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FISCAL DECENTRALIZATION IN GHANA:
PROGRESS AND CHALLENGES

Fiscal Decentralization in Ghana: Progress and Challenges

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Abstract

Policy makers in Ghana have lauded fiscal decentralization as a positive driver of subnational government growth and development. Since 1992, Ghana has made important strides in implementing a fiscal decentralization program. However, the implementation of the program, and management of revenue at the local government level have been challenging. This paper provides a general overview of fiscal decentralization in Ghana, and examines local government fiscal management. It finds that fiscal decentralization in Ghana is characterized by a number of weaknesses including: excessive control and interference by the central government in local government matters; lack of clarity in functional assignments of subnational governments; and limited capacity of local governments to raise adequate revenue. The paper recommends that in order to address these weaknesses, innovative ways of managing and sustaining revenue sources to local governments must be explored. Additionally, there must be a clearer delineation of expenditure responsibilities across various levels of government; local governments must strive for efficiency gains; and deficiencies in the operational capacities at the local government levels must be addressed.

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List of Abbreviations

DA	District Assemblies
DACF	District Assemblies Common Fund
DCD	District Coordinating Director
DCE	District Chief Executive
DDF	District Development Facility
DPCU	District Planning and Coordinating Unit
GOG	Government of Ghana
IGFs	Internally Generated Funds
IGFF	Intergovernmental Fiscal Framework
IGTs	Intergovernmental Fiscal Transfers
ILGS	Institute of Local Government Service
IMCC	Inter-Ministerial Coordinating Committee
LGS	Local Government Service
LI	Legislative Instrument
M&E	Monitoring and Evaluation
MDA	Ministries, Departments and Agencies
MLGRD	Ministry of Local Government & Rural Development
MMDA	Metropolitan, Municipal and District Assemblies
MOF	Ministry of Finance
OECD	Organization for Economic Co-operation and Development
PFM	Public Financial Management
RCC	Regional Coordinating Council
RPCU	Regional Planning and Coordinating Unit
UDG	Urban Development Grant
USAID	United States Agency for International Development

1.0 Introduction

Fiscal decentralization (FD), which primarily deals with the transfer of expenditure and revenue responsibilities from central governments to sub national governments[1], has gained widespread popularity and significant support from many governments in the developed and developing world. The concept has become an intrinsic component of the general public financial sector reform in several countries, and has also been supported by leading international development organisations including the World Bank, Asian Development Bank, the Organization for Economic Co-operation and Development (OECD) and the United States Agency for International Development (USAID). Fiscal decentralization as a policy instrument is believed to engender good governance and advance the wellbeing of ordinary citizens. Fiscal decentralization is considered to lead to efficiency gains in public service delivery, as well as improvement in accountability and transparency in public sector spending.

Policy makers in Ghana have lauded fiscal decentralization as a positive driver of democracy and development, both in the pre and post-independence era. The current practice of fiscal decentralization derives its legal backing from the 1992 Constitution and other legislative instruments. Since 1992, the country has made important strides in mapping out a fiscal decentralisation framework. However, the implementation, execution and management of fiscal policies at the local government level have been challenging. This paper is intended to provide a general overview of fiscal decentralization as it applies to the governance structure of Ghana. More specifically, the paper examines the concept of fiscal decentralization and highlights the underlying principles of the concept. The paper also examines local government fiscal policies and inter-governmental fiscal transfers in Ghana, and provides recommendations to address some of the challenges of fiscal decentralization in the country.

The paper is structured as follows. Section two discusses the conceptual framework of fiscal decentralization by looking at the definitions, rationale, arguments for and against fiscal decentralization, the key elements and the conditions for the success of FD. Section three examines fiscal decentralization in Ghana, focusing on expenditure and revenue assignments to District Assemblies, the intergovernmental fiscal transfers, local government borrowing powers and the institutional arrangements for implementation. Section four discusses the progress and challenges of fiscal decentralisation in Ghana. Section five concludes the paper with some policy recommendations.

[1] *Sub-national government is used synonymously with Local government (LG) in this paper*

2.0 Fiscal Decentralization: Conceptual Framework

The devolution of financial responsibilities to subnational governments is an important component of the overall decentralization framework. Decentralisation is defined broadly as the transfer of some administrative, political and fiscal authority and responsibility from the central government to sub-national governments (states, municipal, regional, and local governments) to perform public functions.

Fiscal decentralization is defined by Akai and Sakata (2002) as the devolution of the authority and power linked with decision-making to sub-national governments. Devkota (2014) describes fiscal decentralization as basically consisting of the devolution of revenue sources and expenditure functions to lower tiers of government in order to boost public sector efficiency and enhance accountability and transparency in service delivery and policy-making by bringing governance closer to the people. According to the World Bank (2007), "Fiscal decentralization involves shifting some responsibilities for expenditures and/or revenues to lower levels of government". The Bank maintains that the key factor in determining the type of fiscal decentralization relies on the extent to which subnational entities are given autonomy in the allocation of their expenditures as well as their ability to raise revenue.

Fiscal decentralisation, thus, primarily refers to the devolution of revenue sources and expenditure responsibilities to lower levels of government. It is seen as pivotal in an efficient decentralization process, but it also depends on how entrenched and developed the political and administrative structures are at the regional and local levels.

2.1 Objectives of Fiscal Decentralization

The underlying economic objective of granting greater financial responsibilities to subnational governments is to ensure improvement in the delivery of services at the local level. This is done with the aim of achieving long term economic growth and sustainable development. The economic case for fiscal decentralization is supported by three main rationales:

i Fiscal decentralization has the potential to improve overall welfare if local governments are able to acknowledge and meet the preferences of people with similar desires for government services in a specific geographical area.

ii Fiscal decentralization has the potential to ensure better accountability on the part of elected officials, increase the revenue mobilisation base, increase the willingness to pay for goods and services, and improve capacity building as a result of participation at the local level.

iii Fiscal decentralization has the potential to provide greater economic efficiency in the allocation of public resources. Another case that is generally made in support of fiscal decentralization is that it is seen as a mechanism that better mobilizes revenue. Busted and Glimeus (2011), for instance, argue that a decentralized tax system and subnational governments, due to their closeness, have the potential to better reach and control the collection of taxes in ways that a central government can not.

Fiscal decentralization has however been criticised by some writers. Tanzi (1995) for instance is critical of fiscal decentralization as producing sub-optimal results because, (i) taxpayers sometimes lack the political power to demand efficient allocation of resources from their local policy makers, (ii) technological changes and increased mobility are most likely to reduce the number of services that are referred to as local in nature and, (iii) fiscal decentralization may complicate the ability of a central government to successfully handle structural fiscal imbalances.

