that local government.[116] The life of such a Commission was however capped at a maximum of nine months, during which time the regional assembly was required to take measures to ensure the reconstitution of the local government authority.[117] Despite being a drastic measure from the perspective of local autonomy, the circumstances were such as to warrant such an intervention to ensure the accountability of local authorities.

2.2 The fiscal autonomy of post-*Majimbo* local authorities

The abolition of regions, as well as the succeeding provincial councils, meant that only local authorities were left as the subnational level of government. The functioning of local authorities under this era was regulated under the Local Government Regulations of 1963 whose provisions were later enacted into the Local Government Act (LGA) that came into effect in 1970, and that continued regulating local governments until the adoption of the Constitution of Kenya in 2010. During this period, Kenya had a total of 175 local authorities made up of municipal councils, county councils, and a second relatively unimportant sub-level consisting of urban, area and local councils.[118]

This period was characterised by a centre-driven narrative of 'national unity' that saw the increasing centralisation of power and the incremental weakening of local authorities both in terms of their functions (as was the case with the enactment of the Transfer of Functions Act in 1969, under which most local government functions were recentralised)[119] as well as in terms of the resources they had access to. The period also saw the re-emergence of the pre-

[115] Constitution (1963), s 235 (2).
[116] Constitution (1963), s 235 (1).
[117] Constitution (1963), s 235(3).
[118] Sharp M & Jetha M 'Central government grants to local authorities: A case study of Kenya' (1970) 13 *African Studies Review* 43.
[119] Smoke (1993) 902; World Bank '*Kenya - An Assessment of Local Service Delivery and Local Governments in Kenya*' (2002) 54.

colonial deconcentrated PA system aimed at maximising control of subnational governance and development while minimising the role of local authorities in this respect.

This section discusses the scope for fiscal autonomy held by local governments under the LGA as well as under succeeding laws between 1964/65, to the period shortly before the enactment of the Constitution of Kenya 2010.

2.2.1 The expenditure autonomy of post-*Majimbo* local governments

While the abolition of regions gave local authorities an opportunity to resume the performance of the broad functions and the exercise of the powers that had been bestowed on them shortly before independence,[120] the central government had such an increasingly significant grip on their operations that the any notion of expenditure autonomy on their part was almost non-existent.

Nonetheless, their functions and powers, as provided for under the LGA, ranged from the performance of specified functions, some subject to the consent of the Minister for Local Government (minister), to broad regulatory powers that allowed them to establish, maintain, control, regulate and prohibit various matters assigned to them under the Act.[121] Some of the matters over which local governments were required to exercise their powers included: the supply of water and electricity; housing and the erection and maintenance of dwelling houses; land-use control; the establishment and maintenance of sanitary services, slaughter-houses, fire brigades, ambulance services, cemeteries and crematoria, lodging-houses, restaurants and footways; as well as the regulation of, among other things, brick-making, quarrying, game parks and forests, public amusements and advertisements.[122] Local governments were also allowed to establish and maintain schools and education institutions subject to the consent of the Minister.[123] With these responsibilities came the power of local governments to make

[120] Rocaboy, Vaillancourt & Rejane (2013) 162.
[121] LGA, s 201.
[122] LGA, ss 178, 181, 177, 166, 160, 162.
[123] LGA s 152 (1).

by-laws in respect of those matters, and to incur expenditure for the carrying out of those functions.[124]

However, similar to the situation with the local authorities under *Majimbo*, the Minister's extensive powers over local authorities overshadowed any shred of independence on their part. The Minister, for instance, had the power to make adoptive by-laws covering any local authority function, which had the same legal force as if made by a local authority.[125] Moreover, the Minister could also specify the extent to which those by-laws could be adopted by the local authorities, and was further allowed the prerogative to propose amendments to them for adoption by local authorities.[126] Furthermore, the Minister retained the last call on the content of any by-law given his or her power to approve all by-laws before such could have any force of law.[127] This therefore gave the Minister ultimate power with respect to the legislative function of local authorities, as he was allowed to alter or reject by-laws at the approval stage.[128]

Moreover, despite the clear stipulation of local government functions and powers in the LGA, the Minister had general powers to direct any local authority to perform any of its duties in a specified manner and within a given time, failure for which the Minister was empowered to undertake such duties and recover the costs from the local authority.[129] In addition, the Minister had the power to require that a local authority submits a proposal to him/her on how it intended to exercise any specific power conferred by law on the local authority.[130] Where such a proposal was acceptable, the Minister was required to instruct the local authority to exercise the specified power in the manner contained in the proposal.[131] In instances where a local authority failed to submit the required proposal or was opposed to any of the Minister's modifications to the submitted proposal, the Minister was given the power to prescribe and

[124] LGA, s 201 as read with s 150*A*.
[125] LGA, s 210(1)(*a*) as read with s 210(8)(*a*).
[126] LGA, s 210 (1)(b) as read with s 210 (8)(*c*).
[127] LGA, s 204(1) & (4).
[128] LGA, s 204(3).
[129] LGA, s 246(1).
[130] LGA, s 247(1).
[131] LGA, s 247(2).

order the local authority to exercise the power in a particular manner and within a specified time.[132] In case a local authority refused to comply with such orders, the Minister was then empowered to exercise those powers on behalf of the local authority and was entitled to recover any costs incurred in the process from the local authority.[133] As such, local authorities lacked even the discretion over the performance of their functions and so any autonomy they may have had over decisions related to their own expenditure was significantly limited.

Additionally, the power of the Public Service Commission (PSC) to appoint senior local government employees further weakened any discretion local authorities had over the hiring of local government employees.[134] In this respect, the PSC was given powers to appoint chief clerks, treasurers, engineers, medical officers of health, public health officers as well as other officers deemed necessary.[135] Although local authorities were granted the discretion to decide their salaries and allowances, this was subjected to the approval of the Minister, thereby further restricting local government discretion over the matter.[136] Moreover, the fact that local authorities had no powers to discipline or dismiss these senior officials meant that they could not be held accountable for failing to follow any instructions given by local authorities.[137] This significantly weakened any administrative control local authorities had over the running of the local government.

Also, although local governments were allowed to prepare and approve annual and supplementary budgetary estimates of their expenditure, they were required to submit such approved estimates for ministerial approval before they could be implemented.[138] The Minister was, in this respect, allowed to either approve or disallow the estimates as a whole or in part, and could make modifications or impose any conditions he saw fit.[139] Although an

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132 LGA, s 247(3).
133 LGA, s 247 (4).
134 LGA, ss 107(1), 109(1), 111(1) & 112.
135 LGA, ss 107(1), 109(1), 111(1) & 112.
136 LGA, s 107(1).
137 Southall R & Wood G 'Local government and the return to multi-partyism in Kenya' (1996) 95 *African Affairs* 515; Muia, Ngugi & Gikuhi (2010) 25.
138 LGA, s 212(4).
139 LGA, s 213(1).

allowance was given for the Minister to exempt any local authority from the requirement of obtaining his or her approval for budgetary estimates, this power, in addition to those above, effectively converted local governments into administrative branches of the central government with no expenditure autonomy.[140]

In addition to the above, the autonomy and effectiveness of local authorities was undermined by the existence and consistent reinforcement of the parallel deconcentrated system of provincial administration (PA) that gave rise to ambiguous authority relationships and jurisdictional overlaps.[141] In this regard, the implementation of the District Focus for Rural Development (DFRD) in 1983, under which the central government used District Development Committees (DDCs) to plan, implement and manage centrally [well-] funded projects at the local level, bypassed locally elected local governments and led to a duplication of mandates, which only served to weaken the poorly funded local authorities.[142] The DFRD bureaucracy at the local level also led to the stalling of legitimate local projects, even in instances where local authorities' representatives had made a genuine case for their implementation.[143] Although hailed by some as progressive and touted as an exercise at decentralisation,[144] in practice the DFRD ended up tightening central control over local development to the detriment of the then greatly-subordinated local authorities.[145] This was worsened by the fact that districts that were the focus of the DFRD had the same geographical boundaries as county councils, hence directly competing with county councils in service delivery.[146] The resulting fragmentation therefore succeeded in blurring the lines of political accountability and administrative authority between the deconcentrated structures and local authorities.[147]

[140] LGA, s 213(3).
[141] See also, Smoke (1993) 904-5; Stamp (1986) 29-30; World Bank (2002) viii & 7; Chapman J, Gakuru P & De Klerk G 'Local fiscal stress in sub-Saharan Africa: The Kenyan example' (2003) 26 *International Journal of Public Administration* 1542.
[142] See also, World Bank (2002) 7 & 8.
[143] Smoke (1993) 905.
[144] Barkan J & Chege M, 'Decentralising the state: District focus and the politics of reallocation in Kenya' (1989) 27 *The Journal of Modern African Studies* 431.
[145] Southall & Wood (1996) 508 – 509.
[146] World Bank (2002) 8.
[147] Stamp (1986) 30.

Moreover, the creation of the Constituency Development Fund (CDF) in 2003, which provided funds for the implementation of local projects by Members of Parliament (MPs) also served the same purpose of undermining local government authority over local service provision and local development in favour of the central government.[148] The fact that control over CDF was undertaken by MPs meant that the planning and management of projects under the CDF was not subject to or linked to local authorities.[149] The parallel nature of this arrangement thus often led to a lack of coordination and duplication, which adversely affected service delivery by local authorities.[150]

In the end, therefore, increased central control and extensive interference with the expenditure mandates of local authorities[151] immensely undermined any room for the exercise of expenditure autonomy by local authorities. This meant that local government expenditure was often de-linked from legitimate local service delivery needs, a factor that weakened local authorities and their relevance to the public, while also impacting the allocative efficiency of their expenditure decisions. Moreover, the fact that central decision-making in this regard was subject to few rational guidelines or rules[152] further weakened the position of local governments in this respect.

2.2.2 The revenue autonomy of post-*Majimbo* local authorities

As with the situation regarding the expenditure autonomy of local governments above, this period was characterised by the clamping down on the revenue autonomy of local governments, leading to the increased dependence by local authorities on the central government for transfers to finance local government expenditures. This section discusses this by looking at the scope for own revenue, revenue administration and the nature and extent of transfers extended to local authorities over this period.

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148 Rocaboy, Vaillancourt & Rejane (2013) 165.
149 Muia, Ngugi & Gikuhi (2010) 26.
150 Muia, Ngugi & Gikuhi (2010) 26.
151 Smoke (1993) 905.
152 Smoke (1993) 904.

2.2.2.1 **The autonomy of post-*Majimbo* local authorities over their own-source revenue (OSR)**

While post-*Majimbo* local authorities had access to relatively broad revenue-raising powers, discretion over taxable bases and the applicable rates was restricted by their subjection to ministerial approval.[153] Some own revenue sources were also recentralised over this period, hence further weakening the revenue autonomy of local authorities. Aside from this, various factors that were internal to local authorities impaired the ability of local authorities to maximise the realisation of revenue from the sources they had access to. In the end, therefore, the percentage of local budgets that was funded from local OSR kept declining which implied an increasing reliance by local authorities on central transfers for the financing of local expenditure, along with a corresponding decline in the revenue autonomy of local authorities.

Although access to income tax through the imposition of Graduated Personal Tax (GPT) had initially supported the bulk of local expenditure, the recentralisation of GPT alongside other sources of fees and charges, following the recentralisation of local government functions under the Transfer of Functions Act of 1969, greatly weakened the revenue autonomy of local authorities.[154] This left post-*Majimbo* local governments with four main sources of own-source revenue, provided for under the LGA, namely charges and fees drawn from the exercise of their regulatory powers, charges and fees drawn from the provision of services, revenue drawn from income-generating activities, and revenue from the imposition of fines and penalties.[155] Although no direct provision was made under the LGA empowering local governments to impose rates on land and property, various other indirect provisions in the Act point to such authority, and local authorities continued to collect rates from property.[156]

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[153] Smoke (1993) 903.
[154] Smoke (1993) 902; Nyariki T, Wa Luka G, Too J *et al* 'Financial management in local authorities' in T Barasa & W Eising (eds) *Reforming Local Authorities for Better Service Delivery in Developing Countries: Lessons from RPRLGSP in Kenya* (2010) 119. GPT was levied on an individual's annual income. See, Sharp & Jetha (1970) 43; Bosire (2013) 125.
[155] LGA, s 148(2).
[156] See, s 2 which defines revenues to include rates. See also, ss 222(2), 224, 236(2) and s 269(1)(3).

With respect to revenue from regulatory services, local government authorities had broad powers of regulation that were comprehensively detailed under the LGA. They were allowed to charge fees for the issuance of licenses and permits with respect to specified persons, matters, premises or trades which they had power to control or license.[157] In this respect, local governments were required to regulate, control and/or license:

a activities such as dealings in hides and skins; brickmaking and quarrying; the keeping of animals, birds and bees; musical performances, public amusement activities, and entertainments and advertisements, among others.[158]

b businesses, premises and trades such as lodging and boarding-houses; factories where food or drink are manufactured, prepared or stored; ferry boats; public halls and recreational facilities; as well as hawkers, barbers and other traders;[159] and

c persons such as undertakers and keepers of lodging and boarding-houses.[160]

To facilitate the collection of charges and fees, local government authorities were granted enforcement powers which, for instance, in respect of the regulation of vehicles, animals and birds, involved impounding them, charging the owners, and, where necessary, selling such items.[161] This, while constituting a regulatory enforcement mechanism, also served as a source of own revenue. In addition to the above, local government authorities were allowed to impose fines and penalties for breach of their by-laws and for delays in the payment of applicable charges and fees.[162]

With regard to revenue drawn from the provision of services, local government authorities could impose charges or fees for the provision of any service or good or documents in the ordinary course of discharging their duties or powers.[163] In this respect, local governments were required to establish and maintain: cattle cleansing facilities; premises for dealing in

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157 LGA, s 148(1)(*a*) & s 163*A* (1).
158 LGA, s 152 & s 162.
159 LGA, ss 161(*c*) & (*d*)(ii), s 162 & 163.
160 LGA, ss 161(*a*) & (*c*).
161 LGA, s 160 (*q*).
162 LGA, ss 201(2) & s 163*A* (3).
163 LGA, s148(1)(*b*).

hides and skins; game parks and accommodations within the parks; sanitary services for refuse and effluent removal; depots for dealing with milk and milk products; mortuaries, cemeteries and crematoria; works for the supply of water; and the supply of electricity or power within their areas.[164] The charges and fees obtained from the provision of these services constituted a critical source of revenue for the local authorities.

Revenue from income-generating activities also added to the local authorities' OSR. For instance, local authorities were allowed to establish and maintain omnibuses or other vehicles for the carrying of passengers[165] They could also engage in the manufacturing and sale of by-products resulting from the carrying out of any of their statutory functions[166] such as distributing, buying and selling milk or milk products as part of their obligation to establish and maintain milk depots.[167] Alongside their obligation to provide works for the supply of electricity, local governments were allowed to sell electric lines, fittings and appliances to private consumers.[168] Additionally, local authorities were allowed to establish, maintain and let lodging-houses and boarding-houses, tea-rooms, cafes, restaurants, houses, snack bars, shops, stalls and stands,[169] in addition to their power to establish housing schemes, erect dwelling-houses and charge rent for the tenancy or occupation and/or to sell such dwelling houses or the land set aside for such schemes.[170] Engagement in these income-generating activities added to their OSR.

However, although post-*Majimbo* local government authorities had a diversified base for the generation of own-source revenues compared to their predecessors, they were only required to raise revenue from bases and on rates approved by the Minister as well as other central government ministries.[171] Although a limited degree of discretion was allowed in the imposition of property rates, an upper limit of 4 per cent was set in legislation beyond which

[164] LGA, ss 154 (*a*) & (*b*), 155(*e*), 160(*a*) & (*g*), 161(*a*), 178(1) & s 181(1).
[165] LGA, s 153(1)(*a*).
[166] LGA, s 160 (*f*).
[167] LGA, s 160 (*g*).
[168] LGA, s 181 (1).
[169] LGA, s 161(c) & (*d*)(*i*).
[170] LGA, s 177(1)(*d*), (*e*) & (*f*).
[171] Smoke (1993) 903; World Bank (2002) 59.

local authorities would have required ministerial approval.[172] Additionally, the Minister's prior approval was required before local authorities could use revenue collected from the Local Authorities Services Charge (LASC) that was introduced in 1988/89 to boost local authorities' OSR (although these charges were later recentralised).[173] All these limitations impacted the economic efficiency as well as the downward accountability of local authorities. They also complicated revenue projection during budgeting, as any proposed increases in rates under local government budgets were subject to approval or rejection by the central government.[174] Moreover, restrictions on expanding own revenue bases further prevented local authorities from exploring ways to strengthen their revenue autonomy.

Nonetheless, according to a World Bank report for the 2009/2010 financial year, local authorities were able to finance an average of 59 per cent of their spending from their OSR.[175] This, however, represented a general decline from previous records that had put this figure at 74 per cent in the 2000/2001 and 62.4 per cent in 2005/2006.[176] Out of this 59 per cent, individual local OSR sources contributions were as follows: property rates (12.1%);[177] other sources (10.7%); single business permits (a form of regulatory revenue) (9.8%);[178] vehicle parking (7.9%); market fees (4.1%); agricultural cess (3.9%); game park fees (3.9%); house rents (2.1%); contributions in lieu of rates (2.0%); plot rents (1.3%); and water and sewerage fees (0.9%).[179] While contributions from rates and water and sewerage fees would have been expected to be higher, their contribution was affected by the fact that out of the 175 local authorities, only 79 had been approved as rating authorities with the power to collect rates.[180] Moreover, only 41 local authorities could collect water and sewerage charges which were, moreover, required to be utilised to service water debts and the maintenance and

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172 World Bank (2002) 59.
173 Muia, Ngugi & Gikuhi (2010) 20; LASC authorised local authorities to collect taxes from individuals as well as business entities resident or operating within the jurisdictions.
174 World Bank (2002) 59-60; Smoke (1993) 906.
175 World Bank, *Devolution Without Disruption: Pathways to a Successful New Kenya* (2012) 73.
176 Osiolo H 'Intergovernmental fiscal transfers and fiscal capacity in Kenya' (2016) *International Journal of Public Administration* 2.
177 World Bank (2002) 56.
178 World Bank (2002) 57.
179 World Bank (2002) 70.
180 World Bank (2002) 57.

management of supply infrastructure within the water sector, rather than being used to defray the local authorities' operational expenses.[181]

Besides the growing decline in OSR's contribution to local government expenditure, it was also common for local authorities to realise less than half of their annual revenue targets.[182] Among the underlying factors included poor revenue administration, the effect of cultural factors, the general lack of enforcement authority on the part of local authorities, political interference as well as the impact of growing intergovernmental transfers on revenue effort. In terms of revenue administration, local government institutional weaknesses such as the failure to keep, or the keeping of inaccurate or incomplete financial records affected the ability of local authorities to project and collect revenue from their own sources.[183] Moreover, the lack of qualified staff affected the ability of local authorities to maximise their own revenue by, for instance, basing their rates on the value of unimproved land. This made the property rates tax-base inflexible relative to the rate of land-based economic activity. Also, by charging other local taxes based on the number of units rather than their value, they created a mismatch between the overall volume of trading and the revenue generated.[184] Moreover, cultural factors made the taxation of some culturally significant assets such as land and livestock difficult.[185]

Local government OSR outputs were also affected by the general lack of legal enforcement authority for certain revenue sources which forced local authorities to rely on the central government that was under no legal obligation to assist.[186] Where local authorities sought to enforce the payment of taxes and fees by, for instance, disconnecting water or evicting tenants, the political interference of local councillors prevented them from going through with this, thus affecting their ability to collect owed revenues.[187] Lastly, the lower political and

[181] World Bank (2002) 59.
[182] Smoke (1993) 906.
[183] Smoke (1993) 907.
[184] Smoke (1993) 905.
[185] Smoke (1993) 906.
[186] Smoke (1993) 906.
[187] Smoke (1993) 907.

administrative cost that came with the commencement and growth in transfers from the central government is reported to have disincentivised local authorities from maximising the collection of their own revenues, thus leading to possible revenue substitution.[188] All these factors thus collectively impaired the revenue autonomy of local authorities.

2.2.2.1.1. The autonomy of post-*Majimbo* local authorities over revenue administration

Local governments had the power to levy and collect their own revenues. To facilitate this, they were granted the power, for instance, in regard to the supply of water and electricity, to deny access, or cut off and charge administrative costs for reconnecting supply to any person that had defaulted or had outstanding arrears.[189] This was in addition to their power to impound, charge for or sell offending properties, discussed above. This went a long way in facilitating their revenue autonomy as they were in charge of their own revenue effort, which translated to the amount of OSR eventually collected.

2.2.2.2. Intergovernmental transfers and grants and the autonomy of post-*Majimbo* local authorities

To supplement the revenues of local government authorities, various grants were issued by the central government both conditionally and unconditionally.[190] While initially some of these grants were issued temporarily to cover the recentralisation of local government OSR sources such as the GPT,[191] with some being discontinued following the recentralisation of some local government functions[192] or at the end of their stipulated periods,[193] some existed until the coming into effect of the Constitution of Kenya 2010. Generally, the average contribution of intergovernmental transfers to the annual local government budgets grew incrementally

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[188] World Bank (2002) 60; Muia, Ngugi & Gikuhi (2010) 20; Nyariki, Wa Luka, Too *et al* (2010) 115. Revenue substitution refers to the substitution of OSR with transfers.
[189] LGA, s 178(3) & s 181(2).
[190] Muia, Ngugi & Gikuhi (2010) 18.
[191] Muia, Ngugi & Gikuhi (2010) 19; Stamp (1986) 29.
[192] Muia, Ngugi & Gikuhi (2010) 19; Smoke (1993) 902.
[193] Nyariki, Wa Luka, Too *et al* (2010) 119.

from 26 per cent in 2000/2001[194] to 30 per cent in 2003/2004[195] to 37.6 per cent in 2005/2006[196] to 41 per cent in 2009/2010.[197] This pattern revealed an increasing dependence by local authorities on central transfers to finance their expenditure, a factor that pointed to their declining revenue autonomy over the period. Out of the grants issued to local authorities, the most significant ones, which lasted until the dissolution of local authorities, are the grants from the Local Authorities Transfer Fund (LATF) and the Road Maintenance Levy Fund (RMLF). These are discussed in detail below.

The Local Authorities Transfer Fund (LATF) was established as a grant under the Local Authorities Transfer Act enacted in 1998, to allow for the sharing of income tax collected centrally.[198] The Act required 5 per cent of personal income tax collected by the central government to be paid into the Fund for distribution among local authorities.[199] Although the LATF transfers had conditions for the release of funds aimed at incentivising improvements in service delivery, as well as improvements in financial and debt management, they were otherwise unconditional (discretionary block grants) upon release.[200] However, the specific amount to be paid out to each local authority and the manner of payment was required to be stipulated by the Minister of Finance on the advice of an Advisory Committee[201] largely made up of officials appointed by central government ministries.[202] This, hence, placed the process of revenue distribution at the discretion of the central government, a factor that didn't augur well for transparency and objectivity such as would extend a degree of autonomy to receiving local governments. Moreover, the Minister of Finance, in consultation with the Minister for Local Government, retained the power to stipulate the criteria for the disbursement of whichever amount was allocated to the various local authorities.[203] The exclusion of local

[194] Osiolo (2016) 2.
[195] Nyariki, Wa Luka, Too *et al* (2010) 115.
[196] Osiolo (2016) 2.
[197] World Bank (2012) 73.
[198] Local Authorities Transfer Fund (LATF) Act No 8 of 1998, s 3 & 4; World Bank (2002) x.
[199] LATF Act, s 5(2); Muia, Ngugi & Gikuhi (2010) 20; World Bank (2002) 55.
[200] World Bank (2002) x & 55-56; Chapman, Gakuru & De Klerk (2003) 1532; World Bank (2012) 69.
[201] LATF Act, s 6(1).
[202] LATF Act, s 8.
[203] LATF Act, s 10 (a).

authorities or their representatives from any decision-making relating to the distribution as well as the disbursement of transfers, hence weakened any claim local authorities could have had to revenue autonomy drawn from their receipt of unconditional transfers.

However, efforts were subsequently made to ensure objectivity and transparency in the distribution for LATF funds. In this regard, a formula was adopted that shared the aggregate LATF funds as follows: at least seven per cent was shared equally across all local authorities, 60 per cent of the fund was shared based on a local authority's population size, while the balance was shared based on the aggregate urban population in each local authority.[204] While this ensured transparency and objectivity, thus providing a basis for local authorities to exercise autonomy over the expenditure of their allocated shares, the fact that disbursement decisions were still made centrally without the involvement of local authorities and without a guiding framework meant that the centre still had control over when local authorities could receive the funds as well as the amounts to be received. Nonetheless, after its introduction, the LATF became the primary source of funding for local authorities,[205] accounting for around 35 per cent of their total revenue in 2008,[206] with this figure being as high as 90 per cent for some local authorities.[207]

In addition to the LATF, an amendment to the Road Maintenance Act in 1997/98 saw the initiation of the RMLF to provide conditional grants to local authorities for the maintenance of local government roads.[208] The RMLF was financed by the imposition of tax on petroleum products as well as from the imposition of toll charges.[209] Although meant for local authorities, these funds were spent centrally by the Ministry of Local Government on behalf of the local authorities.[210] This, hence, converted the RMLF into an indirect conditional grant over which local authorities had no expenditure discretion.

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[204] Osiolo (2016) 1; Rocaboy, Vaillancourt & Rejane (2013) 185.
[205] World Bank (2012) 69.
[206] Rocaboy, Vaillancourt & Rejane (2013) 185.
[207] Nyariki, Wa Luka, Too *et al* (2010) 129.
[208] World Bank (2012) 69.
[209] Rocaboy, Vaillancourt & Rejane (2013) 186.
[210] World Bank (2002) 56.

2.2.3. The budgetary autonomy of post-*Majimbo* local authorities

Whereas post-*Majimbo* local authorities had a broad scope for the exercise of their budgetary autonomy, and could raise loans for any purpose in relation to their functions, most of these avenues were accessible only with the approval of or under rules issued by the central government through the Minister for Local Government.[211] The sources of loans that were open to local authorities included a specially-established and funded Local Government Loans Authority (LGLA), floating of stocks and bonds, temporary loans and overdrafts from the central government and commercial banks, as well as loans from a specially-set-up local authority's own 'lending fund'. Such loans were to be charged and/or recovered from the revenues of the local authorities or from any security provided by them.[212]

While local authorities could access loans and advances from the Local Government Loans Fund, established under statute and managed by the LGLA,[213] the LGLA is reported to have had a reputation for politicised fund allocation,[214] a factor that pointed to there having been the problem of inequitable access to loans by local authorities. Nonetheless, money for the Fund was drawn from: parliamentary appropriations towards the Fund; money borrowed by the LGLA; money derived from any investment made by the LGLA; and repayments of loans and interest on those loans by local authorities.[215] Despite the possible inequity in access to loans from the LGLA, it nonetheless facilitated the budgetary autonomy of those local authorities that were able to access loans from it, with its eventual dissolution leading to a major decline in borrowing by local authorities.[216]

Also, while local government authorities were allowed to borrow by issuing bonds and/or stock redeemable within a period of fifty years[217] the Minister of Finance held the power to make rules for the issuance of such bonds and/or stock including stipulating a lesser maturity

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[211] LGA, s 222(1).
[212] LGA, s 222(2) as read with the LGA s 8.
[213] LGA s 3 as read with ss 6(1) & s 7(1) & (2).
[214] Smoke (1993) 904.
[215] LGA s 6(3) as read with s 12.
[216] World Bank (2002) 62.
[217] LGA, s 223(1) & (3).

period for the loans.[218] The Minister was also allowed to stipulate the rates for a local authority's annual contributions to a sinking fund set up for the repayment of such loans.[219] Despite this level of central control over the issuance of bonds, Nairobi went on record as the only local authority to have issued bonds.[220] However, its last bond issue attracted no offers, thus necessitating the central government's intervention and forcing the city to cease floating bonds.[221]

In addition to the above, the consent of the Minister was required for local government authorities to take out short-term loans or overdrafts from the government, banks or other sources.[222] Such loans were, however, to be utilised in instances where a local government authority required temporary funds to generally facilitate the proper carrying out of its functions or to take care of local expenses pending the taking out of a planned loan.[223] The challenge, however, was that local authorities ended up with large overdrafts, beyond approved levels, a factor that contributed to fiscal stress at the local level.[224]

Moreover, although local authorities were given the leeway to establish rules for their borrowing from their own 'lending funds', these rules nonetheless required the approval of the Minister.[225] Under this form of borrowing, a local authority was permitted to use funds from its own revenues that were not immediately required to establish a lending fund from which the local authority would then advance itself a loan.[226] Money borrowed in this way was, however, required to be repaid with interest, whenever required, to meet their original expenses.[227]

[218] LGA, s 223(2).
[219] LGA, s 223(3).
[220] Chapman, Gakuru & De Klerk (2003) 1530-31; World Bank (2002) 62.
[221] Chapman, Gakuru & De Klerk (2003) 1530-31; World Bank (2002) 62.
[222] LGA, s 225(1).
[223] LGA, s 225(1).
[224] Chapman, Gakuru & De Klerk (2003) 1531.
[225] LGA, s 221 (1) & (2).
[226] LGA, 221(2).
[227] LGA, 221(2).

Generally, however, while post-*Majimbo* local authorities were able to undertake borrowing both externally (through development agencies such as the World Bank) and locally from the central government or from local banks,[228] they ended up unable to service their debts, thereby causing further fiscal stress at the local level.[229] This forced creditors to move in to attach local authority properties with the central government being compelled to intervene to finance foreign debt.[230] Eventually, local authorities were unable to access commercial debt due to a general lack of creditworthiness resulting from unreliable OSR, huge outstanding debts as well as the lack of clean audited financial reports.[231]

2.2.4. **Oversight and expenditure control of post-*Majimbo* local authorities**

A prominent feature of the post-*Majimbo* local authorities was the firm grip held by the central government through the Ministry for Local Government on their operations. Such grip became even more apparent when it came to the oversight and expenditure control powers bestowed on the Minister. While the supervision of local governments generally involved aspects of regulation, monitoring and support, there was evident bias towards control and interventionist measures.[232]

As part of the regulatory requirements aimed at securing expenditure control, local authorities were required to maintain balanced budgets[233] and to comply with budget ceilings issued by the Minister in the preparation of their annual budgets. In this regard, the Ministry, as part of its obligation to regulate and approve local budgets, annually issued a circular detailing revenue and expenditure ceilings that would guide both local budgeting and expenditure.[234] Under the circular, budgetary estimates were, among other things, required to be based on an average of a local authority's performance in the past three years.[235]

[228] World Bank (2002) 61; Chapman, Gakuru & De Klerk (2003) 1531.
[229] Chapman, Gakuru & De Klerk (2003) 1531.
[230] Chapman, Gakuru & De Klerk (2003) 1531.
[231] World Bank (2002) x, 61 & 62.
[232] Nyariki, Wa Luka, Too *et al* (2010) 110 & 124.
[233] Chapman, Gakuru & De Klerk (2003) 1536.
[234] Nyariki, Wa Luka, Too *et al* (2010) 104-105 & 113.
[235] Nyariki, Wa Luka, Too *et al* (2010) 113.

However, the lack of proper financial records and poor book keeping by local authorities made most of these estimates largely unrealistic, thus converting budgeting from a planning exercise to an annual ritual staged to satisfy legal requirements.[236] Additionally, although some of the ceilings required, for instance, that at least 10 per cent of total local expenditures to be channelled towards the repair and maintenance of projects, and that the share of personnel expenditure to total revenues should not exceed 45 per cent, local authorities found compliance with these ceilings difficult and as a result some failed to comply with them.[237]

Although the LGA obligated local government authorities to keep proper financial records and books of accounts of all their transactions,[238] its failure to provide specific sanctions for any failure to do so[239] resulted in local authorities having and producing financial records and statements of accounts that were incomplete, and that failed to meet generally acceptable accounting standards.[240] This often led to audit reports from the auditor general that were disclaimers of opinion for most local authorities, with a few qualified opinions.[241]

While local authorities had internal auditors who were supposed to assist with monitoring to ensure expenditure control and proper financial management, their being part of and under the direction of the local authority's treasurer, as well as their preoccupation with operational issues, made them fail at providing the necessary checks with respect to local expenditure.[242] This is one of the reasons behind poor financial management in local authorities, and informed the central government's decision in 1990/2000 to amend the LGA to require each local authority to establish an internal audit unit that was independent from the local authority's

[236] Nyariki, Wa Luka, Too *et al* (2010) 113.
[237] Rocaboy, Vaillancourt & Rejane (2013) 174-5.
[238] LGA, s 228(1).
[239] Nyariki, Wa Luka, Too *et al* (2010) 110.
[240] Nyariki, Wa Luka, Too *et al* (2010) 103-4.
[241] Nyariki, Wa Luka, Too *et al* (2010) 103-4.
[242] Nyariki, Wa Luka, Too *et al* (2010) 123.

treasurer's office, in order to aid internal processes of monitoring and supporting proper financial management by local authorities.[243]

Despite the involvement of the public in local decision-making serving to ensure a local authority's responsiveness to local service delivery needs, while at the same time facilitating horizontal accountability for local expenditure through mechanisms of social auditing,[244] the LGA fell short of providing a direct role for communities in this regard. While the LGA made provision for access, by a local government's inhabitants, to annual budgetary estimates, audit reports and annual reports, such access was subjected to their having to apply for them, with local authorities having no obligation to actively provide this information or to provide forums for community participation.[245] Although the emergence of multiparty democracy in Kenya in 1992 saw a gradual increase in participatory approaches to local decision-making[246] the lack of a formal legal requirement in this regard significantly weakened any form of horizontal accountability, thus largely excluding the people from local decisions affecting them.

Outside the systems of internal controls, local authorities were required to annually prepare and submit their financial statements to the Controller and Auditor General (CAG) for external auditing,[247] with final audit reports being submitted to the Finance Minister (as well as the local government and the Minister for Local Government).[248] The reports were then required to be tabled and considered by both Parliament and the relevant local government authorities.[249] Although the procedure and nature of oversight measures required to be undertaken upon tabling and consideration of the reports were not stipulated, the Minister of Local Government was allowed, after receipt of the report, to issue whichever instructions he considered fit based on the report, and which the relevant local authority was under an

[243] World Bank (2002) 50.
[244] World Bank (2002) 48.
[245] LGA, s 212(9), 230(*b*) & 243(3)(*b*).
[246] World Bank (2002) 53.
[247] Public Audit Act No 12 of 2003, s 21(1).
[248] Public Audit Act, ss 24 (1) & (3) as read with s 27.
[249] Public Audit Act, ss 25(1) & (2); LGA, s 230(a).

obligation to comply with.[250] While such unregulated powers by the minister could have resulted in possible limitations on any fiscal autonomy held by local authorities, the measures were nonetheless necessary to ensure expenditure control and the accountability of the local government authorities.

Additionally, section 249(1) of the LGA empowered the Minister to reduce any central government transfers or grants to a local government for a succeeding year where the Minister was of the opinion that: a local government authority was not utilising its revenues in the best interests of the local government as a whole; the affairs of the local authority were administered in a wasteful or inefficient manner; or that the local authority had failed to conform with any provisions of the LGA.[251] Although this was a drastic measure with significant consequences, not only on the expenditure and revenue autonomy of local authorities but more importantly on actual service delivery, the requirement for the Minister to have an inquiry undertaken prior to taking such a decision served to ensure that the circumstances of the affected local authority merited such an intervention.[252]

Moreover, in an apparent counter to the broadened space for the exercise of budgetary autonomy, various intervention measures were built into the system to secure the repayment of loans whose implementation had the potential to significantly limit various aspects of the fiscal autonomy of local authorities. To begin with, where a local authority was unable to settle a debt pursuant to a court order, the High Court had the power, upon a petition by the creditors, to appoint a person (receiver) who would be charged with receiving the local authority's revenue for purposes of settling the loan.[253] Where the failure to repay was in respect of a loan obtained from the LGLA, the law also allowed the Minister, 60 days after the loan had fallen due, to take over revenue collection from the local government authority so as to recover the sums owed, as well as any costs and expenses incurred in the process of

[250] LGA, s 234 (1).
[251] See also, LGA, s 250(1).
[252] LGA, s 239(1).
[253] LGA, s 224(1).

recovering the loan.[254] Also, where a local authority had defaulted on repaying a loan that had been taken to finance an income-generating facility, the Minister of Finance was allowed to appoint an agent to collect payments from the services provided by the facility, and to use the proceeds to settle the outstanding loan.[255] Moreover, the Minister was also allowed to deduct money from transfers and grants meant for a local government for purposes of paying off the central government, or any other person owed money by a local government authority.[256] Although some measures such as engaging the defaulting local authority were required to be taken prior to the adoption of these intervention measures, the assumption of the revenue administration mandate of local authorities, or the deduction of revenues due to a local authority as part of their implementation, meant a direct limitation on both the revenue as well as the expenditure autonomy of local governments. The fact that they were warranted by the default of local authorities served to deter the failure of local authorities to honour their debt obligations.

Lastly, the Minister had the power to remove members of a local government authority from office and to appoint a commission in their place to run the affairs of the local authority, or to alternatively order the winding up of the local authority.[257] The Minister was allowed to exercise this power where, in his or her opinion, the local authority was unlikely to be able to meet its financial commitments or was failing to exercise its functions in the best interests of its inhabitants.[258] The appointed commission was allowed to exercise all the powers and discharge all the duties of the local authority, thereby negating any local fiscal autonomy for the two-year duration over which it was required to be in existence.[259] The central government is reported to have used this intervention measure to dissolve 12 local authorities between 1970-1992, replacing them with nominated commissions on the suspicion of mismanagement.[260] Although the Minister was required to have an inquiry conducted prior to

[254] LGA, s 9.
[255] LGA, s 251*A* (1).
[256] LGA, s 251.
[257] LGA, s 252.
[258] LGA, s 252(1).
[259] LGA, s 252(2) & (3).
[260] Southall & Wood (1996) 508.

exercising this power,[261] so as to ensure that its use was justifiable on the basis of securing accountability, there were instances where the central government was reported to have abused this power to pursue political vendettas against 'local adversaries'.[262] The lack of checks and balances on the central government's intervention decisions, therefore, posed a major threat to any form of fiscal autonomy exercised by local authorities.

3 The transition to devolved governance (1998 – 2010)

Kenya's post-colonial centralisation of power and the resulting increased concentration of state power in the person of the president resulted in the diminution of democratic space, underdevelopment (selective development) and ethnic conflict. As a result, the political opposition, civil society organisations, religious groups, among other collectives, began agitating for constitutional reform. This gave rise to two separate constitutional review and constitution-making phases.[263] The first began in 1998 with the enactment of the Constitution of Kenya Review Act of 1997 (CKRA)[264] and culminated in a new draft constitution (the Wako Draft) that was subjected to and defeated in the referendum of 2005.[265] The second was initiated following the 2007/2008 post-election violence and resulted in the adoption and promulgation of Kenya's current constitution after a national referendum in 2010. Although separate, the second phase drew on and was a harmonisation of the issues and proposals gathered in the first phase.[266] The issues and rationale for the various proposals, therefore, largely remained the same.

Among the issues raised by the public during the constitution-making process include: the centralisation of power that had led to the shrinking of democratic space; exclusion of the people from political decision-making that in turn resulted in exclusionary policies; marginalisation of communities in the distribution of resources and development as well as

[261] LGA, s 252(4).
[262] Stamp (1986) 29; Southall & Wood (1996) 508.
[263] Bosire (2013) 146.
[264] Constitution of Kenya Review (CKRA) Act No 13 of 1997.
[265] Formally, the process started in April 2001 with the constitution of the Constitution of Kenya Review Commission (CKRC). See, Bosire (2013) 154.
[266]Constitution of Kenya Review Act, 2008, ss 23, 30 & 32; Mutakha (2014) 118.

the lack of downward accountability to the people by the government and public officials.[267] Devolution of power was, therefore, proposed and universally supported by the people as a way of restructuring the state to grant the people greater control over their affairs, including their participation in governance as well as access to national resources and control over their own development.[268]

From the onset of the push for constitutional review, even prior to the above proposal from the public, devolution and the consideration of devolution of powers was pivotal, with the CKRA setting it out as one of the objects and purposes of the constitutional review process.[269] Other objectives sought to be achieved by the review process included: the establishment of a free and democratic system of government that would guarantee, among other things, good governance, constitutionalism and the rule of law; the promotion of people's participation in governance through, inter alia, the devolution of and exercise of [state] power as well as the establishment of checks and balances that would ensure the accountability of government to the people.[270] These objects were retained for the second constitutional review phase under section 4 of the CKRA of 2008.[271] In a way, therefore, the constitution-making process sought to respond to the specific issues experienced in post-colonial Kenya, and which the people had raised as deserving of redress.

More specifically, with regard to the devolution of power, the people proposed a strengthened system of local governance that would: enable them to determine their own choices of lifestyles including undertaking own budgeting at the local level; have financial independence; be accountable to the people; be free of interference from the centre; and be represented in national decision-making through the Senate.[272] Based on these proposals,

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[267] Constitution of Kenya Review Commission (CKRC) *The Final Report of the Constitution of Kenya Review Commission* (2005) 234; See also, Ghai Y 'Devolution: Restructuring the Kenyan state' (2008) 2 *Journal of Eastern African Studies* 215.
[268] Mutakha (2014) 114; Bosire (2013) 146, 150.
[269] CKRA, 2008, s 2A; Mutakha (2014) 112.
[270] CKRA, 2008, s 2A.
[271] They also guided the principles developed by the Committee of Experts to guide its work in the second phase. See, Committee of Experts on Constitutional Review (COE) *Final Report of the Committee of Experts on Constitutional Review* (2010) 37.
[272] CKRC (2005) 239-241; Mutakha (2014) 114.

recommendations were made for the entrenchment of devolution and devolved structures in the new constitution, including the design of clear independent functions and powers for the various levels of government,[273] as well as recommendations for fashioning the system of financing devolved units and the system of intergovernmental fiscal relations in such a way as to ensure autonomy as well as accountability by the devolved units.[274] This included a recommendation for the entitlement by devolved units to an equitable share of revenue raised nationally that would enable the units to provide basic services and perform their responsibilities.[275]

The above issues, proposals and their rationales, as well as the recommendations presented, therefore, informed the nature and form of devolved governance adopted under the Constitution of Kenya 2010.[276] Devolution under the Constitution of Kenya 2010, therefore, sought to achieve, among other things: the democratic and accountable exercise of power; enhanced checks and balances; inclusive development through the recognition of diversity and the granting of powers of self-governance to communities; and the equitable sharing of national and local resources throughout Kenya.[277] These goals were outlined in the Constitution as the objects of devolution.

4 Devolution under the Constitution of Kenya 2010

Although proposals had been made during the constitution-making process for the adoption of federal-like strong regional governments akin to the Independence *Majimbo*, a majority of Kenyans preferred a devolved system of government within a unitary state.[278] The Constitution of Kenya 2010 (Constitution), therefore, adopted a hybrid multilevel form of government with two levels of government made up of the national government and 47 county governments (moulded on the 47 administrative boundaries of pre-existing districts).

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[273] CKRC (2005) 239; Mutakha (2014) 115.
[274] CKRC (2005) 243.
[275] CKRC (2005) 243.
[276] See also, Mutakha (2014) 120.
[277] Constitution of Kenya, 2010, art 174.
[278] Bosire (2013) 156.

With this, Kenya departed from its historically centralised system of government and, much like South Africa, adopted a hybrid of both federal and unitary features.

Specifically, article 1 of the Constitution indicates that the people's sovereign power is exercised at two levels, the national and the county level. This power is then delegated to the national executive and Parliament at the national level, and to the executive structures and legislative assemblies at the county government level. The Constitution goes further to divide the territory of Kenya into 47 counties (listed under the Constitution's First Schedule).[279] On this basis the Constitution of Kenya reinstated and entrenched the constitutional status of subnational governments in Kenya.

At the subnational level, a county government is made up of a county executive, consisting of the county executive committee (CEC) headed by a governor, and a county assembly (CA) whose members represent wards[280] and special interests.[281] Despite counties functioning as the principal subnational unit, the Constitution requires each county government to decentralise its functions and the provision of its services.[282] In this respect, counties are required to decentralise further, mainly through a system of delegation, to urban areas and cities,[283] sub-counties,[284] wards, villages[285] and any other further units as might be determined by a specific county.[286] Pursuant to this, various decentralised units were created by various counties to facilitate the performance of functions and the provision of services. However, all of these are subject to, and report to, the respective county governments.

[279] Constitution (2010) art 6(1). The demarcation of the boundaries of the counties however coincided with those of pre-existing districts.
[280] Areas into which a county is divided for purposes of representation in the county assembly.
[281] Constitution (2010), art 176(1) as read with arts 177 & 179.
[282] Constitution (2010), art 176(2).
[283] Established pursuant to the Urban Areas and Cities Act No 13 of 2011. See, Constitution (2010), art 184.
[284] The equivalent of constituencies (areas established for purposes of representation in the National Assembly) contained within the county.
[285] These are required to be established at the discretion of a respective county assembly.
[286] County Governments Act No 17 of 2012, ss 6(2)(c) & s 48(1).

4.1 The framework for intergovernmental fiscal relations (IGFR)

Kenya's framework for IGFR operates within the broader framework of intergovernmental relations with specialised structures put in place to govern relations pertaining to the functioning of the intergovernmental fiscal system. As to the nature of relations between the two levels of government, the Constitution states, in terms that are somewhat similar to the South African Constitution, that they are 'distinct and interdependent'.[287] Moreover, the Constitution enjoins both levels of government to perform their functions and exercise their powers in a manner that respects the functional and institutional integrity of the other level of government as well as the constitutional status and institutions of the other level of government.[288] All this points to the conferment of a degree of autonomy on county governments and to the equality of status between the two levels of government.

However, in addition to and as an extension of the 'inter-dependent' qualification of the distinctiveness of the two levels, the Constitution requires the two levels to 'conduct their mutual relations on the basis of consultation and cooperation'.[289] This means that they are not independent of each other in the execution of their functions and the exercise of their powers; but they are required to liaise with each other for purposes of, among other things, coordinating policies and administration.[290]

Various institutions have been set up in legislation as fora for intergovernmental relations. These include: the National and County Government Coordinating Summit (Summit), which is the apex intergovernmental relations body;[291] the Council of County Governors (Council of Governors (COG)),[292] which is the equivalent of South Africa's organised local government; as well as the Intergovernmental Budget and Economic Council (IBEC) that provides a forum for

[287] Constitution (2010), art 6(2).
[288] Constitution (2010), art 189(1)(*a*); s 4 of the Intergovernmental Relations Act (IGR) Act No 2 of 2012 lists these as part of the core principles governing intergovernmental relations and the operation of intergovernmental relations structures under the Act.
[289] Constitution (2010), art 6(2); See also IGRA, s 4(*h*).
[290] Constitution (2010), art 189(1)(*c*).
[291] IGRA, s 7; the Summit is made up of the President as the Chair and all the 47 county governors.
[292] IGRA, s 19; the COG is made up of the 47 county governors.

intergovernmental fiscal relations in a manner similar to the roles played by both the Budget Council and the Budget Forum in South Africa (its role is further detailed below).[293] These intergovernmental structures provide fora for the coordination of policies, legislation and functions, as well as working towards the promotion of accountability across the levels of government.[294]

To support this system of intergovernmental relations, the Constitution puts in place independent constitutional commissions and offices that are equivalent to South Africa's Chapter Nine Institutions. These include the Commission on Revenue Allocation (CRA), the Controller of Budget (CoB), the Auditor-General (AG) and the Salaries and Remuneration Commission (SRC), among others.[295] Each of these plays a role in Kenya's intergovernmental fiscal system hence a role in facilitating fiscal autonomy, including ensuring accountability in the exercise of fiscal autonomy by Kenya's county governments. While each of these is equally important, the CRA plays a crucial role in Kenya's intergovernmental fiscal relations and is highlighted below.

4.1.1 The Intergovernmental Budget and Economic Council (IBEC)

The IBEC is established under section 187 of the Public Finance Management Act (PFMA) and is made up of a mix of representatives of the national government, independent national institutions and representatives of county governments. These representatives are: the Deputy President, who chairs the Council; the cabinet secretaries for finance and intergovernmental relations; representatives of the Parliamentary Service Commission and the Judicial Service Commission; the Chairperson of the CRA (or her, or his representative); the Chairperson of the COG as well as the 47 CEC members for finance from every county.[296]

[293] Public Finance Management Act No 18 of 2012, s 187; IBEC is made of representatives from the national level (the Deputy President who is the Chair and the cabinet secretaries for finance and IGR), the county level (the COG Chair and all 47 County Executive Members for Finance) as well as from independent commissions (Commission on Revenue Allocation, Public Service Commission and the Judicial Service Commission).
[294] IGRA, s 5 (*c*) & (*f*).
[295] Constitution (2010), art 248(2) & (3).
[296] PFMA, s 187(1).

The IBEC serves as a forum for consultation between the two levels of government on various matters that touch on the expenditure, revenue and budgetary autonomy of county governments. This includes consultations on: any proposed legislation or policy with a financial implication for a county or counties, as well as the contents of the national Budget Policy Statement, the Budget Review and Outlook Paper and the Medium-Term Debt Management Strategy; matters relating to budgeting, the economy and financial management and integrated development at both levels of government; and recommendations on the vertical and horizontal distribution of equitable shares of revenue, including consultation on the disbursement schedule for available funds from the Consolidated Fund to counties.[297] The IBEC also provides a forum for consultation on matters relating to borrowing and the issuance of national guarantees for county borrowing.[298] As the main consultative forum for intergovernmental financial matters, its role critically cuts across various aspects of the fiscal autonomy of county government.

4.1.2 The Commission on Revenue Allocation (CRA)

The CRA is established under the Constitution with the principal mandate of making recommendations on the basis for the equitable division of revenue both vertically between the two levels of government, and horizontally across all 47 counties.[299] Although seven of its nine members are appointed through political parties represented in both the National Assembly and the Senate, the constitutional requirement for them to have extensive professional experience in financial and economic matters[300] ensures the technical competence and professionalisation of the Commission. The Chairperson of the Commission, who is the eighth member, is also required to be equally qualified with similar extensive experience.[301] The ninth member is the Principal Secretary in the Ministry of Finance. Despite their political appointments, once in office, the CRA and its members, constitute an

[297] PFMA, s 187(2).
[298] PFMA, s 187(2)(c).
[299] Constitution (2010), art 216(1).
[300] Constitution (2010), art 215(2) & (4).
[301] Commission on Revenue Allocation Act No 16 of 2011, s 6(1).

Independent Commission whose operations are subject only to the Constitution and the law, and are required to operate independent of any direction or control from any person or authority.[302] This gives the CRA room for ensuring that its recommendations are objective, and are backed by sound technical know-how. As the main independent institution in intergovernmental financial decision-making, the CRA plays a crucial role in the facilitation of the fiscal autonomy of county governments.

