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Influence of Fiscal Asymmetric Decentralization on Household Effects—A Review of Recent Literature

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Abstract

The study is in line with Oates (1951), where fiscal decentralization is explained as the delegation of income and consumption powers from the central government to the devolved units, both local and national levels within the framework of decentralization. Fiscal decentralization is considered to be the panacea in eradicating poverty, particularly in developing countries. This review entails the assessment of the influence of fiscal asymmetric decentralization on household effects. Specifically, the review looks at the interaction between budget efficacy, fiscal policy, and county treasury management and household effects. Despite the fact that scholarly work has been conducted on all the concepts, arguably inadequate attention has been given to the influence of fiscal asymmetric decentralization on household effects. Furthermore, scanty information was found on revenue disparity or financial planning attributes. In addition, not much has been done on fiscal control by subnational governments and self-fiscal reliance as counties continue to rely on funding from the national governments although counties have considerable potential to generate their own revenue. The challenges of comprehensive results are observed, and the study concludes that it appears critical to focus more on analysis that will establish the link of control theory and practice, which will need more firm and integrative study process.

Keywords: Fiscal asymmetry; Income inequality; Household effects.

1. INTRODUCTION

Kenya experiences high levels of income inequality against a backdrop of information that fiscal decentralization may yield unintended economic consequences in states attributed with increased levels of overall income inequality and/or large regional economic and political disparities. Kenya is characterized by various features including demographics, demographic, social and disparities. It is among the states in the subregion that have high levels of inequality. About 42% of the people are poor and survive with less than one dollar per day as per the GNI coefficient used by the World Bank to measure the cost of living index (UNICEF, 2018).

Tiebout (1956) alludes to fiscal decentralization as the procedure through which controls over consumptions and incomes are appointed from the national administration to the devolved units of the government. Furthermore, the degree of monetary decentralization relies on the capacity of the devolved units to make income and consumption decisions independently without obstruction by the national administration (Martinez-Vazquez and McNab, 1997).

Around 75 countries all over the World have endeavored to decentralize duties to lower levels of government in the last 25 years using various ways. It is also estimated that over 80% of the World, in the late 1990s, were experimenting various forms of devolution. Many industrialized states have expanded their level of financial decentralization, beginning with Europe which has been leading, trailed by Austria,

Germany, Switzerland, Belgium, Italy, and Spain just to specify a couple. Various public services highlight fiscal decentralization in the United States by exchanges of administrations to the provincial governments, for instance, welfare, Medicaid, legitimate administrations, occupation training, and housing (Oates, 1999).

Some of the African countries that have also decentralized their goods and services provision from the central level to the county governments include Botswana, Burkina Faso, Ethiopia, Ghana, Mali, Mozambique, Nigeria, South Africa, Tanzania, Uganda, and Kenya (Dickovick and Riedl, 2010). Sub-Saharan Africa has experienced an astrophysical economic augmentation ranging between 3004 and 2013 estimated at a yearly average of 5.66%, this precedes a yearly rate of 6.43% amid 2005-2010 and 4.56% amid 2010-2013 (World Bank IBRD-IDA, n.d.). Important to note is that 6 out of the 10 quickest developing economies originated from Africa around 2011 and 2015, whose reverberating economic growth made it to be ranked as the second quickest developing continent globally, notwithstanding the slow global economic growth then. Several factors contributed to this performance.

Despite the previously mentioned tremendous economic outturn, poverty just declined insignificantly, from 56.5% in 1990 to just 48.5% in 2010 far underneath the 28.2% expected by 2015, as per the World Bank. The development flexibility of poverty has been very low in the African continent, which is considered to be as a result of a high level of income inequality causing a great disparity in household effects.

Income inequality that is estimated by the Gini coefficient is exceptionally high in Africa 0.411 in 2000-2009 compared to 0.5211 (Latin America and the Caribbean) and 0.367 (Asia). However, Africa had the quickest decrease in disparity among growing continents over the referenced period. Accordingly, Africa encountered the most elevated decrease in revenue imbalance (4.3%) trailed by Asia (3.1%) amid the periods (1990-1999 and 2000-2009), However, inequality widened in Latin America and the Caribbean, and Europe. Nonetheless, the regional average generally covers contrasts in the Gini coefficient: Southern Africa (0.485), Central (0.450), East Africa (0.410), and North Africa (0.374) (AUC *et al.*, 2014; UNDP, 2013).

In the same breath, the Republic of Kenya has in the recent past initiated changes aimed at promoting regional independence. This includes enacting and repealing a wide range of existing Acts of Parliament to achieve full decentralization and give more autonomy to county governments. Consequently, county government can now access grants and other moneys such as development and recurrent votes directly instead of accessing the same through the line ministries. The government has also created an equalization fund to bridge the gap between the poor and rich counties, all aimed at increasing the household effects.

