FISCAL DECENTRALIZATION, TRANSPARENCY AND RISK ANALYSIS IN PUBLIC SECTOR

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Outline of presentation

- Definitions
- PFM Components
- Pillars of Fiscal Decentralization (FD)
- Revenue mobilization - Taxation
- Raising Additional Resources
- Allocative Efficiency
- Horizontal Allocation
- County Funds flow – Loans, Grants and donations
- Risk Analysis
- Q & A

Definitions

- **Fiscal Policy** - means by which a Government adjusts its spending levels and taxes to monitor and influence a nation's economy.

- **Fiscal decentralization (FD) -** means devolution of power and responsibilities of NG towards CG.

PFM Encompasses

- Collection of revenues
- Allocation of funds through the budgetary process
- Utilization of public revenues - spending
- Auditing of public spending and performance of state institutions – both internal and external

Pillars of FD

- Fiscal balance and fiscal autonomy - How much autonomy? Vertical and horizontal balance?
- Revenue assignment -Taxation powers among levels of Government
- Expenditure assignment – based on efficient performance
- Intergovernmental transfers

Revenue mobilization – Taxation

- Legal provisions on taxation
- Taxation challenges
- Way forward on taxation issues

Legal provision on Taxation

- Article 209(1) provides that only NG may impose-

  a) income tax; b) value-added tax; c) custom duties; d) other duties on import and export goods and; e) excise duty

- Article 209 (3) provides that a CG may impose-

  a) Property rates; b) Entertainment taxes and; c) any other tax that it is authorized to impose by an Act of Parliament

Legal provision on Taxation.....cont'd

- Article 209(4) provides that both NG and CG may impose user fees/charges
- Article 209 (5) stipulates that taxation and other revenue raising measures shall not be exercised in a way that prejudices national economic polices, economic activities across county boundaries or the national mobility of goods, services, capital and labour.

Legal provision on Taxation .....cont’d

- Section 161 of the PFM Act, 2012 affirms that any tax or revenue measure imposed shall conform to Article 209(5) and any other legislation and before imposing any tax or revenue measures, shall seek views of the CS and CRA

- Section 159 of PFMA,2012 gives direction on powers of the CECM-Finance to waive or vary tax , fees or charges.

The_Public_Finance_Management_Act_2012.pdf

Taxation Challenges

- **Double taxation:** there exists aspects of double taxation at both levels of government which is impacting business environment negatively and is also affecting revenue generating ability at both levels of government
- **Revenue raising measures not supported by law:** County Governments have in the past introduced some revenue raising measures in their finance bills that are not anchored in law

Taxation Challenges …Cont'd

Low revenue streams of County Governments: this maybe attributed to inefficiency in revenue collection and also untapped potential sources of revenue.

Inaccurate revenue projection by County Governments: that ultimately results in huge financing gaps when the ambitious revenue targets are not met.

Way forward on taxation issues

1. Prepare policy brief outlining taxes and user fees
2. Develop a framework for county revenue enhancement
3. Review methodologies on the inclusion of county fiscal capacity in determining intergovernmental transfers
4. Hold a conference to discuss County revenue mobilization and fiscal capacity.

Way forward on taxation issues...cont'd

5. Automation of revenue collection at the Counties
6. Compilation of official data on county fiscal capacity and the efficiency of revenue collection
7. Review and issue advisory on County Finance Bills under Sec 161 of the PFMA

Raising Additional Revenues

1. External and domestic borrowing

- Article 212 of the constitution allows County Governments to borrow with the approval of the County Assembly and guarantee of the National Government.

Raising Additional Revenues…cont'd

- A framework for County borrowing has been agreed and provided for in the PFM Regulations, 2015. The framework provides for among other things:

PFM Regulation 2015 Legal_Notice_No._34.pdf

a. The **sources/types of debt** which are available to County governments.

b. The **purposes** for which debt may be contracted

Raising Additional Revenues...cont'd

c. **Procedures of borrowing**, which includes the process of approval (including issuance of guarantee) and guarantee eligibility criteria

d. **Hard budget constraints**. The controls include setting limits to level of debt that may be contracted as well as debt service costs.

e. **Mechanisms to enforce compliance** with the borrowing framework as well as reporting requirements.