4.2 Parliament and the protection of county government interests in the national legislative process

As with the Parliament at Independence, the Kenyan Parliament is bicameral and consists of two houses, the National Assembly and the Senate.[303] The National Assembly represents constituencies and special interests, and is generally charged with deliberating on and resolving issues of concern to the people.[304] The Senate, for its part, represents the counties and works to protect the interests of counties by, among other things, deliberating on and approving Bills concerning counties.[305] In terms of the legislative process, the Constitution requires that both Houses concur on any Bill that concerns county governments.[306] The Senate's participation in the legislative process serves to enhance the system of checks and balances at the national level in favour of county governments, while ensuring the participation of people (of counties) in national decision-making.[307] This informed its retention by the Committee of Experts despite an attempt by the Parliamentary Select Committee on Constitutional Review to have it stripped of its legislative role during the second phase of constitutional review.[308] The details of its role are discussed in the next chapters.

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[302] Article 248(2)(f) & 249(2).
[303] Constitution (2010), art 93(1).
[304] Constitution (2010), art 95(1) & (2).
[305] Constitution (2010), art 96(1) & (2).
[306] Constitution (2010), art 110 (4) & (5); 110(1) defines 'a bill concerning county government' to include 'a Bill referred to in Chapter Twelve affecting the finances of county governments.'
[307] COE (2010) 114-115.
[308] COE (2010) 114; Bosire (2014) 193.

5 Conclusion

From the discussion above, it is apparent that, historically, while subnational fiscal autonomy was highest at independence under *Majimbo*, it was almost immediately shelved in favour of a more centralised intergovernmental fiscal system. Subsequently, central government influence dominated almost every aspect of subnational decision-making in post-*Majimbo* local governments thereby taking away from any expanded room that could have been extended to local governments for fiscal autonomy by the abolition of *Majimbos*. The post-independence centralisation of power, and the subordination and consistent weakening of local government powers, however, provided a basis for the demand for more autonomy (including fiscal autonomy) for subnational governments under the Constitution of Kenya 2010, as well as informing the specific purposes in pursuit of which such autonomy was sought. The lessons learnt from the period also underlay the nature of the intergovernmental fiscal system that was adopted under the Constitution of Kenya 2010, including its various institutional structures and features. The next chapters explore the nature and extent of fiscal autonomy extended to county governments under the Constitution, and the extent to which this is realised in practice. It also highlights instances where Kenya's past experience with subnational fiscal autonomy underlies experiences in Kenya's current implementation of subnational fiscal autonomy.

Chapter Five

THE FRAMEWORK AND PRACTICE OF SUBNATIONAL FISCAL AUTONOMY IN KENYA: The expenditure autonomy of county governments

To achieve the objects of devolution outlined under the Kenyan Constitution, county governments require autonomy and particularly, fiscal autonomy. Chapters five, six and seven, therefore, seek to examine the scope for fiscal autonomy which is accorded to counties under the Kenyan Constitution, as well as under national legislation. The chapters also explore whether, and the extent to which, this autonomy has translated to actual fiscal autonomy in practice. Although the three chapters actually constitute one comprehensive chapter examining the fiscal autonomy of county governments, they have been split up due to their extensive nature, and will be discussed as separate chapters. The three chapters analyse the scope for fiscal autonomy afforded to county governments under the threefold classification of fiscal autonomy (expenditure, revenue and budgetary) respectively. While chapter seven focuses on a discussion of the budgetary autonomy of county governments, it also provides a general conclusion relating to the fiscal autonomy of county governments in Kenya.

This chapter focuses on the expenditure autonomy of county governments, as well as the extent to which this autonomy is exercised in practice. Subnational expenditure autonomy entails the freedom to determine subnational policy and development priorities, the freedom to appropriate funds and incur expenditure in regard to the selected priorities (including other subnational needs), as well as discretion in implementing spending decisions. To assess the scope for expenditure autonomy afforded to and exercised by county governments in Kenya, this chapter discusses both the factors that facilitate the expenditure autonomy of county governments as well as those that limit the exercise of expenditure autonomy by counties. The chapter then draws a conclusion on what scope is available for counties to exercise autonomy over their own expenditure.

1 Factors facilitating the expenditure autonomy of county governments

Various factors exist that extend scope to county governments to exercise autonomy over their own expenditure. These include those arising out of Kenya's constitutional architecture, as well as those that have revealed themselves in practice over the years and which have been instrumental in firming up the expenditure autonomy of county governments. The Constitution's contribution in this regard relates to the fact that it protects the institutional and functional autonomy of county governments, entrenches the primary functions and powers of county governments, and also provides safeguards against centralisation and unfunded mandates. These constitutional foundations have been supported in practice through the willingness of the courts to enforce the constitutional boundaries relating to the expenditure autonomy of counties as well as through a firm demonstration of political will by counties to assert and exercise autonomy over their own expenditure. Cumulatively, these factors have been key in ensuring that counties have and exercise a degree of autonomy over their own expenditures. Each of these factors is discussed below.

1.1 The institutional and functional autonomy of county governments is protected

The constitutional protection of the legislative and executive mandates of counties from national interference serves to shield prioritisation and general expenditure decision-making by counties, thus facilitating their expenditure autonomy. To this end, the Constitution establishes county assemblies and county executive committees (CECs) for each county government, and vests in them the county's legislative and executive authority towards the effective performance of their functions and powers.[1] The Constitution then proceeds to require both levels of government to mutually respect the 'functional and institutional integrity' as well as the 'constitutional status and institutions' of government at the other level.[2] This constitutional imperative serves to protect county governments and their

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[1] Constitution of Kenya, 2010, art 185(1) & (2) and art 179 (1) as read with art 183(1)(*a*) & (*c*). See also, the County Governments Act (CGA) No 17 of 2012, s 5. A county assembly is made up of elected ward representatives while a CEC is made up of an elected governor and deputy governor as well as members appointed by the governor with the approval of the assembly.

[2] Constitution (2010), art 189(1).

institutions from the national government's interference in the execution of their functions and powers. Key among these functions and powers is county prioritisation and implementation of own expenditure. The constitutional protection, thus, means that county assemblies are able to: approve county plans, policies and budgets; pass legislation aimed at financing county budgets and appropriate funds for the implementation of county government spending priorities, freely and independent of any interference from the national government.[3] Similarly, the CEC is able to, among other things, implement county legislation as well as manage and coordinate the functions of the county administration and its departments, without the fear of any powers of review or negation by the national government.[4] The constitutional protection, therefore, serves to facilitate the exercise of expenditure autonomy by counties.

1.2 Primary and incidental county government functions and powers are constitutionally entrenched

The Constitutional entrenchment of county government functions and powers confers functional autonomy to counties and prevents their arbitrary re-assignment or recentralisation. This provides a definite protected basis for the exercise of autonomy over county planning and expenditure. While the allocation of functions to counties informs county expenditure responsibilities, their effective execution underlies the continued relevance of counties, and devolution at large.[5] This makes constitutional entrenchment critical. In this regard, the Constitution expressly details county government functions and powers under its article 186 as read with Part 2 of its Fourth Schedule. These are classified into functions and powers of the national and county governments (exclusive), functions and powers falling within the concurrent jurisdiction of both levels of government (concurrent), as well as those functions and powers not assigned by either the Constitution or national legislation to a

[3] Constitution (2010), art 185(2) & (4).
[4] Constitution (2010), art 183(1).
[5] Intergovernmental Relations Technical Committee (IGRTC) *Emerging Issues on Transfer of Functions to National and County Governments* (2018) 41.

county, which then fall to the national government (residual).[6] Such constitutional entrenchment was a transformative shift from the previous system of local government where the functions and powers of subnational units were defined by and were subject to re-assignment or recentralisation through changes in national legislation. Entrenchment, therefore, takes this decision away from the national government thus affording counties scope to exercise autonomy over a defined and protected set of functions and powers.

Moreover, the constitutional entrenchment of incidental county government powers serves to extend the scope of autonomy that county governments may exercise over their expenditure beyond the strict boundaries of their primary functions and powers. In this respect, the Constitution grants discretion to a county assembly, in exercise of its legislative powers, to legislate on any matter that it considers necessary for, or incidental to, the effective exercise of the powers and performance of the functions bestowed on the county government.[7] An incidental function or power deals with a grey area around the cut-off point between a county and a national function or power.[8] In this regard a county assembly may be allowed to legislate on a matter that may otherwise be regarded as falling within the national government's jurisdiction, where it can be proven that the particular national government function or power is 'so integrally linked to'[9] the corresponding county function or power such that the effective discharge of the county function or power is contingent on extending the county function or power into the corresponding national government's functional arena. This takes away rigidity from a county government's legislative powers thus extending the range of autonomy counties may exercise over their expenditure.

[6] Constitution (2010), art 186(1) - (3).
[7] Constitution (2010), art 185(2).
[8] Mutakha JK *An Interpretation of the Constitutional Framework for Devolution in Kenya: A Comparative Approach* (LLD thesis, University of the Western Cape, 2014) 238.
[9] Mutakha (2014) 238.

1.3 Constitutional safeguards are provided for the intergovernmental transfer of functions

The intergovernmental transfer of functions and powers is constitutionally regulated to protect the functional autonomy of county governments from the imposition of unfunded mandates, as well as from attempts at recentralisation. While the Constitution allows either level of government to transfer a function or power to the other,[10] it requires that this be done only if the receiving government is in a position to perform or exercise the function or power more effectively.[11] The constitutional requirement for such transfer to be done by agreement[12] serves to underscore the sanctity of its functional demarcation, and the functional autonomy of counties. The requirement for arrangements to be made for requisite resources to accompany the transferred functions or powers[13] on the other hand, provides a constitutional check against unfunded mandates. This ensures that county governments are not forced to choose between expending money earmarked for their development priorities and financing the performance of a transferred function or power. Additionally, the Constitution's vesting of constitutional responsibility for the transferred function or power in the transferring government serves to ensure that, despite the transfer, the transferring government retains supervisory control, and where the function is not performed to the required standard, the transferring government could terminate the transfer and resume the discharge of the function or power.[14] This ensures that the downward-accountability of county governments that underpins their autonomy is sustained, hence the sustenance of their expenditure autonomy. Cumulatively, these constitutional safeguards work to secure the expenditure autonomy of county governments.

National legislation has gone a step further to enhance the above constitutional safeguards, thus, providing more protection to the expenditure autonomy of county governments. These

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[10] Constitution (2010), art 187. See also, CGA, s 5(2)(*d*) & Intergovernmental Relations Act (IGRA) No 2 of 2012, s 24(*a*).
[11] Constitution (2010), art 187(1). See also, IGRA, s 25(*a*).
[12] Constitution (2010), art 187(1).
[13] Constitution (2010), art 187(2)(*a*). See also, IGRA, s 25(*b*).
[14] Mutakha (2014) 250.

include the requirements that the intergovernmental transfer agreement be in writing,[15] and that the agreement sets out the reasons informing the transfer, as well as the terms and conditions for the performance of the transferred function or power, including the time frame.[16] The requirement for a written agreement emphasises the explicitness of subnational consent, thus further protecting the functional autonomy of counties from any attempts at recentralisation by stealth. The rest of the measures are key in ensuring that a transfer is objectively justifiable, has set objectives and is time-bound, with a view to ensuring that any remediable underlying reason for the transfer is addressed and, where necessary, capacity built and the function or power reinstated to the relevant county government. This way the expenditure autonomy of county governments is protected from any predatory advances by the national government, while providing room for transfers to guarantee effective service delivery.

However, a number of issues have arisen from the only case of transfer of functions between the national government and county government of Nairobi. In 2019, the Governor of Nairobi County executed a deed of transfer which bestowed specific functions and powers to an entity of the national government, the Nairobi Metropolitan Services.[17] However, allegations of undue national influence that compelled the transfer[18] cast doubts on the efficacy of the constitutional protection of the transfer of functions process from the political influence of the national government.

[15] IGRA, s 26 (1).
[16] IGRA, s 26(2)(*c*) & (*i*).
[17] Gazette Notice No 1609 of 2020.
[18] Agutu N 'Sonko: State House gave me liquor before signing Nairobi deal' *The Star* 24 July 2020 available at https://www.the-star.co.ke/news/2020-07-24-sonko-state-house-gave-me-liquor-before-signing-nairobi-deal/ (accessed 11 February 2022); Mukere T 'I was totally drunk when I signed it – Sonko says in latest attempt to disown transfer of functions' *Pulse* 24 July 2020 available at https://www.pulselive.co.ke/news/i-was-totally-drunk-when-i-signed-it-governor-mike-sonko-says-in-latest-attempt-to/2gvnz8t (accessed 11 February 2022).

1.4 The courts have demonstrated willingness to enforce the expenditure autonomy of counties

The willingness of Kenyan courts to enforce constitutional principles relating to the autonomy of county governments has been key in securing the expenditure autonomy of counties. The courts have on various occasions protected the institutional and functional independence of county assemblies as well as CECs from interference by national government institutions, particularly the national Parliament. This was the case when Parliament attempted to usurp county executive functions through the establishment of County Development Boards (CDBs). Based on the Constitutional requirement for inter-dependence (art 6(2)), the County Governments Act (CGA) initially required (and still requires) cooperation in planning to be undertaken within the context of the law governing intergovernmental relations,[19] hence through fora[20] such as the Summit[21] and the Intergovernmental Budget and Economic Council (IBEC).[22] Parliament, however, later sought to amend this to create CDBs as a separate intergovernmental forum with powers to consider and give input on both county development plans as well as annual county budgets before they were tabled in county assemblies for consideration.[23] The composition of the CDBs, however, was made up of members from both the Senate and the National Assembly.[24] County governments contested the constitutionality of CDBs on the basis that it infringed on the institutional and functional autonomy of CECs. Both the High Court[25] and Court of Appeal[26] upheld the argument declaring that the oversight mandate of Parliament did not extend to performing executive functions at the county level, as this was the purview of the CEC. The courts hence played a

[19] CGA, s 106(1).
[20] CGA, s 106(1).
[21] IGRA, s 8(*j*): the summit has the responsibility of coordinating and harmonising the development of county and national policies.
[22] Public Finance Management Act (PFMA) No 18 of 2012, s 187(2)(*b*): the IBEC serves as a forum for consultation and cooperation between the two levels of government on, among other matters, integrated development at the national and county level.
[23] CGA, ss 91A (2) (a), (b) & (c).
[24] CGA, s 91A (1).
[25] *Council of Governors & 3 others v Senate & 53 others* [2015] eKLR.
[26] *Senate & 48 others v Council of County Governors & 54 others* [2019] eKLR.

key role in enforcing the constitutional principles supportive of the expenditure autonomy of counties.

Similarly, in defence of the legislative independence of county assemblies, the High Court in *County Government of Kiambu & another v Senate & others*[27] held that a county government's legislative authority lies with a county assembly and that the Senate's oversight mandate does not extend to scrutiny of the process or legality of county legislation, as this is outside the Senate's constitutional authority. This position was subsequently cited with approval by the Court of Appeal in *Senate & 48 others v Council of County Governors & 54 others.*[28] In making these decisions the courts have reinforced the functional autonomy of county assemblies, as well as that of CECs, a factor that enhances their autonomy over county expenditure.

1.5 County governments have demonstrated political will to exert their expenditure autonomy

In addition to all the above, county governments themselves have demonstrated a willingness, in practice, to exert autonomy over their own expenditure since the start of devolution. In this regard, counties have independently undertaken annual own expenditure prioritisation (planning), adopted their own budgets and implemented them in the discharge of their constitutional functions and powers over the years. Moreover, as demonstrated in the court cases discussed above, where their autonomy over county expenditure was threatened by national government institutions, counties, both individually and through the Council of Governors, have initiated court proceedings to enforce their autonomy as granted under the Constitution. This demonstration of political will by counties to exert their autonomy has been a key ingredient in guaranteeing their continued exercise of autonomy over their own expenditure.

[27] *County Government of Kiambu & another v Senate & others* [2017] eKLR.
[28] *Senate & 48 others v Council of County Governors & 54 others* [2019] eKLR.

2 Factors limiting the expenditure autonomy of county governments

Despite the list of supportive factors above, an even longer list of factors exists that militate against the exercise of expenditure autonomy by county governments. While a majority of them arise out of the constitutional architecture as well as its interpretation and implementation by actors in practice, others arise in spite of and in violation of the constitutional architecture. These factors include the fact that: the constitutional demarcation of functions and powers lacks sufficient clarity, and the Constitution's mechanism for providing functional clarity has not been adequately utilised; the autonomy of county governments over their own public service is limited; national legislation limits the scope for county own prioritisation of expenditure as well as the fact that behavioural and institutional inertia at the national level, combined with a blatant violation of devolution principles by the national government, continues to undermine the scope for and the exercise of expenditure autonomy by county governments. Each of these factors is discussed below.

2.1 The constitutional demarcation of functions and powers lacks sufficient clarity

The Constitutional demarcation of functions into exclusive, concurrent and residual lacks sufficient clarity, hence leaving the determination of precise county government functions open to interpretation. This exposes county functions and powers to potential restriction, depending on the approach to functional interpretation adopted at the national level. Clarity of a function or power refers to the extent to which the function or power is objectively knowable or identifiable, alongside its constituent components, without calling for interpretation. This, therefore, requires a more granular approach to the allocation of exclusive functions which unbundles and disaggregates them into their constituent components prior to allocation. Where a function or power is concurrent, clarity requires that the boundaries and cut-off points, as well as the exact level of responsibility of each level of government, be clearly spelt out so as to leave no doubt as to where one level of government's function/power starts and ends. This level of clarity is, unfortunately, not provided under the Constitution despite its potential utility.

Clarity in the allocation of functions and powers serves various core purposes. Under the constitutional dispensation that preceded the Constitution of Kenya, 2010, the lack of clarity over expenditure responsibilities, as well as the lack of awareness by citizens as to which level of government was responsible for which public service, resulted in, among other things, discordant policy and legislative frameworks, duplication of services, wastage of resources as well as a failure of down-ward accountability of local governments.[29] There was, therefore, a need to ensure clarity in the allocation of functions and powers so as to not only ensure expenditure autonomy, but also to facilitate efficient and effective service delivery. Clarity is also important in ensuring that local communities are aware which level of government to hold to account for the delivery of specific services.[30] Clarity, therefore, ensures specificity as to the nature and extent of responsibility borne by each level of government thus checking the mischief of 'if everyone is accountable – no one is accountable'.[31] Lastly, clarity is key in checking the temptation by the national government to claw-back on[32] or recentralise subnational functions.

Although article 186, as read with the Fourth Schedule of the Constitution, provides some general direction as to the intention to demarcate functions into exclusive, concurrent and residual national and county functions, its failure to explicitly classify each of the listed functions under each of these categories leaves it wanting for clarity. Thus, questions as to which of the functions and powers listed under the Schedule can be rightly classified under each of the categories, as well as the scope and boundaries of each of the listed functions and powers (hence the scope for expenditure autonomy), are left open for interpretation.[33]

As a result, various interpretations have been advanced, all of which have constitutional validity. Mutakha, for instance, distinguishes a power from a function (functional area) and

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[29] Task Force on Devolved Government '*Functional Assignment for Effective Public Service Delivery in Kenya*' in Task Force on Devolved Government *Final Report on Devolved Government in Kenya* (2011) 109.
[30] World Bank *Special Focus: Kenya's Momentous Devolution* (2011) 30-32.
[31] World Bank (2011) 30-31.
[32] World Bank (2011) 10.
[33] See, Mutakha (2014) 213; Bosire CM *Devolution for Development, Conflict Resolution, and Limiting Central Power: An Analysis of the Constitution of Kenya 2010* (unpublished LLD thesis, University of the Western Cape, 2013) 264.

makes a case for applying the distinction in the interpretation of exclusive and concurrent functions.[34] He argues that a 'power' refers to the legal authority conferred on a government to 'act or take certain actions within the confines of a permitted functional area'.[35] On the basis of this definition, Mutakha then proceeds to argue that a function that may otherwise be interpreted as concurrent may not necessarily be concurrent when its constituent powers are considered. When disaggregated, such a function may contain powers that are either exclusive or concurrent or both, with each power (either legislative or executive or both) being assigned to a different level of government.[36] The specific approach adopted in the interpretation of functions and powers would, therefore, determine whether one emphasises an otherwise apparent high-level concurrency, at the functional area level, or the exclusivity of the individual powers within the broader functional area. Bosire distinguishes this interpretative dichotomy as being either a 'pro-centre approach', which amplifies concurrency, or a 'pro-county approach' that amplifies the exclusivity of county functions and powers.[37] Although both Mutakha and Bosire argue that the latter approach more closely embodies the letter and spirit of the Constitution by being more in line with the objects of devolution, as well as a holistic reading and analysis of article 186 of the Constitution (including the Fourth Schedule), theirs is but one approach to interpretation which does not offer any finality or solution to the problem of clarity.[38] The scope for expenditure autonomy may hence expand or shrink, depending on the interpretation adopted nationally at any given time.

2.1.1 Exclusive county functions and powers are unclear

The specific functions and powers which may be classified as being exclusive to the county level of government are unclear under the Constitution. Unlike both Kenya's Independence Constitution and the South African Constitution which explicitly list areas of exclusive competence separate from areas of concurrent competence, the current Kenyan Constitution

[34] Mutakha (2014) 207-213.
[35] Mutakha (2014) 207.
[36] Mutakha (2014) 213.
[37] Bosire (2013) 265-268.
[38] Mutakha (2014) 218; Bosire (2013) 268-270.

avoids any direct reference to exclusivity, and instead adopts a hybrid model which complicates the search for clarity. Under this model, although the Constitution details a list of county government functions and powers separately from the list of national government ones (Part 2 and 1 of the Fourth Schedule),[39] it goes ahead to indicate that any functions or powers listed on both lists falls under the concurrent jurisdiction of both levels of government,[40] thus rendering the lists non-exclusive to either level. One would, therefore, have to resort to interpretation to determine which functions under Part 2 are exclusive to county governments.

Various approaches to interpretation may be adopted to identify functions and powers that may be classified as being exclusive to the county level. For a function or power to be classified as being exclusive to the county level, it ought to be determined that it unambiguously appears only in Part 2 of the Fourth Schedule.[41] A close analysis of Part 1 and 2 of the Fourth Schedule reveals that, except for the facilitation of public participation of local communities in governance, almost all other county government functions can be classified so as to fall within a broader functional area or sector, an aspect of which has also been assigned to the national government. These sectors include agriculture, health, environment, trade, economic planning and development, transport and education among others. Taking Bosire's alternative pro-centre approach would interpret all these as concurrent functions. However, applying Mutakha's 'functional area versus power' distinction and Bosire's pro-county approach reveals dichotomous trends that may be used as a basis for interpreting functions and powers, under Part 2 of the Fourth Schedule, as being exclusive to counties. These are the policy-making versus service delivery dichotomy, and that which focuses on the 'national' versus 'county' qualification in functional allocations.

While the policy-making versus service delivery dichotomy isolates county governments' mandates over otherwise concurrent functions, as being actual service delivery or

[39] Constitution (2010), art 186(1).
[40] Constitution (2010), art 186(2).
[41] Bosire (2013) 268.

implementation, and that of the national government as being solely sector-level policy-making, the lack of clarity in the scope of these policy-making powers renders the scope of the service delivery or implementation powers held by counties unclear.[42] For instance, the national government has policy-making jurisdiction over matters such as agriculture, health, transport, energy, economic policy and planning and tourism.[43] Counties on the other hand have a service delivery role over specific aspects of agriculture, county health services, county transport, electricity and gas reticulation, trade development and regulation as well as local tourism, respectively.[44] Nothing in the constitutional demarcation dictates the scope of the national government's policy-making mandate over these county functions and powers, hence national policy may extend or limit the level of autonomy counties exercise over the identified functions or powers.

Further, although focus on the dichotomous 'national' versus 'county' qualifications in functional allocations under the Fourth Schedule may help in identifying those functions that may be classified as being exclusive to the county level, the specific determination of what qualifies as 'county' or 'national' in regard to these functions is not clear. This covers functions such as national public works versus county public works, and national health referral facilities versus county health facilities under the Constitution's Fourth Schedule. While the 'county' geographical boundary meaning may be clear, the challenge lies in instances where what qualifies as a 'county' function or service has to be determined under national policy. Although the definition under national policy may provide a level of clarity, it gives the national government a longer leash in deciding the full extent of the county function,[45] with the potential to provide an interpretation that may be restrictive to county expenditure autonomy. This power by the national government was, however, confirmed by the High Court in the case of *Okiya Omtatah Okoiti & another v Attorney General & 6 others.*[46] When requested to provide an interpretation of 'national health referral facilities and county health

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[42] Task Force on Devolved Government (2011) 110-111; World Bank (2011) 32.
[43] Constitution (2010), Fourth Schedule, Part 1.
[44] Constitution (2010), Fourth Schedule.
[45] Bosire (2013) 276.
[46] *Okiya Omtatah Okoiti & another v Attorney General & 6 others* [2014] eKLR.

facilities', the court indicated that, given such distinction was not proffered in the Constitution, the classifications can only be a matter of national policy which fell in the purview of the national executive. The lack of clarity thus allows national policy to dictate the scope of autonomy to be exercised by counties over each of the affected functions.

Notwithstanding the above limitations, applying the policy-making versus service delivery as well as the national versus county dichotomies, provides a general basis for interpreting functions and powers under Part 2 of the Fourth Schedule, as being exclusive to counties. On this basis, exclusive county government functions cover service delivery in respect of: agriculture; county health services extending from county health facilities to refuse removal and solid waste disposal; county transport including county roads and street lighting; county planning and development including housing; county public works including water and sanitation services as well as cultural activities and public entertainment, among other functions.[47] In regard to these functions, counties have exclusive legislative and executive powers and the national government's role is restricted to general high-level policy-making at the sectoral level.[48]

However, although the above interpretation helps identify functions that could be classified as exclusive to county governments, most of these functions and powers are highly aggregated and lack precise definition, hence their exact nature and scope is also subject to interpretation.[49] The attempt made by the Constitution to detail the specific components of some functions and powers is largely generic and uses the 'including' phrase hence still leaving a great deal to be unbundled for sufficient clarity. While the lack of clarity may not generally prevent the exercise of expenditure autonomy by counties in practice, the imprecision leaves most of the county government functions and powers open to potential restriction, in nature and scope, by national government policy and legislation, depending on the approach to interpretation that may be adopted at the national level. It is against this

[47] Constitution (2010), Fourth Schedule, Part 2.
[48] Bosire (2013) 268.
[49] Bosire (2013) 272.

background that Steytler and Ghai argue that, as with the situation in South Africa, an analysis of the functional demarcation reveals a bias towards national legislative dominance and that, generally, 'it is doubtful whether any aspect of the subnational governments' [functional] domain is beyond the reach of national legislation'.[50]

In practice, however, the functions listed under Part 2 of the Fourth Schedule are generally treated as being exclusive to counties, and most of the interviewed counties did not feel there was a clarity problem in the demarcation of county functions and powers.[51] This is largely due to the fact that the national government has not moved to enforce a central-leaning interpretation of the functions under Part 2, nor has it utilised its unbridled policy-making powers to dictate the scope of autonomy counties may exercise over the functions. What counties currently enjoy, therefore, is but an unsettled illusion of exclusivity in Part 2 functions and powers, which can be highly restricted by the national government's adoption and enforcement of a centralised interpretation and approach to its sweeping policy-making powers.

2.1.2 Concurrent functions and powers are unclear

Similar to the case with exclusive functions and powers above, and unlike the South African Constitution which explicitly lists areas of concurrent competence, the specific functions and powers under the Kenyan Constitution that may be classified as concurrent are unclear. Instead of explicitly listing concurrent functions and powers, the Constitution states, generally, that a function or power will fall in the concurrent jurisdiction of both levels of government if it is conferred on more than one level of government, that is, if it appears on both lists in Part 1 and 2 of the Fourth Schedule.[52] A function or power is said to be concurrent where both levels of government are allowed to freely legislate on any matter touching on it

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[50] Steytler N & Ghai Y 'Devolution: What can Kenya learn from South Africa?' in Steytler N & Ghai Y (eds) *Kenya-South Africa Dialogue on Devolution* (2015) 452.
[51] Out of the interviews conducted across Kisumu, Uasin Gishu, Machakos, Makueni, Nairobi and Kakamega counties in March 2021, only Kisumu County acknowledged an aspect of vagueness in the demarcation of county functions and even then, the respondent held that there were clear boundaries for most other functions.
[52] Constitution (2010), art 186(1) & (2) as read with the Fourth Schedule.

and to have such legislation coexist alongside that of the other level of government.[53] However, due to the lack of an explicit list, resort will have to be had to interpretation to determine which functions and powers under the Fourth Schedule are concurrent to both the national and county levels of government.[54]

While the list of functions that qualify as concurrent may change depending on the interpretation adopted, a textual analysis of the Fourth Schedule reveals the following as potential concurrent functions:

Table 5.1: Potential concurrent functions and powers

No	National government function (Part 1)	County government function (Part 2)
1	11) National statistics and data on population, the economy and society generally	8) County planning and development including – a) statistics
2	17) Promotion of sports and sport education	4) Cultural activities, public entertainment and public amenities, including – h) Sports and cultural activities
3	24) Disaster management	12) Fire-fighting services and disaster management
4	34) National betting, casinos and other forms of gambling	4)a) Betting, casinos and other forms of gambling
5	35) Tourism policy and development	7) Trade development and regulation, including – (d) Local tourism
6	22) Protection of the environment	3) Control of air pollution
7	22)c) Water protection, securing sufficient residual water and	11) Water and sanitation services

[53] Mutakha (2014) 221.
[54] Bosire (2013) 265.

	safety of dams	

Source: Adapted from a report of the Intergovernmental Relations Technical Committee (IGRTC)[55]

Even with the textual analysis and identification of potential concurrent functions, it is still indeterminate as to what the exact boundaries or cut-off points as well as the specific levels of responsibility to be borne by each level of government are.[56] It is also not clear as to what the financing arrangement for the functions would be.[57] Such lack of clarity would, hence, require further unbundling, and assignment of specific responsibilities under the shared functional areas, to each level of government.[58] Otherwise, as Steytler and Ghai argue, the lack of clarity may result in the domination of national legislation in concurrent functional areas, thus rendering counties mere implementers of such legislation, as is the case in South Africa and other federal systems.[59]

In practice, this lack of clarity with respect to concurrent functions has translated into a lack of clarity in the execution of the affected functions. While the national government is reported to have capitalised on the want of clarity to undertake most of these functions through national government institutions, the performance of others is said to be duplicated at both levels.[60] This covers functional areas such as: water; agriculture; betting, casinos and gambling; control of air and noise pollution and statistics, among others, with the key challenge being the failure to conclude the process of unbundling and assignment of concurrent functions that would have addressed the clarity problem, and provided room for the exercise of expenditure autonomy by counties in relation to these functions.[61]

[55] IGRTC (2018) 41.
[56] IGRTC (2018) 5.
[57] IGRTC (2018) 5.
[58] IGRTC (2018) 37.
[59] Steytler & Ghai (2015) 453.
[60] IGRTC (2018) 17-28; See also, National Treasury *Medium Term Budget Policy Statement, 2019* (2019) 62-63.
[61] IGRTC (2018) 17-28.

2.1.3 The paramountcy clause permits national legislative dominance

Although the Constitution provides a paramountcy clause as a mechanism for the resolution of instances of conflict between national and county legislation relating to concurrent functions,[62] the clause is generously worded in favour of national legislation thus posing the risk of national legislative dominance. While the clause's rationale is to underscore the parity of legislation enacted by both levels of government over concurrent mandates (in contradistinction to a general overriding pre-eminence of national-level legislation),[63] the nature and scope of circumstances under which national legislation prevails are phrased so broadly as to eventually defeat the purpose. Under the clause, the Constitution provides a criteria detailing circumstances under which national legislation prevails over county legislation in instances of conflict while indicating that county legislation prevails in all other circumstances.[64] The Constitution goes further to state that, even after the application of the criteria and a provision in national legislation prevails, this does not invalidate county legislation but that the affected provision only becomes inoperative to the extent of its inconsistency.[65] This, at first, seems to reinforce the constitutional status, relative equality and autonomy of counties (relative to the national government) which is key in facilitating their expenditure autonomy.[66] However, a keener analysis of the overriding circumstances reveal a generously worded list that could provide opportunity to national legislation to prevail in most instances of conflict.

Under article 191, national legislation prevails over county legislation in two broad instances. The first is where national legislation applies uniformly throughout Kenya and the national legislation: provides for a matter that cannot be effectively regulated by individual county legislation; provides for norms and standards as well as national policy which is required to be uniform across the country; is necessary for the maintenance of national security or economic unity or the protection of the common market, the promotion of economic activities across

[62] Constitution (2010), art 191(1).
[63] Mutakha (2014) 254.
[64] Constitution (2010), art 191(4) as read with 191(2).
[65] Constitution (2010), art 191(6).
[66] Bosire (2013) 255.

county boundaries, equal opportunity, as well as for the protection of the environment.[67] The second instance is where the national legislation in question is aimed at preventing unreasonable action by a county, which is either prejudicial to the economic health or security interests of Kenya or another county, or where such action impedes the implementation of national economic policy.[68] All these are rather broad circumstances and have been argued to be 'subject to very limited safeguards',[69] hence posing an unrestrained threat to conflicting county legislation. A generous application of the paramountcy clause stands to limit the scope of county powers (hence the scope of their expenditure autonomy) in areas of concurrent jurisdiction.[70]

However, the existence of these circumstances is justiciable, and the national government has the burden of proving their existence as jurisdictional facts, where this is contested.[71] Bosire argues that, purposively, the paramountcy clause should be interpreted strictly against the national government so as to protect the county governments' functional areas from encroachment by the national government, and to prevent the clause from being used as a backdoor for the recentralisation of power.[72] Although such strict interpretation would augur well for the expenditure autonomy of county governments, by protecting the scope of concurrent powers over which they have autonomy, all this will depend on how the clause is interpreted and applied in practice.[73] This leaves conflicting county legislation open to domination by national legislation.

2.2 The constitutional mechanism for providing functional clarity has not been adequately utilised

Despite the lack of clarity in the constitutional functional demarcation, the Constitution's article 186(4) mechanism aimed at supplying clarity has not been adequately used. Article

[67] Constitution (2010), art 191(2)(a) & (3).
[68] Constitution (2010), art 191(2)(*b*).
[69] Bosire (2013) 267.
[70] Bosire (2013) 276.
[71] Bosire (2013) 255 & 257.
[72] Bosire (2013) 254-255.
[73] Bosire (2013) 267.

186(4) acknowledges that, despite the constitutional objective of conferring exclusive, concurrent and residual mandates under article 186(1)-(3), 'some areas of uncertainty or lack of clarity may exist'' such as to warrant Parliamentary intervention to legislate for clarity on those areas.[74] The article provides that, 'For greater certainty, Parliament may legislate for the Republic on any matter'. This, therefore, provides an opening for Parliament to address the questions of clarity raised above by: disaggregating/unbundling and defining exclusive county government functions and powers; identifying concurrent functions and powers, disaggregating and defining their scope, then allocating them between the two levels of government; as well as detailing which functions and powers qualify as residual, disaggregating and defining them too, then making a determination whether they are best performed at the national or county level, and what needs to be done to assign or transfer them accordingly. This power has not been adequately applied by Parliament to provide the required clarity in the demarcation of functions and powers. This continues to hinder clarity and certainty over the scope of expenditure autonomy that may be exercised by counties in regard to the functions.

An attempt by Parliament to have the Transitional Authority (TA) undertake a process of functional analysis that would have provided clarity at the inception of devolution failed to effectively achieve this goal. Parliament had made provision for the functions and powers to be analysed prior to their transfer to the (then) newly created county governments, over the transition period. In this regard, section 7(2)(a) of the Transition to Devolved Government Act (TDGA) required the TA (the body that had been charged with managing the transition process) to facilitate the analysis and phased transfer of functions from the national government to county governments. 'Analysis of functions', under section 2 of the TDGA, referred to the 'process and mechanism of reviewing and reassigning of functions, powers and competences between the national government and county government in accordance with the Constitution'.[75] This power by the TA presented an opportunity for unbundling and

[74] Mutakha (2014) 224.
[75] 'Review and reassign' in this case is interpreted restrictively to fit within the confines of article 186(4) of providing clarity.

clarifying the nature and scope of county government functions and powers. Under the phased transfer, the Constitution had allowed for the asymmetrical transfer of functions and powers during the transitional period.[76] On this basis, Parliament mandated the TA to transfer the functions in two phases, the first being immediately after the first elections establishing counties (March 2013),[77] and the second being asymmetrical, based on an individual county's application and upon proof of capacity.[78] It was expected that the TA would then undertake functional analysis prior to the transfer of functions in each of these phases.

However, the TA transferred the initial functions and powers in the same aggregated form they were listed under Part 2 of the Constitution's Fourth Schedule without undertaking any unbundling or analysis.[79] Additionally, the TA was subsequently pressured, by a resolution of the Summit, to transfer almost all the remaining county functions simultaneously to all counties, six months after gazetting the first transfer.[80] This infamous 'big bang' transfer was, hence done hurriedly and in violation of the Constitution.[81] Although the TA made an attempt to undertake functional analysis and unbundle this second list of functions and powers into their specific components prior to transfer, the disaggregation was neither exhaustive nor conclusive. This is because some constitutional functions remained unbundled while the components of others were detailed using the 'including' term which made them inconclusive. The TA also failed to address the unbundling and assignment of concurrent functions and powers, as well as determining how the functions will be operationalised, including how they would be funded.[82] Although the TA's mandate was passed on to the Intergovernmental Relations Technical Committee (IGRTC),[83] the unbundling of these

[76] Constitution (2010), Sixth Schedule, s 15.
[77] Transition to Devolved Government Act (TDGA) No 1 of 2012 s 23(1).
[78] TDGA, s 23(2) & (3).
[79] Legal Notice No 16 of 2013.
[80] Legal Notices 137-183 of 2013. The transfer of the management of agricultural training centres and agricultural mechanisation stations were postponed by a further 6 months. See, Bosire CM 'Powers and functions of county governments in Kenya' in Steytler N & Ghai Y (eds) *Kenya-South Africa Dialogue on Devolution* (2015) 192; IGRTC (2018) 3.
[81] Constitution (2010), Sixth Schedule, s 15(2); IGRTC (2018) 3.
[82] IGRTC (2018) 14 & 33.
[83] IGRA, s 12 (*b*).

functions and powers has never been concluded.[84] As such, the exact scope of the county governments' expenditure responsibilities in respect of the 'non-unbundled' functions and powers, as well as over concurrent ones, remains indeterminate,[85] a situation the IGRTC has not attempted to resolve. This continues to hamper the exercise of expenditure autonomy by counties over the affected functions.

2.3 Autonomy over the county public service is limited

The autonomy constitutionally granted to county governments over the hiring and determination of terms of service of their employees is limited under both national legislation and in practice. The Constitution grants county governments responsibility over the establishment of their own county public service (CPS).[86] This entails the power to establish and abolish offices in the CPS, appoint persons to those offices, as well as the power to exercise disciplinary control over them and to remove them from office.[87] This role is given to the County Public Service Board (CPSB) which is established under the County Governments Act (CGA).[88] However, while the Constitution grants the Salaries and Remuneration Commission (SRC) the power to advise county governments on the remuneration and benefits of all public officers including those at the county level,[89] the CGA gives power to the CPSB to make recommendations to the SRC, on the remuneration, pensions and gratuities of CPS employees.[90] The import of the CGA provision, therefore, is to take away decision-making in this regard from the CPSB and confer it to the SRC with the CPSB playing only a supporting role through making recommendations. While there may be good reasons for wanting the SRC to make final decisions in this regard, this goes against the Constitution which only gives the SRC an advisory mandate in this regard. Other than being unconstitutional, the financial

[84] IGRTC (2018) iii.
[85] IGRTC (2018) iii.
[86] Constitution (2010), art 235(1).
[87] Constitution (2010), art 235(1). See also, CGA, s 5(2)(*f*) & s 56.
[88] CGA, s 57 as read with s 59 & 62 (1).
[89] Constitution (2010), art 230(4)(*b*).
[90] CGA, s 59(1)(*j*).

implication of the attempt by the CGA to take away decision-making from the CPSB would immensely undermine the expenditure autonomy of counties.

In addition to the above, various limitations have emerged in practice that limit the scope of autonomy the CPSB has over county government employees. First, during the transition to the devolved system of government, county governments were required to absorb all employees that were working in the defunct local authorities. Such absorption did not give counties an opportunity to renegotiate the terms of engagement, hence county governments picked up a fixed wage bill along with long term contracts that they could not terminate without cause. Secondly, employees that were working at institutions of local government at the national level were also seconded to county governments. Although counties were initially intended to have a choice as to whether to absorb the seconded staff or hand them back to the national government,[91] the employees ended up being permanently placed at the county level along with their wages and terms of employment.[92] This further increased the counties' wage bills and further restricted their ability to dictate terms. Thirdly, counties have been compelled, through sustained industrial action over the years, to meet the terms of Collective Bargaining Agreements which had been entered into between the national government and staff unions of county employees such as doctors and nurses, prior to the establishment of devolution. In the end, counties are left with a staff structure that they can hardly modify and terms of employment that they can hardly negotiate thus resulting in huge wage bills over which the respective county governments have no full control. All these factors therefore limit the scope of expenditure autonomy held by counties over their respective administrations.

2.4 The scope for own prioritisation of county expenditure is limited

Discretion with regard to prioritisation lies at the heart of county expenditure autonomy. Any factor that limits the exercise of this discretion by counties limits their expenditure autonomy.

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[91] World Bank (2011) xxiii.
[92] Interview with the Governor of Kisumu County held in Nairobi on 10 March 2021.

Prioritisation by counties is undertaken at various stages in their individual budget processes. These stages include: long term and medium term planning through the integrated development planning process (both the 5-year County Integrated Development Plan (CIDP) and the Annual Development Plan (ADP));[93] the setting out of a county's medium term financial and economic priorities through the County Fiscal Strategy Paper (CFSP); the preparation of budget estimates incorporating the county's revenue and expenditure estimates and culminating in the legislative stage that involves the approval of the budget estimates accompanied by the enactment of the finance and appropriation Acts as well as other laws necessary for the implementation of the budget.[94] The scope of discretion exercised by county governments in the planning and budgeting stages is, however, limited as discussed below.

2.4.1 County planning and budgeting autonomy is limited by legislative requirements for linkages and alignment

The constitutional provisions relating to subsidiarity, and its emphasis on the role of communities in county-level decision-making, is undermined by the unilateral requirement, under national legislation, for county plans to have linkages with the national planning framework. The Constitution recognises, as a key object of devolution, the right of communities to govern themselves, manage their own affairs and further their own development, including their right to participate in decision-making in this respect.[95] This objective is realised at the county level through systems of participation in the county processes of expenditure prioritisation at the planning and budgeting stages. However, while the County Governments Act (CGA) recognises the need for counties to give priority to the basic needs of the public,[96] it proceeds to require county planning to be linked to the national planning framework.[97] This undermines the constitutional imperative of community-led prioritisation, especially where such prioritisation at the planning stage is at variance with the

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[93] CGA, s 107(1) as read with ss 108, 109 & 110; PFMA, s 126(1) as read with (3).
[94] PFMA, s 125(1).
[95] Constitution (2010), art 174(*c*) & (*d*).
[96] CGA, s 117(1)(*a*).
[97] CGA, s 105(1)(*c*).

national planning framework. While the Constitution does not envision that the two levels of government would be completely distinct from each other (arguably including in their overall planning),[98] it requires that their interdependence and the conduct of their mutual relations (including the occasional need for bilateral linkages) be based on consultation and cooperation.[99] The unilateral nature of the legislative requirement for linkages, therefore runs contrary to this constitutional principle, with the consequence that the constitutional requirement for community-led decision-making (hence, expenditure prioritisation at the planning stage) is also undermined.

Similarly, the legislative requirement for the CFSP to be aligned with national objectives outlined in the Budget Policy Statement (BPS)[100] undermines the constitutional imperative for community-led prioritisation. The CFSP, which is prepared by county treasuries,[101] outlines the broad strategic priorities and policy goals that will serve as a guide to a county government in the preparation of its budget for the next financial year and over the medium term.[102] When preparing CFSPs, county treasuries are required to seek and consider the views of among others, members of the public as well other interested persons or groups at the county level.[103] This is in line with the principle of community-led prioritisation. Although the National Treasury is required to seek and consider the views of county governments in the preparation of the BPS,[104] a requirement that could be met through the intergovernmental deliberations undertaken in the IBEC,[105] nothing in the law gives any sort of binding force to the views received from the counties, nor is there a requirement for intergovernmental consensus in the identification of shared objectives to be included in the BPS. The actual impact of this 'consultation and cooperation' with counties, therefore, only exists in the realm of possibility. Thus, while counties undertake an extensive process of community-led prioritisation that

[98] Constitution (2010), art 6(2).
[99] Constitution (2010), art 6(2).
[100] PFMA, s 117(2).
[101] PFMA, s 103(1).
[102] PFMA, s 117(3).
[103] PFMA, s 117(5).
[104] PFMA, s 25(5).
[105] PFMA, s 187(2)(*a*). The IBEC is required to provide a forum for consultation on, among others, the contents of the BPS.

informs their CFSPs, in line with the Constitution, the legislative requirement for alignment with national objectives, whose formulation lacks clear processes of consultation that are based on parity of constitutional status, undermines the expenditure autonomy of county governments.

In practice, while some counties admit to have aligned their expenditure priorities to national objectives and planning frameworks crafted by the national executive, they, however, seem reluctant to admit that this in any way impacts their expenditure autonomy.[106] This was in respect of a presidential legacy development plan crafted by the national executive and termed the 'Big Four Agenda'. This Agenda was adopted in 2018, a year after the 2017 general election that had ushered in new county government administrations, and long after most counties had already undertaken their 5-year CIDPs. The Agenda isolated four development priorities (manufacturing, affordable housing, universal health care and agriculture) that would be the president's focus for the remaining four years of his term in office (2018-2022).[107] The Big Four Agenda was, hence subsequently co-opted into the national planning framework and BPS objectives with which county governments are required to align their prioritisation. While the priorities isolated under the Agenda are largely county government functions, its formulation was done without there having been any intergovernmental consultation or any framework for cooperation in financing and implementation of these priorities.[108] Nonetheless, counties such as Kakamega and Makueni felt that this did not impact their autonomy over expenditure given that it did not require them to deviate from their functions and given that, although they had already drafted and adopted their CIDPs, most of the priorities identified under the Agenda were already part of the CIDPs. While there may be validity in this argument, the perspective of the counties seems to demonstrate a clear failure to understand the import of their powers of prioritisation and their role in regard to

[106] Interview with the County Executive Committee Member for Finance of Kakamega County held in Nairobi on 18 March 2021; Interview with the County Executive Committee Member for Finance (together with chief officers and directors from the Finance Department), County Government of Makueni, held in Nairobi on 18 March 2021.
[107] National Treasury *Implementation Status of the Big Four Agenda 2018/2019* (2020) 1.
[108] Parliamentary Budget Office *Eye on the 'Big Four'- Budget Watch for 2018/19 and the Medium Term* (2018) 17 & 45.

intergovernmental consultation. The unilateral isolation of priorities by the national government and the requirement for linkages and alignment contravenes constitutional principles with the consequence that county discretion with regard to their own prioritisation is limited.

2.4.2 **County budgeting autonomy is limited by the imposition of ceilings**

Fiscal responsibility principles outlined under the PFMA impose expenditure ceilings to various county expenditure lines, thus limiting the autonomy of counties over their own budgeting. The county treasury is required to enforce fiscal responsibility principles (FRPs) laid out under the PFMA and its regulations when preparing the county budget.[109] Under the FRPs, the county treasury is required to ensure that: over the medium term, a minimum of 30 per cent of a county's budget is allocated to development expenditure;[110] the county's expenditure on wages and benefits of county public officers does not exceed 35 per cent of the county government's total revenue[111] and that a county assembly's approved expenditure does not exceed 7 per cent of the county's total revenue, or twice the county assembly's personnel emoluments, whichever is higher.[112] Where the latter is not achieved at the end of a financial year, the PFMA Regulations require the CEC member for finance to submit to the county assembly a responsibility statement explaining reasons for the deviation, and providing a binding compliance plan for subsequent years.[113] In addition to these, the changes a county assembly may make to a specific vote, in the budgetary estimates submitted to it for approval, are prohibited from exceeding more than one per cent below or above the respective vote's ceiling.[114] In the end, therefore, a county government may only exercise as much spending autonomy as may be possible within those ceilings and generally over any room left after the ceilings have been accounted for. Although the Constitution requires public money to be used in a prudent and responsible way, a requirement which is classified

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[109] PFMA, s 107(2) as read with s 104(1)(*b*).
[110] PFMA, s 107(2)(*b*); Public Finance Management (County Governments) Regulations, 2015 (PFMA Regulations), s 25(1)(*g*).
[111] PFMA Regulations, s 25(1)(*a*) &(*b*).
[112] PFMA Regulations, s 25(1)(*f*).
[113] PFMA Regulations, s 25(1)(*h*) & (*i*).
[114] PFMA Regulations, s 37(1).

as one of the FRPs (and arguably the constitutional basis for the imposition of FRPs), the imposition of these ceilings nonetheless limits the expenditure autonomy of county governments.

2.5 National inertia and violation of devolution principles persists

In addition to the above limitations, the general reluctance by the national government and its institutions to adjust to the advent of devolution, and to mainstream and ensure compliance with principles of devolution in their operations, continues to hamper the expenditure autonomy of county governments. The adoption of devolution under the Constitution of Kenya of 2010, and its implementation, meant that the hitherto highly centralised government and government institutions at the national level needed to radically restructure and undertake a 'culture change' so as to align with the devolved system of government.[115] Aside from its being a constitutional imperative, this called for a willingness from the national government to relinquish power to counties and 'the political will to engage in the shared exercise of power' where needed.[116] Line ministries at the national level, hence needed to reorient their mandate from service delivery and to refocus it on policy-making, regulation and support to counties.[117] However, as the Taskforce on Devolved Government acknowledged: 'One of the most challenging aspects of devolution is the need to 'let go' at the central level'.[118] Given that the bureaucracy that had been in existence since independence at the national level was accustomed to the centralised exercise of power and control over resources, it was anticipated that the process of implementing devolution, especially the transfer of functions and resources to counties, would be met with one form or another of behavioural and institutional inertia, or even deliberate delay and/or frustration of the transition process, by pro-status-quo forces at the national level.[119] It was also foreseeable

[115] World Bank (2011) 7 & 18; IGRTC (2018) 11.
[116] IGRTC (2018) 81.
[117] World Bank (2011) xxiii.
[118] Task Force on Devolved Government (2011) 125.
[119] IGRTC (2018) 11-12; World Bank (2011) 7.

that this would be worsened by the lack of clarity in the constitutional allocation of functions, which opened up the functions and powers to diverse interpretations.[120]

As expected, a failure by national government institutions at the onset of devolution to cooperate with the TA, coupled with their active withholding of information that would have aided the TA's efforts in undertaking functional analysis prior to the transfer of functions to counties, frustrated this process and is partly the reason for the persisting lack of clarity in functional demarcation.[121] Specifically, government institutions were required to take part in the formal process of intra-sectoral analysis of their existing functions, unbundling them, costing them, assigning them and eventually transferring them to counties in line with the Constitution. The relevant national government institutions, however, failed to cooperate, while others such as the National Treasury opted to undertake their own analyses when trying to cost functions that were to be transferred to counties, in the process of developing the initial budget documents after devolution.[122] This move by the Treasury masked the transparency and objectivity of the functional analysis and costing of functions process, given the National Treasury's interest in retaining as many resources as possible at the centre. Moreover, and subsequent to this, while some sector ministries made an attempt at incorporating principles of devolution in their policy development process, others continued creating structures that partly ignored the devolution and fiscal decentralisation imperative, hence resulting in lack of clarity in formulated policies.[123] Such inertia and institutional defiance to the onset of devolution, which is reported to persist,[124] thus inhibited and continues to inhibit the attainment of functional and policy clarity which is critical for the exercise of expenditure autonomy at the county level.