2. CONNECTION BETWEEN FISCAL SPACE AND INEQUALITY

Fiscal refers to the states degree of freedom to manage their income and consumption plans with no partiality to the supportability of their financial positions. Kenya's recent attempt at devolution builds on earlier attempts to decentralize services and finances. For example, the creation and funding of local authorities started in 1999 when a similar, albeit less ambitious decentralization reform was embarked on. The 2010 constitution is a more rigorous, transparent, and equitable approach to sharing resources across counties than what was undertaken with local authorities. However, discussions of equity and marginalization in Kenya have tended to focus more on the level of broad regions, now organized as counties. There also has been considerable attention to the national revenue sharing formula among counties in the last few years. However, inequalities are just as severe below the county level in Kenya (KNBS, 2016), which indicates that the inequalities that exist within counties are wider than those between counties (Heller, 2005; Roy and Heuty, 2009; KNBS, 2016).

It is interesting to note that in many federal or highly decentralized local governments, there has been a mismatch between revenue sharing and expenditure sharing. Ordinarily, revenue collection is left to the national government, while expenditure responsibilities fall on local governments. For this reason, among others, local governments lack the capacity or authority to execute their responsibilities due to limited capacity to raise revenues and insufficient levels of transfer from the national level. Revenue mobilization in Kenya is majorly the responsibilities of the national government through the Kenya Revenue Authority although county governments can still levy taxies at local level (Frumence, 2013).

The ability of subnational governments to execute their responsibilities in the health sector for example is hampered by the absence of real capacity to generate their own revenue; on the other hand, federal

transfers are insufficient or are late to be disbursed. Such is the case in Kenya, where fiscal decentralization is based on principles that give authority to county government authorities to levy local taxes; however, in reality, the county governments do not have adequate sources to generate their own revenues. Similar case has been sighted in Tanzania among other studies conducted mostly in developing countries. Revenue sharing in Kenya is pegged at revenue collected in any given year and not exceeding 15% or as may be provided for in an Act of parliament (Constitution of Kenya, 2010; Frumence, Nyamhanga *et al.*, 2013).

The imbalance in local government responsibility and available funding can also be the result of the lack of capacity and know-how on spending the resources given that representation is based on popular vote. However, in other countries such as Indonesia, districts have the autonomy to tailor services and expenditures for local needs, and thus improve the allocative efficiency of health spending. Contrary to this, local governments and health institutions defer to instructions from the central government on how to spend their resources (World Bank, 2007).

Several studies have been conducted with an aim to uncover possible causes of disparity (factors leading to imbalanced distribution of resources). The current study is not left out on this. Some of the factors among others include the dimension of GDP that is basic in deciding imbalance (Barro, 2000); whereas, studies such as Ramos and Roca-Sagales (2008) and Marreo and Rodrıguez (2013) state that financial development is not a reason, rather it is a tool to handle imbalance (Rodrıguez, 2013).

Kenya's Revenue sharing is based on the revenue growth factor, but the CRA also looks at changes in functions that affect county costs. For the year 2017/2018, the CRA proposes for example to transfer additional funds to the counties for roads and libraries (CRA, 2018).

2.1. Household Effects

In study, household effects is a variable representing the change occurring in the welfare of individual citizens of a country occasioned by fiscal shocks as a result of factors related to fiscal decentralization. There seems to be a remarkably very few empirical studies on how households allocate resources among their members. There are opposing discoveries that rise up out of the numerous methods for estimating and translating African family unit neediness concerning specialist issues in pinpointing the idea of destitution and fitting approach mediations. Examinations of information on family revenue imbalance once in a while unequivocally consider the idea of the "families" they are contemplating. This is for instance evident in light of the fact that the case with secondary investigations, which suggest expanding family unit measure, is related with expanding neediness. Recent anthropological and subjective studies demonstrate that analysts clarify what they comprehend by family and utilize domestically grounded meanings of family. Analysts regularly characterize family by the consideration of enrollment than is utilized in national family unit reviews (Randall, Coast, and Dial, 2013).

In most family unit studies, revenue and consumption information are gathered at the family unit level as opposed to individual level and therefore consumption at individual level is not clearly seen. This poses no problem for goods, such as leisure, as they are consumed by only one member in a household although there are few such goods but their identification is not trivial. Most test of family unit designation models have, thus, centered on recreation request or work supply (KNBS, 2016).

