DECENTRALISATION AND FINANCIAL PERFORMANCE: A COMPARATIVE ANALYSIS OF LOCAL GOVERNMENTS' FINANCIAL SUSTAINABILITY IN TANZANIA

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STUDENT DECLARATION

I declare that while registered as a candidate for the research degree, I have not been a registered candidate or enrolled student for another award of the University or other academic or professional institution.

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ABSTRACT

This study focuses on analysing the financial sustainability of local government authorities (LGAs) in Tanzania with reference to decentralisation. In this context, the financial sustainability of LGAs is considered as an important aspect for decentralisation to succeed, especially in enhancing horizontal equity and public services in general. Specifically, the study attempts to: (i) assess and explain variations in financial sustainability across LGAs (ii) explore consequences of financial difficulties whenever they arise in the course of budget execution, and ways used to mitigate the difficulties. The study uses a quantitative approach, whereby financial indicators are used to analyse LGAs' financial performance reports to achieve the first objective, and qualitative analysis of interview data from three case studies to achieve the second objective.

The empirical findings suggest decentralisation in Tanzania influences financial sustainability of LGAs in different ways. First, councils with a large proportion of poor people not only have low financial sustainability, low expenditure per person and low own source revenue per person but also receive a lower average grant per person. This poses the danger of exaggerating the horizontal gap in service access. Secondly, council size and population size contribute negatively while the flow of government grants and poor financial management practices contribute positively to variations in financial sustainability. Thirdly, the findings suggest decentralisation may not discourage complacency in LGAs' revenue mobilisation and financial management practices. On the other hand, observation from the case studies suggests financial difficulties are prevalent in LGAs. They adversely affect LGAs' operations, especially in executing development projects in priority sectors: health, education, water and agriculture. To mitigate the difficulties, LGAs involve people in service provision, cuts or postponing activities as immediate options, and seeking alternative revenues sources for the long term.

The study offers three main contributions. First, it bridges two interrelated but distinct research themes: financial sustainability and fiscal decentralisation studies. This broadens the scope of analysing both themes. Secondly, it offers insights into why decentralisation may or may not achieve its potential. This is in response to the observation from some studies, which report the outcome of decentralisation in developing countries to be limited. Lastly, it offers feedback on the way decentralisation is executed in a country that has long-standing initiatives on enhancing horizontal equity and improving provision of public services in general.

Key words: Decentralisation, Financial Sustainability, Local Government, Service Provision

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LIST OF ABBREVIATIONS

ACIR - Advisory Commission on Intergovernmental Relations (US)

CAG -T – Controller and Auditor General (Tanzania)

CICA – Canadian Institute of Chartered Accountants

D by D- Decentralisation by Devolution

DEA – Data Envelopment Analysis

DMUs - Decision Making Units

ICMA - International City/County Management Association (US)

ILO – International Labour Organisation

LAAC- Local Authority Accounts Committee

LGAs –Local Government Authorities

MPs- Members of Parliament

MTEF - Medium Term Expenditure Framework

NPM - New Public Management

O&OD - Opportunities and Obstacles to Development

OLS- Ordinary Least Squares

PMO-RALG – Prime Minister's Office, Regional Administration and Local Government

SORP - Statement of Recommended Practice

UK- United Kingdom

UN-HABITAT - United Nations Human Settlements Programme

URT- United Republic of Tanzania

US- United States

USAID - United States Agency for International Development

CHAPTER 1 : INTRODUCTION

This study focuses on analyzing the financial sustainability of local government authorities (LGAs) in Tanzania, with reference to decentralisation. The context of the study considers assessing financial sustainability of LGAs as an approach for evaluating the way decentralisation has been designed and executed. In this respect, financial sustainability is considered as a precondition for decentralisation, particularly in improving access to public services and enhancing horizontal equity in service provision. The rationale is based on the need for balancing resource availability with expenditure functions so as to make LGAs effective in their operations. Smoke (2001) and Wang and Ma (2014) stressed the importance of proper design and implementation of reform programmes to attain the benefits. It is imperative that the decentralised agencies have sufficient financial capacity to deliver devolved functions on a continuing basis, and hence realise the benefits.

The outcome of decentralisation in developing countries is a mixed bag. Several studies such as Smoke (2001), Scott (2009), Cabral (2011) and Boex and Yilmaz (2010) report limited success of decentralisation in different contexts, which lead to deeper questions about the desirability of the decentralising approach. However, it can be argued that the right decentralisation approach is the one that enables LGAs to deliver their devolved responsibilities effectively and continuously. The ability of the LGAs to deliver assigned responsibilities is the focal point for achieving the benefits, especially those related with service provision. The literature (chapter 3) emphasises matching responsibilities assigned to LGAs with resource availability. Conversely, LGAs may not be able to operate effectively because of difficulties arising from the mismatch of responsibilities.

Inappropriate design of decentralisation and/or its operationalisation can perpetuate inequity in the provision of public services. This is likely to happen if the design does not embed an adequate intergovernmental grant system to compensate for differences in LGAs' resource capacity. In the absence of a proper mechanism, LGAs with a rich financial resource base will be more able to sustain provision of public services than poor LGAs (Buchanan, 1950). The use of intergovernmental grants is consistent with central government's income redistribution role, so as to ensure that a satisfactory level of key public services is offered in all jurisdictions (Oates, 1972).

1.1 Background to the Research

In Tanzania, the government has used decentralisation reform as a platform for improving the wellbeing of citizens, which enhances the role of LGAs significantly (URT, 1998). In the course of implementing a decentralisation programme, the country, in collaboration with development partners, has invested significant resources. According to the World Bank Report (2013), for instance, the financial support to LGAs solely for development activities was US$379 million from 2005/06 to 2010/11. Thus, it is appropriate to appraise decentralisation processes while they are still ongoing. Moreover, the decentralisation reforms are identified as unfinished work and take longer time to mature (Guess, 2007).

The design and implementation of decentralisation reforms is crucial in propelling achievement of their aims. Cabral (2011) emphasizes that the success of decentralisation reforms largely depends on appropriate design and execution of the reform programmes and processes. The decentralisation system influences both LGA's functions and their respective financial performance. Furthermore, as Wang and Ma (2014, p.756) noted, "the inappropriate operationalization of fiscal decentralisation can result in inconclusive findings" on the impact of decentralisation. Smoke (2001) emphasizes matching decentralised responsibilities with stable and assured financial resources if reforms are to be effective. This study recognises the need for decentralisation to ensure that LGAs become financially sustainable. Being financially sustainable would facilitate LGAs to discharge the responsibilities entrusted to them, effectively over time.

Empirical evidence suggests that poor financial sustainability hinders the ability of LGAs to deliver services. A good example is provided by Carmeli (2007) who found a positive relationship between LGAs' financial health and their ability to provide public services in Israel. LGAs with relatively poor financial health were observed to have delivered poor services in subsequent years. Thus, if fiscal decentralisation does not enhance financial sustainability of LGAs, success is less likely to materialise. Specifically, it will be difficult to (i) improve access and efficiency in service provision if responsibilities overwhelm financial ability; and/or (ii) bring equity in accessing public services if poor LGAs are marginalised. It is noted that adequate financial health is a precondition for the attainment of objectives in any organisation (Cabaleiro et al., 2012).

In LGAs, financial sustainability refers to the ability to deliver responsibilities on a continuing basis, in both the short and long term (Dollery and Crase, 2006; Dodor et al., 2009). It determines the ability of LGAs to meet current and future obligations as they arise throughout the fiscal year, without compromising the existing level of public services. The flow of central government grants to each LGA is most important in determining their fiscal position. As observed in the US, the structural deficit in Michigan caused a reduction in revenue share to local authorities and contributed to the financial troubles of LGAs (Skidmore and Scoresone, 2011). On the other hand, the ability of LGAs to raise revenues from their own sources is vital towards budget execution and in determining their financial sustainability. It facilitates their flexibility in mitigating financial shocks. LGAs will not be able to respond to fiscal stress that may arise from reduction in intergovernmental grants if their ability to generate revenues from their own sources is constrained (Reschovsky, 2003). If LGAs become fiscally stressed, they are unlikely to meet devolved responsibilities properly.

According to Skidmore and Scorsone (2011), the two options LGAs can take during the period of financial difficulty are to either increase efficiency or cut down expenditure. The first enables them to continue with the same level of public services with fewer resources, and the second cuts down expenditure to match generated fund/revenues. However, considering the execution of LGAs' responsibilities is reflected in their annual budgets, the first option seems rarely possible especially for difficulties that arise during the course of the current budget. It would be difficult for LGAs to reorganise their service provision arrangements within a short period in order to solve the problem through enhanced efficiency. On the other hand, the second option has negative implications for the provision of services and overall success of decentralisation reforms. Insufficient revenue to finance social and economic infrastructure, for instance, negatively affects service delivery (Folscher, 2007). In the short run, the consequence will be to reduce the quality and level of services while in the long run it will be to extinguish economic competitiveness and its underlying benefits. The difficulty of obtaining a solution to financial troubles without compromising service provision enhances the need for appropriate reform design and its operationalisation.

Thus, based on the theoretical and empirical literature, there is an inherent relationship between decentralisation and financial sustainability of LGAs. On one hand, the design and operationalisation of decentralisation influences financial sustainability through assignment of responsibilities and resources to LGAs. As Stone (2015) identifies, decentralisation could influence financial sustainability of LGAs in both ways, positively and negatively. On the other hand, financial sustainability of LGAs influences the success of decentralisation through the execution of devolved functions. For instance, Krueathep (2014) acknowledges the importance of establishing a clear distribution of budgetary responsibilities to key budget actors within decentralisation settings, to avoid poor fiscal conditions in LGAs. This underscores the importance of decentralisation design to assign responsibilities to LGA officials in order to steer towards a successful outcome. Despite the inherent relationship between decentralisation and financial sustainability of LGAs, there is limited research that explores the role of decentralisation on financial sustainability, as Stone (2015) recommends, or the other way round. Considering this gap, this study examines the financial sustainability of LGAs in Tanzania with reference to decentralisation.

1.2 Rationale of the Study

Tanzania has prioritised the provision of public services in an equitable manner since attainment of independence in 1961 (Belshaw, 1982). Since then, the government has taken a number of remarkable steps, such as the Arusha Declaration (1967), which emphasised horizontal equity through socialist policies. This was followed by a massive decentralisation reform in 1972, which collapsed over the next 10 years due to poor design and operational problems (URT, undated). The collapse of the decentralisation programme was partly attributed to the absence of LGAs, which had been abolished in the process. The implementation of such reform was coordinated by regional planning committees without local elected leaderships. Also, the execution of the programme faced financial difficulties because of donor withdrawal in financing regional plans.

To support the initiatives, the government re-introduced LGAs in 1982. This was followed by introduction of a structural adjustment programme in 1986, which guided the macroeconomic policies of the country until 1996. However, the implementation of the structural adjustment programmes was given mixed interpretations because of deviations between stated and actual actions and a lack of grounded data to verify the impact (Ellis and Mdoe, 2003). Until the late 1990s, the level of income inequality in the country seemed to deepen, as evident in the World Bank Gini coefficient for the country which increased from 0.353 to 0.373 between 1991 and 2000. Following this concern, the government re-initiated the decentralisation agenda under the name of Decentralisation by Devolution (D by D) in 1996. The D by D programme paralleled the introduction of the National Poverty Eradication Strategy, which identifies LGAs as important implementation agents in the poverty eradication initiatives. Considering this, the introduced reforms aim at improving access to public services, particularly to the poor, so as to induce their economic wellbeing, reducing the poverty level and inequality (URT, undated). Therefore, in the new settings LGA's operations embed both components of poverty reduction and the equity in service provision. While considering the experience from previous refoms, this study examines whether the D by D programme offers the prospect of enhancing horizontal equity and improving service provision in general.

1.3 Study Objectives

The main objective of the study is to investigate the financial sustainability of LGAs with reference to decentralisation reforms. Following this, the study aims to identify whether the execution of the reform offers prospects of attaining the decentralisation objectives of enhancing equity in service access and improving service provision in general. Specifically, the research has the following two research objectives.

The first objective is to investigate and explain variations in financial sustainability. The analysis of LGAs' financial sustainability is made over time and in comparison to others, and by identifying factors that explains the variations in order to establish the influence of decentralisation. To accomplish this objective, answers to the following question are sought:

i. How does the financial sustainability of local governments vary across Tanzania in the context of decentralisation reforms?

This question provides insight into whether the design and implementation of decentralisation enhances the financial sustainability of LGAs in a way that would enhance horizontal equity in service provision. The assessment of financial sustainability uses financial indicators derived from financial performance reports of LGAs before evaluating factors that explain the variation. Specifically, the study considers two groups of financial indicators, which are budgetary solvency and services solvency. These categories are considered appropriate because they are capable of reflecting LGAs' long-term fiscal performance corresponding with the execution of the devolved responsibilities, which tend to be of long-term in nature (more details about selection of measurement indicators are provided in subsection 5.6). Thus, the comparative financial sustainability analysis encompasses a sample of LGAs comprising communities with different income poverty levels. More details about the sample and data used are provided in the methodology chapter, subsection 5.4.

Secondly, the study analyses the consequences of financial difficulties that arise while LGAs are working to meet their annual targets, and the approaches used to mitigate the difficulty and to enhance financial sustainability. This objective is intended to identify the impact of the difficulties and corresponding mitigation techniques on the overall purpose of improving public services. In order to accomplish this objective, the research intends to address the following research question:

ii. What are the consequences of financial difficulties arising while LGAs are in the course of executing their annual financial budgets, and how do LGAs mitigate the difficulty?

In seeking answers to this second question, the study employs comparative analysis of three LGAs as case studies. This involved collecting the views of LGA officials through interviews. While seeking response to this question, the study also sought to identify challenges associated with enhancing financial sustainability in LGAs.

1.4 Thesis Structure

The rest of the thesis comprises seven chapters. The second chapter provides the theoretical framework underpinning the research work in seeking responses to the research questions. It reviews the fiscal decentralisation theory and its link with fiscal condition studies. Chapter three reviews theoretical and empirical literature related to two main themes: decentralisation and financial sustainability. The first theme explores decentralisation experiences from both developing and developed countries. The second theme discusses financial sustainability of LGAs, factors influencing their financial sustainability, how they are linked to decentralisation design and/or operationalisation, and the practice of measuring this.

Chapter four discusses the background of decentralisation reforms in Tanzania. It explores the historical background of LGAs, their institutional settings, functions and their financing arrangements under the decentralisation system. Chapter five describes the methodology; it discusses the research paradigm, data and methods used. It also provides a discussion of the measurement indicators, associated meanings and their link to decentralisation reforms. Chapter six provides analysis of the financial sustainability of LGAs and a discussion of explanatory variables. Chapter seven presents analysis and discussion of the consequences of financial difficulties, methods used to mitigate them and challenges facing Tanzanian LGAs in enhancing their financial sustainability. Finally, chapter eight provides the conclusion, the study's significance and contribution, acknowledging its limitations, and areas for further research.

CHAPTER 2 : THEORETICAL FRAMEWORK

2.1 Introduction

This chapter presents the theoretical background that has been used to guide the research processes and interpretation of the results. It starts by explaining the evolution of decentralisation, which is followed by describing the fiscal decentralisation theory which provides the basis for redistribution of roles between different levels of government. The theory provides the rationale for decentralising government functions as well as the redistribution of resources that ultimately have an impact on the public services offered and the wellbeing of the people served. It is considered to be relevant to the context of Tanzania because, as in many developing countries in Africa (Smoke, 2001), people have high hopes from their local government in offering access to basic public services such as health, education, water, and basic infrastructure. The study does not test the theory but rather uses it in evaluating the ongoing decentralisation reforms, particularly in interpretation of the findings. The chapter also describes the link between fiscal decentralisation and financial sustainability of LGAs, the conceptual framework, and it ends with the chapter summary.

2.2 Decentralisation Evolution

The concept of decentralisation has its roots back in the non-centralised political structures of the ancient Greek kingdoms, followed by the Roman Empire which underwent “advanced decentralisation reforms on a large scale” (Widmalm, 2008: p. 27). It evolved through different stages of transfer of authority and responsibilities from central to lower governments. However, the form and terminology used to reflect reforms differ with time. According to Petak (2004), in the 1950s the emphasis was on the deconcentration of decision-making power from central government to lower levels of government in dispersed locations. Following this, the term decentralisation arose in the 1970s, and the new wave of public sector transformation occurred worldwide, involving a diffusion of power and responsibilities over public service provision from central to lower levels of government and the private sector. Other new terms, such as devolution, emerged together with decentralisation to reflect the scope of institutional changes coupled with the transfer of decision making to lower levels of government. However, devolution itself is considered as the higher level of decentralisation that involves transfer of both fiscal and political powers to lower levels of government.

On the other hand, Widmalm (2008) identified three aspects that together define decentralisation, particularly when referred to the vertical transfer of power: geographical location, legal status and area of responsibility, and power distribution. For reforms to be considered as decentralisation, they should involve transfer of real power to lower levels of government, corresponding with the allocation of geographical areas and legal recognition of responsibility. Otherwise, decentralisation is in fact only delegation, which implies that responsibilities are assigned to an institution that will have no means of influencing the method of implementation. In this regard, evaluation of decentralisation's success through a decentralised agency becomes unrealistic. When Wildman (2008) identified assignment of power to a decentralised agency, he also meant to include resources. An institution assigned with an area of responsibility and legal recognition but without resources has no power in terms of resources. These aspects determine whether decentralisation prevails or not, especially in the transfer of responsibility to a decentralised agency. They are preconditions for identifying whether decentralisation is really translated into practice or not.

2.3 Fiscal Decentralisation Theory

Fiscal decentralisation is a long-term gradual process of assigning revenue sources and expenditure functions from central to local government (Salman and Iqbal, 2011; Eleccion, 2013). It is also referred to as fiscal federalism, and is broadly identified as the study of structure and functioning of central and local governments (Smoke, 2001; Oates, 2005, Dziobek, 2011). Basically, there are two issues in any fiscal decentralisation: the assignment of responsibilities and distribution of resources. Stable and assured financial resources that match the functions of decentralised agencies are a top priority for effective decentralisation reforms (Crook and Manor, 2000). The fiscal decentralisation theory explains how the fiscal system should be designed in a multilevel government in order to establish optimal government. The theory was developed by Wallace Oates in 1972 and is linked with Musgrave's theory of public finance (1959) which categorised functions of national governments into three groups: allocation of resources, income distribution and macroeconomic stabilisation. Thus, fiscal decentralisation theory requires each level of government to perform what it can do best.

In multilevel government settings, the theory proposes that central government should take charge of macroeconomic stabilisation policies, income distribution and monitor and balance provision of public goods whenever there is the possibility of negative spill-over between LGAs. On the other hand, LGAs should provide local public goods because their proximity to people enables them to know local preferences. Demand and preferences for some public services vary across localities, which puts LGAs in a better position than central government to provide such services. Also, the LGAs' proximity to people minimises the cost of extracting information on local preferences and needs (Salman and Iqbal, 2011). Services which reflect both the interest of local people and also external users should be dealt with by central government. In addition, the central government should handle provision of services which significantly benefit individuals of all jurisdictions. Thus, capital-intensive projects such as electricity and transport infrastructure are better managed by central government, because of the possibility of economies of scale (Smoke, 2001).

In relation to income distribution, central government should be responsible for the equitable offering of public services across LGAs. LGAs cannot perform their functions in a fair manner if they are left to finance themselves entirely. If they are required to finance their all operations independently, then fiscal inequalities among them will persist unless they all have the same fiscal capacity (Buchanan, 1950). However, in reality it is difficult to find a country whose LGAs have the same fiscal capacity. As a result, poor LGAs will impose higher tax rates than wealthier LGAs, with correspondingly inferior public service programmes (Buchanan, 1950; Oates, 1972; Prud'homme, 1995). Poor people in well-off LGAs will be better-off than those in poor regions because their LGAs can collect more taxes, which enhances the level of public services. Alternatively, if the same level of service is to be offered, then the tax burden on residents of different LGAs will have to differ (Buchanan, 1950). This is likely to cause movement of people from one LGA to another with more attractive tax policies. For instance, if a LGA has a higher rate of tax on rich people to fund services benefiting the poor, then the rich people will move to LGAs with a lower rate and the poor people will move in to benefit from better services (Prud'homme, 1995; Smoke 2001). Hence, in the absence of central government intervention, population mobility between jurisdictions will make an income redistribution policy self-defeating (Martnez-Vazquez and McNab, 2003).

The use of intergovernmental grants is consistent with the income distribution role, to ensure that a satisfactory level of key public services is offered in all jurisdictions (Oates, 1972). As Smoke (2001, p.5) identifies "...central government is in position to redistribute resources from wealthier to poorer jurisdictions". This can be done through the national budget, whereby richer LGAs subsidise poorer ones. Meanwhile, LGAs should be responsible for intra-jurisdictional income redistribution, through local tax policies and prioritisation of public service provision. Prud'homme, (1995, 2003) notes that analytical and empirical research indicates that national budgets tend to regulate regional disparities.

Nevertheless, Oates (2005) identifies that the emergence of second generation theory of fiscal federalism in the 1990s considers the relationships between decentralised organs differently. As summarised in table 2.1, the second generation builds on the traditional theory, which is the first generation by relaxing the assumption about incentives of implementing agents. The traditional version assumes the objective function is to maximise social welfare under benevolent actors, while the second generation considers the influence of political environment and fiscal incentives on actions of implementing agents (Weingast, 2014).

Table 2.1: Assumptions of First- and Second-Generation Theory

First Generation of Decentralisation Theory	**Second Generation of Fiscal Decentralisation Theory**
• Assumes governments operate in order to maximise social welfare. • Therefore, decentralisation is favoured because local governments can easily capture local preferences while central government concentrates on macroeconomic stabilisation and income redistribution. • The central government can also offer services which cut across jurisdictions.	• Built upon the first generation theory, but it assumes governments maximise their own objective functions through political processes and information asymmetry. • Thus, decentralisation can reduce inefficiency through reducing information asymmetry and/or promoting tax competition among LGAs.

Source: Author derived from literatures

The second-generation theory of fiscal federalism explains the behaviour of political agents in political processes and their influence in objective functions, while simultaneously focusing on information problems, moral hazard, and free-riding between government sub-levels (Dziobek et al., 2011). The assumption is that political and fiscal institutions operate under imperfect information while the behaviour of participants is induced by utility maximisation. Thus, the emphasis is not just on decentralisation but also on the form it takes. Decentralisation processes that make LGAs rely on their own resources should be seen as more efficient than those which make LGAs rely heavily on central government transfers. Hence, competition among LGAs is inevitable since utility maximisation is the driver of their objective function. This is contrary to first-generation theory, whereby the tax base for local government focused only on property taxes and user fees but not on other sources. The first generation aimed to avoid competition, economic distortions and double taxation that would lead to the shifting of economic activities from one LGA to another with lower tax rates.

However, from the view of public service users, the availability of balanced and satisfactory services on a continuing basis takes priority, regardless of the source of funding. Whether LGAs raise funds from their own revenue or receive funds from the central government is less important, as long as the system treats them equitably. The case is more relevant to developing countries where, as Prud'homme (1995) points out, the main concern is not difference in preferences but rather availability of basic services such as health, education, water and infrastructure. Therefore, the intergovernmental fiscal system needs be designed properly and operationalised to match the distribution of resources with responsibilities. Effective fiscal decentralisation should ensure appropriate assignment of expenditure functions between different government levels, appropriate assignment of tax revenues and efficient fund transfer systems (Kardar, 2006). This will minimise imbalances in service delivery while simultaneously bringing public goods and services close to the people. Table 2.1 provides a summary of the assumptions behind the first- and second-generation theories of fiscal decentralisation.

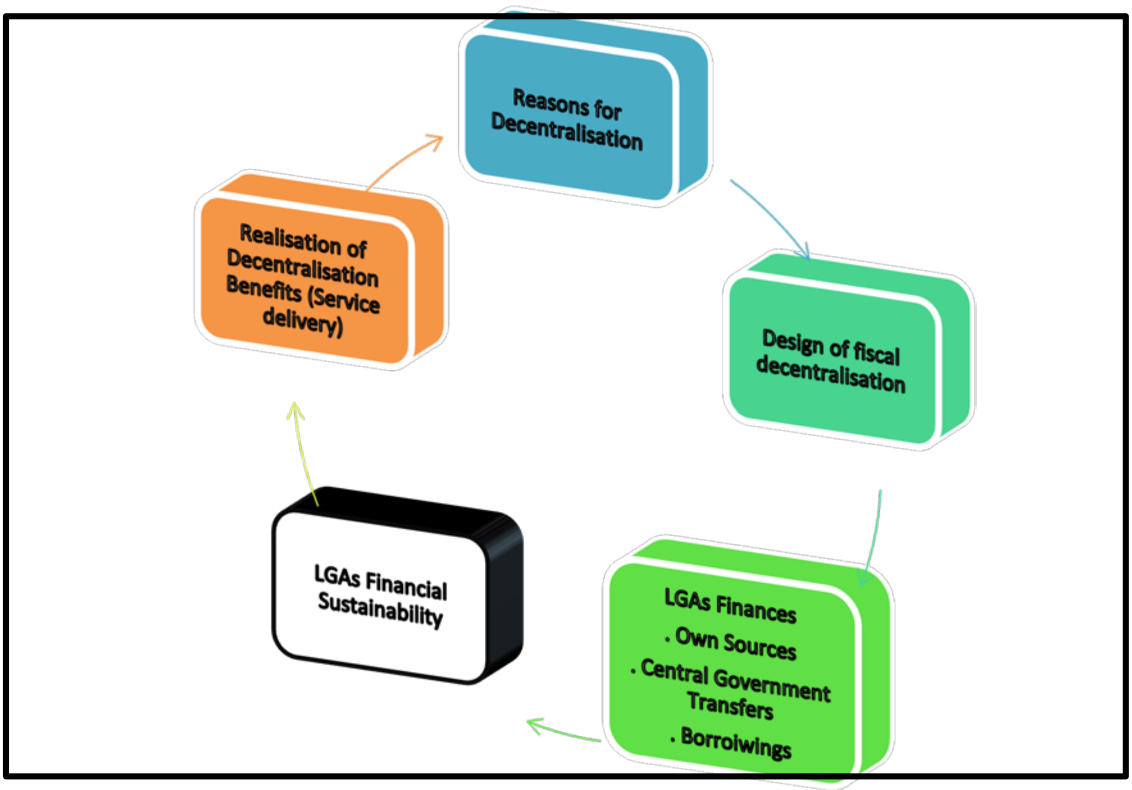
2.4 Relationship between Fiscal Decentralisation and Financial Sustainability

The design of fiscal decentralisation and its execution are keys to the success of decentralisation reforms. These determine the distribution of responsibilities and resources between government tiers. Effective fiscal decentralisation requires clear distribution of roles and responsibilities to LGAs and assignment of sufficient finance to execute them (World Bank, 2010). If LGAs "are to carry out decentralised functions effectively, they must have adequate revenues – raised locally or transferred from the central government – as well as the authority to make expenditure decisions" (UN-HABITAT, 2002: p.6). A well designed decentralisation system is an essential precondition to achievement of the decentralisation benefits (discussion about the benefits of decentralisation is in the next chapter). It establishes the system which enables LGAs to meet their expenditure obligations on a continuing basis, which is a function of financial sustainability. As Huang and Ho (2013) identify, financial sustainability of LGAs determines their ability to meet short-term and long-term financial obligations arising from service delivery functions and borrowings as they come due. If reforms do not match resources following an increase in responsibilities, then financial sustainability of LGAs will deteriorate.

In any local government system, fiscal decentralisation determines resource distribution to different government levels, which is vital for fulfilling citizens' demands (World Bank, 2010). It is the design of the fiscal decentralisation system which affects LGAs' expenditure decisions, revenue mobilisation power, borrowing power and intergovernmental fiscal transfers (Vo, 2010). All components are very important in LGAs' financial sustainability. Therefore, on one hand the design of the system affects LGAs' financial sustainability and on the other financial sustainability influences attainment of decentralisation benefits (as presented in figure 2.1). Moreover, the system should emphasise horizontal equity, as the theory suggests. This will provide a balance in LGAs' capacity to deliver responsibilities regardless of the differences in their resource base. It is intergovernmental transfers as part of the income redistribution role which is expected to handle LGAs' disparities in resource base.

Furthermore, Dollery (2009) identifies two factors that associate financial sustainability with fiscal decentralisation design. The first is the existence of vertical revenue imbalance where central government collects taxes exceeding expenditure. This factor will clearly persist since the central government is always in charge of major sources of tax collection for the sake of the country's economy, as previously noted. However, the impact can be eliminated through an intergovernmental transfer system. The second factor is horizontal fiscal imbalance, where different LGAs have different revenue mobilisation capacity. The findings of Johnson et al. (1995) indicate local governments in rural areas impose a higher fiscal burden on their tax payers, compared to metropolitan areas, to support their budgets. This shows that differences in tax bases impose different tax burdens on their citizens. If LGAs' financial sustainability persistently differs because of the second factor, there must be an inherent problem in fiscal system design. Johnson et al. (1995) indicate weaknesses in intergovernmental transfers contributed to the fiscal burden in rural LGAs in the US. A well designed system in a unitary government, as theory suggests, would ensure all LGAs have the same capacity despite their revenue capacity. The figure 2.1 below summarises the linkage between decentralisation design, its influence on LGAs' financial sustainability and realisation of decentralisation benefits.

Figure 2.1: Interrelationships between decentralisation and LGAs' financial sustainability



Source: Author

Besides ensuring the equity of LGAs, the design of the system should also discourage soft budget constraint practices. LGAs should be efficient in mobilising revenues from internal sources so that intergovernmental transfers aimed to equalise their financial capacity become meaningful. Otherwise, the people who are the beneficiaries of the services provided by LGAs will not benefit from the equalising system. Less efficient LGAs will distort the whole fiscal system by depending heavily on intergovernmental transfers. Thus, for LGAs to have sustainable finance, the system should ensure financial resources match devolved responsibilities while simultaneously ensuring equity and discouraging slack in revenue mobilisation. These are vital components for decentralisation reform to succeed. If this is the case, then evaluating financial sustainability of LGAs offers the prospect of identifying whether the design and/or operationalisation of the decentralisation system is likely to succeed. It will provide insight into the impact of decentralisation on LGAs' financial sustainability and the likely impact of LGAs' financial sustainability on the success of decentralisation. Despite financial sustainability not being an ultimate measure of LGAs' success in exercising their functions, its absence compromises the level and quality of services provided (Huang and Ho, 2013).

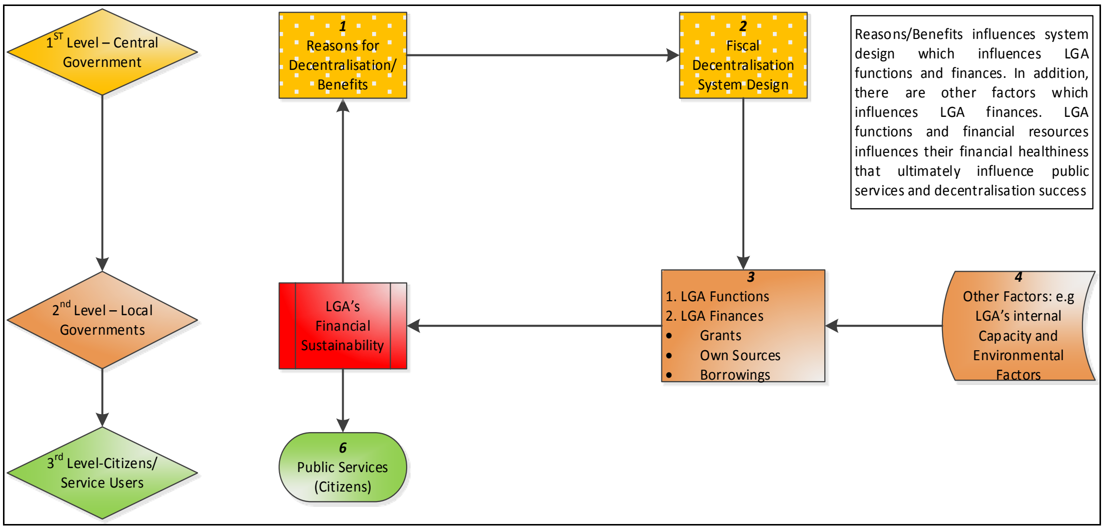
2.5 Conceptual Framework

The study blends together the framework of Hendrick (2004) and the Canadian Institute of Chartered Accountants (CICA) to draw up a framework that suits the context of this study. Hendrick's (2004) view of LGAs' financial condition has a multidimensional aspect which results from the interrelationship between various factors in the local government system. Meanwhile, SORP-4[1] in the CICA (2013) handbook identifies three components of financial conditions. The first reflects the ability to maintain existing service levels and credit or requirements without an enhanced debt burden on the economy. The second reflects the ability to raise additional finance in response to additional commitments, and the third reflects the extent of dependence on external finance sources which are out of the LGA's control. The combined framework allows consideration of variables that are influenced by decentralisation reforms in evaluating

[1]Statement of Recommended Practice (SORP-4) Indicators of Financial Condition, Adapted from CICA Handbook-Public Sector Accounting, CGA Student Edition, 2013, with permission of the Chartered Professional Accountants of Canada, Toronto, Canada. "Any changes to the original material are the sole responsibility of the author and have not been reviewed or endorsed by the Chartered Professional Accountants of Canada."

financial sustainability. It helps to identify suitable financial sustainability measurement indicators, along with fiscal decentralisation theory, to interpret the outcome. The framework adopted in this study is presented in figure 2.2. The intention is not to test the theory but rather to apply it in evaluating similarities and differences in LGAs' financial sustainability. As Whitaker (1985) concludes, factors which influence LGAs' spending also influence financial health. The design and operationalisation of the decentralisation system influence not only LGAs' spending patterns and finances but also their ability to cooperate with other players.

Figure 2.2: Combined Conceptual Framework



Source: Author derived from Hendrick's (2004) and CICA's (2013) Frameworks

2.6 Chapter Summary

The chapter presents the fiscal decentralisation theory developed by Oates in 1972, which provides the basis of the research processes and interpretation of the results. The theory requires central government to discharge macroeconomic stabilisation and income redistribution roles, and local governments to be responsible for delivery of services which reflect local needs. It discourages horizontal imbalance through an income redistribution role, in which intergovernmental transfers can be used to promote fiscal equity across LGAs. If reform adheres to this theory, the expected impact is not just the improvement of services because of efficiency in resource allocations, but also equity in such services. The theory is considered appropriate in the context of decentralisation reforms in Tanzania, where the provision of basic public services is a major concern. Thus, people have high hopes from different government levels, especially from LGAs, to meet basic public services such as health, education, water and infrastructure. The relevance of the theory is enhanced by the variations in financial resources across regions (as discussed in chapter 4), making income redistribution a crucial issue in implementation of the reform. Thus, the research questions aim to evaluate whether reform design conforms to the theory, hence offering the prospect of improving service provision in an equitable manner. The chapter describes the evolution of decentralisation, the link between fiscal decentralisation and financial sustainability, and the conceptual framework.

CHAPTER 3 : LITERATURE REVIEW

3. 1 Introduction

This chapter presents a review of the theoretical and empirical literature related to decentralisation and the financial sustainability of local governments. It starts by discussing ways in which decentralisation reforms can be evaluated, followed by drawing experiences relating to the achievement of decentralisation benefits. Thereafter, the chapter discusses the general challenges of decentralisation, the decentralisation process in developing countries and related challenges, and the role of fiscal relations in shaping financial sustainability of LGAs. It further discusses the functions and importance of LGAs, the meaning and background of financial sustainability in LGAs, including the reasons for evaluating financial sustainability and the practice of measuring it.

3.2 Background of Decentralisation

Decentralisation of government functions has been a global agenda since the 1970s. Its meaning in relation to the public sector depends on the two forms that it can take (Litvack et al., 1998; Litvack and Seddon, 1999). First, it refers to transfer of responsibilities from central government downwards to states and local authorities, which is the focus of this study. The devolution of power is expected to reduce the role of central government and to induce intergovernmental competition; checks and balances hence increase responsiveness and efficiency (Bardhan, 2002, Widmalm, 2008). Secondly, it refers to transfer of responsibilities between governmental and non-governmental sectors to incorporate market forces. This is also referred to as market or economy decentralisation because it involves shifting responsibilities from public to private sectors.

Despite decentralisation reforms being underway globally, the processes and programmes involved seem to differ between developing and developed countries. Developed countries consider decentralisation as a better option for providing public services in a more cost-effective approach (Petak, 2004). Thus reforms mainly involve re-alignment of procedures and processes of public service delivery through the introduction of various New Public Management (NPM) tools. This includes reengineering the public service delivery function, while employing various private sector tools and the marketisation of public service delivery (Halligan, 1997).

Meanwhile, developing countries consider decentralisation reforms as a means of tackling economic inefficiencies, macroeconomic instability, and ineffective governance (Petak, 2004; Manor, 1999). Reforms in these countries aim to boost economic development, political stability and poverty alleviation. Over 80 percent of developing and transition economies implement decentralisation policies following failure of a centralised strategy to promote development and poverty reduction (Johnson[2], 1999). Thus, in developing countries reforms focus on transfer of power and responsibilities to lower levels of government, seeking community participation in development projects, involving the private sector in development programmes and enhancing political stability (Crook and Manor, 2000).

As in many developing countries, Tanzania attempted to decentralise its government functions for the first time in 1972. The aim was to deal with interregional development gaps and access to public services between urban and rural areas and within the rural areas. However, the introduction of reforms went hand in hand with the abolition of the local government structure inherited from colonial rule. This structure was considered inconsistent with the decisions of the then new government. As a result, during implementation the reforms raised a number of problems[3] partly as a result of the abolition of the LGAs, and hence the programme ceased just after 10 years. The implementation of government functions from 1972 to the early 1980s was made through regional planning committees coordinated by the central government, but in 1982, LGAs were re-introduced. In the late 1990s, the country re-initiated another reform under the name of Decentralisation by Devolution (D by D) in order to enhance local government functioning. The reform is still ongoing and its long-term goals include poverty alleviation, improving quality and access to public services especially to the poor, and ensuring equity in public services (URT, undated).

The decentralisation policy paper of 1998 provides the foundation of the ongoing reforms; it identifies four main aspects of D by D. First is political decentralisation, which aims to devolve decision-making power to LGAs within the national legislation framework. Secondly, fiscal decentralisation is intended to provide LGAs with

[2] Foreword provided by Ian Johnson, the World Bank Vice President (Environmentally and Socially Sustainable Development Network), in Manor, J. (1999). The political Economy of Democratic Decentralisation

[3] For more details about these problems see URT (undated), the History of Local Government System in Tanzania issued by the Prime Minister's Office- Regional Administration and Local Government.

discretionary power over financial decisions and own-source revenue generation. Thirdly, administrative decentralisation aims to provide LGAs with discretionary power over staff recruitment and local decisions and to make the staff accountable to their local councils. Finally, it brings changes to central-local relations by setting clear communication links between LGAs and central government ministries and departments; the policy paper identifies the minister in charge of LGAs as the coordinator of other central government ministries in communicating regulations and guidelines to LGAs.

3.3 The Practice of Evaluating Decentralisation Reforms

As presented in chapter two, decentralising government responsibilities encompasses three basic functions: resource allocation, income redistribution and macroeconomic regulation. However, considering the broad nature of these functions, it is not an easy task to assess the success of decentralisation reforms. Also, the execution of reform normally carries multiple objectives which increase the difficulty of establishing their success (Rees and Hossain, 2010), especially as in most cases reforms are ongoing (Halligan, 1997). The objectives might even differ from one level of government to another (central government and LGAs). Furthermore, the goals might not be explicitly identifiable and/or might be changing while reforms are in progress. The time span needed for decentralisation to show a result is another issue that contributes to the difficulty in evaluating the decentralisation reforms. Usually, it takes longer for the impact of decentralisation to be seen because it involves fundamental changes in long-held attitudes and knowledge of how the public sector works (Smoke, 2003). In relation to duration, it becomes difficult even to obtain appropriate data for evaluating the success of reforms, which poses a challenge to the suitability of some standard analysis tools (Smoke, 2001).

Despite the complexity of reform execution, various approaches have been identified in the literature that can be useful for evaluating reform design and its implementation. Petak (2004), for example, suggests using basic normative criteria to evaluate the success of decentralisation policies regardless of the country’s development level. These criteria are the basic conditions for successful decentralisation reform, and they can be analysed individually or in combination. According to Litvack and Seddon (1999), there are five basic conditions for successful decentralisation reform:

i. There should be a link between service provision responsibilities and functions of local government with local financing and fiscal authorities.
ii. Informing the local community about the cost of services and delivery options together with resource availability and sources so that they can make appropriate decisions.
iii. Existence of an accountability system based on transparency of information that would enable the community to effectively monitor the performance of local government.
iv. Existence of a system that would enable communities to express their preferences to politicians, hence motivating them to participate.
v. Reform execution should be supported by appropriate design of the legal and institutional frameworks, organised structures of service provision responsibilities and a well-designed intergovernmental fiscal system.

Moreover, decentralisation has been assessed based on its ability to discourage soft budget constraint; it is an inefficient project if fiscal decentralisation allows soft budget constraint (Petak, 2004). The presence of soft budget constraints would undermine decentralisation efforts and devolution of decision-making processes because LGAs will remain relaxed and will not seek alternative ways of achieving fiscal needs. LGAs will be highly dependent on intergovernmental transfers to finance their budgets instead of making an effort to mobilise revenues from their own sources. This soft budget aspect is related to the ability of accountability systems aimed to make LGA officials work hard to mobilise resources.

Among the studies which evaluated decentralisation, Wallis and Oates (1988) applied two measures to assess the extent of decentralisation. The first is expenditure share between central and local government, and the second is the revenue share of local government from central and own sources. Dziobek et al. (2011) used four measures to assess the degree of decentralisation: revenue, tax effort, expenditure and compensation of employees. Uchimura and Suzuki (2012) used five indicators to assess intergovernmental fiscal relations: the share of LGAs in total fiscal expenditure, share of LGAs in total fiscal revenue, dependency of LGAs on fiscal transfer, LGAs' fiscal autonomy and discretion in LGAs' expenditure. The diversity of measures reflects the variety of aspects that each study wished to evaluate.

However, in order to assess the potential of decentralisation reforms to enhance access to public services, this study considers it appropriate to evaluate LGAs' financial sustainability. The rationale is that the financial sustainability of LGAs determines their ability to deliver services and hence attain decentralisation's objectives. This corresponds with the proposition of Salman and Iqbal (2011) in evaluating the impact of decentralisation. They note that, whether decentralisation yields a positive or negative impact, it depends on expenditure distribution among different levels of government and their ability to execute them. Similarly, Scott (2009) identifies that one of the conditions for efficient service delivery in LGAs is the availability of sufficient financial resources. If LGAs are assigned expenditure functions without sufficient resources, their ability to deliver them will be limited and hence their objective not attained. On the other hand, if the income redistribution function is not well exercised within decentralisation settings, the danger of exaggerating inequity in the public services offered is high. Moreover, it is appropriate to consider soft budget constraints as part of evaluating decentralisation design and operationalisation, because it also influences the financial ability of LGAs to sustain their operations.

3.4 Benefits of Decentralisation: International Experience

There is little empirical evidence on the impact and attainment of decentralisation benefits in practice, given the paucity of reliable data concerning decentralisation reforms (Scott, 2009). However, from the limited literature, there is no consensus as to whether decentralisation benefits are realised in practice. Smoke (2001), for example, raises concern on the desirability of the decentralising approach because of the modest achievement of stated goals, despite extensive and costly effort. Similarly, Scott (2009) argues that, despite the difficulty of researching the area which limits conclusions about the subject matter, the expected benefits of decentralisation have not been realised in practice. However, for decentralisation to succeed it is imperative that its design and operationalisation ensure availability of fiscal resources which correspond to the responsibilities of the executing agencies and appropriate coordination. On the whole, the benefits are simply the end products of a holistic decentralisation system which needs to function properly. The following subsections discuss the empirical findings about the effect of decentralisation on some of its potential benefits.