In addition to the above, the continued performance of county government functions by the national government[125] in violation of the Constitution, undermines the expenditure

[120] World Bank (2011) 7.
[121] Bosire (2013) 190.
[122] Bosire (2013) 190 & 194.
[123] IGRTC (2018) 11 & 78.
[124] IGRTC (2018) 71.
[125] IGRTC (2018) iii.

autonomy of county governments. In the period up to 2018, the national government is reported to have continued undertaking functions or some aspects of functions that are considered exclusive to the county level of government, even after these had been gazetted and legally transferred to counties.[126] This mainly involved functions such as county health,[127] housing, museums, libraries, county roads,[128] county public works and agriculture.[129] The national government also continues to undertake some devolved functions through State Corporations that existed prior to the adoption of devolution. No efforts have been made to restructure these corporations or their roles to reflect the constitutional allocation of functions and powers.[130] A 2013 report of the Presidential Taskforce on Parastatal Reforms indicated that there were in existence a total of 18 State Corporations that were still undertaking devolved functions, and that needed to be dissolved or be reconstituted.[131] Eight of these corporations were Water Services Boards (WSBs),[132] six were Regional Development Authorities (RDAs),[133] while the remaining four were the Kenya Rural Roads Authority (KeRRA), the Kenya Urban Roads Authority (KURA), Rural Electrification Authority and the Kenya National Library Services.[134] The fact that these corporations mainly undertake functions that are either wholly or partially county government functions, and utilise

[126] IGRTC (2018) 5.
[127] This mainly relates to the unilateral procurement by the national government of specialised equipment on behalf of county governments under a lease agreement which, to date, counties are still making payments. See, Institute of Economic Affairs (IEA) *8 Facts on the Medical Equipment Leasing Project in Kenya* (2019) 3.
[128] This is mainly through the functions of the Kenya Rural Roads Authority (KeRRA) and the Kenya Urban Roads Authority (KURA). See, Commission on Revenue Allocation (CRA) *Recommendation on the Sharing of Revenue Raised Nationally between the National and County Governments for the Financial Year 2016/2017* (2015) 36.
[129] IGRTC (2018) iii & 17-29; See also, National Treasury (2019) 62-63. The library function was, however, eventually transferred to counties and there are ongoing efforts to transfer the museums as well. See, National Treasury *Medium Term Budget Policy Statement, 2020* (2020) 59.
[130] IGRTC (2018) 57.
[131] Executive Office of the President - Republic of Kenya *Report of the Presidential Task Force on Parastatal Reforms* (2013) 110; IGRTC (2018) 57.
[132] The Water Services Boards (WSBs) were, among other things, tasked with implementing government policies related to water services. They are made up of: Athi Water Services Board, Coast Water Services Board, Lake Victoria North Water Services Board, Lake Victoria South Water Services Board, Northern Water Services Board, Rift Valley Water Services Board, Tana Water Services Board and the Tanathi Water Services Board.
[133] RDAs were in charge of ensuring integrated regional development and are made up of the: Coast Development Authority, Ewaso Ng'iro North Development Authority, Ewaso Ng'iro South Development Authority, Kerio Valley Development Authority, Lake Basin Development Authority as well as the Tana & Athi Rivers Development Authority.
[134] IGRTC (2018) 58; CRA (2014) 31.

substantial resources in the process, significantly undermines the functional autonomy of county governments including by denying counties resources that would otherwise have expanded the scope for expenditure discretion at the county level.[135]

Moreover, a failure by Parliament to review Acts of Parliament that existed prior to the adoption of devolution, or to enact replacement legislation which is aligned with the constitutional principles of devolved governance, serves to further limit and undermine the expenditure autonomy of counties. This also extends to some legislation enacted immediately after the adoption of devolution, but which contains offending provisions thus requiring streamlining. Most of the affected legislation are those establishing the State Corporations above as well as sectoral laws related to the functions undertaken by the State Corporations.[136] This failure by Parliament, therefore, continues to enable the continued violation of the Constitution by the national government, to the detriment of the expenditure autonomy of county governments.

3 Conclusion

The Constitution provides substantial bases for the exercise of expenditure autonomy by county governments. It, however, both expressly and through unwitting gaps, opens up these bases to potential restrictions and limitations by the national government. The national government therefore holds the powers to either seal these gaps, where needful, thus cementing the scope for expenditure autonomy extended to county governments or to opt to maximise on them thus significantly limiting room for county expenditure autonomy. While the national government has not moved to directly clamp down on this room for expenditure autonomy, it has also not actively sought to seal the gaps so as to enhance the expenditure autonomy of county governments. It has, however, maximised on the grey areas arising out of these gaps to continue undertaking functions that ought otherwise to be devolved to counties. What the Constitution of Kenya, therefore, does is create a framework which,

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[135] IGRTC (2018) 69; CRA (2014) 31; CRA (2015) 32.

[136] Intergovernmental Relations Technical Committee *Finalisation of Outstanding Issues in the Transfer of Functions in the Agriculture Sector* (2018) vii.

though highly permissive of the exercise of expenditure autonomy by counties, relies heavily on political goodwill from the national government for optimum access by counties to their autonomy over expenditure. While counties have demonstrated, with the support of the courts, a willingness to exert their expenditure autonomy, political will from the national government has largely been absent. While political will may not be always guaranteed and may not be legally enforced, unless in instances where it violates constitutional principles, this study will make recommendations on what measures should be taken to enhance the scope for expenditure autonomy extended to counties under the Constitution.

Chapter Six

THE FRAMEWORK AND PRACTICE OF SUBNATIONAL FISCAL AUTONOMY IN KENYA: The revenue autonomy of county governments

Revenue autonomy entails having revenue resources over which a subnational government can independently exercise autonomy (including spending autonomy). This extends to both the revenue that accrues to it, either from its own sources of revenue (OSR) or that which comes from intergovernmental fiscal transfers (IGFTs) and grants. With regard to OSR, revenue autonomy entails the discretion over the nature of the tax, its base and the rates to be imposed, as well as discretion over revenue administration including the nature and extent of reliefs applicable over OSR. In the context of IGFTs and grants, subnational revenue autonomy means having influence over the size of the shareable pool and distribution criteria as well as retaining discretion over the use of the transferred resources. However, any factor that increases, decreases or prevents timely access to the total amount of unconditional revenue eventually received by counties from the equitable share also increases or reduces the scope for expenditure autonomy held by counties, hence such factors would also be a key concern.

As in South Africa and most other countries, the constitutional design of Kenya's intergovernmental fiscal system was largely a product of political negotiation.[1] The vertical allocation of revenue and revenue instruments to either levels of government was, therefore, not preceded by any scientific or systematic analysis of aggregate revenue needs. An integrated approach to the financing of county governments was, hence settled on and laid out under the Constitution through an allocation of own revenue sources, and through a

[1] Interview with the leading economist of the Committee of Experts on Constitutional Review's finance subcommittee held in Nairobi on 6 February 2019.

system of IGFTs and grants.[2] The margin of autonomy held and drawn from these two financing approaches is, thus, the focus of this chapter.

The chapter has three sections. The first discusses the scope for revenue autonomy extended to county governments through the provision of own sources of revenue (OSR). The second focuses on fiscal autonomy drawn by counties from the system of IGFTs and grants, while the last makes a conclusion concerning the nature and scope of revenue autonomy afforded to county governments in Kenya.

1 The autonomy of county governments over their own sources of revenue (OSR)

The Constitution allocates counties a number of revenue sources over which they have jurisdiction to determine the base, the applicable rates, as well as the manner of administration. The revenue collected from these sources constitutes an unconditional source of revenue over which counties have complete expenditure discretion. OSR is thus a crucial source of both revenue and expenditure autonomy for county governments. OSR also serves to promote downward accountability which is critical in ensuring accountable fiscal autonomy. To analyse the scope of autonomy counties draw from their OSR, this section discusses how the legal framework facilitates the autonomy counties exercise over their OSR, the legal and practice-related limitations on the autonomy of counties over their OSR, as well as measures being explored to enhance county OSR with a view to expanding the fiscal autonomy counties draw from their OSR.

[2] Constitution of Kenya, 2010, art 202.

1.1 How the legal framework facilitates the autonomy of county governments over their OSR

Various factors drawn from both the Constitution and national legislation work to enable counties to exercise autonomy over their OSR, while also allowing county OSR to facilitate discretionary county expenditure. These are discussed below.

1.1.1 Counties have autonomy over specific constitutionally entrenched OSR sources

While the constitution outlines three principal sources (property rates,[3] entertainment taxes and charges), it also confers regulatory powers to counties which then become the basis for the imposition of licensing fees, fines and penalties as additional county OSR sources.[4] Concerning these sources, county governments have discretion over the setting of taxable bases and rates as discussed below. The Constitution also specifically excludes property rates and entertainment taxes from the scope of taxes that the national government may be allowed to impose, thus protecting them as an exclusive revenue source for county governments, and providing a basis for the exercise of autonomy by counties over their imposition.[5]

1.1.1.1 Counties have autonomy over property rates

Counties have discretion over the setting of taxable bases in regard to property in their jurisdiction, through the creation and the periodic updating of valuation rolls. Given that no national framework legislation has been enacted to generally regulate the imposition of property rates by counties, the nature and extent of this discretion is, therefore, still regulated under the Rating Act (Cap 266) of 1956 and the Valuation for Rating Act (Cap 267) of 1963,

[3] A property rate is a tax imposed on the value of property. See, National Treasury *National Policy to Support Enhancement of County Governments Own-Source Revenue* (2019) 4.
[4] Constitution (2010), art 209(3) & (4) as read with the Fourth Schedule.
[5] Constitution (2010), art 209(2).

being legislation that existed immediately before devolution.[6] Under this framework, counties (as rating authorities) are required, from time to time but at least once every ten years, to undertake the valuation of rateable property within their jurisdiction and to have this value entered in a valuation roll.[7] The respective values then constitute the basis for the assessment of the rate amount payable in regard to each piece of land in the roll.[8] Counties are, additionally, allowed to prepare supplementary rolls more often, to reflect any changes in the ownership or use of property.[9] This allows counties to regularly update their tax bases in respect of property within their jurisdictions.

Counties, moreover, have discretion over the form and method of rating to apply to properties within their jurisdictions. With regard to the form of rating, a county is allowed to choose from any of the four forms of rating under Cap 266.[10] These are: an area rate, where the county subdivides its region into various rating areas then decides which rates to apply to each of those areas; an agricultural rental value rate, which is a rate levied on the annual value of agricultural land; a site value rate, which is a rate on the value of unimproved land; or a combination of a site value rate; and an improvement rate, being the combined value of unimproved land together with any improvements undertaken on the land that increases its value.[11] Where a county elects to use the area rating approach, further discretion is provided in terms of choosing the method of rating to be applied to the areas. In this regard, the county can elect to use: a flat rate, in which case a particular tax rate is applied regardless of the taxable base; a graduated rate, whereby the tax rate increases with the increase in the taxable base; or a differential flat rate or differential graduated rate, whereby the rate changes

[6] Section 7 of the Transitional and Consequential Clauses under Schedule Six of the Constitution (2010) authorises the continued applicability of all laws in force prior to Constitution (2010), with necessary adaptations. See also, Council of Governors, Kenya Law Reform Commission & Commission on Revenue Allocation (CRA) *Model County Revenue Legislation: Handbook* (2014) 22.
[7] Valuation for Rating Act Cap 267 of 1963, s 3. Under s 6 of the Act, a valuation roll is required to contain: the description of the land valued; name and address of the rateable owner; the value of the land, the value of the unimproved land as well as the assessment for improved rate.
[8] National Treasury (2019) 5.
[9] Valuation for Rating Act, s 4.
[10] Rating Act Cap 266 of 1956, s 4(1).
[11] Valuation for Rating Act, s 2 of as read with Rating Act ss 2 & 4.

depending on the land's use.[12] Counties, therefore, have discretion in deciding the form and method of rating to apply in imposing property rates within their jurisdictions.

However, despite the huge potential that property rates have to contribute to county OSR, various factors militate against the uniformity of their significance and productivity across all county governments in Kenya. Factors such as: poverty, which hampers the capacity to pay; (unregistered) freehold and communal ownership of land, both of which make valuation and rating difficult; poor or deficient government services in rural counties, which disincentivises the payment of rates, render property rates less significant for rural counties.[13] This is in comparison to urban counties, which have improved land, which increases the tax base, registered ownership, which makes the tracking of ownership easy, and the benefit of active urban services, which incentivise payment of property rates.[14] Therefore, the revenue potential of property rates may not accrue equally to all counties, thus resulting in differentials in its contribution to the overall county OSR pool.

1.1.1.2 Counties have autonomy over entertainment taxes

County governments have autonomy over the setting of the taxable bases and rates for public entertainment within the counties.[15] Examples of aspects of public entertainment over which counties have jurisdiction are racing, cinemas, video shows and hiring, as well as sports and cultural activities.[16] The Entertainments Tax Act (Cap 479) of 1990,[17] however, defines entertainment as including all exhibitions, performances or amusements to which persons are admitted upon payment of an admission fee.[18] The Act also extends the definition to include

[12] Rating Act, s 5; Council of Governors, Kenya Law Reform Commission & CRA (2014) 22.
[13] Bosire CM *Devolution for Development, Conflict Resolution, and Limiting Central Power: An Analysis of the Constitution of Kenya 2010* (unpublished LLD thesis, University of the Western Cape, 2013) 320-21; Kirira N 'Financing counties in Kenya' in Steytler N & Ghai Y (eds) *Kenya-South Africa Dialogue on Devolution* (2015) 231-32; Steytler N & Ghai Y 'Devolution: What can Kenya learn from South Africa?' in Steytler N & Ghai Y (eds) *Kenya-South Africa Dialogue on Devolution* (2015) 455.
[14] Bosire (2013) 320-21; Kirira (2015) 231-32; Steytler & Ghai (2015) 455.
[15] Constitution (2010), art 209(3)(*b*) as read with Part 2 of the Fourth Schedule.
[16] Constitution (2010), Fourth Schedule, Part 2, para 4.
[17] Still in force pursuant to and within the limits of s 7 of Constitution (2010)'s Sixth Schedule
[18] Entertainments Tax Act (ETA) Cap 479 of 1990, s 2.

subscription or contribution-based clubs, associations or societies that offer entertainment, where one pays a lump sum to cover admission over a given period of time.[19] In respect of these, an entertainment tax is applied to the admission income, based on the amount paid for admission (ticket or lump sum), which then constitutes the tax base.[20] While the Act fixes the rate at 18 per cent of the amount collected,[21] this is arguably subject to the discretion of county governments under the new constitutional regime.

However, various factors affect the productivity of this source for counties. For instance, operators offering entertainment but who are registered for Value Added Tax (VAT) are exempted from paying entertainment tax under the Act.[22] While this is important in preventing double taxation, it limits the scope of a county government's entertainment tax to establishments whose income is below the VAT threshold, thereby narrowing the tax base over which county governments may impose entertainment tax.[23] Also, given the fact that a large part of public entertainment is currently provided via electronic media,[24] it is not clear whether county governments may be able to leverage on this in cooperation with the national government which is mainly in charge of the regulation and licensing of electronic media and, more recently, the imposition of digital services tax. Nonetheless, entertainment taxes constitute a critical constitutionally entrenched OSR source for counties.

1.1.1.3 Counties have autonomy over charges for services

The discretion county governments have over the adoption and implementation of tariffs and pricing policies in relation to services they provide constitute a key source of revenue autonomy for county governments.[25] This is drawn from the Constitution which allows county

[19] ETA, s 8.
[20] ETA, s 3; Adam Smith International *Final Report: Own-Source Revenue Potential and Tax Gap Study of Kenya's County Governments* (2018) 25.
[21] ETA, s 3.
[22] ETA, s 2.
[23] Adam Smith International (2018) 25.
[24] Kirira (2015) 232.
[25] County Governments Act (CGA) No 17 of 2012, s 120(1).

governments to charge for the services they provide.[26] Some of the services listed under the Constitution include: county health facilities and pharmacies; ambulance services; county abattoirs; veterinary services; cemeteries, funeral parlours and crematoria; refuse removal, refuse dumps and solid waste disposal; parking; electricity and gas reticulation as well as the provision of water and sanitation services.[27] Although counties have discretion in adopting and implementing tariffs and pricing policies in respect of these services, they are required to exercise such discretion subject to national government laws and policies, key among them being the County Governments Act of 2012 (CGA).[28] Although the Act generally limits the pricing of charges to cost recovery,[29] it nonetheless goes ahead to allow county governments to impose a surcharge[30] on a tariff in appropriate circumstances.[31] This gives room for counties to obtain income from the imposition of charges, a factor that adds to their OSR and reinforces their revenue autonomy.

As part of their autonomy over the imposition of charges, counties are allowed to differentiate between users, and to adopt special tariffs, a factor that not only extends their autonomy but also provides room for the realisation of more OSR from charges. With respect to differentiation, counties may differentiate between different categories of users, debtors, service providers, services, service standards as well as geographical areas provided this does not amount to discrimination.[32] Differentiation is key in matching the level of service provided with the tariffs applied, which ensures access to services for all which is directly linked to their ability to pay. Counties are also allowed to impose special tariffs for categories of commercial and industrial users for purposes of promoting local economic development.[33] This serves to

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[26] Constitution (2010), art 209(4) as read with CGA, s 116(1).
[27] Constitution (2010), Fourth Schedule, Part 2.
[28] CGA, s 120(1A). See also Water Act No 43 of 2016, s 159(*b*).
[29] CGA, s 120(3)(*d*).
[30] Drawing from South Africa's Municipal Fiscal Powers and Functions Act whose s 1 defines a 'municipal base tariff' as the fees necessary to cover the actual cost associated with rendering a municipal service and a 'municipal surcharge' as a charge in excess of the municipal base tariff, a surcharge may therefore be argued to constitute an income source.
[31] CGA, s 120(3)(*f*).
[32] CGA, s 120(4).
[33] CGA, s 120(3)(*g*).

further the discretion counties have over the imposition of charges and generally over their OSR, while also allowing counties to optimise the collection of revenue from charges.

1.1.1.4 Counties have autonomy over revenue raised from regulatory and licensing services (fees, fines and penalties)

The Constitution confers various regulatory and licensing powers on county governments through which counties have the autonomy to raise additional revenue, either in the form of licensing fees or through fines and penalties for instances of violation of county regulations.[34] These include powers over: county planning and development, including land survey and mapping; trade development and regulation which covers markets, trade licences, fair trading practices, local tourism and co-operative societies; the licensing and control of undertakings that provide food to the public; control of air and noise pollution, as well as other public nuisances; liquor licensing as well as animal control and welfare. While some of these regulatory powers are indicative of the corresponding licences that may be required, some may require unpacking to identify the specific activity that requires licensing. For instance, under the county planning and development role, counties can charge fees for the approval of plans, registration of plans or for change of user,[35] and under the power to regulate pollution, counties are able to impose fees for outdoor advertising, inter alia.[36] Counties generally have discretion in identifying the specific activities under their broad mandates that would require licensing hence have discretion in determining what would constitute their revenue bases. County governments also have discretion in setting the rates for their licensing and regulatory services, including the applicable fines and penalties for regulatory violations. This falls under their discretion to adopt and implement tariffs and pricing policies for their services, discussed above.

[34] Constitution (2010), Fourth Schedule, Part 2; Bosire (2013) 327.
[35] Bosire (2013) 329.
[36] Adam Smith International (2018) 29.

1.1.2 Parliament has the discretion to grant counties more OSR sources

Although the county OSR sources are largely limited to those borne by pre-devolution local authorities, the Constitution empowers Parliament to pass legislation to confer additional taxing powers on counties.[37] National legislation may hence confer further revenue-raising powers to county governments in addition to those discussed above. This provides room for strengthening the revenue autonomy of county governments. This is also in line with the constitutional principle of ensuring that county governments have reliable sources of revenue to enable them to govern and deliver services effectively.[38] While the prerogative to confer or not confer additional taxes is Parliament's, the High Court has held that, in line with this principle, county governments are allowed to petition the national government to legislate for purposes of conferring additional resources to them.[39]

The scope of this parliamentary power is, however, not clear. The discretion to legislate on new taxing powers allows Parliament to dictate the nature and scope of autonomy county governments may exercise over the additional taxes. Additionally, the power to legislate implies the corresponding power to withdraw the additional taxing powers by repealing the enabling legislation.[40] The full extent of revenue autonomy that these additional taxing powers may confer on county governments will hence be known once such enabling legislation has been enacted. To date, however, this power has neither been activated by Parliament, nor been invoked by county governments.

[37] Constitution (2010), art 209(3)(*c*).
[38] Constitution (2010), art 175(*b*).
[39] *Robert N Gakuru & Others v Governor Kiambu County & 3 others* [2014] eKLR, para 82.
[40] Mutakha JK *An Interpretation of the Constitutional Framework for Devolution in Kenya: A Comparative Approach* (LLD thesis, University of the Western Cape, 2014) 286.

1.1.3 Counties have the power to pass legislation to give effect to own revenue-raising measures

The constitutional conferment of legislative powers on county governments[41] serves the important function of enabling them to pass legislation to give effect to their powers to raise their own revenue. This is especially important given the constitutional requirement that the imposition, waiver or variation of taxes and licensing fees be done only as provided under legislation.[42] Counties are thus able to pass either sector-specific or revenue-source-specific laws that serve to regulate the imposition of taxes and fees in those sectors.[43] County legislative powers also allow county assemblies to approve any revenue-raising measures proposed for a given financial year by the county executive as part of the budget process, thereby furthering the revenue autonomy of counties.[44]

1.1.4 Counties have autonomy over the administration of revenue from their OSR

As highlighted in Chapter two, a subnational government's autonomy over its OSR extends to and is strengthened by its right to administer (assess, collect and enforce) its own revenue.[45] In this regard, the discretion extended to counties to either designate own receivers and collectors of revenue,[46] or to appoint external revenue collection entities,[47] as well as the

[41] Constitution (2010), art 185(1) & (2).
[42] Constitution (2010), art 210(1).
[43] Development Initiatives *Strengthening Subnational Government Own-Source Revenue Mobilisation in Kenya - Progress, Challenges and Opportunities* (2018) 4.
[44] Municipal Fiscal Powers and Functions Act (MFPFA) No 12 of 2007, s 132 as read with s 133. See also, Constitution (2010), art 185(4)(*a*).
[45] Bird RM 'Fiscal decentralisation and decentralising tax administration: Different questions, different answers' in Valdesalici A & Palermo F (eds) *Comparing Fiscal Federalism* (2018) 193; Farber G 'Taxing powers of subnational entities: Between domestic and supranational constraints' in Valdesalici A & Palermo F (eds) *Comparing Fiscal Federalism* (2018) 149.
[46] PFMA, s 157(1) & (2).
[47] PFMA, s 160.

discretion to waive or vary taxes, fees or charges[48] serves to extend the autonomy they have and draw from their OSR.

County governments are empowered, through the County Executive Committee (CEC) member in charge of finance (CECMF), to designate persons either as receivers or collectors of own revenue who are then in charge of collecting, receiving and accounting for county OSR.[49] Although the absence of a national framework legislation for guiding and ensuring uniformity in the practice of revenue administration has led to county governments struggling for a long time to settle on efficient revenue administration frameworks and systems, it augurs well for county government autonomy and has provided room for innovation.[50] At the onset of devolution, counties inherited revenue administration procedures, guidelines and personnel from the defunct local authorities.[51] With these came a host of inefficiencies including: lack of requisite revenue administration skills, which affected the capacity of counties to effectively forecast or project, assess, collect and enforce OSR; laxity among revenue administration personnel as well as weaknesses in OSR management upon collection.[52] Counties, therefore, had to make efforts to resolve these issues and to adapt, restructure or overhaul the inherited systems. In the end, counties generally adopted three approaches to administering their own revenue: some designated a specific department within the county government as receiver and/or collector of revenue; others required each department to have its own revenue administration unit which administers revenue and remits proceeds to the county's designated receiver; while some set up their own revenue collection agencies, mirroring the national revenue collection authority, which then acted as both collector and receiver of county revenue.[53]

48 PFMA, s 159 (1).
49 PFMA, s 157(1).
50 Adam Smith International (2018) 32.
51 National Treasury (2019) 3.
52 National Treasury (2019) 3.
53 Adam Smith International (2018) 33.

The discretion conferred on counties to delegate revenue administration to bodies outside their own administrations, while not desirable from a fiscal autonomy perspective, serves to help counties address their own revenue administration efficiency challenges. Moreover, the fact that this option is placed at the discretion of counties rather than being made mandatory serves to recognise and respect the autonomy of counties in this regard. On this basis, counties are allowed to either appoint an external entity as a collection agent or to utilise the national revenue collection body, the Kenya Revenue Authority (KRA). Over the years, counties have, hence experimented on this discretion by engaging external collection agents on a commercial basis where they pay a fee to have OSR collected on their behalf. However, although the use of KRA comes with well-established infrastructure and systems of revenue administration, better expertise and forecasting capacity, as well as economies of scale that may reduce the cost of revenue administration at the county level, only Nairobi County is on record to have engaged its services.[54] The use of external agents has, however, been argued as being done at the expense of county governments given that: the terms of engagement are often in favour of the agents; there is weak oversight and audit of external collection by the county governments and further due to the fact that it is not clear whether the engagement of agents leads to any performance improvements in revenue collection.[55] Nonetheless, the availability of these avenues to counties expands their discretion over the scope of options available for the administration of their own revenue.

The discretion county governments have to waive or vary taxes, fees or charges[56] is important in allowing flexibility to counties in responding to deserving circumstances, such as those caused by natural phenomena that affect the ability of taxpayers to meet their tax obligations. Tax holidays and amnesties, when based on objective factors and offered following appropriate policy processes, have the potential to encourage tax compliance hence

[54] Adam Smith International (2018) 34; It is worth pointing out that an interview with an official in Nairobi County's finance office revealed that the engagement of the KRA by Nairobi County was done at the instance of the National Government at a time when the County was undergoing leadership challenges that eventually led to a transfer of some of its functions to the national government.
[55] Adam Smith International (2018) 33.
[56] PFMA, s 159 (1).

improving county OSR. This power is required to be exercised through the CEC member for finance, in accordance with criteria established in regulations.[57] Although this augurs well for autonomy, it holds potential for abuse. As such, waivers and variations are only allowed to be granted if authorised by an Act of Parliament or under county legislation.[58] This ensures that the exercise of the discretion is guided to safeguard autonomy while at the same time ensuring accountability.

1.2 Legal and practice-related limitations to county fiscal autonomy over OSR

Despite the above factors that work to facilitate the revenue autonomy of county governments, a number of factors emanating from both the legal framework as well as from practice, limit the scope of both revenue and expenditure autonomy counties are able to draw from their OSR. These are discussed below.

1.2.1 Limitations emanating from the legal framework

While the Constitution serves as a source of revenue autonomy of counties through OSR, it also doubles as a source of limitations on the scope of this autonomy. It achieves this by providing only a limited amount of OSR sources to counties, and also by imposing an open-ended obligation on counties not to prejudice the national single market. This constitutes a potential basis for the limitation of the autonomy counties exercise over their OSR. These factors are discussed in detail below.

1.2.1.1 County OSR sources are limited – a constitutionally entrenched vertical fiscal asymmetry (VFA)

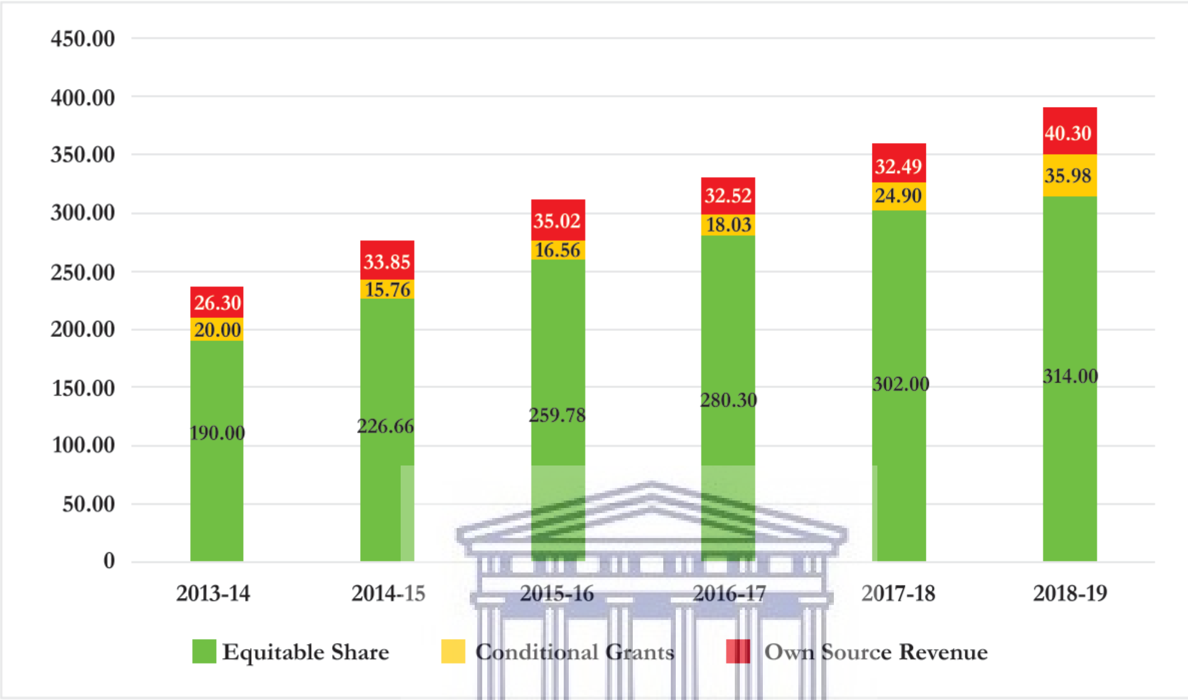
Despite the devolution of more expenditure responsibilities to counties compared to those held by the defunct local authorities, county OSR sources remained largely the same as those imposed by local authorities. These sources are also far less than the lucrative sources

[57] PFMA, s 159(1).
[58] PFMA, s 159(1)(c).

retained at the national level, which include income tax, Value Added Tax, customs duties and other duties on the export or import of goods, and excise tax.[59] As a result, on average, county OSR contributes about 11 per cent to the total annual county government budgets.[60] This reveals a constitutionally entrenched vertical fiscal asymmetry (VFA)[61] which leaves counties depending on the supplementary system of intergovernmental fiscal transfers (IGFTs) and grants to finance the larger portion (90 per cent) of their annual budgets. Figure 6.1 below shows the contribution of these sources of revenue to annual county government budgets from the inception of devolution in Financial Year 2013/14 to Financial Year 2018/2019.

[59] Constitution (2010), art 209(1).
[60] Development Initiatives (2018) 7. Despite the above figure, whose calculations place OSR at 10.6 per cent of annual county budgets, the latest report of the CRA (from which the figure is adapted) quotes OSR contribution to annual county budgets for the period at 7.7 per cent. See, Commission on Revenue Allocation *Counties' Efforts Towards Revenue Mobilisation - A Stock of the Last Six Years* (2019) 11&12.
[61] See also, Commission on Revenue Allocation *Recommendations on Sharing of Revenue Raised Nationally between the National and County Governments for the Fiscal Year 2012 / 2013 and among County Governments for the Fiscal Years 2012/13 - 2014/15* (2012) 13.

Figure 6.1: The contribution of various revenue sources to annual county budgets for FY 2013/14 – 2018/19 (in Ksh. Billions)



Source: CRA, 2019[62]

From the figure above, county OSR, on average, contributed 11.13 per cent, 12.25 per cent, 11.25 per cent, 9.83 per cent. 9.04 per cent and 10.30 per cent to the annual county budgets for the six financial years between 2013/2014 and 2018/2019. Even then, this average does not apply evenly to all county governments. Some counties raise more OSR than others. OSR is, in fact, said to be 'concentrated in ten counties that have high levels of urbanisation and diverse economic activities'.[63] These are: Nairobi, Mombasa, Kisumu, Nakuru, Uasin Gishu, Kiambu, Narok, Machakos, Nyeri and Kajiado, which together accounted for 72.8 per cent of the total OSR raised by all counties over the period above.[64] Hence, the contribution of OSR to the

[62] CRA (2019) 1.
[63] Development Initiatives (2018) 6.
[64] Development Initiatives (2018) 6; Nairobi funds about 45 per cent of its budget from OSR, Mombasa (30%), Narok (25%), Nakuru (18%), Kiambu (17%) & Machakos (15%). See, CRA (2019) 10 & 19.

overall budget for most counties is much less than the average. For instance, in the period between 2013/2014 and 2017/2018 financial years, only 11 counties were able to fund at least 10 per cent of their budgets from OSR, meaning that for the remaining 36 counties, OSR contributed less than 10 per cent to their budgets, with the bottom five counties funding less than 1.5 per cent of their budgets from OSR.[65] The level of dependence on OSR, which is occasioned by the constitutionally entrenched VFA, thus varies across counties, with the majority being heavily reliant on transfers to fund most of their budgets.

1.2.1.2 The broad obligation not to prejudice the 'single national market' holds potential for abuse

The open-ended nature of the constitutional requirement for county governments to exercise their taxation and other revenue-raising powers in such manner as not to prejudice 'national economic policies, economic activities across county boundaries or the national mobility of goods, services, capital or labour' (article 209(5) requirement) holds the potential to provide an avenue for the national government to restrict the autonomy county governments exercise over their OSR. The broadness of this constitutional requirement has made it the subject of various interpretations, most of which have been restrictive on the autonomy of county governments.

Parliament's interpretation under the PFMA, for instance, lacks sufficient clarity, hence holding the potential to impinge on the institutional autonomy of county executives and county legislatures. Under the PFMA, county governments are required to seek the views of the Cabinet Secretary for Finance and the CRA prior to imposing a tax or other revenue-raising measure.[66] While consultation and cooperation is a constitutional imperative and a key pillar of devolution, the PFMA is not clear as to: at what level in the county policy-making or legislative process this consultation is required to take place; what the scope of views offered would be, whether this is limited to the propriety of a revenue-raising measure or whether it

[65] Development Initiatives (2018) 7.
[66] PFMA, s 161.

extends to questions of the tax base and rate to be applied as well as any proposed variations by the respective county governments. While this requirement for consultation can constitute a check that secures accountable fiscal autonomy in compliance with the constitution, its lack of sufficient clarity holds the potential to conflict with the policy-making and legislative mandates of county executives and legislatures and so constitutes a barrier to efforts by counties to expand their own revenue bases.

While some proposed interpretations could be supportive of county autonomy, such as the one that construes the obligation as providing a basis for the Parliament to pass framework regulatory legislation that would provide general guidance and ensure uniformity in the adoption and implementation of revenue-raising measures by counties across the country,[67] some have been outright unconstitutional. The latter was contained in the County Governments (Revenue Raising Process) Bill, 2018 and attempted to interpret the art 209(5) requirement as allowing both prior consultation as well as giving room for the enactment of framework legislation. The Bill sought to regulate the process through which county governments may introduce new taxes and fees or vary or waive them, and was premised on the article 6(2) principle of consultation and cooperation.[68] However, while the Bill had the potential to provide the required clarity as to the scope of the article 209(5) requirement, some of its provisions were arguably unconstitutional.

First, the Bill indicated under its memorandum of objects and reasons that the process under it was for securing the approval of county government taxes.[69] The Constitution does not envision any processes for approval of any county tax, fee or charge by the National Treasury as long as these are imposed within the purview of allowable revenue-raising measures under the Constitution. The determination of the constitutionality of a county revenue-raising measure can only be done by the courts. Secondly, while the Bill was stated to apply to new revenue measures, it set up an Inter-Agency Transitional Committee with the mandate to

[67] Mutakha (2014) 279-280.
[68] County Governments (Revenue Raising Process) Bill 2018, s 3(2)(*b*).
[69] See the explanation given as the object of Clause 4.

review revenue-raising measures that were already being imposed by counties prior to the coming into effect of the Bill, for purposes of ascertaining their compliance with article 209(5). While this is constitutional, the Committee was required, out of the list of all revenue-raising measures being imposed by counties, to prepare a list indicating which of them was allowable and which the Cabinet Secretary was to then go ahead and gazette.[70] The impact of this would be the rendering of all other revenue measures not so gazetted illegal, a function that can only be done by the High Court which has jurisdiction over constitutional interpretation. Lastly, the Bill made the CRA's role that of making recommendations that would then inform the National Treasury's decision on the approval of the county revenue-raising measure, rather than requiring the CRA to submit its recommendations as well directly to county governments.[71] In the end, therefore, while the Bill would have served to provide the needed clarity on the scope of the article 209(5) requirement, it would also have resulted in an imperial National Treasury which had the final say in the approval of county government revenue-raising measures, a situation that would have been in contravention of the Constitution. The Bill, however, lapsed before it could be passed into law and is yet to be reintroduced.[72]

1.2.2 Limitations emanating from practice

A number of factors have emerged from practice since the inception of devolution in 2013, which continue to limit the scope of both revenue and expenditure autonomy counties are able to draw from their OSR. These are discussed below.

[70] County Governments (Revenue Raising Process) Bill, s 8(3) & (4).
[71] County Governments (Revenue Raising Process) Bill, s 4(3) & (5).
[72] National Assembly Bill Tracker 2021 available at http://www.parliament.go.ke/the-national-assembly/house-business/bill-tracker (accessed 15 May 2021).

1.2.2.1 The national government continues to provide water and electricity centrally

The continued provision of water and electricity by the national government continues to inhibit the productivity of charges as a source of revenue for county governments.[73] Water provision, as discussed in the previous chapter, is still being done by State Corporations (Water Services Boards) which are yet to be restructured to allow counties to fully undertake the services. While some counties do provide water services based on the limited mandate they assumed by taking over the function from the defunct local authorities, the continued existence of these State Corporations cuts down on the amount of revenue that counties would otherwise realise from the exclusive provision of the service. This limits their revenue autonomy.

With regard to county jurisdiction over the provision of gas and electricity, three issues limit the role played by counties hence the scope of revenue they may draw from provision of the service. First is the finding, as with the situation with water provision, that some State Corporations, such as the Rural Electrification Authority, are still undertaking functions that ought to be devolved to counties.[74] Secondly, the national government has interpreted its policy-making mandate over electricity and gas reticulation[75] to include actual service provision. In this regard, the Energy Act (2019) confers a concurrent mandate to both the national government and county governments over electricity reticulation.[76] While this may be argued as being unconstitutional, the conflict is mainly attributed to the lack of clarity in functional allocation, especially with respect to mandates that may otherwise be interpreted as concurrent. The result is that any argument of unconstitutionality then becomes an exercise at constitutional interpretation whose final arbiter is the court. Thirdly, unlike South African Municipalities, which are allowed to provide electricity on retail to consumers, the

[73] See also, Kirira (2015) 233; Steytler & Ghai (2015) 456.
[74] Intergovernmental Relations Technical Committee (IGRTC) *Emerging Issues on Transfer of Functions to National and County Governments* (2018) 58.
[75] Constitution (2010), Fourth Schedule, Part 1, Para 31.
[76] Fifth Schedule, Part A, para 3(*d*) and Part B, Para 3(*a*).

mandate to reticulate for Kenyan counties is defined narrowly to restrict the function to the planning and construction of the network used to supply electricity.[77] The national government, on the other hand, has retained jurisdiction over generation, transmission, distribution and retail supply of electricity.[78] This is in addition to the reticulation mandate it has allocated itself. Consequently, the place of county governments in the provision of electricity is largely weakened, as is any potential OSR that could be gleaned from the discharge of the function.

1.2.2.2 Counties have been unwilling or unable to maximise revenue from their OSR

Even though county OSR sources are limited, county governments have played a role in the small contribution OSR makes towards the revenue and expenditure autonomy of counties. This has been achieved by their failure to maximise their discretion to legislate and to set tax bases and rates for their OSR, their unwillingness or inability to address inefficiencies arising from revenue administration as well as instances of abuse of their discretion in revenue administration.

1.2.2.2.1 Discretion to legislate and set tax bases and rates has not been fully utilised

Although counties are free to legislate for the raising of revenue from their OSR,[79] not all county governments have utilised this power to pass their own legislation to facilitate the imposition of taxes and fees.[80] Some counties still utilise the transitional clauses in the Constitution[81] as a basis for continuing to rely on national legislation that was utilised by the defunct local authorities, when imposing taxes and fees.[82] For instance, as of 2019, less than

[77] Energy Act No 1 of 2019, s 2.
[78] Energy Act, Part A, para 3(*d*).
[79] Constitution (2010), art 209(3).
[80] Development Initiatives (2018) 4.
[81] Constitution (2010), Sixth Schedule, s 7.
[82] National Treasury (2019) 4.

ten counties had enacted property rating and valuation legislation to facilitate the imposition of property rates.[83] Others utilise their annual Finance Acts as the primary basis for the imposition of various taxes and fees. The failure to enact revenue-raising legislation has led to the continuation of an inherited disconnect between taxes, fees and charges and their underlying policy objectives.[84] This affects tax compliance hence the productivity of OSR, as communities are not able to understand the link between taxes and fees and the objectives they serve. This failure undermines the ability of counties to realise increased OSR outputs, a factor that further undermines both their revenue and expenditure autonomy.

Additionally, a failure by county governments to maximise their discretion over the setting of tax bases and rates in relation to property rates continues to undermine the productivity of this OSR source. While the updating of property valuation rolls provides counties an opportunity to revise applicable tax bases and rates, this has not been achieved in practice with most counties' valuation rolls dating several years before devolution – Nairobi (1982), Machakos (1983), Mombasa (1991), Kisumu (2008), Nyeri (2009) – with Kiambu County being the only one that has undertaken valuation within the last 10 years (2014).[85] This has been attributed to the high cost involved in their preparation.[86] As a result, county governments continue to operate using rating systems and outdated valuation rolls inherited from the defunct local authorities, a factor that has contributed to the under-performance of this revenue source against its projected huge potential when compared to other developing countries.[87] Moreover, although counties have discretion over the form and methods of rating to apply over the various properties in their jurisdiction, most counties have failed to explore this discretion to expand the OSR collected from property rates. For instance, most counties utilise the site value rate (rate on the unimproved value of land) in calculating the applicable rate and do not impose a rate on improvements to land, while those in rural areas

[83] National Treasury (2019) 4.
[84] Adam Smith International (2018) 6.
[85] National Treasury (2019) 5.
[86] National Treasury (2019) 5.
[87] National Treasury (2019) v & 5.

mostly apply the agricultural rental value rate.[88] This has led to the realisation of minimal own revenue from property rates compared to their estimated potential.

Further, despite the discretion extended to county government to adopt and implement their own tariffs and pricing policies, a 2018 report by Development Initiatives[89] and a 2019 report by the National Treasury[90] found that none of the counties have adopted them. It is, therefore, not clear on what basis they are imposing charges for the services they provide, and whether in the imposition of charges they are complying with the guidelines laid out under the law. It is also not clear what impact, if any, this has on the productivity of this source of revenue, hence its possible impact on the revenue autonomy of county governments.

1.2.2.2.2 Inefficiencies and instances of abuse of county revenue administration autonomy persist

Despite the efforts and progress that has been made by county governments to stabilise their own internal revenue administration systems, their inability to address various challenges and inefficiencies has contributed to the under-performance of county OSR. Some of these challenges include: 'out-dated databases inherited from the defunct local authorities'; 'scanty information on existing and potential taxpayers'; weak revenue enforcement units; tax evasion and resistance; skills and capacity weaknesses; political interference; underreporting of actual OSR collected, either due to the use of OSR at source by counties or due to revenue leakages as well as lack of effective internal control and audit mechanisms.[91] As a result of skills and capacity weaknesses (coupled with inadequate relevant OSR-related data), for instance, counties have consistently had problems with revenue projection with most

[88] Council of Governors, Kenya Law Reform Commission and CRA (2014) 23.
[89] Development Initiatives (2018) 5.
[90] National Treasury (2019) v.
[91] Adam Smith International (2018) 32; National Treasury *Medium Term Budget Policy Statement, 2017* (2017) 61; Commission on Revenue Allocation *Recommendation on the Basis for Equitable Sharing of Revenue between National and County Governments for the Financial Year 2018/2019* (2017) v & 10; National Treasury *Medium Term Budget Policy Statement, 2018'* (2018) 59; Commission on Revenue Allocation *Recommendations on the Basis for Equitable Sharing of Revenue between National and County Governments for the Financial Year 2019/2020* (2018) 16; Development Initiatives (2018) 11; National Treasury *Medium Term Budget Policy Statement, 2019* (2019) 58.

counties ending up consistently collecting much less than their annual projections.[92] For example, between 2013/2014 and 2016/2017, counties on average collected almost 40 per cent less than the total revenue they had projected.[93] Moreover, these inefficiencies continue to underlie the constant inability by counties to meet their estimated revenue potential. For instance, between 2013/14 and 2018/19, all counties, apart from Samburu County, underperformed in revenue collection relative to their estimated revenue potential.[94] Out of these, only six counties (Samburu, Narok, Isiolo, Laikipia, Baringo and West Pokot) were able to raise more than 42 per cent of their estimated revenue potential with 24 counties collecting between 20-42 per cent while 17 counties raised less than 20 per cent of their estimated revenue potential.[95]

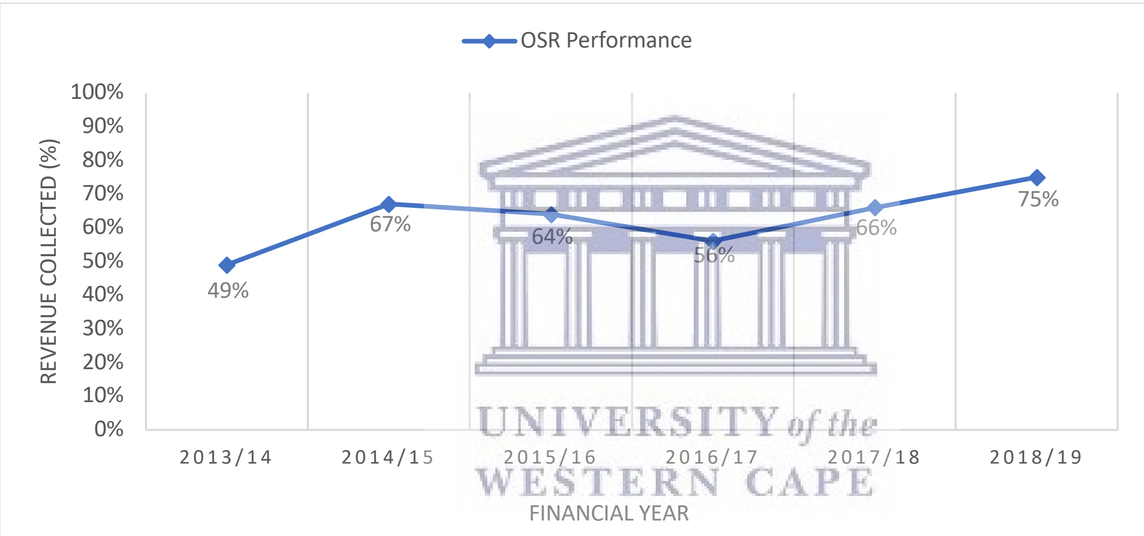
Also, revenue compliance at the county level has been largely affected by political interference in the form of 'road-side' tax amnesties. While tax amnesties have the potential to improve compliance, politicians in counties such as Nairobi have resorted to issuing politically instigated repeated amnesties which have undermined compliance and enforcement in the long-term,[96] as taxpayers hold off payment in the hope that amnesties would be re-issued. This, among other issues, continues to impede the ability of counties to effectively administer their own revenue, hence affecting overall performance of county OSR.

For instance, between the 2013/2014 and 2018/2019 financial years, county government OSR consistently underperformed due to counties constantly failing to meet their revenue targets. Over that period, actual county revenue realised remained volatile, with counties collecting:

[92] Adam Smith International (2018) 35.
[93] Adam Smith International (2018) 35.
[94] CRA (2019) 6; The estimation of county revenue potential was undertaken by the National Treasury in 2018 through an own-source revenue potential and tax gap study and was based on six main county revenue streams (Property tax, building permits, business licenses, liquor license, vehicle parking fees and outdoor advertising).
[95] CRA (2019) vi & 6.
[96] Adam Smith International (2018) 32.

48.5 per cent in 2013/2014;[97] 67.3 per cent in 2014/2015;[98] 63.5 per cent in 2015/2016;[99] 56.4 per cent in 2016/2017;[100] 66 per cent in 2017/2018[101] and 74.8 per cent in 2018/2019[102] (see Figure 6.2 below). On average, therefore, county governments were only able to collect about 61 per cent of their revenue projections between 2014/2015 and 2018/2019 (excluding the first year of devolved government).[103] Although the realisation rate has improved the last two years, there is a notable consistent pattern of over-projection and under-collection of OSR at the county level.

Figure 6.2: Annual County OSR Performance between 2013/2014 and 2018/2019



Source of data: CRA (2015 – 2018), CoB (2017) and National Treasury (2017 and 2020)[104]

[97] Development Initiatives (2018) 11.
[98] Commission on Revenue Allocation *Recommendation on the Sharing of Revenue Raised Nationally between the National and County Governments for the Financial Year 2016/2017* (2015) 10; CRA (2017) 61; National Treasury (2017) 61.
[99] Office of the Controller of Budget (CoB) *Annual County Governments Budget Implementation Review Report - FY 2016/17* (2017) 64; Commission on Revenue Allocation *Recommendation Concerning the Basis for the Equitable Sharing of Revenue Raised Nationally between the National and County Governments for Financial Year 2017/2018* (2016) 10; National Treasury (2017) 61.
[100] CoB (2017) 64; CRA (2018).
[101] National Treasury *Medium Term Budget Policy Statement, 2020* (2020) 54.
[102] National Treasury (2020) 54.
[103] National Treasury (2020) 16.
[104] See also, fn 99-104 above.

The huge shortfalls in meeting OSR targets occasioned by county government administrative inefficiencies result in financing gaps in county budgets, which constrain the capacity of counties to finance their adopted budgets, contribute to huge pending bills at the county level and add to the dependency of counties on intergovernmental transfers.[105] This, in the long run, undermines the fiscal autonomy of county governments.

