

**IMPACT OF LOCAL AUTHORITIES TRANSFER FUNDS ON THE  
DISTRIBUTION OF RESOURCES OF LOCAL AUTHORITIES IN  
KENYA**

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## **DECLARATION**

### **STUDENT'S DECLARATION**

This research project is my original work and has not been submitted to any other University for examination.

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### **SUPERVISOR'S DECLARATION**

This project has been presented for examination with my approval as project Supervisor

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## **DEDICATION**

To my lovely wife

Grace Muema

My dear son Collins

As well as

My

Daughters

Brenda and Katumbi

for your great source of inspiration and joy in my daily endeavors to better my best.

To my other family members who offered

me unconditional love and support throughout the course of this project.

## **ABSTRACT**

There has been a lot of criticism, from various quarters, on the way the LATF is managed and implemented. Grants to local governments may raise local government employment and contribute to expansion of local industries. But characteristics of the local government and the local economy also will determine how federal or central government grants are distributed. In Kenya, service provision in Local Authorities includes maintenance of local roads, public markets, bus parks, slaughter houses, municipal housing, solid waste management and social welfare programme,

The study used cross sectional research design methodology with a population of 175 local authorities. Stratified random sampling technique was used to select the sample. From each stratum the study used simple random sampling in selecting 53 local authorities. The sources were obtained from the treasury, Kenya local governments reform programme, the ministry of local government. The study used secondary data and they include; local authority approved budget estimates, Statements of actuals receipts and expenditure and financial statements for a period of 5 years (2006-2010).

Based on the findings, it is clear that most of the local authorities cannot finance fully the recurrent expenditure from the locally generated revenues. The locally generated revenues are not reliable to the extent of financing the necessary personnel, operations and maintenance and for that reason they literally depend on LATF to finance development expenditure.

Going by the analysis, some of the funds on LATF allocation actually go to the performance so as to make LAs operate at optimum level. Without LATF most of the local authorities will be in deep debts and not offering any meaningful development to the local residents. As LATF funding increased over the years, the performance capacity of the LAs increased thereby increasing the locally generated revenue. This translated to more funds going to development expenditure and therefore LATF has a major impact on Local Authorities.

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## **ABBREVIATIONS**

CDF:	Constituency Development Fund
CDFC:	Constituency Development Fund Committee
CILOR:	Contribution in Lieu of Rates
DDC:	District Development Committee
KLGRP:	Kenya Local Government Reform Programme
LADP:	Local Authorities Development Programme
LAs:	Local Authorities
LASDAP:	Local Authorities Service Delivery Action Plan
LATF:	Local Authority Transfer Fund
LDC:	Locational Development Committees
MDGs:	Millennium Development Goal
MOLG:	Ministry of Local Government
REP	revenue enhancement plan
RMLF:	Roads Maintenance Levy Fund
WDC:	Ward Development Committees

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 Background of the study**

#### **1.1.1 Theoretical Background**

Governments collect revenues through taxes, fees and charges, royalties on natural resources, and the sale of goods and services. They also receive income from investments and often from borrowing. These revenues are used to make transfer payments to individuals and businesses, pay interest on accumulated debt, and finance general expenditures. Most countries have a system for allocating public funds from the central (or federal) government to regional and/or local jurisdictions and for redistributing revenues from higher to lower income areas. Reallocation of financial resources among jurisdictions is very important to the local government operations and management. For example, in the UK ‘local authorities’ (local municipalities) receive 60 percent of their funding from central government grants (the remaining funding comes from the council tax, fees and charges), making these local authorities highly dependent on central government decisions. Quite a number of European countries have similar reallocation schemes.

Many developing countries have adopted decentralization strategies for effective service delivery to varying degrees. After selecting the unit of analysis and the income measure, the next step in expenditure incidence exercises is to allocate the benefits of government spending. Before going into the details of this allocation, a number of conceptual issues must be addressed. As the practice of decentralized development funding gains

momentum, stakeholders have become involved in developing strategies for the management of these funds. The Kenya government has made significant developments in fiscal decentralization, with a number of initiatives making provision for the lower levels of resource reallocation including Constituency Development Fund (CDF), Local Authority Transfer Fund (LATF), Roads Maintenance Levy Fund, Water Services Trust Fund, Free Primary Education, Bursary Funds, HIV/AIDS fund among others. These decentralized funds are administered at the local authority, district, constituency and other lower levels of government, and were established in the belief that local level governance has a better understanding and is more accountable to local demands and aspirations.

The Local Authorities (cities and Local Governments) are very important to the citizenry. They are the engines of growth and centres of development. They provide cultural; educational; management, research, commerce and political services. They also do offer employment, best health facilities and boost the country's economy (UN-HABITAT (2004). For instance, the City Council of Nairobi, the largest Local Authority in Kenya, produces more than half of the country's Gross Domestic Product. This means that Local Governments are important institutions in a country's development. LATF distribution is an intergovernmental transfer system that provides resources to local authorities to supplement their own resources in the financing of services and facilities required by citizens. The fund was formed through LATF Act No.8 of 1998 and operationalised in 1999. It constitutes 5% of the income tax which is allocated to Local authorities based on basic amount of Kshs.1.5 million per Local authority, 60% based on relative general

population of a local authority and the balance on relative urban population of a local authority.

The government of Kenya has made deliberate efforts to decentralize most of its development projects over the past five years, key among them, the projects aimed at meeting the MDGs. More precisely, in the year 2007-2008 budgetary allocations, more than Ksh 58 Billion went to devolved structures. One of the devolved fund regimes instituted under this period was Constituency Development Fund through the CDF Act, which was later changed to CDF amendment act of 2007. The fund comprised of an annual budgetary allocation equivalent to 2.5% of all the government ordinary revenue collected in every financial year. Constituency development fund is managed at the national and the grass root levels. At the national level there are constituency development fund boards and the constituency fund committees, while at the grass roots the fund is mainstreamed in the provincial administration structure under the District development Committee (DDC), Constituency Development Fund Committee (CDFC), Locational Development Committees (LDC), and the Ward Development Committees (WDC). Other decentralized projects that enjoy this synonymous resource distribution in Kenya include The Local Authority Transfer Fund, Constituency Bursary Fund, Free Primary Education Fund, Constituency HIV/AIDS Fund, The Roads Maintenance Levy Fund, Rural Electrification Levy Fund, The Water Service Trust Fund, The Women Enterprise Fund, The National Development Fund For Persons With Disability, and The Poverty Eradication Fund.

The mission of the Ministry of Local Government (MOLG) is to facilitate Local Authorities (LAs) to achieve good governance and improved service delivery for enhanced socioeconomic development. This can be realised through viable, autonomous, accountable and responsive LAs. The Ministry has been implementing local government reforms since the early 1990's aimed at building the LA's capacity in financial management, service delivery, participatory planning and good governance. To enhance service delivery, various tools have been developed over the years for local authorities to assist them in preparing projects and the delivery of services, most notably those prepared under the Local Authorities Development Programme (LADP) and the Local Authorities Service Delivery Action Plan (LASDAP). The available tools mainly focus on project planning and identification rather than the operations and management of services offered by local authorities. On the other hand the tools are superseded in relation to current developments in technology and management of various services delivered by the LAs. There is also lack of clarity about the quantity and quality of the guidance in respect of service delivery available to LAs, and there are certainly gaps in the adequacy of that information.

Despite the shortcomings that plague devolved democratic structures of development in Kenya, both the critics and the sympathisers of the government cannot ignore one fact; the bottom-up approach of development is a shared responsibility between the government and the citizens and its success or failure lies in the hands of all players in policy making including the citizenry. Since the inception of this approach of development in the country, more gains have been seen at the grass roots in terms of

employment opportunities, schools enrolments and increased construction of local infrastructures than at any other time in the history of Kenya, but in order to make these initiatives last the test of time, serious checks and balances must be put in place to ensure that this holistic development approach of engaged governance is watertight from abuse and easy manipulation by people with less regard for the wider society.

According to Richard (2009), performance encompasses three specific areas of firm outcomes financial performance (profits, return on assets, return on investment, etc.; product market performance (sales, market share, etc.); and shareholder return (total shareholder return, economic value added, etc.). In a survey on the quality, uses and perceived importance of various financial and non-financial measures, Lingle and Schiemann (2006) report wider disparities between the perceived quality and importance of non-financial measures as compared to financial measures. Perceived inadequacies in a traditional performance measurement system that focuses on financial measures have led many organizations to switch to and put greater emphasis on forward-looking non-financial measures such as customer satisfaction, employee learning and innovation (Ittner and Larcker, 2008).

A subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation (Bernardin and Russel, 2009). There are many different ways to measure financial

performance, but all measures should be taken in aggregation. Line items such as revenue from operations, operating income or cash flow from operations can be used, as well as total unit sales. Furthermore, the analyst or investor may wish to look deeper into financial statements and seek out margin growth rates or any declining debt. Ultimately the universal measure of business performance is money and the ultimate forms of this measurement are the final accounts of the company. Money has the advantage that it can be used to measure the effectiveness and efficiency not only of different business functions (marketing, engineering, production etc.) but also of different businesses (from manufacturing companies to retailers and from hotels to garages).

Most organizations view their performance in terms of "effectiveness" in achieving their mission, purpose or goals (Guralnik and David, 2004). According to Guralnik and David (2004), financial performance is achievement which is often used to show the ability or "the show" which is commonly used to show up the performance or it also means "doing the task that shows someone's action in working. On the other hand, Bernardin and Russel (2009) define that financial performance is the record of the result which is gained from the function of certain work or certain activities in the certain period of time. Performance commonly used to evaluate the strategy. There are some obstacles in implementing the strategy that can be overcome by implementing the components of management strategy (Kaplan and Norton, 2001). In the perspective of management strategy, environment is the important and contextual factor which has the effect to the performance of the company (Child, 2000). The concept of modern management shows that the industry which is conducting an economic activity does not stand independently,

but it is in the business environment which is affected each other. Generally, the company is in the centre of business environment that consists of government, people, customers, distributors, employees and the same industry with its competitors.

The need to ascertain the extent to which each of these system constraints contribute to the performance, programmatic and financial gaps and address them through robust recommendations that will eventually lead to the harmonization of decentralized development is urgent. This will also facilitate optimization of ownership by all stakeholders and lead to attainment of improved results from each additional shilling invested at the decentralized level. Previous research made largely the same findings; absence of citizen participation, lack of responsiveness and social accountability of duty bearers, a poor legal framework, inadequate capacity within management committees and political interference are the main reasons for failure of decentralization funds to deliver the expected benefits of poverty reduction through increased access to human rights and development.

The relationship between the level of citizen awareness/participation in decentralized funds and performance/impact of these funds. This includes establishment of opportunities for community participation in prioritization of decentralized funds' projects for equitable and sustainable development. Monitoring of LATF funded projects is mainly done via performance contracts. However, the communication systems employed in outreach to the public and citizens' participation in the project identification,



and monitoring of LATF funded projects is wanting despite the existence of a LASDAP process. Mobilization is done through word of mouth or advertisement in the media.

Message is passed through social workers, local churches, chiefs, councilors etc. Important to note is that councilors participate on equal basis with other citizens. In addition, LASDAP guidelines, though well intentioned in their provisions to enhance public participation, do not have a proper institutional framework. For instance, there is lack of clear roles and responsibilities for the community in other levels of project implementation. In addition, it's not clear with whom the community representatives engage.

Government spending affects the economic position of individuals and families through two main channels: changes in earnings and changes in gross income. When government alters the level or mix of its expenditures, relative factor income and the relative prices of goods and services produced in the private sector are affected. Government spending are allocated in a distributionally neutral manner (Ruggeri, 2005). This approach has a number of desirable features. First, it involves a balanced-budget exercise in which both the level of expenditures and the revenues used to finance them are kept constant. Therefore, it bypasses the thorny issues associated with comparisons of income with and without government spending. Second, it minimizes the potential indirect effects because it confines them to the changes in the distribution of a given level of government expenditures. These indirect effects would arise only when these distributional changes affect the behavior of economic agents. Third, the inclusion of both cash transfers and

transfers in kind (the allocated benefits from government purchases of goods and services) provides a more meaningful concept of economic well-being.

This distinction between expenditure incidence and benefit incidence reflects the differentiation between general equilibrium and partial equilibrium analyses (Ruggeri, 2005).. The direct effects of government spending on the distribution of gross income, which includes the benefits from such spending, are measured by partial equilibrium analysis. Government activity affects the economic dimensions of peoples' lives through a variety of channels: public spending, taxation, borrowing, monetary policy, foreign policy, competition policy, regulatory activities, and ownership or control of business enterprises (Ruggeri, 2005). By concentrating on public spending, analysis of government expenditure incidence focuses on only one of the channels through which government activity affects the relative well-being of individuals and families. The government uses four major vehicles for delivering its spending programs: (a) direct spending through its departments and agencies as recorded in budgetary transactions, (b) direct spending through funds that are not included in the budget, (c) indirect spending through the business enterprises it owns or controls, and (d) spending programs delivered through the tax system, commonly known as tax expenditures.

### **1.1.2 Contextual Background**

The Kenyan system of the government since independence in 1963 has been a two tier system consisting of local government and central government which is represented by the provincial administration and in most cases the delegated authority goes to lower

district and division levels of central government administration. The number of Local Government authorities was much fewer than currently and they were then relatively powerful and well functioning institutions, delivering a wide range of services including primary education, health, road maintenance, water and sanitation, public housing and land administration. Lack of national policy and recognition of local government system in the Kenyan constitution compromised greatly the development of local government as the national politics favoured the provincial administration in which they had full control from government headquarters in Nairobi. Local government system was established through the Act of parliament “Local Government Act Chapter 265” and therefore the system did not have strong foundation as the Act could be amended to suit the interest of the ruling government by the minority vote in the parliament. While these dual structures remain, there has been a gradual weakening of LAs; for instance, the Transfer of Functions Act of 1969, led to the transfer of major services such as primary education, health services, roads maintenance and major local revenue sources, to central government agencies. The situation in LAs has further been complicated by the creation of many more LAs, which now total 175, some of which are observed to be unviable entities.

There are currently 175 LAs in Kenya Authorities made up of 1 City Council, 45 Municipal Councils, 62 Town Councils and 67 County Councils Each local government is divided into wards and each ward elects one councillor. The councillors elect from amongst themselves a mayor (in cities and municipalities) or a chairman (in towns and counties). The councillors elected have 5 years term in the local council. Additional

councillors are nominated by the political parties pro rata to their representation in the council. The mayor or the chairman position of the local authority is not an executive position but more of a ceremonial position. The local government chief officers which includes the Town Clerks (Chief executive Officer), Treasurer, Engineers etc are public services appointed by the central government LAs have been further weakened by the loss of local revenue sources, combined with increased demand for services, resulting in a situation where financial resources are no longer commensurate with services currently expected of Local Authorities residents. The institutional, operational and technical capacities of LAs to deliver services are also weak.

Currently, service provision in Local Authorities includes maintenance of local roads, public markets, bus parks, slaughter houses, municipal housing, solid waste management and social welfare programmes. A few local governments also provide services in respect of health and education. All these services provision are not mandatory required service provision by the local authorities as they are expected to be provided by the central government. This has contributed to huge contradiction as the public expects service delivery from their local government yet the finances for provision of such services are bestowed at the central government and its agencies at the provinces and districts level. Arising from these confusion and pressure from the public, the government in 1995 established commission to examine the key features and operations of the local government and give recommendations on how to strengthen local authorities through devolution. The key findings of the commission included promoting a participative approach to local government, enhancing local government's capacity, both in terms of

human resources and functional streamlining and promoting a collaborative and effective Central-Local Government linkage. Arising from the findings, in 1998, a fiscal transfer fund mechanism to transfer fund from the central government to local government was established under the act of parliament. This marked the genesis of fiscal decentralization to devolved local government in Kenya.

Local Authority Transfer Fund (LATF) was Established in 1999 through the LATF Act No. 8 of 1998, Objectives: improve service delivery, financial management, and reduce outstanding debts of local authorities (LAs). comprises 5% of the national income tax collection in any year, currently makes up approximately 45% of local authority revenues. At least 7% of total fund is shared equally among the country's 175 local authorities; 60% of the fund is disbursed according to the relative population size of the local authorities. balance is shared out based on the relative urban population densities. LATF monies are combined with local authority revenues to implement local priorities. An advisory committee comprising the private sector, the Ministry of Finance, the Permanent Secretary Ministry of Local Government, and the Kenya Local Government Reform Programme's secretariat, guides LATF operations. LATF annual reports and other disbursement information are disseminated through newspaper advertisements. 60% of LATF allocations is released based on LAs meeting set requirements. Remaining 40% is released based on LAs performance measured through LASDAP and other indicators. Budgeted LATF allocations are gazetted but no disbursement is made unless LAs meet the requirements. (LATF report 2008).

LATF monies, together with revenues generated by individual councils, are used to implement development projects. Since 2001, LATF's general objectives were to improve service delivery to the public, financial management, and accountability. It was expected that councils would eliminate debts within five years. LATF transfers funds from Central Government to civic authorities under the supervision of the Ministry of Finance. The funds should ideally be used to address needs identified through a participatory process called Local Authority Service Delivery Action Plan (LASDAP).

