FINANCING LOCAL AUTHORITIES IN KENYA : A CASE STUDY OF MERU MUNICIPALITY

BY

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DECLARATION

This project paper is my original work and has not been presented for a degree in another university.

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This project paper has been submitted for examination with my approval as University Supervisor.

Mr. G. K. Ikiara

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ABSTRACT.

The aim of this study is to determine the adequacy of the traditional sources of Local Government Finance relative to expenditure needs of local authorities. The study is also aimed at exploration of various variables that influence the degree of inadequacy of the traditional sources of local government finance.

It has been found out that the traditional sources of Local Government finance are generally inadequate largely because of their narrow economic base and excessive fiscal mismanagement. Both resource underutilization, illegitimate expenditure and ineffective and inefficient methods of revenue collection have been identified as the main constituents of fiscal mismanagement. It has further been found out that intergovernmental fiscal co-ordination is also inadequate.

Various policy recommendations on how to alleviate Local Government from their current financial plight and to enable them to be more effective in national development have been made. They include the redistribution of fiscal resources and responsibilities

between Central and Local Government with the interest of national development in mind, introducing sense of responsibility and commitment in local authorities and the Ministry of Local Government and introducing sound fiscal management techniques.

TABLE OF CONTENTS

PAGE

CHAPTER THREE

CHAPTER FOUR

CHAPTER FIVE

LIST OF TABLES

CHAPTER ONE

Introduction

1.1. Statement of the Problem.

Local authorities or Local Government units are political subdivisions below the central government level, which are constituted by law and have substantial control of local affairs. They include municipalities, county councils, town councils and urban councils. In effect, local authorities are integral parts of the structure for national governance. Their character and scope of powers and responsibilities are determined by the National Government which has superior sovereignty and status. Traditionally there are two legal doctrines that are invoked in defining the scope of local Government authority. Under the 'British System', local authorities carry out only those functions allowed by law. Under the 'Continental System', local authorities can undertake any activity which has not been specifically assigned by law to the National Government.[1]

Local Government systems are advocated for reasons whose details vary from one country to the other. However, and in general, local authorities are deemed to serve some useful roles in the social, political and economic subsystems of the national system of governance. From the political point of view, the existence of local

Government system provide basis for popular participation of local populace in decisions that affect their own lives. In this respect Local Government system enhances the realization of right to self-determination by the local people. U.K. Hicks describes it as Local Socialism.[2] Secondly, not only that local authorities have been used as a potential defence against authoritarian centralism but also as an instrument for fostering national unity.[3] From the socio-economic point of view, local authorities have long been acknowledged as effective democratic institutions that can promote social, political and economic development from below.[4] By encouraging popular participation and instilling sense of responsibility at the local level by using local authorities, the nation finds itself in a better position to mobilize its population for greater social political and economic achievements. Perhaps, it is in recognition of this fact that quite a number of National Governments including Kenyan, have involved local authorities in the mainstream of national planning and in the implementation of national development programmes.[5]

For local authorities to be able to perform their roles more efficiently and effectively, they must have access to adequate finance, among other things. Unfortunately, however, and due to the varying criteria that determine the optimal structure of allocation of functions on one hand, and optimal structure of allocation of fiscal resources on the other hand, there is often a fiscal imbalance between the responsibilities and financial resources allocated to local authorities. Intergovernmental fiscal co-ordination is usually used to bring about the balance.

Whereas the above intergovernmental fiscal relations are true in Kenya, studies on local government finance in Kenya have indicated that the co-ordinative activities of central government have always been inadequate as well as some of them being retrograde to the financial viability of local authorities.[6] The following are some of the Government decisions or co-ordinative activities which have seriously eroded the financial viability of local authorities making them even more incapable of coping with their legitimate roles in the society. Firstly, the decision of the Government to abolish the Graduated Personal Tax (GPT) in county councils and in municipalities in 1970 and 1974 respectively denied local authorities one of their major sources of finance.[7] The Government compensated the loss of GPT revenue to municipalities with GPT compensation grant which were conspicuous by their inadequacy as a substitute for GPT and by their income inelasticity.[8] Since then these grants have been phased out without any replacement. Secondly the

Government took a series of decisions between 1973 and 1978 which saw the abolition of Primary school fees in the country. The local authorities affected by these decisions were compensated with education subvention grants which were both inadequate and income inelastic.[9] Thirdly, the Government, between 1981-83, elevated many urban centres to the status which bestowed responsibilities which were disproportionate to their resources. The new local authorities do not only sometimes lay a claim to the fiscal resources at the command of the central government but also they duplicate its functions at local level.[10] The Government should now be expected to dish out more grants to the local government system. However, in the past the government has registered its unwillingness to make local authorities reliant on grants.[11] Accordingly, the government has demonstrated its unwillingness to extend the existing tax capability for local governments.[12] This, in turn, implies the Government intention to have local authorities financially dependent on the traditional sources of local government finance. Attendant to this implication is the question of the extent to which the traditional sources of Local Government finance are or can be adequate to enable the local authorities to discharge their responsibilities.

The Government appreciates both the roles the local authorities are playing and their financial plight. However, it insists that any redress to this situation must come by way of developing and improving the traditional sources of Local Government finance.[12]

The purpose of this study is to examine the extent to which the traditional sources of Local Government finance are adequate or inadequate to meet the expenditure needs of local authorities. It is also intended to explore the factors impinging on the ability of the traditional sources of Local Government finance to be adequate. The study is expected to be useful to both the Government and Local authorities in their efforts to find a solution to the financial predicaments in which the Local Government system in Kenya finds itself.

1.2. The Objectives and Assumptions of the Study

1.2.1 Objectives

The main objectives of this study are:

(1) To establish the existence of fiscal imbalance in Local Government finance by studying the revenue and expenditure patterns of Meru Municipal Council.

(2) To explore the various factors that attribute to this fiscal imbalance.

(3) To recommend the various ways in which the existing fiscal imbalance can be eleminated or improved.

1.2.2. Assumptions.

The following assumptions are made

(1) Meru Municipal Council is a fair representative sample of local authorities in Kenya for the purpose of studying Local Government finance. This assumption is valid on the following grounds:-

(a) Local authorities in Kenya are established under Local Government Act, cap.265 of Laws of Kenya. Meru Municipal Council was established under this Act in 1971.

(b) The expenditure pattern and revenue structure of Meru Municipal Council are largely similar to those of other Local athorities in Kenya. Table 1.1 below shows the expenditure pattern and expenditure sizes of eleven Municipal Councils in Kenya. Meru Municipal Council is among the few Municipalities which do not provide primary education and whose expenditures are relatively small when compared with large municipalities like Nairobi and Mombasa. The four municipal councils include Meru, Nyeri, Embu and Kakamega. Nevertheless and except for Nairobi and Mombasa, all the municipal councils cited in table 1.1 belong to committee No.2*. The urban, town and county councils' expenditures follow the same pattern as that of municipalities except that the former's expenditures are smaller in size than the latter's. Table 3.1 demonstrates this fact.

Among the factors influencing Local Government expenditure is the population. Table 1.2 shows population distribution among the eleven municipalities in which Meru municipal council is well represented.

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*All municipal councils under committee No.2 have similar terms and conditions of services and hence similar responsibilities.

Table 1.1

Comparative Expenditure Patterns For Municipal Councils For 1979 (K£'000')

Municipalities	SERVICES				
	Administration	Community	Social	Economic	Total
Nairobi	3027	6736	7850	9077	26690
Mombasa	629	916	1721	1344	4606
Nakuru	255	457	824	688	2225
Kisumu	290	293	466	510	1559
Eldoret	158	166	273	674	1270
Kitale	91	260	169	458	978
Thika	343	200	177	319	1039
Nyeri	103	85	3	114	305
Embu	66	37	3	110	216
Meru	125	56	3	59	242
Kakamega	92	27	28	131	279
	5178	9229	11518	13484	39409

Source: Kenya: Central Bureau of Statistics, Statistical Abstract, Nairobi: Govt. Printer, 1981.

Table 1.2.

Comparative Population Distribution Among Municipalities for 1979

Municipalities	Population	Municipal Area (SQ KM)	Population Density
Nairobi	827,775	684	1210.0
Mombasa	341,148	210	1625.0
Nakuru	92,851		
Kisumu	152,643	270	565.0
Eldoret	50,503	57	886.0
Kitale	28,327	80	354.0
Thika	41,324	92	449.0
Nyeri	35,753	71	503.0
Embu	15,982	24	666.0
Meru	72,042	128	563.0
Kakamega	32,025		

Sources: Kenya: Central Bureau of Statistics, Population Census 1979.

The sources of Local Government finance in Kenya are the same and are defined in Local Government Act. and Rating Act.[15] They include property taxes, fees and charges, produce cess, grants and loans. Table 1.3 compares the sources of finance for municipal councils and the other local authorities.

Table 1.3: Sources of Local Government Finance (K£'000') 1979

	Municipalities	%	Other Local Authorities	%
Direct Taxes (eg.Rates)	7883	20.9	995	8.9
Indirect Taxes(Gc.ecess)	589	1.6	4677	41.6
Income from Properties land rent)	783	2.1	965	8.6
Sale of goods & services	15,522	41.2	3403	30.3
Grants	6,954	18.5	98	2.6
Total Current revenue	31,731	84.3	10338	92.0
Add.				
Loans	5833	15.6	870	7.7
Grants	-		-	
Loan repayment	38	0.1	26	0.3
Total Capital Revenue	5871	15.7	896	8.0
Total Revenue	87602	100	11234	100

Source: Compiled from Central Bureau of Statistics, Statistical Abstracts 1981.

(2) The Kenya Government has the intention of making local authorities viable instruments for social economic development. This is in comformity with the views of the Working Party appointed by the President to recommend on Government expenditure.[16]

1.3. Hypotheses

The general hypothesis of this study is that the traditional sources of Local Government finance in Kenya are inadequate to meet the expenditure needs of local authorities. This hypothesis is disaggregated into several working hypotheses as follows.

1. The income yield of the traditional sources of Local Government finance is low relative to expenditure requirements.

2. The intergovernmental fiscal co-ordination is inadequate for the purpose of solving fiscal imbalance problems.

3. Fiscal mismanagement at Local Government level creates false financial inadequacy i.e.

(a) The available financial resources are not exhaustively exploited.

(b) Some expenditure requirements are socially undesirable because they are not dictated by societal needs.

(c) Inefficient and ineffective methods of revenue collection as well as tax evasion and tax avoidance affect the adequacy of Local Government finance.

1.4 Study Methodology

1.4.1 Sources of data

(a) Secondary data

The study uses secondary data obtained from Government publications, University discussion papers, Meru municipal council's estimates, abstracts of accounts and subsidiary accounting records. Publications from other organizations which have relevance to Local Government finance are also used.

(b) Primary data

Primary data is obtained through oral interviews with the relevant authorities. Free interview technique where open-ended questions are used is adopted Town treasurer and officers of his department answer most of the questions relating to revenue collections tax evasion and avoidance and methods of financing deficits. The primary data obtained is used to support or supplement the secondary data.

I.5 SCOPE OF THE STUDY

The study is limited to Meru Municipal Council and covers the period 1973 - 1980. This period is prefered because it covers a substantial lifetime of the Council and bacause most of the necessary data is obtainable.

1.6 TESTING OF THE HYPOTHESES

(1) The general inadequacy of the traditional sources of Local Government finance is calculated as follows,

(a) Computation of the difference between nongrant revenue and expenditure for each year. This gives a figure for an absolute inadequacy in a period of time.

(b) Compute a coefficient of the inadequacy of nongrant revenue by relating the results obtained in (a) to the related expenditure. For example:-

Let NR = Nongrant Revenue for the period (Yr)

E = Expenditure for the same period (yr)

K = Inadequacy of nongrant revenue

C = Coefficient of nongrant revenue inadequacy

$$K = NR - E$$

$$C = \frac{K}{E}$$

(c) <u>Interpretation of Results</u>

(i) $\frac{K}{E} = 0$ Indicates that the nongrant revenue is just adequate to meet the expenditure requirement.

(ii) $\frac{K}{E} > 0$ Indicates that the nongrant revenue is more than adequate to meet the expenditure requirement.

(iii) $\frac{K}{E} < 0$ Indicates that nongrant revenue is inadequate to meet the expenditure requirements. The smaller the $(\frac{K}{E})$ the greater the inadequacy of nongrant revenue Note that $\frac{K}{E} < 0$ is always negative.

(d) The coefficient of nongrant revenue inadequacy for a number of years is the average of the sum of coefficients for the period in question. For example:-

LET: $\frac{K}{E}$ = Yearly coefficient of nongrant revenue inadequacy.

$I = \frac{K}{E}$

j = Year

N = Number of years in the period of time.

p = Coefficient-of revenue inadequacy over a period of time.

$$\therefore \quad p = \frac{1}{N}\sum_{j=1}^{N} I_j.$$

(2) Income yield for each source of finance is compared with the actual over-all expenditure of the council over the period of the study. This indicates the relative size of revenue yield from each source.

(3) It is assumed that the intergovernmental fiscal co-ordination is intended to balance Local Government revenue and expenditure. Since Government grants constitute such co-ordinative efforts, the inadequacy of intergovernmental fiscal co-ordination is measured in terms of inadequacy of Government

grants to Local authorities. This inadequacy is calculated as follows:-

(a) compute the difference between nongrant revenue and expenditure for each year.

(b) express the results of (i) as a percentage of the total expenditure for each year.

(c) express the Government grants as a percentage of total expenditure for each year and subtract the result from the result obtained in (ii). The answer is the coefficient of intergovernmental fiscal co-ordination inadequacy. The above steps are expressed algebraically as follows:-

LET: K = Nongrant deficit for one year

E = Total expenditure for one year

G = Government grants

g = Coefficient of intergovernmental fiscal co-ordination inadequacy.

$$\therefore \quad g = \frac{K}{E} - \frac{G}{E}$$

$$G \quad \frac{K - G}{E}$$

(d) Interpretation.

When $g = 0$ the intergovernmental fiscal co-odination is just adequate to balance the revenue and expenditure of the Local authority.

$g > 0$ The intergovernmental fiscal co-ordination is more than adequate to balance the revenue and expenditure of a Local authority.

$g < 0$ The intergovernmental fiscal co-ordination is inadequate to balance the revenue and expenditure of a Local authority.

(e) The coefficient of intergovernmental fiscal co-ordination inadequacy for a period of time is the average of the sum of the coefficients for that period. For example:-

LET g = coefficient of annual intergovernmental fiscal co-ordination.

j = year

N = number of years in a period.

$$\therefore g = \frac{1}{N} \sum_{j=1}^{N} g_j$$

4. The effect of fiscal mismanagement on the adequacy of revenue from the traditional sources of Local Government finance is assessed as follows:

   (a) The extent to which the available financial resources are not used is assessed by projecting the revenue potentials of each source of revenue and subtracting what is actually collected from the projected figure.

   (b) Expenditures which are not legitimate are explored, discussed and estimated.

   (c) The ineffectiveness and inefficiency of the tax collection method will be demonstrated by the revenue in arrears.

   (d) Various ways in which tax evasion occurs are described and the amount of revenue involved is estimated.

1.7 LIMITATIONS OF THE STUDY

(1) Kenya Local authorities differ substantially in respect to (a) the magnitude of their public responsibilities, (b) the financial competence and problems, (c) the management and organizational

capabilities. Consquently, the results of this study cannot be generalized to apply equally to all Local authorities in Kenya.

(2) In view of the difficulties involved in accurate identification of the allocative and distributive effect of the council's expenditure, the discussion on the legitimacy of the various expenditure requirements of the council is not conclusive and merits further study. Accordingly accurate allocation of expenditures to various expenditure heads may be difficult.

FOOTNOTES - CHAPTER ONE

1. United Nations: Local Government Reform:Analysis of Experience in Selected Countries, New York, 1975, P.45.

2. U.K. Hicks: Development from Below: Local Government Finance in Developing Countries of Commonwealth, Oxford, U.P. 1961.

3. United Nations: Op.cit P.20.

4. U.K. Hicks: Op.cit, Also See Public Finance, Planning and Economic Development' by Wilfred. L David, Wheation & Co., Great Britain, 1972, p.304.

5. Republic of Kenya: Report and Recommendations of Working Party on Government Expenditure, Government Printer, Nairobi, 1982, p.55.

   United Nations: Op.cit. p.52-53.

6. ________: See chapter II which deals with the Local Government Literature Review.

7. Wilfred L. David: Public Finance, Planning and Economic Development' Wheaton & Co. Great Britain, 1972. p.135.

   N.W. Kariuki: Intergovernmental Fiscal Relations in Kenya. A M.A. Thesis, University of Nairobi, 1980, p.117.

8. ________: Ibid. p.117.

9. ________: Ibid. p.121

10. Republic of Kenya: Op.cit. p.52. The report states that there is duplication of functions at the District level i.e. there is Provincial Administration (district level), county council, urban and town councils are carrying out similar functions.

11. ________: See The Standard Newspaper dated 30/5/79, Nairobi, Kenya. In the report titled'councils urged to be financially independent', the then Minister of Local Government indicated unwillingness to be asked for more grants by the Local authorities.

12. Republic of Kenya: Sessional Paper No. 12, Government Printer, 1967, P.14-15.

13. ______________: Ibid.

14. Republic of Kenya: Report and Recommendations of the Working Party. Government Printer, 1982, p.50.

15. Local Government Act: Cap 265 and Rating Act Cap. 267.

16. Republic of Kenya: Op.cit.

CHAPTER II

Theoretical Framework and Local Government Finance Literature Review.

2.1 The Theory of Public Finance

2.1.1. Government Revenue and Expenditure

Public Finance describes and analyses government services, subsidies and welfare payments and the methods by which the expenditures to this end are covered through taxation, borrowing, foreign aid and creation of new money[1] Essentially Public Finance is concerned with ways of raising public revenue, its expenditure, and their macro-economic effect on national income.

(a) Taxation.

Taxes are compulsory contributions imposed by the Government or taxing authority for the purpose of financing activities whose benefits are general in character. They constitute a major source of Government revenue. Taxes are characterised by their lack of direct relationship with the services offered to the taxpayer and by their compulsion of payment. The services offered are characterised by jointness of consumption and non-exclusion of consumers.

Social and economic criteria provide the basis on which taxes are evaluated and assessed. The social criteria of equity, certainty, convenience and economy have their implications for social justice. Individuals who are equally circumstanced should be equally taxed. Individuals should know, with certainty, their tax liabilities in order that they can make adequate provision for them. The taxes levied should have least disruption of the private activities of the individual and the revenue thus raised should be used without waste. The economic criteria that influence taxation include:-

(i) Production Optimum : This concept implies a position in which it is impossible to increase the total volume of national production by any adjustment in the structure of the economy. Under this criterion, the effect of taxation on resource allocation and resource supply as well as redistribution of income, purchasing power and ease of administration are considered.