1.2.2.3 Counties and Parliament are disinterested in pursuing additional county OSR sources

Despite the Constitution giving power to Parliament to legislate to confer additional taxing powers on county governments and the High Court confirming that county governments were allowed to petition Parliament to exercise this power,[106] no additional OSR source has been assigned to counties, nor has any county petitioned for any such assignment of additional revenue-raising powers.[107] This is despite counties facing consistent challenges with the disbursement of transfers. What counties are on record petitioning for is an increase in transfers, something that points to the growing dependency syndrome at the county level. This is, however, not uncommon. Subnational governments in South Africa and across the world are argued to:

> Prefer the comfort of relying on transfers to taking the arduous and politically unpopular route of imposing taxes on and collecting from their constituencies, and then accounting to those constituencies for their spend.[108]

This informs Steytler and Ghai's argument that: 'Whereas the first democratic cry of the American revolution was 'no taxation without representations', there is no modern-day equivalent of 'no representation without taxation''.[109] The consequence is that the VFA persists as does the growing dependence of counties on the equitable share which, in this

[105] CRA (2017) v & 10; Development Initiatives (2018) 11; National Treasury (2018) 60.
[106] Constitution (2010), art 209(3)(c); *Robert N Gakuru & Others v Governor Kiambu County & 3 others* para 82.
[107] Steytler & Ghai (2015) 456.
[108] Steytler & Ghai (2015) 456.
[109] Steytler & Ghai (2015) 456.

case, comes at the expense of more predictable OSR through which counties could exercise greater ownership and control of their expenditure.

1.3 The impact of measures explored to enhance county OSR is minimal

Although various measures have been explored with a view to enhancing county OSR, mainly as a result of the fiscal constraints occasioned by over-projection and underperformance of county OSR, including budget deficits and huge pending bills, their impact has been minimal. Some of these measures include: a proposal by the National Treasury to cap annual county own revenue projections; the adoption by the CRA of a 'fiscal effort' parameter in the horizontal division of revenue; efforts by some counties to fully automate their revenue collection and management as well as the adoption of a national policy on the enhancement of county OSR. All of these have been geared towards the important objective of aiding counties to have greater ownership and control over their own development and service delivery, as well as being more accountable to the taxpayers who fund county expenditure.[110]

In order to address the problem of over-projection by counties, the National Treasury, in 2017/18, undertook an 'Own-Source Revenue Potential and Tax Gap Study of Kenya's County Governments',[111] with the aim of using the estimated revenue potential of individual county governments, together with an analysis of the specific county's historical OSR performance, to cap the scope of that county's annual OSR estimates.[112] This had the underlying objective of ensuring that counties provide more stringent justification in instances where their revenue projections exceed what is statistically regarded as realistic.[113] Although the estimated county revenue potential has been instrumental in providing a general basis for evaluating county OSR performance, the estimation was not comprehensive and focused only on six county OSR

[110] Development Initiatives (2018) 3.
[111] National Treasury (2018) 60; National Treasury (2019) 58.
[112] National Treasury (2018) 60.
[113] National Treasury (2018) 60.

streams, thereby failing to capture the full OSR potential of counties.[114] This informed a recommendation by the CRA for a more comprehensive study on county revenue potential to be undertaken, which covers all county revenue streams while taking into account data on the individual counties' Gross County Product (GCP).[115] However, while the National Treasury's capping proposal was well-intentioned, from a policy perspective, and would have served to cure the mischief of over-projection, the result would be a requirement for the annual approval of county government budget estimates, a factor that would not only constrain the autonomy of county executive committees, but would also be unconstitutional for breaching the institutional autonomy of county executives and legislatures. The outcome of this endeavour by the National Treasury is, however, indeterminate.

In response to the constitutional requirement that the revenue division criteria takes into account the need for the economic optimisation of counties, including the need to provide incentives for counties to optimise their capacity to raise revenue, the CRA, in its second and third horizontal revenue sharing formulas, included 'fiscal effort' as one of the formulas' parameters.[116] Although the objective was to incentivise greater effort by counties to maximise their revenue potential by, among other things, increasing their efficiency in revenue administration, this parameter unwittingly provided a perverse incentive for some counties whose OSR sources had been performing well to under-project so that they can qualify to receive the allocation for fiscal effort in the subsequent year.[117] Although the parameter has the potential to lead to genuine improved county OSR outcomes, it is not clear to what extent it has been able to achieve this.

As a result of revenue leakages at the county level, mostly attributed to manual and semi-automated revenue collections systems, some counties have resorted to full automation of

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[114] CRA (2019) 6; The revenue streams used were property tax, building permits, business licenses, liquor license, vehicle parking fees and outdoor advertising.
[115] CRA (2019) 20. GCP data focused on providing a picture of the economic structure and relative size of each county government's economy. See, Kenya National Bureau of Statistics *Gross County Product* (2019) 1-2.
[116] CRA (2017) 11.
[117] Interview with the Director of Revenue Management of Uasin Gishu County held in Eldoret on 16 March 2021.

revenue collection and management. This has been effective in: improving transparency, ensuring efficiency and minimising revenue leakages in counties; incentivising revenue compliance by making the payment process simpler and more accessible to taxpayers; as well as facilitating the collection of relevant revenue-specific data which is key in revenue administration.[118] Counties such as Kiambu, Mombasa, Kisumu and Bungoma, for instance, recorded significant improvements in their OSR performance after automating their revenue collection and management.[119] The challenge with automation, however, lies in the huge costs associated with setting in place the requisite infrastructure, or engaging external agents with the requisite infrastructure which chips away at the OSR collected. Also, given the legal and political consequences of disbanding entire revenue administration departments within counties in favour of automation, counties have been reluctant to pursue this option. In order to leverage on the benefits of automation while avoiding the consequences of declaring redundancies, most counties have opted for semi-automation which serves only to increase the costs of revenue administration and so defeats the underlying motive of having more OSR at their disposal for discretionary county expenditure.

Lastly, although a national policy framework for the enhancement of county OSR was adopted at the national level,[120] the proposals made under it are yet to be implemented. The policy, developed by an Interagency Working Committee established under the IBEC, was prepared alongside a national framework legislation, both aimed at providing ways through which county OSR tax bases could be broadened and measures taken to strengthen the revenue administration capacity of counties.[121] The policy proposes a number of measures including: assisting counties in determining their own revenue potential and training them in tax analysis and revenue forecasting; supporting counties in developing county legislation and policies that would enhance OSR mobilisation; ensuring the establishment of appropriate institutional arrangements for revenue collection and management; as well as

[118] Development Initiatives (2018) 13.
[119] Development Initiatives (2018) 13.
[120] National Treasury (2019) foreword; National Treasury (2020) 55.
[121] National Treasury *Medium Term Budget Policy Statement, 2016* (2016) 64-5; National Treasury (2017) 64.

intergovernmental cooperation in revenue enforcement.[122] The national government was also required to undertake legislative reforms at the national level directly related to county government OSR sources and targeted at facilitating the enhancement of county OSR.[123] While holding promise in relation to helping counties address their revenue administration challenges, none of these measures has since been implemented. Moreover, aside from introducing a number of unconstitutional provisions, the proposed national framework legislation (the County Governments (Revenue Raising Process) Bill), which was drafted to guide the introduction of new county revenue streams, lapsed in Parliament and is yet to be reintroduced.[124]

In conclusion, while most of the measures above, both proposed and undertaken, have the potential to contribute to the enhancement of county OSR, their impact has so far been minimal, at best. This leaves counties with limited yet underperforming OSR which renders them dependent on intergovernmental transfers and grants to fund the larger part of their budgets, with their unconditional equitable share being the main source of their discretionary spending.

1.4 Conclusion on the fiscal autonomy of counties over and from their OSR

The Constitution grants counties limited own sources of revenue compared to their expenditure responsibilities. However, with regard to these sources, county governments have autonomy over the determination of the 'taxable' bases as well as the applicable rates. Counties also have autonomy over the administration of revenue with regard to each of the OSR sources. In general, therefore, county governments in Kenya have autonomy over their own sources of revenue.

The challenge, however, is the extent to which revenue drawn from these OSR sources enables and contributes towards their autonomy over their own expenditure. This is because

[122] National Treasury (2018) 59; National Treasury (2019) 57; National Treasury (2020) 55.
[123] National Treasury (2019) 57-58.
[124] National Treasury (2019) 57-58.

the revenue that counties have been able to realise out of these sources has been minimal, contributing a paltry 11 per cent to their annual budgets on average. And even then, this contribution has been declining over the years, thereby increasingly diminishing the significance of OSR to their general fiscal autonomy, while increasing county dependence on transfers and grants to finance the bulk of their annual budgets.

Although part of the reasons underlying the poor performance of county OSR is related to counties' own internal failings, the correction of these shortcomings (through some of the measures discussed above) may not significantly improve the extent of expenditure autonomy counties may eventually draw from their OSR. This is mainly due to the constitutionally entrenched VFA, which means that even at its optimum level, the potential held by devolved revenue-raising measures would still be way below the expenditure responsibilities assigned to county governments.

While the solution to genuine fiscal autonomy drawn from county OSR may lie in increasing the revenue-raising measures available to counties through national legislation, this possibility has never been explored. Although this is partly due to the disinterest by both Parliament and counties in pursuing more county own-revenue-raising powers, other considerations, such as the unavailability of sufficient appropriate taxes to devolve, the need for equalisation based on historically unequal development and inequality in the spread of tax bases, as well as the national government's general fear of losing macroeconomic control, stand in the way of exploring options for increasing the taxing powers of county governments.

In the end therefore, counties are compelled to look to the system of intergovernmental fiscal transfers and grants to finance their discretionary spending, and for their general fiscal autonomy.

2 Intergovernmental fiscal transfers (IGFTs) & grants and the fiscal autonomy of counties

Given the constitutionally entrenched VFA, which is made worse by the inability of county governments to maximise their OSR potential, and the constitutional imperative to ensure that county governments have reliable sources of revenue to enable them to govern and deliver services effectively,[125] intergovernmental fiscal transfers (IGFTs) and grants constitute not only a critical source of county revenue but also a key source of fiscal autonomy for county governments. The entrenchment of the VFA and the consequent elevation of the place of IGFTs and grants in Kenya's 'financial' Constitution, besides being a manifestation of the unitary nature of Kenya's devolved system, seems to have been an acknowledgement of the need to balance the need for subnational fiscal autonomy through OSR, and the principle of solidarity that recognises and calls for the equalisation of horizontal fiscal imbalances arising out of the varying resource capacities of the various county governments in Kenya.[126] The VFA also acknowledges Kenya's constrained fiscal environment, and the need to ensure that available resources are shared equitably through the system of IGFTs and grants. What is critical in this case, therefore, is the scope for fiscal autonomy which is then afforded to county governments through these IGFTs and grants. By examining both legal and practice-related factors that either facilitate or limit the extent of fiscal autonomy counties draw from IGFTs and grants, this chapter argues that notwithstanding the limitations, the unconditional equitable share of revenue received by counties has been able to extend considerable fiscal autonomy to counties.

[125] Constitution (2010), art 175(*b*).
[126] See also, Mutakha (2014) 269; Commission on Revenue Allocation *Recommendation on the Sharing of Revenue Raised Nationally between the National Government and the County Governments for the Financial Year 2015/16* (2014) 13.

2.1 How the legal framework for IGFTs and grants facilitates the fiscal autonomy of counties

Various factors arising out of the legal framework have enabled the system of IGFTs and grants to extend counties' scope for fiscal autonomy. These include the fact that: the system of IGFTs and grants is entrenched in the Constitution; the Constitution provides a criteria to be applied in revenue division; the revenue division process is transparent, consultative and objective; both the revenue division criteria and process are justiciable; the equitable share of revenue received by counties is unconditional as well as the fact that the discretion of the national government in relation to conditional grants is checked under the law. Each of these factors is discussed separately below.

2.1.1 The system of IGFTs and grants is entrenched in the Constitution

The Constitution entitles counties to an equitable share of revenue raised nationally,[127] provides for additional discretionary allocations drawn from the national government's equitable share,[128] sets up an Equalisation Fund for redistributive purposes[129] and requires the equitable sharing of benefits accruing from the exploitation of natural resources,[130] thus providing a basis for a tax-sharing regime for the sharing of royalties between the national and county governments. The constitutional entrenchment of each of these sources of IGFTs and grants means that their variation or abolition can only be done within the constitutional framework for amendment, and not at the option of the national government.

Based on the constitutional entitlement of county governments to an equitable share of revenue raised nationally, revenue raised at the national level is annually shared equitably between the two levels of government (vertically) and the counties' share is then distributed equitably across the 47 county governments (horizontally). In the vertical division of revenue,

[127] Constitution (2010), art 202(1) & art 201(*b*)(ii).
[128] Constitution (2010), art 202(2).
[129] Constitution (2010), art 204.
[130] Constitution (2010), art 69(1)(a).

the Constitution goes further to require that the share annually allocated to counties should not be less than 15 per cent of all revenue collected nationally, a factor that provides counties with a minimum safety net that the national government cannot deviate from.[131] The amount is required to be calculated based on the most recent audited accounts of revenue receipts approved by the National Assembly.[132] Given that transfers from the equitable share of revenue are guaranteed and are unconditional, they afford county governments scope for exercising autonomy over their expenditure.[133]

Although the Constitution provides for additional discretionary grants as well as the Equalisation Fund, access to funds by counties from these two sources is placed at the option of and on terms issued by the national government. While the national government has the discretion to issue additional discretionary allocations unconditionally,[134] in which case they would then constitute a source of county discretionary spending, this has never been done in practice hence this source is usually provided conditionally with the consequence that county spending autonomy is limited by the terms and conditions that accompany the grants. Funds from the Equalisation Fund, on the other hand, can either be used directly by the national government, or provided conditionally to county governments,[135] so county autonomy in their application is also limited. Nonetheless, their constitutional entrenchment comes with directions on how they can be applied, thereby serving to shield the fiscal autonomy of counties.

While the tax-sharing regime that guides the sharing of royalties from natural resources is provided for under national legislation, the constitutional requirement that these taxes be shared equitably guarantees that the national government cannot choose not to share them. In this regard, the law entitles counties to royalties obtained from natural resources extracted within their territories. This applies to the extraction of minerals, petroleum and geothermal

[131] Constitution (2010), art 203(2)
[132] Constitution (2010), art 203(3).
[133] Mutakha (2014) 303; Ministry of Finance *Medium Term Budget Policy Statement, 2012* (2012) 27.
[134] Constitution (2010), art 202(2).
[135] Constitution (2010), 204(3)(*b*).

energy resources. With regard to minerals, the county government where the minerals are extracted is entitled to 20 per cent of the proceeds of the royalty paid to the State by the holder of a mineral right.[136] With regard to proceeds from petroleum operations, the county government is entitled to an equivalent of 20 per cent of the national government's share of profits.[137] In regard to geothermal energy, the county government's share is required to be equivalent to 20 per cent of the royalties paid by a licensee based on the value of geothermal energy resources extracted,[138] provided that the total amount the county gets does not exceed the amount allocated to the county by Parliament in that financial year.[139]

The law does not make any provision for the attachment of any conditions to transfers emanating from royalties to the relevant counties. Being unconditional, such transfers afford scope for discretionary spending by the receiving county governments. However, given that the entitlement by counties to share in the proceeds is provided for under legislation, Parliament retains the discretion to revise the law to make provision for any conditions that may be attached to revenue transferred to counties from natural resources, a situation that would then dictate the scope of autonomy that counties may exercise over such revenue. In practice, however, while there are currently no revenues from petroleum to be shared, no royalties have been shared from proceeds of either minerals or geothermal resources.[140] This is partly attributed to the non-existence of regulations to operationalise the Mining Act, for example, thus standing in the way of the sharing of royalties from minerals.[141]

[136] Mining Act No 12 of 2016, s 183(5) as read with s 183(1).
[137] Petroleum Act No 2 of 2019, s 58(1) & (2).
[138] Energy Act, s 85(1).
[139] Energy Act, s 85(3)(a).
[140] CRA (2020) 24.
[141] CRA (2020) 25.

2.1.2 The Constitution provides the criteria to be applied in the division of revenue

By providing criteria to be applied to the specific bases or formulae for the sharing of national revenue (both vertical and horizontal),[142] the Constitution replaced the historical system of resource allocation that was based on political discretion with an objective rule-based one[143] that then offers counties room for the exercise of expenditure autonomy over the revenue that accrues to them. This criteria is provided for under article 203(1) of the Constitution (Article 203(1) criteria) and is required to be applied, not only in the division of revenue, but also in all national legislation relating to the financing or finances of county governments.[144] The Article 203(1) criteria consists of the following 11 factors:

a National interest;

b Any provision that must be made in respect of the public debt and other national obligations;

c The needs of the national government determined by objective criteria;

d The need to ensure that county governments are able to perform the functions allocated to them;

e The fiscal capacity and efficiency of county governments;

f Developmental and other needs of counties;

g Economic disparities within and among counties and the need to remedy them;

h The need for affirmative action in respect of disadvantaged areas and groups;

i The need for economic optimization of each county and to provide incentives for each county to optimize its capacity to raise revenue;

j The desirability of stable and predictable allocations of revenue; and

k The need for flexibility in responding to emergencies and other temporary needs, based on similar objective criteria.

142 Constitution (2010), art 203(1) as read with art 216(3) & 217(2).
143 IGRTC (2018) 11.
144 Constitution (2010), art 203(1).

While this criteria is largely similar to that applied in South Africa,[145] two issues stand out in the Kenyan list of factors. First is the added emphasis on equity evidenced by the focus on the need to remedy economic disparities in (g) and the addition of affirmative action in (h) as a factor. Additionally, revenue effort is used as a factor in the division of revenue, which is a key step towards ensuring the self-sufficiency of county governments that would secure more room for county expenditure autonomy.[146]

The Constitution requires specific bases or formulae for the sharing of revenue raised nationally to be developed taking into account the above criteria.[147] In this regard, the CRA is mandated to make recommendations regarding the basis for both vertical and horizontal division of the revenue raised nationally.[148] In making its recommendations, the CRA has split the 11 factors into two: those that are relevant in the vertical division of revenue, and those pertinent for the horizontal division of revenue. In this regard, the factors in article 203(1)(a), (b), (c), (d), (f) and (k) are classified as essential for vertical revenue division while those under article 203(1)I, (g), (h), (i) and (j) are applicable to the horizontal revenue division.[149] By providing the criteria the Constitution provides a basis for objectively undertaking both the vertical and horizontal division of revenue raised nationally.

2.1.3 The revenue division process is objective, transparent and consultative

The constitutional requirement for the vertical division of revenue to consider the article 203(1) criteria,[150] and for the National Treasury to explain how the Division of Revenue Bill (DORB) and the County Allocation of Revenue Bill (CARB) have taken the criteria into account,[151] as well as CRA's constitutional mandate to provide recommendations on the

[145] Constitution of the Republic of South Africa, 1996, s 214(2).
[146] Constitution of the Republic of South Africa, s 227(2).
[147] Constitution (2010), art 216(3) & 217(2).
[148] Constitution (2010), art 216(1).
[149] CRA (2014) 24.
[150] Constitution (2010), art 203(1).
[151] Constitution (2010), art 218(2)(b). See also, PFMA, s 191(5).

division of revenue,[152] serve to ensure objectivity in the revenue division process. The participation of the CRA, as an independent constitutional commission ensures that objective considerations are supplied to Parliament to aid in its consideration of the annual vertical revenue split proposed by the National Treasury. These, when coupled with the constitutional requirement for the National Treasury to explain any significant deviations in the DORB and CARB, from CRA's recommendations[153] reinforce both the objectivity of the process, as well as facilitating its transparency. The PFMA's additional requirement for the National Treasury to include in its explanation any assumptions and formulae used in the revenue division also further serves to provide transparency to the process.[154]

However, the recommendations obtained from the CRA are not binding on the National Treasury and the Treasury has always found a way to explain away its deviations from CRA's recommendations thereby disregarding CRA proposals and sticking with its own determinations of the vertical division of revenue.[155] The CRA has also not shown consistency in its recommendations, often, as seen above, eventually leaning towards alternative positions taken by the Treasury to its recommendations. This was the case in the position the CRA took over the years regarding the meaning and import of 'national interest' and 'national obligations' with respect to application of the article 203(1) criteria. The case has also been the same with the bases the CRA has adopted for annually adjusting the vertical revenue due to county governments over the years. However, outside these internal failings by the CRA, and unlike its South African counterpart, the FFC, the CRA's recommendations have constituted an important objective alternative basis for the Senate, which has an actual say in the division of revenue, to assess the validity and propriety of the National Treasury's determination of the vertical division of revenue raised nationally.

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[152] Constitution (2010), art 216(1) as read with art 205. See also, the Commission on Revenue Allocation Act No 16 of 2011, s 10(1)(c).
[153] Constitution (2010), art 218(2)(c) as read with PFMA, s 191(5).
[154] PFMA, s 191(5)
[155] See, the Explanatory Memoranda to the DORBs for 2016 (para 21 & 24), 2017 (para 23 & 25), 2019 (para 20) & 2020 (para 31 & 32).

In addition to the factors facilitating objectivity and transparency, the highly consultative nature of the vertical division of revenue process works to ensure that the concerns and interests of county governments are taken care of. Besides the involvement of the CRA, the revenue division process also involves the participation of IBEC and the Senate. Before submitting legislative proposals for the division of revenue to Parliament, the National Treasury is required to notify the IBEC, which is then required to provide its recommendations on the legislative proposals to Parliament.[156] The involvement of the IBEC allows counties to be directly involved in the revenue division process in addition to their involvement through the Senate. Although the PFMA's requirement for the National Treasury to explain any deviations from IBEC's recommendations reinforces IBEC's role in the process,[157] the only record of the National Treasury explaining its failure to adopt the IBEC's recommendations is from five years ago in the 2016 DORB. This casts doubts on the impact of IBEC's participation in the process, and the Senate's commitment to ensuring that the National Treasury complies with this requirement as part of its constitutional obligation to protect the interests of counties.[158]

Notwithstanding the above shortcoming by the Senate, it nevertheless constitutes the most important representation of counties whose views on the division of revenue actually matter. Its role is strengthened by its constitutional equality of consensus over all legislation concerning counties. As pointed out above, while the CRA's recommendations may not on their own influence the vertical division of revenue, they have been instrumental in aiding the Senate in its concurrence mandate. A case in point is the DORB 2019 which the Senate failed to pass as a result of having adopted the CRA's recommendation on the total revenue due to counties.[159] The position by the Senate resulted in an impasse between the Senate and the

[156] PFMA, s 191(4) as read with s 187(2)(g) & s 191(5)(c).
[157] PFMA, s 191(5)
[158] DORB, *2016, Explanatory Memorandum*, para 27 & 28.
[159] Katiba Institute & The Institute for Social Accountability (TISA) *Statement on the Supreme Court Advisory Opinion on Division of Revenue Bill Stalemate Introduction* (2020).

National Assembly due to a failure by both Houses to agree on the revenue due to counties.[160] While the impasse had the consequence of delaying the planning and budgeting processes at the county level, it underscored the importance of the alternative positions contained in the CRA's recommendations, and the centrality of the Senate in giving life to them during the vertical revenue division process.

All the above factors serve to ensure objectivity, transparency as well as subnational participation in the vertical revenue division process, factors that count towards guaranteeing that the eventual vertical share received by counties is arrived at equitably, and that counties are not disadvantaged resource-wise at the option of the national government.

From the perspective of the horizontal revenue division process, the annual application of a formula, arrived at through a transparent and consultative process undertaken by the Senate, with the assistance of the CRA,[161] and based on objective factors,[162] ensures that no county is beholden to the national government for the equitable share it receives. This gives counties room to exercise autonomy over own-prioritisation and spending. To facilitate this, the Constitution requires the Senate, once in every five years, to determine the basis/formula for horizontal revenue sharing.[163] Although the final determination of the basis for the horizontal division of revenue lies with the Senate (with the concurrence of the National Assembly),[164] the actual work of coming up with a basis and selecting the relevant parameters, as well as justifying the choice, lies with the CRA.[165] In exercising this mandate, the CRA opted for a formula on grounds that a formula-based approach was better placed to: be less susceptible

[160] *Council of Governors & 47 others v Attorney General & 3 others (Interested Parties); Katiba Institute & 2 others (Amicus Curiae)* [2020] eKLR, para 65

[161] Constitution (2010), art 217(2)(c) &(d); CRA (2012) vi-vii; Commission on Revenue Allocation *Recommendation on the Criteria for Sharing Revenue among Counties for Financial Years 2016/2017, 2017/2018, 2018/19'* (2016) 14; Commission on Revenue Allocation *Recommendation Concerning the Third Basis for Revenue Sharing among County Governments for Financial Years 2019/20 - 2023/24* (2019) iii.

[162] Constitution (2010), art 217(2); See also, CRA Act, s 10(1)(*b*).

[163] Constitution (2010), art 217(1) & (4).

[164] Constitution (2010), art 217(5)(*b*); A two-thirds majority is required for the National Assembly to either amend or reject it, failure for which the resolution, as passed by the Senate, is considered approved. This gives an upper hand to the Senate in this process.

[165] Constitution (2010), art 216(1).

to influence or distortion such as to skew allocations; be transparent given the wide public participation involved in the formula's development; and would ensure certainty and predictability of county revenue as well as the autonomy of counties, given the fact that upon approval by Senate, the formula would be in place for the prescribed period (3-5 years).[166] In this regard, the CRA has so far made three recommendations on the formula for horizontal revenue division, referred to as the First, Second and Third Generation formulas, which were subsequently adopted by the Parliament in 2012, 2016 and 2020 respectively. Once the formula is objectively determined, the annual process of horizontal revenue sharing then becomes a routine application of the formula to the aggregate vertical county share to determine each county's equitable share. The removal of political favouritism and patronage in the process reinforces the expenditure autonomy county governments draw from their equitable shares.

2.1.4 The revenue division criteria and process are justiciable

Failure to consider the constitutional criteria and processes prescribed in the division of revenue is justiciable, thus guaranteeing objectivity, transparency and consultation in the revenue division process. This is because the Constitution makes the consideration of the article 203(1) criteria mandatory in both the vertical and horizontal division of revenue.[167] The High Court could, therefore, be approached to declare the revenue division process unconstitutional and require the process to be redone where the criteria has not been considered.[168] With regard to the determination of the meaning and scope of the various factors under article 203(1), the court in *Council of County Governors v Attorney General & 4 others; Controller of Budget (Interested Party)* [2020] eKLR, while making it clear that this is the province of the executive and the legislature,[169] still went ahead to exercise limited jurisdiction, by recommending intergovernmental mediation and adopting findings contained

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166 CRA (2012) 22; Constitution (2010), Sixth Schedule, s 16- Although the basis is required to be determined every five years, the Constitution made provision for the first and second bases to be applied for a transitional period of three years each.
167 Constitution (2010), art 203(1).
168 Mutakha (2014) 308.
169 *Council of County Governors v Attorney General & 4 others; Controller of Budget (Interested Party)* [2020] eKLR, para 89.

in the mediation report in the case where both levels of government had been unable to come to an agreement on the meaning and scope of the article 213(1) factors.

The court could also exercise jurisdiction to give orders requiring the constitutional and legislative prescriptions relating to the revenue division process to be complied with.[170] This is especially the case where critical players such as the Senate and the CRA are either not involved, or their involvement is not taken with the seriousness contemplated in the Constitution. At the inception of devolution in 2013, the Supreme Court in *In the Matter of the Speaker of the Senate and another* [2013] eKLR (*Speaker of the Senate*) declared unconstitutional the DORB for being enacted by the National Assembly alone without the involvement of the Senate.[171] With regard to the role of the CRA in the revenue division process, the Supreme Court in *Council of Governors & 47 others v. Attorney general & 3 Others (Interested Parties); Katiba Institute & 2 Others (Amicus Curiae)* [2020] eKLR held that, although the recommendations of the CRA are not binding on Parliament, the Constitution places a very high premium on them and so, once tabled, Parliament must accord them due consideration before voting on the DORB and that any DORB passed by either House of Parliament without consideration of the CRA's recommendations would be unconstitutional.[172]

With regard to the horizontal revenue division process, a failure by the Senate to take into account the Article 203(1) criteria, consider the recommendations from the CRA and, more importantly, to consult, among others, county governors and any other organisation of county governments when determining the basis for horizontal revenue division, as required by article 217(2) of the Constitution, would be justiciable.

[170] Mutakha (2014) 307.
[171] *In the Matter of the Speaker of the Senate and another* [2013] eKLR, para 144 & 148.
[172] *Council of Governors & 47 others v. Attorney general & 3 Others (Interested Parties); Katiba Institute & 2 Others (Amicus Curiae) [2020]* eKLR paras 56-7.

The courts have, hence been and will continue to be instrumental in safeguarding the revenue division process by ensuring that constitutional requirements relating to the criteria, process and stakeholder participation are complied with.

2.1.5 The county equitable share is unconditional

Despite reservations expressed below relating to the impact on county expenditure autonomy of the specificity of the Third-Generation horizontal revenue sharing process, the unconditional nature of the county equitable share constitutes the core source of both revenue and expenditure autonomy for county governments in Kenya. This is especially the case given that counties annually rely on the equitable share to defray an average of between 79.5 per cent to 81.2 per cent of their budgets,[173] with county OSR only funding about 11 per cent of the county budgets. The fact that neither the Constitution nor legislation contemplates the imposition of conditions on the county equitable share is a critical factor that works to facilitate the fiscal autonomy of county governments.

2.1.6 National government discretion over conditional grants is checked

Although conditional grants are generally understood to be at the discretion of the national government, there are in place constitutional principles and objectives as well as legislative guidelines which regulate and place measured constraints on the exercise of this discretion.

While well-intentioned, conditional grants could pose several challenges to the fiscal autonomy of county governments and to devolution generally if their use is not adequately checked. For one, given that allocations are at the discretion of the national government, a failure to effectively check the exercise of this discretion, so as to ensure objectivity, transparency and accountability in its exercise, is likely to lead to skewed and inequitable allocation of additional resources thus opening room for political favouritism similar to that

[173] CRA (2018) 14; CRA (2020) 19.

which existed in Kenya's past, which led to unequal development and the marginalisation of communities in the allocation of resources. Checking the national government's discretion also helps to ensure that terms and conditions, including attendant financial frameworks relating to the grants, are clear and comprehensive, in order to prevent the imposition of unfunded mandates on counties in the process. A proliferation of conditional grants, especially indirect grants, also has the potential to lead to the 'indirect' recentralisation of the provision of some services that otherwise lie within the functional jurisdiction of county governments. A framework to mitigate such recentralisation by stealth is, therefore, important.

Even though there is no express constitutional prescription on how the issuance of conditional grants should be structured, the exercise of this discretion is still bound by the constitutional principles and objectives relating to devolution, as well as to the sharing of national resources. The constitutional requirement for the two levels of government to respect the functional and institutional autonomy of county governments, as a recognition of their distinctiveness,[174] when coupled with the requirement for the execution of intergovernmental agreements prior to the transfer of functions,[175] works to ensure that the national government does not use the mechanism of conditional grants as permission to directly provide county services to the exclusion of counties. Also, the constitutional requirement for the two levels of government to conduct their mutual affairs based on consultation and cooperation, as part of their interdependence,[176] works to ensure that a process of consultation is involved in cases where the national government seeks the implementation of its policy priorities at the county level through conditional grants. Moreover, the constitution requirement for the allocation of resources (including conditional allocations) to be done equitably[177] and in compliance with the public finance principles of

[174] Constitution (2010), art 6(2) as read with art 189.
[175] Constitution (2010), art 187.
[176] Constitution (2010), art 6(2).
[177] Constitution (2010), art 174(*g*) & 201(*b*)(ii).

openness and accountability, prevents any form of political favouritism in the issuance of conditional grants.[178]

More specific structure and constraints on the exercise of the national government's discretion over conditional grants are provided by the requirement by the PFMA that conditional allocations, together with their accompanying conditions, be provided for under the CARA.[179] For a start, this requirement brings the issuance of conditional grants within the scope of 'national legislation relating to county finances', the formulation of which is required to take into account the Article 203(1) criteria.[180] Additionally, the constitutional requirement relating to the contents of the explanatory memorandum accompanying the CARB also applies. In this regard, the national government is then obligated to provide an explanation regarding how the grants are proposed to be allocated, an evaluation of the allocations against the Article 203(1) criteria, and an explanation for any significant deviation from the CRA's recommendations.[181] The implication of this interpretation is to impose specific constraints within which the national government's discretion over conditional grants may be exercised.[182] Though uncharacteristic of fiscal federalism's general approach to conditional granting, such constraints should, however, be understood within the context of Kenya's history of skewed allocation of resources and development at the option of the central government, and the ensuing constitutional objective of ensuring equity, openness and accountability.[183]

Additionally, the PFMA's requirement for conditional grants to be provided for under the CARA rather than the DORA places the scrutiny of the allocations within the expanded jurisdiction of the Senate, which has more say in the passing of the CARB.[184] This grants the

[178] Constitution (2010), art 201(*a*).
[179] PFMA, s 191(3)(*b*). See also, Mutakha (2014) 309.
[180] Constitution (2010), art 203(1).
[181] Constitution (2010), art 218(2).
[182] See also, Mutakha (2014) 309.
[183] Constitution (2010), art 174(*e*) & (*g*) as read with art 202(1) and art 201(*a*). See also, Mutakha (2014) 146.
[184] Constitution (2010), art 217(5)(*b*).

Senate the mandate to ensure that the allocation of conditional grants is subject to, and in compliance with, the relevant constitutional architecture.[185]

2.2 Practice-related factors that have facilitated the fiscal autonomy of counties drawn from IGFTs and grants

In addition to the above legal factors, some factors have arisen in practice that have enabled the exercise of fiscal autonomy by counties in relation to funds received from IGFTs and grants.

2.2.1 The vertical division of revenue is based on costed county expenditure needs

The initial historically costed equitable share amount due to county governments, though contested for transparency and objectivity, constitutes the original county equitable revenue base against which subsequent annual vertical allocations to counties have been calculated. The costing has ensured that the annual vertical division of revenue is based on a statistically determined bare minimum of resources generally required by counties to implement their respective functions.

A failure by the Transitional Authority (TA) to undertake a comprehensive costing of county government functions[186] forced the Ministry of Finance in 2013 to undertake its own costing to facilitate the initial revenue division process.[187] To facilitate this, the Ministry requested all line ministries that had been undertaking devolved functions to cost the functions based on their budget allocations for 2010/2011 to 2012/2013.[188] This historical costing approach was, therefore, utilised to estimate the aggregate amount of resources that county governments would need to be able to continue the provision of services at the level at which they were

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[185] See also, *Institute of Social Accountability & Another V. National Assembly & 4 others* [2015] eKLR, para 96.
[186] Transition to Devolved Government Act (TDGA)No 1 of 2012, s 7(2)(*b*); IGRTC (2018) 33.
[187] This led to criticisms relating to the transparency and objectivity of the costing process given the National Treasury's self-interest in retaining as much revenue as possible at the centre.
[188] Ministry of Finance *Medium Term Budget Policy Statement, 2012* (2012) 28-9.

provided prior to devolution.[189] The cost arrived at was adjusted to make provision for the costs of setting up and running new county administrative structures.[190]

In this regard, in the first division of revenue for the 2012/2013 financial year, the National Treasury estimated the cost of providing devolved functions, including the cost of running new administrations, to be Ksh. 198.6 billion.[191] CRA's estimate differed from that of the National Treasury, at Ksh. 203 billion.[192] However, after going through Parliament, the total allocation to county governments was set at Ksh. 210 billion, of which Ksh. 190 billion was the equitable share and Ksh. 20 billion consisted of conditional allocations.[193] Despite all the issues surrounding the objectivity of the National Treasury's costing of county functions, and despite the fact that the costing was historical and not based on current costs for the provision of services, this initial allocation of Ksh 190 billion was adopted as the base for calculation of the next financial year's vertical allocation to counties.[194] This 'costed' base was instrumental in that in all subsequent years, the portion of revenue raised nationally that was due to county governments, was estimated by applying an adjustment or growth factor to the preceding year's equitable share (new yearly base), all these yearly bases being traceable to the initial 'costed' base.[195] Thus, the formula for determining annual county equitable share can be represented by the formula below.

$ES_x = ES_y + (ES_y \times GF)$
Where:
ES_x – County Equitable Share for the current year
ES_y – Equitable Share for the preceding year
GF – Growth Factor applicable to the current year

[189] Ministry of Finance (2012) 28-9.
[190] CRA (2012) 18.
[191] Explanatory Memorandum to the DORB, 2013.
[192] CRA (2012) 18.
[193] Schedule to the Division of Revenue Act, 2013.
[194] Explanatory Memorandum to the DORB, 2014.
[195] See, CRA recommendations on the vertical sharing of revenue for years 2013/14 – 2019/20.

2.2.2 High-level proxies for county needs were adopted in the first and second horizontal revenue division formulas

While county spending discretion would require the adoption of a horizontal revenue division formula with high-level proxies of county expenditure needs, the interest of the national government in ensuring allocative efficiency and the prudential use of resources calls for a formula that adopts needs-specific parameters. These two interests, therefore, jostle for dominance or balance in the determination of the specific indices that constitute the horizontal revenue division formula. County government spending discretion through its own prioritisation of expenditure requires that the equitable share received be entirely unconditional. This is supported by the objectives of devolution relating to self-governance,[196] as well as the flexibility imperative,[197] which is part of the revenue division criteria. The national resource constraint for its part drives the national government's interest in ensuring allocative efficiency and prudential county expenditure. Thus, while subnational fiscal autonomy demands for a horizontal revenue division basis/formula that incorporates high-level proxies of subnational needs and costs such as 'population' (thus leaving room for allocative autonomy), national interest would require a basis or formula which is very specific to actual needs or unit costs (for allocative efficiency), and would, hence, use targeted factors such as 'school-age children' or 'primary health care visits' (a subset of the overall population which is the subject of a specific subnational need or service).[198] However, a basis or formula which is very needs-specific would need to exhaustively capture all possible subnational needs to be effective, otherwise the specificity would leave some needs unfunded while at the same time performing the needs-prioritisation function of county governments contrary to the letter and spirit of the Constitution. Also, the fact that there are no unlimited resources such as would facilitate an ideal needs-to-funding matching for maximum allocative efficiency would, therefore, demand a level of flexibility in the basis or formula to enable county

[196] Constitution (2010), art 174(*c*), (*d*) & (*e*).
[197] Constitution (2010), art 203(1)(*k*).
[198] World Bank *Devolution without Disruption: Pathways to a Successful New Kenya* (2012) 93-94.

governments to undertake their own prioritisation as well as allowing expenditure on other needs including incidental ones.

The First- and Second-Generation horizontal revenue division formulas adopted objectively identifiable high-level proxies of county needs, thereby extending counties room for discretionary spending. The First-Generation formula adopted five parameters: Population (45%), Basic Equal Share (25%), Land Area (8%), Poverty Index (20%) and Fiscal Responsibility (2%).[199] While the Second-Generation formula made slight adjustments to the parameters and the weights attached to them, its retention of high-level proxies of county expenditure needs and determinants of service delivery cost differentials across counties[200] helped secure the continued expenditure autonomy of county governments. The six parameters adopted under the Second-Generation formula are: Population (45%), Basic Equal Share (26%), Land Area (8%), Poverty Index (18%), Development Factor (1%) and Fiscal Effort (2%).[201]

2.3 Legal and practice-related factors limiting the level of fiscal autonomy counties draw from IGFTs and grants

Various factors stand in the way of IGFTs and grants extending scope for fiscal autonomy to counties. These arise in the course of the vertical and horizontal division of the equitable share of revenue raised nationally as well as out of the allocation and administration of conditional grants. Each of these is discussed separately below.

2.3.1 Limiting factors arising in the vertical division of revenue

Factors limiting the autonomy counties draw from the equitable share arise out of both the legal framework as well as out of practice.

[199] CRA (2012) vii.
[200] CRA (2012) 22-3 & 24.
[201] Commission on Revenue Allocation *CRA Recommendation on the Criteria for Sharing Revenue among Counties for Financial Years 2016/2017, 2017/2018, 2018/19* (2016) iii & 30.

2.3.1.1 What constitutes 'revenue raised nationally' is not constitutionally defined

While the Constitution requires the county equitable share to be drawn from revenue raised nationally,[202] it does not offer a definition of what qualifies as 'revenue raised nationally' (the base) thus leaving to interpretation the determination of which specific national revenue streams fall into this pool.[203] The national government has, therefore, taken advantage of this to: opt for a limited interpretation which allows for the exclusion of various revenue streams from the overall pool in its own favour; disaggregate national revenue into a shareable and non-shareable pool and top-slice out of the shareable pool money for various national government expenditure prior to the vertical division of revenue, with the consequence that counties are increasingly getting smaller shares from revenue raised nationally.

Although the Constitution's article 203(2) provides an alternative reference to 'revenue raised nationally' (the base) as 'all revenue *collected* by the national government', this does not help with providing clarity. While it has been argued that all national revenue sources should, without exception, be included in the base,[204] a reading of article 206(1),[205] regarding which money ought to be paid into the Consolidated Fund, however, reveals an intention, by drafters of the Constitution, to make a distinction between money 'raised' and money 'received' by or on behalf of the national government, with the consequence that this could allow for the exclusion of 'money received' from the definition of revenue raised nationally. Worth noting from this interpretation is that both articles 202(1) and 203(2), which make reference to the base, use the terms 'raised' and 'collected' respectively. Although there is no definition of what either 'raised' or 'received' entails in this context, emphasis on these terms based on their ordinary meaning, would mean that, while the pool of resources could include all revenue 'raised' or 'collected', it excludes any monies that could be classified as having

[202] Constitution (2010), art 202(1).
[203] See also, World Bank (2012) 63-64.
[204] Mutakha (2014) 288.
[205] 'There is established the Consolidated Fund into which shall be paid all moneys raised or received by or on behalf of the national government …'

been ‘received’ by or on behalf of the national government. The latter may be argued to include donor grants which are not predictable and come with specific conditions as to their use, hence rendering them ineligible for pooling into the national purse for redistribution.

However, the only legal definition, contained in section 2 of the Commission on Revenue Allocation Act, makes provision for the exclusion, from the base, of additional funds over and above those that could fall within the scope of the interpretation of monies ‘received’ above. The section defines ‘revenue’ [raised nationally] as:

> All taxes imposed by the national government under article 209 of the Constitution and any other revenue (including investment income) that may be authorised by an Act of Parliament, but excludes revenues referred to under Articles 209(4) and 206(1)(a)(b) of the Constitution.

Article 209(4) relates to charges imposed for the provision of government services, while article 206(1)(a) & (b) makes reference to monies that are excluded by Parliament from the Consolidated Fund for payment into a specific-purpose fund, as well as monies approved by Parliament for retention by a state organ that received it for purposes of defraying the organ’s expenses. This, therefore, excludes from the base, fees and charges imposed by national government entities, monies meant for dedicated funds as well as Appropriations in Aid (AiAs) from national government organs. Charges constitute a revenue source out of which the Constitution allows the national government to raise revenue, hence except for its linkage to AiAs, the basis for its exclusion from the revenue base is not clear. Also, while the Constitution excludes dedicated funds and AiAs from the Consolidated Fund, this cannot be equated or translated as excluding them from the ambit of revenue raised nationally. As Mutakha argues, any monies dedicated for use for any national government function ought to count towards the vertical division of revenue, so as to avoid instances where the national government receives a double allocation for the performance of the same function.[206] Consequently, the exclusion of these monies is unconstitutional and serves only to limit the pool of resources available for vertical sharing, hence limiting the extent of fiscal autonomy that would

[206] Mutakha (2014) 291-293.

otherwise be drawn by counties from access to a larger unconditional equitable share allocation.

In practice, however, the definition utilised when referencing revenue raised nationally is that contained in the CRA Act.[207] What is not clear is the extent to which this definition affects revenue division, because charges (and fees), as a source of national revenue, are included in the list of revenue which is shareable vertically (discussed in detail below),[208] while it is not clear how other AiAs and dedicated funds are dealt with.

Besides the narrowing down of revenue raised nationally through the definition of what constitutes 'revenue' above, what is left of the revenue raised nationally is further disaggregated into 'shareable' and 'non-sharable' revenue.[209] The classification was adopted from how the line items in the Statement of Exchequer Account receipts were being recorded, and has also subsequently been used by the CRA as the basis for its recommendations on the vertical division of revenue.[210] Although the CRA has more recently been equating the scope of what is classified as 'shareable' revenue to that contained in the definition of 'revenue' under section 2 of the CRA Act,[211] a scrutiny of the revenues contained under the 'shareable' classification reveals that the scope of revenues excluded is broader. For instance, while the definition of 'revenue' excludes charges, dedicated funds and AiAs, the classification of revenue as 'shareable' excludes additional revenues such as those raised from borrowing including domestic (T-bills and T-bonds) and foreign or external loans or grants as 'non-

[207] CRA (2012) 13-14.
[208] See, Table 5 in CRA (2017) 15-16.
[209] CRA (2012) v & 14; Commission on Revenue Allocation *Recommendation on Sharing of Revenue Raised Nationally between the National and the County Governments for the Financial Year 2013/2014* (2012) 4-5.
[210] See, CRA recommendations on sharing of revenue raised nationally for years 2012/13 14; 2013/14 4-5 and 2014/15 17.
[211] CRA (2016) 13[32]; CRA (2017) 15-16.

shareable' revenue.[212] This segregation, therefore, cuts a portion of total revenue receipts from the pool of resources available for vertical sharing.

As with the practice in South Africa,[213] Kenya's National Treasury engages in top-slicing,[214] a practice that further reduces the revenue contained in what is classified as 'shareable revenue' above. With the Constitution requiring the utilisation of the Article 203(1) criteria for the vertical division of revenue, the National Treasury resorted to using factors under the criteria as a basis for top-slicing revenue collected nationally prior to vertical sharing (otherwise termed as constituting a *first charge* on national revenue). Funds allocated to factors such as national interest, public debt, other national obligations (which includes pensions, salaries for constitutional offices, costs for other statutory bodies and statutory allocations) as well as emergencies are, therefore, deducted from the shareable revenue and allocated to the national government before the vertical split.[215] The net effect is that any increases in national government loans, among other commitments that fall under the top-sliced categories (at the sole discretion of the national government), would directly translate to a reduction in total revenue available for vertical sharing. This puts county governments, and the expenditure autonomy that counties draw from the unconditional equitable share, in a precarious position especially since they have no direct say in decision-making relating to any of these top-sliced categories.

The implications of disaggregation and top-slicing is that revenue raised nationally is disproportionately reduced in favour of the national government hence the final amount of

[212] CRA (2012) 14; CRA (2012) 5; Commission on Revenue Allocation *Recommendation on the Sharing of Revenue Raised Nationally between the National Government and the County Governments for the Financial Year 2014/15* (2013) 17; CRA (2017) 15-16.
[213] Wehner J 'Fiscal federalism in South Africa' (2000) 30 *Publius: The Journal of Federalism* 64 & 66; Financial and Fiscal Commission (FFC) *The Recommendations of the Budget Council: Implications for the Provision of Public Services during the 1997/98 FY* (FFC Comment Series, 1998) 3.
[214] The deduction, from national revenue, of obligatory or non-discretionary payments that are required to be paid yearly by the national government, before undertaking the vertical division of revenue. See, Financial and Fiscal Commission (FFC) (1998) 4; Kinuthia J & Lakin J *Sharing revenue: How much of Kenya's Budget is Already Committed and Cannot be Shared?* (2014) 1.
[215] See the explanatory memoranda for all Division of Revenue Bills between 2015 and 2021.

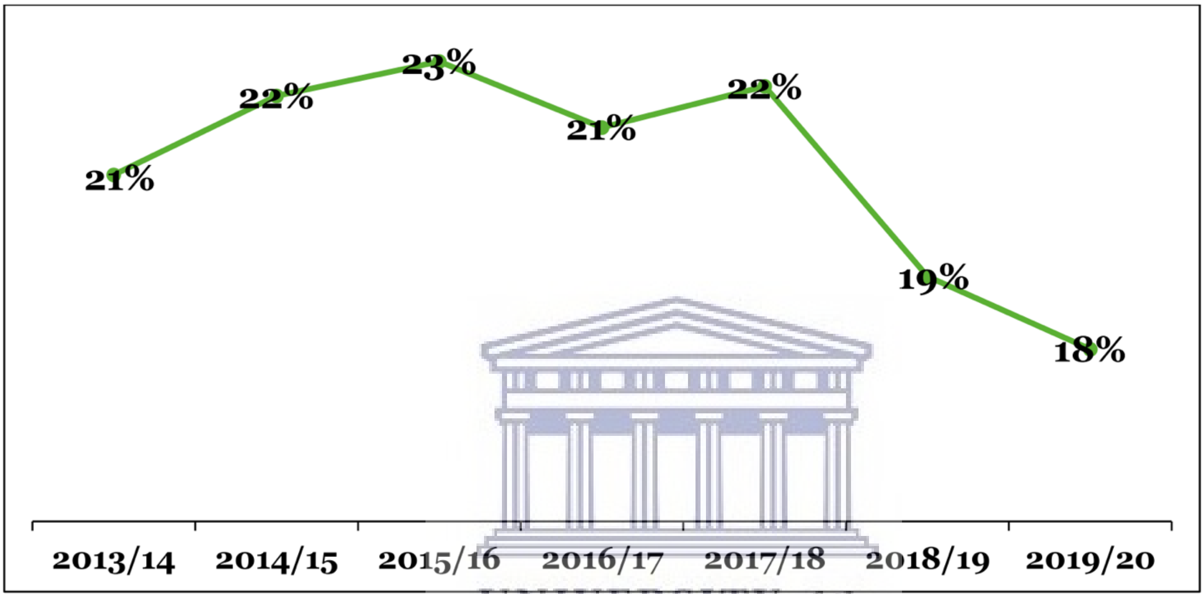
revenue available for vertical sharing is greatly reduced. In 2012/2013,[216] for instance, the International Budget Partnership Kenya estimated that in total, about 43 per cent of revenue raised nationally was deducted prior to the vertical division of revenue.[217] This translates to only about 57 per cent of revenue raised nationally being available for vertical sharing. Seeing as this example was before the utilisation of the article 203(1) factors as a basis for top-slicing,[218] it could be reasonably concluded that the actual revenue raised nationally which is available for sharing annually would be substantially lower. This amount is also bound to decrease with any increases in obligations that fall in the top-sliced categories. Public debt is one example of the categories whose increase has translated to an increase in the annual cost of servicing the debt,[219] which directly translates to an increase in the top-sliced amount and a resulting decrease in the total amount of revenue available in the shareable pool for vertical sharing. This, therefore, risks the financial autonomy of county governments especially in light of their dependence on the equitable share as a source of their unconditional revenue.

The concerted effort by the national government to significantly reduce the final amount of revenue that becomes the subject of vertical sharing can be argued to be motivated by the need to ensure that the actual amount annually received by counties meets the constitutional minimum threshold of 'not less than 15 per cent of the last audited and approved national revenue receipts'. A lower shareable amount thus guarantees that no matter how low the actual county equitable share is in a particular year, it will be more than 15 per cent of the last audited and approved national revenue received (which is usually at least 2-3 years back in any current year).[220] While this has always been the case, the proportion of the county equitable share to the total shareable revenue raised nationally has been declining over the years (see Figure 6.3 below). While there could be various reasons to explain the trend, the decrease is

[216] This is the first financial year that financed the full operation of counties that was to start at the beginning of the 2013 calendar year.
[217] Kinuthia & Lakin (2014) 4.
[218] Top slicing at the time was done to finance 'Consolidated Fund Services' that included debt repayment, pensions and salaries for constitutional offices. See, Kinuthia & Lakin (2014) 1.
[219] CRA (2020) 15.
[220] CRA (2017) iv; CRA (2019) iv; National Treasury (2018) 69.

partly informed by an increasing accumulation of the top-sliced portions of revenue highlighted above (especially debt service costs).[221] This does not augur well for the sustained fiscal autonomy of county governments drawn from their unconditional equitable share of national revenue.

