Influence of Locally Generated Revenue on Performance of County Governments in Kenya

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Abstract

Revenue collected from sources such as trading licenses, market dues, fines, and fees was also declining tremendously to be effectively utilized to provide the required services to the public. This study seeks to establish locally generated revenue has an influence on performance in County Governments in Kenya. The current study took a descriptive design, which involved assessing whether funding from National Governments influence the performance in County Governments in Kenya. For the purpose of this study the target population comprised of all 47 County Governments in Kenya. Sampling frames was done for 5 County Governments as per the Kenya 2010 Constitution. Descriptive statistics was used to determine the relationship between the dependent and the independent variables These statistics includes mean, median, mode, skewedness, range, standard deviation, kurtosis and percentages. The data was presented in form of tables, pie charts, column and bar graphs. The study found that that there is a positive and significant relationship between Revenue Generated by County Governments and Performance because it had a Pearson correlation coefficient (r) of 0.688 and a p- value of 0.000. This means that as Revenue Generated by County Governments increases there is an increase in Performance of counties.

Keywords: Revenue, cost, devolution and county Government.

1.   Introduction

Local governments were given the mandate to raise their own revenue to finance their activities (Local Government act 1997). Local revenue collection refers to the procedures put in place by different local government agencies in collecting all assessed revenue as pre-determined in the budgets and work plans on due dates, (local revenue handbook MOLG, 2007). It also refers to the procedures through which taxes and fees payment are obtained from different sources of income to government agencies, (Kawesa, 2001), local revenue collection involves the management of tax laws, rules and regulations promulgated by the local government on behalf of the state, (Zaake, 1998). Revenue refers to the total amount of money received by a company from goods and services sold (Parkin 1995). According to Patton (1993), Public revenue means those amounts the Local Government (LG) receives from different sources (donations, government grants and local revenues e.g. licenses, market dues and other miscellaneous revenues). In other words, the income of the local government is public revenue. The major sources of local revenue include; parking fees, market dues, land fees, trading licenses, inspection and plan fees, registration fees, water revenue, taxes on specific services, local service tax (LST) , local hotel tax(LHT),operational permits and many others. (Andrew Patton).

2.   Problem Statement

Local revenue collected enables local governments to implement their planned budgets and work plans. They use this revenue for co-funding on capital projects, monitoring of all the programs and the general supervision of constructing latrines, classrooms and health centre's and opening of community roads to ensure better standards so as to meet the desired services. Revenue collected from sources such as trading licenses, market dues, fines, and fees was also declining tremendously to be effectively utilized to provide the required services to the public. According to the Controller of Budget report for 2013/14, the first year of devolution in Kenya, the County Governments approved expenditure outlay amounted to 5.4 percent of GDP. The County Government targeted to collect 1.2 percent of GDP as own source of revenue while receiving transfers approved at Kshs.210 billion, which is equivalent 4.3 percent of GDP. County Governments were only able to collect 0.5 percent of GDP as own- source of revenue and national transfers amounted to 3.9 percent of GDP. It is upon this that this study will establish locally generated revenue has an influence on performance in County Governments in Kenya

3.   Research Hypothesis

H0: Locally generated revenues do not influence the performance of county governments in Kenya.

H1: Locally generated revenues have an influence on the performance in Counties in Kenya.

4.   Theoretical and Literature Review

4.1 Cost Recovery Theory

The **cost recovery theory** which emphasizes that making service more demand responsive through

decentralization has added benefit that increases households" willingness to pay for services (Briscoe & Garn 1995). Households are argued to be more willing to pay for and maintain services that match their demand: this is the flip side of the allocative efficiency coin. Moreover, a relatively close match between supply and local demand, if coupled with transparency and with local cost-sharing or cost recovery, can provide the incentives and information base for effective local monitoring. The latter is a necessary ingredient in an overall anti-corruption strategy, and in particular helps to shrink the information asymmetries and leakages that can undercut both allocative efficiency and cost recovery (Litvack & Seddon1999).

On the other hand the allocative efficiency theory argues that the most common theoretical argument for decentralization is that it improves the efficiency of resource allocation. Decentralized levels of government have their reason in the provision of goods and services whose consumption is limited to their own jurisdictions. By tailoring outputs of such goods and services to the particular preferences and circumstances of their constituencies, decentralized provision increases economic welfare above that which results from the more uniform levels of such services that are likely under national provision. The basic point here is simply that the efficient level of output of a local public good (i.e. that for which the sum of residents" marginal benefits equals marginal cost) is likely to vary across jurisdictions as a result of both differences in preferences and cost differentials (Oates, 1999).

