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The Nature of Local Revenue Decisions within the Decentralized Structures in Kenya

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Abstract:
Fiscal decentralization is widely recognized to bring leaders and decisions makers closer to the citizens resulting in better delivery of public services. Underperformance in the revenue collection has a significant effect on the ability of the sub-national governments (SNGs) to deliver services to its citizens. Due to these challenges, this study sought to examine the state of the local revenue decisions among sub-national(county) governments with a focus on Kiambu, Vihiga and Baringo Counties in Kenya. The study was descriptive in nature and used interviews with purposefully directors from budget, finance and planning departments and secondary data collected from Commission on Revenue Allocation (CRA) and Kenya National Bureau of Statistics (KNBS). Data obtained was analyzed thematically and descriptively. The analysis shows that the revenue collection by the SNGs in Kenya have increased marginally since the establishment of the devolved structures but have stagnated when they are adjusted for inflation. The revenue collection figures of the SNGs are underperforming and are drawn from a relatively small base. User charges, business licenses and property tax are the main revenue bases contributing about 86 per cent with user fees contributing more than half of the revenues. The effective own source revenue (OSR) to budget funding indicates that six counties can fulfil the requirements for devolution of at least 10 per cent effective OSR to budget. This scenario impeded the attainment of the objectives of devolution and increases dependence on fiscal transfers. The study recommends the following; the county governments should give realizable estimates of local revenues, improve on the management and control of the current revenue bases and lastly integrate new revenue bases. The study contributes to the existing knowledge by delving more into the elements of revenue decentralization and recommends further studies on how other elements of revenue decentralization impact the performance of the subnational governments in sub-Saharan Africa

Keywords: *County governments, decentralization, local governments, local revenue decisions, sub national government (SNGs)*

1. Introduction

Local revenue structures reflect the blend of the decisions made at the subnational government level and are affected by the local laws, historical patterns, competitive pressures and administrative realities (Bartle, Kriz & Morozov, 2011). In practice, country-specific factors play a crucial role when considering optimal ways of dividing revenue responsibilities between national and sub-national governments (Fjeldstad & Heggstad, 2012). The local revenue policy is a mixture of principles, practical considerations, political decisions, historical context, and interactions among local governments possibly involving strategic or self-interested behaviour by local actors (Bartle *et al.,* 2011). Furthermore, the administrative capabilities of sub-national governments in developing countries must be taken into consideration when designing revenue decisions (revenue bases and rates) (Modica, Laudage, & Harding, 2018).

Subnational governments are creatures of the state, and so the structure of state tax and expenditure policy largely determines the fiscal powers donated to local governments. States always determine which revenue instruments are available to subnational governments and impose tax and spending limits, which further constraints their revenue collection. Thus, the productivity of revenue systems of the subnational governments and their administrative and political acceptability is subject to change (Bartle, *et al.,* 2011). A study by Bartle *et al.,* (2011) reported that external economic, technological and demographic changes and trends are posing a significant challenge to the ability of the subnational governments to generate sufficient own source revenues. These trends are captured by the volatility in sales tax, decreasing property values and diminishing grants from central governments (Fjeldstad & Heggstad, 2012).

In the US, the largest revenue sources for subnational governments are; state aid at 33.6 per cent, followed by property tax at 27.6 per cent, user charges at 15.7 per cent and miscellaneous revenues (sales and excise tax) at 6.4 per cent and federal aid at 4.3 per cent. These taxes comprise over four-fifths of the all-revenue for the sub-national governments (Bartle *et al.,*2011). Although property tax was a significant tax base for the subnational governments in the US during the last millennium, its contribution has substantially dropped from 51.4 per cent to 27.2 per cent of total local general revenue, and it has been replaced by intergovernmental fiscal transfers, user charges, local taxes and miscellaneous revenues (Bartle, Ebdon & Krane, 2003).

Local government revenue in Norway amounts to about 18 per cent of GDP while user charges account for about 12 per cent of total revenues (Geys & Sørensen, 2016). The property tax is one of the oldest and most widely used forms of local tax. (Bartle *et al.,* 2003). In most African states, the main sources of local revenue for subnational governments are rates and rents, business licenses and permits, user fees and other non – tax sources. Property tax is levied in all Anglophone countries in Africa except in Seychelles but accounts for less than 0.5 per cent of GDP in many African countries and 40% of all sub-national taxes in developing countries (Fjeldstad & Heggstad, 2012).

1.1. Statement of the Problem

The rapid population growth in Africa has outstripped the capacity in terms of management, infrastructure, and financing of the subnational governments to provide public services. The subnational governments in Africa face several challenges that include; financial dependence on grants and transfers from national governments and donors, inefficient tax administration, lack of accountability and the growth of informal settlement deficient in basic services such as housing, clean water, electricity, sanitation, refuse collection, roads and transport (Fjeldstad & Heggstad, 2012). Studies have attributed the failure of decentralisation initiatives in Africa to several challenges that include; limited legislative and regulatory changes, centralization of resources, limited fiscal transfers, weak local revenue bases and lack of local planning capacity (Robinson, 2007).

It is becoming increasingly important to know the effect of fiscal decentralisation on the economy, society and politics (Martinez-Vazquez *et al.,* 2017) because the subnational governments are particularly important actors in the provision and delivery of public goods and services (Veiga & Kurian, 2015). Revenue decentralisation in Kenya is affected by weak governance and lack of prioritization and goodwill between county leaders and the national government (Cannon & Ali, 2018). Data and information on the local revenue decisions in Africa are insufficient because of limited studies from sub-Saharan Africa (Robinson, 2007; Cabral, 2011). It is against this background that the paper examined the state of local revenue decisions among the subnational governments in Kenya.

2. Literature Review

There are differences in the type and nature of revenue decentralisation between different countries. In OECD countries, revenues for the sub-national governments are made up of income tax, profits and capital gains and thus these tax sources can be strategically used to attract populations and business, whereas, in non-OECD countries particularly in India, Thailand and Brazil, the revenues are drawn from taxes on goods and services (Veiga & Kurian, 2015). The three main sources for local authorities in Norway comprise tax revenue, government grants and user charges (Geys & Sørensen, 2016). In Africa, locally generated revenues are drawn from a variety of sources such as the tax and non-tax revenues (Adenugba & Ogechi, 2013; Abiola & Kizito, 2014). The main local revenue sources for the SNGs in Africa are rates and rents, business licences and permits, user fees and other charges and other sources (Fjeldstad & Heggstad, 2012).