Figure 6.3: County Equitable Share as a percentage of ordinary revenue for FY 2013/14 – FY 2019/20



Source: Adapted from the CRA Recommendation for the FY 2020/21

Although the High Court declared the practice of top-slicing unconstitutional in *Council of County Governors v Attorney General & 4 others; Controller of Budget (Interested Party),*[222] where it held that national interest (for instance) is but a factor in a criteria to be considered when funds are being equitably divided and does not constitute a separate faction that has to be allocated money, nor can it be used as a basis for setting aside revenue, this decision was only handed down in December 2020. It is, therefore, yet to be seen whether the national treasury will comply with the Court's finding.

[221] National Treasury (2020) 62; Explanatory Memorandum to the DORB, 2018, para 5.
[222] *Council of County Governors v Attorney General & 4 others; Controller of Budget (Interested Party* paras 99 & 100.

2.3.1.2. **The meaning and scope of the Article 203(1) is not clear**

In addition to contestation that has arisen out of the general reliance on article 203(1) factors as the basis for top-slicing, there has been further contestation in practice relating to the meaning, scope and import of the individual factors applicable in the vertical division of revenue. This has had various impacts on the exercise of fiscal autonomy by county governments. Some of the most critical issues have arisen in relation to the following factors: national interest; provision for public debt and other national obligations; and the desirability for stable and predictable allocations.

Contestation with respect to the application of the 'national interest' factor[223] related to questions regarding: whose interest this referred to (national or county governments); how the specific national interest project ought to be identified; which level of government ought to be allocated funds for the projects as well as how the projects will be implemented. The national government initially took the view that national interest referred to the interest of the national government, in respect of which it had the prerogative to identify beneficiary projects, allocate itself funds for the projects and undertake the relevant projects.[224] While the CRA initially supported this view,[225] it later differed, arguing that national interest referred to the interest of both levels of government and that the identification of projects ought to be done jointly by consultation and their implementation be undertaken by: either level in whose functional jurisdiction the function lay; by county governments as part of their obligations to implement national policy (with funding provided as conditional grants); or by either level best suited to implement the projects [either by assignment or transfer accompanied by requisite resources].[226] Although the CRA subsequently seemed to abandon this position by making recommendations on national interest based on the national government's priorities contained in Medium Term Plans and Budget Review and Outlook

[223] Constitution (2010), art 203(1)(a).
[224] *Council of County Governors v Attorney General & 4 others; Controller of Budget (Interested Party)* para 92; See also the explanatory memoranda for the Division of Revenue Bills for 2013 and 2014.
[225] CRA (2013) 14-15.
[226] CRA (2014) 25.

Papers,[227] an intergovernmental report agreed upon as part of a court-ordered mediation on the issue, in a case brought by the Council of Governors, adopted the CRA's interpretation (save for the requirement for intergovernmental consultation in identifying the projects which was not directly addressed in the report).[228] The Court endorsed the report and, among other things, made a declaration that any funds allocated under 'national interest' ought to be channelled to counties either as conditional or unconditional grants [where applicable].[229]

With respect to the 'public debt and other national obligations' factor,[230] the contestation has been around the role county governments ought to play in the acquisition of debt and the identification of what constitutes 'other national obligations'. Although the CRA's position is that both the raising of debt as well as the expenditure of funds raised through borrowing ought to be preceded by intergovernmental consultation and cooperation,[231] given the direct impact national borrowing has on both the county equitable share as well as county borrowing (since national borrowing exhausts the general ceiling imposed on public debt by Parliament),[232] there is no record of any intergovernmental consultation relating to public debt. Also, while the CRA recommended that costs related to 'other national obligations'[233] need to be fully disclosed by the national government and discussed at the Summit before allocations are made for them in the annual division of revenue process,[234] there are no records of this ever having taken place. Except for the role played by the Senate in the approval of public borrowing, therefore, the national government holds the sole prerogative of acquiring loans and deciding how they will be spent, as well as identifying and allocating funds to 'other national obligations'. This comes at an increasing cost to the county equitable

[227] CRA (2017) 23; CRA (2018) 29.
[228] *Council of County Governors v Attorney General & 4 others; Controller of Budget (Interested Party)* [2020] para 89.
[229] *Council of County Governors v Attorney General & 4 others; Controller of Budget (Interested Party)* para 103(*e*).
[230] Constitution (2010), art 203(1)(*b*).
[231] CRA (2014) 26.
[232] CRA (2014) 26.
[233] 'Other national obligations were defined to mean obligations which the national government may have and whose performance affects the entire country, excluding those that arise as part of the functions of the national government under the Fourth Schedule. See, CRA (2014) 27; CRA (2017) 24.
[234] CRA (2014) 27.

share that funds county discretionary spending, hence negatively impacting the fiscal autonomy of counties.

While a framework exists to prevent any in-year instability and unpredictability of the county equitable share that may be occasioned by shortfalls in the actual revenue collected by the National Treasury, no similar framework exists for ensuring year-to-year stability and predictability of the county equitable share. To account for the article 203(1)(j) factor that requires stability and predictability in allocations, provision is annually made in the DORA that any shortfalls in the actual revenue raised nationally, within the year, would be borne by the national government.[235] However, unlike South Africa which undertakes a three-year (medium term) projection of vertical shares of revenue due to provinces such that subnational governments are annually guaranteed a minimum of the amount projected for the next financial year, revenue division in Kenya is done on a year-to-year basis, thereby leaving counties uncertain as to what their next year's equitable share may likely be. Therefore, while the South African approach serves to ensure year-to-year stability and predictability, hence facilitating subnational planning and expenditure autonomy, the Kenyan approach opens up the vertical revenue division process to unpredictable year-to-year fluctuations that in turn impact medium-term planning and budgeting at the county level.[236]

2.3.1.3. There is no framework for annually adjusting the county equitable revenue base

The lack of legislation, policy or framework to ensure an objective and predictable basis for subsequent adjustments or growth rates to be applied to the original county equitable revenue base has resulted in inconsistencies in practice, which impact the objectivity and predictability of annual vertical allocations to county governments. This has also given the national government room to cherry-pick approaches that favour the retention of a

[235] See, s 18 of the explanatory memorandum to the DORB, 2016 as well as s 5 of all Division of Revenue Acts between 2016-2021.
[236] World Bank (2012) 146-147.

disproportionately higher share of revenue at the national level, contrary to the constitutional requirement for equity in the vertical sharing of revenue.

While the vertical county equitable revenue base above was founded on the outcome of a costing exercise, no legislation, policy or framework was established to ensure an objective and predictable basis for subsequent adjustments or growth rates to be applied to this revenue base. As a result, the National Treasury and the CRA have not been able to settle on a standard basis for annually adjusting/growing the equitable share to be allocated to county governments. Also, neither of them has been consistent in its choice of adjustment/growth factors/bases to be applied hence leading to inconsistencies which impact the predictability of vertical allocations to county governments. The table below provides a summary of the growth rates applied by both over the years and the bases for their application.[237]

[237] See also, International Budget Partnership (IBP) Kenya *Memorandum to the Senate on the Division of Revenue, 2018/19* (2018).

Table 6.2: Annual adjustments to the county equitable share

	Proposed adjustment/growth rate (%)		Basis for proposed rate/share	
Year	**CRA**	**National Treasury**	**CRA**	**National Treasury**
2013/14	14.00	-	3-year average historical cost escalation	Costing
2014/15	-	19.3	Costing based on analysis of historical allocations and actual costs of new structures	2-year average growth in revenue
2015/16	10.41	10.41	3-year average growth in shareable revenue & GDP	3-year average growth in revenue & GDP
2016/17	15.09	7.80	3-year average growth in revenue	Growth in revenue (agreed growth factor). No specific explanation given.
2017/18	15.18	6.72	3-year average growth in revenue	3-year average month-on-month inflation
2018/19	8.50	4.00	7.1% based on 3-year average inflation & 1.4% based growth in service delivery	Negotiated factor (at IBEC) based on fiscal framework factors
2019/20	6.90	-	3-year average annual inflation	A combination of a negative rate (amounting to Ksh. 9b) and a positive rate (Ksh. 5b) was applied to adjust for revenue underperformance. No specific rationale provided.
2020/21	5.70	0	3-year average economic growth	No adjustment was made due to continued underperformance in revenue.

Source: Annual CRA recommendations on the vertical division of Revenue, Annual Budget Policy Statements, Explanatory Memoranda to the annual DORBs & IBP Kenya (2018)

Other than the glaring inconsistencies in the bases utilised to annually adjust the county equitable share, which impacts the predictability of growth in the annual county equitable share, another issue arising from the table above is the use of 'inflation' versus 'growth in revenue' as a basis for the annual adjustment to the county equitable share. Using inflation instead of growth in revenue has two implications. One is that it implies that counties are entitled only to the revenue allocated to them at the inception of devolution adjusted over the years to solely cater for growth in prices.[238] This goes against the letter and spirit of the Constitution that requires that revenue, including any growth in revenue over the years, is shared equitably/fairly between the two levels of government.[239] The other implication is that the use of inflation biases the vertical division of revenue in favour of the national government in instances where the revenue growth margins are consistently higher than the inflation rate, seeing as the difference is then retained at the national level.[240] This runs contrary to the requirement for fair sharing of revenue raised nationally hence growth in revenue raised nationally ought be the standard adjustment factor that would ensure objectivity and equity in the vertical division of revenue.[241]

The lack of a framework for determining the growth factor has also allowed the National Treasury to generally decrease its growth/adjustment rate from year to year (to zero) as shown in the table above, with the result that the year-to-year growth in the county equitable share has equally been declining.[242] For instance, growth in the equitable share is reported to have declined from 19 per cent in the 2014/15 financial year to about 8 per cent in the 2017/18 financial year.[243] Also, according to a memorandum by a consortium of civil society organisations to Parliament on the 2020 BPS, this growth has declined from 15 per cent in 2015/16 to an anticipated zero per cent (0%) in the 2020/21 financial year (which growth becomes negative if adjusted for inflation).[244] While it is conceded, in part, that the decline is

[238] IBP Kenya *How much for counties in 2017/18? The Commission on Revenue Allocation versus the National Treasury* (2016) 8.
[239] IBP Kenya (2016) 8.
[240] IBP Kenya (2016) 2-3; IBP Kenya (2018) 6.
[241] IBP Kenya (2018) 3.
[242] CRA (2017) 8; CRA (2018) 14-15.
[243] CRA (2017) 8; CRA (2018) 14-15.
[244] Civil Society Organisations *Memorandum to Parliament on the Budget Policy Statement (BPS) 2020* (2020) 6.

informed by an increasingly constrained fiscal environment in the country,[245] it nonetheless does not account for the reported consistent average growth in revenue raised nationally of about 13 per cent.[246] This has led civil society organisations to call on Parliament to set a growth factor for the county equitable share that is linked to the annual growth in revenue raised nationally,[247] so as to ensure not only equity in the division of revenue between the two levels of government as required by the Constitution, but to also facilitate transparency and predictability. This will enhance the revenue and expenditure autonomy of county governments.

2.3.1.4. There are consistent delays in the passing of the annual DORA

Although the PFMA prescribes specific timelines for the passing of the national revenue division legislation (DORA & CARA),[248] whose allocations of revenue constitute the basis for county planning and budgeting, the political nature of the vertical revenue division process and the 'problem' of equality of concurrence[249] between the National Assembly and the Senate provide no guarantees of consensus, thus making delays almost unavoidable.[250] Also, the unpredictability that comes with Kenya's year-to-year vertical division of revenue – when coupled with the fact that the national government shares the same financial year with county governments and the fact that counties rely heavily on the equitable shares for their functioning – make the impact of these delays on county governments debilitating. Delays in

[245] National Treasury (2019) 64-65.
[246] Civil Society Organisations (2020) 6.
[247] Civil Society Organisations (2020) 6.
[248] The PFMA requires that they both be submitted to Parliament by 15 February each year and be debated and passed in time for both the national and county governments to prepare and have their budgets and appropriation laws approved by 30 June. See, PFMA s 191(1) as read with s 25(2); PFMA s 39(1) & s 131(1).
[249] Art 113 of the Constitution (2010) requires consensus between the two houses on Bills concerning county governments, with no house having veto over the other, failure for which the Bill is subjected to mediation until consensus can be reached.
[250] National Treasury (2016) 68.

the passing of the DORA have, nonetheless, been a consistent phenomenon over the years and continue to limit the ability of counties to exercise their autonomy over expenditure.

With an approved horizontal revenue division formula in place, the contents and passing of the CARA are less political or contentious than the passing of the DORA. The lack of an adjustment factor that dictates how the vertical county equitable share grows from year to year, together with the annual independent alternative recommendations from the CRA on the vertical division of revenue, annually provide fodder for political haggling over the allocations indicated by the National Treasury in the DORA. Also, although the Constitution provides the mechanism of mediation in instances where both Houses of Parliament are unable to reach an agreement on a Bill concerning counties (the DORA in this case),[251] it falls short of providing a way out in cases where an agreement is not reached even after various rounds of mediation, thereby opening the possibility of debilitating deadlocks. This is unlike the South African case, where the National Assembly holds a weighted veto over the National Council of Provinces. In the end, all these factors have worked in concert to produce prolonged delays in the approval of the DORA, with the most prolonged parliamentary stalemates having been recorded in 2015 and 2019.[252]

As mentioned above, unlike South Africa, which provides indicative vertical allocations to its provinces over the medium term (three years) and provides guarantees that the indicative amounts would constitute the minimum revenue to be received for the subsequent years, Kenya undertakes a year-to-year vertical division of revenue. This means that county governments are not able to plan and budget ahead of time, but have to wait until the revenue division processes are concluded at the national level for them to know how much revenue to expect from the equitable share in the upcoming financial year, after which they can proceed to initiate their own planning and budgeting for the financial year.[253] This is compounded by

[251] Constitution (2010), art 113.
[252] National Treasury (2016) 67-68.
[253] See also art 224 of the 2010 Constitution, which expressly requires counties to adopt their budgets and appropriation laws based on the approved DORA.

the fact that, unlike South Africa, which has a financial year for the national & provincial governments (ending on 31 March) that is separate from that applicable to local governments (ending on 30 June),[254] a factor that provides room for flexibility in financial planning and implementation at the local level, both levels of government in Kenya are required to budget, implement their budgets and report within the same financial year (ending on 30 June).[255] These two factors, therefore, heighten the importance of passing the DORA in time, as any stalemate or impasse occasioning a delay would mean a delay in county planning and budgeting, as well as the unavailability of funds for recurrent spending, hence effectively, the stalling of all county services.

Although delays in passing the DORA have consequences for both levels of government, given that the national government also relies on the vertical allocations to draft its budget, the Constitution allows the national government to access at least 50 per cent of its expenditure estimates for the upcoming financial year to enable it to discharge necessary expenditure pending the passing of the relevant enabling legislation.[256] A similar provision is not made in respect to county governments, meaning that service provision stops in instances of prolonged delays (that last beyond what county OSR can support). This was the situation in 2020 when a stalemate between the Senate and the National Assembly regarding the 2019/2020 DORB survived two rounds of mediation and progressed until towards the end of the first quarter of the 2019/20 financial year when a version of the DORB was agreed on and adopted.[257] This led to a constitutional crisis and the stalling of county functions for the duration of the stalemate.

[254] Based on definitions given to 'financial year' in sections 1 of both the Public Finance Management Act 1 of 1999 and the Municipal Finance Management Act 56 of 2003, respectively.
[255] Article 260 of the 2010 Constitution defines a financial year as the period of 12 months ending on 30 June or another day prescribed by national legislation. The latter discretion has not been utilised to define a financial year differently for the benefit of counties.
[256] Constitution (2010), art 222.
[257] *Council of Governors & 47 others v Attorney General & 3 others (Interested Parties); Katiba Institute & 2 others (Amicus Curiae)* para 65.

When petitioned by the Council of Governors to pronounce itself on the stalemate by way of an advisory opinion, the Supreme Court declared that Parliament had a legislative duty to ensure that it reached a consensus during the second round of mediation so as not to stall county operations, thus preventing counties from undertaking their constitutional functions.[258] The Court stated that, where Parliament failed to reach an agreement after the second round of mediation, any person could approach the High Court for a declaration that Parliament be dissolved for violating the Constitution and that upon the issuance of the declaration, the Chief Justice could be petitioned to advise the President to dissolve Parliament.[259] On the question of what happens in the unlikely event of a delay, the Court analogously borrowed from the Constitutional provision relating to the national government above and recommended that the National Assembly approve the withdrawal of at least 50 per cent of the revenue allocated to counties in the previous financial year's DORA or, alternatively, at least 15 per cent of the most recent audited and approved revenue raised nationally, for disbursement to counties to enable them undertake necessary expenditure pending the resolution of the stalemate.[260] Given the loophole in the law, the Court signalled Parliament to commence legislative steps to seal it based on the recommendation issued.[261] This is, however, yet to be done.

2.3.2. Limiting factors arising from the horizontal division of revenue

A number of factors have arisen at the horizontal revenue division stage that have limited the scope of autonomy counties draw from the equitable share as well as from conditional grants.

[258] *Council of Governors & 47 others v Attorney General & 3 others (Interested Parties); Katiba Institute & 2 others (Amicus Curiae)* paras 88-90.
[259] *Council of Governors & 47 others v Attorney General & 3 others (Interested Parties); Katiba Institute & 2 others (Amicus Curiae)* para 90.
[260] *Council of Governors & 47 others v Attorney General & 3 others (Interested Parties); Katiba Institute & 2 others (Amicus Curiae)* paras 79-83.
[261] *Council of Governors & 47 others v Attorney General & 3 others (Interested Parties); Katiba Institute & 2 others (Amicus Curiae)* paras 84 & 91.

2.3.2.1. The current horizontal revenue-sharing formula limits county own-prioritisation

As discussed above, the unconditional equitable share of revenue is only able to extend to counties discretion over own-prioritisation and spending where the formula used to allocate the funds horizontally uses high-level proxies for county expenditure needs, as was the case with the First and Second Generation horizontal revenue division formulas. While the Third Generation horizontal revenue division formula is singled out for seeking to closely align revenue with county government functions in its selection of parameters,[262] this constitutes its undoing, from the perspective of county expenditure autonomy. This is because needs-specific formulas tend to limit subnational expenditure autonomy by inadvertently undertaking prioritisation on behalf of subnational governments, while at the same time leaving other subnational functions/services, not included in the formulation of the parameters, 'unfunded'. This was the case with the Third-Generation formula (shown in Table 6.3 below) which is the one currently applied in horizontal revenue division.

Table 6.3: Summary of the Third Generation Formula

No.	Objective	Parameter	Indicator of expenditure need	Assigned weight
1.	To enhance service delivery	Health services	Health index	17%
		Agriculture services	Agricultural index	10%
		Other county services	Population index	18%
		Minimum share	Basic share index	20%
2.	To promote balanced development	Land	Land area index	8%
		Roads	Rural access index	4%
		Poverty level	Poverty head count index	14%
		Urban service	Urban index	5%

[262] CRA (2019) iii, 13 & 40.

3.	To incentivise fiscal effort	Fiscal Effort	Fiscal effort index	2%
4.	To incentivise fiscal prudence	Fiscal Prudence	Fiscal prudence index	2%

Source: CRA (2019)

Out of all county government functions, two functions (health and agriculture) were selected and featured as parameters to measure county service delivery expenditure need. No specific rationale was provided for selecting these two (out of the list of all county functions) to constitute standalone parameters, and assigning them a weight that is only a percentile lower than all other combined county services.[263] This amounts to a prioritisation of these two above all other county functions, which prioritisation ought to be within the province of counties. No rationale was either provided why all the remaining county functions were bundled into 'other county services', a gesture that amounts to their subordination to health and agriculture. However, the CRA argues, in respect of the formula, that it is 'an allocation framework and not a budgeting tool' and that the end result is a general-purpose (unconditional) transfer over which counties have total spending discretion.[264]

While this may be true, at least theoretically, the specificity of the indices and data used to measure the service needs in each of the sectors means that counties may not be able to use the funds allocated to these services for any other function, unless the specific county chooses to: not provide the service; under-provide the service; or to provide it at a relatively lower level than that utilised in calculating the allocation at the horizontal revenue division stage. For instance, the health index used to measure demand for health services is based on data on 'health facility gaps, primary health care visits and in-patient days'.[265] The agricultural

[263] CRA (2019) 22-23; Although IBP Kenya tries to justify the choice on the basis that the two are the most expensive of county functions, their expenditure is less compared to planning and development as well as roads and transport, based on data contained in the same CRA report at page 14. See, IBP Kenya *Issues, Analysis and Recommendations Related to the Third Formula for Revenue Sharing among Counties in Kenya* (2018) 3.
[264] CRA (2019) 10, 33 & 36; See also, Steytler N & De Visser J, *Local Government Law of South Africa* (2019) 12-10.
[265] CRA (2019) iv & 23.

index, for its part, is based on a county's proportion of rural households based on the Kenya Population and Housing Census of 2009.[266] With accurate data sources, therefore, the estimations at the horizontal revenue division stage have the potential of being an accurate measure of a specific county's expenditure need. Hence, there is a high likelihood that the prioritisation and weighting used in the formula has a direct influence on the prioritisation and weighting used in the county budgets for the relevant services. Besides, the World Bank argues that there is empirical evidence that, despite the fungibility of money, prescriptive (sector-specific) transfers find a way of sticking to their earmarked sectors,[267] a situation that would restrict the expenditure autonomy of counties. Nonetheless, the fact that the two functions only account for about 27 per cent of the formula leaves a substantial room for counties to exercise autonomy over funds accounted for by the remaining high-level parameters.

2.3.2.2. The constitutional requirement for timely disbursement of the equitable share is violated

Despite the constitutional requirement for the timely disbursement of the equitable share to county governments[268] and despite the legislative requirement for monthly disbursements of funds required by counties in line with agreed disbursement schedules,[269] a consistent failure by the National Treasury to adhere to the disbursement schedule has resulted in constant annual delays in the disbursement of funds to counties. This often has diverse and adverse consequences that impact both the fiscal autonomy of county governments as well as service delivery. This trend has continued despite the Supreme Court's declaring it a violation of the

[266] CRA (2019) iv & 25.
[267] World Bank (2012) 107.
[268] Constitution (2010), art 219.
[269] PFMA, s 17(6).

Constitution to release funds to counties at a time when they cannot be realistically utilised by counties to implement their budgets.[270]

Notwithstanding constitutional and legislative prescription, delays in the disbursement of the county equitable share is a common consistent phenomenon. The Constitution requires the national government to transfer a county government's equitable share without undue delay and without deduction, unless the transfer is stopped as part of an ongoing national intervention in an individual county.[271] Pursuant to this, the PFMA requires funds to be disbursed to counties on a monthly basis,[272] with the National Treasury disbursing monies needed by a county for the following month by the 15th of every month.[273] The disbursements are required to be in line with the disbursement schedule prepared by the National Treasury, in consultation with IBEC, and approved by the Senate and published in the Gazette.[274] However, no recourse is provided to counties should disbursements not be availed per schedule. As a result, the National Treasury annually fails to adhere to the disbursement schedule, with some disbursements only reaching counties at the end of the financial year, by when it is too late to put them to meaningful use.[275] This has, however, largely been attributed to challenges affecting cash flow at the national level.[276]

These delays in disbursement of the equitable share to counties have had diverse adverse consequences for county governments including: inability to pay staff salaries and statutory

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[270] *Council of Governors & 47 others v Attorney General & 3 others (Interested Parties); Katiba Institute & 2 others (Amicus Curiae)* para 95.
[271] Constitution (2010), art 219.
[272] PFMA, s 17(6).
[273] PFMA, s 17(6).
[274] PFMA, s 17(7).
[275] Council of Governors *Press Statement on the Delayed Disbursements of Funds to Counties by National Treasury* (14 June, 2021) (2021).
[276] PFMA, s 17(7) as read with s 187(2)(d) requires the disbursement Schedule to be based on the National Treasury's cashflow projections; Interview with an advisor in the National Treasury's Intergovernmental Fiscal Relations Department held in Nairobi on 15 February 2019; Interview with the leading economist of the Committee of Experts on Constitutional Review's finance subcommittee held in Nairobi on 6 February 2019.

contributions;[277] accumulation of huge pending bills;[278] ineffective budget execution;[279] low absorption rates for both recurrent and development expenditure,[280] with development spending being the most affected, due to the prioritisation of recurrent expenditure by counties as well as the in-year reallocation of development expenditure to recurrent expenditure as a way of adapting to the delays.

In response to complaints by county governments against the annual delays in the disbursement of funds, the National Treasury has maintained that it will prioritise disbursing funds to county governments with the smallest balances in their CRFs at the Central Bank.[281] The National Treasury argues that this is aimed at ensuring prudent cash management in keeping with article 201(d) of the Constitution.[282] From this perspective, the National Treasury labels cash balances held at any point in CRFs as idle cash[283] that ought to be utilised before counties can have access to additional disbursements. This position, however, fails to meet the constitutional requirement of due delay, and borders an indirect stoppage of funds to county governments outside the confines of article 225 of the Constitution. Labelling the balances as 'idle' and directing that they be used also has the consequence of interfering with the institutional autonomy of county governments, and more so, the autonomy of the county executives to make spending decisions. Also, unless it can be shown that the balances had long fallen due to be utilised according to an individual county's budget, but had not been utilised, it is difficult to see the link between cash balances and fiscal prudence. Besides, gauging fiscal prudence in the management of funds should only come in at the oversight and audit stage which is a preserve of the county assemblies and Parliament. The position taken by the National Treasury is, hence unconstitutional, and only works to constrain the fiscal autonomy of county governments.

277 Council of Governors (2021) 2.
278 CRA (2020) 20.
279 CoB (2017) xvi.
280 CRA (2015) 13; CRA (2016) 15.
281 National Treasury (2016) 25 & 64.
282 National Treasury (2016) 25.
283 National Treasury (2016) 63.

Although the Supreme Court, by an advisory opinion in a case brought by the Council of governors relating to the inordinate delays, took the view that the failure by the Constitution to set specific disbursement time-lines allowed some flexibility to the National Treasury, it stated that this does not give the National Treasury 'the latitude to capriciously decide when to disburse funds to the counties', and that any delay in disbursements ought to be justifiable and be explained in good time at an intergovernmental forum convened for that purpose.[284] The Court also declared that it would be a violation of the Constitution for the National Treasury to release funds to counties at a time when they cannot be realistically utilised by counties to implement their budgets.[285]

However, despite the above declaration by the Court in December 2020, the issue of delays in disbursement has persisted in 2021. As of 14 June 2021 (barely two weeks to the end of the financial year) Nairobi County had not received any disbursements for 6 months (January to June); 25 counties had not received disbursements for 4 months (March to June); and all 47 counties had not received disbursements for 3 months (April to June).[286] This led to county governors issuing a notice warning of impeding suspension of county services or a total shutdown of services at the county level should the National Treasury fail to release the funds.[287] While the fact that the financial year was ending (more than the threat of shutdown) forced the National Treasury to eventually release funds, the persistence of this issue poses a significant threat to the fiscal autonomy of county governments, while at the same time substantially affecting service delivery at the county level.

[284] *Council of Governors & 47 others v Attorney General & 3 others (Interested Parties); Katiba Institute & 2 others (Amicus Curiae)* para 94-95.
[285] *Council of Governors & 47 others v Attorney General & 3 others (Interested Parties); Katiba Institute & 2 others (Amicus Curiae)* para 95.
[286] Council of Governors (2021) 2.
[287] Council of Governors (2021) 4.

2.3.3. Limiting factors arising from the allocation and administration of conditional grants

While the Constitution gives discretion to the national government to provide counties with additional allocations drawn from its equitable share of revenue raised nationally,[288] a number of issues have arisen in the allocation and administration of these additional discretionary allocations (mainly given as conditional grants) that have an impact on the fiscal autonomy of county governments. These are discussed below.

2.3.3.1. The national government has attempted to distort the definition of 'conditional grants'

Whereas the Constitution requires that conditional grants be netted from the national government's share of revenue raised nationally,[289] the national government has sought to redefine this in its formulation of the annual CARBs, with the acquiescence of Parliament, in its approval of the CARBs. All CARBs between 2015 and 2020 and their corresponding approved CARAs have defined 'conditional allocations' as 'additional resources allocated to county governments *from revenue raised nationally* or in the form of loans and grants from development partners'.

This definition has the effect of distorting the revenue division process in two ways. First, it draws conditional allocations directly from the revenue raised nationally rather than the national government's share of the revenue, thus depriving county governments of money that would otherwise have gone towards their unconditional equitable share. Secondly, by setting apart the proceeds of loans and grants as a source of revenue separate from 'revenue raised nationally', it advances the national government's distorted definition of 'revenue [raised nationally]' (contained under section 2 of the CRA Act) that excludes some revenue sources, termed as 'non-shareable', from the ambit of 'revenue raised nationally', which is the

[288] Constitution (2010), art 202(2).
[289] Constitution (2010), art 202(2).

subject of vertical sharing. The end goal of this approach, it would seem, is to retain as much revenue as possible at the national level and out of the pool of 'revenue raised nationally' that ought to be equitably shared between the two levels of government.

The national government, however, recently conceded to the constitutional definition of 'conditional grants' as emanating from the national government's share of revenue.[290] This was done as part of an intergovernmental mediation directed by the Supreme Court, on the basis of whose report the Court proceeded to declare the distorted definition unconstitutional for going against the prescription of article 202(2) of the Constitution.[291] Although this may have informed the National Treasury's omission of the definition from the 2021 CARB, it is not clear whether the Court's declaration and National Treasury's omission in any way affected the substance of how conditional grants were allocated in 2021.

2.3.3.2. Terms and conditions accompanying conditional grants lack sufficient clarity

The frameworks setting out the terms and conditions for grants lack sufficient clarity, often leaving out important information that would have a bearing on the fiscal autonomy of county governments. This includes information relating to: the totality of applicable conditions; the basis for the initial amount of funds assigned to each conditional grant vis-à-vis the grant's objective; the basis for annually adjusting or growing the amounts assigned to the respective grants as well as the full extent of the financial obligation of each level of government from year to year under each grant. The lack of clarity impacts various aspects of a county's fiscal autonomy.

Although a consistent effort has been made to provide terms and conditions for the issuance of conditional grants, with all CARBs from 2014-2020 (except for the 2017 CARB) having always annexed detailed frameworks for conditional grants, these frameworks appear to not

[290] *Council of County Governors v Attorney General & 4 others; Controller of Budget (Interested Party)* para 9.
[291] *Council of County Governors v Attorney General & 4 others; Controller of Budget (Interested Party)* para 74.

constitute the totality of all conditions applicable to the grants contrary to the PFMA.[292] First, the relevant CARBs (as well as their corresponding CARAs) contain a provision bestowing power to the Cabinet Secretaries in charge of the various sectors under which each conditional grant falls to, at the start of each financial year, outline conditions to be met by counties prior to their accessing the conditional grants.[293] Also, the frameworks for the 2018-2020 CARBs added, as one of the responsibilities of the national government's accounting officer, the setting of conditions for transfers. All these obscure the full extent of conditions that counties have to comply with under the various grants, thus allowing the national government to complicate or even frustrate county access to the grants by imposing whichever additional conditions they see fit outside the scrutiny of Parliament, which comes with including all of them under the CARB as envisioned by the PFMA. Any delays in the release of funds, implementation of projects and delivery of services budgeted as being funded by the affected conditional grants, would hence negatively impact the expenditure autonomy of county governments. This would especially be the case where, as a result of the delays, counties are forced to divert funds from other functions to finance basic services funded by the delayed conditional grants.

Additionally, the basis for the initial size of conditional grants has never been explained in relation to the objectives stated to be pursued by the grants.[294] This creates a disconnect between the amounts allocated and the objectives sought to be achieved by the grants. For instance, it was not clear why the initial amount allocated for the conditional grant to Level Five hospitals stood at Ksh 3.4 billion, or that compensating for user fees foregone by counties stood at Ksh 900 million.[295] Also, the initial 15 per cent allocation from the RMFLF was criticised for not having been commensurate with the number of kilometres of roads that had been and that were eventually transferred to counties.[296] All these make it difficult for

[292] PFMA, s 191(3)(b) requires conditions to be set out under the CARB/CARA.
[293] See, s 5(3) of the 2015-2020 CARBs (s 5(4) for the 2017 CARB).
[294] See also, IBP Kenya *Memorandum on the Division of Revenue Bill, 2016* (2016) 3.
[295] CRA (2018) 17-18; IBP Kenya (2018) 5.
[296] CRA (2016) 4[23].

counties to spell out whether the grants are meant to fully cover the functions or projects to which they relate or whether the conditional grants come with a matching requirement.[297] In the end, therefore, counties are forced to spend money to fill the unfunded gaps left by this want of clarity.

Moreover, while clarity regarding the basis for the initial allocation vis-à-vis the purpose also provides a basis for determining whether the allocations need to be adjusted annually, the lack of clarity mentioned has obscured this important issue as well. It is not clear, for instance, why the grant to compensate for foregone user fees has remained constant at Ksh 900 million since its inception in 2015,[298] a factor that makes its real value, after factoring in inflation, less and less from year to year.[299] Although the other grants have occasionally been adjusted or have experienced marginal growth,[300] this has not been consistent, and the basis for these adjustments has not been clear given that both the National Treasury and the CRA apply different growth factors whenever recommending adjustment.[301] It is, therefore, not clear whether these grants ought to be adjusted annually to account for objective variations in sectoral service delivery cost factors, or at least to account for inflation. This impacts the adequacy of the grants for the intended purpose, as well as their long-term predictability and sustainability, with the consequence that counties are continually forced to provide additional funds to make up for increasing costs for the provision of the conditional-grant-funded services, at the expense of their fiscal autonomy.

Furthermore, the lack of clearly stipulated financial obligations for each level of government allows the national government room to act unilaterally in altering attendant terms to the financial detriment of county governments. This was the case in respect of the conditional grant for the leasing of medical equipment in the 2018/19 financial year. Although the

[297] See also, Institute of Certified Public Accountants of Kenya & IBP Kenya *Joint Memorandum to the Senate on the Division of Revenue 2019/20* (2019) 6.
[298] CRA (2018) 17-18.
[299] IBP Kenya (2018) 5.
[300] CRA (2018) 17-18.
[301] IBP Kenya (2016) 6; CRA (2016) v; Explanatory memorandum to the DORB, 2018, para 23.

projected annual cost of servicing the contractual obligations under the grant was Ksh 6 billion (for seven years),[302] this grant was annually allocated Ksh 4.5 billion based on an agreement for the 47 counties to each make an annual contribution of Ksh 95 million, albeit indirectly through the conditional grant.[303] The national government, however, increased this allocation by 109 per cent in 2018 without specifically engaging the counties.[304] This was explained away by the National Treasury as being *possibly* attributed to more counties having joined the project, leading to increased maintenance costs.[305] Despite the fact that this explanation defied logic, the lack of clear terms and conditions governing the grant, as well as the lack of access to any of the intergovernmental agreements allegedly signed by counties makes it difficult to verify this. The impact is that the amount of revenue available for vertical sharing was greatly reduced at the instance of the national government, to support the grant, to the detriment of the fiscal autonomy of county governments.

2.3.3.3. The administration and implementation of conditional grants violates the functional and institutional autonomy of counties

The national government has failed to respect the functional and institutional autonomy of county governments by allocating itself and spending funds assigned for indirect conditional grants, as well as by undertaking the procurement and management of funds on behalf of counties under the conditional grant for the leasing of county medical equipment, in the absence of prior intergovernmental agreements with the counties.

In 2017, the national government converted the free maternal health-care grant from a direct grant (disbursed to counties) to a special indirect grant channelled to the National Hospital

[302] See the annexes detailing the management framework for the grant in the 2016, 2018, 2019 & 2020 CARBs.
[303] CRA (2017) 35.
[304] Compare the allocations under the Schedules to the 2015, 2016 & 2017 DORBs, where the allocation was Ksh 4.5 billion, and the 2018 DORB with an allocation of Ksh 9.4 billion. The allocation was adjusted downwards to Ksh 6.2 billion in the 2019 and 2020 DORBs but then increased to Ksh 7.2 billion in the DORB, 2021. See also, IBP Kenya *Memorandum to the Senate on the Division of Revenue, 2018/19* (2018) 6.
[305] Explanatory memorandum to the DORB, 2018, para 23.

Insurance Fund (NHIF), a national government entity, which was then to undertake reimbursements to health facilities at the county level for maternal delivery services offered.[306] This amounted to the national government allocating itself money for a county function (health) and going ahead to spend the money on behalf of the county government without first executing an intergovernmental agreement giving it the powers to act either for individual counties, or for all counties in this regard.[307] By doing this, the national government violated the functional and institutional autonomy of counties, while also encroaching on the expenditure autonomy of counties in relation to county health spending.

Moreover, the unilateral procurement/leasing of specialised medical equipment on behalf of counties, and the direct management of the conditional grant set up to pay for the leasing of the equipment by the national government, without having executed intergovernmental agreements authorising this violated the functional and institutional autonomy of county governments while resulting in a financial burden on counties with consequences for their fiscal autonomy. After contracting six global medical firms to 'supply, install, train users and offer maintenance and repairs of diagnostic medical equipment' across the counties in 2015,[308] the national government proceeded to issue an annual conditional grant, initially totalling Ksh 95 million, to each county to support payment for the medical equipment.[309] Subject to the execution of an intergovernmental agreement under the auspices of article 187 of the Constitution (on the transfer of functions), this amount was to be retained by the national government which was then to annually make the necessary payments.[310]

Counties decried the fact that procurement for the project was undertaken at the national level without consulting them on the project design, which adopted a homogeneous one-size-fits-all approach instead of being guided by an assessment of county health infrastructure and

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[306] CRA (2017) 10 & 35; CRA (2018) 18.
[307] *Council of County Governors v Attorney General & 4 others; Controller of Budget (Interested Party)* paras 84 & 85.
[308] Institute of Economic Affairs (IEA) *8 Facts on the Medical Equipment Leasing Project in Kenya* (2019) 1.
[309] CRA (2017) 35.
[310] Explanatory memorandum to the DORB, 2016, para 7; s 5(4) as read with s 5(1)(e) of the CARA, 2016.

capacity needs.[311] Also, even though it is reported that most counties signed Memoranda of Understanding (MOUs) with the national government for the national government to spend money emanating from the grant, none of the MOUs could be accessed even by the Auditor-General.[312] As a result, counties had no information on how the lease rentals under the grant were calculated, and could not ascertain the value of the equipment provided under the grant.[313] The consequence of all this was that counties annually had to make payment for a project they never needed, as well as bearing other hidden costs associated with the maintenance and operation of the equipment.[314]

When approached by the Council of Governors to provide an advisory opinion regarding the allocation and administration of conditional grants, the Supreme Court[315] made the following declarations:

i That the national government cannot allocate itself funds for and undertake devolved functions without first executing inter-governmental agreements and that spending money meant for conditional grants directly by national government accounting officers amounts to an encroachment on the functions and mandate of county governments and is a violation of articles 187 and 189 of the Constitution.[316]

ii That in accordance with article 202(2), all funds characterised in the Division of Revenue Act as conditional or unconditional grants should be disbursed to the counties through the County Revenue Fund.[317]

The import of this decision, therefore, is to compel the national government to disburse all funds labelled as conditional grants to CRFs, irrespective of financing agreements with

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[311] Mutua J & Wamalwa N *Leasing of Medical Equipment Project in Kenya: Value for Money Assessment* (2020) 6 & 21.
[312] Mutua & Wamalwa (2020) 6 & 22; IEA (2019) 3.
[313] Mutua & Wamalwa (2020) 21 & 22.
[314] IEA (2019) 2.
[315] *Council of County Governors v Attorney General & 4 others; Controller of Budget (Interested Party)*.
[316] *Council of County Governors v Attorney General & 4 others; Controller of Budget (Interested Party)*, para 103(a) as read with paras 80, 85, 86 & 88.
[317] *Council of County Governors v Attorney General & 4 others; Controller of Budget (Interested Party)*, para 103(b). See also, the Public Finance Management (National Government) Regulations, 2015, reg 130.

development partners, or at least to ensure that development partners expressly agree to this being done as a constitutional requirement; and to ensure that national government does not spend any funds under a conditional grant to directly provide a county service unless it has first executed the requisite intergovernmental agreement. This is critical in safeguarding the fiscal autonomy of county governments.

2.3.3.4. There has been a proliferation of conditional grants over the years

The proliferation of conditional grants over the years translates to a continuing decrease in the fiscal autonomy of counties, both as a result of the increasing conditioning of their expenditure, as well as through the attendant decrease of the unconditional equitable share that comes with increased conditional grants. An increase in conditional grants also results in dependency and erodes the need for downward accountability by counties.

Conditional grants have increased in number in each subsequent year since the start of devolution.[318] The 2018-2020 DORBs, for instance, have the most conditional grants, mainly drawn from proceeds of loans and grants from development partners. The nature of these grants, however, is such that the national government is in charge of their initiation, distribution and implementation.[319] As of 2018, the percentage of total conditional grants to total county revenue had increased from 9.3 per cent in 2013/14 to 11.9 per cent in 2017/18.[320] These grants spanned across various county government functions, therefore giving the totality of the conditions attached to them the potential to dictate policy in the specific sectors to which the grants related. This makes them a core cause for concern from a subnational fiscal autonomy perspective, as it means that the national government has been increasingly influencing expenditure at the county level over time.

318 IBP Kenya (2016) 1-2.
319 S 5(a) of the DORB, 2018.; s 5(3) of the CARB, 2014; s 5(6) of the 2015 & 2017 CARBs & s 5(5) of the 2016 & 2018, 2019 2020 CARBs.
320 CRA (2018) 17-18.

Additionally, despite the fact that conditional allocations are required to be drawn from the national government's equitable share, an increase in the amount of revenue set aside for conditional allocations directly translates to a general decrease in the amount of revenue available for (unconditional) equitable sharing, a factor that affects the fiscal autonomy of county governments.[321]

This has been the experience in South Africa where conditional grants have been slowly but persistently growing at the expense of the equitable share.[322] This outcome may be explained in two ways. First, availability of increasing amounts for conditional grants from year to year means that the national government is overstating its resource needs at the vertical revenue division stage so as to have extra funds to channel towards conditional grants. Alternatively, it could mean that the national government is increasingly taking out loans from development partners to finance conditional grants hence accumulating debt which, as a first charge on the Consolidated Fund, directly impacts the balance of revenue available for vertical sharing. Increasing conditional grants, therefore, has the potential to crowd out funds available for equitable sharing at the expense of county fiscal autonomy.

In addition to the consequences highlighted above, the proliferation of conditional grants has the unintended incremental consequence of eroding the ability of county governments to independently manage and be accountable for important functions that fall under their jurisdiction. This is achieved by the conditional grants' facilitation of the development of a financial and institutional dependency, by counties, on the national government. The continued financing of particular county-level functions through conditional grants, serves to sustain a bail-out perception, which then leads to not only a failure by counties to take initiative to strengthen their own capacity to provide the relevant services, but also to a weakened sense of horizontal accountability. Whereas revenue autonomy seeks to make counties independent and accountable to the people at the local level for their expenditure

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[321] See, *Council of County Governors v Attorney General & 4 others; Controller of Budget (Interested Party)*, para 73.
[322] Steytler & Ghai (2015) 458.

decisions, a proliferation of grants breeds dependency leading to the inversion of the direction of this accountability from the people to the national government. This also weakens allocative efficiency and the imperative of ensuring that value for money is achieved in respect of projects selected for funding through conditional grants. The long-term financing of some county functions through conditional grants hence needs to be regulated to check its impact and to also consider a plan for phasing out conditionality.[323]

2.4. Conclusion on IGFTs and grants

Although the Constitution puts in place general measures aimed at ensuring that the unconditional equitable share annually received by counties affords them scope for fiscal autonomy, its inability to cover every single detail opened up some critical aspects to both limiting statutory interpretation and, largely, to national executive fiat. In the end, a combination of these two factors has meant that, annually, a substantial portion of the revenue raised nationally is deducted and retained at the national level prior to the commencement of the vertical revenue division process. This then takes place against a portion, rather than the whole, of revenue raised nationally, as the Constitution would have otherwise had it. Additionally, even out of the greatly reduced portion allocated to counties, the National Treasury retains a significant say on whether and how this grows from year to year, and when counties are able to receive the actual funds.

While institutions like the CRA and IBEC are critical in the revenue-sharing process, their impact in practice, especially as relates to addressing the above issues that have limited the level of fiscal autonomy counties draw from the equitable share, has been negligible. This is mainly because their recommendations, though important, are not binding on the national government, which has often chosen to disregard them. This is compounded by the fact that the Senate, despite being a key actor in the passing of legislation including the annual DORA

[323] World Bank (2012) 107.

and CARA, has not come out strongly in defence of devolution, especially when it comes to the debilitating delays by the National Treasury in disbursing funds to counties.

Although the current horizontal revenue division formula seems to be moving in the direction of South Africa by utilising needs-specific parameters which indirectly dictate county expenditure, counties still retain and are able to exercise a substantial level of autonomy over their unconditional equitable share of revenue. The implementation of court decisions relating to issues of top-slicing and the administration of conditional grants, coupled with a reversion by the CRA to high-level proxies of county expenditure needs as well as a resolution to the issue of consistent delays in disbursing this share to counties, by for instance adopting the South African approach of having two separate financial years for each level of government, would go a long way in securing this autonomy.

3 Conclusion on the revenue autonomy of county governments

Kenya's legal framework adopts various features that are key to the exercise of revenue autonomy by county governments. The framework for county own-source revenue allows county governments discretion over the setting and varying of their OSR bases and rates as well as discretion over administration of their OSR. Further, the framework for IGFTs and grants makes room for objective criteria for vertical and horizontal division of revenue, while also ensuring that both the vertical and horizontal revenue division processes are transparent, consultative and are guided by objective considerations. The legal framework, therefore, sets the stage for county governments to exercise autonomy over the revenue that constitutionally accrues to them.

However, the Constitution entrenches a vertical fiscal asymmetry in its allocation of own revenue sources to county governments. This prevents counties from drawing a significant level of fiscal autonomy from revenue realised out of their OSR. While IGFTs and grants step in to try and even out the resulting gap, this is largely inhibited by the national resource constraint, which makes finite the amount of resources available for sharing, and the need for equalisation, which further thins out the aggregate pool of resources allocated generally to counties. Although this still leaves room for counties to exercise a level of autonomy from their unconditional equitable share, the overbearing control held by the national government over IGFTs and grants, when coupled with the heavy reliance placed by county governments on the unconditional equitable share, has meant that the level of revenue autonomy exercised by counties in practice continues to lie precariously in the hands of the national government. While this is largely attributed to national executive action, national legislation and inaction or acquiescence by the national legislature also play a role in limiting the level of revenue autonomy actually exercised by county governments in practice. The chapter has made proposals, mostly drawn from the South African experience, whose consideration may hold the key to counties accessing and exercising the full extent of their revenue autonomy.

Chapter Seven

THE FRAMEWORK AND PRACTICE OF SUBNATIONAL FISCAL AUTONOMY IN KENYA: The budgetary autonomy of county governments (and general conclusion)

Budgetary autonomy refers to a subnational government's freedom to utilise debt as a financing tool, mainly to cover either a deficit in its budget or shortfalls in its revenue receipts. This extends to questions such as: whether subnational governments are allowed to borrow; whether the borrowing extends to capital or recurrent spending or both; whether both domestic and external borrowing is permitted; whether guarantees or approvals from the national government are required; and the scope and impact of any underlying conditions or restrictions to borrowing. As highlighted in Chapter two and as seen in the South African case, although subnational borrowing is a critical part of subnational fiscal autonomy, it is generally closely regulated for purposes of ensuring intergenerational equity (fiscal discipline), and macroeconomic stability. Such regulation, however, needs to be within the constitutionally allowable limits.

This chapter looks at nature and scope of budgetary autonomy extended to and exercised by counties in Kenya. The chapter argues that while the legal framework provides room for the exercise of budgetary autonomy by county governments, its provision for the regulation of this discretion has constituted a barrier to the exercise of county budgetary autonomy in practice. The chapter is presented in five parts. The first discusses factors that provide room for the exercise of budgetary autonomy by counties. The second looks at the factors inhibiting the exercise of budgetary autonomy. The third discusses the consequences of the limitations on the exercise of budgetary autonomy by counties. The fourth provides a conclusion on the budgetary autonomy of county governments; and the fifth makes an overall conclusion on the nature and scope for fiscal autonomy in Kenya.

1 Factors facilitating the exercise of budgetary autonomy by counties

Various factors have been built into the constitutional and legislative framework to enable the exercise of budgetary autonomy by county governments in Kenya. These are discussed briefly below.

1.1 The constitutional and legislative frameworks allow for county borrowing

County governments are allowed to borrow and to raise loans both within and outside Kenya, provided the loan is approved by the respective county assemblies and guaranteed[1] by the national government.[2] To borrow, a county is allowed to issue tradable securities,[3] borrow using a loan or credit instrument evidenced in writing, or to use bank overdrafts from the Central Bank of Kenya.[4] Although the Constitution generally requires a guarantee to be obtained from the national government as a precondition for accessing debt,[5] the PFMA Regulations require a guarantee to be obtained only for the first two forms of borrowing above.[6] Under the Regulations, borrowing by use of bank overdrafts is deemed to be guaranteed by the national government, and is secured by the respective county government's equitable share of revenue.[7]

While the PFMA requires county budget revenue and expenditure appropriations to be balanced,[8] this only applies to the county government's recurrent expenditure and does not prevent county deficit financing[9] through debt, provided such deficit financing is for

[1] Constitution, art 260 - the Constitution defines a guarantee as an 'absolute or conditional promise, commitment or undertaking by the national government to partially or completely re-pay a loan to a county government.'
[2] Constitution, art 212 as read with PFMA, s 140.
[3] Section 2 of the PFMA defines a 'county government security' as a including a treasury bill, treasury bond, treasury note, government stock as well as any other debt instrument issued by a county government.
[4] PFMA Regulations, s 177(2) as read with PFMA, s 144(3) & (13).
[5] Constitution, art 212. See also, CGA, s 8(1)(d).
[6] PFMA Regulations, s 177(3).
[7] PFMA Regulations, s 177(4)
[8] PFMA, s 107(2)(a) as read with PFMA Regulations, s 31(c).
[9] 'Deficit financing' is used to refer to financing through borrowing that is specifically meant to cover a budget deficit (the difference between expenditure and anticipated revenue in a subnational government's budget).

capital spending and has been approved by the county assembly and guaranteed by the national government.[10] This facilitates a county's budgetary autonomy.