## **1.2 Statement of the Problem**

There has been a lot of criticism, from various quarters, on the way the LATF is managed and implemented. Grants to local governments may raise local government employment and contribute to expansion of local industries. But characteristics of the local government and the local economy also will determine how federal or central government grants are distributed, While new national budget laws in most of the countries envisage decentralization of fiscal policy including shift of service provision and spending responsibilities to the local level, few of them provide the necessary financial autonomy and revenue authority to local governments to fulfill those central mandates (Gibson 2003). This discrepancy between legal provisions for fiscal autonomy and actual conditions for its practical application is further deepened by the fact that many central governments still prefer to maintain control over major local taxes and other local revenue sources.

In Kenya, service provision in Local Authorities includes maintenance of local roads, public markets, bus parks, slaughter houses, municipal housing, solid waste management and social welfare programmes. A few local governments also provide services in respect of health and education. All these services provision are not mandatory required service provision by the local authorities as they are expected to be provided by the central government. This has contributed to huge contradiction as the public expects service delivery from their local government yet the finances for provision of such services are bestowed at the central government and its agencies at the provinces and districts level (LATF Report 2005). The government of Kenya has set up several funds aimed at serving specific functions including easier access to public services. In as much as the current legal framework provides for specific criteria for establishing funds, the terminating side is not adequately provided for. In some cases these funds have not adequately served the purposes they were created and hence minimal impact on livelihoods. Further, the said funds have remained inactive yet they continue to receive funding thereby denying other deserving sectors the much needed resources.

Local studies done are; Mitullah, and Oloo (2004) did on Innovative best practices in Local Authorities a case of Mavoko Municipal Council” Nairobi: Association of Local Government Authorities, Vincent Okong’o. 2005 “The E-Government Experience in Kenya: The Story So Far” , Mitullah and Kiura, 2006. “Small and medium scale urban centers IFRA research program – baseline survey on Nyeri Municipal Council”. Nairobi: IFRA and Bagaka (2008) asserts that fiscal decentralization in the form of devolved funds has brought about allocative efficiency as well as equity but in the process,

increased tax burden to the central government in form of operations and maintenance. LATF has been noted as a good example of a fund that has exported serious tax burden to the central government with serious policy implications. Reforms of the LATF programme will be needed to reflect a benefit-expenditure structure. Oftentimes, for an increasing number of fund accounts there's lack of clarity on and overlap of roles and responsibilities. Furthermore, too many funds whose totality is not known makes it difficult to achieve a comprehensive view of government revenue and spending necessary to sustain fiscal discipline and bring about contestability in public resource use. Lack of local fiscal discretion, imprecisely defined spending responsibility, vague accountability requirements, as well as a general absence of revenue autonomy and authority to set local tax rates were and still are characteristics of local governments in the ex-socialist countries (Surazska, Blazek, 1997). Based on this review, the study seeks to analyze the impact of local authorities transfer funds on the performance of local authorities in Kenya. And guided by the following research question; what is the impact of local authorities transfer funds on the financial performance of local authorities in Kenya?

### **1.3 Objective of the Study**

To determine the impact of local authorities transfer funds (LATF) on the distribution of resources of local authorities in Kenya

### **1.4 Specific Objective**

To investigate the impact of central government grants to local authority based on the respective Kenya's fiscal legislation and municipal budget laws.



## **1.5 Importance of the study**

This study explores some specific approaches in dealing with the impact of central government grants to local authority based on the respective Kenya's fiscal legislation and municipal budget laws. It is also an attempt to link available statistical data to the legal bases of local government revenue systems in Kenya. Without adequate revenues and resources, local governments will neither be able to justify the expectations of the drafters of the reform nor of the wider public for an improvement of services, better living conditions, poverty alleviation, good governance and a more dynamic process of development. The study will thus enhance local governments in Kenya in planning process including budget preparation and authority to generate their resources through levying various fees and charges as approved by the ministry of local government.

The importance fiscal decentralization in any economy cannot be downplayed. The study hopes to show a great improvement in services delivery to the public by devolving the funds to the lowest level of government system. This will enhance appropriate legal, administrative and institutional framework and as well relevant policies to be put in place to ensure the objectives set for decentralization are met.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

The chapter outlines the impact of local authorities transfer funds on financial performance of local authorities in Kenya. The study is subdivided into sections; section 2.2 presents theoretical literature, section 2.3 presents empirical review, section 2.4 review of local research on impact of local authorities transfer funds (IATF) on the distribution of resources of local authorities in Kenya and finally on the section 2.5 is on the summary of literature review.

#### **2.2 Theoretical Literature**

##### **2.2.1 Economic-based theory**

The economic-based theory also recognizes that efficiency may not be the sole objective sought from public services. Equity goals may be more effectively achieved through central government taxing and spending decisions. Likewise, there is recognition that macroeconomic stability is not likely to be sought or obtained through sub-national government policies; indeed, it is argued by some that decentralized fiscal arrangements will be destabilizing (Prud'homme, 1995; Tiebout, 1956). While the “decentralization theorem” by Oates (1999) provides a theoretical basis for efficient provision of public services, it leaves open the question as to what mechanism or mechanisms can ensure that local decisions reflect local preferences.

The theory suggests are practices that lead to accountability on the part of devolved local governments. The paper emphasizes that accountability at the local government level is a multi-faceted phenomenon. That is, even though the principal concern when local accountability is considered is accountability of locally elected officials to local residents, it is only a part of the issue, albeit the most critical. Local government accountability also extends vertically from the local government to “higher” levels of government. Likewise, since the local bureaucracy constitutes the group with the most direct impact on services ultimately obtained by local residents, they too must be considered a part of the mix since even if local officials are strongly committed to responding to local needs, without appropriate inputs by the bureaucracy, the intended services may not be forthcoming.

### **2.2.2 Local public finance theory**

Local public finance theory in its simplest form relies on two different mechanisms to achieve the outcome mobility and elections. If it is assumed that there is a number of alternative localities in which a household might reside, mobility can provide a way for persons who feel that the combination of public services they receive and the tax prices they pay is not appropriate, can move to another jurisdiction. This theory, first posited by Tiebout (1956), stipulates that, if multiple local jurisdictions provide a variety of different service-tax price combinations, geographic mobility will ensure that efficient outcomes will occur. The model relies, however, on a number of strong assumptions including the obviously unrealistic assumption that mobility is costless. At the same time, it does

suggest that the threat of out-mobility by local residents who are dissatisfied with local decisions may serve as a factor to encourage local accountability.

The theory underlying fiscal decentralization relies heavily on only two accountability instruments linking local preferences to local elected official's elections, which serve as a voice instrument and exit, which can be used by resident-consumers of public services to express their strong disapproval of the revenue-service mix provided by a local government. Since mobility is costly, it cannot be expected to constitute a significant accountability instrument in most developing countries. And elections, while necessary, are very imperfect accountability instruments (Southall and Wood, 1996).

Transparency suggests that residents can observe the policy alternatives available and the outcomes of decisions. However, other actors can facilitate the transfer of such information. Accountability of local governments to the central (or regional) government is also necessary although the nature and degree of that accountability is ultimately critical in determining a municipality's accountability to its own residents. Accountability concerning the use of funds transferred to a local government should be as important as accountability of how it uses funds collected directly from local revenue payers. Likewise since centrally imposed rules over local government actions are, at least in principle, often made to encourage accountability to local residents, insuring that those rules are followed should be of concern to the higher level of government.

### **2.3 Empirical Review**

Omamo report (1995) sites the second reason for the slow growth as the lack of insufficient taxing authority at the local level and shortfall in revenue collection (Omamo, 1995). Many countries aware of this potential are transferring more resources and service responsibilities to Local Authorities. Equipped with such resources Local Governments are increasingly taking on more responsibilities to meeting Millennium Development Goals (MDGs) as well as facing the challenges of globalization” (Basil Morrison 2008).

Hines and Thaler (1995) elaborate on the main paradox, the flypaper effect: Spending is stimulated more than theory expect. In theory local governments are expected to allocate grants between local public and private goods in accordance with the income elasticities of the median voter. In practice, and as summarized already by Gramlich (1977), grants tend to expand spending with about the same amount, and this is the flypaper effect or ‘money stick where they hit’.

This research reflects the fact that expansion and equalization of social services represent the main motivation for grants. Extra grants are typically distributed to state and local governments with high out migration and low economic growth. Strengthening of local governments in the periphery is expected to improve their services and stimulate the local economic development. Regional policy concerns are important in the Kenya grant system for local governments. The LATF and other grants to local governments has lead to increase local government employment and contribute to expansion of the local industries through improved services like roads, water services and security. But

characteristics of the local government and the local economy also will determine how central governments grants are distributed.