There are also differences in revenue decentralization initiatives for the subnational governments. On average, locally generate revenues averages of 27 per cent and is 37 per cent in advanced economies and 23 per cent in emerging economies and developing countries (Sow & Razafimahefa, 2017). In France however, own-source revenue comprises 60.6% in municipalities and associations, 58.6 % for the *departments*, and 41.7 per cent for the regions. In total, sub-national government's own-source revenues account for approximately 55% of the total revenues (Garello, 2016). In Japan, it is reported that sub-national governments collect about 33% as own-source revenues (Miyazaki, 2016) and 48% in China (Shen *et al.,*2012). Other studies report modest figures for revenue decentralisation; 16.6% in developing countries, 18.4% in transition economies and 19% in OECD counties (Shen *et al.,* 2012).

The revenue decentralisation in South Africa sees the provincial governments having virtually no own source revenues while the local governments derive their revenue to the tune of 84 per cent from property taxes and user charges (Ahmad & Tanzi, 2002), while in Uganda, local authorities retain about 65 per cent of the revenues with the rest being remitted to the central government (Okidi & Guloba, 2006). Business permits and licenses are regulatory by nature and generate between 5% and 30% of the local revenues in Africa. However, they are poorly designed and administered and therefore, the coverage, assessment, collection and enforcement are low, thereby leading to low revenue potential. User fees in Africa can be a main source of revenue to the SNG. On the converse, user charges can impose a heavy burden on low-income service users (Fjeldstad & Heggstad, 2012).

2.1. Theoretical Review

Fiscal federalism theory proposes a set of tax-assignment rules but there is no ideal assignment of revenue sources between national and subnational government (Oates 2005; Musgrave, 2000). The principles of fiscal federalism posit that the different levels of governments ought to provide goods and services efficiently within their given jurisdictions (Ryan & Woods, 2015). Theoretically, SNGs are considered as the developmental or competitive state, therefore, decentralization promises that competition between levels of government will promote greater responsiveness to local needs and fiscal discipline to prevent an oversupply of public goods, thereby enhancing efficiency and democracy (Warner & Pratt, 2005).

Oates (1999) emphasizes that the lowest levels of government within a territory should rely on the benefit tax, that is, the user charges and allotted taxes to mobile economic units such as households and firms. On the converse, the use of non – benefit tax (such as sales tax, income tax whenever possible) should be employed on the relatively immobile tax bases such as property tax, income tax and sales tax wherever possible. Thus, a well-structured revenue assignment system provides clarity on the power granted to each level of government to levy specific taxes, and the discretion granted to every level of government in charging and managing the tax administration (Bahl, 2008).

The tax assignment models argue that there are few meaningful taxes available to the SNG when compared to property tax, hence, in principle, the property tax is unavoidable and, if well administered, it represents a non-distortional and highly efficient fiscal tool (Fjeldstad & Heggstad, 2012). Bird, (2009) notes that user fees and property taxes should be the main tax bases for the sub-national governments (Dziobek, Mangas & Kufa, 2011). In addition to raising revenues, local revenue mobilization has the potential to foster political and administrative accountability by empowering communities (Oates 1998) and that the revenue sources must be politically acceptable (Fjeldstad & Heggstad, 2012). Putnam, Leonardi and Nanetti (1994); Ebel and Yilmaz, (2002) note that fiscal decentralisation is often considered as a way to improve participation, transparency and accountability of local government leaders in policy-making.

2.2. Fiscal Decentralization in Kenya

At independence, Kenya as a state had a three-tier decentralised structure comprising national, federated regional and local governments at the lowest level. This was provided for by the sessional paper No. 1 of 1965, which supported decentralisation initiatives but the subsequent local authorities Act of 1967 created the local authorities to replace the federal system. Further, due to political and parochial interest, parliament passed an amendment to the constitution repealing the regional governments and replacing them with appointed provincial administrators (Mitullah, 2012).

The creation of local authorities (LAs) then did not portent much for decentralisation because the central government took much authority and legal framework and created a supervisory government ministry to run the affairs of the local authorities (Mitullah, Odhiambo & Kichamu, 2005). Between 1969 and 1989, a series of political reforms and Constitutional amendments transferred the powers of the LAs to Central Government ministries and departments. Take for instance, the Transfer of Functions Act (1969) moved functions such as primary health and health services to central government with the exception of seven major municipalities (GoK, 2016). Further, the Act took away the power of municipalities to levy the Graduated Personal Tax (GPT) and was replaced. with a grants system covering certain services. In 1989, the specific grants were replaced with a service charge levied on business premises and employees in formal and informal sector. Later on in 1998, the service charge was itself abolished and replaced with the Local Authorities Transfer Fund (LATF). By and large, this permitted the LAs a narrow range of local taxes, fees and charges (GoK, 2016).

With the promulgation of the Constitution of Kenya 2010, the country adopted devolution which split the territorial state of Kenya into two – tiers of governments; national and county. The lowest tier is the sub-national (county) government with subjugated urban (town and municipal) councils (The Constitution of Kenya, 2010). The Constitution of Kenya, 2010 provides for at least 15 per cent of national revenues of the total government expenditure during the financial year (The Constitution of Kenya, 2010) to be transferred to county governments, while the national government spend 84.5 per cent with 0.5 per cent allocated to an equalization fund (Cannon & Ali, 2018). The devolved services include Agricultural development, health services, pollution control local transport and road infrastructure, animal control and welfare, trade development and regulation, county planning and development, county public works and services, pre-primary education, village polytechnics and craft centres, firefighting services and disaster management, and promotion of governance and local levels (The Constitution of Kenya, 2010).

