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Title
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Permalink
https://escholarship.org/uc/item/59h6z3mh

Journal
International Development Planning Review, 26(1)

ISSN
1474-6743

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Publication Date
2004

Peer reviewed

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Central-Local Transfers in Kenya:
Options for Incremental Reform*

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Abstract
Until 2000, Kenya was unique among nations by having no formal means for sharing central government revenues with local authorities. Urban and rural governments alike had to cover their capital and current expenses on roads, education, public health, etc., entirely from own resources. This paper discusses the constructive role transfers can and should play in Kenyan development and the tradeoffs they impose between resource benefits and behavioral incentives. It then recommends several specific proposals for transfer reform, particularly regarding local road maintenance and basic equalization, along with the implementation mechanisms needed to address associated legal, institutional, and administrative issues. In addition, an action plan for a limited grant program is proposed for the short term.

Acknowledgments
This paper draws on reports prepared for the World Bank's Intergovernmental Fiscal Relations/Kenya Local Government Reform Programme, which is not responsible for its content. I am grateful for discussions with Kenneth Davey, Roy Kelly, Blane Lewis, Paul Smoke, and several officials in the Kenyan Ministries of Finance and Local Government for their patience, interest, and support, and to anonymous referees and the editor for additional advice.

1. Introduction

The 150 local authorities in Kenya, a country of roughly 30 million, are a critical component of any national development strategy.[1] They are close to the people and, given the geographic and economic diversity of circumstances in Kenya, are often better able to prioritize local service and infrastructure needs and demands than the central ministries. They are also less able to raise revenues. Local authorities have long lacked adequate access to elastic, stable, and robust revenue sources, such as retail sales and personal income. In recent years significant revenue sources and service functions were shifted to the center, though the net fiscal effect on local authorities has not been closely examined (Smoke, 1993).

It is widely accepted that the preferred mechanism for addressing this common gap between local responsibilities and resources is a system of central-local transfers. The center might simply rebate some part of the taxes collected by higher level authorities to the local authority in which they were generated (i.e., "tax sharing") and/or target central development and operating funds for specific or general purposes for local use (i.e., "grants"). However, Kenya had no significant grants or transfer system in place until 2000. Local authorities were required to finance their service and investment responsibilities almost entirely from their own sources.[2]

In some if not most instances they did so poorly with the result that local services were inadequately provided, even by historical standards. In many respects, that continues to be the case. In recent years Kenyan local authorities were estimated to contribute only 5% of total national recurrent expenditures and perhaps 17% of national capital investment. (The capital investment figures are not considered reliable; they are estimated from a non random sample of councils likely biased in favor of the very largest.) The Nairobi City Council alone spends over a third of this amount, just less than that spent by the 34 other municipal councils together (Republic of Kenya, Economic Survey, 1996). The remaining 115 or so town, urban and county councils in Kenya spent only 1% of national

public recurrent expenditures and 3% of public capital investment. The figures for recurrent expenditures are extremely low by both international and African standards (Bahl and Linn, 1992).

While part of the difficulty is the inadequacy of own revenue sources there is also evidence of low revenue effort as well as inefficient spending practices by many councils (Devas, 1997). The accountability, responsiveness, and capacity of local governance are thus significant issues. Suspicion remains within the Government of Kenya regarding the ability and willingness of local authorities to carry out substantial service responsibilities as a result. It must be noted that accountability and responsiveness are also issues for the central government ministries, especially for services that are primarily local in nature. Another complication is that the pattern of local responsibilities varies somewhat across councils, largely for historical reasons (Smoke, 1993). A few municipal councils have health and education responsibilities, for example. More have some water responsibilities. While all municipal and town councils are responsible for the maintenance of unclassified roads in their jurisdiction, county council responsibility for road maintenance is now unclear. County council responsibility for coffee and tea roads was recently shifted to the coffee and tea parastatals, along with the agricultural cess used to finance all road maintenance in county councils.