(ii) Utility Optimum: This concept implies maximization of the consumers' satisfaction. This is achieved by selecting from among various production optima the one which achieves the utility optimum.

For the purpose of evaluating the different forms of taxation against the above criteria, and for the purpose of providing basis for tax assessment, taxes are classified into direct and indirect taxes. A direct tax has the impact and the incidence of taxation on the same individual i.e. the person who is assessed or on whom the tax is imposed is the person who pays tax. An indirect tax is a tax under which the impact of taxation and incidence of taxation fall on different persons. i.e.- the person on whom the tax is imposed is not the person who pays it. For the purpose of equity, the determination of incidence of tax is extremely important in taxation.

(b) Expenditure

There are two types of Government expenditure. These are the explicit and imputed expenditures. Explicit expenditure involves transfer payments or payment for services. Transfer payments are further divided into unrequited transfer payments involving no quid pro quo and requited payments in which exchange of values takes place. Imputed payments on the other hand do not involve actual cash outlay but are mere offsetting entries in books of account. For example when a government allows

25% tax allowance on capital investment of Ksh.10 million it is as if the government received Ksh.2.5m and then contributed it towards the purchase of the capital equipments constituting the capital investment.

Government expenditure are influenced by population, price levels, development programmes and increased need for protective, administrative and social services. Some considerations are kept in view when public expenditure are incurred. These considerations are generally referred to as the principles of public expenditure. The first one of these principles is that of maximum social benefit. The expenditure must be incurred in such a way that the maximum people get maximum possible benefit from the expenditure. The second one is the economy. PUblic expenditure must be incurred in the most economical way. The third principle is that of elasticity. Public expenditure must be capable of being expanded and contracted depending on the prevailing circumstances. Finally, the public expenditure must be sanctioned by the higher authorities and must be adequately accounted for.

2.1.2. Fiscal Policy Determination

Fiscal policy determines the composition and level of Government expenditure programes and tax structure as well or the use of aggregate tax and expenditure measures in stabilization policy. This process differs from one country to another depending on the system of the government and political structure.

Generally, expenditure is determined through budgetary process by the executive arm of the government. It is then approved by the legislature. Expanditure control is exercised by either an agency of the legislature or by both legislature and excutive. The extent to which the executive budget is subject to modification by the legislature varies from one country to another. Accordingly the procedures at the legislative level differ in the degree to which the budget is examined and passed upon as an overall plan or is dealt with in a piecemeal manner.

The determination of tax structure involves the same process. However and under parliamentary form of government tax programmes are introduced by the government and expected to be passed without modifications. Otherwise, the determination of tax structure is the responsibility of the legislature. The extent to which the economic and political groups influence the determination of tax policy differ.

The determination of expenditure programmes and revenue creates either a budgetary surplus or a deficit. One of the differences between Local Government and Central Government finance arises when fiscal policy determination creates a budgetary deficit, namely:-

(i) While both central and Local Governments adjust their incomes to their expenditures during fiscal policy determination, the Local Governments do so within the ultimate limit set by the physical resources which they command. The Central Government on the other hand can to some extent use deficit financing mechanism.

(ii) Theoretically, Central Government has unlimited credit facilities. It can borrow from the Central Bank or from its citizens to whatever extent it may desire. However, and under normal circumstances, this theoretical assumption, does not hold. The Government is constrained by economic consideration of excessive borrowing. Excessive external borrowing lowers the standard of living of the people of the debtor country. The repayment of loan and interest thereof impinges on the balance of payment requiring the debtor country either to export more without corresponding imports or to import less if the demand for export is inelastic. Excessive internal borrowing by Government raises inflation rates and thus reduces the purchasing power of people particularly the lower income groups forcing them to cut in their standard of living. The credit facilities to Local Government Units are limited by their ability to pay and regulations from Central Government.

2.1.3 The Role of Public Finance in an Economy.

In modern market economies, there are four economic goals to be achieved. The first one is the attainment of maximum individual freedom of choice. Individuals must have right to decide which commodities they wish to acquire. They must also have the right to decide their own expenditure outlay. The producers also should have the right to decide what to produce and what production technique to use. The second economic goal is to achieve optimum level of living. Individuals must be able to enjoy the highest level of satisfaction of wants given the available factors of production and techniques and pattern of distribution. For the optimum level of living to be attained, there should be optimum efficient use of available resources, production must be tailored to consumers' preferences and all the production factors which the owners want employed for the purpose of production should be employed at the going factor prices. The third economic goal is economic growth and the fourth one is equity in the distribution of income.

Market economy has been able to achieve some of the above objectives but not others. Some degree of freedom of choice is attained in the market economy but because of the development of monopoly power, there is restriction in the freedom of producers to undertake new enterprises and in consumers' freedom to acquire goods they want. Optimum level of living is not achieved because of imperfection of the market. Market economy results into unequal income distribution. This income inequality is facilitated by the existence of monopoly power in the market.

The failure of the market economy to achieve all the desired economic goals has invited and encouraged the development of governmental activities to this end. Government steps in to correct the deficiencies of the market economy by undertaking the functions of allocation, redistribution and stabilization. The allocative functions of the government are designed to provide for social and merit goods which the market economy cannot provide efficiently, to absorb the external diseconomies of private production, to finance external economies and to eleminate any interference with perfect competition. Local authorities can undertake this function without any relocation of economic resources or without adverse economic effect. The redistributive functions of the Government are intended to increase the relative economic well being of certain groups within the economy, particularly those with very low incomes. Local authorities cannot perform this function efficiently because the resultant pattern of post-tax distribution would not conform to what is generally considered as socially acceptable. The stabilization function of the government is designed to stabilize the economy and promote economic growth. Local authorities cannot perform this function in a socially desirable manner because of the limited plans and impact of their decisions.

The determination of the optimum levels at which these functions can be performed depends on particular function. For allocative functions, the marginal rule and price system are used. For pure government services, the allocative activities of the government must be extended to the level at which the marginal social benefits from the activities are equal to marginal social costs. For governmental activities whose benefits accrue directly and separately to individuals, and unless equity conditions state otherwise, price system can be used to adjust the levels of such activities.

2.1.4. Determination of Optimum Structure for Allocation of Functions and Fiscal Resources Among Levels of Government.

In a state with multilevel governments legally constituted, the above functions of the government and the necessary fiscal resources must be optimally distributed among various levels of Government. Various theoretical suggestions and practices to this end are discussed below. The two-level government, central and local government situation is discussed here.

(1) Division of Functions

The very existence of a local government system presupposes an assignment of powers and responsibilities to its constituent units. Theoretically, the allocation of functions among the levels of government should be based on the principle of 'fiscal equivalence' which states that public programmes should be vested in the government which happens to encompass all those who benefit and not others.[2] According to this principle

Local authorities should be allocated the functions whose fiscal equivalence coincides with their jurisdictional boundaries i.e. public programmes of local interests, while the central government should be allocated the functions which are national in character and scope. However, and because of citizen mobility and resource migration, rarely does the coincidence between fiscal equivalence and jurisdictional area at the local government level occur. There are distortions which require fiscal adjustments.

In practice both political and economic considerations determine the ultimate division of functions between central government and local authorities. The considerations include:-

(a) Political Criterion

Political considerations are based on "Presence" of local authorities. "Presence" is a quality of local authorities by which they are readily perceived by their clients and other groups with which they have working relationship.[3] From a political viewpoint, the "presence" of local authorities is determined by the minimum amount of activities that they should be left with, without killing all interest in their activities.[4]

(b) Economic Criterion

From the standpoint of economic efficiency, all the functions from which a country can obtain certain economies of scale should be allocated to the central government and those functions which require great manoeuverability and flexibility should be left to local authorities. For example, national defence would be economically operated at the national level while fire services would be effectively operated at the local level.

(c) Other Criteria

The need for uniformity in standards and policies would suggest that such functions as stabilization and redistribution be handled solely by the central government.

The above criteria suggest that except where it is in the interest of national efficiency, uniformity of policy and other national interests, all functions should be undertaken by local authorities which can perform them efficiently in a manner consistent with the interest of society as a whole.[5] This point is emphasized by the following exerpt.

"While increased complexity and interdependence of the economy have resulted in great centralization in government, there is a wide acceptance of the principle that functions should not be transferred to the higher levels of government except in those cases in which there is clear demonstration of net gain from doing so."[6]

(2) Division of Financial Resources.

There are three primary criteria that determine the allocation of financial resources among the levels of government. These are political, administrative efficiency and the economic effect which result from the tax.

(a) Political Criterion

The political criterion in most countries requires local authorities to be self supporting and financially independent from the central government. This criterion emphasizes local sovereignty which would be adversely affected by financial dependence of local authorities on central government. The argument for financial independence of local authorities is best explained by the following exerpts.

'On the general principle that the greater the degree of independence on the revenue side, the more scope there is for local control over local expenditure, and hence the more likely it is that local government will be active and flourishing, one must declare that the more revenue local authorities raise for themselves the better it will be for them'[7]

This argument is further supported as follows:-

'...... From this it follows that if local government is to effectively administer services, then it must have major source of finance which is independent of central government, otherwise its ability to develop policies will be very severely curtailed'[8]

This political view of the intergovernmental tax structure however is modified to accommodate the inherent limitations of local authority taxation as well as the need for central authorities to exercise some control over local government fiscal management.

(b) Administrative Efficiency

The efficiency of a system for tax collection is judged by the ease with which it accurately assesses taxes. This, in turn, depends on the ability of the unit of government, administering the system, to obtain the requisite information about the tax base of the activity under consideration. As a general rule, this is possible where the taxable activity is within the jusisdictional area of the taxing authority. The larger the jurisdictional area of the taxing authority, the fewer will be taxable activities without its borders. It therefore follows that a larger unit of government can administer taxes more efficiently than a smaller one. Therefore, for the sake of administrative efficiency, taxation should be undertaken by the larger unit of government.

(c) Economic Effect of Taxation

The posibility that a tax base may migrate as a result of local taxation is of primary consideration in allocating taxes among the levels of government. Where and when migration is relatively easy, the tax under consideration should be handled by the unit of government that encompasses all the other levels of government in order to control resource movement.

All-in-all, the various criteria that determine the location of tax responsibilities, allocate more taxable capacity to the central government than to the local authorities.

The results of the diverse criteria that determine the optimal structure of allocation of functions on one hand and the optimal tax structure on the other hand is that a fiscal imbalance is created between the functions and revenue resources allocated to the local authorities. From the aforegoing discussion, local authorities can undertake all the allocative functions of the government in so far as the national efficiency and uniformity of policy are not affected. Generally local authorities undertake such allocative functions as education, health and roads. On the revenue side, the only major tax which can be levied locally with a measure of administrative efficiency and with less taxation effect on the economy is property tax. Property tax and fees and charges are the main sources of local government finance.

Property tax does not have much distorting effect on the national economy. It does not place direct burden on the results of current economic activities and thus may have less adverse effects upon incentives towards economic activities. This tax is justifiable on grounds of benefit principle. It is based on benefits which the property owners receive from services such as street lights, sewerage, roads etc. However, it is highly inequitable and income inelastic. Nevertheless, it is a major source of local government finance in many countries.

2.1.5. Fiscal Co-ordination

The unequal distribution of taxable activities between the levels of government results into sub-optimum overall pattern of governmental activities and expenditure. The fiscal imbalance encourages the provision of public services whose standards are below levels which are regarded by society as optimum. The The fiscal inequality among the lower levels of government violates the basic equity rule of equal treatment for those equally circumstanced as well as resulting into uneconomic relocation of economic activities.

The above structure and consequences of inter-governmental fiscal relations suggest a need for an induced fiscal balance between the functions and finances of local authorities (vertical fiscal co-ordination) and fiscal equalization among local authorities themselves (horizontal fiscal co-ordinations). Note that the vertical fiscal co-ordination also includes tax restriction of junior or lower level government by the superior government for the purpose of national fiscal management. For example the central government may deny a local authority the right to tax a revenue source that is crucial as a purchasing power base for a given community.

The following forms of fiscal co-ordination are generally used.

(1) Separation of Revenue Sources

This involves the allocation of various revenue resources (tax bases) to various levels of government ensuring that each revenue resource is used by only one level of government. The criterion used in this allocation is the relative advantage enjoyed by a particular level of government by using a certain tax base. Each level of government should be allocated the tax base in which it has absolute advantage. Where an absolute advantage does not exist, the level of government should be allocated the tax base in which it does not perform poorly. The separation of revenue sources minimizes the over-all administrative expenses on taxes but does not meet the basic problem of intergovernmental fiscal relations. Under any system of revenue source separation, the tax sources which can be allocated to the lower levels of government are limited and insufficient. This is because the higher level of government has absolute advantage over the whole taxation system.

(2) Sharing Revenue

Under this approach, the tax collection responsibility is allocated to one unit of government and the revenue thus collected is distributed to the other levels of government on basis of either geographical origin of the revenue or tax base. This approach is applicable where a particular revenue source is used by many lower level governments and when such a revenue source is desirable to support all levels of government. The allocation of tax collection responsibility is determined by the criterion of economic efficiency and convenience of tax collection. Usually, such a responsibility is allocated to the superior government that has the necessary machinery to collect the revenue.

Like the separation of sources,-sharing revenue approach minimizes tax administrative expenses but reduces the discretionary role of lower levels of government over taxation. In effect, it reduces local autonomy, Accordingly, the distribution of revenue on basis of origin or tax base ignores the disparity in relative needs of the lower levels of government.

(3) Grants-in-Aid

Grants are funds drawn from the general fund of the central government and transferred to the lower level governments to aid in financing their activities. Grants do not have any relationship with a particular tax imposed by the central government.

There are two major types of grants. These are general or block grants and categorical, also known as selective, functional or conditional grants. Each of these grants can further be classified as matching or non-matching. A matching grant supports only the provision of social goods while a non-matching grant is general and may support the purchase of additional private goods by way of tax reduction. Grants are also considered by the extent to which they relate to the fiscal needs of the recipient government.

(a) Block or General Grants

These are granted unconditionally, without specification of purpose or supervision. These grant do not take into consideration the fiscal need or competence of the donee government. The implicit index of need for the grant is the population of the donee government. Block grants are mostly used to achieve the objectives of fiscal equalization and support of the provision of merit goods. Unlike the conditional grants, an appropriately designed system of general grant can solve the problem of fiscal imbalance efficiently. Under the general grant system, the pareto-optimal distribution of resources between the private sector and public sector is both facilitated and hindered. It is facilitated by the fact that the grant lessens the pressure for tax reduction by lower levels of government under conditions of competition. It is hindered by the fact that

'No one group of persons compares the marginal value of expenditure with the marginal value of tax raised; there is no opportunity for application of Wicksell principle'.[9]

(b) Conditional Grants

These are the grants in which the donor government specifies the purpose to which the recipient government must put the funds. If the recipient government is not supposed to use its own funds on the programme financed with conditional grant then the latter is a non-sharing conditional grant or non-matching conditional grant. If, however, the specific purpose grant requires the donee government to participate in the programme by spending a stipulated sum of its own funds,- then the grant is a sharing or matching one. Non-sharing grants invite a high degree of supervision from the donor government thus making the donee government a mere administrative agent of the latter.

According to the theory of optimizing grants, the expansion of conditional grants should concentrate on the lower level government activities which have important spillover benefits of national character. Conversely the grant programmes for public services whose benefits are confined within a geographical area should either be reduced or eleminated because such grants lead to decisions that misallocate the expenditure. For eaxample they may lead to the consumption of more private goods than merit goods. It is apparent from the above theory that the optimizing grants are designed to minimize the distorting effects of benefit spillovers. For them to achieve this objective, they must have the following characteristics.

(i) They should be categorical or conditional. That is, they should be confined to local programmes with significant external benefits. The size of the grant should increase with increase in external benefits.

(ii) They should be matching grants with both the grantor and grantee governments sharing in the cost of the supported programme. An open type of grant that allows the expenditure of the recipient government to be matched without limit is desirable since the external benefits may be expected to continue to rise in total as the expenditure and internal benefits rise. This view is in contradistinction to the block grants which assume, interalia, a predetermined level of expenditure beyond which the externalities cease to exist. The problem with this view, however, is that the finances of the grantor government have a limit.

(iii) The grantor government deserves the right to demand or ensure efficient utilization of the grant by the grantee government. This means that under the system of optimizing grants, a high degree of control of donee's government activities by the donor government is necessary.

The optimizing grants are ideal instruments for approaching pareto optimum by taking into consideration the externalities. They are used to achieve spillover correction and to support the provision of merit goods. They also have a substitution effect in that by encouraging the donee government to increase its expenditure, they also promote the consumption of more merit goods than private goods. However and because of their concentration on the external benefits they do not solve the fiscal problems of the lower levels of government.

2.1.6 Principles of Local Government Finance

From the aforegoing theoretical literature, the practice, and principles on which local government finance should be based can be determined, namely:-

(a) All the functions of the government, particularly those which do not affect the redistribution and stabilization activities of a government can be more efficiently performed at local level. Therefore as much as possible these functions should be allocated to the local authorities.

(b) Some of the functions of the government provide merit goods whose benefits can be directly attributable to some individuals or groups of individuals. Local authorities should provide these goods on commercial basis and charge for them on basis of the benefit principle.

(c) Financial independence of local authorities is impossible because of economic effects of local taxation and administrative efficiency considerations. Consequently, a system of grants from central to local governments should be introduced.

2.1.7. The Intergovernmental Fiscal Relations in Developing Countries.

The intergovernmental fiscal relations discussed above vary from one country to another depending on the social political philosophy of the country and political expediency of the leaders as well as the economic wellbeing of the country. However, a general pattern of intergovernmental fiscal relations is today identifiable along the lines of the dichotomous worlds of development. The intergovernmental fiscal relations in less developed countries (LDCs) are characterized by general inadequacy of fiscal resources at all levels of government, the tendency of the national governments to pre-empt almost all the available revenue resources leaving the lower levels of governments with the least productive sources of finance and almost absolute reliance on local taxes for the purpose of financing expenditure needs which are generally beyond their fiscal capabilities. The LDC's experience of general fiscal inadequacy arises because the infrastructure of their taxable capacity is too underdeveloped to yield adequate revenue for all levels of government.[10] Consequently and because of the priority they attach to their own financial problems, the national governments allocate to themselves all the resourceful revenue sources leaving the local authorities with less productive ones. Table 2.1 below shows that approximately, the expenditure of the lower levels of governments in LDC constituted about 23.9% of the total government current expenditure for the countries under review in 1968*. Table 2.2 shows a similar comparison for the developed countries. It is apparent from the comparative tables that the local authorities in developed countries are endowed with more fiscal resources than their counterparts in LDCs and play a more significant role in national development than the latter. Table 2.3 shows the percentage of grants to the total revenue accruing to local government units in LDCs. The implication here is that most of local authorities in LDCs depend exclusively on local taxes. Accordingly it implies that the intergovernmental fiscal co-ordination in LDCs is very insufficient."[11] One possible reason for this phenomenon is the general inadequacy of fiscal resources. The national governments in LDCs do not have enough funds for their own use and for distribution among local authorities. The second possible reason is that the national governments in LDC's are not prepared to risk the available scarce resources with local authorities.