Accordingly, the sub-national governments in Kenya have both the administrative structure made up of the appointed county executive committee headed by a directly elected governor and supported by a secretary and the political structures consisting of legislative arms which consist of a majority elected and smaller appointed Members of the County Assembly (MCAs), led by a speaker, who is elected from among other persons. Thus, fiscal aspects of decentralisation are observed in both the administrative and political structures where the county executives draft the county fiscal budgets and submitted them for approval by the county assembly (The Constitution of Kenya, 2010).

3. Methodology

The study adopted a descriptive design as it was the most appropriate in instances where a description of the features of specific phenomena is required and also produce an accurate profile of factors, events and situations. The use of the design was accompanied by a survey approach that allowed for the collection of sets of quantitative data from the given population.

3.1. Sampling Procedure

The study drew subjects from the three purposely selected counties of Kiambu, Baringo and Vihiga based on the distinct overall absorption rate of funds assigned in the financial year 2017/2018. This rate is indicative of the efficiency of the county governments in delivering public services. Kiambu and Vihiga Counties are extreme outliers with Kiambu having the highest overall absorption rate of 85.5% while Vihiga had the lowest overall absorption rate of 48.5%. Baringo, on the other hand, had a median absorption rate of 74.8% (Controller of Budget, 2019).

The target population comprised purposively selected nine (9) directors from the finance, budget and planning departments (or equivalent) because of their in-depth knowledge of the state of fiscal decentralisation in their respective counties. The study used interviews and documentary reviews as the major tools for data collection. First, secondary data on decentralisation was collected from the Constitutional offices and commissions such as the Auditor General, Controller of Budget (COB) and Commission on Revenue Allocation (CRA). Secondly, the study interviewed directors in the three-county governments of Vihiga, Baringo and Kiambu to ascertain their perceptions on the local revenue decisions.

3.2. Data Analysis

The secondary data was entered into an excel sheet and analysed by descriptive statistics and the output presented in a tabular and graphical format, while the quantitative data was entered into Microsoft Excel and analyzed by descriptive statistics and presented in a tabular format. Qualitative data was analyzed through a combination of deductive and inductive approaches which include transcription, summarizing, categorizing and structuring.

4. Results

The information presented in Figure 1 illustrates the trends in revenue collection for the county governments (SNGs)in Kenya. The figure shows that the total revenue available to the subnational governments are increasing largely due to the increases in the fiscal transfers. A close examination shows a direct proportionality between the fiscal transfers and subnational governments' revenues, illustrating an overall dependence by the subnational governments on the intergovernmental fiscal transfers. The lowest amounts of the intergovernmental transfers are about 87% of total subnational governments budgets in the 2014/2015 financial year and the maximum is 91% in the 2019/2020 financial year. The total local revenues averaged 10% and fluctuated between 13% in 2014/2015 and 9% in 2017/2018. The real increase in the local revenues for subnational governments when adjusted for inflation is probably a decline considering that the 12 – month inflation rate ranged between 3.73% and 9.71% or an average of 6%. This would indicate a subpar performance in revenue collection which portends serious ramifications in service delivery among SNGs in Kenya.

Second, the conditional grants from the national government rose from 1.44 per cent of total revenue received in 2013/2014 to about 12.36 per cent in 2019/2020. This represent about a 1,400 per cent increase between 2012/2013 and 2019/2020 and are not related to any transfer of functions as envisioned by the constitution of Kenya 2010 but it can be inferred to be a form of coercion of subnational governments to implement the desired goals of the public sector. This is supported by the fact that these grants went to the construction of physical infrastructure such as roads, social welfare infrastructure such as hospitals, vocational and technical schools, which are under the mandate of the county governments. The rise in conditional grants has also seen the reduction in the unconditional funds.

Third, there is an average of 13.55% in unabsorbed funds which indicate underutilization of funds by SNGs in Kenya. This figure ranges between 7.75 per cent of all the SNG revenues in 2016/2017, 15.24 per cent in 2017/2018 and 13.9 per cent in 2019/2020.Fourth, there is a rise in the conditional grants from the bilateral and multilateral donors from 0.28% in 2014/2015 to 5.73 in 2018/2019 representing about 2,100 per cent increase. This figure could have risen further, had it not for the Covid – 19 pandemic which affected revenues. This rise is meant to provide support to specific programmes such as capacity building for these SNGs and to promote devolution as well as support specific functions which are under the mandate of the county governments.

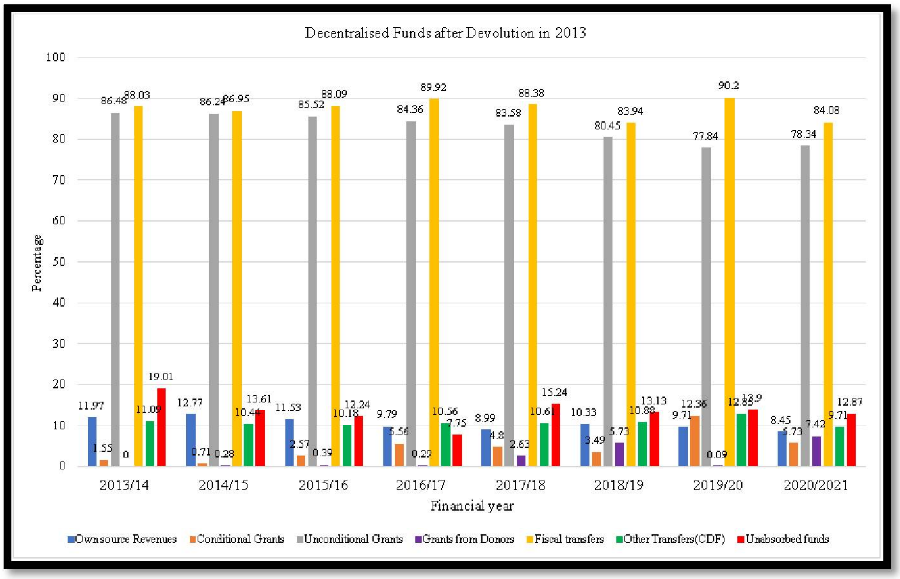

Figure 1: Decentralised Funds 2013/14 -2019/2020
Data Sources: Controller of Budget (Various Reports)

The information contained in Table 1 illustrates the summaries of the categories of OSR for the SNGs in Kenya. SNGs have put more emphasis on the most visible forms of revenue bases such as the user fees and charges, business permits and licences that can be easily collected.

