



THE REPUBLIC OF UGANDA

## Local Government Finance Commission

# ANNUAL REPORT 2005

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THE REPUBLIC OF UGANDA

**LOCAL GOVERNMENT FINANCE  
COMMISSION**

**10<sup>th</sup> Floor Workers' House**

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**KAMPALA**

**IN ANY CORRESPONDENCE**

**ON THIS SUBJECT PLEASE QUOTE NO.....**

The Hon. Speaker of Parliament

Parliament House

Kampala

Dear Mr. Speaker

**LOCAL GOVERNMENT FINANCE COMMISSION ANNUAL REPORT: JULY 2004 – JUNE 2005**

In accordance with section 25 (1) of the Local Government Finance Commission Act, 2003, I have the pleasure to submit to you, and through you to the Parliament of Uganda, the Local Government Finance Commission Report for the period July 2004 to June 2005.

Yours faithfully

Johnson Bitarabeho

CHAIRPERSON

c.c. The Hon. Minister of Local Government



## Profile Of Members Of The Local Government Finance Commission

### Johnson Bitarabeho - Chairperson



Mr. Bitarabeho is a well trained and experienced Public Administrator with over 25 years in the service of both the central and local governments. At the time when the decentralisation policy was conceptualised, Mr. Bitarabeho was already at the senior rank of District Executive Secretary and was instrumental in the debates and drafting of the policy, laws and regulations that culminated in the implementation of decentralisation. Subsequently, he has been at the highest level of Chief Administrative Officer (CAO) and has won many awards as an individual and as head of the technical teams of Bushenyi district, one of the model local governments in Uganda where he was CAO for over ten years. He retired with excellence before being elected Chairman of the Commission.

### Ziria Ndifuna Vice - Chairperson



Ms Ndifuna is a Financial and Strategic Management Expert who served in various organisations in senior positions and roles as Chief Accountant, Senior Management Analyst, Principal Consultant, rising through the ranks to become Head Consultancy Division and Head Entrepreneurship Division in Management Training & Advisory Centre (MTAC). She served as National Expert and Institutional Reform Specialist in the government Restructuring and Re-organisation (1993 – 1999) and helped restructure a number of government ministries, departments and institutions that included the Office of the Prime Minister, Ministry of Justice and Constitutional Affairs, the Judiciary, Ministry of Public Service, Ministry of Works, Housing and Communications, Ministry of Health, all Constitutional

Commissions, to mention just a few. She has also participated in the divestiture of various government departments, including the department of Museums and Antiquities. Ziria served as the Vice Chairperson of the previous Commission and has wide experience which the current Commission has benefited from.

### Richard Santos Apire – Member



Mr. Apire is a Financial Specialist with a long service track record at Bank of Uganda where he served and retired at the rank of Director. Currently, he works with the Tropical Bank as a Consultant. Mr. Apire brings into the Commission a meticulous and professional approach to work. These are qualities that have proved invaluable in informing the advice and recommendations the Commission makes in the discharge of its functions and duties.

### Ruth Adupa Atala - Member



Ms Adupa is an experienced administrator with many years in Lira District Council and currently is a technical officer at the Uganda Local Governments Association where she has served as Administrative Officer for over four years now. Ms Adupa is a young and upcoming politician with an eloquent and amiable approach. Her last political involvement was during the 2006 elections where she stood for woman Member of Parliament for Dokolo district. Her hands-on experience with local government practices has immensely helped the Commission appreciate and appropriately engage with local governments in the course of its work.



### **Ian Kyeyune - Member**



Engineer Kyeyune is a professional engineer, physical planner, university lecturer, and a consummate politician who has been at the helm of a cosmopolitan Wakiso District Local Government where he has recorded tremendous successes. Eng. Kyeyune is methodical and professional in approach. This has not only endeared him to the people of Wakiso district but a number of other influential organisations and personalities both nationally and internationally. These contacts have been very beneficial to the Commission in harnessing stakeholders' acceptance of the work of the Commission. Eng. Kyeyune is equally a successful consultant in private practice working on various big projects. Mr Kyeyune has held various leadership positions in a number of associations. His thorough understanding of local government issues gained from many years of active participation has steered the Commission to levels it would never have reached without him.

### **Eric Mucunguzi - Member**



Mr. Mucunguzi is a Certified Public Accountant with extensive skills in financial matters in the areas of budgeting, taxation, audit, investigations and Public Financial Management. He has worked at the Inspectorate of Government for over twelve years and rose to the rank of Principal Inspectorate Officer. During his tenure at the Inspectorate, he investigated a number of high profile cases in Local Governments, and

Central Government some of them abroad. He was instrumental in the drafting of many legislations and regulations including those in local government sector and public finance and accountability generally. Mr. Mucunguzi is versatile in understanding and applying these skills whenever the need arises.

He has, in the course of his work had extensive interactions with most of the Local Governments on investigative assignments and training programmes organised by the Inspectorate and other Institutions where he would be called from time to time to share in the experiences of fighting corruption. Mr. Mucunguzi is a problem-solver blending professionalism and hands-on approaches concentrating on finding lasting solutions to even apparently not so permanent situations.

### **George Michael Egonyu**



Mr. Egonyu is a seasoned career teacher and administrator with record performance in various schools across Uganda. He has been the Mayor of Soroti Municipal Council for over 10 successive years, a period during which Soroti was rated one of the cleanest towns in Uganda. As an experienced practitioner and local government leader, Mr. Egonyu has been instrumental in shaping the insights of the Commission on local government issues especially those concerning urbanisation and urban development. He is an amiable and humorous politician whose temperament has been very commendable in times of tough decision-making.

# Local Government Finance Commission Secretariat



**Lawrence Banyoya**  
Commission Secretary



**Bernard Ogwang Okuta**  
Director Grants & Local Revenues



**Lucas Omara Abong**  
Director Finance & Administration



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## ABBREVIATIONS AND ACRONYMS

BFP	Budget Framework Paper
CAO	Chief Administrative Officer
CBO(s)	Community Based Organisation (s)
CSO(s)	Civil Society Organisation(s)
DANIDA	Danish International Development Assistance
DDP	District Development Plan
DDP II	District Development Programme (Phase Two)
DDSG	Donor Decentralisation Sub-group
DFID	Department for International Development
DPSF	Decentralisation Policy and Strategic Framework
DTS	Development Transfer System
EPRC	Economic Policy Research Centre
FDS	Fiscal Decentralisation Strategy
FY	Financial Year
GOU	Government of Uganda
GT	Graduated Tax
HLG	Higher Local Government
IGG	Inspector General of Government
IOBP	Inventory of Best Practices
JARD	Joint Annual Review of Decentralisation
LG	Local Government
LGBC	Local Government Budget Committee
LGBFP	Local Government Budget Framework Paper
LGDP II	Local Government Development Programme (Phase Two)
LGFC	Local Government Finance Commission
LGPAC	Local Government Public Accounts Committee
LGROC	Local Government Releases and Operations Committee
LLG	Lower Local Government
LoGSIP	Local Government Sector Investment Plan
LRECC	Local Revenue Enhancement Coordination Committee
MOFPED	Ministry of Finance, Planning and Economic Development
MOLG	Ministry of Local Government
MTEF	Medium Term Expenditure Framework
NPA	National Planning Authority
NUSAF	Northern Uganda Social Action Fund
PAF	Poverty Action Fund
PEAP	Poverty Eradication Action Plan
PEF	Performance Enhancement Fund
PSRP	Public Service Reform Programme
PSPEP	Public Service Performance Enhancement Programme
RTS	Recurrent Transfer System
SDU II	Strengthening Decentralisation in Uganda Phase Two
SNV	Netherlands Overseas Development Organisation
UAAU	Urban Authorities Association of Uganda
ULGA	Uganda Local Governments Association
UNCDF	United Nations Capital Development Fund

## FOREWORD

I am pleased to present the second Annual Report of the Local Government Finance Commission (LGFC) for the period July 2004 to June 2005 in accordance with section 25 (1) of the Local Government Finance Commission Act, 2003. It is prepared in the context of the functions of the Commission as spelt out in article 194 (4) of the Constitution of the Republic of Uganda (1995), and further elaborated in section 9 of the Local Government Finance Commission Act.

The Report covers activities planned and implemented within the ambit of the Commission's medium-term Corporate Strategy (2004 - 2008) and intended to achieve the Commission's long-term objective "to ensure that there is a match between services and functions of local governments and the financial resources available for local governments to optimally undertake them". To attain this objective, the Commission has identified four key thematic priority areas which are to be implemented within the medium term. The annual activity and work plan of the Commission therefore are geared towards outputs that are relevant to realise the objective.

The Commission's mandate is centred on matters to do with revenues locally raised by local governments and grants transferred from the Consolidated Fund to local governments. These are given prominent coverage in the period under review. Other issues that impact on decentralisation in the country, especially the aspects relating to financing of local governments are equally given attention.

The major concern of the Commission remains the inadequate funds available to local governments for financing decentralised services and responsibilities. The combined funding, both through grants from the central government and locally raised revenue, continues to be insufficient. This is partly a result of under-funding through grants and continued interventions of government agencies in the collection of local revenues.

During the year of this report, the Commission continued with its efforts to seek ways and means to reduce the gap between funding and needs though a number of challenges continue to mount. The activities implemented and reported on herein

were the efforts of the Commission with stakeholders to make a contribution toward reducing the gap. At the time of writing this report, some significant policy changes have occurred in the country with direct bearing and impact on financing and operations of local governments by necessary inference, the functions and mandate of the Local Government Finance Commission.

A number of new local governments have been created with the attendant added administrative and overhead costs. This is against the background that there has not been a corresponding increase in the respective funding provisions. The overall impact is likely decline in service delivery oversight and quality.

On a positive note, many stakeholders have a shared interest in ensuring that local governments function in a sustainable manner. LGFC will continue to play its part in this quest and requests that appropriate resources are made available to enable it to play that role. In this respect I appreciate the interest Government, Parliament and development partners, have shown, in funding the Commission.

As a result of the many policy changes and the need to fully streamline the financing systems for local governments, the Commission needs to undertake a number of policy-oriented analyses and engagements to inform policy formulation processes. However, funding has continued to be a major problem. This has affected the performance of the Commission generally.

Last but, by no means least, the report contains information, issues and recommendations which I believe will be found useful as part of a contribution toward deepening decentralisation and improving service delivery within a transparent and accountable framework.

Johnson Bitarabeh

**CHAIRPERSON  
LOCAL GOVERNMENT FINANCE COMMISSION**



## ACKNOWLEDGEMENT

The Local Government Finance Commission is a public organisation funded from public resources. Government has continued to fund the Commission for which I express our unreserved appreciation. In the period covered in this report, a total of 1.4 billion shillings was provided for wage, non-wage and development expenditures. This was short of the requirements of the Commission. While we appreciate the competing demands on the public purse, the constrained funding profile means that the Commission is not in position to adequately carry out its role. The impact is that resource allocation to local governments for service delivery may not be efficiently and effectively done.

I extend our appreciation to Parliament which has taken a very active interest in the Commission and continued to recognise the contribution the Commission makes. We trust that together we will chart out an optimal mechanism for resource availability to local governments.

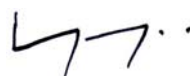
The Hon. Minister and Hon. Minister of State, the Permanent Secretary and staff of the Ministry of Local Government have been very commendable partners. The guidance from the Hon. Ministers and Permanent Secretary has always been very useful and helped the Commission tremendously. The cooperation of the entire staff of the Ministry has been very opportune. We will continue to promote a harmonious and collaborative relationship with the Ministry.

The Commission appreciates the invaluable support from development partners who have continued to partner with the Commission in its activities and programmes. Particular recognition is made of DANIDA, DFID, UNCDF, SNV, SDU II/USAID, and the Royal Netherlands Embassy who have rendered valuable support to the Commission.

Appreciation is further extended to all stakeholders, in particular, Office of the Prime Minister, Ministry of Finance, Planning and Economic Development, Ministry of Public Service, sector

Ministries, local government associations (ULGA and UAAU) and local governments for their cooperation.

I extend special thanks to the Chairperson, Vice-Chairperson and Commissioners who have constantly provided guidance and made invaluable inputs into the activities and programmes reported on. Finally I extend appreciation to all members of staff of the Local Government Finance Commission whose tireless efforts and dedication, in one way or another have contributed to the work of the Commission.



Lawrence Banyoya

**COMMISSION SECRETARY**

## Executive Summary

### BACKGROUND

The Local Government Finance Commission is established under article 194 (1) of the Constitution to perform the functions stipulated in article 194 (4) and section 9 of the Local Government Finance Commission Act respectively. Section 25 (1) of the Act requires the Commission, every twelve months, to prepare and submit a report to Parliament on the performance of these functions. This report is prepared in fulfilment of that legal requirement.

#### **Strategies and Objectives**

In order to perform the functions in an orderly and consistent manner, the Commission developed a medium term Corporate Strategy (2004 – 2008) outlining the vision, mission, objectives and strategic priorities for the period. In line with the corporate strategies, work plans were developed for the reporting period in the major functions of local revenue enhancement, grants, implementation of the fiscal decentralisation strategy, administrative improvements and other stakeholder programmes. In the report, the performance of the Commission during the year is also presented together with challenges faced and recommendations on the way forward are made.

### LOCAL REVENUES

Article 191 (1) mandates local governments to levy, charge, collect and appropriate fees and taxes in accordance with laws enacted by Parliament. These have been elaborated in the Fifth Schedule to the Local Governments Act (CAP 243). Article 191 of the Constitution and section 9 of the Local Government Finance Commission Act stipulates the functions of the Commission in relation to local revenues. Local revenues play an important role in promoting decentralisation through funding of local government programmes and expenditures. However over the recent past collections have seen a downward trend, falling from 129 billion shillings to 99 billion shillings in the FY 1997/98 and FY 2002/03 respectively.

In the period under review, personal Graduated Tax (GT) which constituted the single major source of locally raised revenue was proposed for suspension. This caused anxiety among stakeholders which necessitated quick action. A study was conducted by the Commission to establish the implications of abolishing GT on the financing of LGs. The study revealed that abolition of GT would result in a revenue loss of approximately 60 billion shillings annually. It was also established that in the immediate term, there is no revenue source at the LG level within the present legal framework which could raise that amount. Government would have to compensate LGs for the loss.

