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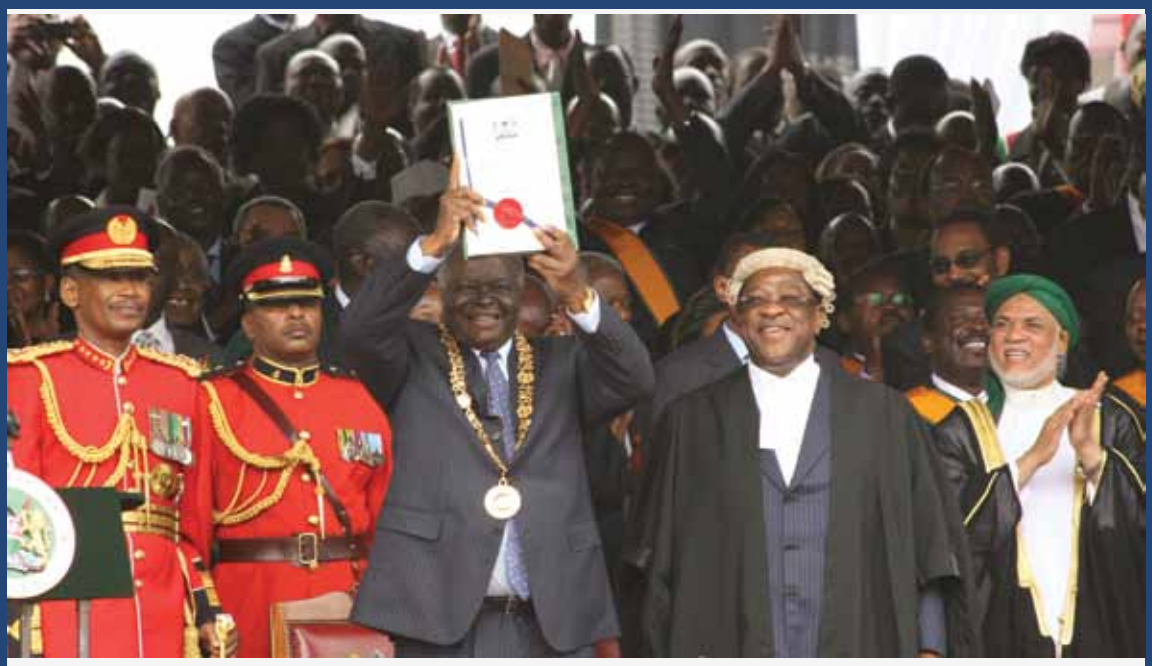

# DEVOLUTION WITHOUT DISRUPTION – PATHWAYS TO A SUCCESSFUL NEW KENYA

## EXECUTIVE SUMMARY

*June 2012*

Australian AID

THE WORLD BANK
*Kenya Fiscal Decentralization Knowledge Programme*

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1. **Kenya's new Constitution marks a critical juncture in the nation's history.** It is widely perceived, by Kenyans from all walks of life, as a new beginning. Indeed, many feel that post-Independence Kenya has been characterized by centralization of political and economic power in the hands of a few, resulting in an uneven and unfair distribution of resources and corresponding access to social services; the opposite of an inclusive state. Born of the political opportunity created by the 2008 post-election violence, the Constitution finally adopted, after almost a decade of unsuccessful reform attempts, presages far-reaching changes. Its vision encompasses a dramatic transformation of the Kenyan state through new accountable and transparent institutions, inclusive approaches to government and a firm focus on equitable service delivery for all Kenyans through the newly established county governments.

2. **Devolution is at the heart of the new Constitution and a key vehicle for addressing spatial inequities.** A more decentralized government makes eminent sense, given Kenya's diversity and experience with political use of central power. Decentralization has been increasingly seen and adopted worldwide as a guarantee against discretionary use of power by central elites as well as a way to enhance the efficiency of social service provision, by allowing for a closer match between public policies and the desires and needs of local constituencies. Kenya's Constitution entrenches devolved government by guaranteeing a minimum unconditional transfer to countyies under the new dispensation.

3. **From a social and institutional perspective, Kenya's devolution makes a lot of sense.** This is a very diverse country with ten major and more than thirty minor ethnic groups. Needs are very different between the arid and semi-arid North and the highlands, between the rural Northern Rift and the urban centers of Mombasa, Nairobi, and Kisumu, and between the coast and western Kenya. Kenya's fourty seven counties will soon have an average population of one million people. This means they will be relatively homogenous, but not big enough to become strong regional blocks. Counties will be better placed than the national government to deliver social services because they have specific challenges and the local knowledge to address them. For instance in the case of health, lagging counties still need to catch-up in providing basic health services while the leading urban counties will be faced with new types of diseases (mostly non-communicable such as diabetes and cancer). With these stark differences, it makes little sense to provide the same mix of services across the country. And even if there are no dramatic improvements in service delivery, people prefer to make decisions themselves rather than following directions imposed by a central government. With a constitutional guarantee of unconditional transfers from the center, Kenya's counties will have the means and the autonomy to begin to address local needs, and their citizens will be able to hold them accountable for their performance.

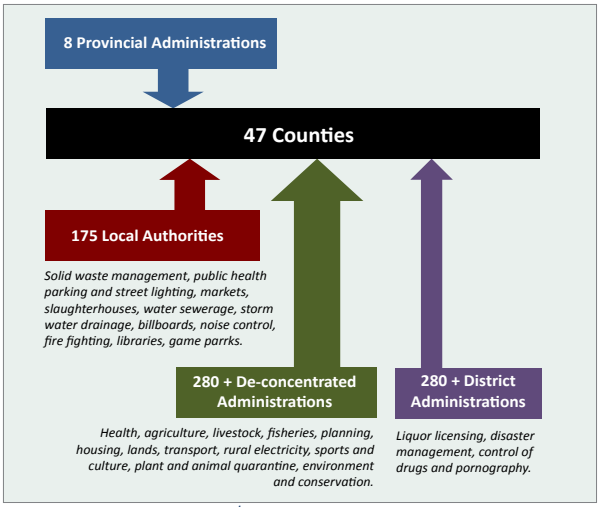
4. **But Kenya's devolution is incredibly ambitious, and therefore commensurately risky.** It is a massive undertaking from a logistical point of view. In one go, on day one after the next general election, Kenya's system of government will be profoundly remodeled and the transition will inevitably encounter teething problems. Moreover, there are diverging views on how far and how fast it should go. Since Independence, Kenya's leaders have held diverging views about devolution. From one perspective, it offers the potential to redress perceived ethnic and political bias by giving local communities far greater control over resources and decisions about service delivery. However, from another perspective, devolution could potentially undermine national unity by encouraging fragmentation of the state along partisan lines or by 'decentralizing corruption', leaving citizens worse off if local elites are able to capture resources to the detriment of

the majority or if newly established counties fail to put in place the systems needed for effective and transparent service delivery.

5. **In the short run, managing the transition to the new system and people's expectations will be critical.** From a political standpoint, the devolution process has generated tremendous hope in the population and sometimes unrealistic expectations of how quickly things can and will change in the ordinary lives of Kenyans. From a logistical, technocratic standpoint, this is a highly complex undertaking, which Kenya has embarked upon in a context of political division. Going forward, the challenge will be to manage expectations of how much and how quickly devolution can deliver and to make sure that the transition to devolved government causes as little as possible disruption (and litigation) to the delivery of services that are essential for the welfare of the people of Kenya as well as for the health of its growing economy. Equal distribution of wealth across Kenya may be desirable politically but it is impossible economically. With a few exceptions, counties will be too small to generate the economies of scale, which companies need to be successful. Firms will only come to Kenya and expand if they can operate in the whole country and beyond. Moreover, no matter what remote counties do to attract them, most will chose to locate their operations in Kenya's big cities to benefit from the markets around them.

6. **The next two years will be critical because the foundations of the devolution architecture will be laid then.** Anyone who has ever built a house knows that it is impossible to alter the foundations once the building is finished, at least not without knocking it down and starting again. Kenyans sense that a momentous restructuring of their country is underway. There are high expectations and much anxiety. Kenya's devolution is not only a critical milestone in this country's history; it is also remarkable in global terms. Many countries –both rich and poor– have transferred power and resources to lower levels of government. Few have done so to entirely new sub-national units, which they have had to establish from scratch. Kenya will undergo a dual transition: a transfer of power and resources from the center to the sub-national level and a simultaneous reorganization of local government, with the consolidation of existing local structures into forty-seven newly-created county governments (Figure 1).