OSR Category	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Business Permits and licence	1.2	9.6	12.0	14.8	15.9	15.9
Business Permits and licence	1.2	9.6	12.0	14.8	15.6	15.7
Building plans approvals	-	-	-	-	0.3	0.2
Rates and rents	12.5	17.1	22.3	17.0	16.5	18.4
Property rates	12.5	14.9	17.4	14.1	14.5	15.2
Housing rents	-	2.2	4.9	2.9	2.0	3.2
User fees and Charges	10.1	22.5	25.2	31.9	51.8	51.7
Administrative fees*	-	-	-	-	12.2	14.4
Vehicle parking fees	1.0	8.2	10.8	12.2	10.0	12.3
Health facility operations/services	0.7	6.5	6.9	11.0	16.5	12.9
Game Park fees*	-	-	-	-	7.3	6.1
Natural resource exploitation*	5.0	5.1	4.8	5.6	0.6	1.4
Environment and conservancy*	-	-	-	-	2.6	1.7
Market/trade centre fee	3.4	2.7	2.7	3.1	2.6	2.9
Miscellaneous fees	0.4	8.3	11.3	7.6	9.5	8.6
Cesses	0.3	2.7	3.6	3.5	3.8	3.6
External services fees*	0.1	0.6	0.1	1.5	1.1	1.5
Technical services*	-	-	-	-	3.2	2.2
Liquor licences	-	-	-	-	0.5	0.5
Fines, penalties and forfeitures	-	-	-	-	0.3	0.2
Advertising and billboard signs	-	-	-	-	0.6	0.6
Other unclassified receipts	0.0	5.0	7.6	2.6	-	-
Other revenues	75.8	42.5	29.2	28.7	6.3	5.4
All other sources	75.8	42.5	29.2	28.7	6.3	5.4
	100	100	100	100	100	100

Table 1: Categories of Own Source Revenues 2013 -2019
Source: CRA Reports

This is indicative of the orientation of government bureaucrats at the county level. This is indicated by the cumulative growth in the OSR for these SNGs, which has stagnated for the last six years when it is adjusted for inflation. Their classifications are unnerving, for instance, garbage collection is referred to as environment and conservancy, natural resource exploitation at some point means fees from the extraction of natural resources (sand, minerals as well as game parks, etc), administrative fees and charges may refer to any charge such as weighing, slaughterhouses, burial fees and any other aspects, technical services may refer to veterinary services, audit and supervision fees*,but the study tried to simplify them into five categories; permits and licences, rates and rents, user fees and charges, miscellaneous revenues and other revenues. There is growth in the user fees and charge which make up over half of the revenues while the business permits and licences make up 16 per cent with rates making up 18.4 per cent.

The lack of clarity in the local revenue collection efforts may indicate several issues at the local level: the lackadaisical approach on the part of the government officials at the county level on the need to streamline revenue collection efforts, thereby indicating the preference for the fiscal transfers; the ineptitude of the revenue collection agents in planning, controlling and managing revenues at the county level, the lack of strategic emphasis at the county level and may other issues. By organizing, clustering and managing the revenue streams, it would be easier to emphasize those revenue bases that would have a significant impact on the revenue for the counties.

Take for instance, the valuation rolls which would determine the property rates; it is a legal requirement that valuation rolls are prepared every ten years with supplementary rolls being prepared regularly to represent the significant changes in ownership and land use. However, this has not been the case, and has seen the SNGs being dependent on rating systems drawn from the preceding local authorities. The dates of current valuation rolls in use in Nairobi City County (1982); Machakos (1983); Mombasa (1991); Kisumu (2008); Nyeri (2009); and Kiambu (2014) (GoK, 2016). This is seen by the urgency by several countries which include Nairobi City, Nakuru and Uasin Gishu counties to develop valuation rolls and property registers that would improve revenue collection efforts.

Lastly, development expenditure should be indicative of the growth in the revenue bases as any capital expenditures such as infrastructure should have a commensurate effect on the revenue growth. Take, for instance, the following revenue bases; vehicle parking fees, health facility operations/services and cesses which have grown at an average of 11 times. The health facility operations/services revenues have grown 17 - fold during the last six year and is indicative of the construction of more health infrastructure facilities, vehicle-parking fees has grown 11-fold probably due to the growth in the consumption of service as a result of infrastructural developments. The agricultural cess income has grown 11 - fold and this could be indirectly attributable to the actions of the SNGs to improve the livelihoods of residents in agriculture-dependent counties.

The underlying challenge in the OSR among SNGs is the existing natural agro-ecological system existing in Kenya. More than 70% of the land mass in Kenya is classified as arid and semi-arid (ASAL) regions and covers more than 14 counties: Kitui, Makueni, Baringo, West Pokot, Turkana, Marsabit, Samburu, Isiolo, Wajir, Mandera, Garissa, Tana-River, Lamu and Taita-Taveta. These counties have OSR collections of below USD 4 Million due to the fewer revenue streams. However, some have resource endowments like wildlife parks and mineral deposits which has seen counties such as Narok, Baringo, Samburu, Taita-Taveta derive significant revenues streams not available to counties in ASAL regions.

The main sources of OSR are property rates in urban areas, business licenses, market fees and various user charges. Nevertheless, experiences from several African countries show that these revenue instruments have serious shortfalls. For instance, property taxes can be very costly to administer and the enforcement of user fees has resulted in widespread resistance to pay from the poorer segments of the urban population (Fjeldstad & Heggstad, 2012). However, experiences from other regions show that when well administered, these revenue instruments can provide substantial and reliable revenues for urban municipalities (Fox & Pimhidzai, 2011).

According to a study by Organization for Economic Co-operation and Development (OECD), SNGs of low-income countries should finance 7.8 per cent of their budgets while SNGs of middle-income countries should finance 20.9 per cent of their budget. Due to the recommendations of the report, the CRA (2020) challenged the SNGs in Kenya to finance their annual budgets by a proportion of upto 21 per cent considering that Kenya is a middle-income country. Using this criterion only three of the 47 counties, that is Narok, Mombasa and Nairobi meet the OECD set threshold of 21 per cent (CRA reports, 2020).