The theoretical literature on economic models of household behavior goes back to Becker's (1964) expansion of the neoclassical model of individual consumption demand to families. For this situation, all individuals from the family unit are accepted to together amplify some family level welfare work, while pay is allotted with the goal that the peripheral rate of substitution between any two products is equivalent to that for some other combination. Vitally nonetheless, as long as the family stays flawless, it might be treated as though it goes about as a solitary individual; in other words, all assets are pooled and afterward reallocated by some basic guideline inside the family.

3. THE BUDGET EFFICACY

Budget efficacy focuses on outputs and outcomes, measuring the impact of the budget planning policy while the effectiveness of budgeting relates to the dimension of ecological unpredictability. Feasible planning

would involve managing the activities of an organization that largely relies on environmental unpredictability in which the expenditure is carried out (Pilkington and Crowther, 2007; Kren, 1992).

Most researchers express a budget as a quantitative articulation of an arrangement of activity with impediments on the arrangement. Horngren *et al.* (2008) relate budgeting to cash inflows and outflows. This definition nevertheless does not make reference to the object of time to which a financial plan relates. A financial plan ought to dependably be in regard of a timeframe, it could be half yearly, yearly, quarterly, month to month, week after week, day by day, or other timespans (Harper, 1995; Frederick, 2001).

Other scholars view the budget as a management tool through which a manager utilizes his resources and that of an organization to achieve the objectives of an organization. According to Horngren *et al.* (2008), budget efficacy is utilized as a control variable in management. The concern of this study is on the role of budget in assisting the researcher to find out how the budget can be utilized to achieve the purpose for which devolution in Kenya was set and especially as it relates to household effects.

4. FISCAL POLICIES

Fiscal policy is characterized as the system by which a government manages its expenditures aimed at enhancing growth. The fundamental thought of macroeconomic strategy is to utilize financial and money-related arrangement to accomplish a yield gap that is neither so high that it prompts exorbitant joblessness neither too low that it prompts increased prices. Both policies are utilized in different mixes to coordinate a nation's monetary objectives. These approaches have been minimized in later monetary strategy exchanges (Arestis, 2007), despite the fact that the experimental proof on the adequacy of fiscal policy does not always support this perspective (Arestis, 2008).

Neyapti (2010) posits that income decentralization minimizes spending shortages, with respect to the quantity of nation explicit factors including population size and domestic elections. Furthermore, Eyraud and Lusinyan (2014) examined the effect of vertical financial instability on general monetary execution in 20 OECD states and found that the general government financial offsets gradually improve with decrease in fiscal instability. Therefore, narrowing the gap between subnational consumption and own income is connected with better monetary results.

There are more negative outcomes given by De Mello (2000). He demonstrates that the level of expense approach of devolved units may lead to disappointments in the inter-administration coordination, expanding open shortage at the national and county government levels. Thornton (2009) similarly centers on two proportions of income decentralization described by more and less domestic approach. By assessing findings using panel approach from 19 OECD nations over the period 1980-2000, he finds that when precisely estimated, income decentralization seems to have had no negative effect on monetary order.

5. ACTUAL COUNTY EXPENDITURE AND TOTAL BUDGETED EXPENDITURE

Horngren *et al.* (2008) portray a financial plan as a quantitative articulation of an arrangement of activity; whereas, Atkinson *et al.* (1997) characterize a financial plan as a quantitative articulation of the cash inflows and outflows to decide if a monetary arrangement will meet association objective. Nevertheless, the definitions by the two researchers do not specify the object of time to which a financial plan relates. A financial plan is set up for a particular period in time and ought to subsequently dependably be a timeframe, it could be half yearly, yearly, quarterly, month to month, week after week, every day, or other timespans (Harper, 1995; Frederick, 2001).

The government that is key in this study frequently endorses a spending plan and after that keeps up consumption around the limit recommended by the financial plans (Ehrhart *et al.*, 2006). Section 126 of the Public Finance Management Act 2012 makes it a prerequisite that devolved governments set up a coordinated advancement plan that incorporates key needs for the medium term that mirror the devolved government's needs and plans, a portrayal of how the area government is reacting to changes in the money related and monetary condition, and the projects to be conveyed (PFM Act, 2012).

Actual expenditures refer to the cash spent as per the money-related designations recorded in the administration general spending. The money is divided and assigned depending on the current or capital spending. A surplus or shortage alludes to the contrasts between the incomes and consumptions. On account of an excess, the incomes surpass the consumptions, while shortfall implies that uses surpass incomes. In the administration general spending plan, the surpluses or shortages are not real and assessed. Often, the deficiency is called purposeful shortage (Farshad, Sameni and Keivani, 2013).

Rose and Lawton (1994) emphasize on the importance of financial planning on the success of a budget. They posit that as public sector organizations take decisions and make plans in turbulent environments that are prone to be affected by internal dynamics of the organizations and views from various stakeholders as well as external factors, planning has to be dynamic in the formulation and implementation of budgets as well. On the contrary, Scholes and Whittington (2006) argue that such plans will be translated differently by people in the organization.