The other activities in this area were mainly continuation of those started earlier under the District Development Programme Phase two (DDP II). The Commission continued with taxpayer education through radio interactions throughout the ten districts covered by DDP II. The responses received were very positive. The Commission provided a total of 101 million shillings to the ten DDP II districts to implement their local revenue enhancement activities. The Commission had



provided similar funding to the districts in the FY 2003/04 and evaluation of usage of the money indicated that some positive trends in local revenue collection had started to be registered. An average improvement of up to 50% in revenue collections in these districts was observed. The Commission facilitated meetings of the Local Revenue Enhancement Coordination Committee (LRECC) in which many policy issues regarding local revenue were handled in addition to backstopping a number of local revenue enhancement activities. The findings from a Rural Taxation Study carried out by the Economic Policy Research Centre (EPRC) were disseminated to some LGs. The study documented a number of key issues of rural taxation and proposed mechanisms for improvement.

Despite the vital role local revenues play in the operations of LGs and in the successful implementation of decentralisation, they face many challenges. The legal framework in most cases is not conducive. For example, the law governing property rating as well as markets are way out of touch with current economic and political circumstances. Political interference in local taxation has remained a constant impediment. The revenue bases decentralised to LGs are generally low yielding and difficult to manage especially taking into account the poverty level of the rural tax payers. The net effect of all these is the steady decline in local revenue, which means that activities, programmes and expenditures of LGs, which by law, can only be financed from local revenues cannot be fully carried out.

## **CENTRAL GOVERNMENT GRANTS TO LOCAL GOVERNMENTS**

Article 193 of the Constitution provides unconditional grant, conditional and equalisation grants to be transferred from the Consolidated Fund to LGs. All these grants are being transferred to LGs in varying proportions. Grants now form the dominant source of revenue for LGs. The total grant amounts have grown from 330 billion shillings to 806 billion shillings in FY 1999/00 and FY 2004/05 respectively, representing growth of approximately 160% in the period. Of these, conditional grant is the major component. It stood at 714 billion shillings in the FY 2004/05 from 261 billion shillings in the FY 1999/00 representing an increase of 174% in that period. The other grants have not significantly grown in absolute terms. Unconditional grant has increased from 66 billion shillings to 120 billion shillings, while equalisation grant from 2.5 billion shillings to 3.5 billion shillings respectively in the same period. However these increases seem to be outweighed by service delivery needs of LGs arising out of general increase in price levels, increase in overhead costs arising from increased number of LGs and need for co-funding among others.

### **Unconditional Grant**

Unconditional grant is the amount to be transferred to LGs to run decentralised services and covers both the wage and non-wage expenditures. The Seventh Schedule to the Constitution provides a formula that guarantees provision of the grant levels for LGs. The wage component is allocated to LGs based on actual payroll requirement while the non-wage component is allocated on two factors of population (85%) and area (15%).

There are two main challenges to unconditional grants. One, the amount has remained small with minimal growth despite the constitutional guarantee. LGs have also experienced increased expenditure needs arising from price increases and overhead costs. Unconditional grant cur-

rently therefore is insufficient for most LGs to meet their wage requirements and in most cases there is no balance for non-wage expenditures. Two, because the wage component is allocated on the basis of payrolls, staff who have not been enlisted on the roll pose a problem which has resulted in many LGs accumulating wage arrears. It is recommended that sufficient funds under unconditional grant be provided to LGs at least to cover the actual wage requirements of LGs.

### **Conditional Grants**

Under article 193 of the Constitution conditional grants are transferred to LGs to fund programmes agreed upon between the Government and LGs and on conditions similarly agreed. Currently conditional grants are the dominant source of funding for LGs. It stood at 714 billion shillings in the FY 2004/05 representing approximately 89% of the total transfers to LGs from the Consolidated Fund. Conditional grants fund programmes in the Poverty Action Fund (PAF) priority areas of agriculture, health, education, water, roads, gender and community development as well as natural resources.

A major challenge with conditional grants is in putting into practice the constitutional requirement of “agreement” between the Government and LGs. The LGs are neither directly involved in choosing programmes to be funded by conditional grants nor the sectoral policies, standards and specifications which form the major aspects of conditions for use. LGs are only involved in discussing aspects related to accountability and reporting. The consequence is that onerous conditions are set by the Central Government, to which LGs “agree” during negotiations. Compliance with these conditions creates increased burden on LGs’ resources in time and personnel while the Central Government itself expends considerable amount of resources to supervise and monitor compliance. As a result LGs have a reduced interest in ownership of programmes for they consider themselves as mere implementers rather than owners and beneficiaries.

It is recommended that the Central Government should strengthen participation in all aspects of selection, design, implementation and evaluation of programmes financed under conditional grants. In the long term, Government should consider reduction in funding through conditional grants and increase unconditional grants as capacity issues are addressed through training and manpower restructuring.

### **Equalisation Grant**

In accordance with article 193 of the Constitution, equalisation grant is money given to a local government that lags behind the national average standard for a particular service. The grant was operationalised in the FY 1999/00. However, the absence of service delivery standards for most sectors meant that the grant could not be operationalised fully as provided in the Constitution. Instead proxy data were used to estimate general expenditure needs and revenue potentials. The amount of the grant has remained small at 3.5 billion shillings annually for 34 district and 40 urban LGs. Currently the proxies used are Human Poverty Index (HPI), Human Development Index (HDI) and Household Consumption Index (HCI).

The use of proxy data poses a challenge of universal acceptability of the formula used. Standards for service delivery are a mandate of sector ministries. LGFC does not have the mandate to request sectors to compile the necessary standards. The amount of equalisation grant provided by Government has remained very small. The Commission recommended 12 billion shillings in 1999/00 but only 2.5 billion shillings was provided.



LGFC recommends that the legal framework be reviewed so as to make work easier and the amount for equalisation grant should be increased to reflect the important function it is intended to serve.

### **Extending Transfers to Lower Local Governments**

The structure of local governments provide for Lower Local Governments (LLGs) below the district and municipal levels, i.e. sub-counties and divisions. Article 193 (5) requires district LGs to indicate how they plan to pass conditional and equalisation grants to these LLGs. LGFC is also required, in consultation with the National Planning Authority, to recommend the amount of grants to be transferred to each local government including LLGs (emphasis added). Currently conditional grants allocated to districts are not transferred directly to the budgets of LLGs. Usually districts plan, hire contractors, suppliers or service providers, deliver goods/services and make the necessary payments through the district budgets and arrangements. This could have been brought about by concerns on capacity in terms of manpower, skills, equipment etc.

LGFC therefore conducted a study to evaluate factors conducive for extending transfers within LGs. The study was conducted in selected LGs to collect data and gather necessary information. Preliminary findings show that circumstances are conducive to transfer grants to LLGs as required by law. The Commission will present a final report with recommendations to stakeholders.

### **Allocation Formula**

Technical work on designing new allocation formulae was completed in the previous period. Implementation awaits approval by Cabinet. At the close of the reporting period LGFC had not yet received feedback from the Ministry of Local Government (MOLG). LGFC received information that consultations were still being undertaken within Government to gain consensus of all sectors.

## **FISCAL DECENTRALISATION STRATEGY**

The Fiscal Decentralisation Strategy (FDS) was approved by Cabinet in June 2002 as a framework for strengthening decentralisation through increased local governments' autonomy, widening local participation in planning and budgeting decisions and streamlining fiscal transfer modalities within a transparent and accountable framework to achieve poverty reduction goals. The following activities were implemented during the year under review.

### **Local Government Budget Committee (LGBC)**

LGBC was created under FDS to coordinate stakeholders so as to create a coordinated and systematic management of the local government budget process. In the period under review LGBC met four times to discuss budget related policy issues. The Committee oversaw the provision of technical support to the districts of Kabarole, Kyenjojo, Kamwenge, Sironko, Kapchorwa and Kumi on use of the budget guidelines and manuals provided by Government.

## **Negotiations Between Sector Ministries and Local Governments**

In pursuance of Article 193 of the Constitution, LGFC had developed a process of negotiations between LGs and sector ministries to agree conditions for utilisation of conditional grants. In the period under review, the exercise was conducted in November and December 2004. These were the second set of negotiations which reviewed the previous year's agreements and emerging issues. A report of the agreed issues was prepared. A major challenge to the negotiations is monitoring observance of the agreed conditions and impact. It was noted however that the air of cordiality and respect between parties had tremendously improved.

## **Budget Manuals**

LGFC within the ambit of LGBC produced budget manuals to guide LGs in budget preparation. In the year under review, a revised user-friendly version of the manuals was issued to LGs. Analysis of the BFPs prepared during the year indicated that many more LGs have significantly improved. Some LGs however still need assistance on a hands-on basis.

## **Challenges in Implementation of FDS**

Key challenges observed related to acceptability by sectors of the flexibility principle under which LGs are permitted to reallocate up to 10% of the non-wage recurrent PAF conditional grants to meet their local priorities. The other challenge concerns capacity of LGs generally to implement the requirements of FDS. It is recommended that sectors be sensitised on the flexibility principle while capacity building programmes under the central government auspices should increasingly cover the FDS related fields.

# **ADMINISTRATIVE AND OTHER STAKEHOLDERS' ACTIVITIES**

A key priority area in LGFC's Corporate Strategy is to strengthen its internal systems and procedures to achieve efficiency in execution of its functions. The Commission believes that the successful implementation of its activities requires involvement with stakeholders and to accordingly plan for them. In the period under review, the following were undertaken.

The Commission implemented partially its Human Resources Policy (HRP) and Communication Strategy through skills improvement training of staff and Commissioners. The Commission produced a handbook summarising the salient features of the HRP. The Commission produced its first Annual Report and presented it to the Speaker of Parliament. Commissioners and staff participated in a number of other stakeholders' programmes including the Joint Annual Review of Decentralisation (JAR), the Local Government Releases and Operations Committee (LGROC), the Donor Decentralisation Sub-Group (DDSG), National Planning Authority (NPA), Northern Uganda Social Action Fund (NUSAF) as well as programme reviews of DDP II, Danida Support to Decentralisation in Uganda and DFID Decentralisation Support Programme. Delegations from Sudan, Zambia and Netherlands visited the Commission during the period.



## CHALLENGES AND RECOMMENDATIONS

Some of the key challenges, which the Commission faces are:

### LOCAL REVENUES

#### Low Tax Yields

Most local revenue sources are characterised by low yields. This has been made worse by the threats to GT. This has resulted in constrained funding for programmes that cannot be funded from grants such as council and administrative expenditures, co-funding donor programmes etc.

*It is recommended that exhaustive studies be carried out and an appropriate financing regime for LGs be designed and implemented.*

#### Political Interventions

Political interventions on local revenues have had adverse effects on performance. These have affected market dues, parking fees etc. Most taxpayers now tend to believe that Government has relieved them from the burden of paying all (direct) taxes.

*It is recommended that Government co-ordinates its policy implementation which should be done after appropriate assessment of the intended policy pronouncements.*

### GRANTS TO LOCAL GOVERNMENTS

#### Legal Framework

The Local Governments Act gives the responsibility to sector ministries to develop standards for service delivery. In most cases these standards are not available so the Commission has to use proxy information. Complying with the requirements therefore becomes difficult. LGFC is also required to recommend allocation to each LG, which requires that empirical data is collected from each of them. This cannot be done because of funding constraints.

*It is recommended that adequate funding is provided for research and data collection to ensure that legal requirements are complied with.*

#### Conditional Grants

Conditional Grants constitute the major source of revenue for LGs. The law requires that the conditions for use of these grants are agreed between Government and LGs. However, the process of formulating conditional grants cannot be said to be one in which the parties are “equal”. This has problems of ownership and oversight.

*It is recommended that the negotiation system facilitated by LGFC be supported and GOU should strengthen participation in all aspects of formulation, design, implementation and evaluation of programmes to be funded under conditional grants.*

### **Allocation Formulae**

*The Commission recommends that the allocation formulae developed and present to Government during 2003/04 be implemented.*

### **Unconditional Grant**

The amount of unconditional grant remains so low and in most cases it is not sufficient to cover wage requirements for LGs.

*It is recommended that in the short term, Government should ensure that the actual wage requirement for each LG is provided for by unconditional grant to avoid accumulation of arrears. In the long term appropriate levels of grants should be provided as stipulated under FDS.*

### **Equalisation Grant**

The main challenge with equalisation grant is the amount, which is too small to make any impact; and the lack of national service delivery standards thereby impeding its implementation as required by law.

*It is recommended that LGFC be provided with funding to carry out necessary research to design an acceptable formula for equalisation grant. Government should increase the amount of equalisation grant, from the current 3.5 billion shillings, so as to make it achieve its objective and reflect the important development role it is expected to play*

## **CAPACITY BUILDING**

LGs require capacity to be able to deliver on the mandates assigned to them. FDS has brought in new methods and new policies come with new requirements with which LGs should cope.

*It is recommended that comprehensive training and capacity building be provided to LGs to enhance their capacity to apply the tools, skills and concepts they are required to use in handling their mandates.*

## **FUNDING OF THE COMMISSION**

The Commission is seriously under-funded, considering the tasks assigned to it by law. New policy changes including creation of more districts, threats of GT etc imply more work for the Commission. The LGFC Act provides some protection for LGFC budget but in practice MOFPED has not only made drastic cuts on estimates from the Commission but even what is approved by Par-



liament has been subjected to periodic cuts in releases. The net result is that the Commission is not adequately facilitated to fully execute its mandate.

*It is recommended that the MOFPED respects the budget status granted to LGFC by law and adequate resources are availed to the Commission to be able to execute its functions fully to advise on more effective resource allocation for service delivery.*

## **UPTAKE AND IMPLEMENTATION OF LGFC RECOMMENDATIONS**

In some instances LGFC has registered low or delayed implementation of some of its recommendations without appropriate feedback. The negative effect this has on the morale of those concerned cannot be overemphasised.

*It is recommended that a forum should be established within Government, especially in the local government sector, where discussions of such recommendations are done and appropriate feedback made.*

## CHAPTER ONE:

# FUNCTIONS, STRATEGIES AND OBJECTIVES

## 1.1 Functions

The Local Government Finance Commission is established under article 194 of the Constitution and operationalised by Local Government Finance Commission Act, 2003 (Appendix III). This report makes assessment of the work undertaken by the Commission to discharge its constitutional functions as encapsulated in the LGFC mission.