Since the level of taxes in an economy is an indicator of the resources available to governments, it also provides a rough estimate of the burden placed on the economy by the tax system (Modica, Laudage & Harding, 2018). In the Kenyan context, agriculture is the mainstay sector for the economy and this translates to marginal revenue streams such as land rates, produce and livestock cesses. According to CRA (2020), agriculture contributes between 40 and 85 per cent of the gross county product (GCP) in 37 counties with Nyandarua (86%) and Elgeiyo-Marakwet (80%) being the outliers. The remaining10 counties with diversified revenue streams still have significant agricultural sector–based streams of less than 40 per cent includes Embu (39%), UasinGishu (35%), Kilifi (30%), Kiambu (30%) and Kisumu (25%) with the Nairobi City, Mombasa, Kajiado, Isiolo and Machakos Counties having lower percentages of agricultural-based economies.

Due to this scenario, there is need to further evaluate the proposition that Kenya being a middle-income economy, its SNGs should universally contribute 20.9 per cent of their annual budgets as proposed by OECD. This proposition cannot hold because of imbalances in economic growth and unequal state of development of SNGs as indicated by the economic sectors of the counties. The majority are agricultural-based and thus their revenue streams are limited, therefore, the study proposes a ratio that takes cognizance of the differences in the potential of the SNGs to raise revenues and seeks to evaluate the SNG OSR by introducing agradual measurement that takes two forms; the projected OSR to budgetary funding and the effective OSR to budgetary funding. The effective OSR is calculated as follows

$$Effective\ Own\ Source\ Revenue = \frac{\text{Actual collected own source revenue}}{\text{Sub} - \text{national government fiscal budget}}$$

Whereas the projected OSR to budgetary funding represents the real fiscal budgets, the effective OSR to budgetary funding ratio is illustrative of the capabilities of SNGs to support devolution and decentralization efforts. The higher the ratio, the more sustainable the SNG structure, on the converse, the lower the ratio, the more unsustainable the SNG structures will be. The challenge is the need to determine the minimum level of effective OSR to budgetary funding. This is achieved by examining the levels of intergovernmental transfers of a specific country, evaluate the economic impact of the transfers over specific periods and then projecting the levels of transfers over a specified period.

The study examined the OSR and intergovernmental transfers and proposed that within a ten–year period, SNGs should move up the scale in terms of the effective OSR to budgetary funding. The study opines that if all the 47 counties would attain an effective OSR to budgetary funding of over 5 per cent, there would be a significant gain in the achievement of the devolution goals. Since sustainability of the devolution (SNG) structures is dependent on the local revenues, counties with a larger ratio of effective OSR to budgetary funding would sustain devolution in the long run, while those with lower effective OSR to budgetary funding would face challenges in sustaining devolution.

The data in Table 2 in the Appendix shows the effective own-source revenues to budgetary funding of the SNGs in Kenya. The figures illustrate the capacities of the SNGs in Kenya to support financial decentralization through their own-source revenues.

The first observation is that Nairobi City County is the county with the largest own-source revenue that are currently over USD 100,000,000 but has the potential to collect more revenue. The second cluster which comprises the counties of Mombasa, Narok, Kiambu, Nakuru, Machakos can collect between USD 10 Million to USD 25 million, while a considerable few are able to collect between USD 5 Million and USD 10 million (Uasin Gishu, Kisumu, Nyeri). Seven counties can collect between USD 4 million and USD 5 Million (Kajiado, Laikipia, Murang'a, Bungoma, Kilifi, Meru and Kakamega counties). The rest of the 27 counties collect below USD 5 million. Over the past six years, the trends in revenue collection show that Kakamega, Kajiado, Kisumu and Nyeri counties continue to improve their revenue collection.

The median figure for the revenue collected is about USD 2 million to USD 5 million with a mean of about USD 7 million. The big challenge is in the revenue planning and forecasting and as seen from the table, Nairobi City County has the largest revenue capacity and its effective OSR to budget ratio averages about 37.48 per cent, with Mombasa (23.27%) and Narok (21.73%) following closely. The other counties with significant local revenues are Kiambu (16.77%), Nakuru (14.54%), Machakos (12.83%) and Uasin Gishu (10.12%). Their effective OSR to budgetary funding is between 10% and 17% and imply that these counties can fare better in terms of devolution if they can optimize their potential revenue bases.

Nairobi City, Mombasa, Nakuru counties can generate most of the revenues from business licenses, property tax and user fees which are attributable to the concentration of businesses and population in these urban areas. Kajiado, Kiambu and Machakos Counties are at the periphery of the metropolitan system of Nairobi City County and thus can exploit their proximity to gain from the spill overs of the metropolis. Narok on the other hand is a rural county but can generate most of its revenues from the exploitation of natural resources (wildlife parks and conservancies).

The next set of counties with effective OSR to the budget ratio of between 5% to 10% include; Kajiado, Kisumu, Nyeri, Laikipia, Kericho, Murang'a, Embu, Bungoma, Kirinyaga, Baringo, Kilifi and Nyandarua counties seem to lack consistent and optimal revenue bases and thus there is a fluctuation in their revenue collection. Kajiado County is in proximity to Nairobi City, Baringo County is closer to Nakuru while Kilifi County borders Mombasa County and thus they can draw more revenues by exploiting their closeness to their wealthier counterparts. Except for Kisumu being an urban environment, the counties of Nyeri, Laikipia, Kericho, Murang'a, Embu, Bungoma, Kirinyaga and Nyandarua have more rural populations than the urban population and therefore rely more on agricultural activities hence lower local revenue potential and is symptomatic of the rural economies.