Raising Additional Revenues...cont'd

2. Increased Own Revenue collection by County government

Article 209 provides that a county government may impose:

a) Property rates

b) Entertainment taxes and;

c) Any other tax that it is authorized to impose by an Act of Parliament

d) User fees/charges

Raising Additional Revenues...cont'd

3. **Grants and donations in accordance with section 138 & 139 of PFMA**

Raising Additional Revenues...cont'd

Challenges:

a) No established fiscal capacity of all County Governments leading to over ambitious revenue projections
b) Inefficiency in revenue collection
c) untapped revenue sources of the County Governments
d) Issues of double taxation by both levels of Government

Allocation Efficiency

Article 201 of the constitution sets out the principles of public finance which also inform decisions on how to enhance '*allocative efficiency*'. – CAP 12

Allocation Efficiency....cont'd

- Article. 201(b) provides that the public finance system shall promote an equitable society and in particular-

  - Revenue raised nationally shall be shared equitably among national and county governments;
  - Expenditure shall promote the equitable development of the country, including by making special provision for marginalised groups and areas

Allocation Efficiency...cont'd

- Further Article 202(2) stipulates that County Governments may be given additional allocations from the National Government's share of the revenue either conditionally or unconditionally.
- Article 203(1) provides for the criteria to be taken into account in determining equitable shares of revenue for each level of Government

Horizontal Allocation is driven by:

- **Expenditure needs:** the cost of delivering a basket of goods of standard quality. These may vary according to supply/cost factors (e.g. transport costs, prices) or demand factors (e.g. demographic and economic conditions)
- **Fiscal Capacity:** the potential revenues that can be generated from the tax bases assigned to the region when a standard average level of effort is applied to those tax bases.
- **Fiscal Effort:** the amount of revenue collected by a Government, often shown as a percentage of fiscal capacity.

Horizontal CRA Sharing Formula

COMMISSION ON REVENUE ALLOCATION

PARAMETER WEIGHTS (%)

PARAMETER	CRA INITIAL RECOMMENDATION	COUNTIES' PROPOSAL	CRA FINAL RECOMMENDATION
POPULATION	60	47.6	45
EQUAL SHARE	20	21.6	25
POVERTY	12	18.0	20
LAND AREA	6	8.2	8
FISCAL RESPONSIBILITY	2	3.0	2
OTHERS	-	1.6	-
TOTAL	100	100	100

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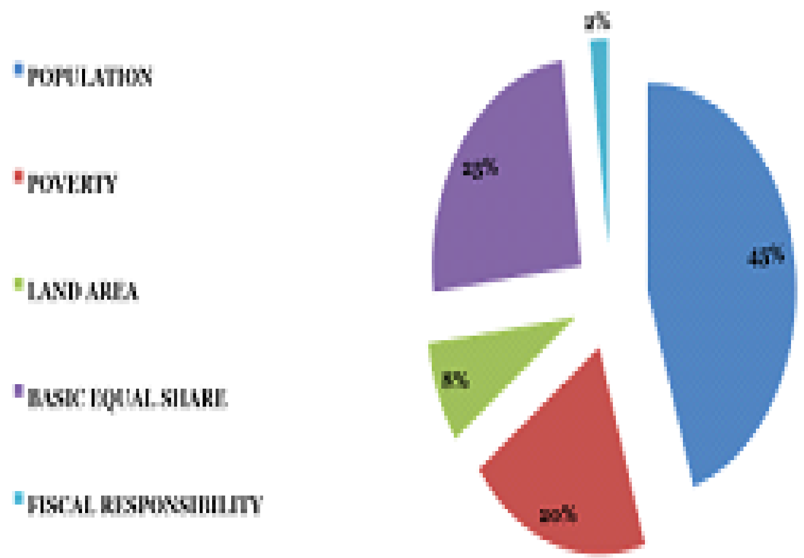
COMMISSION ON REVENUE ALLOCATION

PARAMETERS AND WEIGHTS IN THE RECOMMENDED HORIZONTAL FORMULA



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Fiscal Responsibility 2% (suspended in 2012/13, 2013/14, 2014/15)

Horizontal CRA Sharing Formula cont'd:

- **Equalisation Fund** which is targeted at marginalised Counties is to be shared on the basis of County Development Index (CDI) which emphasizes local expenditure needs.
- Parameters used under CDI include:

  - Poverty Gap(16%);
  - Infrastructure(28%);
  - Health(28%); and
  - Education(28%).