**Figure 1: Kenya's devolution presents massive challenges for political and administrative restructuring**




*Source: World Bank KEU, 5th edition.*

7. **The devolution train has already left the station: the challenge is to make sure it arrives at destination, safely and on time.** The politics of devolution explain the high intensity of hopes and expectations that have been pinned to it. It also means there are high risks if they are disappointed. There are great opportunities and enormous challenges waiting for Kenya, in a critical election year, which will determine the fate of the country, politically and economically for years to come. This report takes a snapshot look at the critical issues facing Kenya's policy makers today. It does not argue for or against devolution (a decision that belongs solely to Kenyans), but presents suggestions and recommendations on how best to navigate the tough choices ahead. It's main focus in on helping Kenya manage a delicate transition.

## Financing county needs: Transferring the right amount with an appropriate mix of instruments

8. **Decentralizing power requires transferring resources from the center to the local level: but how much, how fast and to whom is not obvious.** Resourcing Kenya's future counties involves a two-step process to "fairly" divide national resources. First, it requires determining the optimal aggregate "vertical" split between the national and county governments, in such a way that each is adequately resourced to carry out its mandated functions. Second, total county resources must be split across the forty-seven counties in a way that recognizes their different inherited needs and also addresses historical inequalities between them. This will be particularly difficult in an overall context of fiscal stress with limited scope to increase public funding.

9. **A golden rule of decentralization is "funding follows function", which is why the function assignment process is so important.** While Kenya's Constitution provides high-level guidance on the respective responsibilities of the national and the county governments, much more granular work is needed to provide a basis for sharing resources. A Transition Authority (TA) will be set up with the mandate to carry out a detailed assignment of functions, but there are two major constraints. First, the TA may simply take too long to get established, with the result that detailed function assignments will not be determined in time adequately to inform the budget process. Second, the asymmetric transfer of functions currently envisaged (with each county applying to the TA for each function to be devolved to it on an *ad hoc* basis) may be overly complex to manage and may also lack transparency, potentially undermining accountability at the local level. In this report, we argue that the process of function assignment should start now, possibly under the aegis of the Commission on Revenue Allocation (CRA), until the TA is fully operational. We also propose three optional frameworks for organizing a phased "'bulk" transfer of functions to counties in a way that minimizes *ad hoc* arrangements and maximizes efficiency and transparency (Table 1 shows one proposed option).

10. **By prescribing a minimum transfer to counties, Kenya's Constitution has not pre-empted the use for aggregate costing of county needs.** This is essentially for two reasons: first, the overall cost of functions to be devolved is likely to be significantly in excess of the constitutionally guaranteed share of 15.5 percent of national

**Table 1: A Phased Approach to Transferring Functions to Counties**

| | Timing of transfer | Readiness criteria | Types of functions | Examples |
|---|---|---|---|---|
| **Phase 1** | Immediately after county formation | • None / automatic | Functions not currently being performed by any national agency | • Local government functions<br>• County assemblies<br>• Establishment of basic systems |
| **Phase 2** | Transfer when basic county systems are operational | • Basic county HR and PFM systems in place<br>• Sectoral plans in place | Basic operation of service delivery programs | • Operation of rural and district health facilities, ambulance services etc. |
| **Phase 3** | Transfer only when specific readiness criteria are met | • Specific system or capacity requirements | More complex programs and supply chain management | • Purchasing and distribution of pharmaceuticals (only after stock control and ordering system in place) |

*Source: World Bank.*

revenue; and second, functions will be phased in over time during the transition period and therefore counties may not initially receive the full amount guaranteed to them. Working out a ''fair split'' of available resources in a context of limited fiscal space as well as the most appropriate mix of grant instruments will require detailed evidence of how much counties will need and when.

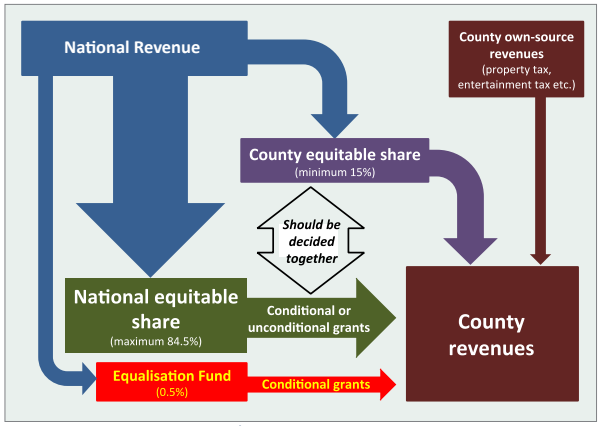
11. **In one "moderate" scenario, this report costed aggregate county needs at Ksh170 billion, just to maintain services at their existing levels.** This is above the amount appropriated in the 2012 Budget Policy Statement (Ksh160 billion) but below the CRA estimate (Ksh200 billion). Moreover, the figure needs to be understood with all its limitations: it is based on a number of assumptions which ultimately the TA / Parliament will need to determine, (such as the fate of CDF, LATF etc); it only costs existing services (and does not provide for additional equalization, for running the new administrations or financing urban services); and it does not account for the transfer of functions over time or the possibility that seconded staff may remain on the national government's payroll.

12. **Because total county financing needs will be in excess of 15%, Kenya's policy makers should consider together the full set of options for resourcing counties.** Figure 2 shows the various ways in which county governments will be resourced, including the equitable share but also own revenues, the Equalization Fund and additional transfers from the national government (conditional or not).

13. **It would be misguided to seek to meet all of county needs through the equitable share.** The equitable share transfer, because it is unconditional, is critical in giving future counties substantial autonomy, but it also imposes significant constraints. Because the equal share transfer is untied and formula based, the central government should consider using additional conditional instruments to (i) secure funding for critical programs at the local level, (ii) reward performance, and/or (iii) correct for imbalances created by applying a crude formula to highly-diverse counties. Given these constraints and additional objectives, there may be a case for limiting the equitable share transfer at –or close to- the constitutional minimum of 15%.

14. **Own-revenues will be critical for resourcing county governments and also –critically– for fostering accountability at the local level.** Yet the Constitution only grants limited revenue-raising powers to counties (broadly those currently enjoyed by Local Authorities), which will remain highly transfer-dependent unless new revenue-raising powers can be granted to them (Figure 3).

**Figure 2: Flows of revenues from different sources for county governments**




*Source: World Bank KEU, 5th edition.*

15. **To maximize the own-revenue potential of Kenya's counties, existing sources should be reformed and new ones found.** The collection of property taxes should be strengthened (as Kenya under-collects by a wide margin by international standards) by updating revenue base information, updating rates and minimizing applicable exclusions. There is also scope to revisit the Single Business Permit. However, increasing county fiscal autonomy would almost certainly require creating additional revenue sources such as piggybacking county taxes on existing national taxes. In addition, it is likely that discussions over the sharing of taxation related to national resources will be brought to the fore.