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*Latest data is not available.

TABLE 2.1: · SUBNATIONAL GOVERNMENT PERCENTAGE SHARE IN TOTAL GOVERNMENT CURRENT EXPENDITURE 19
(LESS DEVELOPED COUNTRIES)

Large Subnational Govt.Share		Medium Subnational Govt.Share		Low Subnational Govt. Share	
Brazil	65.8	Korea	28.9	Malaysia	9.3
Colombia	54.2	Nicaragua	27.7	Rhodesia	8.9
Chile	52.7	Nigeria	27.4	Panama	8.8
India	52.3	Malagasy	25.8	Tunisia	8.2
Mexico	47.5	Ireland	21.5	Senegal	7.8
Pakistan	44.5	Portugal	21.5	Sierra Leone	6.3
Uruguay	44.4	Botswana	20.5	Fiji	6.2
Ecuador	41.4	Philippine	20.4	Thailand	5.7
Venezugla	41.2	Honduras	20.1	Jamaica	5.6
South Africa	40.1	Kenya	18.9	Mauratius	5.5
Cameroon	40.0	Trinidad	18.3	Chad	5.3
El salvador	39.2	Algeria	14.7	Peru	3.8
Costa Rica	37.5	Guatamala	13.7	Zambia	1.8
Bolivia	37.2	Turkey	10.9	Swaziland	1.3
Greece	35.5			Lesotho	1.2
				Ceylon	0.1

Source: 'Fiscal Decentralization and Economic Development, World Bank Studies in Domestic Finance No.10, 1975

TABLE 2.2 LOCAL GOVERNMENT EXPENDITURE AS A PERCENTAGE OF TOTAL GOVERNMENT EXPENDITURE.

DEVELOPED COUNTRIES 1976

Federal Republic of Germany	47.0
France	69.4
Italy	49.0
Netherlands	76.6
Belgium	42.5
United Kingdom	76.6
Ireland	71.3
Sweden	101.0

Source: International Union of Local Authorities

TABLE 2.3: IMPORTANCE OF INTERGOVERNMENT TRANSFERS IN LOCAL GOVERNMENT FINANCE

YEAR	CITY	REVENUE	YEAR	CITY	REVENUE
			1972	Lusaka	6.0
1972	Francistenon	1.9	1974	California	2.8
1968	Mexico city	.8.9	1975	Calcatta	19.4
1975	Lapaz	9.0	1972	Cartepena	12.8
1972	Tunis	0.7	1971	Mboyi-Mayi	29.8
1975	Kitwe	2.2	1970	Manila	30.0
1968	Valencia	9.2	1971	Bukeru	30.1
1972	Lubumbashi	9.5	1976	Madras	25.1
1967	Rio De Janeiro	1.7	1972	Bogota	14.0
1971	Ahmedebad	4.2	1974	Teheran	45.2
1975	Karachi	2.8	1972	Kingston	67.2
1971	Bombay	1.0	1971	Kinshasa	73.1
1971	Seoul	15.8			
1973	Jakarta	21.1			

Source: Roy Bahn and Johannes Linn 'Urban Government Finance and adminstration in developing countries, chapters 11-13, unpublished (I.U.L.A. Report)

The local authorities in developed countries have longer history than their counterparts in LDC's and have evolved through social political and economic systems which have imparted into them some sense of responsibility,making them acceptable and appreciable in their systems. Consequently it is possible for the national governments to trust them with national development without much risk of failure. In developing countries, and in particular, African, the local authorities are too immature and riddled with tribal, ethnic and sectional parochialism to encourage their national governments to trust them with more fiscal resources than they can raise locally. In developed countries, local authorities depend more on government grants than on local taxes. Government grants to local authorities in West Germany, France and Great Britain constituted 42.6%, 34.7% and 49.2% respectively of their total revenue in 1976.[12]

2.2 Local Government Finance Literature Review

Various studies on Kenya local government finance have been carried out as far back as 1961. These studies give a pessimistic picture of local government finance in Kenya and essentially support the foregoing views on intergovernmental fiscal relations. Some of these studies are outlined below.

In 1961 Hicks, in her study of local government finance in commonwealth countries found the financial resources allocated to Kenya local authorities insufficient mainly because of narrow and inelastic tax base on which the finance is based. Accordingly she felt that the financial resources at the disposal of the local authorities were less autonomously controlled by them. Hicks proposed local government revenue sources which would have broad and elastic tax bases. She also proposed more financial autonomy for the local authorities.[14]

In 1962, Kenya government appointed a fiscal commission whose terms of reference were to examine the public revenues available in Kenya then and advise on the possibility of increasing the yield of the then revenue resources as well as the possibility of developing new ones.[15] The commission recommended that the central government surrender some of its rights on personal taxes to local authorities in form of graduated personal tax (GPT). GPT was introduced in 1964 as a local government tax. The commission further recommended the transfer of customs and excise duties and consumption taxes on petrol and diesel from the central government to regional authorities. It also recommended general grants as appropriate instrument for intergovernmental fiscal co-ordination.

In 1966 a local government commission of inquiry was appointed to look into and advise on the reforms necessary to make the local government system in Kenya a more effective instrument for the provision of local services and local development within the framework of national policy and national programmes.[16] The commission was also required to report on the extent and nature of central government control over local authorities and the general financial situation of local authorities.

The findings of the local government commission were in agreement with that of the fiscal commission in respect to the inelasticity of local government finance. However, the commission concluded that any 'additional revenue to the local government services will have to be obtained from the improvement and development of the sources of revenue at present available to local authorities, including grants from government.'[17] The Commission's conclusion to this effect was arrived at after consideration of evidence from the Treasury which advised the former on the state of taxation in Kenya

> "..... The Kenya Government is now taking in taxation about 19.6% of the monetary sector of the gross domestic product and if we add to this local authority taxation and in particular graduated personal tax, it will be seen that the percentage of the national income taken in taxation is high and on basis of advice from a number of outside experts cannot easily be increased without damaging effects on the economy."[18]

The importance of this conclusion cannot be over-emphasized because it explains why the Kenya government holds firmly the instruments of taxation against the local authorities. Accordingly, this recommendation has become a cornerstone of the government implicit fiscal policy towards local authorities.[19]

The commission further noted that the graduated Personal Tax (GPT) had been converted into a poll rate tax thus adversely affecting its revenue resourcefulness. GPT was being levied at a uniform rate throughout the country. The commission recommended that the tax be graduated on basis of income and rural/urban dichotomy. Government grants in-aid were found to be inconsistent with fiscal needs of local authorities and wealth differentials among local authorities. The commission recommended co-ordination between local authorities' budgets and government grants.

In its sessional paper No. 12 of 1967 the central government expressed its satisfaction about the existing intergovernmental fiscal arrangements but it promised to improve fiscal management practices at local government level.[20]

In 1970 V.P. Diejomaoh investigated the determinants of the revenue yields of local government finance sources. He identified GPT, property rates, school fees, sales tax and loans as the major sources of revenue for urban local authorities. He found that during the period 1964-1969 the financial position of municipal councils had depreciated substantially while that of the county councils was fast deteriorating. He attributed this sorry financial situation to the inefficient tax administration found in local authorities and to the enelastic nature of local taxes. He recommended the introduction of progressivity into GPT and the improvement of tax administration. He further recommended property rates to be based on a system of taxation which offers a broad tax base, while at the same time it economises on administration costs.[21]

IN 1971, Westlake, in his study of personal income tax in Kenya, found that the GPT was evolved in an ad hoc way from British income tax and surtax for very high incomes which were not in Kenya. He further found that both GPT and personal income tax were unco-ordinatedly combined resulting into a tax with little progression and some regression. GPT was found to be regressive over much of its range. Westlake observed that GPT levied on income had reverse effect and made the overall income tax system less progressive by pushing higher the starting point at which the richer section of the community began paying income tax. He recommended the combination of income tax and GPT, a combination which he argued would improve the revenue of the government. GPT was abolished in 1970 in county councils and in 1974 in municipal councils. It is important to note that although initially Westlake's study was not directed specifically to local government finance it eventually had an adverse effect on it.[22]

In 1975 the world bank mission investigated the role of public sector in Kenya and found that the Kenya local authorities had played an important role in promoting national development. However, the mission observed that the financial position of the local authorities has always been vulnerable because of fiscal imbalance. The mission felt that this imbalance existed because of the inelastic nature of local taxes and because the local authorities' responsibilities were growing faster with increase in urban population and needs for higher standards of living. The mission also argued that some of the fees that local authorities could charge were influenced by politics rather than by economic considerations. The mission recommended establishment of a financial system that would allow the local authorities in Kenya to participate in national development. The two alternatives offered to the Kenya government by the mission to this end were either to give the local authorities autonomous and elastic sources of income (decentralization of fiscal decisions) or agree to share revenue with the local authorities.[23]

Dr. Z.O. Ebangit of University of Nairobi introduced the element of 'Fiscal Management' in the ongoing discussion about financial inadequacy in local governments in Kenya.[24] Except for the local government commission of inquiry and the World Bank Mission, all the studies on Kenya local government finance cited above were concerned with the adequacy of the available financial resources. None of them attempted to link fiscal adequacy of these resources with fiscal management. There is an obvious correlation between the two. Firstly, the adequacy of financial resources depends on the fiscal demands on them. Secondly, the state of financial resources and expenditure needs, depends on, among others, the management to which they are subjected. Essentially, an effective and efficient fiscal management system ensures optimal exploitation of the available resources and reasonable or fair fiscal demands on them. It is then when a true state of fiscal inadequacy can be established. Thus, the contention here is that the degree of the fiscal imbalance experienced by Kenya local authorities is highly influenced by fiscal management systems found in them.

H.J. Nyamu clarified the above point by citing example of cases in which fiscal mismanagement in local authorities resulted into unfair or exaggerated fiscal demands on the available financial resources. He explained:-

> 'Another example of self-inflicted problems in African city governments emerges from their tendency to structure their operational departments on central government models ..... In all these departments, inefficiency and under-employment leading to improper spending of public funds is the rule rather than exception'[25]

He continued

> 'The third example of critical problem area in third world city governments lies in having to live with grossly unpalatable personnel emolument ratios to the total recurrent budget expenditure. In one of Africa's largest city governments, recurrent staff salaries relative to the total recurrent budget was in the region of 70% in 1965. Experts tell us that the optimum ratio in any organization should be only 40% and below.'[26]

These views are allied with the report of Task Force appointed to probe Nairobi City Council early in 1983. The council's 17,000 member workforce was described by the Government as 'unbelievably too large'.[27]

Although Dr. Ebangit's paper does not explicitly link local government financial inadequacy with fiscal mismanagement, it nevertheless throws light on managerial practices which are conducive to fiscal mismanagement. He listed the inability to generate financial management information and failure to formulate revenue and expenditure forecasts as some of these practices. It would be expected that insufficient financial information or lack of it would make it rather difficult to make correct income and expenditure decisions. Such a situation would also impede proper management of finance. For example, the Task Force probing Nairobi city council found that the council was unable to collect debts amounting to KSh.340,000,000 because of inadequacy of information. The same report says that the council embarked on various projects without identifying sources of funds to finance them.[23] "Accordingly, financial management problems which plague the local governments seem to arise from their failure to forecast revenue and expenditure, resulting in a pay-as-you go system fraught with unexpected expenses and untreaceable sources of income"[29] Dr. Ebangit recommended local government manpower training in financial management among others.

In a report entitled "Growth and Structural Change in Kenya, a Basic Economic Report" the World Bank complains that Kenya government compromised the interests of local government with that of national development resulting in reduced functions of local government.[30] The report further criticises the government for lack of clear policy on the role of local government thus making their financial position difficult. The report says,

> "Unless this issue is dealt with soon, it could have strong repercussions on central government own financial position and with negative consequences "[33]

This report identifies three problematic areas in local authorities. These are:-

(a). Poor quality staff

(b) Inelastic sources of finance

(c) Varying range and quality of services provided.

The Bank raises concern over the continued reliance of local governments on loans for the purpose of capital programmes. It holds the views that for local authorities to play a positive political role they must be financially viable. The Bank recommends the property rates to be made elastic by frequent valuation. The report further supports agricultural produce cess. Finally , the report blames the government for pricing local government services without considering the cost.

The Bank report contains a number of misgivings about local authorities. The first is the assumption that local authorities take precedence over national development. This assumption is wrong because local authorities have their relevance to the national development and not otherwise. Lack of attention to local authorities does not make the national development less important or meaningful. The second misgiving is the assumption that local governments which are financially viable are necessarily politically responsible. Before the Transfer of Functions Act of 1970, local authorities in Kenya were well endowed with the necessary financial resources, but the Transfer had to come because they proved irresponsible.[31] Accordingly, financial inadequacy should not necessarily lead to political irresponsibility such as that led to the 1983 dissolution of Nairobi City Council.[32] Unless local authorities can demonstrate a sense of responsibility over the few resources available to them, they cannot expect to be entrusted with more of such resources. The third misgiving is the assumption that Kenyan local authorities should be self-sufficient in capital funds. Firstly, under the situation in which local authorities cannot be able to meet their recurrent expenditures, it would be very unlikely that they can be able to finance capital projects internally. Secondly, Kenya Local authorities would be unique in world to be self-sufficient in capital finance. Local authorities world-over depend mostly on loans to finance their capital programmes. For example, in 1968, local authorities in United Kingdom financed 75% of their capital programmes of £1745m by loans from government. Thirdly, it is in keeping with proper financial management in local government system to finance capital projects from loans. In order to avoid disproportion between rates levied from year to year it is advisable to borrow rather than to raise internally capital finance. On grounds of equity, borrowing makes the future generations to contribute to the payment of facilities which they enjoy and which . were financed in the past.

In 1982, a Working Party appointed by the President to recommend practical measures for controlling government expenditure gave some recommendations which have financial implications to local authorities in Kenya. The report recommended the transfer of some of county councils' financial obligations such as roads maintainance to central government via District Development Committees.[33] It further recommended the reduction of government grants to county councils. According to this report, the senior officers of both county and municipal councils should be transferred to Public Service Commission.[34] The latter recommendation was intended to enhance the implementation of sound financial management in local authorities. The report conspicuously avoids the crucial issue of financial problems that plague the municipal councils. As is clear from table 3.1 municipal councils have more financial problems than county, town and urban councils.

In march 1983, the Government, vide ministerial circular No. 12/83, withdrew all grants to local authorities implying that henceforth the local authorities must wholly depend on internal sources of their revenue. In absence of government grants, tables 3.1 and 4.1 indicate that the traditional sources of local government finance require substantial development and improvement in order to make local authorities in Kenya and particularly municipal councils financially viable.

FOOTNOTES - CHAPTER II

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6. John F. Due Ibid.
7. Prest A.R. Op.cit. P. . 413.
8. Hepworth N.P. The Finance of Local Government, George Allen & Unwin Ltd, London, 1971, p.14.
9. Carl S. Shoup Op. cit P. 621.
10. Prest A.R. Op.cit p.27 & 28, IN USA Personal tax accounts for 30-40% of the Government revenue while in Jamaica is 2-3% and in Africa 1.2%
11. I.U.L.A. (International Union of Local Authorities) Local Government Revenue, A discussion paper presented to large cities forum held in Nairobi in 1982. A World Bank study covering 30 large cities in less developed countries found that 60-90% of the local expenditure were financed from local sources.
12. Ibid.
13. Republic of Kenya: Sessional Paper No. 12, Government Printer, Nairobi 1967 p.15.

14. U.K. Hicks, Development from Below: Local Government and Finance in Developing Countries of Commonwealth, London, Oxford University Press, 1961. p.218.

15. Republic of Kenya, Report of Fiscal Commission, Government Printer, Nairobi, 1963.

16. Republic of Kenya, Report of the Local Government Commission of Inquiry, Government Printer, Nairobi, 1966.

17. Ibid. p. 37.

18. Ibid. p.36.

19. See 'Standard' Newspaper, Nairobi, Kenya dated, 30/5/79. p.13. The then Minister of Local Government indicated that any future improvement on local government finance will have to come from the existing financial resources with local authorities.

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24. See Z.O. Ebangit, Fiscal Management Problems Affecting the Local Authorities in Kenya, A paper presented to Kenya Economic Association.

25. See H.J. Nyamu, Some Training Misconceptions in Third World Countries, A paper presented to large cities forum held in Nairobi in 1982.

26. Ibid.

27. See Weekly Review, Stella Scope Ltd, Nairobi, Kenya, dated 8/3/83 , p.4.

28. See 'Daily Nation'' Newspaper,Nairobi, Kenya, dated 12/4/83.

29. Ebangit: Op.cit.

30. See 'Daily Nation' Nairobi, Kenya dated 13/3/83. It filed the World Bank Report under review.

31. U.N. op.cit p.1.

32. Prest A.R. op.cit. p.191 table 8

33. Republic of Kenya, Report and Recommendations of the Working Party on Government Expenditure. Government Printer, Nairobi, 1982 p.54-55.

34. Ibid.

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CHAPTER III

3. LOCAL GOVERNMENT SYSTEM IN KENYA.

3.1. Introduction:

The Local Government System in Kenya was established after the 'British System' of Local Government following the building of Uganda Railway and subsequent establishment of British rule in Kenya. The building of Uganda Railway led to growth of population centres and hence towns on various focal points along the railway line from Mombasa to Kisumu. The emergence of towns necessitated the establishment of town councils and municipal councils to provide essential urban services such as sewer disposal, town planning, cleansing, health and housing services. Nairobi became a municipality in 1919.

The completion of Uganda Railway and the establishment of British rule in Kenya facilitated the establishment of white settlements in Kenya Highlands. This, together with the colonial administrative as well as political policies led to the establishment of rural local authorities.

The distinguishing characteristic of the colonial local government system was the racial basis on which it was founded. Both towns and municipal councils and rural district councils were established essentially in areas predominantly occupied by Europeans, while local native councils and African townships were established in African districts. The racial distinction in the colonial local government system greatly influenced intergovernmental fiscal relations between the central and local governments and among local authorities themselves. Firstly, and by the definitions of local government ordinance of 1928 and local government (loan) ordinance of 1929, local native councils were not legitimate units of local government.[1] They were mere regulatory local bodies empowered to pass resolutions that facilitated and enhanced the effectiveness of colonial administration among Africans. Their membership was composed of chiefs as representatives of the Africans and the District Commissioner as the Chairman. In effect they were arms of the colonial government which were centrally controlled. They were wholly financed from internal funds raised from local rates. Local native councils, contrasted sharply with the District Councils. District Councils were composed of elective body headed by an elected chairman. They had ample sources of finance which included loans and government grants besides property rates. They were allocated functions such as education, public health, hospitals and roads. They were relatively independent from the colonial government control. In 1952 the Local native councils assumed the status of district councils while the European District Councils became Country Councils. However, in 1963, the Local government system in Kenya was unified under the Local government regulations of 1963 which became an Act of Parliament in 1978. The municipal and town councils did not experience big changes except that after independence it was possible for the African Townships to become municipal and town councils.