Of the remaining counties, Kakamega and Meru have higher local revenue potential and therefore higher effective OSR to budgetary funding ratio but both have less than 5% effective OSR to budgetary ratio. This is evidenced by the revenue potential of Kakamega County which breached USD 10 million in the2019/2020 financial year because of the establishment of a revenue collection agency (Kakamega County Revenue Authority) while Mandera managed to increase its revenue due to the digitization of the land register. More than half (28) counties have an effective OSR to budget funding of less than 5 per cent and this is indicative of the unsustainability of the SNG structures in Kenya because of their lower revenue generation capacities, therefore, these counties are largely reliant on the fiscal transfers from the national governments.

Indications from the Commission on Revenue Allocation (CRA) are that all counties are raising less than 40 per cent of their estimated OSR potential with the exception of Narok, Samburu, Isiolo, Laikipia and Baringo counties which achieved an effective OSR of 40% due to the user fees derived from game parks (CRA reports, 2020). Based on the fiscal transfers amounts of 90%, only six counties (Nairobi City, Mombasa, Narok, Kiambu, Nakuru, Machakos, Uasin Gishu) can be considered to be able to sustain devolution in the long run while, Kajiado, Kisumu, Nyeri, Laikipia, Kericho, Murang'a, Embu, Bungoma, Kirinyaga, Baringo, Kilifi and Nyandarua counties are closer to realizing the goals of devolution because the tax revenues are increasing in double figures as indicated in table 3 in the Appendix. These counties also have an effective OSR to budget funding of greater than 5 per cent. The remaining 27 counties are largely struggling to sustain the devolution mechanism.

In order to appreciate the nature of the local revenue decision in the SNGs in Kenya, the study interviewed directors who are mainly contacted by the county government during public participation exercises as envisioned by the Constitution of Kenya 2010. Their replies are presented as per thematic areas of policy framework governing local taxation, sustainability of the revenue streams and bases, adequacy of the locally generated revenue, challenges in the revenue collection exercises. In this instance, the respondents were denoted as follows; BAR represents Baringo County, VIH represents Vihiga County and KIA represents Kiambu County and the numerals refer to the specific individual connotation.

When respondents were queried on the need for a legislative and policy framework, one key informant, KIA001 said that 'the county government has taken necessary measures which include drawing up a legal framework that aids in improving the revenue collection. This action will require overarching support from the county assembly in passing the legislation that will guide the revenue collection framework'. Further, 'there is a need for stricter enforcement of the legislation to improve the amounts of revenues that have to be collected'. BAR003 said that 'strengthening county enforcement units and establishing county courts and attorney's office should increase compliance of the public towards the payment of levies and taxes'.

The county governments draw their legislative power for generating and collecting revenue from the Public Finance Management Act (PFMA) which enables them to draw up annual budgets for the county. KIA003 said that 'every year, we are tasked with drawing up of the Finance Act that provides the basis through which we set up charges. Just like the Finance Act of the national government, it may also be used to amend existing acts that offer the basis for charging levies and fees'. The key informants are mainly tasked with spearheading the drafting of the Finance Bill which is then sent to the county assembly for approval. KIA002 affirmed that 'I am tasked with ensuring that the Finance Bill is drafted and goes through all the stages in advance and within the time limits prescribed in the PFMA of 2012''.

Concerning the locally generated revenue decisions, the sustainability of the revenue bases and collection was the major concern of the heads of the different sections under finance and planning. Most of them asserted that the local revenue bases were not sustainable in the long – run and this would indicate that the counties are either falling short on revenue collections or the local revenue bases are limited. When the key informants were asked about the type of measures taken to increase local revenues, one key informant, KIA001said that 'the measures taken include, the coordination of the revenue collection function across all the sub-counties by strengthening the collection from all the revenue sources and seeking to tap into previously untapped revenue bases'.

Another respondent KIA002 said 'improving the legal framework and policy guiding revenue collection by streamlining the policies on revenue generation since the existing policy framework was inadequate'. On the same note, one key informant, BAR001 stated that 'revenue collection can be improved through sensitization and awareness campaigns on the importance of paying the local taxes. Many traders tend to evade paying the local levies and taxes as they considered it a burden to their businesses and thus, play 'cat and mouse with the county revenue officials. Therefore, by raising awareness on the importance of paying the local taxes (levies, permits and licences), the taxpayers would more likely comply and by extent increase the locally collected revenues'.

The next concern on local revenue decisions was the adequacy of the locally collected revenues in improving the levels of services offered by the counties. Virtually all the key informants believed that the revenue collected was insufficient to meet the needs of the counties and therefore much needs to be done for the county governments to generate sufficient own-source revenues. The major themes covering the improvement in revenue collection are clustered into; one, the legislative and policy framework governing revenue collection, two, infrastructure and systems supporting the revenue collection efforts and three, education and informational aspects to support the revenue collection initiatives.

Secondly, it seems like most counties lack modern infrastructure and information systems that support revenue collection efforts. As indicated by one key informant, KIA002, 'the county should introduce information management systems for collecting, managing, accounting and reporting the county revenues. Through automation of the revenue collection and management systems, the county will be able to identify and match the revenues streams with the entities/persons who are meant to pay and thus improving the ease of follow up. Further, there is a need for the establishment of alternative modes of paying for the services, which are in addition to the existing cash system. This includes the use of pay bill numbers, USSD platforms and direct deposits to the county government bank accounts which improve the ease of paying up for the taxes and levies for services offered by the county'. BAR003 said that 'sealing of loopholes for revenue leakages can be done through installation and integration of electronic payment for all the county revenue payments'.

Lastly, the educational and informational aspects of tax obligations should be considered as elicited from BAR002 who said that 'the public should be sensitized on the need for them to pay taxes, inform the county on the defaulting entities and show solidarity and patriotism in payment of taxes'. Evidently, the public seems to appreciate the devolved systems but are disconnected from the fiscal decentralization aspects of revenue generation'. However, the respondents highlighted several challenges to public participation and these includes; ignorance and low literacy levels, lack of interest, poor turnout, limited time frame and budgetary constraints. As observed by KIA001, 'Given the limited time frames and budget constraints, the extent to which public participation of the draft finance bill is limited. As a result, all stakeholders' views and proposals may not be captured and incorporated'. BAR001 said that 'there is lack of interest by the public in attending these forums. Further, conducting public participation forums are expensive in nature and therefore a few forums are held at the sub-county level and thus it doesn't reach all the residents'. BAR002 stated that 'the majority of the residents do not attend the public participation forums because most of them view such forums as a waste of time'.