They however advise that guidelines and rules are required, which should not be highly prescriptive and constraining to prevent interaction, sharing, questioning, and innovative behavior. In addition to this, proper systems, controls, leadership, team membership skills, and training in effective thinking help to stimulate ideas and keep brains fit for innovative thinking.

Previously in Kenya, planning, approach, and budgeting have not been directed in a totally coordinated and far reaching way, thereby leading into irregularities and incoherencies in Kenya's advancement stages. The MTEF model has now been adjusted for use, which is intended to ingrain discipline in overseeing and arranging national assets by setting up an unequivocal connection between the policy system and the budgetary procedure. It tries to bring a superior coordination of strategy changes, planning and use the board and endeavors to align sector goals to national needs and in this manner accomplish more prominent results given the available resources (IEA, 2013).

6. COUNTY TREASURY MANAGEMENT

Service delivery fundamentally refers to the methodical arrangement of activities in service that gives institutions the responsibility of fulfilling the needs and expectations of citizens and other stakeholders with the optimal use of resources. Service delivery is a major component in the contribution in improvement to the establishment of administrative machinery that can face the challenges of the twenty-first century. Key to an effective service delivery is the role of county treasury management, also referred as cash management (Tesfaye, 2006).

Ndalila (2016) sets that the Kenyan law gives the devolved administration lawful obligation to oversee funds dispensed from the national government to the county government through the county treasuries. The responsibilities of the county treasury in the counties are highlighted in sections 109-117 of the PFM Act. The devolved administration is expected to submit financial reports to the Auditor General for accountability purposes. This is in regard to the utilization of the emergency fund, among other funds allocated to county governments.

The PFM Act (2012) establishes county treasuries in the 47 county governments and gives power to oversee national resources as per the standards of financial duty set in subsection (2) of the Act. The county treasury manages the unit government budget process such as overseeing the formulation of economic policies, managing the transfers of funds to a county government in consultation with the cabinet secretary, preparation of yearly budget assessments for the devolved government, and coordination of the arrangement and usage of devolved government spending plan. The county treasury has the overall responsibility for economic affairs at the devolved administration and implements monetary duty standards at the devolved government and planning of the fiscal strategy paper as the coordinated improvement plan for the province government (PFM Act, 2012).

Okumu (2015) asserts that there has been a wide spread imbalance in inequitable distribution of resources in Kenya and notes that there has been an improvement in the appropriation of budgetary assets following the adoption of the Kenya Constitution of 2010. He analyzes devolution as a tool that is meant to address resource imbalance that exists in Kenya. However, the type of a budget reform in use in an organization may determine the effectiveness of the fiscal management. The budget hypothesis proposes that

spending groups, including detail, execution, and program spending plans, serve diverse capacities concerning an administration's money-related administration (Jones and McCaffery, 2010; Schick, 2007).

7. CONCLUSION

Following a critical review of past research, the paper concludes that economic theory is not in line with statistical evidence in relation to the relationship between fiscal decentralization and household effect. Other studies have revealed that decentralization of funds to devolved units results in enhanced financial growth and effectiveness, especially in the provision of services to the public. This prompts the discussion that decentralization propels economic growth at both central and devolved government levels. On the other hand, other scholars have established that there is no link between decentralization and household effect while others found a negative association between the variables (Davoodi and Zou, 1998).

The literature reviewed also plays a significant role in explaining that the arrangement of administration expenditure could explain the indirect association between fiscal decentralization and household effect. According to a majority of the works, the fiscal decentralization estimate fails to separate devolved units spending in relation to recurring and development spending. It also fails to isolate between expenditure on well-being and social protection from development expenditure. According to the theory of economics, there is a direct association between infrastructure and capital expenditure and an indirect association between well-being and recurring expenditure and growth of the economy.

Davoodi and Zou (1997) posit that too much expending by devolved units on unnecessary projects can stagnant the growth rate. Growth of the economy is adopted to estimate the changes either direct or indirect in the household effect (Amagoh and Amin, 2012).

Majority of the works reviewed agree with Oates theoretical estimations that fiscal decentralization results in a direct influence on individuals' well-being at the developed units' level. Nevertheless, it is important to acknowledge that despite bringing out the possible link between county funding and household effect, existing literature has several limitations.

Various devolved units were operating at different levels in terms of growth and development when most of the past works were carried. As such, a certain county's experience cannot be applied to others. Furthermore, various devolved units need varying policies given the dynamisms in the cultural, historical, and economic aspects. Therefore, assuming these aspects could result in wrong or inconclusive findings and conclusion.

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