Some scholars also argue that due to administrative incapability of most local governments in responding to the needs of local residents, fiscal decentralization may derail economic growth in the early stages of development. Also, poor design, sequencing and implementation of fiscal decentralization in most low income countries, especially in the sub-Saharan African region, have resulted in mixed implementation outcomes which have created room for macroeconomic instability, conflicts, inequality and problems in service delivery, as well as increased levels of corruption.

2.2 Principles or Elements of Fiscal Decentralization

Four main principles or elements of fiscal decentralization are discussed in the literature. These principles are also supported by 'best' international practice as being the main building blocks of fiscal decentralization. The principles are:

i **Assignment of Expenditure/Functions:** Stable and meaningful fiscal decentralization requires a well-defined assignment of expenditure responsibilities.[2] This ensures that, each level of government knows their responsibilities and has a clear direction of what is expected of them. This practise encourages accountability and minimises overlaps and duplications of responsibilities across the various levels of government. However, responsibilities should be designated based on the principle of Subsidiarity.[3] This basically means that the responsibility of delivering public services should be carried out by local governments within the jurisdictions that will internalise the costs and benefits of the provision. This reduces the risk of free-riding associated with externalities in the case of central government spending. The principle of subsidiarity connotes that some functions with high spill-over effects, such as national defence, secondary and university education,are better provided by the central government. Some general services, such as garbage collection, traffic lighting, street lighting, street paving, and local primary schools, are often provided by local governments.

ii **Revenue Assignment:** The optimal step after expenditure assignment to local governments should be a clear definition of revenue assignments. In order to achieve macro balance or micro efficiency through fiscal decentralization, sub–national governments must control their "own" sources of revenue.[4] Each class of government should be assigned taxes that correspond to the benefits of its spending.

[2] *"Expenditure assignment/Responsibility" is used synonymously with "Functional assignment/Responsibility"*

[3] *The principle of devolving decisions to the lowest practical level*

[4] *Own sources of revenue are those raised directly by local governments; central governments transfers excluded*

To ensure proper assignment of taxes, well-defined policy objectives should be ascribed to the level of government with the responsibility for such service. This means that, some taxes would be appropriate for assignment to the national government; because, in most cases, the central government carries the responsibility for expenditures with benefits that are defined by large economies of scale. Taxes such as import duties, corporate income taxes and value-added taxes are generally set aside for the central government, while taxes such as property taxes, commercial/business taxes and local retail sales tax are generally collected by local governments.

iii **Intergovernmental Fiscal Transfers (IGTs)** perform a key role in subnational government financing in many countries. It is estimated that IGTs constitute more than 80% of total revenues to local governments in Uganda, Tanzania, Indonesia, Philippines, Bhutan, Nepal, Cambodia, East Timor and many others (Danida, 2010).[5] They are needed to provide funds or revenue to execute the expenditure responsibilities of subnational governments. Intergovernmental fiscal transfers are also used to advance the vertical funding balance between national and subnational governments, enhance the horizontal fairness and equity among subnational governments, compensate for inter-jurisdictional spill overs, maintain minimum standards in service delivery, and promote economic stability. Broadway and Shah (2007) suggest that, the intergovernmental transfer system or structure is required in a decentralized system of government to ensure efficiency, equity and accountability through objective and transparent formulae-based allocation. This is required to support a well-functioning public sector which is in sync and sensitive to citizens' preferences by delivering the right mix of public goods and services. According to the World Bank (2007), the structure of these transfers creates incentives for national, regional, and local governments that affect fiscal management, macroeconomic stability, distributional equity, allocation efficiency, and public service delivery. IGTs, also known as "grants", could also be a general-purpose grant (unconditional) and / or specific-purpose transfers (conditional grant).

iv **Subnational borrowing:** Subnational borrowing is another significant part of financing for local governments especially in developing countries. Subnational borrowing, however, is least practiced in developing countries, and only few countries have well-functioning systems for this function.[6] Subnational borrowing has the potential of being an important source of revenue for long term infrastructure development. It also has the ability to fund the increasing expenditure responsibilities of providing basic services. However, there have been growing concerns of allowing subnational governments the right to borrow. Examples are cited of the debt crisis of subnational governments in Brazil, the inflationary impact of subnational financing in Argentina, and the city-level bankruptcies in the United States. Crises of this nature can be avoided with an appropriate subnational borrowing regulatory framework.

In most countries, decentralization in general and fiscal decentralization in particular is predominantly influenced more by politics than economics.

[5] *DANIDA, Fiscal Decentralization and Sector Funding Principles and Practices, p. 14 (2010)*

[6] *DANIDA, Fiscal Decentralization and Sector Funding Principles and Practices, p. 23 (2010)*

However, as noted by the World Bank (2002), decentralization is one of the happy instances where good politics and good economics serve the same end. Regardless of the motivation for embarking on fiscal decentralization, there are some preconditions that ensure its success.

A well-developed fiscal decentralization framework that links local financing and fiscal authority (that is; taxing powers, budget-making autonomy, transparency and accountability) to functional responsibilities of the subnational government is fundamental. This ensures that local officials and politicians become accountable on delivering their promises, and also live within their means by bearing the cost of their decisions.

A well-established legal and institutional framework that supports fiscal decentralization is essential. Both the political and economic objectives that bring fiscal decentralisation into operation ought to be legally backed by a clearly stated subnational political autonomy, systems of revenue and functional assignments, intergovernmental fiscal mechanisms and structure of service delivery responsibilities. Furthermore, a strong system with the ability to monitor and evaluate fiscal decentralization is essential. Bahl (1999) mentions that, ‘‘a gradual process of fiscal decentralization will require central government leadership on matters such as the imposition of a uniform system of financial account, audit rules, disclosure requirements for borrowing and determination on when to relax spending mandates, how to adjust grant distribution formula, and how to impose proper limits on borrowing.”

3.0 Fiscal Decentralization in Ghana

Decentralization in general and fiscal decentralization in particular is regarded as an important tool for national development in Ghana. Unlike many developing countries which adopted decentralization as a means to rectify unique social and political difficulties, Ghana has detailed an inclusive decentralization policy in its Constitution and other legislative instruments. Since 1988, Ghana has adopted and implemented a comprehensive decentralization and local government[7] policy with the aim of: strengthening and expanding local democracy; promoting local social and economic development; reducing poverty; and increasing the choices of people.