3.4.1 Economic Development and Poverty Reduction

One of the potential benefits of decentralisation is to enhance economic development and reduce poverty (Smoke, 2003; Litivack et al., 1998). This is expected to arise from the economic efficiency, good governance and involvement of deprived groups in reform programmes, resource redistribution and macroeconomic stability that decentralisation advocates. In addition, decentralisation attracts not only public sector but also many other players (Work, 2002), whose actions contribute to the country's economic development. It includes community organisations, the private sector, international agencies and citizens. Although their roles and interests might differ, the overall effect of their actions will increase the success of decentralisation reforms. For instance, when an LGA invites private organisations into a joint venture project in the course of exercising its decision-making autonomy, its impact will be not only to enhance revenue sources but also to create employment opportunities. Similarly, equalisation grants tend to stimulate economic activities in poor regions through LGAs' spending, hence contributing to overall production and economic development.

However, empirical evidence on the impact of decentralisation on economic growth is not conclusive. Some studies have found a positive impact, others not. Iqbal and Nawaz (2010), found a positive impact of fiscal decentralisation on macroeconomic stability in Pakistan as did Stansel (2005) in a cross-section study of US metropolitan areas. However, Neyapti (2010) found a negative relationship between fiscal decentralisation and budget deficits. Nevertheless, since inflation affects macroeconomic stability and economic growth, Neyapti's study implicitly indicates a positive impact of decentralisation on economic growth. Similarly, Hanif et al. (2012) found a positive impact on job creation, negatively related to the inflation level in Pakistan. The findings of Hanif et al. show that fiscal decentralisation encourages employment opportunities and holds down the inflation level through discouraging nominal wage increases. Other studies which found a significant impact include Lin and Liu (2000) for China, Thiessen (2000) for Western Europe and middle income countries, and Zhang and Zou (2001) for India. Yilmaz et al. (2004) found a positive relationship between fiscal autonomy, which is a function of fiscal decentralisation and economic growth using an OECD dataset. Meanwhile, Lindert and Verkoren (2010) conclude that there has been a significant impact of decentralisation on economic development in South American countries.

On the other hand, Martinez and MacNab (2006) did not find any influence of decentralisation in economic growth of developing countries and observed negative influence in developed countries. The aforementioned authors utilised a dataset of 66 worldwide countries, developed and developing, from 1972 to 2003 to examine the impact of decentralisation on economic growth and price stability. In terms of price stability, the study found there to be a positive impact in developing countries and a negative impact in developing countries. Priyadarshee and Hossain (2010) found limited participation of deprived groups in pro-poor decentralisation programmes in India, which raises questions on the relevance of such programmes if they cannot attract those it is supposed to help. Meanwhile, studies that found little impacts include Zhang and Zou (1998) for China and Davoodi et al (1999) for the US. Similarly, Thiessen (2003) found a high degree of fiscal decentralisation in high-income OECD countries contributes to stagnating capita stock growth and economic growth. Nevertheless, Martinez-Vazquez and McNab, (2003) and Scot (2009) argue that a lack of understanding on the linkage between decentralisation and economic growth contributes to the lack of a conclusion, because economic growth is affected by many factors. The discussion about discrepancies in empirical findings is covered in subsection 3.6.

3.4.2 Efficiency and Equity in Service Delivery

Another potential benefit of decentralisation is to improve efficiency and equity in service delivery. Decentralisation fragments the roles of government into small government units to induce intergovernmental competition; this implies that a system of checks and balances will be achieved resulting in increased responsiveness and efficiency (Bardhan, 2002). The resulting intergovernmental competition is expected to promote innovation and experimentation, and hence increase overall productivity. However, Scott (2009) points out that there are many assumptions underlying this argument. It is assumed that LGAs will be close to people and will incorporate their needs and preferences in service delivery. It is also assumed that they will have sufficient funding from central and local taxes to finance services and that they will have adequate administrative capacity and this may not always the case.

The conflicting empirical evidence for the impact of decentralisation on service delivery is perplexing. The study of Robalino et al. (2001) using panel data of low and high-income countries found (i) higher fiscal decentralisation is consistently associated with lower mortality rates and (ii) benefits of fiscal decentralisation are highly significant in low income countries. The implication of such findings is that decentralisation offers significantly higher improvement of services to developing countries than to developed countries. Similarly, Halder (2007) found the same positive impact of decentralisation on the infant mortality rate. The study of Toya and Skidmore (2013) found countries which are more decentralised had a record of fewer deaths. This implies decentralisation has a positive impact on people's life in general. On the other hand, Widmalm (2008) found no relationship between decentralisation and social service provision, specifically primary education and health services in Indian LGAs. Similarly, Robinson (2007) found little evidence to support the argument in favour of decentralisation for equity and efficiency in service delivery. He states that empirical studies in Africa, Asia and Latin America did not necessarily identify any positive impact, while in some cases the service quality declined. On the other hand, the observations of Hossain and Helao (2008) from Namibia suggest that inappropriate decentralising approach in provision of services offers limited potential for that country to remedy unequal and imbalanced access to resources. For example, the country commercialised its water service provision, which limited its access to the poor.

Nevertheless, variations in financial sustainability of LGAs might also be a contributing factor for fiscal decentralisation not attaining equity and efficiency in service delivery. As identified above, availability of sufficient financial resources for LGAs is vital for decentralisation to bring improvement to service provision. For instance, Lindert and Verkoren's (2010) empirical evidence shows LGAs in Latin American countries having a mismatch between revenue flow and the responsibilities assigned; they have only a small share of revenue from the central government budget. Despite decentralisation initiatives over some two decades, in many countries the share of revenue from the central government to LGAs is below 10% and in a few it ranges from 10 to 15%. However, large LGAs have been identified to be efficient and effective in planning and management performance, likely to result in enhanced services, while smaller LGAs were found to be weak. In the latter scenario, it is also difficult for such LGAs to offer equitable access to public services for their communities.

3.4.4 Social Cohesion

Decentralisation is also favoured because it offers the potential to enhance social cohesion by reducing conflicts, wealth inequalities, encouraging people's participation and minimising ethnic tensions (Scott 2009; Salman and Iqbal, 2011). The empirical evidence from a few studies is convincing. For example, Lindert and Verkoren (2010) show that, in addition to economic development, there has been a significant impact of decentralisation on political, social and spatial landscapes in Latin American countries since its introduction. Nations have electoral governments and multiparty systems, and indigenous municipalities have been created in which ethnic groups get representation following introduction of a new constitution, which induced decentralisation reform. Before decentralisation initiatives, only six nations out of eighteen had regular electoral governments in Latin America. Also, the cross-country analysis of De Mello (2011) found people in decentralised countries highly valued their contribution in government decision making, compared to centralised countries. This implies that people feel that they are valued by their government system because of decentralisation aspects, thus enhancing social cohesion. On the other hand, King (2004) examines decentralisation reforms in attempting to give Indonesia peaceful and constitutional transfer of power at the national level. Before reforms, the country had dominant conflicts and instabilities. However, despite some positive impacts, King found social conflict was strengthened and lawlessness increased. Thus, it can be concluded that decentralisation had little impact on social cohesion in Indonesia.

3.4.4 Reducing Corruption

Decentralisation is also associated with a country's level of corruption, but again there are two opposing propositions. Martnez-Vazquez and McNab (2003) provide two contrasting views of the relationship between fiscal decentralisation and corrupt practices. On one hand, they identified there is a possibility of increasing corruption since decentralisation places LGA officials close to the people who are in need of the services. Therefore it is easier for people to use devious means to lobby the officials than it would be to influence central government officials. In LGAs, the distinction between politicians and executives is in most cases not clear, hence exposing them to corrupt practices. As a result, corruption is likely to limit any benefits of decentralisation. On the other hand, decentralisation is considered to have the potential to reduce the opportunities for corruption. The assumption behind this is that LGA officials are close to the society, hence their acts are more visible than those of central government officials. In addition, decisions made by LGA officials usually have a lower impact and cover smaller jurisdictions than those of central government officials whose decisions are of greater import.

The empirical evidence supports the view that decentralisation is related with lower levels of corruption. In Indonesia, for example, decentralisation was seen as a way of transforming the corrupt and highly concentrated government into a democratic, efficient and fair institution (Alm et al., 2004). Moreover, the interpretation of the findings of Robalino et al. (2001) suggests that fiscal decentralisation contributes to reducing the level of corruption in service delivery. The study shows improvement in health service provision in areas with a high corruption level, following decentralisation reform. It is also congruent with Arikan (2004) who found the corruption level to be lower in countries with a higher fiscal decentralisation level, although the relationship is not strong. Nevertheless, the multi-approach study of Treisman (2009) for 80 countries did not find a generalised relationship between decentralisation and corruption.

3.5 General Challenges of Decentralisation

Despite the benefits promised through decentralisation there are some challenges in its implementation. The experiences from Nordic countries, for example, provide a warning that over-decentralisation might lead to extreme autonomy of local governments. According to Lane (1997), prior to the reforms of the 1980s those countries had over-large local governments which led to problems in political participation and economic inefficiency due to out-competing the private sector and challenging the state. Therefore, reforms were initiated in order to improve productivity and effectiveness. The experience drawn from Nordic countries relates to the difficult of identifying an optimum decentralisation level. Establishing an efficient decentralisation structure is a complex process. As Smoke (2001) says, the provision of different public services may require areas of different optimal sizes, which may not necessarily correspond with the physical boundaries of LGAs. This enhances the complexity of setting an optimum structure.

The way decentralisation policies are implemented can be a big challenge to its success. The study of Karanikolas and Hatzipanteli (2010) identifies three factors that hinder successful implementation of decentralisation policy: the concentrated character of central government, a legal framework that hinders lower government levels from making decisions, and a local government decision-making structure that is confined within the centralised decision-making process. Similarly, Larbi (1999) provides evidence from the experience of financial devolution in the UK which shows there was resistance from civil servants to reduce centralised control and inadequate availability of technical systems to support reforms.

Another challenge in decentralisation reform is the possibility of extending previous problems into the newly established structure. Hadiz (2004), for instance, claims that democratisation could hardly be attained in Indonesian decentralisation because it extended into the newly reformed structure, problems that existed before decentralisation. There was emergence of “new patterns of highly diffuse and decentralised corruption, rule by predatory local officials, the rise of money politics and the consolidation of political gangsterism” (Hadiz, 2004: p.711). As a result, beneficiaries were just individuals who previously worked as local operators, business people well connected politically. In addition, the family members of influential local politicians engaged in politics and were elected as parliamentary members, town mayors and village officers. In addition to Indonesia, Hadiz has identified the same experience in Thailand’s reforms, where the status quo interest and the vote-buying practice in rural areas contributed to bureaucratic resistance to decentralisation initiatives. As a result Thailand’s reforms of the 1980s were accompanied by the growing influence of local political groups and business alliances. Such groups included rich businessmen who were also engaging in criminal activities such as gambling, drugs and prostitution.

3.6 Decentralisation Process in Developing Countries

The design and decentralisation processes seem to correspond to the level of a country’s development. Public services that are better offered by LGAs in developed countries might not be better offered by the same level of government in developing countries, and vice versa. As a result, the objectives and processes involved in reform differ between developing and developed countries. Bardhan (2002), for example, concludes that while European Union nations have long debated on subsidiarity and devolution, and the US on states’ rights, most developing and transition economies in Africa, Latin America and Asia are still developing policies and restructuring their intergovernmental relations. This view corresponds with the argument of Bale and Dale (1998), that the most common reforms in developing countries are those which involve realigning their basic operations. They include streamlining procedures, banning dual employment and increasing the salaries of public servants, fighting corruption, upgrading training, and decentralising service provision.

On the other hand, Johnson[4] (1999) stated that the emergence of fiscal decentralisation in more than 80% of developing countries is due to the failure of a concentration strategy in promoting development and reducing the poverty level. In addition, Smoke (2001) provides two additional reasons that contributed to the emergence of fiscal decentralisation initiatives in developing countries. The first is that fiscal difficulties arose from changes in international economic conditions and structural adjustment programmes. The second is changes in the political climate due to people being better educated, improved communication and enhanced awareness of central government bureaucratic problems. Thus, development agencies in collaboration with local leaders had to engineer decentralisation reforms to deal with such problems. Specifically, as Hadiz, (2004) and Widmalm (2008) suggest, the World Bank and USAID have been at the forefront in promoting the decentralisation agenda. The involvement of the World Bank is also reflected in its financial investment in promoting reforms. Between 1993 and 1997, 12% of World Bank-funded projects concentrated on decentralisation reforms (Litvack et al., 1998).

In Africa, the introduction of decentralisation reforms became widespread in the late 1980s. Tanzania, for instance, introduced reforms through the decentralisation reform agenda of 1996 and decentralisation policy paper of 1998. Rwanda initiated reforms from 1997 to 2000 so as to enhance the involvement of people in decisions that affect their socio-economic matters, while South Africa introduced reforms in 1993 as part of the dismantling of the apartheid regime (Kauzya, 2007). Other examples include Morocco, which voted in a decentralisation law in 1973, although it was the constitutional reform of 1986 and 1992 which led to a moderate devolution; and Uganda, which initiated reforms in the early 1990s, with power and responsibilities devolving through a new constitution adopted in 1995 (Work, 2002). In recognising the potentials

[4] Foreword provided by Ian Johnson, the World Bank Vice President (Environmentally and Socially Sustainable Development Network), in Manor, J. (1999). The political Economy of Democratic Decentralisation

of decentralisation to African countries, Prudhome (2003) identifies that the agenda will remain in effect for many years.

However, Smoke (2001), Cabral (2011) and Boex and Yilmaz (2010) argue that decentralisation success, particularly in developing countries, is limited despite the best efforts of international and local development communities. As a result there is strong debate in the literature regarding the desirability of the decentralisation approach (Smoke, 2001). Nevertheless, before discussing its desirability, there are three issues of concern regarding the observations on the success of decentralisation. The first is on the design of the system, as already discussed in subsection 2.4, on which there is common agreement. The overall impact depends on the design of particular decentralised government systems (Cabral, 2011). However, Litvack et al, (1998; p.8) admit that "limited empirical evidence on what works and what does not make the design and implementation of decentralisation" in developing countries difficult. Further to this, Ishii et al. (2007) emphasise that the validity of decentralisation reforms in developing countries requires customisation to the local context rather that employing a general model across nations. The second is on the difficulty of establishing appropriate measures for assessing success, as discussed in subsection 3.4. Linking decentralisation and its potential benefits has been identified in the empirical literature as contributing to the difficulties in researching the area and achieving mixed results. The third issue is the length of time that needs to pass before the benefits of reform are realised; one of the possible reasons for fiscal decentralisation having limited success is the time required to change the long history of centralisation into decentralisation (Ebel and Yilmaz, 2002).

Moreover, there are features that literature consider as common to the majority of developing countries but not the developed ones, and are claimed to challenge the applicability of fiscal decentralisation theory. These are in addition to the general challenges outlined in subsection 3.5, and include the poverty level, cultural and political background, revenue sources to LGAs, people's immobility, and corruption. The figure 3.1 below summarises the arguments, which are outlined in more detail in the following subsections.

Figure 3.1: Arguments on Relevance of Decentralisation to Developing Countries

Poverty Level	• Poverty level makes local preferences homogenous across jurisdictions hence limits applicability of the fiscal decentralisation theory considers variations in local prefferences • However, this shows the need for decentralisation to ensure horizontal equity
Cultural and Political Background	• Cultural differences and political background may lead to resistance to changes brought by decentralisation • However, this emphasises the need for tailoring decentralisation design to cultural and political characteristics
Revenue Sources for Local Government	• Local government have less revenue autonomy because of inelastic revenue sources and poor administration resulting into high dependence on central government grants • Nevertheless, this emphasises the need for proper distribution of revenue sources and empowering local government 's revenue administration capacity
Immobility of People	• Developing countries are said to have less population mobility hence limiting the applicability of fiscal decentralisation theory which assumes people with similar interest will be moving to where such services are available • However, this emphasises the need for decentralisation design to ensure horizontal equity
Corruption	• Corruption level is said to be high in developing countries hence limiting the benefits of decentralisation especially in service provision because it is claimed that it becomes easier to lobby LGAs officials than central government officials • Nevertheless, there is counter argument that decentralisation can reduce corruption since LGA officials are close to the society which can monitor their actions easily than would be to central government officials

Source: Author derived from literatures

3.6.1 Poverty Level

Fiscal decentralisation theory suggests that decentralisation would lead to greater welfare in society through matching local preferences and needs with decision-making autonomy. As identified in chapter two, the theory prefers local public goods and services to be offered by LGAs because local preferences differ from one jurisdiction to another. Also, it assumes people will be moving in and out of LGAs to match their preferences. Thus, poor people will move to LGAs with better social services and good infrastructure to improve their living standard, while well-off people will move to LGAs with a higher level of public services to maximise their satisfaction (Smoke, 2001; Martnez-Vazquez and McNab, 2003). Nevertheless, Prud’homme (1995) argues that poverty is a common feature in developing countries compared to developed countries, which makes local preferences and needs homogeneous across jurisdictions. This implies the majority of households require basic needs which are common between jurisdictions. The similarity of preferences across jurisdictions enhances the need for income redistribution, as the theory advocates, to be effective in promoting horizontal equity in service provision.

3.6.2 Cultural and Political Background

Cultural differences, ethnic groups, and political and institutional conditions tend to undermine the need for and potential success of fiscal decentralisation in the majority of developing countries compared to developed countries (Smoke, 2001). Cultural differences are likely to strengthen resistance to change and lower the likely benefits of decentralisation. For reform programmes to be successful, they should be attuned to national cultural characteristics (Rajiani and Jumbri, 2011). Nevertheless, there are two views regarding the relationship between decentralisation and ethnic groups. On one hand, decentralisation is viewed as a way of reducing tensions between ethnic groups through people's involvement in decision making (Scott 2009). On the other, the presence of ethnic groups is considered as an obstacle to the success of decentralisation, as it is likely to increase the reluctance of central government to decentralise power to LGAs, purposely to weaken those groups (Cabral, 2011). As a result, Cabral (2011) argues that in many African countries, ethno-regional pluralism is one of the factors limiting the success of decentralisation. This is supported by the findings of the cross-country study of Robalino et al. (2001) which found that the benefits of decentralisation tend to be lower in countries with a large number of ethno-linguistic groups.

Moreover, political and institutional structures have been identified as posing more of a challenge to decentralisation in developing countries than in developed countries. For instance, Crook (2003: p.77) says "… elite capture of local power structures" has been a major challenge towards the success of pro-poor decentralisation initiatives in Africa. Ruling party regimes have been identified as designing decentralised structures that safeguard their power and influence in LGAs. Despite of advantages of fiscal decentralisation, the absence of committed support of the political leaders is likely to limit the success of decentralisation. However, as Smoke and Lewis (1996) observe, such circumstances require decentralisation design to encompass strong institutional framework that conforms to reform objectives.

3.6.3 Revenue Sources for Local Government

Successful fiscal decentralisation requires LGAs to have autonomy to raise part of the finance needed from their own revenue sources, as part of power devolution. However, in most cases the types of revenue available to LGAs in developing countries are income inelastic than in developed countries, hence obstructing local governments in raising sufficient income (Smoke, 2001). In addition to their limited autonomy, the ability of LGAs in developing countries to administer revenue mobilisation has also been questioned in the literature. For instance, Brueckner (2000:3) identifies the weakness of LGAs in tax administration as leading to "substantial and costless" tax evasion. In developed countries, tax evasion at LGA levels is relatively low. As a result, LGAs in developing countries are seen as less independent. The heavy dependence on transfers from central government, by itself, is considered as unsuccessful fiscal decentralisation. Nevertheless, it can be argued that this does not undermine the importance of fiscal decentralisation in developing countries. Instead, considered an illustration of how the fiscal decentralisation system should be designed. An effective fiscal system design should be tailored to match the LGA's functions and responsibilities with resource availability, whether generated internally or externally.

3.6.4 Immobility of People

One of the assumptions of fiscal decentralisation theory is the self-adjustment in service demand, particularly when population movement is possible. This assumes that people with similar interests will move to a locality with better public services, to maximise their preference mix. The movement of people in and out of a jurisdiction will continue until there is no more incentive to move. At that equilibrium point, there will be self-adjustment in local taxation and public service provision. However, as Litvack et al. (1998) point out, the mobility of poor people in developing countries, especially in Africa, is limited because of the land, which is the main means of production for the majority of communities. Also, it is difficult for someone to find a quick sale for his/her land so as to shift to another jurisdiction, and for someone to acquire a new means of production in another jurisdiction to establish a new life. Another related challenge is the limited access to loan facilities that would help them to settle in new localities, because most ordinary people have insufficient securities. Thus, it is unlikely that the self-adjustment and equilibrium point will be freely attained, as the theory suggests. Nevertheless, it remains as a challenge in fiscal system design in developing nations to ensure equity in LGAs' financial capacity, so that public services reach ordinary people regardless of the LGA in which they are living. As Prud'homme (2003) argues, in developing countries particularly Africa, the importance of establishing interregional equity and income redistribution is enhanced by less population mobility because people value their regional affiliated identities irrespective of their income level.

Moreover, the feasible mobility in developing countries involves people who are mainly part of the agrarian labour force moving to urban areas in search of greener pastures. Such people tend to move to urban municipalities without their families to seek economic support for them. Hence "...these cities grow rapidly from high birth rates and the in-migration of rural peasants unable to make an acceptable living from agriculture" (Smoke, 2001: 5). This has a multiplier effect. On the one hand it reduces the labour force in the locality they have left, reducing the tax base and leaving the elderly and children, who are more likely to be a burden on the social services. On the other hand, they put pressure on public service provision in the urban areas to which they move. The growth of infrastructure might not keep pace with population growth. Thus, there is little likelihood of attaining the equilibrium point, the point at which everyone is satisfied with the service he/she receives and hence has no further incentive to move from one jurisdiction to another. Therefore, in developing countries, the design and operationalisation of the fiscal system should attempt to ensure an equitable standard of living across jurisdictions and promote equality in regional growth. This will discourage the movement of people in search of greener pastures and better public services.

3.6.5 Corruption

Fiscal decentralisation theory assumes that efficiency in public service provision will be enhanced because LGAs will have easy access to local preferences, and decision-making power comes closer to the people. However, when corruption prevails, there is a danger of offsetting this benefit. Brueckner (2000), for example, argues that the prevalence of corruption in developing countries is likely to result in a higher per capita cost of providing public services by LGAs than would be provided by central government. In addition, LGAs in developing countries are likely to have more poorly trained staff than central government (Brueckner, 2000). All these factors put LGAs in developing countries at a disadvantage in providing public goods and services, compared to their central governments.

Nevertheless, Widmalm (2008) suggests that corruption is more persistent in developing countries because practices which are regarded as corruption in Western countries are here considered as usual and acceptable. According to Widmalm, corruption can be in the form of a public servant's private use of working hours, considered prevalent in LGAs of developing countries. Absenteeism among qualified staff in the public service is seen to be high because they opt to provide their services on a private, commercial basis. However, the findings of Widmalm's study in India show that even in developing countries people are not happy with corrupt practices. Therefore, it is important that decentralisation design to assimilate appropriate institutional settings and control mechanisms to lower corruption.

3.7 The Role of Fiscal Relations in LGAs' Financial Sustainability

The fiscal relationship between different tiers of government affects the wellbeing of billions of people worldwide (Bird, 2011). This is why one of the objectives of the Comprehensive Development Framework of the World Bank, launched in 1999, is to promote decentralisation reform that reduces the poverty level arising from local disparities (Crook and Manor, 2000). However, for decentralisation to succeed, the design and implementation of the fiscal system matters. This is why Oates (1999) emphasises the need for appropriate alignment of responsibilities with fiscal instruments at the proper level of government if reforms are to succeed. There should be a balance between the roles and contributions of both parts, the central government and LGAs, in achieving overall objectives. It is important to align their interests so as to establish institutional convergence towards achieving reform objectives.

Failure in designing and coordinating intergovernmental fiscal systems affects the fiscal condition of LGAs and the nation as a whole. Ignoring completeness of decentralisation systems has resulted in some countries not only missing the benefits but also experiencing deficit and macroeconomic instability (Martinez-Vazquez, 2008). Similar impacts have been reported by De Mello (2000) from a study which involved 30 countries. The interpretation of his findings suggest that failure to coordinate intergovernmental fiscal relations lead to a deficit bias in decentralised policy making. These results indicate the importance of establishing a balance in the design of the fiscal system, which forms the basis of central-local relationships.

It is the fiscal system which lays the basis of assigning both expenditure functions and revenue sources to LGAs. As noted by Conway et al. (2005), the availability of sufficient financial resources for LGAs is the fundamental principle of decentralisation. Similarly, Salman and Iqbal (2011) believe that effective fiscal system design assigns functions followed by revenue assignment that correspond with expenditure needs. All these emphasise the need for reformers to consider resource availability while assigning functions to LGAs. The success of decentralisation depends on the details of policy design and context that consequently affect intermediate variables and service delivery outcomes (Cabral, 2011).

Understandably, many issues require attention in designing a fiscal decentralisation system. Litvack and Seddon (1999) identify four aspects which they consider as principles to be adhered in order to make LGAs effective in discharging devolved functions: assignment of finance should follow clear assignment of functions, informed decision making, conformity to local priorities, and accountability. In addition, Smoke (2001) identifies three issues that also need attention at the macro level. First, in designing fiscal relationships consideration should be given to interdependence and inter-jurisdictional competition to avoid mobility of the tax base. The rationale behind this is that the tax climate between jurisdictions influences tax payers' decisions on where to locate. People and businesses tend to gauge tax climate between alternative jurisdictions whenever deciding where to locate (ACIR, 1970). Thus, reformers should ensure that system design avoids unhealthy competition on tax policies among LGAs. The experience drawn from Italy indicates richer regions were benefiting from stiff tax competition than poor regions (Arachi and Zanardi, 2004). Although the second generation of fiscal decentralisation theories encourages tax competition among LGAs for "healthy" revenue results, its impact in Italy was limited.

Smoke's second consideration is that the design of the fiscal decentralisation system should consider national goals in the provision of public service, and equity between jurisdictions, hence justifying intergovernmental grants and standard of service. Every country has different priorities, which should be helpful in guiding the allocation of functions between central government and LGAs. Also, considering the similar nature of the functions assigned to LGAs, it is essential that the fiscal system emphasise interregional equity. Usually, the expectation of the people, who are the service recipients, is to receive improved public services which reflect fairness and equity regardless of their geographical location. With the use of intergovernmental transfers, the central government is in the position of redistributing resources from wealthier to poorer LGAs (Smoke, 2001). A good example is provided by Arachi and Zanardi (2004) regarding the design of the intergovernmental transfer system in Italy which considers minimum standards in the health sector. The system has been designed to enable each region to achieve at least minimum requirements; this reflects a similarity to LGAs' functions and equity in offering access to health services to all people.

Thirdly, the system should accommodate differences in optimal criteria between central and local government in the assignment of revenue sources to minimise potential impacts. Optimal tax criteria for LGAs do not always conform to those of the nation as a whole. For instance, LGAs may wish to charge taxes on some sources which are limited because of overall national interest. Indonesia's 1997 reforms of the local tax system, as explained in Simanjuntak and Mahi (2005), provide a good example. The central government reduced the number of local taxes and user charges from 40 and 180 to 9 and 30 respectively. Their reduction was due to some of them being considered as inefficient and distorting the national economy. Moreover, the central government may limit some revenue sources to avoid transferring the burden to other LGAs. For instance, Bahl (2000) states that an LGA may force producers to buy all their materials or services from suppliers within the locality, in order to generate employment opportunities within the LGA and to increase the revenue base for tax collection. However, the impact may be to shift part of the tax burden to users of the product/service residing in other LGAs because it might be possible to get such materials elsewhere at lower cost.

The optimal view criterion in allocation of revenue sources for LGAs establishes interrelationships between intergovernmental transfers and their own sources of revenue. Hence an appropriate system of local taxation cannot be established without simultaneously designing an appropriate intergovernmental transfer system (Oates, 1999; Bird, 2011). The way revenues are collected and distributed within and between different government levels plays a vital role in the country's overall fiscal performance. However, in practice the consideration of criteria for resource allocation between the central government and its LGAs is determined based on technical and philosophical considerations (Athanassopoulos, 1995). The technical concern relates to availability of information and data, while the philosophical concern relates to overall objectives. Nevertheless, precautions are still needed because, as Azis (2008) explains, any misallocation of resources associated with national policy is likely to hinder achievement of overall decentralisation objectives.

Generally, the intergovernmental fiscal relations determine systems for expenditure assignment, local taxation, intergovernmental transfers and local borrowings (Alm et al, 2004). The fiscal decentralisation design should provide fiscal environment support for LGAs to execute their entrusted functions. It includes the presence of strong mechanisms for monitoring and evaluating the performance of LGAs. In the absence of fiscal environmental support, there is little chance of LGAs fulfilling their required responsibilities. Fiscal environment support is also meant to include the availability of finances, whether from within or outside, to finance their functions. Usually, there are three main sources of finance for LGAs: own resource revenues, intergovernmental transfers and borrowing. Thus the system should empower them with a certain degree of autonomy to raise part of their finances from within their jurisdiction. It should also ensure equitable distribution of intergovernmental transfers. Whenever possible, the system should set an acceptable environment for LGAs to raise debt finance. Nevertheless, the design of the whole system should aim towards the best deployment of all resources to achieve the overall objectives.

3.7.1 Own Sources Revenue

Own source revenue is important to LGAs not only for financing their expenditure but also because it reflects the extent of revenue autonomy devolved to them. However, as Bird and Vaillancourt (2008) explain, the exercise of assigning correct sources of revenue to multi-level governments is clear in theory but complicated in practice, for two reasons. First, central government is inherently in a position to collect most taxes more efficiently than LGAs, although the main problem associated with this is the possibility of vertical imbalance. Secondly, LGAs' potential revenue sources vary widely from one jurisdiction to another, exacerbating horizontal fiscal imbalance.

To deal with the difficulties of assigning revenue sources to LGAs, two main principles have been suggested. First, the allocation of revenue sources to LGAs should enable the richest LGAs to finance at least their expenditure (Bird, 2011, Bird and Vaillancourt, 2008). This implies that intergovernmental grants should be just for supporting poor LGAs which cannot sustain their operations from own sources revenue. Secondly, local taxes should be raised from static economic units as much as possible, to avoid economic distortion (Oates, 1999; Bird and Vaillancourt, 2008). The rationale is that, charging taxes on mobile sources would encourage them to shift from one jurisdiction to another with a more favourable tax burden. This movement is undesirable because it can create unnecessary interregional economic development imbalances; usually tax sources are also factors of production.

Moreover, it is vital for the distribution of revenue sources to consider the consequential effect on the extent of revenue autonomy of LGAs. According to Dollery (2009), fiscal autonomy should give LGAs not only additional power to levy local taxes but also the freedom to determine local charges, fees and other revenue sources, vital for decentralisation success. It makes LGAs feel that they are part and parcel of reforms rather than implementation agents. In addition, sufficient revenue-raising autonomy enables LGAs to adjust the level of taxes according to their expenditure requirements and this can help to address vertical imbalances. In some cases, as Rodden (2002) and Martinez-Vazquez (2008) suggest, revenue-raising autonomy is used to assess LGAs' ability to raise debt finance. This is used as an indicator of their credit worthiness, and that is why whenever LGAs depend heavily on central government transfers, credit rating agencies may evaluate the credit worthiness of the central government. The logic behind this is that it is the central government which provides the financial backup to LGAs. Limiting revenue autonomy makes LGAs become spending units of the central government because it also limits their expenditure autonomy (Brueckner, 2000; Neyapti, 2010). Thus, revenue-raising autonomy is an essential component in the design and operation of the fiscal system. Nevertheless, in practice LGAs may collect from in fewer tax sources than they are allowed to, either because of insufficient administrative capacity or over-reliance on intergovernmental transfers.

Despite the emphasis placed on LGAs' autonomy, being excessive is equally dangerous. One of the problems associated with excessive power in local taxation is the likelihood of accelerating horizontal fiscal imbalance between LGAs (Bird, 2011, Martinez-Vazquez, 2008). Richer LGAs will be able to finance their expenditure more easily than poor LGAs. It is neither feasible nor desirable for LGAs to collect all their required revenue, but the general rule is to raise local taxes to their margin and not to operate with soft budget constraints (Martinez-Vazquez, 2008). In addition, Bird and Vaillancourt's (2008) specific principles should guide an ideal local taxation system. These include taxing relatively static tax sources; the tax proceeds should increase as expenditure increases; and tax proceeds must be stable and predictable. The tax should also be seen as reasonable and fair to the tax payers, as well as administratively efficient and effective. For the tax to qualify as local tax, Bird (2011) identifies five criteria that must all be met, the LGA's influence on: (i) whether to levy or not, (ii) identification of specific tax base, (iii) setting the tax rate, (iv) administration of tax collection, and (v) retaining all collected revenues. However, he concludes that, in practice, it is inconclusive as to whether a particular country has an ideal local taxation system. This conclusion is based on the difficulty of establishing a system that meets all the criteria. Similarly, Martinez-Vazquez (2008) notes that no single acceptable system exists that suits all countries. Instead, the history of the country and its institutions are most important. It is therefore not surprising to find different countries have different local tax systems. The most important aspect is that the system should not lead to worse outcomes than hitherto experienced success.

The proportion of own source revenue collection to their total revenue budget is normally regarded as the main indicator of LGAs' tax autonomy (Simanjuntak and Mahi, 2005). On the basis of this indicator, Bird (2011) concludes that LGAs in developed countries have greater autonomy than developing and emerging countries. Using IMF data of 2002, his study shows the average revenues collected by sub-national governments of six developed countries was 30.2%, compared to 28.8% for seven emerging countries. However, a huge discrepancy is noted when comparing the two groups in terms of minimum revenue collection percentage. Indonesia had the lowest (2.9%) out of emerging countries group, while out of the developed country group 17% was the lowest (Spain). These figures support the argument of Bahl (2000), that developing and transition countries have limited choices in assigning tax autonomy to LGAs. As a result, their LGAs are heavily dependent on intergovernmental transfers.

3.7.2 Intergovernmental Transfers

The intergovernmental revenue transfer system is an essential and integral part in fiscal decentralisation. It plays three vital roles: internalisation of spillover benefits, equalisation of LGAs' fiscal needs, and improving the whole tax system (Oates, 1999; Bird, 2011). In the absence of intergovernmental transfers, it is likely that those services which also benefit residents of other jurisdictions will be given low priority. LGAs would give high priority to financing those activities which solely benefit their own residents, limiting spillover benefits to citizens of other jurisdictions. In reality, geographical boundaries indicate administrative demarcation between LGAs but they do not bar residents of one LGA from consuming the services of others (Oates, 1999). Thus the first reason for intergovernmental transfers is to enable LGAs to internalise their financing of activities which would also benefit residents of other LGAs. In other words, intergovernmental revenue transfers are used to match expenditure requirements for services which are also consumed by residents of other jurisdictions.

The second reason for intergovernmental transfers is to equalise the spending needs of LGAs. Disparities in fiscal capacity among LGAs mean they have different capabilities in financing their functions in the absence of fiscal support from higher government. If LGAs are left with more power to raise revenues, fiscal disparities will increase because of regional differences in tax bases. Urban LGAs, for instance, are known to have stronger tax bases and administrative infrastructures than their rural counterparts (Bahl, 2000). Richer LGAs would be able to finance their functions more comfortably than poor LGAs. Thus the criteria used for distributing grants to LGAs are of considerable importance in equalising their spending needs (Le Grand, 1975; Oakland, 1994); they should ensure that LGAs have similar spending capacity to deliver their functions, regardless of differences in service preferences. In practice, expenditure tasks devolved to LGAs in many countries substantially exceed their capacity in own source revenue collection (Bird, 2011). As a result, LGAs depend heavily on intergovernmental transfers to meet them. A well designed grant allocation system is very important in addressing disparities in the fiscal capacity of any country. However, the impotence of intergovernmental transfers in addressing fiscal capacity disparities is extremely high in developing and transition countries (Bahl, 2000), because their public sectors are characterised by wider differences in tax capacity among regions.

The third role of intergovernmental transfers is to improve the overall tax system within a country. This is an intermediary role in deciding tax sources that should be collected by either parts of the government, central or LGAs. However, the administrative capacity to assess and collect taxes makes most sources more effectively collected by central government (Bahl, 2000). The reason for this, as discussed in subsection 3.7.1, is that central government is better able to assess and collect taxes, making it superior in terms of administrative efficiency in collection of most taxes. Therefore, the central government can collect taxes from many sources at less cost than LGAs. Thereafter, the transfer system can be used to distribute the proceeds to LGAs. Moreover, the intergovernmental transfer system reduces the possibility of unhealthy competition among LGAs, an essential component in improving the overall tax system. Instead of LGAs competing unhealthily to enhance their tax bases to finance all of their expenditure, transfers offer assurance on the availability of at least part of the needed finances. Nevertheless, there are some revenue sources, such as property taxes, licensing fees and user charges, which are better administered by LGAs. LGAs can collect revenues from such sources not only cost efficiently but also at customised rates according to specific environment of every LGA so the administration of these sources is better left to LGAs.

Generally, there are two approaches that any country may apply to distribute intergovernmental grants to LGAs. The first is the derivation approach, whereby the size of the grant is based on the amount of tax the central government collects from the population of each LGA (Bahl, 2000). A good example is found in Indonesia, where taxes from natural resources are shared through the derivation approach[5]. The second approach is the use of a formula to distribute fiscal resources from the central government to its LGAs. The amount distributed to each is calculated according to their gap on fiscal resources requirement. When an equalising formula is sought, Schneider (2002) identifies four criteria. The first is the needs-capacity gap, which is based on the differences between fiscal requirements and revenue raising capacity. The second is based on differences in LGAs' revenue capacity; it just considers differences in tax capacity. The third is the use of service requirement indicators such as area, population, population density, infrastructure conditions and income per capita. These indicators are used as a proxy for service requirements that ultimately dictate fiscal needs. Such service indicators are found in distribution formulae for general purpose grants to LGAs in Indonesia. The Indonesian formula incorporates population, area, cost differences and poverty level (Brodjonegoro and Martinez-Vazquez, 2004). The fourth criterion is a grant equalisation formula based solely on equality of per capita income. In this approach LGAs receive grants reflecting differences in the per capita income of their

[5] Discussion on Indonesian intergovernmental fiscal relations is provided by Brodjonegoro and Martinez-Vazquez (2004) Chapter 8 in Alm, J, Martinez-Vazquez, J and Mulyani, S.(eds)

residents. However, regardless of the criteria in use, the outcome of equalising grants (Oates, 1999) is for LGAs to receive grants according to their fiscal needs. This will also enhance their relative financial sustainability.

Despite intergovernmental grants being a vital source of finance, they should not be excessive to the extent of undermining LGAs' fiscal discipline (Oates, 1999). Heavy reliance on central government revenue transfers may lead to soft budget practices. This increases the risk of experiencing financial difficulties and even raises the question of whether resources are spent for the better interest of the people being served. When LGA officials become assured of a flow of funds in the form of grants to finance their organisational budgets, they may relax their efforts to collect revenues within their capacity. Italy is an example of countries that suffered the problem of soft budget constraint before its reforms of 2000 (Arachi and Zanardi, 2004). LGA officials had no incentive to manage their local taxes because any deficits were financed by grants pegged to health sector standards. In addition, LGAs had autonomy to raise taxes within a specified limit but they did not exercise this because intergovernmental transfers offered a guarantee. Apart from the soft budget constraint problem, Rodden (2002) claims that excessive use of grants limits the ability of voters to call to account the financial indiscipline of local officials. Rodden continues that the empirical literature shows that grants accelerate greater expenditure than does a similar increase in own source revenues. This is due to the missing link between benefits and source of finance; individuals view grants from different angles from own sources. The use of grants makes residents, who are the voters, feel that their expenditure is financed by non-residents. Therefore, even if there is financial indiscipline, they may not penalise LGA officials.

However, one way of addressing soft budgets constraints, as Hy et al. (1993) suggest, is to incorporate LGAs' tax efforts in grant allocation formulae. LGAs will become motivated to increase efficiency in their own source collection if they know in advance that their taxation is considered in grant allocation formulae. For instance, according to Arachi and Zanardi (2004), reforms in intergovernmental fiscal relationships in Italy which were completed in 2000 aimed to address soft budget constraints. The new system was designed to equalise up to 90% of the differences in own source revenue per capita, leaving 10% to be financed through expansion of local taxes. Moreover, the central government eliminated discretionary transfers and abolished constraints on the use of revenue. All this was done to encourage LGAs to increase their tax raising and give them freedom to spend revenue on any programme they wished.

Therefore, it can be concluded that an ideal grant allocation system is one which not only provides financial support to LGAs but also motivates their efficiency in own sources revenue mobilisation. The system should be designed to reward higher tax efforts and penalise least tax effort. In this case, LGAs will be encouraged to optimise their own tax collection effort because they will be aware in advance of the rewards and penalties attached to grant allocation. In the US, Canada and Australia, for instance, their grant allocation systems consider revenues that LGAs would collect if they exerted average tax effort as a control mechanism (Boex and Martinez-Vazquez, 2007). In Africa, the importance of grant allocation system for establishing interregional equity and income redistribution is enhanced by less population mobility because people value their regional affiliated identities irrespective of their income level (Prud'homme, 2003). However, for this to work out the system should not tolerate inefficiencies.

3.7.3 Local Borrowing

LGAs can use borrowing as a source of finance in addition to own source revenues and intergovernmental transfers, and can be used to enhance financial sustainability. As Alm and Indrawati (2004) state, when LGAs are vested with sufficient autonomy to raise revenues and make expenditure decisions, this can also extend to borrowing. However, the use of debt finance in LGAs depends on a country's specific regulations and policies. It is these policies and regulations which determine the extent of autonomy as well as reflecting the decentralisation system. Therefore, the design and operationalisation of the fiscal decentralisation system will determine the ability of LGAs to use borrowing.

In local government finance, borrowing is useful in two main ways. First, as Alm and Indrawati (2004) explain, borrowing can be used to cover short-term variations in the revenue flow so as to ensure smooth provision of public services. Unpredictability of revenue flow may hinder not only LGAs' operations but also attainment of overall decentralisation. "In most countries, the predictability of transfers from higher levels of government is key to enabling sub national governments to finance their basic service delivery or infrastructure investments" (Martinez-Vazquez and Searle, 2007:9). Therefore if LGAs can predict the flow of revenue versus expenditure, they may plan to use borrowing to cover any foreseen short-term mismatch.

Secondly, borrowing can be used to finance capital projects whose benefits extend to future generations (Alm and Indrawati, 2004). The existing capacity of an LGA might be insufficient to finance such capital projects. However, because their benefits extend beyond the current generation, the use of debt finance is justifiable. In this case, future generations will enjoy the benefits as well as bearing a fair share of the cost through taxation. Moreover, Alm and Indrawati (2004) argue that the use of borrowing in LGAs conforms to the principle of subsidiarity. This principle requires decisions and provision of government services to be made at the lowest possible efficient level and the benefits to fall within the area. Thus LGAs represents best-decision units whose decisions are in favour of the community they are serving. If this is the case, then financing capital projects through borrowing represents best decisions whose benefits are compatible with the needs of the LGA's citizens.