The functions for which the Commission is established are the following:

- a) Advise the President on all matters concerning the distribution of revenue between the Government and Local Governments and the allocation to each local government of money out of the Consolidated Fund.
- b) In consultation with the National Planning Authority consider and recommend to the President the amount to be allocated as equalisation and conditional grants and their allocation to each local government;
- c) Consider and recommend to the President potential sources of revenue for local governments;
- d) Advise local governments on appropriate tax levels to be levied by local governments;
- e) In case a financial dispute arises between local governments, mediate and advise the Minister accordingly;
- f) Analyse the annual budgets of Local Governments to establish compliance with the legal requirements and notify the council concerned and the President through the Minister for appropriate action;
- g) Recommend to the President through the Minister, the percentage of the National Budget to be transferred to local governments every financial year;
- h) Recommend to the President, central government taxes that can be collected by local governments in their respective jurisdictions on an agency basis;
- i) Perform such other functions as may be prescribed by law.



## 1.2 Background

The Commission has been in existence since 1996 and over the time engaged in a number of activities and programmes aimed at making inputs into shaping the fiscal decentralisation regime in the country. This needed to be done taking into consideration a number of reforms the country had to undergo as well as other stakeholder concerns and interests. An important development in the fiscal decentralisation arena was the coming into being of the Fiscal Decentralisation Strategy (FDS) in 2002. This required LGFC to rethink its methods and approach toward work and take on other roles among stakeholders.

In order for the Commission to appropriately position itself to discharge its constitutional mandate within the broader national and stakeholder environment and expectations as above, an organisational development analysis of the Commission was carried out in 2003. The purpose of this analysis was to contribute toward improving the efficiency and effectiveness of the Commission in performing its functions, which are pivotal in the successful implementation of decentralisation policy.

The exercise culminated in the development of a medium-term Corporate Strategy (2004 – 2008) for the Local Government Finance Commission. The Corporate Strategy provides direction on where LGFC would direct its resources and priorities in the medium term.

## 1.3 Corporate Strategy

One product from the organisational development analysis is the Corporate Strategy of LGFC for the period 2004 – 2008. The Strategy document was launched by Prof. Tarsis Kabwegyere, Minister of Local Government (as he was then) in October 2004. The Strategy states the vision, mission, objectives and strategies of the Commission in that period and elaborates four key thematic priority areas which LGFC would emphasise in the period. The thematic priority areas are;

- ◆ Streamlining and harmonising the grant system
- ◆ Supporting local governments to increase local revenue collection
- ◆ Strengthening the administrative and management systems to improve LGFC's efficiency and effectiveness and;
- ◆ Develop and operationalise a communication strategy.

### 1.3.1 Vision

The stated Vision of the Local Government Finance Commission is **“a Uganda in which there is efficient, effective and equitable fiscal decentralisation”**

### **1.3.2 Mission**

The mission of LGFC is “to promote equity in sharing of revenue between governments through appropriate and responsive transfer mechanisms, and efficiency and effectiveness in local revenue mobilisation and generation by use of best practices in a conducive legal and policy environment”.

### **1.3.3 Objectives**

The long term objective of the Local Government Finance Commission is “to ensure that there is a match between services and functions of local governments and the financial resources available for local governments to optimally undertake them”.

The operative objectives of the Commission in the reporting period were in line with what was expressed in the Corporate Strategy and which are closely linked to the local government/ decentralisation sector objectives.

## **1.4 Planned Activities for the Year July 2004 to June 2005**

For the period being reported on, LGFC planned to undertake a number of activities and tasks aimed at attaining outputs relevant to and necessary to achieve the objectives in the Corporate Strategy. The activities planned in the period July 2004 to June 2005 are listed below while the details of the work plans are in the Annex I to this report.

### **a) Local Revenue**

- ◆ Arrange and conduct gender sensitive radio talk shows on issues of local taxation, service delivery and development.
- ◆ Arrange, facilitate and coordinate meetings and activities of the Local Revenue Enhancement Coordination Committee (LRECC).
- ◆ Disseminate to local governments and stakeholders, the findings and recommendations of the Rural Taxation Study.
- ◆ Continue with dissemination, to local governments, of the Inventory of Best Practices (IOBP).
- ◆ Support the ten districts under the District Development Programme Phase Two (DDP II) to develop local revenue enhancement work plans and provide seed money for their implementation.
- ◆ Carry out monitoring of the DDP II districts and assess the impact of the work plans implemented with seed money provided to these districts during FY 2003/04.
- ◆ Arrange and conduct annual regional workshops on local revenue enhancement.
- ◆ Consider and recommend appropriate Graduated Tax bands and advise on GT imputa-



tion values.

- ◆ Develop and promote use of Public – Private - Partnerships in local revenue enhancement.
- ◆ Develop an incentive system to be used in local revenue enhancement and collection.

**b. Grants**

- ◆ Analyse all grants and document issues in their allocations, utilisation and amounts and make appropriate recommendations for their efficient and effective use.
- ◆ Sensitise stakeholders on the new allocation formulae for grants
- ◆ Develop modalities and mechanisms for extending central government grants from higher local governments to lower local governments.
- ◆ Compile minimum standards of service delivery for all sectors to form basis for recommendations on appropriate levels of grants.

**c. Fiscal Decentralisation Strategy**

- ◆ Analyse local government Budget Framework Papers (BFPs) and make appropriate recommendations.
- ◆ Arrange, conduct and coordinate meetings and activities of the Local Government Budget Committee (LGBC).
- ◆ Review the local government budget manuals and disseminate the revised manuals for use by local governments.
- ◆ Arrange, facilitate, coordinate and conduct annual negotiations between sectoral ministries and local governments on conditional grants.
- ◆ Participate in development and dissemination of local government financial and reporting systems.

**d. Administrative and Other Stakeholders Activities**

- ◆ Participate in activities of, consult and interact with stakeholders both as a statutory requirement and as and when required and necessary.
- ◆ Produce and submit to Parliament an Annual Report as required by law.
- ◆ Design and implement an outreach programme for members of LGFC with visits to local governments, sectoral ministries and other stakeholder institutions.
- ◆ Implement recommendations in the LGFC Human Resource Policy and Communication Strategy.

- ◆ Establish and operationalise a resource centre.

In the course of the year, other unplanned but urgent matters that required the immediate attention of the Commission came up. During the period there were deliberations and debates whether Graduated Tax (GT) should be abolished or suspended. Since GT was the single major source of local revenue for local governments, LGFC undertook a study to advise on the immediate implications of the proposed suspension and any alternative sources.

The subsequent chapters provide details of the performance of the Commission in relation to the functions and work plans including challenges and recommendations on the way forward.



## CHAPTER TWO:

# LOCAL REVENUES FOR LOCAL GOVERNMENTS

## 2.1 INTRODUCTION

### 2.1.1 Background

Local governments are mandated under article 191 (1) of the Constitution to levy, charge, collect and appropriate fees and taxes in accordance with any law enacted by Parliament. In sub-article (2), the fees and taxes to be levied, charged, collected and appropriated shall consist of rents, rates, royalties, stamp duties, personal graduated tax<sup>1</sup>, cess, fees on registration and licensing and any other fees and taxes that Parliament may prescribe.

Parliament has elaborated on the fees and taxes that local governments can levy, charge, collect and appropriate through Schedule Five to the Local Governments Act (CAP 243).

### 2.1.2 Role of the Local Government Finance Commission

As shown in Chapter One above, the functions of the Commission include, among others, the following:

- ◆ *Consider and recommend to the President potential sources of revenue for local governments.*
- ◆ *Advise local governments on appropriate tax levels to be levied by local governments.*
- ◆ *Recommend to the President through the Minister, the percentage of the National Budget to be transferred to local governments every financial year.*
- ◆ *Recommend to the President, central government taxes that can be collected by local governments in their respective jurisdictions on an agency basis.*

In order for LGFC to discharge these functions effectively, it is important to ensure that all the specified sources of local revenue are yielding appropriate returns. This necessitates that LGFC works with stakeholders to develop and design mechanisms aimed at maximising local revenue returns as a precursor to advising on appropriate levels and allocation of grants from the Central Government.

In the period under review, personal Graduated Tax (GT), which constituted the major source of locally raised revenue for LGs, was proposed for suspension. The Commission took an immediate step and carried out a study which established that there was no alternative source of revenue, at the local government level, that could fill the gap created by the proposed suspension, at least in the immediate-term. From the study findings, the Commission therefore recommended that if the suspension were affected, Government (GOU) would have to fund the ensuing gap

<sup>1</sup> This article of the Constitution has now been amended<sup>1</sup> repealing the reference to “personal graduated tax”.

from GOU sources to sustain service delivery.

### 2.1.3 Graduated Tax as a Major Source of Revenue to LGs

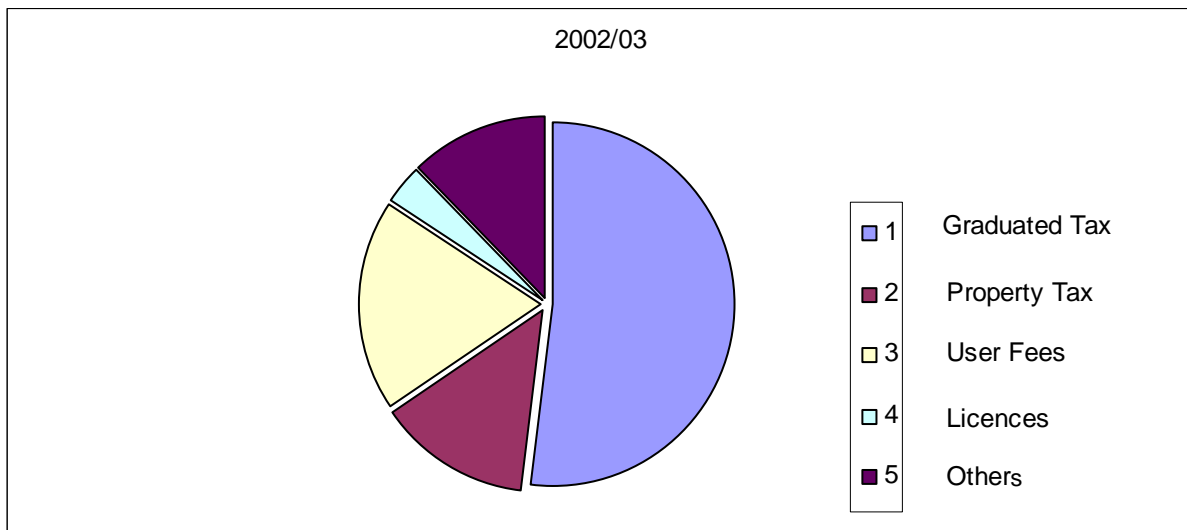
Graduated tax (GT) has been the major source of locally raised revenue for local governments. Available data shows that GT has been the dominant contributor to the total local revenues collected by LGs in both absolute and relative terms. This implies that any change that affects collection of the tax would tremendously affect the local revenue position of LGs.

The table below illustrates the absolute amounts of GT collected in the years 1999/98 – 2002/03.

#### Trend of Local Revenue Performance shs '000

Source		1997/98	1998/99	1999/2000	2000/2001	2001/02	2002/03
1	Graduated Tax	86,924,984	77,854,042	71,056,382	68,009,123	54,504,079	51,778,875
2	Property Tax	8,840,289	10,016,494	10,263,604	6,585,798	14,265,634	13,552,352
3	User Fees	16,386,306	16,690,937	16,239,258	11,868,294	19,400,578	18,430,550
4	Licenses	2,635,129	3,371,760	3,342,144	1,949,306	3,728,859	3,542,416
5	Others	14,145,110	11,747,349	9,846,275	20,975,170	12,912,455	12,266,832
<b>Total</b>		<b>128,931,821</b>	<b>119,680,583</b>	<b>110,747,664</b>	<b>109,387,694</b>	<b>104,811,607</b>	<b>99,571,027</b>
Source: LGFC							

Chart 2: Relative Share of GT in Total Collection in FY 2002/03



## 2.2 ACTIVITIES FOR THE PERIOD JULY 2004 – JUNE 2005

Because of the importance of local revenues in promoting and enhancing the success of the decentralisation policy by supplementing central government grants, LGFC undertook a number of activities, which relate to local revenue enhancement. Some of these activities were a continuation of those begun earlier; others were new ones within the Commission's work plan while others were in response to emerging events. The key activities in the work plan implemented in the period included the following:

- ◆ *Arrange and conduct gender-sensitive radio talk shows on issues of local taxation, service delivery and development.*
- ◆ *Support the ten districts under the District Development Programme Phase Two (DDP II) to develop local revenue enhancement work plans and provide seed money for their implementation.*
- ◆ *Continue with dissemination of the inventory of best practices (IOBP) to local governments.*
- ◆ *Disseminate to local governments and stakeholders, the findings and recommendations of the Rural Taxation Study.*
- ◆ *Arrange and conduct annual regional workshops on local revenue enhancement.*
- ◆ *Carry out monitoring of the DDP II districts and assess the impact of the work plans implemented with seed money provided to these districts during FY 2003/04.*

Due to a number of constraints and challenges, not all the planned activities could be implemented while some which had not been planned were implemented as explained. The following reports are therefore in respect of all activities undertaken in the period.

### 2.2.1 IMPLEMENTED ACTIVITIES

#### i) DISTRICT DEVELOPMENT PROGRAMME PHASE TWO (DDP II)

##### Introduction

The District Development Programme is funded through the United Nations Capital Development Fund in ten districts in Uganda. The component of the programme being implemented by LGFC relates to local revenue enhancement. The primary objective of the component is to document innovations in local revenue enhancement, test them in the ten districts and then have them rolled out to other districts. The districts covered under DDP II are: Arua, Yumbe, Kumi, Sironko, Mukono, Kayunga, Jinja, Ntungamo, Kabale and Bundibugyo.

This second phase follows on phase one whose objective was to design and pilot mechanisms which GOU can use to transfer (unconditional) development grants to local governments. This was done and the recommendations made were taken up in the transfers of the Local Development Grant (under the Local Government Development Programme, phase two (LGDP II)).

Most of the work and activities planned under this component revolved around documenting best practices in revenue enhancement and other related activities. During 2003/04 the main activities undertaken included documenting an inventory of best practices and preparing appropriate guidelines for its use, design of a Cost-Benefit Analysis (CBA) instrument for prioritising best practices and meetings of LRECC.