Emerging issues on Allocation Efficiency

- **Fiscal responsibility weight** included in the horizontal revenue sharing formula is given a low weight (2%);
- There are **no reliable measures of fiscal capacity/performance** as a result, application of **fiscal responsibility weight in the revenue sharing formula was suspended** in the initial years (2012/13, 2013/14, 2014/15).
- **County Development Index (CDI)** developed by the CRA for sharing resources from the Equalisation Fund makes no reference to fiscal capacity/performance of counties.

Emerging issues on Horizontal Allocation…cont'd

- Greater emphasis on allocating resources to Counties on the basis of local expenditure needs, cause the **focus to be on sharing what is collected at the Nationally**
- Thus, **greater demands on the NG** to collect adequate revenues to meet demands of national and CGs.
- Lesser accountability demands on the part of CGs for better fiscal performance, thus giving **incentives for lower local revenue collections** and **imprudent local spending**.

Emerging issues on Horizontal Allocation…cont'd

- Rivalry experienced between County executives and County Assemblies that has disrupted planning and budgeting process as well as execution and reporting on budgets

- CGs not complying with fiscal rule set under Section 107 of the PFM Act,2012 that limits development spending at 30% of CGs budgets.

- High wage bills

Some CGs have not operationalised the County Budget and Economic Forums (Established in PFMA) and hence there is no platform for public participation that should inform the selection

Emerging issues on Horizontal Allocation...cont'd

- Some CGs have not operationalised the County Budget and Economic Forums (Established in PFMA) and hence there is no platform for public participation that should inform the selection of County priority areas in budgeting as envisaged in the constitution.
- Delayed approval of County Allocation of Revenue Bill and unrealistic revenue projection creates uncertainty in county budgets often necessitating adjustments.

Emerging issues on Horizontal Allocation...cont'd

- CGs to operationalize County Budget and Economic Forums (Established in PFMA)
- Introduction of performance based grants to incentivise better financial management by CGs and use measures of fiscal capacity/performance in the determination of horizontal allocation of revenue.
- Timely passage of the CARA
- Deepen engagement at Inter-governmental forums through IGTRC
- Build capacity of CGs on PFM

County Funds Flows – Loans, Grants and/or donations

1. **Grants and donations**: A grant from a development partner can be disbursed directly to the County Revenue Fund (CRF) of a CG but the receiving CG entity must inform the CECM-F and CS/NT of such a receipt (Section 138[4] of PFMA): .
2. **Loans** can be disbursed directly to CG's CRF, provided a NG guarantee has been obtained and the county assembly has approved the borrowing.
3. **Loans and grants** can also be disbursed to Consolidated Fund of the NG (financing agreement is between NG and DP) and then transferred to CGs' CRF as conditional/unconditional grant.
4. If proceeds of a **loan or grant** from a development partner is to be disbursed to another fund of the CG other than the CRF, such an arrangement must be authorized by an Act of Parliament (Article 207[1]). It is preferable that such an arrangement be ratified by the relevant CG.

Risk Analysis in Public Sector

- **Risk, risk analysis**, **risk assessment** and **risk management** are all frequently used expressions in both the business and the public sector today.
- **Risk analysis**, which points attention to the riskiest areas, processes, activities and institutions.

Risk Analysis in Public Sector......cont'd

Examples of risk analysis in public Sector include;

- **Information security risks -** In terms of protecting information stored and processed in central and local government bodies' electronic information systems
- **Risks related to integrity -** the legal regulation defines integrity risk as the possibility of a public administration body's integrity being harmed, and corruption risk as the possibility of granting or acquiring undue advantage

Risk Analysis in Public Sector......cont'd

- **Budget deficits –** not able to mobilize adequate revenue equivalent to expenditures
- **Other nature-related risks** affecting agricultural production
- Others?

Way Forward?

Questions?