The importance of fiscal decentralization and financing of local service provision is a fundamental requirement of the 1992 Constitution. Section 240 (a) of the Constitution stipulates that: “Parliament shall enact appropriate laws to ensure that functions, powers, responsibilities and resources are at all times transferred from central government to local government units in a coordinated manner.” Article 240(b) of the Constitution also makes it clear that District Assemblies “should have sound bases with adequate and reliable sources of revenue”. Again, Article 240(2e) states, “To ensure accountability of local government authorities, people in particular local government areas shall, as far as possible, be afforded the opportunity to participate effectively in their governance.”

[7] The Local Government system in Ghana consists of the Regional Coordinating Council (RCC), and a four-tier metropolitan and three-tier municipal /District Assemblies (DAs) structure. There are ten (10) Regional Coordinating Councils and 216 Metropolitan, Municipal and District Assemblies (MMDAs). According to the Constitution, “a DA shall be the highest political authority in the district, and shall have deliberative legislative and executive powers. The DA consists of one person from each LG electoral area within the district, member(s) of Parliament for the constituencies, the District Chief Executive (DCE) of the district, and other members not being more than 30 per cent of all the members of the DA. The DCE is the representative of the President at the district level.

Other legal instruments that seek to promote fiscal decentralization in Ghana include: the Local Government Act, 1993 (Act 462); District Assemblies Common Fund Act, 2003 (Act 455); National Planning System Act (Act 480); Audit Service Act, 2000 (Act 584); Financial Administrative Act, 2003 (Act 654); Internal Audit Agency Act, 2003 (Act 658); Public Financial Management Reform Programme 1996; Financial Administration Regulations, 2004 (LI 1802); Local Government Act, 2003 (Act 656); Financial Memorandum, 2008 (LI 1802); Decentralization Policy & Framework reviewed, 2010; and Local Government Commencement Instrument, 2009 (L.I 1996, 2009).

In February 2014, the Ministry of Finance and the Ministry of Local Government & Rural Development issued a draft Intergovernmental Fiscal Framework (IGFF). The IGFF focuses on the fiscal components necessary to empower, enable and facilitate District Assemblies to assume their mandated responsibilities and to deliver enhanced governance and improved service delivery in an accountable and efficient manner. The Framework provides guidance on the various aspects of expenditure, revenue and service delivery arrangements which cut across the national and sub-national levels of government as well as the public financial management aspects at the district assembly level.

The key elements of the IGFF are: Expenditure Assignment and Authority, Revenue Assignment, Internally Generated Funds, Intergovernmental Fiscal Transfers, Local Government Borrowing, Financial Management and Accountability Framework Institutional Arrangements.[8]

3.1 Expenditure Assignment of Local Governments

As stated earlier, expenditure assignment is fundamental in achieving the gains associated with fiscal decentralization. Clarity and simplicity are imperative in any expenditure assignment. Clearly defined expenditure assignment is necessary due to the underlying reasons that funding arrangement, public financial management, and accountability, all rely on the knowledge of which level of government is responsible for which function. For purposes of this discussion, the functional responsibilities or expenditure assignments to MMDAs in Ghana are interpreted to include the responsibilities of the sub-structures to the level of Area Council.[9]

The legal framework that guides the assignment of functional responsibilities is made provisional in the national Constitution. Article 245 of the Constitution states that, "Parliament shall, by law, prescribe the functions of District Assemblies which shall include: (a) the formulation and execution of plans, programmes and strategies for the effective mobilisation of the resources necessary for the overall development of the district; and (b) the levying and collection of taxes, rates, duties and fees." Again, the Local Government Act 1993 (Act 462) gives District Assemblies the responsibility to exercise political and administrative authority in the district, provide guidance, give direction to, and supervise all other administrative authorities in the district. It further empowers the District Assemblies to exercise deliberative, legislative as well as executive functions.

[8] This section of the paper has benefited from the Government of Ghana (GoG) Draft Intergovernmental Fiscal Framework, IGFF (2014).

[9] These are found in the metropolitan assemblies and DAs. Area councils exist for a number of settlements/villages which are grouped together but whose individual settlements have populations of less than 5000

The following functional responsibilities are outlined in the Legislative Instrument 1961 (2009) that set up the respective District Assemblies: basic education; primary health; construction/roads/streets; drinking water; agriculture (including livestock); conservation (forest, water and soil); welfare; community development; cottage industry; and physical/land-use planning among others. Table 1 summarizes the functional assignments across the various levels of government.

Legal Instrument 1961 (2009) further clarifies the functional and responsibility assignment to District Assemblies through identifying the organizational restructuring of devolved departments and their various functions. Nonetheless, the assignment of functions and responsibilities across central and local government levels is fragmented in various pieces of legislation, often with inconsistent assignments creating confusion, duplication of authority, unproductive overlaps and legal challenges.

Table 1: Assignment of Functions across Government Levels

FUNCTIONS	RESPONSIBILITY ASSIGNMENT
POLICY: Setting overall service goals, standards & norms, monitoring & evaluation, guiding implementation	Central Government, but with scope for local government to set norms within limits for local public services and local revenue rates. Local governments are also responsible for monitoring and evaluation.
PROVISION: Providing goods and services through planning, budgeting, procuring, overseeing delivery & being answerable for service delivery	Local governments, except in cases of economies of scale and jurisdictional spillovers, but with financing and implementation assistance from central government
PRODUCTION: Designing, constructing, operating & managing service delivery	Local governments, deconcentrated line department service delivery units; and/or private sector, NGOs, and/or user community groups.

Source: IGFF 2014

3.2 Revenue Assignment

A successful and effective system of fiscal decentralization ensures that revenue to Metropolitan, Municipal and District Assemblies is sufficient to fund assigned expenditure functions or responsibilities. The revenue distribution framework and the financing needed by the various District Assemblies will, to a large extent, depend on the nature and type of expenditure responsibilities assigned, as well as the actual spending on a given function or activity. The practice of allocating revenue for actual spending on a given responsibility is somewhat complicated and mostly requires much detailed analyses and deliberation. However, the ultimate goal in revenue assignment regardless of which approach is adopted, is to ensure transparency and accountability.