1.2 The provision of a criteria for the issuance of guarantees ensures objectivity

Although the precondition that counties can only borrow if the loan is guaranteed by the national government is constitutional and is critical in checking the exercise of budgetary autonomy, it also grants the national government powers of review (through the setting and application of conditions precedent to the issuance of a guarantee) and possible negation of a county government's decision to use debt (by refusal to guarantee the debt as requested). Such powers by the national government hence require objectivity in their formulation and transparency in their application, so as not to unduly restrict the budgetary autonomy of county governments.

To facilitate this, the PFMA requires that a criteria for the issuance of guarantees be negotiated at IBEC and be prescribed in the Regulations approved by Parliament.[11] To this end, the PFMA Regulations set out an eligibility and evaluation criteria for guarantees.[12] Under the criteria, a county government is required, in respect of a capital project for which a guarantee is being sought, to: demonstrate that the project could not be financed otherwise than by the loan; outline a clear borrowing and repayment plan based on an economic analysis of the project and its cashflow; and demonstrate that the project is feasible and that the county meets all the relevant fiscal responsibility principles.[13] Moreover, the county government is required to contribute a substantial portion of the funds required for the project from their OSR, being not less than 15 per cent.[14] The provision of this criterion is key in ensuring that objective factors are taken into account with respect to each request for a guarantee across all county governments. This works to prevent the introduction of inconsistent factors, or factors that may be targeted at limiting the budgetary autonomy of county governments.

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[10] Constitution, art 212 as read with PFMA, s 107(2)(a) & (d).

[11] According to PFMA, s 50(4) as read with s 187(2)(c), the criteria used for the guarantee of debts is required to have been agreed upon with IBEC prior to its prescription in Regulations.

[12] PFMA Regulations, s 176(d) as read with s 181.

[13] PFMA Regulations, s 181.

[14] PFMA Regulations, s 181(2).

2 Factors limiting the exercise of budgetary autonomy by counties

A number of legislative, policy and practice-related factors stand in the way of county government borrowing. While some are critical for facilitating fiscal prudence, some unjustifiably limit county budgetary autonomy while others are outright unconstitutional. These are highlighted below.

2.1 County discretion on the use of debt is highly regulated

As indicated above, the regulation of the exercise of budgetary autonomy by counties is important in ensuring intergenerational equity and macroeconomic stability. To underscore the intergenerational equity imperative, the Constitution requires, as one of its public finance principles, that the burdens and benefits of the use of resources and public borrowing be shared equitably between present and future generations.[15] This, therefore, sets the stage for the regulation of the nature and scope of expenditure over which county governments may be allowed to borrow. It is arguably on this basis that county governments are required to ensure that their borrowing, over the medium term, is used only for the purpose of financing development expenditure rather than recurrent expenditure.[16] Similarly, short-term borrowing is required to be applied towards cash flow management and is, moreover, capped at five per cent of the county government's most recent audited revenue.[17]

Purposes for which a county may borrow are also regulated. The PFMA requires that counties borrow to cater only for purposes prescribed under regulations.[18] In this respect, the PFMA Regulations stipulate that a county may only borrow: to finance its budget deficit; for cash management purposes; to refinance an outstanding debt or to repay a loan prior to its maturity date; to mitigate against adverse effects of an emergency in instances where the Emergency Fund has been depleted as well as for purposes of meeting any development policy objective deemed necessary by the county.[19] While this

[15] Constitution, art 201(c). See also, PFMA Regulations, s 176(b).
[16] PFMA, s 107(2)(d).
[17] PFMA, s 107(3).
[18] PFMA, s 141(3).
[19] PFMA Regulations, s 178.

may otherwise be interpreted as limiting on the constitutional obligation placed on county assemblies to approve loans (including purposes for which they may be applied), the framing of the purposes is broad enough for county assemblies to exercise their budgetary autonomy in this respect.

The imposition of debt and annual debt service cost ceilings further restricts county budgetary autonomy. Although the PFMA allows a county assembly to set borrowing limits for the county government,[20] arguably based on a county assembly's constitutional mandate to approve county borrowing, the PFMA Regulations lay out a couple of their own ceilings. For example, at any given time, a county government's public debt is required to not exceed 20 per cent of the county's most recent audited revenues.[21] Also, a county government is required to keep its annual debt service cost below 15 per cent of its most recent audited revenues approved by the county assembly.[22] These restrictions, therefore, constrain a county government's discretion to use debt. Additionally, the imposition of these additional ceilings falls outside of, and has the potential to limit, the constitutional mandate bestowed on county assemblies to approve borrowing (as well as imposing conditions on borrowing).

The autonomy of counties over borrowing (and that of county assemblies to approve borrowing), as well as some of the restrictions imposed on it, ought to be interpreted alongside other broader constitutional objectives such as: the devolved government principle of ensuring continued effective service delivery, by ensuring that county governments (at all times) have reliable sources of revenue; the public finance principles requiring fiscal prudence and responsibility in the use and management of public money as well as the general mandate of the national government to ensure macroeconomic stability imposed on it by its general obligation over national economic policy and planning.[23] Either or a combination of any of these may constitute a justifiable basis for limiting the budgetary autonomy of county governments.

[20] PFMA, s 15(2)(d) as read with s 141(2).
[21] PFMA Regulations, s 25(1)(d) & s 179(1) as read with PFMA, s 50(5).
[22] PFMA Regulations, s 179(2).
[23] Constitution, art 175(b) as read with art 201(d) & (e) and para 9 of Part 1 of the Fourth Schedule.

2.2 Some requirements for the issuance of guarantees hold potential for abuse

While most of the preconditions for the issuance of guarantees for county loans are critical in ensuring fiscal prudence, some hold the potential to restrict the budgetary autonomy of counties. The PFMA requires the Cabinet Secretary to guarantee a loan only if:[24]

- a the loan is for a capital project;
- b the county government has the capacity to repay the loan together with any interest and any other amounts payable under the loan;
- c the fiscal responsibility principles as well as the objectives of the national government are complied with in the terms of the guarantee;
- d the loan does not exceed the loan limits imposed under the PFMA Regulations and where any limit is exceeded, that parliamentary approval is obtained;
- e the equity between the national government's interests and the county's interests has been taken into account so as to ensure fairness;
- f the county government has complied with any conditions imposed by the Cabinet Secretary pursuant to the PFMA Regulations; and that
- g the recommendations of the IBEC with regard to the guarantee are taken into account.

While most of these requirements stand to reason, (c) and (f) hold the potential to limit the budgetary autonomy of county governments given their subjection of guarantees to 'objectives of the national government' and compliance with 'any conditions imposed by the Cabinet Secretary'. With respect to (c), while fiscal responsibility principles are clearly outlined in the PFMA, the scope of national government objectives sought to be complied with is not clear, hence providing a leeway for objectives that may be limiting to the budgetary autonomy of county governments. Similarly, with respect to (f), although the Cabinet Secretary's discretion to impose conditions is tied to the PFMA Regulations, the open-ended nature of this power holds potential for abuse.

2.3 Counties have no recourse where a loan guarantee request is rejected

While section 4(3) of the repealed National Government Loans Guarantee Act (2011) provided recourse to counties in the event that the Cabinet Secretary declines a request for a guarantee, a similar guarantee is not provided under either the PFMA or its

[24] PFMA, s 58(2).

Regulations. Under the repealed Act, counties were allowed to petition Parliament to review the Cabinet Secretary's decision to decline the issuance of a guarantee. The absence of an appellate procedure, therefore, leaves counties with no way of contesting the discretion of the Cabinet Secretary on the subject, a factor that weakens the transparency and objectivity of decision-making in respect of the guarantees. The unchecked nature of this discretion therefore holds potential for its abuse to constrain the budgetary autonomy of county governments.

2.4 Parliament is unconstitutionally required to approve county loans

Although the Constitution does not envisage parliamentary approval of a county government loan as a precondition to county borrowing, section 58(1) of the PFMA requires Parliament to approve a county loan for which a guarantee has been issued. Unless such approval only extends to the approval of the loan guarantee issued by the Cabinet Secretary, such as envisioned under section 184 of the PFMA (County Government) Regulations, the PFMA requirement for parliamentary approval of county loans constitutes an unconstitutional addition that will serve only to further constrain the budgetary autonomy of county governments.

2.5 Increased national borrowing crowds out county borrowing

As mentioned in the previous chapter, growth in national borrowing exhausts the overall borrowing ceiling imposed by Parliament, thereby crowding out room for county government borrowing. This is worsened by the exclusion of counties and their representatives in national decision-making relating to public debt. While it falls to Parliament to check national borrowing, the Senate's role in this regard has not been pronounced, as seen in the failure by the National Public Debt and Borrowing Policy to expressly outline the Senate's role in national borrowing. The equity interests of counties in relation to the acquisition of debt are therefore scarcely taken into account in national borrowing, with the consequence that national borrowing continues to generally hamper county access to loans. For instance, one of the reasons given by the National Treasury for the inability of the national government to guarantee borrowing by Kisumu County was a debt ceiling imposed on borrowing by the International Monetary Fund (IMF) which the national government was wary of exceeding were it to issue a guarantee for the county to borrow externally.[25]

2.6 The National Public Debt and Borrowing Policy reveals a centrist bias

Although the Public Debt and Borrowing Policy, formulated by the National Treasury in 2020,[26] was expected to provide more clarity with respect to borrowing generally and county government borrowing in particular, the policy focuses on national borrowing, asserts the National Treasury's overbearing mandate over borrowing and fails to mention any role to be played by the Senate[27] in national borrowing, despite the direct impact public debt has on the equitable share as well as over borrowing by county governments.

Among other things, the Policy: makes provision for additional conditions precedent to the contracting of external financial support by counties;[28] makes provision for the role of the Public Debt Management Office in promoting the development of the domestic debt market for government securities but fails to provide any specific guidelines on the issuance of securities by counties;[29] extends the mandate of the national government to borrowing on behalf of a county government for subsequent on-lending to the requesting county government;[30] and grants power to the Cabinet Secretary to convert any on-lent loan into a grant or equity without providing any criteria or guidelines to guide the exercise of this discretion.[31] The Policy also introduces 'national interest' as a factor for consideration when appraising county projects for the issuance of national guarantees;[32] and also indicates, outside the PFMA and PFMA Regulations, that the eligibility of requests for guarantees will be evaluated against Loan Guarantee Guidelines and 'stated national development priorities', the nature and scope of which are not delineated in the Policy.[33]

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[25] Interview with the Governor of Kisumu County held in Nairobi on 10 March 2021.
[26] Republic of Kenya, '*Public Debt and Borrowing Policy*' (2020). A reading of the 2021 Medium Term Budget Policy Statement points to this policy having come into effect. See, National Treasury, '*Medium Term 2021 Budget Policy Statement*' (2021) 35.
[27] Republic of Kenya (2020), para 56 & 57 as read with para 100-103.
[28] Republic of Kenya (2020), para 43.
[29] Republic of Kenya (2020), para 94-99.
[30] Republic of Kenya (2020), para 108.
[31] Republic of Kenya (2020), para 110-111.
[32] Republic of Kenya (2020), para 112.
[33] Republic of Kenya (2020), para 113.

The Policy, therefore, reflects a very centrist stance to county government borrowing and has the effect of opening more room to the national government to further constrain the borrowing powers of county governments beyond constitutional limits. However, legislation required to operationalise the policy is yet to enacted, so it remains to be seen whether the Senate's role in the passing of such legislation will have a moderating impact on the Policy. Also, the National Treasury, in the annexure to the Policy, commits to reviewing existing regulations to ensure their compliance with the Policy.[34] Such review of regulations is also subject to the approval of the Senate. This approval, it is hoped, will provide room for canvassing on the constitutionality of some of the provisions of the Policy, with a view to securing the budgetary autonomy of county governments.

3 Prohibitive county borrowing preconditions have forced counties to undertake only short-term borrowing

Notwithstanding the fact that the Constitution and the PFMA (including its regulations) provide a framework for borrowing, counties have not utilised it to undertake borrowing for purposes of capital spending.[35] The failure to take out long-term debt has been attributed to various factors, one of them being the stringent criteria required to be met for the issuance of a national government guarantee.[36] Kisumu County, for instance, was unable to obtain the approval of the National Treasury for an external loan despite the loan having been approved by the Kisumu County Assembly and an agreement having been reached with the lender.[37] The National Treasury cited the county's huge pending bills, bloated workforce, lack of assets to pledge as security for the loan, as well as its inability to provide proof of sufficient OSR to finance the loan repayment as grounds for its refusal to provide a guarantee for the loan.[38]

Although counties are making progress towards improving their financial standing so as to improve their chances of acquiring long-term debt, the requirements for obtaining

[34] Republic of Kenya (2020), para 3.
[35] Commission on Revenue Allocation (CRA), '*Recommendations on the Basis for Equitable Sharing of Revenue between National and County Governments for the Financial Year 2019/2020*' (2018) 13.
[36] Interview with the Chief Finance Officer of Nairobi County held in Nairobi on 11 March 2021; Interview with the Governor of Kisumu County held in Nairobi on 10 March 2021.
[37] Interview with the Governor of Kisumu County held in Nairobi on 10 March 2021.
[38] Interview with the Governor of Kisumu County held in Nairobi on 10 March 2021.

guarantees, and the National Treasury's unrestrained power over this process, make this outcome unlikely. Notable in this regard is that some counties have more recently been able to obtain unqualified audit reports,[39] with some such as Kisumu, Makueni, Mombasa and Laikipia also having been able to take part in a voluntary assessment of creditworthiness (credit rating) undertaken by the CRA with the support of the World Bank.[40] This has, for instance, allowed counties such as Laikipia, Bungoma, Makueni and Kisumu to start processes for obtaining approvals to float infrastructure bonds, which, if approved, would be the first by county governments in Kenya.[41] Unfortunately, however, clean audits and approval by county assemblies and the Capital Markets Authority are only a small portion of the requirement for capital borrowing, and the counties would still have to go through a separate procedure to obtain national government guarantees for the bonds, a process that is more restrictive and may potentially render the issuance of the bonds by counties in the near future unlikely.

County borrowing has, therefore, largely been restricted to short-term loans for bridging purposes to finance recurrent spending, mainly the payment of salaries and statutory deductions.[42] The demand for bridging finance is elevated by the consistent delays by the National Treasury to disburse the county equitable share.[43] As a result, most counties are forced to borrow to cater for the payment of salaries and statutory deductions. Although the Central Bank of Kenya (CBK) and the National Treasury are said to have been opposed to the use of commercial loans by counties due to the high interests that come with such

[39] National Treasury, '*Medium Term Budget Policy Statement, 2020*' (2020) 66.
[40] National Treasury (2020) 66; Interview with the Governor of Kisumu County held in Nairobi on 10 March 2021; Mutua J, 'CRA Mulls County Bond Issues for Projects' (*Business Daily*, 2019) available at https://www.businessdailyafrica.com/bd/news/counties/cra-mulls-county-bond-issues-for-projects-2255836 (accessed 7 June 2021).
[41] Munda C, 'Four Counties Rush to Get Infrastructure Bond Issue Approval' (*Business Daily*, 2021) available at https://www.businessdailyafrica.com/bd/news/counties/four-counties-rush-to-get-infrastructure-bond-issue-approval-3382442 (accessed 7 June 2021); County Assembly of Laikipia, '*Report on the Laikipia County Fiscal Strategy Paper for the FY 2020/21: Report of the Select Committee on County Budget and Appropriations*' (2021) 13.
[42] CRA (2018) 13; Interview with the County Executive Member for Finance (together with chief officers and directors from the Finance Department), County Government of Makueni, held in Nairobi on 18 March 2021; Interview with the County Executive Committee Member for Finance of Kakamega County held in Nairobi on 18 March 2021; Interview with the County Executive Committee Member for Finance of Kakamega County held in Nairobi on 18 March 2021.
[43] Interview with the County Executive Committee Member for Finance of Kakamega County held in Nairobi on 18 March 2021; Interview with the Governor of Kisumu County held in Nairobi on 10 March 2021.

borrowing,[44] most counties that borrow use overdrafts from commercial banks where they maintain their operational accounts.[45] Although commercial borrowing is made unattractive to counties by the fact that costs such as interest payments, potential penalties for any form of default, as well other additional charges attendant to commercial borrowing, are not usually provided for in the annual county budgets,[46] some counties have been able to find a way around this. Counties such as Makueni, for instance, enter into arrangements with their local banks to access interest-free loans to enable them process staff salaries on condition that the loans are repaid within a stipulated time, say 45 days, failing which, the loan would then start accumulating interest.[47] This has been critical in helping counties cope with the problem of delayed disbursements while at the same time providing a way around the issue of high interest commercial rates.

Even then, the prohibitive nature of the conditions and requirements for the acquisition of loans has made some counties to either look to their OSR to bridge cashflow challenges occasioned by delays in the disbursement of the equitable share, or to use other creative approaches to spending that enable them to avoid venturing into borrowing. Nairobi County, for instance, is one of the counties which has reportedly not ventured into borrowing due to its OSR being sufficient to cater for its needs as well as due to its having access to development funding from donors who support the county's capital spending.[48] Nairobi County's case is, however, unique given that its access to substantial OSR is attributed to its being both Kenya's administrative and commercial capital. Kakamega County, on the other hand, is one of the counties that has chosen to avoid borrowing by prioritising personnel emoluments in its planning including through the reallocation of

[44] National Treasury, '*Medium Term Budget Policy Statement, 2017*' (2017) 65; Interview with the County Executive Committee Member for Finance of Kakamega County held in Nairobi on 18 March 2021.
[45] Interview with the Director of Revenue Management of Uasin Gishu County held in Eldoret on 16 March 2021; Interview with the County Executive Member for Finance (together with chief officers and directors from the Finance Department), County Government of Makueni, held in Nairobi on 18 March 2021.
[46] Interview with the Chief Finance Officer of Nairobi County held in Nairobi on 11 March 2021; Interview with the Director of Revenue Management of Uasin Gishu County held in Eldoret on 16 March 2021; Interview with the County Executive Member for Finance (together with chief officers and directors from the Finance Department), County Government of Makueni, held in Nairobi on 18 March 2021.
[47] Interview with the County Executive Member for Finance (together with chief officers and directors from the Finance Department), County Government of Makueni, held in Nairobi on 18 March 2021; Interview with the County Executive Committee Member for Finance of Kakamega County held in Nairobi on 18 March 2021.
[48] Interview with the Chief Finance Officer of Nairobi County held in Nairobi on 11 March 2021.

‘idle’ funds from development expenditure to cater for salaries pending receipt of the (often delayed) equitable share of revenue.[49] While this may help it to avoid the challenges and burdens of borrowing, it however leads to low rates of development spending at the county level, a factor that interferes with the expenditure autonomy of county governments.

4 Conclusion on the budgetary autonomy of county governments

Although both long-term and short-term borrowing by counties is permitted under both the constitutional and legislative frameworks, various constitutional principles provide a constitutional basis for the close regulation of borrowing by counties with the overall objective of ensuring fiscal discipline as well as maintaining macroeconomic stability. Flowing from this, national legislation and policy on borrowing by counties demonstrate a centrist bias that not only utilises these constitutional imperatives to limit borrowing by counties but also occasionally stretches them beyond constitutional limits. This mainly applies to long-term borrowing by counties aimed at deficit financing, and constitutes a foundational reason for the failure by county governments to exercise the full extent of their budgetary autonomy in practice.

Despite these limitations, county governments have been able to exercise a limited level of budgetary autonomy by freely undertaking short-term borrowing, mainly by way of overdrafts aimed at providing bridging finance to cover gaps in equitable share receipts. Comprehensive measures, therefore, need to be put in place to ensure equity in the procurement and use of debt by both levels of government. Clarity and certainty or finality in the list of conditions required to be met for counties to secure national government guarantees, as well as a broader and more instrumental role by counties in the procurement of national debt, will also go a long way in securing their interests in the utilisation of debt in their own spending.

[49] Interview with the County Executive Committee Member for Finance of Kakamega County held in Nairobi on 18 March 2021.

5 General conclusion on the framework and practice of subnational fiscal autonomy in Kenya

An analysis of the legal framework governing Kenya's intergovernmental fiscal system as well as the ensuing practice reveals the following in respect of county expenditure, revenue and budgetary autonomy:

a The Constitutional allocation of expenditure responsibilities reveals an intention to confer on counties exclusive functional mandates, while also recognising that the implementation of some functions may fall within the concurrent jurisdiction of both levels of government. This intention is impaired, though, by the lack of clarity in the demarcation of county exclusive and concurrent powers. This leaves the demarcation of the specific functional boundaries and cut-off points to national legislation, thereby opening up the full extent of county expenditure autonomy to possible national legislative dominance. While in practice counties currently exercise a substantial level of autonomy over their own expenditure, nothing in the law prevents a national legislative regime that is more restrictive on the expenditure autonomy of county governments.

b The Constitutional allocation of own sources of revenue to county governments entrenches a vertical fiscal asymmetry which renders county governments dependent on the national fiscus by default. While the Constitution puts in place measures to ensure that the unconditional equitable share received by county governments affords them scope for fiscal autonomy, a combination of legislative and executive actions during the revenue division process have narrowed the quantum of revenue that counties may draw from the national equitable pool and the practice of delays in disbursements has immensely diminished the level of revenue autonomy exercised by counties in practice.

c While the Constitution provides room for the exercise of budgetary autonomy by allowing counties to borrow, it also provides grounds for the national legislative regulation of its exercise. However, some aspects of national legislation have made access to borrowing by counties unattractive and near impossible in practice, especially as relates to capital borrowing, which undermines the Constitutional provision for it.

Generally, therefore, whereas the constitutional framework is generous enough to allow scope for the exercise of fiscal autonomy by county governments, its inadequacy as relates to clarity and comprehensiveness (although characteristic of most constitutions) opens up room for the restriction of the fiscal autonomy of county governments both under national legislation and in practice. The exercise of fiscal autonomy by counties can only be achieved by the review and enactment of national legislative frameworks that would give effect to and secure the constitutional intention to confer a considerable level fiscal autonomy to county governments.

Chapter Eight

FACILITATING ACCOUNTABLE FISCAL AUTONOMY IN KENYAN COUNTIES: THE SYSTEM OF FISCAL CONTROLS AND OVERSIGHT

Given the relative margin for the exercise of fiscal autonomy that is extended to county governments under the law and in practice, the question that follows is how the design and implementation of the system of expenditure control and oversight ensures that such fiscal autonomy is exercised in an accountable manner so as to secure:

a the realisation of the objects of autonomy/devolution (functional accountability);

b compliance with principles of public finance (financial accountability); and

c the national government's overall jurisdiction over macroeconomic control, equity and its general oversight over devolution (institutional accountability).

This requires a system of fiscal controls targeted at ensuring the accountability of county governments, without contravening the constitutional architecture extending them scope for fiscal autonomy. This chapter discusses the various forms of fiscal controls provided for under Kenya's legal framework and their role in facilitating accountable fiscal autonomy at the county level. The chapter also looks at the extent to which the implementation of these fiscal controls has impacted the accountable exercise of fiscal autonomy by county governments.

In assessing Kenya's system of fiscal controls, the chapter discusses them under three classifications: those controls that are internal to the county level of government and that are aimed at ensuring fiscal responsibility and accountability at the county level without intrusion from the national government (internal systemic controls); those control mechanisms that, while external to the county level, emanate from somewhat neutral or evenly placed sources (supportive controls) and, lastly, those mechanisms that emanate from the national government, which typically involve the national government exerting itself in the county sphere of government (external fiscal controls). The interests of subnational fiscal autonomy would require that each of these controls are applied sequentially, with the involvement of the national government coming last, as a necessary measure, in cases where the other mechanisms have been unable to secure accountability.

The chapter starts by discussing the constitutional basis for fiscal controls and the extent to which it guides, permits and/or limits any statutory regulation of the exercise of fiscal autonomy by counties before getting into the discussion around each of the classifications above. The chapter's objective is to assess whether Kenya's legal framework makes provision for sufficient fiscal controls such as would ensure accountability in the exercise of fiscal autonomy by county governments, while at the same time providing sufficient checks in the implementation of these controls so as to prevent the negation of the constitutional provision for the fiscal autonomy of counties. The chapter also seeks to assess whether such controls have been utilised effectively to secure the accountable exercise of fiscal autonomy by counties. The effectiveness of their use will be measured by the extent to which they have been utilised to produce positive outcomes for accountability.

1 The constitutional basis for fiscal control measures

While the Constitution recognises the distinctiveness of the county level of government and requires that both levels of government respect each other's functional and institutional integrity,[1] it does not envisage unfettered fiscal autonomy for county governments. It therefore: delineates the specific objects in pursuit of which a county's fiscal autonomy should be directed; outlines general principles that should guide public finance and service delivery at the county level; substantively regulates the exercise of aspects of county government functions and powers; and sanctions the enactment of national legislation to regulate various aspects of county functions and powers relating to their exercise of fiscal autonomy. The totality of these measures creates the system of fiscal controls that work to secure uniformity in the exercise of fiscal autonomy and, most importantly, the accountable exercise of fiscal autonomy by county governments.

[1] Constitution of Kenya, 2010, art 6(2) as read with art 189(1)(*a*).

1.1 The Constitution's objects of devolution serve as a check on county fiscal autonomy

Subnational fiscal autonomy is not an end in itself. It is only imperative to the extent that it serves to achieve specific objectives. Chapter two of this study highlighted the general objectives sought to be achieved by the granting of autonomy to subnational governments.[2] These were referred to as the objects of autonomy and include ensuring efficiency in subnational development, securing the accommodation of minorities and marginalised groups, enhancing checks and balances, and promoting democracy and accountability. The chapter also demonstrated the direct link between subnational fiscal autonomy and the attainment of these objects, arguing that the exercise of subnational fiscal autonomy, therefore, requires accountability towards the attainment of these objects. Where subnational fiscal autonomy fails to deliver on these objects, its limitation may therefore be justifiable to such extent as may be provided for under the law. Based largely on these general objects of autonomy, the Kenyan Constitution specifically details the objects which its system of devolution seeks to achieve. These are set out under its article 174 and seek:

- i to promote democratic and accountable exercise of power;
- ii to give powers of self-governance to the people and enhance the participation of the people in the exercise of the powers of the State, and in making decisions affecting them;
- iii to recognise the right of communities to manage their own affairs and to further their development;
- iv to promote social and economic development and the provision of proximate, easily accessible services throughout Kenya;
- v to ensure equitable sharing of national and local resources throughout Kenya; and
- vi to enhance checks and balances and the separation of powers.

While these objects generally provide justification for the adoption of devolution in Kenya (in light of Kenya's history), they, more importantly, 'identify the ultimate ends in pursuit of which power should be deployed', thereby serving as parameters that guide and constrain the

[2] See section 3 of chapter 2.

exercise of devolved power at the county level[3] as well as the development and implementation of legislation and policy at both levels of government.[4] Hence, any exercise of fiscal autonomy by county governments that does not align with these objects may be substantively restricted, and any legislation or policy (at either level) that constrains the attainment of these objects may be rendered unconstitutional. For instance, the High Court in *International Legal Consultancy Group v Senate and Clerk of the Senate*[5] rejected the argument that, since county governors are legally not accounting officers at the county level, they cannot be summoned by the Senate to answer questions relating to county expenditure, arguing that such a holding would defeat the objects of devolution that require accountability and checks and balances in the exercise of power.[6] Thus, the Constitution's objects of devolution, in this case and generally, serve to secure the functional and financial accountability of county governments in their exercise of fiscal autonomy.

1.2 Constitutional principles establish a value system that guides the exercise of county fiscal autonomy

The various principles outlined under the Constitution constitute an objective normative value system that guides the exercise of county fiscal autonomy.[7] These principles, among other things, are important in speaking to the spirit of the Constitution where specific matters are not expressly regulated in the letter of the Constitution and the law. The principles include the national values and principles of governance, the values and principles of public service, as well as the principles of public finance. The national values and principles of governance, to begin with, are articulated under article 4(2) as read with article 10 of the Constitution and, among other things, require the participation of the people as well as transparency and

[3] See also, art 73(1) (*a*) (i) of the 2010 Constitution that constrains State Officers to ensure that the exercise of the authority assigned to them is consistent with the purposes and objects of the Constitution.
[4] Mutakha JK *An Interpretation of the Constitutional Framework for Devolution in Kenya: A Comparative Approach* (LLD thesis, University of the Western Cape, 2014) 136.
[5] *International Legal Consultancy Group v Senate and Clerk of the Senate* [2014] eKLR.
[6] *International Legal Consultancy Group v Senate and Clerk of the Senate* paras 60 & 61.
[7] *Wycliffe Ambetsa Oparanya & 3 others v Director of Public Prosecutions & another [2017] eKLR*, para 158-162

accountability in governance.[8] The values and principles of public service, for their part, include: efficient, effective and economic use of resources; involvement of the people in the process of policy making; accountability for administrative acts as well as transparency and the provision of timely and accurate information to the public.[9] Lastly, the principles required to guide all aspects of public finance include: openness and accountability, including public participation in financial matters; prudent and responsible use of public money; responsible financial management; and clear fiscal reporting.[10]

These principles emphasise public participation, transparency, fiscal prudence and responsibility, as well as accountability in relation to the exercise of fiscal autonomy and are hence critical in guiding and ensuring financial accountability at the county level. They may also be used as justification for the limitation of the fiscal autonomy of county governments where its exercise violates them. For instance, in addition to making reference to the general objects of devolution, the Court in the *International Legal Consultancy Group* case above based its reasoning on article 10(2), which lists transparency and accountability as a national value and principle of governance, to justify the power of the Senate to summon county governors to respond to financial management queries raised by the Controller of Budget (CoB), even though the Constitution and legislation do not expressly provide for this.[11]

1.3 The Constitution itself substantively regulates the exercise of fiscal autonomy by counties

In addition to the above, the Constitution contains a series of substantive provisions regulating various aspects of county government finances and financial management. With respect to financial management by counties, the Constitution: details the basic form and

[8] Constitution (2010), art 10(2)(*a*) & (c).
[9] Constitution (2010), art 232(1) (b), (d), (e) & (f) as read with (2)(a).
[10] Constitution (2010), art 201(a), (d) & (e).
[11] *International Legal Consultancy Group v Senate and Clerk of the Senate*, para 59-60; See also, Bosire CM 'Interpreting the power of the Kenyan Senate to oversee national revenue allocated to the county governments: Building a constitutionally tenable approach' (2017) 1 *AJCCL* 35-66.

content of county budgets;[12] requires all money raised or received by or on behalf of a county government to be paid into the County Revenue Fund (CRF);[13] requires prior approval of the Controller of Budget (CoB) for any withdrawal of money from the CRF;[14] regulates the issuance of waivers by counties on any county taxes or fees; and, among other things, prohibits the passing of any law excluding or authorising the exclusion of a State officer from the payment of tax by reason of their office or nature of work.[15] The Constitution also imposes personal liability on holders of public office who direct or approve the use of public funds contrary to the law or instructions.[16] These provisions provide a basis for the regulation of county financial management and the facilitation of accountability at the county level.

Additionally, various constitutional provisions provide a critical source of internal controls at the county level that work to facilitate the accountability of county governments. In this regard, the Constitution confers supervisory jurisdiction, at the county level, on the County Assembly (CA) and: grants the CA power to exercise oversight over the County Executive Committee (CEC) and other county executive organs;[17] obligates the CEC to provide the CA with full and regular reports on matters relating to the county;[18] and grants the CA powers to summon witnesses for purposes of giving evidence or providing it with any information relevant for the CA's mandate.[19] The Constitution also details grounds upon which a county's governor may be removed from office.[20] These provisions, therefore, constitute the basis of a county government's internal fiscal controls as a way of checking the exercise of county fiscal autonomy to facilitate accountability.

[12] Constitution (2010), art 220(1).
[13] Constitution (2010), art 207(1).
[14] Constitution (2010), art 207(3).
[15] Constitution (2010), art 210(1) – (3).
[16] Constitution (2010), art 226(5).
[17] Constitution (2010), art 185(3) & 226(2).
[18] Constitution (2010), art 183(3).
[19] Constitution (2010), art 195(1) & (2).
[20] Constitution (2010), art 181(1)(*a*) & (*c*).

Moreover, the Constitution confers monitoring and oversight mandates on various independent institutions at the national level in relation to the day-to-day exercise of county fiscal autonomy. In this respect, the Constitution establishes independent commissions and offices with various powers including a general mandate to conduct investigations.[21] In particular, the Constitution establishes the Commission on Revenue Allocation (CRA),[22] the office of the Controller of Budget (CoB),[23] and the office of the Auditor-General (AG).[24] The creation of these institutions, and the designation of their mandates in overseeing financial management by county governments, constitutes a substantive regulation of the fiscal autonomy of county governments with the objective of securing their accountability. Their specific mandates are discussed in detail under supportive controls below.

The Constitution also allows for national supervision and intervention in county governments. In this regard, it confers on the Senate oversight powers over national revenue allocated to the counties, which allows it (limited) supervisory jurisdiction over the expenditure of intergovernmental transfers.[25] The Constitution, also, allows for intervention in instances where a county government is unable to perform its functions or where it does not operate a financial management system that complies with the expenditure control measures prescribed under national legislation, or where a county is in serious or persistent material breach of the expenditure control measures.[26] In exceptional circumstances, the Constitution gives power to the President to suspend a county government.[27] Although limiting on the fiscal autonomy of counties, such limitation is warranted and critical in securing financial accountability in instances where other fiscal control measures have been ineffective, as well as in ensuring the national government retains a measure of control over devolution.

[21] Constitution (2010), art 248 & 252.
[22] Constitution (2010), art 216(2) as read with (3)(c).
[23] Constitution (2010), art 228(1)(4), (5) & (6).
[24] Constitution (2010), art 226(3).
[25] Constitution (2010), art 96(3).
[26] Constitution (2010), art 190(3) as read with art 225(3).
[27] Constitution (2010), art 192.

1.4 The Constitution sanctions extensive legislative regulation of county fiscal autonomy

In addition to, and in spite of, some of the substantive constitutional provisions above, the Constitution allows for the regulation of most of the aspects highlighted above, under national legislation. Some of the enabling constitutional provisions are generously worded and extend wide powers to the national government to closely regulate almost every aspect of a county government's exercise of autonomy over its financial management. For instance, the Constitution mandates the enactment of national legislation: to make provision for *all matters necessary or convenient* to give effect to its Chapter 11 (on devolved government);[28] to *give full effect* to the values and principles of public service;[29] to ensure both expenditure control and transparency in all governments and for the establishment of mechanisms for ensuring their implementation;[30] for the keeping of financial records and the auditing of counties as well as the prescription of *other measures* for securing efficient and transparent fiscal management;[31] and also for prescribing requirements that should be met by a county government's financial management system.[32] While these provisions are targeted at ensuring uniformity in financial management as well as fiscal control, the fact that they are expressed in broad terms poses the risk of over-regulation of the exercise of fiscal autonomy by county governments, which can in turn be a barrier to their effective exercise of fiscal autonomy.

In addition to the broad and general provisions above, the Constitution allows national legislation to regulate specific aspects of county finances, including: which county funds may be excluded from being paid into the CRF, including which other funds(besides the CRF) may be established by counties, and how they will be managed;[33] what money/expenditure may be withdrawn from a county's CRF either as a charge against the fund or otherwise;[34] the

[28] Constitution (2010), art 200(1).
[29] Constitution (2010), art 232(3).
[30] Constitution (2010), art 225(2).
[31] Constitution (2010), art 226(1)(*a*).
[32] Constitution (2010), art 190(2).
[33] Constitution (2010), art 207(1) as read with (4)(*b*).
[34] Constitution (2010), art 207(2)(*a*) as read with (4)(*a*).

procedure of county assemblies and executive committees including the chairing and frequency of meetings, quorums and voting;[35] the structure, timing, procedure as well as the manner of intergovernmental consultations relating to county developmental plans and budgets;[36] as well as providing a framework for the implementation of county procurement and asset disposal policies.[37] Some of these aspects, such as the regulation of the CRF and other county funds, as well as the basic form and content of a county budget, relate to matters that are partly substantively regulated under the Constitution, thus giving national legislation sanction to extend the scope of their regulation.

Given the scope extended to national legislation to regulate the fiscal autonomy of counties, a key concern is whether the nature of the constitutional sanctioning is so broad as to bring every aspect of county fiscal autonomy within the regulatory powers of the national government, which then poses the risk of effectively limiting the scope of fiscal autonomy extended to counties by the same Constitution. This is especially the case given the fact that the sanctioning of regulation of county fiscal autonomy under national legislation translates to the sanctioning of Parliament's power to mandate the formulation of further regulations by the executive under the various pieces of legislation, a factor which poses the risk of over-regulation. From the discussion above, however, the conclusion drawn is that there is little to no rigidity provided by the Constitution to the legislative regulation of the exercise of county fiscal autonomy. This means that national legislation has wide room for manoeuvre and may regulate almost everything relating to county finances and financial management. This makes almost impossible the declaration of unconstitutionality of any law or national conduct fashioned as being targeted at ensuring the accountability of county governments unless such is completely at odds with other constitutional principles of devolution.

[35] Constitution (2010), art 200(2)(*d*).
[36] Constitution (2010), art 220(2) as read with art 224.
[37] Constitution (2010), art 227(2). The 2010 Constitution's art 227(1) generally requires the procurement of goods and services to be done based on a system that is fair, equitable, transparent, competitive and cost-effective.

Based on the above constitutional mandate, Parliament has enacted various pieces of legislation aimed at securing fiscal control and the accountability of county governments in their exercise of fiscal autonomy. These include the County Governments Act (CGA), the Public Finance Management Act (PFMA) (including its regulations), the Intergovernmental Relations Act (IRA), the Public Audit Act, the Controller of Budget Act as well as the Commission on Revenue Allocation Act. Under these Acts, a system of fiscal controls has been created situated at both the county level, as well as at the national level, as discussed below.

2 Internal systemic controls

Internal systemic controls refer to the system of controls which are built into the intergovernmental fiscal system with the aim of allowing counties room to secure their own fiscal responsibility and accountability without intrusion from the national sphere of government. This section discusses two internal systemic control mechanisms: self-regulation and accountability to the county assembly and the mechanism of public participation. These are discussed separately below.

2.1 Executive-level self-regulation and county assembly oversight facilitate accountability

Similar to South African municipalities, Kenyan counties bear the primary responsibility for foreseeing, identifying, avoiding and resolving their financial problems as part of their obligation to ensure adherence to the national values and principles of public finance laid out in the Constitution as well as the fiscal responsibility principles outlined in the PFMA and its regulations.[38] To facilitate this, the legal framework makes provision for county executive-level self-regulation while at the same time providing for county-level oversight by the county assembly.

[38] Public Finance Management Act (PFMA) No 18 of 2012, s 92(1) as read with s 102(1); Refer to section 2.2.4.1.3 of chapter 3 above.

2.1.1 Executive-level self-regulation mechanisms enhance accountability

While the county executive committee (CEC) is charged with overall implementation of county legislation, it also bears the mandate of supervising the administration and delivery of services within the county.[39] In the performance of its functions, the CEC's powers over the creation and management of staff and institutional structures are useful in putting in place a system of self-regulation that facilitates accountability. In this respect, the CEC member for finance (CECMF) is empowered to designate accounting officers for each county government entity.[40] They are then charged with ensuring that the entity's expenditure is lawful and authorised as well as being effective, efficient, economical and transparent.[41] The role accounting officers play in submitting the entity's quarterly reports to the county treasury[42] and annual financial statements to the AG, as well as their obligation to try and resolve any issues identified in audits by the AG,[43] is critical in securing the continued accountability of county governments.

The County Treasury also plays an important role in the self-regulation and accountability of the county government by ensuring legislative compliance in county expenditure and financial management, as well as in identifying areas that need support and capacity building. Generally, the County Treasury is charged with monitoring, evaluation and oversight of the management of a county's public finances, including ensuring the proper management and accountability for the county's finances.[44] In this respect, the county treasury is in charge of ensuring that the management of county finances complies with thresholds and requirements outlined under the PFMA's fiscal responsibility principles (FRPs).[45] These include the principles requiring: the balancing of recurrent expenditure with total county revenue; the utilisation of

[39] Constitution, art 183(1) as read with the County Governments Act (CGA) No 17 of 2012, s 36(1)(*a*).
[40] PFMA, s 148(1); s 2 of the PFMA defines a 'county government entity' as any department or agency of a county government, and any authority or other entity declared as being a county government entity.
[41] PFMA, s 149(2).
[42] PFMA, s 166.
[43] PFMA, s 149(2)(*k*) & (*l*).
[44] PFMA, s 104 (1).
[45] PFMA, s 107(1) & (2).

at least 30 per cent of the county budget for capital spending; the capping of expenditure on wages and benefits at 35 per cent of a county's total revenue as well as those imposing restrictions on the use and proportion of the county's short term borrowing, inter alia.[46]

Although most counties are reported to be struggling with meeting the FRP thresholds,[47] having variously exceeded the expenditure thresholds for personnel emoluments (44.2% in 2020/21) and underspent on development (29.2% in 2020/21),[48] they substantially comply with FRPs[49] in their budgeting, with various factors hindering their realisation in practice. While some of these factors, such as shortfalls in OSR realised are internal to counties, most of them, such as delays in disbursements in the equitable share, the burden of the large numbers of inherited staff that are on permanent and pensionable terms, as well as the multi-year nature of the implementation of capital projects which informs low development spending absorption rates, are external to the county level and hence largely beyond their control.[50] These factors have informed arguments as to the impracticality of the thresholds. For instance, the 35 per cent threshold imposed on personnel expenditure has been criticised by county officials as being a random cap that was imposed without a careful consideration of the variables that dictate annual county spending on personnel.[51] These include factors such as pre-existing collective bargaining agreements as well as mandatory annual statutory requirements relating to staff promotions and salary increments, that result in faster growth in the wage bill relative to any natural attrition which is expected to lower or keep the wage bill balanced at or below 35 per cent.[52] Despite these shortcomings of the FRP thresholds,

[46] PFMA, s 107(2) & (3) as read with the PFM (County Governments) Regulations, 2015, reg 25(1)(*b*).
[47] World Bank *Kenya Public Expenditure Review 2020: Options for Fiscal Consolidation after the COVID-19 Crisis* (2020) 38.
[48] Office of the Controller of Budget (CoB) *County Governments Budget Implementation Review Report for the FY 2020/21* (2021) 451.
[49] Muwonge A *et al Making Devolution Work for Service Delivery in Kenya* (2021) 80.
[50] CoB (2021) 451 Interview with the Director of Revenue Management of Uasin Gishu County held in Eldoret on 16 March 2021; World Bank (2020) 38.
[51] Interview with the County Executive Member for Finance (together with chief officers and directors from the Finance Department), County Government of Makueni, held in Nairobi on 18 March 2021.
[52] Interview with the County Executive Member for Finance (together with chief officers and directors from the Finance Department), County Government of Makueni, held in Nairobi on 18 March 2021.

they are useful in ensuring balanced county expenditure/growth as well as ensuring accountability for expenditure on matters such as salaries and allowances at the county level.

Additionally, the requirement for county government entities to have internal audit units as well as audit committees[53] serves to ensure both functional and financial accountability on the part of county governments. The audit unit plays the important role of reviewing and evaluating the entity's budgetary performance, financial management, transparency and accountability mechanisms and processes, with a view to strengthening the entity's internal control mechanisms.[54] Based on the findings and recommendations of the audit unit, each county government entity's accounting officer is then obligated to make compliance adjustments in respect of their entities.[55] To ensure that these recommendations are implemented, an audit committee is tasked with following up on the implementation of the audit recommendations.[56] The importance of this system of internal audit is enhanced by the granting of operational independence to the county's Head of the Internal Audit Unit, a factor that gives room for objectivity in the internal audit process.[57]

Despite the important role the system of internal audit serves in strengthening county-level internal control mechanisms aimed at securing the financial accountability of counties, there have been reports over the years concerning: delays in the establishment of either or both internal audit units and audit committees; established audit units and audit committees that are either inoperative or ineffective in their operations[58] as well as inaction/failure in implementing recommendations in audit reports attributable to a failure in follow-up mechanisms at the county-level.[59] This, in addition to the high number of qualified, adverse

[53] PFMA, s 155(1) & (5) as read with s 167 of the PFMA (County Governments) Regulations, 2015.
[54] PFMA, s 155 as read with the PFMA (County Governments) Regulations, 2015, s 153.
[55] PFMA (County Governments) Regulations, 2015, s 165.
[56] PFMA (County Governments) Regulations, 2015, s 168(*b*).
[57] PFMA (County Governments) Regulations, 2015, s 155(1).
[58] Office of the Controller of Budget *End of Term Report 2011-2019* (2019) 69; Office of the Controller of Budget *County Governments Annual Budget Implementation Review Report - FY 2018/19* (2019) 313; Office of the Controller of Budget *Annual County Governments Budget Implementation Review Report - FY 2017/18* (2018) 312.
[59] Transparency International *Kenya Strengthening Public Audit Accountability in Kenya: A Baseline Survey Report* (2019) vi & 9.

and disclaimer opinions issued to counties by the AG (discussed below), point to either weaknesses and ineffectiveness of county internal audit units or a general disregard by the counties of reports issued by the units.

In addition to the roles played by the county treasury and internal audit units, the CEC has a mechanism of disciplinary control that serves to ensure the accountability of both members of the CEC as well as the county administration. For instance, the individual and collective accountability of CEC members to the governor for the performance of their duties[60] grants the county governor the power to remove any one of them from office on, among other grounds, incompetence, abuse of office, gross misconduct as well as gross violation of the Constitution or any law.[61] In addition, the CECMF exercises disciplinary control over accounting officers who, in turn, have disciplinary control over a county government entity's public officers in instances where they are reasonably believed to have engaged in improper conduct.[62] Such conduct includes cases where the officers contravene or fail to comply with provisions of the PFMA or its regulations or undermine financial management procedures or controls or where they make or permit unlawful or unauthorised expenditure.[63] Despite the potential held by the mechanism of disciplinary control to facilitate accountability in a county's executive and administration structures, its overall contribution to county-level accountability in practice has so far not been aggregated in literature.

Lastly, the power of the county treasury to intervene in county government entities by taking appropriate measures, including the stoppage of funds, in order to deal with any failure by a county government entity to comply with provisions of the PFMA,[64] provides room for the enforcement of accountability among county entities. It is, however, not clear whether any county treasuries have been able to exercise this power in practice.

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[60] CGA, s 39(1).
[61] CGA, s 40(1).
[62] PFMA, s 156 (1) & (2).
[63] PFMA, s 156(4).
[64] PFMA, s 105 (1)(*b*).

2.1.2 **The oversight mandate of county assemblies facilitates accountability**

Although there is an ongoing contestation between the Senate and County Governors (currently awaiting the Supreme Court's decision on appeal)[65] with respect to the scope of a county assembly's oversight mandate over national revenue (89% of annual county revenue), the supervisory powers bestowed on county assemblies are critical in securing the continued functional and financial accountability of the CEC. In this regard, the Constitution's emphasis on regard for the separation of powers in the county assembly's exercise of its oversight mandate over the CEC[66] ensures the objectivity of the county assembly in the performance of its functions. To facilitate this, members of a county assembly (MCAs) are prohibited from being directly or indirectly involved in the undertaking of any executive functions.[67] Similarly, the PFMA separates the role of preparing and submitting a county assembly's budget estimates and that of accounting for the county assembly's expenditure from the general budgeting and accounting mandate of the county executive, by bestowing these functions on the Clerk to the county assembly.[68]

Although this separation of powers facilitates the independence of the county assembly in its oversight mandate, there have been reports of attempts by the CEC to manipulate this independence by delaying and sometimes declining to approve the withdrawal of funds meant for county assembly expenditure, leading to calls by county assemblies for the separation of the mandate from the county executive as well.[69] Notwithstanding this, the supervisory role of county assemblies provides an important source of county-level checks and balances and, as seen below in relation to impeachments, has served to ensure the accountability of county executives.

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[65] *Council of Governors v Senate, Constitutional Petition No E437 of 2021* para 15 & 55.
[66] Constitution (2010), art 185(3).
[67] CGA, s 9(2).
[68] PFMA, s 129(1)(*a*) as read with ss 129(3) & 148(4).
[69] Ojamaa B 'Senate summons Governor Wangamati over assembly funds tiff' *The Nation,* 14 June 2021.

Besides the county assembly's general mandate to consider and approve county budgetary estimates including any supplementary estimates presented by the county executive,[70] the county assembly's entitlement to receive periodical reports from the CEC when coupled with its powers to receive petitions from the public[71] and to summon witnesses, including CEC members, for purposes of providing information, as well as the power to enforce their attendance and to compel the production of documents[72] is crucial in securing the accountability of the county government. The CEC is under a general obligation to provide the county assembly with full and regular reports relating to county matters as part of its mandate to manage and coordinate county functions.[73] In particular, the county governor is under an obligation to submit annual reports to the CA, including reports on the implementation status of county policies and plans, as well as annual performance reports of the CEC and the county public service.[74] These enable the county assembly to exercise oversight over a county's performance of its functions, thereby facilitating functional accountability. The county treasury's obligation to submit regular reports to the assembly on the implementation of the annual county budget,[75] as well as periodical reports on all loans made to the county,[76] facilitates the monitoring and checking of the exercise of both expenditure and budgetary autonomy by the counties. Additionally, the requirement for county receivers of revenue to submit to the county assembly, at the end of each financial year, a copy of a report on revenue collected, received or recovered, including disbursements, arrears as well as a report on all waivers and variations of taxes, fees or charges granted,[77] gives county assemblies an opportunity to monitor and provide checks on the county's exercise of autonomy over own revenue administration.

[70] PFMA, s 131 as read with s 135.
[71] CGA, s 15.
[72] Constitution (2010), art 195 as read with CGA, s 39(2).
[73] Constitution (2010), art 183(3).
[74] CGA, s 30(2)(*f*) as read with s 47(3).
[75] PFMA, s 104(1)(q) as read with s 108(3).
[76] PFMA, s 122 (1) & (5) as read with s 194(1).
[77] PFMA, s 165.

However, despite county assemblies having the power to receive all the above reports, including receiving audit reports from the AG which highlight financial management issues,[78] the majority of counties still receive recurrent qualified, adverse and disclaimer opinions in the annual reports from the AG (see details in the discussion below on supportive controls). All the issues annually raised in the reports, especially those highlighted by the AG as having remained unaddressed from prior years, cast doubts on the effectiveness of the county assemblies' oversight role in securing accountable fiscal autonomy at the county level.