Since Sub-National Governments are closer to the people than the Central Government, they are considered to have better information about the preferences of local populations than the Central Government (Musgrave, 1998). Hence, such governments, it is argued, are better informed to respond to the variations in demands for goods and Services. Second, s u b -national governments are also considered to be most responsive to the variations in demands for and cost of providing public goods. Decentralization is thought to increase the likelihood that Governments respond to the demand of the local population by promoting competition among Sub-National Governments (Tiebout, 1996).

Competition among Sub-National Governments is said to allow for a variety of bundles of local public goods to be produced, and individuals are said to reveal their preferences for those goods by moving to those jurisdictions that satisfy their tastes that is, by "voting with their feet." This is seen to pressure Sub-National Governments to pay attention to the preferences of their constituents and tailor the service delivery accordingly, whilst risking the loss of tax revenues Breton (1996). This "voting with feet" is thus argued to enhance the efficiency of resource allocation by increasing the likelihood that Governments satisfy the wishes of citizens. Where geographic mobility is constrained, as in many developing and transition countries, alternative service providers such as private firms and NGOs are potentially important in providing exit options (Qian & Weingast, 1997)

4.2 Influence of locally generated revenue on performance

Local revenue is the money income collected from taxes by the local government on behalf of the state, According to Bahemuka (2001). Or Local revenue is the income collected by a Local Government from sources within its jurisdiction. Local Governments should budget for Local revenue basing it on the previous year's revenue. To improve on Local revenue performance, Local Governments are also required to budget for revenue enhancement activities. That is to say, their cost and the income from such activities will be applied. Byakusaaga – Bisobye (2000) dwelt on the significance of tax collection in the generalities of tax revenue, which revenue is used for service delivery. He urged that the revenue collection depends largely on collection of machinery available, tools and the competence of revenue collectors and compatibility of tax collection machinery

Local revenues come from taxes, administrative fees, licenses, and property income. Article 191(2) of the constitution of the Republic of Uganda stipulates the fees and taxes to be levied, charged, collected and appropriated to include rent, rates, royalties, stamp duties, fees on registration and licensing and any other fees and taxes that parliament may prescribe. worse still local authorities are poor at collecting these local revenue because of poor tax administration that is in record keeping, computation and poor accountability Nsibambi, (1984).For example, Local Governments fail to avoid unrealistic increases from revenue enhancement activities, which make the realization of revenue and service delivery to be more of a dream than a reality. In order to create incentive to the local revenue generation at the local level, revenue from the local government need to target services which are visible and not administrative expenses which are rarely appreciated by the service beneficiaries and tax payers.(Ndifuna,2008) Hence local revenue contributes a reasonable percentage in funding service delivery.

According to Carnegie and Baxter (2006) the local revenue generated constitutes 75% of the revenue used in the provision of services to the local communities in the developed countries. The main source of revenue is through taxation which can be defined as an implicit contract between citizens and their government (Moore, 1998). Grants are given to local governments for several reasons. The major objectives of extending grants to local authorities is to ensure that all LGs are able to provide minimum of social services.

Local revenue performance is the percentage of budgeted collections that is actually collected. Local
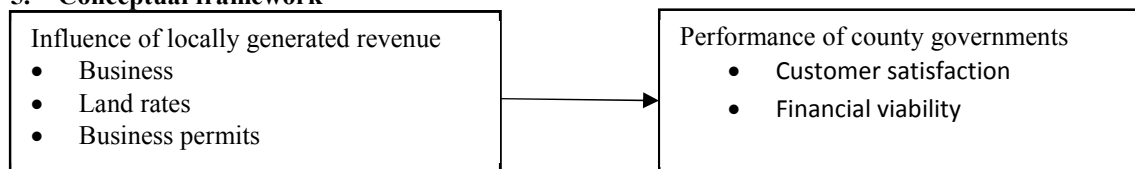
governments are supposed to use their own-revenues to finance local services (Odd-Helge, 2004).He adds that Local authorities are able to derive revenue from property tax, service tax etc, however, it's important to note that taxes don't only provide revenue but also act to decrease private investment and consumption (Hansen and Nanivska, 1990). They further argue that the advice effects of taxation on private investment and consumption are more significant with regard to personal income tax than graduated tax. By impacting on private investment and consumption, taxation becomes an important instrument of fiscal policy. In most countries in Africa, own source revenues compose a small percentage of total sub national revenue and their share has either not improved much or has actually declined. This means that sub national governments have not reduced their dependence on central government transfers (Taliercio, 2001). This was made worse by the removal of graduated tax which was the major source of revenue of the local government affecting the quality service delivery greatly. (Wakudumira, 2005).