Metropolitan, Municipal, and District Assemblies revenue and funding include: internally generated funds, central government transfers, development partner support, and access to borrowing. The central government transfers are made up of the District Assemblies Common Fund (the DACF receives a minimum of 7.5% of national revenue) and the support of the decentralized departments of Ministries, Departments and Agencies (MDAs) in the form of direct salary payments or transfers for administrative, service and investment costs. Internally generated funds of district assemblies (fees, fines, and rates) are used mostly to cover expenses such as travel and transportation, general maintenance, repairs and renewals, personal emoluments, among others. The DACF and revenue from development partners are primarily used for services and investment such as water & sanitation, education, health, agriculture and energy. The bulk of revenue or funds available to MMDAs are derived from central government transfers with very little revenue generated internally by local governments.

3.3 Internally Generated Funds

Internally Generated Funds (IGFs) at the district level are those received by the District Assemblies over which the Assemblies are empowered with sufficient discretion to directly influence the amount of revenue levied and collected. In other words, IGFs are those over which District Assemblies can influence the revenue amount realized (at the margin) by having some direct influence over the tax rate, tax base and/or revenue administration. IGF sources allow MMDAs to differentiate the service levels they offer and allow them to be held accountable for overall expenditures, creating a stronger link between expenditure costs and benefits.

Article 245 of the Constitution empowers Assemblies to levy and collect taxes, duties and fees. These taxes, rates, levies, fees and licences are listed in Schedule Six of the Local Government Act (1993), with further definitions for vehicle licenses and entertainment licenses as listed in the Fourth and Fifth Schedules, respectively. The Local Government Act 462 also empowers District Assemblies to undertake joint commercial activities; charge development fees; charge betterment fees on urban land and property; levy vehicle and entertainment licenses; impose development levy on serviced land; and operate as a rating authority.

The IGFs are the main revenue sources that local governments generate directly in their various jurisdictions and the only sources which they have absolute control over in terms of utilization. The bulk of revenue or funds available to MMDAs emanates from central government transfers. As a result, MMDAs have not fully utilized the capacity of their revenue base. Inappropriate tax policy and tax administration also contribute to the inability of MMDAs to effectively generate high levels of revenue through taxation.

3.4 Intergovernmental Fiscal Transfers (IGTs)

Intergovernmental transfers include cash and/or in-kind payments and transfer of goods and contributions which are compulsory and/or non-compulsory, non-repayable financial payments between government units, typically from the central government to the District Assemblies. The legal basis for intergovernmental transfers is embedded in the Constitution of Ghana (1992). Article 240 (2) (a) and (c) of the Constitution states that,: "(i Parliament shall enact appropriate laws to ensure that functions, powers, responsibilities and resources are at all times transferred from the Central Government to local government units in a coordinated manner"; and (ii) there shall be established for each local government unit a sound financial base with adequate and reliable sources of revenue".

The Intergovernmental Fiscal Transfer system is made up of various mechanisms that distribute the funds to MMDAs to carry out their expenditure responsibilities. These include the following:

i The District Assemblies Common Fund (DACF) which provides for a minimum allocation of not less than 7.5 percent of the total revenue of Ghana to be given to the District Assemblies for development.

ii The District Development Facility (DDF) was established in 2008 as a Memorandum of Understanding (MOU) between the Government of Ghana and some interested development partners namely: Canadian Development Agency (CIDA), Danish Development Agency (DANIDA), Agence Française de Développement (AFD) and the German Development Bank (KFW). The DDF was instituted with the aim of allowing districts to finance their investments and also to maintain projects in economic, social and environmental sectors. Table 2 shows the indicative disbursements of funds totaling about $211 million from the Government of Ghana and the four development partners over the four year period, 2009 – 2012, as a contribution towards the DDF.

Table 2: Disbursement of DDF (US$'million), 2009 - 2012

Financing Partner	2009	2010	2011	2012	Total
AFD	3.10	6.25	6.25	3.15	18.75
CIDA (Canada)	6.50	13.00	15.00	17.50	52.00
DANIDA (Denmark)	5.30	7.90	11.40	13.20	37.80
KfW (Germany)	9.30	9.30	8.75	8.75	36.10
Government of Ghana	10.00	16.00	20.00	20.00	66.00
Total	34.20	52.45	61.40	62.60	210.65

Source: *Agence Française de Développement (AFD)* iii An allocation from the Stool Lands Revenues is also transferred to MMDAs and is considered discretionary to fund administrative, service delivery and development as per the composite budget[10] process. The Stool Land revenues which include rents, dues, and royalties are classified as shared revenue, that is, a central-local government transfer on a formula basis to MMDAs.

As per LI 1961 (Schedule 1) there are other releases from the MDAs to MMDAs as direct dispensations to finance deconcentrated, delegated and devolved functions. These functions include but are not limited to, agriculture, community development and feeder and urban roads. Again, there are other funds which do not flow through the MMDA composite budgets but are transferred to fund development expenditures at the local government level from the vertical statutory funds. These are the Road Fund, the Ghana Education Trust (GET) Fund, the Ghana Health Service and the National Health Insurance Fund.

3.5 The District Assemblies Common Fund (DACF)

In addition to the general financial provisions, the 1992 Constitution provides specifically for the establishment of a District Assemblies Common Fund (DACF). The DACF is a development grant established with the aim of resourcing MMDAs to undertake developmental projects in their various jurisdictions. Article 252 of the Constitution instructs Parliament to allocate not less than 5% (increased to 7.5% since 2006) of the total annual national revenues to the DACF. The DACF is administered through an independent Common Fund Administrator who proposes a formula annually for the distribution of the Fund for approval by Parliament.

The Administrator also distributes monies into the Common Fund in compliance with the approved formula and subsequently reports to the Minister of Local Government and Rural Development in writing on the utilization of the Common Fund by the DAs. The DACF serves as a primary source of revenue to the current two hundred and sixteen (216) MMDAs and the ten (10) Regional Coordinating Councils. Other social intervention programs being supported by the Fund include Persons with Disability, Ghana School Feeding Program, Cured Lepers, and District HIV/AIDS Committees. Table 3 illustrates the four main factors and indicators that influence or inform the formula that is applied in distributing the fund among the districts.