16. **In the short term, the priority is to ensure that county governments are legally entitled to collect revenues as they come into existence.** This is because the constitutional base for county

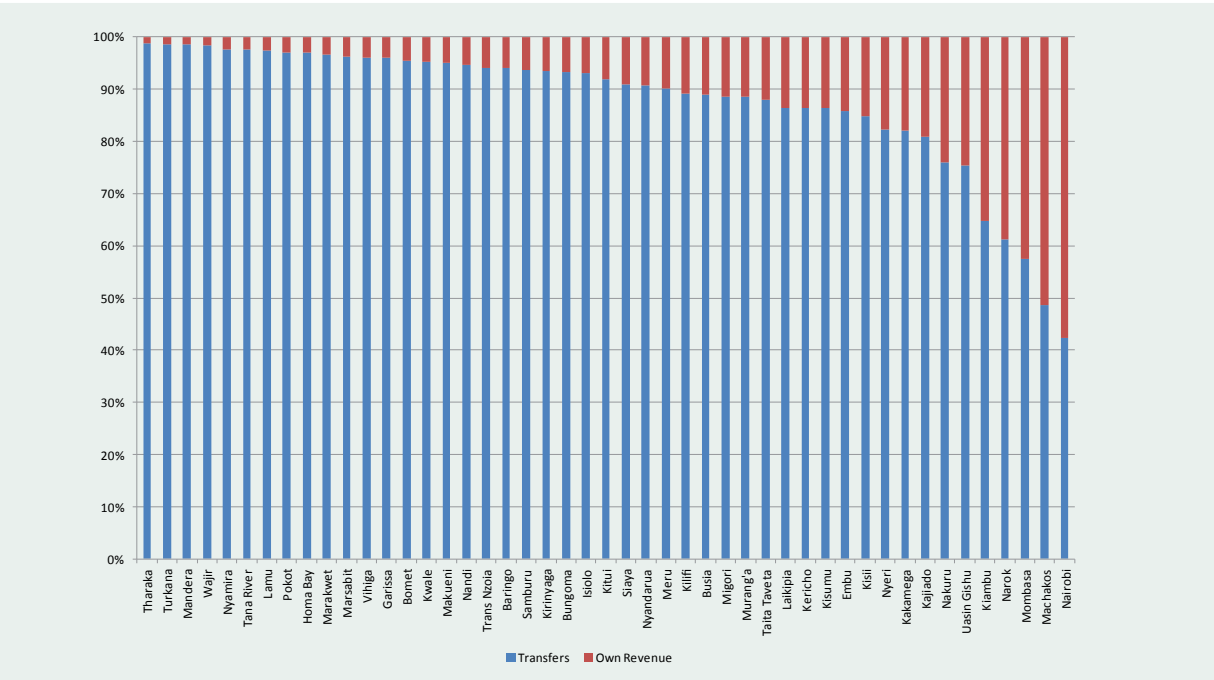
tax collection has not been converted into legal instruments to enable counties to collect revenues on day one. In order to address the current legal vacuum, two instruments could be adopted, one to provide for the interim continuation of LAs' structures after the elections and another to allow counties to collect revenues through LAs' existing staff and systems. Over time a decision will be needed on tax administration at the county level, possibly involving KRA acting as an agent of counties.

17. **There are powerful reasons to consider conditional grants to county governments, although to date the debate has focused exclusively on the equitable share.** Conditional funding will be important in at least four ways to support devolution: to ensure that national priorities continue to be supported under devolution, to address region-specific needs (including marginalization), to mitigate possible shortcomings of the equitable share transfer formula in specific counties and to support a sub-national performance management system.

18. **In the short term, Kenya's policy makers will need to decide on the fate of three earmarked programs, which -if maintained- would constitute conditional grants.** Alone, these three programs –the Road Maintenance Levy Fund (RMLF), the Constituencies' Development Fund (CDF) and the Local Authorities Transfer Fund (LATF)- accounted for Ksh38 billion or 8% of 2010/11 national revenues. Maintaining them, at their existing level, would greatly affect the space available for unconditional funding through the equitable share. Conversely, shifting the responsibility over to counties (and channeling the funding unconditionally) would require a substantial increase above the minimum 15 percent.

19. **A system of capital grants may be required to protect development spending under the new dispensation.** Worldwide, sub-national governments tend to spend a high proportion of their budgets on wages and salaries and relatively little on investment. In order to ensure minimum standards of service delivery throughout Kenya and promote catching up in capital-poor areas the

**Figure 3: Vertical imbalance: applying the CRA formula, only two counties would receive less than half of their resources from transfers**




*Source: World Bank calculations.*

national government may consider implementing a capital grants scheme based on a transparent formula.

20. **Finally, conditional grants could provide the backbone of a county performance monitoring system.** As counties come into existence, there is much uncertainty as to how well and how fast they will be able to perform their missions. As part of a sub-national performance monitoring system, grants can (i) help spur healthy competition between counties, and provide the incentives for county governments to (ii) regularly monitor and report on their performance and (iii) address key service delivery bottlenecks.

**>> Key Recommendations on financing county needs**

- The process of clarifying function assignments should begin now. The CRA could take the lead until the Transition Authority is operational
- There should be a roadmap to streamline and simplify the initial asymmetric transfer of functions, possibly through a three-phase approach with functions transferred in ''lumps''
- Costing devolved functions should begin with historical costing, but a more detailed and thorough costing methodology will eventually need to take into account gaps peculiar to the Kenyan budget and any equalization objectives, which would require significant redistribution or additional budget
- Resourcing counties should consider all possible sources of revenue available to them and the full range of transfer instruments
- The tradeoff between unconditional and conditional funding deserves particular attention as the scope for one will constrain the use of the other. As a matter of urgency, the GoK should decide the fate of existing earmarked programs
- In the immediate term, a decision should be made on financing a number of key ''big ticket items'' which will greatly influence the estimation of total county needs, including provincial hospitals, CDF, construction of new roads and the remuneration of seconded public servants
- Legal instruments ought to be put in place to allow counties to continue collecting revenues and charges currently collected by local authorities until taxation laws can be passed by county assemblies
- A new interim national law to govern county own-revenues could provide an opportunity to revise existing taxes, particularly property rates and SBPs
- Additional local fiscal revenues should be sought among a range of possible options, including PIT surcharges, taxes on the use of motor vehicles, payroll taxes, etc.
- Particular consideration should be given to the sharing of taxation related to natural resources as their potential may increase vastly in years to come and this issue often constitutes a source of conflict
- Given the radical and experimental nature of Kenya's devolution, it may make sense to maximize the scope for conditional funding (and minimize that of unconditional resourcing) if only to ensure that essential programs will remain funded
- Conditional grants programs could be considered specifically for
  - Capital projects, possibly folding together the current RMLF and CDF programs
  - Supporting urban service delivery
  - Providing temporary stop-gap support to counties at risk of experiencing severe fiscal shortfalls during the transition
  - Fostering inter-county performance and promoting a system of performance monitoring at the local level.

## Promoting greater equity while safeguarding service delivery

21. **Promoting greater equity in the allocation of spending and services is at the heart of Kenya's new Constitution.** Moreover, expectations are high that devolution will rapidly bring about spatial equalization, after years of unequal development across Kenya. And yet, seeking to equalize too much too quickly would be a risky strategy. The goal of equalization will need to be pursued in a tight fiscal environment –limiting the scope to increase spending- and without undermining existing service delivery, which is unequally distributed to start with. This has two major implications: first, existing imbalances may only be tackled over time; and second, equalization should target the people who will benefit from services, rather than trying to achieve equalization across geographic locations.

22. **The CRA-proposed formula for allocating the equitable share is highly redistributive.** While the formula places heavy emphasis on county population (60%), this is logical since population is the main driver of service needs. Yet taken together, all of the other components in the formula (amounting to 40%) favor counties that have been historically underserved. (Table 2).

23. **The simulated county transfers, using this formula, display a strong equalization bias.** This is not obvious at first because, on an absolute basis, the better-off counties (such as Nairobi and Kakamega) will be receiving the lion's share of the funds. However, the picture is almost entirely reversed once one looks at allocations on a per capita basis, with Isiolo, Lamu, Marsabit and Tana River coming out the big winners. In other words, once population is "netted out" the poorer and smaller counties receive disproportionately big allocations. (Figure 4).