3.2 Post-Independence Intergovernmental Fiscal Relations in Kenya.

3.2.1. Structure and Control of Local Government

The local government regulations of 1963 reorganized local government in Kenya into a two-tier system. The first tier comprises of municipal councils, town councils and county councils. The second-tier comprises of urban and area councils. Area councils have since been abolished but the 1982 Working Party Report and Recommendations on Government expenditure recommended their re-establishment.

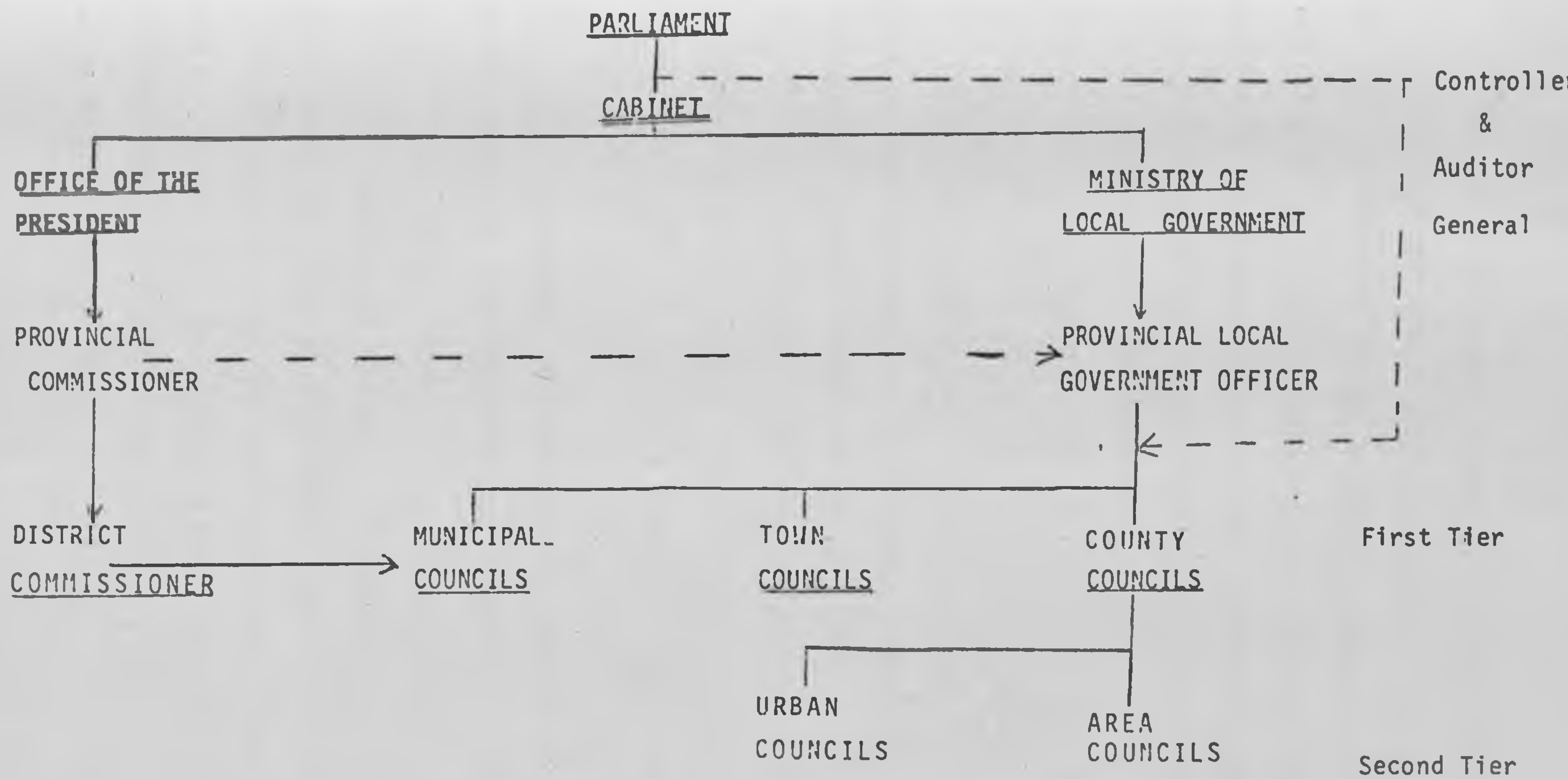
The regional constitution of 1962 granted exclusive powers to regional assemblies over the estabishment and supervision of local authorities within their regions. The regional assemblies determined the powers and functions of their local authorities. Under the regional constitution, local authorities enjoyed a measure of financial independence from the central government and performed most of the central government functions such as education, health, medical, social and communication (roads) services. Most of government revenue raised locally accrued to the local authorities. However, in 1964 the present day Republican constitution replaced the regional constitution and shifted the responsibility for the establishment and supervision of local authorities from regional assemblies to the Minister of local government.

Local government in Kenya today accounts for its public responsibilities to the National Parliament through the ministry of local government which is charged with the responsibility of local government control. For the purpose of this control, the Ministry of local government is organized at two major levels, namely the political and administrative levels. The political level is composed of a minister and a variable number of assistant ministers, usually one or two. The minister is equipped with extensive powers over the local authorities

For example the responsibilities of the establishment, abolition, dissolution and even the upgrading of local authorities are within the ambit of powers conferred to the minister of local government by the local government Act, cap. 265 of Laws of Kenya. Accordingly, the minister yields veto powers over every activity of local government units. The administrative level is composed of a permanent secretariat headed by a permanent secretary. The secretariat performs advisory role to the political level and administrative role to the ministry itself and to the local authorities. The permanent secretary performs his official duties on behalf of the minister of local government. The secretariat has offices at every provincial level. Local authorities within each province are immediately responsible to the provincial local government officer who is charged with the responsibility to oversee their fiscal management. However, urban councils account for their responsibilities through their respective county councils.

Besides the ministry of local government, other government ministries and agencies exercise some controls over the local authorities. The most notable among these are the office of the President and the office of the controller and auditor general.

FIGURE 3.1 THE PATTERN AND CONTROL SYSTEM OF LOCAL GOVERNMENT IN KENYA 1933



The Provincial Local Government Officer is a member of provincial team headed by a provincial commissioner who reports directly to the office of the President. Among its various responsibilities, the provincial administration performs general government and co-ordination of national development activities, the functions which relate to local authorities' responsibilities. Consequently, the office of the President has great interest in the affairs of local authorities. This interest is more pronounced at the district level where, as a matter of law, the District commissioner automatically becomes a member of local authority's council and a chairman of plot allocation as well as the chairman of development committees. The District commissioner exercises a more direct control over local authorities than the provincial commissioner.

The Exchequer and Audit Act, cap.412 of laws of Kenya provides for the audit of local government by the controller and auditor general. The controller and auditor general is directly responsible to the National Parliament for local government audit. He however, informs the Ministry of local government, treasury and office of the President of his audit findings. The Exchequer and Audit department's control of local authorities is indirect.

Local government is organized into councils whose areas of jurisdiction are determined by the minister of local government. Each council is composed of both the elected and nominated members and an employed administrative corp. The executive responsibility of policy determination and policy implementation is vested in council in its corporate capacity. Therefore the elected members of the council perform both the executive and political functions of the local authorities. In order to accompolish its functions efficiently and effectively, the councils are organized into committee systems with each committee supervising a functional department or a group of such departments normally headed by a professional chief officer or officers who, together with their respective committees, report directly to the council in its corporate form. The extensive use of committee system and lack of independent executive are responsible for the absence of central management in local authorities. Consequently, the council, through its committee system, holds each departmental head directly responsible.

The political head of a municipal council is a Mayor who is elected by the other members and among them. After his election he also supervises the election of the chairmen for the various committees.

The chief administrative officer is the Town clerk who is charged with the responsibility of general administration of the council. His duties are specified in the local government Act.[2] The chief financial officer is the Town Treasurer whose duties are also specified in the local government Act. While the town clerk advises the council on matters, of general administration, the Town Treasurer advises it on matters of finance.[3]

3.2.2. Allocation of Functions and Fiscal Resources to Local Authorities.

The scope of public responsbilities and financial authority of local authorities is clearly defined in the local government Act, cap.265 of laws of Kenya, and both are subject to the legal doctrine of ultra vires.

Under local government Act, Kenya local authorities can undertake two types of functions, namely, the mandatory and permissive functions. Mandatory functions relate to the public responsibilities that the law specifically charges the local authorities with their execution. They are the functions which local authorities carry out in their own rights and include the maintenance and operation of public markets, refuse collection and disposal and other public utilities.

Permissive functions relate to public responsibilities which legally belong to the central government but which the local authorities have been delegated with authority to discharge. They include road maintenance, education, health and medical services. The allocation of permissive functions to local authorities is greatly influenced by the 'presence' of local authorities in terms of both politics and management capabilities. The regional constitution allocated permissive functions to local authorities out of political expediency. The regional constitution was a product of tribal insecurity that characterised Kenya politics at the eve of independence. To alleviate the fear of tribal domination, the regional constitution allocated most of the government functions and fiscal resources to local authorities which incidentally were carved along tribal boundaries. The introduction of a Republican constitution in 1964 did not alter this pattern of intergovernmental fiscal relations until 1969. The transfer of functions Act of 1970 reverted all the permissive functions together with some revenue resources such as Graduated Personal Tax (GPT) to the central government. In doing so, the 'Presence' of seven municipalities that included Nairobi, Mombasa, Kisumu, Nakuru, Eldoret, Kitale and Thika both in terms of their organizational and managerial capabilities was recognized and were allowed to retain some of these functions such as road maintenance, education, health and medical services.[4] The government c decision to transfer these services was prompted by the inefficient management that plagued their provision under local authorities.[5] The municipalities emerging after 1970 were allowed to undertake some of the permissive functions provided they were financially capable of financing a certain proportion of the total cost of providing the services thus undertaken.

It is apparent therefore that after 1970 only the municipalities which were financially strong and endowed with the requisite managerial capabilities were allowed to undertake permissive functions. Regardless of the types of functions allocated, the local authorities' expenditure needs, particularly those of urban local authorities, have been increasing fast, firstly because of increasing urban population and secondly because of increasing cost of providing the necessary civic services.

The local government Act, cap. 265 laws of Kenya defines the scope of local government financial authority and structure. On paper, this authority appears extensive. However, in practice, this authority is highly circumscribed by social, economic,political and legal considerations which bear adversely on the resourcefulness of local taxes. In the first instance

local taxes must be approved by the minister of local government to ensure their legality and comformity with the overall taxation system in the country. According to the local government Act, local authorities can impose local taxes only on those activities which they are authorised to control.[6] For example, a local authority which is not authorised to control education and banking cannot impose local taxes on private schools and banking institutions. The government may also intervene in local taxation either to preserve purchasing power or prevent extortion or ensure social justice in local taxes. Sometimes local authorities refrain from excessive business taxes on economic and moral grounds. Exorbitant business taxes are likely to drive small business out of the market or are likely to encourage tax evasion and tax avoidance. Councillors, who are the decision makers, owe their allegiance to the electorate which constitutes the local taxpayers. In order to retain their political posts, councillors ensure that taxes they recommend do not meet with public disfavour. But since no tax is favourable to the taxpayers, there is a general tendency for the councillors to suppress any increases on taxes or any additions to the existing revenue resources. These considerations have the effect of reducing the economic viability of local taxes.

The above situation has further been compounded by various fiscal co-ordination activities of the government which have further reduced the stock of fiscal resources at the disposal of local authorities. For example, the transfer of functions of 1970 was accompanied by a similar transfer of revenue resources from the local authorities to central government. It is argued that the revenue resources taken by the central government more than compensated the cost of providing the services taken. That is, the government took more than a just share of revenue attributed to the services transferred. Accordingly, the government abolition of GPT, school fees and medical fees narrowed down the scope of financial authority and financial structure of local authorities. The government has demonstrated its unwillingness to release more tax instruments to local authorities partly because of fiscal mismanagement and partly because of its likely effect on the national economy.

In general, Kenya local authorities are faced with a situation in which their financial needs are growing faster than their financial resources. The government operates a grant-in-aid scheme but it has proved insufficient as a co-ordinative device for reasons which will be explored in depth later in the text. Municipal councils have experienced more financial hardships than the other local authorities (See table 3.1). Table 3.1 shows that during 1973-1980, the nongrant revenue fell short of expenditure needs in case of municipal councils. County, urban and town councils experienced nongrant surpluses mainly because of their reduced responsibilities. The table shows that even after grants, the municipal councils continued to experience deficits in their budgets.

3.3 Local Government Finance in Kenya

3.3.1. Fiscal Policy Determination

In this section, we explore the process through which the composition and level of expenditure programs as well as the tax structure are determined. The determination of local government expenditure and tax structure involves a budgetary process which is a functional responsibility of the council. However, the law empowers the minister of local government to influence the ultimate level and composition of expenditure and tax structure as already mentioned.

Table 3.1 LOCAL GOVERNMENT

REVENUE	MUNICIPALITIES							COUNTY URBAN & TOWN COUNCILS						
	1973	1974	1975	1976	1977	1978	1979	1973	1974	1975	1976	1977	1978	1979
Graduated Personal Tax	3234	23	-	-	-	-	-	-	-	-	-	-	-	-
Direct Taxes (Rates)	-	-	5665	6628	7137	7772	7883	-	-	567	562	982	904	995
Indirect Taxes	4146	5004	210	449	452	489	589	3138	2161	1729	3219	5431	4831	4677
Income From Property	2262	2714	577	694	832	758	783	747	869	634	716	831	902	965
Sale of Goods & Services	5194	5849	9520	11765	13118	15815	15522	981	1126	1622	2022	2227	3155	3403
Loans	3008	991	3016	5657	5698	5767	5833	6	8	385	345	309	668	870
Miscellaneous Income	271	4544	-	37	36	22	38	131	84	15	19	20	24	26
Total Non-grant Revenue	18408	19329	18988	25230	27273	30623	30648	50764	4169	4952	6883	9800	10487	10936
Less: Expenditure														
Administration	1385	1517	3085	3352	3556	4350	5178	1401	1668	1863	2592	2728	3859	4243
Community Services	4431	5351	5098	6063	8086	8653	9229	456	204	684	486	924	2127	2640
Social Services	7090	7495	7681	8394	9035	10383	11518	692	404	900	704	913	591	807
Economic Activities	6011	7201	8763	10637	11934	12243	13484	314	325	353	373	405	3552	3949
Trading	-	-	-	-	-	-	-	786	1176	1558	2117	1735	-	-
Unallocable Exp.	133	152	-	-	-	-	-	213	186	252	328	443	-	-
Total Expenditure	19050	21716	24627	28446	32611	35630	39409	3862	3962	5608	6600	7145	10129	12763
Gross Deficit Surplus	(642)	(2387)	(5639)	(3216)	(5338)	(5007)	(8761)	(1214)	207	(656)	283	2655	385	(1827)
Add: Grants (Co-ordination)	1436	86	5395	5654	5326	7420	6954	28	24	72	185	262	282	298
Net Deficit/ Surplus	794	(2301)	(244)	2438	(12)	2416	(1807)	1242	231	(584)	468	2917	640	(1529)

Source: Central Bureau of Statistics: <u>Statistical Abstracts</u> 1974-1981.

The council in its various committees and under the guidance of their respective departmental heads and the Town Treasurer, makes expenditure proposals. Normally, these proposals are made by the administrative corp of each department but are ratified by their respective committees. The committees' or departmental expenditure proposals are then submitted to the finance committee which scrutinizes them thoroughly in respect to their desirability, level and composition. The finance committee may or may not make amendments on these proposals. These proposals are further submitted to the council in its corporate form with recommendations from finance committee. They are debated upon and passed with or without amendments for onward transmission to the minister of local government for ultimate approval. They now become draft estimates of the council. The minister approves them with or without amendments and they become approved estimates of the council.

The determination of the tax structure follows a somewhat similar procedure. The finance committee, with the guidance from the Town Treasurer and views from various committees reviews the existing revenue resources in light of the expenditure proposals. Where the expenditure proposals exceed the projected revenue from the existing revenue resources, new fees and charges are recommended. These recommendations must be approved by the council in its corporate capacity and the minister of local government before they can be effective.

3.3.2. Local Government Expenditure.

Local authorities in Kenya undertake administrative, social, community and economic functions which necessitate incurring of expenditure. The administrative function comprises of all the activities that are necessary to enable the councils, as organizations, to discharge their duties efficiently. Community services include roads, sanitary services and others. Under social services is included health, education and others. Economic activities include the provision of housing facilities and supply of water. Except for housing and water supply, these services are provided by both urban and rural local authorities with urban local authorities (municipalities) taking the greater share of the total local government expenditure. For example in 1979 municipal councils were responsible for 75.5% of the total local government expenditure while county Urban and Town Councils were only responsible for 24.5%. It is also noticeable from table 3.1 that on aggregrate both community, social and economic services took the greater share of municipal councils expenditure while administrative and economic activities took the greater share of town, urban and country councils. In 1979, community, social and economic activities took 88.6% of the total municipal councils' expenditure, while administrative and economic activities took 64.2% of the total county, urban and town councils' expenditure for the same period.

The above pattern of expenditure distribution among various expenditure heads varies when considered on the basis of individual local authorities. Some local authorities put more emphasis on administrative functions while others put more emphasis on social or community or economic functions. Tables 3.2A and 3.2B below demonstrate this.

TABLE 3.2.a.. EXPENDITURE DISTRIBUTION PATTERN FOR SELECTED LOCAL AUTHORITIES FOR 1979-1980

MUNICIPAL COUNCILS	ADMINISTRATION		SOCIAL		COMMUNITY		ECONOMIC		TOTAL	
	1979	1980	1979	1978	1979	1980	1979	1980	1979	1980
Nairobi	3027	3339	7850	8897	6736	7316	9077	11533	26690	31035
Mombasa	623	673	1721	1979	912	1389	1344	1919	4606	5961
Nakuru	255	331	824	965	457	639	688	919	2225	2854
Kisumu	290	352	466	667	293	447	510	893	1559	2358
Eldoret	158	177	273	378	166	283	674	642	1270	1481
Kitale	91	139	169	291	260	233	458	474	978	1136
Thika	341	265	177	233	200	237	319	358	1039	1093
Nyeri	103	245	3	11	85	78	114	161	305	494
Embu	66	87	3	4	37	68	110	33	216	192
Meru	125	235	3	3	56	121	59	65	242	423
Kakamega	92	96	28	50	27	67	131	92	279	305
Total	5178	5338	9229	10878	11518	13484	13484	17088	39409	4738[illegible]

Source: Central Bureau of Statistics, Statistical Abstracts 1973-1981.