[10] *The composite budget manual serves as the main source document for Budget Committees of MMDAs and stakeholders in the local government budgeting process*

Table 3: Elements that influence the Distribution of the DACF

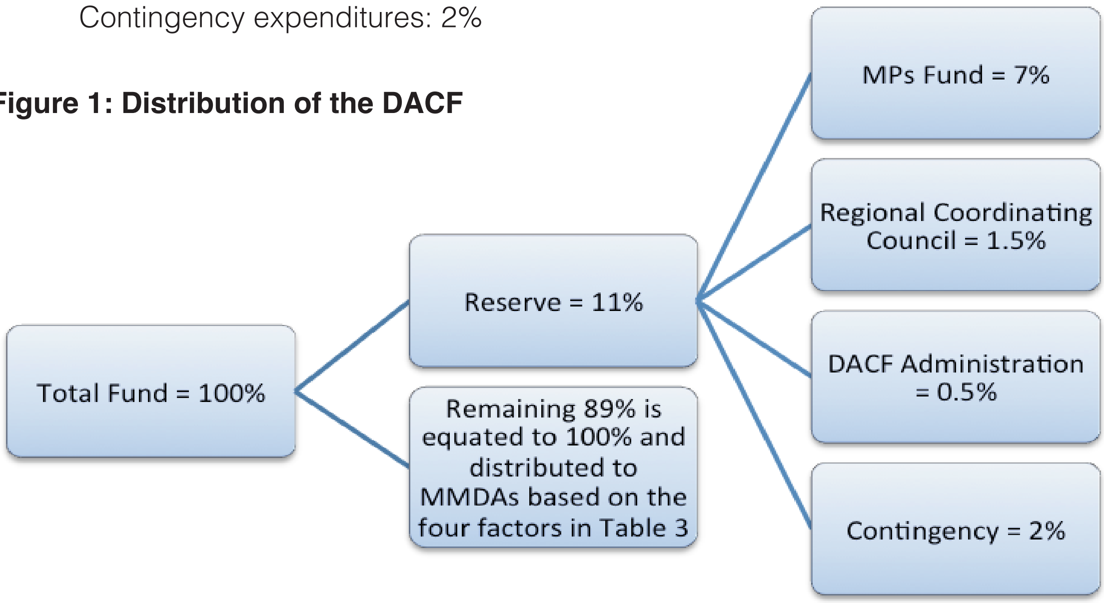
FUNCTIONS	RESPONSIBILITY ASSIGNMENT
Needs-based	Addresses the gaps or imbalances in development. Thus districts with more facilities receive less. The indicators here are health, education services, water coverage and tarred road coverage.
Responsiveness	This is a motivation factor for MMDAs to generate more IGFs. The more they generate IGFs the more they receive.
Services Pressure	This is based on population density. This is to assist in improving upon existing facilities that have deteriorated due to rural-urban migration.
Equality	Each MMDA receives equal amount of funds under this factor.

Source: *DACF Impact Assessment Report 2015*

The total amount of monies received by the DACF from the Ministry of Finance is apportioned into two separate components: the reserve portion (11%) and the remaining (89%) portion to be disbursed to MMDAs (see Figure 1). The reserve portion of the DACF is distributed as follows:

- MPs Fund: 7% for monitoring and evaluation, development projects and response to some critical emergencies
- Regional Coordinating Councils: 1.5% for monitoring and evaluation
- Office of the Administrator: 0.5% for operational support
- Contingency expenditures: 2%

Figure 1: Distribution of the DACF



The initial intention behind the establishment of the DACF was to assist DAs to undertake developmental projects. However, the current practice allows MMDAs to spend their portion of the Fund on projects they consider appropriate, which usually goes into both recurrent and capital (development) expenditures. This is as a result of indirect transfers for government interventions such as the National Youth Employment Program (NYEP), School Feeding Program, National Borehole Program, Ghana Youth Employment and Entrepreneurial Development Agency (GYEEDA), Sanitation Module and Sanitation / Waste Management which are classified as recurrent expenses. There have been a series of expenditure earmarked for special projects which usually take about one-fourth of the allocated funds. These special projects do not follow any transparent formula. However, these projects are approved by Parliament. This situation has led to the evolvement of a dual-structure formula-based system. Under this system, the allocation of the funds must follow the approved formula and the funds must be directly provided to MMDAs to execute their developmental projects. Timely releases of the Fund to the various districts are reported to be problematic. Again, the practice of deducting all administrative and other recurrent costs from DACF also poses some challenges.

Antwi (2013) mentions that, "The DACF which over the years was designed to be a discretionary block grant, continues to dwindle and is more of a centrally determined earmarked grant or expenditure than subnational discretionary intergovernmental transfer grant."

In terms of reporting, the DACF Administrator receives a monthly report from the MMDAs in the form of receipts on the utilization of the funds. However, the Administrator is not under any legal obligation to discuss the reports from the MMDAs with other government stakeholders/institutions including Ministry of Local Government and Rural Development, Ministry of Finance, the National Development Planning Commission and the Regional Coordinating Councils (RCCs). Despite this, the Administrator is required to prepare an annual report to Parliament on the distribution of the Fund.

3.6 Local Government Borrowing

The right of DAs to borrow is provided for in the Local Government Act 462 of 1993. Section 88 of the Act empowers the Assemblies to raise or obtain loans or overdrafts within Ghana in consultation with, and approved by the Minister of Finance. No approval is however required where the loan or overdraft to be raised does not exceed GH¢2,000.00 and the loan or overdraft does not require a guarantee by the Central government.

Given the limited opportunity for local governments to borrow, the central government provides local capital funding through the intergovernmental transfer system. The DACF, along with the District Development Fund and the Urban Development Grant provide an important source of discretionary capital development grants for basic local infrastructure. It is interesting to note that this situation is not peculiar to Ghana. Local governments in countries such as Uganda, Tanzania, Cambodia, Nepal and Bangladesh depend largely on their central governments' fiscal transfers.

3.7 Financial Management and Accountability Framework

Public Financial Management (PFM) reforms have been pursued at the local government level as part of the overall fiscal decentralization reform process and/or as stand-alone initiatives in nearly all developing countries over the past decade.[11] The Government of Ghana ensures sound financial management through an effective budgeting and PFM system. Ghana's PFM system is designed to enhance responsiveness, accountability and efficiency at both the central and district levels. At the central government level, the PFM systems and procedures are utilized to fully support devolved local governments, mainly in the areas of ensuring a system of transparent, reliable, stable and accountable intergovernmental transfers, management of borrowing and fiscal risk, and monitoring financial flows to the devolved governments. The IGFF (2014) proposes that Government will establish and enhance a broad set of subnational PFM systems and procedures, which would provide the framework for District Assemblies to operate within the overall budgeting and public financial management process. The Government will also review and reform the management of inter-governmental financial systems at the central government level and the internal PFM systems of subnational governments at each stage of the budget cycle. These include the macro-fiscal policy formulation, planning and budgeting, budget implementation, budget monitoring, reporting and audit, and budget evaluation.