However, the powers granted to county assemblies to initiate the removal of members of the CEC, including the county governor, have shown a little more success in their exercise.[79] In this regard, the Constitution allows for the removal of a county governor from office on, among other grounds, gross violation of the Constitution or any other law or in instances of abuse of office or gross misconduct.[80] While members of county assemblies (MCAs) are empowered to move a motion and pass a resolution for the removal of a governor, their power in this regard is not final given the Senate's role in reviewing this decision, undertaking its own investigations and having a final say on whether the governor stands impeached/removed from office or not.[81] Notwithstanding the Senate's powers of review, the power MCAs hold to initiate the process of removal of members of the CEC on any of the above grounds is crucial in securing both the functional and financial accountability of the county government. However, there are cases where MCAs have used this power of removal to settle scores against governors for failing to approve expenditure conferring personal benefits to the MCAs. A case reported earlier in the implementation of devolution was that of Makueni County, where the MCAs attempted to impeach the governor for failing to approve expenditure to fund their foreign trips and allowances, as well as salaries which went beyond

[78] Constitution (2010), art 229(7) & (8).
[79] CGA, s 40 (1), (2) & (6).
[80] Constitution (2010), art 181(1).
[81] CGA, s 33.

regulatory thresholds.[82]This was, however, defeated following a petition filed by the residents to suspend the county government.[83]

Nonetheless, over the years MCAs have successfully impeached at least four governors whose removal has been confirmed by the Senate. This is despite the courts having overturned the impeachment of one of the governors (twice), while the impeachment of yet another was halted, thus leaving only two who have been fully removed from office at the instance of the county assemblies acting in their oversight capacity. This involved governors from the counties of Embu, Kiambu, Nairobi and Wajir. While the removal of the Embu governor on charges related to abuse of office, based on the failure by the Governor to act on a procurement impropriety, was among the first impeachment cases to be confirmed by the Senate, the impeachment was reversed twice by both the High Court and the Court of Appeal. This was due to a failure by the county assembly to obey a court order halting the removal proceedings and to accord the governor a chance to be heard prior to the impeachment, in the first case.[84]

The second was reversed for, among other reasons: failing to provide room for public participation in the impeachment process; the appearance of bias in the constitution of the relevant Senate Committee; and the lack of a nexus between the Governor and the alleged violation.[85] The removal of the governor for Wajir County for abuse of office,[86] was also halted, despite having been confirmed by the Senate, because it had been conducted in violation of the High Court's orders barring deliberations on the impeachment pending the

[82] 'Petition for the Suspension of the County Government of Makueni' (2019) available at http://kenyalaw.org/kenyalawblog/suspension-of-the-government-of-makueni/ (accessed 7 November 2021).
[83] Muasya P 'How Kibwana Spanked Makueni's Rebel MCAs' *The Standard,* 2017.
[84] *Martin Nyaga Wambora & 4 others v Speaker of the Senate & 6 others* [2014] eKLR, para 314 & 316; *Martin Nyaga Wambora & 3 others v Speaker of the Senate & 6 others* [2014] eKLR, para 62.
[85] *Martin Nyaga Wambora & 30 others v County Assembly of Embu & 4 others* [2015] eKLR paras 215, 258-260 & 262; *Martin Nyaga Wambora v County Assembly of Embu & 37 others* [2015] eKLR, paras 39-40, 46 & 58.
[86] See, The Senate *The Report of the Special Committee on the Proposed Removal from Office, by Impeachment, of Honourable Mohamed Abdi Mohamud, the Governor of Wajir County* (2021) 137.

determination of a petition that had been filed by the governor.[87] However, the governors for Kiambu and Nairobi Counties were successfully removed from office in January 2020 and December 2020, respectively, for, among other grounds, the violation of the Constitution and the PFMA, as well as on abuse of office charges related to financial impropriety and procurement irregularities.[88] Despite the challenges related to procedure and disobedience of court orders, the power held by MCAs to impeach governors has been effective in securing the accountability of governors hence the overall accountability of county governments.

2.2 The obligation to ensure public participation facilitates horizontal accountability

The requirement for devolution to enhance the participation of the people[89] in subnational decision-making and in the exercise of devolved powers at the county level serves to emphasise the Constitution's objective of promoting democracy and the democratic accountability of county governments.[90] Public participation's facilitation of the horizontal accountability of county governments therefore ensures that the exercise of powers at the county level is directed towards the delivery of specified services and the pursuit of the constitutionally set objectives. As highlighted above, in addition to its being a core object of devolution, the requirement for public participation in policy-making also constitutes a core part of the Constitution's 'national values and principles of governance', as well as the 'values

[87] *Aden Ibrahim Mohammed & 5 others v County Assembly of Wajir & 5 others; Governor of Wajir County Mohammed Abdi Mohammud & 4 others (Interested parties)* [2021] eKLR paras 6 & 16; See also, Wanyoro C 'Court stops replacement of impeached Wajir governor Mohamed Abdi' *The Nation* 18 May 2021. The Deputy was nonetheless sworn in despite the court orders.
[88] Gazette Notice No. 672 of 2020 & Gazette Notice No. 10904 of 2020. See also, Standard Digital Team 'Guilty: Senate upholds Governor Waititu's impeachment' *The Standard* 29 January 2020.
[89] Section 1 of the CGA defines 'the public' in a manner analogous to the definition of 'local community' under section 1 of South Africa's Municipal Systems Act to mean: residents and ratepayers of a particular county or resident civic organisation or NGO, private sector or labour organisation with an interest in the governance of the county as well as a non-resident person who because of their temporary presence in a particular county makes use of services or facilities provided therein. The CGA, however, proceeds to use 'citizen participation' in its provisions even though its definition is not provided.
[90] Constitution, art 174 (*c*) & (*a*).

and principles of public service', which are binding on county governments.[91] This makes its implementation a central constitutional imperative.

However, while the Constitution expressly requires the county assembly to facilitate public participation in the legislative and other business of the assembly and its committees and prohibits the exclusion of the public unless in justifiably exceptional cases,[92] it fails to impose a similar explicit obligation on the county executive committee (CEC). Nonetheless, national legislation steps in to require the county governor to promote and facilitate participation in the development of policies and plans, as well as in the delivery of services in the county (arguably based on the general constitutional provisions above) and to submit an annual report to the county assembly on the participation of the people in the county's affairs.[93] Flowing from this, various offices constituting decentralised administrative structures at the county level are charged with facilitating and coordinating participation in the development of policies and plans and in the delivery of services.[94] These include the offices of the sub-county administrator, the ward administrator as well as the village administrator. To facilitate public participation, counties are required to utilise various modalities and platforms including: ICT-based platforms; town hall meetings; budget preparation and validation fora; notice boards; development project sites as well as establishing citizen fora both at the county level as well as at the level of decentralised units.[95] The variety in these modalities allows counties sufficient flexibility in ensuring the involvement of the public in the affairs of the county and in facilitating democratic accountability.

The various rights granted to the public, as well as the corresponding obligations on the county government arising out of these rights, work to enhance and secure the participation of the people in county affairs. For instance, the legislative requirement for counties to facilitate timely access to information on, as well as reasonable access to, the processes of

[91] Constitution (2010), art 4(2) as read with art 10(2)(*a*) and art 232(1)(*d*).
[92] Constitution (2010), art 196(1)(*b*) as read with art 196 (2).
[93] CGA s 30(3)(*g*) as read with s 115(1) & s 92(2).
[94] CGA, s 50(3)(*g*); s 51(3)(*g*) & s 52(3)(*a*)(*i*).
[95] CGA, s 91.

policy formulation and implementation including the approval of development projects and the establishment of performance standards,[96] translates to a justiciable and enforceable right on the part of the public. Furthermore, the granting of legal standing to all interested or affected persons, organisations and communities to appeal against or review county decisions, or to have their grievances redressed,[97] as well as their having the right to petition the county government including the county assembly on any matter, with the county government bearing the obligation to respond expeditiously to these petitions,[98] serves to ensure that any failure on the part of the county government to involve and take into account the views of the public can be enforced. This further secures democratic accountability at the county level.

Additionally, the obligation on the county executive to involve the public in the county budget process[99] serves to ensure a county's financial accountability to the people. To facilitate this, counties are required to publish and publicise county budget documents in a form which is clear, easily understood and accessible to members of the public.[100] Importantly, county governments are required to establish a County Budget and Economic Forum (CBEF), consisting of both county officials and representatives of various organisations and interest groups at the county level, to serve as a forum for consultation on the county budget.[101] While the CBEF serves as a consultative forum in the county budget process from budget formulation to audit and evaluation,[102] it also works as a coordinating body that helps county governments engage with the larger community on county budgetary and economic matters.[103] The CBEF therefore takes part in: the identification of spending priorities during the formulation of the Annual Development Plan; the development of the annual County

[96] CGA, s 87(*a*) & (*b*).
[97] CGA, s 87(*d*).
[98] CGA, s 88(1) as read with s 15(1) & s 89.
[99] PFMA, s 125(2) as read with s 128 (2) &(3(*d*).
[100] PFMA, s 129(6) as read with s 131(5) & (6).
[101] PFMA, s 137(1)(*c*) as read with (3)
[102] The budget cycle consists of budget formulation, budget approval, budget execution/implementation and, lastly, audit and evaluation. See, Centre for Devolution Studies (CDS) *Kenya Devolution: Practical Approaches for County Governments to Facilitate Public Participation in the Planning and Budget Process* (2015) 4.
[103] Commission on Revenue Allocation (CRA) *Guidelines for the Formation and Functioning of CBEF* (2012) 1.

Fiscal Strategy Paper; the discussion of specific budgetary estimates including estimates of revenue, expenditure and deficits; the review of county quarterly budget implementation reports that highlight progress made with as well as issues encountered in implementation; the discussion of the annual end-of-year County Budget Review and Outlook Paper as well as in the discussion of annual reports including the county governor's report on public participation.[104] In addition to these, the CBEF takes part in the discussion of issues around overall county financial management.[105] In carrying out its functions, the CBEF is required to ensure that all budget-related documents are widely available to the public and that it works through organised citizen groups in the county during its consultations.[106]

Given the discretion extended to counties to enact their own public participation laws that establish institutional frameworks and structures for public participation, including the CBEF,[107] each county has tried to be innovative in its approach to participation, with counties such as Makueni County being lauded for having in place unique and more effective structures from which other counties have had to learn.[108] Although some counties have, over the years, struggled with establishing and operationalising the CBEF as well as other public participation fora,[109] this has improved over time, with the forums providing a basis for communities to track project implementation, undertake social audits and take part in the preparation of citizen report cards on service delivery,[110] all which have served to facilitate and enhance both the functional and financial accountability of county governments.

Although counties are obligated to have civic education units and to implement appropriate civic education programs aimed at building the capacity of the public to actively and

[104] CRA (2012) 2-3.
[105] CRA (2012) 3.
[106] CRA (2012) 3.
[107] CGA, s 92.
[108] World Bank *Realizing the Devolution Dividend in Kenya through Cohesive Public Finance Management and Public Participation at County Level: Challenges, Lessons Learned and Recommendations* (2017) 12-13.
[109] CoB (2019) 69; CoB (2019) 313; Office of the Controller of Budget *Annual County Governments Budget Implementation Review Report - FY 2015/16* (2016) 320. See also, World Bank (2017) 9.
[110] CDS (2015) 14; World Bank (2017) 16.

effectively participate in the governance affairs of the county,[111] a baseline survey undertaken in 2019 revealed that about 71.3 per cent of respondents had no awareness on their role in public finance management, with only 14.1 per cent specifically taking part in public audits.[112] Besides inadequate knowledge on the responsibility of the people in public audit, and the lack of proper access to audit reports being reported as the core factors hindering active public participation in county-level audit processes,[113] public participation at the county level still struggles with general inaccessibility of information that would enable effective participation, tokenism that leads to low quality engagement (including inadequate time allocation), elite capture and the hijacking of meetings for political rivalry and weak to non-existent structures for documentation and feedback to citizens that make it difficult to measure the effectiveness of public inputs.[114] Notwithstanding these challenges, in counties such as Makueni, where public participation has been effectively implemented, it has been a key contributor to the democratic accountability of the county governments.

3 Supportive control systems enhance county-level accountability

Supportive controls refer to those fiscal controls which, while being external to the county level, emanate from somewhat neutral or evenly placed sources and are aimed at supporting county internal control systems. Supportive controls are mainly provided through the mechanism of independent commissions and offices whose work assists in facilitating the accountability of county governments. Key among these are the Commission on Revenue Allocation (CRA), the Controller of Budget (CoB) and the Auditor-General (AG).[115] Being Chapter 15 Institutions, the nature of their supportive mandate is independent of any control or direction from the national government.[116] While each of them is unique in the role they play, they share in the fact that they all have the power to conduct investigations either on

[111] CGA, s 99 & s 100.
[112] Transparency International Kenya (2019) 3.
[113] Transparency International Kenya (2019) 4.
[114] World Bank (2017) 9-10.
[115] Constitution (2010), art 248(2) & (3).
[116] Constitution (2010), art 249(2)(*b*).

their own initiative or on the basis of a complaint by a member of the public.[117] As such, they are in a position to act with the objective of facilitating either the functional or financial accountability of any particular county. Each of these institutions is discussed briefly below.

3.1 The CRA's recommendations encourage fiscal responsibility in county financial management

Although the CRA's general mandate relates to revenue division, it also bears an obligation to make recommendations on matters touching on financial management by counties with a view to encouraging fiscal responsibility where this is required under the law.[118] To aid in this, counties are obligated to submit to the CRA, copies of both their quarterly and annual financial statements[119] as well as copies of accounts of revenue collection including disbursements and arrears.[120] Given the CRA's technical expertise with respect to public finance and financial management, its recommendations in this regard are therefore crucial in facilitating fiscal responsibility at the county level. In this regard, the CRA has, since 2014, had the mandate to make recommendations to the Senate regarding budgetary ceilings for county recurrent expenditure covering both the expenditures of the county executive and that of the county assembly.[121] A constitutional challenge mounted by county assemblies arguing that this CRA mandate was unconstitutional for usurping the budgeting powers of county legislatures was dismissed by the High Court, which found this exercise of power by CRA to be within its constitutional boundaries.[122] This challenge was filed after the CRA issued a circular to counties highlighting the ceilings it had recommended to the Senate and advising counties that any expenditure beyond the ceilings will negatively impact the delivery of the costed

[117] Constitution (2010), art 252(1)(*a*).
[118] Constitution (2010), art 216(2) as read with 216(3)(*c*) & 216(5).
[119] PFMA, s 163(4)(*b*) & s 109(9) as read with s 166(4)(*b*).
[120] PFMA, s 165(3)(*b*).
[121] County Allocation of Revenue Act (CARA) No 15 of 2014, s 12; See also, CARA, s 6 as read with the Fourth Schedule of the CARAs between 2014 and 2020.
[122] *Speaker, Nakuru County Assembly & 46 others v Commission on Revenue Allocation & 3 others [2015] eKLR*, paras 58 & 71.

devolved services.[123] Although the constitutionality of the Senate's powers to impose such ceilings under the CARA is in doubt,[124] such recommendations by the CRA, aimed at encouraging fiscal responsibility at the county level, constitute an important source of supportive controls for counties.

3.2 The CoB supports the prudent and lawful implementation of county budgets

The office of the Controller of Budget(CoB) plays two key roles that serve to ensure both functional and financial accountability by county governments: that of authorising the withdrawal of funds by counties from the CRF and that of reporting on county budget implementation.[125] The Constitutional requirement that the CoB oversees the implementation of county budgets by authorising withdrawals serves to secure the prudent, efficient and lawful use of county funds, by ensuring that funds withdrawn by counties are authorised under their respective approved budgets and appropriation laws and that the specific expenditures do not exceed ceilings imposed by Parliament.[126] The CoB's obligation to submit quarterly reports on the implementation of county budgets to Parliament allows the CoB to monitor, evaluate, report and make recommendations on measures that counties may take to improve budget implementation as well as accountability for the same.[127] Although there is no requirement for the CoB to submit these reports (and its recommendations) to county governments, hence their use is mainly in Parliament's oversight role, the fact that the reports are required to be published and publicised by the CoB[128] allows counties open access to them and the recommendations made thereunder. Further, the requirement for the accounting officers of county government entities to prepare and submit to the county assembly a report detailing actions taken by the entity to implement recommendations of the county assembly issued after its consideration of the CoB's reports[129] serves to ensure that the findings and

[123] *Speaker, Nakuru County Assembly & 46 others v Commission on Revenue Allocation & 3 others* 51.
[124] This was not challenged in court.
[125] Constitution (2010), art 228(4) & (6).
[126] Constitution (2010), art 228(5) as read with s 5(*a*) & (*d*) of The Controller of Budget (CoB) Act No 26 of 2016.
[127] Constitution (2010), art 228(6) as read with s 5(*b*) of the CoB Act.
[128] CoB Act, s 9(6).
[129] PFMA, s 149(3).

recommendations contained in the CoB's reports are taken seriously by counties, thereby facilitating their continued accountability.

While some counties, such as Makueni, have expressed concerns regarding the CoB's mandate over the approval of every single withdrawal of funds, arguing that this amounts to micro-management and an unnecessary process, given the number of qualified professionals counties employ to ensure proper financial management, and given the role of both the internal and external auditors in flagging financial issues, they nonetheless appreciate the CoB's utility in preventing the misuse of funds at the county level.[130]

However, an earlier attempt by the COB to utilise its powers of approving withdrawals by counties to allocate itself the superintending role of reviewing and 'approving' county budgets before their enactment, on the basis that this would prevent the withholding of approval for withdrawals for want of legality, was found by the High Court to be constitutionally and statutorily objectionable despite its good faith basis.[131] The holding was issued after the CoB attempted to enforce the budget ceilings recommended by the CRA above, by requiring counties to present their budgets for review and approval before enactment. The Court's decision, therefore, ensured that the CoB's supportive mandate was not abused to encroach on the legislative jurisdiction of county assemblies.

Despite the supportive role the CoB's reports play in enhancing the transparency and accountability of county governments, the fact that some of the general issues identified have recurred consistently over the years makes it difficult to assess whether the findings in the reports inform actual behavioural and institutional change at the county level, and if so, what the extent of this change is and whether the recurrence is an indication of a systemic problem whose solution would best lie in national legislative and policy adjustments. An example is the county expenditure on personnel emoluments which, despite being required to be below 35

[130] Interview with the County Executive Member for Finance (together with chief officers and directors from the Finance Department), County Government of Makueni, held in Nairobi on 18 March 2021.
[131] *Speaker, Nakuru County Assembly & 46 others v Commission on Revenue Allocation & 3 others*, paras 77 & 81.

per cent of the total county expenditure, has been consistently high with aggregate percentages of 40.2 per cent,[132] 41.1 per cent,[133] 49.7 per cent,[134] 43.2 per cent[135] and 44.8 per cent[136] in the five years between 2015/16 and 2019/20, respectively.[137]

The other issues include delays by counties in submitting their financial statements to the CoB, which lead to delays by the CoB in preparing and submitting its quarterly reports and a further delay in the consideration of the reports[138] as well as high levels of pending bills at the county level which are largely attributable to delays by the National Treasury in disbursing transfers from revenue raised nationally and which in turn affect the alignment of county procurement planning with cash flow.[139] These issues notwithstanding, reports from the CoB have been important in supporting systems of expenditure control both at the national (Senate) level as well as the county level (county assemblies).

3.3 The AG's reports support oversight by the Senate, county assemblies and the public

Other than the roles played by the CRA and the CoB, the AG also plays a crucial role in securing the functional and financial accountability of county governments by providing audit reports to county assemblies and Parliament, both of which have the power to utilise the reports to ensure the accountability of county governments. In this regard the Constitution requires the accounts of county governments to be audited annually by the AG, with audit reports being submitted to both Parliament and county assemblies.[140] In addition to annual audits, the

[132] CoB (2016) 320.
[133] Office of the Controller of Budget *Annual County Governments Budget Implementation Review Report - FY 2016/17 (2017)* 317.
[134] CoB (2018) 311.
[135] CoB (2019) 312.
[136] Office of the Controller of Budget *County Governments Budget Implementation Review Report - FY 2019/20* (2020) 40.
[137] See also, CoB (2019) 69.
[138] See the CoB end of year reports above for the five years between 2015/16 and 2019/20 at 320, 317, 311, 312 and 401, respectively. See also, CoB (2019) 68.
[139] See the CoB end of year reports for 2019/20 402, 2017/18 311, 2016/17 318 and 2015/16 321. See also, CoB (2019) 67.
[140] Constitution (2010), art 226(3) & art 229(4)(*a*) & (*b*).

power bestowed on the AG to undertake periodic, performance and procurement audits[141] serves to secure the financial accountability of county governments. Periodic audits are required to be proactive, preventive and deterrent to fraud and corrupt practices at the county level.[142] Performance audits are undertaken to examine the economy, efficiency and effectiveness with which public funds have been expended, and whether citizens have had value for money from implemented projects.[143] Procurement audits, for their part, are meant to examine the county public procurement and asset disposal processes to determine if they are done lawfully and effectively.[144]

These audit reports from the AG, ascertaining whether or not public funds have been applied and processes carried out lawfully and in an effective way,[145] serve as a critical accountability-enhancing tool that feeds into both the county assembly's oversight role as well as the role of the public in demanding for horizontal accountability from county governments. County assemblies are, for instance, required to consider audit reports and take appropriate action within three months of receiving them from the AG.[146] Subsequent to this, the accounting officer of the relevant audited county entity is required to submit a report detailing how the entity has addressed audit findings and recommendations from the AG, with the AG being allowed to include in subsequent audit reports how responsive county entities have been to past audit findings and recommendations.[147] This serves to ensure the continued functional and financial accountability of county governments.

The fact that county governments have incrementally improved their audit outcomes contained in the annual AG reports between 2013/14 and 2018/19[148] points to an increasing commitment by counties towards the lawful and effective application of funds, as well as the

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[141] Public Audit Act No 34 of 2015, s 34, 36 & 38.
[142] Public Audit Act, s 34.
[143] Public Audit Act, s 36 (1) & (2).
[144] Public Audit Act, s 38.
[145] Constitution (2010), art 229(6).
[146] Constitution (2010), 229(8).
[147] Public Audit Act, s 31(1)(*a*) & (3)(*b*) as read with s 53.
[148] Muwonge *et al* (2021) 75.

improvement of financial reporting. While most county audit reports issued at the start of devolution in 2013/14 were either adverse or disclaimer opinions,[149] the majority of those issued in the 2018/19 financial years are either qualified or unqualified opinions.[150] The intervening period has largely been characterised by a gradual improvement in the audit performance of counties,[151] which is in part attributable to the AG's annual audit reports and the recommendations contained therein. Therefore, despite institutional capacity gaps on the part of the AG that have led to delays of up to 12 months in the preparation and release of audit reports[152] as well as criticism of the AG's reports for being lengthy and for being unable to highlight the most urgent issues as well as those that remain unresolved,[153] the AG's reports have made an important contribution towards the improvement of financial accountability by county governments over the years.

However, the general failure by most county executives to provide effective follow up on the implementation of the recommendations emanating from the AG's reports[154] is argued to contribute towards the ineffectiveness of the external audit process in facilitating adjustments and corrections in the county PFM system,[155] and has led to proposals for the enhancement of the AG's powers to include enforcement powers,[156] as is the case in South Africa. Otherwise, all that the AG does currently is to continually highlight in the annual audit

[149] An adverse opinion is issued where the AG finds many fundamental discrepancies/misstatements in the financial statements such that they are completely wrong or misleading. A disclaimer of opinion, for its part, refers to a finding issued where there are 'so many missing documents or explanations that the AG does not have enough information to form an opinion. See, Office of the Auditor-General *Media Handbook of Reporting Audit Findings* (2016) 16.

[150] Muwonge *et al* (2021) 75. An unqualified or clean audit opinion is issued where the AG is convinced that a county's funds were managed properly and there were no issues with the county's documentation. A qualified opinion, on the other hand, is given in cases where a clean/unqualified opinion would have been issued were it not for specific discrepancies/misstatements which are deemed to be material/major although not recurring in the financial statements. See, IBP Kenya *Kenya: 10 Key Questions About Your County Audit Report* (2019) 4; Transparency International Kenya (2019) 18-19; Office of the Auditor-General (2016) 16.

[151] Muwonge *et al* (2021) 75.

[152] Transparency International Kenya (2019) vi-vii; Kenya Institute for Public Policy Research and Analysis (KIPPRA) *Towards Strengthening Public Financial Management in County Governments in Kenya* (2018) 16 & 21; IBP Kenya (2019) 3.

[153] Transparency International Kenya (2019) 9.

[154] KIPPRA (2018) 16 & 21.

[155] KIPPRA (2018) 16.

[156] Transparency International Kenya (2019) 5.

reports that county entities had not resolved audit issues identified in prior years, or had failed to explain delays in the resolution of the issues,[157] without having any real powers to enforce compliance.

4 External fiscal controls

Despite the elaborate system of fiscal controls provided through both the internal systemic controls as well as through the mechanism of supportive controls, counties have generally performed poorly in their audit outcomes, despite this performance having improved over time. Even though the audit outcomes for the 2018/2019 were the best for the counties over the years, only two county governments obtained an unqualified audit opinion, while a majority of the counties (36) still received qualified opinions (with four receiving adverse opinions while the last five got disclaimers).[158] Moreover, as highlighted above, the CoB has consistently reported cases of counties: exceeding the regulatory threshold for personnel emoluments; having consistently high pending bills;[159] failing to deposit all collected or unspent county OSR into the CRF (using OSR at source);[160] failing to establish and/or effectively operationalise internal audit units and audit committees;[161] failing to establish and/or fully operationalise the CBEFs[162] as well as having high levels of travel expenditure,

[157] Office of the Auditor-General *Report of the Auditor-General on County Executive of Mombasa for the Year Ended 30 June 2019* (2020) 5; Office of the Auditor-General *Report of the Auditor-General on County Executive of Machakos for the Year Ended 30 June 2019* (2020) 3; Office of the Auditor-General *Report of the Auditor-General on County Executive of Kirinyaga for the Year Ended 30 June 2019* (2020) 6; Office of the Auditor-General *Report of the Auditor-General on County Executive of Kiambu for the Year Ended 30 June 2019* (2020) 14; Office of the Auditor-General *Report of the Auditor-General on County Executive of Kakamega for the Year Ended 30 June 2019* (2020) 6; Office of the Auditor-General *Report of the Auditor-General on County Assembly of Nairobi City for the Year Ended 30 June 2019* (2020) 3-4; Office of the Auditor-General *Report of the Auditor-General on County Assembly of Mombasa for the Year Ended 30 June 2019* (2020) 4; Office of the Auditor-General *Report of the Auditor-General on County Assembly of Makueni for the Year Ended 30 June 2019* (2020) 3-4; Office of the Auditor-General *Report of the Auditor-General on County Assembly of Kisumu for the Year Ended 30 June 2019* (2020) 2-3; Office of the Auditor-General *Report of the Auditor-General on County Assembly of Kakamega for the Year Ended 30 June 2019* (2020) 4.
[158] Muwonge *et al* (2021) 75.
[159] See the CoB end of year reports for 2019/20 402, 2017/18 311, 2016/17 318 and 2015/16 321. See also, CoB (2019) 67.
[160] CoB (2020) 402; CoB (2018) 312.
[161] CoB (2019) 69; CoB (2019) 313; CoB (2018) 312.
[162] CoB (2019) 69; CoB (2019) 313; CoB (2016) 320; World Bank (2017) 9.

even during the period that had restrictions on movement as a result of the COVID-19 pandemic.[163] These issues have also been highlighted in the audit opinions issued by the AG.[164] All these point to there being financial management problems at the county level that have remained unaddressed by the systems of internal and supportive controls, hence necessitating the triggering of external fiscal controls. While the Constitution mandates respect for the institutional autonomy of counties, external systems of fiscal control serve as the one limitation to this obligation. This is justifiable on the basis of ensuring functional, financial and institutional accountability. It is also the one instance in which the inter-dependence of the two levels of government comes into focus.

National oversight over county governments is undertaken through regulation, monitoring, the provision of support and, where necessary, through intervention. While regulation revolves around the creation of frameworks within which counties should exercise their fiscal autonomy, monitoring evaluates whether counties are complying with the relevant frameworks, and points out instances where counties may require support to enable them to effectively exercise their fiscal autonomy while complying with laid down frameworks.[165] Intervention, for its part, involves the national government exerting itself in the county fiscal space to direct activities and influence outcomes through processes that involve the limitation of county fiscal autonomy or the full assumption of county functions.[166] All these forms of oversight serve to ensure the functional, financial and institutional accountability of county governments in their exercise of fiscal autonomy.

4.1 The Senate's oversight mandate over counties enhances their accountability

Although, as pointed out above, there is ongoing contestation between the Senate and Governors (awaiting the Supreme Court's decision on appeal),[167] relating to the extent of the

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[163] CoB (2021) 452-3.
[164] See the audit reports referred to in fn 157 above.
[165] Steytler & De Visser (2016) 15-5.
[166] Steytler & De Visser (2016) 15-5.
[167] *Council of Governors v Senate, Constitutional Petition* para 15 & 55.

Senate's oversight jurisdiction over the expenditure of national revenue received by counties, the Senate's oversight role over a substantial portion of county spending (about 89 per cent) as well as its oversight and role in the approval of impeachment resolutions by county assemblies is crucial in facilitating the accountability of county governments.

While the Senate's primary purpose is to protect the interests of counties in the national legislative process which includes the determination of the vertical allocation of revenue raised nationally,[168] it is also charged with exercising oversight over 'national revenue allocated to the county governments'.[169] However, the latter mandate has been the subject of contestation in relation to its apparent conflict with the general oversight mandate bestowed on county assemblies, by the Constitution, over the CEC and other county executive organs and/or entities.[170] As result, there have been at least three High Court decisions,[171] one Court of Appeal decision[172] and the pending Supreme Court decision, highlighted above, over the matter. Despite variations in the decisions, the following practice, distilled from the various positions taken by the courts in the decisions, has emerged by agreement between the Senate and county governors:[173]

a The Senate and county assemblies have a joint oversight mandate over nationally raised revenue that is transferred to counties.[174]

b In line with article 96(3) of the Constitution, the Senate's oversight mandate is restricted to nationally raised revenue transferred to counties and does not extend to county OSR, loans and donations (grants) raised by counties.[175] Similarly, the county assembly's oversight of nationally raised revenue at the county level is limited to

[168] Constitution (2010), art 96(1) – (3).
[169] Constitution (2010), art 96 (3).
[170] Constitution (2010), art 185(3) as read with art 226(2).
[171] *International Legal Consultancy Group v Senate & Clerk of the Senate* [2014] eKLR, *Council of Governors & 6 others v Senate* [2015] eKLR & *Wycliffe Ambetsa Oparanya & 3 others v Director of Public Prosecutions & another.*
[172] *Council of Governors & 5 others v The Senate & another* [2019] eKLR.
[173] *Council of Governors v Senate, Constitutional Petition* para 17 & 18.
[174] *International Legal Consultancy Group v Senate & Clerk of the Senate* para 62; *Wycliffe Ambetsa Oparanya & 3 others v Director of Public Prosecutions & another* para 157.
[175] *International Legal Consultancy Group v Senate & Clerk of the Senate* para 62; *Council of Governors & 6 others v Senate* para 140; *Council of Governors & 5 others v The Senate & another* 17.

expenditure by the county executive with oversight over any expenditure falling outside the CEC being a reserve of the Senate [such as expenditure by the county assembly].[176]

c Where the AG has submitted a report to a county assembly and this is being deliberated upon, the Senate should defer its oversight role until the conclusion of the oversight process at the county level after which it is free to undertake its own oversight process ('superintending oversight').[177] To facilitate this, the Senate and county assemblies need to develop a joint intergovernmental legislative framework for the exercise of oversight in line with articles 6(2) and 189(1) of the Constitution.[178]

d The Senate may summon governors to respond to audit queries as part of its superintending oversight but it should not exercise this power arbitrarily or capriciously or to advance improper political motives or in a manner that micro-manages or cripples the oversight mandate of the county assemblies.[179]

While the above practice demarcates the scope of joint oversight over county government expenditure which governs the current conduct of oversight by both the Senate and county assemblies, the decision in *Council of Governors & 6 others v Senate*,[180] which was confirmed by the Court of Appeal in *Council of Governors & 5 others v Senate*[181] as problematic in the sense that it declared oversight over nationally raised revenue at the county level a preserve of the Senate to the exclusion of county assemblies.[182] This constitutes the core issue for determination by the Supreme Court on appeal given that such a declaration would cripple the oversight mandate of the county assemblies by restricting it to overseeing only 11 per cent

[176] *Wycliffe Ambetsa Oparanya & 3 others v Director of Public Prosecutions & another* para 157.
[177] *Wycliffe Ambetsa Oparanya & 3 others v Director of Public Prosecutions & another* para 149, 150, 169 & 174(3).
[178] *Council of Governors & 5 others v The Senate & another* 21.
[179] *Wycliffe Ambetsa Oparanya & 3 others v Director of Public Prosecutions & another* para 121 & 134 as read with paras 151 & 174(2); *International Legal Consultancy Group v Senate & Clerk of the Senate* para 67.
[180] *Council of Governors & 6 others v Senate* [2015] eKLR.
[181] *Council of Governors & 5 others v Senate* [2019] eKLR.
[182] See para 124 of the High Court decision and page 17 of the Court of Appeal decision.

of county expenditure, with 89 per cent that comes from national transfers being reserved for the Senate.

Although scholars such as Bosire have argued against the Senate's oversight role in county expenditure, preferring an interpretation that restricts the Senate's role to general cross-cutting of matters that would facilitate its core mandate of protecting county interests,[183] there is merit in having the Senate exercise a superintending oversight role over county expenditure. Such oversight is key in facilitating the accountability of county governments, especially that of the county assembly itself whose oversight is not specifically provided for under the Constitution. This is in addition to arguments relating to the compromising of MCAs by governors, which impairs their impartiality.[184]

The challenge in the Senate's oversight role, however, lies in the fact that it lacks any powers to enforce any of its recommendations relating to county financial management. It is on this basis that Mutakha classifies the Senate's oversight role as 'soft supervision'.[185] In this respect, Bosire points out that the Senate lacks the tools to exercise county-level oversight and that it has struggled in crafting appropriate remedies in the few matters it has handled.[186] A case in point is an attempt by the Senate in 2014 to direct the CoB to withhold approval of funds to counties whose governors had failed to appear before its committee to respond to financial management queries raised in the CoB reports,[187] which the court found to be unlawful for not having been initiated by the National Treasury.[188] The only power conferred on the Senate is the power to summon county officials to appear before it and to enforce such attendance by imposing either a fine or instructing the arrest and presentation of the official to respond to issues before the Senate.[189] Given this limitation on the oversight role of the Senate, all it

[183] Bosire (2017).
[184] Bosire (2017) 65.
[185] Mutakha (2014) 315.
[186] Bosire (2017) 63.
[187] *Council of Governors & 6 others v Senate* [2015] eKLR, para 2 & 156.
[188] *Council of Governors & 6 others v Senate* para 165-167 & 183(*k*).
[189] Constitution (2010), art 125; *Wycliffe Ambetsa Oparanya & 3 others v Director of Public Prosecutions & another* para 143-45; National Assembly (Powers and Privileges) Act, s 23 & 27.

can do therefore is to then issue recommendations either to the county assembly or to other national institutions that have powers of enforcement, with no guarantee of their being effected.[190] Besides relying on the shaming effect of summoning and questioning governors over audit queries, the effectiveness of the Senate's superintending oversight mandate in translating to accountable fiscal autonomy at the county level is therefore unclear.

4.2 The National Treasury's monitoring role allows for the provision of support to counties

The National Treasury's role in the monitoring and evaluation of the systems of expenditure control and financial management at the county level is key in the identification of cases where a specific county may benefit from the provision of support from the national government to facilitate the accountable exercise of fiscal autonomy. Given the constitutional requirement for counties to operate financial management systems that comply with national legislative requirements,[191] the National Treasury is tasked, under national legislation, to design and prescribe a financial management system for county governments aimed at ensuring transparent financial management and providing a basis for standard financial reporting.[192] The National Treasury's monitoring mandate is facilitated by the legislative obligation imposed on counties to supply the National Treasury with, among other things, copies of reports from the county receivers of revenue,[193] quarterly reports from accounting officers of county entities[194] as well as county annual financial statements.[195] Access to these periodical reports and statements from counties facilitates the National Treasury's monitoring function, while at the same time providing a basis for the National Treasury to identify cases deserving of national support, either through capacity-building or any other

[190] Bosire (2017) 63.
[191] Constitution (2010), art 190(2).
[192] PFMA, s 12(1)(2) as read with art 226 of the Constitution.
[193] PFMA, s 165(3)(*b*).
[194] PFMA, s 166(4)(*b*).
[195] PFMA, s 163(4)(*b*).

form of support that would enable the continued effective provision of services by the identified county government.

4.3 The provision of support to county governments enhances their accountability

The provision of support to county governments enables them to address any financial management and service delivery challenges they may have, while leaving them room to exercise their fiscal autonomy. The Constitution requires Parliament to ensure, by way of legislation, that counties have adequate support such as would enable them to perform their functions.[196] Pursuant to this, the County Governments Act places this obligation on the national government ministry in charge of intergovernmental relations (Ministry).[197] In this capacity, the ministry has an obligation to assess the performance of individual county governments with a view to determining whether and the nature of support they may require.[198] As part of this, the Ministry is required to help counties in identifying causes of any performance problems they may have as well as potential solutions to them.[199] Where a county has difficulty or is unable to perform its functions, the Ministry is required to take measures including preparing a recovery plan with the aim of building the county's capacity to effectively undertake its functions.[200]

The National Treasury, for its part, is under an obligation to assist counties in developing their capacity to undertake efficient, effective and transparent financial management.[201] This is required to be done in consultation with the Cabinet Secretary (CS) for intergovernmental relations. In addition, the CS for finance is also obligated to share with counties any findings that may help them improve in their financial management, to alert counties in the event an impending financial problem is detected and to support county efforts in averting or resolving

[196] Constitution, art 190(1).
[197] CGA, s 121(1). This role is currently undertaken by the Ministry of Devolution and the Arid and Semi-Arid Lands (ASALs).
[198] CGA, s 121(2)(*a*).
[199] CGA, s 121(2)(*f*).
[200] CGA, s 121(2)(*g*).
[201] PFMA, s 12(1)(*j*) as read with s 46(1)(*b*).

the financial problems.[202] All these forms of support play an important role in ensuring that a county's ability to undertake proper financial management and to effectively deliver services is maintained and that its systems of internal control are also effective.

The National Government, through the Ministry of Devolution and the National Treasury, has over the years worked with development partners to provide various forms of support to county governments with a view to enhancing effective service delivery as well as their accountability. These include the provision of technical support, capacity-building, performance-based grants as well as the formulation and adoption of supportive policies, legislation, regulations and guidelines.[203] This has been achieved under various programmes including the 'Integrated Support Programme to the Devolution Process (ISPDP) in Kenya' which is implemented through the United Nations Development Programme (UNDP) as well as the 'Kenya Devolution Support Programme (KDSP)' and the 'Kenya Accountable Devolution Programme (KADP)', both of which are based on Kenya's National Capacity Building Framework (2013) and are implemented through the World Bank, with joint funding from the World Bank ($200m) and the Kenyan government ($87.3m).[204] The KADP has, for instance, been able to improve the capacity of core county governance systems, improve county audit performance and, among other things, help counties work towards and undergo creditworthiness assessments to help them engage in capital borrowing.[205] Despite the fact that the programmes cover a select number of participating counties, their policy and legislative outcomes provide support to all counties in Kenya.

[202] PFMA, s 46(3)(*b*) & (*c*) as read with s 446(1)(*c*).

[203] In 2014, for instance, the National Treasury developed the County Budget Operations Manual to help counties with budgeting and in 2019 developed the National Policy to Support Enhancement of County Governments' Own-Source Revenue which came with legislative and policy proposals to support the enhancement of county revenue.

[204] See generally, UNDP *The Integrated Support Program to the Devolution Process in Kenya - Mid Term Evaluation (MTE) Final Report* (2017); World Bank *Kenya Accountable Devolution Program: Annual Report* (2018); Ministry of Devolution *Kenya Devolution Support Programme (KDSP)* (2018) available at https://www.devolution.go.ke/kenya-devolution-support-programme-kdsp/ (accessed 24 November 2021).

[205] World Bank (2018) 7 & 11.

4.4 Provision for national intervention in counties serves both as a deterrent and a corrective measure

Where internal systems of control are unable to secure the accountability of county governments in relation to its financial management and service delivery notwithstanding any form of support received from the national government, intervention then becomes a necessary measure. The Constitution envisages the intervention of the national government in counties in four instances: where a county is unable to perform its functions;[206] where a county fails to operate a financial management system that complies with national legislation;[207] in the event that a county registers a serious or persistent material breach of legislative measures aimed at ensuring transparency and expenditure control[208] or where there are exceptional circumstances warranting the suspension of a county government.[209]

For the first three forms of intervention, the PFMA establishes a Joint Intergovernmental Technical Committee (Joint Committee), made of the CSs for finance and intergovernmental relations as well as representatives from the CRA, IBEC and the concerned county, which is charged with undertaking quarterly reviews of interventions to establish the progress made in the resolution of the identified problem as well as assessing the effectiveness of the recovery plan adopted.[210] The Joint Committee is required to submit reports on the progress to the CS finance, the county executive member for finance, the relevant county assembly, the IBEC as well as the Senate.[211] This is critical in ensuring that the national government's powers of intervention are checked to ensure that a county's fiscal autonomy is restored once the problem underlying the intervention has been sufficiently addressed.

206 Constitution, art 190(3)(*a*).
207 Constitution, art 190(3)(*b*).
208 Constitution, art 225(3)(*a*).
209 Constitution, art 192(1)(*b*).
210 PFMA, s 100(1) & (3).
211 PFMA, s 100(4).

Where a county is unable to perform its functions, the Constitution requires national legislation to authorise the national government to take appropriate measures to assist the county government to resume full responsibility for the functions.[212] The CS for finance is required, in this case, to prepare a recovery plan, in consultation with the county government, that would secure the ability of the county to resume its functions.[213] However, although justified in the circumstances, the fact that the recovery plan: provides binding budget parameters for the county; determines revenue measures as well as tariff rates necessary for financial recovery as well providing for the liquidation of specific county assets, directly limits the fiscal autonomy of the affected county government.[214] Moreover, where a recovery plan may not resolve the issue or where it fails to do so, the national government is allowed to assume responsibility for the performance of the affected functions,[215] a situation that involves a complete limitation on the fiscal autonomy of the county.

The fact that the intervention comes with such limitations on the fiscal autonomy of counties should serve as deterrent to counties to ensure that they take necessary measures to avoid its initiation. Nonetheless, the requirement for the Cabinet Secretary for intergovernmental relations to seek Parliament's prior approval before assuming responsibility for county functions,[216] the fact that the national government is required to take only necessary measures,[217] as well as the fact that the Senate is allowed to bring the intervention to an end,[218] serve to provide checks on the exercise of this power of intervention by the national government which secures the fiscal autonomy of county governments. This form of intervention has, however, not been invoked in practice.

The conditions, obligations and powers under the above form of intervention also apply to cases where a county fails to operate a financial management system that complies with

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[212] Constitution (2010) art 190 (4)(*c*) as read with 190(5)(*g*).
[213] PFMA, s 99(1)(*c*) & (3).
[214] PFMA, s 99(4)(*d*) & (e); s 99(5)(*a*).
[215] Constitution, art 190(4)(*d*).
[216] CGA, s 121(4).
[217] Constitution (2010), art 190(5)(*f*).
[218] Constitution (2010), art 190(5)(*h*).

national legislation.[219] This is largely because national legislation has not provided more clear details on how this form of intervention may be executed.[220] What is unique for this intervention, however, is that it may also be brought to an end where the Joint Committee is satisfied that the county government is able and willing to fulfil its obligation,[221] or finds that the county government is operating a financial management system that complies with legislation.[222] However, despite consistent reports from the CoB and the AG that point to the fact that various counties are openly violating various provisions of national legislation (and the regulations issued under them) in their financial management (in relation to thresholds for staff expenditure and procurement regulations), the national government has never initiated this form of intervention to ensure compliance. This may hence be the reason why counties do not feel compelled to address instances of non-compliance identified in the annual AG reports, despite the AG's having pointed out this failure.[223]

In addition to the two forms of intervention above, the CS in charge of finance (through the National Treasury)[224] is allowed to intervene to stop the transfer of funds to a county government in instances where a county is in serious or persistent material breach of legislative measures aimed at ensuring transparency and expenditure control.[225] Factors that may indicate that a county is in serious or persistent material breach include where: a county has failed to make payments as and when due or has defaulted on financial obligations for financial reasons; a county is more than 60 days late in submitting its annual financial statements to the AG; the CoB has raised material issues in their quarterly report or where the AG has withheld an opinion or issued a disclaimer as a result of inadequacies in the county's records or where the AG has identified a serious financial problem in the opinion issued.[226] Similar to the interventions above, the consequences of the stoppage of transfers as well as

[219] Constitution (2010), art 190(4) (*c*) & (*d*) and art 190(5)(*f*) & (*h*).
[220] See for instance, PFMA, s 93(3).
[221] PFMA s 101(1)(*b*).
[222] PFMA, s 101(1)(*d*).
[223] See, fn 157 above.
[224] PFMA, s 13(1)(f).
[225] Constitution (2010), art 225(3) as read with PFMA, s 93.
[226] PFMA, s 94(1).

the limitations [justifiably] imposed on the fiscal autonomy of the counties when a recovery plan is imposed[227] have a deterrent effect that ensures counties take measures to avoid the initiation of the intervention.

However, similar to the intervention above, despite the existence of factors such as huge recurrent eligible pending (unpaid) bills, the raising of material issues in the CoB reports; the issuance of qualified opinions by the AG that identify serious financial problems as well as consistent adverse and disclaimers of opinion issued by the AG against various counties over the years,[228] the national government has never invoked its intervention powers to stop the transfer of funds. What the national executive has done over the years is issue directives to counties to pay pending bills on the threat of initiating a stoppage of transfers.[229] While these are reported to have compelled some counties to act in clearing up eligible pending bills,[230] the national government's reluctance to apply its powers in this as well as other deserving cases only emboldens non-compliance and defeats the end of accountable fiscal autonomy.

Nonetheless, the Constitution puts in place various measures aimed at checking how this intervention is implemented. For instance, an intervention stopping the transfer of funds is required to be approved by Parliament within 30 days, failing which it lapses.[231] Also, given the devastating effect the stoppage of funds may have on the operations of counties, especially seeing as the bulk of their expenditure is funded by transfers, the Constitution prohibits the stoppage of more than 50 per cent of funds due to the county and also requires such stoppage not to exceed 60 days unless renewed by Parliament.[232] Additionally, the requirement for the

[227] PFMA, s 99(1)(*c*) & (3) as read with s 99(4)(*d*) & (*e*) and s 99(5)(*a*).
[228] World Bank (2018) 7.
[229] The Presidency 'Settle all Pending Bills by End of Month, President Kenyatta Orders Accounting Officers' (2019) available at https://www.president.go.ke/2019/06/01/settle-all-pending-bills-by-end-of-month-president-kenyatta-orders-accounting-officers/ (accessed 21 November 2021); The National Treasury and Planning *Budget Statement FY 2021/22* (2021) 33-34.
[230] Kenya Institute for Public Policy Research and Analysis (KIPPRA) 'Pending bills: Will the private sector survive?' (2020) available at https://kippra.or.ke/pending-bills-will-the-private-sector-survive/ (accessed 21 November 2021).
[231] Constitution (2010), art 225(5)(*b*).
[232] Constitution (2010), art 225(4), (5)(*a*) & (6).

CoB to be informed and to investigate the circumstances underlying the decision to stop funds and submit a report to Parliament before Parliament approves the commencement of the intervention,[233] as well as the requirement for the CoB to submit a further report when Parliament is considering a renewal of the intervention,[234] serves to ensure that objective assessments of the circumstances are undertaken and that Parliament is provided with an objective basis to aid its decision-making in checking the national government's use of these powers. In addition to these measures, the courts have also played an important role in preventing the abuse of this power by, for instance, as highlighted above, preventing the Senate from unlawfully invoking this power to direct the CoB to withhold the approval of funds to counties whose governors had failed to honour its summons to respond to financial management queries raised in the CoB reports.[235]

The fourth form of intervention involves the suspension of a county government where it is found to engage in actions that are deemed to be against the common needs and interests of the citizens of the county.[236] In such a case, any person is allowed to petition the President, by a petition supported by at least 10 per cent of a county's registered voters, to suspend the county government.[237] The President is then required to first submit a report on the petition to the Summit for its approval[238] before nominating a commission of inquiry, with the Senate's approval, to investigate the allegations.[239] The Commission's report is then considered by the Senate and where approved, the President is obligated to suspend the county for a period of 90 days with the Senate reserving the right to terminate the suspension.[240] Upon the suspension of the county, the Constitution requires arrangements to be made for the performance of the county's functions and, unless the suspension is lifted, for elections to be

233 PFMA, s 96(2) & (3).
234 PFMA, s 98(1) & (2).
235 *Council of Governors & 6 others v Senate* [2015] eKLR, para 165-167 & 183(*k*).
236 CGA, s 123(1) as read with art 192(1)(b) of the Constitution.
237 CGA, s 123(1) as read with art 192(1)(b) of the Constitution.
238 CGA, s 123(3).
239 CGA, s 123(4) as read with art 192(2) of the Constitution.
240 CGA, s 123(11), (12) & (13) as read with art 192(4) & (5) of the 2010 Constitution.

conducted for the county within 90 days.[241] Given the fact that the county assembly stands prorogued with an interim county management board (ICMB), appointed by the President with the Senate's approval, taking over all the powers and functions of the CEC during the period of suspension, this form of intervention is the most intrusive to a county's fiscal autonomy.[242] Its existence, therefore, apamt from being used to ensure accountability on the part of county government where circumstances demand, also constitutes an important deterrent to ensure that counties handle their affairs in a prudent, effective and accountable way.

The power to suspend a county has only been invoked once in the case of Makueni County in 2015. This followed disagreements between the Governor and MCAs that crippled the operations of the county government including leading to an attempted assassination of the Governor.[243] The Governor had, among other things, declined to implement a CA law establishing a County Ward Development Fund under which the MCAs had allocated themselves almost the entire development budget with powers to oversee the implementation of projects within their wards.[244] This was in addition to a failure by the Governor to approve funds for foreign trips for the MCAs as well as salaries and allowances that exceeded nationally set ceilings.[245] Although the President eventually declined to suspend the county as recommended by a commission of inquiry, following a petition by Makueni residents, the whole process of inquiry and the stakes involved served to rein in MCAs and facilitated the restoration of order in the county.[246] Otherwise, this constitutes the only recorded formal process of intervention initiated by the national government.

[241] Constitution (2010), art 192(3) as read with (6).
[242] CGA, s 124(1) as read with s 125(1) & s 127(1).
[243] Petition for the Suspension of the County Government of Makueni (2019).
[244] Petition for the Suspension of the County Government of Makueni (2019).
[245] Petition for the Suspension of the County Government of Makueni (2019).
[246] Muasya (2017).

5 Conclusion

Given the scope for fiscal autonomy extended to counties, Kenya's legal framework provides a comprehensive array of fiscal controls whose enforcement has the capacity to secure the functional, financial and institutional accountability of county governments. This is notwithstanding the risk of over-regulation posed by the Constitution's generous approach to the sanctioning of the regulation of the exercise of fiscal autonomy by counties under national legislation. While the fiscal autonomy of county governments demands deference to be given to internal systems of control, supportive controls and, where these fail, national government measures aimed at providing support to strengthen the capacity of counties to self-regulate and ensure their own accountability, the mechanism of intervention is crucial in not only serving as deterrent to poor fiscal management practices at the county level, but also in stepping in to remedy deteriorating levels of accountability at the county level. While mechanisms of intervention constitute a legitimate and justified limitation on the fiscal autonomy of counties, their application is balanced by various checks and balances that serve to protect the autonomy interests of counties while at the same time allowing room for corrective measures aimed at facilitating the continued accountability of county governments. Notable in this regard is the role played by the courts which, as demonstrated in this chapter, has been instrumental in ensuring that while the law is interpreted to ensure the accountability of county governments, the implementation of fiscal control measures is not used as a pretext for violating the fiscal autonomy, institutional integrity and constitutional status of county governments.