Given the importance of credit finances and impacts, Weist (2007) suggests that intergovernmental transfer systems should be designed to consider the borrowing capacity of LGAs. She proposes that many of the development projects of LGAs which have strong credit worthiness be financed with borrowing so that grants can be channelled to LGAs which are less creditworthy. Therefore the equalisation of LGAs' capacity should be viewed from a broader perspective to incorporate borrowing capacity, instead of considering own source revenues only. Furthermore, when borrowing is allowed it can automatically regulate soft budget practices in LGAs. LGAs will be facing two options: either, they should exert greater effort so that they can raise sufficient finance to cover their expenditure, or exert less effort and then cover the shortfall by borrowing. A good example is provided in the study of Hull and Searle (2007), which shows the interrelationship between taxation, service level and borrowing. The interpretation of the findings shows that revenue raising effort tends to be above average when sub-government units provide above average services, and vice versa. However, when sub-government units choose lower tax efforts than expenditure requires, they have to borrow above average to finance the difference to support their service level.

Similarly, Oates (2008) shows that the use of borrowing in countries with well-developed and efficient capital markets tends to discipline LGAs with soft budget practices, through higher borrowing costs and limited access. In such instances, LGAs will be forced to operate with hard budget constraints, especially when the central government refuses to provide a rescue package. Otherwise, they will not be able to deliver their responsibilities effectively because of financial difficulties. In the US, for instance, the federal government strictly refuses to offer any package to bail out states facing fiscal difficulties (Inman, 2003). The precedent was set in the 1840s when the federal government rejected fiscal assistance to eight troubled states. This disciplines LGAs in debt policies to avoid financial difficulties.

On the other hand, allowing the use of borrowing in LGAs can be dangerous, particularly when there are no strong control mechanisms in the fiscal system. It may exacerbate soft budget practices instead of controlling them. In the absence of strong control mechanisms, LGAs may borrow to finance capital projects which are not economically justifiable (Alam and Indrawati, 2004). This might be backed by expectations of LGAs to get assistance from the central government when they fail to repay the loans. This can distort the fiscal condition of the whole government. Thus Oates (2005) insists that, despite the intention of central government to resist providing bailout assistance, what matters is the credibility of their assertions. If LGAs believe that the central government will not act firmly on its decision, they may have strong reasons to participate in fiscal deficit policies through the use of borrowing in their financing decisions.

In general, the use of debt finance in LGAs requires special attention so that its benefits can be realised, while simultaneously controlling the likelihood of negative impacts. Weist (2007) identified five aspects that should characterise municipal credit systems. These are presence of creditworthy LGAs, presence of projects which are viable, availability of credit and financial institutions or capital markets, existence of a supportive intergovernmental system, and a sound regulatory framework. These aspects can be incorporated in the design of fiscal decentralisation if borrowings are to make part of financing options to LGAs.

3.8 Structure and Roles of LGAs

The structure and functions of LGAs are mainly determined by the central-local relations in accordance with the country's specific provisions and/or policies. This means that the functions and responsibilities of LGAs differ from one country to another, although in most cases they look similar. According to Olowu (2012), in many cases the extent of the power and authority of LGAs is dependent on the willingness of the central government to surrender some of its powers. However, he also identifies other cases, like Colombia and Bolivia, which reflect the outcome of the struggle from below. In such countries, the devolution of power from central government to LGAs was more of an outcome of people's initiative than the willingness of the central government authority. However, in either case the power and authority of LGAs are usually determined according to the design of the central-local relations. This can be through the constitution, legislation, policies or any other means. As Morphet (2008) points out, reform such as decentralisation reshapes the whole state because LGAs and central governments are not mutually independent.

The experiences from different countries show that there are many ways in which power and its limitations are granted to LGAs. In the US, for instance, Dillion's rule has established the limit of power and authority to LGAs since 1868 (Bowman and Kearney, 2011); LGAs can only exercise powers that are absolutely essential to the objectives that brought them into existence. Thus, state authorities govern LGAs within their jurisdiction. In Australia, LGAs are governed by legislation enacted by states and territory governments which determines the extent of their powers and activities (Dollery et al., 2007). In the UK, LGAs are governed by a number of laws which define their roles and functions; any action against them may be instructed by the court to stop, and be considered as *ultra vires* (Chandler, 2009). However, Olowu (2012) concludes that, generally, LGAs in western and industrialised countries exist as statutory bodies, although they are creatures of the national governments; while in most developing countries the conditions for LGAs are stipulated in their national constitutions.

The constitutionalising of LGAs is intended to provide a balance and to protect LGAs from the vulnerability of central government officials who fear to the loss of power. Examples of constitutions which stipulate the existence of LGAs include Bolivia, Colombia, Brazil, India, Philippines, South Korea, Ghana, Nigeria, South Africa and Uganda (Olowu, 2012). In these countries, the powers and responsibilities of LGAs are laid down in the constitution. In Tanzania, the existence and function of LGAs are stipulated in Local Government Acts, although their existence is also enshrined in the constitution. However, the structures and protection needed to bring LGAs into existence makes them inferior in central-local relations. LGAs' capacity to participate and to have influence in decisions, even those which affect their operations, becomes limited considering that their very existence requires constitutional protection. This is not the case in some developed countries whose LGAs have influence when it comes to matters that negatively affect their operations and/or existence. Elcock (2005) explains that in the UK, for instance, local authorities formed three main representative associations to negotiate and argue with the central government against unwelcome policies. These are the Association of Metropolitan Authorities, the Association of County Councils, and the Association of District Councils. In the US, the Advisory Commission on Intergovernmental Relations (ACIR) enacted in 1959 undertakes the coordination role. The ACIR was established to ensure smooth cooperation and operation of the different tiers of government, coordinates the work of federal, state and local government within the government system. In Australia, The Commonwealth Grants Commission was established in 1933 to take charge of intergovernmental fiscal relations.

In central-local relations, it is important for the structure to establish a clear definition of the roles and functions of LGAs in order to avoid confusion. Overlapping of powers and functions between different tiers of government brings confusion which may result in a waste of resources. As identified in the theoretical framework chapter, it is better for LGAs to provide services that meet local preferences and for central government to take charge of the functions whose scope is beyond local government. However, despite this proposition, the willingness and philosophies of the central government influence the way reforms are designed and/or operationalised in practice. In the UK, for instance, LGAs have gone through a number of changes over time in order to match the philosophy of the government in power. The Thatcher administration abolished six metropolitan counties in 1983 (Davies, 1990) only because the values of the LGAs seemed to contradict central government policies (Elcock, 2005). However, when the Labour government came to power in 1997 it initiated a modernisation programme that enhanced the autonomy of LGAs (Morphet, 2008). All these cases show that the central government can devolve or remove power and functions from LGAs at will. Olowu (2012) also identifies cases in which central governments had to victimise LGAs instead of supporting them, just to avoid competition and being overshadowed. This was prevalent in the immediate post-colonial leadership particularly in Africa. Governments excessively centralised powers to the extent of manipulating laws in order to weaken LGAs.

3.8.1 Roles of LGAs in Relation to Service Provision

LGAs play a vital role in society's wellbeing in any country, despite functional differences from one country to another. Their importance in delivering expenditure functions efficiently increases when the country is particularly large, and heterogeneous in resources or ethnically (Neyapti, 2010). They are assumed to take charge of local developments through the improvements of local production systems and the living standards of their people. Specifically, Chandler (2001) identified a range of tasks usually assigned to LGAs worldwide, either as basic/inexpensive or expensive tasks. Basic tasks include solid waste collection, pavement and minor roads, street lighting, parks and recreational areas, while expensive tasks include education services, rented housing services, social services, hospitals and healthcare, and police control and public safety.

However, the nature of the services and the capacity of LGAs to run them depends on the country's central-local system design. In Germany and the US, LGAs can run even utilities like gas and electricity (Chandler, 2001), while in other countries, such as Australia, LGAs have a very limited capacity. LGAs in Australia are responsible only for local roads, refuse collection and disposal, and maintenance of buildings, but not education, health, policing or public housing (Jones and Walker, 2007). In more general terms, LGAs are the first point of resort in any communities and are there to support the local communities (Morphet, 2008).

In the international development forums, LGAs are considered to be key agents towards local sustainability and in addressing poverty (Lindert and van Verkoren, 2010). They are considered to play an essential role in economic development and poverty reduction in most developing countries. In these countries LGAs foster integration and implementation of societies' development plans for addressing infrastructure challenges (Olowu, 2012), and for basic rural roads, community health, elementary education services, rural water supply and sanitation. However, these LGAs also face a number of challenges of less significance in developed countries, such as insufficient staff, insufficient professional training of available staff, unsatisfactory incentives and poor record keeping (Olowu and Smoke, 1992).

The roles of LGAs have changed with time from traditional to being more engaged. More new functions have been entrusted to LGAs in the modern age than before. For example in the UK, the Local Government Act 2000 charged LGAs with the wider role of not only promoting social welfare but also taking the leading role in economic and social development in their area (Chandler, 2001). In 1997, the incoming UK Labour government completely changed the way local governments were operating, entrusting them with the role of coordinating other public and private organisation partnerships in various projects within their area for the better prosperity of their society and the country in general. Their target was that 80% of all public services be offered by local government more autonomously than under the Conservative administration, and central government directed LGAs to specific targets (Morphet, 2008). The importance of LGAs in the UK became increased to the extent of being seen as defenders of local opinions and values against perceived extravagant, tyrannical and inefficient central government leadership (Elcock, 2005). In addition, LGAs provide employment opportunities which ultimately contribute to the national economy. In countries such as China, Australia, Germany, USA and Canada, by 2000 more than 80% of the total government employees were in LGAs (Olowu, 2012).

3.9 Meaning and Background of Financial Sustainability in LGAs

The word sustainability in relation to organisation performance refers to the ability to accomplish stated missions and serve stakeholders over time (Abt Associates, 1994). When considering this meaning, sustainability in LGAs refers to their ability to serve local communities over time. This is not a one-off event that LGAs have to attain then relax; it is an ongoing process. It corresponds with the way decentralisation devolves responsibilities to LGAs, rarely one-off tasks. From the same viewpoint, Dollery and Crase (2006) and Dodor et al. (2009) define financial sustainability as the ability of LGAs to meet service delivery expenditure obligations on a continuing basis, ensuring financial healthiness of the LGAs both short and long term. Generally, financial sustainability refers to the degree to which the existing level of services and creditor requirements can be met without increasing the burden on the economy. It includes not only the ability to raise sufficient revenue but also the way revenue and expenditure functions are exercised. In this regard, having higher fiscal capacity is essential but it does not necessarily imply that an LGA is financially sustainable. If an LGA struggles to meet its expenditure obligations as they fall due, it can be considered as financially unsustainable. This can happen when there is a mismatch between the expenditure pattern and revenue flows.

Other terminologies used closely or interchangeably with financial sustainability are financial condition, financial stress, financial health, fiscal strain, and fiscal condition (Dollery and Crase 2006; Cabaleiro et al, 2012). For instance, Van Helden (2000) defines financial stress as the LGA's inability to meet near-future financial obligations. Kloha et al. (2005) define financial distress on a long- or short-term basis as the inability to meet standards in operating position, debt repayment, community needs and resource requirements over the foreseeable future. Walker and Jones (2006, p.355) define financial distress as "an inability to deliver services at pre-existing levels". On the other hand, Lin and Raman (1998) provide an extended meaning of fiscal health to include not only good financial capacity but also the ability to maintain the prevailing service level that reflects the taxation level. Hendrick (2004) defines fiscal health in terms of ability to meet financial and service obligations. The Government Accounting Standard Board in the US (GASB, 1987) defines financial condition in terms of government's ability to meet current and future services obligations (Zafra-Gomez et al., 2009), while Kioko (2013) defines it in terms of the ability to meet current and future obligations as they come due, throughout the fiscal year, while maintaining the existing service level. Cabaleiro et al. (2012) summarise various terms and definitions used by different authors, concluding that the use of various terms brings ambiguity in understanding differences, although in many cases the terms have similar meanings and are used interchangeably.

This study uses these terminologies interchangeably to mean the ability of LGAs to meet expenditure on public services on a continuing basis. It adopts the framework of Hendrick (2004) and the CICA to assess an LGA's financial health over time and in comparison with others. As noted previously, financial health is an essential aspect if LGAs are to meet their functions and responsibilities effectively. Factors which influence LGAs' spending also influence their financial health (Whitaker, 1985). Since decentralisation influences LGAs' expenditure functions, it also has an influence on financial sustainability. Well designed decentralisation reforms are expected to ensure the availability of resources to LGAs in accordance with their assigned responsibilities. Although being financially sustainable does not guarantee LGAs success in delivering their functions and reforms in general, it is a necessary condition for sustaining the level and quality of services offered (Huang and Ho, 2013). Weak financial sustainability has negative implications for existing as well as near-future operations of LGAs. According to Helden (2000), an LGA which is financially unhealthy implies that:

i. It has few funds at its disposal to cope with existing service provision expenditure on a continuing basis, or any likely additional financial requirements in the future.
ii. It suffers or will have to deal with financial deficit in the near future, which may be reflected in unavoidable expenditure budget cuts in order to stay healthy.
iii. It has few opportunities for raising additional revenues required in the existing period and in the future.

3.9.1 Why Evaluate the Financial Sustainability of LGAs?

The task of assessing the financial sustainability of LGAs is an organisational performance indicator that aims to identify their strengths and/or weaknesses, over different periods of time or in comparison to each other. It is useful in acknowledging the past and present situation and is vital for future strategies (Tehrani et al., 2012). Various groups have interest in the financial sustainability of LGAs for different reasons. Adequate financial health is a precondition for attainment of objectives in any organisation (Cabaleiro et al., 2012). So whoever is interested in the success of LGAs in delivering their functions should be concerned with their level of financial sustainability. In addition, there might be other players whose interests are associated with LGAs' ability to meet their financial obligations.

Justice and Scorsone (2012) provide a detailed explanation of how different groups might be seriously concerned with LGAs' financial health. According to these authors, stakeholders in the municipal bond market are likely to be interested in LGAs' ability to make timely payments. Reformers and decision makers are concerned with financial health and possible reasons for the prevailing financial condition. They need to know the areas of strength in the system design with regard to financial sustainability, and areas of weakness for improvement. Individual LGAs and elected officials would wish to know their financial health relative to other authorities, and the extent to which they can sustain the desired service level from period to period. Taxpayers and the community in general would wish to have satisfactory services on a continuing basis, while vendors are concerned with the ability of their clients (LGAs) to pay merchandise supply obligations and service contracts.

The importance of evaluating financial sustainability of LGAs is increased when considering the possibilities of dealing with it. LGAs have few options for dealing with financial difficulties, as compared to private sector organisations. In the private sector, financially poor institutions are either taken over or exit the market through a bankruptcy declaration and/or liquidation. Such options are not available to public organisations, particularly LGAs, except in a few countries such as the US (Hendrick, 2011) and Italy, where LGAs can declare bankruptcy. Therefore evaluating financial sustainability will help to ensure that LGAs operate smoothly and any potential consequences are dealt with while they are still at an early stage. The financial health of LGAs is essential not only for their own performances but also for the stability and efficiency of the public finance system of the whole country (Ma, 2001).

Financial sustainability determines the ability of local government to deliver what is expected of them in the course of meeting the service demands of their local communities. It is an indicator of LGAs' ability to meet their financial and service obligations (Huang and Ho, 2013; Honadle et al., 2004). An LGA which is financially unhealthy cannot sustain service delivery at the same level, in quantity and/or quality terms, compared to a financially healthy authority. In the environment of decentralisation reforms, where service delivery responsibilities of LGAs are gradually increased, the concern is not just to meet the current level of services, but also to be able to cope with the trend of the increase in responsibility. The execution of reforms takes time; therefore as service delivery obligations are devolved down to LGAs, it is important for them to have sufficient financial capacity to deal with them. Otherwise, the financial status of LGAs will be suppressed with the increase in responsibilities.

Whenever LGAs experience financial difficulties, they may decide to significantly cut down expenditure in order to deal with it (Skidmore and Scoresone, 2011). However, the consequences of this option will fall on the service recipients because service level and/or quality will deteriorate along with the poor financial condition. In this respect, Carmeli (2007) found a positive relationship between LGAs' financial health and the level of service offered. LGAs in Israel with poor financial health were found to deliver poor services in subsequent years. Also, the findings of Nelson (2012) indicate that distressed municipalities in the US reduced the provision of various public services in order to cut expenditure, to mitigate the situation. For example, some municipalities were found to reduce retirees' health benefits while others had to cancel major community events.

Financially healthier LGAs can provide higher infrastructural support to both individuals and business than can weak LGAs. For instance, Nelson (2012) found weak financial conditions resulted in delaying capital projects and deferring maintenance of municipal buildings or even minor upgrades. The practice was found to be a common source of expenditure reduction in half (of 16) of the financially weak LGAs. Skidmore and Scoresone (2011) also found capital expenditure was vulnerable to reductions during financial difficulties in Michigan Municipalities, a significant impact on municipal infrastructure. In addition, financial sustainability influences residential and business location decisions (Honadle et al., 2004; Carmeli, 2007) and this is closely linked to the ability of LGAs to provide sustainable public services. Individuals and businesses prefer to establish residence and/or business locations in financially sustainable municipalities. The findings of Lin and Raman (1998) provide evidence which supports this argument. They found the financial condition of an LGA is a relevant attribute in property values, hence influences the location of homeowners.

In a situation where financial conditions differ among LGAs, it increases the likelihood of regional disparities between them. Thus, the fiscal system should address it from design through to implementation. Despite the second-generation fiscal decentralisation theories to encourage competition among LGAs in order to attract investment and hence expand their tax base, the effect should not extend to causing variations in their financial sustainability. The competition should aim at promoting efficiency in planning and service delivery. Moreover, it can be argued that applicability of second-generation theories in countries with LGAs whose own source revenue capacity differs significantly, is limited. The experience from Italy supports this argument. Arachi and Zanardi (2004) conclude that poor LGAs in Italy cannot benefit from tax competition because rich LGAs are able to attract more investments. This feature is commonly found in developing countries where urban LGAs have a stronger base than rural LGAs (Smoke, 1993). Financially weak LGAs cannot compete with strong ones in supporting infrastructure if the system is not well designed and/or operationalised. Richer authorities will be able to finance their expenditure at a lower tax rate than poorer authorities (Buchanan, 1950; Aronson, 1977). Thus, financially healthier LGAs will be attractive to individuals and businesses, hence expanding their tax base as well as the gap with weak LGAs (Prud'homme, 1995). Therefore, an ideal decentralisation system would ensure redistribution of income to all LGAs to avoid concentration of individuals and businesses in few municipalities.

Moreover, financial sustainability has an impact on LGAs' ability to raise debt finance, especially when the regulations of a particular country allow them to access borrowings. LGAs with a poor financial condition will find it difficult to raise debt finance, or they will get debt finance at a higher cost. A good example is provided by Kloha et al. (2005): in developed economies where LGAs can access capital markets, such as the US, financial sustainability determines bond ratings and may lead to a declaration of bankruptcy in the worst scenario. The US has a bankruptcy code which provides procedures on municipalities' bankruptcy affairs, which is why it is possible for its LGAs to declare bankruptcy. According to Hendrick (2011), a number of US cities and suburban municipalities have experienced financial difficulties at least once since the 1970s. These include New York City in 1975, Cleveland and Ohio in 1978, Philadelphia, Pennsylvania in 1991, Buffalo, New York in 2003, Jefferson County, Alabama in 2008, and Vallejo, California in 2008. Moreover, Nelson (2012) discovered that out of sixteen US municipalities included in his study, at least three received lower bond rating as a consequence of fiscal distress between 2007 and 2010.

In developing countries where LGAs' access to public debt is limited, financial health affects credit purchases and procurement of service provision contracts, specifically, procurement of development projects which require huge financial outlay and commitment over a considerable period. Being financially weak puts LGAs in a weak position to negotiate such procurement contracts in development projects. Consequently, the economic base of financially sustainable LGAs will continue to flourish because they will be in a strong position to negotiate and implement development projects. They will have relatively good infrastructures that attract investment and individuals, hence expanding their tax base. Therefore, it can be argued that if the decentralisation system does not address interregional disparities, then financially poor LGAs will continue to be poor.

Honadle et al. (2004) provide another reason for the importance of financial sustainability, which is to enhance LGAs' flexibility to deal with unforeseen events and to attract high-quality human resources. Financially healthier LGAs are more flexible in response to the changing needs of services provision than are weak LGAs. Also, there are unforeseen events, such as the eruption of pandemic diseases or natural calamities, which require financial flexibility to deal with them. Although an LGA might have a budget set aside for unforeseen events, the budgeted amount and ability will not be the same between LGAs with different degrees of financial health. Likewise, when it comes to human capital, financially healthier LGAs can more readily attract highly qualified personnel than weak LGAs, as they will be able to offer attractive financial pay and incentive packages. Even in a country where recruitment and payroll of LGA staffs is done by the central government, as in the case of Tanzania, financial health is still vital, as it determines the ability to meet other, non-salary incentive packages which are administered at LGA level. In addition, it determines the likelihood of honouring professional expertise and meeting targets, which is important for job satisfaction. Any rational qualified personnel would prefer to work in an LGA that not only values but also implements the professional expertise he/she contributes, and attains targets. Financially weak LGAs may value expert advice but they are likely to be constrained in attracting the personnel.

Furthermore, closely related to attracting human capital, financial sustainability has an impact on the employment rate. LGAs which are financially weak will not be able to take on new recruits. Also, even maintaining existing employees will be difficult if an LGA is facing a declining financial condition, because it may opt to reduce expenditure through cutting down payroll costs. For instance, Nelson (2012) found municipalities had to lay off some workers so as cut down costs as part of expenditure reduction in order to mitigate a weak financial condition; some municipalities increased the use of volunteer opportunities instead of recruiting new staff. The impact of laying off staff is to increases the overall unemployment rate, which has a negative impact on the national economy.

3.9.2 Factors Influencing Financial Sustainability in LGAs

There is an inherent link between LGAs' financial sustainability and the design and operationalisation of the fiscal system, which forms the basis of central-local relationships. The fiscal system determines the responsibilities and sources of finance to LGAs, which subsequently determine their financial sustainability. In countries which implement decentralisation reforms, as in Tanzania, the design of the fiscal system and its operationalisation forms the heart of LGAs' financial sustainability. It determines their ability to sustain the execution of entrusted functions that ultimately influence the success of the reform. Poor financial sustainability will limit LGAs in executing devolved functions, hence limiting the benefits of decentralisation. Therefore, the financial sustainability of LGAs is an embedded feature of the fiscal system design and implementation. Since fiscal decentralisation emphasises LGAs' equity to avoid regional disparities, the fiscal system is expected to promote equitable financial sustainability to all LGAs.

Despite the central-local relation being at the heart of financial sustainability, there are various specific factors which contribute to LGAs' financial sustainability problems. Such factors are in two broad categories, internal and external. Internal factors are those which are within LGAs' influence, while external factors are those beyond LGAs' influence. However, Hendrick (2004) and Dodor et al. (2009) classified them differently. Hendrick classified such factors as organisational and environmental, while Dodor et al. (2009) classified them into three categories: financial, environmental and organisational factors. Honadle et al. (2004) have provided an exhaustive list of specific factors: the physical environment, the nation's economic health, the LGA's status and that of neighbouring LGAs, national economic development policies, changes in population, central government transfers, the autonomy level of the local officials, and public service demand within the locality. Some of these factors may be associated with decentralisation reforms while others may not be.

The physical environment in which LGAs operate is identified as having an impact when it comes to determining the economic base for local taxation. LGAs which are located in geographically wealthy areas are in a better position to raise revenue than their counterparts. As Johnson et al. (1995) point out, the quality of services and infrastructure depends on the economic base because it affects LGAs' ability to generate the required revenue to support them. Furthermore, when economic conditions change within an LGA over time, the impact will also be reflected in the revenue-raising capacity. Skidmore and Scoresone (2011), for instance, claim that one of the major reasons contributing to Michigan's financial hardship between 2001 and 2006 was the decline of the manufacturing sector, which formed its economic base.

Although it may be difficult to contain short-term changes in LGAs' physical conditions within the fiscal system, long-term ones can be integrated, hence limiting variations in LGAs' financial sustainability. For instance, it is difficult to deal with variations in financial sustainability in LGAs which are heavily dependent on seasonal crops as their tax base, especially in developing countries where irrigation is limited. However, the situation can be minimised if a thorough analysis is undertaken to establish the need-capacity gap before setting equalisation grant formulae. Also, if it happens that the national economic condition changes, it is expected that this will have a similar impact on LGAs' financial conditions throughout the country. A good example is provided by Skidmore and Scoresone (2011), who explain that one of the reasons why LGAs in Michigan suffered financial hardship in 2007 was the structural deficit at the state level, which was reflected in revenue share. Thus in a unitary state, national economic deterioration will affect transfers to all LGAs. Any decline in central government's ability to provide financial support because of the changes in economic conditions will affect all LGAs, instead of making some of them better off than others.

Another factor that contributes to LGAs' financial sustainability problems is the mismatch between the functions and their financing capacity. Factors which influence municipal spending also affect financial sustainability (Whitaker, 1985). If the decentralisation is designed to transfer more responsibilities to LGAs than resources available to them, LGAs are likely to experience financial difficulties. Bhattacharyya and Bandyopyadhyay (2012), for instance, found constitutional amendments of 1992 led to a mismatch between revenue and functions in Indian urban authorities. In such a situation, LGAs are hardly capable of meeting their service delivery expenditure on a continuing basis. The service level and/or quality are susceptible to deterioration. As Spahn (1999) suggests, LGAs can overcome the difficulties through varying output services. The mismatch between financial capacity and LGAs' entrusted functions can be seen as a failure of fiscal system design. Spahn (1999) emphasises that as reform vests allocation functions to local authorities, there is a need for consistence in revenue outlay in order to stabilise macro-economic objectives.

Mismatch between the revenue flow and the expenditure pattern has also been identified as contributing to financial difficulties. One aspect of fiscal difficulties in LGAs is the requirement to meet immediate financial obligations as they fall due (Justice and Scorsone, 2012), that is, it is a liquidity issue. The fiscal system should consider not only availability of financial resources to LGAs but also predictable flows of the resources. The emphasis should be on both, in collecting own source revenues and in the flow of central government grants. LGAs should collect revenues from their own sources not only through their best efforts but also as a predictable flow so as to match them with their expenditure pattern. Failure to do this means they cannot meet their revenue targets, hence limiting their power to finance their activities. Similarly, the flow of central government transfers should be sufficiently predictable to enable LGAs to execute their plans on time. Otherwise, they will not be able to meet their budgets, which may result in some of their targeted activities being postponed or cancelled despite having been approved. Consequently, the attainment of decentralisation benefits becomes limited. The findings of Nelson (2012) provide a good example. He found some LGAs had to cancel major approved events while others had to delay development projects because of their financial difficulties.

National development policies and regulations may influence the financial sustainability of LGAs. If such policies and regulations are not well designed, they may suppress the financial sustainability of LGAs, even treating LGAs unequally. Such unintended effects of policies can result in halting the financial sustainability of LGAs. It is unlikely for a country to design policies which aim to favour the financial sustainability of some LGAs and to halt it in others. Policies which aim to ban local taxes from some sources to benefit the whole economy, for instance, are likely to have a negative effect on the financial sustainability of all LGAs which use such a revenue source. However, there might be some LGAs which are more heavily reliant on such sources than others, in which case it is expected that any compensation scheme that aims to neutralise the impact will consider the differences. Moreover, national policies which aim to attract investment projects in certain regions are also likely to benefit LGAs located in that area. For instance, in Tanzania the export processing zone authority can declare an area to be a special zone by providing tax incentives to attract investments that aim to produce export products. This provides an example of a situation in which a national policy may create favours for some LGAs but not others.

Changes in population within LGAs have been identified as influencing financial sustainability in two ways. The first is associated with population increase, which implies increased demand for public services. The second is population decrease which implies a lower tax base and hence reduction in revenue collection. Hendrick (2004) provides an example from the US where the movement of individuals and businesses from city centres to the suburbs in the 1950s greatly affected fiscal health. It increased service demand in the suburbs, which were not prepared to provide them, and drained the revenue base of the centre. Increase and decrease in population might be due either to migration or to natural increase/decrease through birth and death; whichever the reason, the change should be incorporated in fiscal system design. In African countries, for instance, urban areas experience rapid population increase, which is a major challenge for public service provision (Olowu and Smoke, 1992). The population growth in these cities is caused by immigration, especially of the workforce, in search of employment opportunities and better services. A well designed fiscal system would ensure that the availability of essential services is balanced, while simultaneously promoting economic activities across regions to discourage undesired movement. Also, a natural population increase/decrease can be integrated in central government revenue transfers and LGAs' plans because they can be forecast.

Moreover, financial management decisions have an impact on financial sustainability (Skidmore and Scoresone, 2011). It is those decisions which can enhance or impair the ability of LGAs to collect revenue. They may include decisions on identifying new revenue sources and on how to enforce collection, which can affect financial sustainability. For instance, Nelson (2012) found that one LGA out of the sixteen he studied decided to form a task force comprising employees and independent experts to increase the effort on uncollected amounts as part of addressing financial difficulties. He found another LGA which decided to lease its gaol spare-capacity to other municipalities as a new source of revenue. Another example of financial management decisions is on using debt finance, although its excessive use is risky and LGAs have to strike a balance with their payment capacity. Similarly, decisions on using unsustainable revenue sources tend to have only a short-term positive impact on financial health. Nelson (2012) also found that some LGAs decided to sell land, part of its long-term assets, as a source of revenue to mitigate the financial difficulties they were facing. This decision clearly provides only a short-term solution and is likely to accelerate financial difficulties in the future. When an LGA disposes of long-term assets that would generate revenue over time, its revenue raising capacity in the future becomes impaired.

In addition, the introduction of tax limitation can contribute to financial sustainability problems in LGAs. Limits might be established for good reasons, but their impact will be to reduce LGAs' revenue raising capacity, and their autonomy in responding to increase in financial demands. Some sources might be completely restricted while others are limited through the imposition of a maximum tax rate. In both cases, LGAs will be unable to stretch their capacity to respond to any increase in service demand, especially when their collection capacity is exhausted. For instance, Nelson (2012) found state caps and valuation limitations restricted LGAs in Michigan and California in raising property tax during financial hardship.

3.9.3 Measuring Financial Sustainability in LGAs

The task of evaluating the financial sustainability of LGAs is well organised in some developed countries, to the extent of having specific bodies responsible for it. In the US, for instance, the American Advisory Commission took initiatives to systematically evaluate the fiscal condition of its LGAs in the 1970s. The Commission made a first attempt in 1973 by establishing six warning indicators of local financial emergencies (Dollery and Crase 2006). Similarly, in the UK the National Audit Office is responsible for evaluating the financial sustainability of its local authorities. Zafra-Gomez (2009b) notes that, in February 2007, the UK Audit Commission published a paper which emphasises the need for councils to have sound financial resources to support services provision. Similarly, in 2013 the National Audit Office assessed the impact of a 26% gradual reduction in central government transfers to LGAs from April 2011 to March 2015, as part of establishing their financial health. Meanwhile, Australia has financial sustainability boards which have been established as part of public sector reforms. According to Dollery and Crase (2006), such boards are responsible for setting financial indicators and evaluating the financial sustainability of LGAs. According to Cabaleiro et al. (2012) and Casal and Gomez (2011), the Institute of Chartered Accountants in

Canada has established a framework for assessing financial sustainability which also applies to LGAs. South Africa, too, established the Financial and Fiscal Commission in 1994 which provides independent, technical advice on intergovernmental fiscal relations to central government. In its 2013 technical report, the Commission recommended that the government should develop an early warning system for evaluating financial distress in LGAs. Generally the trend shows governments are concerned with the financial sustainability of their local authorities.

In the academic literature there are various studies that have attempted to assess financial sustainability of local authorities in different countries. To mention but a few: Brown (1993) developed a 10-point test for smaller cities in the US; Kloha et al. (2005) developed another 10-point scale for providing early warning in US states; Murray and Dollery (2005) developed a financial sustainability model in Australia; Zafra-Gomez et al. (2009a and 2009b) established financial sustainability models for Spanish LGAs; Cohen et al. (2012) measured financial sustainability of Greek LGAs; Jorge et al. (2006) and Alfonso and Fernandes (2008) assessed the financial sustainability of Portuguese LGAs; Ritonga et al. (2012) assessed the financial condition of local authorities in Indonesia; and Huang and Ho (2013) analysed the financial health of Taiwanese LGAs. The focus of many of these studies has been to establish models and techniques for evaluating LGAs' financial sustainability independently of fiscal system design. However, they offer a very useful insight in terms of measurement indicators and approaches that can be considered in assessing the financial sustainability of LGAs in the context of decentralisation reforms.

3.10 Measurement Indicators of Financial Sustainability

Financial ratios have been key inputs in financial sustainability analysis. As Feroz et al. (2003) state, financial analysts have commonly used ratios to measure organisations' performance over a number of years. Similarly, Modell (2004) concludes that reliance on quantitative indicators, primarily based on accounting information, has been common in performance measurement of public sector programmes. Ratios express the relationships between variables, and although the number of ratios from financial data sets is only limited by the scope of the analyst, just a subset can be meaningfully interpreted (Feroz et al., 2003). Thus, usefulness of ratios depends on the analyst's objectives, which determine what should be measured.

In the private sector, ratios have been used for many years to analyse financial performance and assess the risk of corporate failure. Similarly, the use of financial indicators to analyse the financial health of LGAs has been in practice for over 30 years (Rivenbark et al., 2010), and they are valuable for analysing, interpreting and communicating financial. Financial ratios are used to develop quantifiable measures of financial health, developing an overall system that provides relationships between indicators and determining the overall financial health of an entity by tracking the direction and speed of the changes that take place in financial characteristics of an entity (Groves, Godsey and Shulman 1981; Rivenbark et al., 2010).

Thus, a vast range of indicators has been used by different authors in analysing the financial health of LGAs in different countries and contexts (see appendix A). Some of these indicators are similar, while others differ from study to study. Factors and dimensions affecting LGAs' fiscal condition in particular study settings have been major determinants of the measurement indicators used (Jung, 2008). The dimensions referred to are either short or long term, social-economic, political or demographic features. There is no single indicator which captures all the different dimensions that influence the financial sustainability of LGAs (Groves et al., 1981; Jung, 2008).

The possibility of more than one factor influencing an organisation's financial performance explains the existence of multiple indicators in financial sustainability studies. Financial health can be measured using short-term or long-term indicators (Kloha et a.l, 2005). The former consider the mismatch between committed expenditure and the resources available, while the latter consider revenue raising capacity relative to expenditures and commitment. CICA (2013) identifies three groups of measures: sustainability, flexibility and vulnerability. Sustainability refers to LGAs's ability to maintain the existing service level and creditor requirements without increasing the debt burden on the economy. Flexibility refers to the ability to raise additional finance to respond to additional commitments. Vulnerability refers to the extent of dependence on external sources of finance which are outside LGAs' control. In the US, the Government Accounting Standard Board considers the financial condition on the basis of net assets position, budget balance or the net cash position (Zafra-Gomez et al., 2009b).

In spite of the use of multiple variables, there are four common categories of measurement indicators for financial sustainability: cash solvency, budget solvency, long-term solvency and service-level solvency (Justice and Scorsone, 2012; Padovan and Scorsone, 2011; Honadle et al., 2004). Cash solvency measures liquidity, cash management and the ability to meet current liabilities; budgetary solvency measures the ability to generate sufficient revenue to finance the current services offered; long-term solvency measures the impact of existing long-term obligations on future resources; and service solvency measures the ability of the local authority to offer and sustain a service level desired by its citizens. The same four common dimensions are also promoted by the International City/County Management Association (Casal and Gomez, 2011); however, there is no consensus on which dimensions or indicators to use, although the conceptual framework and information availability are the main drivers of variable choice. Likewise, Jacob and Hendrick (2012) note the absence of a single best strategy. Instead, they insist on the ability of the analyst to understand the interrelationship between different dimensions that influence financial health, which should guide them in determining the best approach to measuring the financial condition.

Cohen et al. (2012) used six financial ratios to evaluate the financial health of Greek municipalities. These ratios were obtained on the basis of the literature on both public and private sectors, and the underlying characteristics of the municipalities' financial structure. Casal and Gomez (2011) used 34 indicators obtained on the basis of CICA and ICMA, while Zafra-Gomez et al. (2009b) used 13 financial indicators reflecting cash solvency, flexibility, independence, sustainability and service level. Cabaleiro et al. (2012) used 20 indicators in their assessment of the financial health of Spanish municipalities, based on the CICA framework. Ritonga et al. (2012) used 18 indicators to assess the financial condition in Indonesia. Lewis (2003) used only one indicator, surplus or deficit, to measure financial performance.

3.11 Chapter Summary

The review of the literature has shown that, through redistribution of resources, decentralisation offers the prospect of reducing poverty, enhancing equity and improving public services in general. In addition, decentralisation promotes social cohesion and poverty reduction through enhanced and equitable public services. Despite these promising benefits, studies suggests that the success of decentralisation is limited, especially in developing countries, to the extent of questioning its desirability and the approach used. However, in response to this Litvack et al. (1998) decided that the debate on whether decentralisation is good or not is unproductive, because it is a worldwide phenomenon whose form varies significantly within and between countries. However, due to the failure of centralisation strategies to promote development and reduce poverty levels (Johnson, 1999), it is difficult to abandon decentralisation as long as the prospect exists. The emphasis should be on appropriate design and execution of reform programmes in order to realise the benefits, and this is the common view derived from the literature. Cabral (2011), for instance, states that the overall impact depends on the design of a particular decentralised government system. Similarly, Salman and Iqbal (2011) argue that whether fiscal decentralisation brings positive or negative results, it depends on the distribution of expenditure responsibilities among different levels of government and their ability to execute them. Meanwhile, Widmalm (2008) argues that decentralisation should consider devolving power in terms of responsibilities, resource allocation and revenue raising options, and institutional autonomy in designing own policies.

Generally, the literature recognises the importance of decentralisation which matches devolved responsibilities with the availability of resources if the executing agents are to succeed. The significance of matching resources with responsibilities is imperative in determining the financial sustainability of LGAs, which are the implementing agencies of reform programmes. Stone (2015) states that decentralisation could influence financial sustainability of LGAs both positively and negatively. In considering this, the chapter also discusses the role of fiscal relations in shaping the financial sustainability of LGAs. The discussion covers the importance of intergovernmental transfers, own source revenue and borrowings in enhancing financial sustainability, which enables not just service delivery but also equity. This forms the basis of this research: to evaluate the financial sustainability of LGAs in Tanzania within the context of decentralisation. It aims to identify whether the design and implementation of decentralisation offers the prospect of improving service provision in an equitable manner. Moreover, the chapter presents the importance of evaluating the financial sustainability of LGAs, reviewing the practices of assessing financial sustainability and its measurement indicators.

CHAPTER 4 : BACKGROUND OF LOCAL GOVERNMENT AUTHORITIES IN TANZANIA

4.1 Introduction

This chapter presents the background of local government in Tanzania. It explains the history of LGAs, their current structure and institutional settings, their functions, and details the ongoing reform of decentralisation by devolution. It also explains the meaning of equity and the government's efforts towards it since independence in 1961, details of local government finance and the budgeting process, and it ends with a chapter summary.

4.2 History of Local Government

In Tanzania, LGAs have a long-standing history throughout different administrative regimes. According to URT (undated), the history can be traced back over more than 100 years covering the pre-colonial, colonial and post-colonial eras. In the pre-colonial era, LGAs took the form of chiefdom administrations. Such administrations had power and control over a certain geographical area as demarcated by tribal presence, but had no clear boundaries. Geographical boundaries for districts were established during the German colonial era in the 1890s. The German administration abandoned chiefdoms and introduced the post of district commissioner. However, when the British colonial administration took over in 1918, some changes were made by introducing urban administrations, while districts were adopted in rural areas. In 1926, the British rule restored the native administration parallel to the district and urban system. Also in that year, 11 provinces were established (URT, 2007b), followed by the introduction of provincial commissioners in 1928 (URT, undated). In 1953, the British rule enacted a local governance ordinance which laid down the structure of local government that persisted until independence in 1961.

After independence, the post-colonial government inherited the local government structure left by the British colonial rule, but provinces were reorganised into 18 regions (URT, 2007b). A number of key decisions were made soon after independence, intended to have a major impact on rural development and people's participation, but they were made centrally (Picard, 1980b), at a distance from the people. The government also struggled to align the implementation of such decisions with the inherited structure, because they were designed for a different purpose (Picard, 1980a). During colonial rule, the structure of LGAs aimed to facilitate native involvement in their administration (Reed, 1979). Due to the limitations of this system, LGAs were abolished in 1972 and the central government changed modalities of development planning and service provision.

At the time of the abolition, there were 81 councils comprising 15 urban and 66 rural councils. Development plans for the new arrangements were made through committees from villages, wards and regional committees to enable people's participation (URT, undated). The new arrangements were introduced through a "decentralisation umbrella" in the absence of LGAs. The changes were in line with the country's national development strategy, which followed the Arusha Declaration of 1967. The original declaration emphasised rural development for reducing urban-rural income inequalities, but later considered inter-regional disparities within the rural economy as well (Belshaw, 1982).

By design, the decentralisation arrangements of 1972 had good intentions but were difficult to execute in practice, which led to their failure after 10 years. There was insufficient knowledge for the regional committees to organise and consolidate development plans, and a lack of donors' funding commitments (Belshaw, 1982). Regional development plans had to be made with the help of technical assistance from international aid organisations, and their financing depended on specific donors' commitment for each region. It was taking longer to consolidate regional plans, and the commitment of donors diminished so that some regions could not obtain the funding to finance their plans. All these factors contributed to the demise of the "new" system. Also, in the absence of LGAs, the provision of public services deteriorated and development projects could not be sustained due to lack of democratically elected representatives (URT, undated).

The history of LGAs in Tanzania does not seem to differ from that of many developing countries. Smoke (2001) commented that it was the colonial rules and development assistance programmes which introduced local government in many developing countries. Nevertheless, they neither fulfilled their purpose nor gained acceptance by the local community. After independence, local governments were seen as inconsistent with local culture and needs. Moreover, central governments were reluctant to strengthen LGAs because of legitimacy, building a state unit over different ethnic societies, and macroeconomic control. This was partly attributed by early economists to favour centralisation over the development of LGAs; government officials were advised to maximise growth through centralising economic power. LGAs were used only for administrative and control reasons by post-independent governments, rather than enhancing their autonomy, democracy and economic wellbeing. Nevertheless, the former British colonies have a more semi-autonomous local government than do the French. Smoke offers another reason for the slow development of LGAs in developing countries, the lack of sufficient managerial and technical resources immediately after independence. Central governments feared stiff competition from local government over qualified human resources. Similarly, training and educational facilities were insufficient to fill the human resources requirement gap.

In 1982 local governments were reintroduced through parliamentary acts no. 7 and 8 of 1982, in 1984 enshrined through constitutional amendments. These acts reintroduced both rural and urban councils, which became operational in 1984. By 2014, there were 134 LGAs and 21 regions on the Tanzania mainland,[6] comprising 28 urban and 106 rural councils. Nevertheless, reintroduction of the LGAs could not produce all the anticipated benefits because of a number of shortfalls[7]. As a result the government introduced reform initiatives known as Decentralisation by Devolution (D by D) in the late 1990s. The reform programme aims at strengthening and transforming LGAs into effective vehicles for social and economic development of the communities within their areas.

The lessons learnt from previous reforms should provide useful insight into implementing new reforms. The abolition of LGAs in favour of the previous decentralisation policy (1972-1982) could never have succeeded because there were no LGAs to coordinate its implementation. Similarly, the re-introduction of LGAs (1982-1998) had only limited success because power remained largely under the control of the central government. Thus the operationalisation of D by D is expected to benefit from experiences drawn from previous reforms, but these need to be revisited while it is still in progress in order to address any weaknesses that may limit its success.