5. Discussion

The analysis shows that revenue collection and its commensurate efforts by the SNGs in Kenya are below par. The notable counties whose revenue performance is satisfactory are Kiambu, Nakuru, Mombasa and Narok whose revenue collection efforts are commendable. A World Bank report (2014) indicated that there is a clear disconnect between revenue collection and policy objectives at the county level. The rationale and the design of the county taxes and levies are ambiguous and, in most instances, they are drawn from the defunct local authorities without adequate review and refinement. Further, the report suggested, the counties cannot rely on the legal transitional provisions of the Constitution of Kenya, 2010 and therefore counties need at least two legislations for revenue collection and management. The first legislation is the Finance Act which draws and sets up the revenue bases from which charges, levies and taxes can be collected and separate legislation which will provide for an adequate regulatory function and collection procedures.

Smith *et al.,* (2020) observed that inconsistencies in the classification and reporting of revenue streams make it difficult to report accurately the number of counties making use of each of these revenue streams or the value of revenues by source. Locally generated revenues by their nature are affected by economic, environmental, technological and demographic shifts and since local revenue generation is open to the external environment, the output of revenue systems and their administrative and political acceptability is exposed to rapid changes (Bartle*et al.,*2011). Furthermore, a key consideration in the creation of a sub-national government is its capacity to generate own-source revenue (Olusola & Siyanbola, 2014; Kithatu-Kiwekete, 2016).

Empirical studies observed that revenue decentralization increases medium-term economic growth and improved budget balance in sub-national units (Bodman *et al.,*2009). Mutua and Wamalwa (2017) indicated that Nairobi City County lacks a comprehensive policy and legislative framework to support its revenue administration, hence affecting revenue mobilization resulting in local revenue collection falling short of its targets. Odoyo *et al.,* (2013) in a study to determine the effects of the automated revenue collection system in Homabay County established a strong positive relationship between automation and effectiveness in OSR collection.

According to Mutua and Wamalwa (2017), Nairobi City County is not able to undertake revenue forecasting and monitoring because of the lack of a revenue database, therefore its revenue base is thin hence affecting the revenue collected. Fjeldstad & Heggstad, (2012) observed that the lack of capacity and coordination between the two governments limits SNG proposals to raise taxes, duplication and inconsistencies in local taxes. Lastly, improved revenue administration cannot compensate for bad revenue design. However, the exploitation of the property taxes in Africa is constrained by several reasons; underdeveloped property markets, lack of property registers and valuation rolls or outdated rolls and registers, lack of administrative capacity (Fjeldstad & Heggstad, 2012).

The potential for raising substantial own revenues in rural-based SNGs in Kenya is constrained by several challenges that include: inappropriate institutional arrangement, the absence of revenue policies and legislation, weak understanding of county revenue administration costs; human resources capacity and enforcement issues and low automation and integration of revenue administration (GoK, 2016). The urban-based SNGs have the potential for revenue enhancement, they are constrained by the following reasons: (1) poor administrative capacity for assessing and enforcing tax collection; (2) explicit and intentional tax evasion and resistance; (3) corruption, including embezzlement of tax revenues; (4) external pressure on the local finance department to provide optimistic projections; and (5) political pressure on the local tax administrators to relax on revenue collection, especially during election periods (Fjeldstad & Heggstad, 2012). In the US, the decline in federal aid and the devolution of responsibilities to lower levels of government put increased pressure on local governments to raise their revenues (Warner & Pratt, 2005).

6. Conclusion

Drawing from the findings, the study concludes that the local revenue decisions among the SNGs in Kenya are underperforming in terms of revenue collection and this, in turn, affect the sustainability of the devolution initiatives. These SNGs have lower effective OSR to budget funding and this may hinder the attainment of the devolution goals in Kenya.

7. Recommendation

Because of the shortfalls and underperformance in revenue collection, the county governments should set optimum and realizable revenue targets to improve the service delivery. Most of the time SNGs can collect less than two-thirds of the revenue projected as illustrated by the Machakos, Kilifi and Kisumu counties whose average revenue projections for the last six years are 57.15 per cent, 58.88 per cent and 51.37 respectively. The overestimation of the revenue targets is an affront to devolution as it makes the counties to be financially dependent on the fiscal transfers with the consequent negative effect on service delivery.

SNGs in Kenya should seek to improve their revenue management and collection efforts as this will improve their effective OSR to budget funding. The counties should integrate modern infrastructure and information systems that support revenue collection efforts while sensitizing the local population on the need to pay local taxes. Importantly, the county government act allows them four options for the collection and management of revenue: use of their departmental function; subcontracting the function, use of a government agency like the Kenya Revenue Authority and establishing an autonomous revenue collection agency. These counties should follow the steps taken by Kakamega County in establishing an autonomous revenue collection agency which managed to increase revenue collection by over 20% in 2019/2020. Nakuru county is in the process of setting up a revenue collection agency.

SNGs should seek to diversify revenue bases. Each SNG should reduce the reliance on few revenue sources and in turn seek multiple sources of revenue to support local governments. More sources of revenue have positive consequences for local governance; for example, additional funding sources allow local officials to spread the burden of taxation across different sectors of the local economy. Alternative sources of taxes also make possible more stability in cash management, more flexibility in budgetary planning, and perhaps offer some room to manoeuvre in regards to tax resistance.

8. Contributions, Limitations and Suggestions for Future Research

Based on the findings, conclusion and discussion the study contributes to the existing knowledge in public policy and management. First, most empirical studies have extensively examined the local revenue decision of SNG in developed countries. This indicates that there is a paucity of information on the local revenue decision of the subnational governments in sub-Saharan Africa.

The study was limited to the examination of secondary data from the constitutional offices and commissions in Kenya and other primary data sources and, therefore other studies may seek to examine the effect of local revenue decisions on the service performance of sub-national governments in Sub – Saharan African. Other scholars can also develop a model that is flexible to support forecasting of OSR.