A report prepared by Syagga and Associates (2007) on the impact of LATF for the Kenya Local Government Reform Programme (KLGRP) noted that though the Fund is presumed to provide supplementary funding to the LAs, it has become a significant source of funding for the majority of LAs. The study recommends that there is need to establish and maintain an appropriate balance between the amount of decentralized financial resources and the services devolved to local governments at different levels and match this with their technical capacity to effectively utilize the funds. It is noted that the above allocation criteria exclude some major considerations such as poverty index, the spatial coverage of the local authority/area of jurisdiction as well as regional cost variations. As such, the Fund's allocation criteria should be revised to incorporate poverty levels in each local authority. Syagga and Associates (2007) also recommend that each Local Authority's percentage contribution to Gross Domestic Product (GDP) should be incorporated in the criteria.

LAs in Kenya are charged with the provision and management of infrastructure and services in their respective jurisdictions. LAs have two main sources of revenue, namely grants from the central government and revenue from local sources. Grants from central government include LATF, Road Maintenance Levy Fund (RMLF) and Contribution in Lieu of Rates (CILOR). Prior to setting up of LATF, there was limited sharing of resources with central government. Since the 1999/2000 financial year, LAs have been

accessing LATF. Through it, the government transfers 5% of personal income tax to LAs. Disbursement of LATF funds depends on strict conditions which if adhered to, would not only improve financial management but greatly enhance accountability and citizens' participation in the affairs of the councils (Mitullah and Kiura, 2006).

Most LAs face a number of challenges in realizing this mandate. The challenges include: delivery of infrastructure and services, financial management, institutional and legal framework, human resource capacity and managing rapid growth. These challenges have resulted in poor service provision and management and many analysts have criticized the LAs, and questioned their role in local development. It is this inefficiency that justified a re-examination of their role and the launching of the Local Government Reform Programme, which also include the decentralization of service provision and management, which is still in the initial stages.

The Kenya Local Government Reform Programme (KLGRP) was conceptualized by the government of Kenya in the early 1990s and became operational in 1996. The programme has three components: rationalization of central – local fiscal relationship, enhancing local financial management and revenue mobilization and improving local service delivery through greater citizen participation. KLGRP focuses on deepening the legal, financial management and institutional reforms in Local Government sector.

KLGRP began with financial reforms aimed at enhancing inter-governmental fiscal transfers, improving financial management, debt resolution, streamlining budgeting system and service provision capacity building for LAs. A key instrument in this process

was the enactment of the Local Authority Transfer Fund (LATF) in 1998. The act provides 5 percent of national income tax to LAs in line with population, resource base and financial performance. In order to access LATF, LAs are administratively required to develop a Local Authority Service Delivery Action Plan (LASDAP) using a participatory approach.

The reforms have also included putting in place Fuel Levy Fund, Contribution in Lieu of Rates, user charges rationalization, single business permits and most greatly Integrated Financial Management System. These programs aim at restructuring the local public sector and more importantly, strengthening local level accountability mechanisms. Lack of participation of residents of LAs in service delivery and management has been highlighted as one of the factors contributing to poor service delivery. LASDAP became a requirement of LATF allocations in the 2001/2002 financial year. The LASDAP process approximates a participatory planning process where the LAs are supposed to involve local communities in prioritizing projects to be undertaken using LATF. The process requires LAs to organize consultative meetings and to submit a list of community organizations/individuals in attendance. It further requires LAs to publish invitation notices concerning the LASDAP consultative meetings and resources available to the councils. This process is aimed at providing opportunities for LA's residents to participate and ensure effective management of resources.



## **2.4 Review of local research**

### **2.4.1 The Local Government**

Local Government has been defined differently by different people and organizations. The Omamo Commission of Inquiry on Local Authorities defines Local Government as “a system of government whereby the state allows the establishment of local units of government with powers and authority to make local decisions on matters that affect the local communities and to mobilise local resources for implementation or execution of the decisions made” (Omamo, 1995). Wanjohi (2003) considers Local Government as an institution whose operations addresses the needs and aspiration of the citizenry and also extends the administrative and political control to the community. The American Local Government is an example of a popular participation and sovereignty system. Local Governments elsewhere (as shown below) are also referred to as sub-national organizations which are comprised of democratically elected representatives. The definitions of Local Government outlined here emphasize the concepts of decentralisation and participation. For example, communities in America form Local Governments which in turn form states and states form the federal government. In Europe similar types of Local Governments can be found in the United Kingdom, Germany and Sweden. In the African continent, South Africa, Namibia, Uganda and Malawi are good examples of decentralised Local Governments. The Constitution of the Republic of South Africa of 1996 devotes chapter seven (7) to Local Government covering the status, objects, duties, establishment, powers and functions of municipalities

Currently the Kenyan Local Authorities have a number of sources for their revenues. These include: Local Authority Transfer Fund (LATF), Roads Maintenance Levy Fund (RMLF), Contribution in Lieu of Rates (CILOR), property rates, single business permit, vehicle parking, plot rents, water and sewerage fees, cess receipts, game park fees, and house rents. LATF is the main source of Local Authorities revenue. For instance, the revenue structure for the years 2010/2011 shows the LATF allocation of KShs. 7,460.7M. This accounts for 43% of the total revenue. The LATF allocation percentage for the year 2010/2011 is 36.3 percent. LATF's position as one of the main source of Local Authorities revenue. How LATF is managed will therefore reflect on the effectiveness of the targeted services by that fund. The focus of the citizen's attention on the evaluation of the use of the Local Authority revenue should focus more on the LATF.

#### **2.4.1 Distributional Effects of LATF**

A government's role as it relates to taxation and public spending has never gone unquestioned. The controversy arises from conservatives advocating fiscal responsibility and limited government intervention in a market economy, and thus supporting the notion that taxes should be levied at the lowest possible level specifically designated for the financing of the few public goods that only government can provide. There are advocates, on the other hand, supporting an expanded role for government and arguing in favor of higher taxes to finance more public goods, and for a social protection system of redistributive schemes that, to some extent, will correct the stark inequities in our society (Nell, 1988). Presenting the estimates of the distributional effects of public expenditure

incidence requires a choice of the categories of government spending and the selection of the appropriate indices of redistribution.

The final step in the expenditure incidence exercise is to summarize the results using some indexes of redistribution. These indexes can be applied to total government expenditures or to selected components. The first group includes all expenditures and provides an overall picture of the redistributive impact of government spending (Ruggeri, 2005). This type of information by itself provides little guide to policy makers because it does not identify the programs that deliver the measured redistribution. Therefore, it must be complemented by a more disaggregated analysis. The most detailed approach is to present indexes of redistribution for each of the spending programs for which a separate allocation was made. If the expenditure incidence study involved a detailed disaggregation of government spending, presenting redistributive indexes for each program may add excessive and perhaps unnecessary details. It may be preferable, as an alternative, to group the spending programs in categories that are meaningful for policy analysis. One useful disaggregation of government expenditures is between transfer payments and purchases (Ruggeri, 2005).

#### **2.4.3 LATF and Performance of Local Authorities**

A statement of receipts, payments and balances for the financial year, a statement of debtors and creditors for the financial year with an explanation of the previously signed debt reduction plan. A Local Authority Service Delivery action plan (LASDAP) documenting that Local Authority conducted a participatory planning process and

identified a 3 year rolling programme of projects and activities- the first year of which was to be incorporated into the next years budget. An abstract of accounts for the financial year to be submitted to be submitted to the Controller and Auditor general for audit. Copies to be submitted to the Ministry of local Government and Ministry of Finance. A revenue enhancement plan (REP) outlining how the Local Authority was going to improve its revenue mobilization during the financial year. The LATF service delivery and performance conditionality and the penalties form part of the accountability checks on Local Authorities' compliance to LATF Act. The other measures are the publication of the LATF allocations by the Ministry of Local Government and the financial profiles/ budgets by the Local Authorities. The signing of the performance contracts by all Local Authorities is aimed at ensuring that the targeted activities planned and agreed upon by the Local Authorities and government are implemented and these include the LATF projects. The LASDAP process is meant to create an opportunity for members of the public to take part in the planning of activities that will be funded by LATF and other council revenues.