This paper illustrates how a simple yet appropriately designed system of transfers can, at least as a first cut, address both sets of issues in Kenya: inadequate local authority revenues and poor local authority performance. The main purpose of transfers is to redistribute a share of central revenues to local authorities to fund local spending obligations; however, matching requirements and other administrative or financial conditions can be placed on these funds as necessary to prompt improvements in local authority performance. The downside to such conditions are their data requirements and that they may prove too restrictive, particularly as local authorities develop their capacity to govern, and some care is advised in their design and application. The paper will also

describe some limitations to transfer policy in this setting; i.e., where local governments presently have little capability to administer a significant increase in funds and where the central ministries have few incentives to either provide technical assistance or share funds. Each of these obstacles is particularly problematic in Kenya, where the accounts of most local councils have not been kept in order for years. Data on local budgets and spending performance is simply unavailable.

The general characteristics of transfer programs are first described as a range of options within the Kenyan context. The paper next takes a more direct look at Kenyan circumstances by considering two specific transfer candidates: A basic equalization grant and the national levy on petroleum. Associated implementation issues are then reviewed.

2. Transfer Options in Kenya

Any transfer system essentially represents three sets of compromises: Between central control and local autonomy, between the desirable and undesirable impacts of central conditions on the use and level of transfers, and that implied by the diversity of local authorities. In addition the administrative and political costs of transfer programs vary with their complexity and size, apart from the quantity of funds involved.

The design of a given transfer system depends then on an evaluation of each of these tradeoffs in the Kenyan context. Two distinct forms of transfers, having much in common, are grants from the central government and tax-sharing (see Table 1 for a summary). The latter are in their simplest form some share of the tax revenues collected by the center that are rebated to the area from whence they came. An example would be a share of the Value-Added Tax (VAT) that is rebated directly to the general operating budget of the local authority in which it was generated. Grants, on the other hand, are central payments to local authorities from central sources

Otherwise, tax-sharing programs are like grants in that they can have conditions that restrict their use. They may have matching requirements, be confined to particular

purposes or reserved for local authorities having met minimum performance standards. Shared road maintenance levies could be dedicated to road maintenance exclusively, for example. Recall that any conditions have associated data, monitoring, and enforcement requirements.

Tax-sharing often has certain administrative and political advantages over other transfers. The allocation scheme is typically uniform across local authorities (e.g., 1% of a given tax base throughout the country), the local contribution to that tax base is readily understood at all levels (though it may be difficult to accurately measure), and the cost of collecting these extra revenues is low. Drawbacks include the fact that revenues accrue mainly, if proportionately, to higher income areas and that the shared revenues may, over time, substitute for local revenue sources such as the property tax. Performance conditions attached to shared revenues can be employed to offset this behavior, but they also add to the associated administrative burden and monitoring costs.

Note that shared taxes which are earmarked for a particular purpose, such as road maintenance levies, can also displace other local revenues in some circumstances. This is a potential problem where local funds are currently generated and used for that category. New revenues for the same purpose, whether from tax-sharing or a conditional grant, might be used to replace the local funds previously used for that purpose. As mentioned above, a further condition can be placed on these funds that spending for that reason must increase by some fraction of the amount of earmarked funds. This may increase the reporting requirements however. The larger problem, as discussed by Devas (1997), shared VAT and income taxes do not appear to be a feasible option in Kenya at this point owing to the way in which they are collected (i.e., not by local authority of residence).

3. General Purpose and Equalization Grant Options

A growing problem in Kenya is the bankruptcy of some local authorities as revenue sources are removed, either by the central government or by the creation of new local

authorities that capture revenue sources previously available to county councils especially. There is a strong need for a basic grant to those local authorities with particularly weak revenue bases. Because these local authorities are likely in the worst financial shape regarding expenditure effort and their accounts, it would be difficult to enforce, at least initially, a performance incentive program in conjunction with a transfer from the central government.

A relatively small base grant could address this problem. The issue is how to identify the truly needy councils without politicizing the process and without relying on ad hoc indicators. This is difficult. A grant that is higher the lower per capita revenues from own sources would discourage local revenue collections. A minimum grant to all local authorities would not differentiate among local authorities. A grant to only "poor" councils invites political definitions of that standard.