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Appendix

	OSR	**Government Fiscal Years**							
County	**(Million USD)**	**2013/2014**	**2014/2015**	**2015/2016**	**2016/2017**	**2017/2018**	**2018/2019**	**2019/2020**	**Average***
		%	%	%	%	%	%	%	%
Nairobi City	>100	44.70	46.70	40.22	32.09	30.05	31.13	23.05	37.48
Mombasa	10 to 25	7.00	25.22	29.48	27.24	25.08	25.62	23.84	23.27
Narok	10 to 25	20.30	20.50	21.10	17.17	22.62	28.69	19.56	21.73
Kiambu	10 to 25	12.90	20.30	21.66	16.09	13.44	16.23	13.80	16.77
Nakuru	10 to 25	14.80	19.90	12.87	10.32	14.12	15.20	7.90	14.54
Machakos	10 to 25	14.60	14.40	9.55	11.22	16.81	10.41	12.44	12.83
Uasin Gishu	5.1 to 10	11.70	11.52	9.56	8.64	10.00	9.27	6.75	10.12
Kajiado	4.0 to 5	9.90	13.80	7.55	7.94	8.86	11.17	6.06	9.87
Kisumu	5.1 to 10	3.20	12.20	10.22	10.95	9.53	11.04	6.60	9.52
Nyeri	5.1 to 10	10.00	12.50	10.77	4.52	9.58	9.46	7.38	9.47
Laikipia	4.0 to 5	10.12	10.70	9.14	3.68	5.63	11.73	11.00	8.50
Kericho	2.0 to 3.9	10.00	8.60	7.80	7.80	6.35	5.66	5.49	7.70
Murang'a	4.0 to 5	8.20	9.42	8.94	6.22	5.09	7.96	6.04	7.64
Embu	2.0 to 3.9	5.90	8.00	6.92	6.22	7.10	9.22	7.42	7.23
Bungoma	4.0 to 5	6.60	8.50	6.28	6.42	5.51	5.10	2.80	6.40
Kirinyaga	2.0 to 3.9	6.40	7.60	3.44	6.12	6.03	7.34	6.10	6.16
Baringo	2.0 to 3.9	11.00	4.90	4.74	4.46	4.31	4.45	3.60	5.64
Kilifi	4.0 to 5	6.90	6.00	4.50	4.66	4.33	5.45	5.23	5.31
Nyandarua	2.0 to 3.9	3.95	5.41	4.98	5.33	5.24	5.22	4.76	5.02
Meru	4.0 to 5	6.10	2.84	6.63	5.44	4.12	4.40	3.42	4.92
Samburu	Below 1.9	6.90	4.94	3.74	4.18	5.30	4.22	3.07	4.88
Busia	2.0 to 3.9	9.90	5.00	4.60	3.41	2.35	3.38	2.42	4.77
Trans Nzoia	2.0 to 3.9	4.50	5.72	6.20	3.23	4.06	4.62	4.49	4.72
Bomet	2.0 to 3.9	9.70	4.60	4.24	4.31	2.90	2.22	2.70	4.66
Kakamega	4.0 to 5	3.30	4.90	4.10	3.57	3.42	6.20	7.66	4.25
Taita/Taveta	Below 1.9	4.60	5.21	4.17	1.60	3.67	5.55	5.28	4.13
Migori	2.0 to 3.9	1.30	6.11	4.66	3.81	2.67	4.31	3.12	3.81
Elgeyo/Marakwet	Below 1.9	8.10	3.40	3.25	2.07	2.04	2.50	2.38	3.56
Kitui	2.0 to 3.9	3.90	3.40	4.04	2.93	2.95	3.77	3.49	3.50

	OSR	Government Fiscal Years							
County	(Million USD)	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018	2018/2019	2019/2020	Average*
Makueni	2.0 to 3.9	3.17	3.10	2.24	3.03	3.30	4.82	4.20	3.28
Kwale	2.0 to 3.9	4.90	3.90	2.78	2.80	2.47	2.70	2.40	3.26
Nandi	2.0 to 3.9	3.10	3.50	4.90	1.35	2.87	3.43	3.24	3.19
Tharaka -Nithi	Below 1.9	3.40	2.92	3.65	2.22	2.75	4.21	5.25	3.19
Kisii	Below 1.9	3.80	3.30	3.36	2.78	2.35	2.75	2.57	3.06
Isiolo	Below 1.9	4.55	3.90	3.03	1.06	2.63	3.00	2.14	3.03
Vihiga	Below 1.9	3.60	2.43	3.20	1.92	2.44	2.42	2.16	2.67
Siaya	Below 1.9	2.60	2.42	2.35	2.43	2.01	2.22	2.00	2.34
Nyamira	Below 1.9	2.82	2.24	1.95	2.46	1.57	2.40	2.67	2.24
Homa Bay	Below 1.9	2.50	3.20	3.00	1.39	1.44	1.18	1.31	2.12
Lamu	Below 1.9	2.40	2.40	1.82	2.00	1.82	1.44	2.29	1.98
West Pokot	Below 1.9	1.60	2.50	2.05	1.57	1.59	1.84	1.43	1.86
Marsabit	Below 1.9	1.10	1.72	1.81	1.93	1.20	1.42	1.49	1.53
Garissa	Below 1.9	0.74	1.70	1.46	1.08	1.08	1.04	1.03	1.18
Turkana	Below 1.9	1.60	1.15	0.01	1.35	1.30	1.12	1.17	1.09
Wajir	Below 1.9	1.03	1.44	0.98	0.89	0.72	0.45	0.52	0.92
Tana River	Below 1.9	1.10	0.56	0.62	0.59	1.24	0.85	0.78	0.83
Mandera	Below 1.9	1.30	0.78	0.75	0.46	0.51	0.69	0.95	0.75
Aggregate		12.00	12.78	11.53	9.79	9.00	10.33	9.70	10.91

*Table 2: Effective OSR to Budgetary Funding (Actual OSR/Total Budget*100)*
Source: CRA, Controller of Budget (Various Reports)
**Financial Year 2019/2020 Has Not Been Considered in the Computation of the Average Due to the Effects of COVID-19 Pandemic*