LATF recurrent expenditure and Local Authority Service Delivery Action Plans (LASDAP) donation (specific grant) amount to what is called a "resource envelope" to the LA. All LASDAP are financed by the resource envelop. It's no doubt then that projects implemented under this arrangement are referred as LASDAP projects and not LATF projects. However, whereas LATF regulations require the development of LASDAP, there is no allocation of monies for capacity building of communities, committees involved in project identification and management at community level, which

negatively impacts on the effective implementation of the Fund. Action Aid Kenya (2006) notes that there is no formal communication structure on LASDAP as information is passed on an *ad hoc* basis and recommends a uniform way of communicating with the public. The Study also recommends the need to sensitize the community to participate in the process as a way of checking excesses on the part of the councilors. In addition, Syagga and Associates (2007) recommends internal capacity building is undertaken within LAs to enable them properly embrace LASDAP processes in a comprehensive way that includes all stakeholders.

Monitoring of LATF funded projects is mainly done via performance contracts. However, the communication systems employed in outreach to the public and citizens' participation in the project identification, and monitoring of LATF funded projects is wanting despite the existence of a LASDAP process. Mobilization is done through word of mouth or advertisement in the media. Message is passed through social workers, local churches, chiefs, councilors etc. Important to note is that councilors participate on equal basis with other citizens. In addition, LASDAP guidelines, though well intentioned in their provisions to enhance public participation, do not have a proper institutional framework. For instance, there is lack of clear roles and responsibilities for the community in other levels of project implementation. In addition, it's not clear with whom the community representatives engage. For example, if they find fault with the way a project is run, to whom do they report? It is for these reasons that the LASDAP guidelines are being reviewed.

To enhance financial performance and accountability of local authority, before any payment is made to contractors, it must be approved by a technical audit team who are different from the implementers. There are also ad hoc opportunities to request community feedback. Public participation in budget-hearings: Currently the issue is not whether citizens participate but the nature and quality of their input during the process. The Council usually has a great turn out of people but end up getting very little from them due to limited capacity to engage with the issues. Professionals rarely participate. The process also lacks continuity. Every year, there are new people participating.

## **2.5 Summary**

The chapter concludes that local authorities transfer funds has the influence on performance of local authorities in Kenya. The study has reviewed on two theories of economic based theory and local public finance theory. Local authorities derive local revenue from user charges and taxes from local sources which include: property rates, single business permits, plot rent, quarry fees, market and bus park fees, water and agricultural cess, national reserve and park fees. Municipalities rely more on water and sewage fees, property rates and single business permits while county councils and town councils on single business permits, market fees, bus parks and cess revenue. The LATF service delivery and performance conditionality and the penalties form part of the accountability checks on Local Authorities' compliance to LATF Act. The literature review concludes that financial performance and accountability of local authority is enhanced by having measure; that is, payment is made to contractors, payment must approved by a technical audit team who are different from the implementers

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter highlights the methods and procedures used in carrying out the study. It includes the following; section 3.2 presents survey research design; section 3.3 presents the population and sampling; section 3.4 presents data collection methods instruments used; section 3.5 presents data analysis, Conceptual and analytical model as well as data presentation methods.

#### **3.2 Research Design**

The study used cross sectional research design. Phil (1996) says that descriptive research studies are designed to obtain information concerning the current situation and other phenomena and wherever possible to draw valid conclusion from the facts discussed. According to Ghauri and Gronhaug (2005), descriptive research is used when the problem is structured i.e. it gives answers to who, where, what, how and when questions. It is used to make clear the distinctiveness of a population or an observed fact. According to Zinkmund (2000), “descriptive research studies are based on some previous understating of the nature of the research problem”. This is a survey research to explore the existing status of two or more variables at a given point in time. In this study, the researcher prefers to carry out survey on impact of intergovernmental transfer using a relationship model. This design is suitable for this study since through data collection and analysis draw conclusions based on the findings.

### **3.3 Population and Sampling**

Borg and Gall (1999) define population as all the members of a real or hypothetical set of people, event or objects to which a researcher wishes to generalize the results of the study. The population of this research consisted of all the 175 local authorities in Kenya.

Stratified random sampling technique used to select the sample. The technique produced estimates of overall population parameters with greater precision. From each stratum the study will use simple random sampling to select 53 local authorities. Since this category of the target population is not that big, the sample size will undertake a census of this management team. Mugenda and Mugenda, (2003), states that a sample of 30% is considered representative for a population less 500. So if the population is less or equal to 30% it is appropriate to carry out census study. The sample size is justified by 30% since it will minimize the duplicity and redundancy of to be data obtained and the size is large enough to ensure collection of comprehensive data.

### **3.4 Data and Data Collection Instruments**

The research used secondary sources to collect the data. According to Ghauri and Gronhaug (2005), this can be referred to as information collected by others for certain purposes that can be different from that of a researcher who intends to use the same information. These types of data can also be called second hand data due to the fact that they were not collected for a particular purpose but can be of importance to several researchers at different time. Ghauri and Gronhaug (2005) states that secondary data can be gathered from both internal and external sources. The internal sources are data's being



collected from employees, suppliers etc. And the external sources include the collection of data from published articles, books, research reports etc. as well as commercial, panel research, reports etc. This type of data can also be gathered from online sources which may include web pages of government organizations, companies, symposium, seminar etc., Secondary data therefore saves time as well as money, it helps to better understand and explain our research problem, broaden the base from which scientific conclusion can be drawn etc. All these are because it is an already existing data that can be used almost at any time it is needed. For this study, secondary data will be collected from local authority annual reports, articles using the university library as well as the through internet e.g. Google scholar. The sources were obtained from the treasury, Kenya local governments reform programme (KLGRP), the ministry of local government. Secondary sources will include local authority approved budget estimates, Statements of actuals receipts and expenditure and financial statements for a period of 5 years (2006-2011).

### **3.5 Data Analysis**

Data analysis is the process of bringing order, structure and meaning to the mass of information collected. It involves examining what has been collected and making deductions and inferences Kombo and Tromp (2006). Qualitative data will be analyzed using content analysis techniques. For quantitative, descriptive statistics percentages and frequencies will be derived and used. In addition, mean and standard deviation will be used alongside the frequencies for Likert items. Presentations will be done by use of tables, graphs as well as charts. Items from the open ended questions will be analyzed and organized into themes and then presented in narrative form.

### 3.5.1 Conceptual Model

The main purpose of expenditure incidence is to measure the effect of government spending on the well-being of individuals in different economic circumstances. The simplest and most widely used index of expenditure incidence is

$$g = G/Y$$

The ratio ( $g$ ) of benefits ( $G$ ) to some measure of income ( $Y$ ); that is,

This ratio is calculated for each income group selected in the study; it is often presented in graphical form, with income classes on the horizontal axis and the benefit ratio on the vertical axis.

The benefits are accrued through the spending of LATF funds on capital expenditure for development of new infrastructure, education, health and social welfare programmes.

Income is derived from the grants (Local Authorities Transfer Funds) and it is expected that increased funding of local authorities through LATF will translate to increased benefits to the local residents.

### 3.5.2 Analytical Model

The model specification is as follows

$$Y_i = \alpha + \beta X_i + \varepsilon_i \quad \text{Where } i = 1, \dots, 4$$

Where;

$Y_i$  = Local Authorities Transfer Funds

$X$  = Aggregate expenditures

$X_1$  = Education expenditure

X<sub>2</sub>= Health expenditure

X<sub>3</sub>=Infrastructure expenditure

X<sub>4</sub> = Social expenditure

ε= error term,

β=coefficient,

α= constant

Performance is measured using Development index

Development Index= Development expenditure

Recurrent expenditure

Development index refers to the relationship between development expenditure and recurrent expenditure.

Development expenditure includes; capital expenditure for development of new infrastructure, human capital development, marketing programmes.

Recurrent expenditure refers to the expenditure on personnel, operation and maintenance.

Local government expenditure is a function of the total Local government revenue which can be expressed in the function below

$$LGE = f (GR, PI, TP)$$

GR = grant (Local Authorities Transfer Funds)

TP= Tax price, Median or mean income

PI =Private income

LGE =Local government expenditure

GR has positive, PI has negative and TP has negative

From the incidence analysis ratio

$$g = G/Y$$

G = Benefits (spending LATF on capital expenditure)

Y = Income is derived from the grants (Local Authorities Transfer Funds)

The selection of the appropriate income concept depends on the purpose of the analysis.

The main focus is on the total fiscal incidence as apposes to distribution analysis

## CHAPTER FOUR

### DATA ANALYSIS, RESULTS AND DISCUSSION

#### 4.1 Introduction

This study presents the data analysis and interpretation of the results. This chapter provides various sections. Section 4.2 provides the Summary Statistics, Section 4.3 provides the Discussion, section 4.4 presents Empirical Model of the study and finally 4.5 summary of the chapter.