Local Governments are capable of providing public services, mobilizing community resources, stimulating private investments, expanding rural-urban linkages, adopting national development to Local conditions and investing in Local infrastructure (Ssentamu 2004).A description indicating how services are being delivered to the community throughout the Local Government can be formulated. For example there is a section that sets out the summary for the District as a whole, then a section that splits the sector budget into geographical areas (for example the Local council, and provides information on the service outputs. Indicators may be on service delivery levels and not traditional activities. For example in education, information on the enrolment and number of teachers, textbooks and pupils in a given sub county/division will be provided in place of indicators on the number of activities. This service being delivered data will provide information on the service delivery outputs, such as the pupil to teacher and textbook ratios.

Being a major source of revenue to Local Governments, taxes are used to finance the recurrent and development expenditures. Local revenue contributes to service delivery with such services as feeder roads, health centres, and donations to schools, among others. This is done through Local Government development programs (LGDP).Local revenue is not subject to central Government control and it encourages ownership of Local investments by taxpayers thereby linking their taxes directly to usage. Local revenue allows maintenance and servicing Local Governments' sustainable investments and it finances remuneration of all elected leaders in Local council systems. Such services offered by Local Governments are effectively undertaken with sufficient and efficient revenue collections. A decline in revenue collection will mean less or poor services offered by Local Governments to the Local community. This is because Local revenue contributes a reasonable percentage in funding service delivery.

The Local Government Act,1997; Local Governments budgetary powers laid down in the Local Governments Act, 1997, Section 78(1), which states that Local Governments shall have the right and obligation to formulate, approve and execute their budgets and plans provided the budgets should be balanced. Local Government serves as an administrative management instrument providing detailed information about revenues to be collected and the expenditures to carry out the projects and activities set by the council hence effective service delivery. The Local Government Financial and Accounting Regulations, 1998; The Local Government financial and accounting regulations, 1998 make up the principal financial management framework for Local Governments. The main regulations concerning Local, Government budgets are contained in parts III of the Local Government financial and accounting regulations 1998. Therefore, the Local Government financial and accounting regulations enable the Local Governments to collect revenue and thereafter deliver services to the people. Compliance with national priorities; It is a legal requirement for Local Governments to comply with national priorities by implementing various national programmes to ensure service delivery. The central Government ensures that national priorities are reflected in Local Government budgets through allocation and transfer of conditional grants to Local Governments.

5. Conceptual framework

Influence of locally generated revenue • Business • Land rates • Business permits	→	Performance of county governments • Customer satisfaction • Financial viability

6. Methodology

The current study took a descriptive design, which involved assessing whether funding from National Governments influence the performance in County Governments in Kenya. For the purpose of this study the target population comprised of all 47 County Governments in Kenya. Sampling frames was done for 5 County Governments as per the Kenya 2010 Constitution. For the purpose of this study and taking into considerations

that the County governments are scattered all over the Country, hence presenting logistical problems, a stratified random sampling was used to select the sample of counties that was studied.

The study targeted key staff in the CGs and stakeholders including the residents of the county in the study. The Current staffing details as documented by the Salaries and Remuneration Commission (SRC) and Council of Governors (CoG) was utilized in sampling the sample population from the selected counties from stratified sampling that was exposed to questionnaires.

The proposed instruments of data collection were through questionnaires with both open-ended and close-ended questions. Secondary data on fiscal data was also collected from the Constitutional Commissions such as COB and CRA. A questionnaire is a method of data collection in which respondents provide written answers to written questions (Gall, Gall & Borg, 2007).

The questionnaires were sent out sent to the respondents attached with the forwarding letter accompanied by an introductory form the University. The service of a research assistant trained in handling data collection was tasked with the delivery and collection of questionnaires.