One approach is a conditional grant program that explicitly rewards revenue effort and financial management while explicitly recognizing differences in revenue capacity. A flat per capita grant, subject to a floor, would address the needs of the poorest councils. Higher grant levels would be allocated to local authorities with greater expenditure responsibility, higher capacity for revenue generation, and greater success in doing so. For example, an index could be calculated by the Ministry of Local Government for each local authority as:

Grant index = population + share of local taxes actually collected + index of financial management

Local authorities would be categorized as low, medium, or high by these criteria and receive less, the average amount, or more from the central grant pool accordingly. This essentially gives population, revenue effort, and financial management equal weight in the allocation equation; alternative weighting schemes are possible.

Not all these data are currently available, however. A grant with minimal criteria, based on population, would be the best alternative in the short run. A total pool size of 1% of Government revenues would be a reasonable initial level. It would facilitate the transition to the new system to begin with only a share of the full funding levels, perhaps 25% the first year. It is important that the schedule be fixed, however, to provide for budget certainty by local authorities and the central government alike.

Particular emphasis should be given to establishing a rigid framework for systematically assisting the poorest authorities for equalization purposes. It is critical this grant not be allocated on an *ad hoc* or discretionary basis to provide revenue stability and avoid politicizing fund distribution. Once the basic grant system is in place, an inter-ministry task force should be created at a later point to consider issues of local authority capacity and the potential for additional sectoral grant programs for water/sewer, health, and education. The next section suggests that the time for a sectoral road grant for local authorities is now, however, rather than later.

4. The Road Maintenance Levy

The Kenyan Road Maintenance Levy is a tax collected from petroleum fuel sales. These funds are transferred from the Treasury to the Ministry of Public Works "for the repair and maintenance of public roads," and it is Treasury's responsibility to "impose conditions on the use of any expenditure . . . and impose any reasonable prohibition, restriction or any other requirement on the use of such expenditure." (Kenya Gazette Supplement, 1993, 1994). While all such funds are currently spent by the Ministry of Public Works the legislation does not appear to prohibit their expenditure by local authorities for that purpose. Further, the Act could easily be amended to explicitly call for some sharing arrangement, such as separate accounts for Ministry of Public Works and local authorities.

These revenues have increased greatly in recent years, climbing from 67.6 million Kenyan pounds in 1994/95 to an estimated 158.9 million pounds for 1996/97, due in part to a substantial rate increase. The current figure is roughly 75% of all central traffic revenue, 20% of domestic VAT collections, and nearly 5% of all central revenue for the year.

There have been calls to share some part of these revenues with local authorities for roads under their jurisdiction. There are clear arguments for doing so: local authorities perform road maintenance as a normal function but possess no revenue sources linked to road use, half or more of the road system is under local authority, that activity is underfunded by any reasonable criterion, and the Road Maintenance Levy funds are generated locally. In addition this represents a relatively stable revenue source that, owing to its rapid growth, may be more accessible than many others.

A recent technical paper from the World Bank's Road Maintenance Initiative, a component of the Bank's Sub-Saharan Africa Transport Policy Program, provides a detailed rationale and set of practices for properly managing and financing roads (Heggie, 1995). It reports that most of the nine countries participating in the Initiative (Kenya, Cameroon, Madagascar, Nigeria, Rwanda, Tanzania, Uganda, Zambia, and Zimbabwe) spent less than half the amounts estimated to be necessary to keep their roads in good condition. Kenya was next to the worst, by this criterion, spending only 22% of the 133 million Kenyan pounds calculated to be required for minimal sustainable maintenance in 1991/92. The Road Maintenance Levy is the Kenyan response.

Problems

Still, under the present system, where local authorities lack access to these funds, it is unlikely that all important maintenance needs can be met by the Levy Fund. Some sharing arrangement or new funding mechanism is necessary to do so. At the same time, transferring too large a share of national Levy funds is also problematic. The road maintenance capacity of local authorities is untested at greater funding levels; there are

few institutional or financial incentives in place to encourage local authorities to manage an externally funded road maintenance program effectively. Dedicating a substantial share of this fund to local authority use would increase local revenues considerably. Transferring half the fund would increase local revenues by nearly 50%, for example and thus increase the local authority share in public spending to nearly 8%.