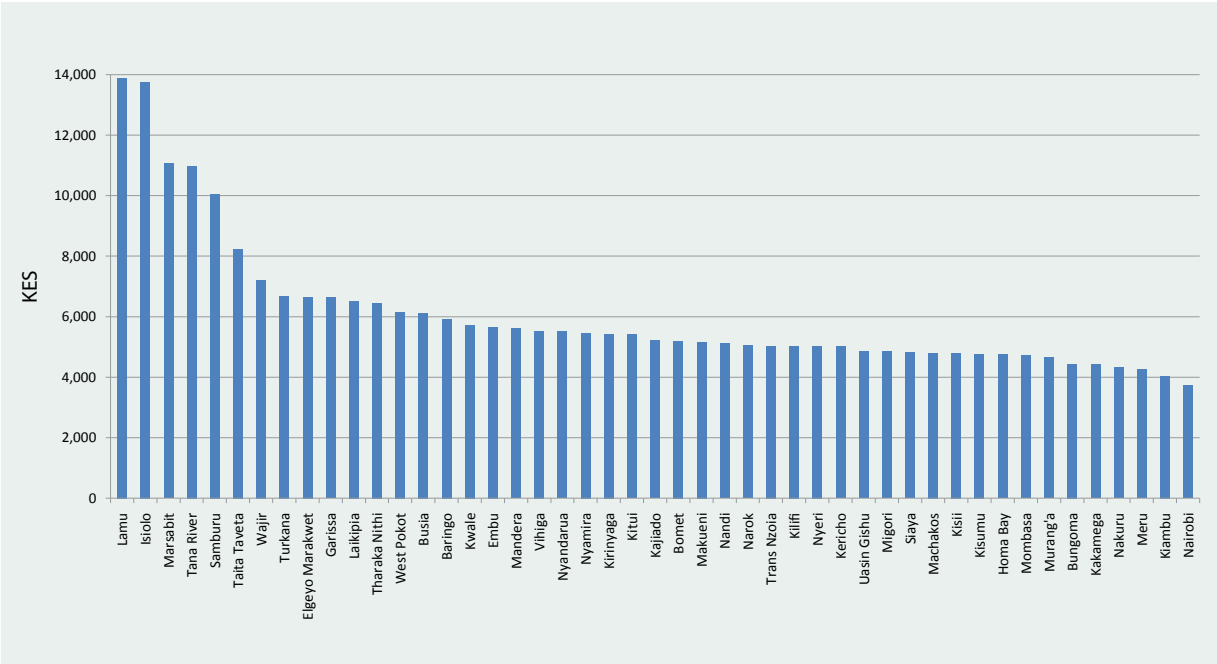
24. **Because it promotes substantial re-distribution of resources across counties, the CRA formula creates risks for both "winners" and "losers" on day one.** There are two twin challenges. Those areas that were historically privileged will inherit service delivery obligations that will require substantial funding (by definition above and beyond what a strictly population-based formula would provide). There, the challenge will be to rapidly streamline service delivery without interrupting key services or making inefficient reallocations. By contrast, those counties that were hitherto underserved

**Table 2: Components' Source, Weights and Objectives in the CRA Consultation Formula**

| Components | Population | Poverty | Equal Share | Land Area | Fiscal Discipline |
|---|---|---|---|---|---|
| Year / Source | Census (2009) | KIHBS (2005/06) | | | TBD (allocated equally initially) |
| Weight | 60% | 12% | 20% | 6% | 2% |
| Objective | Resource counties to deliver services equally on a per capita basis | Promote redistribution in favour of historically lagging areas | Provide each county with resources to cover the fixed costs of running county administrations irrespective of population or size | Factor in the higher cost of delivering services in remote, sparsely populated areas | Provide incentives for prudent fiscal management |

*Source: World Bank based on CRA documentation.*

**Figure 4: Per capita equitable share allocations to counties (assuming 15% equitable share)**




*Source: World Bank calculations.*

will receive substantial extra cash (relative to their current service delivery obligations) and the challenge will be to manage these resources well and to scale-up service delivery with limited capacity. Unfortunately, alleviating one bottleneck (such as increasing the share of the equitable transfers) would only exacerbate the other.

25. **These likely imbalances call for three short-term actions to phase in equalization over time.** First, it is urgent to model inherited costs of service delivery at the county level. This would require compiling detailed geographically-disaggregated spending data on services to be devolved from which to estimate the future cost of service delivery at the county level. Second, with this information, the GoK may need to consider complementing the CRA-formula based equitable transfers with "hold-harmless" provisions that would be limited in time and specifically targeted to allow cash-strapped counties to maintain existing services at least at their current level. Third, a strategy is needed, to build capacity rapidly and systematically in lagging counties to develop adequate PFM, HR and service delivery capacity. Additionally, this may require only phasing-in the transfer of functions over time, following predefined capacity benchmarks.

26. **The Equalization Fund, provided for in the Constitution, will be too small to address deep spatial inequalities.** At 0.5 percent of national revenues (and even increased as per the current BPS) the Equalization Fund will represent a fraction of the resources currently channeled through the CDF. Moreover, if the Fund crowds out existing funding for lagging areas, such as programs currently under the Ministry for the Development of Kenya and other Arid Lands or the Ministry of Special Programs, its net impact could be nil or negative. Therefore, as a matter of urgency, policy makers should clarify the Fund's objectives and target it as much as possible to specific areas or communities and uses. Given its modest size it might be better used as 'seed money' to leverage additional resources into a bigger, more effective fund.

**>> Key Recommendations on financing county needs**

- *It may make sense to limit the equitable share transfer at –or close to- 15% during a transitional period, given the experimental nature of the CRA formula and lack of clear estimate of actual county needs and capacity*
- *Unmet needs at county level could be filled via other unconditional or conditional instruments*
- *In counties that have been historically over-serviced (relatively) the key would be to avoid service delivery interruptions by extending 'stop-gap' funding to be phased out overtime*
- *In counties that have been historically under-serviced and marginalized, it will be vital to build up the capacity to handle vastly increased funding efficiently and transparently*
- *A priority should be to clarify the object of the Equalization Fund and particularly*
  - *the definition of ''marginalized areas''*
  - *the scope of interventions which should be focused on alleviating key service bottlenecks*
- *It may not make sense to dedicate the Fund to financing infrastructure. Instead catalytic interventions could consist in addressing:*
  - *staff incentives problems in working in remote locations*
  - *capacity constraints in applying for capital funding (under a capital grants program) and for managing capital projects*

## Managing money efficiently and transparently for county development

27. **For counties to make the most of their resources sound PFM systems will need to be in place.** At county level, this may be particularly challenging as many PFM related functions will need to be established more or less from scratch. In turn this raises the question of the degree of oversight that the national government should be allowed to exert over counties - sufficient to lead capacity building and promote application of standards but limited enough to prevent abuse and excessive control.

28. **Kenya's new Constitution has provided the basis for a more coherent PFM legal framework but oversight remains contentious.** As well as replacing or consolidating a number of existing laws, the PFM Bill provides a framework for PFM in the new county governments as well as urban areas and cities: for the first time in Kenya there will be a single PFM legal framework for all levels of government. However, the Constitution leaves room for interpretation regarding the extent to which the national government has a role in "overseeing" county PFM.

29. **Budgeting for the transition will be difficult given the asymmetric transfer of functions.** The transition period –during which functions will be gradually transferred to counties- raises challenges for the annual budget process: the new counties may simply not have the capacity or the time to budget for 2013/14 and there is the additional question of how to budget for devolved functions temporarily executed at the national level. To limit the confusion that a fully asymmetric transfer of multiple devolved functions could cause in the budget process, the GoK could consider some 'bundling' of functions to simplify the functional transfer process into manageable "chunks" (Table 1).

30. **While the national government would continue to assume some devolved functions during the transition, allocations to counties could be clearly shown in the budget under ''county votes''.** While counties may not have responsibility initially for all devolved powers and functions, specific resource allocations will be made to counties on day one. During this transition period there could be county votes clearly set out in the national budget showing explicitly the total funding allocated to each county and specifying how much is to be spent directly by the county and how much will be spent on its behalf through national government systems. This may require a short amendment to the transitional provisions of the PFM Bill.

31. **The new Constitution greatly increases the power of the legislature in the budget process, creating risks of gridlock.** In particular, because the Division of Revenue Bill (DoRB) is not defined as a money bill (which must be passed or amended by the Assembly only on the recommendation of the relevant committee of the Assembly) there is a risk that delays in approval of the DoRB could derail the budget process at both national and county levels. One approach adopted elsewhere is a two-tiered budget process in Parliament, where the legislature at national and county levels bind themselves to a fiscal framework for the duration of the fiscal year prior to the consideration of the DoRA, CARA and budget estimates.