The percentage distribution of expenditure among various expenditure heads for the above municipal council for 1979 and 1980 is shown below in table 3.2b.

Table 3.2b: Title: Percentage Distribution of Expenditure Among Expenditure Heads for Selected Councils 1979-1930.

MUNICIPAL COUNCILS	AADMINISTRATION EXP.		SOCIAL EXP.		COMMUNITY EXP.		ECON Exp.	
	1979%	1980%	1979%	1930%	1979%	1980%	1979%	1930%
Nairobi	11.3	10.7	29.4	28.6	25.2	23.5	34[illegible]	37.1
Mombasa	13.7	12.3	37.4	33.2	19.8	23.3	29.2	32.2
Nakuru	11.5	11.6	37.0	33.8	20.5	22.4	30.9	32.2
Kisumu	18.6	14.9	29.9	28.3	18.8	19.0	32.7	37.9
Eldoret	12.4	11.9	21.4	25.5	13.1	19.1	51.1	43.3
Kitale	9.3	12.2	17.3	25.6	26.6	20.5	46.8	41.7
Thika	33.0	24.2	17.0	31.3	19.2	21.7	30.7	32.8
Nyeri	33.7	49.6	1.0	2.2	27.9	15.8	37.4	32.6
Embu	30.6	45.3	1.4	2.1	17.1	35.4	50.9	17.2
Meru	51.7	55.6	1.2	1.2	23.1	28.6	24.4	15.4
Kakamega	33.0	31.5	10.0	16.4	9.7	22.0	47.0	30.2

Source: Central Bureau of Statistics, Statistical Abstracts 1973-1981.

A comparison of local and central government's expenditures vis-a-vis the gross national product (GNP) indicates that local authorities play a less significant role in the national economy than the central government. This, in effect, means that local authorities are less responsible to the national population than the central government. A number of reasons are available to explain this. First, local authorities command fewer resources than the central government because of reasons already mentioned. It was further pointed out that local government expenditure is limited by available revenue resources. On basis of this argument it is clear from table 3.3 below that local authorities command less than 10% of the central government revenue resources. Second, there has been a tendency towards centralization of government responsibilities to the central government. This explains why during 1973-1979 period the local government contribution towards GNP has been declining while that of central government has been rising.

In absolute terms the local government expenditure more than doubled between 1973 and 1979, rising at an annual average rate of 13.8%. Accordingly, the central government expenditure more than trebled increasing

TABLE 3.3 GOVERNMENT CONTRIBUTION TO GROSS NATIONAL PRODUCT (GNP) 1973 - 1979.

YEAR	GNP(K£m)	LOCAL GOVT. EXP.(K'000')	CENTRAL GOVT. EXP.(K£'000'	% OF EXP. TO GNP LOCAL GOVT.	CENTRAL GOVT.
1973	784.99	22912	230167	2.9	29.3
1974	975.83	25678	301442	2.6	30.0
1975	1120.70	29494	384215	2.6	34.0
1976	1372.19	34670	398805	2.5	29.0
1977	1781.18	39926	590389	2.24	33.0
1978	1967.59	45096	697611	2.29	35.0
1979	2212.60	51049	781306	3.00	35.0

SOUCE: Data Compiled from Kenya Bureau of Statistics, Statistical Abstract 1974-1981.

at an annual average rate of 22.8%. Table 3.4 below shows annual changes in Government expenditure during 1973-1979.

The rise in local government expenditure was greatly impelled by increases in urban population which made heavy demand on social, community and economic services. The rising cost of providing these services and the expansion of administrative capacity also contributed a great deal towards the rise in local government expenditure. Table 3.5 shows urban population between 1969 and 1979.

3.3.3. Local Government Revenue

The main sources of local government finance in Kenya are rates, grants, fees and charges and loans. Some of these sources are discussed below.

(i). Rates

Rates are a form of local tax levied on rateable property within a local authority. Only the local authorities which are rating authorities in accordance with Rating Act cap. 267 of laws of Kenya are authorised to levy rates within their jurisdiction. In principle

Table 3.4: <u>Changes in Government Expenditure 1973-1979</u>

	LOCAL GOVERNMENT		CENTRAL GOVERNMENT	
	Exp. (K£'000'	% Annual Change	Exp. (K£'000')	% Annual Change
1973	22912		230,167	
1974	25678	12	301,442	30
1975	29494	14	384,215	21
1976	34670	17	398,805	3
1977	39826	15	590,389	48
1978	45096	12	697,611	18
1979	51049	13	781,306	11
Annual Average		13.8		22.8

Source: Data compiled from Kenya Bureau of Statistics, <u>Statistical Abstracts 1974-1981</u>

Table 3.5 Urban Population Growth 1969-1979

	1969	1979	% Change
Nairobi.	509,000	828,000	62.7
Mombasa	247,000	341,000	38.1
Nakuru	47,000	93,000	97.9
Kisumu	32,000	153,000	478.
Eldoret	18,000	51,000	183.
Kitale	11,000	28,000	154.5
Thika	18,000	41,000	127.8
Nyeri	10,000	36,000	260.
Embu	3,900	16,000	410.
Meru	4,475	72,000	1509.
Kakamega	6,200	32,000	416.
	Average		339.7

Source: Kenya Central Bureau of Statistics
Population Census 1969 and 1979.

rates is a general tax based on benefit taxation and is essentially meant for financing general rate fund services. According to section 3 (1) and (2) of Rating Act cap. 267, sufficient rates should be raised to discharge all liabilities falling to be discharged out of general rate fund. The financial implication of this section of law is that deficit budgeting in general rate fund cannot exist side by side with local rates. It means that both the rate struck and the property value must be reviewed frequently to adjustthem to the expenditure demands of the general rate fund services.

In Kenya there are two methods of rating, namely, the factual or area rating method and the valuation methods. In 'area rating' a flat or graduated rate is levied on either superficial area of the land or upon an area of the land according to potential use of land. This method of rating is simple to apply and requires no technical skills. It is mainly used by rural local authorities. Area rating has the disadvantages of rigid application, poor distribution of burden and low income yield. Among the valuation methods, capital value site rating, based on unimproved sale value of site is very popular with urban local authorities. Capital value rating is preferred to other valuation methods because it is said to encourage development, it is easy to maintain and it distributes the tax burden fairly. However it has the disadvantages of placing high tax burden on undeveloped land and requires professional skills.

The usefulness of rates as a source of local government revenue varies from one local authority to the other. However, in general, this usefulness is influenced by the process of rates administration. In Kenya, the responsibility for rates administration is allocated to both the rating local authorities and the Ministry of Lands and Physical Planning. Local authorities area allocated the responsibility of determining the rate struck while the Ministry of Lands and Town Planning is allocated the responsibility of physical planning which is a prerequisite to valuation and property valuation. Several cases have been noted where the valuation by the Ministry of Lands and Physical Planning grossly underrated the market values of the rateable property.[7] The local authorities affected had to contend with less rates income than they were entitled to. In some other cases physical planning was lagging behind the need for valuation for rating purposes. In such circumstances the local authority affected had to do without the rates income it so badly deserved. According to section 6(i) of Rating

Act site value rates cannot exceed 4% of rateable value without the approval of the minister of local government. However, the extent to which the minister can consent to higher site value rates is limited by political pressure. Therefore the local authorities can neither adjust the rateable property values within a minimum period of five years nor freely adjust the rate struck to meet expenditure needs in the general rate fund. This is why it is possible with Kenya local authorities to run a budgetary deficits concurrent with local rates against the provision of the Rating Act.

The most problematic area with local rates is the collection of rate income. The collection becomes problematic because of a number of reasons, viz:-

(a) The rating does not take into consideration the ability of rateable property owner to pay. He may be willing to pay but does not have the means to pay.

(b) Most of the rateable property owners are absentee landlords and difficult to trace.

(c) The officials of the council may connive with the ratepayers to have rate payments postponed indefinitely.

(d) The civil proceedings for the recovery of rates are lengthy and expensive and therefore there is a tendency to avoid them.

(e) Execution sale is rarely applied because it is considered socially and politically damaging to the decision makers.

The effect of all these weaknesses is that much of the realizable rates income is always in arrears.

Table 3.6 below shows the relative importance of property rates to some selected local authorities.

(2) Government Grants

Kenya government provides local authorities with two types of grants, namely, the compensatory and specific grants. The compensatory grants were designed specifically to ameliorate the financial position of local authorities over a period of time following government action or actions which adversely affected their revenue. Specific grants are kind of subvention grants designed to assist the local authorities to provide and improve some specialized services such as road maintenance and medical services.

Table 3.6 Sources of Revenue and Their Growth Rates for Selected Municipal Councils K£'000' 1977-1981

Councils & Years	Rates	%	Compen-satory Grants	%	Specific Grants	%	Fees and Charges	%
Nairobi								
1977	4874	28	3132	18	252	1.4	3796	21.8
78	5066	26.8	2509	11.9	2095	9.9	4308	20.4
79	5910	24.5	1328	5.5	3870	16.	4749	19.7
80	6380	25.8	1000	4.1	4012	16.2	4018	16.3
81	10240	32.5	617	1.9	4960	15.2	6757	21.5
Mombasa								
1977	1063	28.6	962	25.9	84	2.3	39	
78	1063	26.4	680	17.	554	13.8	39	
79	1115	25.2	410	0.2	1000	22.6	38	
80	1115	22.6	300	6.1	1069	20.6	49	
81	2609	39.5	199	3.	1568	23.7	30	
Kisumu								
1977	316	35.6	157	17.7	59	6.7	355	40
78	316	31.1	115	11.3	204	20	382	37.6
79	316	26.6	67	5.6	377	31.7	430	36.1
80	316	19.8	67	4.2	379	23.8	835	52.2
81	320	18.6	67	3.9	231	13.4	1104	64.1

Source: Ministry of Local Government; Annual Estimates 1977 - 1981.

The abolition of graduated personal tax in 1974 led to the establishment of graduate personal tax grant (GPT grant) which was to be phased out over a five-year period. The full compensating grant was paid for the remainder of government fiscal year 1973/74, 1974/75 and 1975/76. However, because of urban councils' fiscal problems the grant was continued after 1976. The determination of GPT compensation grant was based on actually collected GPT income in 1972 instead of 1973 which was the closest year to the GPT abolition year. HOwever, as a result the local authorities were under-compensated by K£0.3m given that the actual GPT collections for 1972 and 1973 were K£4m and K£4.3m respectively. Worse still the determination of the GPT compensation grant did not take into consideration the growth aspect of the revenue base being considered. The grant remained at K£4m throughout the compensatory period. Therefore the GPT compensatory grants were not adequate.

Between 1973 and 1978 the government abolished primary school fees and consequently the local authorities affected were to be compensated for the loss of school fees. The school fees compensating grant was determined on basis of a rebate of Ksh.60/- per child enrolled in standard 1 - 4 in 1973. On this basis the ministry of education estimated that the local authorities would loose K£310,000 for fiscal year 1974/75. hence the compesatory grant allocable to local authorities. The actual school fees collection in 1973 was K£320,000. Therefore the school fees compensatory grants under-compensated local authorities by K£10,000. The determination of this grant did not consider the increases in enrollment following the introduction of free primary school education.

In general, the compensating grants have not been adequately compensatory revenue loss resulting from government co-ordinative actions. Accordingly, the compensatory grants have been on a declining trend after 1976 while the specific grants have been increasing. Nevetherless, the government grants have been a sub-stastantial source of local government finance. However, according to ministerial circular No. 12/83 of 1983, the GPT grants, drug and dressing grants, school fees grants and Pumwani Maternity grants have now ceased to exist. Table 3.6 below shows the trends in government grants for some selected local authorities.

(3) Fees and charges

Fees are charges in respect of those activities which a local authority in legally empowered to control. For example business licenses. Charges are raised on goods and services provided by the local authorities.

Local authorities in Kenya are not able to realize the full potential of fees and charges because fees can only be charged on specified activities whereas charges are principally determined on marginal pricing system. In effect, charges are mere recoupment of cost of providing commercial services. Table 3.6 shows that fees and charges are assuming an important position as a source of finance to some local authorities.

One of the important and controversial revenue sub-head under fees and charges is agricultural produce cess. Agricultural produce cess is mainly imposed and collected by rural local authorities but some urban local authorities in agricultural rural districts also impose and collect it. Because of collection difficulties produce cesses are concentrated upon those crops which are disposed of through recognized market organizations. Coffee is one of the highly cessed agricultural produce under this arrangement. Coffee cess is assessed at 3% of the total pay-out to the farmers within the jurisdiction of cessing authority.[8] The pay-out to the coffee farmers is dependent on many variables among which climatic conditions, marketing expenses and coffee market prices are most important. Since most of these variables are uncontrollable by either the farmers and the local authorities and despite the fact that coffee earnings provide a substantial base for local taxation, coffee cess cannot be a reliable source of local government income because of the attendant uncertainty that surround the amount collectable. Table 3.7 below shows how the amount of coffee cess fluctuates with changes in market prices and quantities delivered.

Produce cess as a form of taxation is inequitable in several respects. First, produce cesses are imposed in what in colonial times were African Districts. Therefore there is geographical discrimination in produce cessing. Second only some of the agricultural produce are cessable. Therefore there is produce and farmers discrimination. Third, and except for coffee, the produce cess rates chargeable vary from one local authority to the other. Produce cess and notably coffee cess is objected to because it has disincentive effect on this agricultural industry. It is argued that with increased cost of coffee production and in face of declining world prices, coffee cess on top of government export tax reduces profit margin to a too low level to encourage agricultural improvement. In some areas of the Republic, some farmers resist coffee cess because they do not get benefits from the recipient local authorities. The government has been urging local authorities to use coffee cess exclusively for the benefit of the coffee farmers.

Table 3.7 Efeect of Production and Market Prices on Coffee Cess. 1976 - 1981.

Crop Season	Total Coffee Deliveries (KGS)	Market Price Per 50KG (Kshs.)	Coffee Cess Earned (Ksh.)
1976/77	73,895,892	59.80	88,385,863
76/78	76,254,921	39.00	56,434,301
78/79	67,976,721	39.07	53,127,719
79/80	72,185,977	43.51	62,813,967
80/31	94,865,138	31.42	59,603,857

Source: Coffee Board of Kenya. Annual Reports and Financial Statements 1976-1981.

(4) Loans.

Local government authorities are empowered by Local Government Act, cap. 265 of laws of Kenya to borrow from such sources as the minister may approve any amount of money for purposes related to their functions.[9] The act also empowers the local authorities to borrow by means of issue of bonds or stocks.[10] The latter alternative of raising finance has not been explored by local authorities in Kenya, except for Nairobi City council, because:-

(a) The financial infrastructure on which this operation is supposed to take place is too insufficiently developed to be advantageously exploited by both the central government (Treasury) and local authorities. There is always a tendency by the Treasury to preclude local authorities from the use the securities markets.

(b) Local authorities do not have the necessary facilities to enable them to undertake the operations involved in this alternative efficiently.

(c) Financially, local authorities do not command public confidence because of their constant financial problems. Investors fear their inability to honour their financial obligations in this respect.

There are two main specialist public financial institutions which provide development finance to local authorities. They include local government loan authority (L.G.L.A.) and national housing corporation (NHC).

(1). <u>Local Government Loan Authority (L.G.L.A.)</u>

L.G.L.A. is a corporate body charged with the responsibility of providing development finance to the local authorities. It obtains its funds from the government in form of treasury funds and from interest income from investments. Treasury funds are provided by the government for the purpose of financing earmarked capital projects within local government system. In this regard, L.G.L.A.is a mere government agent for distributing and collecting Treasury funds from local authorities. However, the Treasury funds are issued to local authorities in form of loans from L.G.L.A. L.G.L.A. receives Treasury funds at an interest rate of 6% and issues them to the local authorities at 6½%, thus earning ½% interest.

Treasury funds are normally received by L.G.L.A. in form of exchequer issues and before they are distributed to the relevant local authorities the L.G.L.A. invests them temporarily at a market interest rate. The income earned in this respect provides capital development finance which is fully controlled by L.G.L.A. and in which the latter has discretion over its distribution among the local authorities. The annual interest earnings from temporary investments averages K£1.5m.

L.G.L.A. is financially weak as is unable to meet the financial needs of local authorities. This situation is aggravated by the fact that L.G.L.A. is not efficient in collecting its debts. For example in 1980 loan applications to L.G.L.A. amount to K£26.5m. whereas the loanable funds available amounted to K£1.6m. Accordingly by 1983, the local authorities had defaulted the payment of loans from L.G.L.A. amounting to K£71.50m."

(2) National Housing Corporation (NHC)

The NHC specializes in providing housing loans but not solely to local authorities. However local authorities are its major customers. NHC obtains its funds from government, external borrowing and from interest earned from investment. The contribution of national housing corporation to local authorities funds is best shown in table 3.8 below.

TABLE 3.8 Distribution NHC Housing Schemes as at 30-12-79

State	Area	Housing Units(Nos)	Capital Value (K£)
1.Completed during 1979	Nairobi	3456	5,869,694
	Rest of Kenya	629	684,234
Total		4085	6,553,928
2. Under Construction	Nairobi	1364	6,028,849
	Meru	26	49,300
	Rest of Kenya	2999	3,986,160
Total		4889	10,064,309
3. At Planning Stage	Nairobi	4095	9,462,580
	Meru	194	142,000
	Rest of Kenya	4889	8,616,509
		9178	18,221,089

Source: Data compiled from NHC 1979 Annual Report and Financial Statements.

The above distribution of NHC housing finance indicates that, among local authorities, Nairobi city council has benefited the most.

3.3.4 Fiscal Management at Local Authority's Level.

Financial planning in local authorities takes the form of determination of annual revenue and expenditure budgets and rarely is long-term planning used as a means of fiscal management. Approved revenue and expenditure budgets for local authorities provide authority to incur expenditures and to collect revenue. The outstanding characteristics of local government expenditure and revenue is the deterministic nature of the former and uncertain nature of the latter.

A local authority can incur expenditure in accordance with the approved estimates and at any time convenient to it irrespective of its revenue collecting efforts and immediate availability of funds. Expenditure requirements higher than the available funds can always be supported by credit facility systems such as bank overdrafts and local purchase orders. On the other hand, the amount of revenue available at any time and the timing of revenue collection are influenced by the ability of people to pay taxes, the enforcement powers at the disposal of a local authority and the effectiveness with which these powers are used. Local authorities are generally weak in enforcing revenue collections and often than not revenue collection lags behind the incurrence of expenditures to which they are related. In some cases, the budgeted revenue is not collected at all. Table 4.4 shows that over 80% of budgeted land rates for Meru municipal council remains uncollected each year. This is mainly because of physical and administrative problems. There are many small and widely scattered land owners whom the council does not have direct contact. Enforcement of revenue collection in this respect would be very expensive.