A transfer of 50% of these funds, as was recently proposed by some officials, is much too large in the absence of evidence that local authorities now appropriately spend considerable funds on road maintenance, or that these funds could be absorbed for that purpose. While local budgets could use an infusion of new money, these funds are earmarked for road maintenance only under current law. There are few reliable estimates of what shares of local authority budgets are now devoted to this category of spending. The 1994/95 provisional figure for all roads spending (construction and maintenance) by municipal councils was 141 million Kenyan pounds, or 26% of all municipal council spending on average. Through the early 1990s, total road expenditures were roughly 10% of all town, urban and county council expenditures (Republic of Kenya, Statistical Abstract, 1995).

Thus while current spending levels are below the levels required to adequately maintain the existing road network, it is unclear how effective a 2- to 5-fold increase in funding would be in the absence of means to improve the manner in which local funds are currently spent for this and other purposes. A simple description of the source of the levy, corresponding to the fuel sales in each local authority, and how this corresponds to both road maintenance needs and local authority spending on road maintenance (as a share of all local authority expenditures), would clarify this matter. In the absence of such data it may be advisable to start small and scale up the share of the Fund by 10% or 15% per year, and/or start with the larger municipal councils.[3]

Allocation Issues

There are competing arguments regarding how to distribute road levies among Kenyan governments. The two most compelling are based either on the origin of the levy collections or by measures of local authority need. Within those two broad types are several other important alternatives. They vary with respect to their regional impacts and, depending on the availability of data and the capacity of the central ministries to monitor performance, with respect to their effectiveness.

There are few estimates of local need or demand for road maintenance, or how these vary with either the number of miles of roadway in different categories or the amount of such funds generated (i.e., the quantity of taxed fuel sold) in each local authority. We are also unable to reliably calculate how the current expenditure of these funds by the Ministry of Public Works corresponds to geographic variation in need or revenue generation, though there do exist estimates of the amount of roadway under local authority responsibility (i.e., "unclassified" roads). It is nonetheless difficult at the moment to determine how a transfer of funds to local authorities would change their current pattern of use across the communities and regions of Kenya.

A transfer of part of levy receipts would thus have an unknown impact on the regional pattern of road maintenance or the structure of local finance across local authorities. The real obstacle to a successful levy-sharing program is making sure that the new revenues correspond to local authority capacity to put them to appropriate use. That is difficult to determine without a closer examination of the impact of Levy receipts on individual local authority budgets and expenditure practices.

Implementation Timetable and Procedures

One strategy would be to restrict such funds in the first year of the program to municipal councils and those for which relatively current road maintenance figures are

available. For example, road maintenance monitoring data will be available for the 26 local authorities included in the Kenya Urban Transport Infrastructure Project (KUTIP).

Another approach would be to determine the maximum allocation for each local authority and then designate the Ministry of Public Works to spend the funds on behalf of either each local authority or only for those judged to lack the capacity to do so. Many other options are possible, such as having all or some local authorities identify road maintenance projects and then employ the Ministry of Public Works to do the work. The last proposal is closest to the current arrangement with the differences that the geographic pattern of spending will likely change and a new layer of bureaucratic coordination and authority will be required between local authorities and the Ministry of Public Works. In particular, the Ministry of Public Works would essentially have to have its expenses for these projects approved by each local authority, rather than the other way around. The new administrative arrangement would likely arise more naturally if local authorities had the option of employing the Ministry of Public Works rather than the requirement to do so. The contracting out of road maintenance work to private contractors should also be encouraged.

Finally, the Road Maintenance Levy Act could be revised to indicate that all or only Local Road Maintenance Levy account funds would be administered by a new Ministry of Public Works/Ministry of Local Government/local authority framework, such as a national road board as suggested below. The Road Maintenance Levy Act would replace the role of the road ministry with that of a new national road board described below. Then all the issues raised in the previous two paragraphs could potentially be determined in the by-laws or other formal agreement forming the board. This approach would require first that a national road board exist. Otherwise, it would also be necessary to spell out in the revised Road Maintenance Levy Act whether the Ministry of Finance, Ministry of Public Works and/or Ministry of Local Government will monitor or approve the expenditure of Local

Road Maintenance Levy account funds, the formula for allocating Road Maintenance Levy funds across local authorities, etc.