3.8 Institutional Arrangements

The coordination and implementation of fiscal decentralization in Ghana has been made possible through participation of several stakeholders as well as institutional arrangements in the general decentralization policy framework. Institutional arrangements here refer to the formal rules, policies, systems, processes and government administration which have significant effect on resource allocation and accountability that comes through decentralization. However, each institutional arrangement adopted must be properly examined to establish its costs and benefits in order to determine which of such arrangements would yield the best of outcomes in transparency, equitability and sustainability. There are a considerable number of government institutions, civil society organisations and development partners that directly or indirectly coordinate and implement fiscal decentralization in Ghana. For the purposes of this paper we would look at the Ministry of Local Government and Rural Development, Ministry of Finance, Regional Coordinating Councils and District Assemblies, which are the key implementers.

The Ministry of Local Government and Rural Development (MLGRD) is the main government agency with the mandate of ensuring the establishment and development of a well-resourced decentralized system in Ghana to promote good governance. The MLGRD executes its responsibility by formulating, implementing, monitoring, evaluating and co-ordinating reform policies and programmes to democratize governance and decentralize the machinery of government. In performing these coordination functions, MLGRD is required to work closely

[11] *DANIDA, Fiscal Decentralization and Sector Funding Principles and Practices, p. 27 (2010)*

with agencies and other institutions including the Office of the President, the Inter-Ministerial Coordinating Council (IMCC), the Office of the Head of Civil Service (OHCS), Office of the Head of the Local Government Service (OHLGS), the National Development Planning Commission (NDPC), the Ministry of Finance (MOF) and other MDAs, some of whose functions are transferred and assigned to the local government units.

The Fiscal Decentralization Unit (FDU) of the Ministry of Finance was established in 2011 to serve as the focal point in the Ministry to support the Intergovernmental Fiscal Framework. The objective of the unit is to provide a comprehensive framework for the long-term development of intergovernmental fiscal arrangements, including the assignment of expenditure responsibilities, revenue responsibilities (internally generated funds), intergovernmental transfers, borrowing and institutional arrangements. The Unit is also responsible for developing and formulating financing policies and funding arrangements for effective functioning of the Metropolitan, Municipal and Districts Assemblies (MMDAs).

The Regional Coordinating Councils (RCCs) operate as deconcentrated arms of the central government. The RCCs coordinate, provide technical assistance and support those activities linked to the assignment of expenditure functions, revenue allocation, intergovernmental transfers and borrowing. In addition, the RCCs on behalf of the central government are mandated to provide support and monitor issues on budgeting and public financial management in line with the laws and regulatory framework established by the Ministry of Finance.

District Assemblies are responsible for the delivery of local governance and public services within the context of national policies and guidelines. Planning, budgeting, implementing and monitoring governance and public services are some of the duties carried out by DAs. Also, the DAs are obligated to mobilize internally generated funds which, combined with all other resources, will be utilized in an efficient and accountable manner through the district composite budgeting system. Sub-district-level institutions, including the sub-metropolitan district councils, urban, zonal and town councils are also expected to support the delivery of responsive, efficient and accountable governance and services.

3.9 Monitoring and Evaluation (M&E) [12]

The legal basis and requirements for conducting M&E activities in local governments are underpinned in Sections 120, 121 and 142 of the LG Act. The Internal Audit Operations, External Audit Operations and the mandate given to the RCCs as the main authority in monitoring, co-ordinating and evaluating the performance of DAs are clearly stated under these Sections respectively – in order to measure and assess performance of public funds.

According to the GoG Composite Budget Manual for MMDAs (2012), monitoring and evaluation are classified as separate activities. However, monitoring and evaluation have interrelated strategies for collecting data and reporting on how well MMDA services, projects and programmes are performing.

[12] *This subsection benefited from the GoG Composite Budget Manual (2012)*

The Manual further stipulates that monitoring shall take place during the implementation stage while evaluation takes place after the budget implementation period. Lessons learnt are expected to inform management in formulating the budget for the ensuing year.

The Regional Planning and Coordinating Council, District Planning and Coordinating Unit, Ministry of Local Government and Rural Development and other key government institutions are responsible for monitoring the use of funds, plans and programs of MMDAs as well as the use of funds. District Planning and Coordinating Units have the added responsibilities of monitoring all MMDA financial activities and achievement of set targets relating to revenue mobilization and expenditure; DACF-funded programmes and projects; DDF and UDG-funded projects; and Donor-funded programmes and projects.

Periodic internal and external audit of district budgets and transaction details are required to ensure proper and effective use of public funds, and compliance with sound financial management practice. To this end, the Audit Report Implementation Committee (ARIC) ensures compliance with internal and external audit recommendations. MMDAs are required to submit their financial statements to the Auditor General by end of March each year.

The monitoring of District's financial activities is expected to be executed on a quarterly basis by the RCCs and Sector Agencies, with a progress report completed and circulated by the DPCU. This serves as a basis that allows the Assembly and the government to take action on issues that require redress before the next assignment is undertaken. Again, it also serves as a performance audit to assess the extent to which programme implementation is delivering "value for money".

4.0 Progress and Challenges

4.1 Revenue Sufficiency and Financial Autonomy

The inability to generate adequate local revenue is a dominant problem of local governments in delivering local public services in Ghana. Low IGFs by districts has become a regular occurrence because some districts have very narrow revenue bases due to the structure of the local economies and activities. Others have strong revenue bases but do not have the capacity, political will or incentives to identify and capture those bases on the revenue roll in order to collect their revenues (IGFF, 2014). Also, in most cases, the cost incurred by local governments in collecting taxes far exceeds the actual revenue realised. Table 4 shows that, current IGF revenue collections by MMDAs are low and inconsistent across the regions. The bulk of revenues or funds available to MMDAs emanate from central government transfers as well as development partner support such as the DDF. Due to the inability of most districts to raise enough revenue to support their growing functional responsibilities, the central government through its transfers retains significant operational control with respect to the utilization of funds at the local level; a typical example is that of the DACF.

This practice undermines confidence and revenue generating initiatives at the local level.