In the year 2004/05 activities planned were aimed at providing guidelines on implementation of specific best practices recommended in the DDP II programme documents. They are reported on below:

**a) Gender-Sensitive Radio Talk Shows**

One of the activities under DDP II was continuous interaction between taxpayers and other parties regarding taxpayer information, provide feedback to stakeholders and facilitate interaction between local leaders and taxpayers on local taxation, service delivery and general development issues. The talk shows were conducted for all the ten DDP II districts but the discussions involved wider listenerships as they would be heard beyond those DDP II districts. The accruing benefits therefore spread further and wider.

Reports, feedback and experiences from radio talks previously conducted provided useful lessons and experience in these shows and the overall conclusion is that this is a very useful tool in communicating to the populace and encouraging engagement between LG leaders and taxpayers.

**Objective of the Talk Shows**

The talk shows were aimed at increasing gender sensitive public awareness on the value of paying tax, obligations of citizens, responsibilities of LGs and the uses to which taxes are applied. This was intended to improve communication and awareness with a view to promoting responsiveness and compliance by taxpayers.

In all the shows conducted, there were lively interactions between the Commission and local government leaders on the one part and the taxpayers on the other. The issue of the impending suspension or abolition of GT and what would be the alternative dominated the exchanges and debates during the talk shows.

The other issue that came out quite repeatedly during the radio discussions concerns the link between taxes paid and services provided. Many taxpayers held the perception that most of the locally raised revenues were either embezzled by collectors or used for the personal benefit of leaders. It was further observed that taxpayers claimed that they do not see a connection between the taxes paid and services delivered by their respective local governments. They attribute the services being delivered largely to GOU grants.

The talk shows however provided an opportunity, for both elected and appointed leaders in local governments, to explain the benefits of taxes. In many of the shows, examples were cited of programmes and activities funded from local revenues such as construction of office premises, co-funding donor projects and other services not catered for by GOU grants.



In addition the talk shows were used to provide more information to the public on all important aspects of local government taxation, operations, budgets, plans and the obligation of citizens to contribute to their community's development and service delivery. The shows were therefore a useful tool for inculcating a positive culture to appreciate the benefits of taxes which would improve tax compliance and ultimately enhance development.

**b) Support to Local Revenue Enhancement Work Plans**

Under the DDP II work plan, LGFC undertook to provide technical support to the districts in developing their local revenue enhancement work plans. The objective was to provide technical advice and support to these local governments to enable them to develop revenue enhancement work plans for utilising funds (seed capital) being provided to the districts under DDP II support.

During the period under review all the ten districts covered by DDP II received technical support from LGFC to draw their local revenue enhancement work plans based on and to fit within the funds availed by LGFC for each district. A total of 101 million shillings was transferred to the ten districts. The table below shows the main activities of the work plans for each of the districts and the funds provided.

**DDP II District Local Revenue Enhancement Work Plans**

District	Amount (shs)	Main Areas Covered in Work Plan
Arua	15,455,330	Sensitisation of taxpayers. Strengthening enforcement mechanisms Radio talk shows Coordination of revenue enhancement programme
Bundibugyo	7,087,432	Compilation of potential revenue sources Training of revenue mobilisers/collectors Facilitation of revenue taskforce Provision of tax identification numbers (TIN)
Jinja	9,093,945	Radio talk shows Sensitisation of taxpayers Development of and updating business registers
Kabale	10,019,887	Mobilisation and training of tax collectors Training of sub-county officials on tax administration Research on new sources of revenue Completion of computerisation of tax registers
Kayunga	8,161,087	Establishment and update of four year-rolling tax register with TIN
Kumi	9,308,004	Survey of markets to determine realistic reserve prices. Review and prioritisation of local revenue enhancement strategies Sensitisation of communities at parish levels

District	Amount (shs)	Main Areas Covered in Work Plan
Mukono	16,698,722	Enumeration, registration and assessment of taxpayers. Updating the imputation values
Ntungamo	9,095,420	Collection of data from sub-counties for registration of taxpayers. Sensitisation of various stakeholders on importance of taxes. Research on new sources of revenue Enumeration of properties Baseline survey for tendering out revenue collection. Computerisation of tax register
Sironko	7,908,687	Registration of tax units Identification of new sources of revenue Sensitisation of taxpayers
Yumbe	8,171,482	Training revenue collectors Sensitisation of taxpayers.

### c) Monitoring and Evaluation of DDP II Districts

A number of activities supported under DDP II have already been implemented. LGFC, together with other representatives of LRECC undertook monitoring and evaluation exercises aimed at reviewing the impact of these activities on revenue performance of the districts being supported. These monitoring and evaluation exercises were conducted in March 2005 in all the 10 DDP II supported districts.

It evaluated the utilization of the funds provided to the districts to fund the LGs' revenue enhancement work plans to promote implementation of Best Practices.

### Findings

All the DDP II districts had formed the Local Revenue Enhancement taskforces as was presented in the draft guidelines for implementation of best practices. It was also established that the level of involvement and participation of political leaders in local revenue enhancement activities and mobilisation had tremendously increased in these districts. Sub counties particularly reported increased involvement of political leaders in mobilisation than before. This had resulted into improvement in revenue performance in nearly all the DDP II pilot districts as shown in the table over leaf.



## Summary of the revenue performance

Local Government	Total revenue collection before DDP II Support (FY 2002/3) "shs"	Total revenue collection after DDP II Support in FY 2003/4) "shs"	% Increment in collection
Sironko	509,886,000	627,530,871	23
Kumi	638,238,720	1,101,357,217	73
Yumbe	158,603,994	256,991,429	68
Kayunga	332,611,500	385,998,000	16
Arua	1,162,526,782	1,610,926,481	39
Ntungamo	984,066,650	1,693,955,029	72
Kabale	960,456,218	1,653,429,266	72
Mukono	1,696,880,000	2,954,445,571	74
Jinja	858,899,122	1,448,506,025	69
Bundibugyo	270,346,395	309,088,000	14

Source: LGFC Databank

- ◆ All the districts had included the local revenue enhancement work plans in their Budget Framework Papers (BFPs) as required under the Fiscal Decentralisation Strategy (FDS). BFPs create link between budget estimates with the district development plans.
- ◆ The districts had started to compile and maintain registers for most of the revenue sources in fulfilment of the requirement of the law and financial regulations.

### d) Training on Implementation of the Inventory of Best Practices (IOBP)

During the year 2003, LGFC compiled an Inventory of Best Practices (IOBP) for local revenue enhancement in local governments. The inventory was prepared together with guidelines for selection and implementation of best practices depending on the source of local revenue identified for improvement.

This exercise was funded under DDP II and undertaken in all the 10 supported districts during April 2005. It was conducted through workshops which drew participants from representatives of the Chief Administrative Officers (CAO), Chief Finance Officers (CFO), chairpersons LC III, sub-county chiefs, sub accountants, and parish chiefs. A total of 837 officials attended the workshops.

## ii) THE LOCAL REVENUE ENHANCEMENT COORDINATION COMMITTEE (LRECC)

### Background

The importance of locally raised revenues in implementation of the decentralisation policy cannot be overemphasised and is a concern of all stakeholders. A lot of effort has been expended toward finding an optimal and sustainable local revenue base. Over time it was realised that there was no forum to coordinate and harmonise these efforts. As a result, a Local Revenue Enhancement Coordination Committee (LRECC) was formed in 2003.

The Committee chaired by LGFC draws membership from a cross – section of stakeholders whose mandates and functions impact on the financing of local governments. The membership includes; Local Government Finance Commission (LGFC), United Nations Capital Development Fund (UNCDF), Ministry of Local Government (MOLG), Ministry of Finance, Planning and Economic Development (MOFPED), Uganda Local Governments Association (ULGA), Urban Authorities Association of Uganda (UAAU), Ministry of Water, Lands and Environment (MWLE), Kampala City Council (representing urban local governments), Bushenyi District Administration (representing district/rural local governments), Uganda Revenue Authority (URA) and Ministry of Justice and Constitutional Affairs.

The objectives of the Local Revenue Enhancement Coordination Committee are:

- ◆ Co-ordinating decision-making regarding local revenue enhancement.
- ◆ Providing support to the policy and legal framework for local revenue enhancement.
- ◆ Promoting best practices for revenue mobilisation at the local government level through capacity building and taxpayer education.

### Issues Considered

During the year under review LRECC met and deliberated on revenue enhancement efforts. Members of the Committee also participated in field monitoring of the implementation of revenue enhancement work plans and activities in the ten districts being supported under DDP II as well as the dissemination of the results and recommendations of the Rural Taxation Study.

### Achievements of LRECC

LRECC has continued to be instrumental in providing a forum for stakeholders to consult and attain consensus on a number of issues regarding local revenue. Some of the main achievements of LRECC in the period under review are:

- ◆ Consideration and recommending optimal approaches during the restructuring of Component 4 of LGDP II. This component is targeted to providing support to the processes aimed at improving performance of local governments. LRECC inputs have contributed immensely to the improvement of this component.
- ◆ The Committee serves as a steering committee to oversee studies which are undertaken by LGFC and other partners in relation to local revenue. For example, the Committee considered the report of the study carried out by LGFC in partnership with the Netherlands Development Organisation (SNV)<sup>2</sup>. This study was aimed at establishing the financing gap that would result from abolition of GT. The study established that local governments would in total lose 60 billion shillings in annual revenue as a result of abolition of GT. The Committee then gave its views which were subsequently included in the recommendations LGFC made to GOU.

<sup>2</sup> Study to Establish the Impact of Suspension of Graduated Tax on the Financing of Local Governments (2005) LGFC & SNV



### iii) DISSEMINATION OF THE RESULTS OF THE RURAL TAXATION STUDY

#### Background

The need for adequate local revenue to contribute towards funding of decentralised services has for long been a concern of many stakeholders in Government, the donor community, local governments and others. There is however need to pursue revenue enhancement efforts taking into account issues of poverty especially among the rural communities so as to establish a fair taxation regime that does not hamper poverty eradication initiatives.

As a contribution to this need, a study was conducted by the Economic Policy Research Centre (EPRC), Uganda in collaboration with the Overseas Development Group (ODG) of the University of East Anglia (UK) and Chr. Michelsen Institute (CMI), Norway. LRECC, with LGFC chairing, provided back up to the study as a Steering Committee. The study was completed in January 2004. The purpose of the study was to inform policy development especially with regard to the impact of local taxation on income distribution and therefore poverty eradication programmes and efforts. The findings from this study would therefore guide the streamlining of the local government taxation system. Findings and recommendations were documented in the study report.

#### Findings of the Study

Two key findings from the study are:

- ◆ Market dues are highly regressive and affect poor people more than the rich, therefore leading to inequality in society. For example; the smallest rural businesses pay 47.2% of their gross profit in tax while the largest rural businesses pay only 5% while urban small businesses pay 47.2% and the largest pay 23.8%.
- ◆ Privatised tax collection in local governments is good and should be encouraged. However there are major flaws that need to be rectified if it is to deliver the intended benefits. One major flaw is that this process transfers huge sums of money from taxpayers to private tenderers and political “godfathers”. This means that the tendering process is prone to political interference and local governments seem incapable of stopping it. The reserve prices for tendered sources are not scientifically set and end up leaving huge margins for tenderers.

#### Recommendations From the Study

Some of the major recommendations from the study which formed the basis of the dissemination exercise are:

- ◆ Local governments need to revise rates charged so that poor people are not burdened more by the tax system. This can be done by fairly computing share of taxes in prices of different commodities. Local governments also need to strengthen the process of assessment in order to set robust and realistic reserve prices. The process of reserve price setting should be de-linked from vested interests. This can be done by establishing a fluid committee that does the market assessment each year with membership constantly changed.

- ◆ The district tender board system needs to be changed as they are heavily influenced by political considerations. A neutral system that can be checked and is sanctionable needs to be established to replace the current one.
- ◆ There is need for local governments to provide information to the public that shows the link between taxes paid and services provided.

The dissemination exercise was conducted through workshops attended by key local government political leaders and technical officers. Due to limited funding the workshops were held in only six districts of Arua, Wakiso, Mbarara, Kamuli, Mbale and Lira between 24th January and 9th February 2005. It is expected that further dissemination will continue if funding becomes available.

### **Objective of the Dissemination Exercise**

The overall objective of the dissemination was to support tax reform in the local governments through the effective and widespread dissemination of the findings and recommendations from the Rural Taxation Study and the LADDER research both conducted by EPRC.

During the workshops emphasis was put on three main sources of local revenue, namely: graduated tax, market dues and business licenses and the basic principles to be followed in privatisation of tax collection.

### **2.2.2 ACTIVITIES IMPLEMENTED OUTSIDE THE WORK PLAN**

#### **i) Background**

Graduated tax generated a lot of debate with many leaders calling for its abolition as the tax was considered primitive and collection methods deemed oppressive. Many political leaders contended that general poverty of the population made the tax untenable considering Government's priority of poverty eradication. At the time, LGFC made analysis and at different fora presented the opinion that removing GT would create a huge gap in the funding for LGs that could only be filled either by increased transfers or an alternative revenue source that was not immediately foreseen.

However, in June 2004 Government announced the intention to suspend GT but no alternative source was identified. Since GT played a major role in the funding of LGs, the Commission took an immediate step to carry out a study. The purpose of the study was to make recommendations in light of the impending suspension.

#### **ii) Study on Implications of Abolishing Graduated Tax**

LGFC<sup>3</sup> undertook a study, through a consultancy, to establish the implications of suspending collection of GT on the financing of LGs and the decentralisation process generally. The study was conducted during the first quarter of 2005.

<sup>3</sup> LGFC in partnership with Overseas Development Organisation of Netherlands (SNV) and the Department for International Development of UK (DFID)



### The major findings from the study were the following:

- ◆ GT was the main source of revenue for local governments and raised about 60 billion shillings annually for local governments; contributing on average for the period 1999/00 to 2003/04, more than 70% of total local revenue. Abolition of GT would therefore result in a deficit in revenue of local governments to the tune of 60 billion shillings annually.
- ◆ There is no alternative source of revenue at the local government level which can raise similar amount of revenue in the immediate term. Any alternative source in the immediate to medium term would have to be an indirect source as any direct taxation would be difficult to collect as the perception that has been created is that suspension or abolition of GT is a wholesome exemption from payment of taxes.
- ◆ As a consequence of the above, Government would then have to compensate local governments, from the Consolidated Fund, for the revenue shortfall arising from suspension or abolition of GT. If this is not done and in an adequate manner, operations and functioning of local governments would be severely impaired. This would, as a result, lead to a weakening of the decentralisation process in Uganda.