In addition, the mechanism for disbursing funds plays an important role. As suggested in Heggie (1995), Road Maintenance Levy funds could be transferred directly to local authorities, used to pay local authority expenses for approved expenditures on road work, or transferred to local authorities subject to *ex post* technical and financial audits.

A Regional Example: Tanzania

The World Bank report on African road management and financing describes the current system (as of 1992 at least) in several African nations, but the case of Tanzania appears to be most relevant to the current situation in Kenya (Heggie, 1995). That allocation scheme resembles the simple rating system mentioned earlier for general grants in Sri Lanka, applied to road data and performance issues.

The Tanzania program allocates 20% of the national road fund to the 101 eligible district councils. After unsuccessful attempts to allocate these funds according to more general guidelines, a formula-based system was designed. The scheme intended to be simple, transparent, fair, and based on measures of local need, allowing for the availability of data. Districts are graded on a 9 point scale calculated from this index:

Allocation Index = population density category + road density category + an index of development

The population density factor is expected to capture trip generation rates, the road density factor is an urbanization index, and the development index (calculated by the Prime Minister's Office) mainly corresponds to the level of local commercial activity. Each factor is given between 1 and 3 points, so the maximum score is 9 points for each district and the minimum score is 3. The total score for each district is then categorized as one of three further categories: low (3-4 points), medium (5-7 points) and high (8-9 points). The

districts receiving a medium score obtain 1% of the total district pool, those with a low score receive 0.7%, and the high scoring districts are allocated 1.3% of the pool.

While this system is simple and straightforward, it lacks any performance incentives and the ratings are not entirely based on objective criteria. Thus there is no behavioral impact of the rating scheme; it can not be expected to improve local spending or planning practices, except by providing additional funds for road maintenance.

Any of these alternatives is expected to substantially improve local authority finances, though perhaps by compromising overall spending efficiency or revenue effort. This is because while road maintenance levy revenues are restricted to that use by law, the sharing program should free up local authority funds now spent on road maintenance for other purposes, thus effectively increasing the budget beyond road matters. It would be difficult to attach performance standards to those newly freed-up funds however.

Near Term Reform Proposal

An initial target level of 20% of Road Maintenance Levy funds should be diverted to a "local authority Account" within the Road Maintenance Levy Fund. It would be desirable to have the allocation of these funds made by a national road board with local authority participation, but the Ministry of Finance could be given this responsibility for the time being.

Once the role to be played by local authorities and each ministry in the administration and expenditure of these funds is specified, a rigid formula for allocating them across local authorities must be established. The Tanzania system does a reasonable job of allocating road maintenance funds for local purposes based on feasible indicators of need. There are no means to encourage local authorities to make better use of their total resources, however, aside from whatever improvements can be instituted in the disbursement process by the Ministry of Local Government (i.e., technical and financial auditing). This drawback can be addressed by incorporating basic performance criteria into the allocation formula. Three recommended criteria, in addition to those used in Tanzania, are

• the per capita expenditure on road maintenance from own sources,

• the share of billed taxes and fees actually collected, and

• a measure of local road quality.

Each could be given a score of from 1 to 3 and the share of road maintenance funds allocated to that local authority would rise or fall accordingly. This system would reward local revenue effort and road maintenance performance.

Though these data are not currently available on a reliable and timely basis, it should be possible for the revenue effort and road expenditure indicators to be determined in the future by the Ministry of Local Government in the course of its normal functions. The road quality indicator would be best determined by the Ministry of Public Works.