[6] The country is made up of Tanzania mainland and Zanzibar which has its own local government system

[7] History of Local Governments in Tanzania (URT, undated) provides more details

4.3 Current Structure of LGAs and Intergovernmental Institutional Settings

In Tanzania, LGAs are rural and urban councils which make up the second tier of government and their corresponding lower levels. Rural councils comprise district councils, and their sub-tiers are town authorities, wards, villages and *vitongoji* (sub-villages), while urban councils comprise municipal and town councils, with wards and *mitaa* (streets) as sub-tiers (Njunwa, 2006). Planning decisions and budget execution functions are carried out by the council at district or higher level in urban councils. Wards operate as administrative units while *mtaa*/village government, headed by an elected chairperson, have power to plan and execute approved policies through assembly. The council, which is the superior organ is made up of elected councillors from each ward, with one third special seats for women councillors and members of parliament whose constituencies fall within the council area.

For the purpose of this study, the term LGA refers to either rural or urban councils, but not to their sub-tiers. They were established through the District Authorities Act no. 7 and Urban Authorities Act no. 8 respectively, both of 1982. The Local Government Finance Act no.9 of the same year governs the financial matters of LGAs; together with its amendments, it identifies revenue sources of LGAs and provides guidance over the management of funds and resources. The Prime Minister's Office, Regional Administration and Local Government (PMO-RALG) is the parent ministry of LGAs which coordinates their operations. The ministry is also in charge of Regional Administration/Secretariats and it provides the link between LGAs and other government ministries whose operations are delivered through LGAs. The Regional Secretariats are not considered as local government since they do not have democratically elected officials. Instead, they are representatives of central government. Their role with regard to LGAs as established in Act no. 19 of 1997 is to provide advisory and supervisory services.

4.4 Functions of Local Government in Tanzania

In Tanzania, LGAs play a vital role and they are an integral part of the public sector that influences people's lives. They have three main functions, as identified in the District Authorities Act no 7 of 1982: maintenance of laws and good governance, promoting economic wellbeing and social welfare of people within their area, and furthering economic and social development that conforms to national policies and plans within their areas. Some of the functions are offered in collaboration with sectoral ministries under the coordination of the PMO-RALG, the parent ministry. These are known as concurrent functions and they are funded and regulated by the central government ministries (Venugopal and Yilmaz, 2010).

The functions of LGAs in Tanzania can be classified into two groups, mandatory and permissive (Venugopal and Yilmaz, 2010). Mandatory functions are those which are performed by local government, although it is the central government which is responsible for policy making and regulating through sectoral ministries. These fall in five prioritised sectors: education, health, water, agriculture and roads. Permissive functions are those which can be performed by LGAs at their own discretion. LGAs have power to decide and regulate such functions. The funding of permissive functions is exclusively from internally generated revenues, contrary to mandated functions which receive the support of central government funding. Examples of permissive functions are land use planning and management, management of market places, fire brigade operations, and waste and sanitation management.

In general, LGAs in Tanzania have dual allegiance, one to the central government and the other to their community. They act as agents of central government in the delivery of key responsibilities which affect the wellbeing of people and the prosperity of the nation as a whole. They have responsibilities for overseeing and executing the policies, laws, procedures, regulations and guidelines of the central government (URT, 1998). Sectoral services such as education, health, water, agriculture (which is the backbone of the national economy) and road infrastructure delivered through LGAs are crucial to both human development and the national economy. On the other hand, LGAs' permissive functions enable provision of public services which are specific to each LGA. LGAs have to plan and execute such services according to local needs, as their second agency role to the community.

The significance of LGAs in the implementation of national policies and strategies is enhanced by the huge area of the country. They provide an important link between the central government and its people in the development process, and particularly in poverty alleviation. The country's 883,600[8] square kilometres of land area is too large to deliver some public services in the absence of LGAs. The detailed list of the functions of LGAs is provided in the first and second schedules of the Local Government Act

[8] National Bureau of Statistics (2013) Tanzania in Figures 2012

number 7 and 8. These include, but are not limited to, provision of primary and secondary education, promotion and provision of basic healthcare, provision, maintenance and control of water supplies, construction of local roads and streets, managing fire brigades, agricultural development, managing a range of natural resources, management of land use and provision of building permits, allocation and control of market places, and waste and sanitation management. Provision of all such services requires sufficient resources, both financial and non-financial, including human resources.

4.5 Decentralisation by Devolution - Local Government Reform Programme

The post-colonial history of LGAs in Tanzania involves significant interventions to their existence and operations. All such interventions are aimed at improving delivery of public services to local communities, and contributing to the achievement of national targets. The most recent reforms are the ones introduced by the local government reform agenda of 1996, and the local government policy paper of 1998. These reforms are just part of long-term efforts by central government and development partners towards improving delivery of public services. As previously noted, soon after independence the government intended to bridge the interregional development gaps between urban and rural areas and within the rural sectors. In addition, it intended to involve people in planning decisions within their areas. These objectives remain, and they are congruent with fiscal decentralisation theory which discourages interregional development disparities and emphasises community participation.

The restoration of LGAs in 1982 was expected to improve performance in service delivery and development initiatives through people's participation, but until 1990s this was not the case (URT, undated). LGAs had poor human resource capacity, weak management, insufficient financial resources and lack of accountability and transparency. These deficiencies prompted the new local government reform programme identified as Decentralisation by Devolution (D by D), which is still ongoing. The long-term goals of these reforms are similar to those stated in the previous decentralisation reforms of 1972. They include poverty alleviation, improving the quality and access to public services, especially for the poor, and to ensure equitable public services.

As the decentralisation policy paper of 1998 identifies, D by D comprises four main aspects of reform. The first is political decentralisation, which aims to devolve decision-making power to LGAs within the national legislation framework. The second is financial decentralisation, to provide LGAs with discretionary power over financial decisions and own-source revenue generation. The third is administration decentralisation, to provide LGAs with discretionary power over staff recruitment and local decisions and to make their staffs accountable to their local councils. The fourth is the changed central-local relations which aim at setting a clear communication link between LGAs and central government ministries and departments. The minister in charge of LGAs coordinates with other central government ministries in communicating regulations and guidelines to LGAs concerning the devised central-local relations.

4.6 The Concept of Equity in Public Services and Financial Sustainability

Equity is a crucial aspect in the design and execution of government policies that affects provision of public services. The meaning of equity encompasses fairness and equal treatment, resource allocations towards reducing inequalities in universal programmes and redistribution of services and resources geared to specific programmes that address marginalised groups (Norman-Major, 2011). In contrast, inequity refers to differences that are unnecessary and avoidable, and that can also be regarded as unfair or unjust (Whitehead, 1985). Thus unfair and unjust treatment of some individuals/groups of users with similar requirements should be avoided in the provision of public services. Governments should consider not only economy and efficiency in service provision but also equity, because it addresses the recipients of the services delivered (Norman-Major, 2011). This aspect is embedded within fiscal decentralisation theory through discouraging regional disparities, and decentralisation reforms worldwide have attempted to achieve it. The consequences of inequity include perpetuation of poverty in areas with poor services, inducing migration to areas with better services, and social unrest in areas with poor services (Hofman and Guerra, 2007).

Tanzania has been striving for equity in the provision of public services since its independence in1961. Basically, there are two main reasons contributing to spatial inequalities in Tanzania (Maro, 1990). The first is the ecological differences among regions and the second is the historical factors related to colonialism and capitalism. Consequently, equity was one of the major objectives of the Arusha Declaration of 1967, a major objective in the decentralisation reform of 1972, and it is still a major objective in the ongoing reforms. The ongoing reforms specifically aim to improve the quality and access of public services, particularly to the poor, and to ensure equity in public services.

The involvement of central government in decentralisation reforms, by formulating policy and regulating key public services through its ministries, makes prioritisation of equity viable. It would be difficult to embed equity in service provision if policy making and regulating functions were left entirely to LGAs, as rich LGAs would be able to offer better services than their poorer counterparts.

Considering the role of central government in ensuring equity, it is expected that development plans including the budgets of LGAs reflect equity in public services throughout the country. Thus, how LGAs' budgets are set and implemented forms a crucial component towards equity in public services. If the equity aspect is embedded in the allocation of resources to LGAs from central government, proper execution of such budgets will eventually result in equity in the services offered. Similarly, if during budget implementation the financial resources are insufficient to cover the grants allocated to LGAs, reallocation should also consider equity. This will contribute to giving LGAs similar financial sustainability relative to each other, because they have similar functions.

4.7 Local Government Finance

D by D has brought major changes in intergovernmental fiscal relationships. These changes are geared towards improving public sector performance and financial management practices in LGAs. Among the objectives of fiscal decentralisation in Tanzania are to improve intergovernmental fiscal transfers, to improve own-source revenue generation in LGAs, and to improve efficiency in service delivery and make them equitable (World Bank, 2013). Prior to D by D, the LGAs' financing system was uneven. There was no sufficient financial commitment, either from internally generated funds or from central government that would allow LGAs to execute their functions effectively (World Bank, 2013). Moreover, the allocation of central government grants to LGAs was based on ad hoc and discretionary decisions resulting in some LGAs receiving more than others (Boex 2003; Allers and Ishemoi, 2011a). Thus reforms were intended to correct such misshapen in local government financing. As a result the government asserted in 2006 that "substantial progress has been made in recent years on transforming the previously highly discretionary transfer system into a more objective, transparent, stable and pro-poor funding mechanism for local governments" (URT, 2006: 3).

4.7.1 Intergovernmental Grant System

As identified above, before reform there was no adequately established allocation mechanism. Boex (2003) identifies the process as complex, and he found some LGAs were unjustifiably receiving more than others, while wealthier LGAs were getting greater allocations. This implies that the allocation process was perpetuating differences between rich and poor LGAs in their ability to deliver public services. This was contrary to the long-term goals of discouraging interregional imbalances between urban and rural areas and within the rural areas, which was initiated by the government just after independence. Thus, the reforms of 1998 aimed to address such shortcomings in the distribution of central government grants to LGAs.

In 2004 the government introduced a formula-based grant allocation system which became operational in 2005/06 (URT, 2007a). The formula is used to allocate recurrent block grants and capital development grants (Venugopal and Yilmanz, 2010). Recurrent block grants are specific to priority sectors which are education, health, water, agriculture and roads. Meanwhile, capital development grants are non-sectoral discretionary grants allocated for the provision of new and rehabilitation of existing infrastructure and capacity building activities. In addition, LGAs receive ministerial subventions which are sector specific, and general purpose grants (Allers and Ishemoi, 2011b). General purpose grants are distributed to LGAs as compensation for local taxation revenue sources abolished in 2003 due to being considered inappropriate. They are used for general administrative purposes and LGAs have discretionary autonomy, unlike for block grants.

The design of the intergovernmental grant allocations in Tanzania is intended to equalise fiscal disparities in spending needs, which is essential in maintaining equity in financial sustainability across LGAs. The background paper on local government finance states that:

> *The formula allocates greater resources to poorer local government authorities, as well as to geographically larger local government districts (in other words, rural district authorities). This is consistent with a needs-based equalization approach. As the CDG system evolves over time, the allocation formula should be reviewed from time to time to assure that the formula achieves the policy objectives that it is intended to secure (URT, 2006: 10-11).*

There are minimum conditions to be met in order for an LGA to qualify for central government grants. These acts as control mechanisms embedded in the grant allocation system to discourage slackness in LGAs' financial management practices. LGAs are assessed by external independent teams annually, based on a predefined set of criteria. These criteria are categorised into Financial Management; Fiscal Capacity; Planning and Budgeting; Transparency and Accountability; Interaction between Higher Local Government Level (District/Municipal Councils) and Lower Local Government (Wards and Villages); Human Resource Development; Procurement; Project Implementation; Council Functional Processes. The aim is to ensure that LGAs exercise financial management discipline and attain good governance. Minimum conditions are based on the minimum total scores an LGA has to attain after being assessed. LGAs failing to meet minimum conditions receive only 25% of their discretionary capital development grant, 50% of sector specific grants and 100% of their capacity building grants (URT, 2008). They are then placed under strict monitoring by the parent ministry and regional secretariats.

4.7.2 Own Source Revenues

In 2003/04 the government reformed regulations governing LGAs' arrangements for revenue generation from own sources. The aim was to harmonise the local government financing system. The reform affected the distribution of revenue sources between central and local governments. As a result, LGAs were given discretion to set bylaws and collect their own revenues, but within a specified limit set by central government. In general, they have a mandate to collect revenues from more than 50 sources as published on the website of the Ministry of Finance (summarised in table 4.1).

However, there are two contrasting views regarding LGAs' ability to mobilise revenues from such sources. On the one hand, it can be construed as McCluskey (2005) reports that many of the revenue sources available to LGAs in Tanzania are insignificant in revenue terms and hence are rarely collected. The collection process tends to have higher administration costs than the actual proceeds. However, this can be construed differently, and Bird (2011) argues that LGAs may collect revenues from fewer sources than those allowed because they are considered as service providers. They act as agent in providing devolved services of the central government resulting in reliance on central government grants instead of generating their own finances. Thus, the design control mechanisms in the local government financing system need to be sufficient to discourage slackness in generating revenues from own sources.

Based on the Local Government Finance Act, the list of revenue sources which can be collected by LGAs as published on the website of the Ministry of Finance is provided in table 4.1. The Ministry strictly limits LGAs from going beyond the list by saying “Local Governments are not allowed to levy any taxes, levies or fees which are not on this list”.

Table 4.1: Sources of Revenue of LGAs in Tanzania

Taxes on Property	**Administrative Fees and Charges**
Property rates	Market stalls / slabs dues
Taxes on Goods and Services	*Magulio* (on markets) fees
Crop cess, (a tax levied on farm produce, maximum 5% of farm gate price)	Auction mart fees
Forest produce cess	Meat inspection charges
Taxes on Specific Services	Land survey service fee
Guest house levy	Building permit fee
Business and Professional Licences	Permit fees for billboards, posters or hoardings
Commercial fishing license fees	Tender fee
Intoxicating liquor license fee	Abattoir slaughter service fee
Private health facility licence fee	Artificial insemination service fee
Taxi licence fee	Livestock dipping service fee
Plying permit fees	Livestock market fee
Other business licence fees	Fish landing facilities fee
Motor Vehicles, Other Equipment and Ferry Licences	Fish auction fee
Vehicle licence fees	Health facility user charges
Fishing vessel licence fees	Clean water service fee
Other Taxes on the Use of Goods, Permission to Use Goods	Refuse collection service fee
Forest produce licence fees	Cesspit emptying service fee
Building materials extraction licence fee	Clearing of blocked drains service fee
Hunting licence fees	Revenue from sale of building plans
Muzzle loading guns licence fees	Building valuation service fee
Scaffolding / Hoarding permit fees	Central bus stand fees
Turnover Taxes	Sale of seedlings

Service levy	Insurance commission service fee
Entrepreneurial and Property Income	Revenue from renting of houses
Dividends	Revenue from renting of assets
Other domestic property income	Parking fees
Interest	**Fines, Penalties and Forfeitures**
Land rent	Stray animals' penalty
	Share of fines imposed by Magistrates Court
	Other fines and penalties

Source: Ministry of Finance (Tanzania) - *http://www.mof.go.tz/mofdocs/revenue/revlocal.htm accessed on 11th September, 2015.*

4.7.3 Borrowing

LGAs in Tanzania rarely use debt finance, and it has an insignificant contribution in financing their activities (Ishemoi, 2011). The limited use of debt seems to correspond with suggested measures against soft budget practices (discussed in chapter 3). Usually central governments lay out strict conditions towards use of borrowings in LGAs, so as to discourage soft budget practices. Hence, LGAs can only raise debt finance if they are capable of repaying it from internally generated funds. The same applies to Tanzania, where debt finance to LGAs is allowed only for financing capital development projects. The borrowing procedures are also strict and centrally regulated by the Local Government Loan Board. On the other hand, the private financial market considers LGAs as non-creditworthy because they lack sufficient autonomy, and hence their interest rates are very high (Ishemoi, 2011).

4.8 Budgeting Process

In any organisation, the budget and the budgeting process are essential components for success. They form the basis of attaining long-term targets as identified in mission and vision statements, being broken down into short-term implementable targets. However, "budgets in the public arena are often considered the definitive policy document because an adopted budget represents the financial plan used by a government to achieve its goals and objectives" (Allison and Johnson, 2015: p.14). They serve as a means of allocating resources according to established priorities, to attain objectives. In addition, they serve as a means of controlling the accountability of organisational management. The budgeting process in public sectors such as LGAs is complicated because of the difficulties in striking a balance between the multiple objectives they are required to meet. On one hand, LGAs are expected to meet the need of the communities they are serving, through a range of services which may have varying degrees of importance for the recipients. On the other hand, they are simultaneously required to fulfil national priorities as predefined by central government through various policies. “Unlike most private-sector organizations, governmental entities must be responsive to a number of different groups and organizations—including elected officials, other governmental entities, investors, creditors, and citizens—that monitor their activities” (Allison and Johnson, 2015: p.27). Private sector organisations are usually striving to meet shareholders’ interests. It is the budget guidelines and procedures that can help to reduce the complexity in LGA budgeting process.

In Tanzania the budgeting process of LGAs is guided by the Local Government Finance Act (1982) and a number of guidelines issued from time to time. The Act stipulates procedures for the preparation of revenues and expenditure estimates, while other guidelines provide practical procedures, such as format, timing and ceilings to be adhered to. The procedures and processes involved in LGAs’ budgeting have been well summarised by HakiElimu and Policy Forum (2008). The budgeting exercise involves processes that link national development goals and policies with local priorities. While the PMO-RALG is responsible for issuing policies and guidelines to be followed, individual ministries are responsible for issuing policy guidelines specific to each particular sector and they are consulted for resource allocation. These guidelines are aligned with the National Strategy for Growth and Reduction of Poverty, Millennium Development Goals 2020, International Agreements, Goals and Targets, Ruling Party Election Manifesto and situational analysis from LGAs in the form of opportunities and obstacles to development (O&OD) (URT, 2012). Generally, the central government sets national targets and budget priorities, which incorporate inputs from LGAs, to be achieved annually for the next two years through the Medium-Term Expenditure Framework (MTEF).

Figure 4.1 LGAs' Budgeting Process in Tanzania

Source: HakiElimu and Policy Forum (2008)

Regional secretariats provide the link between central government and LGAs to facilitate communication of guidelines on planning, budgeting and implementation. In the upper LGA level (district/municipal councils), council directors are responsible for formulation and execution of their budgets in accordance with issued guidelines, including the budget ceiling. Departmental heads provide their budget inputs and are responsible for execution of departmental budgets. Budgets of LGAs are reviewed and approved by the council comprising councillors and local members of parliament. After approval at the council level, LGA budgets are submitted to the parent ministry for approval and consolidation into a national budget. On the other hand, the ward development committee provides a link by consolidating the budgets of lower LGAs (villages, *vitongoji* and *mitaa*) and upper LGAs. They consolidate the budgets of the lower levels before submitting them to the upper LGAs for approval and consolidation in the upper LGA budgets.

The budgeting exercise in Tanzania LGAs involves two-way opposing traffic (as presented in 4.1), which is in line with financial management practices. The first communicates policies and procedures from top to bottom levels; and the other is from bottom to top, communicating requirements. The budgeting process indicates the importance of LGA budgets in meeting people's requirements in terms of public services as well as meeting the country's overall objectives. Both the requirements of the local communities and national targets are incorporated in the budgeting process. Thus, proper execution of LGA budgets should lead to successful attainment of both service delivery and national targets. Nevertheless, the process is complicated and the budget cycle takes too long, about a year, to prepare.

4.9 Chapter Summary

This chapter provides the background of LGAs in Tanzania. It covers the history of LGAs from the pre-colonial era to the current ongoing D by D reforms. Generally, the history of LGAs in Tanzania can be broken into three phases, pre-colonial, colonial and post-colonial. The roles and significance of LGAs throughout these phases differs. However, the importance of LGAs in facilitating implementation of government plans towards service provision has been significantly increasing since attainment of independence in 1961. A number of challenges have forced various reforms designed to improve provision of public services to be revised. The most recent reform, which is still ongoing, was introduced in 1998 with a similar view to previous reforms, enhancing access to public services particularly by the poor. The programme is known as Decentralisation by Devolution; it aimed to devolve political, administrative and financial power to LGAs and to improve central-local relations.

CHAPTER 5 : METHODOLOGY

5.1 Introduction

This chapter presents the research philosophy underpinning the design and processes involved in meeting the research objectives. It starts by presenting philosophical stances for social science research and how this study fits in. This is followed with the details of the research design, sampling and data used in quantitative analysis in seeking responses to the first research question regarding variations in financial sustainability and corresponding explanatory factors. Also, the discussion covers the detail of financial indicators used and analytical tools. The chapter then discusses case study selection for answering the second research question, regarding the impact of financial difficulties, mitigating approaches and associated challenges. This discussion includes processes involved in collecting interview data from the selected cases, and the corresponding analysis. The chapter ends with a summary.

5.2 Research Philosophy

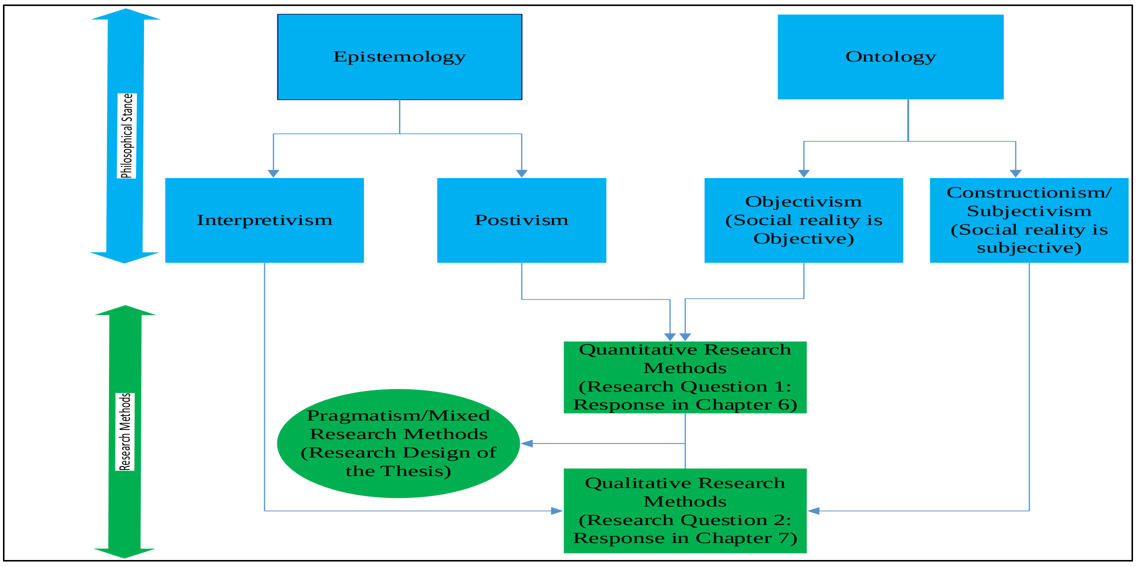
According to Saunders, Lewis et al. (2012) research philosophy is concerned with knowledge development and its nature. It is related to the way in which the researcher develops knowledge and the belief vested in the nature of that knowledge. It is vital to be aware of the philosophical stances in undertaking research as these determine how it is conducted. It is the set of implicit or explicit assumptions over the nature of the social world and how it has to be studied that establishes the bases of social science studies (Burrell and Morgan, 2011). This provides justification for the kind of methodology and research methods to be used.

As presented in figure 5.1, there are two philosophical stances which explain the nature of knowledge and how it has to be developed. The first is epistemology which is concerned with what is considered to be acceptable knowledge within a discipline, and the second is ontology which is concerned with whether the social reality is internal or external to the social actors (Bryman, 2008). The latter explains whether the social reality is objective or subjective to the actors. The objectivism ontological position considers the social reality to exist independently of the social actors, while constructionist ontological assumptions view the social reality to be embedded to the social actors (Gill and Johnson, 210). On the other hand, epistemology is further divided into two main stances, positivism and interpretivism. Positivist considers the acquisition of knowledge by following the same principles and procedures as natural sciences (Bryman, 2008). The knowledge developed through the positivist approach involves examining the objective reality that exists external to the actors (Creswell, 2014). In contrast, the interpretivist approach considers reality to be socially constructed by human behaviour, hence it requires different research procedures to those applied in natural sciences (Bryman, 2008). This study aims to acquire knowledge about the financial sustainability of local governments within the context of decentralisation through pragmatism, whereby positivist and constructivist epistemological stances are used together.

5.2.1 Pragmatism Research Approach

This study undertakes a pragmatist approach by mixing the positivism and interpretivism paradigms (mixed methods) as discussed in Morgan (2007), Feilzer (2010), and Teddlie and Tashakkori (2010). It uses positivism in assessing variations in financial sustainability against fiscal decentralisation theory, and interpretivism in understanding the impacts of financial difficulties within decentralisation settings and the approaches used to mitigate them. It is the nature of research questions that determines whether to use qualitative or quantitative methods (Sounders et al., 2012). As summarised in figure 5.1, the researcher employs quantitative analysis in accomplishing the first research objective and qualitative analysis for the second (chapter one offers details of the research objectives). The quantitative analysis utilises financial information from performance reports and demographic data, while the qualitative analysis utilises interview data from the three case studies.

Figure 5.1: Research Philosophical Stance



Source: Author

5.3 Comparative Research Design

The study uses a comparative research approach to evaluate the financial health of LGAs with reference to decentralisation reforms. As Boddewyn (1965, p.261) explains, the comparative approach involves "systematic detection, identification, classification, measurement and interpretation of similarities and differences" among the units investigated. It is commonly used in studies analysing fiscal conditions of local governments. Such studies include Krueathep (2010), Casal and Gomez (2011), Cohen et al. (2012), Huang and Ho (2013) and Krueathep (2014), which involved ranking LGAs according to their financial performance. Also, studies by Nelson (2012) and Krueathep (2014) provide examples of the usefulness of the approach in case study analysis. As the ILO (2001) explains, when evaluating municipal functioning with reference to reforms it is necessary to analyse each unit singly and in comparison with others. This study makes a comparative analysis of LGAs with reference to each other over a five-year period, which helps to identify similarities and differences among evaluated units. On the other hand, Pennings et al. (2006) believe that comparative design is suitable when it is inappropriate to use experimentation or to apply statistical based techniques because of an insufficient number of observations comprising the sample. This study exhibits these conditions. The total number of LGAs is too limited to apply sampling-based statistical analysis and it is impossible to undertake experimentation due to the nature of the study.

The comparative approach in sub-national studies has two main strengths, the possibility of including a large number of cases and the possibility of easily constructing controlled comparisons (Snyder, 2001). It also allows the analysis to start with a large number of cases in the initial stage, narrowed down to a few cases for detailed evaluation of financial sustainability and revenue collection with reference to system design. Likewise, the comparative design can accommodate mixed methods either through triangulation, facilitation or in complimentarity. A good example is the study of Krueathep (2010) which applied a mixed analytical approach in analysing 14 LGAs quantitatively, then narrowed this down to four cases for qualitative analysis. When comparative design is used, there are three dimensions on which the comparison can be based (Wollmann, 2008). The first is territory analysis, which may involve comparison between countries or between different levels of government within a country. The second is the sector or policy dimension, which may involve multi-sector analysis or policy areas across sectors either within a country or across more than one country. The third is the time frame, which may involve analysis within one or more countries over time. This study undertakes territorial comparative analysis of financial sustainability of local governments within a single country over time.

Wollmann (2008) notes that the comparative approach is useful when the study undertakes either descriptive, explanatory or evaluation comparisons. Descriptive comparative studies seek to assess divergence/convergence in LGAs' institutional developments within/across countries, or classification of the countries under investigation according to local government systems. Explanative comparative studies build upon descriptive comparison by incorporating causal relations analysis among variables that influence institutional change. Meanwhile, evaluation comparative studies involve assessment of key profiles of LGA systems based on chosen dimensions such financial, political, organisational or functional performance. This study encompasses all three aspects. It uses evaluative comparisons by ranking LGAs according to their financial sustainability. This is followed by explanatory comparison which involves identifying factors that explain variations in financial sustainability. Lastly, it undertakes descriptive comparison regarding the conformity of the fiscal decentralisation design/operationalisation to the theory.

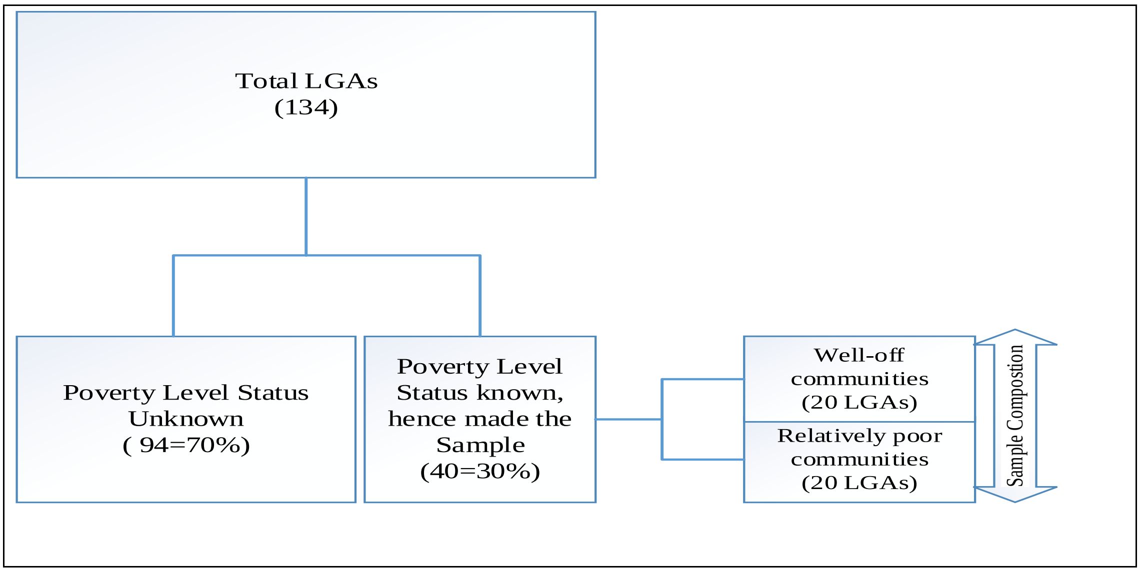
5.4 Data and Sampling for Financial Performance Analysis

The study uses purposive sampling, whereby two groups of LGAs comprising communities which differ in terms of income and poverty level. The composition of LGAs in the sample corresponds with the first research objective of examining financial sustainability within the context of decentralisation, in which horizontal equity of service access is a priority. Nevertheless, the availability of data regarding the income poverty level of the people within LGAs limited the number of LGAs into the sample to 40 out of 134 nationwide[9]. These LGAs have been identified through the Poverty and Human Development Report of 2005, which is the only available source that provides the ranking of councils based on the income poverty level of their people. The report was issued as part of a government initiative on monitoring poverty and it provides a list of the top twenty and bottom twenty LGAs, as presented in figure 5.2. After screening,

[9] The number of LGAs has changed from time to time, but this is the total number in 2008/09, the first year for data inclusion in the sample

four LGAs were dropped because of being considered as outliers. Thus, the quantitative analysis involved 36 LGAs (listed in appendix C), of which 19 were ranked at the bottom in terms of people living below the income poverty line, and 17 at the top.

Figure 5.2: Sample Composition



Source: Author

It is essential for the sample to consider the living standards of the people within the LGAs because, under the horizontal equity assumption, LGAs comprising a large proportion of people living below the income poverty line require extra efforts to improve access to public services. People living below the income poverty line, for instance, are less capable of affording similar services offered through private sector organisations, compared to those above the line. Hence, the financial sustainability of their LGAs should be equal to those of LGAs comprising relatively well-off communities. It is vital for reforms in Tanzania to consider this because private sector organisations participate in the provision of a number of public services, such as education and health, in parallel with government institutions. Nevertheless, the cost of such services is significantly higher in the private sector than the same services offered by the government.

The population in selected LGAs is 10,178,255, which is equivalent to 23.33% of the country’s mainland population of 43,625,354 as per the 2012 national census. Their total geographical area is 202,695 square kilometers, 23.5% of the total country’s land area of 883,600 square kilometers. All LGAs included in the sample have populations of more than 50,000 people as per 2012 census report.

5.5 The Use of Accounting Information

In government institutions, accounting information can be used to monitor and enforce accountability and hence improve their performance (Chan, 2003). They provide information on revenue generation and expenditure transactions. To LGAs, such information includes but is not limited to tax collection, intergovernmental transfers, lending and borrowing, as well as purchasing transactions. This justifies the wide use of financial information in assessing the financial health of LGAs, because these elements reflect financial undertakings. Some countries, like the US and Australia, have bodies which employ financial information to develop financial health measurement indicators for their LGAs. These bodies are ACIR and Australian Financial Sustainability respectively. As discussed in chapter 3, the practice of using financial information for assessing the financial health of LGAs has also extended to academic studies.

Financial reports are the main channel used to disseminate accounting information, which makes them an important source of accounting-based performance measurement analysis conducted at organisational levels (Kihn, 2005). Considering the value of the information contained in financial reports of LGAs, various standards have been devised worldwide to regulate reporting practices. In the US, for instance, the Government Accounting Standard Board issued financial Statement No. 34 in 1999 for instituting a robust model of financial reporting to states and local governments. Similarly, the Canadian Institute of Chartered Accountants issues standards that regulate the financial reporting of their LGAs. In addition to specific national regulatory bodies, the International Public Sector Accounting Standard Board issues financial reporting standards for public sector institutions that also apply to LGAs, and the majority of developing countries use these standards. The aim of developing standards is to provide guidance in the preparation of financial reports so as to enhance their usefulness.

Tanzania is one of the countries whose LGAs use International Public Sector Accounting Standards (IPSAS) in the preparation of financial reports. The use of IPSAS became a mandatory requirement for LGAs in the financial year 2008/09, through a directive of the parent ministry (CAG-T, 2010). Prior to adoption of IPSAS, LGAs implicitly used

International Financial Reporting Standards (IFRS) in preparing their financial reports from 2005. The Accountancy Professional Body in collaboration with the government decided to adopt IFRS wholesale in July 2004. However, the accrual basis of accounting has been in practice since 1997 when the government released Local Authorities Financial Memorandum No. 52 (CAG-T, 2009). The use of the accrual basis of accounting and adoption of IFRS then IPSAS makes information contained in financial reports of LGAs ideal for assessing their financial sustainability.

For quantitative analysis, the study uses financial performance reports which include LGAs' budget information. Data has been extracted from reports for five years (2008/09 – 2012/13). The time frame is influenced by data availability because the formula-based allocation system, which is a key component in reform execution, became comprehensively applied in 2006/07. The provision of one year is provided for such programme to be effective, which is why the data starts in 2008/09. This also corresponds with the year in which the usage of IPSAS in financial reporting became mandatory to LGAs. On the other hand, 2012/13 is the year with the most current data at the time this study began (2013). The reports have been obtained from the parent ministry, although for the last three years (2010/11-2012/13) have been available from the online database (http://lginf.pmoralg.go.tz/lginformation/monitor.php). Other information, such as the type of audit report LGAs received and council types (district, municipal or town council) have been extracted from Annual Audit reports issued by the National Audit Office. These reports are available online (http://www.nao.go.tz/?cat=34). In addition to financial information, the study used statistical data, such as population and distance, from the National Bureau of Statistics, available online from the website of the Bureau (http://www.nbs.go.tz/).

5.6 Choice of Indicators in Relation to Decentralisation

The study utilises financial indicators that best suit the intended objectives of measuring financial sustainability within the context of decentralisation. Specifically, the concern has been on budgetary and service solvency as these reflect long-term capacity of LGAs in providing public services. The two categories are considered appropriate in the decentralisation context, which aims to enhance horizontal equity, because this objective is long-term in nature (Beckett-Camarata, 2004). Becket-Camarata (2004) believes that it is suitable to evaluate the long-term fiscal behaviour of LGAs whenever assessing long-term impacts of fiscal condition. For this reason, cash solvency indicators are ignored because they reflect short-term fiscal behaviour. Similarly, indicators for long-term solvency are not considered because, as Ishemoi (2011) notes, debts make an insignificant contribution to LGA finances in Tanzania. The inclusion of indicators from the two groups, budgetary and service solvency, is based on the literature, and in some cases customised to suit analysis.

In addition to other indicators derived from the literature, this study considers resource requirements for providing the planned activities to be reflected in budgeted expenditure. Budgets always incorporate the short- and long-term targets of each LGA implemented on an annual basis. The use of budgets eliminates ambiguity in establishing a standard package of public services across LGAs. As Bahl et al. (1992) suggest, it is very difficult to establish a standard package because determinants like cost of services may differ, and the composition of service requirements is not always similar from one LGA to another. Thus budgeted expenditures provide a good proxy for the bundle of public services the council is determined to deliver, after considering both the preferences and requirements of the public and respective costs. This implies that if an LGA can raise sufficient finance to cover its budgeted expenditure, it is considered to be solvent enough to delivery public services as planned, holding other things (such as changes in price and service demand) constant. On the other hand, an LGA is considered to experience budget insolvency/difficulty if resources collected from all revenue sources are insufficient to cover its planned activities as reflected by budgeted expenditure.

The concept of using budgeted expenditure to assess budget solvency is similar to the definition of "resource requirement gap" used by Bahl et al. (1992) in assessing fiscal disparities. However, their resource requirement gap was expressed in per capita terms, while in this study the indicator for ex-ante surplus/deficit is expressed in ratio terms. The concept also matches the criteria used to measure financial difficulties in some previous studies (such as Lewis, 2003; Dollery and Crase, 2006). The exception is that these studies used only actual expenditure in establishing surplus/deficit, hence they could not capture the financial difficult that would have been dealt with by cutting down expenditure. Thus, the ex-ante surplus/deficit indicator is used in addition to indicators commonly used in previous studies. It is defined as $\mathrm{Y}i = \mathrm{OS}i + \mathrm{GR}i - \mathrm{BE}i$. Where $\mathrm{Y}i$

represents ex-ante surplus or deficit of the *i*th LGA, OS*i* represents total revenues collected from own sources by the *i*th LGA, GR*i* represents total grant received from central government by the *i*th LGA, and BE*i* represents total budgeted expenditure of the *i*th LGA. Hence, when expressed in ratio terms, an LGA is budgetary solvent when the outcome of total revenues (OS*i* + GR*i*) divided by budgeted total expenditures (BE*i*) is greater than or equal to 1.

5.6.1 Meaning Attached to Measurement Indicators Used

As discussed in the literature review, a number of indicators can be used to evaluate financial sustainability, but relevance and usefulness are the key criteria for inclusion in this study. Previous publications form a foundation for the identification of the indicators, and in some cases adjustments have been made to make them more useful for the purpose. Following extraction of information from financial performance reports and demographic data, a total of 22 indicators was established (see appendix B). Some of the indicators are used for evaluating the pattern of financial sustainability and others as explanatory variables of the variations in financial sustainability.

The first indicator is the total expenditure per person as a measure of the LGA's ability to provide service per person (Groves et al., 1981; Merrifield, 2000; Zhao, 2009). For example, Zhao (2009) used this indicator primarily for assessing disparities in service provision among Chinese provinces. It is a measure of service level solvency. Ceteris paribus, the higher the total expenditure per person, the better the ability to provide service and vice versa. In addition, as Dollery et al. (2006) indicate, lower expenditure per person may imply low quality of services offered. The indicator for expenditure needs per person has been used for distributing equalisation grants in local councils in the UK (Andrews et al., 2005). Considering the emphasis in fiscal decentralisation theory is on promoting horizontal equity, the indicator is aimed to assess any discrepancies in LGAs' ability to provide services to their citizens.

The second indicator is the central government grant per capita (Doamekpor 2007), which reflects the extent of central government support to LGAs. In central-local relations, the central government grant is used for equalising vertical (between central and local governments) and horizontal (between LGAs) fiscal imbalances. Thus the higher the value of this indicator, the better the financial sustainability position of an LGA. Arguably, this might be considered to be conflicting with the notion of discouraging LGAs' dependence on central government. In response, three distinct financial independence indicators have been included in the analysis.

The three financial independence indicators are own source revenues to total expenditure (Ritonga et al., 2012), own source revenues to recurrent expenditure, and total government grant to own source revenues. The first assesses the ability of an LGA to finance its expenditure from its own resources, the second to finance at least its own recurrent expenditures, and the third the comparability of its own revenues over the amount of grant disbursed to an LGA. For these indicators, the higher the independence level the better the financial sustainability of an LGA since it can dictate a large part of its expenditure from its own resources.

Another indicator is the total own source revenues per capita (Groves et al., 1981; Merrifield, 2000), which is used as a measure of the amount that an LGA raises per person. Ceteris paribus, the higher the value of this ratio, the better the financial sustainability of the LGA. An LGA which is capable of raising a higher amount per person is less likely to experience financial difficulty than an LGA that can only raise a smaller amount. Generally, in this study the indicator is used to assess revenue contribution of the people residing within the council area.

Own source collection effort, customised from Hy et al. (1993), has also been used as a measure of LGAs' efficiency in mobilising resources. The unmodified version of this indicator from Hy and colleagues used total taxable value versus the actual amount collected. However, given the limitations in establishing the total taxable value available to LGAs in Tanzania, the budgeted value replaces the total taxable value in the formula. The budgeted value provides the true picture of the amount that an LGA can realise, provided that the budgeting process is properly done. Nevertheless, Brodjonegoro and Martinez-Vazquez (2005) discourage the use of a budgeted estimate if it is for deciding grant allocations, because LGAs can manipulate the estimates. The indicator may suffer from a moral hazard problem whereby LGAs may lower enforcement and administration efforts or the tax rates or manipulate the tax base provided that such options exist. However, grant allocation in Tanzania still considers this indicator when LGAs are assessed if they have met minimum conditions, but its weight is minimal, at just ten points out of one hundred. The indicator is calculated based on the actual amount that an LGA has realised versus the budgeted amount. This variable assesses the extent of administration efforts exerted by LGAs in collecting their own revenue, based on their budget. Ceteris paribus, the higher the effort in resource mobilisation, the higher the likelihood of an LGA having better financial sustainability. The variable is also used as a control check over the soft budget constraint practices in LGAs. As the literature says (chapter 3), whenever there is higher dependence on central government grants, there is the danger of LGAs becoming careless in mobilising their own revenues unless sufficient control is incorporated in grant allocation.

Meanwhile population, population density and the council area in square kilometres have been used as a measure of council size. The use of population as an indicator of council size can also be seen in Doamekpor (2007) and Merrifield (2000). Population density has been applied in Merrifield (2000) and council area in Casal and Gomez (2011) and Merrifield (2000). These indicators are used as drivers of the level of services required within the council. Hence, the higher the population and/or population density, the higher the pressure associated with service demand. Similarly, the greater the council area, the greater the pressures on service demand. Nevertheless, council size can also have a positive impact in mobilising resources.

Venugopal and Yilmaz (2010) argue that, in Tanzania, LGAs experience a significant difference between the amount of central government grant allocated at the beginning of a budget period and the actual amount disbursed. Thus, the researcher established three new indicators to reflect the flow of government grants. These are established by comparing the actual amount disbursed versus the amount allocated for recurrent expenditure, development expenditure and the total intergovernmental grant. These indicators assess the predictability of the flow of the central government grant in each respective category, and they are expected to have a positive impact on the financial sustainability of LGAs.