For the purpose of this study Descriptive statistics was used to determine the relationship between the dependent and the independent variables These statistics includes mean, median, mode, skewedness, range, standard deviation, kurtosis and percentages. The data was presented in form of tables, pie charts, column and bar graphs. The relationships in the research questions was determined using the following Ordinary Least Squares (OLS) regression model as prescribed by various Scholars (Faraway, 2002; Cohen, West & Aiken, 2003 and Kline, 1998).

7. Results

The independent variable Revenue Generated by County Governments comprised of seven (7) items. In measuring the variable, a five point continuum Likert scale was used, where 1 represented 'strongly disagree' and 5 represented 'strongly agree'. The main objective was to establish locally generated revenue has an influence on performance in County Governments in Kenya. County revenue planning ought to involve effective revenue collection system, calculation of monthly revenue, preparation of monthly accounts to receive all monies due to the municipality. The revenue plan must be based on management, accounting and information system, internal control-debtors and revenue, charges.

Table 4: Revenue Generated by County Governments

N=202	Mean	Std. Deviation	Std. Error of Mean	Variance	Kurtosis	Skewness
County Government generates revenue for delivery of services within the county	3.2426	.90635	.06377	.821	-.134	-.176
The County Government engages the public in approving the rates and taxes at the county level	3.6980	.70032	.04927	.490	4.634	-1.611
Residents participate in approving the public financial management.	3.0941	1.51479	.10658	2.295	-1.536	.108
The residents are explained the services to be provided from the revenues generated by the County Government	2.5594	1.28479	.09040	1.651	-1.287	.158
The County Government utilizes the revenue collected for the Intended service delivery	2.4703	1.25845	.08854	1.584	-1.152	.113
The County Government collects all the revenues fairly and without discrimination	2.9455	1.45308	.10224	2.111	-1.386	.135
The County Government utilizes technology in collecting the revenue and there is no misappropriation of the revenue collected	2.8267	1.37666	.09686	1.895	-1.195	.385
There has been improvement in service delivery with the introduction of County Governments	3.2129	1.56110	.10984	2.437	-1.535	-.082

Table 1 shows that the highest rated item was The County Government engages the public in approving the rates and taxes at the county level as shown with a mean of 3.6980, Kurtosis 4.634 and Skewness -1.611. Other statements were rated moderately and include County Government generates revenue for delivery of services within the county with a mean of 3.2426, Kurtosis -.134 and Skewness -.176; There has been improvement in service delivery with the introduction of County Governments was rated with a mean of 3.2129 Kurtosis -1.535

and Skewness -.082. Residents participate in approving the public financial management was rated with a mean of 3.0941 Kurtosis -1.536 and Skewness .108 and The County Government collects all the revenues fairly and without discrimination was rated with a mean of 2.9455, Kurtosis -1.386 and Skewness .135. The lowest rated item were The County Government utilizes technology in collecting the revenue and there is no misappropriation of the revenue collected as rated with a mean of 2.8267, Kurtosis -1.195 and Skewness .385; The residents are explained the services to be provided from the revenues generated by the County Government as rated with a mean of 2.5594, Kurtosis -1.287 and Skewness .158 and The County Government utilizes the revenue collected for the Intended service delivery as rated with a mean of 2.4703, Kurtosis -1.1527 and Skewness .113.

This findings can be supported by studies by White (2013), revenue diversification in government finance relates to the correlation between two or more taxes. In order to reduce revenue fluctuation, a desirable tax structure should include taxes that are not perfectly correlated. In other words, the different tax revenues will not move in exactly the same direction and magnitude at the same time. In this way, when one tax shrinks for some reasons such as an economic downturn, the total loss of government revenue is minimized because other revenue sources have not experienced the same changes.

According to Dye & Merriman (2004), corporate and individual income taxes have been generally classified as having high income elasticity, general sales taxes as medium and property and excise taxes as having low income elasticity. A larger share of total revenue from elastic taxes results in the total revenue being more susceptible to the short-run business cycle, which causes fluctuations in revenue streams. On the other hand, it is an often unstated assumption that an inelastic revenue system typically leads to a cyclically stable revenue system (Dye & Merriman, 2004). Therefore, by changing the tax structure to include taxes with low elasticity, the revenue risk subject to economic cycles can be reduced. The trade-off is that returns or revenue growth will not increase as much during periods of economic growth as it would for a tax structure with more elastic taxes. Revenue diversification can increase the overall elasticity or beta and reduce the revenue stability by having a combination of elastic taxes, though it may lead to revenue growth. Similarly, revenue diversification can also help to create a revenue portfolio with low elasticity with the appropriate tax selection. Therefore, the overall effect of revenue diversification is unclear without specific analysis on the nature and composition of the tax portfolio.