In the absence of data that permit this system, the Ministry of Finance could have the option of either entering into formal agreements with local authorities for the Ministry of Public Works to spend Road Maintenance Levy funds for local purposes on their behalf or, in the case of more capable local authorities, it could disburse these funds for approved purposes. The initial allocation across local authorities could be based on simpler system based on available data: (1) a weighted measure of local road length by classification, (2) current population to proxy for road use, and (3) a measure of local authority financial management. The last factor might be simply a 3 point index of the status of their accounts, possibly combined with performance indicators of local revenue collections, road quality, etc., as reasonably accurate data for those become generally available. There are various means of evaluating local authority performance but the data on all but council account status appear to be unavailable for most, let alone all, local authorities at present.

The preferred disbursement procedure is the third World Bank model described above, where funds are disbursed to local authorities on a regular basis (i.e., monthly or

quarterly), to be followed-up by technical and financial audits to verify their proper use. Disbursements could be suspended for good cause.

It is also recommended that the program be implemented gradually, both with respect to the level of funding and the number of local authorities receiving funds. It would seem that a basic prerequisite for receiving any transfers is that local authority accounts be judged satisfactory by the Controller-General. According to the Ministry of Local Government, only 10 of the current 153 local authorities in Kenya fall into this category. Other local authorities would become eligible as they pass this threshold. On the other hand, this restriction may not be political viable.

It may also aid the transition to initially provide less than full funding. Perhaps only 25% or 50% of the full local authority allocation could be distributed the first year, with subsequent funding conditioned on the outcome of the ex post technical and financial audits of the Ministry of Public Works and the Controller-General. These amounts would be increased according to a fixed schedule if the audit results are satisfactory, perhaps will full funding in 3 to 4 years. The success of this schedule depends critically on the capacity of the auditing authorities to complete the reviews on a timely basis.

A remaining issue is the involvement of the Ministry of Public Works in local authority road maintenance functions that are financed by the local authority share of the Road Maintenance Levy. This turns on the capacity of each individual local authority to take on these responsibilities through its own roads department, through private contracting (which requires a local authority contract officer, etc.), or by contracting to the Ministry of Public Works. It is unclear if the Ministry of Public Works has the interest or ability to perform local authority road maintenance functions for all roads, but this should be less a problem for trunk and other major roads under local authority.

Consideration should also be given, as mentioned, to establishing a National Road Board to oversee Kenyan road investment and maintenance policies, including the Road Maintenance Levy Fund, with a Local Authority subcommittee. The latter would in turn

review the allocation criteria and the arrangements among the Ministry of Public Works, the Ministry of Finance, the Ministry of Local Government, road user groups, and local authorities for prioritizing and completing local road maintenance and construction. An advisory board is permitted under current legislation.

Update: Recent Progress

The Local Authorities Transfer Fund, introduced in 1999, shares many features with the "Near Term Reform Proposal" outlined above (Kenya, 2001, 2002). It provides discretionary monies to local authorities based on a transparent, objective formula, that formula is based on simple, measurable factors such as population and revenue capacity, and there are certain administrative performance and participation conditions (Ngugi and Kelly, 2002). The Fund is financed by 5 percent of national income tax collections, which is fairly predictable.

That said, the data required for the allocation formula are hard to come by, and administrative performance standards will take time to have effect. Until 2002, only population estimates were used as an allocation criterion. Data on poverty and revenue capacity were unevenly available. In addition, the performance criteria were initially unrealistic in many respects, with poor compliance. However, early reports also indicate that such criteria had substantial stimulative and other incentive effects on record keeping (World Bank, 2002).

5. Concluding comments

Local authorities in Kenya have three serious problems. They lack authority for many public services that, both in theory and in the experience of many countries, should be locally controlled. They also lack the resources to finance many of the services they do have responsibility for. And finally, many localities do a poor job of carrying out those

functions which are sufficiently funded. These problems are partly political and partly historical in nature, but they can be addressed. This paper is concerned only with the proper design and implementation of a formal system of intergovernmental transfers, now completely absent in Kenya. Such a system has implications for two if not all these problems to some extent. It is not a sufficient condition for progress in these respects, but one can argue it is a necessary condition. Without a means of properly financing local responsibilities it is difficult to imagine how local governments can meaningfully contribute to either local or national development, or to the larger process of national political reform.