32. **Building-up the capacity to budget at county level will be a tall order.** Counties will be comprised of staff from Districts, who have very limited experience of preparing and managing budgets, and from former Local Authorities, who have only limited experience in budget management. Therefore, in anticipation of the

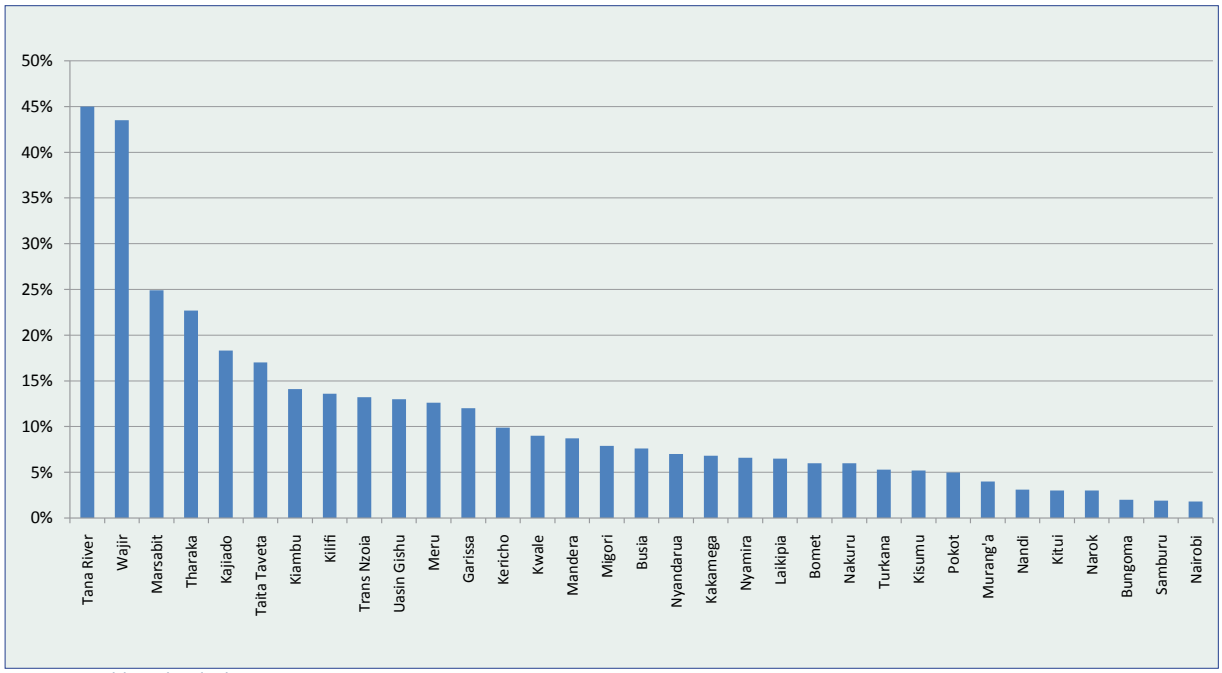
difficulty of establishing budgeting functions from scratch at county level, guidelines and associated templates should be developed to guide the formulation of county budgets. This would also provide an opportunity to integrate the planning and budgeting functions into a single process, to be overseen ideally by a single county institution. Lastly, it will also be essential to ensure that county budgets are prepared, executed and reported, using a single country-wide chart of accounts.

33. **Kenya's counties may not manage to spend the funds available to them, without determined capacity building and monitoring.** Experience among Kenya's local authorities suggests that this is an issue many counties –particularly those historically marginalized- may face (Figure 5). Specific capacity needs to be developed for resource allocation, cash management -in line with the principle of a treasury single account- and budgetary oversight through the Controller of Budget. The national government will also have a key role to play in setting standards and monitoring performance, for instance through league tables and rankings and a system of early warnings to identify service delivery problems in devolved functions. One way of promoting this would be through a ''county performance assessment tool''.

34. **PFM is only one dimension of promoting accountability at the local level – and there would be important payoffs from setting up accountability systems at the local level from the get-go.** Contrary to the common expectation that decentralization enhances accountability and efficiency in service delivery, experience suggests that the contrary often holds true. Devolution presents a particular challenge for service delivery by breaking apart existing more centralized accountability relationships and requiring new ones to be established. This is also an opportunity to start from a clean slate and Kenya has all the assets to be a leader in Africa with respect to transparency and local government accountability.

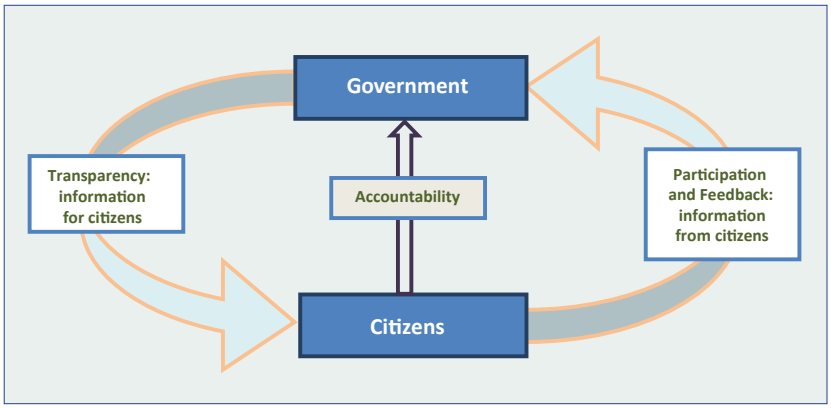
35. **Transparency, participation and accountability are clear requirements in the Constitution but laws alone are insufficient.** Instead a social accountability system must be developed with three core elements: (i) fiscal transparency, (ii) participation mechanisms and (iii) accountability mechanisms. (Figure 6).

**Figure 5: Counties where local authorities ran budget surpluses in 2008/09**




*Source: World Bank calculations.*

**Figure 6: Elements of Social Accountability Systems**




*Source: World Bank.*

36. **Kenya can draw on its extensive experience with devolved funds to reinforce both upward and downward accountability.** For instance the LATF system was largely successful in ensuring reporting by local authorities even though the information they produced is not usually made public. As for the CDF experience, it shows that there is an important role for civil society in auditing projects. Building on LASDAP, county governments could be required to involve citizens in the budget and planning process.

37. **For social accountability systems to function, supporting institutions need to be put in place.** Key elements include accurate and timely financial and performance information – and in turn this would require both capacity building and enforcement mechanisms (such as penalties for failure to produce accurate information). A second priority is to strengthen the relation between planning and the budget process, since public participation in planning will only be meaningful if the choices made are translated into spending. Lastly, county governors and administrators should have easy access to "social accountability toolkits" guiding them on the use of popular interventions such as participatory budgeting, scorecards, social audits and procurement oversight committees.

**>> Key Recommendations for promoting sound and transparent financial management in counties**

- *During the transition period, the budget could include "county votes" showing total county allocations even if a portion remains executed by the national government on behalf of counties*
- *A two-step budget process could be introduced with parliamentary votes at each stage to generate consensus around the fiscal framework and mitigate the risk of executive-legislative gridlock*
- *Building county PFM systems from scratch will require central support to capacity building, monitoring of county progress against clear benchmarks and standardized guidelines and templates developed nationally*
- *Public financial information (including results) should be made public in a way that allows citizens to assess the efficiency and effectiveness of national and county spending*
- *Citizens should be actively involved in planning and budgeting at local level and equipped with the tools to make significant contributions*
- *Accounting systems at county level should allow to track spending on individual projects and by service delivery unit*
- *Social accountability toolkits should be developed for the benefit of local administrators*

# Protecting the urban growth engine

38. **Unless corrective action is taken, Kenya's cities may well be the big losers of the devolution process.** This would be dramatic as Kenya's cities are growth engines for the entire country and the main source of own fiscal revenues for local administrations. Kenya is experiencing a demographic transition that will see increasing numbers moving to the cities seeking the opportunities that urban areas have to offer, and cities are also increasingly useful and meaningful to rural residents as well: they are the main source of local fiscal revenue and provide services and infrastructure that reach well beyond city boundaries.

39. **Kenya's devolution is unique in that it involves simultaneous decentralization of key services and resources from the national to county governments but also recentralization of urban management.** Existing arrangements will be profoundly affected in the new dispensation, as the current system of local authorities, with elected management and significant discretion over resources and functions, will be replaced by a new system that gives much more power to county executives. In the new dispensation, Kenya's cities will be managed by appointed boards, with far less power and autonomy than the local authorities they replace: most of their functions will be delegated by county governments and they will have no guaranteed funding.