### Recommendations to Government

The major recommendations from the study which were communicated to Government and stakeholders were:

#### Short-term Measures

- ◆ *Since there is no immediate alternative revenue source at the local government level that can feasibly and adequately compensate local governments for the fiscal deficit of 59.1 billion shillings, Government will have to find, from its sources (Consolidated Fund), the requisite funds to cover the deficit.*
- ◆ *During the ten years when Graduated Tax is suspended, there should be three – yearly reviews to determine new possible sources of revenues to local governments. The Local Government Finance Commission will explore mechanisms of progressively capturing new groups of taxpayers to include ranchers, plantation owners and large – scale farmers etc.*

#### Long-term Measures

- ◆ *The issue of funding local governments (fiscal decentralization) is critical in the success of the decentralisation policy. There is therefore need to holistically review the current local government financing regime. This will result in the establishment of an appropriate mix of central government grants with local government revenue that will make available adequate resources to all levels of governments to attain efficiency and effectiveness in service delivery.*

In accordance with the above, LGFC embarked on a plan to comprehensively review the financing regime of local governments. These reviews include current sources, collection procedures and practices, possibilities of introducing new avenues that include agency fees, royalties and other sources currently managed by the central Government that could be ceded to LGs.

Due to funding constraint and the activities leading to preparations for the change of the political system and the resultant elections, the Commission was not able to undertake the activities. They will however form the major part of the activities of the Commission in the coming periods.

### **2.2.3 PLANNED ACTIVITIES NOT IMPLEMENTED**

#### **◆ Annual Regional Workshops on Local Revenue Enhancement**

These workshops could not be conducted as the funds which were expected from DDP II were not availed.

#### **◆ Graduated Tax Bands and Imputation Values**

It had been planned that the Commission would recommend new GT bands and appropriate imputation values to be used in levying GT by local governments. This work was overtaken by events.

#### **◆ Public Private Partnerships in Local Revenue Enhancement**

This activity was deferred to the next financial year because funds under DDP II were released late. The terms of reference for carrying out the work were drawn and approved.

#### **◆ Incentive System for Local Revenue Enhancement and Collection.**

This activity was rolled over to the next financial year as the funds under DDP II were released late. All the necessary preliminary documentation was undertaken during the year.

## **2.3 GENERAL OBSERVATIONS ON LOCAL REVENUES**

During the period under review, the Commission continued with efforts to encourage LGs to collect adequate revenues from sources assigned to them by law using best practices and continued taxpayer education, among others.

However, the performance of local revenues continues to nosedive largely due to policy interventions that have been pronounced beginning in the years prior to this reporting period. A case in point is GT on which debates and proposals for suspension started way back before 2004. The result of these debates and the ensuing confusion is the reversal of the gains that had started to be registered through the implementation of best practices.

Some of the local revenues are difficult to collect due to either lack of enabling legislation or, where legislation exists, it is way out of tune. Examples are; property tax, cess on produce, royalties and agency fees to mention a few. Efforts of stakeholders including LGFC have resulted in the enactment of a new Property (Rating) Act in the year 2004. The regulations to give operational guidelines were yet to be approved and published. LGFC will continue to engage with stakeholders to ensure that appropriate legislation is in place to enable LGs to collect revenues with minimum impediment.

The net effect of the policy changes and political interventions as well as lack of clarity in the enabling laws and the general poverty of the population has been a steady decline in local reve-



nue collections in both absolute and relative terms. This means that activities, programmes and expenditures of LGs, which by law can only be funded from local revenues e.g. council, administrative expenses, co-funding obligations etc, cannot be fully carried out. This affects the operations of LGs and their ability to effectively handle oversight and service delivery responsibilities.

Most of the grants from the central governments are provided to LGs with conditions as to their utilisation and appropriation based on priorities normally determined by the sector Ministries. Grants therefore cannot be perfect substitutes to make up for gaps arising from declining local revenues. This is a concern of all stakeholders and LGFC will step up its efforts to find solutions and possible options.



## CHAPTER THREE:

# CENTRAL GOVERNMENT GRANTS TO LOCAL GOVERNMENTS

## 3.1 INTRODUCTION

Under the law<sup>4</sup> LGFC is mandated, among others, to:

- ◆ *Advise the President on all matters concerning the distribution of revenue between the Government and Local Governments and the allocation to each local government of money out of the Consolidated Fund.*
- ◆ *In consultation with the National Planning Authority consider and recommend to the President the amount to be allocated as equalisation and conditional grants and their allocation to each local government.*
- ◆ *Recommend to the President through the Minister, the percentage of the National Budget to be transferred to local governments every financial year.*
- ◆ *Perform such other functions as may be prescribed by law.*

Since the inception of decentralisation, the main source of funding for LGs has been the grants transferred from the Consolidated Fund. Article 193 provides for three grants to be transferred to LGs namely; unconditional grant, conditional grant and equalisation grant.

## 3.2 TRENDS

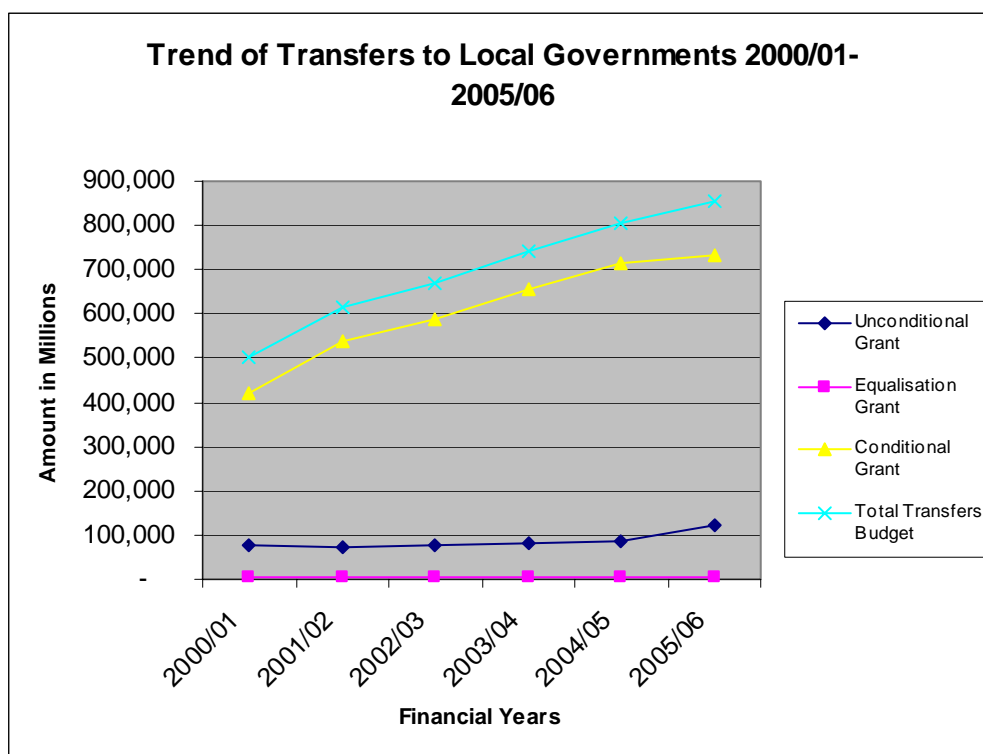
Grants have become the dominant mode of funding for local governments. The levels of grants, especially conditional grants have tremendously increased, in proportion to the other grants, since the inception of decentralisation. For example the total amount for all grants has increased from 330 billion shillings in the year 2000/01 to 856 billion shillings in the year 2004/05, representing an increase of approximately 160% in the same period.

Conditional grants have grown from 261 billion shillings to 732 billion shillings representing an increment of 281% in the same period. The unconditional grant and equalisation grant increased from 66 billion shillings to 120 billion shillings (182%) and 2.5 billion shillings to 3.5 billion shillings (140%) respectively. These trends are shown in figure 1 and table 1 overleaf.

<sup>4</sup> Article 194 of the constitution of the Republic of Uganda (1995) and section 9 of the LGFC Act.



Figure 1: Trend of Grants (Transfers from Central Government)



Source: LGFC Databank

Table 1: Trend of budget transfers to Local Governments ('000)

Grant	Unconditional	Equalisation	Conditional	Total
1999/00	66,619,503	2,000,000	261,480,672	330,100,175
2000/01	79,138,036	4,000,000	418,841,963	501,979,999
2001/02	73,342,506	4,400,000	537,257,494	615,000,000
2002/03	77,436,440	4,334,277	588,178,297	669,949,014
2003/04	82,797,234	3,534,278	655,135,923	741,467,435
2004/05	87,529,621	3,534,581	714,483,235	805,547,437
2005/06	120,466,350	3,479,913	732,335,339	856,281,602

Source: LGFC Databank

### 3.3 OBSERVATION

However these increases are outweighed by increases in the service delivery needs of local governments which include:

- ◆ Increase in the general price levels for goods and services such as fuel, construction materials and general consumables and supplies,
- ◆ The number of local governments has substantially increased resulting in more expenditure needs to cater for more staff, more elected leaders, more operational expenses etc.
- ◆ Some donors have been demanding co-funding of projects to be assured of interest, ownership and sustainability.

Therefore, despite the increment in grants, local governments are still facing the challenge of delivering decentralised services as a result of the increased expenditure needs coupled with dwindling local revenues.

### 3.4 ACTIVITIES FOR THE PERIOD JULY 2004 – JUNE 2005

Grants are the major source of funding for LG activities and programmes. The way they are allocated and utilised therefore has a significant impact on service delivery and operations of local governments. LGFC therefore planned a number of activities aimed at streamlining the transfer system for effective service delivery. The activities planned in the period were:

- ◆ Analyse all grants and document issues in their allocations, utilisation and amounts and make appropriate recommendations for their efficient and effective use.
- ◆ Sensitise stakeholders on the new allocation formulae for grants
- ◆ Develop modalities and mechanisms for extending central government grants from higher local governments to lower local governments.
- ◆ Compile minimum standards of service delivery for all sectors to form basis for recommendations on appropriate levels of grants.



### **3.4.1 IMPLEMENTED ACTIVITIES**

#### **i) ANALYSIS OF GRANTS**

##### **a) UNCONDITIONAL GRANT**

###### **Background**

Unconditional grant is defined as the minimum grant to be paid to local governments to run decentralised services<sup>5</sup> and consists of wage and non-wage components. The grant is derived using a formula<sup>6</sup> provided in the 7<sup>th</sup> Schedule to the Constitution. The formula provides that the amount to be given in a financial year should be the amount received in the previous financial year adjusted for general price changes (inflation) and the cost of added or subtracted services to local governments.

The non-wage component of unconditional grant is computed on the basis of two factors, namely; population (85%) and area (15%). The wage component is computed based on the LG payrolls authenticated by the Uganda Computer Services.

However, many local governments had not fully consolidated their payrolls which resulted into inadequate amounts being allocated for wages under the unconditional grant.

###### **Challenges**

###### **◆ Inadequate Amount**

Over time the amount of unconditional grant has remained comparatively small and its growth minimal. Whereas the Constitution provides that the grant should increase, at least by factor of price changes and in tandem with added responsibilities, this has not been the case in practice. The increased number of new districts means that the overhead costs have equally increased yet there is no proportionate increase in unconditional grant.

At present unconditional grant is insufficient for most LGs to meet their wage requirements. As a result most LGs use the non-wage component of the grant to top up the wage requirements. In most cases there is no balance to cover the basic administrative expenditures.

###### **◆ Allocation of the Wage Component**

Because the wage component is allocated on the basis of each LG's payroll, an issue of the staff who are not on the payroll has arisen. The result is that many LGs have faced difficulty in paying wages for all their staff, especially those not captured on the payroll.

###### **Recommendation**

The Fiscal Decentralisation Strategy (FDS) recognises the need for adequate funding of the basic services of LGs. It had therefore been recommended that the transfer system be reorganised and sufficient resources provided under unconditional grant. This recommendation has not been implemented. It is therefore the recommendation of the Commission that unconditional grant is increased to cover at least the actual wage requirements and critical basic administrative expenditures of LGs. The manpower establishment of LGs after the ongoing restructuring programme, when completed, should form the basis for determining the wage component.

<sup>5</sup> Article 193 (2) of the Constitution

<sup>6</sup> details contained in Annex II to this report

## **b) CONDITIONAL GRANTS**

Article 193 (3) of the Constitution defines conditional grant as “moneys given to local governments to finance programmes agreed upon between the Government and the local governments and shall be expended only for the purposes for which it was made and in accordance with the conditions agreed”.

### **Status of Conditional Grants**

Conditional grants constitute the main mode of transfer of funds from the Central Government to the LGs. The total amount of conditional grants increased from 655.1 billion shillings in 2003/04 to 714.5 billion shillings in 2004/05 representing, 88.4% and 88.7% respectively, of all transfers to local governments. Conditional grants are sourced from the Poverty Action Fund (PAF) and as such provide an assured stream of resources to address sectoral issues considered pivotal in poverty eradication. Currently the sectors that have conditional grants are; agriculture, health, education, water, roads, gender and community development as well as natural resources and environment.

### **Issues in Conditional Grants**

- ◆ Under the law, conditional grants are to be utilised to finance programmes and conditions agreed between the Central Government and LGs. However in practice, local governments have not been directly involved in choosing the programmes to be funded under conditional grants. The sectoral policies, standards and specifications which constitute the major aspects of the conditions for use of conditional grants are equally developed without active involvement of LGs.

LGs are involved in discussion of mainly the accountability and reporting conditions. During these discussions the Central Government takes the stature of a stronger party relative to the LGs which are the weaker party probably due to the fact that the funds come from the Central Government. In such a situation, it cannot therefore be said that the programmes and conditions are genuinely agreed upon.

- ◆ As a consequence, onerous conditions in form of stringent accountability and reporting requirements are set by the Central Government to which LGs “agree” during negotiations. Compliance with these controls creates increased burdens on LGs’ resources in terms of time and personnel. The Central Government also spends considerable amount of resources to supervise and monitor compliance with the conditions. Non-compliance with the conditions attracts sanctions which include actions such as suspension of funding irrespective of the level of implementation of the programmes.

The result is that LGs have a reduced interest in ownership of the programmes for they consider themselves as mere implementers rather than owners and beneficiaries.

During the reporting period, LGFC conducted, for the second time, negotiations between Sectoral Ministries and LGs. The negotiations have seen an improved understanding and appreciation of the conditions and the perception of each party’s role which contributed towards a harmonised approach.