Having said that there are also severe obstacles to implementing an appropriate transfer system, even where the political will to do so exists. The data needed to allocate funds by either equity or efficiency criteria are mostly lacking. Few local accounts have been in order for the past decade. Measures of local government performance, in the past or in the future, cannot be reasonably determined in the near term. This precludes a transfer system with effective behavior incentives. Measures of local demand are similarly difficult to calculate, even roughly. In addition, there are the political and administrative costs of transitioning to a new and untested system of distributing national resources to be reckoned with.

It will thus be some time before a transfer system in Kenya is able to do all that is asked of it. In the near term, however, this paper argues that much progress can be gained by a few simple initiatives. These include the earmarking of a significant share of national road fuel taxes for local purposes, to be distributed based on miles of roadway in each jurisdiction, and the allocation of a small share of national general revenues to authorities based on population. Each allocation and disbursement scheme should incorporate a simple measure of local government performance, such as acceptable accounts, as soon as proves feasible. Some share of the new funds might be made available for just that purpose. Beyond more detailed attention to concrete forms of these general considerations, the next phase of this research should address the construction of

measures of local need, resource effort, and expenditure efficiency, along with clear examples of how alternative allocation plans will affect the spatial distribution of services among Kenya's local governments.

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Table 1: Types and Properties of Transfers

	Revenue Sharing/ Shared Taxes	Grants
"unconditional" (Unrestricted funds)	Allocated to each local authority based on some specified share of centrally collected revenues originating in that local authority. **Pros:** Returns locally generated revenues that would otherwise be difficult to collect. Usually the smallest administrative burden. Generally predictable and stable revenue source. **Cons:** Requires that the origin of each shared revenue source be documented. Allocates the largest shares to highest income areas. **Example:** 1% of the VAT collected from Thika would be periodically rebated directly to the general fund of the Thika municipal council, and so on for each local authority.	Allocated by ad hoc or by formula. The formula is usually either a flat grant per local authority, or based on measures of need and resources, or some combination. **Pros:** Redistributes centrally collected revenues according to differences in need and resources across local authorities. Can address different regional circumstances and equalization objectives. **Cons:** Data required for allocation formula must be current. Disbursement procedures somewhat more complicated that revenue sharing. **Example:** 10% of central government revenues allocated to local authorities -- 10% as a flat grant to each local authority and 90% on an equal per capita basis.
"conditional" (Restricted funds)	Same as above and in addition conditioned on specified performance criteria (e.g., staffing levels, acceptable accounts, etc.) and/or restricted to particular purposes (e.g., road maintenance). **Pros:** Same as above but with additional incentives and/or requirements to enhance local authority spending and revenue performance. **Cons:** Same but additional monitoring and measurement burdens by center, and reporting burdens on local authorities. May excessively distort local spending choices. **Example:** 10% of the Road Maintenance Levy collected from Thika would be periodically rebated directly to the Thika municipal council, earmarked for road maintenance expenses, and so on for each local authority.	Same as above and in addition subject to matching local contribution, conditioned on specified performance criteria (e.g., staffing levels, acceptable accounts, etc.) and/or restricted to particular purposes (e.g., road maintenance). **Pros:** Same as above but with additional incentives and/or requirements to enhance local authority spending and revenue performance. **Cons:** Same but additional monitoring and measurement burdens by center, and reporting burdens on local authorities. May excessively distort local spending choices. **Example:** 10% of central government revenues allocated to local authorities by a formula that rewards local revenue effort (e.g., % increase in rates collections). Another 5% of central revenues allocated for water projects, where need is demonstrated.

Notes

[1] Local governments include county councils, urban councils (which are mainly subordinate to county councils), municipal councils, and town councils. New councils have been carved out of county councils at a brisk pace in the past decade, with 174 as of June 2002.

[2] The liabilities the central government incurs for bad local authority debt do represent a transfer program of sorts.

[3] Devas (1997) suggests starting with a transfer of 20% of Road Maintenance Levy funds, amounting to a 10% increase in LA revenues and a 200% increase in road expenditures on average, allocated on the basis of the length of unclassified (local) roads (i.e., need) or by the location of petrol stations (i.e., origin).