#### 4.2 Summary Statistics

The LATF distribution criterion provides that: A basic minimum lump sum of Kshs 1.5 million be allocated to each LA; 60% is based on the relative population of each LA; and the balance is based on the relative urban population of each LA. The amount allocated to each LA is divided into the service delivery account (60%) and performance account(40%). budgeted LAFT allocation are gazette but no disbursement is made unless Las meet the requirements

**Table 4.1: Distriptive Statistic of LATF disbursement to date**

Financial year	Amount (Kshs)
2005-2006	5,000,000,000
2006-2007	7,500,000,000
2007-2008	8,250,000,000
2008-2009	9,250,000,000
2009-2010	10,400,000,000
Total	40,400,000,000

Source: Ministry of Local Government

The local authority transfer fund (LATF) act ( NO.8/98), which came into effect on 10 June 1999, established a central-local revenue transfer mechanism to facilitate the disbursement of funds to Las ‘ ’ to supplement the financing of the services and facilities they are required to provide under the local government act.’’

To receive LAFT funds, all Las are required to submit budget estimate outlining how the LATF funds, in combination with the local own source revenues , are to be used; preparation of a local authority service delivery action plan (LASDAP) which was introduced I 2011 through ministerial circular MLG No.11/2011 of 19<sup>th</sup> July 2001.

#### **4.2.1 LATF Allocation for the FY 2006-2007.**

The LATF act stipulates that the fund will receive 5% of the national income tax to be distributed to Local Authorities to address the objectives listed in box 4. The amount of LATF allocation for the FY 2006/2007 is KShs.7.5 billion the disbursement dates are as shown below:

**Table 4.2: LATF Allocation for the FY 2006-2007**

<b>Date Payment Due</b>	<b>Gross Amount (Ksh)</b>	<b>Net Amount After Penalties</b>
30th September 2006	3.3	3.37
31st January 2007	3.5	3.49
30th April 2007	0.6	0.60
<b>Totals</b>	<b>7.5</b>	<b>7.46</b>

Source: LATF Annual Report FY 2006-2007.

Table 4.2 below shows the different amounts allocated and expected by the sample Local Authorities. The criteria used to distribute LATF for the year 2005/2006 was as follows:

A basic minimum lump sum of KShs.1.5 million was allocated to each Local Authority

(6.56%); 60% was allocated on the relative population of each Local Authority; 30.73% was allocated based on the relative urban population of each Local Authority. The remaining 2.71% is left for the administration of the fund (LATF annual report of FY 2006/2007).

**Table 4.3: LATF Allocation for the FYs 2005/2006; 2006/2007 (in KShs. Millions)**

No	Local Authority	KSh.05/2006	KSh.06/07
1	City Council of Nairobi	889.44	1,350.
2	Municipal Council of	273.69	430.33
3	Municipal Council of Kisumu	96.43	148.44
4	Municipal Council of Eldoret	73.50	113.41
5	Municipal Council of Nyeri	26.39	39.94
6	Municipal Council of	25.21	38.20
7	County Council of Kakamega	52.03	77.30
8	County Council of Embu	19.25	28.14
9	County Council of Narok	36.33	53.81
10	County Council of Olkejuado	64.74	98.04
11	County Council of Gusii	33.24	49.11
12	Town Council of Mandera	15.07	22.58
13	Town Council of Kwale	5.78	8.01
14	Town Council of Malakisi	6.63	8.46
15	Town Council of Litein	11.04	15.87
16	Town Council of Chogoria	5.27	7.21

Source of Information: LATF Annual Report for the FY 2006-2007.

For example as shown in table 4.3, in the year 2006/2007 the City Council of Nairobi received KShs. 1.35 billion, the Municipal Councils of Mombasa, County Council of Kakamega, and Town Council of Mandera received KShs. 430M; 77M and 22M respectively. This illustrates that the bigger Local Authorities in terms of population and activities receive larger amounts of LATF allocation.

#### 4.2.2 LATF Allocations and Disbursements for Sampled Local Authorities

**Table 4.4: Both Allocations and Disbursements (2005/6 - 2007/8) and Allocations for Selected Local Authorities (2008/9 - 2009/10)**

Local Authority/FY	2005/06	2006/07	2007/08	2008/09	2009/10
Nairobi City Council	889,446,590	1,383,563,693	1,531,798,825	1,729,445,664	1,956,739,527
Baringo County Council	28,623,471	42,335,644	46,449,296	51,934,164	58,241,763
Buere-Mumias County council	44,821,006	66,709,878	73,276,540	82,032,089	92,100,971
Isiolo County Council	20,984,543	31,401,886	34,527,088	38,694,025	43,486,004
Kabarnet Municipal Council	7,047,054	20,413,282	10,944,106	12,143,200	13,522,155
Kisumu County Council	20,354,739	29,844,975	32,692,045	36,488,138	40,853,646
Kisumu Municipal Council	96,429,002	148,441,472	164,045,214	184,850,202	208,775,938
Luanda Town Council	11,339,969	16,464,833	18,002,292	20,052,238	22,409,675
Maridera County Council	30,502,305	45,529,988	50,038,292	56,049,365	62,062,098
Mandera Town Council	15,077,156	22,577,748	24,827,926	27,828,163	31,278,435
Mumias Municipal Council	22,277,400	33,512,056	36,882,453	41,376,316	46,544,258
Nyeri County Council	60,453,390	90,165,145	99,078,673	110,963,374	124,630,782
Nyeri Municipal Council	26,390,878	39,935,208	43,998,508	49,416,240	55,046,632
Taita/Taveta	20,933,453	30,838,097	33,809,490	37,771,347	42,327,483



County Council					
Taita Town Council	10,545,996	15,337,932	16,775,513	18,692,288	20,896,578
National Total (175 Local Authorities)	5,000,000,000	7,500,000,000	8,250,000,000	9,250,000,000	10,400,000,000

Source: LATF Annual Reports, various years.

The table below shows three years of LATF allocations and disbursements (2005/6 to 2007/8) and two years of LATF allocations (2008/9 and 2009/10) for the 15 LAs sampled for this study and the overall national performance. Analysis of the data shows that all the 15 LAs were allocated as per the 60% and 40% provision for the Service Delivery and Performance Components criteria respectively. In addition, the compliance level is high. For instance, among the sampled LAs, in 2006/7 where both allocations and disbursements were available, it is only Nairobi City Council and Luanda Town Council were penalized and lost Ksh 33.2 and Ksh 1.02 million respectively.

In 2007/8, Luanda and Taveta Town Councils were penalized at Ksh 216,028 and Ksh 201,306 respectively. The non-compliance of Luanda Town Council for two years may indicate a lack of capacity within small LAs.

#### **4. 2.3. LATF in Local Authorities' Revenue Base and Expenditure Analysis**

National level revenue and expenditure analysis for Local Authorities' in 2007/08 are shown in the figures below. The figures reveal that nationally, LATF accounted for 35% of LA revenues. This is in addition to the portion of the Roads Maintenance Levy Fund that LAs receive from the central government that nationally accounts for 6% of LAs'

revenue. The national average of capital expenditure is 15% which constraints infrastructure development for better service delivery by LAs.

Annex one detail the revenue and expenditures for the 15 LAs sampled in this study. The Annex shows there are huge differences on the LATF's dependency' level with Nairobi City and Mandera County Councils having the least and highest LATF proportions of 19% and 75% respectively among the 15 sampled LAs. Generally, the small LAs exhibit more dependence than the big ones.

This supports the Ministry of Local Government wish of reducing the number of LAs to only those that are economically viable. Interestingly, Mandera County Council is the one with the highest proportion (31%) of expenditure going to capital expenses. At 7%, Isiolo County Council has the least capital expenditure proportional to total expenditure. The Nyeri Municipal Council has a recurrent expenditure (civic expenditure, personnel costs, Operational and Maintenance, loan repayment and debt resolution) of 82% of total expenditure.

## 4.3 Empirical Model

### 4.3.1 Correlation analysis

**Table 4.5: Pearson Correlation coefficients**

		LATF	Education expenditur e	Health expenditur e	Infrastructure expenditure	Social expenditur e
Pearson Correlatio n	LATF	1.000	.733*	.712*	.654*	.534*
	Education expenditure	.733*	1.000	.536*	.752*	.467*
	Health expenditure	.712*	.536*	1.000	.118*	.247*
	Infrastructur e expenditure	.654*	.752*	.118*	1.000	.247*
	Social expenditure	.534*	.467*	.247*	.247*	1.000

Note: \* Correlation significant at the level 0.001 (two-tailed)

The Pearson product-moment correlation coefficient (or Pearson correlation coefficient for short) is a measure of the strength of a linear association between two variables and is denoted by  $r$ . Basically, a Pearson product-moment correlation attempts to draw a line of best fit through the data of two variables, and the Pearson correlation coefficient was conducted to examine the relationship between variables,  $r$ , indicates how far away all

these data points are to this line of best fit (how well the data points fit this new model/line of best fit). The Pearson correlation coefficient,  $r$ , can take a range of values from +1 to -1. A value of 0 indicates that there is no association between the two variables. As cited in Wong & Hiew (2005) the correlation coefficient value ( $r$ ) range from 0.10 to 0.29 is considered weak, from 0.30 to 0.49 is considered medium and from 0.50 to 1.0 is considered strong. However, according to Field (2005), correlation coefficient should not go beyond 0.8 to avoid multicollinearity. Since the highest correlation coefficient is (0.752) being indicated between Infrastructure and Education which is less than 0.8, there is no multicollinearity problem in this research.