However, negotiations do not involve setting of specifications, costing and procurement methods of the goods, works and services necessary in implementation of programmes. It is therefore unlikely that the negotiations will eliminate the need for stringent controls and supervision unless their scope is extended to include all pertinent matters.

## **Recommendations**

- ◆ The Central Government should strengthen participation in all aspects of selection, design, implementation and evaluation of programmes financed under conditional grants.
- ◆ The Central Government should consider a reduction in funding through conditional grants and increase unconditional and other grants. This would empower LGs to enhance their discretion in implementing their local priorities. Efforts through restructuring and capacity building of the LGs should allay the fears of the Centre that the funds will not be properly utilised to serve the interest of local governments

## **c) EQUALISATION GRANT**

### **Background**

Article 193 (4) of the Constitution defines equalisation grant as the money to be paid to local governments for giving subsidies or making special provisions for the least developed districts; and shall be based on the degree to which a local government unit is lagging behind the national average standard for a particular service.

NPA and LGFC are enjoined to make recommendations on allocation of equalisation grant as well as selecting the services and local governments to be targeted. Because of the difficulty in obtaining the requisite data and absence of standards of service delivery for most sectors, it has been difficult to operationalise the grant in full compliance with the above constitutional requirement.

### **Operationalisation of Equalisation Grant**

Actualisation of the above definition has, for now, been impractical as the question of standards for service delivery remains unresolved for most sectors. The Commission and stakeholders therefore have to make use of proxies as a way forward.

During the period under review and as part of the process of reviewing grants allocation formulae, LGFC proposed, and it was adopted for use, that new parameters be applied in allocation of equalisation grant. The parameters adopted and used are; the Human Poverty Index, the Human Development Index, Household Consumption Expenditures index and local revenues index of local governments. The number of beneficiaries of equalisation grant was proposed for reduction from 34 to 21 districts and from 40 to 34 urban councils.

LGFC undertook a study in 1999 aimed at making recommendations to operationalise the equalisation grant. This was the first phase of the study which was aimed solely at the district local government service. Because of the absence of standards and data on service delivery levels, LGFC used two main proxies to arrive at need for equalisation, namely:

- ◆ Using budget and actual expenditure data, the relative level of expenditures and importance attached to each service considered was determined. The aggregate figures were used as proxy for total expenditure requirements. This also reflected the relative importance put on the service and appropriate weights were attached. The average expenditure need for each defined service was then derived against which expenditure need for each LG was compared.

The local governments that had their expenditure needs greater than the average were considered for equalisation on the basis of that.

In order not to appear to be rewarding LGs who don't put in maximum efforts, it was felt that the revenue potential for each local government should be assessed. This was done by estimating household incomes for each district based on household expenditure data available.

The average national revenue potential was derived against which each LG's revenue potential was compared. Those LGs whose potential was below average were considered for equalisation on that basis.

At the end the two were combined and a total of 27 districts were found to require equalisation grant totalling 12 billion shillings. This was recommended to Government. However, only 2 billion shillings was made available in the FY 1999/00 to be distributed to the 27 districts.

The total amount of equalisation grant has remained very low and has stagnated at 3.5 billion shillings for both district and urban local governments. Local governments that receive equalisation grant are free to utilise the grant in any of the agreed priority areas under PAF based on work plans approved by the respective sector ministry.

In the process of reviewing allocation formula and as a result of the absence of clear standards for service delivery in most sectors, LGFC and stakeholders agreed that poverty indices be used to identify the local governments to benefit. Accordingly it was recommended that the new allocation formula for equalisation grant be based on Human Poverty Index (HPI), Human Development Index (HDI) and Household Consumption Index (HCI) which give an indication of the needs for service as well as proxy for level of income.

### **Issues in Equalisation Grant**

The issues affecting the operation of equalisation grant include the following:

- ◆ Equalisation grant continues to be allocated based on proxy data which is not accepted by all stakeholders as either fair or equitable. This is primarily because most sectoral ministries have not developed standards of service delivery. These standards are necessary for the Commission to determine which local governments lag behind in respect to what services. The law vests the responsibility to develop the standards with the sector ministries.



- ◆ The amount provided by MOFPED for equalisation grant has remained quite small. Shillings 3.5 billion for 34 districts and 40 urban councils cannot make any meaningful impact on service delivery. LGFC and NPA are required to recommend the amount for equalisation grant and its allocation. However, the recommendation made by LGFC at the time of operationalising equalisation grant of 12.5 billion shillings was not accepted by MOFPED.

### **Recommendation**

- ◆ It is recommended that the legal framework should be reviewed so as to ease the work of the Commission. LGFC cannot compel sectoral ministries to develop standards yet they are considered necessary for successful operationalisation of equalisation grant.
- ◆ The amount of equalisation grant should be increased to reflect the important objective it is intended to achieve. The legal framework needs to be reviewed so as to ensure that MOFPED is required to take into account stakeholders' views in determining amounts for grants including equalisation grant.

### **ii) GRANTS ALLOCATION FORMULAE**

Under FDS it was decided that there was a need to review the formulae used in allocation of grants to LGs to make them transparent, equitable and focused on poverty factors in order to contribute toward attainment of PEAP goals. LGFC undertook the task in collaboration with stakeholders beginning in the year 2002.

The allocation formulae were reviewed in a two-stage process. Phase I was the identification of the necessary and appropriate principles on which to base an allocation formulae. Phase II was the development of the actual formulae. After consultations with stakeholders on all the aspects of the new allocation formulae, LGFC submitted them to MOLG in October 2004 for onward submission to Cabinet for approval.

LGFC had planned to sensitise LGs and sectoral ministries as to the application of the new allocation formulae, however the sensitisation could not be undertaken because by end of the period it had not received feedback from MOLG on the status of the formula. LGFC received information that the Ministry of Education and Sports (MOES) was still consulting with their funding agencies on the aspect of the resultant reallocations if the formula is applied. LGFC hopes that these consultations will be concluded soon and the formulae will be operationalised.

### **iii) STUDY ON EXTENDING GRANTS TO LOWER LOCAL GOVERNMENTS**

#### **Background**

The local government structure provides for Lower Local Governments (LLGs) below district and municipal council levels that directly interface with the central government. The Lower Local Governments (LLGs) are sub-counties in the rural areas and divisions and town councils in the urban settings. These LLGs have specific responsibilities assigned to them by law. Article 193 (5) of the Constitution requires district councils to indicate how conditional and equalisation grants acquired from the central government are to be passed on to lower levels of local government.

On the other hand, LGFC Act requires the Commission, in consultation with the National Planning Authority to consider and recommend to the President the amount to be allocated as equalisation and conditional grants and their allocation to **each local government** (emphasis added).

Currently some conditional grants allocated to LGs are passed to district local governments which at times, depending on the grant in question, plan, hire contractors, suppliers or service providers to execute works, deliver goods and services and pay the contractor, supplier or service provider directly on behalf of the lower local governments (LLGs).

The procurement laws sometimes do not give powers to LLGs to conduct procurement on their own behalf.

This position was due to a number of factors at the start of decentralisation that include manpower (skills and capacity), equipment (e.g. for road works) and others. However, with time these factors have changed and necessitated review of the current state of transfers.

Despite the validity of these concerns it cannot be said that the legal provisions are being complied with. In light of the apparent non-compliance with the legal provisions, LGFC decided to conduct a study to review the capacity of LLGs to ascertain whether the factors have changed to enable the legal provisions to be complied with.

### **Objective of the study**

The general objective of the study was to evaluate whether the factors conducive for transfer modalities that would enable the legal provisions to be complied with were in place and to propose a framework for the transfers.

### **Scope of the Study**

The study involved reviewing the relevant literature, factors and conditions prevailing at the HLGs and LLGs and was conducted in selected local governments. The selection took into account geographical distribution and other factors.

During the period under review, data was collected and analysed. Preliminary findings indicate that it is possible to transfer the grants to the LLGs as required by law if certain aspects are attended to. The findings and recommendations will be presented in the next report when the study will have been concluded.

### **3.4.2 ACTIVITIES NOT IMPLEMENTED**

#### **◆ Sensitisation of Stakeholders on the New Allocation Formulae**

It had been planned that when Cabinet approved the new allocation formulae, LGFC would sensitise LGs, sectoral Ministries and other stakeholders on their application, implications and effects as part of the process for implementation. This however could not be done because the formulae had not yet been approved by the Cabinet.



- ◆ **Minimum Standards for Service Delivery**

It is considered necessary that optimum levels of grants can be determined based on costing of service delivery needs to agreed standards. LGFC had planned to coordinate the respective sector ministries to develop these standards. However the activity could not be carried out because there were no funds to undertake it.

## CHAPTER FOUR

# FISCAL DECENTRALISATION STRATEGY

## 4.1 Background

The Fiscal Decentralisation Strategy (FDS) was approved by Government in 2002 with the objective of “Strengthening the process of Decentralization in Uganda through increasing Local Governments’ autonomy, widening local participation in decision making and streamlining of fiscal transfer modalities to local governments in order to increase the efficiency and effectiveness of local governments to achieve Poverty Eradication Action Plan (PEAP) goals within a transparent and accountable framework”. Implementation of the various activities aimed at carrying the strategy into effect commenced in July 2003.

The specific objectives of FDS are:

- a) *Streamlining transfers to local governments to remove administrative burdens while increasing transparency and efficiency, both at the centre and within local governments.*
- b) *Increasing local government autonomy with respect to planning, budgeting and implementation of national sector policy, while taking care of local priorities.*
- c) *Achieving transparent, needs based and poverty sensitive allocations of sector funds between local governments.*
- d) *Increasing effectiveness of local government expenditures in achieving PEAP objectives and goals*

FDS aims at reforming the local government budget preparation and implementation processes. FDS does not radically alter the LG budget process, but brings together various long running efforts in order to make the relationship between the centre and local governments compliant with the Constitution and the Local Governments Act and other relevant laws of Uganda.

FDS accommodates the respective policy imperatives of poverty eradication, decentralization and sector wide planning approaches and simplifies the system of fiscal transfers by using a development and recurrent transfer system. It uses, as far as is possible, the modalities of LGDP II, and provides for increasing discretionary funds as capacities are developed and tested at the local level.

The responsibility of local governments in service delivery places them in a pivotal position in the implementation of the Poverty Eradication Action Plan (PEAP), which sets out the strategy by which Uganda aims to eradicate absolute Poverty by 2017.

LGFC was specifically tasked to implement or oversee the implementation of objectives (a), (b) and (c) above.



## 4.2 ACTIVITIES FOR THE PERIOD JULY 2004 – JUNE 2005

During the period LGFC planned to implement the following activities in light of the above objectives. These activities are a continuation of previous reporting periods but the specific tasks were planned for this period.

- ◆ Arrange, conduct and coordinate meetings and activities of the Local Government Budget Committee (LGBC).
- ◆ Arrange, facilitate, coordinate and conduct annual negotiations between sectoral ministries and local governments on conditional grants.
- ◆ Review the local government budget manuals and disseminate the revised manuals for use by local governments.
- ◆ Analyse local government budget framework papers and make appropriate recommendations.
- ◆ Participate in development and dissemination of local government financial and reporting systems.

### 4.2.1 IMPLEMENTED ACTIVITIES

#### i) Local Government Budget Committee (LGBC)

The Local Government Budget Committee (LGBC) was created on the background that there was need for a more co-ordinated and systematic management of the Local Government Budget Process by central government. However, before the LGBC, there was no forum at which local governments could formally discuss budget-related issues with central government. There was also need for more meaningful negotiations with local governments on the allocation of funds.

On that background, the LGBC was created to provide a forum for deliberations on the local government budget process and financing issues. During the FY 2004/05, the LGBC performed a number of tasks, which included the following:

- a) Convened four meetings to discuss a variety of budget related policy issues including flexibility during budget formulation process, technical assistance to weak local governments in budgeting, issues for negotiations, agreeing on issues for submission to Ministry of Finance, Planning and Economic Development for inclusion in the National Budget framework paper.
- b) Provided technical support to weak local governments in the budget process identified during the BFP analysis. Those supported included Kabarole, Kyenjojo, Kamwenge, Sironko, Kapchorwa and Kumi.
- c) Convened and facilitated the negotiations between the local governments and Government represented by respective sector ministries. Key issues on the agenda of negotiations included the following:
  - ◆ The identification of national sectoral policies which local governments are re-

quired to implement.

- ◆ Issues with respect to local government establishments. An example of this is the Technical Support Units which many local governments regard as being contrary to the spirit of decentralization. To some sectors, this is technical support but ultimately it works to undermine capacity building in local governments.
  - ◆ Relevant modalities with respect to work plans, budgeting and reporting. These are of particular concern as they have direct impact on releases and implementation of activities.
  - ◆ The responsibility of the Government in the implementation of national sector policy is a two-way street, where both parties must fully live up to their obligations if the system is to work. Sanctions and rewards are other issues.
  - ◆ Other examples of subjects for negotiation are the interference by line ministries in the location of investments in local governments as this is outside their area of jurisdiction.
- d) Enlarged the LGBC membership by inviting the National Planning Authority to join as a member institution.
- e) Analysed the Local Government Budget Framework Papers (LGBFPs) for compliance with the laws and regulations and providing feedback to those local governments, which require adjusting. The analysis also helped to identify issues for submission to MoFPED for attention.

## **Challenges**

While acknowledging that FDS has enabled the long awaited interface between local governments and central government officials to conduct some form of cordial discussion, there is a need to strengthen the negotiation framework and institutionalise the system.

Funding for LGBC meetings is still inadequate. In the FY 2004/05, the LGFC had planned to convene 8 LGBC meetings but could only afford 4 in the end. More financial and logistical support is required to strengthen the operations of this forum.

## **ii) Negotiations Between Sector Ministries and Local Governments**

Under article 193 conditional grants are to be utilised upon conditions agreed between the Government and LGs. To implement this provision of the Constitution and the requirements of FDS, LGFC arranges for annual negotiations on conditional grants. The aim of the negotiation is to promote efficient and effective utilisation of conditional grants and bring closer understanding between the Government and LGs on matters concerning conditional grants.

For the last two years now, LGFC has organised and facilitated the negotiations between sector ministries managing conditional grants and local governments represented by their associations. During the period under review, the negotiations were held between 28<sup>th</sup> November and 2<sup>nd</sup> December 2004.