Other indicators include total expenditure over total revenue (Ritonga, et al., 2012; Cohen et al., 2012; Dollery and Crase, 2006; Dollery and Murray, 2005) and total actual revenue over budgeted total expenditure as measures of budgetary solvency. The total actual expenditure to total actual revenue assesses the extent to which collected revenue has been consumed in financing expenditure. When revenue exceeds expenditure, the difference of the indicator from 1 is surplus, otherwise it is a deficit. Since LGAs may manipulate the pattern of their expenditure so as to avoid reporting deficit (Skidmore and Scoresone, 2011), the ratio is designed to measure the extent of surplus. From the financial management perspective, deficit in financial reports tends to attract audit queries that may consequently have an impact on the final audit report, so there are strong motives for LGAs to avoid it by restricting their expenditure pattern. Meanwhile the total revenue to budgeted expenditure is intended to assess whether the extent of revenues mobilised would be sufficient to cover the expenditures as planned.

Furthermore, council type, whether urban or rural; type of audit report, whether clean on not; and degree of wealth, whether the council comprises relatively poor or rich people, are involved in assessing the variations in financial sustainability. The council type is meant to check whether there is any relationships between financial sustainability and being urban or rural. The type of audit report is used to capture LGAs' financial management practices in assessing variations in financial sustainability. The wealth of the people is meant to assess whether the ability of the LGA to raise revenue differs, hence contributing to variations in financial sustainability. It also measures whether the two groups have the same capacity to provide the required level of public services, and the extent of government support provided to the two groups. LGAs comprising poor communities are likely to experience more financial difficulty if sufficient support is not provided, because their ability to raise their own revenue is likely to be low, while at the same time the level of service demand is likely to be high.

The study used the distance of the council from Dar es Salaam city, where many government offices are located, to assess whether distance matters in LGAs' financial sustainability. Lastly, the research includes three indicators which provide an overall picture of the way LGAs manage to implement their expenditure budgets. These are the total expenditure ratio, recurrent expenditure ratio and development expenditure ratio.

After establishing composite score of financial sustainability, the model for explanatory variables aims to discover whether financial sustainability is influenced by any of the following factors, and if so in which direction:

(i) The variation in poverty level of the people in LGAs, comprising a large population of poor people versus relatively well-off people
(ii) Council type, whether urban or rural
(iii) The variations in own source revenue collection
(iv) The variations in population size
(v) The variations in council size in square kilometres
(vi) The variations in population density
(vii) The variations in the flow of central government grant

(viii) The variations in the LGAs' distance from the region which forms the key point for financial decisions, Dar es Salaam

(ix) Adherence to financial management practices as reflected by the type of audit report attained (clean or unclean).

5.6.2 Standardisation of Measurement Indicators

Before undertaking the analysis, the financial indicators have been standardised as Rees (1995) recommends. Rees states that it is suitable to standardise financial indicators when analysing a large group of financial ratios so as to attain normality, and hence ensure valid conclusions. Similarly, as Ezzamel and Mar-Malinero (1990) stipulate, the raw values of financial ratios are unlikely to have a normal distribution. Thus, indicators used to establish financial sustainability composite scores have been normalised into a similar scale range so that they can have similar weighting in the aggregation process. Other indicators were standardised within their scale range, except for categorical variables, which maintained their values.

5.7 Data Analysis Tools

The study employed Data Envelopment Analysis (DEA) in aggregating financial indicators into composite financial sustainability scores, and regression analysis (panel data liner regression models and Tobit regression model) in identifying explanatory variables. These tools are explained in details in the following subsections.

5.7.1 Aggregating Measurement Indicators of Financial Sustainability

DEA is employed in aggregating financial measurement indicators to establish overall performance scores for financial sustainability. As Groves et al. (1981: p.9) point out, the process of measuring the financial condition of LGAs requires aggregating various pieces of information because "no single piece tells the whole story". The pieces of information include those which reflect cash solvency, budget solvency, long-term solvency and service-level solvency. The ACIR, for instance, established a financial trend monitoring system which involves identification of various factors which can be analysed, measured and organised, and hence evaluate the financial health of LGAs. The practice in academic studies is similar to the financial trend monitoring system, with the exception of the variety of aggregation methods. A number of studies, as discussed in chapter three, have attempted to establish models for evaluating the financial health of LGAs, mainly based on a scoring system after aggregating measurement indicators.

Some of the methods developed for assessing financial health (such as Dollery and Crase, 2006; Cabaleiro et al., 2012) were based upon the explicit distinction of financially healthy and non-financially health LGAs before analysis. The definitions have been derived from regulations governing financial matters of LGAs specific to the country involved in developing such models. This made it possible to use discriminant analysis to identify characteristics of financially poor LGAs as opposed to strong LGAs. However, the applicability of such models to other countries which have no clear definition of financial health is limited, especially when there are no specific requirements for evaluating the financial health of their LGAs. In such cases, the definition derived from the theoretical background becomes applicable, and different approaches have been used to aggregate financial measurement indicators into a comprehensive measurement index. Casal and Gomez (2012) used cluster analysis, while Cohen et al. (2012) used simulation/scenario analysis to aggregate financial indicators into ratings of LGAs' financial health.

Methods like the 10-point test developed by Kloha et al. (2005) and Brown (1993) can be applied in different contexts since they are not bound to the definition of financial health. Huang and Ho (2013), for instance, used Kloha's 10-point scale to establish an aggregate measure for evaluating 21 Taiwan LGAs. Nevertheless, their relevance depends on the availability of information that fits the measurement indicators' definitions. They are dependent on the way information is presented in financial reports. Moreover, the approach of Kloha et al. (2005) suffers from the problem of arbitrary weights/scales assigned to measurement indicators, because they were established by the authors' judgement. Meanwhile, the 10-point test of Brown (1993) suffers the limitations of using a historical benchmark which is likely to become obsolete with the passage of time and changes in LGAs' operating environment. In some cases, only one indicator (financial surplus/deficit) has been used to rank the financial health of LGAs, but this indicator did consider different variables of cost and revenue. Other examples include Lewis (2003), who used surplus/deficit derived from financial reports; Skidmore and Scorsone (2011), who used surplus/deficit derived from the LGA's service cost index and revenue index; and Krueathep (2010), who used an index derived from differences in revenue raising capacity and expenditure needs.

Thus, no unified technique dominates previous studies to measure the financial health of LGAs, despite the commonalities of the factors considered. The concern has been mainly to establish a score/ranking to compare LGAs with others before further analysis is done. In many studies, including the present one, establishing the ranking/score of LGAs' financial health is not the ultimate objective. It is simply an intermediate process towards analysis of either the factors influencing it (like Casal and Gomez, 2011; Cohen et al., 2012; and Huang and Ho, 2013) or the impact of financial difficulties (like Chamel, 2007; and Skidmore and Scorsone, 2011).

Evaluating the financial health of LGAs is similar to assessing any other type of organisational performance: it requires a benchmark as reference point. The benchmark in evaluating financial health can be the same organisation but at different periods of time, or a comparison with others, or professional standards promoted by regulatory bodies (Rivenbark et al., 2010). In Tanzania, however, there are no specific requirements or standards for LGAs or any other body to assess financial health, apart from the normal financial audit which evaluates the "going concern[10]" of LGAs. The only feasible benchmark in Tanzania is either trend analysis or comparison with others, or both. These two approaches match the objectives of this study and have therefore been adopted. The financial health of LGAs is assessed both relative to others and with reference to their own performance over time.

5.7.2 The Uses of DEA in Performance Evaluation

Data Envelopment Analysis is a non-parametric technique used to evaluate the relative performance of a set of organisations performing similar tasks and consuming multiple inputs to attain multiple outputs or goals (Feroz et al., 2003; Edirisinghe and Zhang, 2007). The approach analyses the organisation's technical efficiency based on predefined input and output indicators. Organisations involved in performance evaluation with the use of DEA are usually referred to as Decision Making Units (DMUs). The approach is very useful in evaluating efficiency of both private and public sector organisations (Ogawa and Tanashi, 2008). However, initially the technique was used in public sector organisations before being applied to the private sector. DEA is considered appropriate in the public sector because of its capacity to consider non-

[10] Financial accounting concept which requires Auditors to establish whether an organisation can operate in the foreseeable future without being in financial trouble

market priced outputs in evaluating performance (Smith, 1990). This is contrary to private sector organisations which aim to maximise the shareholder's wealth as their main objective; thus, as Smith (1990) notes, the performance measure of private sector organisations can be established based on their earnings. Moreover, public sector organisations usually have more than one objective and they use multiple inputs, making the approach more appropriate. As Halkos and Salamouris (2004: 204) point out "the technique's main advantage is that it can deal with the case of multiple inputs and outputs as well as factors, which are not controlled by individual management".

DEA measures relative efficiency of DMUs, the LGAs in this case, without requiring assumptions about the form of production functions. It is an alternative method to traditional ratio analysis that is dependent neither on pre-set weights nor on validation assumptions, as in traditional regression techniques (Emrouznejad and Cabanda, 2010). DEA uses linear programming to establish an efficient frontier based on best performers as a benchmark for other organisations being evaluated. The technique was developed by Charnes, Cooper and Rhodes in 1978. Their model computes the efficiency scores based on the fraction of the weighted sum of outputs to the weighted sum of inputs (i.e. Efficiency= $\frac{Weighted\ sum\ of\ outputs}{Weighted\ sum\ of\ inputs}$). Its objective function specifies variables that can be either maximised or minimised. Mathematically the formula for maximising the efficiency of a DMU, as provided by Charnes et al. (1978), is as follows:

Maximise $h_0 = \frac{\sum_{i=1}^{s} u_r y_{r0}}{\sum_{i=1}^{m} v_i x_{i0}}$

Subject to

$$\frac{\sum_{i=1}^{s} u_r y_{rj}}{\sum_{i=1}^{m} v_i x_{ij}} \leq 1, \quad j = 0, 1, 2, \ldots., n, ,$$

$$V_{i0} \geq 0, \quad i = 1, 2, \ldots., m, ,$$

$$U_{r0} \geq 0, \quad r = 1, 2, \ldots., s.$$

Where *n* is the number of homogeneous organisations to be evaluated, *m* is the number of input variables ($x_1 \ldots., x_m$), *s* is the number of output variables ($y_1 \ldots., y_s$), and *u* and *v* are the weighted values of input and output variables.

The approach is a commanding tool for multivariate ratio analysis in comparative studies. It can aggregate measurement indicators of different dimensions to establish the overall performance score of an organisation relative to best performers. Its applicability is not limited to the presence of physical inputs and outputs but can be extended to financial indicators (Edirisinghe and Zhang, 2007), making the technique applicable to the appraisal of both financial and non-financial performance. Financial variables are used as inputs and outputs in the DEA model in the absence of physical performance indicators. Since performance evaluation in the model is based on input minimisation and output maximisation, the most important aspect is identification of inputs and outputs before analysis. However, it is not always straightforward to identify whether an indicator is an input or an output; the option is to use undesirable indicators as inputs requiring minimisation and desirable indicators as outputs requiring maximisation (Smith, 2000; Morita and Avkiran, 2009). Nevertheless, the technique requires caution in the total number of measurement indicators involved in performance evaluation. When the number of indicators is larger than the number of organisations to be evaluated, the degree of freedom becomes higher in combining their weights; hence average efficiency scores becomes higher, and vice versa (Ogawa and Tananshi, 2008). The number of measurement indicators has to be balanced. In response to this, Nunamaker (1985) suggests the number of measurement indicators should not exceed one third of the total number of organisations involved in performance evaluation.

Several studies have used DEA to evaluate financial and non-financial performance both in private and public sector organisations. They include Cielen et al. (2004), who used DEA to establish a corporate failure prediction model through aggregating financial indicators of bankrupt and surviving organisations, and Halkos and Salamouris (2004), who used it to evaluate the efficiency of commercial banks in Greece through aggregating financial indicators. The findings of the latter suggest that DEA can either complement or be used as an alternative to traditional ratio analysis in performance evaluation. This concurs with the commendation of Nyhan and Martin (1999) on DEA's ability to eliminate problems of traditional ratio analysis, which cannot deal with a large number of input and output variables in establishing an overall comparative performance measure. Zafra-Gomez et al. (2010) applied DEA in analysing financial health of small suburban municipalities in Spain. Ogawa and Tanansh (2008) used it to evaluate the productive efficiency of LGAs in Japan, before running Tobit estimation in their second-stage analysis. Other studies include Nyhan and Martin (1999), who used DEA to evaluate service performance of municipal police; Thore et al. (1994), who applied DEA and a financial reports data set to evaluate the US computer industry; and Moore et al. (2005), who used it to establish a performance score for municipal services of the 46 largest US cities before using second-stage analysis to examine factors explaining their differences. Da Cruz and Marques (2014) used DEA to establish efficiency scores used as input in Tobit and OLS analysis in the course of identifying explanatory variables of municipal performance in Portugal. DEA is also used in Korea for assessing the financial health of its LGAs (Padovan and Scorsone, 2011) and in Japan for evaluating the performance of public organisations (Ogawa and Tanashi, 2008).

This study uses DEA as an aggregation technique for financial sustainability measurement indicators. These indicators reflect the financial performance indicators extracted from financial reports of LGAs, as explained in previous sections. It is used to establish an overall financial health performance index/score of LGAs that is then used as input in the second-stage analysis. Since identification of the inputs and outputs depends on the context in which the performance evaluation is made, input/output indicators are based on the context of equitable service provision in decentralisation settings. They have been identified on the basis of maximising an LGA’s service provision while simultaneously ensuring its financial solvency.

5.7.3 Independent Samples T-Test

In order to distinguish the financial sustainability positions of the two groups of LGAs which represent communities with different poverty levels, the researcher uses the independent samples t-test. The test is performed in addition to graphical visualisation on the trend of financial sustainability composite scores, in order to determine whether the means of the two groups are significantly different, in the same way as applied by Deno and Mehay (1987) and Faguet (2004). The comparison extends to individual indicators used in constructing a financial sustainability composite score so as to establish which group of LGAs performs better for each financial indicator. The t-test is undertaken before running regression analysis to identify explanatory variables of financial sustainability.

5.7.4 Regression Analysis

After aggregation of financial indicators into financial sustainability composite scores, the study uses pooled ordinary least squares regression and random effects regression model which is specific for panel data to identify explanatory variables of financial sustainability. Then the Breusch-Pagan Lagrange Multiplier test suggested by Torres-Reyna (2007) is used to crosscheck the suitability of the random effects model over a pooled linear regression model. Pooled OLS and random effects model are commonly used in the presence of time invariant independent varibles, but the later should work better than the first (Plumper and Troeger, 2004). The fixed effects regression model which is also applicable to panel data is considered irrelevant because some of the independent variables are time invariants (Plumper and Troeger, 2007).

The use of regression in identifying explanatory variables of financial sustainability is consistent with the experience drawn from previous studies in this area. Da Cruz and Marques (2014), for instance, used OLS and Tobit model to analyse explanatory variables of financial sustainability after establishing composite scores through DEA. Jones and Walker (2006, 2007) use regression to identify explanatory variables of financial conditions in Australian LGAs. Meanwhile, the use of tobit for second-stage analysis of DEA scores is recommended by Ji and Lee (2010). Skidmore and Scorsone (2011) also applied Tobit regression in conjunction with panel data regression models to analyse the impact of financial difficulties and various municipal expenditure categories. Other studies applying Tobit regression include Kwon (2012) and Moore et al. (2005).

The general formula for the panel data estimation model, as Green (2005, p.385) specifies, is as follows:

$$Y_{it} = X_{it}\beta + Z_i\alpha + \varepsilon_{it}$$

Where: *t =1,…, T and i =1,…, N*

Y_{it} is the dependent variable observed for individual i in time t.

X_{it} are the independent variables

$Z_i\alpha$ is unobserved individual specific effect

ε_{it} is the error term

Green (2005) continues that, in instances where the heterogeneity or fixed effect $Z_i\alpha$ contains a constant term Z_i for a set of individual or group-specific variables which are observable or unobservable, all are taken to be constant over time *t*. When Z_i is observed for all individuals, the entire model can be seen as an ordinary regression model that fits by least squares. On the other hand, the random effect model assumes individual specific effects are uncorrelated with independent variables while the fixed effect model assumes individual specific effects correlate with independent variables. Thus, the formula for fixed effect and random effect regression models can be summarised as follows:

$$Y_{it} = X_{it}\beta + \mu_i + \alpha_i + \varepsilon_{it}$$

Where: *t* =1,…, *T and i* =1,…, *N*

Y_{it} *is the dependent variable observed for individual i in time t.*

X_{it} *are independent variables*

μ_i *are the time-invariant independent variable; observed and cannot be estimated directly by the fixed effect model but can be estimated by the random effect model*

α_i *is the unobserved individual effect*

μ_{it} *is the error term*

Along with the random effects model which became preferable after running the Breusch-Pagan Lagrange Multiplier test, the Tobit model is used to crosscheck consistency of results because the dependent variable, the financial sustainability composite scores, is somehow censored. Tobin (1958) testifies that whenever the dependent variables contains observations representing maximum or minimum likelihood, least squares regression methods may become inappropriate. This is the case for the dependent variable, the financial sustainability composite scores have a maximum limit of one (1) and minimum limit of zero (0). The general Tobit regression model in which the dependent variable y is left censored at zero is presented in Greene (2005) and Henningsen (2010), as follows:

$$y_i^* = x_i'\beta + \varepsilon_i$$

$$y_i = \begin{cases} 0 \text{ if } y_i^* \leq 0 \\ y_i^* \text{ if } y_i^* > 0 \end{cases}$$

The generalised version of the formula for censored regression which incorporates either upper limit, lower limit or both is presented by Henningsen (2010) as follows:

$$y_i^* = x_i'\beta + \varepsilon_i$$

$$y_i = \begin{cases} a \; if y_i^* \leq a \\ y_i^* if \; a < \; y_i^* < b \\ b \; if \; y_i^* \geq b \end{cases}$$

Where: i = 1,...,N indicates the observation, y_i^* is an unobserved ("latent") variable

x_i is a vector of explanatory variables

β is a vector of unknown parameters, and ε_i is an disturbance term.

a is the lower limit and b is the upper limit of the dependent variable.

If $a = -\infty$ or b = ∞, then the dependent variable is neither left-censored nor right-censored, respectively.

In addition to estimating the explanatory variables of financial sustainability, the study uses regression to establish relationships between grant distribution and the poverty level in LGAs, and the level of effort in LGAs' own revenue collection. This is in response to the importance of grant allocation to consider poverty level in order to enhance horizontal equity in service access, and the need for decentralisation to discourage soft budget constraints. Both aspects are essential is establishing a sustainable fiscal system that promotes the fiscal health of LGAs.

Table 5.1: Summary of Stages Involved in Quantitative Financial Sustainability Analysis

Stage	Process/Analysis	Objective/rationale
1st	Extraction of financial information from financial performance reports and computation of financial indicators from extracted data	To obtain indicators for assessing financial sustainability
2nd	Standardising and running correlation test of variables	To establish normality and establish basis of controlling multicollinearity of the variables
3rd	Establishing financial sustainability composite scores	To assess comparative financial performance over time and in comparison to others

Stage	Process/Analysis	Objective/rationale
		To establish dependent variable for regression analysis
4th	Running independent T-test on composite scores and variables	To compare financial performance of LGAs with poor communities vs LGAs with well-off communities
5th	Running regression analysis	To establish explanatory variables of the variations in financial sustainability within decentralisation
6th	Running regression on grant distribution versus poverty level and revenue efforts	To assess whether grant distribution considers poverty level of the people and revenue collection efforts

Source: Author

5.8 The Use of Case Study Analysis

In accomplishing the second research objective, the study uses a case study approach to evaluate the impact of financial difficulties on LGAs' operations, mitigating strategies employed and corresponding challenges. It aims to establish emerging influences on achieving the overall decentralisation goal of improving public services. Case study analysis is a useful approach for an in-depth investigation of a contemporary phenomenon within the real-life context, particularly when there is no clear boundary between the incidence and the context (Yin, 2009). Moreover, the case study method is an effective way of identifying causes and effects of changes in the state of affairs, attached to policies to substantiate the validity of original claims related to the policy (Leo, 2009). For these reasons, and the context of the investigation, the use of case studies proves valuable.

The use of case study in financial sustainability studies is not a new approach, although infrequent. Studies using this approach include Krueathep (2010), Carmel (2008) and Nelson (2012). The approach has the advantage of involving wide sources of evidence to enquire into the reality of the issues being investigated (Leo, 2009). It may involve secondary sources, official documents, informal documentary sources such as personal letters, interviews and/conversations, participant observation as well as direct observation. As Leo (2009) notes, variety in the sources of information is very useful especially when the actions of power holders are among the issues being investigated; the power holders may be unable or unwilling to reveal an accurate account of their actions, especially if unfavourable outcomes result from such actions.

Nevertheless, despite its value, the case study approach faces one frequently and challenging question regarding the generalisation of its research findings. The question is considered to be relevant for establishing external validity of the findings. However, as Yin (2009) notes, although the findings of the case study are not generalisable to the population or the universe, they are of value when interpreted against theoretical propositions. Moreover, to enhance the validity of the findings it is considerably worthwhile to include more than one case in the analysis. Here, three case studies are involved in seeking answers to research objective two.

The use of case study faces another challenge which is related to the selection of evidence from the multiple sources that might be available. It is sometimes criticised because sources of evidence may not have been fairly selected, but rather are made on the basis of the researcher's bias. However, a systematic and critical approach to establishing validity curbs this challenge (Leo, 2009). This study is conducted systematically, especially in the selection of data sources, in order to reduce the identified problem. It involves interviews with council officials, in which the same instrument comprising the same set of questions is used to probe information.

5.8.1 Case Study Selection and Data Collection Process

As presented in earlier sections, the study involved three councils as case studies to accomplish the second research objective. The number of cases corresponds with the recommendation of Yin (2009), to include more than one case study in order to enhance the external validity of the outcome. The researcher picked cases after the initial quantitative analysis of financial sustainability carried out just before upgrading the study programme from MPhil to PhD. The initial analysis utilised a data set of three years (2010/11-2012/13), and the results showed that all 36 councils examined experienced financial difficulties in at least one of the three years. This was reflected by the inability of the LGAs to realise sufficient revenues to finance their annual expenditure according to their budgets. Based on the initial analysis, the researcher selected one case from top performers, one from the middle and one from the bottom, while simultaneously considering council status (district, municipal or town), council size (by population and geographical area), and income poverty level (at least one case from each of the two groups described in subsection 5.4).

The interview involves local government officials who are informative on the matter enquired into. As Vaismoradi et al. (2013) identify, qualitative research seeks to understand a particular phenomenon from the viewpoint of those experiencing it. The officials involved in this study range from the operating staff dealing with revenue mobilisation to decision-making staff involved in budgeting, execution and monitoring, and council governance. They included council treasurers, council planners/economists, councillors and operating staff from finance departments. The number of interviews conducted was five in the first case study, four in the second, and five in the third, all averaging one hour each. The knowledge obtained prior to the field visits from various guidelines on how to conduct a good interview equipped the researcher with the necessary skills to complete the task successfully. Consequently, the researcher managed to collect rich information from participants. Morse and Richards (2002) believe that good data is extracted carefully through recognising the interviewee's perspective, and to adhere with this, the researcher guided the participants to give their views with minimum interruptions. The interviewer probed with more questions as the participants responded.

5.8.2 Instrument Validity and Reliability

The design of the interview guide was made after the initial quantitative analysis described in the previous subsection (the interview guide is in appendix G). As Berg (2001) recommends, the researcher was aware of the nature and objectives of the study before designing the interview schedule. This facilitated inclusion of questions that probe deeper into the impact of financial difficulties, mitigating approaches and challenges to improving financial sustainability. Moreover, the background knowledge acquired through reviewing the literature enhanced the relevance and validity of the interview questions resulting in the acquisition of rich information. The supervisory team reviewed the instrument before field visit. We avoided closed-ended questions (Jacob and Ferguson, 2012), in order to avoid yes/no responses.

5.8.3 Ethical Considerations and Confidentiality

Before undertaking the fieldwork, ethical considerations and confidentiality were considered and adhered to throughout the research process. The researcher secured ethical approval from the University, and permission from the ministry in charge of LGAs, from the specific councils and from the participants themselves. Kaiser (2009) states that, whenever data collection cannot be anonymised, the researcher must process and report the data without compromising participants' identities. Accordingly, the confidentiality and anonymity of respondents was ensured, from data collection to handling the gathered information. Pseudonyms are used for councils and participants.

5.8.4 Interview Data Processing

Processing the qualitative data started by transcribing the recorded interviews, followed by annotation of the transcripts and then coding with the help of NVIVO software. The study employs thematic analysis in which themes were derived from previous literature corresponding with the topic and from issues that emerged in the course of the research process. These new themes emerged as the researcher became familiar with the data through interviewing, transcribing and his own interview notes. As DeSantis and Ugarriza (2000) iterate, thematic analysis involves the search for and identification of issues that unifies the nature or experiences from interview or set of interviews into a meaningful account. Thus, the coding of the interview transcripts is based on themes that provide meaningful interpretation regarding the experiences of local government officials on enquired matters.

Table 5.2: Summary of Processes Involved in Case Study Analysis and Reflection

Stage	Activity and reflection
1st	Designing interview guide and securing ethical approval
2nd	Securing access from the Ministry in charge of Local Government. The follow up process was challenging since the Ministry office is located at some distance (Dodoma) from the researcher's base (Dar es salaam). Thus, it took a month to secure permission, and this was after submitting another letter which introduced the researcher by the Institute to which he is affiliated.
3rd	Securing access from three specific local government authorities. The process went smoothly and took about two days for each case study.

Stage	Activity and reflection
4th	Interview arrangements with participants and conducting interviews. The exercise took place in August and September, just after the end of the financial year (July), so officials were busy preparing reports. This was a challenge, and as a result interview arrangements with participants had to be rescheduled in some instances.
5th	Transcribing recorded interviews; the process is time consuming and it took about three months to accomplish.
6th	Coding and analysing transcribed scripts using NVIVO software; this took about two months, especially as the process required learning new skills in using the software.
7th	Reporting the findings in the thesis.

Source: Author

5.9 Chapter Summary

This chapter presented the philosophical underpinning of the research design and the methodology used. The study uses pragmatism in seeking answers to research questions, in which the positivist and interpretivist paradigms are used concurrently. As Saunders et al. (2012) recommend, it is the nature of research questions explored which determines the use of mixed methods. In attempting the first research question, quantitative methods are sought because it involves assessing variation in financial sustainability and its relationship with explanatory factors. In contrast, a qualitative approach is employed in attempting the second research question because explored matters regarding the impact of financial difficulties and approaches used to mitigate require experience-based account of LGA officials. The chapter provides details of the sample and data used in quantitative analysis and case study selection. Details cover the financial indicators used in assessing financial sustainability, and the corresponding analytical tools, and explanations of the processes involved in collecting and analysing interview data from the three case studies.

The methodology employed facilitates the analysis of LGAs' financial sustainability in the context of decentralisation reforms. It fosters evaluation of the factors that contribute to variations in financial sustainability of LGAs in Tanzania with reference to the context. Also, it facilitates exploring the impacts of financial difficulties on LGAs' operations, how LGA officials strive to mitigate the difficulties and strengthen their financial sustainability, and the corresponding challenges. The approach chosen provides an additional avenue to the existing body of knowledge on evaluating decentralisation design and its implementation.

CHAPTER 6 : ANALYSIS OF LGAS' FINANCIAL SUSTAINABILITY

6.1 Introduction

This chapter presents the quantitative analysis and discusses the financial sustainability of LGAs in Tanzania with reference to decentralisation reforms. It starts by presenting details of the correlation test, followed by constructing the financial sustainability composite scores. These scores are used in assessing LGAs' performance over time and by comparing the two groups of LGAs through independent sample t-tests. After comparing performance, the financial sustainability scores are used as dependent variables in regression analysis aimed to identify explanatory variables. The regression analysis is followed by discussion of the results for the explanatory variables in relation to reform. Moreover, the chapter provides analysis and discussion of the relationship between the flow of government grants, poverty level and the extent of LGAs' revenue collection efforts, and it ends with a summary.

6.2 Correlation Test

As discussed in the methodology chapter, the analysis starts by establishing a total of twenty two (22) variables before undertaking the correlation test. Several indicators with the highest degree of correlation are not suitable to be included in evaluating the financial condition (Altman, 1968; Pedraja-Chaparro et al, 2005). Inclusion of these variables would imply that they are measuring the same thing, which is redundant and may cause distortions. Similarly, higher correlation between independent variables is a problem in regression analysis, posing the risk of obtaining coefficients with very high standard errors and low significance level, although the overall goodness of fit might be good (Greene, 2005; Walker and Jones, 2006). Also, the coefficients may take wrong signs and incorrect magnitudes which are likely to distort the inferences about the relationships between dependent and explanatory variables.

While Simkiss et al. (2011) and Grewal et al. (2004) consider the correlation between variables to be appropriate when it does not exceed 0.8, Tabachnick et al. (2001) consider to be appropriate when it does not exceed 0.7. Based on a 0.8 cut-off point, the correlation results in table 6.1 show 4 pairs of indicators with correlation values above the limit and which are significant at <1% p-value. The first is own source revenue per person and own sources to total expenditure, at 0.86, implying that the ability to raise revenue per person moves together and in the same direction with LGAs' ability to finance their total expenditure by 80.6%. The second pair is total expenditure per capita with actual government grant per capita, with a correlation value of 0.854. This implies that the ability to spend per person moves together and in the same direction with the amount of grant disbursed per person by 85.4%. Although correlation does not measure causality, the higher correlation does provide an indication of the extent of dependence on central government grants. The third pair is the own source revenue to recurrent expenditure with own source revenue to total expenditure, which correlates by 0.981. The fourth is budgeted transfer per capita, which correlates with actual transfer per capita by 83.7%; the correlation value of this pair provides an overview of discrepancy in grant disbursement per person. If the amount of grant disbursed matched the amount of grant allocated, then this pair would have a perfect correlation of 100%.

In addition there are other 6 pairs of variables which have slightly high correlation of between 0.6 and 0.8. The first is the ability to raise revenue per person with own source revenue to recurrent expenditure, which has a value of 0.768. This means the ability to raise revenues moves together and in the same direction with the ability of LGAs to finance their recurrent expenditure from own revenues by 76.8%. The second pair is the ability to raise revenue per person with population density, which has a correlation value of 0.628. The third is total expenditure per capita with budgeted grant per capita which correlates by 0.672. Thus, the ability to spend per person moves together and in the same direction with budget amount of grant per person by 67.2%. The fourth pair is government grant to own source revenues with own source revenues to total expenditure, which has a correlation value of -0.719; and the fifth is government grant to own source revenues with own source revenues to recurrent expenditure, with a correlation value of -0.739. This implies that the extent of financial dependence moves together with but in a different direction from the ability of the council to finance their total expenditure and recurrent expenditure by 71.9% and 73.9% respectively. The last pair is the actual government disbursement ratio with total revenue to budgeted expenditure which has a correlation value of 0.665, implying that the proportion of government grant disbursed moves together and in the same direction with the LGAs' ability to cover their budgeted expenditure from total mobilised revenues by 66.5%.

Table 6.1: Correlation Test

		ZOwnSourceRevs.ratio	ZActualTotalTransfersratio	ZOSpercapita	zGovt grnt/OS	ZSqKm	ZPoppersqkm	OSTTexp	OS/Rec Exp	ZPopulation	TTexpTTRev	zTTExppercapita	TotoRevBgtExp	ZTTtransferspercapita	ZBudTransPercapita	ZROADDISTANCE
ZOwnSourceRevs.ratio	Pearson Correlation	1	.242**	-.121	-.085	.152*	.025	-.059	-.049	-.059	.115	-.070	.177*	-.231**	-.324**	-.080
	Sig. (2-tailed)		.001	.106	.254	.042	.742	.435	.516	.433	.125	.347	.018	.002	.000	.287
	N	180	180	180	180	180	180	180	180	180	180	180	180	180	180	180
ZActualTotalTransfersratio	Pearson Correlation	.242**	1	-.026	.093	-.021	.083	-.079	-.085	-.079	.049	.148*	.665**	.050	-.439**	.015
	Sig. (2-tailed)	.001		.733	.213	.782	.267	.291	.259	.293	.514	.047	.000	.502	.000	.846
	N	180	180	180	180	180	180	180	180	180	180	180	180	180	180	180
ZOSpercapita	Pearson Correlation	-.121	-.026	1	-.592**	-.385**	.628**	.806**	.768**	-.084	-.015	.415**	-.042	.438**	.402**	-.120
	Sig. (2-tailed)	.106	.733		.000	.000	.000	.000	.000	.260	.845	.000	.575	.000	.000	.108
	N	180	180	180	180	180	180	180	180	180	180	180	180	180	180	180
zGovt grnt/OS	Pearson Correlation	-.085	.093	-.592**	1	.096	-.394**	-.719**	-.739**	-.102	-.044	.139	.097	.185*	.107	-.062
	Sig. (2-tailed)	.254	.213	.000		.199	.000	.000	.000	.175	.560	.062	.196	.013	.152	.410
	N	180	180	180	180	180	180	180	180	180	180	180	180	180	180	180
ZSqKm	Pearson Correlation	.152*	-.021	-.385**	.096	1	-.425**	-.269**	-.216**	.150*	.016	-.368**	-.038	-.316**	-.275**	.113
	Sig. (2-tailed)	.042	.782	.000	.199		.000	.000	.004	.045	.831	.000	.616	.000	.000	.131
	N	180	180	180	180	180	180	180	180	180	180	180	180	180	180	180
ZPoppersqkm	Pearson Correlation	.025	.083	.628**	-.394**	-.425**	1	.544**	.485**	-.099	.001	.237**	.092	.188*	.117	-.088
	Sig. (2-tailed)	.742	.267	.000	.000	.000		.000	.000	.187	.991	.001	.220	.012	.118	.238
	N	180	180	180	180	180	180	180	180	180	180	180	180	180	180	180
OSTTexp	Pearson Correlation	-.059	-.079	.806**	-.719**	-.269**	.544**	1	.981**	.113	-.147*	-.051	-.042	-.032	.034	-.039
	Sig. (2-tailed)	.435	.291	.000	.000	.000	.000		.000	.130	.050	.498	.578	.670	.653	.601
	N	180	180	180	180	180	180	180	180	180	180	180	180	180	180	180
OS/Rec Exp	Pearson Correlation	-.049	-.085	.768**	-.739**	-.216**	.485**	.981**	1	.120	-.098	-.079	-.070	-.088	-.016	-.010

		ZOwnSourceRevs.ratio	ZActualTotalTransfersratio	ZOSpercapita	zGovtgrnt/OS	ZSqKm	ZPoppersqkm	OSTTexp	OS/RecExp	ZPopulation	TTexpTTRev	zTTExppercapita	TotoRevBgtExp	ZTTtransferspacapita	ZBudTransPercapita	ZROADDISTANCE
	Sig. (2-tailed)	.516	.259	.000	.000	.004	.000	.000		.109	.191	.291	.348	.238	.836	.891
	N	180	180	180	180	180	180	180	180	180	180	180	180	180	180	180
ZPopulation	Pearson Correlation	-.059	-.079	-.084	-.102	.150*	-.099	.113	.120	1	.058	-.518**	-.157*	-.456**	-.395**	.338**
	Sig. (2-tailed)	.433	.293	.260	.175	.045	.187	.130	.109		.438	.000	.035	.000	.000	.000
	N	180	180	180	180	180	180	180	180	180	180	180	180	180	180	180
TTexpTTRev	Pearson Correlation	.115	.049	-.015	-.044	.016	.001	-.147*	-.098	.058	1	.208**	-.433**	-.115	-.132	.198**
	Sig. (2-tailed)	.125	.514	.845	.560	.831	.991	.050	.191	.438		.005	.000	.124	.078	.008
	N	180	180	180	180	180	180	180	180	180	180	180	180	180	180	180
zTTExppercapita	Pearson Correlation	-.070	.148*	.415**	.139	-.368**	.237**	-.051	-.079	-.518**	.208**	1	.099	.854**	.672**	-.256**
	Sig. (2-tailed)	.347	.047	.000	.062	.000	.001	.498	.291	.000	.005		.188	.000	.000	.001
	N	180	180	180	180	180	180	180	180	180	180	180	180	180	180	180
TotoRevBgtExp	Pearson Correlation	.177*	.665**	-.042	.097	-.038	.092	-.042	-.070	-.157*	-.433**	.099	1	.123	-.219**	-.103
	Sig. (2-tailed)	.018	.000	.575	.196	.616	.220	.578	.348	.035	.000	.188		.100	.003	.169
	N	180	180	180	180	180	180	180	180	180	180	180	180	180	180	180
ZTTtransferspacapita	Pearson Correlation	-.231**	.050	.438**	.185*	-.316**	.188*	-.032	-.088	-.456**	-.115	.854**	.123	1	.837**	-.278**
	Sig. (2-tailed)	.002	.502	.000	.013	.000	.012	.670	.238	.000	.124	.000	.100		.000	.000
	N	180	180	180	180	180	180	180	180	180	180	180	180	180	180	180
ZBudTransPercapita	Pearson Correlation	-.324**	-.439**	.402**	.107	-.275**	.117	.034	-.016	-.395**	-.132	.672**	-.219**	.837**	1	-.245**
	Sig. (2-tailed)	.000	.000	.000	.152	.000	.118	.653	.836	.000	.078	.000	.003	.000		.001
	N	180	180	180	180	180	180	180	180	180	180	180	180	180	180	180
ZROADDISTANCE	Pearson Correlation	-.080	.015	-.120	-.062	.113	-.088	-.039	-.010	.338**	.198**	-.256**	-.103	-.278**	-.245**	1
	Sig. (2-tailed)	.287	.846	.108	.410	.131	.238	.601	.891	.000	.008	.001	.169	.000	.001	
	N	180	180	180	180	180	180	180	180	180	180	180	180	180	180	180

Source: Author derived from analysis **. Correlation is significant at the 0.01 level (2-tailed). *. Correlation is significant at the 0.05 level (2-tailed).

6.3 Financial Sustainability Composite Score

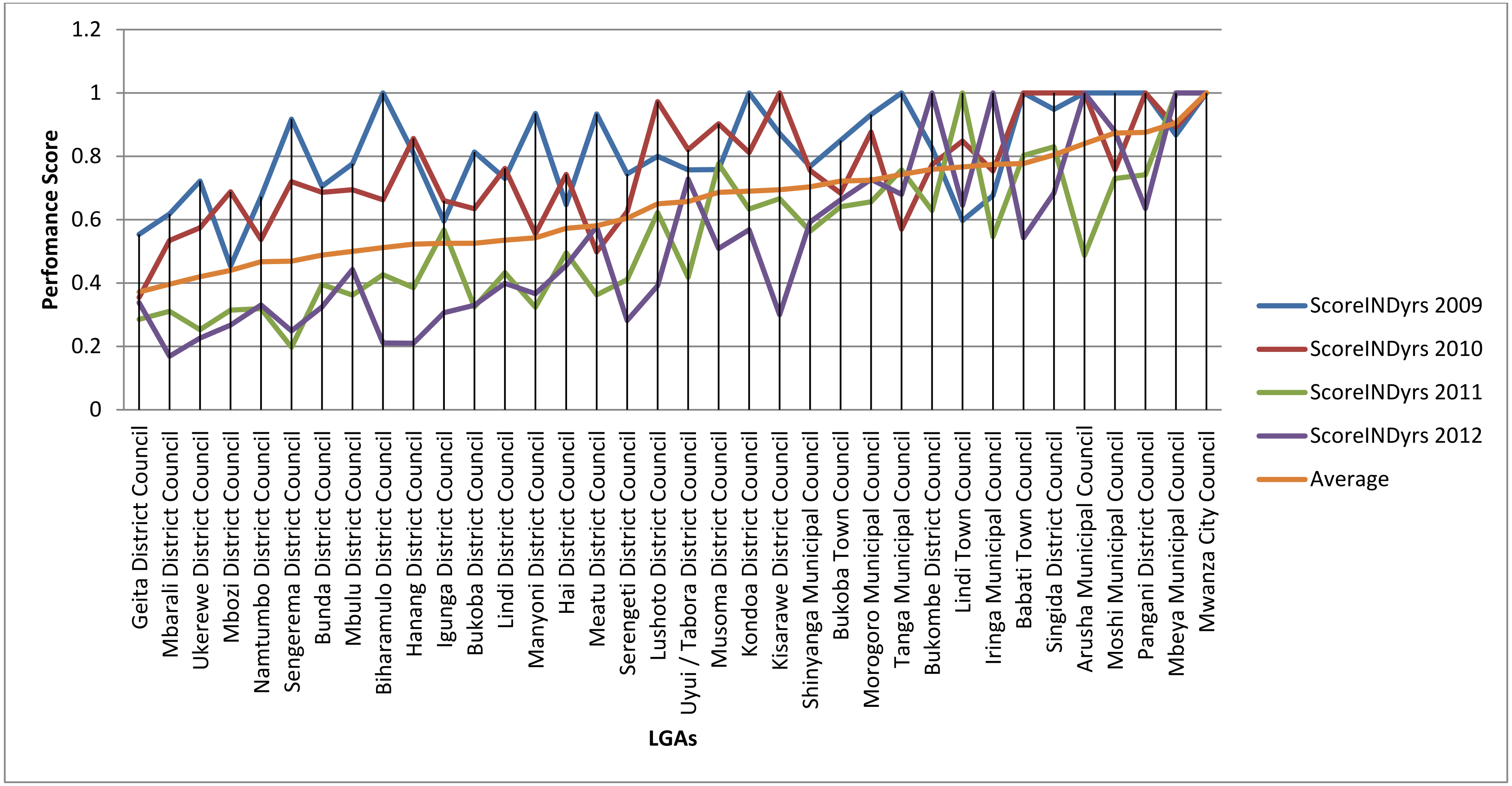
The study uses four indicators to construct the composite score of financial sustainability after correlation screening. These are total expenditure versus the total revenue realised by the LGAs, the amount of revenue realised versus the total budgeted expenditure, the total expenditure per capita and total government grant versus own source revenues. The first measures service-level solvency, the second and third measures budgetary solvency and the fourth measures financial independence. The number of indicators fits the recommendation of Nunanamaker (1985) regarding the usefulness of DEA, as explained in the methodology chapter. The number of indicators should not to exceed one third to the assessed organisations for effective DEA results. Thus, four is less than one third of the 36 LGAs involved. Before establishing the composite score, variables were normalised to bring them into the same scale range. The combination of indicators used to establish the composite score leads to a meaning of financial sustainability that translates as follows:

> An LGA is better off if it has relatively higher expenditure per person, relatively lower dependence on central government grant and relatively larger surplus without manipulating its planned expenditures in order to match collected revenues.

The meaning satisfies the main objective of analysing financial sustainability with reference to decentralisation reforms. Thus, the comparative performance of LGAs was analysed for each of the five years before establishing an average score for overall performance.

The results of the financial sustainability composite score, as presented in figure 6.1, indicate that the financial condition of individual LGAs fluctuates in a non-consistent pattern over time throughout the period of analysis, except for three LGAs. The three LGAs are Kondoa district, Babati Town council and Mwanza city council. The first two had declining trend and the third steady performance, which is also the best performance throughout the period of analysis. Thus, out of 36 LGAs only one has consistently performed better throughout the five year of analysis.

Figure 6.1: Variations in LGAs' Financial Sustainability Composite Score



Source: Author derived from analysis

However, the general observation on figure 6.1 shows that LGAs with lower financial sustainability have higher variations over time compared to those with higher performance. Based on components in the composite score, the variations in individual LGAs' financial sustainability suggests one of four implications, or any combination. First, individual LGAs have varying capacity to raise revenue compared to their expenditure need as reflected in their budgets, or the vice versa. Secondly, individual LGAs have varying capacity to offer service to their citizens. The third is that LGAs have varying dependence levels in financing their budgets, and the last is that LGAs have varying budgetary surplus.