The availability of credit facilities and perhaps the expectation of government financial aid reduce the incentive to enforce revenue collection. This argument is supported by the fact that the continued use of bank overdraft facilities and at the same time, the existence of revenue arrears are common financial features in local authorities. This point is explained in greater details in chapter four. During 1932 financial year, ninety business organizations with licence fees amounting to KSh.50,325 remained unlicensed in Meru municipal council. However, and with the abolition of government grants in March, 1983, the council had overcollected its estimated business licence fees of K£35,000 by June 1983. The lack of government financial aid prompted the council to be more vigorous in revenue collection.

The above characteristics of local government finance lead to a situation in which local authorities are more able to incur expenditures than they are able to collect revenue. In some local authorities any attempts to control expenditures by either curtailment or by matching expenditures with the availability of revenue is impeded by the fact that the greater portion of such expenditures goes to fixed overheads such as employees emoluments which can neither be avoided nor be postponed. Table 3.9A shows that Meru municipal council administrative expenses were consistently high and above 50% for the period 1973-1977. In such cases, any attempts to curtail expenditure on the remaining portion would mean denying public some essential services and essentially would be met with public disapproval. This situation makes local government expenditure difficult to control and is responsible for deficits experienced by local authorities at the end of each financial year. These deficits are transferred to be financed by the following year's income thus setting up a vicious circle difficult to break.

3.4 Meru Municipal Council

3.4.1. Introduction

(1) Regional Setting

Meru municipality is in Meru District of Eastern Province of the Republic of Kenya. It is situated on the forested north-eastern slopes of Mt. Kenya. Of its area of 61 sg km, 44 sq km are occupied by Imenti forest which is an extension of Mr. Kenya forest. The remaining 17 sq km are occupied by Meru town, public institutions and freehold small scale farms. Meru town is the administrative and commercial centre of Meru District. Appendix II shows Meru municipal boundaries.

(2) Historical Background

Meru town was established in 1900s as a colonial administrative post. The choice of its site was influenced by a number of factors, namely:-

(a) The local leaders of this area were not hostile to the first colonizing district commissioner in Meru. Everywhere else on his way from Embu through southern Meru he was not received with favour.

Table 4.1c. Adjusted Deficits for Meru Municipal Council 1973-1980 K£

(K£)

	1973	1974	1975	1976	1977	1978	1979	1980
Adjusted Revenue Table 4.1b)	81,000	95,000	96,000	91,000	194,000	137,000	107,000	117,000
Total Exp.(Table4.1a)	88,000	209,000	121,000	406,000	327,000	168,000	243,000	424,000
Adjusted nongrant Deficit/Surplus	(700)	(114000)	(25800)	(315000)	133000)	19,000	(136,000)	(307,000)
Add Grants (Table4.1b)	26,000	36,000	25,000	32,000	31,000	43,000	43,000	58,000
Net deficit/surplus	19,000	(78,000)	(800)	(283,000)	(102,000)	62,000	(93,000)	(59,000)
Adjusted cumulative deficit/ Surplus	19,000	(59,000)	(59,800)	(342,800)	(444,000)	(382,000)	(475,000)	(134,000)

It became a municipal council in 1971. The area of the new municipality was at first confined within the boundaries of old township but on request from freehold land owners surrounding the old township, the area of the municipality was extended to cover 207sq km.

On its establishment, the new council became financially and administrative independent of Meru county council and was directly responsible to the ministry of local government for its financial and administrative responsibilities. Under the local government Act the council inherited, interalia, both financial resources and civic and other responsibilities falling within its new area of jurisdiction and which hitherto had been under Meru county council. By section 269 of local government Act Meru municipal council became a rating and cessing authority and even adopted Meru county council's by-laws for the purpose of general and financial administration.

In 1979 the area of Meru municipality was reduced from 207 qg km to 61 sq km with over 70% of the new municipality area falling in Imenti forest. A number of factors triggered this move :-

(a) According to physical planning officials, the area of Meru municipality was too big to be effectively planned.

(b) The compulsory land acquisition by the government for the purpose of urban development that preceded the the reduction of municipality threatened the freehold land owners within the municipality with eventual landlessness. The public feeling was that by pulling out of municipal area their land would be free from compulsory land acquisition by government.

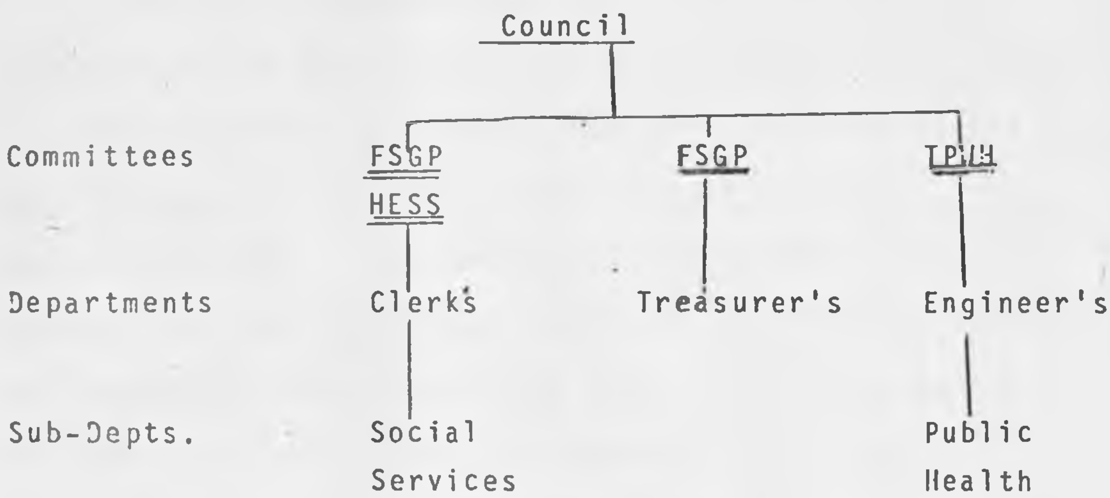
(c) The people in pre-urban area of the municipality were disenchanted with the performance of the municipal council. Whereas the municipal tax collection covered the whole area of the municipality, its services were concentrated within the township. The pre-urban people wanted to avoid the taxes for which no civic services were available.

Whatever the reasons, the reduction of Meru municipality adversely affected the council's revenue potentials in coffee cess, business licences and area rates. The financial effect of the reduction of municipality was felt after 1980 when the reduction was fully implemented. For example, despite the increase in the average price per 50 kgs of Meru municipality coffee from Kshs.45.01 in 1980 to Ksh.46.72 in 1981, the coffee cess to Meru municipal council declined from K£45,500 in 1980 to K£22,500 in 1981 because of the decline in coffee delivery from 1000,000 kgs in 1980 to 500,000 kgs in 1981.[12]

3.4.2. Organization of the Council

Meru municipal council is organized into three committees which include, finance, staff and general purpose committee; town planning, works and housing; and health education and social services committees. These committees supervise three main functional departments that include Town Clerk's, Town Treasurer's and town Engineer's departments. Town clerk'sdepartment is responsible for a sub-department of social services while town engineer's department is responsible for a sub-department of public health. Each of these departments, with their sub-departments and together with their related committees are charged with specific and accountable responsibilities. They all account for their responsibilities to tbe council. Town clerk's department is charged with the responsibility of general administration of the council. Town Treasurer's department performs advisory and financial management roles to the council. Town Engineer's department is responsible for all engineering and construction works in the council. The sub-department of social services provides social services and the sub-department of public health provides public health services. The organization of the council is shown diagramatically in Figure 3.2 below:

Fig. 3.2. The Organization of Meru Municipal Council



KEY: 1. FSGP - Finance Staff and General Purpose Committee.

2. HESS - Health Education and Social Services Committee.

3. TYWH - Town Planning, Works, Works and Housing Committee.

Source: Meru Municipal Council.

3.4.3. Meru Municipal Council Finance

(1) Expenditure

Meru municipal council provides administrative, social, community and economic services. The distribution of council's expenditure among these expenditure heads is discussed below.

(a) Administrative Expenses

These are expenses incurred for the purpose of maintaining the council as a viable organization. They include employees' emolument, cost of providing office equipments, furniture and office supplies. The purchase of office equipments and furniture is not regular and both their cost and cost of office supplies are neglegible constituents of administrative expenses. Therefore the administrative expenses of the council are mainly composed of employees emoluments.

Various factors have influenced the growth and size of administrative expenses in relation to the total expenditure of the council. The most important among these factors has been the expansion of council's establishment and improvement of terms and conditions of service. The number of employees in the council increased from 97 in 1971 to 254 in 1979.[13] Under collective agreements concluded between local government workers union and and local government employers association after every two years, the terms and conditions of employment for local authorities' employees have improved substantially. The improvement in basic salaries for local government-workers in municipal councils under committee No.2* is shown in Table 3.9. Since these improvements in terms and conditions of service are uniform for all councils in this committee, it is reasonable to conclude that the high proportion of administrative expenses to total expenditure of Meru municipal council evidenced in tables 3.2A, 3.2B and 3.9A is a consequence of expansion in establishment.

(b) Community Services Expenses

In this category is included roads and sanitary services. The council maintains roads within the municipality either by resurfacing them or by providing drainage tunnels. The greatest expenditure on this head goes to the maintenance of the equipments and machinery. The council also had a labour force of 61 street cleaners and three vehicles for refuse collection in 1980. The allocation of expenditure to community services is shown in Table 3.9B below.

2* The municipal councils under this committee include Meru, Nyeri, Embu, Kakamega, Nakuru, Thika, Kisumu, Eldoret and Kitale.

Table 3.9 Improvement of Basic Salaries for Committee No. 2. 1976 - 1981

(K£)

JOB CATEGORY	SALARY SCALES		%
	1976	1981	CHANGE
1.	2712	4200	54.9
2.	2445	3855	57.7
3.	1980	3198	61.5
4.	1860	2547	36.9
5.	1680	2152	28.1
6.	1632	2091	28.1
7.	1356	1735	27.9
8.	1212	1551	28.0
9.	1020	1308	28.2
10.	852	1188	39.4
11.	780	1092	40.0
12.	696	969	39.2
13.	612	852	39.2
14.	546	759	39.0
15.	432	621	43.8
16	408	585	

Sources: Local Government Employers Association, Committee No.2 Terms and Conditions of Service 1976 and 1981.

(b) Social Services Expenses.

The council provides health and education services. Under the sub-department- of public health there are 55 employees who deal with the eradication of mosquitos and rodents. Some of these employees are used as hides and skins inspectors. Under the sub-department of social services there are 15 employees 10 of whom are manual workers and aided nursery school teachers. The council provides school bursaries to the needy students and aids self-help projects within the municipality. The council does not have nursery schools of its own but merely aids the parent nursery schools within the municipality by providing teaching equipments and materials and by meeting a portion of teachers' salaries. There is also an aid programme for the destitutes.

(c) Economic Services Expenses

The council provides sewer disposal and refuse collection services. It also provides meat transport services. Until recently, the council was not a water undertaker but from 1981 it was permitted to distribute water to the consumers from treatment works and storage tanks. The council buys $1000m^3$ metres of water on wholesale basis from the ministry of water development at KSh.1.10 and retails it at KSh.2. The cost of water supply in influenced by the amount of water purchased and the administrative and maintenance cost associated with the water supply section of the council.

It was expected that after the implementation of municipality reduction in 1980, the council's expenditure would also be reduced. However, this did not happen because the expenditure related to services offered in these areas was insignificant when compared with total expenditure budget. Infact the expenditure budget for 1981 showed a 29% increase on 1980 expenditure.

The general distribution of council's expenditure among various expenditure heads both in absolute and relative terms is shown in table 3.9B below. One noticeable feature of the distribution is the relative importance attached to administrative services. Note that the data on expenditure of Meru municipal council is obtained from an independent external source because of incompleteness of council's expenditure records and therefore the unreliable nature of the data.

(2) Sources of Revenue

Meru municipal council obtains its revenue from rates, fees and charges, government grants and loans. These sources of revenue are discussed below.

Table 3.9A Meru Municipal Council Expenditure Distribution Among Services 1973-1980 K£'000'

	1973	%	1974	%	1975	%	1976	%	1977	%	1978	%	1979	%	1980	
Administration	68000	77.8	59000	28.2	79000	50.6	366000	62.5	144000	38.5	96000	57.1	125000	51.4	235000	55
Community	5000	5.7	40000	19.1	16000	10.1	3000	2.4	62000	20.8	28000	16.7	56000	23.0	121000	[illegible]
Social	10000	11	14000	6.7	6000	3.8	15000	14.2	31000	10.5	2000	1.2	3000	1.2	3000	[illegible]
Economic	5000	5.5	81000	38.8	3800	2.5	63000	1.2	42000	25.0	59000	24.4	59000	24.4	65000	15
Unallocatable	-	-	15000	7.2	17000	10.9	19000	18.4	27000	9.1	-	-	-	-	-	
	88000	100	209000	100	121800	100	406000	100	327000	100	168000	100	243000	100	424000	[illegible]

Sources: Central Bureau of Statistics, Statistical Abstracts 1973-1981

(a) Property Rates

Property rates in Meru muncipal council are charged on rateable property within Meru township on basis of 6½% of the value of unimproved site. Freehold property owners outside the township are charged a flat rate of 30/= in form of land rates while the leasehold plot owners pay only plot rent to the council. The rate struck has been adjusted twice since the council was established in 1971. In 1975 the rate was raised from 4% to 5% and in 1979 it became 6½%. Accordingly, property valuation has been done twice, first in 1975 and second in 1979. Despite these positive changes deficit budgeting remained a permanent feature of fiscal policy of the council between 1973 and 1979. Two reasons are offered for this phenomenon. First is that the determination of the rate struck was not done according to the law i.e. the fiscal needs of the general rate fund services were not adequately identified or considered. Second, there was apparent undervaluation of property for rating. The Overseas Development Administration (ODA) study conducted in Meru municipal council revealed that an empty plot in Meru town easily fetched K£10,000 in the market. Yet the valuation roll for 1979 had very many plots whose values for rating were under K£500. However, rates have remained one of the major source of revenue to Meru municipal council as can be seen from table 3.9B below.

(b) Fees and Charges

For the purpose of this discussion, both business licence fees, plot rent, market fees and coffee cess are included in this category. Fees and charges are determined by the council and approved by the minister of local government. All tax rates chargeable under this category, except for coffee cess rate can be freely varied by the council. Coffee cess rate is fixed at 3% of the total payout to farmers. The fees and charges schedule of Meru municipal council in which these rates are indicated was changed in 1975 and 1979.

Business licence fees is charged on all business activities which the council is authorised by law to regulate and supervise. Meru municipal council is not authorised to control and supervise education and health as well as banking services. Consequently it is not authorised by local government Act to raise tax from these activities. Business licence fees is easy to administer and enforce collection because of the involvement of provincial administration in licensing process. The determination of licence fee chargeable is based on no verifiable criterion. It is fixed arbitrarily. Market fees is charged on farmers and retailers who sell their produce in municipal markets. Market fee is collected before the produce enters the market. Coffee cess is charged on the pay-out to coffee farmers within the municipality. It is collected through Coffee Board of Kenya and therefore does not fall in arrears. However, the council cannot plan for it effectively because it does not determine the timing for coffee pay-out. Plot rent is charged on all leasehold plots within the municipality. Although under council's own arrangements, plot rent and property rates should be paid at the same with business licenses, both plot rent and property rates usually fall in arrears.

It is observable from table 3.9c that coffee cess outstripped all other revenue sources both in terms of yield and contribution to general rate fund between 1976 and 1979. Thereafter and following the reduction of municipality, government grants becamec the major source of councils revenue. Business licences, market fees, and plot rent showed a steady growth during this period.

(c) Government Grants

Meru municipal council has been a recipient of GPT grants since 1974. The grant was not phased out after 1976 because of council's finance problems. Infact as it can be seen from table 3.9c the grant continued to increase until 1979. After that year, it was reduced to K£22,400 in 1980 and was phased out in 1983. The payment was received quarterly and very often it was characterised by delays.

(d) Loans

The two main sources of capital finance for Meru municipal council are the national housing corporation and local government loan authority. The national housing corporation has financed the construction of 75 housing units for Meru municipal council.[14] The capital value of these units could not be determined because the council does not maintain a loan ledger. One obstacle to extensive use of NHC loan facilities has been lack of public land within the municipality. NHC has shown interests to advance more loans to the council but the latter has not taken the opportunity because of shortage of land on which to put such projects as would be financed by NHC. Local government loan authority has financed the construction of Town Hall, Meru municipal market and the tarmacking of a number of streets in Meru town. In 1981 Meru municipal council had loans amounting to K£178,470.95 outstanding to both NHC and L.G.L.A. of which K£125,150.95 was in arrears indicating inability to pay.[15]

Table 3.9B: Sources of Meru Municipal Council Revenue K£, 1973 - 1980

Sources	1973	%	1974	%	1975	%	1976	%	1977	%	1978	%	1979	%	1980	%
Property Rates	10,000	8.8	10000	8.5	10,000	9.	10,000	9.4	18,000	8.2	18,000	7.9	17,000	12	23,000	12.4
Plot Rent	4,000	3.5	4000	3.4	5,000	4.5	10,000	9.4	8,000	3.6	10,000	4.4	10,000	7	12,000	6.5
Coffee Cess	4,000	3.5	4000	3.4	17,000	15.3	17,000	16.0	81,000	30.0	10,00	30.0	46.000	32.4	46,000	24.7
Business Licence	7,000	6.1	7000	6.0	15,000	13.5	18,000	17.0	17,000	7.7	15,000	6.6	25.000	17,6	35,000	18.8
Govt. Grants	48,000	42.0	48000	41.0	28,000	25.3	32,000	30.2	31,000	[illegible]4.4	43,000	18.9	43,000	30.3	58,000	31.2
Milk Income	31,000	27.1	44000	37.6	36,000	32,4	19,000	18.0	65,000	[illegible]9.5	73,000	32.2	11,000	7.7	12,000	6.4
	114,000	100	117000	99.9	111,000	100	106,000	100	220,000	100	227,000	100	142,000	100	186,000	100

Source: Meru Municipal Council Estimates 1973-1980.

The revenue data used in table 3.9b is extracted from council's estimates. The actual revenue data was not obtainable because of incompleteness of revenue records. There was also no independent external source which could provide reliable actual revenue data.

FOOTNOTES: CHAPTER III

1. Kenya Colony: 1948 Ordinance: Govt. Printer, Nairobi.

2. Republic of Kenya: Local Government Act, cap.265 Third schedule Part I, Govt. Printer, Nairobi, 1963.

3. Ibid Third schedule Part II.

4. United Nations: Local Government Reform; Analysis of Experience in Selected Countries, New York, 1975. p.1.

5. Ibid :

6. Republic of Kenya: Op.cit. Section 148.

7. See Nakuru municipal council budget speech of 1978 by the chairman of finance committee. The complaint was that property valuers had unduly lowered the property values. He proposed that the council employs its own valuers.