**Table 4.6: Model of fitness results**

R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
				R Square Change	F Change	df1	df2	Sig. F Change
.918(a)	.843	.805	.51038	.843	1.242	4	96	.000

*Predictors:* (Constant), Education expenditure, Health expenditure, Infrastructure expenditure and Social expenditure

Dependent Variable: LATF

The F-Statistics produced (F=1.242) was significant at 0 per cent level (Sig. F<.000) thus confirming the fitness of the model. Analysis in table below shows that the coefficient of determination (the percentage variation in the dependent variable being explained by the changes in the independent variables) R2 equals 0.843 that is, Education expenditure, Health expenditure, Infrastructure expenditure and Social expenditure have been explain 84.3 percent of LATF.

**Table 4.7: Coefficients of regression equation**

		Unstandardized		Standardized	t	Sig.
		Coefficients		Coefficients		
		B	Std. Error	Beta		
(Constant)		.260	.460		0.565	.231
Education expenditure	X <sub>1</sub>	.131	.048	.254	2.729	.001
Health expenditure	X <sub>2</sub>	.170	.045	.300	3.778	.002
Infrastructure expenditure	X <sub>3</sub>	.251	.023	.113	2.217	.002
Social expenditure	X <sub>4</sub>	.575	2.074	.056	2.444	.000

*Dependent Variable: LATF*

From these findings, it can be noted that Education expenditure, Health expenditure, Infrastructure expenditure and Social expenditure relate to LATF, where a significant increase in each of these influences LATF.

The established multiple linear regression equation becomes:

$$Y_i = \alpha + \beta X_i + \epsilon$$

Where i= 1,..4

Where;

Y1= Local Authorities Transfer Funds

X= Aggregate expenditures

X1=Education expenditure

X2= Health expenditure

X3=Infrastructure expenditure

X4 = Social expenditure

$\varepsilon$ = error term,

$\beta$ =coefficient,

$\alpha$ = constant

The relationship between development expenditure and recurrent expenditure, Development expenditure includes; Education expenditure, Health expenditure, Infrastructure expenditure and Social expenditure.

$$Y = 0.260 + 0.131X_1 + 0.170X_2 + 0.051X_3 + 0.575X_4$$

### **Where**

Constant = 0.260, shows that if Education expenditure, Health expenditure, Infrastructure expenditure and Social expenditure relate to LATF =0, then LATF would be 0.260

X<sub>1</sub>= 0.131, shows that one unit change in Education expenditure results in 0.131 units increase in LATF distribution.

X<sub>2</sub>= 0.170, shows that one unit change in Health expenditure results in 0.170 units increase in LATF distribution.

$X_3 = 0.251$ , shows that one unit change in Infrastructure expenditure results in 0.251 units increase in LATF distribution

$X_4 = 0.575$ , shows that one unit change in Social expenditure results in 0.575 units increase in LATF distribution.

**Table 4.8 Correlation Before LATF**

Before LATF	Local Authorities Transfer Funds	Aggregate expenditures	Education expenditure	Health expenditure	Infrastructure expenditure	Social expenditure
Local Authorities Transfer Funds	1.000					
Aggregate expenditures	0.812	1.000				
Education expenditure	0.655	0.168	1.000			
Health expenditure	0.621	0.124	0.135	1.000		
Infrastructure expenditure	0.513	0.116	0.154	0.24	1.000	
Social expenditure	0.638	0.261	0.217	0.162	0.178	1.000

The researcher performed a regression analysis to establish the association between before and after LATF which shows that before LATF the variables were insignificant and after the introduction of LATF funds and distribution mechanism was put in place by Ministry of local authority the dependent variable and independent variables became significant.

#### **4.4 Discussion**

A Ministry of Local Government assessment found that out of the current 175 LAs, only about 100 are economically viable. Even those that are viable require capacity development. There are situations where the public has written to the Ministry requesting LAs be abolished for non-delivery of services. Action Aid Kenya (2006) notes that local authorities are generally associated with inadequate service delivery, corruption and mismanagement, inefficiencies in project implementation, poor service delivery, lack of equity and political interference.

Any new institutional framework must also clearly demarcate the roles of the three arms of the Government - the executive, judiciary, and legislature. In some devolved funds e.g., the legislature is taking over the roles of the executive resulting in a system without checks and balances.

There have been several cases of duplication reported mainly from CDF, line ministry allocations and LATF leading to wastage. This takes place even under the supervision of the DDC which is mandated to coordinate district development. It is for this reason that the LASDAP guidelines discourage co-funding unless there are specific and clear funding proportions. There is need for scaling-up consultations *vis-à-vis* strengthening the available structures to undertake their roles.

It is also noted that the requirement under the LATF regulations for LAs to have eradicated their debts initially by 2005, and later by 30th June 2010 for them to



continue receiving LATF seems elusive especially for the 13 most indebted ones<sup>40</sup>, which account for 84% of LAs' total outstanding debt (LATF 2007-08 Annual Report). Among the sampled LAs, Nairobi City Council had the highest (26%) of debt resolution repayment as a proportion of total expenditure while Taita Taveta County Council had the least (5%). The national average stood at 19%.

A majority (an average of 21% among the sampled LAs) of capital projects have been undertaken in the roads sector. This has been followed by water (6%), health (4%) and education (3%) among the sectors targeted by this Study. However, the LATF 2007-08 Annual Report cautions that these data are not audited. Indeed, it was noted that a majority of the projects were lumped as 'others'.

#### **4.5 Summary**

The study summarizes citizens' awareness and participation in different aspects of LATF management by gender and constituencies. Compared to CDF, the awareness is generally low and levels of participation are also very low. This can be explained by the fact that most aspects of the LATF funded projects are driven by the LAs.

Past fiscal indiscipline at the sub-national level has resulted in large accumulated arrears. The LATF regulation required that local authorities clear their outstanding debts by 2009/10. However outstanding debts have continued to grow, as past arrears accumulate penalties for non payment. Outstanding statutory arrears, accounted for 60 percent of total in 2008 up from 51 percent in 2007. The larger local authorities seem to have low

levels of commitment to meeting their debt reduction plans. As a consequence the four largest- Nairobi City council, Mombasa Municipal council, Kisumu Municipal council and Nakuru Municipal council account for 74 percent of total outstanding debt in 2007/08.

The biggest challenge to improving management of tax payers' resources under the fiscal decentralization framework is establishing an overarching policy and legal framework for fiscal decentralisation. Evidence shows that there are overlaps in the LATF and between the central and subnational levels of government. The new Constitution will add in a new layer of fiscal decentralization as the new counties are established. This is the opportune time to review the entire framework and to revisit the success and failures of the LATF and CDF funds, learn from them for new fiscal decentralization plans and ensure that the new framework is comprehensive and eliminates any duplication and overlap in mandates and financing. At present decentralized funds cannot really be used to redress any central government spending imbalances: since the small amounts being disaggregated by location are only a fraction of the resources being spent each year; this limits their ability to rectify any regional imbalances, even if they were efficiently expended along equitable lines.

## **CHAPTER FIVE**

### **SUMMARY AND CONCLUSION**

#### **5.1 Introduction**

This chapter presents summary of findings as discussed conclusion and discussion. This chapter provides various sections of research methodology. Section 5.2 include summary of the study, section 5.3 includes conclusion, section 5.4 presents limitations of the study and finally section 5.5 is on recommendations for further research.

#### **5.2 Summary of the Study**

LATF, local revenue e.g. Contribution in Lieu of Rates (CILOR), Property rates, and other funds i.e loans, grants, recurrent expenditure and Local Authority Service Delivery Action Plans (LASDAP) donation (specific grant) amount to what is called a “resource envelope” of a LA. All LASDAP activities are financed by the resource envelop. It’s no doubt then that projects implemented under this arrangement are referred as LASDAP projects and not LATF projects. However, whereas LATF regulations require the development of LASDAP, there is no allocation of monies for capacity building of communities, committees involved in project identification and management at community level, which negatively impacts on the effective implementation of the Fund.