6.3.1 Financial Sustainability of the Two Groups of LGAs: Independent Samples *t*-Test

Based on the graphical presentation of composite financial sustainability scores in figure 6.1, LGAs with relatively well-off communities seem to have better financial sustainability compared to the other group. Out of 19 LGAs comprising relatively poor communities, only six have an overall performance in the top half of the graph; the rest are in the bottom half (see appendix C for councils' poverty level status). In contrast, 12 LGAs out of 17 with relatively well-off communities have a performance score above average, and only five are in the bottom half of the graph. In order to establish whether there is any statistical significance in the differences between the two groups, the independent samples *t*-test is done.

Before undertaking the *t*-test, however, the data sets are checked if they meet the required assumptions of the *t*-test. Such assumptions include presence of independent samples, normal distribution of dependent variables in each group, and homogeneity of the variance between the two groups. Thus, the normality assumption for both groups, LGAs with poor communities and those with well-off communities were checked. The descriptive statistics presented in table 6.2 indicate financial performance scores are considerably normally distributed for each of the two groups. The respective values of skewness and kurtosis for a group of LGAs with well-off communities are -0.334 and -0.718 and for a group comprising a large proportion of poor people are 0.217 and -1.060. These are within the range of ±2 suggested by George and Marley (2010).

The results of Levene's test, presented in table 6.3, show that the assumption of homogeneity of variances holds. The test has a significance p-value of 0.341, which is above the acceptable level of 5%. Thus, it is appropriate to interpret the results of the independent *t*-test based on the “equal variances assumed”. The interpretation of the results of independent samples t-test is that there is significant difference in the mean score of the two groups of LGAs. The significance value in the t-test for equality of means is less than 1%. As shown in table 6.2, the mean score value for the group of LGAs with well-off communities is 0.718, which is higher than that of the other group, 0.575.

Table 6.2: Descriptive Statistics for Financial Sustainability Composite Score

				Statistic	Std. Error
Scores	LGAs with Relatively Well-off communities	Mean		0.71780	0.02385
		95% Confidence Interval for Mean	Lower Bound	0.670371	
			Upper Bound	0.765222	
		5% Trimmed Mean		0.727071	
		Median		0.729854	
		Variance		0.048	
		Std. Deviation		0.219873	
		Minimum		0.168913	
		Maximum		1.000000	
		Range		0.831087	
		Interquartile Range		0.348575	
		Skewness		-0.334	0.261
		Kurtosis		-0.718	0.517
	LGAs with Relatively Poor Communities	Mean		0.57465	0.02404
		95% Confidence Interval for Mean	Lower Bound	0.52693	
			Upper Bound	0.62238	
		5% Trimmed Mean		0.571095	
		Median		0.561770	
		Variance		0.055	
		Std. Deviation		0.234290	
		Minimum		0.196719	
		Maximum		1.000000	
		Range		0.803281	
		Interquartile Range		0.403447	
		Skewness		0.217	0.247
		Kurtosis		-1.060	0.490

Source: Author derived from analysis

Table 6.3: Independent Samples t-Test - Financial Sustainability Score

		Levene's Test for Equality of Variances		t-test for Equality of Means			
		F	Sig.	Sig. (2-tailed)	Mean		Mean Difference
					Rich	Poor	
Score	Equal variances assumed	0.910	0.341	0.000	0.71780	0.57465	0.14315
	Equal variances not assumed			0.000	0.71780	0.57465	0.14315

Source: Author derived from analysis

6.3.2 Independent Samples T-Test on Indicators of Financial Sustainability

The two groups of LGAs are further analysed based on financial indicators making up the composite scores in addition to comparison made on financial sustainability composite scores. This is to gain further insight into which group performs better in each of the financial indicators making up the composite scores. Thus, the researcher performs independent samples *t*-tests for each variable; the results are presented in table 6.4.

The first indicator is total expenditure per person, which assesses the ability to offer services. The independent samples t-test for this variable indicates that there is significant difference in the average amount spent per person by the two groups of LGAs. LGAs with well-off communities have higher average expenditure per person than their counterparts. The average normalised expenditure per person (on a scale of 0 to 1) is 0.463 for LGAs with well-off communities and 0.334 for LGAs with poor communities. This implies that the former have a higher capacity to spend per person in service provision than the latter. Also, Levene’s test signifies that the variation is statistically significant since its p-value is less than 1%.

The second variable is total expenditure over total revenues, which assesses budgetary solvency. The difference of this variable from 1 indicates either surplus if it is positive or operating deficit if it is negative. The result of the t-test shows that there is no statistical difference in their level of operating surplus despite a slight difference in their mean values. On average, LGAs with well-off communities consumed 79.3% of their revenue while the other groups consumed 82.2%, but the p-value is 0.139 which is not significant. Thus, the difference in their level of ex-post operating surplus is not statistically evident.

Table 6.4: Independent Samples T-Test - Indicators Making Up Composite Score

		Levene's Test for Equality of Variances		t-test for Equality of Means			
		F	Sig.	Sig. (2-tailed)	Mean		Mean Difference
					Rich	Poor	
Total Expenditure per capita (normalised)	Equal variances assumed	1.283	0.259	.000	0.463	0.334	0.129
	Equal variances not assumed			.000	0.463	0.334	0.129
Total Expenditure to total Revenues	Equal variances assumed	0.224	0.637	0.139	0.793	0.822	-0.029
	Equal variances not assumed			0.138	0.793	0.822	-0.029
Total Revenue to Budgeted Expenditure	Equal variances assumed	1.508	0.221	0.499	0.996	0.970	0.026
	Equal variances not assumed			0.505	0.996	0.970	0.026
Total Government grant to Total Own Source Revenue (normalised)	Equal variances assumed	0.14	0.709	.000	0.2295	0.364	-0.1345
	Equal variances not assumed			.000	0.2295	0.364	-0.1345

Source: Author derived from analysis

The third indicator used to establish an overall performance score is total actual revenues mobilised over budgeted total expenditures. The results of independent samples t-test in table 6.4 shows that there are no statistically significant differences in the proportion of revenues raised compared to their budgeted expenditures. LGAs with well-off communities seem to have a higher proportion of actual revenue to budgeted expenditure (0.996 versus 0.970) but the p-value is insignificant (0.449). This implies that the difference happened by chance, because the Lavene's test p-value as shown in table 6.4 is above 5%. The interpretation is that, on average both groups of LGAs could not manage to raise sufficient revenue to cover their budgeted expenditure. This implies that LGAs have to adjust their expenditure to fit revenue raised. Despite both groups of

LGAs having an operating surplus on their actual performance (ex-post), they experienced a slight ex-ante budgetary deficit.

The fourth indicator is government grant to own source revenues, which is used as an indicator of financial independence. The analysis on this indicator shows LGAs with well-off communities are less dependent on central government grants than those with poor communities. As shown in table 6.4, the average dependence ratio on central government grants is 0.2295 for the first group and 0.3640 for the latter. The p-value in Lavene's test is less than 1% which implies that the difference between the two groups is statistically evident. The interpretation is that LGAs with relatively poor communities are heavily dependent on government grants, despite having lower expenditure per person.

6.4 Analysis of Explanatory Variables of Financial Sustainability

The following analysis of the way financial sustainability varies among LGAs examines variables which provide explanations for the variation. Knowing how the financial sustainability varies between LGAs provides less information for those who wish to know the reasons. Also, it does not show its relationship with variables that are related to the design and implementation of decentralisation reforms. Thus, this section examines factors that are likely to explain the reasons for variation, while simultaneously referring to decentralisation reforms. In this analysis, the composite financial sustainability score becomes the dependent variable, and other variables, identified according to the literature and relevance to the study, are involved as independent variables.

6.4.1 Regression Analysis and Results

As explained in the methodology chapter, subsection 5.7.4, the regression analysis on explanatory variables of financial sustainability utilises pooling regression model and the random effects regression model. The explanatory variables in both models, pooling OLS and random effects model, have similar signs but they slightly differ in terms of magnitude (see table 6.6). Thus, the Breusch-Pagan Lagrange Multiplier test helped in choosing the more appropriate model out of these two options. The results of this test, shown in table 6.5, indicate a significant p-value of 0.02876. The test rejects the null hypothesis that there is no panel effect, hence random effect is preferred. This corresponds with Plumper and Troeger's (2004) argument that in the presence of time invariant independent varibles, the random effects model should work better than pooled OLS. As explained in the methodology, the study employs Tobit regression model along with the random effects model for crosschecking the consistency of the estimated results.

Table 6.5: The Breusch-Pagan Lagrange Multiplier Test

Breusch-Pagan Lagrange Multiplier: Testing the Presence of Random Effects in panel (Pooling Least Squares regression Vs Random Effects Regression Model)
p-value = 0.02876 chisq = 4.7816, df = 1, p-value = 0.02876
Alternative hypothesis: significant effects

Source: Author derived from analysis

Validation tests, such as residual plot, serial correlation and heteroscedasticity tests show that the model is robust. The visualisation of the residual plot shows that the normality assumption is not violated, while the result of the Breusch-Pagan test indicates an insignificant p-value of 0.2412 which implies that there is no heteroscedasticity. Similarly, the result of the Breusch-Godfrey test indicates an insignificant p-value of 0.214 which implies that there is no serial correlation in the model. The variables in the estimated model are considered exogenous because the dependent variable is just an aggregation of four different indicators. On the other hand, multicollinearity has been controlled from the initial stage of analysis by examining correlation values among variables. All variables in the final model have a correlation of less than 0.6. Also, as presented in table 6.6, the result of the random effects model corresponds with that of the Tobit regression.

The final model identifies five significant variables out of six with p-values of less than 5%. The first is the level of richness of the people living in LGAs, i.e. whether an LGA comprises relatively well-off communities or not. Others are population size, the council size in square kilometres, variations in the flow of central government grants and the type of audit report. However, the model has r-square of only 34.89% which leaves part of the variations in financial sustainability unexplained. The results indicate that the efforts in own source revenue collection has no influence on variations in financial sustainability among LGAs. The discussion of explanatory variables and their implications for decentralisation follow in the next subsection.

Table 6.6 Results of Regression Analysis

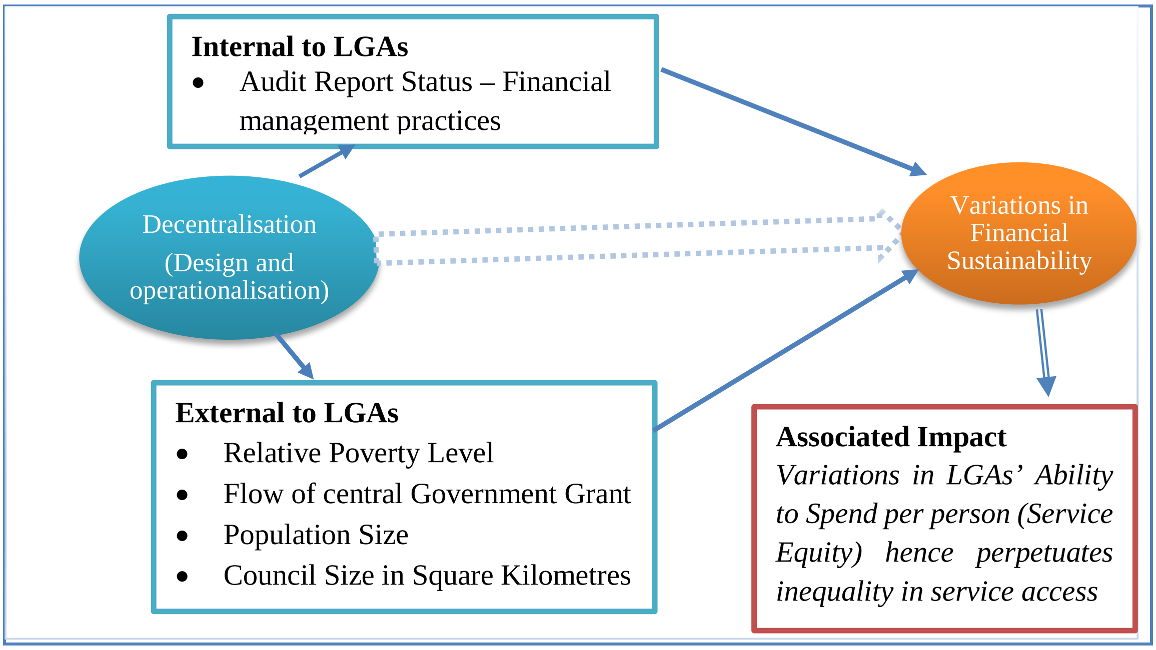
	Pooled OLS		Random Effects Regression Model		Tobit Regression Model (Censored Regression)	
	Coefficients	Pr(>|t|)	Coefficients	Pr(>|t|)	Coefficients	Pr(>t)
(Intercept)	0.565451	< 2.2e-16***	0.581639	< 2.2e-16 ***	0.55324	< 2e-16 ***
Richness	-0.076262	0.015918 *	-0.07661	0.012992 *	-0.08897	0.015497 *
ZActual TotalTransfers ratio	0.079239	3.13E-07 ***	0.076513	6.34E-07 ***	0.09097	2.07E-06 ***
ZPopulation	-0.066025	1.81E-05 ***	-0.064528	1.42E-05 ***	-0.07223	1.75E-05 ***
ZSqKm	-0.051916	0.001177 **	-0.051332	0.001193 **	-0.05718	0.000459 **
ZOwn Source Revenue ratio	0.024251	0.11332	0.017768	0.248123	0.02223	0.214398
Auditreport	0.086346	0.00592 **	0.07454	0.015114 *	0.1127	0.001303 **
	R-Squared: 0.37414 Adj. R-Squared: 0.35959 F-statistic: 17.2363 on 6 and 173 DF, p-value: 1.4001e-15		R-Squared: 0.36299, Adjusted R-Squared: 0.34888 F-statistic: 16.4305 on 6 and 173 DF, p-value: 6.0747e-15		Right censored observations are 25 out of 180 Log-likelihood: -5.103795 on 8 Df	

Source: Author derived from analysis

6.4.2 Discussion of the Results: Explanatory Variables of Financial Sustainability

In line with the literature reviewed in chapter three, the observed explanatory variables of financial sustainability can be classified as internal or external to LGAs. The results identify one internal and four external factors that contribute to variations in the financial sustainability of LGAs in Tanzania. The internal factor is the audit report status, which represents financial management practices; and the external factors are relative poverty level, the flow of central government grants, population size, and council size in square kilometres. The classification is summarised in figure 6.2, while the discussion of these factors follows in next subsections.

Figure 6.2: Explanatory Factors of LGAs' Financial Sustainability in Tanzania



Source: Author derived from analysis

6.4.2.1 The Influence of Financial Management Practices on Financial Sustainability

The results show that the type of audit report, which reflects financial management practices, contributes negatively to variations in financial sustainability. Contrary to the literature in chapter three, which postulates that sound financial management enhances financial sustainability, LGAs with unclean audit reports seem to have stronger financial sustainability than those with clean reports. The interpretation of this suggests that enhancement of financial sustainability is made at the expense of financial management practices. Albeit that the type of external audit report being input are to assess minimum conditions for grant allocations, this seems insufficient to discourage malfunction in financial management practices. Usually before receiving grant allocations, LGAs are assessed by independent consultant teams based on a number of indicators, of which the type of audit report is one (URT, 2008).

Moreover, along with internal and external auditing, the government introduced a computerised management information system in 2002 in order to improve the planning process and financial management of local government. However, the existence of malpractice in LGAs' financial management, as reflected in the regression results, suggests that all such controls embedded in the decentralisation set-ups are either insufficient or ineffective. The interpretation is that LGAs override financial management procedures in the course of maximising their financial sustainability position. In confirmation of this, the number of LGAs which have been receiving unclean audit reports provides additional evidence. For instance, about 36% of the 180 LGA financial reports (36 LGAs for 5 years) had unclean audit report status. Similarly, the average number of councils with unclean reports for the whole country (133 LGAs) over the five years is 36.54%. The findings support Tsui's (2005) claim which states that LGAs can use devious means to enhance their fiscal position whenever possible.

6.4.2.2 The Influence of Relative Poverty Level on Financial Sustainability

The results of regression analysis shown in table 6.6 indicate that the difference in poverty level of the people within LGAs contributes to variations in financial sustainability. LGAs comprising a large proportion of poor people are more likely to have lower financial sustainability scores. Similarly, the analysis of independent samples t-test, in table 6.4, shows that councils with a large proportion of poor people also have lower average expenditure per person. Since fiscal decentralisation advocates horizontal equity, it is expected that LGAs with poor ability should receive favourable consideration in grant distribution. The evidence from Jurado et al. (2015) indicates that expenditure in public services significantly reduces inequality and the poverty level. Since councils which comprises a large proportion of poor people have lower financial sustainability, their ability to sustain service provision is also limited. Hence, the fiscal decentralisation system in Tanzania does not seem to offer the prospect of discouraging horizontal imbalance in service access.

6.4.2.3 The Flow in Central Government Grants and Financial Sustainability

Another factor identified as contributing to variations in financial sustainability is the subsequent release of the grants versus the amount promised at the beginning of financial year. The results show that variation in the flow of central government grants contributes positively to the variations in financial sustainability, implying that those LGAs which received a higher ratio of what had previously been allocated have higher financial sustainability. It seems unfair for some LGAs to receive a smaller proportion of what has been allocated than do others, as this is likely to perpetuate the variations in financial sustainability. As Skidmore and Scoresone (2011) say, decline in revenue share from top level (state/central government) affects underlying financial health at the lower level.

The tendency of attaching allocated grants to specific projects or sector expenditure seems to contribute to variations in grant release. Shah (2004) states that it is better for decentralisation to distribute central government grants through formulae rather than through projects. However, despite the country's use of formulae, the allocation of central government grants for recurrent and development expenditures gives priority to five sectors: health, education, water, agriculture and infrastructure. Thus, whenever the central government experiences difficulty in meeting its promise for each sector, the actual release vary from one LGA to another depending with how much each LGA had budgeted for each sector, resulting in variations in financial sustainability. Furthermore, Allers and Ishomoi (2011a) have questioned even the ability of formulae to offer equitable expenditure to LGAs.

6.4.2.4 The Influence of Council Size on Financial Sustainability

The results of quantitative analysis identify that council size in square kilometres has a negative relationship with variations in financial sustainability. There has been sufficient literature documenting the impact of geographical location on municipal financial capacity (Andrews et al., 2005). The results suggest that those LGAs which have larger areas are more likely to experience financial sustainability difficulties. This means that as the council size increases, the LGAs' ability to discharge their entrusted functions declines. This outcome is congruent with the study of Casal and Gomez (2011) who found geographical size to have a negative influence on financial condition. Despite the formula for grant allocation in Tanzania to incorporate council size (Allers and Ishemoi, 2011), it is not enough to have a positive influence on the financial sustainability of LGAs.

6.4.2.5 The Influence of Population Size on Financial Sustainability

Population size has a negative relationship with the level of financial sustainability. This implies that, as population size increases, the ability of the council to sustain service provision declines. Therefore, those councils with relatively large populations are more likely to experience lower financial sustainability difficulties. Surprisingly, population size is one of the criteria used in the allocation of the central government grants in Tanzania (Allers and Ishemoi, 2011a). In this case, LGAs with relatively large populations would be expected to receive sufficient central government grants to sustain service provision, and to generate sufficient revenue from their internal sources, given that the population constitutes the tax base. Casal and Gomez (2014), for instance, found a positive relationship between population and budgetary solvency in Spain, because the law recognises population size in determining the level of services. However, based on our results, we can argue that the impact of population size on service demand is higher than its corresponding impact on revenue generation.

6.4.2.6 Own Source Collection Efforts and Financial Sustainability

The results of regression analysis show that efforts in own source revenue collection have no influence on variations in financial sustainability. These results are contrary to the findings of Casal and Gomez (2014), which indicate that tax collection effort is capable of providing an early warning sign of the financial condition of municipalities. Thus, our findings suggest that the level of effort offered by LGAs makes no difference to their financial sustainability.

6.5 Relationship between Government Grant, Poverty Level and Revenue Efforts

The results of the independent samples t-test, described in section 6.3, have shown that LGAs with poorer communities have lower expenditure per person. The question arises as to whether grant allocation from the central government considers poverty level of the people, as claimed. Further to this, the results of the correlation test indicate that expenditure per person and grant per person move together and in the same direction by 85.4%. It is imperative for grant distribution to consider the level of poverty, because this would help to enhance horizontal equity in service access. Along with this, it is essential for grant distribution to discourage complacency in LGA budgetary responsibilities for the better fiscal performance of the whole country (Hy et al., 1993).

Thus, the analysis also aims to identify whether grant allocation discourages soft budget practices in terms of revenue collection.

To examine these two issues, we performed regression analysis on two models. The first uses grant allocation per person as dependent variable and the second uses actual disbursed grant per person. Both models use revenue collection efforts and income poverty level of the people as explanatory variables. In addition, we use population, council size in square kilometres, and the type of audit report obtained in the previous year as control variables. The aim in involving two models is to assess if the explanatory variables have a similar influence on both the amount allocated at the beginning of the year and the actual grants disbursed. This reflects Plekhanov's (2005) and Bahl's (2000) propositions, that central government may transfer the fiscal burden to local government whenever it experiences financial difficulties. Consequently, the meaning attached to grant allocations can be altered during disbursement. Similarly, Keefer and Khemani (2005) state that expenditures aimed to benefit the poor can be deliberately diverted by policy makers for political motives, especially when there is weak democracy. In this regard, it is important to analyse both grant allocations and actual releases concurrently, to identify if there is consistency in grant allocation decisions.

The analysis employs two regression models which can also incorporate time-invariant independent variables in a panel data. These are pooling ordinary least squares and the random effects regression model. Then, the study uses the Breusch Pagan Lagrange Multiplier test to identify the more suitable model. The test results shown in table 6.7 identify preference for the random effects model, for both the analysis of allocated grants and the analysis of actual disbursed grants. Nevertheless, the two models differ in terms of significance level of the variables and their r-square values.

Table 6.7: The Breusch-Pagan Lagrange Multiplier Test

Allocated Grant	Disbursed Grant
p-value= 0.0001379 chisq =14.53, df= 1	p-value = 5.099e-08 chisq =29.679, df = 1
Alternative hypothesis: significant effects	

Source: Author derived from analysis

The model for allocated grant per person, as presented in table 6.8, has the adjusted r-square value of 0.31599 and four significant variables at a p-value of less than 5%. The significant variables are weatlh of the people within a council, own source revenue collection efforts, population, and council size in square kilometres. In contrast, the type of audit report attained by the council in the previous financial year, whether clean or not, is not statistically significant. Similarly, the model for actual grant disbursement per person in table 6.9, has four significant variables at the p-value of less than 5% and adjusted r-square of 0.36512. The significant variables are the same as those in the first model, which are wealth of the people within the council, own source revenue collection efforts, population, and council size. The type of audit report received by the council in the previous financial year is also statistically insignificant.

The results of both models show that the amount of grant per person is negatively related to the poverty level of the people in the councils. This implies that LGAs with a larger proportion of people living below the income poverty line have been receiving less financial support per person from central government, from allocation to disbursement.

Table 6.8 Allocated Grant Per Capita

	Pooled OLS		Random effects model	
	Coefficients	Pr(>|t|)	Coefficients	Pr(>|t|)
(Intercept)	0.14941	0.47812	0.107235	0.623383
Richness	-0.31972	0.01928*	-0.28573	0.005635**
ZOwnSourceRevs.ratio	-0.34501	2.22E-07***	-0.25721	2.30E-05***
ZPopulation	-0.37814	2.07E-08***	-0.38799	1.97E-10***
ZSqKm	-0.11036	0.10721	-0.12439	0.006691**
PrevAuditreport	0.013974	0.91471	0.031494	0.794599
	R-Squared: 0.32631 Adj. R-Squared: 0.31543 F-statistic: 16.8555 on 5 and 174 DF, p-value: 1.43E-13		R-Squared: 0.32689 Adj. R-Squared: 0.31599 F-statistic: 16.9 on 5 and 174 DF, p-value: 1.33E-13	

Signif. Codes: 0 ‘***’ 0.001 ‘**’ 0.01 ‘*’ 0.05 ‘.’ 0.1 ‘ ’ 1
* Indicates significance at the 95 percent confidence level for a two-tailed test.
** Indicates significance at the 99 percent confidence level for a two-tailed test.
*** Indicates significance at the 99.9 percent confidence level for a two-tailed test.

Heteroscedasticity and Serial Correlation consistent Random Effects Models

Source: Author derived from analysis

Table 6.9 Actual Disbursed Grant Per Capita

	Pooled OLS		Random effects model	
	Coefficients	Pr(>|t|)	Coefficients	Pr(>|t|)
(Intercept)	0.122724	0.555606	-0.00915	0.963858
Richness	-0.31535	0.019578*	-0.24449	0.042392*
ZOwnSourceRevs.ratio	-0.24795	0.000127***	-0.13539	0.026406*
ZPopulation	-0.42708	2.58E-10***	-0.42858	1.51E-12***
ZSqKm	-0.15942	0.019107*	-0.19515	0.001908**
PrevAuditreport	0.031598	0.806515	0.099895	0.389544
	R-Squared: 0.3413 Adj. R-Squared: 0.32994 F-statistic: 18.0327 on 5 and 174 DF, p-value: 2.16E-14		R-Squared: 0.37771 Adj. R-Squared: 0.36512 F-statistic: 21.1221 on 5 and 174 DF, p-value: < 2.22E-16	
Signif. Codes: 0 ‘***’ 0.001 ‘**’ 0.01 ‘*’ 0.05 ‘.’ 0.1 ‘ ’ 1 * Indicates significance at the 95 percent confidence level for a two-tailed test. ** Indicates significance at the 99 percent confidence level for a two-tailed test. *** Indicates significance at the 99.9 percent confidence level for a two-tailed test.				

Heteroscedasticity and Serial Correlation consistent Random Effects Models

Source: Author derived from analysis

However, the coefficient of wealth indicator for the actual grant model (-0.24449) is slightly lower than that of the allocated grant model (-0.28573). The implication is that the impact of less support per person to LGAs with relatively poor people is slightly reduced in the actual grant per person model than in grant allocations. Along with these results, the independent samples T-test results in table 6.10 show that, on average, LGAs comprising relatively poor people have lower revenue raising capacity per person than their counterparts. Therefore, LGAs with a large proportion of poor people are not only marginalised by the grant allocation system, but also have lower average ability to raise own revenue per person. In this regard, the danger of enhancing inequity in LGAs' ability to offer services to their citizens becomes high. It is contrary to the fiscal decentralisation theory, which emphasises grant allocation to motivate horizontal balance. The findings are in line with limitations of the grant allocation system identified by Allers and Ishemoi (2011a), who identified that the grant allocation formula is based on expert opinion rather than on research, and that some grants which are allocated through ministerial subventions are subjected to the influence of politicians.

Table 6.10: Independent Samples t-Test for Own Source Revenue Per Capita

		Levene's Test for Equality of Variances		t-test for Equality of Means			
		F	Sig.	Sig. (2-tailed)	Mean		Mean Difference
					Rich	Poor	
Own source revenues per capita	Equal variances assumed	94.69	.000	.000	7132.87	2892.15	4240.72
	Equal variances not assumed			.000	7132.87	2892.15	4240.72

Source: Author derived from analysis

The results of both models show that there is a significant negative relationship between the amount of grant per person, and the level of own source revenue collection efforts. This implies that LGAs which have been exerting less effort in revenue collection were still receiving large grant allocations and disbursements. Therefore, grant allocations and disbursements do not discourage complacency in own source revenue mobilisation. The design and operationalisation of the intergovernmental grant system seems to lack sufficient control to discourage soft budget constraint practices in LGAs. This poses the danger of LGAs always depending on central government transfer, which is not good for the long-term sustainability of the fiscal system of the whole country. DeMello (2000) and Roden (2002) state that LGA officials consider intergovernmental transfers differently from their own source revenues. This makes LGAs feel that their expenditure is financed by non-residents, which may escalate their overspending behaviour. Thus, if the system does not discourage soft budget practices in LGAs, even the spending of money may deviate from the interest of the community served.

For decentralisation to succeed, imposing fiscal discipline on subnational governments is a crucial prerequisite (DeMello, 2000; Shah, 2004). The country has three main controls which are supposed to offer protection over the financial performance of LGAs. These are external audit undertaken by the Controller and Auditor General- Tanzania (CAG-T), council *baraza* comprising councillors, and the annual assessment for minimum conditions undertaken by an independent team of consultants. The council *baraza* is LGA's specific oversight body that functions simultaneously with council operations. The annual assessment for minimum conditions is the only control which is specifically for allocating the development grant for the forthcoming year, although it incorporates the external auditing outcome. The assessment evaluates the LGAs' own source revenue mobilisation capacity based on the previous year's performance. The guiding manual (URT, 2008) for the assessment states that revenue mobilisation is assessed by actual collection percentage versus budgeted amount and the comparative trend against the previous year. If actual collection against budget is 80% or more, 5 points are scored, if 50-79% the score is 3, and below 50% is 0. If collection exceeded the preceding year by 30% or more, 5 points are scored, 10-29% scores 3 and below 10 is 0. The presence of soft budget practices as identified in the models suggests that the assessment for minimum conditions is insufficient to discourage moral hazard. After all, the total weight for own source revenue collection is only 10 out of 100 in the whole assessment exercise.

Moreover, both regression models show negative relationships between the amount of grant per person, the council size in square kilometres and population. This means that those LGAs which have a relatively large area are allocated and receive less grant per person. Although the grant allocation formula incorporates council size, this seems to be insufficient to compensate for the impact of size. Similarly for population, the amount of grant per person, both actual and allocated, has been declining with an increase in the number of people. This might be due to the presence of a fixed component in the allocated grant: grant allocation comprises a fixed lump sum and a portion which varies according to different indicators. In Tanzania, LGAs receive general purpose grants and ministerial subventions in addition to recurrent block grants and capital development grants which are based on the formula (Allers and Ishemoi, 2011a).

On the other hand, the type of audit report from the previous year was found to be statistically insignificant in both cases, the allocated and disbursed government grant per person. This result for the type of audit report is contrary to expectations. In the assessment for minimum conditions used to guide the allocation of government grants to LGAs, the type of external audit for the previous year is one of the criteria (URT, 2008). However, it seems the weight of this criterion is not sufficient to have a significant impact on the amount of grant allocated to LGAs.

6.6 Chapter Summary

The analysis and interpretation of the findings from this chapter suggest that financial sustainability of LGAs in Tanzania varies over time and relative to each other. However, the group of LGAs comprising a large proportion of poor people has been found to have lower financial sustainability performance than the group with well-off communities. Further analysis of explanatory variables identifies five factors that contribute to the variations: first, the poverty level, whereby LGAs comprising poor communities are more likely to have lower financial sustainability; council size in square kilometres which suggests that larger area constrains financial sustainability; and population size, which also constrains financial sustainability. In contrast, the flow of central government grants has been found to contribute to some LGAs having better financial sustainability than others; and the type of audit report, which indicates the level of financial management, also influences the variation in financial sustainability of LGAs but in the opposite direction. Councils with unclean audit reports are more likely to have higher financial sustainability, which is contrary to discouraging soft budget constraints. This implies that LGAs that tend to override financial management practices are more likely to have higher financial sustainability, which is a bad indicator of the effectiveness of decentralisation.

The results of regression analysis on explanatory variables of grant distribution in subsection 6.4 show grant per capita favours LGAs which are better off. Both allocation and actual grant releases per person favour LGAs with more ability to generate revenue from their own sources. Based on these findings, the design and operationalisation of decentralisation seem to contradict decentralisation theory in relation to equity enhancement. The obvious impact of marginalising LGAs with lower ability to raise revenue, and which also have a large proportion of poor communities, is to perpetuate inequity is service provision. The evidence from Jurado et al. (2015) indicates that expenditure in public services significantly reduces inequality and the poverty level. Some literature, in section 2.3, suggests that the movement of people can stabilise differences in LGAs' ability to offer services, but this option is not viable in Tanzania. The reason is that land, which is immobile, is a major factor of production and agriculture is the backbone of the national economy. Litvack et al. (1998) state that in many developing countries migration is limited because of the unavailability of a ready market for land, which is the main factor of production.

On the other hand, the interpretation of the findings suggests that the decentralisation system lacks sufficient controls to discourage creative financial management and soft budget practices. First, the results suggest that financial sustainability is negatively related to financial management practice; councils with unclean audit reports are more likely to have stronger financial sustainability. This suggests that LGAs which undertake creative financial management practices are more likely to improve their financial sustainability. Secondly, the analysis found that own source revenue collection efforts have a negative relationship with grant allocations and disbursements. The implication is that LGAs which receive higher allocations and grant releases per person tend to exert less effort in mobilising their own revenue, and vice versa. The logic is that officials of LGAs which receive large grants per person becomes relaxed and hence exert less effort.

CHAPTER 7 : CONSEQUENCES OF FINANCIAL DIFFICULTIES AND APPROACHES USED TO MITIGATE THEM

7.1 Introduction

This chapter discusses the impact of financial difficulties on LGAs' operations, ways used to tackle these difficulties, and associated challenges. The discussion offers feedback on the overall aim of decentralisation of improving service provision in general, using the qualitative information derived from interviews conducted with officials of three councils. As discussed in the literature review, the success of decentralisation in service provision depends on LGAs' ability to deliver their functions. Thus, limitations in their operations arising from financial difficulties also imply impediments to the success of decentralisation. The chapter starts by presenting the consequences of financial difficulties for LGAs' operations, followed by discussion of the ways used by LGAs to mitigate these difficulties and strengthen their financial sustainability. Thereafter, it presents the challenges experienced by LGAs in the course of improving their financial sustainability and ends with a chapter summary.

Table 7.1:Chapter Coverage in Summary

Stage	**Process**	**Objective**
1st	Discussing the impact of financial difficulties, whenever they arise, on budget execution	To identify areas which are highly vulnerable whenever financial difficulty arises and the implications for service provision
2nd	Discussing approaches used by LGA officials to handle any financial difficulties and to improve financial sustainability	To identify approaches used to mitigate difficulties, and their corresponding impact on service provision
3rd	Discussing challenges faced by LGAs in improving financial sustainability	To identify obstacles that constrain LGAs' efforts in improving financial sustainability

Source: Author

7.2 Consequences of Financial Difficulties in LGAs' Operations

Despite the findings described in section 6.4 to show that some LGAs' financial sustainability is relatively better than others', all LGAs in the sample experienced financial difficulties at least once in the five years. Based on independent samples t-test of the ex-ante budgetary solvency indicator (table 6.4, subsection 6.3.2), neither of the two groups of LGAs involved in the quantitative analysis could finance their budgeted expenditure over the five years of analysis. Similarly, based on this indicator, none of the 36 LGAs could raise revenue to finance budgeted expenditure consistently throughout the five years. This implies that there are times when LGAs experience financial difficulties in financing their planned expenditure. The immediate impact of this difficulty is reflected in LGAs' ability to execute expenditure budgets on service provision, although in the long term the impact may extend to the perpetuation of poverty.

As Hastings et al. (2015b) observed, reduction in financial support from the central government affects LGA's ability to offer services. The report of Hastings et al. (2015b) indicates that government's austerity program has led to budget cuts in English municipalities that consequently started to affect services provision. Although an austerity program is not in effect in Tanzania, the reduction of fiscal support has a similar impact on LGAs' ability to offer services. The official C who is a chairperson of council K, for instance, admitted that, "… this year [2014/15] we have many projects that we could not implement because the fund from central government could not be disbursed". Similarly, official R2 who is the revenue accountant in case study T said that, "there are many development projects that are stacking up ... we are blamed that we are squandering the money but the reality is that the money is not coming [from the central government]".

Observation suggests that development expenditure is much more highly vulnerable than recurrent expenditure. A good example is provided by official C, the chairperson in case study K who identified that the flow of the recurrent grant is very good, "but it is in development projects that we have a headache". The severity of the impact on development expenditure seems to be attributed to greater dependence on central government grants in this category. Official C, the chairperson in case study B explained that, "in development projects, to a large extent we are just waiting until the funds are disbursed [by the central government]". This corresponds with the proposition of

Skidmore and Scorsone (2011) that decline in financial support from higher government level could have adverse effects on LGAs' fiscal condition. On the other hand, the observation suggests own source revenue not only constitutes a small part of LGAs' expenditure budgets (only 7.4% for 36 LGAs; see descriptive statistics relating to the previous chapter in appendix D), but also that councils have discretion over its allocation. For instance, the revenue accountant in case study T said, "own sources revenues are used for running offices ... to run offices involves many things, including paying allowances to staff, purchase of stationery, running meetings, purchasing office furniture. However, grants are for facilitating development projects". This suggests that own source revenue is mainly allocated to recurrent expenditure, hence providing cover for any shock in the flow of the central government grant. Moreover, the group of 36 LGAs involved in the quantitative analysis collected an average of 86.16% of their annul targets, which is slightly higher than the rate of total grant released for the same group, 83.75%.

Moreover, the sensitivity of cost components comprised in recurrent expenditure makes this category less vulnerable. Recurrent expenditure budgets comprise personal emoluments of LGAs' staff, which is sensitive to any under-release of funding because of possible reaction from council staff. Therefore, whenever there are insufficient funds to finance both categories at once, recurrent expenditure supersedes development expenditure. In all three case studies, officials acknowledge that the flow of the recurrent grant is good. However, their concern is that recurrent grants cannot provide significant improvement in service provision as people expect. "The money we are getting is for normal expenses such as paying salaries ... This goes to all the staff in health centres and other areas; how can you expect results in improving services?" (official C, the chairperson in case study T).

Given the under-release of government grants, LGAs' officials admit that they have been struggling in executing their responsibilities. In case study B, for instance, the official A who is in charge of budgetary coordination said that the council has difficulty even in providing sufficient explanations to citizens whenever approved grants are not received. This official noted that "people at lower levels have already sat down and agreed [on which projects to implement], so if the fund is not disbursed it becomes an issue". The same situation was found in case study T, where the council chairperson felt that the grant allocation puts the council into discord with its people, because citizens always think that funds have been received but not spent accordingly. “Once we have established targets, we are required to publish them on notice boards; it has to be open on notice boards. Now, once the ordinary citizens see a budget showing that we are going to construct a road of two, three or four kilometres, their understanding is that the fund is already available and the project is going to be implemented” (Senior finance official R, case study T). Similarly, official E who is in charge of planning department in case study K noted that due to the non-predictability of the grants, the council even refrained from publishing some budget figures on council notice boards. “There were times we were issuing notices, but even issuing projections had problems. We were projecting the distribution of the fund to villages based on population but when you issue a projection the villagers interpret this as the fund already being there”. Therefore, it becomes difficult for the council to explain to ordinary citizens when it receives a smaller amount than that published in the budget figures.

While explaining the impact of financial difficulties to the council one official said, “we have started a health centre at [*ward name withheld*], but to date no fund has been received, after more than three years; it has ceased” (Council chairperson, case study T). Meanwhile the official in charge of budgeting coordination in case study B said that at the time the researcher was in the field, there was construction of health centres in two wards. However, this official noted that “they are also having some delays because for instance in the last year we expected to receive some funds but they were not disbursed”. He further noted that many projects in the health sector have stopped because there is no funding. “You plan in the budget but you can wait up to two years without getting funding, although every time you include it in a budget and citizens have already started contributing their efforts”. He also discussed the construction projects for agricultural extension resource centres in two wards, “but it reached a point where they stopped” because the funds were not released. However, he noted that, “this year a fund is provided, but I don’t think it will be sufficient to finish [the work]”.

On the field visit, the researcher physically observed some unfinished buildings for classrooms in a school which is at the town centre of case study B. In the same school, one building was at the level which require roofing but it looked older than another one which was just at the foundation stage. This prompted the researcher to ask for clarification. In response, the official in charge for budgetary coordination said, “it is the contribution of the citizens which goes as far as the level of roofing; then they wait for the government to fund the remaining part ... So it is the citizens who have done their part and have started on the new one”. Meanwhile in case study K, the council chairperson said, “this year we have many projects that we could not implement because the funds from central government could not be disbursed”. The official mentioned maintenance of school buildings and construction of five ward offices as examples of projects affected by such difficulties.

Generally, LGA officials explained that the most affected projects are those which involve construction of buildings in the health and education sectors. However, other sectors such as water and agriculture, were also mentioned. As explained in chapter four, the allocation of grants in Tanzania is intended to consider five priority areas: education, health, water, agriculture and roads. Thus, if there is any shortage in fund disbursement, it implies that services in such sectors will be affected. The problem of under-disbursement of grants has persisted throughout the five years of analysis (2008/09-2012/13) in all LGAs. The CAG report (2014) shows under-disbursement for the whole country over the five years reaching an average of 39.2% of the approved development grant, and an average of 11.6% for the recurrent grant. Nevertheless, the report revealed that the under-release of grants is attributed to central government’s budget deficit. For the year 2012/13, for instance, donor withdrawal contributed to a deficit that caused under-release of 38% of the development grants to LGAs. This is consistent with the joint report prepared by Rutahiwa (2013: 41) which states that:

> *The scale of Budget Support peaked during the three fiscal years 2007/08 – 2009/10, and in nominal Tanzania shillings has since declined by 11% from that 3-year average. The number of partners providing Budget Support has reduced, from 14 to 12, with the withdrawal of the Netherlands and Switzerland.*

Apart from under-release, the timing in the flow of such grants has been found to be a major concern, contributing to difficulties in implementing council activities. Officials in all three case studies showed dissatisfaction with the flow of the development grant, to the extent of failing to implement some projects as scheduled. In contrast, officials offered positive explanations regarding the flow and timing of recurrent grants. While explaining their concern over the timing of development grants, the official in charge of budgetary coordination in case study B said the money is sometimes released at the end of the year. As a result, “if we have to undertake the purchasing procedures, it takes almost three months before the contractor starts the work". This implies that the money will have to be carried forward, hence the expenditure will have to be made beyond the existing financial year. While clarifying why councils sometimes find themselves with huge account balances at the end of financial year, the official said, "someone gives you money at the end of the year, how can you say that the person has less capacity to spend?".

The impact of carrying forward received funds aimed to serve the community limits access to services. The Controller and Auditor General has also shown concern about the unspent amount in LGAs. The CAG report (2014:42) specifically states that, "unutilized development grants imply that some of the approved development activities in the respective LGAs were either partially or not implemented at all, and therefore the earmarked benefits to the intended community have not been achieved".

However, according to council officials, the central government has issued directives which require LGAs to allocate 60% of their own source revenue to development expenditure from 2015/16. This is expected to reduce the impact of the non-predictability of government grants on development expenditure. Prior to this directive, LGAs were spending the money on a discretionary basis, hence mainly for recurrent expenditure. The policy seems to be a control tool for LGAs to exert more effort in enforcing revenue collection beyond that required to cover their running costs. Nevertheless, LGA officials appeared unconvinced that the remaining 40% would suffice to run the offices in some councils with limited own source revenues. The official in charge of budgetary coordination in case study B said that central government should have made an assessment before introducing the policy, since the capacity of councils differs. He feels that the policy will limit the ability of the council to cover its office expenses. Further, the view of the LGA officials is that the policy undermines LGAs' autonomy in budgeting decisions.

7.3 Approaches to Tackling Financial Difficulties and Enhancing Financial Sustainability

Following the unpredictable trend in the flow of central government grants, LGAs have been striving to find ways to keep themselves financially sustainable. Generally, these methods can be grouped into two categories, short-term and long-term approaches. The short-term techniques include cutting down and/or postponement of expenditure and harnessing contributions from individuals and other stakeholders. Long-term techniques aim at enhancing revenue generation, with greater emphasis on revenue sources which do not directly involve citizens.