8. C.B.K*. Annual Reports and Financial Statements. 1976-1981.

9. Republic of Kenya: Op.cit section 222.

10. Ibid : Section 223

11. Ministry of Local Govt. Oral interview.

12. C.B.K Op.cit.

13. Meru Municipal Council: 1971-1980 estimates

14. O.D.A.** Study Report, phase I, Vol.4 on Meru

15. Ibid.

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* Coffee Board of Kenya.

** Overseas Development Administration.

CHAPTER FOUR

EMPIRICAL RESULTS

4.1. Introduction.

Chapter three of this study was devoted to the description of local government finance in Kenya in general and Meru municipal council finance in particular. The analysis in this chapter is mainly concerned with data from Meru municipal council for the purposes of testing the hypotheses. However, the data on local government finance in general is used, where applicable, to support the results of the analysis. The hypotheses are tested in the order in which they are outlined in chapter one.

4.2. Testing of Hypotheses.

4.2.1. The Hypothesis of General Inadequacy of Traditional Sources of Local Government Finance.

The reported fiscal performance for Meru municipal council during the period 1973-1980 is shown in table 4.1A below. In this table it is clear that except for 1978, the nongrant revenue from the traditional sources of local government finance was too inadequate to meet expenditure demands of the council. The coefficients of the traditional sources of local government finance inadequacy (nongrant revenue inadequacy) are shown in table 4.1b below. However, data obtained indirectly from sources within the council and from independent sources indicate

Table 4.1a: Meru Municipal Council Fiscal Performance - 1973-1980.

Revenue (Non Grant)	1973	1974	1975	1976	1977	1978	1979	1980
Property Rates	10,000	10,000	10,000	10,000	10,000	18,000	17,000	23,000
Plot Rent	4,000	5,000	5,000	10,000	8,000	10,000	10,000	12,000
Coffee cess/Produce	4,000	4,000	17,000	17,000	81,000	68,000	46,000	46,000
Business Licence	7,000	7,000	15,000	18,000	17,000	15,000	25,000	35,000
Miscellaneous	31,000	44,000	36,000	19,000	65,000	73,000	11,000	12,000
Total Nongrant Revenue	66,000	69,000	83,000	74,000	89,000	134,000	99,000	128,000
Less% Expenditure								
Administration	68,000	59,000	79,000	366,000	144,000	96,000	125,000	235,000
Community	5,000	4,000	15,000	3,000	62,000	28,000	56,000	121,000
Social	10,000	14,000	6,000	15,000	31,000	2,000	3,000	3,000
Economic	5,000	81,000	3,800	3,000	63,000	42,000	59,000	5,000
Unallocable	-	15,000	17,000	19,000	27,000	-	-	-
Total Expenditure	88,000	209,000	121,800	406,000	327,000	168,000	243,000	424,000
Nongrant deficit	(22,000)	(140,000)	(38,800)	(332,000)	(238,000)	16,000	(144,000)	(296,000)
Add Grants	48,000	48,000	28,000	32,000	31,000	43,000	43,000	58,000
Surplus/Deficit	26,000	(92,000)	(10,000)	(300,000)	(207,000)	59,000	(101,000	(238,000)
Cumulative Deficit/ Surplus	26,000	(66,000)	(76,000)	(376,000)	(583,000)	524,000	(625,000)	(863,000)

Source: Compiled from Tables 3.9a and 3.9b.

that the council's revenue estimates do not reflect fairly on the resourcefulness of the traditional sources of local government finance. A number of cases of revenue underestimation and over-estimation were noted. The general pattern is that the revenue for the period 1973-1976 was underestimated and revenue for the period 1977-1980 was over-estimated. Below is the adjusted table of the sources of Meru municipal council revenue. The adjusted nongrant deficit and after grant deficits for the period are shown below.

The results in tables 4.1A and 4.1c confirm the hypothesis of general inadequacy of the traditional sources of local government finance for the purpose of financing local authorities' expenditure needs. However, table 4.1c reveals that the inadequacy usually reported by local authorities is always exaggerated Below is a comparative analysis of reported and adjusted coefficients of nongrant revenue inadequancy for Meru municipal council for the period 1973-1980.

Table 4.1d shows that except for 1980, the reported revenue from the traditional sources of local government finance was understated throughout the period. The adjusted coefficient of of nongrant revenue inadequacy for the period was (0.40) and that of the reported revenue was (0.50) approximately. One main reason for overstatement

Table 4.15: <u>Adjusted Sources of Meru Municipal Council Revenue</u>

KE

Sources	1973	1974	1975	1976	1977	1978	1979	1980
Property Rates	13,000	13,000	13,000	13,000	18,000	18,000	17,000	23,000
Plot Rent	9,000	10,000	13,000	12,000	13,000	13,000	13,000	13,000
Coffee Cess/Produce	18,000	16,000	20,000	30,000	81,000	68,000	46,000	46,000
Business Licence	10,000	12,000	14,000	17,000	17,000	15,000	20,000	23,000
Govt. Grants/GPT.	26,000	36,000	25,000	32,000	31,000	43,000	43,000	58,000
Misc. Income	31,000	44,000	36,000	19,000	65,000	73,000	11,000	12,000
Total	107,000	131,000	121,000	123,000	225,000	230,000	150,000	175,000
Less Grants	26,000	36,000	25,000	32,000	31,000	43,000	43,000	58,000
Total Nogrant Revenue (Adjusted).	81,000	95,000	96,000	91,000	94,000	187,000	107,000	117,000

Sources: 1. Meru Municipal Council, <u>Incomplete Cash books and ledgers, estimates 1973-1980.</u>

2. Coffee Board of Kenya, <u>Reports and Financial Statements 1976-1981.</u>

Table 4.15: Adjusted Sour

Sources	1973
Property Rates	13,000
Plot Rent	9,000
Coffee Cess/Produce	18,000
Business Licence	10,000
Govt. Grants/GPT.	26,000
Misc. Income	31,000
Total	107,000
Less Grants	26,000
Total Nogrant Revenue (Adjusted).	81,000

Sources: 1.

2.

ces of Meru Municipal Council Revenue

K£

1974	1975	1976	1977	1978	1979	1980
13,000	13,000	13,000	18,000	18,000	17,000	23,000
10,000	13,000	12,000	13,000	13,000	13,000	13,000
16,000	20,000	30,000	81,000	68,000	46,000	46,000
12,000	14,000	17,000	17,000	15,000	20,000	23,000
36,000	25,000	32,000	31,000	43,000	43,000	58,000
44,000	36,000	19,000	65,000	73,000	11,000	12,000
131,000	121,000	123,000	225,000	230,000	150,000	175,000
36,000	25,000	32,000	31,000	43,000	43,000	58,000
95,000	96,000	91,000	94,000	187,000	107,000	117,000

Meru Municipal Council, *Incomplete Cash books and ledgers, estimates 1973-1980.*

Coffee Board of Kenya, *Reports and Financial Statements 1976-1981.*

Table 4.15: Adjusted Sources of Meru Municipal Council Revenue

K£

Sources	1973	1974	1975	1976	1977	1978	1979	1980
Property Rates	13,000	13,000	13,000	13,000	18,000	18,000	17,000	23,000
Plot Rent	9,000	10,000	13,000	12,000	13,000	13,000	13,000	13,000
Coffee Cess/Produce	18,000	16,000	20,000	30,000	81,000	68,000	46,000	46,000
Business Licence	10,000	12,000	14,000	17,000	17,000	15,000	20,000	23,000
Govt. Grants/GPT.	26,000	36,000	25,000	32,000	31,000	43,000	43,000	58,000
Misc. Income	31,000	44,000	36,000	19,000	65,000	73,000	11,000	12,000
Total	107,000	131,000	121,000	123,000	225,000	230,000	150,000	175,000
Less Grants	26,000	36,000	25,000	32,000	31,000	43,000	43,000	58,000
Total Nogrant Revenue (Adjusted).	81,000	95,000	96,000	91,000	94,000	187,000	107,000	117,000

Sources: 1. Meru Municipal Council, Incomplete Cash books and ledgers, estimates 1973-1980.

2. Coffee Board of Kenya, Reports and Financial Statements 1976-1981.

Table 4.1c. Adjusted Deficits for Meru Municipal Council 1973-1980 K£

(K£)

	1973	1974	1975	1976	1977	1978	1979	1980
Adjusted Revenue Table 4.1b)	81,000	95,000	96,000	91,000	194,000	137,000	107,000	117,000
Total Exp.(Table4.1a)	88,000	209,000	121,000	406,000	327,000	168,000	243,000	424,000
Adjusted nongrant Deficit/Surplus	(700)	(114000)	(25800)	(315000)	133000)	19,000	(136,000)	(307,000)
Add Grants (Table4.1b)	26,000	36,000	25,000	32,000	31,000	43,000	43,000	58,000
Net deficit/surplus	19,000	(78,000)	(800)	(283,000)	(102,000)	62,000	(93,000)	(59,000)
Adjusted cumulative / deficit/ Surplus	19,000	(59,000)	(59,800)	(342,800)	(444,000)	(382,000)	(475,000)	(134,000)

Table 4.1D. A COMPARATIVE ANALYSIS OF NON GRANT REVENUE INADEQUACY, FOR MERU MUNICIPAL COUNCIL

1973-1980 K£

YEAR	EXPENDITURE	DEFICIT / SURPLUS		COEFFICIENTS OF INADEQUACY	
		REPORTED	ADJUSTED	REPORTED	ADJUSTED
1973	88,000	(22,000)	(7,000)	(0.25)	(0.08)
1974	209,000	(140,000)	(114,000)	(0.67)	(0.55)
1975	121,800	(38,800)	(25,800)	(0.32)	(0.21)
1976	406,000	(332,000)	(315,000)	(0.82)	(0.78)
1977	327,000	(238,000)	(133,000)	(0.73)	(0.41)
1978	168,000	16,000	19,000	0.10	0.11
1979	243,000	(144,000)	(136,000)	(0.60)	(0.56)
1980	424,000	(296,000)	(307,000)	(0.70)	(0.72)
Period Coefficient of nongrant Revenue Inadequacy				(0.50)	(0.40)

of nongrant revenue inadequacy or conversely under-statement of revenue from the traditional sources of local government finance is that with the abolition of graduated personal tax (GPT) in 1974, local authorities have endeavoured to create a false impression that they are not financially viable with the intention of attracting more government financial aid. The competence of local authorities to make accurate estimates has been questioned in several occasions but this alone cannot explain adequately the consistent revenue underestimation vis-a-vis the actual revenue collection that characterised the period under this study.

4.2.2. <u>The Hypothesis of Low Income Yield Relative to Expenditure.</u>

The adequacy of revenue from the traditional sources of local government finance is relative and essentially depends on the magnitude of the expenditure needs a local authority intends to finance. The ability of revenue sources to generate the requisite revenue to meet predetermined expenditure depends on the size of their economic base, the income elasticity of the base and the ability of the local authority to manipulate the tax rate structure in response to changes in expenditure needs. The broader the economic base, and the more the ability a local authority has to manipulate its tax rate structure, the higher the income yield from the source and the more important is the revenue source to a local authority.

Table 4.2 below compares annual income yields from various revenue sources with related annual expenditures for the period under review. It is apparent that except for isolated cases, the revenue contribution from each revenue source to related total annual expenditure is relatively low. It is equally apparent from the same table that not only is the income yield low but also it is both fluctuating and on declining trend in most cases as expenditure needs expand. The average ratio of annual total revenue yield to annual total expenditure for the period is 77.4. This indicates that the total revenue yield from the traditional sources of local government finance was low relative to expenditure needs.

A number of reasons are available to explain why the traditional sources of local government finance for Meru municipal council have relative low income yield. First and except for coffee cess and government grants, most of the traditional sources of Meru municipal council finance have narrow economic bases. The economic base of property rates is narrow because rating is confined to a small area - Meru township. Business licence fees are obtained from small scale retailers and wholesalers within Meru town. There are no substantial industries within Meru municipality. Coffee farming area within the municipal council is very limited. Second, their economic bases are income inelastic. The expansion of business activities in Meru town is limited by economic activities in Meru district and availability of business premises within the town. The raising of business licence fees is also limited by social economic and political consideration by the council. Property rates cannot be freely increased by the council and the expansion of the area under rating is impeded by delay in physical planning. In short, the traditional sources of Meru municipal council do not generate income proportionate to expenditure. It is observable from table 4.2 that their contributions to expenditures are inconsistent over the whole period under study indicating that their increases has been disproportionate to increases in expenditure. Third, some of the bases such as that of coffee cess and business licence are unstable and fluctuate depending on exogeneous factors. For example, the decline in coffee cess contribution to total expenditure in 1980 was as a result of decline in coffee pay-outs to coffee farmers within the municipality during 1980/81 crop season. Such economic bases provide unreliable sources of council's finance. Finally, the ability of the council to influence tax rate structure is very much limited. For example, coffee cess rate is fixed at 3% and cannot be changed.

Table 4.2 RATIO OF INCOME YIELD TO EXPENDITURE FOR MERU MUNICIPAL COUNCIL 1973-1980

Sources Of Revenue	% OF REVENUE TO EXPENDITURE							
	1973	1974	1975	1976	1977	1978	1979	1980
Property Rates	14.8	6.2	10.7	3.2	5.5	10.7	7.0	5.4
Plot rent	10.2	4.8	10.7	3.2	4.0	7.7	5.3	3.1
Coffee Cess	20.5	'7.7	16.4	7.4	24.8	40.5	18.9	10.8
Business Licence	11.4	5.7	11.5	4,2	2.1	8.9	8.2	5.4
Grants	29.5	17.2	20.5	7.9	9.5	25.6	17.7	13.7
Misc. Income	35.2	21.2	29.6	4.7	19.9	43.5	4.5	2.8

Source: Compiled from tables 4.1A and 4.1B.

Therefore there are plenty of forces that tend to hold down tax rates with the consequence that the revenue yields lag behind the expanding expenditure.

4.2.3. <u>Hypothesis of Inadequacy of Intergovernmental Fiscal Co-ordination.</u>

It was pointed out in chapter two of this study that the intergovernmental fiscal co-ordinative is essentially meant to harmonize the fiscal needs and fiscal means of local authorities in their efforts to provide public goods and services. In other words, intergovernmental fiscal co-ordination would be expected to eleminate fiscal imbalances in local government finance.

Kenya government has taken several intergovernmental fiscal co-ordinative steps which thus had mixed effects on local government finance. Firstly, the abolition of graduated personal tax, school fees and medical fees had the effect of reducing the taxable capacity at the disposal of local authorities thus increasing fiscal imbalance. The government grants that followed the above action considerably alleviated the resultant financial situation but not enough to offset the imbalance. The local governments continued to have budget deficits notwithstanding government grants. Table 3.1 shows the local government fiscal conditions during the period under review. It is noticeable that municipal councils perennially experienced deficits during the period except for 1973 and 1979. In 1973, the government had not abolished GPT,school fees and medical fees. The 1978 coffee boom had a boosting effect on local government finance. The county, urban and town councils continued to enjoy surplus until 1979.

The situation for Meru municipal council during the period is well demonstrated in table 4.1c. Except for 1973, and 1978, the council experienced budget deficits throughout the period despite the government grants. The implication here is that government grants were not adequate enough to offset the deficits. The extent to which the government grants were inadequate is shown in table 4.3 below.

Several reasons can be cited to explain why the government grants remained inadequate during the period. Firstly, the grants were meant to compensate local authorities of revenue lost as a result of government action and not to replace the revenue sources thus lost. The grants were retrospective in determination and fixed regardless of the fiscal needs of local authorities. The growth in economic bases of the revenue sources lost was not considered for the purpose of compensation. In effect, government grants were partial compensation of revenue lost to local authorities as a result of government action. These factors, combined

Table 4.3 Indexes of Government Grant Inadequacy for Meru Municipal Council 1973-1980

Year	Total Expenditure 1	After Grant Deficit/ Surplus 2	In adequacy Indexes 2 ÷ 1.
1973	88,000	19,000	0.22
1974	209,000	(78,000)	(0.37)
1975	121,800	(800)	(0.007)
1976	406,000	(283,000)	(0.7)
1977	327,000	(102,000)	(0.31)
1978	168,000	62,000	0.37
1979	243,000	(93,000)	(0.38)
1980	424,000	(259,000)	(0.61)

Source: Data compiled from table 4.1c.

together, have had the effect of making government grants both income inelastic and inadequate as tools for fiscal co-ordination.

4.2.5. The Hypothesis of Fiscal Mismanagement

Fiscal management is the art of planning and controlling the use of public funds so that a government can be able to meet the present and future needs of its people. It includes such activities as budgeting, accounting, forecasting, treasury management and performance measurement. Therefore fiscal management is concerned with effective utilization of revenue resources and optimal allocation of expenditure to various expenditure items or services, among others.

It has been pointed out elsewhere in this text that the inadequacy of the sources of local government finance is relative to its expenditure. That is, in so far as the available revenue resources do not meet the related expenditure needs, the former is said to be inadequate. The assumption here is that the available revenue resources are exhaustibly exploited and the expenditure needs are genuine and legitimate. However, very often fiscal mismanagement creeps in and invalidates this assumption. Resource underutilization and revenue undercollection as well as illegitimate and unplanned expenditures are common features in local government finance. Such fiscal mismanagement has the effect of falsifying the true state of revenue resources and expenditure needs usually resulting into exerggerated fiscal inadequacy. The following cases from Meru municipal council support this proposition.

Resource Underutilization

(a) Underutilization of Property Rates

It has already been demonstrated in this chapter that rates contribution to Meru municipal council's expenditure is low relative to the other sources of finance. But the economic base of rates depends on the size and value of the reteable properties within the rating authority's jurisdiction.

Since the inception of Meru municipal council, the latter has maintained a rating policy which has tended to reduce the size of rateable properties within the municipalty. Rates are only levied on leasehold properties within the old township. In 1980 it was estimated by town treasurer's department that about two-thirds of rateable properties within the municipality was not included in the valuation roll.

This in effect means that the rates which the council can legally realize is always understated by $^{2}/_{3}$. From table 4.1b, the council should have realized K£66,000 instead of K£23,000 in 1980. Efforts to include all rateable properties in the valuation roll have been impeded by the continuing feeling among the decision makers that only the leasehold property should be rated. This feeling appear to have influenced physical planning for the purposes of valuation.

(b) Revenue Undercollection.