The negotiations reviewed the performance of the two parties on the previous year's negotiation agreed positions, matters arising, emerging policy issues and their impact on local government operations and the appropriate modalities for implementing programmes for effective service delivery. A report detailing the above matters and the memoranda of understanding between the parties on each of the conditional grants was prepared and shared with stakeholders.

A major challenge remains monitoring the observance of the agreed conditions and the impact of the process on efficiency and effectiveness. During the second negotiation, the air of cordiality and better understanding between the parties was very evident. This suggests that the parties have begun to appreciate each other's roles in successful implementation of conditional grant programmes.

### **iii) Budget Manuals**

One of the key tasks undertaken under FDS was the development of budgeting manuals under the supervision of Local Government Budget Committee and LGFC. The manuals in two volumes were developed in 2003. Volume one targets the political group including lower local governments, civil society, non-government organisations (NGOs), Community Based Organisations (CBOs) and opinion leaders role in the budget process. Volume 2 targets the planning and budgeting by the sectors and the role of the budget desk and political leaders at the district/municipal level.

The key features of the budgeting manuals are that they clarify on the key stakeholders and the process of undertaking an effective budget process. It highlights the key outputs at every stage in the process, defines the structure of the budget framework paper for local governments, gives a layout of the work plan format and emphasises the role of the budget desk in co-ordinating the budget process in each local government.

The budget manuals also provide the budget and expenditures along two structures namely Recurrent Transfer System (RTS) and Development Transfer System (DTS) in line with the budget process.

The Budget Manuals were piloted in 12 districts and three municipalities. The evaluation of the report recommended the simplification of the manuals before roll out to other local governments. That was done and the budget manuals were rolled out to all higher local governments in FY 2003/04.

In the period under review, the main task of the LGFC was to assess and evaluate how local governments have grasped the manuals and their use in the budget process especially preparation of Budget Framework Papers (BFPs).

The evaluation showed that the revised manuals were much simpler and easier to understand. The quality, in terms of compliance with format and other requirements under FDS of plans, budgets and BFPs had significantly improved. Some technical support is still required for a number of districts. It is therefore recommended that more hands – on support should continue to be provided to local governments.

#### iv) Local Government Budget Framework Papers

Under FDS, use of planning and budgeting as tools in the management of local governments affairs is emphasised. Local governments are required to prepare three – year – rolling District Development Plans (DDP) which are implemented annually through the budgets.

An important link between the DDP and the annual budget is the budget framework papers (BFP) which local governments are required to prepare every year as part of the budgeting process.

A format showing what a BFP should contain has been developed by LGFC through LGBC. This is to guide LGs in presenting review of the previous year's performance and description of what is planned for the coming year. The Budget Framework Paper should logically present and show linkage between the budget and DDP.

The analysis follows a set of criteria which contains information on; review of performance in the previous year, sectoral performance, objectives and priorities, priorities and the process involved and indication of unfunded priorities, budget estimate and the accompanying annual work plan.

BFPs are analysed with regard to the following matters to assess compliance and whether or not the BFP conforms to expectation. The matters considered are;

- ◆ Whether there exists a budget desk at the LG
- ◆ Whether a budget call circular was issued
- ◆ Evidence that the DDP is resource – constrained
- ◆ Compliance with the sequencing and the format for Budget Framework Paper presentation
- ◆ Inclusion of provision for operation and maintenance (O&M) budget
- ◆ Identification of un-funded priorities
- ◆ Analysis of and consideration of the 10% flexibility
- ◆ Provision for monitoring and supervision (5%)
- ◆ Integration of local revenue enhancement work plans in the annual work plan
- ◆ Proposed budget and evidence that a budget conference has been held as required.

LGFC analyses these BFPs for compliance with budget guidelines, ensuring that the process was properly followed, highlighting issues that should feed into the National BFP and also informing the national institutions which local governments require support.

Although the analysis by LGFC of the BFPs for FY 2005/06 shows increasing improvement in presentation and preparation, there is still room for improvement and support to LGs in that



respect. Local governments receiving specific support under SDU II and SNV are among those whose compliance and appreciation levels are highest.

#### **v) Support to Local Government Planning and Budget process**

Under support from Strengthening Decentralisation in Uganda Project Phase II (SDU II), technical assistance is provided to local governments in two areas, namely:

- ◆ Support to local government on the planning and budget process; and
- ◆ The improvement of the procurement process.

Until recently support has been limited to the first one, pending the revision of the laws governing procurement in local governments. As of now, SDU II has contracted a procurement specialist and as soon as the Government processes of revising the appropriate laws and guidelines are complete, SDU II will provide the technical assistance.

The observations from the monitoring exercises indicate that the supported local governments appreciate the support. However a few LGs complained of the software that was given to them to develop the BFP, the Budget and Work plan. The problem was mainly caused by low levels of computer literacy, constant power failures thus disrupting the functioning of the software and the issue of calling for someone from Kampala to address some minor problem.

Following from these shortcomings, a revision was made with the participation of MOFPED, SDU II and LGFC and LGBC approved its use. The revised software gives a standard format of presenting the BFP based on the Budgeting Manuals developed by the LGBC and being used by LGs upon authorisation by MOLG. The manuals were provided to all Higher Local Governments (HLGs) in both soft and hard copies. What now remains is the need to provide hands-on technical support to LGs that still face challenges in their use and thereby improve on the quality of BFPs presentation.

## **4.3 Challenges in FDS Implementation**

### **4.3.1 Implementation Flexibility**

As a way of promoting discretion by LGs over their budgeting, it was agreed that LGs be permitted room to reallocate conditional grants across sectors within agreed limits and conditions. As a start, agreement was reached in 2004 that this flexibility should be limited to 10% of each non wage recurrent sectoral grant and in the health sector to apply to only 50% of the grant for drugs.

During the budgeting process for FY 2005/06 it was observed that acceptability and appreciation of the principle by LGs is gradually picking up. In the analysis of the BFPs for FY 2005/06, it was noted that LGs were eager and willing to apply it but they were not yet fully compliant with the principle. During the subsequent BFP workshops, LGFC gave feedback on issues that emerged from the analysis of the BFPs, which covered flexibility as a special area of clarification.

#### **4.3.2 Conditional Grants for LGs in Disturbed Areas**

The framework for operation of conditional grants in LGs is ideal to a normal situation. Those local governments operating under disturbed situations such as insecurity are not in position to utilise the grants on the usual terms and would require a special dispensation. This matter was discussed within the ambit of LGBC and the office of the Prime Minister and special guidelines for use in handling conditional grants in such situations were developed. The import of the guidelines is to permit districts in areas affected by insecurity more flexibility in the use of grants to address pressures brought about by insecurity. The funds would then be used to address emergent needs such as, food, sanitation, health etc which are critical for the people in such situations.

The proposals were submitted to Government but there are no indications that they were considered. Many local governments in that situation have therefore largely failed to utilise the conditional grants which would help the people who are in great need.

#### **4.3.3 Capacity Building for FDS successful Implementation**

FDS implementation issues are largely crosscutting. Matters of training, planning, budgeting, financial management, leadership, reporting, accountability and capacity building generally are pre-requisites for successful FDS implementation.

Stakeholders that include MOLG, SDU II and CSOs have, in various forums, played different roles to address these issues. Despite these efforts there are challenges yet to be addressed which include:

- ◆ Local government budget process (which incorporates FDS) because of the direct linkages to the development planning, local governments' revenues and the like.
- ◆ Integrated Financial Management System (IFMS) which has linkages to most LG activities
- ◆ Delivery of 'new' methodologies e.g. a 'Best Practice' paper in an area of local government operation does not fit with current modules. This is compounded by the LGDP II modules being optional.



## CHAPTER FIVE:

# ADMINISTRATIVE AND OTHER STAKEHOLDERS ACTIVITIES

## 5.1 BACKGROUND

One of the key activities in the Commission's Medium -Term Corporate Strategy is to strengthen its internal systems and procedures to achieve efficiency in execution of its functions, develop and operationalise an outreach and communication capability in order to deepen understanding of fiscal decentralisation issues.

This flowed from the organisational development analysis of the Commission which was carried out in 2002. In the period under review, the following were the activities undertaken within the Commission.

## 5.2 ACTIVITIES FOR THE PERIOD JULY 2004 – JUNE 2005

One of the thematic areas identified in the LGFC medium – term Corporate Strategy is the need for institutional development to enable the Commission efficiently and effectively undertake its functions. The Commission is also required to work in consultation with some specific stakeholders in execution of its functions, and in many instances, involvement of other stakeholders as well as participation of LGFC in other stakeholders programmes are considered necessary.

Other stakeholders' programmes and activities which the Commission participates in are not in the plan of LGFC and participation is normally on invitation. The activities planned were therefore mainly those aimed at LGFC's institutional development and included the following:

- ◆ Produce and submit to Parliament an Annual Report as required by law.
- ◆ Implement recommendations in the LGFC Human Resource Policy and Communication Strategy.
- ◆ Arrange and implement an outreach programme for members of LGFC with visits to local governments, sectoral ministries and other stakeholder institutions.
- ◆ Participate in activities of, consult and interact with stakeholders both as a statutory requirement and as and when required and necessary.
- ◆ Establish and operationalise a resource centre.

## **5.2.1 ACTIVITIES IMPLEMENTED**

### **i) HUMAN RESOURCE POLICY AND COMMUNICATION STRATEGY**

Due to limited financing, implementation of recommendations on organisational development of the Commission has been slow. Implementation of the Human Resource Policy approved in July 2005 has been slow. A handbook summarising the salient features of the policy has been prepared and is ready to be printed and published for use in the Commission.

Training was provided to both members of staff and Commissioners on tools and techniques of Communication. The training was conducted for three categories, namely: junior staff, senior staff and Commissioners combined with members of management. The training clusters lasted one day in each case. The training which was financed under DANIDA support received positive assessment and commentary by all categories as very useful and instructive.

The Commission continues to face hardships especially in respect of transport. It is worth noting that a vehicle was procured for the Chairman in the period. However, the older vehicles have become barely serviceable now rendering field visits a big challenge. There is provision in the budget for one vehicle and the procurement process has commenced.

#### **Human Resource**

As a policy, staff training is limited to short – term skill improvements programmes. Long and professional courses will no longer be sponsored using GOU funds because the provision for this activity in the budget is insufficient. The Commission will however continue to provide modest financial support to staff under-going training to cater for learning materials such as books, stationery etc. During the period under review, the commission extended financial support to one Economist and the Procurement officer who are pursuing post-graduate qualifications.

The Commission plans to embed the process of performance appraisal in its human resource management process as a tool for improving performance as well as a motivation opportunity. The performance management process will be based on the principles contained in the Human Resource Policy and form part of the overall implementation of the policy. Both staff members and supervisors will be inducted in the use and tools of performance appraisal system.

The Government of Uganda has commenced implementation of the third phase of the Public Service Reform Programme (PSRP). This phase is intended to enhance the public service performance under the Public Service Performance Enhancement Programme (PSPEP). The programme is to be funded through a basket of funds under the Performance Enhancement Fund (PEF) on a supply driven basis. The Commission is working on proposals and work plan to access this fund based on a needs assessment that has been carried out as required.

### **ii) ANNUAL REPORT**

The Commission prepared the Annual Report for the period ending June 2004 and presented it to Parliament, through the Speaker of Parliament in August 2005 in accordance with section 25 (1) of the Local Government Finance Commission Act, 2003



### iii) PARTICIPATION IN STAKEHOLDER ACTIVITIES

The Commission has been an important player in activities organised by stakeholders mainly with impact on local government financing and within the local government sector. Major activities that LGFC participated in are:

#### ◆ **Joint Annual Review of Decentralisation (JARD)**

The Commission was represented on the organising committee for JARD 2004 held in November 2004. The Chairperson participated actively in the JARD where he chaired a number of sessions. The Commission Secretary and other staff also attended the review. The Commission is further being represented on the working group making a follow up on the three documents that were presented at the review, namely: The Decentralisation Policy Strategic Framework (DPSF), the Local Government Sector Investment Plan (LoGSIP) and the post LGDP Concept Note.

#### ◆ **Local Government Releases and Operations Committee (LGROC)**

The Local Government Releases and Operations Committee (LGROC) is one of the Committees created under FDS to spearhead its implementation. LGROC handles matters concerned with releases of grant funds to LGs and accountability thereof. As a partner, LGFC has been participating in the LGROC activities. In the period under review LGFC participated in the following programmes:

##### ⇒ **Conditional Grants Bank Accounts Issues**

One of the areas addressed in financial management was the reduction in the number of bank accounts operated by the respective local government councils. The new modalities provide that there should be bank accounts at the level of a sector. The others are a General Fund Collection Account, a Salary Account and a Donor Account. This makes the total number to be at least 12 bank accounts.

This undertaking has led to significant reduction of the number of bank accounts from as many as 100 in some local governments to less than 20 and has promoted the use of vote books in the financial management. The major challenge however, is the insistence of each donor demanding a separate bank account. Other notable bank accounts being demanded which are out of the new modality are the LGDP account and the NAADS accounts.

##### ⇒ **Financial Management and Reporting**

This activity area is principally under the Local Government Releases and Operations committee in the FDS implementation but with very active involvement of LGFC. Under this activity, LGFC, MOFPED, SDU II, MOLG and the respective sectors worked together and developed performance indicators for all local government activities, whether funded from conditional grants or not. These together with other attributes were tested in some local governments with support from SDU II. After testing, the MOFPED sought clearance from MOLG to roll out the new modalities to all districts and municipalities. The MOLG opted for piloting in selected local governments. The new modalities are being piloted in 24 districts and respective municipalities countrywide. The results of the review of the performance for the first quarter are not yet out to guide the next steps.

◆ **Other Activities**

The Commission is represented in a number of fora. The Chairperson has attended a number of meetings of the Board of Directors of the National Planning Authority. The Commission is also represented on the Policy Committee and the National Steering Committee of the Northern Uganda Social Action Fund (NUSAF). The Commission has participated in the monthly meeting of the Donor Decentralisation Sub-Group (DDSG). The Commission also participated in the reviews of the Local Government Development Programme, District Development Programme and DFID Support to Decentralisation Project.

**iv) VISITS BY FOREIGN DELEGATIONS**

The Commission continues to receive delegations from various jurisdictions which come to Uganda to share the experiences the country has gone through in implementation of decentralisation. These visits have been very useful in sharing information and experiences. The following delegations visited the Commission during the period under review.