7.3.1 Involving People and Other Stakeholders in Project Financing

The decentralisation policy insists on citizen participation from planning to implementation of council projects. As a result the study found LGA officials utilise such opportunities as a strategy to enhance their financial sustainability. “What we do is to use available opportunities and not just to rely on the government budget. To initiate fund rising, we sit down with the citizens in their respective areas, and tell them so that they can also help” (Council chairperson, in case study T). The findings from the three comparative case studies indicate that this strategy has been useful especially in implementation of development projects. According to the CAG-T report for the year 2012/13, the contributions can be of two types, in cash and in kind. In the case of cash contributions, the LGA raises a specified amount of money from individuals or a group of individuals to finance part of a specified project. For instance, in case study T the chairperson said that in addressing the shortage of desks in schools “we have already informed them [citizens] of the arrangement, and they will contribute so much and the council will contribute so much ... that is our strategy for ensuring that we reduce the extent of the needs of our citizens so as to meet their demand”.

Meanwhile, the contribution in kind encompasses individuals and other stakeholders in directly participating in providing services that would otherwise have to be offered by the council. Council officials just remain as coordinators. The use of contributions in kind is similar to the observation made by Nelson (2012), who found some municipalities in the US were using volunteers in some activities as a strategy for dealing with financial difficulties, instead of recruiting new staff. In case study T, individuals are involved in solid waste management by forming groups which take responsibility, for the cleanliness of their respective streets. “Our city is clean ... we are shaping our citizens in such a way that they are the ones who help us in keeping the city clean; we are encouraging them to initiate cleanliness groups” (Council chairperson, case study T). The council officials only provide coordination assistance through street chairpersons. Also, on every first Saturday of the month, council officials make physical visits to inspect cleanliness. This has resulted in the city having tidy streets. Similarly, in case study B official M who is a senior finance officer explained that the council involved citizens in cleaning their streets, but that the contribution was in financial terms. “There is a fee for solid waste; we collect solid waste, but that is for residents who use such services”. Meanwhile the official in charge of budgetary coordination said that council B also involves private surveyors who enter into agreement with the citizens to survey their plots, because the council does not have sufficient capacity. This results in the council having buildings constructed on surveyed plots, except in village areas; without the involvement of private surveyors, the council would be attracting squatters to the town centre, which would hinder distribution of services such as water supply and waste collection. With unplanned building it is not easy to distribute networked services such as water, electricity and sewage systems.

Most common in all three case studies is involvement which combines both financial and non-financial contributions, especially in the construction of community service buildings, including schools, health centres and ward offices. Citizens are asked to contribute basic materials which require a financial outlay to furnish such projects to a certain level, and to engage physically in the construction of such projects. In case study B, for instance, when explaining the involvement of citizens in the construction of school buildings and health centres official in charge of budgetary coordination said:

> *all projects which are at lower levels require people to start themselves to undertake construction work, such as establishing the foundation, although engineers are also present to oversee that it is initiated correctly… It is the contribution of the citizens which goes to the level of roofing then waits for the government to fund the remaining part.*

In the planning and budgeting process, LGAs involve citizens through O&OD. This makes citizens aware that they will have to contribute to the construction of certain buildings as soon as the council budgets are approved. The same approach of involving people facilitated one council (case study K) to construct dispensaries in border areas and ward offices in seven out of fifteen wards. The number of dispensaries and health centres in the council increased from 17 in 2008 to 22 in 2012 (case study K and NBS[11], 2013). With the use of a similar strategy, the council has planned to construct at least two dispensaries in each financial year.

[11] Council K’s Social Economic Profile: Jointly prepared with the National Bureau of Statistics (NBS).

Generally, the contribution of individuals in council activities throughout the country is invaluable. It would amount to a very significant sum if LGAs had to pay for. However, according to CAG-T (2014), until December 2013 the contribution had never been recognised in books of accounts, despite its relevance in enhancing LGAs' financial sustainability. The LAAC committee had to recommend that the government recognise both contributions, in cash and in kind, in councils' accounting records. "Cash contributions will have to be reflected in the LGAs' accounts whereas contributions in kind will be disclosed in the financial statements by way of a note", (CAG-T, 2014; 27).

7.3.2 Postponing Expenditure

LGA officials in Tanzania have relied heavily on cutting down expenditure whenever they experience financial difficulties. This corresponds to postponing some of the intended activities, provided that they remain a priority, and relevant, in the next budget period. Beckett-Camarata (2004) and Nelson (2012) observed similar techniques of postponing or cutting down expenditure in some US municipalities to cope with financial difficulties. When explaining the strategies the council uses when the government grant is not disbursed, the official in charge of planning department in case study K said "we suspend that project". However, if the project is still relevant, the official said "because it is a priority project, we don't cancel it, we carry it forward. So the project becomes a priority in the order of implementation". It has been found that the approach of postponing expenditure, particularly for development projects, is also preferred by the central government. Official in charge of budgetary coordination in case study B said that whenever the central government grant is not disbursed the council cuts off the expenditure, "except for development projects". For such projects, the council has been advised to "re-budget them afresh for that amount which is not disbursed". However, re-budgeting is similar to writing off in the books of accounting as non-recoverable. In addition, re-budgeting raises one more technical question, as to how such amount can be re-budgeted when the following year has its own ceiling. What if the amount to be re-budgeted is higher than the ceiling for the next year? Similarly, in case study T, official R who is senior finance officer said that grant allocation, "says how much we are going to get for which project, so whatever we will get for that specific project is what we are going to spend". Thus, if an activity is not funded, it is either cancelled or carried forward to the next financial year.

7.3.3 Expanding Revenue Sources

In the course of enhancing councils' financial sustainability and in order to reduce reliance on central government grants, LGA officials have identified alternative ways to widen their revenue sources. As official in charge of budgetary coordination in case study B noted, the central government is reducing its support, hence ability to generate revenue is becoming a key for LGAs' survival. It is the trend for under-release of grant disbursements, as explained in subsection 7.2, which makes them feel that the government is reducing its support to LGAs. Findings from all three case studies shows councils have a common focus towards the improvement of their financial condition. The creativity of specific councils' management in identifying opportunities according to their environment has been found to be the key in identifying such alternatives.

One of the ways the councils use to increase their revenue sources is through the sale of land. Officials in all three case studies identified the proceeds from the sale of plots and the consequent benefits will increase their financial sustainability. Despite the revenue from the sale of plots being short term in nature, because the sale is made only once, officials identified the benefits that accrued as significant. They include revenue from land rent, fees on issuance of construction permits and approval of architectural designs, property tax after construction of buildings, and service levy.

Regarding the sale of plots, in case study K official RA who is in charge of revenue mobilisation said "the plan we have this financial year (2014/15) is to sell 6,000 plots; they are still in progress". This official further noted that "once we have sold these plots it means people will engage in different activities; there are factory site areas, so factories will be established, and economic activities and houses will increase as well". All these will boost revenue sources to the council. Similarly, in case study B officials identified that the council expected to sell plots for two consecutive years, which would bring revenue to the council. One senior finance official said, "we thought if we could sell plots we could get revenues; if we could sell plots consecutively in two years in areas where we are surveying it could be a good source of revenues". However, the budgetary coordination official admitted that the council failed to sell these plots as expected because of a dispute with the land owners. The sale is expected to be continued as soon as the dispute is resolved. Meanwhile, in case study T, the official in charge of planning department said that the council has farms with long-term leases which pose a major challenge in surveying plots for sale; as a result the council misses some potential revenue. This official said, “we fail to extend swiftly hence we miss revenues because if people build residential buildings we could get revenues from different ways; there is land rent, property tax, etc.”.

Another strategy pursued by LGAs to enhance revenue sources is through engaging in investment projects. This option is similar to the one of the strategies Beckett-Camarata (2004) observed in Ohio, in the US. The only exception is that officials in Ohio made efforts to attract investments, while in this study LGAs are actively engaging in investment projects, some executed in collaboration with private investors. All three case studies are active in investment projects that aim to generate revenue without involving taxpayers. “We have started to establish other sources apart from those which depend on citizens; in the budget for this year (2014/15) we have included a shopping mall with a conference hall” (official A who is in charge of budgetary coordination, case study B). This official also explained that the council has a plan to improve business frames which surround the bus stands so that they can attract improved letting fees. “We were considering how we can write a proposal that will allow us to enter into a contract with someone to construct one-storey buildings around the bus stands, and then our revenue will come from leasing them instead of just following someone to ask for the money”. The bus stand is owned by the council but the existing frames are owned by individuals who are under contract to the council until after the lapse of a certain period. However, they are still paying fees to the council, although the amount was said to be very small.

Similarly, the official in charge of planning department in case study T said that, “we want to construct a five-storey building in collaboration with another government agency... It won’t involve asking collection agents what we can do; we will know that our building is bringing money”. Beside the building project, officials explained that the council had set aside an area for factory sites so as to attract investors. Meanwhile in case study K, officials confirmed that the council had already allocated investment areas for various projects to be developed by private investors. According to official C who is a chairperson in case study K, the council lacked a reliable electricity supply for many years, which made it unattractive to investors, but “In the near future, the council will provide an electricity network to about 75% of the area”, which will facilitate the swift implementation of development projects.

Council officials also consider expanding revenue sources through investment projects as a way of reducing not only reliance on central government but also reliance on revenues directly charged from individuals. One official who is dealing with revenue mobilisation in case study B said that sometimes citizens are not happy when they see LGA officials in the streets enforcing revenue collection. They feel that they are victims. Nevertheless, LGAs official blamed bureaucratic arrangements and lack of policy support for constraining their ability to participate in investment projects. The official in charge of the planning department said that councils have to ask permission from the Prime Minister's Office if they are to enter into partnership to implement investment projects and/or to acquire loans to finance such proposals. This is despite the central government having introduced a public private partnership policy in 2009. Regulation governing the implementation of the policy requires all projects that LGAs would like to collaborate with the private sector, must be reviewed and get approval of the central government. Thus according to LGA officials, their initiatives to expand revenue bases through investiment are limited by bureacratic procedures which are not coherent with reform execution.

7.4. Challenges to Enhancing Financial Sustainability

7.4.1 Own Source Revenue Enforcement

All three councils involved as case studies are attempting to increase revenue collected from their own sources. In the course of doing this they use both agents and their own staffs to enforcing collection. For sources which have been outsourced, councils seem to be assured that these amounts meet the expected targets. In order to ensure the council does not lose revenue from these subcontracted revenue sources, officials in all councils confirmed that contractual agreements include a specific clause to bind agents. The official in charge for budgetary coordination in case study B, for instance, said that the council requires all agents to meet or exceed the budgeted amount. This requirement is enforced by a clause which requires agents to deposit a certain amount in advance at the beginning of the contractual arrangement, to hedge against potential loss. The amount required is equivalent to two months' revenue collection targets, as agreed between the two parties. The official further noted that if the agent "doesn't remit in the first month we deduct one month's collection from the security; if he/she doesn't submit in the second month, we deduct from the balance of the security". Thereafter the contract ceases and the council starts to collect through its own staff. Meanwhile in case studies

K and T, the use of penalties to enforce remittance of revenues from outsourced sources is common. In case study T, one of the conditions to own source revenue collectors is to remit the agreed amount within the first five days of the month following the collection month. Otherwise, a 20% penalty will apply for a delay of five days. This is similar to case study K, where the senior finance officer said “we have a clause in the contract we are signing with them [agents]; it says once you delay one day there will be a certain percent as a penalty”.

However, there are still challenges to the council associated with the use of agents in enforcing collections. The first is the trustworthiness of the agents. As explained by senior finance officer M in case study B, the revenue collection from outsourced sources is not problematic, except for some agents who are not trustworthy and who tend to terminate their contract before its completion. This official said that this is because they bid to collect large amounts without undertaking sufficient research. As a result, when the agent goes into the field to execute the contract, the reality is different from what the agent perceived when the bid was submitted. Official R who is responsible for revenue mobilisation in case study B said that despite the council undertaking a feasibility study before outsourcing, the procurement law requires them to award the tender to the highest bidder. If the council decides otherwise, it may attract investigation from the corruption prevention bureau. However, councils still have the opportunity to adjust outsourced revenue targets through negotiation during the process of awarding the tender. Official RA who is responsible for revenue mobilisation in case study K said, “we can’t award a contract just on the amount agents have proposed unless it is fine... if the amount is not reasonable, we will invite them to negotiate; once we reach agreement then we sign the contract”. However, this is very likely to happen when the amount indicated by the highest bidder is still low and not appealing to the council.

Another challenge associated with revenue collection through agents is the ability of councils to administer and manage the contracts entered into with the agents. According to the senior finance officer M in case study B, some agents are reluctant to submit copies of their receipt books to the council after the collection exercise, although they submit the agreed amount. He noted that “…you give agents receipt books; now in order to know exact collections, [copies of] those books are supposed to be returned, but when it gets to the point of submitting them for verification, for some of them it is a challenge”. These copies of the receipts are the basis for comparing the amount collected versus the amount submitted to the council, and hence any difference can be accounted as a cost associated with revenue enforcement to the council. In such instances it is likely that the agents are benefitting considerably, which is why they do not want to expose the actual amount collected as it will prompt the council to demand more in the next period. Generally, these challenges can be seen to reflect the council's weakness in drafting and enforcing contracts, and the dishonesty of the revenue collection agents. The same challenge is found in case study K. The senior finance officer to the council K said, "we had an audit query last year; they [the agents] delayed for some days, so we were told that we should make a charge for the delay". Therefore, despite the council having a penalty clause in the contract, it could not enforce it until after receiving the audit query. Meanwhile, the CAG report (2014: 21) stated that, "58 LGAs were noted to have a sum of Shs.6,710,548,469 being revenue collected from various centres by collecting agents but apparently not remitted to the respective LGAs". The report also identified the problem of non-remittance as one of the reasons 27 LGAs received unclean audit reports in the financial year 2012/13.

For the collection of revenues from sources which are not outsourced, LGAs use their own staff. Business development officers in collaboration with finance staff coordinate the exercise. All three case studies utilise street/village executive officers in administering collection from some of their sources. In the hierarchy of LGAs' personnel, street and village officers report to the directors of their respective councils. Such officers work very close with the community in their daily routine. Thus, the councils feel it is convenient to use them to enforce some of the taxes within their areas. In case study B, street executive officers are involved in the administration of property tax. In case study K, the official RA who is responsible for revenue mobilisation said village officers are involved in mobilising revenues such as "fees on the sale of land, auctions and fines to bylaw defaulters within their areas". Similarly in case study T, street executive officers were involved in a feasibility study when the council had to establish taxpayers' records in each street. To encourage their morale, all three councils reward the staff who are directly involved in enforcing revenue collection in the field, with a certain amount from the proceeds.

Nevertheless, the cost of mobilising resources has been found to constrain LGAs' ability to collect revenue from their own sources. As Bird (2015) says, in developing countries administration and compliance costs pose challenge in revenue mobilisation and can account for up to 80% of the revenues collected. In case study B, for instance, the senior finance official R said the costs of enforcing revenue collection are sometimes higher than the amount recovered. “It reaches a point where the person hides to evade payment, closing the door because of Tsh. 2,000; if you check the cost of arresting that person and taking them to court it becomes larger than the money you are enforcing”. This is similar to the details provided by revenue mobilisiation official RA in case study T regarding enforcement cost versus benefit. “Someone may evade paying Tsh. 200,000, you go there to make all the follow-ups until you get to the court, but in the end the person will pay only Tsh. 50,000 as a fine plus the 200,000”. In case study K, revenue mobilisation official RA admitted that tax evasion exists, although the council charges fines to those who are caught. “Those dealing with forest products sometimes look to escape on remote roads to avoid paying”. Obviously the cost of dealing with such evaders in remote areas is very high compared to the benefit to be accrued once they are caught. The council, for instance, gets Tsh. 800 per charcoal bag, which is less than half the fuel cost per litre for visiting these areas. These concerns of the LGA officials are in line with the economic canon of taxation which requires the cost of tax collection not to exceed its benefits. It seems the design of the local tax system for some sources does not conform to the canons of taxation.

In addition to the above challenges, at the time of the field visit all three case study councils had no electronic system to synchronise their local revenue data and to act as a control tool in enforcing revenue collection. Revenue collection and issuance of receipts are done manually, which makes the collection exercise difficult and the collected revenues susceptible to misappropriation. However, officials in all three case studies said that they are in the process of instituting electronic databases for synchronising revenue collection. According to the responsible official for budgetary coordination in case study B, with the help of donors (the World Bank) who are funding the “Urban Local Government Strategic Cities Project”, the council is in the process of establishing an electronic system for revenue collection. The case is similar to case study T. The project will help the council in monitoring revenue and mobilising own source revenue, particularly from property tax and business licensing. It will involve establishment of an electronic database to store statistics relating to business, plots and their corresponding owners. Meanwhile in case study K, according to revenue mobilisation official RA, the council is implementing an electronic system in accordance with the directive from central government. The official RA further noted that councils are required “to make sure that all revenues must be collected through an electronic system”. He acknowledged that the system which is about to be installed will be very useful; there will be a server in the council’s office which will show the amount collected by the collection centres promptly.

7.4.2 Politics at the LGA Level

One of the main challenges affecting the ability of councils to improve their financial sustainability is local politics, resulting from the multiparty system and conflicts of interest of councillors who are also political figures. Just as Casal et al. (2014) observed, the territorial political situation influences some local government decisions, although the nature of the decisions differ. Casal et al. (2014) found that the local political situation influences the ratio of transfer received and transfers made, real investment and urban policies in Spain. Meanwhile, in this study the influence was found to affect revenue mobilisation decisions. LGA officials in all three case studies admitted that the influence of local political leaders on their communities hinders council efforts to improve financial sustainability. “Currently there are many political parties, so democracy has gone beyond the normal system; it contributes to persuading citizens to reject those issues which, if implemented, will help to strengthen a certain political party” (Official C who is a councillor, case study B). When explaining this challenge, official R who is responsible for revenue mobilisation in the same council confirmed that political leaders “are telling us that we are disturbing their voters, and once the taxpayers realise this they report it to the councillor or the MP who raises his voice”.

Similarly, the council chairperson in case study T said, “when you increase tax from some source, let’s say the market place, your fellow [politician] tells people not to accept it, so opposition sometimes becomes an obstacle”. This corresponds with Poterba’s (1994) observation which identifies that whenever state government and corresponding LGAs are controlled by the same part, there is more likelihood of responding quickly to unexpected fiscal troubles than the opposite. Meanwhile official C in case study B, who is a councillor and also a politician, said, “as a community leader I will try to motivate people to contribute to the extent that I think is appropriate”. Obviously, two or more political leaders will have different understandings of “appropriate” in influencing people about council activities. As a result, this official noted that, “this is a problem when it comes to own source revenue; the same leader who is supposed to seeing the council generating sufficient revenue is the one who is going to oppose decisions he/she had approved; that is a big challenge". Due to the governance power of the councillors who are also politicians, permanent staff sometimes agree with the views of such leaders only because of the fear of being penalised. Official R who is responsible for revenue mobilisation in case study B, expressing this concern, said, "currently you have given a councillor wide authority, to sanction the council director, to sanction any employee who will be executing those bylaws, so in order to avoid being sanctioned it is better to remain silent". These findings add insight to the observations of Allers and Ishemoi (2011b) who found regional differences in political representation contributed to diversions in grant distributions from the national grant formula. The influence of the local political situation extends to local government revenue mobilisation.

Apart from the influence of local politicians, council officials are not satisfied with the role of members of parliament (MPs) in the governance of their respective councils. According to regulations, MPs are also members of council *baraza* in their specific jurisdictions. The concern of local government officials is that the MPs do not participate effectively in council meetings which deliberate important matters. Hence, they are not well informed on LGA matters, which make them raise poorly researched questions relating to LGAs in parliamentary sessions. According to the senior finance official M in case study B, ineffective participation of MPs in council issues results in the enactment of laws which are not practicable or which adversely affect citizens. The official said "… that is why even when they go there in the parliament to set laws they fail to understand that the law will come back to be implemented in their areas; other laws fail to be implemented or they don't work properly, hence people are tortured". This argument is supported the way the Tourism Act no. 29 of 2008 has been enacted. It disowns the hotel levy, which had been a reliable source of revenue from LGAs to the central government. Its enactment repealed the sections of the previous Hotels Act which had given LGAs a mandate to collect a hotel levy.

7.4.3 Policy and Regulations

LGA officials expressed that the design of policies and regulations constrained their efforts towards improving financial sustainability and dealing with financial difficulties. Specifically, they are concerned about the distribution of revenue sources between central and local governments, autonomy in setting revenue rates and autonomy in spending the proceeds, as explained in the following subsections.

7.4.3.1 Distribution of Revenue Sources

One of the factors that affect the ability of LGAs to deal with financial difficulties and improve financial sustainability is the extent of the revenue sources they can access, which provide LGAs with flexible revenue mobilisation and the ability to handle financial difficulties (Reschovsky, 2003). This concerns not only the amount of resources available within a council but also its distribution among the levels of government. If LGAs have limited exposure to resources, their ability to cope with the danger of financial difficulties becomes limited. The observation from case studies is that LGA staff feel that the distribution leaves them with limited resources which are difficult to enforce. For instance the senior finance official M in case study B said “all lucrative sources” are controlled by the central government while those sources which are “not collectible” or are a “headache” to enforce are the ones given to LGAs. Officials in all three case studies identified land rent as an example of a revenue source that would ideally enhance their ability to raise revenue. However, currently the source is under central government control, while LGAs simply remain collection agents. “For land rent we are just agents, at the end of the day we get back 30% so as to facilitate the sustainability of that source so that we can continue to collect” (official RA who is responsible for revenue mobilisation, case study T). Furthermore, official M in case study B said that despite council bylaws for mobilising revenue, the sources are “weak” and are insufficient even to cover office expenditure.

The LGA officials are especially concerned about the introduction of policies and regulations that revoke revenue sources which have already been useful to them. Introduction of such policies and regulations by the central government has been found to affect the distribution of revenue sources, moving them from LGAs to central government. As a result, officials feel that LGAs are guinea pigs for testing the applicability of various policies relating to revenue sources. “When the government recognise there is something good and significant they take it” (senior finance official M, case study B). The example provided by that official to support this claim is the property tax, which was “initially shifted to the central government” before being returned to LGAs. This is also in line with the concern raised by officials in two case studies regarding the shifting of the hotel levy from LGAs to central government, although it was not found in case study K as the hotel levy is not among its significant revenue sources. As previously stated, the enactment of the Tourism Act in 2008 repealed the Hotels Act and its amendments of 2006. Section 10 (1) of the Tourism Act (2008) requires all activities classified as “tourism facility or activity” to be registered to the director under the Ministry of Tourism. Section 17 (1) gives power to the Minister, after consultation with the director, to “declare any premises, place, facility or activity which affords amenities to tourists, to be a designated tourism facility or activity”. Consequently, LGAs are prevented from collecting the hotel levy. The Hotels Act had allowed LGAs to collect 20% of hotel charges per guest. As a result, official C who is a councillor in case study B complained that “for about two years now the hotel levy has not been collected because of the introduction of the Tourism Act”.

Despite the central government’s compensation for revenue lost with the abolition of various inconvenient sources in 2004, the senior finance official M in case study B provided a different view. The official argued, “how can someone come and say that this tax is unlawful or it is a nuisance to citizens while we have seen that the source will help us to collect revenues? We are at the source, we sit down with citizens in our meetings and we agree together that we are going to charge tax on certain sources”. LGAs are required to involve their citizens in identifying new sources and rates, so the view of the official is that as long as the citizens who are the taxpayers are involved and consent to the revenue sources to the council, then the tax cannot be a nuisance. Also, the unpredictability of the grants made the official feel that such sources would enhance LGAs’ ability to raise revenue to finance their budget needs. These views support the findings of Gao et al. (2014), that decentralisation of revenues improves life satisfaction, especially in underdeveloped areas. Thus, limiting revenue autonomy reduces the chance of attaining such benefits. Generally, LGAs’ staff are not comfortable with the allocation of resources within the design of the decentralisation system.

7.4.3.2 Autonomy in Setting Rates of Own Source Revenue

The views of LGA officials is that the design of the decentralisation system limits them in setting own source revenue rates. As a result, it is difficult for LGAs to adjust them according to needs and the environment, which is very important for a sustainable financial condition. A good example is found in Nelson’s (2012) study, which observed that limitations on adjusting property tax rates to have limited ability of LGAs to respond to fiscal difficualties in Michigan and California, in the US. In Tanzania, as discussed in chapter four, most of the rates for own source revenue collection are prescribed in various regulations set out by central government. However, according to senior finance official M in case study B, it is the LGA officials who are in a better position to understand the ability of their citizens to pay tax on certain sources than central government officials. This view corresponds to the fiscal decentralisation theory, which considers LGA officials to be more aware of their local environments than central government officials (Salman and Iqbal, 2011). Furthermore, official RA who is responsible for revenue mobilisation in case study T suggested that it would be better if LGAs could be able to adjust the tax rates for some sources, such as business licences according to business size. “The rate is established by central government but we are the ones who know the real situation; we know the economic power of the people.”

LGA officials also identified instances of central government reversing decisions made earlier to restrict LGAs from collecting revenues from certain sources, affecting their ability to generate revenue. This contributes to making citizens resistant to such taxes, hence constraining LGAs’ financial sustainability. According to senior finance official M in case study B, taxpayers sometimes question the genuineness of such taxes, which makes them reluctant to accept. An example is the business licence fee which was abolished in 2004 but reintroduced in 2011. Before its abolition, the business licensing fee contributed between 20 and 30 percent of own source revenue of urban councils (Fjeldstad et al., 2010). The senior finance official M asked, “in reintroducing the tax to the citizens, what are you prepared to tell them?”. He noted that, as a result, there was a delay from when the fee was re-introduced to its actual operationalisation because of grey issues related to the reintroduction. The official M said “it was delayed for about a year from reintroduction to implementation; we budgeted for it but the budget didn’t work”. Both the abolition and the delay during its reintroduction affected LGAs’ fiscal position. As Brueckner (2000) warns, limited revenue autonomy in LGAs endangers the realisation of the full benefits of decentralisation reforms.

7.4.3.3 Council Type

The findings from the three comparative case studies suggest that national regulations are a challenge to rural LGAs because they limit some revenue sources which are allowed in urban councils. Under regulations in Tanzania, urban councils are allowed to collect property taxes while rural councils are not. Official RA who is responsible for revenue mobilisation in case study K, which is a rural council, said, “there are some revenues that we are losing. An example is the property tax and that is why we are becoming a township authority, so that we can collect those taxes which we are currently not allowed according to the laws". This sheds light on Smoke's (1993) argument which suggests that the type of LGA, whether urban or rural, makes a difference in their revenue bases. However, the observation from this study suggests the difference is partly attributable to regulations. The property tax makes a significant contribution to the own source revenues of urban councils. In 2012/13, for instance, the contribution in case study T was about seven percent of the total collected own revenues, and in case study B about one percent.

On the other hand, the observation suggests that limitations in LGAs' autonomy over human resource functions is a challenge in resource allocation within a council. LGAs do not have autonomy over functional departments and their respective personel. According to official E who is in charge of planning department in case study T, there are some human resource functions/departments, especially in urban councils, which consume significant financial resources but their contribution in LGAs' operations is limited. While explaining this with reference to public services, the official said:

> *you can't have significant results* [in service delivery]; *the problem is that we have created job posts* [according to regulations] *which are unnecessary. We could have few posts which comprises competent people, that's all… for instance you create bee keeping section in city councils, what is it for?*

The challenge highlights poor coordination in reform execution, in which LGA functions have not been streamlined properly towards decentralisation. Moreover, the official E iterated another challenge associated with poor coordination in reform execution, which is the changes in priority areas in LGA operations because of changes in country's administration regime. He said that "when everyone gets in power, for instance when Mr. Pinda took charge [as a prime minister] he is talking about bee keeping, there is no continuity" from one regime to another. Consequently, LGAs lose operational focus because ot the need to adjust to new requirements hence constrain their abilities to improve service provision. As DeMello (2000) cautions, coordination failure in executing decentralisation reforms endangers attainment of the underlying benefits.

7.4.4 Procedures for Setting Bylaws

The process involved in setting or revising bylaws that guide LGAs in mobilising their own source revenues has been identified as a major challenge to their ability to enhance their financial sustainability. It also limits their ability to respond to financial difficulties in budget financing. As Olowu and Smoke (1992) identify, the impact of bureaucratic procedures in revewing and approving LGAs' plans and budgets is to limit their ability to exercise entrusted functions effectively. In Tanzania, the process of setting bylaws as required by regulation[12] is too involving and takes a long time to complete. The process starts with drafting a proposal in consultation with the community. This is then submitted to council meetings for deliberation before being submitted to the prime minister for approval. The length of time involved in setting bylaws can even make the proposed rates obsolete by the time it is approved. "You can submit bylaws but the submission stays in the prime minister's office for a whole year or nine months … currently there is a bylaw that we have been waiting for almost the year, and we are moving into the second year" (official A, who is responsible for budgetary coordination in case study B).

Generally, the processes involved in setting bylaws seem to constrain LGAs not only in raising revenue in the present but also in adjusting to future financial needs. Consequently, the official in charge of budgetary coordination in case study B questioned the integrity of the relationships among government agencies regarding the approval process of bylaws. The view of the staff is that approval could be given at the level of regional office, or could be delegated to a permanent secretary instead of the prime minister, who is likely to be already overloaded. For instance, at the time of the field visit, all three case study councils said that they have bylaws in the process of review, meaning that they will have to be signed by the prime minister. "We are submitting many activities here at the regional office; why should these [bylaws] not be approved at the regional level?" (official A, who is responsible for budgetary coordination in case study B). Official A also explained that the council had already made such a request to the parliamentary committee that deals with legal affairs when its members visited the council, but there had been no feedback. Karanikolas and Hatzipanteli (2010) caution that the legal framework that hinders LGAs in making decisions, coupled with centralised decision making, limits the successful implementation of decentralisation programmes.

7.4.5 Limited Involvement of LGAs in Matters Affecting their Operations

One of the factors identified as limiting LGAs in improving their financial ability is the loose interrelationships between the central government and LGAs. LGA officials

[12] The Local Government Finance Act 1982 provides guidance on how LGAs should set their bylaws

confirmed the existence of a gap between the two levels of government, particularly when it comes to making decisions which affect the operationalisation of LGAs. Smoke and Lewis (1996) observed similar problem in Indonesia, because the central government considered LGA officials to have limited capacity to contribute in key decisions. However, it is contrary to the fiscal decentralisation theory which assumes LGA officials know their operating environments better than central government officials. For instance, LGA officials described that if they had been involved in the introduction of the Tourism Act of 2008 they would not have restricted their collection of the hotel levy. They also claimed to know better their environment and the behaviour of people in their areas, so it would be better if they were involved in various decisions. For instance, senior finance official M in case study B said, “the central government can decide about something but we are the ones who know the environment, we know what can work here and what can’t”. He emphasised the need for LGAs to be involved by saying, “they are supposed to give us the option to contribute”. The importance of being involved in decision making is enhanced by the way LGA officials value their function in serving the community. They consider their work as the final stage in the government’s system of providing services to the community. The senior finance official M said, “we are the final people; if it is a product we are the ones at the end process that makes the product useful to the community”.

Similarly, the interrelationships among different government institutions seem to have an impact on the financial sustainability of LGAs in general. For instance, official A who is responsible of budgetary coordination in case study B feels that there is too little coordination between the ministry in charge of LGAs and other ministries. He said, “there are some issues which look as if PMO-RALG is skipped; some sort of bypassing because there are other directives which come straight from respective ministries to local governments”. The view of the staff is that it would not have been easy to move the hotel levy from LGAs to central government if the ministry in charge had been fully involved. If that is the case, then it is contrary to what the statement in the decentralisation policy paper, which says that the ministry in charge of local government will coordinate all issues relating to LGAs. While explaining similar challenges of loose coordination between government institutions in Indonesian decentralisation, Smoke and Lewis (1996) point out that the problem highlights the failure of decentralisation design to simplify institutional framework. Due to poor coordination, observation from case studies suggests that councils are required to prepare reports on the same issue in different formats. For instance, the budgetary coordination official in case study B said that, “you will find everyone requires his/her format, the same report can be in two or three formats”. Some formats are specific to donors and others to ministries. This consumes time and financial resources unnecessarily.

7.4.6 Budgeting Process

Limited autonomy in the budgeting process has been identified as a challenge in LGAs’ execution of their budgets. Officials complained that the process of being given a ceiling for different expenditure categories limits their ability to make adjustments according to the expenditure needs of different sectors. Smoke (2013) emphasises that the basic principle in LGAs’ budgeting process is that finances should follow LGA functions. However, the observation from evaluated case studies shows the practice is opposite. While explaining how the budgeting process limits the council’s ability to adjust according to council needs, the senior finance official R in case study T, for instance, said:

> *In budgeting we are given ceilings; for example, the central government says this council will be given this amount for roads, this amount for health, etc. If the government had really given LGAs power, it would be the LGAs who are supposed to send their priorities to the central government, to send their finance needs for budget allocations. But the central government decides on our behalf and LGAs remain as implementers, so they can decide something that is either not needed or the need is bigger than what is provided or otherwise.*

According to budgetary coordination official A in case study B, if the ceiling is not adhered to the whole budget will be refused by the ministry. Nevertheless, LGA officials seem to lack a clear understanding of the criteria used in the allocation of grants. When asked about the criteria for the ceiling and grant allocation, the budgetary coordination official in case study B said, “they just look at population, and the other criterion they say is the poverty level of the council; but I don’t think this is used”. Meanwhile official C who is a councillor in the same case study said, “allocation of the grants to a large extent considers the number of people; it also considers the administrative size of the council and priority areas”. Since the ability of the council to meet service demand is affected by the ceiling and the grant allocated, a clear understanding by all council staff of the criteria used is vital.

Moreover, as already identified in section 7.2, financial sustainability of LGAs has suffered from partial release of the allocated grants from central government for many years. However, LGA officials in the case studies believed that the unreleased amount is not carried forward in the accounts, because "central government is dealing with cash basis accounting and the cash basis doesn't need to have accruals" (budgetary coordination official, case study B). Accounting practice in the central government differs from the accrual accounting system used by LGAs. Under accrual accounting the amount is supposed to be carried forward as a debt, unless confirmed as unrecoverable and written off.

7.4.7 The Nature of People

Personal characteristics have been identified as one of the challenges in the improvement of financial sustainability of assessed LGAs, especially in own source revenue mobilisation. The findings from the comparative case studies indicate that LGAs perceive people as lacking the moral behaviour required to comply with regulations voluntarily, and hence pay taxes accordingly. For instance, according to the senior finance official M in case study B, despite their unwillingness to pay taxes, citizens are the first to complain whenever the council is unable to provide satisfactory services. He believes that one of the reasons for this is deficiency in the education system, which is supposed to mould the behaviour of citizens towards regulatory compliance. He criticised the curriculums of education institutions for not providing practical civic education, which he considered necessary for voluntary compliance. "It is very likely that our young generation goes through colleges, they get training, but something might be missing, that module of development studies; I don't know if it is still taught, it is supposed to be taught to every student, and if it is still taught it might be hypothetical rather than practical" (senior finance official M, case study B). As a result he does not see the purpose of conducting awareness campaigns for tax payers, because he believes those who evade taxes are not layman. Instead, he pointed out the need for reinstating compulsory army service so that citizens always remain loyal and obedient to the laws and regulations, including paying taxes.

While the concern of official M in case study B is on personal characteristics of the people for the country in general, the senior finance official R in case study K is more specific to his council. The official believed that agricultural productivity is low, which limits the council's revenue, because its people are not hard workers. This official said, "it just the nature of the people themselves ... it is natural". However, if they are "Sukumas, once they get a farming place, they will work harder than a machine". The Sukumas, referred to as hard workers, are a tribe found in the central and lake zone regions of Tanzania including Tabora, Shinyanga, Simiyu, Geita and Mwanza. This observation corresponds with Ishii et al.'s (2007) findings which show that differences in social background distinguishes the participation level of the people in decentralised programmes between two cities in Philippines. On the other hand, in case study T, the view of one official is that "laws are not strong enough", which is why people are not motivated to pay local taxes.

7.4.8 Age of the Council: Reflecting Maturity

Observation from the case studies suggests that the maturity of the council, as reflected by its age, is a challenge in raising revenues as well as in pressurising the council on the expenditure side. In corporate fiscal distress studies, organisation's age has been considered as a prominent factor in determining survival or failure (Altman, 1993; Liu and Wilson 2002) but not in LGAs studies of similar nature. However, the observation from case studies suggests that councils' age is also relevant in shaping their financial sustainability. For instance, the official in charge for budgetary coordination in case study B said, "small towns like ours, which are growing, need strong support from the government until they can stand on their own. Citizens have not changed from the idea of "villageship"; you tell someone that you have to pay for everything, and he/she sees it as if you are disturbing him/her". Before the establishment of the council B in 2004, the area was part of a rural district council where charges such as property tax are not allowed. Other charges such as contributions for cleaning and toilet fees in market areas are also less common in rural councils. As a result, the budgetary coordination official A in case study B said, "if you introduce a policy that the people themselves must pay for cleaning, this becomes an issue because it is perceived that the service should be offered by the government and it is not their responsibility. So that is a big challenge for us". On the other hand, council chairperson in case study T said that people in that area are no longer interested in using water wells because they feel that their status has changed with the change in council status. The council changed its status from a municipal to a city council in 2005. As a result, people demand tapped water in order to match their status of living in a city. Moreover, the staff noted since they became a city, the demand for an electricity network increased because people living in a city use electric appliances such as TVs in their daily life. Thus, the council has experienced the pressure of increased service demand since it became a city council. Issues related to the age of the council were not found in case study K, which has maintained its rural council status for over 67 years.

7.5 Chapter Summary

The findings in this chapter indicate that the design and operationalisation of decentralisation design in Tanzania contributes to constraining the general financial sustainability of LGAs. Observation from case studies shows LGAs are facing recurring financial difficulties in meeting their annual budgets. The difficulty is mainly attributed to the non-predictability of the central government grants during budget implementation. The non-predictability is in terms of both, the amount released and the timing of the grant release. Observation shows the impact to be more severe on development activities than on recurrent activities. This is due to heavy dependence on central government grants for financing development activities, although central government's dependence on donor support also seems to play a role. Own source revenues are mainly spent on recurrent activities, while the CAG report (2014) reveals donor withdrawal incapacitating the government's ability to finance LGAs. Consequently, LGA officials identify the execution of many development projects as being stacked. Projects which appear worst affected are in the health and education sectors, although water and agriculture are also affected.

Observation from case study analysis reveals three approaches used by LGA officials to deal with financial difficulties and to increase financial sustainability. The first is to involve people in carrying out council activities, either in kind or through financial contributions. This option enables the council to offer services even if it is in financial trouble. The second approach is to postpone or cut off some of their projects until funds become available, which limits access to services. The last approach is to find alternative revenue sources to enhance their financial sustainability in the future. However, officials indicated that there are a number of challenges which constrain this. Most are external to LGAs related either to the operating environment or the design and/or operationalisation of decentralisation.

CHAPTER 8 : CONCLUSION AND DIRECTION FOR FURTHER RESEARCH

8.1 Introduction

This chapter summarises the findings and their implications. It starts by summarising the findings and the implication of variations in LGAs' financial sustainability, in response to the first objective of the research. For the second objective, a summary of the findings and the consequences of fiscal difficulties, mitigating approaches and challenges facing LGAs in improving their financial sustainability is provided. Finally, the chapter outlines the significance and contribution of the study, its limitations, and areas for further research. The table 8.1 below provides the findings in glance from the two analysis chapters; chapter six and seven.

Table 8.1: Findings in Summary

Findings from Chapter Six: Assessing variation in LGAs' financial sustainability and identify its explanatory variables
1. Assessing Variations in Financial Sustainability • LGAs comprising a large proportion of poor communities have lower financial sustainability compared to LGAs with relatively well-off communities. In connection to this, LGAs with poor communities have lower expenditure per person, lower revenue raising capacity per person and lower financial independence.
2. Variables explaining variations in financial sustainability • Councils' welfare status whereby LGAs with relatively well-off communities have a better financial sustainability position compared to LGAs with a large proportion of poor communities. • The flow of central government grant; it has a positive relationship with the variation in financial sustainability of LGAs • The population size; it has a negative relationship with the variation in financial sustainability of LGAs. • Council size in square kilometre; it has a negative relationship with the variation in financial sustainability. • Financial management practices as reflected by audit report status (whether clean or not). The observation indicates that LGAs with poor financial management

practices are more financially sustainable compared to LGAs with better financial management practices.
3. Relationship between government grant, councils' welfare stutus and revenue collection efforts • LGAs with relatively poor communities are getting lower average grant allocation and distribution per person; this implies grant allocation and distribution marginalise LGAs with a large proportion of poor communities. • Revenue collection effort has a negative relationship with grant allocation and distribution per person. This implies that LGAs that are exerting lower efforts are getting higher average grant per person and vice versa. • Grant allocation and distribution has a negative relationship with population size and council size.
Findings from Chapter Seven: Consequences of Financial difficulties, Approaches used to mitigate and Challenges facing LGAs in enhancing financial sustainability.
1. Consequences of Financial Difficulties • Financial difficulties are prevalent in LGAs' budget financing throughout the five years involved in the analysis. However, development expenditures are more vulnerable compared to recurrent expenditures. • Observation from case studies suggests four priority service sectors are more vulnerable whenever LGAs experience financial difficulties. Such sectors are education, health, water and agriculture.
2. Ways used by LGAs to mitigate financial difficulties and enhance financial sustainability • Cutting down or postponing the expenditure to the next budget period if it remains a priority to the council. • Involving people in executing council activities either in kind or in cash terms. • Engaging in investment projects to establish alternative revenue sources.
3. Challenges facing LGAs in enhancing financial sustainability • As presented in subsection 7.4, LGAs in Tanzania experiences a number of challenges while attempting to mitigate financial difficulties and enhance their financial sustainability. The majority of the observed challenges is external to LGAs and relate to the design and execution of the decentralisation, meanwhile few of them are specific to LGAs.

8.2 Variations in LGAs' Financial Sustainability in Tanzania

The first objective of the study is to explore the way financial sustainability of LGAs in Tanzania varies with reference to decentralisation. In particular, it aims to observe whether the design and operationalisation of the reform offer a prospect of enhancing equity in access to services. The findings show that LGAs with a large proportion of poor people experience lower financial sustainability than those with a smaller proportion of poor people. In line with this outcome, the independent sample t-tests (subsection 6.3.1) show that the group of LGAs comprising a large proportion of poor people has low average spending per person and low average ability to raise revenue per person. This confirms the proposition of Andrews et al. (2005), which identifies that the wealth or poverty level of service recipients determines the economic resources available to LGAs.

The analysis of explanatory variables of financial sustainability identifies five contributing factors. The first is the relative poverty level of the people within the council, which has a negative influence. It implies that councils with poor people are more likely to experience lower financial sustainability. The second is financial management practices reflected by the status of the audit report received. The findings suggests that unclean audit reports tend to strengthen financial sustainability, as opposed to clean reports. The implication is that there are insufficient fiscal controls within the decentralisation system that would reward good performance and penalise financial indiscipline. The third contributory factor is the flow of government grants, reflected by the proportion actually released versus the amount allocated at the beginning of the budget period, which has positive influence. This means LGAs which receive larger proportions of their promised grants experience better financial sustainability, and vice versa. The fourth is the council size in square kilometres, which contributes negatively; and the last is population size which also has a negative contribution. This implies that populations and council size tend to constrain the financial sustainability of LGAs. Despite the fact that the grant allocation formula allows for population and council size (Allers and Ishemoi, 2011a), it seems to be insufficient to make a positive contribution to the financial sustainability of LGAs.