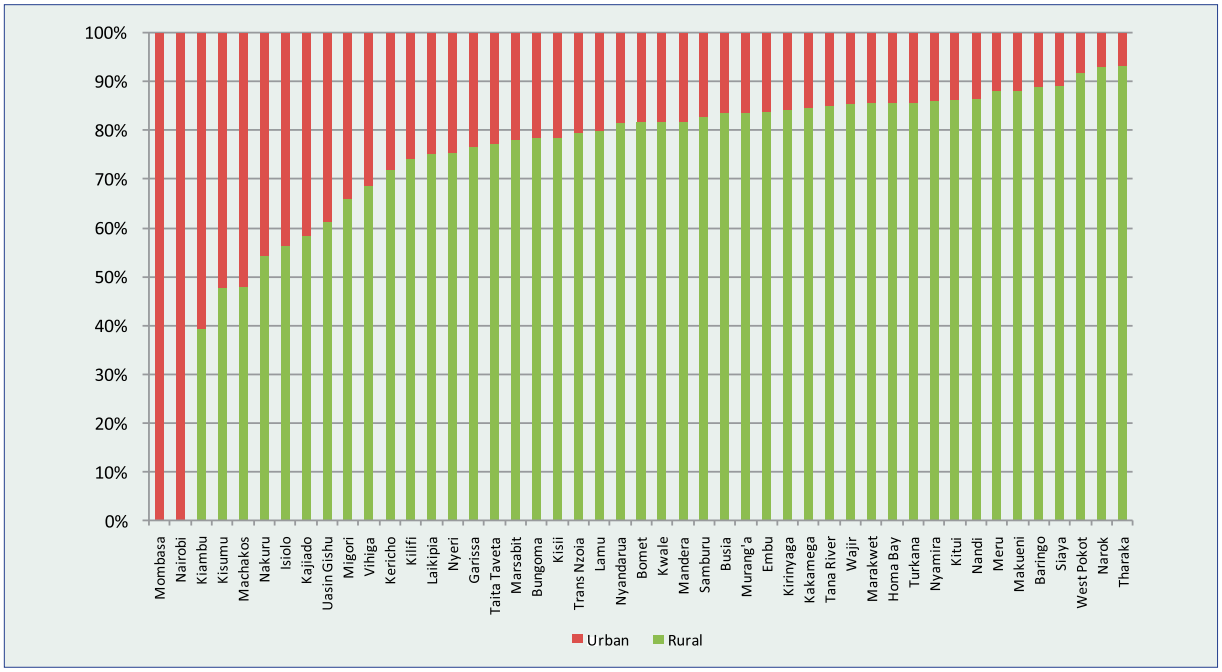
40. **Moreover, only three urban centers will have municipal or city boards.** The Urban Areas and Cities Act (UACA) sets the threshold for city status at 500,000 and for a municipality at 250,000 and only cities and municipalities are entitled to boards. Yet at present there are only five urban areas in Kenya with a population over 250,000 (Nairobi, Mombasa, Kisumu, Nakuru and Eldoret), two of which will effectively be county-cities and will be governed as county governments (without city boards). In all other urban centers, a rather uncertain arrangement for "town committees" will apply. A number of substantial urban centers with viable existing local governments, including twenty-one urban centers each with more than 80,000 residents will thus be effectively recentralized into the county administration. (Table 3).

**Table 3: Twenty-one urban centres with more than 80,000 residents will not have municipal boards**

| Urban centre | Population |
|---|---|
| Ruiru | 240,000 |
| Kikuyu | 230,000 |
| Kangundo-Tala | 220,000 |
| Naivasha | 170,000 |
| Machakos | 150,000 |
| Mavoko | 137,000 |
| Thika | 135,000 |
| Vihiga | 120,000 |
| Nyeri | 120,000 |
| Malindi | 120,000 |
| Ngong | 110,000 |
| Kitui | 109,000 |
| Karuri | 107,000 |
| Mumias | 100,000 |
| Kitale | 100,000 |
| Kericho | 100,000 |
| Kimilli | 95,000 |
| Awasi | 93,000 |
| Kakamega | 90,000 |
| Kiambu | 85,000 |
| Kisii | 80,000 |

*Source: World Bank based on KNBS 2009 census.*

**Figure 7: Despite rapid urbanization, most counties are still predominantly rural**




*Source: World Bank calculations based on KNBS Census.*

41. **Looking forward, there are three ways in which the management autonomy of cities could be expanded.** One is by lowering the threshold for the definition of municipalities. Alternatively, the Act could deem all county capitals to be municipalities (which would still leave out important towns like Riuru, Naivasha, Ngong, etc.). A third option would consist in enhancing the managerial autonomy of town committees to make them function in the same way as municipal boards.

42. **With all urban functions and resources vested by the Constitution in county governments, specific functions and resources will need to be delegated to city and municipal boards.** Yet there is no clear process or framework for such delegation and no transparency requirement concerning the delegation by county governments to city and municipal boards. A useful measure would be to require county governments to publish the functions and revenue streams assigned to urban boards so that urban residents understand what services they are entitled to receive as services from which level of authority.

43. **Kenya's Constitution makes county governments responsible for financing urban service delivery, and there is a risk that urban services may be under-funded as a result.** Because rural residents will dominate most counties (Figure 7), county governments may chose to preference rural services and to redistribute revenues raised from urban residents to their rural constituencies. This may jeopardize the economic development potential of Kenya's urban areas and violate the fiscal federalism axiom that revenues and expenditure responsibilities should be aligned to the extent possible at the local level.

44. **Urban service delivery will depend largely on the priority which county assemblies give them, but the national government could also consider urban grants.** The UACA envisages that county governments will provide transfers to city and municipal boards but not to town committees and it offers no guidance as to how these amounts ought to be calculated. In this context, the national government could help to ensure that urban services are adequately provided through earmarked urban services grants which could be

paid either to county governments or to the urban boards directly. To ensure that counties maintain their own levels of funding for urban services, the transfer could include an additionality clause binding the county to maintain a certain level of funding.

45. **However, even additional transfers may be insufficient to finance the type of infrastructure that Kenya's cities need.** While counties may be able to borrow, this will be subject to national government review and guarantee. This is helpful to prevent the risk of uncontrolled borrowing at the sub-national level. However, the flipside may well be insufficient access to capital for infrastructure, particularly in Kenya's larger cities, as the national government may well be reluctant to encourage sub-national borrowing that would end-up on its balance sheet.

**>> Key Recommendations on protecting urban areas under devolution**

- *More urban centers should have corporate bodies to manage them. This could be achieved either by lowering the threshold for 'municipality' status or by amending the powers and functions of towns under the current law*
- *Functions of city and municipal boards should be clarified as well as the formal process for counties to delegate additional functions to them*
- *Standards ought to be set for urban service delivery and urban boards should be required to report against those to the county assembly*
- *City and municipal boards should be given own revenue powers through delegation of additional national taxing power*
- *Cost benchmarks are needed to monitor future resourcing of urban functions. The current cost of urban services should be calculated, based on past spending and monitor that funding is adequate to at least maintain resourcing for services at current levels*
- *The role and functions of local authorities should be extended during the transition until their staff, functions and assets can be accommodated by the new counties*

## Decentralizing Public Service in a sustainable way

46. **Kenya's existing public service structure is currently highly centralized, so devolution will bring about major changes.** Forty-seven new county civil services will be created with two immediate sets of challenges: to define the overall governance framework for county civil service and to manage the HR transition implied by their creation.

47. **The new devolved arrangements offer the opportunity to rationalize the current highly fragmented arrangements for service delivery, but the legal framework for managing county public services has important gaps.** By contrast to today, counties will have considerable autonomy over public service management: the county governments will be responsible within a framework of uniform norms and standards, for establishing and abolishing offices, appointing public servants and exercising disciplinary control over them. In each county a public service board –whose members will be nominated by the Governor- will exercise these powers on behalf of the government.

48. **The County Government Bill (CGB) provides the regulatory framework for counties to engage their own public servants but it leaves a number of important gaps in the policy framework.** In particular, while the Constitution provides clear authority for the national government to set out a framework of national standards, this could still leave room for counties to regulate some aspects of civil service management. Going forward there should be a clear decision as to which issues national laws and policies should cover and which should be left to counties. Also some interim provisions will be needed before counties develop their own laws (the Transition Authority could usefully propose an approach to government). The new framework should set national standards and guide counties in their day-to-day management of public servants by setting the general framework for management, specifying who is responsible for regulating the detail of how county public servants should be managed and providing statutory instruments to specify the detail of the management arrangements.