Table 4: IGF of selected Districts in 2014 (GH₵)

Districts	Total IGF	Total Revenue -All Sources	% of IGF to Total Revenue
Bia East	164,258.25	1,911,324.69	8.59
Birim Central	882,771.73	4,524,155.72	19.51
Dormaa West	125,435.63	1,295,967.01	9.68
East Mamprusi	86,641.45	3,813,770.06	2.27
Ekumfi	158,727.54	1,715,081.88	9.25
Ga South	1,528,325.03	4,917,379.00	31.08
Ho West	195,015.76	2,304,565.01	8.46
Offinso	450,171.12	4,067,628.72	11.07
Talensi	83,112.50	3,821,988.17	2.17
Wa West	81,955.71	6,164,078.49	1.33
Total	**3,756,414.72**	**34,535,938.75**	**10.88**

Source: *Computed from the 2014 composite budgets of the Districts*

4.2 Expenditure Assignment and Management

The assignment of functions and responsibilities across central and local government levels in Ghana is fragmented in various pieces of legislation, often with inconsistent assignments creating duplication of authority, unproductive overlaps and legal challenges. The assignment of functions is also not clearly defined. Many services including health care, roads and rural development are defined or provided as a shared responsibility rather than assigning those independently to local governments. The lack of clarity in assignment usually leads to the under-provision of certain services. The funding mechanism sometimes contributes to the confusion in the assignment of responsibilities. For instance, the introduction of various earmarked transfers leads to limitation and lack of independence to allocate resources by local governments, leading to the central government having more operational autonomy in local governance. This tends to undermine subnational autonomy and reduces production efficiency. It also restricts the power or authority of subnational governments to act or respond to the unique needs of the local taxpayer.

4.3 Inter-Governmental Transfers

Heavy dependence on revenue transfers from the central government by DAs has been the norm. It has also been noted that the DACF forms a significant revenue source for DAs. Yet, the DACF is plagued by weaknesses including misalignment of the utilization of the Fund from its original objective, managerial lapses, untimely release of the funds, and excessive deductions before allocation to the districts, as well as weak monitoring procedures at both the national and subnational levels of government.

Tables 5 & 6 show the differences that exist between the DACF formula-based budgeted amounts and funds that are actually disbursed. The relationship between the DACF budgeted amounts and actual disbursed amounts is shown in Figures 2 & 3. Table 5 shows the constitutionally mandated[13] allocations to the DACF, actual releases to the DACF Administrator and outstanding balances (if any) of the Common Fund from 2008 to 2015. As the Table shows, there is not a single year within the period where the required allocations were fully disbursed. This indicates that the DAs have been deprived of some funds for development. Table 6 on the other hand, shows the budgeted amounts, actual releases from the central government to the DACF Administrator, and outstanding balances (if any) of the Common Fund from 2008 to 2015. The table shows that with the exception of 2008 and 2011 where amounts released exceeded budgeted figures, all the other years saw shortfalls in allocations.

Table 5: DACF disbursement based on 7.5% of Tax Revenue from 2008 – 2015

Year	7.5% of Tax Revenue	Prov. Outturn	Outstanding Balance
2008	322,458,885.53	252,075,728	70,383,157.53
2009	349,314,559.80	153,497,792	195,816,767.80
2019	472,102,307.55	410,281,200	61,821,107.55
2011	733,206,768.98	621,951,335	111,255,433.98
2012	929,165,792.70	406,512,700	522,653,092.70
2013	1,404,908,270.70	498,898,500	906,009,770.70
2014	1,794,849,266.85	330,309,000	1,464,540,266.85
2015	2,201,922,444.23	1,470,439,451	731,482,993.23
Total	8,207,928,296.33	4,143,965,706	4,063,962,590.33

Source: *Ministry of Finance, Author's calculations based on MoF Fiscal Tables*

[13] *Constitutionally mandated here refers to the 7.5% of total tax revenue that is legally required to be allocated to the DACF every year*

Figure 2: DACF disbursement relative to 7.5% of Tax Revenue from 2008 – 2015

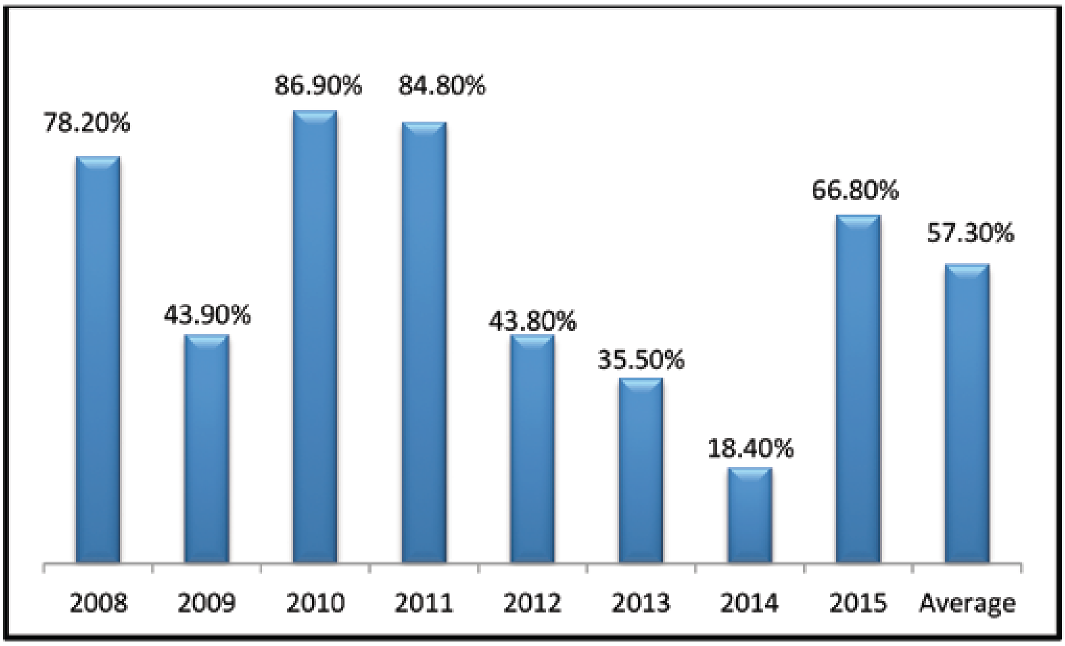
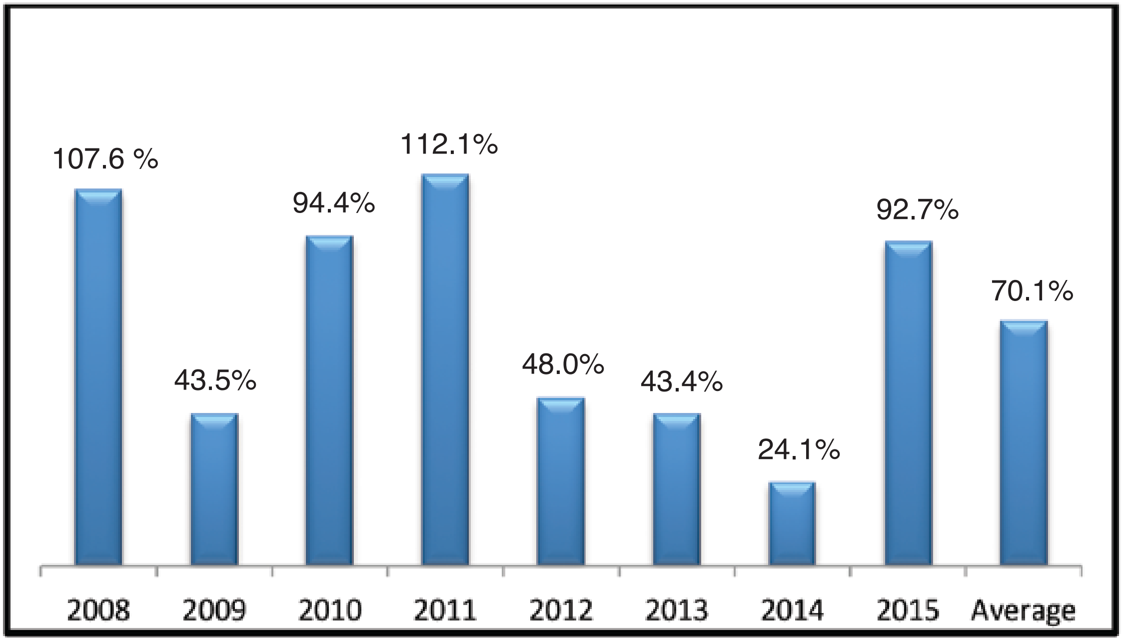