Along with the explanatory factors of financial sustainability, the study also explores whether grant allocations and disbursement consider the poverty level and discourage soft budget constraints. The intention is to identify whether the design of intergovernmental grants promotes horizontal equity. This is in response to the observation in chapter six, that on average the group of LGAs with a large proportion of poor people experience lower financial sustainability, lower spending per person and lower revenue raising per person. Andrews et al. (2005) states that whenever the financial capacities of LGAs differ, the allocation of central government grants is expected to neutralise the differences.

The analysis also aimed to identify whether grant allocation and disbursement discourage complacency in LGAs' own source revenue mobilisation, as Hy et al. (1993) propose. The result shows a negative relationship between the level of effort exerted in mobilising revenue and both grant allocations and disbursement. The corresponding interpretation is that decentralisation in Tanzania does not discourage soft budget practices, which is why grant allocation does not reflects revenue mobilisation efforts. On the other hand, the results indicate that LGAs with a large proportion of people living below the income poverty line have lower grant allocations and disbursement per person than those with relatively wealthier populations. This affirms the argument of Allers and Ishemoi (2010) that the present grant allocation formula in Tanzania does not incorporate fiscal capacity measures, and Allers and Ishemoi (2011b) who revealed the existence of divergence from the formula application resulting from regional differences in political representation. The impact of this departure from the theory is to increase the gap in service access between people living in LGAs with different revenue raising capacity. It implies that decentralisation design in Tanzania has not managed to address the problem that persisted before the introduction of the grant allocation formula in 2004. Boex (2003) found that, prior to its introduction, LGAs with relatively higher financial capacity were receiving higher allocations than their counterparts.

The danger of marginalising LGAs with relatively poor people is that it will exaggerate the imbalance in service access over time. Consequently, it presents the risk of disturbing social cohesion, with the possible eruption of conflict against incumbent administrations, especially in those marginalised areas. The recent conflict (of 2013) between the people in the marginalised Mtwara region and the government regarding the natural gas investment project sends a bad signal to the country. The conflict was partly attributed to underdevelopment of the region coupled with the lack of key social services such as electricity, good roads and schools (Ndimbwa, 2014). Ndimbwa further noted that, lack of secondary schools in the region was the reason for 77% of the qualified children not progressing with their studies in 2003. That group of young people, who lacked the chance to progress with secondary education have limited opportunities and are likely to be at the forefront whenever disruptions of such a kind arise.

8.3 The Impact of Financial Difficulties on LGA Operations

As part of the second research objective, the study explores the consequence of financial difficulties. The findings suggests that LGAs in Tanzania experience recurring financial shortfalls in the course of implementing annual budgets. This is due to their heavy dependence on central government grants, especially for development activities, grants which are unpredictable in terms of the amount allocated versus that released and timing. This affects development activities more severely than recurrent expenditure, as the flow of grants for recurrent activities is observed to be good. It might be due to the sensitivity of recurrent grant in LGA operations. The category comprises grants for personal emoluments and other office expenses.

The most affected projects, as identified by council officials, are those which involve construction projects particularly in four service sectors, health, education, water and agriculture. Besides non-disbursement, delays in releasing grants were observed to lead to constraining LGAs' ability to execute their annual service provision targets. LGA officials revealed that grants are sometimes released late in the year, making it difficult to execute plans for that year; hence a significant amount of the funds is carried forward every year. As a result, citizens miss the benefits that would have accrued from the postponed activities.

Own source revenue makes little contribution to LGAs' overall budget, about 7.4% for the group of LGAs analysed in chapter 6; and LGAs have discretion over its use. As a result, LGA officials say that own source revenues are spent on office expenses and other recurrent expenditures. They added that the central government has issued a directive which requires LGAs to allocate 60% of their own source revenues to development activities. This directive seems to aim at reducing the load of central government in financing LGAs and to strengthen the financial independence of LGAs by requiring them to contribute to development activities. Moreover, the requirement seems to bring the action of LGAs officials close to the community in order to enhance fiscal discipline. When projects are financed by grants, people tend to feel that the project is financed by others and hence are unlikely to institute strong monitoring of the actions of local officials (Rodden, 2000). Rodden (2000) adds that the empirical literature shows that an increase in grants tends to accelerate spending patterns more than the same increase in own source revenue.

Nevertheless, it can be argued that the financial difficulties in LGAs' budget execution and their consequences arise because of heavy dependence on central government, which in turn depends on donor support to fund LGAs. This is reflected in the CAG (T) report (2013) which concludes that the ability of central government to release funds to LGAs has been affected by withdrawal of donor commitments. For instance, the government under-received a significant amount from donors for the year 2011/12, corresponding to the under-released amount to LGAs in that year. This may reflect Plekhanov (2005) and Bahl's (2000) proposition, that central government may use intergovernmental grant system as part of the strategy to relieve its own budget deficit.

Generally, both problems of shortfall in the amount of revenue and delay in grant release reflect shortcoming in the operation of decentralisation. Considering these findings, the prospect of decentralisation to improve public services is generally limited unless remedial actions are undertaken to adjust reform implementation, as Guess (2007) suggests. Guess (2007) states that decentralisation reform is a work in progress which requires sufficient monitoring and rectification of any encumbrances.

8.4 Ways Used to Mitigate Difficulties and Enhance Financial Sustainability

This study concludes that LGAs in Tanzania use three main approaches to mitigate financial difficulties whenever they arise, and to improve their financial sustainability. The first involves people in the provision of services. Council officials revealed that they harness the contribution of the populace either through volunteering or as partners in the provision of services, that is either in kind or in cash terms. Officials in one council, for instance, said that cleaning within the council is done in partnership with small groups formed in each street. Such groups collect solid waste from households under the coordination of a street chairperson, for a small fee. Similarly, the use of contributions in kind is common in construction projects, whereby people are involved directly in some construction activities under the supervision of the council's technical person. Contributions, both in kind and in cash increase the ability of councils to offer services, even if the council experiences a shortage of funds.

The second approach is the postponement of council activities until the fund becomes available, but only if the activity remains a priority to the council. Otherwise, the activity is trimmed down. Based on the view of LGA officials, the approach of postponing activities is also preferred by the central government, particularly for development projects which are funded through grants. Whenever the amount of grant disbursed falls short of the promised amount, LGAs are advised to re-budget afresh to accommodate the missed portion. However, the impact of this approach is to curtail the availability of services to the people by delaying it.

The third approach is expanding the revenue base. Council officials in the three case studies identified two approaches LGAs use to expand their revenue base. These are the sale of land plots, and engaging in investment projects. The sale of land generates revenue to the council not only from the sale itself, but subsequently as land rent and by attracting benefits related to the buildings constructed on such plots. Benefits attached to buildings include property tax, and business licensing fees for commercial buildings. However, the direct proceeds from land sales are not sustainable because plots are only sold once and, according to national regulations, the shortest lease agreement is 33 years. Meanwhile, the realisation of the subsequent benefits such as property tax is subjected to many factors, such as the fiscal ability of the purchasers to construct the buildings and the council's ability to attract investment projects.

Regarding investment activities, council officials in all three case studies identified different projects already underway, including the construction of shopping malls, conference facilities and buildings for commercial frames. The officials explained that the aim is to reduce financial dependence on central government, while simultaneously establishing revenue sources that will provide them with a steady revenue flow. LGAs also aim to reduce dependence on income that involves taxpayers. Nevertheless, increasing financial sustainability through expanding revenue bases will take longer to materialise because investment in real assets takes longer to provide returns.

Hastings et al. (2015a) observed three approaches to be used in English municipalities to mitigate the impact of difficulties arising from austerity programmes and their usage follows a pattern. The findings of Hastings et al. (2015a) suggest that, to deal with prolonged fiscal difficulties municipalities start to optimise efficiency at early stage, followed by retrenchment while waiting for investment projects to materialise. In contrast, the three approaches observed in this study are used concurrently although investment projects also require time to materialise. The difference might be due to operating environment LGAs are subject with, but they are all aiming to sustain service provision. In Tanzanian LGAs, for instance, retrenchment is not viable option because recruitment and payroll function is controlled by the central government.

8.5 Challenges to Enhancing Financial Sustainability

The researcher observed a number of challenges that constrain the ability of LGAs to improve their financial sustainability in general. The first challenge is lack of trust in the revenue collection agents, although this is related to the LGAs' inability to efficiently manage the outsourced agents. Another challenge associated with enforcing own source revenue collection is the enforcement costs compared to the benefits derived. Officials said that some revenue sources, such as property tax, are difficult to enforce through legal action against defaulters, because the cost would exceed the benefit.

Other challenges include politics at the local government level, whereby local politicians discourage people from contributing to council activities; the age of the council; and the attitude of people towards hard work. LGA officials also believed that the design of policy and regulations within decentralisation constrain LGAs' autonomy in own source revenues. The official of a rural council gave the example of the prohibition on rural LGAs to collect property tax, while urban councils are allowed to collect it. LGA officials also questioned the bureaucratic procedures relating to policy and regulations which prolong the process of setting bylaws to administer own source revenue collection, consequently limiting LGAs' ability to adjust with changing needs. Moreover, observation from the case studies suggests there is limited involvement of LGAs in matters affecting their operations, and limited autonomy in the budget-setting process. Generally, LGA officials agreed that limited autonomy over revenue sources and in setting rates constrained their ability to increase their financial sustainability. This poses the danger of missing the benefits of decentralisation, as Brueckner (2000) stated, especially those related to service provision. Based on experience from Latin American countries, Brueckner (2000) concludes that limited autonomy in LGAs constrains the realisation of the full benefits of decentralisation reforms.

8.6 Recommendations

Based on the findings, there is a need of revisiting the design and implementation of decentralisation in order to address identified shortcomings. The study specifically recommends three policy issues that need considerations. First, is to revisit intergovernmental grant system so as to reflect welfare status of the people hence enhancing equitable access to public services across jurisdictions. Secondly, is to increase financial independence of LGAs, which should go parallel with enhancing financial management controls. This will help not only reducing heavy reliance on central government grants, but also increase accountability of LGAs to own source revenue mobilisation and grant utilisation. As Prud'homme (2003) point out, the importance of own source revenues to LGAs tend to decline with the increase in central government transfers. Thirdly, to streamline policies and legal frameworks accordingly so as to address challenges that constrain ability of LGAs to enhance their financial sustainability and improve public services.

8.7 Contribution and Significance of the Study

The study offers three main contributions. First, it links two research themes, fiscal decentralisation and financial sustainability, which have previously been considered as distinct and therefore studied independently of each other, even though they are inherently interrelated. Empirical studies concentrated on exploring the success or failure of reform without considering how reform processes have been carried out, or on examining LGAs' financial conditions independently of decentralisation reforms. The scarcity of research that assesses the impact of decentralisation on the financial condition of LGAs has been observed by Stone (2015). Moreover, the methodology applied in this study, mixed methods, provides additional insight into analysing the two interrelated themes together.

Secondly, the study provides feedback on the progress of decentralisation reform in Tanzania while it is still underway. Tanzania being a developing country, high expectations have been attached to the implementation of reform in improving services to citizens and reducing the poverty level. Therefore, the research findings offer insights into areas of weaknesses that can be addressed by policy makers to improve the likelihood of achieving the intended benefits. On the other hand, the findings provide explanations of why decentralisation does not always provide the intended benefits. This offers useful insight for other developing countries with a similar political and social context to Tanzania.

Thirdly, the study broadens the context in which the financial sustainability of LGAs can be analysed. The interpretation of the case studies suggests that there are some factors that have been overlooked in analysing the financial sustainability of LGAs, although they are also relevant to analysing the financial condition of private sector institutions. These factors include councils' age/maturity and the nature/attitude of people towards hard work. The age of the organisation has been considered a prominent factor in corporate distress studies (Altman, 1993; Liu and Wilson 2002). In contrast, there is no apparent evidence of this factor being considered in local government studies of a similar nature.

8.8 Study Limitations

The study has some limitations which indicate the need for further research. First, the study has not covered the views of the policy makers regarding the design and implementation of decentralisation. Although efforts have been made to crosscheck the responses of the LGA officials, the views of policy makers from central government would provide additional insights. Secondly, generalisation of the findings to the wider world are limited because the research employed case study analysis which face such criticism. Thirdly, in relation to the generalisation problem, the study has not included all LGAs in the quantitative analysis of financial sustainability because of the limitations of the criteria used for inclusion. The Poverty and Human Development report used to identify the proportion of people living below the income poverty line within LGAs reported on only forty councils. However, the limitations do not nullify the usefulness of the research outcome.

8.9 Areas for Further Research

The research has identified a number of challenges regarding the implementation of reform. There is a need for further research to identify whether all the challenges are the result of chance or are inevitable. This will provide further insight into the intention of those in power to implement reform successfully and attain the anticipated benefits. As Keefer and Khemani (2005) suggest, some benefits of decentralisation can only be achieved if there is deliberate intention and credibility of power holders to honour their promises. Otherwise, political motives will limit its achievement especially in the presence of weak democracy. On the other hand, based on literature Conyers (2007: p.22) claims that the problems which hinder benefits of decentralisation in Africa are not associated with decentralisation failures as revealed in many studies. Instead, they are reflecting "fundamental characteristics" of such countries and would happen even within centralised governments. Thus, any further research may also need to explore this claim.

Another area which requires further research is the reliability of external assistance in supporting reform programmes. The study found that inadequate government support for LGAs is partly due to withdrawal of donor commitments. This problem also contributed to the collapse of the earlier decentralisation initiatives of 1972 (Belshaw, 1982). The study should therefore suggest possible ways in which central government can increase its financial independence in supporting LGAs.

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APPENDICES

Appendix A: Measurement Indicators Used in Previous Studies

Author(s)	Type of Ratio/ Measure as categorized by Author	Formula/Indicators
Ritonga et.al (2012)	*Short term Solvency*	*1. Ratio A = (Cash and Cash Equivalent + Short-term Investment) / Current Liabilities*
		2. Ratio B = (Cash and Cash Equivalent + Short-term Investment + Account Receivables) / Current Liabilities *3. Ratio C = Currents Assets / Current Liabilities.*
	Budgetary Solvency	*1. Ratio A = (Total Revenues – Special Allocation Fund Revenue) / (Total Expenditures – Capital Expenditure),*
		2. Ratio B = (Total Revenues – Special Allocation Fund Revenue) / Operational Expenditure,
		3. Ratio C = (Total Revenues – Special Allocation Fund Revenue) / Employee Expenditure,
		4. Ratio D = Total Revenue / Total Expenditure
	Long Term Solvency	*1. Ratio A = Long Term Liabilities / Total Assets,*
		2. Ratio B = Long Term Liabilities / Investment Equities,
		3. Ratio C = Investment Equities / Total Assets
	Service Solvency	*1. Ratio A = Total Equities / Population,*

Author(s)	Type of Ratio/ Measure as categorized by Author	Formula/Indicators
		2. Ratio B = Total Assets / Population,
		3. Ratio C = Total Expenditures / Population
	Financial Flexibility	*1. Ratio A = (Total Revenues – Special Allocation Fund Revenue – Employee Expenditures) / (Repayments of Loan Principal + Interest Expenditures),*
		2. Ratio B = (Total Revenues – Special Allocation Fund Revenue – Employee Expenditures) / Total Liabilities,
		3. Ratio C = (Total Revenues – Special Allocation Fund Revenue – Employee Expenditures) / Long Term Liabilities,
		4. Ratio D = (Total Revenues – Special Allocation Fund Revenue) / Total Liabilities.
	Financial independence	*1. Ratio A = Total Own Revenues / Total Revenues,*
		2. Ratio B = Total Own Revenues / Total Expenditures
Bhattacharyya and Bandyopadhyay (2012)	*Own Fund Ratio*	*(Amount of Own Fund/ Amount of Total Receipts) x 100*
	Own Fund Coverage Ratio (independent variable)	*(Amount of Total Expenses- Amount of Grant)/ Amount of Own Fund x 100*
Lewis (2003)		*Surplus or Deficit*

Author(s)	Type of Ratio/ Measure as categorized by Author	Formula/Indicators
	Financial Performance indicator	*(Defined as local government routine revenues minus routine expenditures)*
Michigan Department of treasury as acknowledged by Plerhoples and Scorsone (2010) ;	*Budget Solvency*	***1(General fund expenditures – General fund revenue)/General fund revenue.*** *If ratio is < -.01, unit receives a 1; If ratio is ≥ 1, unit receives a 0.*
		2. (General fund expenditures – General fund revenue)/General fund revenue all measured in previous year, and two years past *For each year that ratio is < -.01, unit receives a 1.* *For each year that ratio is ≥ 1, unit receives a 0.*
		3. General fund balance/General fund revenue *If ratio is < half a standard deviation, unit receives a 1.* *If ratio is ≥ 0, then unit receives a 0.*
		4. Fund (general, special, capital, and debt service funds) deficit in current and previous year *If a unit had a negative fund balance in any of these funds in the current or prior year, it receives a 1. If it did not, it receives a 0.*
	Long run	***1. Current population - population of 2000*** *If population change is < 0, unit receives a 1.*

Author(s)	Type of Ratio/ Measure as categorized by Author	Formula/Indicators
		If population change is ≥ 0, then unit receives a 0.
		2. Current taxable value – taxable value from two years past *If change in two year taxable value was < 0, unit receives a 1.* *If two year TV was ≥ 0, unit receives a 0.*
		3. Current taxable value – taxable value from two years past *If change in two year TV was < one standard deviation, unit receives a 1.* *If change in two year TV was ≥ one standard deviation, unit receives a 0*
		4. General long-term debt/taxable value *If ratio is > one standard deviation, unit receives a 1.* *If ratio is ≤ one standard deviation, unit receives a 0.*
	Service Solvency	***1. General fund expenditures/ taxable value*** *If ratio is > one standard deviation, unit receives a 1.* *If ratio is ≤ one standard deviation, unit receives a 0.* *(Note: standard deviations different for townships and cities for this indicator only.)*
Murray and Dollery (2005)	*Performance indicators i.e. financial and non-financial*	*1. Ordinary Revenue – Total*
		2. Ordinary Revenue - Per Capita
		3. Ordinary Expenditure – Total
		4. Ordinary Expenditure - Per Capita

Author(s)	Type of Ratio/ Measure as categorized by Author	Formula/Indicators
	indicators used in the model (were not categorized by the author)	*5. Current Ratio (Unrestricted)*
		6. Debt Service Ratio
		7. Capital Expenditure Ratio
		8. Annual Report Submitted On-time
		9. State of Environment Report Submitted On-time
		10. Financial Report Submitted On-time
		11. Population within council's boundaries
		12. Area of council in square kilometres (sqkm)
		13. A dummy variable, where 1 = Council in Rural/ Regional area
		14. A dummy variable, where 1 = Council supplies water/ sewerage services
Australian Financial Sustainability Review Board as identified in Dollery and Crase (2006)	*Indicators of Financial Sustainability*	*1. Net financial liabilities - as the key indicator of the council's indebtedness to other sectors of the economy*
		2. Operating surplus or deficit - as the 'key indicator of the intergenerational equity of the funding of the council's operations
		3. Net outlays on the renewal or replacement of existing assets- as the key indicator of the intergenerational equity of the funding of the council's infrastructure renewal or replacement activities
		4. Net borrowing or lending- as the key indicator of the impact of the council's annual transactions – both operating and

Author(s)	**Type of Ratio/ Measure as categorized by Author**	**Formula/Indicators**
		capital – upon the council's indebtedness to other sectors of the economy
Cohen et al. (2012)	*Indicators of Financial distress to local municipalities*	*1. Total liabilities / Total assets – as indicator of municipal reliance on third part financing*
		2. Own revenues/ Total liabilities – as indicator of municipal's capacity to pay interest from own revenue
		3. Short term liabilities / Own revenues- as liquidity ration indicating relationship between short term liabilities and own revenues
		4. Operating expenses/ Own revenues – as indicator of municipal's reliance on central government subsidies to finance operating expenditures
		5. Subsidies/ population – as indicator of central government subsidy
		6. Own revenues / population – as a measure of financial autonomy and easiness to overcome financing problems when central government faces difficulties in providing subsidies

Source: Author derived from literatures

Appendix B: Variables Used in this Study and their Formulae

Abbreviation	Formula	Measure
Richness	0 for LGAs with well-off communities 1 for LGAs with poor communities	An indicator for the extent of poverty level in LGAs
Type	Categorical variable: 0 for urban councils and 1 for rural councils	Control variable
Auditreport	Categorical Variable; 0 for Clean report and 1 for unclean report	Financial Management Practices
TTexppercapita	Total Expenditure/ Number of people in council	Ability to Spend on Service Provision per Person
OSpercapita	Own source revenues/ Number of people in council	Ability to Raise Revenue per Person
ActualTotal Transfersratio	Actual Total Government Grant/ Budgeted Total Government Grant	Reliability of Central Government Grant flow
ActualRecGrant ratio	Actual Recurrent Grant/ Budgeted Recurrent Grant	Reliability of Recurrent Grant flow
ActualDevGrant ratio	Actual Development Grant/ Budgeted Development Grant	Reliability of Development Grant flow
Total Expend.ratio	Actual total Expenditure/ Budgeted Total Expenditure	The extent of total expenditure Budget execution
Recurrent Expend.ratio	Actual Recurrent Expenditure/ Budgeted Recurrent Expenditure	The extent of Recurrent Expenditure Budget execution
Develop. Expend.ratio	Actual Development expenditure/ Budgeted Development Expenditure	The extent of Development Expenditure Budget execution
Poppersqkm	Number of people in a council/ Square kilometres	Population Density
OwnSource Revs.ration	Actual own source revenues / Budgeted own source revenue	Own Sources Revenues Efforts

Abbreviation	Formula	Measure
TTtransfers percapita	Total Central Government Transfers[14]/ Number of People	Amount of Central Government Support per Person
Population	Number of people within LGA	Council Size
SqKm	Number of square kilometres	Council Size
TotoRevBgtExp	Total Actual Revenues/ Budgeted total expenditure	Ability to Finance Budgeted Expenditures; it is an indicator for budgetary solvency
TTexpTTRev	Total Actual Expenditure/Total Actual Revenues	The extent of actual surplus; it is an indicator for budgetary solvency
OS/RecExp	Own Source Revenues/ Recurrent Expenditures	Financial Independence
OSTTexp	Own Source Revenues/ Total Expenditure	Financial Independence
Gvtgrnt/OS	Total Central Government Grant/Total Own Sources Revenues	Financial Independence
ROADDISTANCE	Road Distance from Dar es salaam to region in which the council is located (plus 1 km for councils not in the regional headquarter)	Control variable for Environmental factor

Source: Author and derivation from Literatures

[14] Includes both, development and recurrent grants

Appendix C: LGAs' Financial Sustainability Composite Score 2008/09 - 2012/13

SN	Name	Richness[15]	2009	2010	2011	2012	2013	Average
1	Geita (R)	1	0.5538	0.3545	0.2851	0.3384	0.3262	0.3716
2	Mbarali (R)	0	0.6179	0.5348	0.3109	0.1689	0.3482	0.3962
3	Ukerewe (R)	1	0.7216	0.5741	0.2526	0.2266	0.3242	0.4198
4	Mbozi (R)	0	0.4535	0.6882	0.3140	0.2668	0.4758	0.4396
5	Namtumbo (R)	1	0.6729	0.5376	0.3186	0.3304	0.4759	0.4671
6	Sengerema (R)	1	0.9170	0.7198	0.1967	0.2488	0.2621	0.4689
7	Bunda (R)	1	0.7055	0.6866	0.3952	0.3243	0.3297	0.4883
8	Mbulu (R)	1	0.7766	0.6944	0.3612	0.4424	0.2261	0.5002
9	Biharamulo (R)	1	1.0000	0.6624	0.4263	0.2104	0.2616	0.5121
10	Hanang (R)	1	0.8096	0.8567	0.3856	0.2102	0.3499	0.5224
11	Igunga (R)	1	0.5954	0.6595	0.5669	0.3058	0.4991	0.5253
12	Bukoba (R)	0	0.8136	0.6346	0.3243	0.3296	0.5267	0.5258
13	Lindi (R)	1	0.7298	0.7618	0.4328	0.3992	0.3544	0.5356
14	Manyoni (R)	1	0.9352	0.5554	0.3231	0.3665	0.5329	0.5426
15	Hai (R)	0	0.6470	0.7430	0.4957	0.4549	0.5247	0.5731
16	Meatu (R)	1	0.9335	0.4978	0.3629	0.5785	0.5312	0.5808
17	Serengeti (R)	1	0.7445	0.6257	0.4104	0.2815	0.9588	0.6042
18	Lushoto (R)	0	0.7995	0.9728	0.6225	0.3914	0.4629	0.6498
19	Uyui/Tabora (R)	1	0.7570	0.8210	0.4181	0.7284	0.5626	0.6574
20	Musoma (R)	1	0.7580	0.9029	0.7766	0.5087	0.4849	0.6862
21	Kondoa (R)	0	1.0000	0.8118	0.6336	0.5680	0.4356	0.6898

[15] Zero for LGAs comprising well-off communities and one for LGAs comprising poor communities, as per Capital and Human Development Report, 2005

SN	Name	Richness[15]	2009	2010	2011	2012	2013	Average
22	Kisarawe (R)	1	0.8722	1.0000	0.6663	0.3000	0.6337	0.6944
23	Shinyanga (U)	0	0.7684	0.7557	0.5637	0.5928	0.8375	0.7036
24	Bukoba (U)	0	0.8503	0.6831	0.6412	0.6622	0.7710	0.7215
25	Morogoro (U)	0	0.9314	0.8766	0.6561	0.7269	0.4318	0.7245
26	Tanga (U)	0	1.0000	0.5697	0.7577	0.6796	0.7080	0.7430
27	Bukombe (R)	1	0.8251	0.7740	0.6289	1.0000	0.5677	0.7591
28	Lindi (U)	0	0.5970	0.8483	1.0000	0.6451	0.7431	0.7667
29	Iringa (U)	0	0.6765	0.7534	0.5461	1.0000	0.8975	0.7747
30	Babati (U)	1	1.0000	1.0000	0.8027	0.5429	0.5417	0.7775
31	Singida (R)	1	0.9482	1.0000	0.8298	0.6849	0.5618	0.8049
32	Arusha (U)	0	1.0000	1.0000	0.4874	1.0000	0.7128	0.8400
33	Moshi (U)	0	1.0000	0.7577	0.7299	0.8786	1.0000	0.8732
34	Pangani (R)	0	1.0000	1.0000	0.7413	0.6356	1.0000	0.8754
35	Mbeya (U)	0	0.8675	0.8918	1.0000	1.0000	0.7683	0.9055
36	Mwanza (U)	0	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000
	Average	-	**0.8133**	**0.7557**	**0.5462**	**0.5286**	**0.5675**	**0.6423**

Source: Author - DEA model output and Calculations

Note: (U) stands for urban Council and (R) for rural council

Appendix D: Descriptive Statistics

	Minimum	Mean	Maximum	Std. Deviation
	Statistic	Statistic	Statistic	Statistic
ScoreINDyrs	.168913	.642249	1.000000	.238007
Total Expend.ratio	34.42	77.9788	131.24	17.50646
Recurrent Expend.ratio	38.50	87.7881	129.98	18.15815
Develop. Expend.ratio	6.82	56.6304	176.08	25.10830
OS/Rec Exp	.012459	.096210	.369602	.064989
OSTTexp	.010198	.077411	.310535	.054708
ActualTotalTransfersratio	9.53	83.7488	132.78	17.05265
ActualRecGrantratio	44.70	90.5184	140.60	17.89948
ActualDevGrantratio	2.29	70.1824	189.52	29.78237
OwnSourceRevs.ratio	19.56	86.1578	155.00	24.93959
Poppersqkm	9.11	358.8442	3123.59	633.21
ROADDISTANCE	35	826.47	1434	377.690
OSpercapita	697.25	4894.71	20630.33	4356.79
Population	49521	268913.07	663034	129199.88
SqKm	59.0	5630.43	28620.0	6552.479
TTExppercapita	15904.39	63308.76	138622.10	25844.27
TTtransferspacapita	16713.45	66166.82	148775.82	26415.49
BudTransPercapita	22296.11	82110.75	192766.55	37251.77
N=180				

Source: Author derived from analysis

Appendix E: Received Grant versus Unspent Amount (in Tanzanian Shillings) – All LGAs

Recurrent Grant	2008/09	2009/10	2010/11	2011/12	2012/13
Amount Received	1,023,504,263,229	1,521,937,206,309	2,105,926,241,086	2,311,080,861,836	2,867,426,385,004
Amount Spent	976,332,807,352	1,373,576,272,098	1,978,117,478,839	2,186,486,605,144	2,721,098,075,973
Unspent Amount	47,171,455,877	148,360,934,211	127,808,735,247	124,594,256,692	146,328,309,031
Percentage	4.6	9.7	6	5.4	5
Development Grant	2008/09	2009/10	2010/11	2011/12	2012/13
Amount Received	328,203,178,845	507,866,599,666	542,339,143,645	535,017,077,030	686,302,878,625
Amount Spent	239,482,549,650	332,092,443,562	367,778,247,642	346,716,653,619	442,625,815,185
Unspent Amount	88,720,629,195	175,774,156,104	174,560,896,003	188,300,423,411	243,677,063,440
Percentage	27	35	32	35	36

Source: Compiled from CAG Report (2014: 41-42) for financial Year 2012/13

Appendix F: Grant Release Trend– Total Amount for All LGAs (in Tanzanian Shillings)

Recurrent Grant	2008/09	2009/10	2010/11	2011/12	2012/13
Amount Approved	848,244,823,445	1,248,760,338,699	1,242,318,963,483	1,618,877,128,175	2,102,969,648,522
Amount Released	757,195,467,343	1,104,588,746,584	1,111,762,925,260	1,447,482,142,661	1,827,566,402,405
Amount Unreleased	91,049,356,102	144,171,592,119	130,556,038,222	171,394,985,514	275,403,246,117
Percentage-unreleased	11	12	11	11	13
Councils involved	73	87	78	87	99
Development Grant	2008/09	2009/10	2010/11	2011/12	2012/13
Amount Approved	386,165,146,158	395,038,612,520	529,494,590,274	595,064,422,505	673,590,626,951
Amount Released	245,623,406,798	246,475,254,935	308,572,669,609	345,568,067,477	420,283,949,168
Amount Unreleased	140,541,739,360	148,563,337,585	220,921,920,666	249,496,355,027	253,306,677,783
Percentage-unreleased	36	38	42	42	38
Councils involved	105	86	105	113	114

Source: Compiled from CAG Report (2014: 32-35) for Financial Year Ended 2012/13

Appendix G: Case Study – Interview Guide

1. Questions for Revenue Collection - Operational Staffs

Questions	Probes/further questions	Rationale
1. Can you tell me what your current role is all about?	Which activities are you involved with?	To understand participant's day to day activities in own sources revenue collection
2. How do you manage you revenues collection activities?	Do you use agents in collecting revenues? How do you monitor their revenue collection activities to ensure that you meet revenue targets?	To understand if the council uses revenue collection agents and how do they manage them to ensure revenue targets are attained.
	Do you make visits to revenues sources to collect revenues?	To understand if the council uses its own staffs who make physical visits to local tax payers
	Do you conduct self-compliance awareness campaigns? How do you make it?	To know if there are any local tax compliance campaign, the media used and the frequency of the campaign.
	How do you enforce non tax payers	To know the methods used to enforce compliance from tax evaders
3. What are main problems you encounter in your daily revenue collection activities?	What problems are you facing in revenue collections? How do you solve them to ensure that targets are met?	To know problem an LGA is facing in collection revenues and how do they solve them
	In your view what are the causes of these problems? Are there any problem which are associated with policy/ regulatory shortcomings?	To understand problems encountered in the course of collecting revenues.
4. What are your main revenue sources?	Which sources provided you with large share of revenues? Which are providing you less contribution?	To identify sources of revenues contributing a lot to the own sources
	Which sources are providing you reliable revenues every year?	To identify sources which provides reliable revenues
	Which sources are giving you fluctuating revenues from year to year?	To identify revenue sources which cannot be relied upon
5. Are there any rewards for meeting or exceeding targets or punishment for not meeting targets?	What are the rewards you are getting when targets are met or exceeded? What are the penalties for not meeting targets	To identify motivations and penalties offered to motivate own sources collection staffs

2. **Questions for Revenue Collection – Decision making Staffs**

Questions	Probes/further questions	Rationale
1. Regulations allow you to collect own revenues from a number of sources. Do you deploy all allowed sources?	Which revenue sources are you currently deploying?	To identify sources of revenues which are currently deployed
	Which revenue sources are you currently not deploying? Why are you not deploying them?	To identify sources of revenues which are not deployed and reasons for not deploying them
2. Are there revenue sources that would be appropriate for enhancing your revenues but regulations constrain you?	Which revenue sources would be suitable for you to enhance your revenue sources?	To identify revenue sources that would enhance LGAs' revenues but regulations constrain to engage them.
	What would you suggest to make them useful to you?	To identify recommendations on enhancing revenues sources
3. In some revenues sources, rates have been established by the central government through various regulation. Do you think established rates are appropriate?	Are there sources which you would wish to charge higher or lower rates but regulation constrain you?	To find out if there are any regulatory constraints over revenue rates setting discretionary
4. What challenges are you facing in collection of revenue from allowed sources? E.g. Economy condition, rain, political interference, spatial population, internal capacity.	Are there any challenges associated with economic condition that affects revenue collection? How do they affect you?	To identify if there are any factors associated with economy (such as inflation, GDP growth/fall) that affects local revenue collections
	Are there any factors associated with weather condition (such as rain) that affects your revenue collections? How do they affect you?	To identify if there are any environmental factor that affect local revenue collections
	Are there any factors associated with geographical size of you council that affects your revenue collection? How do they affect you?	To establish if there are any factors associated with geographical size of the LGA on local revenue collection
	Are there any factors associated with population geographical distribution (i.e. population density) that affects your revenue collections? How do they affect you?	To establish if there are any factors that are associated geographical distribution of the population within an LGA on local revenue collections

	Are there any factors associated with resources required affecting your revenue collection? How do they affect you?	To identify if there are any factors associated with resource availability to enforce local revenues collections
5. Do you have any external binding requirements that require you to collect revenue to certain targeted amount?	Are there any requirements from other government institutions such as ministry on amount of local revenues you supposed to collect? Are there any CAG recommendations that require you to collect revenue to certain targets?	To identify if there are any requirements from the central government or CAG that pressurises LGAs to meet specific revenue collection targets.
	Are there any requirements on own sources collection before you are allocated with central government grants? Any fiscal system built in measures?	To identify if the design of the central government system imposes specific own source revenues collection targets to be met before grant allocation is made
6. Do you have any internal measures taken to ensure revenue targets are attained?	Which controls do you use to enforce revenue collection targets attainments?	To identify operational controls used to enhance revenue collection efforts hence attaining targets
7. Do you offer any rewards or penalties to your revenue collection staffs when targets are met or not met?	Are there any motivations to your revenue collection staffs for meeting or exceeding targets? What are the rewards do you provide them?	To identify if there are any rewards offered to operation staffs especially those concerned with enforcing revenue collection for meeting or exceeding revenues targets.
8. How do you ensure that your budgeted revenue targets are always realistic?	How do you ensure that revenue targets are neither underestimated nor overestimated? Which factors do you consider to establish realistic targets?	To establish if there are any measures/controls the council uses to ensure that the revenue targets are always realistic.
9. Do you involve agents in revenue collection including those from lower LGA levels (if any)?	How do you recruit them?	To identify approaches used to recruit revenue collection agents (if any)
	How do you ensure what they remit is what you are supposed to receive? How do you ensure all revenues collected by third parties are timely remitted into your account?	To find out the way the council enforces revenue amount and timing of remittance from collection agents.
On Central Government Grant		

1. What factors determine your grant allocation share? Do they include any specific requirements in own sources revenue collection?	Which factors determine your grant share from the central government? Do they include any specific requirement over own sources revenues collection?	To establish understanding of members of council management on factors determining their grant share
2. Are there any criteria used to disburse grants during budget implementation? If yes what are they?	Which criteria are used in disbursements of grants during budget implementation?	To identify criteria used to disburse grants during budget implementation
	Which factors affects the flow and timing of grant disbursement to your council?	To identify factors which influences amount and timing of grant flow to LGAs
	As a council, do you have any influence on the timing and amount government grants to be disbursed?	To identify if LGAs can influence amount and timing of grant flow.
3. Does Association of Local Authority Tanzania (ALAT) have any influence in grant allocations and disbursements to its members?	Can ALAT influence amount and timing of government grant to its members?	To identify if the association of local government (as LGAs' forum) has power to influence amount and timing of grants to its members
4. CAG general reports for Local Governments indicates consistence shortage in central government grant disbursed to LGAs in recently 3 years. Do you know any main reasons that contribute into consistently shortage in central government grant disbursement across LGAs?	Which factors contribute to consistently shortage of grant disbursed to your council compared to amount approved?	To identify if LGAs are aware of the reasons contributing to cutting down of central government grants during disbursement.
5. Is the timing flow of central government grant appropriate for you to implement your activities as planned?	Is the timing of grant flow similar for both recurrent and development grants? If not which is appropriately disbursed compared to the other?	To identify similarities and differences in grant flow to LGAs
	Which grant categories are highly vulnerable in grant disbursement when central government is unable to disburse approved budgets?	To identify grants that are shortly disburse frequently

On Expenditure Side of the Budget		
1. What factors exerts pressure in spending requirements?	Which factors influences your expenditure needs from time to time? Population growth? Geographical size of the council? Changing weather condition exerts any specific expenditure needs? Central government directives? Political interferences?	To identify factors that exerts pressure in LGAs expenditure side of their budgets
2. How do you establish realistic expenditure budgets?	What are the main challenges in expenditure budgeting? What are the main challenges of establishing realistic expenditure budgets?	To identify the way LGAs establish realistic budgets and challenges they are facing
3. Have you experienced shortfall in central government grant disbarment in recently 3 years?	How do you mitigate shortfall in central government grant allocations? Which expenditure categories are mostly vulnerable when you decide to cut expenditure to mitigate shortage?	To identify if there are specific categories of expenditures which are highly vulnerable whenever an LGA decides to cut down expenditures to mitigate financial difficult
	Is it possible to use short term loans from financial institutions?	To identify it the council is capable of using short term loans to mitigate short term financial difficulties
	Have you ever thought of improving operational efficiency so that you meet the same targets at less cost without compromising quality?	To identify if there is a room for LGAs to mitigate financial difficult by increasing operational efficiency
	Do central government offer any directives/advice on how you should handle the shortfall in disbursed grants?	To identify if LGAs get any assistance from central government on how they should handle financial difficulties whenever happens
4. How do you mitigate shortfall in own source revenue collections (whenever arises) while considering budgeted expenditures attached to these revenues?	Do you cut expenditure? If yes which expenditure are highly vulnerable whenever there is own sources revenue collection shortage?	To identify if LGAs cut expenditure to mitigate shortage in revenue collection
	Have you ever though using debts to finance	To identify if LGAs use debts to finance budgeted

	expenditures attached to own source revenues?	expenditures instead or cutting down expenditures
5. Regulations allow you to borrow, have you ever thought using borrowing to finance your expenditures?	Which type of expenditures are you allowed to finance through borrowing? Are there any challenges that limit council's ability to use borrowings?	To identify the perception of LGA officials and practicability of using debt finance in LGAs
6. Do you have any projects that stacked half way complete or complete but not functioning due to shortage of funds?	Are there projects stagnant for more than two years without receiving sufficient fund to finance them?	To identify the impact of financial difficulties on accomplishing projects which are still in progress
7. Can you provide your opinion on the implication of current decentralisation reforms in meeting your long term goal within LGA and national goals as whole of ensuring equitable services particularly to the poor and reducing gap between urban and rural and within the rural sectors.	Is the grant allocations system offer prospect to achieve the long term goals?	To establish the view of LGA officials on prospect of intergovernmental transfer system to meet long term goal of the council and the nation as a whole
	Do allowable sources of local revenue offer prospect of reducing dependence on central government grants hence implement your budgets effectively?	To establish the view of officials on possibility of the council to generate more revenues to finance their activities and to reduce dependence
	Is the discretion over own sources rates sufficient to collect sufficient revenues hence reduce dependence rate?	To establish the view of LGA officials on revenues collection autonomy on generating sufficient revenues to reduce dependence
	Are the borrowing requirements sufficient to raise debt finance whenever required?	To establish if there is any obstacles in term of requirements for LGAs to use debt finance

3. Questions on Governance Issues – Members of Council

Questions	Probes/further questions	Rationale
1. Regulations allow you to collect own revenues from a number of sources. Do you deploy all allowed sources?	Which revenue sources are you currently deploying?	To identify sources of revenues which are currently deployed
	Which revenue sources are you currently not deploying? Why are you not deploying them?	To identify sources of revenues which are not deployed and reasons for not deploying them
2. Are there revenue sources that would be appropriate	Which revenue sources would be suitable for you to	To identify revenue sources that would enhance LGAs'

for enhancing your revenues but regulations constrain you?	enhance your revenue sources?	revenues but regulations constrain to engage them.
	What would you suggest to make them useful to you?	To identify recommendations on enhancing revenues sources
3. In some revenues sources, rates have been established by the central government. Do you think established rates are appropriate?	Are there sources which you would wish to charge higher rates but regulation constrain you?	To find out if there are any regulatory constraints over revenue rates setting discretionary
4. What challenges your council is facing in mobilising revenues?	How do you find the effectiveness of your council in mobilising revenues?	To find the views of councillors on the challenges facing the council in mobilising revenues
	How do you ensure that your revenue targets are met?	To identify ways used by councillors to enhance mobilisation of revenues in their councils
5. How do you reach into agreement regarding the best ways on utilising collected revenues?	Is there any conflict of interest between council staffs and councillors and even between councillors themselves?	To find out if there is any conflict of interest on the way council revenues are allocated
On Central Government Grant		
6. What factors determine your grant allocation share? Do they include any specific requirements in own sources revenue collection?	Which factors determine your grant share from the central government? Which role do you play to ensure that these criteria are always met so that you get maximum grant allocation for service provision in your council?	To identify understanding of councillors and their role in managing central government grant allocation
	In the recently 3 years has it happened that you did not met some criteria hence reduced you grant share? If yes what measure did you take to avoid recurrence?	To understand measure taken by councillors in ensuring that their council receive maximum grant share to offer equitable services.
On Expenditure Side of the Budget		
7. What factors exerts pressure in spending requirements?	Which factors influences your expenditure needs? Population growth? Geographical size of the council? Changing weather condition exerts any	To identify factors that exerts pressure in LGAs expenditure side of their budgets

	specific expenditure needs? Central government directives? Political interferences?	
8. Which services are mostly affected whenever the raised revenues is insufficient to meet all budgeted expenditures?	Are there expenditure categories that are most likely to be reduced whenever revenues are insufficient to finance all budgeted expenditures? If yes what are those expenditure categories?	To identify whether councillors use specific expenditure categories to mitigate revenue shortage
9. Do you have any projects that stacked half way complete due to shortage of funds?	Which projects are frequently stagnating due to lack of fund to finance them?	To identify if there are specific areas which are highly vulnerable due to lack of fund.
General Question		
10. Can you provide your opinion on the implication of current decentralisation reforms in meeting your long term goals?	How do you enhance your revenue sources of the council and enhance the prospect of being financially independent?	To establish the view of local government councillors on ways of enhancing revenues sources and reducing dependence
	How do you find the level of autonomy in revenue mobilisation, is it sufficient?	To establish the view of councillors on council's autonomy level in revenue mobilisation

Source: Author