49. **It is unclear who should fill existing regulatory gaps.** The most immediate issue is to determine which agency in government should be responsible for the making laws covering county civil servants. From a legal perspective, the missing elements of the regulatory framework could be provided in regulations under the CGB, or they could be in separate legislation under the auspices of the Ministry of State for Public Service. Alternatively, individual counties could be left to fill these gaps with their own laws. If the former approach is adopted, two ministries will regulate public service matters at different levels of government (since the CGB is the responsibility of the Minister responsible for intergovernmental relations). If the latter is chosen, the two ministries will regulate county public service concurrently, with scope for overlap and contradiction.

50. **Devolving public service management involves balancing the risks of too much central control against excessive local autonomy.** With too much control, county autonomy and accountability may be undermined. With too little oversight, local controls could be ineffective undermining service delivery. This is a paradox of decentralization – that effective devolution actually requires a strong central government. Failing local controls could result, for instance, in elite capture and politicization of appointments. Establishing independent county public service boards has the potential to mitigate these risks but they have been given too much power. In particular, the concentration of human resource management creates the potential for fiscally unsustainable

recruitment and excludes direct supervisors and other stakeholders from an appropriate role in recruitment. In addition, the governor will appoint board members with approval of the county assembly but in the absence of a specific process to ensure their integrity and competency. Areas that may benefit from a national framework include providing career development pathways to encourage service in remote counties and imposing limits on salary spending. In addition, the CGB could set out the process for selecting county public service board members and the national government should provide support (training mentoring, procedures…) to the boards as they come into existence.

51. **Matching sub-county structures to political boundaries (constituencies and wards) could exacerbate the risk of –a different kind of-political capture.** For instance, if the CDF is maintained, this alignment could increase the allegiance between sub-county administrators and local politicians (MPs). Moreover, while political boundaries are drawn up with regard to demography, they may not make sense from the point of view of managerial efficiency.

52. **Uncontrolled spending on personnel expenditure is a common feature of decentralization and an issue for Kenya.** The reasons for excessive local spending on wages are complex: they often reflect patronage but also the fact that it is easier to spend money on salaries than on investment projects. Spending on personnel alone does not contribute to better services per se, if the recruited staffs have insufficient access to funding for operating costs and facilities. In Kenya, there is already anecdotal evidence that uncontrolled salary spending is rife in local authorities despite national controls. The public service provisions of the CGB emphasize control over recruitment of public servants but leaves employment of non-public-service staff relatively unregulated.

53. **Paradoxically, devolution could widen capacity gaps across Kenya.** There is already gross inequity in the distribution of public service skills across the country. For instance the ratio of doctors to population varies across counties by a factor of ninety! Yet the counties that currently have the lowest levels of public service skills are also likely to be those which will have the hardest time attracting skilled personnel, given their overall remoteness, lack of mobility prospects they offer and weak systems for incentivizing staff. In turn this could put undue upward pressure on remuneration, crowding out other important types of expenditures. These risks call for incentives – especially non-financial- within the framework of a single public service where staff can be offered greater access to training and promotion if they serve in remote counties and where mobility from one county to another can be guaranteed.

54. **In coming months, managing the transfer of staffs to counties will be the number one challenge.** Most of the public servants needed to run county functions are already there but the conditions under which they will remain are unclear and fiscal implications have not been properly assessed.

55. **Initially, national public servants will be seconded to county governments but the "zero-basing" approach is unusual and risky.** Most commonly, countries that establish a new level of government simply transfer existing staff performing devolved functions to the new governments. In Kenya, in order to maximize county flexibility, a secondment approach was chosen. The secondment of national staff will come to an end when the seconded officer is either appointed to the county public service or handed back to the national government. Moreover, if public servants feel they have the right of return to the national government they may also opt *ex ante* not to apply for a position in the county civil service. But if a large number of secondees are returned to the national government, it may not have the jobs or the funding to absorb them.

56. **It is unclear how the salaries of the seconded staff will be managed.** The CGB provides for the salaries of national officers on secondment to continue to be paid by the national government

unless there is an agreement to the contrary. But it is not fiscally realistic to expect the national government to transfer the full amount of the county revenue share while continuing to pay the salaries of seconded staff. Therefore, some arrangement will need to be made to fund salaries of county public servants from the county equitable share (although no conditions may be attached to it) or the national government could be left with an unsustainable fiscal burden.

57. **The fate of local authorities' staff needs to be addressed.** Existing public employees at the county level include some 33,000 LA staff of whom 30,000 are not civil servants. They are employed and managed by the LAs themselves outside of the state civil service. But LAs will cease to exist on the day of the next general elections and further laws called for under the UACA to cover what happens to the staffs assets and liabilities of the former LAs have not yet been prepared.

**>> Key Recommendations for managing the public service transition**

- *National policy on county public services should be developed but first a national law should make it clear who is responsible for it*
- *At the very least, the framework of regulation should provide uniform procedures and a comprehensive regulatory framework to apply until the counties pass their own laws*
- *National regulation of some aspects of county public service management is needed, in order to maximize career progression opportunities and encourage public service mobility*
- *Some national standardization of county pay policy would be beneficial, but care needs to be taken not to impose unaffordable fiscal burdens on county governments*
- *The national government should support the establishment of county public service boards to ensure that they are fully independent and competent and a regulation under the County Government Act should set out the process and criteria for appointing Board members*
- *As a matter of urgency the fate of Local Authorities' employees should be clarified through a law to deal with transition issues involved in abolishing local authorities*
- *A priority should be to tighten the loopholes that may allow uncontrolled non public service employment at the county level*
- *As a matter of priority the GoK should decide which level will be responsible for paying the salaries of seconded staff and if these will be deducted from the counties' equitable share transfers*
- *A plan should be developed to absorb redundant staff at the national level should a significant number of county secondees seek to return to the national civil service*

## Promoting intergovernmental coordination between national and county governments

58. **Devolution everywhere complicates the management of government, but intergovernmental coordination will be particularly important in Kenya.** Devolution potentially diffuses accountability between levels of government and introduces the possibility of mismatched resources, responsibility and authority. In Kenya, the Constitution mandate shared responsibility for some important aspects of service delivery, with the national government generally responsible for policy and counties in charge of implementation. But it gives the national government limited fiscal or supervisory levers with which to influence the achievement of national policy priorities. In the absence of such levers, given Kenya's long standing history of distrust between government and local stakeholders and the fact that no level of government is superior to the other, the institutions of cooperative government become all the more important.

59. **The current framework for devolution focuses mainly on the relations between governors and around the budget process, overlooking issues in sectors.** International experience suggests that frictions between levels of government undermine service delivery. In Kenya, the main devolved sector is health. Coordination and decision making will be complicated by the sheer number of counties and creative approaches will be needed to ensure that the coordination bodies can still make decisions effectively.

60. **Effective intergovernmental coordination will require both a change of culture and capacity building at both levels of government.** Line ministry staff will have to reorient from a service delivery role to a policy role and understand how to use new tools at their disposal to influence policy outcomes (like standards and expenditure norms). At the county level also, sector staff will have to adapt to new roles including resource constrained budgeting and independent formulation of policy or legislation.

61. **Two laws -one proposed and one passed- establish the framework for future relations between levels of government.** The Intergovernmental relations Act (IRA) establishes intergovernmental mechanisms (such as the National and County Government Summit, the Intergovernmental Relations Technical Committee and the Council of Governors) and the Public Financial Management Bill (PFMB) establishes a Budget and Economic Council.

62. **A particular challenge will be to get the system working with forty-seven counties and to effectively coordinate implementation.** Many of the international models for intergovernmental coordination involve much smaller numbers of sub-national units. Moreover, in some countries the main objective of coordination is joint policy development. In Kenya the real challenge will be to coordinate at the level of implementation in areas where both levels of government share service delivery responsibilities. The first area of policy coordination that will be required is the unbundling of the constituent elements of the different functions to ensure clarity as to who will do what. As part of this exercise there should also be a joint planning process to work out day-to-day coordination around implementation.