However, despite the comprehensiveness of the framework for fiscal controls and its potential to secure accountable fiscal autonomy, the implementation of this framework has been far from satisfactory. Systems of internal control have largely been ineffective in securing fiscal prudence at the county level as evidenced by the CoB's and the AG's reports. They have, moreover, been ineffective in resolving issues identified through the systems of supportive control, given the recurrence of the identified financial management issues.

Although these circumstances demand that external fiscal controls step in to ensure the continued effectiveness of the systems of internal and supportive controls and the facilitation of accountable fiscal autonomy, the national government has been reluctant to initiate and implement them. While this may be partly attributable to the intermediate superintending oversight role played by the Senate, which renders the national government complacent by providing an appearance of national action relating to the accountability of county governments, the lack of enforcement powers on the part of the Senate makes its role ineffective. In the end, therefore, counties seem to experience very minimal limitations to their fiscal autonomy at the expense of functional, financial and institutional accountability.

Chapter Nine

CONCLUDING ANALYSIS

This study's theoretical approach shifts from classical federal theory, that is largely based on assessments of developed aggregative federal states, in four important respects based mainly on nuanced approaches adopted in the context of devolved developing countries. First, while federal theory conceives self-rule as absolute autonomy from the federal government, this study looks at self-rule from the perspective of the margin of autonomy constitutionally extended to subnational governments in the context of a unitary devolved state. In this respect, assessments of subnational autonomy shift from the dichotomy of whether or not subnational governments are autonomous to the spectrum of what margin of autonomy is constitutionally extended to subnational governments under a particular constitution.

Secondly, while federal theory treats self-rule as an end, this study approaches the margin of autonomy extended to subnational governments only as a means towards the attainment of the objectives of autonomy or devolution. While these objectives may vary from one state's constitution to the next, the underlying implication is that the constitutional design for subnational autonomy should be done with particular attention to building in mechanisms for guaranteeing that such autonomy will be applied towards the attainment of the stated objectives.

Thirdly, while fiscal federalism theory focuses on vertical fiscal balance that emphasizes subnational own 'tax' autonomy as the core of subnational fiscal autonomy, this study focuses on vertical fiscal equity in the context of devolved states which entails a focus on subnational fiscal autonomy (revenue autonomy, in particular) as drawn from the integration of subnational own 'tax' autonomy and autonomy as drawn from unconditional intergovernmental fiscal transfers. This leverages both James Buchanan's emphasis on vertical tax separation[1] and Richard Musgrave's emphasis on centralized transfers[2] to provide an integrated intergovernmental financing model for devolved

[1] Sharma (2012) 105. See also the discussion under section 1 in chapter one above.
[2] As above.

states. Under this approach, the mere existence of a vertical fiscal asymmetry (VFA) in an intergovernmental fiscal system's design is not in any way indicative of the nature or scope of subnational revenue autonomy.

Fourthly, while subnational accountability is treated as a passive, self-regulating and self-perpetuating end product of subnational 'taxation' in fiscal federalism literature, this study focuses on the need for an explicit, comprehensive and active system of oversight and expenditure control. This is aimed at ensuring the accountable exercise of subnational fiscal autonomy by addressing the general perverse incentives created by the grant of subnational autonomy while at the same time paying particular attention, in its design, to the above unique nuances brought in by devolution.

Against this theoretical background and using Kenya as a case study, this study interrogated how the design and implementation of intergovernmental fiscal systems in devolved states facilitate the accountable exercise of the margin of autonomy constitutionally extended to subnational governments.

While the Kenyan Constitution is explicit in its intention to create distinct (self-ruling) county governments, this autonomy is not absolute. By indicating that the two levels of governments are interdependent, the Constitution recognises the unitary nature of the Kenyan state within which its system of devolution is set. It nonetheless extends county governments a margin of autonomy by requiring the two levels of government to conduct their mutual relations on the basis of consultation and cooperation and further requiring that they respect each other's institutional integrity and constitutional status. The Constitution also lays out the specific objectives which its system of devolution seeks to pursue. While all these constitutional provisions reveal an intention to confer substantial political autonomy to county governments, this study sought to find out whether the financial constitution that embodies Kenya's intergovernmental fiscal system demonstrates a similar intention by conferring a correspondingly similar margin of fiscal autonomy to county governments and, further, whether such fiscal autonomy has been developed and enforced in practice to support the realisation of the political autonomy conferred on counties (and its objectives).

To respond to this enquiry, the study first sought to establish international fiscal federalism literature's position regarding what mix of design features and approaches a devolved state's constitution could adopt so as to equip its intergovernmental fiscal system with the potential to deliver optimal outcomes for subnational autonomy (self-rule). Given the influence of the South African constitution on the design of Kenya's financial constitution, this study undertook an assessment of whether and how the design and implementation of South Africa's intergovernmental fiscal system has advanced the margin of autonomy extended to South African provinces and municipalities, with a view to drawing lessons for the Kenyan case study. Being a devolved state, Kenya's system of devolution and its granting of autonomy to county governments was done in pursuit of specific objectives. To establish these objectives and their underlying rationale, this study undertook an analysis of Kenya's history of multilevel governance and the forces that underlay the adoption of the current system of devolution. Having laid this foundation, the study embarked on the core of its analysis by assessing how the design and implementation of Kenya's framework for county expenditure, revenue and budgetary autonomy advances the margin of autonomy afforded to the county governments. Given the role of accountability in securing Kenya's objectives of devolution, the study then assessed the extent to which the design and implementation of Kenya's system of fiscal controls and oversight has been effective in securing the accountable exercise of fiscal autonomy by county governments. Having undertaken the above analyses, this chapter seeks to provide a concluding analysis of the study's findings in order to respond to the question of whether reform of Kenya's intergovernmental fiscal system is necessary.

1 A theoretical model of an intergovernmental fiscal system for subnational autonomy in devolved states

The devolution of power to subnational governments in devolved states seeks to facilitate efficient local development, the accommodation of minorities and marginalised groups, the enhancement of democracy and accountability and the checking and balancing of the use or misuse of central power (the general objectives of devolution). The attainment of these objectives requires that subnational governments have the autonomy (powers of initiative and immunity) to pursue their realisation at the local level. Such autonomy is only meaningful if it includes the conferment of fiscal autonomy. Devolved states are therefore only able to achieve the objectives of devolution where their intergovernmental fiscal system makes provision for and supports the exercise of fiscal autonomy by subnational governments. This involves the conferment of expenditure, revenue and budgetary autonomy to the subnational units. However, fiscal autonomy has the potential to be abused by subnational governments if its exercise is left unregulated. Therefore, a critical part of subnational fiscal autonomy is an explicit and active system of oversight and expenditure control that ensures that such exercise serves the objectives of autonomy, while also ensuring financial and institutional accountability.

While there is no universal model of an intergovernmental fiscal system that is best suited to deliver subnational autonomy, the theoretical approaches outlined in this study offer guidance on design features whose adoption holds the potential to deliver optimal outcomes for subnational autonomy in devolved states.

With respect to design of an intergovernmental fiscal system for subnational expenditure autonomy, literature points to a specific country's constitutional demarcation of vertical competences to determine the margin of expenditure autonomy extended to the country's subnational levels of government. Two vertical functional demarcation models, the dualist and the integrated model, are critical in this respect. The dualist model where each level of government holds exclusive functions and powers offers the highest margin of subnational expenditure autonomy. To facilitate this, subnational governments ought to have full powers of initiative and immunity in respect of these exclusive functions, in the sense that, they should be able to plan, budget and implement subnational projects independent of national control or national powers of review, amendment, negation and enforcement. Where coordination and/or cooperation is required, subnational governments should have the right to be consulted and the freedom to negotiate and/or reject any expenditure policies or priorities emanating from higher tiers of government, especially those imposed outside constitutional prescription.

Where a state adopts an integrated vertical functional demarcation model that combines exclusive and concurrent mandates, the constitutional design should ensure, in respect of exclusive functions and powers, that subnational governments have such optimal expenditure autonomy as is availed to subnational governments under the dualist model. The interdependence aspect brought in by concurrency, however, makes the nature and extent of concurrent mandates critical in the determination of the overall margin of expenditure autonomy extended to subnational governments. This requires particular attention to be given to their formulation. The design of concurrent mandates should, therefore, while paying attention to their interdependence objective, be done in such manner as not to undermine the ability and autonomy of subnational governments in exercising those functions falling within their exclusive jurisdictions, nor should it undermine the overall margin of autonomy constitutionally extended to the subnational governments. Literature also points to the need for overall greater detail to be provided for within the constitution so as to guarantee the protection of the margin of autonomy constitutionally extended to subnational governments from legislative and/or regulatory distortion.

The design of an intergovernmental fiscal system for subnational revenue autonomy, for its part, depends largely on the model adopted for the vertical allocation of revenue means in a given state. Two approaches are key in this regard. The first emphasizes vertical fiscal balance (the notion that subnational own sources of revenue should match or balance subnational expenditure responsibilities) hence adopts a dualist intergovernmental financing model that focuses on vertical tax separation. Under this model, subnational tax (OSR) autonomy is regarded as the source of subnational revenue autonomy, with centralized transfers often disregarded on grounds of being a source of subnational dependency. The second approach emphasizes vertical fiscal equity whose core focus is guaranteeing equitable access, by the various tiers of government, to adequate financial resources to facilitate their functioning in line with the respective constitutional frameworks. This approach adopts an integrated intergovernmental financing model that merges vertical tax separation with a system of transfers, with both being designed such as to constitute a source of subnational revenue autonomy.

The dualist intergovernmental financing model's emphasis on subnational self-sufficiency makes it an archetypal model for the highest form of subnational revenue autonomy. To extend full powers of initiative and immunity under this model, literature requires the constitutional design to confer on subnational governments the power to independently enact own tax laws identifying the subnational taxes to levy, determine the respective tax bases and the applicable rates as well as the power to administer the subnational taxes (OSR). The literature points to the statutory (including constitutional) listing of tax types applicable to subnational governments as a limitation on the revenue autonomy of a subnational government, under this model, alongside the setting of ceilings and bands for rates as well as the earmarking of user charges for specific subnational expenditure. Most devolved states, however, divide taxes (tax-types) vertically which involves an assessment of which taxes qualify for subnational imposition. In respect of these qualifying taxes, revenue autonomy then requires that the subnational governments be given the power to determine the applicable tax bases and rates as well as the power to administer the allocated taxes (assess, levy and enforce collection).

With respect to the design of the integrated intergovernmental financing model for revenue autonomy, subnational governments should be granted the same powers over their own sources of revenue as those extended under the dualist model above. Of particular interest in this model, however, is the design of the intergovernmental fiscal transfer system that has otherwise been referred to by Saunders as the welfare or solidarity component[3] in light of its equalisation/redistribution objective. This is key given its centralized administration and the need to structure it with particular attention to addressing Buchanan's view of the state a Leviathan whose control needs to be checked.[4] To facilitate subnational revenue autonomy, the design of the intergovernmental fiscal transfer system, therefore, needs to ensure: that the rules regulating the sharing are provided for under the constitution; that eligibility and the sharing formula are determined objectively, with subnational governments or their national-level representatives having a say over the revenue division process and any adjustments to the sharing formula and, importantly, that the revenue transferred to subnational governments is unconditional. Bahl also adds that the specification of a (minimum) percentage of revenue raised nationally to be shared to subnational governments provides certainty of revenue flow

[3] Saunders (2018). See also the discussion under section 1 of chapter one.
[4] Sharma (2012) 105. See also the discussion under section 1 of chapter one.

while also making subnational governments partners in the central tax system.[5] Alongside these design approaches, Shah adds the principles of predictability (that requires multi-year vertical revenue division projections with minimum guarantees), efficiency (that requires that the revenue sharing formulas be neutral in their effect on subnational spending choices), incentive (that requires motivation for good fiscal management) and accountability (that requires the incorporation of a mechanism for both vertical and horizontal accountability) that need to be considered in the course of designing the intergovernmental financing framework.[6] These principles are key in both constitutional as well as legislative design and are targeted at facilitating subnational revenue autonomy through the system of transfers.

While fiscal federalism literature supports subnational access to and utilisation of budgetary autonomy, it argues for its close regulation so as to ensure both intergenerational equity and macroeconomic stability.[7] On intergenerational equity grounds, for instance, the design of an intergovernmental fiscal system for subnational budgetary autonomy requires that subnational governments be granted the liberty to access deficit financing but only when it is meant for capital spending. On similar grounds, subnational governments are required to maintain a balanced budget in so far as it relates to recurrent spending and only undertake short-term borrowing for bridging purposes where there is a shortfall in revenue receipts within a financial year. Central to the subnational exercise of budgetary autonomy, however, is the capacity of subnational governments to repay loans from their own sources. The design is therefore required to establish a link between a subnational government's freedom to borrow and its capacity to repay so as not to undermine the state's macroeconomic stability. Alongside this is the proposal in the literature for the imposition of a strict no-bail-out policy that is aimed at facilitating fiscal discipline by imposing hard budget constraints.[8]

A central factor in the design of the intergovernmental fiscal system for subnational autonomy is the linkages and interrelatedness of the three forms of fiscal autonomy.

[5] Bahl (2008) 35. See also the discussion under section 7.2.5.2. of chapter two.
[6] Shah (2007) 15-16. See also the discussion under section 7.2.5.2. of chapter two.
[7] See the discussion under section 7.3 of chapter two.
[8] Oates (2005) 354 & 360. See also the discussion under section 7.2.2 as well as section 8 of chapter two.

Subnational expenditure autonomy is for instance reliant on revenue autonomy to facilitate subnational own-prioritisation which is the core of expenditure autonomy. Similarly, the conferment of revenue autonomy requires attention to the scope of expenditure responsibilities conferred on subnational governments with the aim of ensuring that the scope of revenue autonomy extended to subnational governments sufficiently capacitates them to efficiently discharge the scope of their expenditure responsibilities. As highlighted above, as well, is the linkage between the subnational exercise of budgetary autonomy and the subnational government's revenue autonomy (based on OSR) whose design is aimed at facilitating subnational fiscal discipline in relation to borrowing. This study argues that these interlinkages, therefore, require that the design of the intergovernmental fiscal system for any one form of fiscal autonomy be done with specific attention to how it will impact the realisation of the other forms.

Importantly, the integrated nature of intergovernmental fiscal systems in devolved states and the fact that autonomy in devolved states is adopted for the pursuit of specific purposes, however, demands that consideration be given to the perverse incentives these design features bring to bear and for an explicit system to be put in place to ensure the accountable utilisation of fiscal autonomy by subnational governments. A model for an oversight and expenditure control mechanism for securing functional, financial and institutional accountability would hence require institutional mechanisms and processes at both the subnational level as well as the national level to facilitate both horizontal (downward) and vertical accountability. Such would involve aspects of legal regulation, monitoring, support and, when necessary, intervention. UN-HABITAT international guidelines on decentralisation recommend that, in the interest of subnational autonomy, deference be given to subnational level mechanisms with national supervision being confined to the posterior verification of the legality of subnational actions.[9] The design should also ensure that national-level oversight is exercised through or in consultation with institutions of shared rule to ensure objectivity, secure subnational interests and preserve subnational fiscal autonomy.

[9] UN-HABITAT (2009) 38. See also the discussion under section 8 of chapter two.

The unique circumstances of devolved developing countries, however, tend to bias their choice of subnational expenditure and revenue autonomy designs towards the integrated models. These include: their unitary state settings, which require a level of national involvement in subnational matters; the limited nature of revenue sources coupled with the inequality in their regional spread, which makes tax separation for vertical fiscal balance difficult; their overriding national objectives such as nation-building, which requires systems of horizontal equalisation and redistribution and the developing nature of their economies that requires centralized macroeconomic control, among other social-cultural, economic and even historic circumstances. While the designs for budgetary autonomy and subnational accountability may remain the same, these circumstances make the integrated expenditure and intergovernmental financing models more attractive to devolved developing countries.[10]

However, the adoption of the theoretical design outlined above only extends potential to an intergovernmental fiscal system to realize optimal outcomes for subnational autonomy thus falling into what Clark,[11] in his abstraction of the concept of local autonomy, refers to as the first level of appearance which is a 'realm of social aspirations and conceptions of the proper form of society'.[12] The success or otherwise of the theoretical model hence relies heavily on what Clark refers to as the second level of appearance, practice, which per Clark is an arena of contention and conflict. To facilitate the exercise of subnational fiscal autonomy in practice, therefore, the design of the intergovernmental fiscal system requires to go a step further to make provision for mechanisms that will facilitate the effective implementation of those design features targeted at subnational fiscal autonomy. This requires a carefully designed mechanism of intergovernmental fiscal relations which include a mechanism for ensuring that the practice does not undermine the design and that measures exist to restore and facilitate compliance with the underlying constitutional model of the intergovernmental fiscal system. This makes critical the effectiveness of institutions of shared rule and, importantly, the independence of judicial mechanisms for the realisation of subnational autonomy in devolved states.

[10] See the discussion under sections 7.1 and 7.2 of chapter two.
[11] Clark (1984) 195-208.
[12] Clark (1984) 196.

2 The design and implementation of South Africa's intergovernmental fiscal system exemplifies the theoretical model but also offers comparable lessons

While South Africa's intergovernmental fiscal system, which Kenya's mirrors, adopts the theoretical model discussed above in the grant of subnational fiscal autonomy to its subnational governments, nuances in its design as well as challenges experienced in its implementation provide a number of comparable lessons to the Kenyan case.

In terms of the design of the intergovernmental fiscal system for subnational expenditure autonomy, South Africa adopted an integrated vertical functional demarcation model. While the national, provincial as well as local spheres of government have individual exclusive competences, the constitutional framework also makes provision for an extensive list of concurrent national and provincial mandates. However, while the constitutional framework presents a picture of a more autonomous provincial sphere of government in terms of functions, an assessment of the practice reveals a very small margin of expenditure autonomy exercised by provinces with most functions either being concurrent or being undertaken at the local level. Consequently, provinces have a limited scope for expenditure autonomy. Additionally, the extensive nature of the concurrent mandates has in practice served to predispose some of the concurrent mandates to recentralisation by the national sphere of government, thereby restricting provincial expenditure autonomy. Local governments, however, tend to exercise a broader margin of expenditure autonomy over the local service provision mandates, a factor that is closely associated with their having a relatively broader margin of revenue autonomy compared to that of the provincial sphere. In this regard, the South African case highlights the impact of practice on the actual autonomy exercised by subnational governments, the negative impact of extensive concurrent mandates and the correlation between the scope of expenditure autonomy exercised in practice and the subnational government's scope for revenue autonomy.

With respect to subnational revenue autonomy, South Africa's intergovernmental fiscal system also adopted an integrated intergovernmental financing model. The system, hence, adopted aspects of both vertical tax separation and a system of intergovernmental fiscal transfers. While both provinces and local governments have access to own sources of revenue, the constitution also entitles them to an equitable share of the revenue raised nationally. While provinces have very limited sources of OSR hence relying mainly on transfers, local governments have access to a broader base of OSR which grants them more revenue autonomy relative to provinces. As a result, most local governments are able to finance a substantial amount of their annual expenditure from their own sources which extends their expenditure autonomy allowing them to freely deliver services independent of the national government's financial control or influence. This reinforces the close link between high subnational OSR and the margin of expenditure autonomy enjoyed by subnational governments in practice.

Although the South African model for intergovernmental fiscal transfers largely mirrors the theoretical model, provinces and other local governments that rely heavily on national transfers have their expenditure autonomy limited by the indirect predetermination of spending at the national revenue division stage. In this respect, the South African case reveals how specificity in revenue sharing parameters converts unconditional equitable shares into a form of prescriptive grants, whose prescription or predetermination of subnational expenditure results in the indirect limitation of subnational expenditure autonomy. Importantly, however, the transfer system has implemented Shah's principle of predictability by providing multi-year projections of vertical shares of revenue raised nationally with minimum guarantees, thereby injecting a measure of stability and certainty in the system that facilitates subnational expenditure autonomy. Additionally, the absence of disbursement delays or issues in relation to the transfer of equitable shares of revenue raised nationally to subnational governments further reinforces this stability and certainty and enhances the revenue autonomy drawn by subnational governments from their unconditional transfers.

Regarding the intergovernmental fiscal system's design for subnational budgetary autonomy, South Africa also adopts the theoretical model to the letter. While it allows subnational long-term borrowing for capital spending, it limits short-term borrowing to bridging purposes and requires subnational governments to maintain balanced budgets. It moreover does not provide for any form of national guarantees for subnational borrowing thereby eliminating the notion of a bail-out mechanism in the event of default.

Although subnational budgetary autonomy is generally scarcely utilised in practice, local governments, especially metropolitan cities, have exercised their freedom to borrow more relative to provinces which currently do not undertake any borrowing. South Africa's subnational budgetary autonomy model and practice offers a number of comparable lessons. The inability of provinces to borrow, for instance, highlights the direct link between a subnational government's access to substantial OSR and its ability to borrow. Given that the existing moratorium on borrowing between the national government and provinces was settled on against a background of the abuse of borrowing powers by provinces, the South African case also illustrates the need for tighter oversight over subnational borrowing, given its impact on macroeconomic stability, especially where the affected subnational governments do not have the capacity to repay loans.

With regard to the model for oversight and expenditure control, South Africa adopted a tiered system with mechanisms at the local level, the provincial level as well as the national level. This reflects the theoretical model's emphasis of deference. Local governments, bear the primary responsibility for the identification and resolution of fiscal problems with the provincial and national spheres coming in only where subnational mechanisms have failed to restore the accountable exercise of fiscal autonomy. Institutions of shared rule such as the NCOP are also involved in processes relating to the supervision of provinces and local governments, a factor that ensures the protection of subnational interests in the processes. While oversight and expenditure control mechanisms may otherwise be seen as limiting subnational fiscal autonomy, the South African case highlights their utility in restoring accountable fiscal autonomy in cases where its exercise has led to dysfunctionality and a failure of service delivery. Importantly, in respect of oversight and expenditure control, the South African case highlights why it is important, in the interest of subnational autonomy, to structure oversight mechanisms hierarchically, with internal systems being resorted to first and external mechanisms only coming in where these have failed to facilitate accountable fiscal autonomy at the subnational level.

In addition to the above, the inequality of concurrence of South Africa's bicameral Parliament that confers weighted veto power to the National Assembly as well as its setting of the local governments' financial year separate from that shared by the national government and provinces, provide key learning points to issues observed in the implementation of Kenya's intergovernmental fiscal system and which have a negative impact on the fiscal autonomy of Kenyan counties.

3 Kenya's history of decentralisation and decentralised financing shaped the form and objectives of devolution

Kenya's brief experience with extensive subnational autonomy under *Majimbo*, at independence, as well as its long-standing experience with the increasingly centralised system of local administration that followed the abolition of *Majimbo* underlay the devolution design, the objects of devolution, and importantly, the intergovernmental fiscal system that was adopted under the Constitution of Kenya 2010.

In terms of devolution design, although no direct references were made during the constitution-making process to weaknesses in the constitutional design under *Majimbo*, it is remarkable that the composition and the powers of the Senate under the Constitution of Kenya 2010, for instance, are structured in a manner that may be argued as responding to the Senate's weaknesses under *Majimbo*. The fact that membership of the Senate under *Majimbo* was not directly drawn from regions coupled with the Senate's subordination to the House of Representatives arguably informed its inability to prevent either the abolition of *Majimbo* or even its own abolition. It is, therefore, noteworthy that the Constitution of Kenya 2010 ensures that Senate's membership is actually elected at the county level which in a way intertwines the life of the Senate to the protection of the existence and interests of counties. The 2010 Constitution's ensuring of an equality of concurrence powers between the two houses of parliament in relation to legislative bills affecting counties also constitutes a remarkable design feature with the potential to prevent the *Majimbo*-style unilateral abolition of the Senate or, by extension, any institutions of devolution.

In terms of the formulation of the goals of devolution, systemic problems that arose as a result of the increased centralisation of power (including fiscal powers) under the local administration system that succeeded *Majimbo* informed the push for the adoption of devolution and each of its specific objectives.[13] Key among the objectives included

[13] See the discussion under section 3 of chapter four.

expanded subnational autonomy and an increased role for the people to take part in their own governance; increased democracy and accountability at the local level as well as fiscally autonomous subnational units that would have the power to check and balance the central government's excesses. These became part of the objectives of devolution under the Constitution of Kenya 2010 and constitute the objectives in pursuit of which county autonomy is conferred.

With respect to the impact on the design of the intergovernmental fiscal system, although there are a couple of differences, a number of similarities can be drawn between the system that existed under *Majimbo* and Kenya's current framework. In relation to subnational expenditure, for instance, Kenya's current constitutional framework adopts an integrated constitutional functional demarcation model akin to that adopted under Kenya's Independence Constitution. The possession of exclusive and concurrent mandates by regional governments, including the constitutional requirement for consultation with regions prior to any form of functional delegation from the national government to regions, found expression in Kenya's Constitution of 2010. Although regional governments had access to broader OSR, including sharing in the imposition of personal income tax, compared to current county governments, Kenya retained the integrated intergovernmental financing model that existed under *Majimbo* with counties having access to both OSR and intergovernmental transfers. Also, the constitutional principle setting a minimum percentage of revenue to be shared to counties under the current constitution can be traced back to the Independence Constitution which had required the national government to pay 32% of proceeds of any tax or duty on any commodity other than petrol and diesel or agricultural produce, to regions.

In terms of the framework for oversight and expenditure control, while the mechanisms for oversight and expenditure control under *Majimbo* were structured such as to facilitate the autonomy of regions by granting them the power to resolve their affairs prior to national-level intervention, this changed with the overly interventionist and controlling approach adopted under the post-*Majimbo* system of local administration. Kenya's current subnational-autonomy-enhancing approach to oversight and expenditure control may hence be traced as well to the design under *Majimbo.*

In general, therefore, Kenya's current approach to subnational fiscal autonomy largely mirrors that which was adopted under *Majimbo* while also incorporating adjustments that remarkably correspond to and arguably address what features may be considered to have constituted structural weaknesses under both the *Majimbo* constitutional framework as well as under the succeeding over 45 years of centralized local governance. The similarity in the current approach to the intergovernmental fiscal arrangements to that which existed under *Majimbo* would seem to suggest the persistence of the issues and circumstances that existed at independence as well as the persistence of a foundational policy approach that sees their resolution through a system of expanded subnational fiscal autonomy.

4 Constitutional design issues underlie both factors enabling as well as those limiting the exercise of county expenditure autonomy

Kenya's constitutional design for county expenditure autonomy is made up of a mix of both features that are facilitative of county expenditure autonomy as well as those that underlie both current and potential future limitations on county expenditure autonomy. For one, the constitutional entrenchment of both primary and incidental county government functions and powers provides a protected basis for the exercise of county expenditure autonomy given that any form of reassignment (including transfers), amendment and/or recentralisation is safeguarded from the whims of the national government unlike the case under Kenya's preceding system of local administration. This is further strengthened by the constitutional protection of both the institutional and functional integrity of counties from interference by the national government. Both these provisions extend functional 'immunity' to county governments that furthers their expenditure autonomy. This constitutional basis has, for instance, emboldened county governments to exert and successfully defend their expenditure autonomy through the courts.[14]

While Kenya's current constitutional framework adopts an integrated vertical functional demarcation design akin to the model under *Majimbo*, its lack of sufficient clarity has been

[14] See the discussion on sections 1.4 & 1.5 of chapter five.

both a basis for the exercise of broader county expenditure autonomy as well as being the source of implementation challenges. Although the Constitution demonstrates a clear intention to confer both exclusive and concurrent functional mandates on county governments, it, unlike both the *Majimbo* Constitution and the South African case, falls short of either using the term 'exclusive functions' or having separate explicit lists of exclusive and concurrent functions. As a result, this subjects the determination of the full extent of a county government's powers of initiative and immunity, in relation to a particular function or power, to constitutional interpretation which constitutes a source of both current and potential future conflicts.

A textual reading of Part 1 and Part 2 of the Constitution's Fourth Schedule which list national and county government functions reveals a very limited scope of functions that can be interpreted as qualifying to be strictly exclusive to counties. This interpretation would hence translate to very limited county government powers of initiative and immunity in relation to county-level planning, budgeting and implementation. However, a more generous interpretation of the Schedule that disaggregates functional areas from specific powers and/or policy-making mandates from service provision ones opens up the scope for county expenditure autonomy, with the former approach rendering more functions concurrent between the two levels of government.[15] Alongside the distinction problem, between exclusive and concurrent functions, is the problem relating to the aggregated nature in which individual functions are listed under the Fourth Schedule that makes the determination of their exact components subject to further disaggregation and precise definition and/or interpretation. This lack of clarity and specificity hence complicates the identification of the exact scope of expenditure autonomy extended to county governments under the constitutional framework.

While the lack of clarity may not generally prevent the exercise of expenditure autonomy by counties in practice, the imprecision leaves most of the county government functions and powers open to potential restriction, in nature and scope, by national policy and legislation, depending on the approach to interpretation that may be adopted at the national level. Although the national government has not moved to enact central-leaning

[15] Mutakha (2014) 207-213. See also the discussion under part 2.1 of chapter five.

legislation and policies that may restrict county expenditure autonomy thereby allowing counties, in practice, to exercise significant autonomy over the functions listed under Part 2 of the Fourth Schedule, there is very little that legally prevents it from doing this. As a result, unless courts intervene to provide a more generous interpretation of county government functions or a restrictive interpretation of the national government's, what extended scope of expenditure autonomy counties currently enjoy is largely dependent on central political goodwill which is unpredictable in the long run.

The want of clarity over concurrent functions has, for instance, allowed the national government to capitalize on this to undertake most of these functions without regard to the principle of subsidiarity, while the performance of others is being duplicated between the two levels of government thus leading to a waste of resources and further blurring lines of accountability. In addition to this, overall national-level inertia and institutional defiance to and blatant violation of principles of devolution, as evidenced in the national government's continued performance of some county functions,[16] undermines and continues to inhibit the attainment of functional and policy clarity which is critical for the exercise of county expenditure autonomy.

Given that the core problem above is structural and stems from the constitutional vertical functional demarcation, it follows that a structural solution is necessary to secure the expenditure autonomy of county government. However, while the Constitution contains a mechanism that allows for the unbundling and disaggregation of functions such as would give clarity to the vertical functional demarcation, institutional failures, originally by the Transitional Authority and subsequently by its successor, the Intergovernmental Relations Technical Committee (IGRTC), with Parliament's acquiescence, have led to the continuation of the problem.

Outside the limitations above arising from the constitutional design, a number of additional limitations can be traced to national legislation that seeks to implement the constitutional framework. This covers those legislative requirements which, for instance, pose a threat to county-level own prioritisation that is the core of subnational expenditure

[16] See the discussion under section 2.5. of chapter five.

autonomy. These include the imposition of expenditure ceilings on county expenditure as well as the unilateral and unconditional national legislative requirements for linkages and alignments of county plans and fiscal strategies to national planning frameworks and annual Budget Policy Statements.[17] While such requirements are conceivable for a devolved state within a unitary context, to be constitutional, the latter legislative obligation, for instance, ought to require that the formulation of the national planning frameworks and the objectives under the annual budget policy statements complies with the constitutional imperative for consultation based on parity of constitutional status. This will ensure that county-level compliance with such legislative obligations does not undermine the constitutional provision for county expenditure autonomy.

5 Implementation hurdles have largely derailed Kenya's potential for county revenue autonomy

As was the case under the *Majimbo* Constitution and same as the South African case, Kenya has adopted an integrated intergovernmental financing model that combines both vertical tax separation as well as a system of intergovernmental transfers and grants. The margin of autonomy exercised by Kenyan counties over revenue hence is drawn from these two sources. With respect to the autonomy of counties over their OSR, the Constitution assigns specific, though limited, revenue sources that are exclusive to the county level of government. These include property rates, entertainment taxes and charges for county-level services. In addition to this, the constitutional assignment of functions and powers under its Fourth Schedule provides an avenue for counties to raise additional revenue from regulatory and licensing services (fees, fines and penalties). In relation to each of these sources, counties have autonomy over the determination of the tax base, the applicable rates and also have power over their administration. While parliament has the power to legislate for additional county-level revenue sources, this avenue has not been explored. Although there are a number of both legal and practice-related factors that limit the scope of autonomy counties eventually draw from their OSR, it suffices to conclude, on a structural level, therefore, that Kenya's intergovernmental fiscal system allows for the exercise of county revenue autonomy, as drawn from county OSR. In this regard, the

[17] See the discussion under chapter five's section 2. 4.

unconditional nature of the revenue drawn from county OSR goes a long way in extending the scope for county expenditure autonomy.

However, in practice counties are only able to raise an average of about 11 per cent of their annual revenue needs from OSR. This is attributable to the asymmetry that exists in the vertical allocation of revenue means versus expenditure responsibilities which sees most revenue means retained at the national level. The result is made worse by the unwillingness and/or inability of counties to maximise their revenue potential over time. While increasing county OSR sources through national legislation may increase the scope for county revenue autonomy, disinterest from both parliament and counties in pursuing this path as well as other considerations such as the need for equalisation and centralized macroeconomic control stand in the way of its consideration. The resulting constitutionally entrenched vertical fiscal asymmetry (VFA) has therefore meant that counties look to (and depend on) their unconditional equitable shares of revenue raised nationally for the bulk of their revenue autonomy. In itself, this does not constitute a design shortcoming nor does it directly translate to limited revenue autonomy for counties. This is given the fact that the source of revenue autonomy in integrated models is shared between OSR and unconditional transfers. It however places a huge burden on transfers whose design and implementation then dictate the actual scope of revenue autonomy that is exercised by counties.

With respect to the design of the system of intergovernmental fiscal transfers, the Kenyan Constitution has, in line with the theoretical model and similar to the South African case, made provision for: objective criteria to be considered in the vertical division of revenue raised nationally; the participation of counties (through the Senate) in the revenue division process; and has as well ensured that the equitable share of revenue received by counties is unconditional such as to extend them scope for both revenue as well as expenditure autonomy. Over and above the South African model, the Kenyan Constitution has gone a step further to impose the minimum percentage (15%) of revenue raised nationally that is required to be shared annually with counties, an approach whose roots may be generally traced to the Independence Constitution. The Constitution adds to this an independent constitutional commission, the Commission on Revenue Allocation, which is tasked with providing independent recommendations relating to the division of revenue which contribute to the objectivity of the annual national revenue division process. All these design features together go to ensure that the equitable share of revenue raised nationally that is received by a specific county extends to it both revenue and expenditure autonomy thus furthering the county's overall autonomy. The justiciability of both the division criteria and process are as well critical in ensuring the implementation of this constitutional features.

However, unlike expenditure autonomy, which has been expanded in practice despite the constitutional lack of functional clarity, the legislative design and implementation of the system of intergovernmental transfers has been done in such a manner as to result in the retention of as much monies as possible at the national level, while giving the impression that the constitutional minimum threshold of 15 per cent is annually complied with. While the vertical division of revenue process has largely been done objectively and transparently, the lack of clarity in the applicable constitutional criteria has also resulted in variations in practice between recommendations from the CRA and the National Treasury regarding the exact vertical split and the rationale for the same.

Also, while the high-level parameters initially adopted by the CRA for the horizontal division of revenue (in line with Shah's principle of efficiency) allowed expanded space for the exercise of expenditure autonomy by counties, the CRA's subsequent adjustment towards expenditure-specific parameters in its latest formula moves Kenya in the South African direction of national-level expenditure predetermination through prescriptive grants. While the national allocative efficiency rationale for this may have a valid basis in light of the finite resources available nationally for sharing, its long-term use stands to incrementally erode subnational prioritisation, which is the core of subnational expenditure autonomy. The interests of sustaining the system of devolution and the list of other efficiency gains achieved by fiscal autonomy, therefore, may in the long run demand a trade-off between national-level allocative efficiency (that has always been the basis for centralisation) and subnational fiscal autonomy (that demands high-level horizontal revenue division parameters).

In addition, the equality of concurrence between the two Houses of Parliament has consistently resulted in stalemates that delay the conclusion of the vertical revenue division process, which in turn delays the passing and implementation of county budgets. Moreover, and notwithstanding the understanding that the disbursement of transfers by the National Treasury is dependent on cash flow, the consistent failure by the National Treasury to disburse funds to counties per schedule has resulted in delays in budget implementation at the county level, while also informing other county financial management issues such as pending bills.

In the end, therefore, the overreliance by counties on the equitable share as a source of their revenue (and expenditure) autonomy places the realisation of such autonomy in the hands of the national government, which has so far only worked to frustrate its attainment.

6 Prohibitive borrowing requirements constrain the exercise of county budgetary autonomy

The model adopted under Kenya's intergovernmental fiscal system for county budgetary autonomy closely aligns with that outlined under the theoretical model in literature.[18] While the Kenyan Constitution permits county-level borrowing, it differs with the theoretical model by requiring the provision of national-level guarantees to county borrowing which may in effect be translated as a bail-out mechanism for counties in the event of default. While, in principle, counties are free to borrow for both capital and current spending, the nature of regulations and requirements imposed on its exercise has meant that this aspect of county fiscal autonomy is hardly exercised in practice. While some counties have been able to borrow to cover shortfalls in revenue within the year, none have been able to explore borrowing for capital expenditure due to the prohibitive requirements imposed for securing national government guarantees. While counties' lack of sufficient OSR and assets that would serve as collateral for borrowing partly explains overall national reluctance to issue guarantees, this ground should only serve to limit the amount of money that can be borrowed and should not be a ground for a complete

[18] See the discussion under section 1 of this chapter. See also the discussion under section 7.3 of chapter two.

restriction of borrowing. However, although permitted under the constitutional design, budgetary autonomy has ended up being the most underutilised aspect of county fiscal autonomy.

7 Want of consequences undermines Kenya's otherwise adequate system of subnational accountability

Given the objects in pursuit of which fiscal autonomy is required to be directed, Kenya's intergovernmental fiscal system provides for both internal, supportive as well as external fiscal controls, aimed at ensuring the accountable exercise of fiscal autonomy by counties. While most counties have been able to set up and operationalise their own systems of internal control, and while a few have been effective in facilitating financial accountability, the issues consistently identified by the Controller of Budget (CoB) and the Auditor General (AG), including the consistently high number of counties receiving qualified, adverse and disclaimer audit opinions, illustrate endemic weaknesses in the systems of internal control among counties. Although the systems of supportive control consistently play their role in identifying financial management issues that need to be addressed by counties, weaknesses in systems of oversight affect the effectiveness of follow up mechanisms, thus leading to the recurrence of the identified issues. Despite these weaknesses, the systems of external control at the national level have been reluctant to intervene to secure greater compliance, with the Senate, which plays a somewhat intermediate oversight role being unable to ensure accountability as a result of its lack of enforcement powers. The inaction by systems of external control hence continue to inhibit the accountable exercise of fiscal autonomy by county governments, and is by extension the reason why counties have not made steps to address weaknesses in their own internal control systems, which underlie their continued receipt of negative reports from the CoB and the AG.

The reluctance by the national government to undertake intervention measures at the county level despite the existence of legitimate grounds for intervention, may however be explained by the fact that the intermediate oversight role played by the Senate gives an appearance of 'national' action aimed at securing accountable fiscal autonomy at the county level hence rendering the National Treasury complacent. The other reason for national inactivity is the fact that the national government bears the responsibility for some financial management issues identified at the county level, so it lacks the moral authority to intervene based on factors that are of its own making. For instance, the consistent violation of the legislative threshold for county expenditure on personnel emoluments is partly attributable to the national government staff that were offloaded to counties during the transition period, and whose terms of employment prevent counties from dismissing them to lower the wage bill. Also, the problem of consistently huge pending bills at the county level is largely informed by the constant failure by the national government to disburse equitable shares of revenue to counties per the agreed schedule, which in turn impacts county procurement and payment plans. A central resolution to these issues may therefore hold the key to the enhancement of county compliance with the law on these matters.

In conclusion, Kenya's intergovernmental fiscal system is designed such as to extend substantial scope for counties to exercise their constitutionally conferred margin of autonomy or self-rule. Despite the various challenges encountered in practice that either hold the potential to limit the sustained exercise of fiscal autonomy by counties, or that have and continue to limit aspects of its exercise, counties have so far been able to exercise a substantial amount of fiscal autonomy, hence an equally substantial level of self-rule. Other than these limitations, the other challenge that needs addressing is ensuring that functional, financial and institutional accountability is facilitated in the exercise of fiscal autonomy by counties.

8 The significance of the Kenyan case study

The Kenyan case makes a number of contributions to the international literature on subnational autonomy in the context of devolved states as well as to the literature specific to Kenya's system of devolution. While it confirms the centrality of an intergovernmental fiscal system's design to the realisation of subnational autonomy (and its objectives), it also illustrates the following.

First, while Parolari argues for a more detailed financial constitution as a measure to safeguard the fiscal autonomy of subnational units against legislative distortion,[19] there has been little written on the need for constitutional clarity in vertical designation of functional mandates to subnational governments as a measure against national legislative dominance and potential recentralisation of functions and powers that may otherwise qualify as subnational. The analysis of the Kenyan case in this study illustrates how a lack of clarity and certainty as to what specific functions and powers belong to which level of government exposes such determination to interpretation which then opens up the scope of subnational functions and powers (hence their expenditure responsibilities) to potential limitation under national legislation that may be enacted to disaggregate and assign specific mandates. The Kenyan case therefore helps underline the importance of constitutional clarity in the vertical demarcation of mandates as a way of safeguarding the constitutional margin of subnational autonomy (expenditure autonomy in particular) from legislative distortion.

Secondly, the Kenyan case also confirms this study's argument, traceable to Beer-Tóth,[20] that a well-designed and effectively implemented integrated approach to the financing of subnational governments is equally capable of conferring subnational revenue autonomy. However, the Kenyan case demonstrates that, while this is true, the realities of developing countries often predispose them to almost always bend the division of revenue raised nationally towards predetermination (and against Shah's efficiency principle), which consequently impacts subnational expenditure autonomy. While this may be interpreted as confirming substantial OSR as the surest subnational financing mode for optimal and sustained subnational revenue autonomy, it more importantly demonstrates that for intergovernmental fiscal transfers to confer subnational expenditure autonomy in devolved states, there is need for a trade-off between national-level allocative efficiency (that requires predetermination through expenditure-specific parameters) and subnational fiscal autonomy (that demands high-level horizontal revenue division parameters).

[19] Parolari (2018) 27.
[20] Beer-Tóth (2009) 82. See also the discussion under section 7.2.5.2. of chapter two.

Thirdly, while literature generally discusses subnational autonomy and accountability separately, with classical federal literature seeing subnational accountability as a passive outcome of tax autonomy, the Kenyan case demonstrates that, in the context of devolved states,[21] subnational accountability towards the objectives of devolution is an integral defining part of subnational autonomy, and should be a precondition for its continued exercise. While reference to the accountability of subnational governments (both horizontal and vertical) has often been taken to refer to fiscal prudence and financial accountability, the Kenyan constitution's entrenchment of the objects in pursuit of which county autonomy or devolution should be directed towards extends this scope to include a qualitative supervisory assessment of whether subnational fiscal autonomy is being exercised in a manner that achieves or contributes to the achievement of laid down purposes and goals. From the Kenyan case study, therefore, an exercise of fiscal autonomy that undermines the objectives of devolution would justify its limitation (vertically) or a horizontal petition for its limitation.

Fourthly, classical federal theory's emphasis on subnational tax autonomy is partly grounded on its role in facilitating subnational downward accountability to the people. While the Kenyan case confirms this approach, it also illustrates that while an integrated model to subnational financing still comes with this downward accountability advantage, it further strengthens subnational accountability by incorporating an explicit, carefully designed system of oversight and expenditure control that facilitates both downward and vertical accountability. The advantage of an integrated intergovernmental financing model is that the explicit system of oversight reinforces downward accountability by providing for platforms and modalities for guaranteeing its functioning. In this regard, therefore, downward accountability becomes more than just a presumed consequence of subnational taxation but a carefully planned for and supervised aspect of subnational fiscal autonomy.

Lastly, although the literature explored does not highlight the role of courts in the realisation and protection of subnational fiscal autonomy, especially in the context of unitary devolved states, the Kenyan case demonstrates that a strong and independent

[21] See definition under section 1 of chapter one.

judicial system is critical in safeguarding the sustained autonomy of subnational governments. For instance, the Kenyan courts have on occasion stepped in to protect the institutional and functional independence of county assemblies as well as that of county executive committees from interference by the national parliament.[22] The courts have also played a critical role in the protection of the interests of counties at the national level by, for instance, ensuring the mandatory involvement of the Senate in the enactment of the annual Division of Revenue, and by also emphasizing the gravity of the Commission on Revenue Allocation's recommendations in the division of revenue.[23] The courts have also aided in the provision of clarity in relation to the application of the constitutional considerations under article 203(1) in the vertical division of revenue raised nationally by mandating intergovernmental mediation.[24] The declaration of unconstitutionality of the practice of top-slicing of national interest expenditure prior to the vertical division of revenue by the courts has also contributed to equity in the vertical division of revenue.[25] Moreover, the courts have also stepped in to recommend an interim legislative solution to the problem of stagnation in county planning and budgeting by reason of delays in the annual enactment of the Division of Revenue Act at the national level.[26] All these interventions by the courts have been critical in safeguarding the fiscal autonomy of Kenyan county governments.

9 Policy implications arising from the study

As discussed in this study, a central part of devolution, and the autonomy granted as part of its design, is the objectives that underlie its adoption. Experience suggests that where devolution fails to meet these objectives, popular support for the system ceases and the centre is often tempted to legislate towards recentralisation. The realisation of the objectives of devolution is hence critical for its continued support and longevity. In the Kenyan case, these objectives include efficient subnational development, the accommodation and minorities and marginalised groups, the checking and balancing of the central exercise of power as well as the enhancement of democracy and

[22] See the discussion under section 1.4 of chapter five.
[23] See the discussion under section 2.1.4 of chapter six.
[24] See the discussion under section 2.3.1.2 of chapter six.
[25] See the discussion under section 2.3.1.1 of chapter six.
[26] See the discussion under section 2.3.1.4 of chapter six.

accountability. It is towards contributing to the realisation of these objectives that this study makes the following recommendations relating to what policy implications and reforms are necessary to facilitate the effective exercise of the margin of autonomy constitutionally extended to Kenyan counties. The recommendations are made pursuant to the study's findings and are specific to the aspect of county fiscal autonomy to which they apply.

9.1 County expenditure autonomy

Given the potential risk of centralisation, besides duplication and wastage of resources, posed by the lack of functional clarity in the constitutional allocation of functions, the Intergovernmental Relations Technical Committee (IGRTC) needs to conclude the process of unbundling and assignment of county and national government functions in order to provide more clarity in the allocation and implementation of the various expenditure responsibilities. Such unbundling should be preceded by a review of any existing analysis of functions that has so far been undertaken by the IGRTC and adopt both an intergovernmental and multisectoral approach in the constitution of the membership of the body that will be charged with the process. The process of functional analysis, unbundling and assignment should also entail the identification and clear demarcation of those functions and powers that will be classified as being concurrent as between the two levels of government. A framework will then need to be put in place to guide the performance of these concurrent responsibilities which will clearly stipulate the roles and obligations of each level of government including the financing model. Also, given the dynamic nature of competences, a periodic system needs to be put in place for continuous functional analysis, allocation and, where necessary, re-allocation.

9.2 County revenue autonomy

Even though counties are demanding an increase in national transfers rather than OSR, the sustainability of devolution demands that ways be explored through which the OSR sources of county governments could be enhanced so as to strengthen their revenue autonomy. A broader OSR base for counties will reduce county dependency on transfers and will not only ensure sustainability but will also facilitate horizontal accountability for the use of collected revenue and may as well encourage fiscal discipline at the county level by hardening budget constraints.

Also, the problem of delays in the passing of the Division of Revenue Bill needs to be addressed by, for instance, amending the Constitution to confer a weighted veto on either House of Parliament which comes into effect only in situations where there is a stalemate. This way, the House with veto will have to muster the required threshold of votes to break any stalemates in passing the annual Division of Revenue Bill. Alternatively, the current equality of concurrence between the two Houses could be retained but a vertical revenue division framework be built into legislation that adopts a multi-year approach to vertical revenue allocation (with two outer-year projected allocations). The two outer years will have projected allocations with minimum guarantees as to what counties will be entitled to for each subsequent financial year, as is the case in South Africa. This will build stability and predictability in the vertical revenue division process and will ensure that counties get the minimum guaranteed amounts for expenditure each year notwithstanding any delays in the passing of the annual Division of Revenue Bill. In the interim, national legislation should be enacted to give effect to the Supreme Court's advisory on the interim access by counties to part of their funds pending the enactment of the Division of Revenue Act.

The problem of delays in the disbursement of the equitable share of revenue also needs to be addressed by, for instance, adopting separate financial years for the national and county governments, based on South Africa's approach. This will ensure that county governments receive their full equitable shares of revenue raised nationally at the end of the national government's financial year and prior to the start of their own financial year. Adopting this approach will cure the current problem of overlaps in the financial year where any cashflow problems or shortfalls in revenue targets at the national level directly translate to delays in disbursements to the county governments.

9.3 County budgetary autonomy

While the regulation of borrowing is important, the conditions and processes need to be streamlined to allow for capital borrowing by counties so as not to negate the constitutional provision for it. Counties, or at least the Senate, also need to be given a proactive role in the regulation of national borrowing so as to ensure that national borrowing does not perpetually crowd out the room for county borrowing. Importantly, given the centrality of subnational OSR and fiscal discipline (clean audits) in the access to borrowing by counties, there is need to for the national government to continually support the revenue administration systems at the county level to address challenges affecting their effectiveness thereby improving OSR revenue yields. There is also need to ensure that national-level fiscal control and oversight mechanisms effectively undertake their roles to facilitate the accountable exercise of fiscal autonomy at the county level. Such improved levels of accountability will be key in ensuring clean audits for counties which will improve their creditworthiness thereby allowing them access credit facilities and debt financing as provided for under the Constitution.

9.4 County-level oversight and expenditure control

To ensure that fiscal autonomy is utilised to achieve both the objectives of devolution, as well as being in compliance with public finance principles, the question of the practicality of some of the legislative expenditure thresholds needs to revisited, since a consistent breach of the legislative requirements without consequences stocks a general disregard for the law at the county level. Also, the National Treasury needs to be more proactive in its obligation to provide support to counties to ensure that their systems of internal control are operational and effective in addressing identified financial management problems. More proactivity is also required on the part of the National Treasury in its role of initiating national intervention measures where this is necessary in order to ensure the accountable exercise of fiscal autonomy at the county level. The role of the Senate in exercising oversight over county-level expenditure also needs to be clearly outlined in a policy or legislative framework to ensure that there is no duplication or encroachment on the mandates of county-level internal oversight mechanisms and the both internal and external mechanisms of fiscal control work in concert to ensure the accountable exercise of fiscal autonomy at the county level.

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