Sudan People's Liberation Movement (SPLM)	9 <sup>th</sup> August 2004
Delegation from Government of Zambia	30 <sup>th</sup> November 2004
Delegation from the headquarters of Netherlands	
Overseas Development Organisation (SNV)	7 <sup>th</sup> February 2005

In addition a number of scholars, researchers and representatives of donor and other organisations abroad visited and consulted with the Commission on diverse issues and topics.

**5.2.2 ACTIVITIES NOT IMPLEMENTED**

**i) Outreach Activities**

It had been planned for Commissioners to visit local governments to acquaint themselves with the issues of financing and operations of local governments. A plan was also drawn to conduct a study tour for Commissioners to other countries to share experiences on local governments financing generally. However both activities could not be undertaken due to funding constraints.

**ii) Resource Centre**

It had been planned that initial work on establishing a resource centre built around the Fiscal Databank of the Commission would commence in the period under review. However, funding constraints meant that this could not be done.



## CHAPTER SIX:

# CHALLENGES AND RECOMMENDATIONS

## 6.1 INTRODUCTION

In the course of performing its functions, the Commission faces and has identified a number of challenges to implementation of the decentralisation policy. Some of the challenges have been indicated in the different chapters of this report. In the same light suggestions as to the prospects and way forward have been mentioned. In this chapter some of the major constraints are presented with recommendations as to the way forward.

## 6.2 LEGAL FRAMEWORK

LGFC is a constitutional organisation with defined functions. However, the Local Government Finance Commission Act, which is the enabling legislation, does not provide for full protection of its budget. For example while the Act provides in section 17 (2) that “*all monies required to defray all expenses that may be incurred in the discharge of functions of the Commission or in carrying out the purpose of this Act, including the payment of allowances, salaries and pension payable to or in respect of persons serving with the Commission, shall be submitted to Parliament for approval without alteration and when approved shall be directly charged on the Consolidated Fund*” (emphasis added), MOFPED has not followed this provision of the law. LGFC has always been given ceilings by MOFPED under which to prepare its budgets. These ceilings do not take into account the mandate and responsibilities of the Commission.

As a consequence the Commission has suffered consistent under-funding from GOU for both recurrent and capital expenditures. The effect has been the thin number of technical officers to handle Commission assignments, lack of transport to facilitate interface and interactions with local governments and generally underperformance on functions. If it were not for the short-term interventions of donors, the Commission would hardly be able to undertake basic activities.

The outputs of the Commission arising from well researched recommendations can be very useful to GOU in determining allocation of grants to local governments. Currently there is no empirical data to rely on in making allocation of grants to individual local governments. Allocations are sometimes arbitrary or are based on estimates and proxy data. This is not only contrary to the law but also potentially contentious and is evidenced, for example, in the clamour by almost all LGs for equalisation grant, for no other reason than that other LGs do get the grant.

## Recommendation

It is recommended that the independent budget status granted to the Local Government Finance Commission by statute should be operationalised to enable it execute the statutory functions of advising the President on appropriate Grants and other taxation matters as required by law.

## 6.3 LOCAL REVENUES

The importance of local revenues in financing decentralised services cannot be overemphasised. With the support of GOU and development partners, the Commission has expended considerable time and efforts to support LGs to improve collection of local revenues using fair and humane methods and using best practices. Despite the indication of a positive trend that had started to be registered, more concerted efforts are still required in a number of areas.

### a) Low Tax Yields

Local governments have continued to register very low yields of local revenue. The situation has been aggravated by the negative pronouncements and statements on Graduated Tax (GT) and confusion in implementation of property rates and market charges among others.

The consequence of low local revenue yields include:

- ◆ Lack of funding for programmes and activities which by law cannot be financed from central government grants such as council operation expenses.
- ◆ Inability to co-fund donor supported projects with the risk of donor withdrawal.
- ◆ Inability to finance local development projects such as office blocks.

The impact on the overall operation and functioning of local governments is enormous. The net result is weakening the principle of decentralisation and quality of service delivery.

Lower local governments (LLGs), especially sub-counties are likely to be worse hit as they rely more heavily on local revenues for operation of their budgets and the bulk of these is contributed by GT.

## Recommendation

The central Government should, in the short-term, avail enough funds to LGs to sustain service delivery. Stakeholders, involved in finding a sustainable solution to this problem, should be supported so as to find an optimal arrangement to address the situation. LGFC remains available and eager to make its contribution to efforts to find this solution. In this regard, LGFC has drawn plans to carry out a comprehensive review of the financing regime for local governments with a view of advising GOU on the optimal mix of grants and local revenues appropriate to each LG.



## b ) Political Interventions

The low tax yield explained above is partly a result of poverty levels among taxpayers and lack of household incomes where to levy the taxes. However, politicisation of some of the revenue sources and uncoordinated pronouncements on whether to collect or not or the amount to be levied has significantly affected local revenue sources generally. Many taxpayers carry the belief that when GT is abolished it means all taxes have been abolished.

The Commission recognises that some of the pronouncements may be necessary because of apparent non-application of the law and or lack of enabling legislation to collect the taxes. However, it is evident that some of the pronouncements might have been made considering other factors not related to apparent breach of the law.

### Recommendation

**Irrespective of the reasons of the pronouncements, the Commission recommends that before such interventions are made, their impacts on overall collection of the taxes countrywide are carefully assessed and the timing considered. This is because when such pronouncements are made abolishing or stopping the collection of some revenue sources, they become difficult to reverse even if the circumstances have favourably changed.**

## 6.4 GRANTS TO LOCAL GOVERNMENT

### a) Legal Framework

The legal regime for the transfer of the Grants to the Local Governments is fairly elaborate and provides among others for the Commission to:

- ◆ *Advise the President on all matters concerning the distribution of revenue between the Government and local governments and **the allocation to each local government of money out of the Consolidated Fund.***
- ◆ *In consultation with the National Planning Authority consider and recommend to the President the amount to be allocated as **equalisation and conditional grants** and their allocation to each local government;*
- ◆ *Recommend to the President through the Minister, **the percentage of the National Budget to be transferred to local governments every financial year( emphasis added)***

In order for the Commission to deliver on this mandate there is an absolute need for it to conduct research and gather empirical data on the status of each Local Government in terms of their individual need. This would then form a basis for allocations to them.

Unfortunately, there are no standards for service delivery for most sectors. The budgets for LGFC have always been inadequate to undertake the necessary research and studies to gather the empirical data. In the circumstances, MOFPED has been indicating the amounts available in respect of each grant in the Medium Term Expenditure Framework (MTEF) and the Commission's role working with sector Ministries has been to identify proxies that can be

used in the circumstances to be the bases for appropriate allocation formulae. It is equally worth noting that the formulae currently do not include amounts for the Lower Local Governments.

Due to the above problems, the allocation mechanisms are not universally accepted as being transparent and fair. Such a scenario creates perceptions of unfairness, discrimination and under-allocations relative to others. The proposed formulae are based on sound general economic principles and parameters. However, it cannot be said that if applied they will promote fairness and transparency in the distribution of given amounts of the grants. This is because the features of service delivery needs of each local government have to be separately considered to make the allocation scientific.

### **Recommendation**

**It is recommended that LGFC is availed adequate funding to enable it conduct the necessary research and gather data that would be used to design universally accepted allocation system.**

### **b) Levels of Conditional Grants and Conditions**

Grants (transfers from the central government) to local governments remain the major form of funding for local governments<sup>7</sup>. This trend is a result of the decline in collection of local revenues by local governments. The bulk of this (over 90%) is conditional grants for implementation of key government priority programmes under PEAP and through PAF arrangements.

The Constitution and the Local Governments Act provide that conditional grants be allocated to fund programmes agreed upon between the central Government and local governments. Looking at the current structure of the grants, it cannot be said that the agreements have been arrived at through a process that connotes equality of the parties. The central Government has, in the process, become a dominant party and the negotiations that take place tend to be lopsided as LGs are seen as the weaker party who have to largely take what is availed and comply with the conditions the dominant party has come up with. LGFC has started to facilitate and chair the negotiations between the central Government and LGs on an annual basis.

### **Recommendation**

**The Commission recommends that as the solution to the local revenues is being sought, the Central Government sector ministries and other institutions should treat the local governments as equal partners in the implementation of decentralised services the source of funding not withstanding. Equally, the local governments should treat the Central Government as equal partners. The two should accord each other mutual respect and implement positions agreed upon while setting the conditions.**

### **c) Allocation Formulae**

Cabinet approved the Fiscal Decentralisation Strategy (FDS) way back in 2002. One of the objectives of the strategy is that resource allocation to local governments should be made sensitive to needs and poverty as well as ensuring equity across local governments. This led to the process of reviewing the principles and parameters to form the basis of resource allocation.

Consequently, new allocation formulae for all grants were developed with participation of sec-

<sup>7</sup> See Chapter 2 on the analysis of grants to Local Governments, above



tors and representatives of local governments. The recommended formulae are intended to be considered by Cabinet to get the highest political ownership. This process has dragged on since the Commission presented the formulae to Government in 2004. Up to the time of this report, LGFC did not have information as to the actions taken on the formula following its submission to the Ministry of Local Government.

LGFC notes that the design of the formulae was done at the request of Government as part of the implementation of FDS. A number of stakeholders were involved in the process leading to their design including development partners, which funded the biggest chunk of the costs and technical input involved. The Commission is of the opinion that non-application of the formulae may discourage stakeholders from participation in future similar assignments.

### **Recommendation**

**The Commission recommends that the formulae be implemented or if there are any outstanding issues, the Commission be informed for appropriate action.**

#### **d) Unconditional Grant**

Unconditional Grant increased from 66 billion shillings to 120 billion shillings in the period 2000/01 to 2004/05 representing a growth of (182%) in shilling terms. However, during the same period the cost of living has significantly gone up, more local Governments have come on board; salaries of Civil servants have gone up through normal growth, promotions and recruitment. The net result of these needs has seen the unconditional grant being mainly a wage grant with hardly anything for budget support to service delivery. Currently the unconditional grant is inadequate even to meet the wage bill of many local governments. It can not therefore be said that unconditional grant currently serves the purpose for which it was intended under the law.

### **Recommendation**

The Commission recommends that:

- ◆ In the short term, the central Government should step up efforts of ensuring that the wage bills of local governments are met by the unconditional grants provided to avoid accumulation of salary arrears and pensions that are a financial burden and hamper service delivery.
- ◆ Funds should be provided to the Commission to undertake studies on the level of inadequacy of the unconditional Grant. This will enable appropriate allocations to each local Government as required by the law.

#### **e) Equalisation Grant**

Equalisation grant is envisaged to be paid to local governments for giving subsidies or making special provisions for the least developed districts and is to be based on the degree to which a local government unit is lagging behind the national average standard for a particular service.

However, currently national service delivery standards do not exist for most of the sectors. This therefore makes determination of the qualifying criteria difficult which has led to almost every local government clamouring for the grant. The overall amount of equalisation grant has stagnated at 3.5 billion shillings for both district and urban local governments against an initial projection of 13 billion shillings (for districts only) as of year 2000.

This little amount is distributed to far too many local governments to have any tangible impact. In addition, the choice of sectors in which to utilise equalisation grant is left to the local governments without any guidance as to which services the beneficiary LG has a critical deficiency in. It cannot therefore be said that the Grant has met its constitutional objective.

The Commission had planned to coordinate stakeholders to facilitate the development of standards for service delivery but has not been able to access funds to carry out the necessary research to establish the standards of service delivery. This has resulted in equalisation grant being distributed using proxies and therefore not in total compliance with the objective in the Constitution.

#### **Recommendation**

**Comprehensive training should be provided to LGs. In order for LGFC to tender the advice in accordance with the legal requirements, it needs to urgently carry out the necessary research and establish the qualifying local governments based on assessment of their situation in respect of delivery of agreed services. This task is a high priority especially following the creation of the new local governments apparently without proper evaluation as to their economic viability.**

## **6.5 PLANNING AND BUDGETING**

Under FDS and the public finances management reforms, local governments are required to use harmonised planning, budgeting, accounting and reporting systems and formats. With regard to budgeting, FDS requires that each local government should annually prepare a Local Government Budget Framework Paper (LGBFP) which should link the DDP and the budget for the coming year. Analysis of these BFPs show that a number of local governments still lack the skill and expertise in preparation of these important planning and budgeting documents. The Commission plans to continue building capacity and offering technical support to the LGs which have areas of weakness

#### **Recommendation**

**The Commission recommends that comprehensive training be provided to the LGs to enhance their capacity to apply the tools, skills and concepts of planning and budgeting in handling their mandates.**

## **6.6 FUNDING OF THE COMMISSION**

Under - funding of the Commission continues to pose a big challenge. This under - funding has been persistent despite the increasing role of LGFC in respect to Government policy changes that include but are not limited to:

- ◆ Rapid creation of new local governments apparently without proper evaluation of their financial and economic viability that has created an increased workload for LGFC to perform its functions.
- ◆ The confusion relating to graduated tax that used to be the single major source of LGs' locally raised revenue has meant that LGFC has to step up its efforts to advise LGs and the President on a possible appropriate replacement of the abolished tax.



In order for LGFC to handle these additional responsibilities, it requires:

- ◆ Greater mobility in terms of sufficient number of sound vehicles to reach the LGs, some of them in difficult terrain;
- ◆ Sufficient manpower in terms of number of staff, skills and motivation.

#### **Recommendation**

**While the Commission is aware of the demands on the national public resources, it should be appreciated that it has a crucial role of tendering advice to the presidency and other stakeholders on decisions that affect the allocation of resources for service delivery to the population.**

**LGFC should accordingly be facilitated with adequate resources to execute the crucial mandate.**

## **6.7 UPTAKE AND IMPLEMENTATION OF LGFC RECOMMENDATIONS**

The Commission continues to register slow or delayed implementation of some of its advice or recommendations by some stakeholders without appropriate feedback. This has dampened the morale and enthusiasm of LGFC in tendering some of the recommendations. For example upon submission of the New Allocation Formulae to MOLG in October 2004, LGFC has not received feedback on the status of its implementation.

It is important to note that all stakeholders have a role to play in serving the interest of LGs and all players need to be respected and effectively coordinated to make a united effort. The Commission however appreciates many stakeholders who have continued to implement the recommendations and/or offered feedback on the advice and recommendations tendered.

#### **Recommendation**

**A forum should be established in the Local Government Sector where all recommendations from the respective sector group members are discussed, and in case of non-implementation of a particular recommendation appropriate feedback is provided.**