63. **It is not yet clear how the existing system provincial and district administration will relate to county governments.** The Constitution requires the system of provincial administration to be restructured in line with devolution within five years but how exactly remains to be worked out. A key question is how the remaining national

functions not devolved to county governments will be organized: in some cases functions that are best performed at local level (like social welfare or children's and gender programs) have not been devolved and in others, functions of existing department heads might be split (like education). Therefore it will be important to define a new architecture both for day-to-day relationships between national and local agencies in each county, and also for arranging the functions that remain national.

64. **Given the resilience of provincial administration over the years, Kenya will need to manage the risk that parallel and competing structures could undermine the effectiveness of county government.** Administrative parallelism, under which staff of central government either continues to manage sub-national functions or jointly administer them alongside national staff, would weaken the accountability of county governments.

**>> Key Recommendations for promoting intergovernmental coordination under devolution**

- *It is important to focus on getting intergovernmental relations bodies functioning early on*
- *The first priority is to get sector bodies working on issues of function assignment, service delivery standards, and performance monitoring*
- *The second priority is to focus on intergovernmental relationships at the county level, particularly by resolving the role of provincial and district administration staff, and designing the new arrangements for remaining national staff at county level*

## Managing the transition to hit the ground running

65. **Kenya's transition to devolved government will be as complex as it is ambitious.** Managing such dramatic transition will be key since it will set devolution back or forward for years to come. Immediate challenges include the movement of public servants from line ministries to county governments, setting up sound PFM systems in counties and ensuring continuity of urban services.

66. **For the transition to be as smooth as possible, Kenya needs institutional arrangements for managing the transition itself.** There is a clear legal framework but much work remains to be done. In February 2012, Parliament enacted three laws to implement Chapter 11 of the Constitution. Together with the provisions of the Fifth Schedule of the Constitution, they provide a set of institutional arrangements for managing transition through a Transition Authority, an independent body with broad membership and powers to coordinate implementation by the various organs of government.

67. **Irrespective of when the election is held ushering in the new counties, the Transition Authority has a great deal to accomplish in a very short time.** The TA will need funding to be effective both under the current financial year and under the 2012/13 budget. The Commission on Revenue Allocation (CRA) and the Commission on Implementation of the Constitution (CIC) were established in early 2011, and found their operations were constrained by not having their own budget appropriation until July 2011, when the 2011/12 fiscal year began.

68. **It will need to command respect across government.** The TA cannot make devolution happen alone. Devolution will occur through the actions of line ministries in each sector, and the Transition Authority's job will be to ensure that they all do their part. Although the Transition to Devolved Government Act (TTDG Act) gives the Transition Authority power to make regulations, there is no clear sanction if they are not followed. The best way the Transition Authority can ensure that the rest of government follows its lead is by (a) ensuring that it gets Cabinet sign off on its strategic direction; (b) meaningful involvement of the implementing ministries; and (c) using transparent reporting of expectations and progress in meeting them, to create an environment in which line ministries feel public pressure to meet their planned obligations.

69. **A detailed planning process for the transition should also be considered.** Under the TTDG Act, the CIC is responsible for requiring individual ministries to submit implementation plans and for monitoring their implementation, but the TA issues the guidelines about what the plans should contain. The guidelines issued by the TA could play a crucial role in setting the agenda of issues the line ministries should address, but ideally it should be determined in dialogue with line ministries. This is why it would be useful to develop an overarching strategy as well. The strategy should guide the decision about what to do first. It should highlight the respective roles of the TA and line ministries, and the relationship between the bureaucratic machinery and the political leadership.

70. **The process of developing the detail of the system of devolution has so far not been well integrated with line ministries.** It is the line ministries who are devolving their functions, seconding their staff, and reorienting their own role to reflect a new focus on policy, standards and service delivery performance, and supporting the development of county capacity. Ministries are most likely to undertake effective change

if they are actively responsible for planning it. Some further ways in which the TA can enhance coordination could include: seconding an official from each main ministry to the TA, providing line ministries with standard toolkits that they can use and holding regular structured discussions with the Principal Secretaries (Permanent Secretaries) of the key ministries in devolved sectors.

71. **The TA will also need to engage county governments on day one.** A great deal will be expected of the forty-seven new governors, and they should have the basic systems in place that allow them to achieve some early wins. The TA could appoint teams for each county to help get these systems established. It is helpful to think about what decisions the county governments will want to make first, and focus on putting in place the systems they will need for those. For example, the county assemblies will need clerks and other staff to make the work of the assembly and its committees effective. Those staff can only be appointed by the County Public Service Board and therefore appointing the county public service boards and establishing the systems to make them functionally effective are first-order priorities.

72. **There will be big differences in capacity between weaker and stronger counties.** One of the main risks of devolution is that it actually exacerbates these gaps. The TA should develop a strategy for ensuring that weaker counties receive special assistance. This might involve targeting donors to give priority to supporting specific counties, or developing special programs of assistance for them.

**>> Key Recommendations to manage the transition process**

- *The TA will need to be empowered financially and statutorily to lead the transition process with clear authority over other organs of government*
- *The TA should develop an overarching strategy for implementing devolution and provide uniform guidelines for line ministries to follow when preparing their implementation plans*
- *The TA should appoint teams in each county to help establish basic systems in a sequence prioritizing the first decisions county governments will have to make*
- *The TA should develop a strategy for filling major capacity gaps in Kenya's most disadvantaged counties so as to pre-empt a widening of these gaps under devolution*

# Conclusion

73. **Managing expectations will be a big challenge because decentralization is no silver-bullet.** It will take time to balance resource allocations, let alone improve equity of access to services. Many Kenyans believe that devolution will bring dramatic change overnight: upgraded infrastructure, more jobs and opportunities and better services (see Box 1). But they have different and often contradictory views of how this will happen. For instance, lagging areas are counting on redistribution of national wealth to help them catch-up, while leading regions see devolution as a chance to run their own affairs un-impeded.

74. **The transition to devolved government will be long, complex and risky but the potential payoffs are commensurately high.** This executive summary provides a snapshot look at main devolution-related challenges and opportunities in months ahead. A more detailed analysis will be presented in the forthcoming full report, along the following lines. Part I, sets the stage and provides contextual elements. It retraces the historical and political-economy context against which the devolution project has been developed (chapter 1) and emphasizes the ambitious character of the administrative reorganization it implies in a country that remains highly unequal (chapters 2 and 3). Part II, focuses on the main parameters of the devolved intergovernmental fiscal architecture, starting with an estimation of future county needs (chapters 4 and 5) and laying out the overall funding architecture through which they will have to be addressed (chapter 6). Part III, examines one by one by one each of the possible funding streams for decentralized services including own revenue sources (chapter 7), the unconditional equitable share (chapter 8), additional conditional instruments (chapter 9), and the Equalization Fund (chapter 10). Finally Part III, tackles implementation challenges in translating into reality the vision of a more responsive and accountable government through devolution. Chapter 11 addresses intergovernmental coordination challenges while chapters 12 and 13 focus on the systems to put in place to ensure that sound public financial management and effective social accountability are effectively promoted in the new counties. The final chapters relate to key issues in the transition namely the management of urban areas (chapter 14), the public service implications of devolution (chapter 15) and the management of the transition itself (chapters 16).

**>> Box 1: What Kenyans hope devolved government will do for them**

***Alice Vutage*** *– Housekeeper in Nairobi. Born in Western Kenya 32 years ago, Alice Vutage migrated to Nairobi in 2000 in search of employment. With little education and great determination to support her family back home, she found a job as house-help. Alice is not conversant with the new Constitution. All she knows is that it will improve the livelihood of Kenyans, a fact gathered from her daily interaction with friends and relatives. "People say that the new Constitution will bring a lot of development in the country, and this makes me happy, because I would like to see people in my village leading a better life," she said. Alice who is a single mother of a two year old daughter, hopes that the new Constitution will help to create job opportunities in her rural area, so that people can engage in economic activities, and become less dependent on financial support from relatives who work in big cities. "I am really eager to see how life will improve for my daughter and me when the new Constitution is implemented," she said, with a hint of apprehension in her voice.*

*Source: World Bank interview.*

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