T-Test statistic of Revenue Generated by County Governments

Table 5: T test of Revenue Generated by County Governments

One-Sample Test

	Test Value = 0				95% Confidence Interval of the Difference	
	t	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
Revenue Generated by County Governments	60.404	200	.000	3.19266	3.0884	3.2969

Since $p < 0.000$, we reject the null hypothesis that the sample mean is equal to the hypothesized population mean and conclude that the mean Revenue Generated by County Governments of the sample is significantly different than the average Revenue Generated by County Governments of the overall population.

Based on the results, we can state the following: There is a significant difference in mean Revenue Generated by County Governments between the sample and the overall population ($p < .000$). The average Revenue Generated by County Governments of the sample is about 3.1 higher than the overall 3.2 population average.

Correlations of Revenue Generated and Performance

Table 6: Correlations of Revenue Generated and Performance

Correlations

		Performance	Revenue Generated by County Governments
Performance	Pearson Correlation	1	.688**
	Sig. (2-tailed)		.000
	N	202	201
Revenue Generated by County Governments	Pearson Correlation	.688**	1
	Sig. (2-tailed)	.000	
	N	201	201

**. Correlation is significant at the 0.01 level (2-tailed).

The Pearson (r) correlation coefficient showed a positive and significant relationship between Revenue Generated by County Governments and Performance because it had a Pearson correlation coefficient (r) of 0.688 and a p- value of 0.000. This means that as Revenue Generated by County Governments increases there is an increase in Performance of counties.

Regression analysis of Revenue Generated and performance of County Governments

Table 7: Model Summary

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.688[a]	.473	.471	.51692	1.470

a. Predictors: (Constant), Revenue Generated by County Governments

b. Dependent Variable: Performance

Table 4 presents the model summary on how effective Revenue Generated by County Governments explain performance of counties. The performance has an overall correlation with Revenue Generated by County Governments of 0.688 which is strong and positive. Revenue Generated by County Governments that are included in the model explain 47.3% of the changes or variations in performance of counties. This shows that 52.7% of the variations in performance of counties is explained by other factors not captured in the model. This presents an opportunity for future studies to include additional variables that could explain banks' profitability.

Table 8: ANOVA- Revenue Generated and performance County Governments

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	47.778	1	47.778	178.809	.000[b]
	Residual	53.173	199	.267		
	Total	100.951	200			

a. Dependent Variable: Performance

b. Predictors: (Constant), Revenue Generated by County Governments

Table 5 shows the overall significance of the regression estimation model. It indicates that the model is significant in explaining the relationship between Revenue Generated by County Governments and performance of counties at a 5% level of significance. The analysis of variance of the predictors of the model have a significance is 0.000 and fails to accept the null hypothesis and conclude that Revenue Generated by County Governments have a positive influence on explain performance of counties.

Table 9:Coefficients- Revenue Generated by County Governments

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.482	.160		9.266	.000
	Revenue Generated by County Governments	.652	.049	.688	13.372	.000

a. Dependent Variable: Performance

The beta was significant (β = .68.8, t = 13.372, at p < 0.000). The beta value implies that for one unit increase in Revenue Generated by County Governments, performance of counties increase by .68.8 or 69%. From the regression results, it is noted that the relationship between Revenue Generated by County Governments and performance of counties is positive and statistically significant. The null hypothesis is not supported and therefore is rejected and the alternative hypothesis accepted.

8. Conclusion

The study concludes that there is a positive and significant relationship between Revenue Generated by County Governments and Performance because it had a Pearson correlation coefficient (r) of 0.688 and a p- value of 0.000. This means that as Revenue Generated by County Governments increases there is an increase in Performance of counties.

The study concludes that the County Government engages the public in approving the rates and taxes at the county level. The County Government generates revenue for delivery of services within the county. There has been improvement in service delivery with the introduction of County Governments. It was moderately agreed that residents participate in approving the public financial management and the County Government collects all the revenues fairly and without discrimination among the statements that were lowly rated was the County Government utilizes technology in collecting the revenue and there is no misappropriation of the revenue collected. There was disagreement on statements that residents are explained the services to be provided from

the revenues generated by the County Government and the County Government utilizes the revenue collected for the Intended service delivery.

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