Table 6: DACF disbursement based on actual budget figures from 2008 - 2015

Years	Budgeted Amount	Prov. Outturn or Actual Releases	Outstanding Balance
2008	234,290,700	252,075,728	17,785,028*
2009	352,723,045	153,497,792	199,225,253
2010	434,484,803	410,281,200	24,203,603
2011	554,623,850	621,951,335	67,327,485*
2012	847,087,069	406,512,700	440,574,369
2013	1,149,286,950	498,898,500	650,388,450
2014	1,369,764,728	330,309,000	1,039,455,728
2015	1,585,919,077	1,470,439,451	115,479,626
Total/Average	**6,528,180,222**	**4,143,965,706**	**2,384,214,516**

Note: (**) denotes amounts paid in excess of initial budgeted figures;
Source: Ministry of Finance, Author's Calculations

Figure 3: DACF disbursements relative to actual budget figures from 2008 - 2015



The Auditor-General in his 2011 report on the management and utilization of the DACF and other statutory funds stated clearly that, the deficiencies noted in the operations of the Assemblies created avenues for some officials in some Assemblies to mismanage funds and resources of the Assemblies amounting to approximately GH¢43,975,431.83 during the year under review. The lapses and deficiencies were identified in transactions such as cash management, which repeatedly recorded payment cycle irregularities, unsubstantiated payments, misappropriation, and misapplication of earmarked funds. It also noted procurement, store and contract irregularities in the transactions of some Assemblies as well as tax irregularities. In the same report, the Auditor-General mentions that most of the recommendations made by his outfit to both the MLGRD as well as the management of the MMDAs towards the implementation and enforcement of audit recommendations have been flouted on several occasions.

According to Banful (2009), the mechanism for allocating the DACF does not eliminate politically motivated targeting of the grant. She mentions that, per capita DACF grants were higher in districts where vote margins in the previous presidential election were lower, suggesting that districts with more swing voters were targeted. According to her, there is evidence that DACF formula indicators and their weighting were chosen and amended to produce politically desired patterns of transfers.

4.4 Political Autonomy

As stated earlier, one important factor that is critical in the success of fiscal decentralization is political autonomy. However, in Ghana's case, there has been indirect control by the central government in overseeing matters at the local level, usually through the appointment of local government leaders. For example, District Chief Executives (DCEs) are appointed by the President of the Republic with legal backing from the LG Act of 1993, Section 20. Ideally, such high ranking local government officials should be elected. As can be expected, DCEs hold allegiance to the central government and are directly accountable to the President. The central government has consistently used the excuse of lack of capacity at the local level for refusing to transfer complete political authority to local governments. There is no doubt that the existing human and other resource capacities at the local level fall short of undertaking new and expanded responsibilities. Inadequate transfer of political autonomy nonetheless undermines democratic leadership at the local level. This practice of political interference promotes upward accountability to the central government instead of downward accountability to the local citizens. The political appointment of local government officials also complicates the strengthening of local competence.

5.0 Conclusion and Policy Suggestions

The fiscal decentralization framework of Ghana abounds with a number of weaknesses. These include: excessive control and interference by the central government in matters at the local government level; lack of clarity in the definition of functional assignments of subnational governments; and limited capacity of local governments to raise adequate revenue in order to become financially independent. For local governments in Ghana to meet their responsibilities and address both short and long term challenges in implementing fiscal decentralization policies, there is the need to strengthen the existing fiscal framework. The following recommendations are made for the attention of policy makers to ensure effective fiscal decentralization in Ghana:

1. The overall objective in any reform agenda towards local government finances should focus on increasing reliance on own revenue. Innovative ways of managing and sustaining the revenue sources available to local governments must be explored. Empirical evidence points to the property tax as having the potential to provide adequate evenue to local governments especially in developing countries. There is the need therefore to review and improve the property tax administration system in Ghana.

2. Local governments must strive for efficiency gains by reducing their operational costs and initiating programs to improve revenue generation. Municipalities in countries such as Nepal and India have shown encouraging results by reducing their reliance on central government cash transfers through improving their billing and collection of revenues and minimising operating costs. There must be strong political will and discipline on the part of policy makers in the implementation of policies and the formulation of the right mechanisms for evaluating the costs and benefits of instituting programs.

3. Clearer delineation of expenditure responsibilities across the various levels of government is necessary and crucial, especially in the areas of social development, healthcare and education. There is also the need to ensure a transparent, reliable and regular transfer system, specifically in the disbursement of the DACF.

4. The limitation of MMDAs' ability to borrow must be addressed with strong risk mitigating measures and legal framework. Countries such as the Philippines and Indonesia allow local government borrowing within a regulated framework.

5. Deficiencies in the operational capacities at the local government levels must be addressed through partnerships with the private sector, civil society organizations and international development agencies.

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