Revenue undercollection causes financial inadequacy forcing the local authorities to rely heavily on loans and bank overdrafts for the purpose of financing their recurrent expenditures. From 1974 to 1979 Meru municipal council operated a perpetual bank overdraft of K£20,000 for the purpose of financing its general rate fund services. The overdraft was used from April to December each year and was cleared between January and March each year. The use of bank overdraft gave the impression that the available revenue resources were inadequate. However, records from Meru municipal council show that during that period, much of its budgeted income fell into arrears mainly because of weak methods employed in enforcing revenue collection.

Table 4.4: Meru Municipal Council Rates Collection Performance 1973-1980

(K£'000)

	Property Rates			Land Rates		
Year	Estimated	Collected	Over/Under Collection	Estimated	Collected	Over/Under Collection
1973	13,000	10,400	(2600)			
1974	13,000	6,600	(6400)			
1975	13,000	7,800	(5200)			
1976	13,000	21800	3800			
1977	18,000	16300	(1700)	11,000	2889	(7113)
1978	18,000	13900	(4100)	-	-	-
1979	17,000	22250	(5250)	11,000	1481	(8619)
1980	23,899	22899	11,100	11,100	1879	(9221)

Source: Meru Municipal Council Estimates and Cashbooks. 1973-1980.

NB. 1. Records for property rates collection between 1974-1978 were not available.

2. Land rates was introduced in 1975 to replace poll rate.

The state of revenue collection from property rates and land rates for selected years during the period under study is shown in table 4.4.

Table 4.4. shows that much of rates were in arrears during the period under review. The council also had problems in the collection of plot rents and sewerage rates from its residential estates. Both the property rates and plot rents are collected at the same time during business licensing. The fact that some of the property rates escaped payments during this period suggests that some of the plot rent also fell in arrears. Accordingly the council would not enforce the the payment of sewerage rates from the residents in its estates because it did not have a direct contact with them. Water undertaking enables local authorities to collect sewerage rate. Meru municipal council was not a water undertaker until the end of 1982.

The use of bank overdraft stopped temporarily in 1979 and 1980 but was resumed in 1981. By the end of 1982, the council had K£27350 in arrears in respect of rates and plot rent but this figure was reduced to K£22,200 by July 1983. At this same time, the council was operating bank overdraft of K£25,000.

Illegitimate Expenditures

These are fiscal requirements which are dictated by factors other than legitimate needs of the society. They arise out of official misconception of real societal needs or from desires to satisfy egocentric political needs of individual councillors. Illegitimate expenditures are generally wasteful and therefore socially undersirable. Examples of such expenditures are discussed below.

(a) Organizational Multiplier.

Organizational multiplier is a wasteful practice in which an organization feeds on itself more than serving its real purpose. The purpose of local authorities in Kenya is to provide civic services which are social and economic in character. To be able to achieve their objectives in this respect, local authorities require to be administratively efficient. They require qualified and skilled staff in sufficient numbers as well as the necessary tools. Experts tell us that an optimum administrative unit should not cost more than 40% of the total expenditure to be incurred at any time. However, some local authorities have built administrative machineries out of proportion to this optimum level and to the services they provide. The case of Meru municipal council is demonstrated below in table 4.5a. It is noticeable from the table that except for 1974 and 1977, the council maintained excessive and wasteful administrative capacity throughout the period. It is further observable from table 4.5b that the council maintained an administrative capacity far in excess of an average administrative capacity for all municipal councils in Kenya during the period.

Table 4.5A Comparison of Optimum and Meru municipal Council's Administrative Capacities.

Years	Expert Optimum Level % of total Exp.	Meru Municipal nouncil % of total Exp.	Excess (Under) Capacity
1973	40%	78%	38%
74	"	28	(12)
75	"	51	11
76	"	63	23
77	"	39	(1)
78	"	57	17
79	"	51	11
80	"	54	14

Source: Central Bureau of Statistics, Statistical Abstracts 1973-1980.

Table 4.5b: Comparison of Average Administrative Capacity for all Municipalities with that of Meru Municipal Council 1973-1980.

Year	All Municipal Councils (%)	Meru Municipal Council (%)	Excess/(Under) Capacity.
1973	7.3.%	78%	70.7%
1974	7.0	28	21.0
1975	7.7	51	43.4
1976	7.5	63	55.5
1977	7.0	39	32.0
1978	12.2	57	44.8
1979	13.1	51	37.9
1980	25.0	54	29.0

Sources: Central Bureau of Statistics, Statistical Absracts 1973-1980.

The administrative costs of Meru municipal council are greatly influenced by excessive employment of personnel on wrongly and politically conceived manpower needs.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND POLICY RECOMMENDATION

5.1. Summary

1. Local authorities are government bodies which play important social, economic and political roles in a society. Their financial structure and scope of public responsibility are determined by the national government.

2. Local authorities can perform most of the government functions efficiently but their ability to handle taxation is limited by distorting effect it produces on national economy. The only tax which they can manage efficiently without disastrous effect on national economy is property rates. Consequently, there is a tendency for local authorities to have more responsibilities than they can be able to finance. Usually the national governments step in to co-ordinate the fiscal needs and fiscal means of local authorities. The extent of intergovernmental fiscal co-ordination varies from one country to another. Generally there is less intergovernmental fiscal co-ordination in less developed countries than in developed countries. The former depend mainly on local sources while the latter depend on government grants.

3. Studies conducted on local government finance in Kenya have indicated existence of fiscal imbalance in local government finance and have invariably brought to attention the gross fiscal mismanagement and excessive revenue resource underutilization which have contributed a great deal to the inadequacy of local government finance.

4. Arising from the above point is the fact that the traditional sources of local government finance are capable of tremendous improvement, although one would not expect them to generate sufficient income to meet all the expenditure needs. It is perhaps because of this observation that the central government has been unwilling to allocate more revenue resources to local authorities and has withdrawn all grants from them.

5. Government grants have been inadequate largely because of the manner in which they were determined and the purpose for which they were issued. All compensatory grants were supposed to compensate local authorities of revenue, lost as a result of government action. These grants were determined as a total compensation of revenue over a period of time. For example, the GPT grants were revenue compensation for five years and were designed to be phased out.

5.2. Conclusions.

The following generalized conclusions about local government finance are arrived at after the study of Meru municipal council finance.

1. The nongrant revenue sources of local government finance are generally inadequate for the purpose of financing local government expenditure needs. However, much of the reported inadequacy of nongrant revenue sources is fictitious and arises from fiscal mismanagement. Some of the potential revenue resources like property rates are underutilized either because of official ineptitude or because of political pressures against their full utilization. Too much realizeable revenue is allowed to fall in arrears forcing the local authorities to depend on loans and bank overdrafts for the purpose of financing their recurrent expenditures. Some of the expenditure needs are falsified either to win more government grants or for political reasons. This mainly affects expenditure on personnel. Some local authorities have unscrupulously built administrative organizations which are disproportionate to their responsibilities.

2. The traditional sources of local government finance are composed of many revenue sources, with small yields, and which are income inelastic. They have narrow and unstable economic base.

3. Local governments in Kenya are generally financially weak. This is notwithstanding the central government's co-ordinative efforts. However, municipal councils experience more financial problems than county, council, urban and town councils. For example, except for 1973 and 1978, Meru municipal council experienced deficits in its finance throughout the period 1973-1980.

4. The reasons why municipal councils have more financial problems than other local authorities is that the latter have less responsibilities than the former. The 1970 transfer of functions Act withdrew all the permissive functions from county, urban and town councils but left them intact in municipal councils. At the same time there has been an influx of population from rural areas to the urban centres and consequently pressurising scarce resources of municipal councils. Thus municipal councils have found themselves in a situation in which their expenditure needs are expanding faster than their revenue resources.

5. The capital finance available to local authorities is not adequate. The two financial institutions that provide capital finance to local authorities, the National Housing Corporation and local government loan authority, do not command sufficient resources to meet the demands of local authorities.

5. The financial plight of local governments in Kenya cannot be sufficiently explained and understood exclusively in terms of the inadequacy of the traditional sources of local government finance and intergovernmental fiscal co-ordination. There are other intervening variables which require attention. For instance, why should the local authorities not have more than just the traditional sources of finance? Why does the government not increase its grants to local authorities substantially enough to offset all recurrent budgetary deficits evidenced in local government finance? Answers to these questions revolve around the availability of fiscal resources in the economy and the willingness of the central governments to allocate more of these resources to local authorities. Among the many factors influencing the willingness of the government in this respect are the sense of political and financial responsibility demonstrated by local authorities and the functions allocated to them. Chapter two of this study has hinted that Kenya, being one of the less developed countries, suffers from general inadequacy of fiscal resources at all levels of government. Accordingly the Kenya national government shoulders greater public responsibilities than the local authorities and therefore it logically follows that she must have more fiscal resources than the local

authorities. This is besides the social political and economic advantages realizeable by the whole nation for her being in charge of most of the fiscal resources. Excessive taxation would have a distorting effect on economic activities. These considerations have the effect of limiting fiscal resources which in addition to the traditional sources of finance can be made available to local authorities.

Kenyan local authorities have not been responsible enough to encourage the central government to increase its intergovernmental fiscal co-ordination positively.*
The transfer of functions of 1970 came about because local authorities proved irresponsible financially and functionally. Nairobi city council was placed under commission in 1983 because of gross mismanagement. Cases of resource underutilization are prevalent in local government finance. According to report and recommendations of working party on government expenditure, government grants to local authorities are used to,

"Overstaff and overspend without regard for the efficient provision of services"[1]

These facts partly explain why the government had to withdraw all grants from local authorities.[2] Because

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* In Chapter Two it was mentioned that intergovernmental fiscal co-ordination can have a negative effect on local government finance. The abolition of government grants, GPT etc are such negative co-ordinative activities of Kenya government. Positive co-ordinitive activities of government should have the effect of improving local

of this apparent lack of sense of responsibility there is a tendency in Kenya towards centralization of public responsibility to the central government.

5.3. Policy Recommendations

The following recommendations are made on the following problematic areas of local government finance.

(1) Distribution of Fiscal Resources and Responsibilities Between Central and local Governments.

The existing pattern of distribution of fiscal resources and responsibilities between the central and local governments leads to sub-optimal provision of public services. However, given the financial and political irresponsibility of local leaders and civic officials and unless there is a drastic change in this behaviour, it is recommended that the current centralization of public responsibilities to central government should continue unabated. This recommendation is made on the understanding that local autonomy does not mean development and essentially does not in itself supercede national development. Where and when local authorities demonstrate mature sense of responsibility, public responsibilities should be allocated to them on basis of their financial and managerial capabilities. The objective of this recommendation is to ensure effective and efficient use of scarce national resources.

The role of local authorities in national development cannot be overemphasized. It is reckoned that there is no practical and effective substitute for them in pursuit of national development. They facilitate the process of national development by enabling the central government to make effective use of local resources. Therefore it is recommended that the central government should strive to establish viable and responsible local authorities. This end should be achieved in the following manner and order:-

(a) To make local authorities politically and financially responsible, the central government should:-

(i) design a local government electoral system which provides local authorities with civic leaders who are politically mature and who are capable of understanding the role of local government in society and the financial and administrative processes of local government.

(ii) Provide local authorities with civic officials who are well versed in managerial skills besides their professional orientation. Such officials should be independent of local leaders in so far as their employment is concerned. This will give them security and courage - to stick to their professionalism.[3]

(b) Experience shows that the political and financial irresponsibilities exhibited by local authorities is also perverse in the ministry of local government which is supposed to control them. Most of the unwarranted man-power recruitments in local authorities are done with prior knowledge and blessing of ministry officials. The recent establishment of numerous, yet unviable and redundant local authorities in Kenya by the ministry of local government was politically inspired and an example of lack of fiscal responsibility. It is therefore recommended that some discipline and reorganization be introduced in the ministry of local government, namely:-

(i) Ministry of local government should be manned by officials who are professionally qualified, honest and dedicated in their work. Such officials must be capable of understanding local government problems and providing practical solutions to these problems.

(ii) Politics at the ministry's level should be divorced from the management of local authorities by introducing a powerful administrative office of a commissioner for local governments. This office should exclusively deal with the management of local authorities.

(c) The central government should make local authorities financially viable by providing them with fiscal resources that match their public responsibilities.

2. Improving the Resourcefulness of the Traditional Sources of Local Government Finance.

The traditional sources of local government finance have a wide scope for improvement and development. Local authorities should be encouraged to be creative in exploring new ways of financing their expenditure needs. The ministry of local government support and advice in this respect is very vital. The existing economic base of revenue sources should be expanded. Property rates should not only be confined to the immovable assets but also on personal assets.

Property valuation should be done as frequently as possible. The local authorities should also be allowed to vary tax rates freely as the financial needs arise. The above proposals are possible provided the rating Act is amended and the physical planning department take lead of the development. Local authorities have been unable to make effective use of property rates because of delays in physical planning. Accordingly the methods of rating used should have the comparative effect of increasing the income yield from the property.

3. Improving Fiscal Management.

It was pointed out in chapter three and four of this paper that some of the reported financial inadequacy in local authorities is fictitious and arises from fiscal mismanagement. This problem should be overcome by:-

(a) Introducing sound fiscal management techniques such as planning and forward budgeting. The revenue and expenditure budgets of local authorities should be based on long-term plans. Accordingly, the long-term plans should reflect the national developmental needs. The sporadic and random manner in which revenue and expenditure activities of local authorities are currently treated should be discouraged completely.

(b) Local authorities should be encouraged to make effective and full use of fiscal resources at their disposal. In so far as there are unexploited or partialy exploited revenue resources which under normal circumstances are exploitable the local authorities should not be authorised to borrow externally to finance their recurrent expenditures. The central government should use matching grants to induce full utilization of local taxes. That is, the grants should be based on a percentage of locally raised revenue. Deficit budgeting should be restricted as much as possible.

(c). The central government should assist local authorities in the enforcement of revenue collection. This can be done by the Provincial Administration collecting revenue on behalf of local authorities and making nonpayment of local taxes a criminal offence.

(d) Government should maintain strict control over local government expenditures, particularly on personnel employments. A reward and punishment system for local authorities should be maintained to ensure strict adherence to fiscal management procedures. The fiscal performance of local authorities should be appraised regularly and advice given on time.

4. <u>Improving Intergovernmental Fiscal Co-ordination</u>

The government grants should not only be related to the fiscal needs of local authorities but also should be used to improve fiscal performance of local authorities. Two types of grants are proposed. These are:-

(a) General matching grants: These are grants which the local authorities have the discretion to use as they choose but which are determined on the basis of locally raised revenue. They should have co-ordinitive as well as optimizing effect on local government finance.

(b) Special matching grants: These are grants given to local authorities to enable them to discharge a specialized function in a predetermined manner and according to set standards. Such grants should be determined as a percentage of the total cost required to provide the services in question. Special matching grants should have both optimizing and standards maintenance effects.

Government grants should also be used to introduce discipline in local authorities. For example, the local authorities which do not demonstrate sense of responsibility and whose financial management is not in conformity with the established procedures should be denied rights to government grants.

FOOTNOTES: CHAPTER FIVE

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2. Republic of Kenya, Ministerial Circular No. 12/83.

3. The Report and Recommendations of the Working Party on Government Expenditure has recommended the transfer of chief officers of local authorities to the employment of public service commission.

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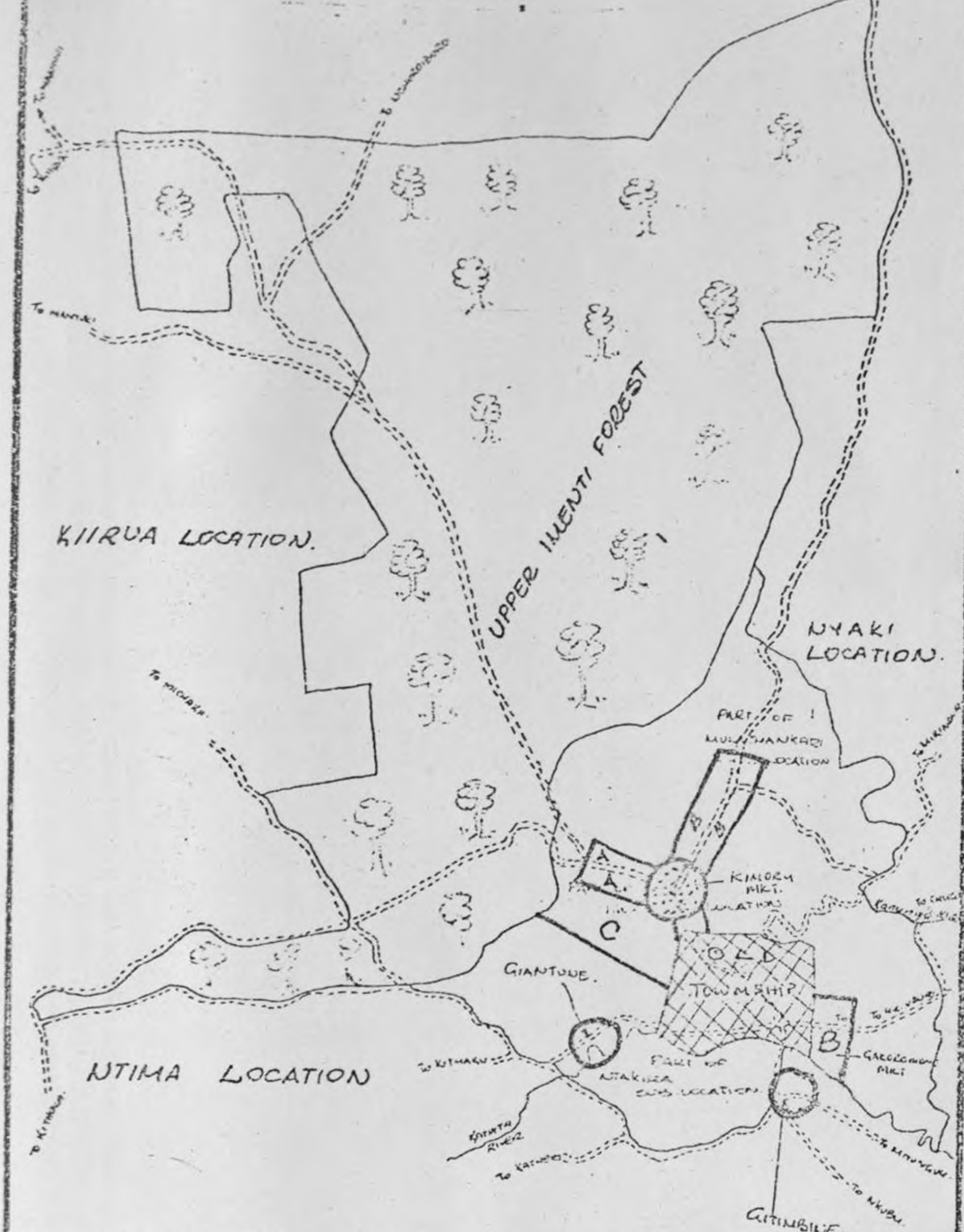
APPENDIX II



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