The Study also recommends the need to sensitize the community to participate in the process as a way of checking excesses on the part of the councilors. In addition, Syagga and Associates recommends internal capacity building be undertaken within LAs to enable them properly embrace LASDAP processes in a comprehensive way that includes

all stakeholders. This Study further recommends the need for the Ministry of Local Government to facilitate recruitments and ensure an enabling working environment for the retention of technical personnel within the LAs.

The Local Authority Transfer Fund system seeks to reinforce both citizen participation and timely submission of plans and financial reports, by linking a proportion of funding to compliance with these requirements. A Local Authority Service Delivery Action Plan (LASDAP) must be prepared annually with input from citizens. The LATF Regulations specify in detail the penalties for late submission of required information, but there is no requirement in the Act for the reports to be made public, so the information has typically not been made available to citizens. The Public Expenditure Review of 2010 also observed that the quality of reports was quite substandard, reinforcing the need for enhanced capacity and transparency.

The LASDAP process is intended to include citizens in the local authority planning process through public meetings, but several reports suggest that attendance is often limited, and budgets are not well aligned with the priorities identified in the LASDAP plans.

### **5.3 Conclusion**

Leaders at the national and local levels need to devise ways and means of engaging the citizenry in addressing their demands. Provision and monitoring of services by the stakeholders is one way of demonstrating ownership and involvement. As Africa

becomes more and more urbanized; many governance issues will manifest and strategies must be found and put in place to address them. This project is a contribution towards that goal of addressing citizens' needs and demands.

The information and references contained in the project will be useful to Local Government stakeholders, and the central government when discussing reforms of the Local Government system in Kenya. It is hoped that the project will motivate citizens to find a role to play in Local Government matters that affect their livelihoods.

#### **5.4 Limitations of the Study**

This Study acknowledges that many studies have been done on decentralized development in Kenya. Although a geographical representation of the sample was factored in, the eight sampled constituencies may not reflect the full social-economic diversity of the Country. The need for a comprehensive study was hampered by time and other resource constraints. Despite frantic follow ups, responses from key informants, especially those at the national level, were generally poor.

In addition, information received from the constituency-level key informants were scanty. There were also challenges experienced during the data collection in the field: there were insecurity experiences in Isiolo North and transport challenges in the vast Mandera West due to on-set of the short rains.

Further, most of the responses from the sampled general public were perceptions-based. Hence, a detailed study is needed to objectively establish the impact on quality of life and criteria for funding allocations of the various decentralized funds among other areas of study.

### **5.5 Recommendations for Further Research**

Local Authorities need to take into account the changed environment where residents are more aware of their rights and will demand better services. Addressing community's needs and demands will be a priority for all Local Authorities. The Citizen and stakeholders equipped with this information should realize their roles and responsibilities in paying the required revenues for the operation of their councils and call upon the council leaders and managers to account for the services rendered. Most of the development activities are implemented using revenue from rates. It is therefore important that rates are collected by Local Authorities. Citizens should also take keen interest and involve themselves in the operations of the Local Authority programmes.

Local Authorities are the backbone of sustainable development and are central in implementing MDGs. The Government needs to provide an enabling environment by establishing Local Government structures, developing policies and providing adequate resources required by Local Authorities to play their rightful roles and perform their functions. Crucial steps should be taken to review and overhaul and harmonize the legislations that affect the functions of Local Authorities.

Finally the project challenges national and Local Authorities/governments to put in place processes and legislative frameworks for representative and participatory democracy. Such processes and structures will facilitate direct involvement of the community in policymaking and service delivery.

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**Appendix 1: Revenues and expenditures (Kshs Mn.) for selected local authorities**

Las/Revenues / Expenditure	National	Nairobi CC	Baringo CC	Butemias CC	Isiolo CC	Karbanet MC	Kisumu CC	Kisumu MC	Luanda TC	Mandera CC	Mandera TC	Mumias CC	Nyeri CC	Nyeri MC	Taitaveta CC	Taitaveta TC
LAFT	8,232	1,532	46	73	35	11	33	164	18	50	25	37	99	44	34	17
RMLF	1,485	741	3	3	3	3	-	85	1	-	3	1	-	8	-	1.0
Total central government transfer	9,716	2,272	50	76	37	14	33	249	19	50	27	38	99	52	34	18
CILOR	327	150	0.5	-	-	-	0.5	21	-	-	-	0	2	4	-	2
PROPERTY RATES	3,067	1,719	-	2	0.02	1.04	0.4	40	-	-	-	4	0	15	2	0.97
Single business permit	2,232	772	3	6	1.44	3	1.8	43	2	1	2	5	24	25	6	3
Market fees	1,092	325	0.91	7	0.92	2	1.9	22	6	5	5	5	6	6	2	3
Others	6,999	2,800	12	14	142	6	11	110	10	11	10	22	28	74	16	28
Total local revenues	13,716	5,765	16	29	144	12	16	237	18	17	18	35	60	123	25	37
Total revenue	23,437.	8,038	66	105	182	26	48	486	36	67	45	73	159	175	59	54
% of LATF/ total revenue	35 %	19 %	70 %	70°/s	19 %	42°/o	67 %	34 %	49 %	75 %	55°/i	50 %	62 %	25 %	57 %/n	31°/s
Civic expenditure	1,236	72	13	11	17	3	4	16	3	18	3	4	24	10	6	3
LA person	9,047	3,703	23	40	40	11	13	183	12	9	13	34	36	90	22	14

nel																
LA operations	4,008	990	6	12	56	5	5	59	9	10	6	10	35	40	11	17
LA maintenance	807	13	1.3	11	18	2	2	15	1	2	2	2	3	5	4	0.98
Total recurrent expenditure	15,098	4,777	43	73	130	20	24	273	25	38	24	49	99	146	44	35
Recurrent surplus / deficits	8,334	3,261	23	32	52	6	24	213	11	29	22	24	60	29	16	19

Las/Revenues / Expenditure	National	Nairobi CC	Baringo CC	Butteemias CC	Isiolo CC	Karbanet MC	Kisumu CC	Kisumu MC	Luanda TC	Mandera CC	Mandera TC	Mumia MC	Nyeri CC	Nyeri MC	Taitave ta CC	Taveta TC
Capital expenditure	3,469	1,172	14	22	13	3	6	51	4	22	9	9	37	16	11	6
Loan repayments	13	-	-	-	-	-	-	-	-	-	-	-	0	6	-	-
Net surplus / deficit	4,852	10	9	10	39	2	19	162	7	7	13	15	23	8	4	13
Debt resolution repayments	4,229	7	6	7	28	2	8	95	6	10	3	13	30	11	3	5
Uncommitted surplus / deficits	623	4	3	4	11	0.03	10	67	1	(3)	10	2	(6)	(3)	1.3	8
Total expenditure	22,809	171	64	102	171	26	38	419	35	70	35	71	165	178	58	46

% recurrent / Total expenditure	66 %	.	67 %	72 %	76 %	78%	63 %	65 %	72 %	55 %	67 %	68 %	60 %	82 %	75 %	76 %
% capital/ total expenditure	15 %	22 %	22 %	22 %	7 %	13%	15 %	12 %	12 %	31 %	26 %	13 %	22 %	9 %	20 %	13 5
% debt repayments / total exp	19 %	26 %	10 %	7%	16 %	9%	21 %	23 %	16°	14 %	7%	18 %	18 %	6 %	5 %	11 %
Roads		315		4	4		1	15	2		2.6		7.5	11	0.44	1.8
% roads/ total		27 %	0%	18 %	33 %	0%	9%	30 %	49 %	0%	28 %	0%	20 %	73 %	4 %	31 %
Education			0.88		0.30						0.8	0.49	4.6			0.61
% education/ total		0%	6%	0%	2 %	0%	0%	0%	0%	0%	9%	4%	12 %	0 %	0 %	10 %
Water			0.95		0.30		1.49				2			2.26 %	1.01	
% water / total		0%	7%	0%	2 %	0%	26 %	0%	0%	0%	26 %	0%	0 %	15 %	9 %	0%
				1.3		0.97				1		0.46	4.9			
Health		0%	0%	6%	0 %	30%	0%	0%	0%	6%	0%	5%	13 %	0 %	0 %	0%
% health/ total		67														
Energy / electricity / power		791	12.403	17	8	2	3.81	35.6	2	21	3	9	20	1.89	10	3.5
Other project ( value in		1,172	14	22	13	3	6	51	4	22	9	9	37	16	11	6.0

kshs)																
Total		194	58	37	13	9	9	49	6	42	9	66	30	9	3	3
Other projects (No)																